

# RELIANCE CAPITAL

## Strategy enthusing, execution key

India Equity Research | Banking and Financial Services

We attended Reliance Capital's (RCAP) Lending Day which saw presentation of the business strategies for Reliance Commercial Finance (RCF) and Reliance Home Finance (RHF). Key highlights were: a) **RCF**: Focus will strategically shift from being a predominant SME lender to emerge as a diversified lender. Retail/individual lending will comprise material portion by FY19 with an eye on gaining relevance in under-penetrated segments; b) **RHF**: Humungous opportunities, able management and sharper focus (given separate listing) will further bolster growth. With presence across scalable businesses (benefitting from higher financial savings) and beefed up new leadership team, focus is now on execution with aim to build a profitable business and consequent improvement in RoE. RCAP's focus on profitable growth with run down in non-core assets will not only enhance capital efficiency, but also improve core business performance. Maintain 'BUY'.

### RCF: Focus shifting from SMEs to diversified lending

Armed with an experienced team and heightened focus (now a separate entity), strategically the aim is to move away from being a predominant SME lender to emerge as a diversified lender. The 2-pronged strategy is to carve a niche in personal finance by creating strategic assets (mobile first acquisition process, leveraging group database, etc), while increasing market share in the strong SME domain. Within consumer finance, the aim is to start with products where finance penetration is low, risk adjusted returns are high and gestation is low. Thus, the company plans to start with 2-wheeler, used car, etc., financing, while consumer durable finance (which has longer gestation period) will be the strategic driver for next leg of growth. We are enthused by the strategy, but execution will be key, which could lead to re-rating.

### Outlook and valuations: Execution key; maintain 'BUY'

RCAP's focus on profitable growth with run down in non-core assets will enhance capital efficiency and improve core performance. Though insurance profitability remains under pressure, we expect improvement post consolidation. We believe potential improvement in earnings will narrow down the discount between current price and inherent fair value of core businesses. We maintain 'BUY/SP' with SoTP of INR767.

#### SOTP valuation (FY19E)

Businesses	Method	Value (INR mn)	Value per share (INR)
Asset management	% of AUMs	55,306	225
Life Insurance	Appraisal value	35,681	145
Retail broking business	PE	6,451	26
Commercial finance business	PB	55,054	224
Home finance business	PB	25,988	106
General Insurance	Eco. profit multiple	21,703	88
Excess NW/Investments	Market value	21,500	88
<b>Fair Value (post holding company discount)</b>			<b>767</b>

\* for 51% stake in life insurance & 51% stake in asset management businesses

Edelweiss Research is also available on [www.edelresearch.com](http://www.edelresearch.com),  
 Bloomberg EDEL <GO>, Thomson First Call, Reuters and Factset.

EDELWEISS 4D RATINGS	
Absolute Rating	BUY
Rating Relative to Sector	Performer
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Overweight

#### MARKET DATA (R: RLCP.BO, B: RCAPT IN)

CMP	: INR 600
Target Price	: INR 767
52-week range (INR)	: 693 / 365
Share in issue (mn)	: 252.6
M cap (INR bn/USD mn)	: 152 / 2,348
Avg. Daily Vol.BSE/NSE('000)	: 3,700.1

#### SHARE HOLDING PATTERN (%)

	Current	Q3FY17	Q2FY17
Promoters *	52.0	52.0	52.0
MF's, FI's & BK's	12.2	11.7	10.6
FII's	17.5	17.4	19.1
Others	18.3	18.8	18.4
* Promoters pledged shares (% of share in issue)	NIL		

#### PRICE PERFORMANCE (%)

	Stock	Nifty	EW Banks and Financial Services Index
1 month	(10.5)	2.3	3.3
3 months	7.1	5.8	10.3
12 months	50.0	18.6	31.2

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### Analyst meet: Key highlights

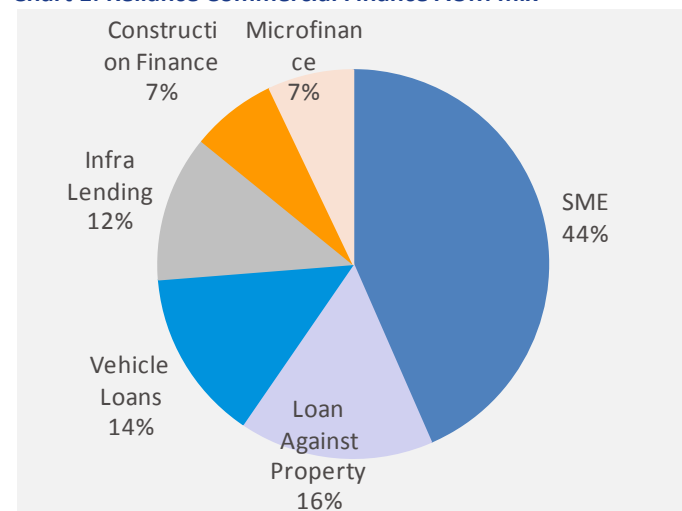
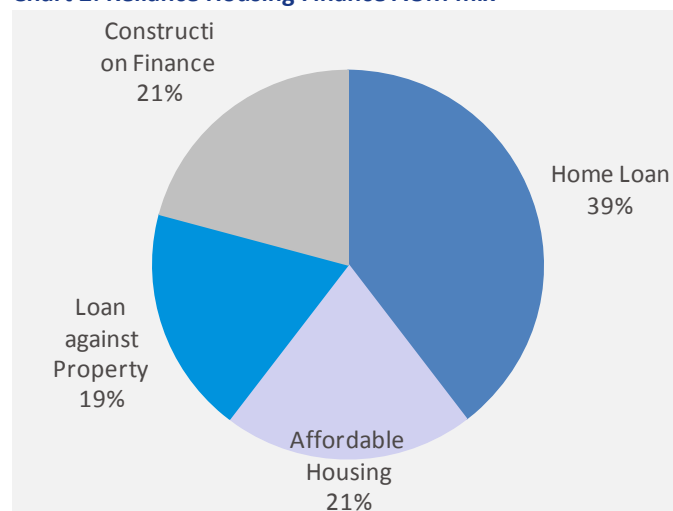
#### Reliance Commercial Finance

- Business strategy was enumerated, viz.,
  - **To diversify revenue pool:** Targets to cater to individual segment with aim to have material contribution from individual lending by FY19.
  - **Achieve relevance in under-penetrated segment:** Aims to launch used car and 2-wheeler financing, while maintaining dominance in niche SME segment.
  - **Create strategic assets:** Focus on mobile first acquisition process, while harnessing group database.
- Product profile
  - **In SME segment,** the company plans to expand footprint in already established education and health care segments.
  - **In infrastructure,** the company plans to leverage on current niche in short-term renewable funding (shorter duration of 12 -18 months). Also, plans to create underwriting capability for hybrid annuity/EPC road projects (shorter tenor).
  - **Micro SME loans** (new segment to be launched) with focus on shopkeepers and food processing units.
  - **Enhance focus on individual lending:** Focus on relatively underpenetrated segments (such as 2 wheeler, used cars) and retail loans (engine to under-write retail/PL/LAS only to group customers). Meanwhile, consumer durable finance (which has longer gestation period) will be the strategic driver for next leg of growth.
  - Being a largely SME focused entity, the company aims to diversify into retail lending segment. The company's current AUM mix: SME (43%), LAP: 16%, vehicle loans: 14%, infra: 12%, construction finance: 7% and micro finance: 7%.
- Growth
  - Targets to achieve loan growth of 18-25% with higher end growth hinged on execution.
  - RoE's will broadly range at current levels of 13-15% in near term.

#### Reliance Home Finance

- The company is able to achieve strong growth rates (AUM growth of 50% plus, albeit on lower base) and aims to achieve similar growth going ahead.
- Currently, a large part of the book is tilted towards self-employed non-professional (SENP) segment (~80%). However, incrementally ~40% is being contributed by salaried segment.
- Margins are supported by lower funding costs. Henceforth, the company aims to maintain margins of 3.4-3.5%. Funding cost has benefitted due to lower reliance on bank borrowings (down to 38% in FY17 from 73% in FY16) and higher market borrowings (moved from 8% in FY16 to 35% till FY17).

- Other highlights
  - AUM composition:** Home loans 38%, Affordable Housing : 20% , LAP : 18% (ATS of INR7mn) and Construction Finance : 20% ( ATS of INR120-140mn)
  - Core home loans:** Around 40% is sourced from DSAs; within LAP, 70% is sourced through DSAs.
  - Prepayment rate of home loans at 18% (stable) and LAP at 24%.
  - RHF will be listing towards September-October.

**Chart 1: Reliance Commercial Finance AUM mix**

**Chart 2: Reliance Housing Finance AUM mix**

**Table 1: Reliance Commercial Finance—Key metrics**

(INR mn)	Q4FY17	Q4FY16	Growth (%)	Q3FY17	Growth (%)
Net interest income	1,985	1,935	2.6	1,416	40.2
Operating expenses	929	925	0.4	808	15.0
Provisions	489	348	40.5	558	(12.4)
PBT	1,314	1,205	9.0	804	63.4
AUM (INR bn)	168	152	10.6	162	3.5

**Table 2: Reliance Home Finance—Key metrics**

(INR mn)	Q4FY17	Q4FY16	Growth (%)	Q3FY17	Growth (%)
Net interest income	420	589	(28.7)	629	(33.2)
Operating expenses	734	397	84.9	453	62.0
Provisions	(37)	39	(194.9)	93	(139.8)
PBT	414	347	19.3	345	20.0
AUM (INR bn)	112	74	51.8	97	15.6

Source: Company

**Table 3: SoTP valuation (FY19E)**

Businesses	Method	Base value (INR mn)	Multiple	Value (INR mn)	Shareholding	Value (INR mn)	Value per share (INR)
Asset management	% of AUMs	28,73,381	3.8%	1,08,442	51.0%	55,306	225
Life Insurance	Appraisal value	40,306	1.7	69,963.13	51.0%	35,681	145
Retail broking business	PE	645	10.0	6,450.61	100.0%	6,451	26
Commercial finance business	PB	31,460	1.8	55,054	100%	55,054	224
Home finance business	PB	14,438	1.8	25,988	100.0%	25,988	106
General Insurance	Eco. profit multiple	2,170	10.0	21,703	100%	21,703	88
Excess NW/Investments	Market value	21,500	0.9	21,500	100%	21,500	88
<b>Fair Value (post holding company discount)</b>							<b>767</b>

Source: Edelweiss research

\* for 51% stake in life insurance & 51% stake in asset management business

## Company Description

Reliance Capital (RCAP) has been actively pursuing growth opportunities in the Indian financial services sector, post the demerger and reorganisation of the Reliance Group, to become a leading financial powerhouse. It has undergone significant strategy changes in the past one to two year, with focus shifting to fast-growing segments in the financial services space, viz., asset management and insurance business, from leasing and infrastructure financing. RCAP is the leader in its existing businesses - one of the largest mutual fund. The company has also forayed into retail broking under the brand Reliance Money and retail financing under Reliance Consumer Finance, including Reliance Home Finance. It also commenced operations in asset reconstruction and institutional broking business.

## Investment Theme

RCAP's earnings have been volatile over the past few quarters due to stake sale and consolidation of group entities. After being in consolidation phase, the company's core businesses viz., AMC and commercial financing, have stabilised a tad or improved. Moreover, third party motor claim reserves in general insurance business have been booked in FY14 and adequate provisioning has been made on its investment portfolio, thereby improving visibility in earnings. Taking cognizance of its inherent value in life insurance and asset management businesses, coupled with scale up in consumer financing and stability in general insurance business, we are positive on the stock.

## Key Risks

Execution failure is the key business risk.

Growth in asset management, life insurance, and broking businesses is highly dependent on the conditions in capital markets. Sustained non-conducive market conditions may hamper our growth assumptions and consequently impact valuations negatively.

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

## Financial Statements

## Key Assumptions

Year to March	FY16	FY17	FY18E	FY19E
<b>Macro</b>				
GDP(Y-o-Y %)	7.2	6.5	7.1	7.7
Inflation (Avg)	4.9	4.8	5.0	5.2
Repo rate (exit rate)	6.8	6.3	6.3	6.3
USD/INR (Avg)	65.0	67.5	67.0	67.0
<b>Company</b>				
Credit growth	9.3	9.0	12.0	14.0
Borrowings growth (%)	8.6	14.0	12.0	13.0
Bank's base rate (%)	9.5	9.0	9.0	9.0
Wholesale borr. cost (%)	8.5	8.5	8.5	8.5
G-sec yield	7.5	6.5	6.5	6.5
<b>CF business assumpt. (%)</b>				
Disbursements	120,579	138,666	159,466	186,575
Repayments	36.2	37.0	37.0	37.0
Securitization	20.0	17.0	18.0	18.0
Leverage	6.0	6.0	6.0	6.0
Yield	14.3	14.0	13.9	13.8
Cost of funds	11.3	11.2	11.1	10.9
<b>Gen. insur. assumptions</b>				
Premium growth	4.2	39.7	18.2	15.3
Reinsurance ceded	35.4	48.1	35.2	34.8
Net claims	74.5	77.6	76.0	75.0
Combined ratio	102.0	104.0	102.0	101.0
<b>MF business assumption</b>				
AUM growth	17.0	31.0	13.0	13.0
AUM fees	0.6	0.6	0.6	0.6
<b>Std. entity assumption</b>				
Profit on sale of invst.	12,000	5,600	5,200	6,700

## Income statement

(INR mn)

Year to March	FY16	FY17	FY18E	FY19E
Interest income	26,553	30,675	35,906	43,411
Interest expended	26,121	28,355	32,059	36,672
Net interest income	432	2,320	3,847	6,739
Non interest income	69,102	78,631	89,434	101,868
- Misc. income	25,613	20,904	21,850	24,774
- Invst. advisory fee	10,442	12,003	14,298	15,821
- Gen ins premium earned	29,899	42,389	49,389	56,939
- Reliance Money	3,148	3,335	3,896	4,334
Net revenues	69,535	80,951	93,280	108,608
Operating expense	50,873	62,353	73,325	83,403
- Employee exp	6,879	7,464	8,505	9,925
- Depn /amortisation	824	822	822	822
- Other opex	43,170	54,067	63,998	72,656
Preprovision profit	18,662	18,598	19,955	25,205
Provisions	1,846	2,599	3,137	4,014
Profit Before Tax	16,816	15,999	16,818	21,190
Less: Provision for Tax	4,126	4,252	5,100	6,492
Profit After Tax	12,691	11,747	11,718	14,699
Associate profit share	320	(300)	(300)	(300)
Profit after min. int.	12,371	12,047	12,018	14,999
Shares o /s (mn)	246	246	246	246
Basic EPS (INR)	50.3	49.0	48.9	61.0
Diluted shares o/s (mn)	246	246	246	246
Adj. Diluted EPS (INR)	50.3	49.0	48.9	61.0
Dividend per share (DPS)	7.5	7.5	7.5	7.5
Dividend Payout Ratio(%)	17.3	17.8	17.9	14.3

## Growth ratios (%)

Year to March	FY16	FY17	FY18E	FY19E
Revenues	10.7	16.4	15.2	16.4
Opex growth	6.3	22.6	17.6	13.7
PPP growth	25.1	(0.3)	7.3	26.3
Provisions growth	51.0	40.8	20.7	28.0
Adjusted Profit	23.6	(2.6)	(0.2)	24.8

Balance sheet		(INR mn)			
As on 31st March	FY16	FY17	FY18E	FY19E	
Share capital	2,462	2,462	2,462	2,462	
Reserves & Surplus	145,749	155,543	165,106	177,648	
Shareholders' funds	148,211	158,005	167,567	180,110	
Minority Interest	5,403	6,603	7,803	9,003	
Short term borrowings	92,606	135,200	168,876	215,579	
Long term borrowings	138,910	202,799	253,315	323,368	
Total Borrowings	231,516	337,999	422,191	538,947	
Def. Tax Liability (net)	201	201	201	201	
<b>Sources of funds</b>	<b>385,331</b>	<b>502,808</b>	<b>597,762</b>	<b>728,261</b>	
Total net fixed assets	701	676	656	639	
Non current investments	156,205	164,165	173,192	183,433	
Current Investments	17,356	18,241	19,244	20,381	
Cash and Equivalents	23,244	28,701	42,055	53,926	
Loans & Advances	218,841	321,191	403,715	520,889	
Other Current Assets	133	133	133	133	
Current Assets (ex cash)	28,436	39,140	40,053	44,398	
Other Current Liab	59,585	69,439	81,287	95,539	
Total Current Liab	59,585	69,439	81,287	95,539	
Net Curr Assets-ex cash	(31,149)	(30,299)	(41,234)	(51,141)	
<b>Uses of funds</b>	<b>385,331</b>	<b>502,808</b>	<b>597,762</b>	<b>728,261</b>	
BVPS (INR)	602.3	642.5	681.4	732.4	

Valuation parameters		FY16	FY17	FY18E	FY19E
Year to March					
Adj. Diluted EPS (INR)		50.3	49.0	48.9	61.0
Y-o-Y growth (%)		23.6	(2.6)	(0.2)	24.8
Book value per share (INR)		602.3	642.5	681.4	732.4
Diluted P/E (x) *		11.0	11.1	10.9	8.5
P/B (x) *		0.9	0.8	0.8	0.7
Dividend Yield (%)		1.1	1.1	1.1	1.1

\*adjusted for life insurance

#### Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		P/B (X)		ROAE (%)	
		FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Reliance Capital	2,348	10.9	8.5	0.8	0.7	7.4	8.6
Capital First	1,051	19.8	15.6	2.8	2.4	14.9	16.6
Dewan Housing Finance	2,176	13.1	11.4	1.7	1.5	13.7	14.3
HDFC	40,829	31.3	27.3	6.0	5.4	20.0	20.8
Indiabulls Housing Finance	7,664	14.0	11.8	3.7	3.2	27.7	29.2
LIC Housing Finance	6,072	18.0	16.4	3.0	2.6	19.6	18.9
Mahindra & Mahindra Financial Services	3,100	29.2	20.0	2.9	2.6	10.2	13.8
Manappuram General Finance	1,239	9.3	8.1	2.2	1.9	24.9	24.9
Muthoot Finance	2,964	13.6	12.1	2.5	2.2	19.7	19.4
Power Finance Corp	5,340	5.0	4.9	0.8	0.8	17.8	16.1
Repco Home Finance	855	26.1	21.6	4.2	3.6	17.5	18.0
Rural Electrification Corporation	5,683	6.2	5.7	1.0	0.9	16.6	15.9
Shriram City Union Finance	2,465	18.9	13.3	2.8	2.4	15.7	19.3
Shriram Transport Finance	3,370	13.1	8.6	1.8	1.5	14.2	18.8
Median	-	13.8	11.9	2.6	2.3	17.1	18.4
AVERAGE	-	16.4	13.3	2.6	2.3	17.1	18.2

Source: Edelweiss research

## Additional Data

### Directors Data

Anil Ambani	Chairman	Amitabh Jhunjhunwala	Vice Chairman
Anmol Ambani	Executive Director	Bidhubhusan Samal	Director
V. N. Kaul	Director	Chhaya Virani	Director
Rajendra Chitale	Director		

Auditors - Pathak H.D Associates

*\*as per last annual report*

### Holding - Top 10

	Perc. Holding		Perc. Holding
Life Insurance Corporation Of India	4.16	Sumitomo Mitsui Trust Holdings	2.77
Valiant Mauritius Partners	2.37	Dimensional Fund Advisors	2.07
Birla Sun Life Asset Management	1.94	Vanguard Group	1.64
Reliance Capital Trustee	1.61	Morgan Stanley	1.32
Causeway Capital Management	0.73	Kotak Mahindra	0.54

*\*as per last available data*

### Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

*\*in last one year*

### Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
No Data Available			

*\*in last one year*



Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Allahabad Bank	HOLD	SU	M	Axis Bank	BUY	SO	M
Bajaj Finserv	BUY	SP	L	Bank of Baroda	BUY	SP	M
Bharat Financial Inclusion	BUY	SO	M	Capital First	BUY	SO	M
DCB Bank	REDUCE	SU	M	Dewan Housing Finance	BUY	SO	M
Equitas Holdings Ltd.	BUY	SO	M	Federal Bank	BUY	SP	L
HDFC	HOLD	SP	L	HDFC Bank	BUY	SO	L
ICICI Bank	BUY	SO	L	IDFC Bank	HOLD	SP	L
Indiabulls Housing Finance	BUY	SO	M	IndusInd Bank	BUY	SP	L
Karnataka Bank	BUY	SP	M	Kotak Mahindra Bank	HOLD	SP	M
L&T FINANCE HOLDINGS LTD	BUY	SO	M	LIC Housing Finance	BUY	SP	M
Magma Fincorp	BUY	SP	M	Mahindra & Mahindra Financial Services	HOLD	SU	M
Manappuram General Finance	BUY	SO	H	Max Financial Services	BUY	SO	L
Multi Commodity Exchange of India	BUY	SP	M	Muthoot Finance	BUY	SO	M
Oriental Bank Of Commerce	HOLD	SP	L	Power Finance Corp	BUY	SO	M
Punjab National Bank	BUY	SP	M	Reliance Capital	BUY	SP	M
Repco Home Finance	BUY	SO	M	Rural Electrification Corporation	BUY	SO	M
Shriram City Union Finance	BUY	SO	M	Shriram Transport Finance	BUY	SO	L
South Indian Bank	BUY	SP	M	State Bank of India	BUY	SP	L
Union Bank Of India	HOLD	SP	M	Yes Bank	BUY	SO	M

## ABSOLUTE RATING

### Ratings

### Expected absolute returns over 12 months

Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

## RELATIVE RETURNS RATING

### Ratings

### Criteria

Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

## RELATIVE RISK RATING

### Ratings

### Criteria

Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

## SECTOR RATING

### Ratings

### Criteria

Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

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## Coverage group(s) of stocks by primary analyst(s): Banking and Financial Services

Allahabad Bank, Axis Bank, Bharat Financial Inclusion, Bajaj Finserv, Bank of Baroda, Capital First, DCB Bank, Dewan Housing Finance, Equitas Holdings Ltd., Federal Bank, HDFC, HDFC Bank, ICICI Bank, IDFC Bank, Indiabulls Housing Finance, Indusind Bank, Karnataka Bank, Kotak Mahindra Bank, LIC Housing Finance, L&T FINANCE HOLDINGS LTD, Max Financial Services, Multi Commodity Exchange of India, Manappuram General Finance, Magma Fincorp, Mahindra & Mahindra Financial Services, Muthoot Finance, Oriental Bank Of Commerce, Punjab National Bank, Power Finance Corp, Reliance Capital, Rural Electrification Corporation, Repco Home Finance, State Bank of India, Shriram City Union Finance, Shriram Transport Finance, South Indian Bank, Union Bank Of India, Yes Bank

### Recent Research

Date	Company	Title	Price (INR)	Recos
14-Jun-17	Banking	Mixed quarter; bumpy ride ahead; <i>Sector Update</i>		
14-Jun-17	Banking	Stress resolution: Credible move; <i>Sector Update</i>		
13-Jun-17	Insurance	Insurance premiums: Private players extend strong run; <i>Sector Update</i>		

### Distribution of Ratings / Market Cap

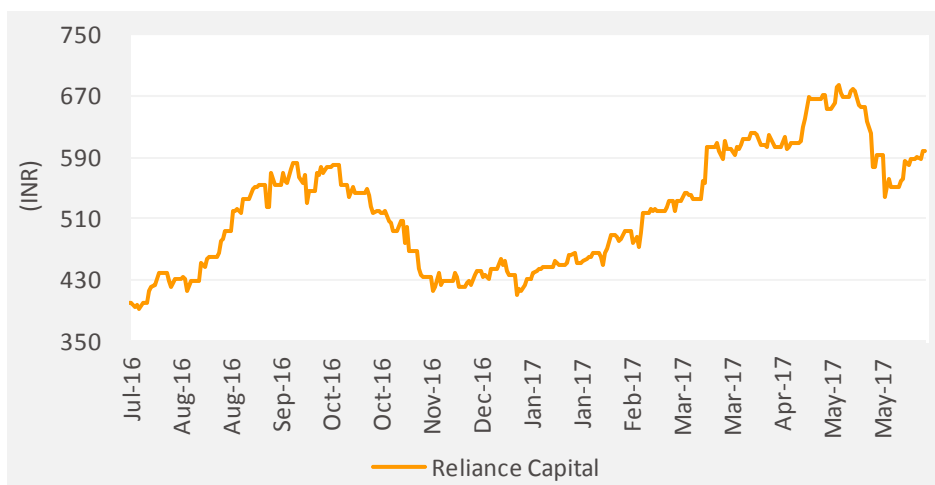
#### Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

### Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

### One year price chart



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