

# MERISTEM EQUITY RESEARCH REPORT



REPORT DATE: APRIL 27, 2007

BUY

12-Month Target Price =N9.30

## EXECUTIVE SUMMARY AND INVESTMENT RATIONALE

- Crusader Insurance Plc was established in 1956 as a subsidiary of Crusader Insurance Company UK. It was incorporated on April 21, 1970 and listed on The Nigerian Stock Exchange (NSE) in 1990. The company is registered to operate Life and Non-Life Business.
- Crusader successfully recapitalized before the National **Insurance Commission (NAICOM)** deadline and in the process, it absorbed **Golden Insurance Company Limited, Royal Trust Assurance Company Limited, Refuge Insurance Company Limited and Admiral Insurance Company Limited.**
- It is a customer based, innovative and value driven company with two subsidiaries namely; **Crusader Trustees Limited** and **Crusader Sterling Pensions Limited.** It also has a strategic alliance with Sterling Bank Plc, a major shareholder in Crusader's Pension Fund Administration Company, **Crusader Sterling Pensions.**
- The company has a well diversified products portfolio (which allows it to spread its income generation risks) and injection of fresh funds from its successful Offer in 2006 is expected to enable it take advantage of emerging opportunities in the insurance industry.
- The increase in the company's cash position is expected to empower it to participate in mega deals along its line of business such as underwriting initiatives in the Oil and Gas, Aviation and Telecoms industries. This provides assurance for better return on equity.
- A technical analysis of share performance revealed that the company's share price has appreciated by over 378% in the last 12 months from the lowest point of N1.33

to the peak of N6.36. It will also be recalled that the stock traded at N0.70k on January 2005, meaning that the holding period yield (HPY) in the last two years is over 800%.

- It is presumed by some analysts that the company is still undervalued as investors are yet to fully acknowledge the prospects of a growing company in a growth industry. Given the outlook of the industry, opportunities abound for companies with competitive advantage and competitive strategies.
- Crusader's current **Earnings Per Share (EPS) of N0.36k** is the second highest in the industry trailing closely behind WAPIC Plc with EPS of N0.50k in the sector. Though the full year result of the company for the year ended 2006 is yet to be released, analyst estimated an EPS of N0.37 for the year 2006. The delay in providing this information may not be unconnected to the merger arrangement of the company with other insurance firms. This is premised on a not too significant growth in earnings expected in the last quarter 2006 resulting from the company's engrossment in merger/consolidation processes.
- The company's performance since year 2000 has been wonderful and dividend payment has been consistent. Profit After Tax (PAT) rose from N40.9m in 2001 to N277.78m in 2005(resulting from a Compounded Annual Growth Rate- CAGR of over 61%). A PAT of N307.36 million was also estimated for the financial year 2006. However, all indications show that the company will most likely surpass this estimate as its quarterly results released for the period Q3-2006 revealed a PAT of N250m.
- A good brand name, strict prudential policy and practices have ensured the company to maintain the highest standard of regulatory compliance for the past 50 years. Crusader Insurance Plc was accorded a first time credit rating of A- in relation to its claims paying ability by **Global Credit Rating (GCR) Company of South Africa**.
- Favourable Government policies such as Pension Reforms in 2004, 45% local content and mandatory Life Assurance in some sectors coupled with the stability in growth of the economy and increased awareness of the public of the viabilities of insurance schemes are expected to grow the company's profits in years ahead.
- We thereby make a **Hold/Buy** recommendation on CRUSADER given the anticipated synergistic growth in Net Premiums and Net Income post-consolidation. Our valuation of the company and the current market indicate that the company is

trading at a discount to its intrinsic value by not less than 40%.

### **Risk Profile**

The company operates in a market where competition is stiff and product pricing is highly elastic. The low level of awareness by the generality of Nigerians (Corporate & individual) about the activities of the industry as well as lack of confidence in claims settlement by insurance company has earlier impacted negatively on the industry. Since the company operates more in the non-life business, its exposure to various risk increases given the level of securities and policy holders' attitude. As a way on minimising its risk, the company has a wide diversified investment portfolio. The industry is highly regulated and technology remains a success factor for the industry. It is expected that the company will be more equipped technologically to respond to the changing needs of the environment.

Foreign exchange risks exist as the insurance in Oil and Gas businesses and many other capital intensive policies are usually US Dollar denominated.

### **Future Outlook**

The future outlook of the industry and Crusader in particular is very promising. The post consolidation effect of the industry is aimed at increasing the capital base so that many insurance companies would be able to participate in mega insurance businesses and also engage in reinsurance businesses; most of which are currently ceded abroad. The reforms policies of the government and the associated economic growth and development in the country are expected to drive the insurance industry thereby increasing the industry profitability. As a company that is well positioned with strong operating and capital base, it is expected that operating margin and return on equity will increase tremendously in the post merger/consolidation process.

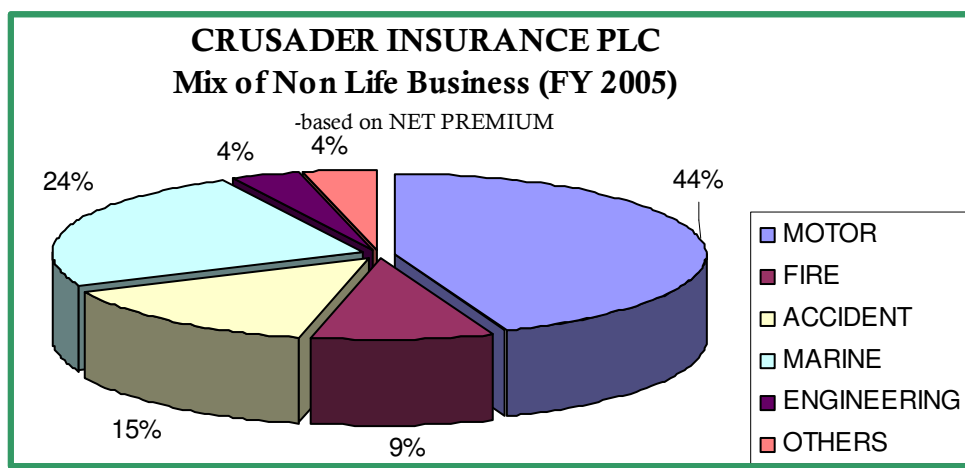
## **ANALYSIS OF FINANCIALS:**

### **BUSINESS MIX**

Crusader Insurance Plc operates a composite insurance business model, underwriting both Life and Non-life risks. Like other insurance companies, it engages in both Life and Non-life businesses. Non-Life business accounts for a huge chunk of the company's total businesses, contributing about 69% of the Net Premium and 66% of the total underwriting profit. Compared to its peers who are also engaged in composite insurance business, Crusader

Insurance has a relatively bigger Life-business both in terms of Net Premium and the size of the Balance Sheet of its Life-business.

Over the past 5 years, the company's business model has undergone a radical metamorphosis. In the past 3 years, precisely from 2003- till date, none of its Strategic Business Units (SBUs) has generated loss, with the Motor Insurance business accounting for N67.8m in underwriting profit in 2005 from a loss position of N0.303 m in 2001. Similarly, its Fire Insurance business generated an underwriting profit of N26.26m in the financial year 2005 as against underwriting losses of N4.14 m and N0.72 m reported in 2001 and 2002 respectively.



Moreover, the relative contributions of the different business units have also changed drastically, with the Marine Insurance business line contributing N41.3 to every N100 of underwriting profit earned in the financial year ended December 31, 2005 compared to a paltry N3.10 and N1.50 contributed to every N100 of underwriting profit in financial years 2001 and 2002 respectively. In the same way, the relative importance of Accident Insurance in the product portfolio has waned, with this business segment contributing only 3.8% of total underwriting profit from the Non-Life business in 2005 as compared to 37.6%, 18.7%, and 19.7% in 2002, 2003 and 2004 respectively. This business unit was one of the company's cash cow units in the prior years until recently. The paradigm shift of focus could be attributed to the declining margin from the Accident Insurance business and new opportunities in marine/Oil and Gas insurance business.

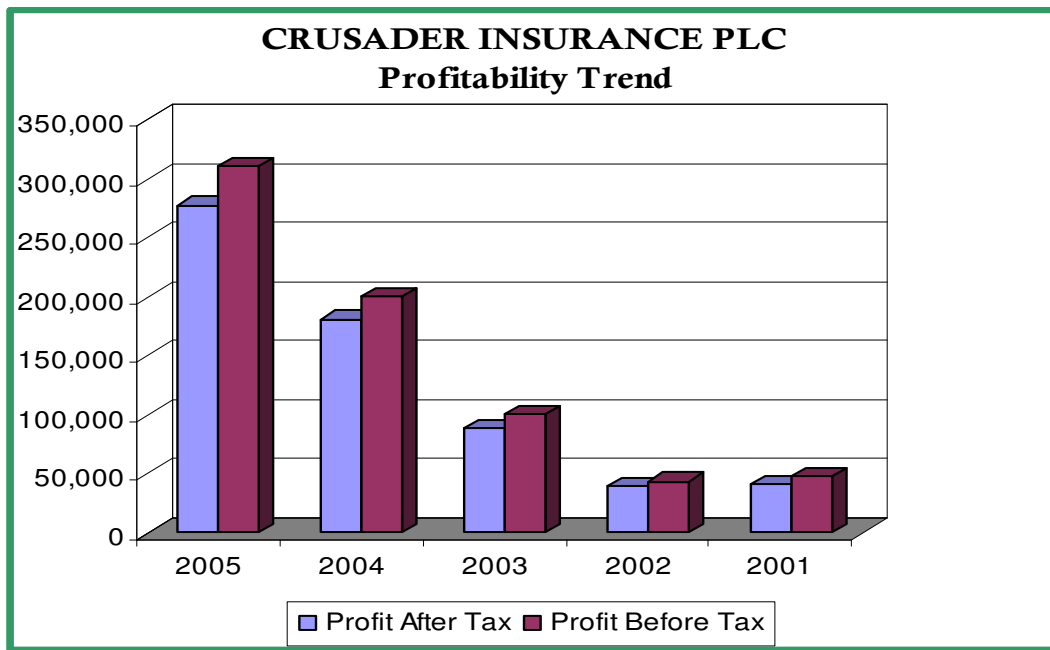
**EARNINGS & PROFITABILITY:**

The company's strategic shift in business model has impacted positively on its bottom-lines. It has been able to grow its underwriting profit from Non Life business by an average Compounded Annual Growth Rate (CAGR) of 199%, from N2.72 m in 2001 to a whopping

amount of N219.2 million reported in its financials report for the year ended December 31, 2005. Also, the Non Life business underwriting profit margin (Underwriting Profit/Net Premium) has significantly improved over the years, from 3.8% in 2001 to 36% in 2005, though with a slight decline in 2004, from 43.5% (in 2003) to 34.7%.

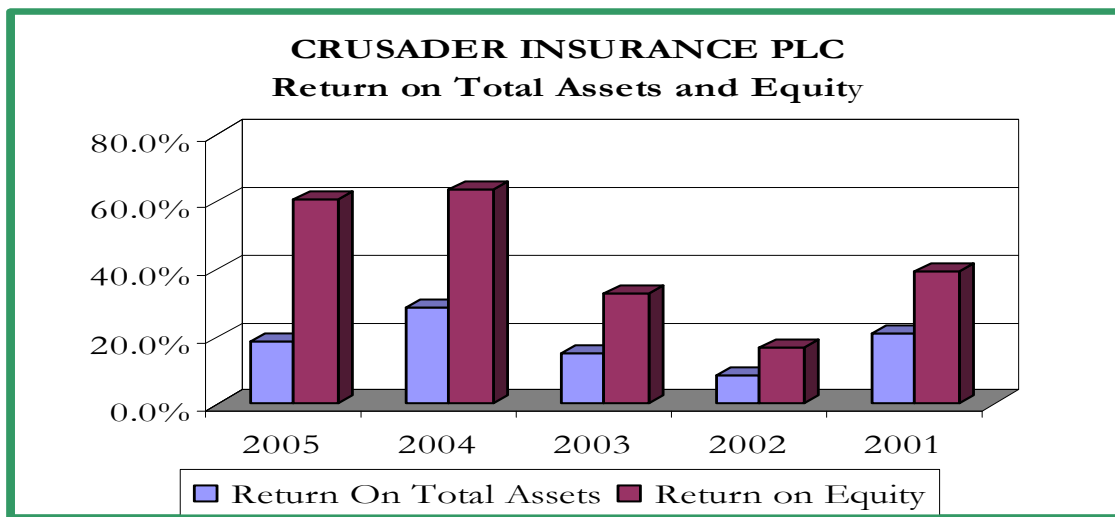
The Life business on the other hand, recorded only a modest growth over same years under review. Net Premium grew by 18% (CAGR), an improvement from N141.8 m in 2001 to N275.4 m in 2005. However, underwriting profit attributable to this business unit soared by 187%, from N4.7 m in 2002 to N112 m in 2005.

Taking a holistic view of the company's performance, our analysis revealed that Crusader Insurance recorded a growth of 61.4% (CAGR) in Profit After Tax (PAT) from N41m in 2001 to N277.8m in 2005.



The remarkable growth in company's earnings has translated to handsome returns to the investors with a record of an average Return of Total Asset (ROTA) of 18.4% and average Return on Equity (ROE) of 42.7% over the 5 years reviewed. Crusader's ROTA and ROE for the financial year ended December 31, 2005 were 18.6% and 60.9% respectively.

This impressive profit performance can be attributed to strong growth in Gross and Net Premiums (by a 42.5% CAGR from 2001-2005). This suggest robust business model, rich products portfolio with aggressive marketing strategy by the company and of course, the growing awareness and patronage of the insurance business by Nigerians. Besides, the company has well managed cost levels.



### **EFFICIENCY:**

Crusader's performance ranks among the best in the Industry in terms of efficiency indices relating to cost management. For its Life business, apart from year 2003 when huge claims were paid, the **Policy holders' Claim Ratio** and the **Expense Ratio** have contributed to the company's remain not only competitive advantage and ability to deliver higher value to shareholders at a minimum cost represent one of the drivers of superior profit performance. **Policy holders' Claim Ratio** represents the proportion of Net Premium utilised for claims payment (i.e. Claims/Net Premium) while the **Expense Ratio** shows the actual costs of doing core insurance business relative to core insurance incomes (i.e. sum of Underwriting Expenses and Claims as a proportion of Net Premium Earned, excluding investment income and commissions received).

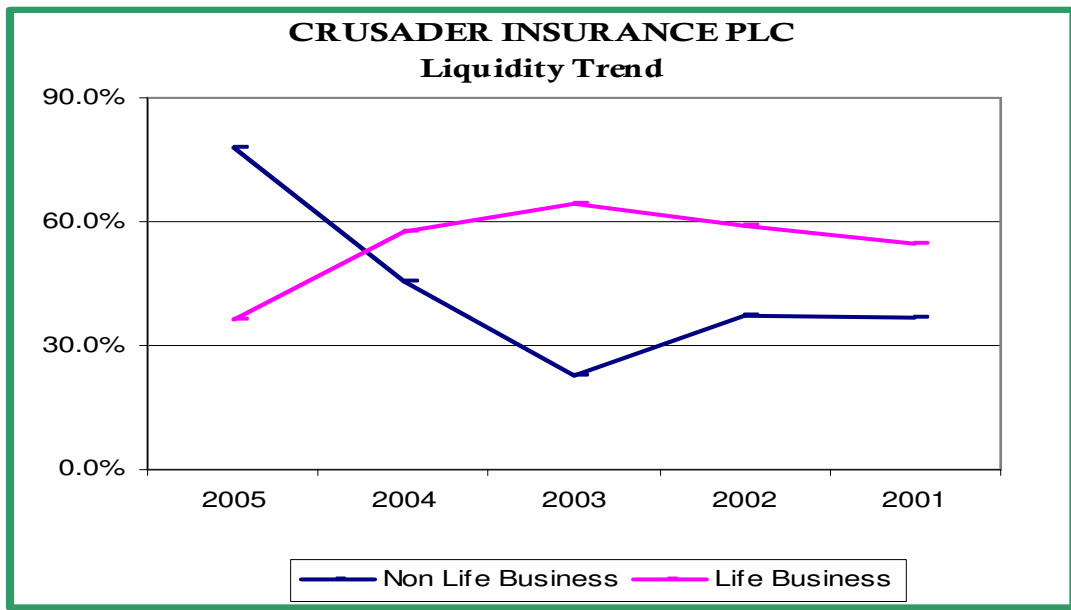
It recorded a 5-year average of 28.1% and 66.3% respectively for the Policy holder Claim ratio and Expense Ratio respectively for its Non-Life business. This contributed to the company's impressive profit performance for 2005.

### **LIQUIDITY/ LIABILITY EXPOSURE:**

The company has consistently maintained a comfortable liquidity position over years. For the period under review, an average of 44.1% of Crusader's total assets is held in liquid resources (Cash and Short term investments) for the Non-Life business. In its financial year ended December 2005, for the Non Life business, 78% of the company's assets are in liquid form for Non-life business, while the company maintained sufficient amount of cash and short term investments to cover 70% of its total liability exposure.

The Life business is equally liquid with an average of 54% of the total assets of the company being maintained in liquid form which is sufficient to cover 61% of the liabilities arising

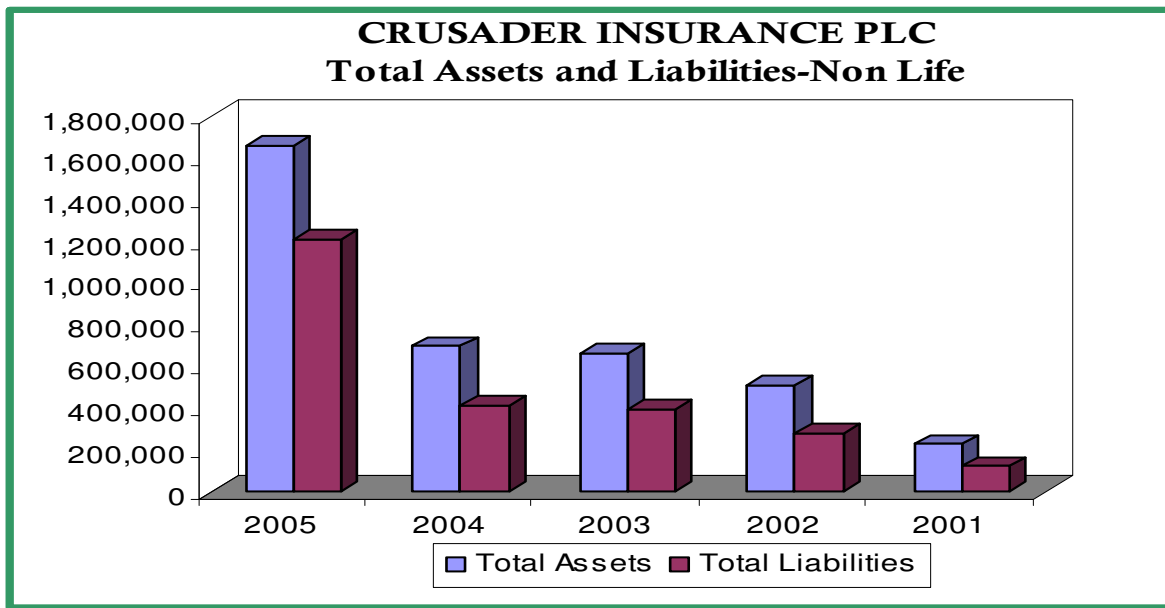
under this class of business. However, in 2005, the liquidity level of the Life business suffered a decline with the ratio of Cash and Short term investments to Total Assets fell from 57.6% to 36.2% and the quick ratio (Cash and Short term investments/Total Liabilities) declining from 68.3% to 48.6%.



Crusader maintained a positive net **Operating Cash Flow (OCF)** between 2001 and 2005, except for 2002. This implies that its profits were converted into cash rather than tying such down in unproductive assets such as balances due from brokers, agents, prepayments and other receivables.

### **GEARING:**

The long term stability of the company is measured by its gearing ratios. The 5-year average debt ratio (Total Liabilities/Total Assets) of Crusader stands at 60% for the Non Life business. This implies that, on average, over the 5-year period only 60% of total assets will settle all its liabilities. The debt ratio which was successfully maintained between 54% and 60% from 2001 to 2004 increased astronomically in 2005 to 72.6%, indicating reduced asset cover for its Non Life liabilities.



The Life business, by virtue of its peculiar nature, has a higher debt ratio. The 5-year average figure indicates that all its liabilities covered 89.4% of the assets. Also, from 2001 to 2004, the ratio remained at not less than 90% with an improvement in 2005 when it dropped to 74.6%. This still is relatively on a high side.

#### **CAPITAL ADEQUACY:**

Capital Adequacy is measured by the ratio of Equity to Total Assets. For the Non Life business, Crusader's index of Equity to Total Assets remained relatively low between 2001 and 2004. The ratio hovered around 10% until in 2005 when it increased to 25.4%, indicating an increase in size of the total assets being financed by shareholders' funds. This improvement can be traced to the injection of fresh funds in 2003 through a Rights Issue of preference shares by the company. Similarly in December 2005, the company converted all its Preference Shares totaling of 325,821,576 units to Equity at a rate of 8 for 5.

In line with the above analysis on **Gearing Index**, the company's Life-Insurance business has grown faster than the size of capital available. This is evidenced by a continuous decline in the ratio of Equity to Total Assets over the years- precisely from 46.1% in 2001 to 25.4% in 2005.

To further adjust for this imbalance, Crusader Insurance went to the capital market in September/October 2006 to raise additional equity capital through a hybrid Offer of 1,665,119,816 Ordinary Shares and 787,573,690 Rights Issue worth N3.42bn. Meanwhile, the multiplier of this is expected on the company's performance in 2007 fiscal year as the funds came at the close 2007 year end.

## VALUATION:

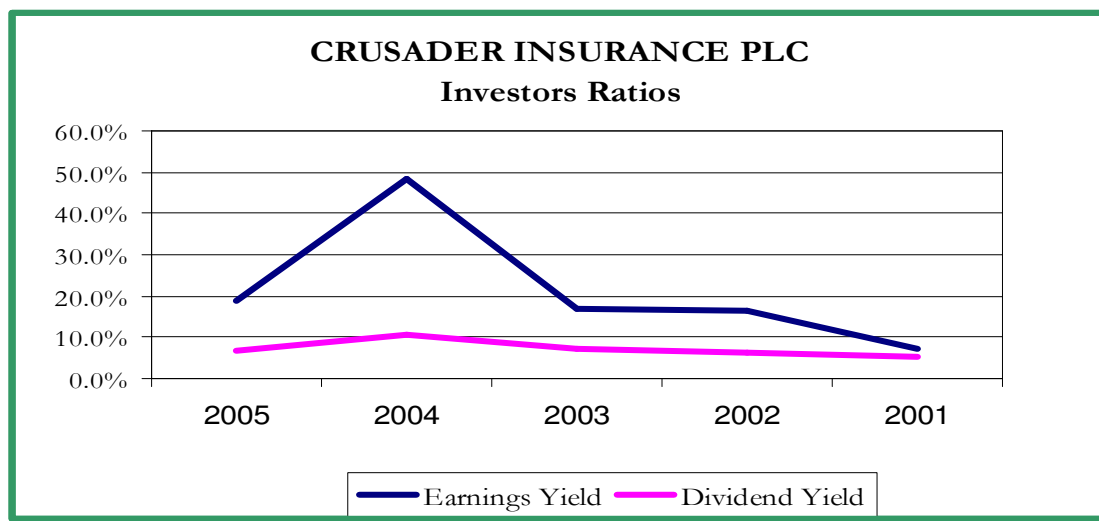
In arriving at a fair value for Crusader Insurance Plc, we have employed a number of valuation metrics peculiar to the Insurance Industry. We used Embedded Value Approach which is popular with insurers and a couple of Relative Valuation Metrics such as the Price to Book Value (P/BV) and Price to Earnings (P/E) metrics.

We attached weights to each of the metrics in order of their appropriateness in insurance businesses to derive the intrinsic value for the stock.

However, we are more overweight in the Embedded Value Method and P/BV given the peculiarity of the industry. In our final analysis, we arrived at an intrinsic value of N9.30. In other words, the stock is currently trading at a discount of about 40% to its current market price of N6.25k as at Friday April 27, 2007.

## STOCK PERFORMANCE:

Like some other penny stocks which are yet to catch the attention of investors, Crusader Insurance has paid dividend consistently over the past 5 years and has given bonus 3 times in 5 years. An investor with 1000 Units in 2001 would have seen his unit holdings grow in the company by more than 200% to 2133 units. This is outside the share price appreciation which was more than 200% over the same period. Apart from capital appreciation, investors have enjoyed cash dividend. The company in the last 5 years maintained a dividend yield of not less than 5%. The 5-year average dividend yield stands at 7.3%, with the highest of 10.7% in 2004 over the years reviewed.



## DIVIDEND & BONUS HISTORY\*

Year	Closure Date	Bonus	Dividend
2006	2-Jun-06	nil	10k
2005	20-Jun-05	nil	7.5k
2004	28-Jun-04	1 for 3	7.5k
2003	3-Nov-03	3 for 4	5k
2002	16-Sep-02	nil	14k
2001	3-Jul-01	1 for 5	nil
2000	6-Sep-00	nil	7.5k
1999	17-Aug-99	nil	5k
1998	14-Aug-98	1 for 6	nil

\* Source:  
Company's annual  
accounts

### Technical Chart: Dec. 2004 – Apr. 2007.



## **TECHNICAL ANALYSIS OF STOCK PERFORMANCE:**

Crusader Insurance Plc shares traded at N0.70 at the open of trading session on the January 4, 2005, reaching an all-time high price of N1.97 in November same year with an average volume of 297, 591 shares traded during the year.

In January 2006, the stock opened at N1.57 on the first trading day exhibiting a random walk (fluctuations) as expected of every stock. It reached a new all time-high of N2.06 on November 10, 2006. However, this new peak was exceeded within a 9-day rally creating another fresh peak on the December 11, 2006. Apparently, this is investors' reaction to the prospects of the company emerging unscathed and stronger post –consolidation exercise.

The share opened at N2.55 in 2007 and this has been the lowest price for the year. The trend has been bullish since the beginning of the year with a new all-time high of N6.36 recorded on Feb. 22, 2007.

Trading volume has soared since the beginning of trading in 2007, **with the average traded volume in January (496,194 Units) growing as much as 100% over the volume for the previous month.**

**Surge in turnover has not receded as an** average volume traded in February rose by 400% over January volume though fell by about 50% in March.

**The bullish trend coupled with volume surges is indicative of further bullish runs. From the point of view of technical analysts, further upward price movement is inevitable even as the investors show more interest in the industry.**

## CRUSADER INSURANCE PLC

### SUMMARY STATISTICS

Valuation metrics		Trading Information	
Market Cap(N'bn)	12.38	<b>Stock price history</b>	
Trailing P/E	17.5	Latest Share Price	6.30
Forward P/E (fye 30-Sep-06)	17.0	Beta ( $\beta$ )	0.12
PEG Ratio (5 yr expected)	0.29	52-Week change (%)	350
Price/Net Premium	9.50	52-week high (25-Apr-07)	6.30
Price/Book value	3.33	52-week low (28-Apr-06)	1.33
Financial Highlights		Volume Traded statistics	
FISCAL YEAR	2007	Avrg volume (latest 5 days) 'Units	1.15 million
Fiscal Year End	31 Dec	Avrg volume (Mar) 'Units	1.23 million
Most Recent Quarter (mrq)	Q3- 2006	Avrg volume (Feb '07)	2.45 million
		Avrg volume (Feb '06)	0.91 million
Profitability & Management Efficiency		Dividend and Bonus History (End Fy 2005)	
Profit Margin (PAT/Net Prem.) (%)	31.4	Last Paid dividend (Ngn)	0.10
Return on Average Asset (%)	26.3	Trailing dividend yield(%)	6.70
Return on Average Equity (%)	48.7	Trailing earnings per share(Ngn)	0.36
Q3 earnings growth (y-o-y) (%)	43.3	Trailing earnings yield (%)	5.71
		Last script issue (1:3)	June 2004
		Payout ratio(%)	35.7
Income Statement (FY 2005)		Balance Sheet (FY 2005)	
Gross Premium (Nbn)	1.31	Total Asset (Nbn)	7.17
Net Premium (Nbn)	0.88	Total Liabilities (Nbn)	5.32
PBT(Nbn)	0.31	Shareholders fund (Nbn)	1.86
PAT(Nbn)	0.28	Insurance Fund (Nbn)	0.46

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