



Analyst

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Executive Summary

Further to the recapitalization exercise and Mergers & Acquisitions in the insurance sector which were concluded in 2007, insurance companies have recorded significant growth. However, this growth slowed in 2009, following the global economic challenges which impacted local economic activities.

We highlight one positive outcome from the 2007 recapitalisation exercise which was the ability of local insurers to underwrite larger risks as a result of their larger capital base, with increased participation growing in the lucrative oil and gas sector.

The Federal Government, in March 2010 passed the Nigerian Oil & Gas Industry Content Development Bill, which is an amended version of the Local Content Bill initiated in 2005. The Act specifies that all entities involved in any project, operation, activity or transaction in the Nigerian Oil and Gas Industry shall consider the Nigerian content as an important element of their overall project development. Furthermore, the Act makes provisions on other sectors of the economy such as Banking, Insurance and Legal Services.

We opine in this report, that the Insurance industry stands to benefit significantly from the provisions in this Act and this note is an attempt to expound on the opportunities created for the Insurance industry by the Act. However, we also note that the implementation efforts of the Local Content bill since its initiation in 2005 had majorly been plagued with some challenges, and provide a caution in this regard to ensure the success of the new Act.

In addition to the above, we also elucidate the potential impact of the new act on other key insurance classes such as Life, Marine, Motor and Fire Insurance, as well as on the development of local knowledge and skill within the industry, even as we anticipate that some foreign insurers will partner with local firms in a bid to participate in the lucrative sector.

However, we note in summary that Nigerian insurers still have a long way to go, with subsisting challenges from the activities of Insurance brokers. In our outlook for the sector, we highlight several key issues:

- We are aware that many insurers invested a significant portion of the monies they raised in 2007/8 in the capital market, buying stocks at prices that obtained when the market was at its peak in March 2008. Following losses in the market in 2008 (-45.77%) and 2009 (-33.87%), a lot of these funds have been lost.
- Further to the above, it would seem that some insurers are currently operating with capital bases below the required levels, as well as not satisfying the required capital adequacy and solvency margin ratios. Our speculative views appear to be confirmed as many insurers are yet to publish full year results for the year ended 2009.
- NAICOM the insurance regulator had earlier said that it would release new guidelines as regards operations and reporting for the industry. These guidelines will be quite useful to guide investor assessments of the health of these companies.

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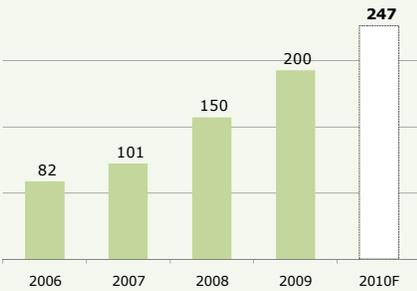
REVIEW AND PROSPECTS

- In our view, and in light of all above, we believe that a clean-up similar to that which was implemented in banking industry recently will be required for the insurers. First, this will aid and ensure real growth is achieved, and second, will enable investors have a clearer picture of the financial health of these companies.
- Though the above prognosis appears unattractive, we highlight that there are still some good spots, which include:
 - The opportunities for growth in the Industry as created by the regulatory environment;
 - A few select companies which even in the midst of all these issues have thrived on account of a strong business model, good investment management practices, and transparency in their operations as well as financial reporting. Our picks within the sector are Custodian & Allied Insurance Plc and GT Assurance Plc.



GROSS PREMIUM INCOME

N\$ Billions



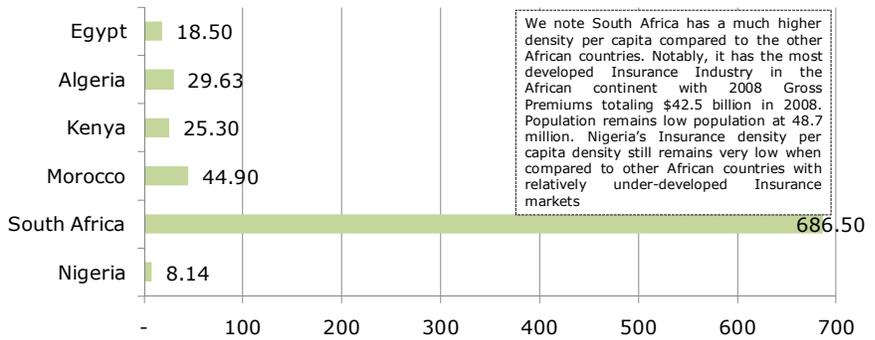
Source: Nigeria Insurance Digest, Vetiva Research

Potential of Nigerian Insurance Market

Gross Premiums in the Nigerian Insurance industry grew at a compounded annual rate of 24% between 2004 and 2009; increasing from ₦82 billion in 2006 to ₦149 billion in 2008 - the first year, following the recapitalisation and consolidation within the insurance sector and to ₦200 billion in 2009. Despite this impressive growth trend, the Insurance sector contributes 0.83% to GDP (2009), significantly less than the regulator’s 2012 target of 3% and much less than comparable countries in Africa and in other parts of the world. The Nigerian Insurance Commission also has a target to grow Gross Premiums to N1.1 trillion in 2012 (and ₦60 trillion by 2020). This would imply a 5.5x increase in Gross Premiums over the next 21/2 years.

INSURANCE DENSITY PER CAPITA

2008 Figures, US\$



We note South Africa has a much higher density per capita compared to the other African countries. Notably, it has the most developed Insurance Industry in the African continent with 2008 Gross Premiums totaling \$42.5 billion in 2008. Population remains low population at 48.7 million. Nigeria’s Insurance density per capita density still remains very low when compared to other African countries with relatively under-developed Insurance markets

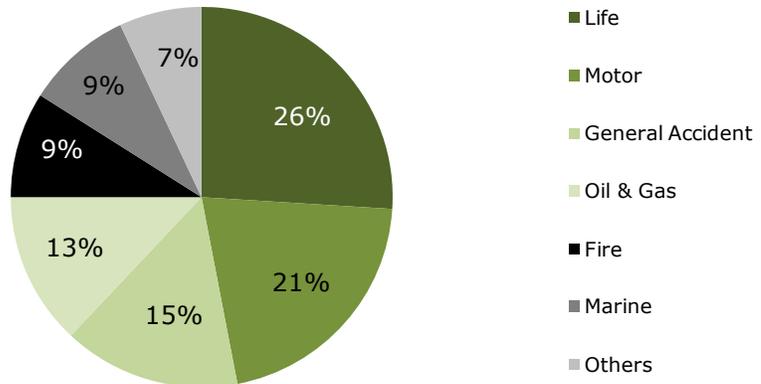
Source: Oxford Business Group, AM Best Country Risk Report, Vetiva Research

Enforcement of Mandatory Policies; a key driver of growth

Non-life insurance accounted for 74% of premiums written in 2009 and we note that mandatory policies have remained the key driver of growth in premiums owing to improved enforceability in recent years. The government has made 16 insurance policies compulsory since 1987 including Third party motor insurance, workmen’s compensation, health care indemnity, group life and builders’ liability insurance.

BREAKDOWN OF 2009 GROSS PREMIUM INCOME

By Policy Class



Source: Annual Reports, Vetiva Research



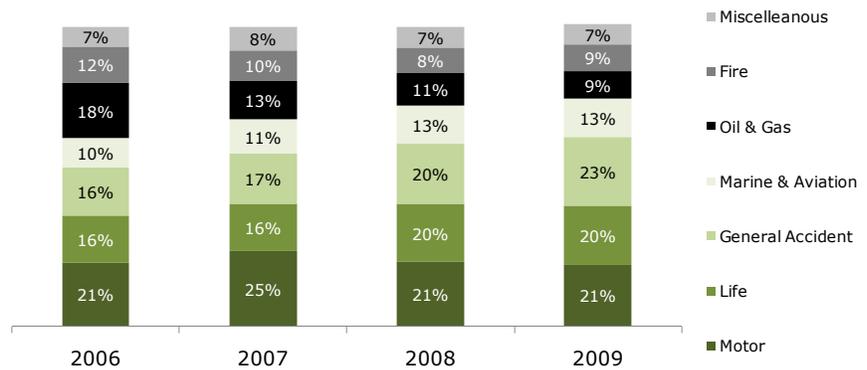
Policy Class Contribution to Gross Premium Income

Historically, motor insurance has been the largest contributor to insurance premiums given that Third – party motor Insurance is compulsory; and in view of the gradual increase in disposable income as well as the emergence of the middle class over the last few years, comprehensive motor insurance has been on the rise. However, other insurance classes are beginning to catch-up and in some instances over take motor insurance. The contribution from life insurance for instance, has risen steadily owing to the improved enforceability of the statutory group life policy of the Pension Reform Act of 2004 as more organizations in the Private sector and Public civil service are beginning to embrace the policy.

The initiation of the Local Content Act has favoured the Marine & Aviation and Oil & Gas policy classes though there is still potential for growth. We note the current local content implementation level is a far cry from the target of 70%, however, gradual compliance is impacting the contribution of the classes to overall gross premiums as the Oil and Gas companies begin to retain a relatively large proportion of their risks. Fire insurance which provides cover for buildings against fire and other natural disasters remains largely untapped and on the other hand has continued to increase at a slower rate owing to the low awareness and enforceability level of the policy.

POLICY CONTRIBUTIONS TO GROSS PREMIUM INCOME

Percentage



Source: Nigeria Insurance Digest, Vetiva Research

Motor Insurance maintains lead in the non-life segment

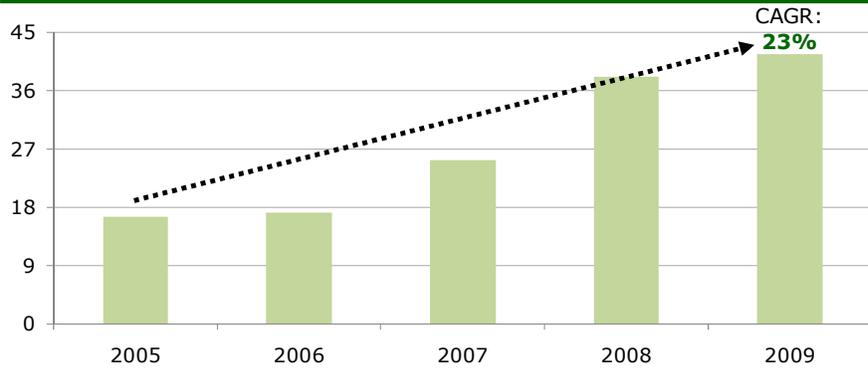
Motor insurance has been the dominant source of premiums for more than four years, with premiums standing at N41.67 billion in 2009, a 9.3% increase over 2008. Although third-party insurance is mandatory, implementation is still patchy; compliance level has however improved commendably. Insurance companies with the bancassurance model have leveraged on their parent banks to sell motor insurance to clients under car loan schemes. Most insurance companies underwrite over N1 billion in motor risks annually.

Growing at a 5 – year CAGR of 23%, we expect the prospects for growth to consolidate as the compliance level of car owners and number of cars increase. Cars have become more of a necessity and less of a luxury with brands that are quite affordable and there seems to be a cultural shift, with consumer preferences for new rather than second-hand cars. Nigeria has a huge population of over 154 billion people and with a huge middle and consumer class.



GROSS PREMIUM INCOME – MOTOR

N'Billions



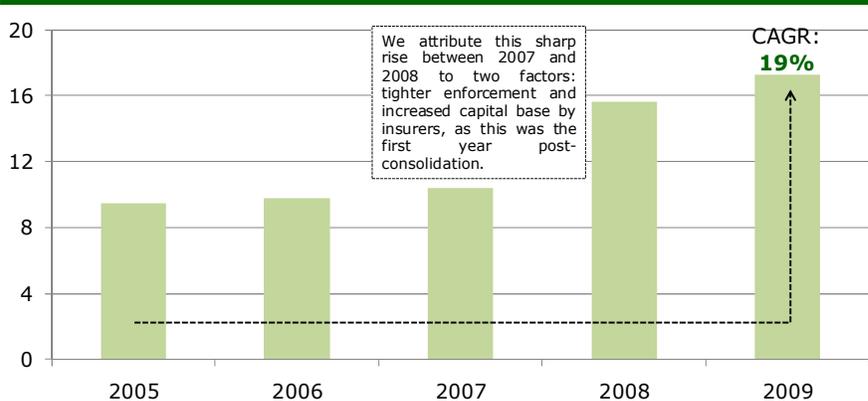
Source: Nigeria Insurance Digest, Vetiva Research

Decelerating growth in Fire Insurance owing to low risk awareness

In 2009, Fire Insurance increased 11% YoY to ₦17.3 billion though growth decelerated from the 50% YoY increase recorded in 2008. Over the past 5 years, the sector has grown at a CAGR of 19% owing to increased awareness of individuals and corporates to possible fire hazards to buildings. The growth rate though commendable does not reflect the assumed progress of the sector given the spate of building constructions and the compulsory nature of the policy class.

GROSS PREMIUM INCOME – FIRE

N'Billions



Source: Nigeria Insurance Digest, Vetiva Research

The following are covered under fire insurance: buildings, plant and machinery such as generators and factory machines, stock or raw materials, work in progress, finished goods, household goods and personal effects. However, we expect this segment to experience stronger growth as Nigerians education and awareness as to the importance of insuring risks increase, especially among the corporates. We recall that a consortium of seven underwriters paid out ₦6.8 billion in claims in 2008 following the fire that razed the Benin plant of the Nigeria Bottling Company (NBC). In addition, a fire incident was recently recorded at Ultima Studios, a state-of-the-art studio that airs both national and international programmes (e.g. "who want to be millionaire"). There is still uncertainty regarding the status of insurance of the property and equipment without which the loss incurred will be enormous.



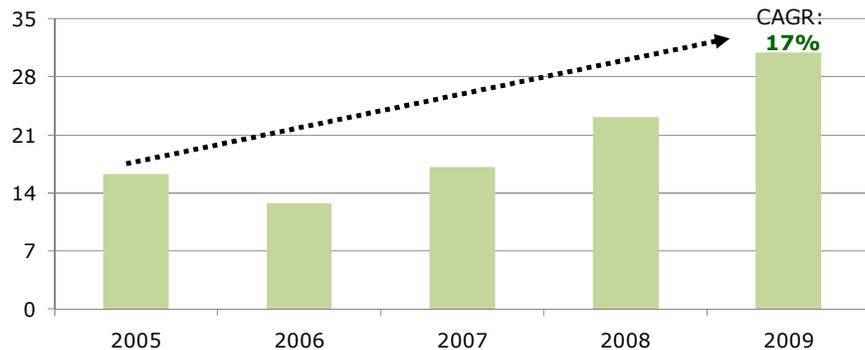
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Workmen Compensation to drive growth in the General Accident segment

The breakdown of policy contributions for 2009 show that General Accident increased 33% YoY in 2009 and has grown at a 5-year CAGR of 18%. The nature of policies in this category includes burglary protection, public liability, travel insurance and workmen compensation. The growth in this segment has been quite erratic over the past 10 years as most products under this class are not compulsory but acquired on a needs basis. The compulsory portion is the Workmen Compensation (WC) which has been driving growth in the last few years.

GROSS PREMIUM INCOME – GENERAL ACCIDENT

N'Billions



Source: Nigeria Insurance Digest, Vetiva Research

WC provides compensation for an employee's bodily injury or accident experienced in the course of duty. The nature of the Oil and Gas Industry which makes employees susceptible to physical hazards has increased the demand for this product class. We expect the segment to experience steady growth on the back of the implementation of the Nigeria Oil and Gas Content Development Act (NCD) which requires all insurable risks to be placed with a local insurer.

Marine and Aviation Insurance gradually picking up

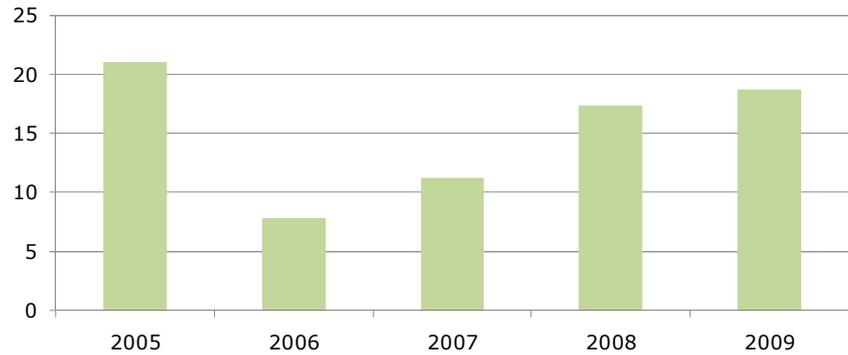
The Marine and Aviation segment has historically been the largest insurance business class under the non-life segment until 2006 when its share fell below the other Insurance classes (Motor Insurance, Oil and Gas, Fire and Motor Insurance). In 2006, it fell 63% YoY, thus recording a negative CAGR of 2% over the past 5 years. Growth in Marine Insurance is majorly driven by cargo imports while the other component, Marine Hull is typically slow. We attribute this slow growth to the huge capital outlay and potential losses associated with this business line which has traditionally made it unattractive for many Insurers.

In addition, the ban on imports in late 2005 saw cargo imports reduce and led to a sharp contraction in premiums in 2006 from the marine sector. With a YoY growth of 9% in 2009, we can say the sector is gradually picking up and has opportunities for growth especially on the back of the Nigeria Oil and Gas development Act which makes mandatory for 40% of marine risks be placed/ insured locally.



GROSS PREMIUM INCOME – MARINE AND AVIATION

N'Billions



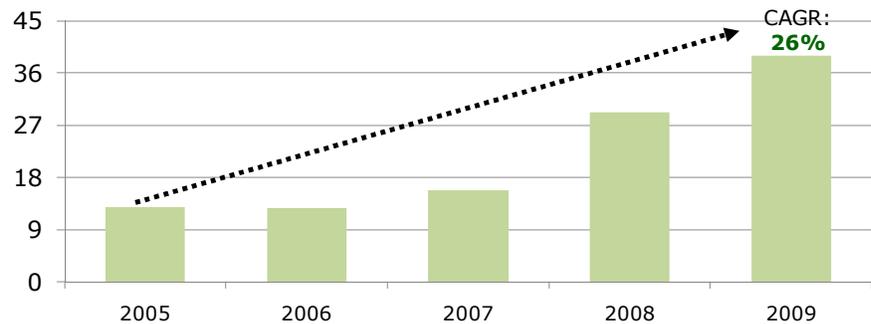
Source: Nigeria Insurance Digest, Vetiva Research

Successful Pension Reforms keeps the "Life" Business afloat

Life business has experienced steady growth as a result of enacted laws which are relatively well enforced. The life segment has received some boost by the enactment of the Pension Act of 2004. With the Pension Reform Act of 2004, all employers with a minimum of five employees must purchase life assurance policies on behalf of their staff. These policies must cover three times the annual emolument of the employee.

GROSS PREMIUM INCOME – LIFE INSURANCE

N'Billions



Source: Nigeria Insurance Digest, Vetiva Research

This continues to provide a significant opportunity for the insurance sector and life insurance business. However, this segment still faces some challenges as it is dominated by group life policies while the informal sector struggles with compliance. Individuals on the other hand are not disposed to paying for life policies given relatively low disposable incomes. A growing middleclass which sprang up in the years between 2003 and 2008 have unfortunately seen cuts in income levels, even as many of the employees in various industries lost their jobs, following the challenging economic conditions in 2008 and 2009.



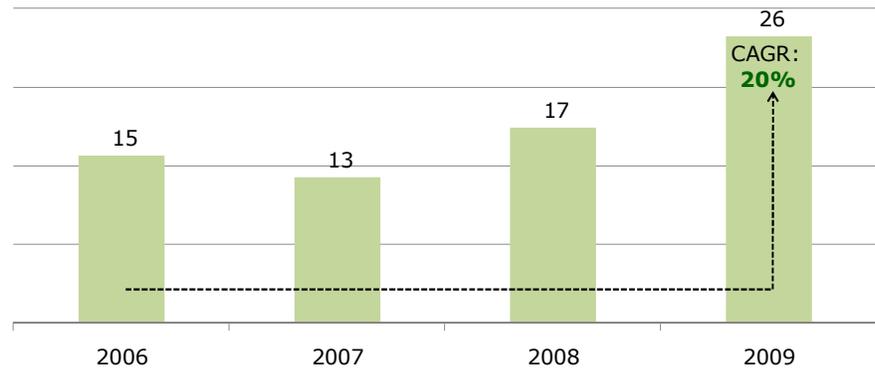
REVIEW AND PROSPECTS

Implementation of the local content policy portends huge opportunities

Oil & Gas Premiums have grown steadily over the past few years recording a CAGR of 20% and 13% YoY growth in 2009. The increase in Oil and Gas business can be explained by the government efforts to implement the local content policy which stipulates that companies must cede all of their risks to local underwriters who must in turn retain 70% of the risks locally. Despite this regulatory incentive, the local insurance companies still do not have the capacity (financial and technical) to underwrite huge Oil and Gas risks and such risks are usually ceded abroad.

GROSS PREMIUM INCOME – OIL AND GAS

N'Billions



Source: Nigeria Insurance Digest, Vetiva Research

Insurance and the Nigerian Oil & Gas Content Development Act 2010

The role of the Oil & Gas sector in Nigeria cannot be overemphasized being the major source of government's revenue, export earnings, foreign exchange and employment. However, even though this oil wealth contributes 29.62% of 2009 GDP, and is a key source of government earnings, it has had only a minimal impact on non-oil sectors. To redress this situation, the Federal Government enacted into law The Nigerian Oil and Gas Content Development Act 2010 ("The Act"). The Act aims at increasing, and in certain cases gives exclusivity to indigenous participation and use of local resources in the Oil & Gas industry.

We acknowledge the Federal Government's efforts at encouraging indigenous participation in the industry vis-à-vis the Petroleum Act 1969 and the Nigerian Content Development Directives 2006. With respect to insurance, the policy aimed to achieve local participation in 45% of oil risks in 2007, and 70% at the end of 2010. Effective implementation of these policies created the need for recapitalization in the industry which eventually took place in 2007. At the completion of this exercise, the minimum capital base of life, non-life and reinsurers increase to ₦2billion, ₦3billion and ₦10billion respectively. Unfortunately, these policies have been unable to achieve the desired impact due to poor implementation.

Only about 33% of Nigerian National Petroleum Corporation (NNPC) risk exposure is retained locally. In 2009, Gross Premium Income (GPI) from Oil & Gas contributed only 13% to total Industry Gross Premiums. However, there is room for growth as GPI grew 33.3% to ₦200 billion in 2009.



Reference to Insurance in Nigerian Content Act

We make specific reference to Sections 49 & 50 of the Act that concedes almost all insurance related services to indigenous contractors. Section 49 (1) in particular states –

"All operators, project promoters, alliance partners and Nigerian indigenous companies engaged in any form of business, operations or contract in the Nigerian oil and gas industry, shall insure all insurable risks related to its oil and gas business, operations or contracts with an insurance company, through an insurance broker registered in Nigeria under the provisions of insurance Act as amended. Section 50 – No insurance risk in the Nigerian Oil and Gas industry shall be placed offshore without the written approval of the National Insurance Commission which shall ensure that Nigerian local capacity has been fully exhausted."

Guidelines in this Act allow 100% of life, 70% of non-life and 40% of all marine insurance risks be placed with insurers in Nigeria. We summarize the main points of the Act as follows:

- All insurable risks must be insured
- Insurance must be done through a registered insurance broker in Nigeria
- Insurance risk must be placed with insurance companies registered in Nigeria
- The supervisory role remains with NAICOM which determines the extent of utilization of local capacity

Unlocking opportunities

The import is clear; the Act will unlock more growth opportunities in the insurance industry. Some of which in our opinion will include:

- Impact on Foreign Direct Investment (FDI) as foreign companies partner with Nigerian companies to tap into the opportunities that the Nigerian Content Development Act will create
- Cross – selling of other Insurance products such as motor, life, workmen compensation amongst others. Better capitalized and regulated insurance companies with stronger balance sheets. On the back of this, insurance companies will be well positioned to take on more risks
- Possible consolidation of companies through Mergers & Acquisitions with meaningful cost and revenue synergies
- Knowledge transfer
- Increase in employment opportunities
- Improved Industry credibility



Challenges still remain

Despite the above gains, the challenges witnessed by the Insurance companies still remain prevalent.

- One of the key considerations that insurance buyers have is the security and capacity of their insurers to meet their financial obligations, when claims are made. In this regard, we define capacity as the maximum amount an insurer is able to commit or provide on any given risk at any given time. Given the value of transactions and risk in the Oil & Gas industry, it is important to understand how much risk the local market can retain.
- Another issue is the pricing of risk when information is incomplete. Most local insurers do not rely on experts to assess the quality of risk and its exposures before decisions on premiums are made. As such, insurance buyers end up understating the premiums required and this has led to high loss ratios. Skill and information gaps have to be addressed.
- International Oil Companies (IOC) usually prefer to deal with rated insurance companies. Currently, there are only a few internationally rated Nigerian insurance companies because ratings have not been an important pre-requisite for attracting business. However, if IOCs decide to use this as criteria, most insurance companies may not meet their required standard.

Strategies for optimization

There may be need for the recapitalization of Insurance companies to strengthen financial capacity that will make them better positioned to assume larger risks normally associated with Oil and Gas deals. Insurers may need to explore other capital raising options other than equity financing. An alternative could be debt financing; lately, there seems to be a larger appetite from investors (Institutional) to patronize debt offerings rather than equity which is understandable given the limited number of asset classes and the risk aversion to the equity market. However, we note this may not be the most viable option due to the adverse impact interest burden would have on insurance companies in view of their unsteady cash flows. However, we do not discount the former as Insurance companies are beginning to explore recapitalization options through share buy-back thereby creating an opportunities for strategic investments or even equity issues at a higher price.

At various levels, there needs to be an intensive drive for knowledge acquisition, the levels being Insurance Companies, Professional bodies and the Regulators. For example, quite a number of the insurance companies have reinsurance agreements with foreign insurance brokers, they should leverage such relationships to achieve knowledge transfer. There should also be huge investments in Training and Development through seminars and conferences.

Rating of the local insurers by an internationally recognized and accepted rating agency should be strongly considered and reviewed. Financial rating will enable Insurance companies participate in underwriting even global risks. Quite a number of countries in the West African region have discovered oil and an internationally acceptable rating will position local companies to participate in underwriting such risks.



Overall, the Act portends unlimited opportunities for growth in the Insurance Industry. However, it is likely that the potential effect of the Act will not be felt until after 2011 when all the existing insurance policies are renewed to reflect higher premium retention in Nigeria.

Conclusion

Insurance Companies have suffered significant losses in the Capital Market especially during the financial crisis in 2008/2009 which unfortunately began soon after the completion of the consolidation exercise in 2007 that led to a huge influx of capital into the Industry. In addition, the industry remains infirmly regulated which continues to dampen investor appetite. Till date, the companies haven't fully recovered from the huge decline in their investment values and currently most of the stocks are traded with speculation.

Brokers who unfortunately remain the most important distribution channel of insurance products continue to default in remittance of premiums thereby impacting the earnings of the Insurance companies adversely. However, there are still opportunities for Investment in cheap equities even as NAICOM takes steps to improve the regulatory framework, sanitize the sector as well as provide an enabling environment for further growth of the insurance companies.



Fair Value Range

~~₦4.56~~ – ~~₦4.96~~

Stock Data

Symbol: NSE CUSTODYINS
Bloomberg CUSTODYI.NL

Current Price (NGN): 2.50
Trailing EPS (NGN): 0.44
Trailing P/E (x): 5.99
2010 P/E (x): 6.91

Shares Outstanding (mn): 5,101
Market Cap (NGNbn): 12.140
Year High (NGN): 4.06
Year Low (NGN): 2.38

Share Price Performance

30 Days (%): (27.88)
90 Days (%): (32.00)
52 weeks (%): (16.78)

Source: NSE, Vetiva Research

Custodian and Allied Insurance Plc- Oil and Gas set to enhance Premiums

- Custodian's Gross Premium Income (GPI) has grown at a 5-year CAGR of 47.75% exceeding total Industry CAGR of 23.57% over the same period. GPI grew by 28.64% and 53.25% YoY in 2009 and H1'10 respectively. These impressive gains have been driven by the company's strong competence in underwriting Oil & Gas risks which was 38% of 2009 GPI. Custodian is currently (2010/2011) the lead underwriter of the Nigerian National Petroleum Corporation (NNPC) Consolidated Insurance Policy.
- However, we expect underwriting margins to come under pressure as outward reinsurance increase on the back of underwriting more Oil and Gas risks which are typically associated with potentially huge losses.
- Custodian remains one of the most profitable companies in the Insurance universe with PBT and PAT margins of 45.1% and 38.0% while ROAE and ROAA stands at 20.31% and 15.63% respectively.
- The company forecasts a 56.53% and 35.97% YoY increase in 2010 Gross Premiums (GP) and PAT to ₦8.260 billion and ₦2.565 billion respectively. As at H1'10, the company had achieved 53.31% and 47.33% of the stated GP and PAT targets. The company also declared an interim dividend of ₦0.06 per ordinary share. This payout represents 35.39% of FY'10 DPS estimate of ₦0.17.
- Notably, the company recently concluded a share buy-back programme of 37,924,787 units from the open market on the floor of the Nigerian Stock Exchange (NSE). With the conclusion of this exercise, the number of shares outstanding reduces to 5,100,846,808 units.
- We expect the growth in top and bottom line numbers to be sustained and estimate 2010 gross premiums and after – Tax profits of ₦7.7billion and ₦2.3 billion respectively; this would be driven by premiums from its Oil and Gas portfolio.

Forecast (N'mn)	2008A	2009A	2010E	2011E	2012E
Gross Premium	4,102	5,277	7,797	12,204	17,086
PBT	1,850	2,172	2,716	3,831	4,358
Tax	291	132	367	462	697
PAT	1,560	2,040	2,349	3,369	3,661
Earnings Per Share	0.44	0.40	0.44	0.56	0.68
Dividend Per Share	0.19	0.17	0.17	0.29	0.38
P/E (x)	8.17	7.20	6.91	7.14	5.88

CUSTODIAN SHARE PRICE Vs. VOLUME TRADED

Rebased : 27 August 2009 = 1



Source: Nigerian Stock Exchange



REVIEW AND PROSPECTS

Fair Value Range

₦1.38– ₦1.47

Stock Data

Symbol: NSE GTASSURE
Bloomberg GTASSURE.NL

Current Price (NGN): 1.39
Trailing EPS (NGN): 0.06
Trailing P/E (x): 23.17
2010 P/E (x): 12.64

Shares Outstanding (mn): 10,000
Market Cap (NGNbn): 13,900
Year High (NGN): 3.54
Year Low (NGN): 1.39

Share Price Performance

30 Days (%): (32.85)
90 Days (%): 43.27
52 weeks (%): (55.73)

Source: NSE, Vetiva Research

Guaranty Trust Assurance Plc "GTA" - Emerging retail insurance leader

- Despite the downturn in economic activities and the negative impact on insurance underwriting, gross premiums written for GTA grew by 29.78% YoY to ₦5,377 billion in 2009. In H1'10 however, YoY gross premiums inched up marginally by 7.06%. Notably, underwriting income improved by 23.82% in H1'10 YoY owing to a reduction in reinsurance costs while after tax profits improved by 25.73% over the same period.
- FY Earnings continue to reflect the impact of the retail business division as the motor portfolio grew YoY by 51.79%; thanks to the direct distribution strategy vis-a-vis the Bancassurance model through GTBank and FCMB branches. The Oil & Gas portfolio increased by 50.47% in the same period while reinsurance costs have declined contrary to the trend witnessed in other Insurance companies that have increased their Oil & Gas portfolios. The reduction in Reinsurance costs by a substantial 54.20% is laudable as it depicts GTAssure's ability to assess risks better and underwrite more risks locally rather than ceding to foreign Insurers.
- Life business portfolio contracted 22.14% YoY in FY'09 due to the cancellation of some government related life policies. However, the Life segment in Nigeria portends limitless opportunities with premiums growing at a 5-year CAGR of 26.31% higher than the total industry premiums which grew at a CAGR of 23.57%. As such, we are convinced this segment will potentially be a major premium driver for GTAssure in the near and long term.
- Furthermore, the company remains competitively positioned to capture a wider retail market through its affiliation with GTBank (subject to the impact of the announced divestiture from GTAssure), and FCMB as well as garner a larger market share of underwriting Oil & Gas risks through the support of the recently passed Nigerian Content Development Oil and Gas act, 2010.

Forecast (N'mn)	2008A	2009A	2010E	2011E	2012E
Gross Premium	4,143	5,377	6,452	7,743	10,065
PBT	2,001	1,312	1,438	2,078	2,762
Tax	125	796	345	449	663
PAT	1,876	516	1,093	1,629	2,099
Earnings Per Share	0.21	0.05	0.11	0.16	0.21
Dividend Per Share	0.15	0.09	0.08	0.11	0.15
P/E (x)	6.62	27.80	12.64	8.69	6.62

GTASSURE SHARE PRICE Vs. VOLUME TRADED

Rebased : 30 November 2009 = 1



Source: Nigerian Stock Exchange



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