

1Q: headline earnings weak, but core strong; Cut SOTP

Cut SOTP on earnings cut post weak 1Q headline earnings

We have cut our SOTP by ~13% to Rs565/shr. to factor in a) the earnings cut (+11/8% for FY12/13) on rising funding costs, post weak 1Q earnings; b) cut in life ins. value driven by cut in growth and rebasing our NBAP multiples in-line with sector avg and; c) cut in multiple for consumer fin. biz. by ~10% to 1.2x owing to headwinds (growth / margins) on weaker macro and low RoEs (~12-13%). But core earnings (cons. fin, AMC and life ins.) to continue to show an improvement, as in 1Q. Hence, we believe risk-return stacks in its favor. Maintain Buy.

1Q: weak on high int. costs / general ins. drag; Core strong

R-Cap reported a net profit of Rs348mn in 1Q12 (55% yoy decline). But Cons. Fin. biz, AMC and Life Ins. continue drive core earnings. Consumer fin. Biz. AUM growth at 28% yoy and despite rising costs, PBT up +60% yoy on lower credit costs. Avg. domestic AUM for AMC biz. flat yoy, but PBT higher (+20% yoy) on better yields. General ins. premia growth strong at 22% yoy. Broking biz. saw flat PBT yoy, but distribution arm (R-Money) saw PBT jump 9x yoy (but off low base).

Life ins. weak on growth, but reports profit

Reliance Life reported a PBT of Rs79mn in 1QFY12 (vs. loss of Rs1.2bn in 1Q11) on strong renewal premia, low new biz. strain and, low opex. But new biz. (APE) declined +60% yoy in 1Q, hence we cut growth est. (new biz.) to flat/10% for FY12/13. Hence, we cut the value of life ins. biz. by 25% to Rs211/shr. factoring in cut in growth and cut in future margins / NBAP multiples (7x vs. 9x earlier). We still value life. Biz. at 1x BofAML est. FY11 EV and 7x FY12 NBAP. Our life ins. biz. value is +50% lower than the yet to be consummated deal with Nippon Life.

Estimates (Mar)

(Rs)	2009A	2010A	2011E	2012E	2013E
Net Income (Adjusted - mn)	10,157	4,334	2,912	5,366	6,907
EPS	41.26	17.61	11.83	21.80	28.06
EPS Change (YoY)	0.7%	-57.3%	-32.8%	84.3%	28.7%
Dividend / Share	6.50	6.50	6.50	7.50	7.50
Pre-exceptional EPS	41.26	17.61	11.83	21.80	28.06
Pre-exceptional EPS Change (YoY)	0.7%	-57.3%	-32.8%	84.3%	28.7%
Book Value / Share	302.79	312.97	316.46	330.76	351.32

Valuation (Mar)

	2009A	2010A	2011E	2012E	2013E
P/E	10.0x	23.5x	34.9x	19.0x	14.7x
Dividend Yield	1.57%	1.57%	1.57%	1.82%	1.82%
Pre-exceptional PE	10.01x	23.47x	34.93x	18.95x	14.72x
Price / Book	1.36x	1.32x	1.31x	1.25x	1.18x
RoE / PB	10.59x	4.33x	2.88x	5.39x	7.00x
Price / Pre-Provision Profit	11.48x	32.37x	64.72x	26.47x	18.48x

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Stock Data

Price	Rs413.15
Price Objective	Rs565.00
Date Established	18-Aug-2011
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs388.10-Rs882.30
Mrkt Val / Shares Out (mn)	US\$2,241 / 246.2
Market Value (mn)	Rs101,701
Average Daily Volume	1,371,440
BofAML Ticker / Exchange	RLCCF / BSE
Bloomberg / Reuters	RCAPT IN / RLCP.NS
ROE (2011E)	3.8%
Total Dbt to Cap (Mar-2010A)	NA
Est. 5-Yr EPS / DPS Growth	35.0% / 20.0%
Free Float	46.0%

Key Changes

(Rs)	Previous	Current
Price Obj.	650.00	565.00
2012E EPS	24.46	21.80
2013E EPS	30.48	28.06

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Refer to important disclosures on page 8 to 10. Analyst Certification on Page 5. Price Objective Basis/Risk on page 4. Link to Definitions on page 5. 11080995

iQprofileSM Reliance Capital

Key Income Statement Data (Mar)	2009A	2010A	2011E	2012E	2013E
(Rs Millions)					
Net Interest Income	7,131	7,350	4,461	3,258	4,290
Net Fee Income	5,329	9,848	9,267	12,029	14,081
Securities Gains / (Losses)	12,127	5,142	4,248	2,989	3,976
Other Income	22,967	25,742	22,389	26,340	31,218
Total Non-Interest Income	40,422	40,732	35,903	41,358	49,274
Total Operating Income	47,553	48,082	40,364	44,616	53,564
Operating Expenses	(33,436)	(39,152)	(35,973)	(36,706)	(43,399)
Pre-Provision Profit	14,117	8,930	4,391	7,909	10,165
Provisions Expense	(2,075)	(3,046)	(1,479)	(1,688)	(1,860)
Operating Profit	12,042	5,883	2,912	6,222	8,305
Non-Operating Income	NA	NA	NA	NA	NA
Pre-Tax Income	12,046	5,929	3,539	6,974	9,208
Net Income to Comm S/Hold.	10,157	4,334	2,912	5,366	6,907
Adjusted Net Income (Operating)	10,157	4,334	2,912	5,366	6,907

Key Balance Sheet Data

Total Assets	241,930	261,190	289,361	340,014	392,133
Average Interest Earning Assets	NA	NA	NA	NA	NA
Weighted Risk Assets	241,930	261,190	289,361	340,014	392,133
Total Gross Customer Loans	119,324	125,639	137,992	172,854	212,384
Total Customer Deposits	NA	NA	NA	NA	NA
Tier 1 Capital	66,097	74,534	77,040	77,900	81,420
Tangible Equity	66,097	74,534	77,040	77,900	81,420
Common Shareholders' Equity	74,534	77,040	77,900	81,420	86,481

Key Metrics

Net Interest Margin	NA	NA	NA	NA	NA
Tier 1 Ratio	27.3%	28.5%	26.6%	22.9%	20.8%
Effective Tax Rate	15.0%	25.2%	16.4%	22.3%	24.4%
Loan / Assets Ratio	48.9%	47.7%	46.9%	49.8%	52.8%
Loan / Deposit Ratio	NA	NA	NA	NA	NA
Oper Leverage (Inc Growth - Cost Growth)	1.0%	-16.0%	-7.9%	8.5%	1.8%
Gearing (Assets / Equity)	3.2x	3.4x	3.7x	4.2x	4.5x
Tangible Common Equity / Assets	27.3%	28.5%	26.6%	22.9%	20.8%
Tangible Common Equity / WRAs	27.3%	28.5%	26.6%	22.9%	20.8%
Revenue Growth	5.5%	1.1%	-16.1%	10.5%	20.1%
Operating Expense Growth	4.5%	17.1%	-8.1%	2.0%	18.2%
Provisions Expense Growth	128.3%	46.8%	-51.5%	14.1%	10.2%
Operating Revenue / Average Assets	22.3%	19.1%	14.7%	14.2%	14.6%
Operating Expenses / Average Assets	15.7%	15.6%	13.1%	11.7%	11.9%
Pre-Provision ROA	6.6%	3.5%	1.6%	2.5%	2.8%
ROA	4.8%	1.7%	1.1%	1.7%	1.9%
Pre-Provision ROE	20.1%	11.8%	5.7%	9.9%	12.1%
ROE	14.4%	5.7%	3.8%	6.7%	8.2%
RoTE	15.4%	5.8%	3.8%	6.9%	8.5%
RoWRAs	4.2%	1.7%	1.0%	1.6%	1.8%
Dividend Payout Ratio	15.8%	36.9%	55.0%	34.4%	26.7%
Efficiency Ratio (Cost / Income Ratio)	94.4%	91.2%	99.6%	88.2%	87.5%
Total Non-Interest Inc / Operating Inc	85%	85%	89%	93%	92%
Market-Related Revenue / Total Revenues	25.5%	10.7%	10.5%	6.7%	7.4%
Provisioning Burden as % of PPP	14.7%	34.1%	33.7%	21.3%	18.3%
NPLs plus Foreclosed Real Estate / Loans	3.0%	2.8%	6.0%	6.6%	6.6%
Loan Loss Reserves / NPLs	31.0%	29.4%	27.6%	33.0%	38.7%
Loan Loss Reserves / Total Loans	0.9%	0.8%	1.6%	2.2%	2.6%
Provisions Expense / Average Loans	1.9%	2.5%	1.1%	1.1%	1.0%

Other Metrics

Income / Employee	1.83	1.66	1.26	1.27	1.41
(Operating Expenses) / Employee	(1.29)	(1.35)	(1.12)	(1.05)	(1.14)
Pre-Provision Profit / Employee	0.543	0.308	0.137	0.226	0.268
Net Profit / Employee	0.391	0.149	0.091	0.153	0.182

Company Description

Reliance Capital is one of India's leading and fastest growing private sector financial services companies. It is one of the largest asset management companies in India. It also offers life insurance and general insurance products through its subsidiaries. It has sizable private equity and proprietary investments and is now pursuing interests in stock broking, consumer financing and the asset recovery business.

Investment Thesis

Play on India's expanding financial sector (ex banking). Cross-selling & building distribution to be key growth driver. Highly leveraged to markets, execution delays. Given that RCAP is in an investment phase, we believe that returns are likely to be more meaningful over the longer term.

Stock Data

Price to Book Value 1.3x

1QFY12 Earnings Summary

R-Cap reported a net profit of Rs348mn in 1QFY12 (sharply below estimates), but still a yoy decline of 55% driven by higher interest costs and general ins. biz.

- Commercial biz. AUM growth at 28% yoy, with disbursement growth at 58% yoy. But clearly the rising funding costs has weighed on the commercial finance biz., with margins declining by almost 100bps qoq to 4.3%. . Moreover, despite rising costs, cons. fin. PBT up +60% yoy on lower credit costs.
- Average domestic AUM for AMC biz. flat yoy, but earnings higher on higher retail participation in debt schemes / better yields.
- General ins. premia growth strong at 22% yoy. Combined ratio (including motor pool) at 130% vs. 124% in 1QFY11.
- The broking arm reported flat PBT earnings yoy, but the distribution arm (R-Money) saw its PBT earnings jump sharply (9x) yoy (but off low base).
- Reliance Life reported a PBT of Rs79mn in 1QFY12 vs. a loss of Rs1.2bn in 1QFY11. Strong renewal premium income, low new biz. strain and, low operating expenses were the key drivers of profitability. But new biz. (APE) declined +60% yoy in 1Q.

Table 1: 1QFY12 Earnings Snapshot

Qtr Ending (Rs mn)	1QFY11	4QFY11	1QFY12	YoY growth	QoQ growth
Gross Income	12,669	16,793	14,921	18%	-11%
Operational Income	12,569	16,793	14,921	19%	-11%
- Consumer finance / Invst co	5,978	7,721	7,425	24%	-4%
-AMC	1,499	1,780	1,572	5%	-12%
-General Insurance	5,092	6,784	5,924	16%	-13%
-Broking					
Operational Expenses	11,563	17,459	14,177	23%	-19%
- Interest Expenses	2,944	4,281	5,130	74%	20%
- General Ins	4,233	7,905	4,602	9%	-42%
- Operating Expenses	4,387	5,274	4,444	1%	-16%
Core operational profits	1,005	(666)	744	-26%	NA
Other income	100	-	-	-100%	NA
EBITDA	1,105	(666)	744	-33%	NA
Depreciation and Amort.	128	136	120	-7%	-12%
Pre-provision Profit	977	(802)	624	-36%	NA
Total Provision	0	0			
PBT	977	(802)	624	-36%	NA
Provision for Tax + Min. int.	211	(240)	276	31%	NA
PAT	766	(562)	348	-55%	NA

Source: BofA Merrill Lynch Global Research Estimates

We highlight below PBT breakdown by each business. Clearly, the finance and general insurance business show a drag on profitability in 1Q for R-Cap.

Table 2: PBT breakdown by segment

	1QFY11	4QFY11	1QFY12	YoY growth	QoQ growth
Finance & Investments					
Revenue	2,544	3,150	2,517	-1%	-20%
PBT	657	339	(238)	-136%	-170%
Asset Management					

Table 2: PBT breakdown by segment

	1QFY11	4QFY11	1QFY12	YoY growth	QoQ growth
Revenue	1,499	1,780	1,572	5%	-12%
PBT	435	476	526	21%	10%
General Insurance					
Revenue	5,092	6,784	5,924	16%	-13%
PBT	(386)	(2,187)	(301)	-22%	-86%
Consumer Finance					
Revenue	3,034	3,756	4,178	38%	11%
PBT	363	928	583	61%	-37%
Others					
Revenue	500	815	731	46%	-10%
PBT	(91)	(447)	55	-160%	-112%
Sum of all					
Total Revenues	12,669	16,284	14,921	18%	-8%
Total PBT	977	(891)	625	-36%	-170%

Source: BofA Merrill Lynch Global Research Estimates

Cut SOTP to Rs565/shr.

We have cut our SOTP by 13% to Rs565/shr. to factor in the +10/14% earnings cut for FY12/13 on rising funding costs and also a cut in life ins. value driven by cut in growth est. and rebasing our NBAP multiples in-line with sector avg. We have also cut the multiple for consumer fin. biz. by 10% to 1.2x owing to possible growth / margin headwinds it will likely face on weaker macro and low RoEs (~12-13%) for the business.

Table 3: SOTP

Aggregate SOTP - US\$ mn	FY11	FY12	FY13 Comments for FY12 basis Valuation
Life Insurance	1,237	1,155	1,241 Valuing insurance at 1x ML estimated FY11 EV and 7x NBAP
General Insurance	176	143	173 Valuing at 8x normalized earnings
Asset Management	1,113	1,123	1,175 Valuing AMC at 3.3% of AUM (6.25% equity and 1.4% debt)
Reliance Money	62	237	241 Valuing broking at 11x FY12 earnings
Investments @ 15% disc.to MV	375	375	375
Consumer Fin (adj. for subs invest)	521	639	805 Valued at 1.2x FY12 Book for structurally low (~12-13%) RoEs for FY12/13
Total	3,484	3,672	4,011
Less: Holdco disc.	523	551	602
Final Value	2,962	3,121	3,409
SOTP - Per Share	FY11	FY12	FY13
Life Insurance	226	211	227
General Insurance	32	26	32
Asset Management	204	205	215
Reliance Money	11	43	44
Investments @ BV	69	69	69
Consumer Finance	95	117	147
Total	637	671	733
Less: Holding co disc. @ -15%	100	106	115
Final Value / Share	537	565	618

Source: BofA Merrill Lynch Global Research Estimates

Price objective basis & risk

Reliance Capital (RLCCF)

We use a sum-of-the-parts valuation to arrive at our Rs565 PO for Reliance

Capital. We are valuing the life insurance at EV and NBAP, assigning 7x NBAP and 1.0x FY11 BofAML estimated EV, and the asset managers at a blended value of 3.0% FY12E AUM. We value the consumer finance business at 1.2x FY12E book. Downside risk to our PO are a lack of growth in the insurance business. Upside risk to our PO are higher-than-estimated insurance business growth and pending stake sale, which when crystalized could drive up the life biz. valuations.

Link to Definitions

Financials

Click [here](#) for definitions of commonly used terms.

Analyst Certification

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India - Financials Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
BUY				
	Corporation Bank	XCRRF	CRPBK IN	Veekesh Gandhi
	Federal Bank	XFDRF	FB IN	Veekesh Gandhi
	HDFC	HGDF	HDFC IN	Rajeev Varma
	HDFC Bank	HDB	HDB US	Rajeev Varma
	HDFC Bank	XHDF	HDFCB IN	Rajeev Varma
	ICICI Bank	ICIJF	ICICIB IN	Rajeev Varma
	ICICI Bank - A	IBN	IBN US	Rajeev Varma
	IndiaBulls Financial Services	IBLFF	IBULL IN	Veekesh Gandhi
	Indian Bank	INDIF	INBK IN	Rajeev Varma
	LIC Housing Finance, Ltd.	LHFLF	LICHF IN	Veekesh Gandhi
	Manappuram	XMGP	MGFL IN	Veekesh Gandhi
	Max India	XMIF	MAX IN	Rajeev Varma
	ORBC	ORBCF	OBC IN	Rajeev Varma
	Power finance corporation Ltd	PWFEE	POWF IN	Veekesh Gandhi
	Punjab	PUJBF	PNB IN	Rajeev Varma
	Reliance Capital	RLCCF	RCAPT IN	Veekesh Gandhi
	Rural Electrification Corporation Ltd	XULEF	RECL IB	Veekesh Gandhi
	SBI	SBINF	SBIN IN	Rajeev Varma
	SBI -G	SBKFF	SBID LI	Rajeev Varma
	Shriram Transport Finance	SHTFF	SHTF IN	Veekesh Gandhi
	Yes Bank Ltd	YESBF	YES IN	Veekesh Gandhi
NEUTRAL				
	Axis Bank	XAXSF	AXSB IN	Rajeev Varma
	Axis Bank - GDR	XBKSF	AXB LI	Rajeev Varma
	Bank of Baroda	BKBAF	BOB IN	Rajeev Varma
UNDERPERFORM				
	Bank of India	XDIIF	BOI IN	Rajeev Varma
	Canara Bank	CNRKF	CBK IN	Rajeev Varma
	IDBI	XDBIF	IDBI IN	Veekesh Gandhi
	Infrastruct Dev	IFDFF	IDFC IN	Rajeev Varma
	Union Bank India	UBOIF	UNBK IN	Rajeev Varma

***iQmethod*SM Measures Definitions**

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

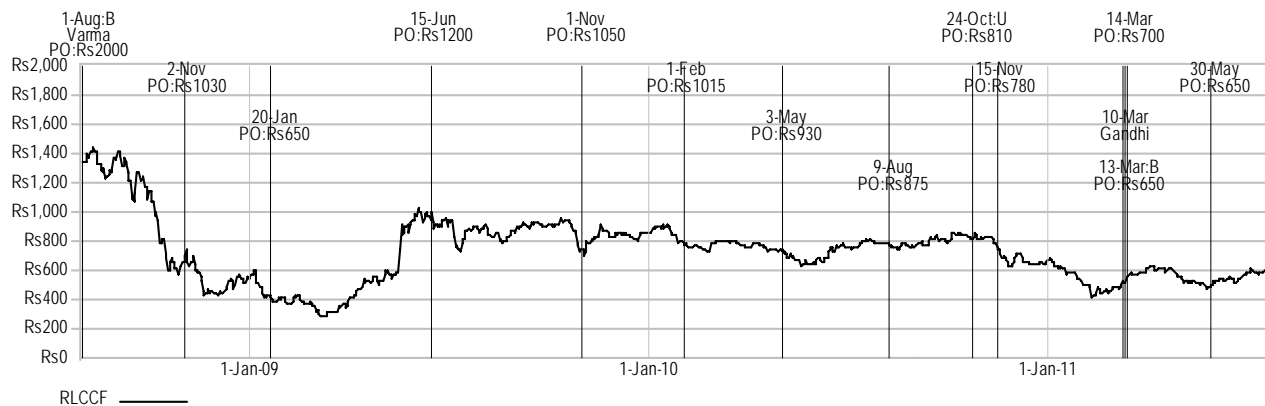
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Important Disclosures

RLCCF Price Chart



B : Buy, N : Neutral, U : Underperform, PO : Price objective, NA : No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of (July 31, 2011) or such later date as indicated.

Investment Rating Distribution: Financial Services Group (as of 01 Jul 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	180	55.38%	Buy	78	45.35%
Neutral	96	29.54%	Neutral	47	50.00%
Sell	49	15.08%	Sell	15	31.91%

Investment Rating Distribution: Global Group (as of 01 Jul 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2024	53.94%	Buy	935	50.68%
Neutral	944	25.16%	Neutral	442	51.64%
Sell	784	20.90%	Sell	273	37.24%

* Companies in respect of which BofA Merrill Lynch or one of its affiliates has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

* Ratings dispersions may vary from time to time where BofA Merrill Lynch Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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