

Company Focus

18 June 2009 | 8 pages

Reliance Capital (RLCP.BO)

Target price change
Estimate change

Sell: Life Valuations Not Assured

- **Capital markets have bounced, but so has the stock** — RCap's businesses are highly levered to capital markets, and recent equity performance should result in higher growth/earnings of individual segments. We revise our target price to Rs821 but maintain Sell (3M) as we believe RCap's earnings/operating growth will lag the sharp increase in its stock price (+137% outperformance in last 3 months), thereby making the stock expensive at current levels.
- **...But the business will grow with a lag** — While equity market performance has a strong correlation with RCaps' businesses, we expect growth in most businesses to lag the rebound in broader markets – in particular, we expect relatively moderate growth in life insurance, non-life insurance and consumer finance segments.
- **Implied valuations for life insurance appear to be at a significant premium** — RCap is seeking to sell up to a 26% stake in its life insurance business, including likelihood of inducting a strategic stakeholder. The transaction does not come under current FDI cap (100% owned) but requires other regulatory approvals. However, current stock price implies valuations of 20x 1Yr Fwd NBAP multiples, which is at 30-40% premiums to our benchmark values for peers.
- **Asset management, equity broking likely first to rebound** — RCap's asset management and brokerage segments should be the first to rebound. While AUMs in the domestic business have grown 46% over Dec'08, retail equity inflows so far, have been modest. We expect brokerage revenues to grow but led by institutional segment as retail investors participate with a lag.

Sell/Medium Risk	3M
Price (17 Jun 09)	Rs926.00
Target price	Rs821.00
	<i>from Rs500.00</i>
Expected share price return	-11.3%
Expected dividend yield	0.8%
Expected total return	-10.6%
Market Cap	Rs227,456M
	US\$4,771M

Price Performance (RIC: RLCP.BO, BB: RCFT IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2008A	10,057	40.85	36.4	22.7	3.5	16.9	0.6
2009A	10,145	41.21	0.9	22.5	3.1	14.4	0.7
2010E	10,551	42.86	4.0	21.6	2.7	13.4	0.8
2011E	11,176	45.40	5.9	20.4	2.5	12.8	0.8
2012E	11,725	47.63	4.9	19.4	2.2	12.1	0.8

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	22.7	22.5	21.6	20.4	19.4
P/E reported (x)	22.7	22.5	21.6	20.4	19.4
P/BV (x)	3.5	3.1	2.7	2.5	2.2
P/Adjusted BV diluted (x)	3.5	3.1	2.7	2.5	2.2
Dividend yield (%)	0.6	0.7	0.8	0.8	0.8
Per Share Data (Rs)					
EPS adjusted	40.85	41.21	42.86	45.40	47.63
EPS reported	40.85	41.21	42.86	45.40	47.63
BVPS	268.35	302.12	336.96	374.33	413.35
Tangible BVPS	268.35	302.12	336.96	374.33	413.35
Adjusted BVPS diluted	268.35	302.12	336.96	374.33	413.35
DPS	5.49	6.50	7.00	7.00	7.50
Profit & Loss (RsM)					
Net interest income	5,050	1,781	6,368	7,327	8,530
Fees and commissions	5,672	8,272	11,710	13,846	17,504
Other operating Income	34,331	36,932	33,506	39,123	45,817
Total operating income	45,053	46,985	51,585	60,295	71,852
Total operating expenses	-32,732	-33,634	-37,095	-45,229	-55,944
Oper. profit bef. provisions	12,321	13,351	14,490	15,066	15,907
Bad debt provisions	-163	-1,314	-1,287	-1,082	-1,237
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	12,158	12,038	13,203	13,985	14,670
Tax	-2,089	-1,881	-2,641	-2,797	-2,934
Extraord./Min. Int./Pref. Div.	-12	-12	-12	-12	-12
Attributable profit	10,057	10,145	10,551	11,176	11,725
Adjusted earnings	10,057	10,145	10,551	11,176	11,725
Growth Rates (%)					
EPS adjusted	36.4	0.9	4.0	5.9	4.9
Oper. profit bef. prov.	51.8	8.4	8.5	4.0	5.6
Balance Sheet (RsM)					
Total assets	184,202	213,001	256,375	293,855	346,155
Avg interest earning assets	121,083	186,485	218,741	255,409	296,400
Customer loans	102,803	105,800	123,160	134,966	156,555
Gross NPLs	0	0	0	0	0
Liab. & shar. funds	184,202	213,001	256,375	293,855	346,155
Total customer deposits	0	0	0	0	0
Reserve for loan losses	0	0	0	0	0
Shareholders' equity	66,057	74,370	82,945	92,145	101,751
Profitability/Solvency Ratios (%)					
ROE adjusted	16.9	14.4	13.4	12.8	12.1
Net interest margin	4.17	0.96	2.91	2.87	2.88
Cost/income ratio	72.7	71.6	71.9	75.0	77.9
Cash cost/average assets	25.3	16.9	15.8	16.4	17.5
NPLs/customer loans	0.0	0.0	0.0	0.0	0.0
Reserve for loan losses/NPLs	na	na	na	na	na
Bad debt prov./avg. cust. loans	0.2	1.3	1.1	0.8	0.8
Loans/deposit ratio	na	na	na	na	na
Tier 1 capital ratio	na	na	na	na	na
Total capital ratio	na	na	na	na	na

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Valuations

We revise our sum-of-parts based target price for Reliance Capital to Rs821 (from Rs500) factoring in higher target multiples across segments and in some cases higher growth rates (especially asset management, brokerage). Reliance Capital's businesses are highly levered to strong performance of equity markets and impact both growth rates and target multiples. We are currently attributing median valuations for its business (in-line with peers) rather than peak/trough valuations. We have also estimated unrealized gains on its listed equity portfolio at 25% of the cost of investments (Rs19bn) and value it at Rs19 per share.

There could be upside risks to our target price if the equity market outlook improves sharply (largely premised on higher market multiples) and vice versa.

Figure 1. Reliance Capital: Sum-of-Parts Valuations Summary

Segment	Earlier	Now, Rs per share	Value, Rsm	Remarks
AMC	124	237	58,286	5% of AUMs
Life Insurance	294	417	102,528	14x 1yr Fwd NBAP
General Insurance	21	4	894	10x 1 yr FWD Economic Profits
Broking	22	53	13,000	15x 1yr Fwd EPS
Consumer Finance	42	92	22,557	1.25x 1yr Fwd BV
Investments	-	19	4,750	Estimated gains @25% of investment cost
Total	503	821	169,200	

Source: Citi Investment Research and Analysis

We revise earnings downwards by 5-6% over FY10-11E largely due to lower estimated capital gains on the investment portfolio, partly offset by higher fee incomes on the asset management and brokerage segments.

Figure 2. Reliance Capital: Earnings Revision Summary

	Net Profit			EPS			DPS	
	Old	New	% change	Old	New	% change	Old	New
FY10E	11,123	10,551	(5.1)	45.2	42.9	(5.1)	7.5	7.0
FY11E	11,871	11,176	(5.9)	48.2	45.4	(5.9)	8.5	7.0
FY12E	NA	11,725	NA	NA	47.6	NA	NA	7.5

Source: Citi Investment Research and Analysis

Reliance Capital

Company description

Reliance Capital is India's largest, diversified retail financial services company with a presence in asset management, life insurance, non-life insurance, brokerage, consumer finance and distressed assets. It is part of the Anil Dhirubhai Ambani (ADA) group, which holds a 53% stake in the company. RCap has leveraged its strong brand and large capital base, and has aggressively built a large distribution network in the country. RCap is among the market leaders in all its business segments.

Investment strategy

We rate Reliance Capital Sell/Medium Risk. RCap's key strengths are: a) a presence in under-penetrated, secular growth businesses; b) strong business growth led by supportive capital markets; c) market leadership in most segments, driven by its large distribution network, product focus and strong and aggressive management. However, almost all its businesses and earnings are inherently linked to capital markets. RCap is also significantly exposed to slower economic growth, higher interest rates and weaker asset quality, which could pressure growth and expected returns. Moreover, we believe its profitability will be under pressure medium term due a likely higher cost distribution build-out and increasing competitive intensity.

While parts of RCap's businesses are likely to grow significantly (especially asset management, broking) in the current environment and profitability is showing signs of stabilization, we expect its insurance and consumer finance segments to continue on a moderate growth path. Moreover, we believe the sharp rise in the stock price more than adequately captures the improvement in the business environment.

Valuation

We have a target price for Reliance Capital of Rs821. We use a sum-of-the-parts methodology to value RCap as it is present in diverse businesses, and each of these businesses is valued based on a different methodology. As many of its businesses are still growing or are not consolidated, we believe P/E or P/BV approaches are not properly reflective of value. We value the AMC business at Rs237 per share (5.0% of AUMs); the life insurance business at Rs417 per share (14x 1-year forward NBAP; at par with peers); the non-life insurance business at Rs4 per share (10x 1-year forward economic profits, in line with peers); the retail broking business at Rs53 per share (15x 1-year forward earnings, in line with peers and a 10-15% discount to the Sensex), and the consumer finance business at Rs92 per share (1.25x 1-year forward book value, in line with peers). We also estimate unrealized gains at 25% of the costs of its listed equity investments to factor in the sharp rise in equity markets.

Risks

We rate Reliance Capital as Medium Risk even though a Speculative Risk rating is suggested by our quantitative risk model, which tracks 260-day historical share price volatility. We believe a Medium Risk rating is appropriate as RCap's businesses, though related to capital markets, are significantly diverse in nature. Key upside risks to our valuations and target price include: a) sustained buoyancy in capital markets; b) an easy liquidity environment or a reduction in interest rates; b) a reversal in the asset quality environment; d) higher than anticipated growth and market share gains in different businesses; and e) early execution of growth plans.

Appendix A-1

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Analyst: Manish Chowdhary, CFA
Covered since September 3 2008

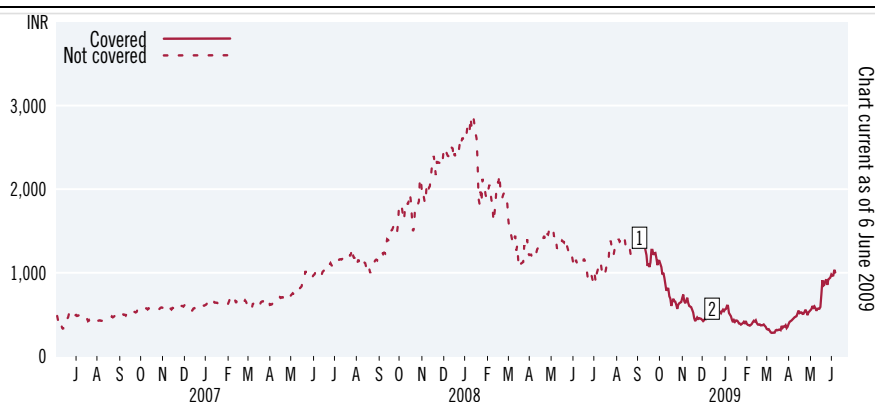


Chart current as of 6 June 2009

	Date	Rating	Target Price	Closing Price
[1]	3-Sep-08	*3M	*1,250.00	1,418.90

	Date	Rating	Target Price	Closing Price
[2]	15-Dec-08	3M	*500.00	546.10

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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