



Company Update

Following recent discussions with the Management team of Custodian and Allied Insurance Plc, we provide an update on the company, which highlights some changes to our near term outlook on its business segments and performance.

▪ **FY'10 Gross Premium Income (GPI) in excess of ₦7 billion:**

We expect Custodian's GPI to reach ₦8.08 billion by FY'10, placing it in the league of Leadway Assurance, IGI and AIICO – the only Insurance companies that have attained premiums in excess of this amount. This growth is to be driven largely by Custodian's Motor and Oil & Energy Insurance portfolios. We note that Motor has historically been the largest contributor to Gross Premiums (2009: 24%, 2008: 29%); however, Custodian's improving competence in Oil & Energy underwriting is increasingly contributing to its top line numbers – 38% in 2009, up from 16% in 2008. We expect growth in the Company's Energy portfolio in 2010 to be supported by the Nigerian National Petroleum Corporation – Consolidated Insurance Policy (NNPC CIP) account, for which Custodian is the 2010/2011 lead underwriter. Nevertheless, it is important to note Management's commitment to growing premiums across all policy classes especially in the retail space. Though we have increased our year end expectations, we note that the NNPC CIP account is open to renewal and bids from qualified Insurance underwriters every year.

▪ **Re-accessing Life Insurance:** From inception in 1995, Custodian was a General Insurer, until 2001 when it diversified into Life Insurance business. However, in a bid to comply with regulatory requirements, the Company in 2007 sold its Life business to Leadway Assurance. In recent years, Life Insurance business in Nigeria has recorded significant mileage aided by better compliance with mandatory Insurance policies. In this regard, we refer to the Statutory Group Life Policy, which mandates employers with a minimum of five employees to purchase Life Assurance policies on their behalf. This policy has supported the strong YoY growth of Gross Premiums in the Life Insurance segment. It is estimated that Group Life Insurance cover for Federal Government employees is in excess of ₦4 billion/annum, and this figure is set to increase as Civil Service participation improves. In addition, considering that Life Assurance has grown at a 5-year CAGR of 26%, Custodian is evaluating plans to re-access this fast growing Insurance class and may consider an M&A in the medium-long term to achieve this objective.

▪ **Impact of stringent regulations:** Regulations have become more severe in recent times, with efforts by the regulator, NAICOM, to stamp out unethical practices and improve the Industry's credibility. One of the key issues in the Sector relates to the menace of premiums owed to Insurance companies by Brokers, who remain the major conduit of Insurance policy/product sales, especially to corporates. In light of this, we note that the 2010 operational guidelines released by NAICOM, now mandates the treatment of *outstanding premiums* as follows:

- Under 90 days: No provision
- 91-180 days: 50% provision
- Above 180 days: 100% provision

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Fair Value Range
~~₦4.35~~ – ~~₦4.49~~

Symbol: NSE: CUSTODYINS
Bloomberg: CUSTODYI.NL
Reuters: CUST.LG

Current Price (NGN): 2.45
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): 13.109
Year High (NGN): 4.06
Year Low (NGN): 2.22

Share Price Performance

30 Days (%): (28.40)
90 Days (%): (50.58)
YTD (%): (16.73)

52-week share price performance



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On the back of this, we expect industry-wide provisioning levels to rise relatively. The Management of Custodian alluded to this, but also expressed optimism on recoveries in Q4'10, which it anticipates will nil-off some of the margin pressures from the revised rules by FY'10. However, we understand that in an effort to effectively manage debtor levels, some Insurance companies may be returning premiums to some clients who they see as most risky on their expected default rankings. Thus, we may see some growth strains at top line level by FY'10.

- **Leasing subsidiary still work-in-progress:** Custodian's leasing business which commenced operations in 2007, currently contributes less than 1% to its Total Income (2009: 0.60%, 2008: 0.33%). Challenging economic conditions in 2009 and 2010, and the fact that leasing businesses typically have relatively long gestation periods have meant a slow start for the business, which we believe has robust potential in the medium term. Custodian still sees the business as relevant to its strategic longer term objectives, and is working on steadily growing the business.
- **Asset allocation:** Compared to most Insurers who have taken a hit on their Investment Income line due to capital market exposures, Custodian has shown dexterity in effectively managing its portfolio, albeit conservatively, as Investment Income inched up slightly by 3% YoY in 2009. To a large extent, Investments have been skewed towards fixed income and money markets securities, whilst focusing on short term maturities. For diversification purposes, we note that the Company is looking at real estate investments, amongst other alternative investment options.
- **Share buy-back:** Custodian recently concluded a share buy-back exercise of 37,924,787 units through the open market on the floor of the Nigerian Stock Exchange (NSE). Following this, the company's shares outstanding reduced by 0.73% to 5,100,846,808 units. Whilst we had expected the company to fully exercise the buy-back option of 5% of its issued and paid-up share capital as earlier hinted, the company's management disclosed that it was constrained by a limited time period, post obtaining regulatory approval, to buy up the shares.
- We value Custodian between **₦4.35 – ₦4.49** and place an **OVERWEIGHT** rating at current market price. The Company recently declared an interim dividend of **₦0.06** per ordinary share held as at October 14, 2010, which represents 35.39% of our FY'10 DPS estimate of **₦0.17**.



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Buy/Overweight $\geq +25\%$ expected absolute price performance

Accumulate $+10\%$ to $+25\%$ expected absolute price performance

Neutral/Hold $\pm 10\%$ range expected absolute price performance

Reduce -10% to -20% expected absolute price performance

Sell/Underweight $\leq -20\%$ expected absolute price performance

Definition of Ratings

Buy/Overweight recommendation refers to stocks that are highly undervalued but with strong fundamentals and where potential return in excess of or equal to **20%** is expected to be realized between the current price and analysts' target price.

Accumulate recommendation refers to stocks that are undervalued but with good fundamentals and where potential return of between **10%** and **20%** is expected to be realized between the current price and analysts' target price.

Neutral/Hold recommendation refers to stocks that are correctly valued with little upside or downside where potential return of between **+/- 10%** is expected to be realized between current price and analysts' target price.

Reduce recommendation refers to stocks that are overvalued but with good or weakening fundamentals and where potential return of between **-10%** and **-20%** is expected to be realized between current price and analysts' target price.

Sell/Underweight recommendation refers to stocks that are highly overvalued but with weak fundamentals and where potential return in excess of or equal to **-20%** is expected to be realized between current price and analysts' target price.



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