

Reliance Capital

Positive catalysts + depressed valuations

*Muted insurance volumes, delay in Nippon Life deal and weak investor sentiment has led to ~20% underperformance over the last 20 days. With current market cap of Rs100bn at less than the insurance valuation from the Nippon life deal, concerns are more than factored in. **Consummation of Nippon Life, removal of assured returns on pensions and improving insurance volumes in 2H would be strong catalysts.***

- Nippon Life deal a big positive catalyst:** Management has indicated that the Nippon life deal should be concluded in the next 2-3 months. This would not only validate the insurance business valuation (JPME insurance valuations at ~40% discount to deal valuation of Rs110bn) but also address balance sheet concerns on leverage/liquidity as it would provide ~Rs27bn of cash and increase net worth by >20%.
- Muted 1Q12, some positive though:** 1Q12 performance was muted with market share loss in life insurance, margin pressure for the lending business and flat AUMs in the AMC business but there were some medium term positives like (1) cost efficiency improvement in the life insurance business with 37% y/y contraction in opex and (2) Continuing strong asset quality in the lending business with <50bps of credit costs.
- 2H could be relatively better:** We believe operationally 2H could be relatively better with (1) growth in insurance volumes expected to pick up given favorable base in 2H and increase in volumes from pension business and (2) margin improvement in the lending business given ~150bps hike taken recently across product categories. Also, capital market buoyancy could provide upside in AMC and other subsidiaries.
- Maintain Overweight:** Our revised Mar-12 PT of Rs650/share (Rs740 earlier) is based on conservative valuations and reflects fundamental value of the various businesses though discounts may persist in the near term due to weak sentiment. We believe improving fundamentals and consummation of the Nippon life deal would address investor concerns and see current depressed valuations as an attractive entry opportunity.

Figure 1: Reliance capital Financials

Year end Mar	FY09	FY10	FY11	FY12E	FY13E
Consolidated PAT	10,157	4,345	1,112	6,005	7,756
PAT growth (%)	-6.4%	-57.2%	-74.4%	440.1%	29.2%
EPS (Rs/share)	41.3	17.7	4.5	24.4	31.5
BPS (Rs/share)	306	312	316	396	407
P/E	10.0	23.3	91.0	16.8	13.0
P/B	1.3	1.3	1.3	1.0	1.0
P/E (Ex-insurance)	5.3	12.4	48.4	9.0	6.9
Dividend Yield	1.6%	1.6%	1.2%	1.9%	2.1%

Source: Company, J.P.Morgan estimates.FY12 PAT is adjusted for profit from Nippon Life deal. Share price data as at 16 August 2011.

Overweight

RLCP.BO, RCAPT IN

Price: Rs411.00

▼ **Price Target: Rs650.00**
Previous: Rs740.00

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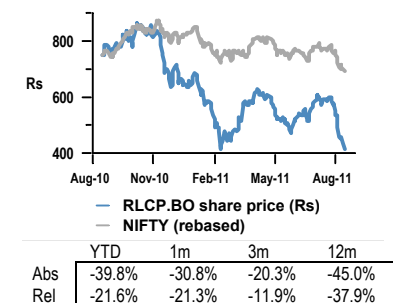
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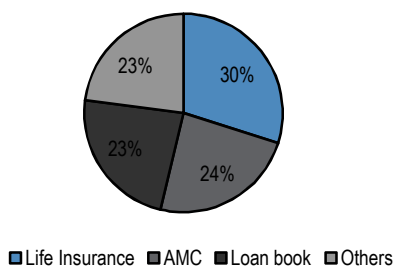
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Company Description

Reliance capital is part of the Reliance group (Anil Ambani) with interests in Insurance (life and general), Asset management, consumer loans, private Equity and brokerage. In the insurance space, Reliance Life is among the largest private insurance companies. Reliance Mutual fund is the largest AMC in the country with >US\$20bn under management.

SOP contribution



Source: J.P.Morgan estimates

EPS: J.P. Morgan vs consensus

	J. P. Morgan	Consensus
FY12E	95.7	26.3
FY13E	31.5	29.9

Source: Bloomberg, J.P.Morgan estimates

SOP Sensitivity

	Business Valuation Impact (%)	SOP Impact (%)
NBAP Margins (base case is 13.3%)		
Impact of each 100bps	3.8%	1.1%
AMC Profitability (base case is ~20bps)		
2 bps profitability (% of AUM)	10.0%	2.4%
Insurance Growth (base case is ~15% growth)		
Impact every 3% growth	8.4%	2.5%

Source: J.P.Morgan estimates

Price target and valuation analysis

Our Price Target of Rs650/share is based on SOP value with insurance valued at 13.7x FY13 NBAP+ EV, AMC valued at 4.0% of AUM and loan book valued at 1.25x FY13 book.

	Rs mn	Rs/share
Life Insurance (13.7x FY13 NBAP)	47,341	192
Lending book (1.25x average FY13 book)	36,900	150
Asset Management (4.0% of AUM)	37,795	154
General Insurance (0.75x FY12 book)	5,567	23
Reliance Money (8x average FY13 profit)	2,877	12
Profit from Nippon Life Deal	17,550	71
Excess Capital	10,380	42
Total	158,410	644

Our valuation implies 11x FY13 profit for reliance capital ex-insurance business. Key risk to our Overweight recommendation is group related issues and high dependence on capital markets with high proportion of SOP valuation linked to market flows. Approval for the Nippon life deal would be a big positive catalyst.

Valuation undemanding, maintain Overweight:

We revise our PT lower by 12% reflecting sluggish volumes across most businesses. Our revised Mar-12 PT of Rs650/share (Rs740 earlier) is based on conservative valuations and reflects fundamental value of the various businesses though discounts may persist in the near term due to weak sentiment. *Our insurance valuation is at a ~40% discount to NBAP valuations implied by the Nippon life deal. At our target price, the valuation for other businesses is 11x FY13 profits which we believe is conservative.*

Likely catalysts over the next 3-6mths are (1) consummation of the Nippon Life deal -expected over the next 2-3 mnts (2) improving insurance volumes in 2H and (3) removal of assured returns on pension policies.

Figure 2: Reliance capital SOP valuation of Rs650/share

	Value	Per Share	Comments/Basis
Life Insurance	47,341	192	74% stake, 13.7x FY13 NBAP + EV - 40% discount to Nippon Deal
Lending book	36,900	150	1.25x FY-13 book
Asset Management	37,795	154	4.0% of AUM
General Insurance	5,567	23	0.75x FY12 book
Reliance Money	2,877	12	bx FY13 profit
Profit from Nippon Life Deal	17,550	71	Profit post 10% tax
Excess Capital	10,380	42	Equity in excess of investments in Subsidiary
Total	158,410	644	

Source: J.P. Morgan estimates

1Q12 Business update

Lending business: Asset quality robust

- Growth continues to remain robust with ~28% y/y growth in AUM with strong growth across categories including mortgages and SME. With moderation in overall growth, management expects loan growth to moderate <20% in FY12.
- Margins have contracted by ~70bps to ~4.3% over the last 2 qtrs but margins are expected to inch back to ~5.0% as Reliance capital has taken ~150bps hike in lending rates across categories.
- Asset quality remains robust with credit costs remaining <50bps in 1Q12. Management does not see any significant asset quality challenges in the near term but high share of SME funding could lead to spike in credit costs over the medium term.

Figure 3: Reliance commercial finance: Margins contract but asset quality robust

Rs mn	1Q11	4Q11	1Q12	y/y	q/q
Total Loans	91,000	123,000	130,000	43%	6%
Auto	4,550	6,150	7,800	71%	27%
CV/CE	13,650	19,680	22,100	62%	12%
SME	30,940	44,280	41,600	34%	-6%
Mortgages	37,310	51,660	57,200	53%	11%
Personal loans	4,550	1,230	1,300	-71%	6%
Securitization	21,000	15,000	13,000	-38%	-13%
Total AUM	112,000	138,000	143,000	28%	4%
Disbursements	12,746	32,115	20,100	58%	-37%
P&L					
Interest income	2731	3299	3888	42%	18%
Interest expense	1473	2106	2673	81%	27%
NII	1258	1193	1215	-3%	2%
Expenses	684	619	789	15%	27%
Other income	303	458	290	-4%	-37%
Provisions	514	103	133	-74%	29%
Profit before tax	363	928	583	61%	-37%

Source: Company, J.P.Morgan

Life Insurance business:

- WRP volumes was down 59% YTD with reliance Life losing ~350bps market share. 75% of the incremental volumes in 1Q12 have come from traditional policies, though management believes future split would be 50:50 between traditional and ULIPs. Management maintained its guidance of flat to positive growth for FY12 given a favorable base from 2H and increase in volumes from pension business.
- Management has guided to ~15% NBAP margins for FY12 inline with our expectations. We assume 13% long term NBAP margins factoring in higher tax rate.
- Management's focus on cost efficiencies is reflected in the operating costs coming off by ~37% y/y. Reliance capital has been churning less productive agency force with total agency strength now at 178K (11% contraction y/y).
- **On the Nippon life deal**, management expects approval to come in over the next 2-3 mnts. We believe this would be a strong stock catalyst as it will not only validate valuation for the insurance business but also address liquidity concerns. Reliance capital (parent) would get Rs27bn of capital from the transaction with rest of the consideration going to subsidiaries.

Figure 4: Insurance business performance

	1Q11	4Q11	1Q12	y/y	q/q
Reliance Life Insurance					
APE (Rs mn)	5,671	7,103	2,348	-59%	-67%
Renewal premium (Rs mn)	5,956	13,045	8,161	37%	-37%
AUM (Rs bn)	141	179	177	26%	-1%
Agents (000s)	200	189	178	-11%	-6%
Reliance General Insurance					
Gross Written Premium (Mn)	4,293	4,373	5,248	22%	20%
No. of policies issued (000)	730	739	685	-6%	-7%
Profit before tax	-386	-2187	-301	-22%	-86%

Source: Company, J.P.Morgan

Reliance AMC:

- AUMs was flat sequentially given weak capital markets but share of equity AUMs inched up to 35% from 33% in 4Q11. Given weak capital market trend, we believe AUM growth would be muted in FY12.
- In terms of profitability, 1Q12 is a seasonally muted qtr as most part of the dividend income is booked in second half of the yr.

Figure 5: Reliance AMC financials

	1Q11	4Q11	1Q12	y/y	q/q
Reliance AMC					
AUM (Rs bn)	1013	1016	1013	0%	0%
Revenues	1642	2058	1674	2%	-19%
PBT	577	752	709	23%	-6%
PBT/AUM (%)	0.22%	0.30%	0.28%	28%	-5%

Source: Company, J.P.Morgan

Reliance Capital: Summary of Financials

P&L - Lending and Inv. book	FY09	FY10	FY11	FY12E	FY13E
Interest Income	17,116	18,272	18,478	21,973	23,682
Interest expenses	12,368	12,595	12,566	14,889	14,659
NII	4,749	5,677	5,911	7,084	9,024
Fees	1,280	782	863	1,005	1,212
Investment gains	11,777	4,855	0	21,575	2,075
Net revenues	17,805	11,315	6,774	29,664	12,311
Opex	5,220	4,447	3,307	3,815	4,367
- employee exp	1,491	1,216	1,095	1,189	1,367
- other opex	3,729	3,230	2,212	2,626	2,999
Operating profit	12,585	6,868	3,467	25,849	7,944
Provisions	1,318	2,563	1,460	755	1,292
PBT	11,268	4,306	2,008	25,093	6,652
Taxes	1,091	890	(285)	3,112	1,381
PAT	10,177	3,416	2,293	21,981	5,271
PAT (ex-exceptionals)	10,177	3,416	2,293	4,431	5,271

Key Balance Sheet - Rs mn	FY09	FY10	FY11E	FY12E	FY13E
Equity capital	2,462	2,462	2,462	2,462	2,462
Reserves	65,603	67,129	67,982	87,659	90,482
Net worth	68,064	69,591	70,444	90,121	92,944
Borrowings	137,807	119,592	145,967	134,581	148,297
Other liabilities	0	0	0	0	0
LIABILITIES	205,872	189,183	216,410	224,702	241,241
Loans	113,459	79,816	108,000	120,450	140,858
Corp. Investments	18,868	18,046	17,144	17,487	17,836
Subsidiaries	11,972	11,742	12,742	13,742	14,742
Other investments	56,626	82,848	78,703	73,729	69,087
Cash/equiv	745	3,923	4,315	4,531	4,758
Fixed assets	1,927	1,678	1,537	1,397	1,257
Other assets	2,276	(8,869)	(6,031)	(6,634)	(7,297)
ASSETS	205,872	189,183	216,410	224,702	241,241

Standalone ratios	FY09	FY10	FY11E	FY12E	FY13E
Credit growth	15.4%	-26.0%	27.9%	10.2%	15.0%
Gross NPA ratio	3.06%	4.47%	1.73%	1.73%	1.82%
Net NPA ratio	1.76%	3.19%	1.23%	1.13%	1.08%
Provision coverage	43.3%	29.5%	28.9%	32.6%	35.9%
NII growth	13.2%	19.6%	4.1%	19.8%	27.4%
Fees growth	-0.7%	-38.9%	10.2%	16.5%	20.6%
OP growth	-38.3%	149.1%	72.3%	23.2%	37.3%
PAT growth	-5.6%	-64.9%	-32.5%	858.8%	-76.0%

Asset Management	FY09	FY10	FY11	FY12E	FY13E
Total Revenues	4,547	6,542	6,981	7,275	8,319
PAT	1,257	1,951	2,119	2,185	2,632
PAT Growth	-16.0%	55.2%	8.6%	3.1%	20.4%
Total AUM	809,000	1,104,000	1,016,000	1,083,564	1,228,801
Equity AUM	194,160	353,280	335,280	368,808	442,570
Debt AUM	614,840	750,720	680,720	714,756	786,232
Equity Mix (%)	24.0%	32.0%	33.0%	34.0%	36.0%
AUM Growth (%)	-11.0%	36.5%	-8.0%	6.7%	13.4%
Profitability (bps of AUM)	14.6	20.4	20.0	20.8	22.8

General Insurance	FY09	FY10	FY11	FY12E	FY13E
Net Premiums	13,995	14,287	11,947	13,739	15,800
PAT	(523)	(504)	(3,098)	(881)	(506)
Premium growth (%)	4.9%	2.1%	-16.4%	15.0%	15.0%
Combined ratio (%)	114%	116%	138%	119%	116%

Life Insurance	FY09	FY10	FY11	FY12E	FY13E
New business premium (Rs bn)					
Individual	29,768	31,499	20,109	16,394	20,635
Group	489	562	646	743	855
Premium growth (%)	58.9%	5.8%	-36.2%	-18.5%	25.9%
NBAP (Rs mn)	6,200	6,016	3,600	2,459	2,682
NBAP margins (%)	20.9%	19.1%	16.7%	15.0%	13.0%

Subsidiary performance	FY09	FY10	FY11	FY12E	FY13E
Consolidated PAT	10,157	4,345	1,112	23,555	7,756
Lending + Investments	10,177	3,416	2,293	21,981	5,271
AMC	1,257	1,951	2,119	2,185	2,632
General Insurance	(523)	(504)	(3,098)	(881)	(506)
Reliance Money	344.7	140	242	270	360
PAT growth	-6.4%	-57.2%	-74.4%	2018.3%	-67.1%
ROE	14.9%	6.2%	1.6%	26.1%	8.3%
EPS (Rs/share)	41.3	17.7	4.5	95.7	31.5

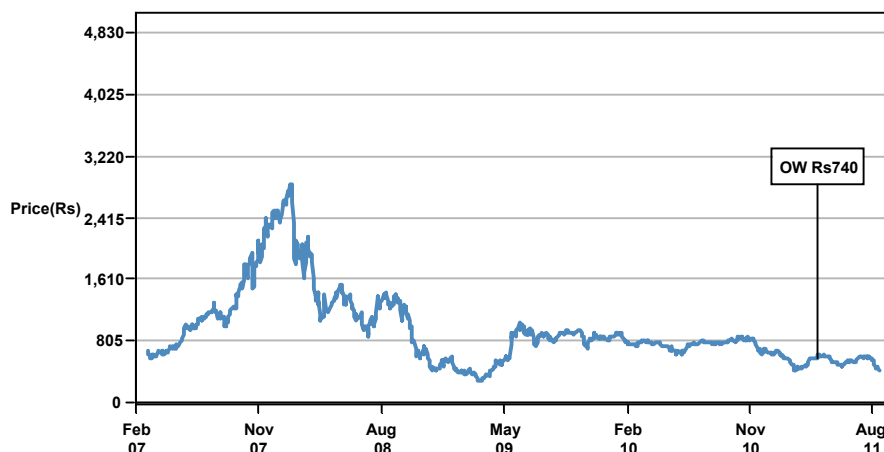
Source: Company, J.P.Morgan estimates. FY09-011 consolidated PAT is reported PAT and FY12-13E is estimated from profits of Lending, AMC, General insurance and Money.

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Reliance Capital (RLCP.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
31-Mar-11	OW	580.05	740.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Mar 31, 2011.

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IB clients*	70%	64%	52%

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