

RCap: Focus on core biz may bridge valuation gap

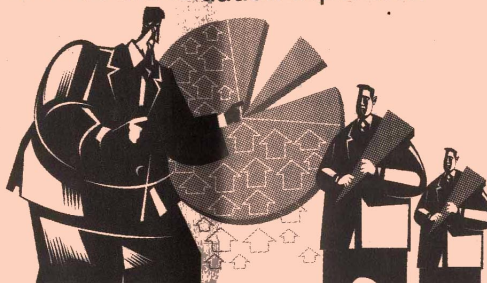
Sale of non-core assets, listing of home finance arm and stake sale in general insurance business will also aid valuation expansion

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With 37 per cent year-to-date gains, Reliance Capital is among the biggest gainers in the category of BSE200 companies since the start of 2017. Its stock price has almost doubled in the past 12 months, thus catching the attention of investors. But its market capitalisation still lags at ₹15,347 crore. This is despite two significant stake sales, which valued the life insurance business at ₹10,000 crore and the asset management company (AMC) at ₹8,500 crore. Reliance Capital holds 51 per cent each in the two businesses. So what's holding back Reliance Capital's stock from mirroring the valuations of its subsidiaries?

While some experts say that the memories of Reliance Power's initial public offer continue to weigh on the group's stocks, others such as Santosh Singh, head of research, India, Haitong Securities, says it is much more than just the perception. "How the business of Reliance Capital performs on fundamental parameters is more important," he says. Analysts say that freeing capital from non-core assets will be the most important move towards realising the potential of the core businesses. "Non-core investments have been a key problem. If they are able to sell them, the balance sheet will look better," Singh says.

Reliance Capital's management, however, is optimistic and expects a substantial reduction in non-core investments in



SOTP VALUATIONS

Businesses	Value per share (₹)
Asset management	207
Life insurance	145
Retail broking	26
Commercial finance	230
Home finance	112
General insurance	79
Other investments*	88
Fair value#	754

SOTP: Sum of the parts; *Valued at market; # Includes holding company discount at 15%
Source: Edelweiss Research

HEALTHY GROWTH

In ₹ crore	FY18E
Total income	18,465
% growth y-o-y	11.3
Profit before tax	1,671
% growth y-o-y	9.1
Net profit	1,253
% growth y-o-y	9.1

Consolidated financials (does not factor for any stake sale)

E: Estimates; y-o-y: year-on-year
Source: ICICI Securities

FY18. They include stakes in Yatra.com, Sula Vineyards, Grover Vineyards and Mahindra First Choice, apart from its interests in the media and entertainment businesses. Sloughing off non-core activities will augment capital allocation for the core areas, as discussed in the analysts' meet, in which the group's chairman, Anil Ambani, and his son Anmol Ambani presented the company's plans. The core businesses include insurance (general, health and life), housing finance, commercial finance and AMC, in which the prospects are beginning to brighten.

For instance, the AMC business fetched a net profit of ₹506 crore in FY16 and is among the profitable asset management businesses in India. Likewise, Reliance General Insurance, which turned profitable in the current financial year, has improved its online presence over what was three years ago, and has also strengthened its banking channel partnerships. As for the 11-year-old life insurance business, the embedded value currently stands at ₹3,074 crore with an improving persistency ratio at 61 per cent versus 56 per cent a year ago. As the latter improves to average levels of

70 per cent plus for the top players, the valuations could also improve. Currently, analysts value Reliance Capital's insurance business at 1.7 times the embedded value, as compared to 2.5 times plus for larger peers.

In housing finance, as loans for affordable housing increased substantially, the business posted 61 per cent year-on-year growth in loan disbursements to ₹4,376 crore in nine months of FY17. Analysts say the asset quality of the business also appears decent with gross non-performing assets at less than 1 per cent. The commercial lending business, focused on small and medium enterprise loans, apart from education, health care and other loans, has a 6 per cent net interest margin, which, according to analysts, is robust.

On the whole, analysts at ICICI Securities recently upgraded the Reliance Capital stock from 'hold' to 'buy' as they expect the lending, AMC and general insurance businesses to grow at a healthy pace of 13.7-18 per cent in FY18.

Analysts at Edelweiss, who increased their target price on the stock from ₹661 to ₹754 after the analysts' meet, say that a potential improvement in earnings will narrow the discount between the current price and the inherent fair value of the core businesses. A stake sale in the general insurance business and listing of the home finance business would help unlock value. For now, the stock now trades at 0.8x FY18 price-to-book and is among the least expensive non-banking finance companies.