

RELIANCE CAPITAL

INR 970

Galloping ahead
ACCUMULATE

Our recent meeting with the top management of Reliance Capital reaffirmed our positive view on the company's growth prospects. We are impressed by the confidence that the management exhibited in growing its key businesses - life insurance, general insurance, and retail broking – and its aim to become one of the top three players in these segments.

Reliance Capital is delivering exceedingly well on its key operating metrics with mutual fund AUMs crossing INR 500 bn mark, achieving 5% market share in life insurance business (among private players), significant scale up in its retail broking venture with over 75,000 customers and an average daily trading volume of INR 4 bn, and sustaining robust growth momentum in general insurance business.

* Valuations

Considering the company's current growth momentum, we have revised our fair value estimate to INR 254 bn (USD 6 bn or INR 1,033 per share) by FY09E (from our previous estimates of INR 200 bn or INR 813 per share), based on the following:

- Revised AUM growth assumption to 41% CAGR over FY07-09E from 29%.
- Increased premium growth assumptions for life insurance industry to 25% CAGR over FY07-09E and revised market share estimates for Reliance Life to 10%.
- Valuing general insurance business based on underwriting surplus plus investment returns.
- Doing away with discount of 40% on investments in ADAG group companies.

Moreover, the following triggers can drive the stock performance beyond our fair value:

- If the AMC stake sale to global firms materialises at ~10% of current AUMs, it would add another INR 80 per share to our SOTP valuations.
- If Reliance Capital plans to bring in a strategic/financial partner in any of its business verticals, it would call for a re-rating.
- Venture into reinsurance business can boost its insurance valuations significantly.
- Any positive surprises in the recently launched retail broking venture and to-be-launched consumer financing business can provide further upsides.

We remain positive on the growth prospects of Reliance Capital's key businesses and consider it a pure play on the fastest-growing segments in the financial services space. There is high probability that the company will outperform our growth expectations, given its track record. We continue to maintain our '**ACCUMULATE**' rating on the stock.

Businesses	Method	FY08E value (INR mn)	FY09E value (INR mn)
Asset management	Discounted cash flow	30,220	33,447
General insurance	PE	14,170	24,333
Life insurance	Appraisal value	92,384	106,331
Broking and related businesses	PE	4,620	10,360
Consumer financing	PB	9,396	18,404
Value of infrastructure & leasing	PB	39,524	26,587
Value of investments	Quoted-mkt price; unquoted-BV	34,472	34,472
TOTAL VALUE		224,787	253,934
Value per share (INR)		914	1,033

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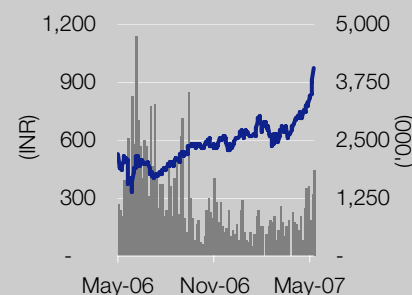
Reuters : RLCP.BO
Bloomberg : RCFT IN

Market Data

52-week range (INR) : 1046 / 320
Share in issue (mn) : 245.6
M cap (INR bn/USD mn) : 238.1 / 5,839.2
Avg. Daily Vol. BSE/NSE ('000) : 2,873.1

Share Holding Pattern (%)

Promoters : 52.2
MFs, Fls & Banks : 2.4
FIs : 30.5
Others : 14.9



Key takeaways

* Mutual fund business - Reliance MF crosses INR 500 bn mark

Reliance Mutual Fund (Reliance MF) has been the fastest growing fund house with AUMs crossing INR 500 bn mark in May 2007, up 8% from March 2007 numbers. Burgeoning investor base to 3.5 mn has been the key driver in taking it all the way to the top spot. Considering stupendous growth in AUMs and future growth plans, we are revising our estimate of AUM growth to 41% CAGR over FY07-09E (from 29% CAGR expected previously).

The company is also positive on its portfolio management services (AUM of INR 30 bn) and offshore funds (current AUMs of USD 125 mn), and expects these to be other growth areas. We now value its asset management business at INR 33.4 bn (USD 796 mn or INR 136 per share) by FY09E as against our previous estimate of INR 24 bn. This value translates into 6.3% of current AUMs of INR 530 bn and 4.8% FY08E AUMs.

* Global firms eye Reliance MF's stake

Global firms, including Blackstone, Schrodgers, and the US-based Capital have shown interest in buying a minority stake in Reliance Capital's mutual fund business. We believe that such a deal could be beneficial from strategic perspective rather than being a pure financial investment. These global leaders would provide strong support to expand Reliance MF's offshore fund that commenced operation in February 2007 with AUMs of USD 125 mn currently. Reliance MF's leadership position, stupendous growth in AUMs, and wide customer base may act as strong competitive edge to attract these global leaders. In that respect, we believe Reliance MF should be able to command higher than estimated valuations.

* Life insurance business – gaining significant market share

The private insurers have doubled their annualised premium equivalent to INR 143 bn, enjoying 36% market share. With strong outlook for insurance industry, given long term structural growth drivers and aggressive expansion of agency force and distribution franchise, we are revising our industry-wide growth assumptions upwards to 25% CAGR over FY07-09E. Reliance Life is inching up its position on the league table from number 12 in FY06 to number 7 in terms of APE. It has aggressive plans to double its agent force from the current levels of 106,000 in next 12-18 months and add 130 branches by September 2007 to the current strength of 217 branches. Consequently, we revise our market share estimates for Reliance Life upward to 10% and fair value by 6% to INR 106.3 bn (USD 2.5 bn or INR 433 per share) for FY09E.

* General insurance business – growth momentum intact

Reliance General recorded five-fold increase in its gross written premium in general insurance in FY07 to INR 9 bn. We expect the growth momentum in this business to remain strong and expect Reliance General to grow its gross written premium by 100% CAGR over FY07-09E. To indicate real earnings in general insurance venture, we are now using sum of underwriting surplus and investment returns, since we believe reported profit is not true reflection of economic profit. On this basis, we now value its general insurance business at INR 24 bn (at PE of 16x) as against our previous estimate of INR 12 bn for FY09E.

Table 1: Non-life insurance valuation

Non-life Insurance	
Gross written premium (FY07) (INR mn)	9,122
GWP Growth in FY07 (Y-o-Y)	462.0
Market share FY07 (%)	10.5
Net Written Prem (FY09E) (INR mn)	19,689
NWP CAGR FY07-09E (%)	98.1
Est. Combined Ratio (%)	98.0
Underwriting Suplus (% of NWP)	2.0
PAT (FY09E) (INR mn)	1,521
P/E Multiple (x)	16
Value of business (INR mn)	24,333
Value (USD mn)	579
% of holding	100.0
Fair value est per share (INR)	99

Source: Company, Edelweiss research

* Churn in investment portfolio

Reliance Capital has sold 13.2 mn shares of Reliance Energy recently, realising handsome gains of INR 3 bn that will be reflected in Q1 FY08 numbers. It has even increased its holding in INOX Leisure to 3 mn shares from 0.5 mn in March 2007 and has acquired 5% stake in Network 18 (2.5 mn shares). It has also accumulated shares of IDFC, Global Broadcasting, and TV Today post January 2007.

While valuing its investments, we had previously provided for a 40% discount to the market price of its investments in ADAG group companies. However, considering that Reliance Capital is liquidating its stake in group companies at the prevailing market price, we are doing away with the discount to any of its holdings in ADAG companies. We, now, value its investments at INR 34.5 bn (USD 821 mn or INR 140 per share).

Company Description

Reliance Capital is largest mutual fund (in terms of AUMs of INR 530 bn) and the fourth-largest general insurer (in terms of gross written premium of INR 9.1 bn in FY07). The company has been actively pursuing growth opportunities in the Indian financial services sector post de-merger and re-organisation of the Reliance Group, to become a leading financial powerhouse. It has undergone significant strategy changes in the past one year, with focus shifting to fast-growing segments in the financial services space, viz., asset management and insurance business, from leasing and infrastructure financing.

Currently, Reliance Capital is aggressively investing to grow its life insurance business by expanding its distribution franchise and increasing its agent force. The company recently launched its retail broking venture under the brand Reliance Money and intends to start consumer financing business in FY08.

Investment Theme

We expect Reliance Capital 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, broking, and general insurance businesses.

Our confidence in Reliance Capital 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, as its value driving businesses are either at a nascent stage (life insurance and retail broking) or are yet to be launched (consumer financing).

We have assigned 100% value to its life insurance and broking business in our valuation estimates, based on our discussions with the management. Though Reliance Capital has 100% economic interest, technically it holds only 16% in Reliance Life and has no direct stake in Reliance Money.

Growth in asset management, life insurance, and broking businesses is highly dependant on the conditions in capital markets. Any unfavourable development in markets, going forward, may hamper our growth assumptions and consequently impact valuations negatively.

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

Financial Statements

Income statement (consolidated)					(INR mn)
Year to March	FY05	FY06	FY07	FY08E	FY09E
INCOME					
Lease rental & other charges	289	205	123	37	-
Inv. mangt., advisory and trustee fee	443	895	1,990	3,093	4,140
Gen.ins. premium and commi. earned	1,959	1,872	9,948	19,785	35,223
Consumer financing income	-	-	-	3,746	11,610
Other income	2,849	6,498	9,100	7,384	4,744
TOTAL INCOME	5,540	9,471	21,161	34,046	55,718
OPERATING EXPENDITURE					
Payment to & provision for employees	223	446	1,472	1,909	2,432
Administrative and other expenses	2,129	2,151	10,996	20,914	35,808
Bad debts written off	81	-	-	-	-
Provision for consumer financing	-	-	-	911	2,824
Impairment loss	(81)	-	-	-	-
Miscellaneous exp written off	16	12	12	10	-
TOTAL EXPENDITURE	2,368	2,609	12,480	23,745	41,064
EBITDA	3,173	6,862	8,681	10,301	14,653
Interest & finance charges	1,511	452	426	2,279	6,168
Depreciation	296	256	140	165	139
PBT	1,366	6,154	8,115	7,857	8,346
Provision for tax	128	336	1,120	1,748	2,389
PAT before extraordinary items	1,238	5,819	6,995	6,109	5,958
Minority interest & share of associate	(879)	(105)	-	-	-
Adjusted PAT	359	5,714	6,995	6,109	5,958
Diluted number of shares (in mn)	127	218	230	246	246
Diluted EPS	2.8	26.2	30.5	24.8	24.2
Proposed div. on equity share capital	382	713	858	980	1,103
Dividend tax thereon	55	100	118	135	152

Growth ratios (%)

Year to March	FY05	FY06	FY07	FY08F	FY09F
Income growth	21.0	70.9	123.4	60.9	63.7
EBITDA growth	(14.3)	116.3	26.5	18.7	42.3
PBT growth	6.8	350.5	31.9	(3.2)	6.2
PAT growth	1.2	370.1	20.2	(12.7)	(2.5)

Valuation metrics

Year to March	FY05	FY06	FY07	FY08F	FY09F
EPS (INR)	2.8	26.2	30.5	24.8	24.2
EPS growth (%)	(79.2)	827.8	16.3	(18.4)	(2.5)
Book value per share (INR)	116	188	216	236	255
Price/Earnings (x)	343.3	37.0	31.8	39.0	40.0
Price/ BV (x)	8.4	5.2	4.5	4.1	3.8
Dividend yield (%)	0.3	0.4	0.4	0.4	0.5
Price to income (x)	22.3	22.3	10.5	7.0	4.3

Balance sheet (consolidated)					(INR mn)
Year to March	FY05	FY06	FY07	FY08E	FY09E
ASSETS					
Gross block	5,521	3,906	3,144	2,369	2,395
Less : Depreciation	3,114	2,463	1,957	1,504	1,617
Lease Adjustment A/c	(203)	327	100	100	100
Net block	2,203	1,771	1,287	965	878
Capital work in progress	131	131	132	133	134
Investments	17,560	23,938	27,758	32,112	39,852
Current assets, loans & advances					
Stock in trade	3,061	62	31	31	31
Sundry debtors	137	777	1,032	1,702	2,599
Cash & bank balances	362	2,016	11,436	11,731	9,023
Other current assets	4,822	6,189	7,255	8,327	9,152
Loans & advances	1,536	12,239	13,389	54,725	99,677
Current liabilities and provisions					
Liabilities	619	1,024	2,496	3,372	4,400
Provisions	830	1,232	3,922	9,447	16,515
Net current assets	8,468	19,027	26,725	63,696	99,567
Miscellaneous exp. not written off	69	62	10	-	-
TOTAL ASSETS	28,432	44,929	55,912	96,907	140,431
LIABILITIES					
Paid-up share capital	1,278	2,234	2,461	2,461	2,461
Reserves	13,653	39,385	50,635	55,629	60,333
Warrants	-	495	-	-	-
Net worth	14,862	42,052	53,087	58,090	62,794
Minority interest	351	387	387	387	387
Secured loans	-	1,675	1,675	37,675	77,239
Unsecured loans	13,136	744	744	744	-
Deferred tax liability (net)	14	9	10	11	12
TOTAL LIABILITIES	28,432	44,929	55,912	96,907	140,431

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INDIA RESEARCH	SECTOR	INSTITUTIONAL SALES
Shriram Iyer - 2286 4256	Head – Research	Nischal Maheshwari - 2286 4205
Gautam Roy - 2286 4305	Airlines, Textile	Rajesh Makharia - 2286 4202
Ashutosh Goel - 2286 4287	Automobiles, Auto Components	Vikrant Oak - 4019 4712
Vishal Goyal, CFA - 2286 4370	Banking & Finance	Shabnam Kapur - 2286 4394
Revathi Myneni - 2286 4413	Cement	Abhijit Chakraborty - 4019 4823
Sumeet Budhraj - 2286 4430	FMCG	Balakumar V - (044) 4263 8283
Harish Sharma - 2286 4307	Infrastructure, Auto Components, Mid Caps	Ashish Agrawal - 2286 4301
Priyanko Panja - 2286 4300	Infrastructure, Engineering, Telecom	Nikhil Garg - 2286 4282
Hitesh Zaveri - 2286 4424	Information Technology	Swati Khemani - 2286 4266
Parul Inamdar - 2286 4355	Information Technology	Neha Shahra - 2286 4276
Priyank Singhal - 2286 4302	Media, Retail	Priya Ramchandran - 2286 4389
Prakash Kapadia - 4097 9843	Mid Caps	Anubhav Kanodia - 2286 4361
Niraj Mansingka - 2286 4304	Oil & Gas, Petrochemicals	Tushar Mahajan - 2286 4439
Nimish Mehta - 2286 4295	Pharmaceuticals, Agrochemicals	Harsh Biyani - 2286 4419
Manika Premeisingh - 4019 4847	Economist	Nirmal Ajmera - 2286 4258
Sunil Jain - 2286 4308	Alternative & Quantitative	Ankit Doshi - 2286 4671
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RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	Reduce	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	Sell	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period

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