RELIANCE CAPITAL

INR 640

Edelweiss
Ideas create, values protect

Beyond banking

BUY

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Pure play on high growth segments of financial services space

We expect Reliance Capital to become India's leading financial powerhouse offering a plethora of products including mutual funds, life insurance, general insurance, retail broking, and consumer financing. We believe it is a pure play on the fastest-growing segments of the Indian financial services space. We expect sustained growth in the company's asset management business and hyper growth in life insurance, broking, and general insurance businesses. Our confidence in Reliance Capital is underpinned by ADAG Group's execution capabilities, competitive skills, and its ability to expand markets.

Leadership in existing businesses; growth to sustain going forward

Reliance Capital is among the largest private players in domestic asset management and the fourth-largest general insurer. We expect it to sustain its market share at 12-13% in asset management business by FY09E, estimating AUM growth of 29% CAGR over FY07-09E. In general insurance, we expect retail products to be the key focus area; future growth will be largely driven by motor and health insurance products.

Life insurance to contribute ~40% to its valuation

Reliance Capital is investing aggressively to grow its life insurance business. We expect its annualised premium equivalent (APE) to grow by 86% CAGR over FY07-FY09E, implying market share of 8-9% among private insurers by FY09E. We value this business at INR 72.3 bn by FY08E and INR 82.4 bn by FY09E.

Broking and consumer finance business in the offing

We expect Reliance Capital's retail broking venture (to be launched soon), under the brand 'Reliance Money', to grow aggressively over the next three years. Innovative technology platforms, deep distribution network, and flat fee pricing are likely to give it the required competitive edge to become a leading retail brokerage. The company also intends to launch consumer financing business in FY08E to optimise its distribution network.

Attractive valuations for high growth businesses

We peg the fair value of Reliance Capital on sum-of-the-parts basis at INR 174 bn (USD 3.9 bn) or INR 708 per share by FY08E and INR 197 bn (USD 4.4 bn) or INR 801 per share by FY09E. We believe as the visibility on FY09E business improves and growth numbers fructify, valuations will move closer to our FY09 estimates. We, therefore, recommend investors to accumulate the stock at the current levels as we assign high probability to future growth. We initiate coverage on Reliance Capital with a **'BUY'** recommendation.

Business	Method	FY08E value (INR mn)	FY09E value (INR mn)
Asset management	Discounted cash flow	22,702	25,084
General Insurance	PE	4,138	11,917
Life Insurance	Appraisal value	72,365	82,425
Broking and related businesses	PE	4,620	10,360
Consumer financing	PB	9,396	18,404
Value of infrastructure & leasing	PB	35,752	23,591
Value of investments	Quoted-mkt price; unquoted-BV	25,174	25,174
Total value		174,147	196,954
Value per share (INR)		708	801

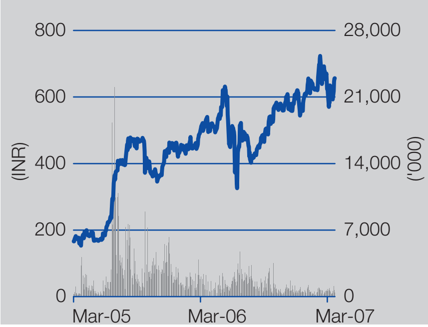
Reuters	:	RLCP.BO
Bloomberg	:	RCFT IN

Market Data

52-week range (INR)	:	729 / 320
Share in issue (mn)	:	245.6
M cap (INR bn/USD mn)	:	157.3 / 3,567.0
Avg. Daily Vol. BSE/NSE ('000)	:	3,037`

Share Holding Pattern (%)

Promoters	:	47.5
MFs, FIs & Banks	:	2.2
FIIs	:	31.9
Others	:	18.4



Pure play on fastest-growing financial services segments

Focus shifting to the fastest growing segments in financial services space

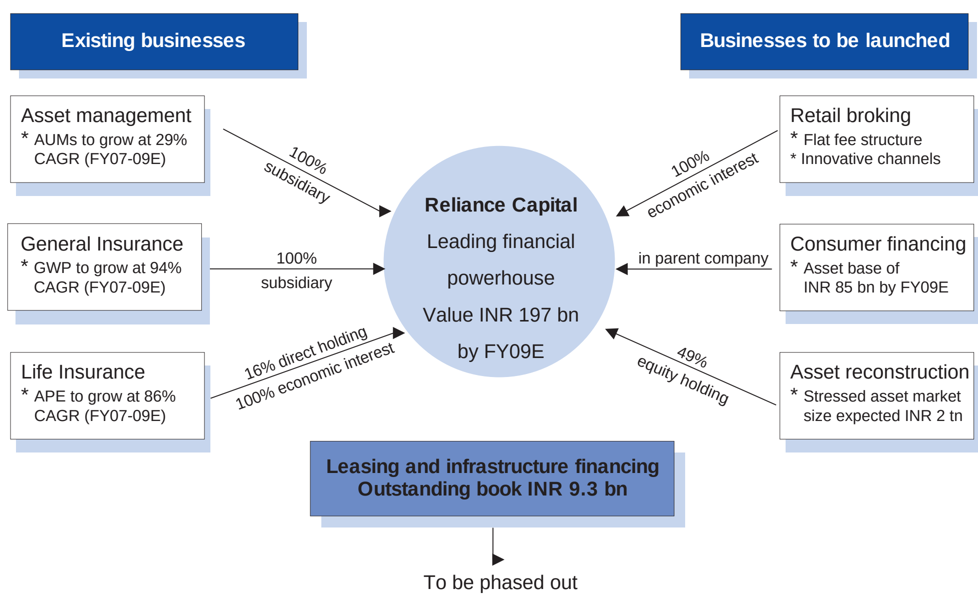
Post demerger and reorganisation of the Reliance Group, Reliance Capital has been actively pursuing growth opportunities in the Indian financial services sector to become a leading financial powerhouse. It has undergone significant strategy changes in the past one year, with focus shifting to the fastest-growing segments in the financial services space, viz., asset management and insurance business, from leasing and infrastructure financing.

Reliance Capital is the leader in its existing businesses, among top two in asset management, and the fourth-largest general insurer. Currently, it is aggressively investing to grow its life insurance business by expanding its distribution franchise and increasing its agent force. We expect the company's life insurance business to be a key valuation driver going forward.

Successful execution of business strategies will position Reliance Capital as India's leading financial powerhouse

Reliance Capital is planning an aggressive launch of its retail broking venture under the brand 'Reliance Money', offering a bouquet of financial products under a single window. Innovative technology platforms, deep distribution network, and flat fee pricing are likely to give the company the required competitive edge to become a leading broker. It also intends to launch consumer financing business in FY08E as an incidental business to optimise its distribution network. As a part of its strategy to provide an entire gamut of financial services, Reliance Capital plans to float an asset reconstruction company and has sent a proposal to the RBI in this connection. Successful execution of these business strategies will position Reliance Capital among the leading players in the rapidly expanding segments of financial services.

Fig. 1: Emerging business model



Source: Company, Edelweiss research

Table 1: Birds eye view of its businesses

Business	Current position	Key features	Growth profile
Asset management	Amongst top 2 (AUM of INR 422bn)	• 150% Y-o-Y growth in AUMs • Largest investor base of 3.1 mn among private sector	• Key strengths - Product differentiation and superior performance • PMS to grow at 50% CAGR over FY06-09E
General insurance	Fourth largest private player (gross written premium of INR 7 bn in FY07 YTD)	• Fastest growing private player registering 448% growth in GWP in 9MFY07 • Motor and health products are gaining traction	• *Aggressively ramping up retail* products • To add 25-30 branches by FY07 and to double agency strength in the next few years
Life Insurance	4% market share among private players (APE of INR 3.3 bn during 9MFY07)	• APE grew exponentially (ten fold) Y-o-Y in 9MFY07 • Expanding distribution franchise and agent force	• Market share to improve to 8-9% by FY09E • Agency force to grow three-fold in two years
Retail broking	To be launched in the next three months	• Innovative technology and distribution network to be its competitive edge • Differentiation on pricing front - to introduce flat fee structure	• Plans to have maximum number of outlets • Expected client base of 0.5-0.6 mn by FY09E
Consumer financing	To be launched in FY08E as an incidental business	• Unlike other NBFCs, will not focus on mortgages and sub-prime segment • Will offer auto loans, personal loans, and credit cards	• Average infusionof - INR 4.5 bn per year estimated in this business • To optimise extensive distribution network
Asset reconstruction	Applied to the RBI to float an asset reconstruction company	• To buy distressed assets by making cash payment upfront	• Stressed assets market expected to be worth INR 2 trillion
Private equity/prop investment		• Diversified investments rather than targeting few specific sectors	• Focus on quality investments to generate superior return

Source: Company, Edelweiss research

Valuations: To move close to our FY09E estimate

We believe it will be incorrect to value Reliance Capital by directly assigning a multiple to its consolidated financials, as the leasing business will be phased out soon. Moreover, its key future valuation drivers are either not yet consolidated in the company's accounts (life insurance) or are yet to be launched (retail broking and consumer financing).

We expect sustained growth in its asset management business and hyper growth in life insurance, broking, and general insurance businesses

We have, therefore, used the sum-of-the-parts (SOTP) methodology to value Reliance Capital, by valuing each of its businesses individually. We expect sustained growth in its asset management business and hyper growth in life insurance, broking, and general insurance businesses. Besides its businesses, significant value is also present in the company's balance sheet in the form of investments and cash.

Overall, we value Reliance Capital (including the value of its investments) at INR 174 bn (USD 3.9 bn) by FY08E; the significant value drivers will be its asset management and life insurance businesses constituting 55% of its FY08 estimated value. We believe the market will start discounting FY09E valuation with greater visibility on its life insurance business growth. Our FY08 estimates do not factor in:

We value Reliance Capital at INR 174 bn (USD 3.9 bn) by FY08E and INR 197 bn (USD 4.4 bn) by FY09E

- Better visibility of its retail broking and consumer finance business that will be launched in FY08E and super normal growth expected in their profitability and asset base in FY09E that is expected to add INR 14.7 bn over FY08E valuations.

- Relatively better profitability to be reported in general insurance business in FY09E (profits expected to be dismal in FY07E and FY08E).
- Sustained growth in asset management and life insurance will lead to an upside in absolute terms of ~INR 12.4 bn or INR 51 per share over FY08E valuations.

These expected triggers will move the company's valuations close to our FY09 estimates of INR 197 bn (USD 4.4 bn) or INR 801 per share. There is high probability that the company may outperform our growth expectations given its past record. Therefore, we recommend investors to accumulate the stock at current levels and at each price decline with 12-18 month's perspective

Table 2: SOTP valuations

		Value based on economic interest (INR mn)		Value based on economic interest (USD mn)	
Businesses	**Method**	**FY08E**	**FY09E**	**FY08E**	**FY09E**
Asset management	Discounted cash flow	22,702	25,084	504	557
General Insurance	PE	4,138	11,917	92	265
Life Insurance	Appraisal value	72,365	82,425	1,608	1,832
Broking and related businesses	PE	4,620	10,360	103	230
Consumer financing	PB	9,396	18,404	209	409
Value of infrastructure & leasing	PB	35,752	23,591	794	524
Value of direct investments	Quoted-mkt price; unquoted-BV	23,394	23,394	520	520
Value of investments through associates	Quoted-mkt price; unquoted-BV	1,780	1,780	40	40
Total value		174,147	196,954	3,870	4,377
Value per share (INR)		708	801		

Source: Company, Edelweiss research

Reliance Capital technically holds only 16% directly in Reliance Life and does not have any direct holding in Reliance Money. Our understanding, based on discussions with the management, is that it has 100% beneficial interest in these companies through associates. We have, therefore, valued Reliance Capital on the basis of this economic interest, assigning 100% value to its life insurance and broking businesses.

The market value of Reliance Capital's quoted investments (based on prices on March 22, 2007) is ~INR 43.7 bn, translating into an unrealised gain of INR 132 per share (20% of the stock's CMP). However, we have not considered the entire unrealised gains on quoted investments based on their market value for our valuation purpose, as some of these investments are either in Anil Dhirubhai Ambani Group (ADAG) entities or companies, in which the company (along with its associates) has majority stakes. We have, therefore, conservatively provided for 40% discount to the market price of these companies and thereafter arrived at the value of the company's investments (quoted and unquoted) at INR 25.2 bn (USD 559 mn) or INR 100 per share.

Most of Reliance Capital's key businesses/growth drivers are either at a nascent stage or are yet to be launched, and they are expected to grow exponentially. We have, therefore, done a sensitivity analysis (considering various assumptions on growth and other key parameters of each business segment). Based on this analysis, we estimate Reliance Capital's value in the range of INR 177-218 bn (INR 722-887 per share) by FY09E.

Table 3: Valuation based on sensitivity anslysis

Businesses	Method	FY09E value based on economic interest (INR mn) Lower range	Upper range	FY09E Value based on economic interest (USD mn) Lower range	Uupper range
Asset management	Discounted cash flow	22,863	27,392	508	609
General Insurance	PE	7,690	16,941	171	376
Life Insurance	Appraisal value	72,543	92,882	1,612	2,064
Broking and related businesses	PE	8,520	12,320	189	274
Consumer financing	PB	17,050	19,793	379	440
Value of infrastructure & leasing	PB	23,591	23,591	524	524
Value of direct investments	Quoted-mkt price; unquoted-BV	23,394	23,394	520	520
Value of investments through associates	Quoted-mkt price; unquoted-BV	1,780	1,780	40	40
Total value		177,430	218,092	3,943	4,846
Value per share (INR)		722	887		

Source: Company, Edelweiss research

Reliance Capital, in the past few years, was primarily focused on:

- Big ticket (corporate) leasing: *Expected to be phased out* in a year or two.
- Infrastructure investments: *Not substantial* at INR 9.3 bn in March 2006 (including INR 8 bn investment in Reliance Communications Infrastructure through deep discount bonds).

Resorted to equity dilution in FY06

To finance its aggressive growth plans and strengthen its financial position, Reliance Capital resorted to an equity dilution in FY06, after a long hiatus. It raised over INR 26.7 bn through preferential issue of equity shares/warrants to the promoters and FIIs at a price of INR 228 per share, growing its then existing equity base by almost 75%. This preferential issue has a lock-in period of one year from the date of allotment.

Table 4: Details of preferential issue

Investors	No. of shares/warrants	(INR mn)
AAA Enterprises	101.0	23,028
FIIs	16.3	3,707
- Copthall Mauritius Investment	6.0	1,368
- BNP Paribas Arbitrage SNC	2.3`	524
- Macquarie Bank	6.0	1,368
- Aranda Investments (Mauritius)	1.0	228
- GMO	0.9	219
Total process raised	117.3	26,735

Source: Company

These proceeds, together with the company's then existing capital base, seem to be adequate to fund its growth plans over the medium term (growing insurance business rapidly, introducing retail broking on a large scale, and launching consumer financing as an incidental business).

We believe that Reliance Capital has the potential to emerge as India's leading financial powerhouse with successful execution of its growth strategies and strong management team in place. Our belief is further underpinned by ADAG Group's execution capabilities, compeitive skills and ability to pursue aggressive growth, already demonstrated in the past in its other group ventures (Reliance Communication). We believe it offers a pure play on the fastest-growing segments of the Indian financial services space and initiate coverage on Reliance Capital with a **'BUY'** recommendation.

Risks and Concerns

- Execution failure is the key business risk, as its value driving businesses are either at a nascent stage or are yet to be launched. Retail broking and consumer financing businesses are expected to be launched in FY08. The company entered the life insurance business in October 2005, by acquiring AMP Sanmar, which had been a laggard in the industry. We have valued all these businesses based on our understanding of the company's growth strategies and business objectives over the next few years. Any delay in execution or failure to pursue these objectives is likely to impact their profitability and hence, their valuations as well.

- We have assigned 100% value to its life insurance and broking business in our valuation estimates based on our discussions with the management. Though Reliance Capital has 100% economic interest, technically it holds only 16% in Reliance Life and has no direct stake in Reliance Money. These entities will, therefore, not be consolidated and published data available on the same will be limited.

- Growth in asset management, life insurance, and broking businesses is highly dependant on the conditions in capital markets. Any unfavorable development in the markets going forward may hamper our growth assumptions and consequently impact valuations negatively.

- Intense competitive pressures in any business segment may affect the expected market share and/or margins.

Mutual Funds: Leading private player

Business structure

Reliance Capital participates in the mutual fund business through its 100% subsidiary Reliance Capital Asset Management (RCAM), the investment manager of Reliance Mutual Fund (RMF).

Fig. 2: Business structure

Source: Company

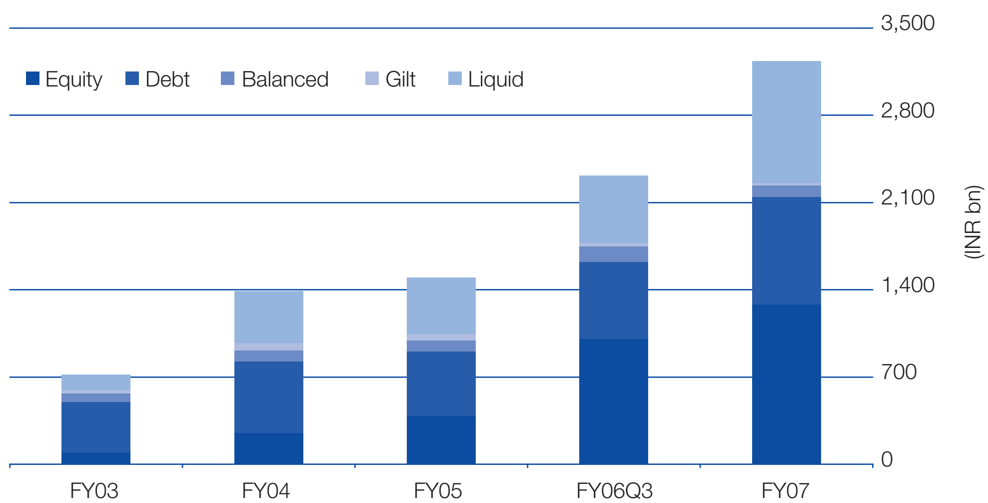
Mutual fund industry dynamics

Indian mutual fund industry recorded 36% CAGR in the past three years, managing over INR 3.5 tn of AUMs as of February 2007 end

The mutual fund industry is one of the fastest-growing sectors in Indian financial markets with 30 asset management companies (AMCs) offering 687 schemes. Indian mutual fund industry has recorded 36% CAGR in the past three years, managing over INR 3.5 tn of assets as of February 2007. This growth was primarily led by the following factors:

- Changing demographics
- Change in risk profile
- Increasing proportion of savings being invested in market-linked products
- Conducive capital market conditions
- Availability of wider range of products
- Better accessibility
- Growing competition amongst leading players

Chart 1: Industry-wide AUMs; equity AUMs have improved significantly



Source: AMFI

The proportion of equity AUMs has improved significantly from ~18% in FY04 to ~40% in FY07; we believe it will improve further from the current levels going forward.

The dynamics for mutual fund industry remains strong and we expect AUMs to continue to grow at 25% over FY07-09E

If we look at this stupendous growth in the Indian mutual fund industry in the context of global statistics, there is clearly a huge opportunity available in this business. Industry-wide AUMs constitute ~10% of GDP, against 30-60% in developed countries. Moreover, the penetration of mutual funds in India is at very low levels, with the AUMs accounting for less than 1% of total financial assets. The dynamics for the mutual fund industry remain strong and we expect AUMs to continue to grow at 25% over FY07-09E. Factors that will drive this growth are more sophisticated capital markets, increased competitiveness, alternative distribution channels, new innovative product offerings addressing investors' risk-return profile, consolidation in the mutual fund industry, improving regulatory framework, and regulatory changes allowing increased money to flow into capital markets.

Reliance Mutual Fund: Leading and fastest-growing private player

The top five players viz., Reliance MF, Prudential ICICI MF, UTI MF, HDFC MF, and Franklin Templeton MF continue to share almost 50% of the industry-wide AUMs.

Table 5: Relative key parameters

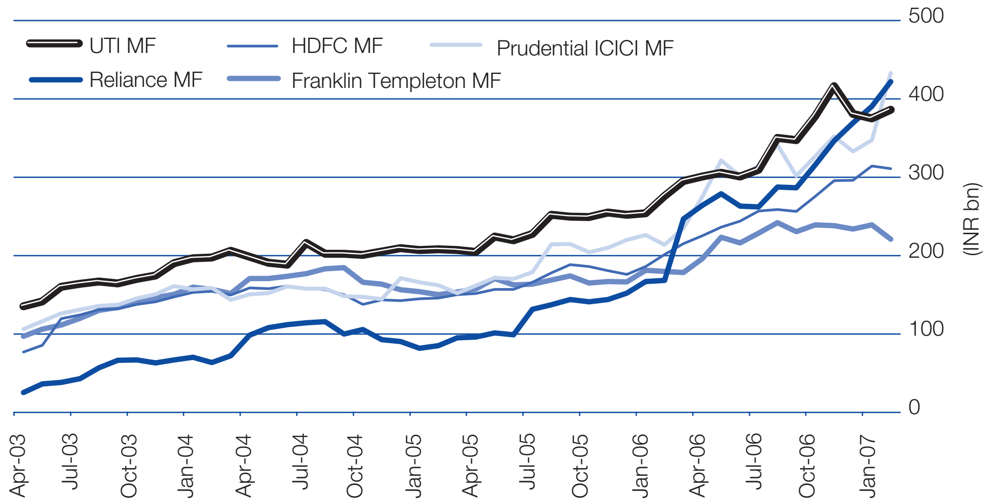
Parameters	Reliance MF	Prudential ICICI MF	UTI MF	HDFC MF
AUM (INR bn) (Feb 07)	422	433	386	311
AUMY-o-Y growth (%)	150	103	40	54
Market share (%)	12.0	12.3	11.0	8.8
Debt/ Equity Mix	53/47	62/38	41/59	55/45
Branch network	46	40	68	37
Investor base (mn)	3.1	2.0	8.0	1.7

Source: Company, AMFI

RMF is the leading private mutual fund with INR 422 bn of AUMs, an increase of 150% Y-o-Y

Reliance Mutual Fund (RMF) is amongst the leading private mutual funds with INR 422 bn (USD 9.4 bn) of assets under management as of February end 2007, an increase of 150% Y-o-Y. This compares favorably with industry-wide growth of 62% during the same period. It has significantly outpaced other leading players viz., Prudential ICICI MF, UTI MF, HDFC MF, and Franklin Templeton MF, which grew 103%, 40%, 54%, and 23% Y-o-Y, respectively.

Chart 2: AUM growth of leading players

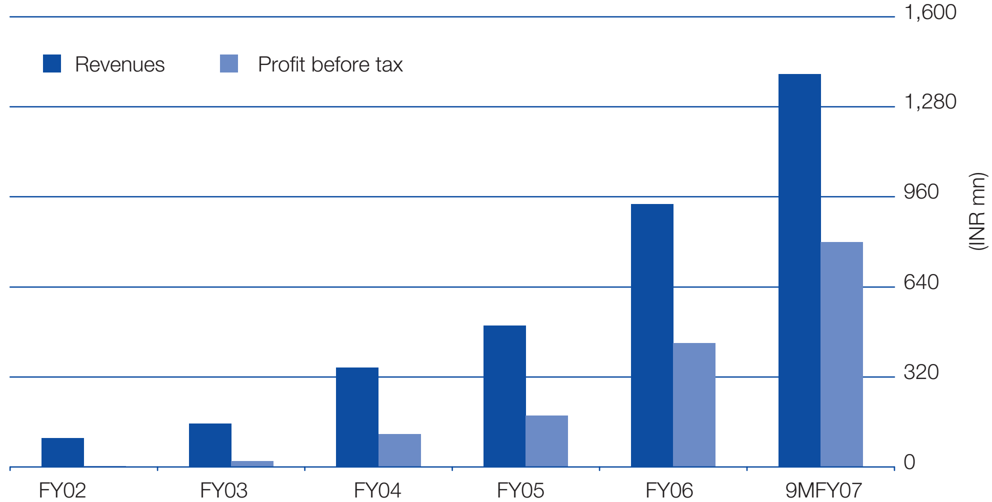


Source: AMFI

Equity AUMs at RMF account for ~47% of the corpus with debt AUMs accounting for the balance, in line with the industry average. RMF has scaled up its investor base rapidly to 3.1 mn investors as of February 2007 (against 2.1 mn investors in March 2006).

Revenues from asset management business have grown by 144% Y-o-Y to INR 1.4 bn in 9MFY07 and profit before tax has jumped 192% Y-o-Y to INR 799 mn. This compares favourably with full year FY06 numbers of INR 935 mn for revenues and INR 438 mn for PBT. This business contributes 10% to Reliance Capital's consolidated revenues and 18% to its PBT.

Chart 3: Reliance MF's financial performance



Source: Company

Table 6: Reliance MF's performance

	9MFY07	9MFY06	*Growth (%)*	FY06
Revenues (INR mn)	1396	573	*143.6*	*935*
Profit before tax (INR mn)	799	274	*191.6*	*438*
AUMs (end of period) (INR bn)	369	152	*142.3*	247
Investor base (mn)	3.0	1.0	-	2.1
Prudential ICICI - AUMs (INR bn)	333	220	*51.4*	235
UTI MF - AUMs (INR bn)	381	252	*51.1*	295
Industry AUMs (INR bn)	3,236	1,989	*62.7*	2,319

Source: Company, AMFI

Key competitive strengths

Reliance MF has almost doubled its market share from 5.4% in FY04 to 12% in FY07. It is building itself further to exploit this fast-growing business segment and sustain its market share at 12-13% by FY09E. The driving factors will be:

Product differentiation, consistent performance and wide distribution network will be its key competitive strengths

- **Product differentiation:** Innovation will be a major contributor to growth and Reliance Capital has demonstrated it by setting a record of largest NFO mobilising INR 57.6 bn from 0.9 mn investors.
- **Consistent performer:** RMF's success has been supported by consistent performance demonstrated by Reliance Growth Fund being ranked by Lipper as the No. 1 for its five-year and ten-year performance.
- **Technology initiatives:** RMF is the first MF to launch online redemption through ATMs/POS.
- **Cross selling**: The group's wide distribution network and large customer base will provide strong cross-selling opportunities.

Portfolio Management: Another growth driver

Another growth area is its portfolio management services and advisory business, launched in August 2004. This segment has grown phenomenally in the current fiscal and has INR 17.6 bn under management with a team dedicated to this business. We expect this business segment to grow at more than 50% CAGR over FY06-09E. The company has recently launched a Mauritius-based India dedicated equity growth offshore fund, whose AUMs currently stand at USD 60 mn.

Valuations

RMF will grow its AUMs by 29% CAGR over FY07-09E as against indsutry-wide AUM growth of 25%

We value the business at INR 25.1 bn FY09E.

Overall, we expect Reliance MF to grow its AUMs by 29% CAGR over FY07-09E, against industry AUM growth of 25%. Consequently, PAT is expected to grow strongly at 32% CAGR over the same period. We value this business at INR 22.7 bn by FY08E and INR 25.1 bn by FY09E on the basis of discounted cash flow method. The value for FY08E translates into 4.3% of its FY08E average AUMs and 22.1x FY08E earnings, while for FY09E it translates into 3.7% of its FY09E average AUMs and 19.1x FY09E earnings. We have done a sensitivity analysis on our AUM growth rate assumption (at ±5% i.e., 24-34% CAGR over FY07-09E) and have valued its asset management business in the range of INR 22.8-27.4 bn by FY09E.

Table 7: Reliance MF key metrics

	FY03	FY04	FY05	FY06	FY07E	FY08E	FY09E
Total AUMs (INR mn)	24,199	72,400	95,426	246,697	456,777	605,827	760,611
Growth (%)		*199.2*	*31.8*	*158.5*	*85.2*	*32.6*	*25.5*
Average AUMs (INR mn)	20,091	48,300	83,913	171,061	351,737	531,302	683,219
Avg management fee (%)	0.7	0.7	0.5	0.5	0.4	0.4	0.4
PAT(INR mn)	16	75	121	300	749	1,026	1,311
Growth (%)		376.8	62.2	148.1	149.7	37.0	27.8

Source: Company, Edelweiss research

We have compared our estimates with the valuations of a few major acquisitions in the mutual fund industry. BNP Paribas acquired 49.9% of Sundaram Asset Management Company in 2005 end for INR 1 bn, valuing its asset management business at 7% of AUMs (60% of the funds were in equity schemes). Templeton AMC in mid-2002 acquired Pioneer ITI for USD 50 mn, valuing the business at 5.3% of its AUMs.

Table 8: Acquisitions in the asset management space

Year	Acquirer	Seller	Acquisition cost (INR mn)	AUMs (INRmn)	Value as% of AUMs	Equity/Debt mix
Oct-05	BNP Paribas AMC	Sundaram AMC (49.9%)	1,004	28,700	7.0	**60 - 40**
Jul-02	Templeton	Pioneer ITI	USD 50-55 mn	40,230	5.3	**20 - 80**
Mar-03	HDFC Mutual Fund	Zurich India MF	1,600	33,320	4.8	
Jun-04	UTI MF	IL&FS MF	350	17,608	2.0	**27 - 73**
Jul-03	Principal MF	Sun F&C	225	5,000	4.5	

Source: Company, Edelweiss research

We have broadly looked at the fundamentals and prevailing valuations of major global players, to get a better perspective on our valuation estimates. Franklin Resources, one of the world's largest asset management companies, currently trades at 16x forward P/E, commanding a market cap of USD 28.3 bn (5.5% of its AUMs). Principal Financial Group, managing USD 316 bn of assets, commands a market cap of USD 15.8 bn, trading at 15x forward earnings.

Table 9: Comparison with leading global asset managers

	Mkt cap (USD mn)	AUMs (USD mn)	Mkt cap AUM	PE (fwd) (x)	P/B (x)	5-year CAGR growth (%) AUMs	Rev	PAT	Equity:Debt
Franklin Resources	28,340	511,300	5.5	16.1	4.3	15.7	16.5	24.0	68:32
Principal Financial Grp	15,800	315,880	5.0	15.2	2.1	18.5	1.4	5.9	
Cohen & Stears	1,570	25,467	6.2	30.8	10.7	37.3	39.3	50.0	
Alliance Bernstein	6,830	659,367	1.0	18.1	4.6	8.7	5.0	11.6	69:31
Janus Group	4,220	154,165	2.7	23.7	1.8	(3.3)	(9.8)	(13.0)	50:50
Reliance Capital		~9,900	-			137.3	82.2	485.9	47:53

Source: Company, Bloomberg

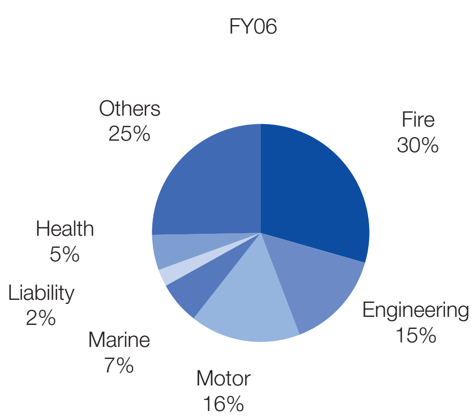
Considering Reliance Capital's phenomenal growth in AUMs and profitability, we believe it deserves a relatively higher valuation multiple compared with these global players.

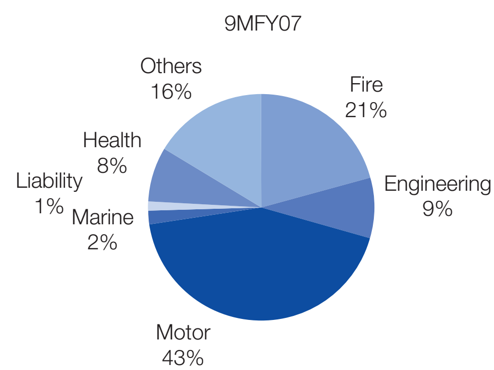
General Insurance: To focus on retail products

Business structure

Reliance General Insurance (RGI) (100% subsidiary of Reliance Capital) was one of the first private players to get a general insurance license from IRDA. It offers a complete range of insurance products—motor, health, home, and travel insurance to individuals; fire, engineering, liability, property, group mediclaim, marine, and hull insurance policies to corporates. The company is gaining traction in motor insurance products, which accounted for 43% of gross premium written in 9MFY07, compared with merely 16% in FY06. It is also increasingly focusing on health insurance.

Chart 4: Product-wise breakup





Source: Company

General insurance industry dynamics

Two major developments in the general insurance industry in India, effective since January 2007, have been:

Dismantling of tariff regime and formation of motor TP pool effective since January 2007

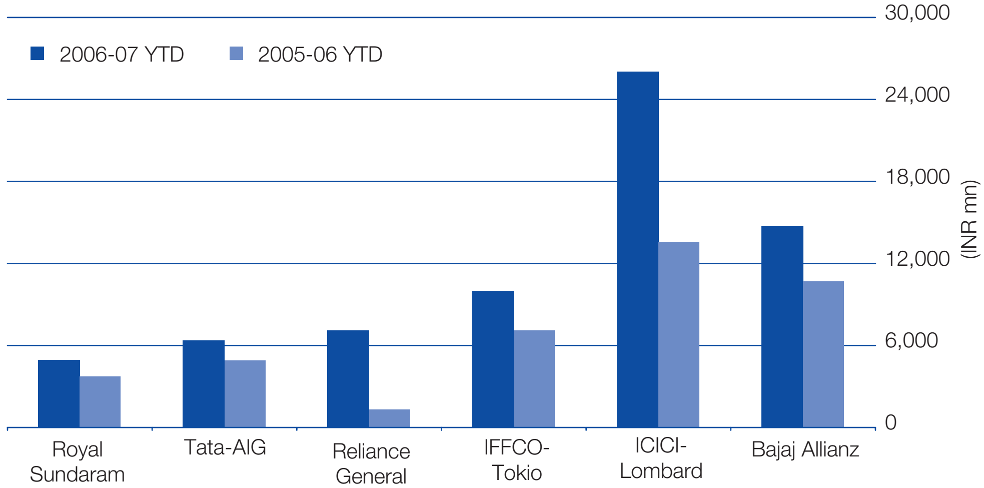
- Dismantling of tariff regime in all business lines (fire, engineering, and health) except for mandatory motor third party (TP) tariff.
- Formation of the motor third party pool and raising of motor TP rates to compensate for heavy losses likely in this segment.

Prior to this, the general insurance industry in India was characterised by controlled tariff regime. Consequently, growth in general insurance was relatively low compared with life insurance and other segments in the financial services space.

General insurance industry in India grew at 15% CAGR in the last five years

General insurance industry in India has grown at 15% CAGR in the past five years in terms of gross premium (GWP) collection. In FY06, it posted a growth of 16%, driven by private players' phenomenal growth of 53%; growth was, however, dismal among public sector players at 7%. The rally in private sector was led by ICICI Lombard and Iffco Tokio. With greater focus on retail products, rapid branch expansion, and greater aggression shown by Reliance General Insurance, growth picked up in FY07 YTD, with the industry growing at 24%, private players at 63%, and public sector players growing at 9%. As a result, private players' market share improved sharply from 20% in FY05 to 35% in FY07.

Chart 5: Gross written premium growth of leading general insurers



Source: IRDA

The product mix in general insurance industry was skewed towards the corporate segment in the past. Growth in FY06, in terms of products, was primarily driven by motor and health segments. Motor insurance (own damage and third party liability) products have posted the highest increase in premium in absolute terms and dominate the general insurance product space constituting ~40% of gross written premium (GWP). This is despite the fact that the third party liability segment is highly unprofitable and detariffed. Private players are less focused on this product and their portfolio within motor insurance is highly skewed in favour of own damage liability products.

The next biggest contributor to the industry's gross written premium is the fire insurance business, constituting ~18% (declined from 24% in FY1999). Private players are more focused on the fire insurance business, as it is a highly profitable segment.

Health insurance is another fast-growing segment (with increase in medical tourism) and now constitutes ~13% of industry-wide GWP. ICICI Lombard is the dominant player and this product is highly concentrated amongst private players.

We believe that opportunities going forward lie in retail products

We believe that opportunities going forward lie in retail products. To encash this opportunity, industry players are gearing up to service the retail segment better by developing distribution channels like direct marketing, telemarketing, setting up call centers as a single point of contact for customers, and setting up web portals for transactions online.

De-tariffing will mature the industry faster. We expect general insurance industry in India to grow at ~15-20% CAGR over FY07-10E

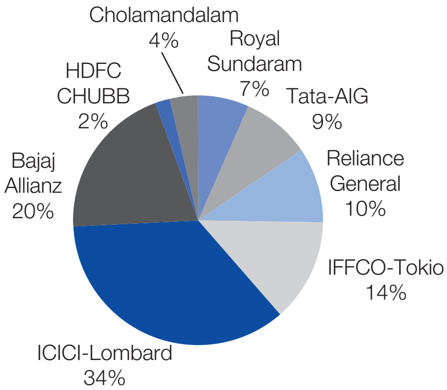
Penetration (as a percentage of GDP) of general insurance in India has improved marginally from 0.53% to 0.64% in the past five years, but is still at low levels. Detariffing will mature the industry faster and offer a big opportunity to private players. Going forward, we expect the general insurance industry in India to grow at ~15-20% CAGR over FY07-10E. Growth will be dominated by private players and their market share will improve significantly from the current 35%.

Reliance General Insurance: Fastest-growing private player

RGI is among the fastest growing private player, achieving a gross written premium of INR 6 bn during 9MFY07, a phenomenal growth at 448%

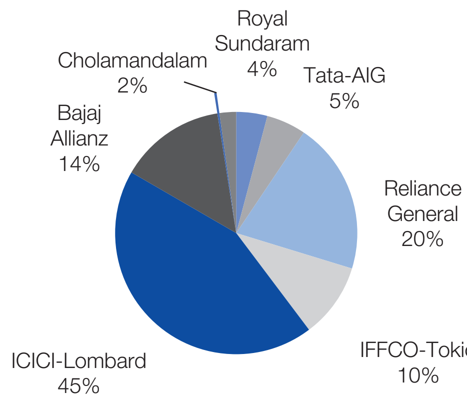
Reliance General Insurance (RGI) is among the fastest-growing private players, achieving a gross written premium of INR 6 bn during 9MFY07, a phenomenal growth of 448%. Consequently, RGI replaced Tata AIG as the fourth-largest private player (up from eighth position in March 2006), following ICICI Lombard, Bajaj Allianz, and Iffco Tokio. Within the gross business recorded in general insurance sector, RGI cornered 10% share during FY07 and 20% of the incremental business within the private sector.

Chart 6: Market share of private players in FY07



Source: IRDA

Chart 7: Incremental market share of private players



Source: IRDA

Increased focus on retail business

The company is now aggressively driving its retail business and plans to have a more even portfolio

RGI's performance had been dismal in the past few years, as its business was primarily generated from group companies. Of late, the company has shown greater aggression in tapping external customers post reorganisation of the Reliance Group. Currently, the portfolio is more skewed towards corporates with 64% share in total premium income. However, the company is now aggressively driving its retail business and plans to have a more even portfolio (50% retail and 50% corporate) by March 2007, increasing the share of retail business further to 60% by March 2008.

Expanding distribution franchise and agent force

RGI has expanded its distribution network to 51 branches (opening 36 new branches in Q107) and 12 regional offices. Further, it has licenses to open 34 new branches and we expect the total tally to be 75-80 by March 2007. The strength of insurance agents has also been substantially increased and it plans to more than double it in the next few years.

Retention ratio to improve with retail focus

We expect its retention rating to go up to 56% by FY09E from 33% in FY06

RGI had the lowest retention ratio in the industry at ~35% in FY06, as the proportion of retail products was significantly lower and it reinsured 80-90% of corporate contracts (big ticket) in fire, engineering, aviation, and personal accident products. HDFC Chubb, on the other hand, retained 72% of its portfolio, while other players viz., Bajaj Allianz, ICICI Lombard, Iffco Tokio, Tata AIG had retention ratios in the range of 45-65%. With motor and health insurance (where retention ratio is high) being RGI's future growth drivers, we expect its retention ratio to go up to 56% by FY09E from 33% in FY06. Claim ratio at RGI is relatively high compared with its peers and we expect it to remain at 64-65% over FY07-09E.

Table 10: Retention and claiim ratio of private players

	Retention ratio (%)		Claim ratio (%)	
	FY05	FY06	FY05	FY06
Reliance General	23.4	34.2	62.0	61.9
Cholamandalam	52.9	44.8	61.2	69.9
ICICI Lombard	36.7	46.4	48.3	53.0
IFFCO Tokio	47.3	53.6	50.8	51.0
Bajaj Allianz	56.3	54.9	47.2	58.7
Tata AIG	58.0	58.8	48.6	47.6
Royal Sundaram	61.0	64.7	56.4	54.5
HDFC Chubb	76.4	71.9	58.9	55.5

Source: IRDA

Assuming 94% premium growth, 65% claim ratio and 15x FY09E earnings multiple, we value this business at INR 11.9 bn by FY09E

Valuation

We expect GWP at RGI to grow by 94% CAGR over FY07-09E. With retail being the key focus area, we believe growth will largely come from motor and health insurance products. Considering this aggressive growth (skewed towards retail products), we have assumed relatively higher commission expenses. With our base case assumption of 94% CAGR growth in GWP, 65% claim ratio and 15x FY09E earnings multiple, we value this business at INR 4.1 bn by FY08E and INR 11.9 bn by FY09E. Since FY08E profitability is expected to be subdued due to increase in reserve for unexpired risk, we have considered normalized profit at 1.5% of gross written premium and assigned 15x P/E multiple.

We have done a sensitivity analysis considering varying assumptions for premium growth, claim ratio, and P/E multiple, and we value this business in the range of INR 7.7-16.9 bn by FY09E.

Table 11: Reliance General key metrics

	FY04	FY05	FY06	FY07E	FY08E	FY09E
Gross written premium (INR mn)	1,611	1,617	1,623	8,879	18,393	33,506
Net premium earned (INR mn)	263	480	540	2,228	4,896	12,111
Net claims incurred (INR mn)	237	384	344	1,426	3,182	7,872
PAT (INR mn)	90	58	144	75	34	794
Claim ratio (%)	90	80	64	64	65	65
Retention ratio (%)	22	25	33	50	53	56

Source: Company, Edelweiss research

Table 12: Sensitivity analysis for general insurance business valuation

Profit FY09E (INR mn)

	GWP growth % (2-year CAGR FY07-09E)				
Claim ratio (%)	74	84	94	104	114
61	543	839	1,128	1,413	1,696
63	409	689	961	1,228	1,492
65	275	539	794	1,044	1,289
67	140	389	628	859	1,086
69	6	239	461	675	883

Valuation (INR mn)

	Profit FY09E (INR mn)				
PE (x)	389	592	794	997	1,199
11	4,279	6,507	8,734	10,962	13,189
13	5,057	7,690	10,322	12,955	15,587
15	5,835	8,873	**11,910**	14,948	17,985
17	6,613	10,056	13,498	16,941	20,383
19	7,391	11,239	15,086	18,934	22,781

Source: Company, Edelweiss research

Life Insurance: Key valuation driver

Business structure

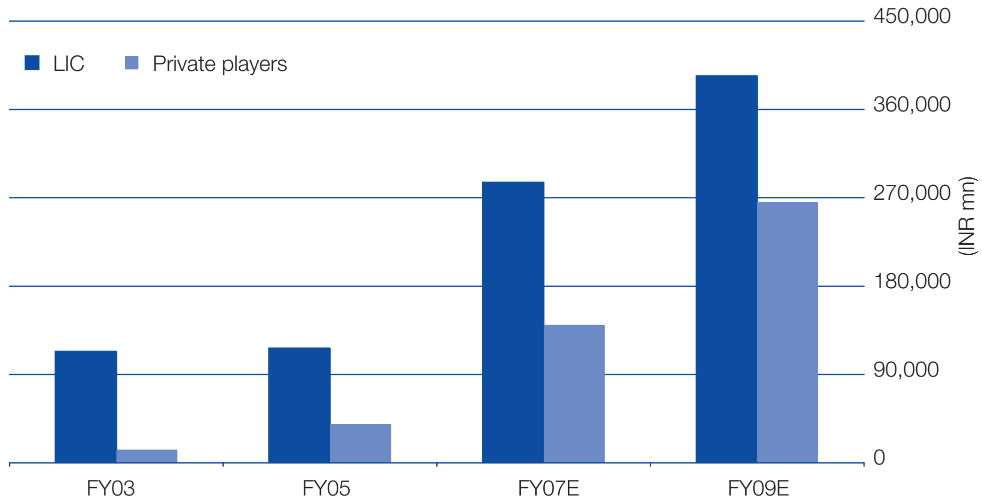
Reliance Capital entered the life insurance business through the acquisition of AMP Sanmar Life Insurance in October 2005 for INR 970 mn. AMP Sanmar, post acquisition, was renamed as Reliance Life Insurance (Reliance Life), wherein Reliance Capital has an 100% economic interest (based on our discussions with the management), but technically holds only 16% directly; the balance is held by its associate companies Viscount Management and Viscount Management (Alpha). Consequently, financials of Reliance Life have not been included in the consolidated financial statements of Reliance Capital either as a subsidiary or as an associate.

Life insurance industry snapshot

Life insurance industry has acquired some distinct characteristics in the past few years which have spurred stupendous growth in its annualised premium equivalent (APE) of 35% CAGR over FY03-07.

- First and foremost is the shift from traditional policies to unit linked plans (ULIP), supported by buoyancy in capital markets. Most of the private players have focused heavily on ULIP and this product now dominates the space.
- Second, insurers have deepened penetration by aggressively increasing their agent force and expanding distribution network. Bancassurance and other alternate channels, viz., brokers, and third party distributors also affected the market.

Chart 8: Life Insurance APE growth over FY03-09E

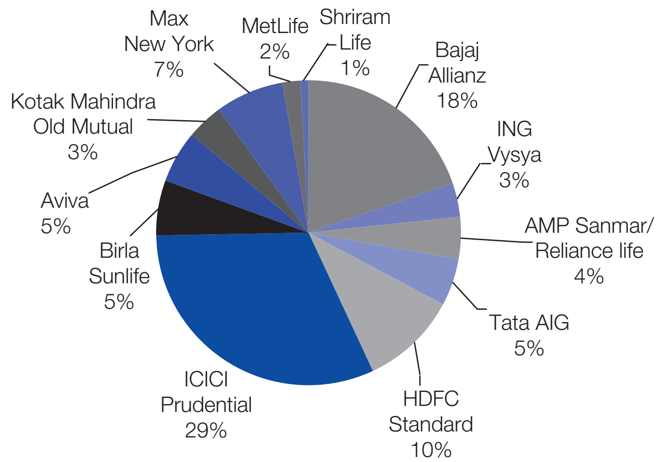


Source: IRDA

Private players recorded a growth of 80% CAGR in APE over FY03-07, against LIC's volume growth of 26%

Private players were in the forefront of this sector rally, recording a growth of 80% CAGR in APE over FY03-07, against LIC's volume growth of 26%. Private insurers improved their market share significantly from 11% in FY03 to 34% in FY06. LIC is struggling against this onslaught since its traditional products are relatively less attractive.

Chart 9: Market share of private players in 9MFY07



Source: IRDA

The market share among private players has also undergone a change. ICICI Prudential and Bajaj Allianz have been fastest off the block and have emerged clear winners with a market share of 29-30% and 18-19%, respectively, among private insurers. HDFC Standard Life is also bombarding the market with its well-planned strategies in place, post setting up of a strong base. However, Birla Sun Life's performance was a disappointment in the past eighteen months and it has, in fact, lost market share to other aggressive players. Reliance Life (after taking over AMP Sanmar) and SBI Life have been aggressive lately and have significantly outperformed other leading players, growing exponentially in the past nine months.

Table 13: Life Insurer's market share

(%)	FY03	FY05	FY06	9MFY07
LIC	89.3	73.3	65.9	70.9
Private insurers	10.7	26.7	34.1	29.1
ICICI Prudential	21.0	34.2	29.7	29.1
Bajaj Allianz	4.3	11.3	18.7	18.3
HDFC Standard Life	7.5	9.1	11.0	9.5
Birla Sun Life	9.4	12.9	7.9	5.3
SBI Life		2.7	4.5	7.6
Reliance Life		0.8	1.1	4.2

Source: Company, IRDA *Note: Individual private insurers' market share is inter se private players*

We expect APE to grow threefold in FY09E over FY06, implying a growth of 44% CAGR over FY06-09E

Going forward, we expect APE to grow threefold by FY09E over FY06, implying a growth of 44% CAGR over FY06-09E. This spectacular growth will be driven by deeper insurance penetration, ballooning ticket sizes, innovative product launches, and distribution ramp up. Penetration of life insurance segment is relatively low at ~2.5% of GDP and long term structural drivers viz., rising per capita income, growing appetite for savings and investments, need for protection, and ageing population will aid in deeper penetration of life insurance in India.

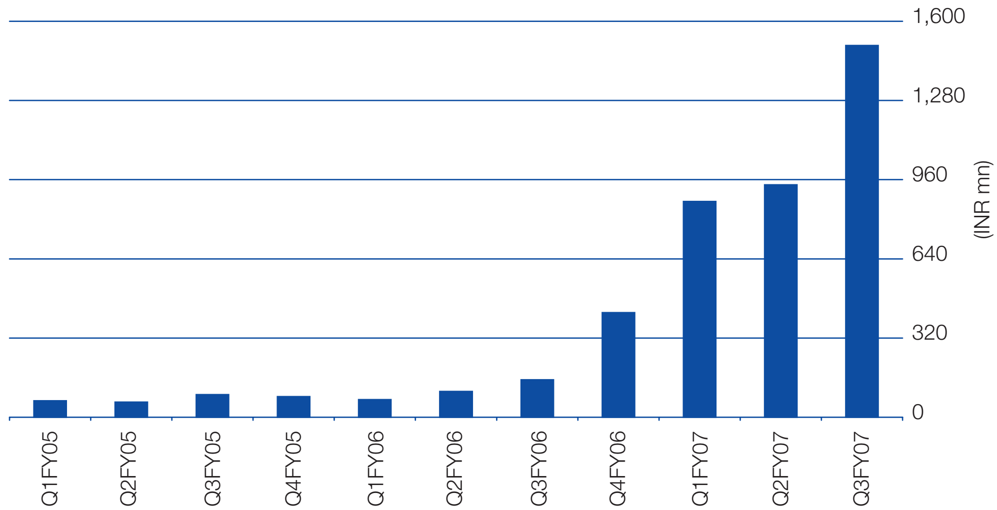
We expect private players to continue to gain market share at the expense of LIC and their share is likely to reach 40% by FY09E. Among the private players, we expect the current winners to continue to grow their market share, while we believe that some of the laggards will catch up a bit. ICICI Prudential will continue to dominate the space and will be a leader by a wide margin. Reliance Life will more than double its market share in two-three years. We believe that the key success factors for private players to emerge as leaders will be their ability to recapitalise themselves, offer sophisticated products addressing customer needs, increase marketing intensity (ramping up distribution network and agency force), and presence in other retail financial segments to facilitate effective cross-selling, and establishing strong brand equity.

Reliance Life: Growing exponentially

Reliance Life posted exponential growth in its premium income, outpacing leaders by a wide margin

AMP Sanmar (prior to acquisition) was a laggard with minuscule market share of less than 1% amongst private life insurers. Post-acquisition by the Reliance Group, it posted exponential growth in its premium income, outpacing leading players and industry growth by a wide margin (on a lower base albeit) and now commands market share of 4-5% amongst private life insurers. Reliance Life has a clear objective of becoming India's leading private life insurer in the next few years.

Chart 10: Reliance Life's APE growth



Source: Company

Table 14: Annualised premium equivalent growth of leading private players

(INR mn)	FY05	FY06	*Y-o-Y (%)*	9m FY06	9m FY07	*Y-o-Y (%)*
Reliance Life (AMP Sanmar)	304	749	*147.0*	327	3,314	*914.0*
ICICI Prudential	13,572	21,261	*57.0*	12,416	23,017	*85.0*
Bajaj Allianz	4,489	13,509	*201.0*	6,638	14,459	*118.0*
HDFC Standard Life	4,025	7,868	*95.0*	4,707	7,545	*60.0*
Birla Sunlife	5,102	5,657	*11.0*	3,289	4,198	*28.0*
SBI Life	1,054	3,222	*206.0*	997	6,014	*503.0*
Industry Total	153,770	209,963	*37.0*	112,534	261,348	*132.0*

Source: IRDA

Aggressively investing in growth

Reliance Life too is aggressively investing in growth, expanding its distribution franchise and increasing its agent force

Private players have heavily focused on growing their agent force at a brisk pace to ramp up volumes along with expanding branches aggressively and increasing geographical footprint. Reliance Life too is aggressively investing in growth, expanding its distribution franchise to 162 dedicated branches across 144 locations, and increasing its agent force to nearly 63,000. Its current network compares well with private players HDFC Standard Life and Birla Sunlife, which command ~10% and 5% market share, respectively.

Table 15: Distribution franchise of leading life insurance

As at Dec-06	Reliance Life	LIC India	ICICI Pru	HDFC Std	Birla Sunlife	Bajaj Allianz
Branches	162	2,048	472	250	130+	900+
Advisors	>63,000	1,002,149	176,000	>52,000	47,000	NA

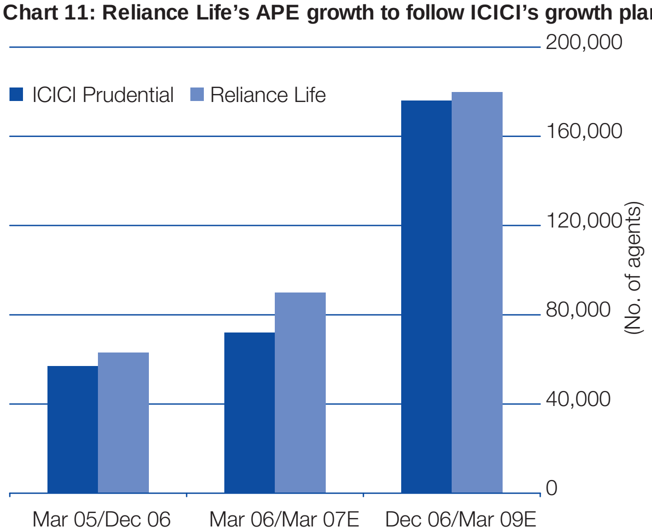
Source: Company, IRDA

Currently, Reliance Life is nearly one-third of ICICI Prudential's network and advisory force (ICICI Prudential's distribution network is largest amongst private players) and one-seventh in terms of volumes. ICICI Prudential's phenomenal growth of 88% CAGR over FY04-07 on a relatively higher base with dominant leadership position (30% market share) was possible due to its clear strategy of aggressively expanding its presence across locations and increasing the quantum of advisors. ICICI Prudential grew its agency force significantly from 57,000 in FY05 to 176,000 in December 2006 and branch network from 177 to 472 in just nine months.

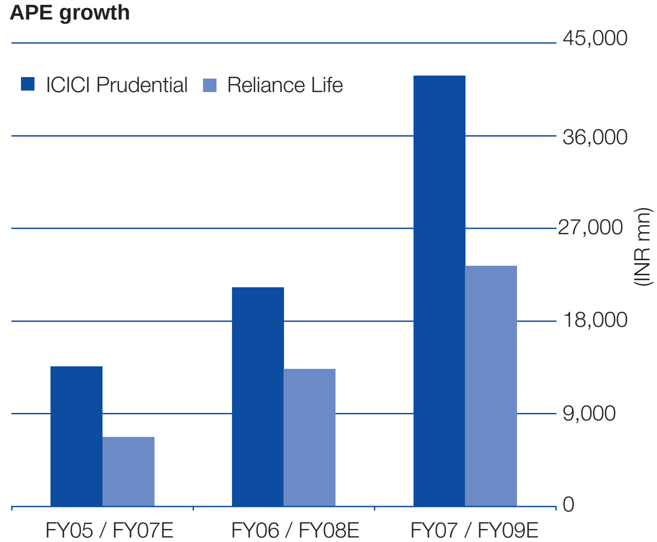
Reliance Life's aggressive growth strategy of increasing its agency force by FY09E to the levels of ICICI's current advisory strength will help it grow its APE by FY09E to ICICI's 9MFY07 levels

Following ICICI's growth story, Reliance Life too is embarking on similar strategies to aggressively grow its current network. It is expected to grow its agent strength to ~90,000 by March 2007 and further double it over the next two years. This will help it to narrow the market share gap with ICICI Prudential (ICICI), Bajaj Allianz, HDFC Standard, Birla Sunlife, and SBI Life, to become a leading private insurer. We have shown graphically how Reliance Life's aggressive growth strategy of increasing its agency force by FY09E to the levels of ICICI's current advisory strength will help it grow its APE by FY09E to ICICI's 9MFY07 levels.

Chart 11: Reliance Life's APE growth to follow ICICI's growth plan



APE growth



Source: Company, Edelweiss research

Note: We have compared Reliance Life's estimated agency force and APE numbers for FY07-09E with ICICI's numbers for FY05-07

Leveraging on retail presence

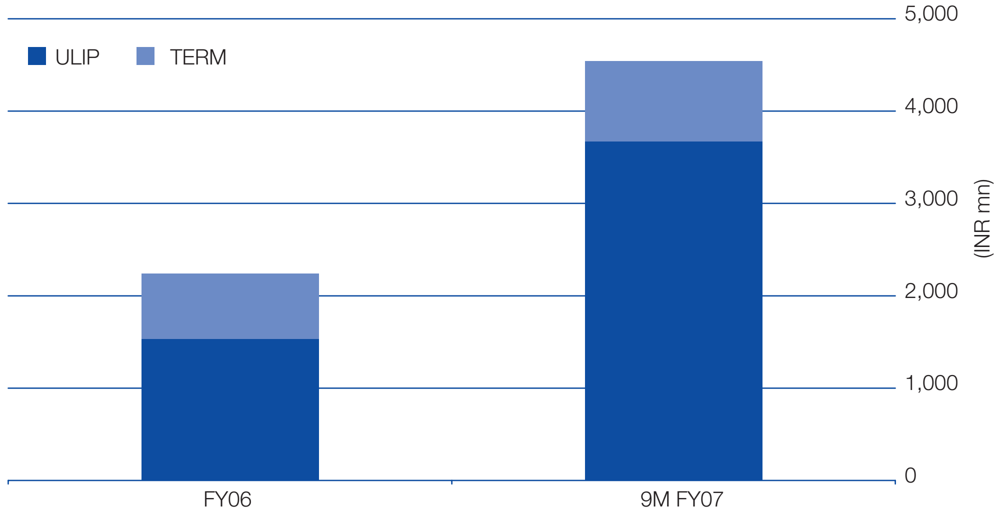
Reliance Life will also leverage on the strong retail presence of Reliance Communications to corss sell its life insurance products

Reliance Life will also leverage on the strong retail presence of Reliance Communications across 700 plus cities through 1,650 owned and operated Reliance World stores to cross sell its life insurance products. Through this franchise, it will gain access to the most underserved segment viz., Tier 3 and 4 cities with minimal additional distribution efforts and investments. Moreover, after the launch of Reliance Money and rollover of its extensive one-stop financial outlets, it will be effectively cross-selling its life insurance products to broking clients as well.

Domination of linked products to decline

Unit linked products dominate Reliance Capital's product mix, with ~80% of the new business premium coming from ULIP in 9MFY07. The linked proportion at Reliance Life compares well with HDFC Standard Life, but is relatively less when compared with other leading private insurers such as ICICI Prudential at 94%, Bajaj Allianz at 90%, and Birla Sunlife at 99%.

Chart 12: ULIP and term policies premium



Source: Company

Though we expect the company to increase the proportion of non-unit linked products and will offer other new and differentiated products, unit linked will still continue to dominate its product mix, with structurally strong demand for unit linked plans in India.

Valuation: Life insurance to be a significant valuation driver

We expect Reliance Life to garner market share of around 8-9% among private insures by FY09E

Broadly, we expect Reliance Life to grow its annualised premium equivalent (APE) by 86% CAGR over FY07-09E and garner market share of around 8-9% among private insurers by FY09E. We believe the company will need to infuse funds (from internal accruals) of INR 11-13 bn in this business over the next two-three years to achieve the projected growth. With our base case assumption of 6.8% market share by FY08E and 8.8% by FY09E and 16% NBAP margin, we value this business at INR 72.3 bn by FY08E and INR 82.4 bn by FY09E on appraisal value basis.

Table 16: Reliance Life's key metrics

	FY06	FY07E	FY08E	FY09E
Annualised premium equivalent (INR mn)	749	6,714	13,341	23,332
New business achieved profit (INR mn)	112	1,074	2,135	3,733
NBAP margin (%)	15	16	16	16

Source: Company, Edelweiss research

Assuming 8.8% market share by FY09E and 16% NBAP margin, we value this business at INR 82.4 bn by FY09E

We have also done a sensitivity analysis, considering its likely market share of 7-10% (among private insurers) by FY09E and NBAP margin range of 14-18%. With this, we have arrived at the value of its life insurance business in the range of INR 72.5-92.9 bn by FY09E.

Table 17: Sensitivity analysis forlife insurance business valuation

	Market share by FY09E (%)				
Margins (%)	7.8	8.3	8.8	9.3	9.8
14	63,238	66,282	69,326	72,370	75,414
15	69,211	72,543	75,875	79,207	82,539
16	75,184	78,804	**82,425**	86,045	89,665
17	81,157	85,066	88,974	92,882	96,790
18	87,130	91,327	95,523	99,719	103,916

Source: Company, Edelweiss research

Reliance Money: Flat fee pricing and wide distribution network

Umbrella brand 'Reliance Money'

Broking products will be the primary point of intorduction and will also cross sell multiple other financial products

Reliance Capital plans to venture into broking and related businesses under the brand 'Reliance Money', to offer a bouquet of financial products to retail investors through a single window. The flat fee-based broking products will be the primary point of introduction for majority of customers. The company will also cross-sell multiple other financial products viz., mutual funds, IPOs, insurance, money transfer, and credit cards.

Business structure

Technically, Reliance Capital does not have direct equity holding in Reliance Money but indirectly has 100% economic interest in it through its associates. In the absence of any direct holding, we have not accounted for financials of Reliance Money in Reliance Capital's estimated consolidated accounts.

Retail broking industry dynamics

Retail penetration in Indian capital market is still relatively low

Capital markets in India have exhibited distinctly buoyant trend in the past few years, triggered by robust macro fundamentals, strong corporate results, a positive investment climate boosting the faith of foreign investors in Indian companies, and increased retail and institutional investors' participation. India's broader market indices have outperformed a majority of global indices (30% average annual return in the past four years) and India is now considered to be a more sophisticated market and preferred investment destination. Presently, market movements are primarily influenced by FII flows. Retail penetration in Indian capital markets is still relatively low; hardly 3% of India's total population constitutes share-owning individuals and <3% of household financing savings makes it into the equity markets.

The retail investor cult is yet to catch up in India. A few macro economic, demographic, structural, and fundamental factors that can probably lead to broader and deeper retail participation are:

A few macro economic, demographic, structural, and fundamental factors can probably lead to broader and deeper retail participation

- Key role of financial services sector in India's growth story.
- Per capita GDP crossing the INR 22,000 mark and savings rate inching up to 30%.
- 60% of population aged below 35 years and growing upper and higher middle income group.
- Increasing appetite for equities among retail investors.
- Proactive regulatory checks and increased transparency of trades, creating safer markets.
- Growing use of online trading, empowering individual investors with access to professional information
- Better interconnectivity

Broadly, if we presume GDP to grow at the current run-rate for the next three years, savings rate curve at 30%, and contribution towards financial savings in low 40s with slightly higher bias towards equities, then cumulative flows into equities from household sector will translate into a linear growth of 25% plus for the next three years.

The broking industry is highly fragmented with the top five brokers accounting for only 14-17% of the market volume. Sensing the opportunity thrown open by deeper penetration and tremendous scope to improve the market share, brokers are now strategically positioning themselves by aggressively spreading their reach, providing superior execution, strengthening their technology platform, and providing a diversified product suite. All these will also act as a tool for client ownership, deeper client relationships, asset retention, and finally attracting maximum share of clients' wallet. Indiabulls followed the same strategy and has grabbed 7-8% market share in the past three years. India Infoline has also started investing aggressively in growth, increasing its branch network and employee strength almost four-fold in the past twelve months.

Reliance Money: Soft launch, but strong numbers on its cards

Reliance Capital is also optimistic about its retail broking venture, expected to be launched in the next three months on a large scale. With a soft launch in select markets through 950 franchises, it already has on its cards a commendable customer base of ~30,000. Equally competitive has been its operational performance, posting average daily trading volume of INR 2 bn in the initial stage itself.

Competitive edge: Innovative technology and distribution network

The strategy in this venture revolves around the basic objective of providing quality broking, enabling convenient and effective anytime-anywhere integrated financial transaction capability. The broking business is likely to be established on similar grounds as that of its telecom business (in terms of infrastructure and technology), to enable it to operate on a competitive fee structure, accessing large number of population in Tier 2, Tier 3 cities, and beyond.

To make innovative use of technology and Group's deep distribution network as its competitive edge

The management is confident of making innovative use of technology and the group's deep distribution network as its competitive edge. It will be the first player to install trading kiosks at various strategic locations attracting maximum customer footfalls. Trading orders can be conveniently placed anytime anywhere through highly secured tokens provided with dynamic passwords. It will also be setting up call centers to take trading orders on the phone.

Differential pricing: Flat fee structure

Reliance Capital will try to grab the market share by following flat fee pricing structure

Reliance Capital will try to grab market share by differentiating its product on the pricing front. It will charge a flat fee of INR 500 for two months per customer with trading limit of INR 1 mn on delivery basis and INR 10 mn on derivatives and intra-day transactions. This flat fee structure implies a charge of 5bps for delivery transactions within trading limit and 0.5bps for derivatives transaction, which is at steep discount to rates offered by other brokerage houses.

Targets to be a leading broker

Reliance Capital aims to be among the leading broking houses. With a flat fee structure it will focus more on tapping maximum customers on its trading platform and eventually target a market share of ~5% plus in the next few years. To value Reliance Capital's brokerage business, we have broadly looked at some leading brokerage houses in terms of their market share, network, client base, financials, and value they command.

Table 18: Key metrics of leading retail brokers

	Average daily trading volume (INR mn)	Branches	Customer base	Market Cap (INR mn)	Revenues (INR mn) FY06	Revenues (INR mn) H1 FY07	Profit (INR mn) FY06	Profit (INR mn) H1 FY07
Indiabulls	~18,000	648	387,131	45,230	3,098	2,083		
Kotak Securities*	~26,300	762	269,000		6,207	3,621	2,155	1,002
India Infoline	~7,500	406	~75,000+	15,361	1,468	1,118	165	329
IL&FS Investsmart#	~4,000	259	~85,000+	14,107	2,170	1,175	691	279
Geojit Securities	~1,400	350+	~75,000+	5,243	1,020	623	227	128

Source: Company, Edelweiss research

** includes retail, online and institutional volume - of which online trading was INR 3.2 bn*

 # Revenues and profit includes syndication and merchant banking income

Indiabulls's brokerage business currently enjoys 7-8% market share and commands market cap of INR 45 bn. India Infoline, with a 2.5% market share, is valued at INR 15.4 bn.

Valuation: INR 10 bn by FY09E based on average revenue per customer model

Expecting 0.55 mn average customer base by FY09E and average revenue per customer of INR 700 (two months), we value this business at INR 10.4 bn

Considering Reliance Capital's principal focus on broking business, the Group's aggression in all new ventures, and steeply discounted rates, we expect it to establish a customer base that is at least on par with Indiabulls's current base, by FY09E. As it will be following a flat fee structure per customer (INR 500 for two months), we have arrived at its value using average revenue per customer model. Considering our base case scenario of 0.28 mn average customer base by FY08E and 0.55 mn by FY09E and average revenue per customer of INR 600 (two months) in FY08E and INR 700 in FY09E, we value this business at INR 4.6 bn in FY08E (assuming P/E of 16x) and INR 10.4 bn in FY09E (assuming P/E of 14x). We have done a sensitivity analysis for FY09E valuations using varying assumptions of its average client base (0.5-0.6 mn), average revenue per customer (INR 650-750 for two months), and PAT margins (30-35%). With this, we arrive at the value of its broking and related business at INR 8.5-12.3 bn by FY09E.

Table 19: Sensitivity analysis for broking and related businesses valuation

Revenue in FY09E (INR mn)

	Average Customer base (FY09E)						
Avg revenue per customer (INR)	400,000	450,000	500,000	550,000	600,000	650,000	700,000
500	1,200	1,350	1,500	1,650	1,800	1,950	2,100
550	1,320	1,485	1,650	1,815	1,980	2,145	2,310
600	1,440	1,620	1,800	1,980	2,160	2,340	2,520
650	1,560	1,755	1,950	2,145	2,340	2,535	2,730
700	1,680	1,890	2,100	2,310	2,520	2,730	2,940
750	1,800	2,025	2,250	2,475	2,700	2,925	3,150
800	1,920	2,160	2,400	2,640	2,880	3,120	3,360
850	2,040	2,295	2,550	2,805	3,060	3,315	3,570

Valuation (INR mn)

	Profit in FY09E (INR mn)						
PE (x)	650	680	710	740	770	800	830
8	5,200	5,440	5,680	5,920	6,160	6,400	6,640
10	6,500	6,800	7,100	7,400	7,700	8,000	8,300
12	7,800	8,160	8,520	8,880	9,240	9,600	9,960
14	9,100	9,520	9,940	**10,360**	10,780	11,200	11,620
16	10,400	10,880	11,360	11,840	12,320	12,800	13,280
18	11,700	12,240	12,780	13,320	13,860	14,400	14,940
20	13,000	13,600	14,200	14,800	15,400	16,000	16,600

Source: Company, Edelweiss research

Consumer Finance: Optimising the distribution network

Consumer financing business is expected to be launched in FY08E to optimise on its wide distribution network

Besides retail broking, Reliance Capital also plans to offer various consumer loan products to its customers to optimise on its wide distribution network. Consumer financing business is expected to be launched in FY08E as an incidental business in the financial services space. Unlike other NBFCs, it will not be focusing primarily on mortgages and subprime segment, but will provide auto loans and non-collateralised products, viz., personal loans and credit cards through this venture.

Funding strategy

The investments in this business are expected to be made in a phased manner for the next three-four years. We have estimated average infusion of ~INR 4.5 bn (from internal accruals) per year in this business. The company will leverage it further (we have estimated 8-10x) and consequently grow its disbursements, and asset base aggressively. Considering the product mix, we expect it to generate an average post tax risk adjusted return of 2.0-2.4% every year. This will translate into a RoE of 17-18%.

Table 20: Business strategy

	FY08E	FY09E	FY10E
Networth at the beginning of the period (INR mn)	-	4,946	10,826
Incremental infusion (INR mn)	4,500	4,500	4,500
Leverage (x)	9	9	9
Outstanding loan book (INR mn)	40,500	85,010	137,935
ROA (%)	2.2	2.2	2.2
Profit (INR mn)	446	1,381	2,452
Networth at the end of the period (INR mn)	4,946	10,826	17,778
ROE (%)	9.0	17.5	17.1
PB (x)	1.9	1.7	1.5
Value at the period end (INR mn)	9,396	18,404	26,668

Source: Company, Edelweiss research

Valuation

Considering 9x leverage, 2.2% RoA, and 1.5x PB multiple, we value this business at INR 18.4 bn by FY09E

With our base case assumption of 9x leverage and 2.2% RoA, we value this business at INR 9.4 bn by FY08E and INR 18.4 by FY09E. We have also done a sensitivity analysis, considering varying assumptions on leverage, RoA, and P/B multiple to value its consumer financing business in FY09E. We expect it to be worth INR 17.0-19.8 bn by FY09E.

Table 21: Sensitivity analysis for consumer financing business valuation

Networth by FY09E (INR mn)

	Leverage (x)				
ROA (%)	7	8	9	10	11
1.6	10,022	10,170	10,319	10,469	10,619
1.8	10,152	10,319	10,488	10,656	10,826
2.0	10,282	10,469	10,656	10,845	11,034
2.2	10,413	10,619	10,826	11,034	11,244
2.4	10,544	10,769	10,996	11,225	11,454
2.6	10,675	10,921	11,168	11,416	11,666
2.8	10,807	11,072	11,339	11,608	11,879

FY09E Valuation (INR mn)

	Networth by FY09E (%)				
PB (x)	10,469	10,655	10,826	10,996	11,225
1.4	14,657	14,918	15,156	15,394	15,715
1.5	15,704	15,984	16,239	16,494	16,838
1.6	16,750	17,050	17,322	17,594	17,960
1.7	17,797	18,115	**18,404**	18,693	19,083
1.8	18,844	19,181	19,487	19,793	20,205
1.9	19,891	20,246	20,569	20,892	21,328
2.0	20,938	21,312	21,652	21,992	22,450

Source: Company, Edelweiss research

Private equity/proprietary investments: Diversified investments

Reliance Capital (along with its associates) has made several investments through private equity and proprietary investment route in Adlabs Films, Spanco Telesystems, Celebrity Fashions, DTDC Courier, Shriram Transport, Financial Technologies, Prime Focus, and others. Reliance Capital Private Equity is one of the domestically managed and funded private equity vehicles, targeting diversified business segments. The returns generated from the sale of a few of its financial investments were relatively better and Reliance Capital will further continue to invest, with focus on quality and mix, to achieve superior returns. Besides private equity, the company has substantial investments in ADAG companies viz., Reliance Communication, Reliance Energy, Reliance Natural Resources and other Reliance group companies, Reliance Industries.

The market value (based on prices of March 22, 2007) of its quoted investments is INR ~43.7 bn, translating into an unrealised gain of INR 132 per share (~20% of the Reliance Capital's CMP).

Table 22: Value of investments

	Qty	CMP (INR)	Market value (INR mn)	Book value (INR mn)	Discount to market value (%)	Unrealised gains (INR mn)
Adlabs Films	1,255,000	436	547	125	40	204
Celebrity Fashions	1,050,000	82	86	122	-	(37)
INOX Leisure	500,000	112	56	81	-	(25)
Kinetic Eng	715,000	112	80	127	-	(48)
Reliance Communication Ventures	17,940,295	426	7,649	1,935	40	2,654
Reliance Energy	11,995,089	492	5,902	2,949	40	592
Reliance Energy Ventures		492	608	284	40	81
Reliance Industrial Infrastructure Ltd	160,100	417	67	5	-	62
Reliance Industries Ltd	13,460,295	1,374	18,498	1,650	-	16,848
Reliance Natural Resources Ltd	16,471,295	22	363	27	40	191
Shri Laxmi Cotsyn	1,300,000	96	125	168	-	(43)
Spanco telesystems	3,550,000	213	755	323	-	433
Total value of quoted direct investments			34,735	7,796		20,911
Value per share of quoted direct investments			141			85
Investment in Adlabs Films by Reliance Land	20,600,000	436	8,982	3,609	40	1,780
Value per share of quoted indirect investments						7
Book value of unquoted investments						2,483
Book value per share of unlisted investments						7

Source: Company, Edelweiss research

Note: 1 Investments mentioned above are those appearing in its book as of March 31, 2006

2: Over and above 3% in Adlabs Films, Reliance Capital also indirectly holds controlling stake (51%+) in Adlabs Films through its affiliate Reliance Land. Reliance Capital holds 50% directly in Reliance Land but has 100% economic interest in it through associates

We arriveat the value of its investments (quoted and unquoted) at INR 25.2 bn (USD 559 mn) or INR 100 per share

We have not considered the entire unrealised gains on quoted investments based on their market value for the valuation purpose, as some of its investments are either in ADAG entities or companies, in which the company (along with its associates) has majority stakes. Though the management considers these as financial investments, we have conservatively provided for 40% discount (to the market price). Besides the quoted investments, the company has investments in other unlisted entities, which we have considered at book value. There could possibly be significant upside, to our estimates, from any gain on these unlisted investments. We thereafter arrive at the value of its investments (quoted and unquoted) at INR 25.2 bn (USD 559 mn) or INR 100 per share.

Distressed Assets: Opportunistic

Business structure

As a part of its strategy to provide an entire gamut of financial services, Reliance Capital plans to float an asset reconstruction company. Reliance Capital's stake in this business is likely to be 49%; other venture partners will be Corporation Bank, Indian Bank, and General Insurance Corporation with equity holding of 10% each. The balance capital is expected to flow in from foreign investors.

Huge opportunity

Stressed asset market in India is expected to be worth INR 2 tn. There is huge opportunity for Reliance Capital, as ARCIL is the only dedicated player in this segment.

Revenue model

Reliance Capital, with a strong financial backing, is expected to buy stressed assets by making cash payment upfront rather than issuing security receipts

Reliance Capital, with a strong financial backing, is expected to buy stressed assets at relatively higher discount by making cash payment upfront rather than issuing security receipts. The company's role is likely to be primarily of a fund manager managing funds raised for investments in the stressed assets.

This venture will be headed by Rajendra Kakkar, former managing director and chief executive officer of ARCIL. However, considering that asset reconstruction business in India is at a nascent stage and RBI is still considering the company's proposal to commence business, we have not attached any value to this business.

Management Profile

Name	Designation	Profile/Experiences
Amitabh Chaturvedi	Group President	• More than 15 years experience • Previously associated with ICICI Bank
		Reliance Mutual Fund
Vikrant Gugnani	President	• More than 10 years experience in financing, retail banking, investments and manufacturing • Previously associated with Citibank N.A. as Vice President, Product Head Indonesia
K. Rajgopal	Chief Investment Officer	• More than 31 years experience in commercial banking, Treasury and investment operations. • Earlier associated with SBI since 1971 where he was GM-Treasury, Investment and Trading Compliance
Madhusudan Kela	Head - Equity Investments	• More than 13 years experience in Sales & Dealing • Held position of Vice President - Equity Sales & Trading with Peregrine Securities, UBS and Motilal Oswal
		Reliance General Insurance
K A Somasekharan	CEO	• 33 years experience in general insurance industry • Earlier associated with United India Insurance, last serving as Regional Manager
Mukul Kishore	Head - Underwriting & Risk Management	• About 17 years of experience in various facets of the insurance domain - Underwriting, Risk Mgt, Claims, Natural Catastrophe Mapping • Previously associated with HDFC Chubb General Insurance - looking after property and casualty loss control and with United India Insurance in Risk Management, Underwriting and Claim functions
		Reliance Life Insurance
P. Nandgopal	CEO	• Over two decades of experience in financial services space, starting from Andhra Bank to GIC and its subsidiaries • Also served as Head of Retail Sales Channel at DSP Merrill Lynch • He was one of the founder members of Birla Sun Life Insurance, working as Senior Vice President responsible for driving the Alternate Channels, Group Insurance and Pension businesses
Rohit Gaurav Mull	Chief Marketing Officer	• Has 14 years of experience in marketing in various industries ranging from FMCG to Life Insurance • Spent a considerable part of career in leading companies - Cadbury India Ltd., Coca-Cola India (as Senior Brand Manager of Sprite and Limca), and Tata AIG Life Insurance Company (as Vice-President, Marketing)
K.V.Srinivasan	Chief Operating Officer	• At Reliance Life Insurance, he heads the Operations, Finance, IT, Legal & Secretarial departments. • Total of 18 years of experience prior to Reliance - 3 years in management consulting with A. F. Ferguson & Co.; 4 years in treasury management with ITC Classic Finance, 5 years in retail liabilities & assets with ICICI, 3 years in agency management with ICICI Prudential and 3 years as a CFO with Citicorp Finance.
		Reliance Money
Sudip Bandopadhyay	Head of securities business	• Previously with ITC

Financial Statements

Income statement (consolidated) (INR mn)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Income					
Lease rental & other charges	289	205	123	37	-
Investment mgt, advisory and trustee fee	443	895	1,621	2,268	2,903
General ins. premi. and commi. earned	1,959	1,872	9,542	19,511	35,440
Consumer financing income	-	-	-	3,746	11,610
Other income	2,849	6,498	4,730	4,745	4,761
Total income	5,540	9,471	16,017	30,308	54,713
Operating expenditure					
Payment to & provision for employees	223	446	745	1,140	1,576
Administrative and other expenses	2,129	2,151	9,705	19,957	35,371
Bad debts written off	81	-	-	-	-
Provision for consumer financing	-	-	-	911	2,824
Impairment loss	(81)	-	-	-	-
Miscellaneous exp written off	16	12	12	10	-
Total expenditure	2,368	2,609	10,462	22,018	39,771
EBITDA	3,173	6,862	5,555	8,290	14,942
Interest & finance charges	1,511	452	452	2,305	6,194
Depreciation	296	256	209	154	129
PBT	1,366	6,154	4,895	5,831	8,619
Provision for tax	128	336	910	1,299	2,250
PAT before extraordinary items	1,238	5,819	3,984	4,532	6,369
Minority interest & share of associate	(879)	(105)	-	-	-
Adjusted PAT	359	5,714	3,984	4,532	6,369
Diluted number of shares (in mn)	127	218	230	246	246
Diluted EPS	2.8	26.2	17.4	18.4	25.9
Proposed div. on equity share capital	382	713	858	980	1,103
Dividend tax thereon	55	100	118	135	152

Growth ratio (%)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Income growth	21.0	70.9	69.1	89.2	80.5
EBITDA growth	(14.3)	116.3	(19.0)	49.2	80.2
PBT growth	6.8	350.5	(20.5)	19.1	47.8
PAT growth	1.2	370.1	(31.5)	13.7	40.5

Balance sheet (consolidated) (INR mn)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Assets					
Gross block	5,521	3,906	3,144	2,369	2,395
Less : Depreciation	3,114	2,463	2,061	1,598	1,701
Lease adjustment A/c	(203)	327	100	100	100
Net block	2,203	1,771	1,183	872	794
Capital work in progress	131	131	132	133	134
Investments	17,560	23,938	27,477	31,482	38,883
Current assets, loans & advances					
Stock in trade	3,061	62	31	31	31
Sundry debtors	137	777	1,032	1,702	2,599
Cash & bank balances	362	2,016	8,141	6,988	4,380
Other current assets	4,822	6,189	7,255	8,327	9,152
Loans & advances	1,536	12,239	13,262	54,341	99,556
Current liabilities and provisions					
Liabilities	619	1,024	2,496	3,372	4,400
Provisions	830	1,232	3,635	8,694	15,385
Net current assets	8,468	19,027	23,589	59,323	95,934
Miscelleneous exp. not written off	69	62	10	-	-
Total assets	**28,432**	**44,929**	**52,391**	**91,810**	**135,745**
Liabilities					
Paid-up share capital	1,278	2,234	2,451	2,451	2,451
Reserves	13,653	39,385	47,125	50,542	55,657
Warrants	-	495	-	-	-
Net worth	14,862	42,052	49,566	52,993	58,108
Minority interest	351	387	387	387	387
Secured loans	-	1,675	1,675	37,675	77,239
Unsecured loans	13,136	744	744	744	-
Deferred tax liability (net)	14	9	10	11	12
Total liabilities	**28,432**	**44,929**	**52,391**	**91,810**	**135,745**

Valuation metrics

Year to March	FY05	FY06	FY07E	FY08E	FY09E
EPS (INR)	2.8	26.2	17.4	18.4	25.9
EPS growth (%)	*(79.2)*	*827.8*	*(33.7)*	*6.2*	*40.5*
Book value per share (INR)	116	188	202	215	236
Price/Earnings (x)	226.8	24.4	36.9	34.7	24.7
Price/ BV (x)	5.5	3.4	3.2	3.0	2.7
Dividend yield (%)	*0.5*	*0.6*	*0.6*	*0.6*	*0.7*
Price to income (x)	14.7	14.7	9.2	5.2	2.9

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Naresh Kothari - 22864246	Head, Institutional Equities
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INDIA RESEARCH			SECTOR	INSTITUTIONAL SALES		
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Ashutosh Goel	-	2286 4287	Automobiles, Auto Components	Shabnam Kapur	-	2286 4394
Vishal Goyal, CFA	-	2286 4370	Banking & Finance	Amish Choksi	-	2286 4201
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Sumeet Budhraja	-	2286 4430	FMCG	Monil Bhala	-	2286 4363
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Priyanko Panja	-	2286 4300	Infrastructure, Engineering, Telecom	Nikhil Garg	-	2286 4282
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Parul Inamdar	-	2286 4355	Information Technology	Neha Shahra	-	2286 4276
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Prakash Kapadia	-	4097 9843	Mid Caps	AnubhavKanodia	-	2286 4361
Niraj Mansingka	-	2286 4304	Oil & Gas, Petrochemicals	Tushar Mahajan	-	2286 4439
Nimish Mehta	-	2286 4295	Pharmaceuticals, Agrochemicals	Harsh Biyani	-	2286 4419
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Sunil Jain	-	2286 4308	Alternative & Quantitative	Ankit Doshi	-	2286 4671
Yogesh Radke	-	2286 4328	Alternative & Quantitative	Dipesh Shah	-	2286 4434

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RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	**Reduce**	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	**Sell**	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	**Trading Sell**	Expected to depreciate more than 10% over a 45-day period