

Equities

16 August 2011 | 11 pages

Reliance Capital (RLCP.BO)

Disappointing Quarter – Operational Headwinds Remain

- **1QFY12 profits down 55%, well below estimates** — RCap's 1Q12 profits were well below our estimates as its core business segments continued to face challenges: a) Market share in the asset management segment fell sharply (though still remains market leader with 13.6% share); b) Life insurance new premiums declined a sharp 57% yoy (vs. -27% for private peers); c) Non-life insurance continues with high combined ratios (130%). While there is robust growth and improving quality in the consumer finance segment, outlook remains challenging as macro headwinds strong.
- **Asset management: Market share loss, stagnant AUMs** — RCap's market share fell to 13.6% in 1Q12 (from 14.5% in 4Q11). While it still remains the industry leader – competition remains high, inflows sluggish and near-term recovery prospects weak.
- **Life insurance: New premiums down 57% yoy** — Indian life insurance industry is still struggling with (regulatory driven) changes in product mix and profitability. RCap has however been hit harder than its private peers with a 59% yoy decline in APE. Profitability is also under pressure, management expects NBAP margins to stabilize ~15% for FY12, down from 16.7% in FY11. There is a positive too – management expects regulatory clearance for its 26% stake sale to Nippon Life in next 2-3 months.
- **Consumer Finance: Growing, but watch the macro** — RCap's loan growth has been strong (+42% yoy), asset book is predominantly collateralized now (98% of book) and profitability has stabilized (NIMs at 4.3%). Recent growth has been driven more by mortgages – 44% of book now. Asset quality has also continued to improve (NPLs at 1.2%, coverage 82%). However, overall macro remains challenging, and its own high SME exposure (32% of loans) could indicate some pressure ahead.
- **Fundamentally sluggish, but near-term bounce possible**— Stock has corrected significantly (down 16% vs. Sensex in last 3months) and valuations seem reasonable (should also be supported by the likely completion of stake sale in life insurance). However, fundamentally we believe the business outlook remains challenging near term and would wait for signs of a turnaround before getting more constructive.

■ Company Update

Sell/Medium Risk	3M
Price (16 Aug 11)	Rs411.25
Target price	Rs555.00
Expected share price return	35.0%
Expected dividend yield	1.6%
Expected total return	36.5%
Market Cap	Rs101,016M US\$2,228M

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



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2010A	4,345	17.65	-57.2	23.3	1.3	5.7	1.6
2011A	2,912	11.83	-33.0	34.8	1.3	3.8	1.6
2012E	5,108	20.75	75.4	19.8	1.2	6.4	1.6
2013E	6,074	24.68	18.9	16.7	1.2	7.3	1.6
2014E	7,025	28.54	15.6	14.4	1.1	8.0	1.6

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Fiscal year end 31-Mar	2010	2011	2012E	2013E	2014E
Valuation Ratios					
P/E adjusted (x)	23.3	34.8	19.8	16.7	14.4
P/E reported (x)	23.3	34.8	19.8	16.7	14.4
P/BV (x)	1.3	1.3	1.2	1.2	1.1
P/Adjusted BV diluted (x)	1.3	1.3	1.2	1.2	1.1
Dividend yield (%)	1.6	1.6	1.6	1.6	1.6
Per Share Data (Rs)					
EPS adjusted	17.65	11.83	20.75	24.68	28.54
EPS reported	17.65	11.83	20.75	24.68	28.54
BVPS	312.97	317.19	330.33	347.41	368.34
Tangible BVPS	312.97	317.19	330.33	347.41	368.34
Adjusted BVPS diluted	312.97	317.19	330.33	347.41	368.34
DPS	6.50	6.50	6.50	6.50	6.50
Profit & Loss (RsM)					
Net interest income	5,834	4,435	7,534	8,881	11,110
Fees and commissions	8,734	10,414	11,877	13,379	15,441
Other operating Income	33,514	25,515	25,561	29,214	33,881
Total operating income	48,082	40,364	44,971	51,475	60,432
Total operating expenses	-39,160	-36,151	-37,301	-42,354	-49,720
Oper. profit bef. provisions	8,922	4,214	7,670	9,121	10,712
Bad debt provisions	-3,039	-1,302	-1,228	-1,470	-1,873
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	5,883	2,912	6,442	7,651	8,839
Tax	-1,492	-579	-1,288	-1,530	-1,768
Extraord./Min. Int./Pref. Div.	-46	579	-46	-46	-46
Attributable profit	4,345	2,912	5,108	6,074	7,025
Adjusted earnings	4,345	2,912	5,108	6,074	7,025
Growth Rates (%)					
EPS adjusted	-57.2	-33.0	75.4	18.9	15.6
Oper. profit bef. prov.	-33.2	-52.8	82.0	18.9	17.4
Balance Sheet (RsM)					
Total assets	261,190	309,550	358,818	431,971	537,918
Avg interest earning assets	238,716	270,539	316,427	374,131	459,478
Customer loans	125,639	147,792	165,702	201,324	262,345
Gross NPLs	0	0	0	0	0
Liab. & shar. funds	261,190	309,550	358,818	431,971	537,918
Total customer deposits	0	0	0	0	0
Reserve for loan losses	0	0	0	0	0
Shareholders' equity	77,040	78,080	81,315	85,517	90,670
Profitability/Solvency Ratios (%)					
ROE adjusted	5.7	3.8	6.4	7.3	8.0
Net interest margin	2.44	1.64	2.38	2.37	2.42
Cost/income ratio	81.4	89.6	82.9	82.3	82.3
Cash cost/average assets	15.6	12.7	11.2	10.7	10.3
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	2.5	1.0	0.8	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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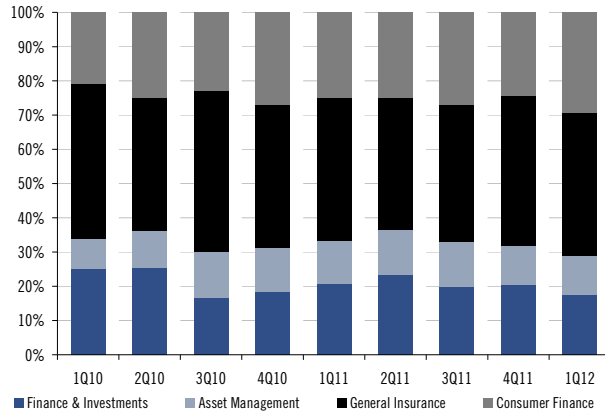


Figure 1. Reliance Capital: 1Q12 Financial Highlights (Rupees Million, Percent)

	1Q12	1Q11	YoY %	4Q11	QoQ%	CIRA Comments
Income from Operations	14,678	11,782	24.6	16,756	-12.4	Decline across core businesses - broking, asset management, insurance all facing challenges - some off set from healthy growth in consumer finance
Other Income	243	886	-72.6	(1,127)	NM	
Gross Total Income	14,921	12,669	17.8	15,629	-4.5	
Interest expense	(5,130)	(2,944)	74.3	(4,272)	20.1	High interest rates remain a key drag with average cost of borrowing at 10.3%
Total Income	9,791	9,725	0.7	11,357	-13.8	
Operating Expenses	(9,166)	(8,748)	4.8	(12,204)	-24.9	Relatively flat as business focus is on leaner cost structures
Pre-Tax Profit	625	977	-36.1	(848)	NM	
Tax	(256)	(200)	27.8	284	NM	
Minorities	(32)	(10)	212.6	35	NM	
Extraordinary Items	12	3	257.6	630	-98.1	
Net Profit	348	770	-54.7	101	243.8	Meaningful profitability contraction as challenges continue to weigh on growth and earning potential
EPS	1.4	3.1	-54.8	0.4	243.1	
Segmental Revenues (Rsm)						
	1Q12	1Q11	YoY %	4Q11	QoQ%	
Finance & Investments	2,517	2,544	-1.1	3,150	-20.1	
Asset Management	1,572	1,499	4.8	1,780	-11.7	Outlook remains weak as inflows are sluggish and competition high
General Insurance	5,924	5,092	16.3	6,784	-12.7	
Consumer Finance	4,178	3,034	37.7	3,757	11.2	A key highlight amongst the various business for RCap, though no securitization this quarter
Others	785	500	56.9	815	-3.7	
Total	14,975	12,669	18.2	16,285	-8.0	
Segmental Rev. Split (%)						
	1Q12	1Q11	YoY %	4Q11	QoQ%	
Finance & Investments	17%	20%	-3	19%	-3	
Asset Management	10%	12%	-1	11%	0	Has lost substantial market share
General Insurance	40%	40%	-1	42%	-2	
Consumer Finance	28%	24%	4	23%	5	
Others	5%	4%	1	5%	0	
PBT (Rsm)						
	1Q12	1Q11	YoY %	4Q11	QoQ%	
Finance & Investments	(238)	657	NM	338	NM	
Asset Management	526	435	21	475	11	
General Insurance	(301)	(386)	-22	(2,188)	-86	
Consumer Finance	583	363	61	927	-37	Strong growth and healthy asset quality key positives
Others	57	(91)	NM	(446)	NM	
Total	627	978	-36	(893)	NM	
PBT (%)						
	1Q12	1Q11	YoY %	4Q11	QoQ%	
Finance & Investments	-38%	67%	-105	-38%	0	
Asset Management	84%	44%	39	-53%	137	
General Insurance	-48%	-39%	-9	245%	-293	Continues to face strong regulatory headwinds
Consumer Finance	93%	37%	56	-104%	197	Profits have been driven by the consumer finance business
Others	9%	-9%	18	50%	-41	

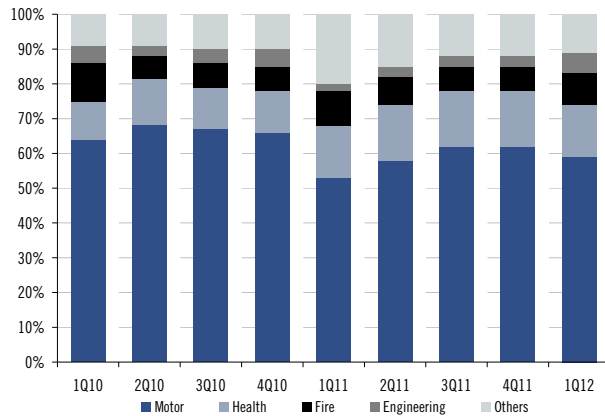
Source: Citi Investment Research and Analysis, Company

Figure 2. Segmental Composition of Revenue (%)



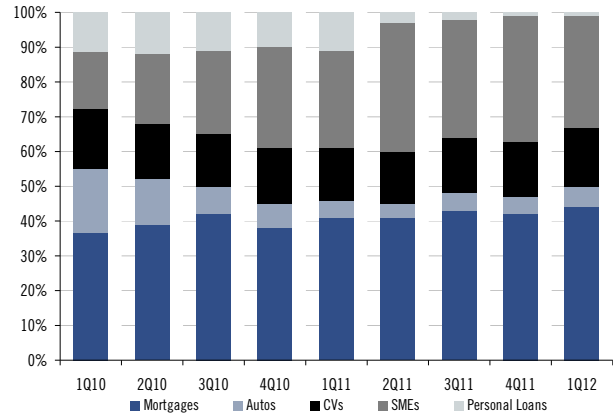
Source: Company Reports

Figure 4. Non Life Insurance: Segmental Contribution to Premium



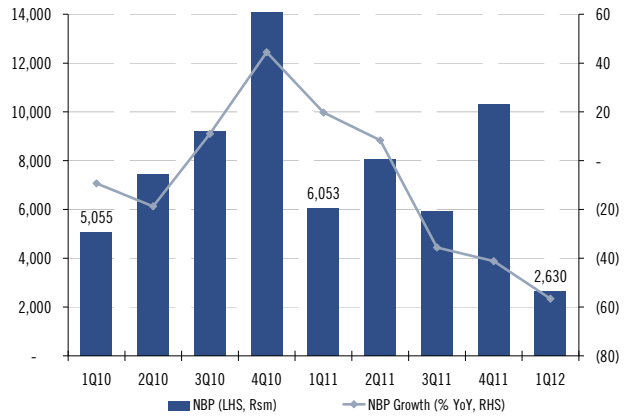
Source: Company Reports

Figure 3. Consumer Finance: Segmental Loans Outstanding



Source: Company Reports

Figure 5. Life Insurance: New Business Premium (Rsm) and Growth (%)



Source: Company Reports

Figure 6. Reliance Capital – Profile of Individual Businesses

Asset Management	1Q12	1Q11	YoY %	4Q11	QoQ%
AUM (Rsb)	1,013	1,013	0	1,016	0
-Equity (Rsb)	NA	365	NM	335	NM
-Debt (Rsb)	NA	648	NM	681	NM
Market Share (%)	13.6%	15.0%	-9	0	-9
PMS - AUM (Rsb)	NA	389	NM	444	NM
Offshore Fund (Rsb)	NA	9	NM	0	NM
Total AUM (Rsb)	1,013	1,411	-28	1,460	-31
General Insurance	1Q12	1Q11	YoY %	4Q11	QoQ%
Gross Written Premium (Rsm)	5,250	4,293	22	4,373	20
Branches	181	200	-10	200	-10
No. of Policies Issued	685,383	730,350	-6	484,223	42
Life Insurance	1Q12	1Q11	YoY %	4Q11	QoQ%
NBP (Rsm)	2,630	6,053	-57	10,297	-74
-First Year Premium (Rsm)	2,317	5,630	-59	6,748	-66
-Single Premium (Rsm)	313	422	-26	3,549	-91
Renewal Premium (Rsm)	8,161	5,956	37	13,045	-37
Total Premium (Rsm)	10,749	12,009	-10	23,342	-54
Funds under mgmt. (Rsm)	177,353	140,920	26	178,553	-1
APE (Rsm)	2,348	5,672	-59	7,103	-67
Agents	177,747	199,711	-11	189,304	-6
Branches	1,252	1,247	0	1,248	0
Reliance Money	1Q12	1Q11	YoY %	4Q11	QoQ%
Outlets	6,600	5,000	32	6,200	6
Broking A/Cs	666,997	642,000	4	663,868	0
Daily Avg Volume (Rsm)	12,000	23,000	-48	14,000	-14
Consumer Finance	1Q12	1Q11	YoY %	4Q11	QoQ%
Loan Portfolio (Rsm)					
-Mortgages	57,332	37,597	52	51,660	11
-Autos	7,818	4,585	71	6,150	27
-CVs	22,151	13,755	61	19,680	13
-SMEs	41,696	25,676	62	44,280	-6
-Personal Loans	1,303	10,087	-87	1,230	6
Total	130,300	91,700	42	123,000	6
Gross NPLs (Rsm)	1,500	2,727	-45	1,600	-6
NPL Ratio (%)	1.2%	3.0%	-182	1.3%	-12

Source: Citi Investment Research and Analysis, Company

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 54% 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 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, a large part of 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 in the medium term due to high competitiveness, industry fragmentation and regulatory challenges. While parts of RCap's businesses are likely to grow at a healthy pace (especially consumer finance) in this environment and profitability is showing signs of stabilization, we expect its insurance and asset management segments to continue on a moderate growth path. Moreover, we believe a rise in overall business momentum likely to be another couple of quarters away.

Valuation

Our Rs555 target price for Reliance Capital is based on a sum-of-the-parts methodology 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 Rs171 per share (4.0% of AUMs); the life insurance business at Rs190 per share (12x 1-year forward NBAP; at par with peers); the non-life insurance business at Rs23 per share (1x 1-year forward P/BV, in line with peers); the retail broking business at Rs18 per share (12x 1-year forward earnings, lower than peers due to lower its profitability and transitioning business model) and the consumer finance business at Rs101 per share (1.25x 1-year forward book value, in line with peers). We also value the surplus capital at book value to get Rs53 per share.

Risks

We rate Reliance Capital Medium Risk even though our quantitative risk model, which tracks 260-day historical share price volatility, suggests a Low Risk rating. We believe a Medium Risk rating is appropriate as RCap's businesses are strongly correlated to capital markets and can be inherently volatile 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; c) continued benign asset quality environment; d) higher-than-anticipated growth and market share gains in different businesses; and e) possible acquisition of a banking license.

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Reliance Capital (RLCP.BO) Ratings and Target Price History Fundamental Research

Analyst: Manish Chowdhary, CFA
Covered since September 3 2008

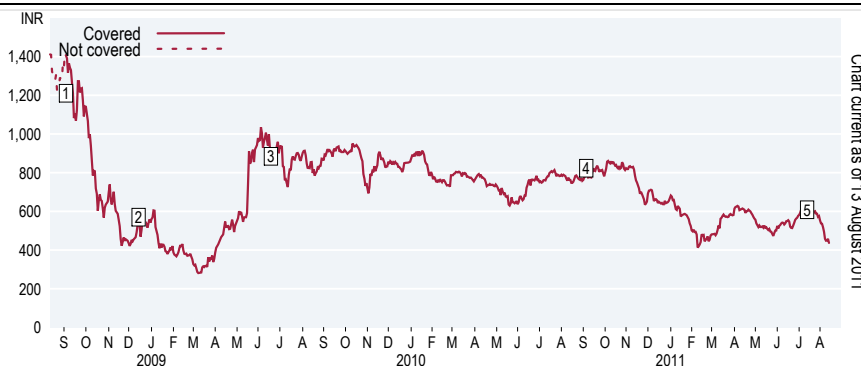


Chart current as of 13 August 2011

	Date	Rating	Target Price	Closing Price
1	3-Sep-08	*3M	*1,250.00	1,418.90
2	15-Dec-08	3M	*500.00	546.10

	Date	Rating	Target Price	Closing Price
3	18-Jun-09	3M	*821.00	884.50
4	5-Sep-10	3M	*788.00	783.00

	Date	Rating	Target Price	Closing Price
5	13-Jul-11	3M	*555.00	590.45

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Reliance Capital (RLCP.BO) Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Manish Chowdhary, CFA
Covered since September 3 2008

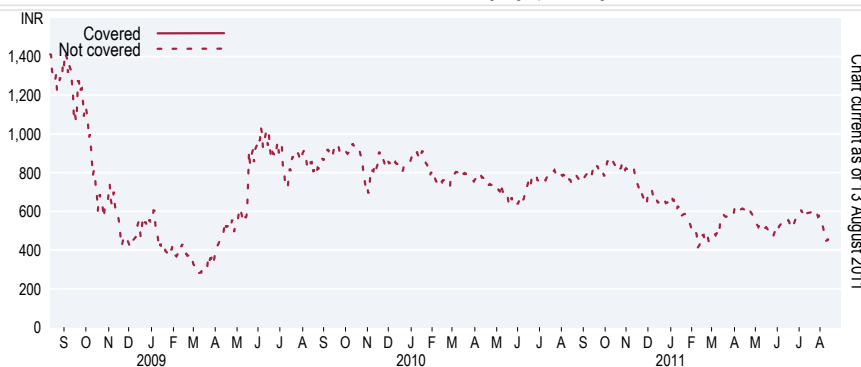


Chart current as of 13 August 2011

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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<i>Data current as of 30 Jun 2011</i>	12 Month Rating			Relative Rating		
	Buy	Hold	Sell	Buy	Hold	Sell
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To satisfy regulatory requirements, we correspond Under Review to Hold in our ratings distribution table for our 12-month fundamental rating system. However, we reiterate that we do not consider Under Review to be a recommendation.

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