

Our view

RLife lost market share in new premium sales again in August, marking the second consecutive month of market-share loss. Overall private-sector growth remains reasonably robust, though growth this month was concentrated among just three players. REDUCE call maintained; PT unchanged at Rs834.

Anchor themes

- ⚓ We believe the insurance industry is in the midst of a mid-term slowdown, and expect sales will continue to be weak over the next two years.
- ⚓ An immediate consequence of the slowdown in sales would be downward revisions of profitability estimates, since companies may be unable to realise the cost efficiencies accounted for in the past. We also expect companies to revise their product structures as they take on more investment and lapsation risks to make products more attractive to customers.

August sales: weak performance

- RLife loses market share for second consecutive month
- For the overall private sector, some slowdown in growth compared with July but still better than 1Q FY10
- Overall private-sector growth masks sharp divergence among players
- Increase in ticket size seen across players
- Maintain REDUCE on RCFT

① RLife loses market share for second consecutive month

RLife's market share in individual non-single new premium sales declined for a second consecutive month. It was 8.9% in August, down from 10.3% in July and 11% in FY09.

② For the overall private sector, some slowdown in growth compared with July but still better than 1Q FY10

Overall private sector growth (y-y) in individual non-single new premium sales in August came in at (-) 4.1%, taking the cumulative growth rate in the year to August to (-) 14.6%. We note there is a significant base effect in play this year, as there was a structural decrease in growth rates in 2H FY09. Hence, we would advise investors not to focus too much on the negative y-y growth seen so far this year.

We would rather look at our de-seasonalised analysis of growth. On this measure, we believe that the August sales data is pointing to full-year growth of around 21% in FY10F. This represents a decline from the data for the preceding month, which was tracking a full-year growth rate of 24%. However, it is clearly higher than the trend seen in 1Q FY10, which was hinting at full-year growth of 10-13%.

Closing price on 1 Oct	Rs912
Price target	Rs834
	(unchanged)
Upside/downside	-8.6%
Difference from consensus	15.0%
FY10F net profit (Rsmn)	4,508
Difference from consensus	na
Source: Nomura	

Nomura vs consensus

We factor in a sharply lower margin in life insurance, as we do not think the company will be able to realise the cost efficiencies built into product pricing.

Key financials & valuations

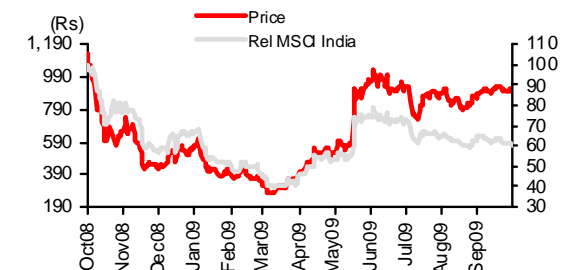
31 Mar (Rsmn)	FY08	FY09	FY10F	FY11F
Operating profit	12,158	10,894	5,304	6,934
Reported net profit	10,091	9,104	4,508	5,894
Normalised net profit	10,091	9,104	4,508	5,894
Normalised EPS (Rs)	40.99	36.98	18.31	23.94
Norm. EPS growth (%)	43.5	(9.8)	(50.5)	30.7
Norm. P/E (x)	22.3	24.7	49.8	38.1
BV/share (Rs)	269	303	319	339
Price/book (x)	3.40	3.01	2.86	2.69
Dividend yield (%)	0.0	0.0	0.0	0.0
ROE (%)	16.9	12.9	5.9	7.3
ROA (%)	7.80	4.70	2.17	2.70

Earnings revisions

Previous nom. net profit	9,104	4,388	5,706
Change from previous (%)	-	2.7	3.3
Previous nom. EPS (Rs)	36.98	17.83	23.18

Source: Company, Nomura estimates

Share price relative to MSCI India



	1m	3m	6m
Absolute (Rs)	5.7	(2.8)	136.2
Absolute (US\$)	8.5	(2.5)	150.7
Relative to Index	(4.7)	(21.0)	63.9
Market cap (US\$m)			4,690
Estimated free float (%)			44.9
52-week range (Rs)			1,141/280.9
3-mth avg daily turnover (US\$m)			111.5
Stock borrowability			Hard
Major shareholders (%)			
AAA enterprises			51.5

Source: Company, Nomura estimates

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See the important disclosures and analyst certifications on pages 8 to 11.**

③ Overall private-sector growth masks sharp divergence among players

While overall private-sector growth was reasonably strong, we highlight that it masks a sharp divergence in growth rates among various players. This makes it hard to decipher whether the key driver of RLife's performance in the past few months was on account of the overall sector trend or because of company-specific factors.

We note that growth in August came in almost entirely from three players – ICICI Pru Life, HDFC Standard Life and Birla Sunlife. Private-sector sales in August were up 9% on an m-m basis. However, excluding the above-mentioned three players, there was actually a contraction of 1%, highlighting the contribution of these three to the overall growth figure.

Historically, spikes in market share have been preceded by rapid expansions in distribution networks. Companies benefited from enhanced distribution networks and this was reflected in their market share. In this case as well, it seems that both HDFC Standard Life and Birla Sunlife are benefiting. However, this may not fully explain ICICI Pru Life's performance, as most of its expansion was done by FY08. On the other hand, we are disappointed with the performance of RLife on this front. We note that RLife has been one of the most aggressive companies in terms of distribution network expansion over the past few years. Hence, we have been expecting RLife to gain market share this year. Performance so far has been disappointing on this count.

④ Increase in ticket size seen across players

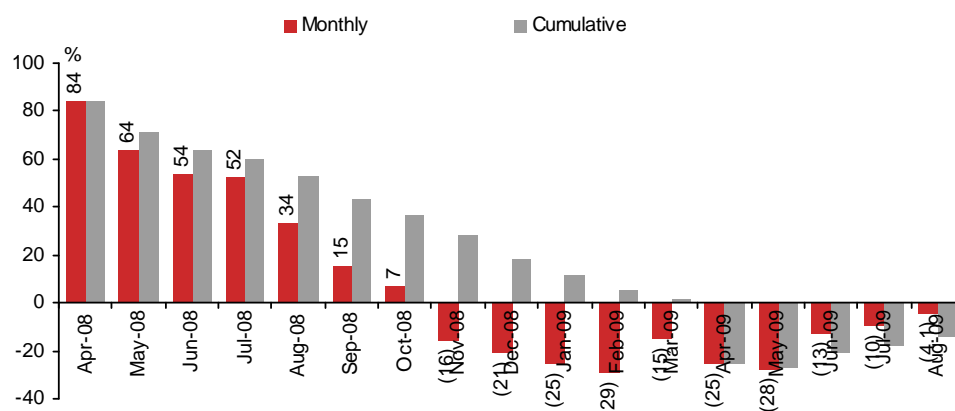
We also highlight a clear trend of increases in ticket size across players, including RLife. This is an indication that it is unit-linked policies that are driving growth, in our view. We also note that the increase in ticket size of those players gaining market share has been even more pronounced and is in fact at the highest level ever.

⑤ Maintain REDUCE on RCFT

Using SOTP valuation, we value the company at Rs834/share (target and method unchanged; see Exhibit 8). FY10-11F earnings fine-tuned; REDUCE call maintained.

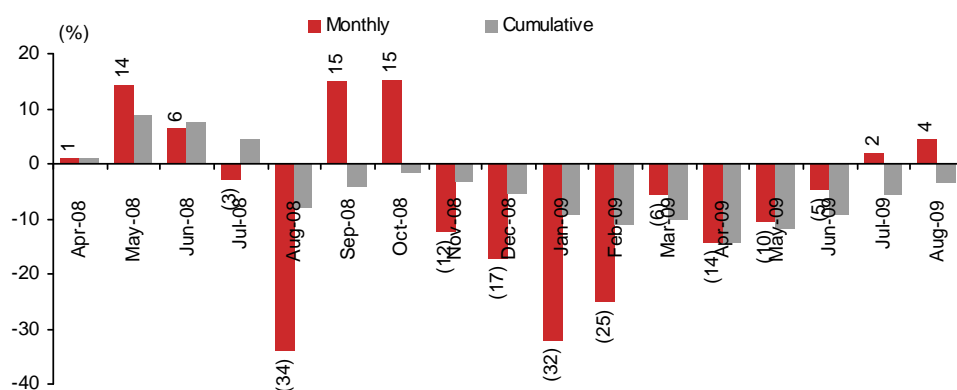
We continue to believe that the risk-reward for RCFT is skewed to the downside. The key upside risk to our valuation: if margins in the insurance business come in higher than we are forecasting. Key to this scenario unfolding would be new premium sales growth coming in significantly higher than we are forecasting.

Exhibit 1. Growth in new business premium (y-y): individual regular premium (private sector)



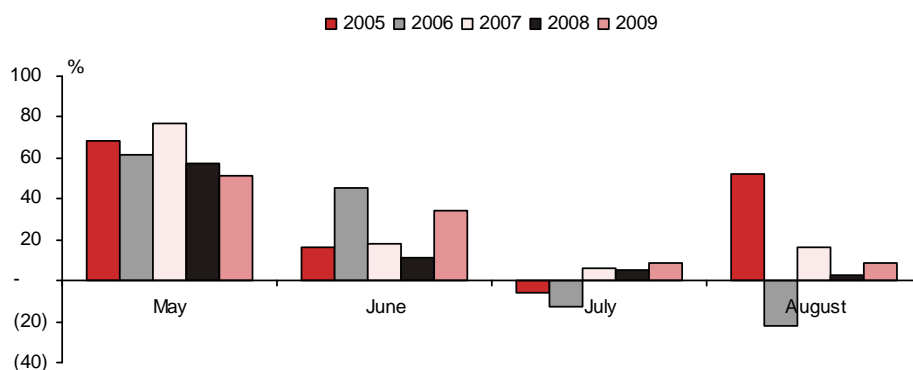
Source: IRDA, Nomura Research

Exhibit 2. Growth in new business premium (y-y): individual regular premium (overall industry)



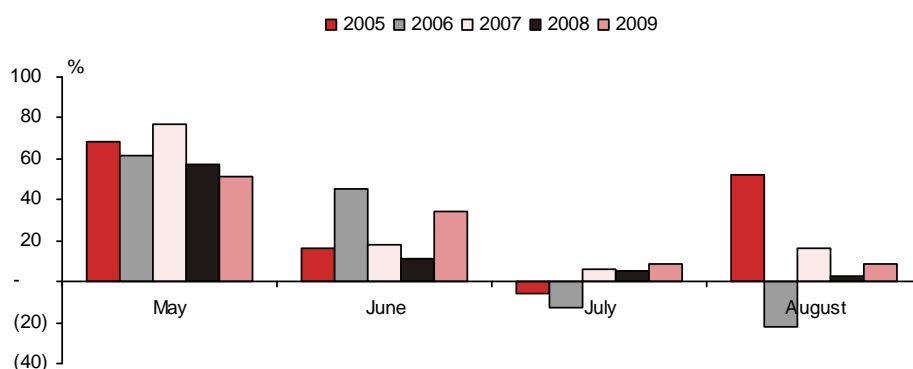
Source: IRDA, Nomura Research

Exhibit 3. Growth in new business premium (m-m): individual regular premium (private sector)



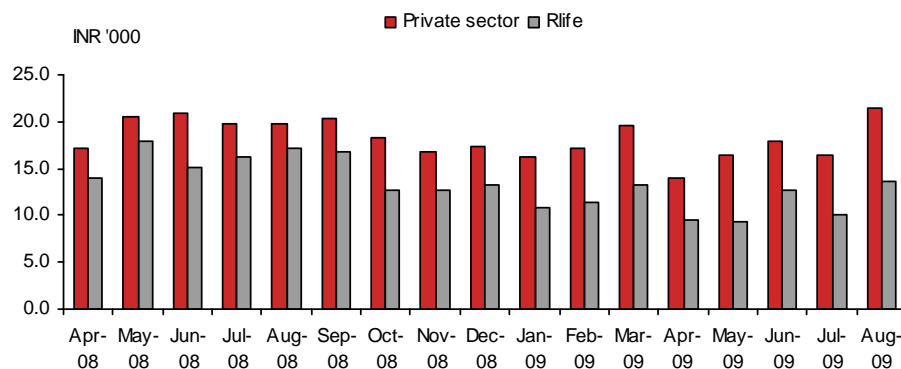
Source: IRDA, Nomura Research

Exhibit 4. Growth in new business premium (m-m): individual regular premium (private sector)



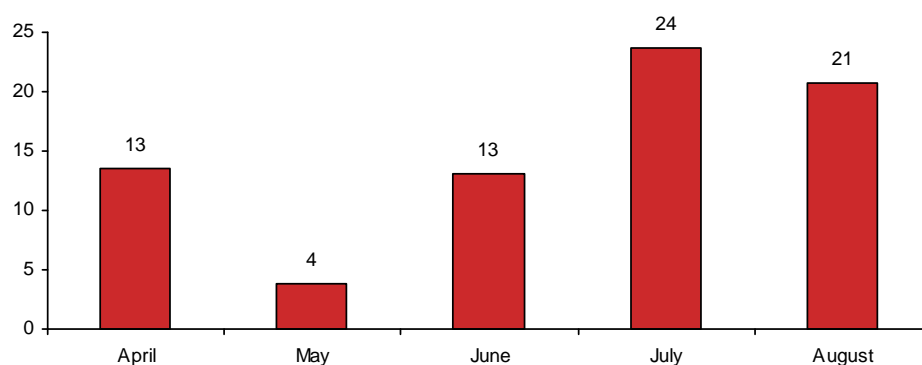
Source: IRDA, Nomura Research

Exhibit 5. Average ticket size – private sector



Source: IRDA, Nomura Research

Exhibit 6. Extrapolated full-year growth for private sector based on actual y-t-d growth (%)



Source: IRDA, Nomura Research

Exhibit 7. Market share within private sector: RLife vs others

%	FY05	FY06	FY07	FY08	FY09	Jun-09	Jul-09	Aug-09
ICICI Prudential	34.3	30.3	25.5	25.4	19.2	13.5	14.9	16.7
Allianz Bajaj	10.3	17.1	20.8	21.3	14.0	10.7	10.8	10.8
HDFC Standard Life	10.0	11.2	10.2	8.4	8.6	8.9	9.2	9.5
SBI Life	2.5	4.5	8.1	9.7	10.7	12.2	12.4	12.0
Birla Sunlife	12.9	8.1	3.9	6.5	9.2	9.2	9.2	9.4
Reliance Life	0.6	0.9	4.5	7.0	11.0	10.8	10.6	10.2
Max New York Life	5.8	6.3	7.1	4.9	5.9	9.5	8.2	7.3
Aviva	4.6	5.6	4.7	3.7	2.4	2.6	2.6	2.5
Tata AIG	6.4	5.5	4.6	3.0	3.6	4.4	4.3	4.2
OM Kotak Mahindra	4.5	5.0	3.3	3.6	4.4	3.0	3.0	2.9
ING Vysya	6.8	3.5	3.2	2.5	2.4	3.0	2.9	2.8
MetLife	1.2	1.8	2.7	2.9	4.0	3.3	3.4	3.3
Shriram	0.0	0.0	0.9	0.5	0.7	1.1	1.0	1.1
Bhavi Axa	0.0	0.0	0.1	0.4	1.0	1.6	1.5	1.5
Canara HSBC	0.0	0.0	0.0	0.0	1.1	3.0	2.7	2.6

Source: IRDA, Nomura Research

Exhibit 8. Reliance Capital: SOTP valuation

	Value	Value/shr	Rationale
Life insurance	94,629	384	15x FY11F NBP; 13% NBP margin; APE growth of 17% over FY09-11F
Asset management	63,624	258	4.5% FY11F AUM
Rmoney	12,829	52	14x FY11F earnings, discounted back to FY10F
Consumer finance	9,333	38	0.8x capital invested in the business; capital invested assuming a leverage of 5x;
General insurance	6,284	26	
Surplus capital	18,550	75	At book value
Total	205,249	834	

Source: Nomura Research

Financial statements

Profit and Loss (Rsmn)					
Year-end 31 Mar	FY07	FY08	FY09	FY10F	FY11F
Brokerage commission	1,225	2,385	3,521	4,296	5,375
Asset management sales fees	1,925	4,558	4,547	5,911	8,646
Underwriting fees	9,143	23,461	23,116	24,203	24,203
Other commissions					
Commissions received	12,293	30,404	31,184	34,410	38,223
Financing revenue	3,449	6,569	18,563	11,874	12,467
Securities-related income	5,751	11,844	9,334	-	-
Other operating income	87	375	(34)	500	500
Operating revenue	21,580	49,192	59,047	46,784	51,191
Commission expense	(8,436)	(18,951)	(17,487)	(17,426)	(17,426)
Financing expense	(427)	(4,139)	(12,638)	(12,006)	(12,006)
Securities-related expense	(15)	(753)	-	-	-
SG&A	(4,586)	(13,192)	(18,028)	(12,048)	(14,824)
Other operating expenses					
Operating expense	(13,463)	(37,035)	(48,153)	(41,480)	(44,257)
Operating profit	8,116	12,158	10,894	5,304	6,934
Other non-operating income					
Associates & JCEs	35	50	5	-	-
Pre-tax profit	8,151	12,208	10,899	5,304	6,934
Income tax	(1,120)	(2,055)	(1,716)	(796)	(1,040)
Net profit after tax	7,031	10,153	9,183	4,508	5,894
Minority interests	-	(62)	(78)	-	-
Other items					
Preferred dividends					
Normalised NPAT	7,031	10,091	9,104	4,508	5,894
Extraordinary items					
Reported NPAT	7,031	10,091	9,104	4,508	5,894
Dividends					
Transfer to reserves	7,031	10,091	9,104	4,508	5,894
Valuation and ratio analysis					
FD normalised P/E (x)	31.9	22.3	24.7	49.8	38.1
FD normalised P/E at price target (x)	29.2	20.3	22.5	45.5	34.8
Reported P/E (x)	31.9	22.3	24.7	49.8	38.1
Dividend yield (%)	-	-	-	-	-
Price/book (x)	4.2	3.4	3.0	2.9	2.7
Effective tax rate (%)	13.7	16.8	15.7	15.0	15.0
Dividend payout (%)	-	-	-	-	-
ROE (%)	na	16.9	12.9	5.9	7.3
ROA (%)	na	7.8	4.7	2.2	2.7
Operating margin (%)	37.6	24.7	18.5	11.3	13.5
Cost-to-income ratio	62.4	75.3	81.5	88.7	86.5
Commission rates (bps)					
Stock brokerage	na	na	na	na	na
on line	na	na	na	na	na
off line	na	na	na	na	na
Asset management products	na	na	na	na	na
Market share (%)					
Stock brokerage	na	na	na	na	na
on line	na	na	na	na	na
off line	na	na	na	na	na
Asset management products	na	na	na	na	na
IB (bond underwriting)	na	na	na	na	na
Per share					
Reported EPS (Rs)	28.6	41.0	37.0	18.3	23.9
Norm EPS (Rs)	28.6	41.0	37.0	18.3	23.9
Fully diluted norm EPS (Rs)	28.6	41.0	37.0	18.3	23.9
DPS (Rs)	-	-	-	-	-
BVPS (Rs)	215.4	268.5	303.2	318.5	338.7

The company may book investment gains, which we are not factoring in our estimates

Balance Sheet (Rsmn)					
As at 31 Mar	FY07	FY08	FY09	FY10F	FY11F
Stocks	16,252	25,619	-	-	-
Bonds	2,028	6,405	-	-	-
Beneficiary certificates (BCs)					
Other	9,896	28,337	66,221	69,452	72,849
Marketable securities	28,176	60,361	66,221	69,452	72,849
Cash and equivalents	2,121	10,563	11,619	12,200	12,810
Guarantee deposits					
Loans to customers	37,538	102,803	113,084	118,738	124,675
Other current assets	4,674	8,490	9,339	9,806	10,296
Current assets	72,508	182,217	200,262	210,195	220,630
Investment securities	355	200	400	500	600
Other investments					
Investments and lt. assets	355	200	400	500	600
Fixed assets	1,389	2,020	2,222	2,333	2,449
Total assets	74,252	184,437	202,884	213,028	223,679
Short-term debt	14,030	84,419	91,524	95,548	98,750
Customer deposits					
Other current liabilities	7,199	24,571	27,008	28,368	29,797
Current liabilities	21,229	108,990	118,531	123,916	128,546
Other LT liabilities	-	8,843	9,728	10,700	11,770
Total liabilities	21,229	117,833	128,259	134,616	140,317
Minority interest	-	507	-	-	-
Common stock	2,462	2,462	2,462	2,462	2,462
Preferred stock					
Retained earnings			-	-	-
Proposed dividends					
Other equity	50,562	63,635	72,163	75,950	80,901
Shareholders' equity	53,024	66,097	74,625	78,412	83,363
Total liabilities and equity	74,252	184,437	202,884	213,028	223,679
Balance sheet ratios (%)					
Equity to assets	71.4	35.8	36.8	36.8	37.3
Total capital ratio	na	na	na	na	na
Net revenue contributions (Rsmn)					
Net commission income	3,857	11,453	13,697	16,984	20,797
Net financing revenue	3,022	2,430	5,925	(133)	461
Net securities revenue	5,737	11,091	9,334	-	-
Others	87	375	(34)	500	500
Net revenue	12,702	25,349	28,922	17,352	21,758
Net revenue contributions (%)					
Net commission income	30.4	45.2	47.4	97.9	95.6
Net financing revenue	23.8	9.6	20.5	(0.8)	2.1
Net securities revenue	45.2	43.8	32.3	-	-
Others	0.0	0.0	(0.0)	0.0	0.0
Commission revenue mix (%)					
Brokerage	10.0	7.8	11.3	12.5	14.1
Asset management sales	15.7	15.0	14.6	17.2	22.6
Underwriting	74.4	77.2	74.1	70.3	63.3
Other	-	-	-	-	-
Growth (%)					
Asset growth		148.4	10.0	5.0	5.0
Client assets		na	na	na	na
Operating revenues		128.0	20.0	(20.8)	9.4
Brokerage commission		94.7	47.6	22.0	25.1
Operating profit		49.8	(10.4)	(51.3)	30.7
Normalised EPS		43.5	(9.8)	(50.5)	30.7
Normalised FDEPS		43.5	(9.8)	(50.5)	30.7

Source: Nomura estimates

Any Authors named on this report are Research Analysts unless otherwise indicated

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Issuer	Ticker	Price (as at last close)	Closing Price Date	Rating	Disclosures
Reliance Capital	RCFT IN	911.50 INR	01 Oct 2009	Reduce	

Previous Ratings

Issuer	Previous Rating	Date of change
Reliance Capital	Neutral	26 Jun 2009

Three-year stock price and rating history

Not Available for Reliance Capital

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Stocks:

- A rating of "1", or "**Buy**", indicates that the analyst expects the stock to outperform the Benchmark over the next 12 months.
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- A rating of "3", or "**Reduce**", indicates that the analyst expects the stock to underperform the Benchmark over the next 12 months.
- A rating of "**RS-Rating Suspended**", " indicates that the rating and target price have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including when Nomura is acting in an advisory capacity in a merger or strategic transaction involving the company.

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- A rating of **"3"**, or **"Neutral"**, indicates that the analyst expects the stock to either outperform or underperform the Benchmark by less than 5% over the next six months.
- A rating of **"4"**, or **"Reduce"**, indicates that the analyst expects the stock to underperform the Benchmark by 5% or more but less than 15% over the next six months.
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A **"Neutral"** stance, indicates that the analyst expects the sector to perform in line with the Benchmark during the next six months.

A **"Bearish"** stance, indicates that the analyst expects the sector to underperform the Benchmark during the next six months.

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Stocks:

Stock recommendations are based on absolute valuation upside (downside), which is defined as (Fair Value - Current Price)/Current Price, subject to limited management discretion. In most cases, the Fair Value will equal the analyst's assessment of the current intrinsic fair value of the stock using an appropriate valuation methodology such as Discounted Cash Flow or Multiple analysis etc. However, if the analyst doesn't think the market will revalue the stock over the specified time horizon due to a lack of events or catalysts, then the fair value may differ from the intrinsic fair value. In most cases, therefore, our recommendation is an assessment of the difference between current market price and our estimate of current intrinsic fair value. Recommendations are set with a 6-12 month horizon unless specified otherwise. Accordingly, within this horizon, price volatility may cause the actual upside or downside based on the prevailing market price to differ from the upside or downside implied by the recommendation.

- A **"Strong buy"** recommendation indicates that upside is more than 20%.
- A **"Buy"** recommendation indicates that upside is between 10% and 20%.
- A **"Neutral"** recommendation indicates that upside or downside is less than 10%.
- A **"Reduce"** recommendation indicates that downside is between 10% and 20%.
- A **"Sell"** recommendation indicates that downside is more than 20%.

Sectors:

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