

## Profitability Declines Amid Strong Underwriting Performance

### Uptrend in Yields and Premium Income from Core Business Spurs Growth

Custodian Investment Plc. (**CUSTODIAN**) recorded a remarkable double-digit growth in gross revenue (+14.23% YoY) to NGN85.74bn in 2021FY. The performance was majorly propelled by the expansion in Gross Premium Income (+13.91% YoY), supported by increase in the life business (+24.61% YoY). Only sales from the property business segment declined by 30.17% YoY, due mainly to decrease in revenue and earnings from its subsidiary (UPDC Plc.) in 2021FY. However, its contribution (0.96% YoY) to total revenue remains insignificant and has minimal impact on the overall business of the firm. Claims expenses on the other hand surged (+40.80% YoY to NGN20.18bn), influenced by huge claims payout from the life business during the period. Thus, combined ratio worsened to 40.05% (vs. 32.84% in 2020FY), which depicts a weak operational efficiency during the period as underwriting expenses also increased (+33.16% YoY). Nevertheless, underwriting performance (up 287.62% to NGN24.87bn) was supported by significant reduction in provisions for life and annuity fund from a loss of **NGN32.79bn** in 2020FY to a profit of NGN4.83bn. The reduction in the life and annuity fund was due to the uptrend witnessed in the general fixed income environment. **While we expect a sustained growth in premium income in 2022FY, we do not anticipate a significant reduction in actuarial valuation for life and annuity funds because the yield environment is expected to remain stable around current levels for most part of the year. This, coupled with elevated claims expenses is expected to moderate underwriting profitability to NGN15.60bn.**

### Fair Value Loss Drags Profitability

Total investment income improved (+16.17% YoY to NGN12.24bn), fueled by growth in interest income (+13.87% YoY) on fixed income assets. However, investment yield declined to 8.63% from 8.83% in 2020FY. Additionally, huge fair value loss of **NGN17.63bn** as the rise in the general yield environment lowered the prices of financial assets; coupled with the spike in management expenses (+40.46% YoY) dragged profitability (down by 20.75% YoY to NGN10.05bn). Thus, the firm's net margin declined to 11.73% below its 5-year average of 13.90%. **Flowing from our expectation of the general yield environment as noted above, we do not anticipate a dramatic change in fair valuations of financial assets. Therefore, we project a PAT growth of 9.41% YoY premised on moderated improvement in investment income.**

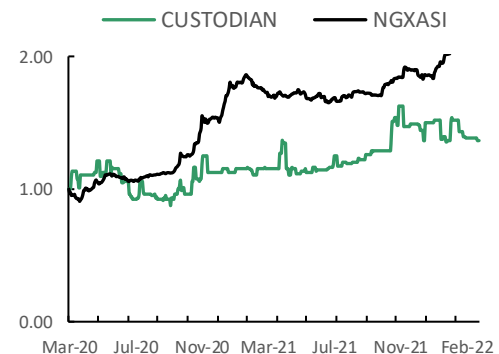
### Strong Solvency and Liquidity Position

As at 2021FY, **CUSTODIAN**'s solvency margin stood at NGN56.63bn (2.15x above the regulatory requirement), while its capital base (share capital, share premium and retained earnings) remains solid at NGN40.97bn above the proposed regulatory benchmark of NGN18bn. This signals the strong risk underwriting capacity of the business. While earnings asset improved marginally (+2.72%) due to slow growth in financial assets, earnings quality declined to 1.86x (vs. 3.42x in 2020FY). Overall, the firm's liquidity remained robust with (short term asset to total asset ratio at 17.22% vs 14.78% in 2020FY).

### Recommendation

Given the decline in profitability in 2021FY, we revised our expected EPS for 2022FY to NGN1.87, while we estimate a trading P/E multiple of 4.21x for the firm. This yields a target price of NGN7.87, indicating an upside potential of 10.88% from its current price of NGN7.10 as of March 18, 2022. Therefore, we rate the ticker a **BUY**.

Company	CUSTODIAN
<b>Valuation</b>	
Trailing EPS	NGN1.71
BVPS	NGN10.72
P/E	4.15x
P/BV	0.66x
Target PE	4.21x
Dec-2022 Exp. EPS	NGN1.87
Dec 2022 Target price	<b>7.87</b>
Current Price	7.10
Up/Downside Potential	<b>+10.88</b>
<b>Ratings</b>	<b>BUY</b>
<b>Key metrics</b>	
ROE	16.51%
ROA	5.58%
Loss Ratio	30.47%
Combined Ratio	40.05%
<b>Share/Share Price Statistics</b>	
Yr Hi	8.00
Yr Lo	7.05
YTD return	-0.10
Beta	0.80
Adjusted Beta	0.87
Shares outstanding	5.88bn
Market cap [NGN]	41.76mn
Financial year end	Dec
Most Recent Period (MRP)	2021FY



**Analyst**

**Samuel Banmeke**

[samuelbanmeke@meristemng.com](mailto:samuelbanmeke@meristemng.com)

+234 (818) 518 2859

Chart 1: Sensitivity Analysis

Sensitivity Analysis of Dec-2022 Target Price to key model inputs						Min	6.93
EPS						Max	8.87
Target PE	7.87	1.71	1.79	1.87	1.95	2.03	
	4.05x	6.93	7.25	7.57	7.90	8.22	
	4.13x	7.06	7.39	7.72	8.05	8.38	
	4.21x	7.20	7.54	7.87	8.21	8.55	
	4.29x	7.34	7.68	8.02	8.37	8.71	
	4.37x	7.47	7.82	8.17	8.52	8.87	

## Financial Highlights and Forecasts (NGN billion)

Profit & Loss Account	2021A	2022 F	2023F	2024F	2025F	2026F
Gross Revenue	85.74	95.54	102.97	109.11	114.26	117.56
Gross Premium Income	66.23	74.84	80.82	85.67	89.10	92.67
OPEX	47.73	66.11	73.01	77.31	80.50	83.89
Net Operating Income	33.19	29.43	29.96	31.80	33.76	33.67
Claims Expenses (Net)	20.18	22.45	24.25	25.70	26.73	27.80
Underwriting Expenses	6.34	6.78	7.32	7.68	8.07	8.58
Total Investment Income	12.24	12.80	13.43	13.83	14.56	13.23
PBT	12.32	11.70	13.01	13.26	14.56	16.56
PAT	10.05	11.00	12.51	12.62	13.93	15.82

Balance Sheet	2021A	2022F	2023F	2024F	2025F	2026F
Investment Assets	145.33	155.85	167.84	177.85	186.24	191.62
Insurance Contract Liabilities	85.04	90.29	92.90	103.15	111.87	117.03
Total Assets	184.47	197.95	215.62	242.25	270.24	298.19
Total Equity	63.07	70.41	78.72	87.14	96.73	107.35
Total Liabilities	183.28	197.95	215.62	242.25	270.24	298.19

Financial Ratios	2021A	2022F	2023F	2024F	2025F	2026F
GPI Margin	77.24%	78.33%	78.50%	78.52%	77.98%	78.82%
Underwriting Margin	7.40%	7.09%	7.11%	7.04%	7.07%	7.30%
Net Margin	11.73%	11.51%	12.15%	11.57%	12.19%	13.46%
Return on Asset	5.58%	5.75%	6.05%	5.51%	5.44%	5.57%
Return on Equity	16.85%	16.48%	16.77%	15.22%	15.16%	15.51%
Investment Yield	8.63%	8.50%	8.30%	8.00%	8.00%	7.00%
Expense Ratio	9.58%	9.06%	9.06%	8.96%	9.06%	9.26%
Loss Ratio	30.47%	30.00%	30.00%	30.00%	30.00%	30.00%
Combined Ratio	40.05%	39.06%	39.06%	38.96%	39.06%	39.26%

## Contact Information

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### Brokerage and Retail Services

topeoludimu@meristemng.com  
contact@meristemng.com

(+234 905 569 0627)

---

### Investment Banking/Corporate Finance

rasakisalawu@meristemng.com  
seunlijofi@meristemng.com

(+234 806 022 9889)  
(+234 808 536 5766)

---

### Wealth Management

funmilolaadekola-daramola@meristemng.com  
crmwealth@meristemng.com  
Tel : +234 01 738 9948

---

### Registrars

muboolasoko@meristemregistrars.com  
martinaosague@meristemregistrars.com  
www.meristemregistrars.com  
Tel: +23401-280 9250

(+234 803 324 7996)  
(+234 802 303 1783)

---

### Trust Services

damilolahassan@meristemng.com  
trustees@meristemng.com

(+234 803 613 9123)

---

### Group Business Development

saheedbashir@mersitemng.com  
ifeomaogalue@meristemng.com  
info@meristemng.com

(+234 802 454 6575)  
(+234 802 3942967)

---

### Client Services

adefemitaiwo@meristemng.com  
blessingogwuiche@meristemng.com  
car@meristemng.com

(+234 803 694 3034)  
(+234 706 896 5173)

---

### Investment Research

timchanggwatau@meristemng.com  
research@meristemng.com

(+234 703 188 3322)

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**Corporate websites:**      [www.meristemng.com](http://www.meristemng.com)      [www.meristemwealth.com](http://www.meristemwealth.com)      [www.meristemregistrars.com](http://www.meristemregistrars.com)

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### Fair Value Estimate

We estimate stock's fair value by computing a weighted average of projected prices derived from discounted cash flow and relative valuation methodologies. The choice of relative valuation methodology (ies) usually depends on the firm's peculiar business model and what in the opinion of our analyst is considered as a key driver of the stock's value from a firm specific as well as an industry perspective. However, we attach the most weight to discounted cash flow valuation methodology.

### Target Price Estimate

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- BUY:** Target Price of the stock is above the current market price by at least **10 percent**
- HOLD:** Target Price of the stock ranges between **-10 percent and 10 percent** from the current market price.
- SELL:** Target Price of the stock is more than **10 percent** below the current market price.

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**Price Targets:** Price targets reflect in part the analyst's estimates for the company's earnings. The achievement of any price target may be impeded by general market and macroeconomic trends, and by other risks related to the company or market and may not occur if the company's earnings fall short of estimates.

**Asset allocation:** The recommended weighting for equities, cash and fixed income instrument is based on a number of metrics and does not relate to a particular size change in one variable.

**Movements in Price Target**

**Company Name: Custodian Investment Plc.**

Date	Price (N)	Previous Target Price(N)	New Target Price (N)	Previous Recommendation	New Recommendation
21-Mar-2022	7.10	8.63	7.87	BUY	BUY

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Custodian Investment Plc.	

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