

RELIANCE CAPITAL

Life insurance stake sale value accretive

Reliance Capital (RCap) has announced the much awaited stake sale in its life insurance business. It will sell 26% stake in Reliance Life (held directly and indirectly by the company) to Nippon Life for USD 680 mn, pegging the value of its life insurance venture at USD 2.6 bn (INR 468/share) - against our valuation estimate for this business at USD 1.4 bn. (INR 260/share) Technically, RCap directly holds only 16% in Reliance Life; the balance is held by its associate companies Viscount Management and Viscount Management (Alpha). Management indicated that significant chunk of stake sale will be secondary and only a marginal proportion will be primary.

■ What's there in it for Reliance Capital?

RCap has not been booking any investment gains since the past few quarters in expectation of stake sale in key operating businesses. Earnings, going forward, besides better traction in operating businesses, will be further buoyed by investment gains. The proceeds of the deal will be utilised to scale up other operating businesses, primarily consumer financing and distribution business. In the near term, capital requirement of Reliance Life will be met by stake sale proceeds and infusion by RCap into the life insurance business will be limited. Management indicated that life insurance business may require ~INR 1.3 bn capital infusion over Q4FY11-FY12.

■ Other details of the deal

1) Nippon Life will hold proportionate directorship. 2) The deal is subject to approval: (a) IRDA, (b) RBI, (c) Nippon to get approval from Japanese regulator and (d) IRDA to get assurance on good health of Nippon Life from the Japanese regulator. 3) The deal will be finalised and executed in next three-six months. 4) The deal structure and price of future stake sale will be discussed in good faith.

■ Outlook and valuations: Positive; maintain 'BUY'

The stake sale that Reliance Life announced is pegged at valuation of INR 468/share much higher than our expectation of INR 260/share. The deal implies price/EV of 3.8x against 2.1x assigned by us. We believe the deal is directionally positive as management has been guiding for stake sale since long and will also shore up capital base to scale up growth for other businesses. The deal will also be sentimentally positive for other leading life insurance companies (indirectly for ICICI Bank, SBI, Kotak, HDFC under our coverage). We had recently upgraded our recommendation on the stock to 'BUY' (refer our note *Core business generating traction*, dated Feb 14, 2011) post which the stock has outperformed the Bankex 27%. We view this deal to be value accretive and maintain 'BUY/Sector Performer' recommendation/rating on the stock.

March 14, 2011

Reuters: RLCP.BO Bloomberg: RCAPT IN

EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Performer
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Equalweight

Note:
Please refer last page of the report for rating explanation

MARKET DATA

CMP	:	INR 562
52-week range (INR)	:	882 / 388
Share in issue (mn)	:	245.6
M cap (INR bn/USD mn)	:	138 / 3,062
Avg. Daily Vol. BSE/NSE ('000):	:	2,207.7

SHARE HOLDING PATTERN (%)

Promoters*	:	54.1
MFs, FIs & Banks	:	4.9
FIIIs	:	20.7
Others	:	20.2
* Promoters pledged shares (% of share in issue)	:	NIL

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Banks and Financial Services Index
1 month	19.5	2.6	2.3
3 months	(22.3)	(7.0)	(6.5)
12 months	(35.5)	6.1	17.0

Financials

Year to March	FY09	FY10	FY11E	FY12E
Net revenues (INR mn)	47,558	44,790	42,023	48,601
Net rev growth (%)	5.6	(5.8)	(6.2)	15.7
Net profit (INR mn)	10,157	4,238	4,505	7,747
Shares outstanding (mn)	246	246	246	246
EPS (INR)	41.3	17.2	18.3	31.5
EPS growth (%)	0.7	(58.3)	6.3	71.9
PE (x)	8.2	19.7	18.6	9.6
Price to book (x)	1.1	1.1	1.1	0.9

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- **Guidance on Reliance Life**

Management maintained that life insurance premium mobilisation continued to contract through February but picked up in March. Further, the company maintained its traditional and ULIP mix at 50:50 which helped it maintain NBAP margins. Management expects to grow life insurance business at 15% in FY12E.

- **About Nippon Life**

Nippon Life is sixth largest insurer (a global Fortune 100 Company) in the world with revenues of USD 72bn and profits of USD 2.6bn. The company has sold over 14mn policies in Japan and offers a wide range of products including individual, group and annuity policies through various distribution channels and mainly uses a face to face sales channel for its traditional insurance products.

■ Company Description

Reliance Capital (RCap) has been actively pursuing growth opportunities in the Indian financial services sector, post the demerger and reorganisation of the Reliance Group, to become a leading financial powerhouse. It has undergone significant strategy changes in the past one to two year, with focus shifting to fast-growing segments in the financial services space, viz., asset management and insurance business, from leasing and infrastructure financing. RCFT is the leader in its existing businesses—the largest mutual fund (in terms of AUMs of INR 1.02 tn), and the third-largest general insurer (in terms of gross written premium of INR 20 bn in FY10). The company has also forayed into retail broking under the brand Reliance Money (acquired ~7 mn broking accounts) and retail financing under Reliance Consumer Finance (outstanding loan book of INR 107 as on December 31, 2010). It also commenced operations in asset reconstruction and institutional broking business.

■ Investment Theme

We expect RCFT to become a 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 fast-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 and broking. Our confidence in RCFT is underpinned by ADAG's execution capabilities, competitive skills, and its ability to create new markets.

■ Key Risks

Execution failure is the key business risk.

We have assigned 100% value to its life insurance and broking business in our valuation estimates based on our discussions with the management. Though RCFT has 100% economic interest, technically it holds only 16% in Reliance Life.

Growth in asset management, life insurance, and broking businesses is highly dependent on the conditions in capital markets. Sustained non-conducive market conditions may hamper our growth assumptions and consequently impact valuations negatively.

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

Financial Statements

Income statement

(INR mn)

Year to March	FY09	FY10	FY11E	FY12E	FY13E
Interest income	12,003	12,868	13,857	17,280	22,612
Interest expended	12,638	12,818	13,942	16,666	20,506
Net interest income	(635)	50	(86)	614	2,106
Non interest income	48,193	44,740	42,109	47,987	53,529
- Misc. income	21,611	15,208	14,343	17,342	20,317
- Investment advisory fee	4,739	6,467	7,238	8,078	9,209
- General insurance premium earned	20,035	20,479	18,229	20,018	21,152
- Reliance Money	1,808	2,586	2,299	2,549	2,851
Net revenues	47,558	44,790	42,023	48,601	55,634
Operating expense	34,208	35,751	33,615	35,984	38,119
- Employee exp	5,541	5,592	5,605	6,117	6,792
- Depreciation /amortisation	566	486	470	468	469
- Other opex	28,101	29,673	27,540	29,400	30,857
Preprovision profit	13,350	9,039	8,408	12,617	17,515
Provisions	1,308	2,759	1,402	1,355	1,635
Profit before tax	12,041	6,280	7,006	11,262	15,880
Provision for tax	1,811	1,977	2,436	3,450	4,616
Profit After Tax	10,230	4,303	4,570	7,812	11,264
Share in profit of associates	73	65	65	65	65
Profit after minority interest	10,157	4,238	4,505	7,747	11,199
Basic shares outstanding (mn)	246	246	246	246	246
Basic EPS (INR)	41.3	17.2	18.3	31.5	45.5
Diluted equity shares (mn)	246	246	246	246	246
Diluted EPS (INR)	41.3	17.2	18.3	31.5	45.5
Dividend per share (INR)	6.5	6.5	7.0	7.0	7.0
Dividend payout (%)	18.4	44.2	44.7	26.0	18.0

Growth ratios (%)

Year to March	FY09	FY10	FY11E	FY12E	FY13E
Revenues	5.6	(5.8)	(6.2)	15.7	14.5
Opex growth	4.6	4.5	(6.0)	7.0	5.9
PPP growth	8.0	(32.3)	(7.0)	50.0	38.8
Provisions growth	676.0	110.9	(49.2)	(3.4)	20.7
Net profit	0.7	(58.3)	6.3	71.9	44.6

Balance sheet**(INR mn)**

As on 31st March	FY09	FY10	FY11E	FY12E	FY13E
Equity capital	2,462	2,462	2,462	2,462	2,462
Reserves & surplus	71,870	74,225	76,705	82,426	91,599
Net worth	74,331	76,687	79,166	84,887	94,060
Secured loans	38,120	51,500	61,500	86,500	121,500
Unsecured loans	62,678	80,016	90,016	98,016	107,016
Deferred tax liability	201	201	201	201	201
Others	140	215	290	365	440
Total liabilities	175,470	208,619	231,174	269,970	323,218
Loans	118,051	124,283	142,399	176,521	221,442
Investments	52,865	85,209	97,795	99,543	101,915
Total current assets	26,646	24,286	19,672	26,808	37,768
Total current liabilities & provisions	23,394	26,274	29,742	33,892	38,846
Net current assets	3,251	(1,988)	(10,070)	(7,084)	(1,079)
Fixed assets	1,169	981	916	856	806
Other Assets	133	133	133	133	133
Total assets	175,470	208,619	231,174	269,970	323,218
Book value per share (INR)	302.3	311.8	321.9	345.2	382.5

Valuation parameters

Year to March	FY09	FY10	FY11E	FY12E	FY13E
Diluted EPS (INR)	41.3	17.2	18.3	31.5	45.5
Y-o-Y growth (%)	0.7	(58.3)	6.3	71.9	44.6
Diluted PE (x)	13.6	32.6	30.7	17.8	12.3
Price/BV (x)	1.9	1.8	1.7	1.6	1.5
Dividend yield (%)	1.2	1.2	1.2	1.2	1.2
Adjustment to price	222	222	222	260	-

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Allahabad Bank	BUY	SO	H	Axis Bank	BUY	SO	M
Bank of Baroda	BUY	SO	L	Federal Bank	BUY	SO	M
HDFC	HOLD	SU	L	HDFC Bank	HOLD	SP	L
ICICI Bank	BUY	SO	L	Indian Overseas Bank	HOLD	SU	H
Infrastructure Development Finance Co Ltd	HOLD	SU	M	ING Vysya	HOLD	SP	H
Karnataka Bank	BUY	SO	L	Kotak Mahindra Bank	BUY	SP	L
LIC Housing Finance	BUY	SP	M	Manappuram General Finance	HOLD	SU	M
Oriental Bank Of Commerce	BUY	SU	H	Power Finance Corp	BUY	SO	L
Punjab National Bank	BUY	SO	L	Reliance Capital	HOLD	SP	M
Rural Electrification Corporation	BUY	SO	L	Shriram City Union Finance	BUY	SO	H
South Indian Bank	BUY	SO	H	SREI Infrastructure Finance	UNDER REVIEW	SO	L
State Bank of India	HOLD	SU	L	Syndicate Bank	BUY	SP	H
Union Bank Of India	BUY	SP	L	Yes Bank	BUY	SO	M

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

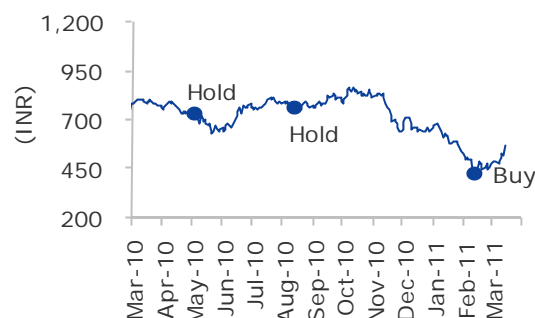
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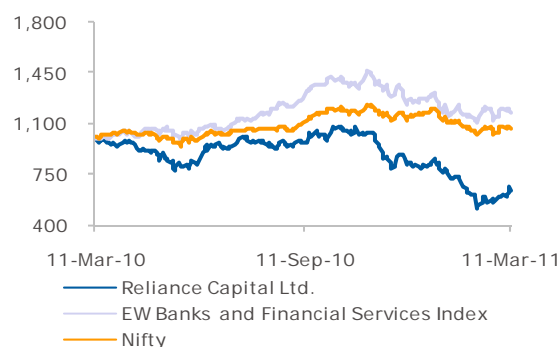
Coverage group(s) of stocks by primary analyst(s): Banking and Financial Services

Allahabad Bank, Axis Bank, Bank of Baroda, Federal Bank, HDFC, HDFC Bank, ICICI Bank, Infrastructure Development Finance Co Ltd, Indian Overseas Bank, Karnataka Bank, Kotak Mahindra Bank, LIC Housing Finance, Manappuram General Finance, Oriental Bank Of Commerce, Punjab National Bank, Power Finance Corp, Reliance Capital, Rural Electrification Corporation, State Bank of India, Shriram City Union Finance, South Indian Bank, Syndicate Bank, SREI Infrastructure Finance, Union Bank Of India, ING Vysya, Yes Bank

Reliance Capital



EW Indices



Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	116	45	12	176
* 3 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	110	53	13	

Recent Research

Date	Company	Title	Price (INR) Recos
09-Mar-11	Banking	Credit momentum intact; LDR easing albeit at a slower pace; <i>Sector Update</i>	
08-Mar-11	Banking	Banks recapitalisation: strengthening the base; <i>Sector Update</i>	

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