

Equities

13 November 2011 | 11 pages

Reliance Capital (RLCP.BO)

2Q12 Results: Lackluster Performance, But Valuations Low

- **2Q12 profits down 66%, well below estimates** — RCap's 2Q12 profits were down 66% yoy and were well below our estimates. Key challenges: a) Asset management business saw further market share erosion (13% now vs 14.5% in Mar 11); b) Life insurance new premiums declined more than peers (-49% yoy vs 41% for other private players); c) Non-life insurance continues to see high combined ratio (123%). The silver lining came from the healthy growth in its consumer financing segment and possible earnings upsides from the 26% life insurance stake sale to Nippon Life.
- **Asset management: Declining AUMs and Market share** — RCap's market share continues to decline, and is a cause of concern. While it still remains a market leader, we expect weak industry flows and high competition make future gains difficult.
- **Life insurance: Stake sold, premium growth still slow, should stabilize ahead** — New business premium has continued to shrink for private insurers in India, however RCap's new premiums have fallen more than peers. However, with a lower base effect going ahead, we expect new business growth to improve and NBAP margins to stabilize at around 15% levels. RCap's 26% stake sale is complete; management is likely to shift it to a more direct subsidiary over time (RCap's stake will remain at 74%).
- **Consumer Finance: Healthy growth but macro a key risk**— RCap's assets under finance has seen healthy growth (25% yoy) and is predominantly secured (99% of book). Growth has largely driven by SME and mortgage segments (78% of loans collectively), though it has created some pressure on NIMs (4.1% now). Asset quality has remained healthy, NPLs have declined to 1.2%, loan-loss coverage is healthy at 80% and management does not foresee meaningful risks ahead; however, given continued macro challenges, will remain on watch.
- **Operationally still weak but valuations look cheap** —RCap should continue to face operational headwinds ahead, especially in capital market-related segments. However, the stock has corrected sharply, underperforming Senses by 16% over the last 3 months; and valuations look cheap – a turn in macro could propel the stock higher.

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	20.3	1.1	5.7	1.8
2011A	2,912	11.83	-33.0	30.3	1.1	3.8	1.8
2012E	5,108	20.75	75.4	17.3	1.1	6.4	1.8
2013E	6,074	24.68	18.9	14.5	1.0	7.3	1.8
2014E	7,025	28.54	15.6	12.6	1.0	8.0	1.8

Source: Powered by dataCentral

Company Update

Buy	1
Price (11 Nov 11)	Rs358.90
Target price	Rs455.00
Expected share price return	26.8%
Expected dividend yield	1.8%
Expected total return	28.6%
Market Cap	Rs88,158M US\$1,764M

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



Manish Chowdhary, CFA

+91-22-6631-9853
manish.chowdhary@citi.com

Aditya Narain, CFA

+91-22-6631-9879
aditya.narain@citi.com

Pooja Kapur

pooja.kapur@citi.com

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Fiscal year end 31-Mar	2010	2011	2012E	2013E	2014E
Valuation Ratios					
P/E adjusted (x)	20.3	30.3	17.3	14.5	12.6
P/E reported (x)	20.3	30.3	17.3	14.5	12.6
P/BV (x)	1.1	1.1	1.1	1.0	1.0
P/Adjusted BV diluted (x)	1.1	1.1	1.1	1.0	1.0
Dividend yield (%)	1.8	1.8	1.8	1.8	1.8
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: 2Q12 Financial Highlights (Rupees Million, Percent)

	2Q12	2Q11	YoY %	1Q12	QoQ%	CIRA Comments
Income from Operations	15,189	12,806	18.6	14,678	3.5	Higher revenues in consumer finance segment, other business continue to see growth headwinds
Other Income	272	192	41.6	243	11.9	
Gross Total Income	15,461	12,998	18.9	14,921	3.6	
Interest expense	(5,832)	(3,397)	71.7	(5,130)	13.7	High interest rates continue to drag profitability with 200bps increase in average borrowing costs yoy - 11.4% now
Total Income	9,629	9,601	0.3	9,791	-1.7	
Operating Expenses	(8,905)	(8,362)	6.5	(9,166)	-2.8	Costs are declining, as expected - management focuses on leaner operations
Pre-Tax Profit	724	1,240	-41.6	625	15.9	
Tax	(359)	(226)	59.0	(256)	40.3	
Minorities	(13)	(39)	-65.9	(32)	-58.4	
Extraordinary Items	(17)	0	NM	12	NM	
Net Profit	334	975	-65.7	348	-4.0	Remains well below estimates as operational headwinds continue remain high

Segmental Revenues (Rsm)	2Q12	2Q11	YoY %	1Q12	QoQ%	
Finance & Investments	3,628	2,929	23.9	2,517	44.1	Some uptick as interest rates have moved higher
Asset Management	1,327	1,628	-18.5	1,572	-15.5	AUMs decline leads to revenue pressures (AUMs down 14% yoy)
General Insurance	5,295	4,831	9.6	5,924	-10.6	Sluggish growth as management seeks to rebalance its product mix
Consumer Finance	4,711	3,120	51.0	4,178	12.8	Healthy loan growth on higher AUMs and loan yields
Others	655	489	34.0	785	-16.5	
Total	15,616	12,997	20.2	14,975	4.3	Some revenue pick though mostly on the consumer finance segment

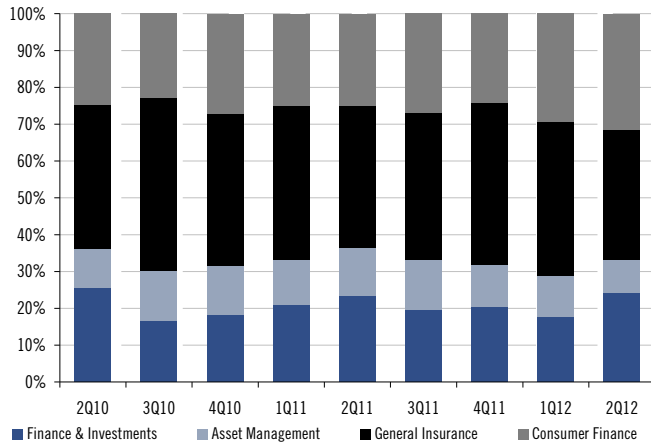
Segmental Rev. Split (%)	2Q12	2Q11	YoY %	1Q12	QoQ%	
Finance & Investments	23%	23%	1	17%	6	
Asset Management	9%	13%	-4	10%	-2	Market share has declined further to 13% (14.5% in Mar 11) though it continues to remain a market leader
General Insurance	34%	37%	-3	40%	-6	
Consumer Finance	30%	24%	6	28%	2	Healthy asset growth of 25% yoy, management guiding to ~20% for FY12E
Others	4%	4%	0	5%	-1	

PBT (Rsm)	2Q12	2Q11	YoY %	1Q12	QoQ%	
Finance & Investments	119	358	-67	(238)	NM	
Asset Management	452	558	-19	526	-14	Largely in line with decline in average AUMs during the period
General Insurance	(288)	(282)	2	(301)	-4	High combined ratio of 128% for the quarter
Consumer Finance	547	610	-10	583	-6	Lower margins (4.1% now), though partly offset by lower credit costs
Others	(105)	85	NM	57	NM	
Total	726	1,329	-45	627	16	

PBT (%)	2Q12	2Q11	YoY %	1Q12	QoQ%	
Finance & Investments	16%	27%	-11	-38%	54	
Asset Management	62%	42%	20	84%	-22	
General Insurance	-40%	-21%	-18	-48%	8	High losses on motor insurance remains a key profitability drag
Consumer Finance	75%	46%	30	93%	-18	Key driver of incremental profitability
Others	-14%	6%	-21	9%	-24	Broking and distribution segments continue to face business headwinds

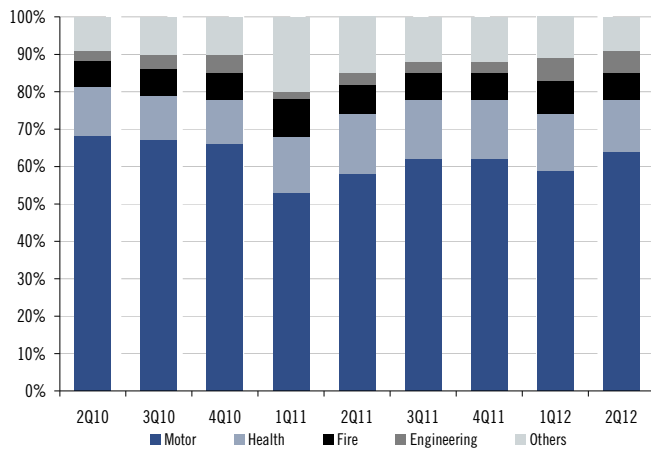
Source: Citi Investment Research and Analysis, Company Reports

Figure 2. Segmental Composition of Revenue (%)



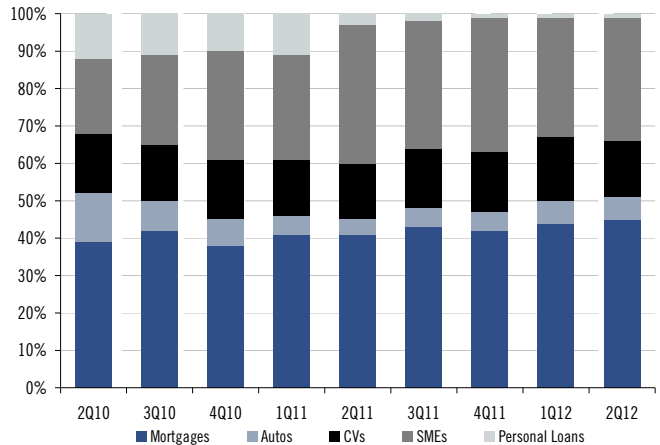
Source: Company Reports

Figure 4. Non Life Insurance: Segmental Contribution to Premium



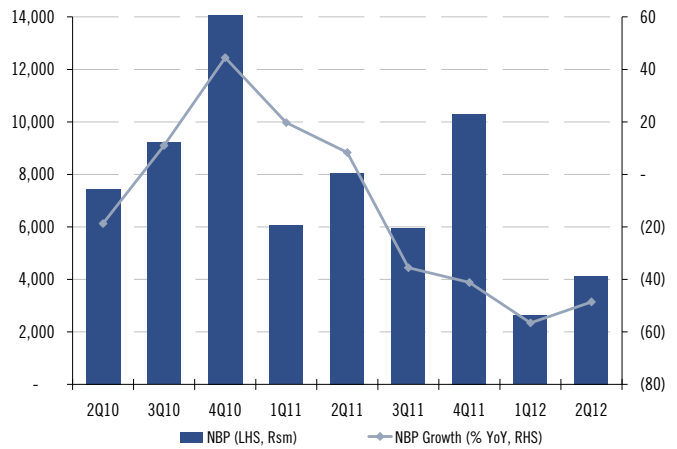
Source: Company Reports

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	2Q12	2Q11	YoY %	1Q12	QoQ%
AUM (Rsb)	931	1,087	-14	1,013	-8
-Equity (Rsb)	315	391	-20	0	NM
-Debt (Rsb)	616	696	-11	0	NM
Market Share (%)	13.0%	15%	-13	14%	-4
General Insurance	2Q12	2Q11	YoY %	1Q12	QoQ%
Gross Written Premium (Rsm)	3,694	3,707	0	5,248	-30
Branches	162	200	-19	181	-10
No. of Policies Issued	604,749	1,381,366	-56	685,383	-12
Life Insurance	2Q12	2Q11	YoY %	1Q12	QoQ%
NBP (Rsm)	4,145	8,062	-49	2,630	58
-First Year Premium (Rsm)	3,055	6,786	-55	2,317	32
-Single Premium (Rsm)	1,090	1,276	-15	313	248
Renewal Premium (Rsm)	8,600	7,791	10	8,161	5
Total Premium (Rsm)	12,634	15,853	-20	10,791	17
Funds under mgmt. (Rsm)	167,474	165,547	1	177,353	-6
APE (Rsm)	3,164	6,914	-54	2,348	35
Agents	165,381	213,504	-23	177,747	-7
Branches	1,252	1,248	0	1,252	0
Reliance Money	2Q12	2Q11	YoY %	1Q12	QoQ%
Outlets	6,100	6,100	0	6,600	-8
Broking A/Cs	670,728	646,000	4	666,997	1
Daily Avg Volume (Rsm)	12,000	15,000	-20	12,000	0
Consumer Finance	2Q12	2Q11	YoY %	1Q12	QoQ%
Loan Portfolio (Rsm)					
-Mortgages	62,550	41,000	53	57,332	9
-Autos	8,340	4,000	109	7,818	7
-CVs	20,850	15,000	39	22,151	-6
-SMEs	45,870	37,000	24	41,696	10
-Personal Loans	1,390	3,000	-54	1,303	7
Total	139,270	99,970	39	130,300	7
Gross NPLs (Rsm)	1,800	2,500	-28	1,500	20
NPL Ratio (%)	1.3%	2.5%	-121	1.2%	12

Source: Citi Investment Research and Analysis, Company Reports

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 as Buy. 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. There are clear challenges in the capital market and financial services segments (asset management, insurance, broking and distribution) – both regulatory and competitive, which will weigh on profitability for the near to medium term. However, 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. Moreover, its valuations have corrected sharply and is now trading at significantly low implied valuations for its individual subsidiaries and we believe, will lead to upsides in the stock price as the economic momentum gathers pace in the medium term.

Valuation

Our Rs455 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 Rs156 per share (4.0% of AUMs); the life insurance business at Rs204 per share (12x 1-year forward NBAP; at par with peers); the non-life insurance business at Rs15 per share (0.75x 1-year forward P/BV, in line with peers); the retail broking business at Rs13 per share (8x 1-year forward earnings, lower than peers due to lower its profitability) and the consumer finance business at Rs87 per share (1.0x 1-year forward book value, in line with peers). We also value the surplus capital at a 50% discount to book value (due to sharp correction in capital markets) to get Rs24 per share. Finally, we apply a 10% holding company discount to the above valuations.

Risks

Key downside risks to our valuations and target price include: a) sustained volatility in capital markets; b) continued tight liquidity environment leading to higher funding costs; b) deterioration in asset quality environment; and d) lower-than-anticipated growth and market shares in individual businesses.

Appendix A-1

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IMPORTANT DISCLOSURES

Reliance Capital (RLCP.BO)

Ratings and Target Price History

Fundamental Research

Analyst: Manish Chowdhary, CFA



Chart current as of 5 November 2011

	Date	Rating	Target Price	Closing Price
1	15-Dec-08	3M	*500.00	546.10
2	18-Jun-09	3M	*821.00	884.50
3	5-Sep-10	3M	*788.00	783.00

* Indicates change

	Date	Rating	Target Price	Closing Price
4	13-Jul-11	3M	*555.00	590.45
5	26-Sep-11	*1M	*500.00	389.35
6	5-Oct-11	1M	*455.00	315.85

	Date	Rating	Target Price	Closing Price
7	7-Oct-11	Stock rating system changed		
8	7-Oct-11	*1	455.00	321.25

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

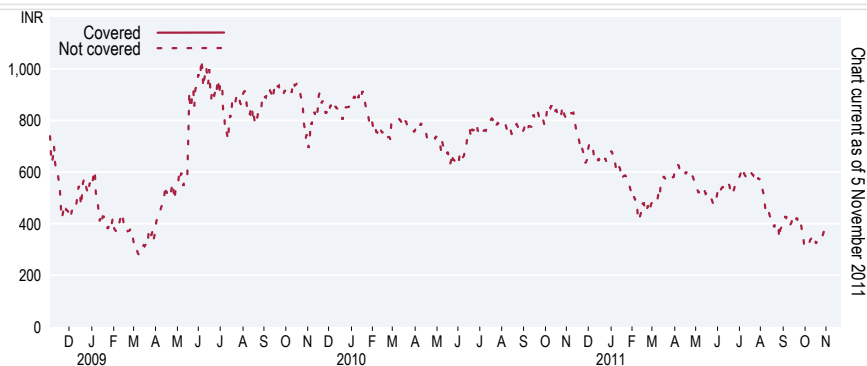


Chart current as of 5 November 2011

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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<i>Data current as of 10 Oct 2011</i>	12 Month Rating			Relative Rating		
	Buy	Hold	Sell	Buy	Hold	Sell
Citi Investment Research & Analysis Global Fundamental Coverage	59%	34%	7%	10%	79%	10%
<i>% of companies in each rating category that are investment banking clients</i>	45%	42%	37%	50%	43%	46%

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