

Reliance Capital

Rs755
OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs186bn; US\$4.0bn

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Result: Q3FY10

Comment: Strategy on track!

Key valuation metrics

Year to 31 March	2006	2007	2008	2009
Net profit (Rs mn)	5,765	6,993	10,091	10,157
yoy growth	368.0	21.3	44.3	0.7
Shares in issue (mn)	223	246	246	246
EPS (Rs)	25.8	28.4	41.0	41.3
EPS growth (%)	168	10	44	1
PE (x)	29.3	26.6	18.4	18.3
Book value (Rs/share)	188.5	215.4	268.5	304.7
P/Adj. book	4.0	3.5	2.8	2.5
ROAE (%)	20	14.7	17.0	14.4

HIGHLIGHTS OF Q3FY10 RESULTS

Reliance Capital ('RCL') reported consolidated PAT of Rs632m for Q3FY10 (at Rs1.3bn in Q3FY09) – down ~52% yoy. Profits across RCL's businesses continue to be mired by challenging industry-specific factors. In its characteristic aggression, RCL is steering the businesses across profitability with strict cost control being the cornerstone of their strategy.

- ♦ **Life insurance – cost control remains the key strategy** APE growth came in at 8% yoy to Rs8.3bn, as against overall industry growth of 40% and 37% for private insurers. At Reliance Life, controlling costs to drive profitability remains the focus with expense ratio (excluding commissions) declining to 27% in Q3 (29.8% for 9MFY10) as against 39% for FY09. Renewal premiums have remained strong, with conservation ratio rebounding to ~64% from 51% in Q2FY10. NBAP stood at Rs1.5bn for Q3FY10 and NBAP margins of 20.1% for 9M FY10 (as against 20.1% for 6M FY10). Branch network has been expanded to 1247 (at 1145 a year ago), agency force has also seen a steady build-up (increase of 35% yoy). Notably, the company has not required any capital infusion in Q3. (Exhibit 2 & 3)
- ♦ **General insurance still in doldrums; higher claims ratio hits the bottom-line:** RCL's general insurance business booked a loss of Rs70m (a profit of Rs1m in Q2FY10), owing to increase in the claims. While the claims ratio had consistently inched downwards since FY08, it surged by ~400bp yoy to 83% in Q3FY10. Gross premium growth remained flat yoy (though up 6% qoq), amidst the heavy price discounting and management's conservative growth posture. Going forward, buoyed by the cautious growth strategy of the recent past, management expects to reduce the combined ratio (excluding the pool) from 110% in Q3FY10 to 106-107%.
- ♦ **Mutual Fund AUM stable; higher investment gains:** RCL retained the top slot amongst mutual fund (~15% market share), with an AUM of Rs1200bn (up 71% yoy and flat qoq). Change in mutual fund regulation with respect to removal of entry loads has led to a surge in the marketing expenses – up 78% qoq in Q3FY10. This modification in

regulation also impacted equity inflows and retail participation; the number of investors came off from 7.3m in Q2FY10 to 7.1m in Q3FY10. (Exhibit 1)

- ♦ **Consumer Finance business...pain continues:** RCL's disbursements were sustained at Rs14.4bn in Q3FY10 – up 6x, (flat qoq) driven by mortgage loans. At the same time, owing to run-off of unsecured loans and securitization of Rs11bn, loan book declined by 12% yoy and 5% qoq. Gross NPAs, while still remaining elevated, have witnessed a slight decline to 5.5% (5.7% in Q2) owing to higher write-offs and slower pace of NPA accretion. Notably, Rs681m of provisions were made in Q3FY10, taking the annualized credit cost (% to average advances) to 3.4% from 2.1% in Q3FY09, which we believe would remain elevated in the near term. (Exhibit 4)
- ♦ **Reliance Money...undergoing restructuring:** Reliance Money reported Rs0.7mn PBT in Q3FY10 as against Rs294m in Q3FY09 and Rs43m in Q2, due to a steep decline in broking income (down 28% qoq and 47% yoy) owing to the ongoing restructuring of the business. However, revival in insurance and mutual fund sales led to a pickup in distribution income (up ~29% qoq). Management is in the process of restructuring the business to make it a more sustainable revenue source. (Exhibit 5)

VALUATIONS & VIEW

RCL is pursuing a strategy of cost control across business, which coupled with buoyancy in capital markets is bound to translate into improved profit and growth visibility. All of RCL's businesses are currently undergoing a fundamental change and we believe Reliance Life would emerge as a key beneficiary of the same. The AMC is likely to emerge as the steady revenue contributor, while consumer finance book is likely to witness some more pain. On the other hand, Reliance Money and Reliance General insurance are struggling to find their feet. Unlock in any of the operating businesses either by way of a strategic investment or a public listing act as a near-term catalyst to the stock performance. Reiterate Outperformer on Reliance Capital with a SOTP price target of Rs950.

Sum of parts valuation

Businesses	Method	FY11 (Rs per share)
Life insurance	EV + 15x FY11E NBAP	630
AMC	3.4% of blended FY10 AUM	207
General Insurance	12 times normalised earnings	36
Broking	12 times profit	14
Consumer Finance	0.8x reported Book	40
Listed investment	Unrealized gains	24
Total		951

Source:IDFC- SSKI Research

Quarterly results

(Rs m)	Q3FY09	Q2FY10	Q3FY10	yoy growth (%)	qoq growth (%)
Total Income	15,731	14,665	14,848	(5.6)	1.2
Less: Expenses					
Staff cost	1,378	1,399	1,453	5.5	3.9
Other exp	3,668	3,420	3,547	(3.3)	3.7
Premium paid on reinsurance ceded	1,935	1,705	1,896	(2.0)	11.2
Claims incurred	3,350	2,113	3,321	(0.9)	57.1
Total	10,331	8,638	10,217	(1.1)	18.3
EBITDA	5,400	6,027	4,631	(14.2)	(23.2)
Less: Interest & Finance charges	3,725	3,608	3,457	(7.2)	(4.2)
Less: Depreciation	153	154	175	14.2	13.8
PBT	1,521	2,266	1,039	(31.7)	(54.1)
PAT	1,310	1,559	632	(51.8)	(59.5)

Exhibit 1: Reliance Mutual Fund – AUM up, margins still see some pressure

	Q3FY09	Q2FY10	Q3FY10	AUM (Rs bn)	Q3FY09	Q2FY10	Q3FY10
AUM (Rs bn)	702	1,183	1,200	Portfolio Management Services	273	332	347
Debt	491.61	816	828	of which EPFO:	244	301	315
Equity	210.69	367	372	Advisory	13	15	16
Debt (%)	70.0	69.0	69.0%	Discretionary	16	16	16
Equity (%)	30.0	31.0	31.0%	Offshore Fund - US\$ mn	152	193	185

- ◆ AUM grew by ~71% yoy, driven by ~77% rise in equity and ~68% in debt
- ◆ Continues to be the leader – market share at ~15%
- ◆ PBT margins declined to 38%, down ~200bp qoq

- ◆ Offshore Fund includes US\$92mn on undrawn funds as of Q2FY10

* Calculated on average quarterly balances

Exhibit 2: Life Insurance - growth sluggish, persistency stable, no capital infusion in Q3FY10

Rs bn	Q3FY09	Q2FY10	Q3FY10	yoy growth (%)
New business premium	8.30	7.44	9.21	11.0
Single Premium	0.73	0.67	1.06	45.1
Regular premium	7.57	6.78	8.15	7.7
APE	7.64	6.84	8.26	8.1
Renewal premium	3.20	5.23	6.86	114.3
APE -total business	10.84	12.07	15.12	39.5
Total Premium	11.50	12.674	16.072	39.8
AUM	49.4	102.8	115.5	134.0
Policyholders FUM	45.0	99.8	112.6	150.5
Persistency	45	51	64	
Share capital	25.3	27.5	27.5	

- ◆ Regular Premium increased by ~8% yoy in Q3FY10, with incremental business primarily from Tier-II and III cities; ULIPs dominate at 90%+
- ◆ Share of single premium continued to inch-down at 11% of new business premium as against 16% in Q4FY09
- ◆ Persistency increased to 64%, taking total premium growth to ~40% yoy in Q3FY10
- ◆ No capital infusion undertaken in Q3FY10, in the wake of the slower growth posture

Exhibit 3: Reliance Life's distribution network –up qoq

Distribution Network	Q3FY09	Q2FY10	Q3FY10
Agents	142,843	185,703	192,347
Branches	1145	1,174.00	1,274.00
yoy growth		1.58	1.11
Agents	(9)	(12)	35
Branches	56	58	11
qoq growth			
Agents	(32)	15	4
Branches	54	3	9

Exhibit 4: Consumer Finance –Credit costs dent a blow; NII strong as borrowings re-price

Rs mn	Q3FY09	Q2FY10	Q3FY10
NII	1,093.7	1,028.0	1,124.0
<i>yoy growth(%)</i>	84	2	3
Other Income	38.1	688	662.6
<i>yoy growth (%)</i>	(76)	255	1639
Net revenue	1,131.8	1,716.0	1,786.6
<i>yoy growth (%)</i>	51	43	58
Operating expenses	608.7	774.0	724.5
<i>yoy growth (%)</i>	27	3	19
Operating profit	523.1	942.0	1,062.1
<i>yoy growth (%)</i>	95	111	103
Provisions	377.40	714.00	681.00
<i>yoy growth (%)</i>	10100	136	80
PBT	145.7	228.0	381.1
<i>yoy growth (%)</i>	(45)	59	162
Ratios (%)			
Interest income/ avg loan book	13.79	13.21	12.99
Interest expense/ avg loan book	9.04	8.29	7.38
NIM	4.75	4.92	5.62
Other income/ avg loan book	0.17	3.29	3.31
Cost/ Net revenue	53.8	45.1	40.6

Source: Company

- ◆ NII growth up by 9% qoq, as declining wholesale costs led to reported margins improving by 30bp qoq to 5.6%

Exhibit 5: Reliance Money

Rs mn	Q3FY09	Q2FY10	% of total	Q3FY10	% of total
Broking Income	490.7	359.31	59	258.00	48
<i>yoy growth(%)</i>	116	(26)		(47)	
Distribution Income	205.8	103.53	17	134.00	25
<i>yoy growth(%)</i>	17	(58)		(35)	
Other income	325.3	146	24	145	27
<i>yoy growth(%)</i>	37	(27)		(55)	
Total	1021.8	609	100	537	100
<i>yoy growth(%)</i>	60	(35)		(47)	

Source: Company

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