Reliance Capital Limited

Q2 FY17 Earnings Conference Call

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SPEAKERS: Management of Reliance Capital

Moderator: Ladies and gentlemen good day and welcome to Reliance Capital Q2 FY2017 earnings conference call hosted by Reliance Securities. As a remainder all participant lines will be in the listen only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Asutosh Mishra from Reliance Securities, thank you and over to you sir.

Asutosh Mishra: Thank you. Good morning everyone and welcome to Reliance Capital Conference Call. Today, we have with us Mr. Sam Ghosh - ED and Group CEO of Reliance Capital, along with the entire senior management team to discuss 2Q FY2017 Earnings and strategy on the key operative business going forward. Over to you, Sir.

Sam Ghosh: Thank you Asutosh, good morning to all of you and welcome to our Q2 FY2017 Earnings Conference Call. We have the CEOs from our businesses with us, KV Srinivasan from Reliance Commercial Finance; Sundeep Sikka from the Asset Management Business, Rakesh Jain from Reliance General Insurance; Manish Dhanuka, CFO for Broking & Distribution is here; as well as the Reliance Capital's CFO Amit Bapna. I would also like to welcome Ashish Vohra, and Ravindra Sudhalkar, who have joined as CEO for Reliance Nippon Life Insurance and Reliance Home Financial respectively.

Let me present a brief summary of our consolidated results and an update on each of our businesses, after that we will take questions.

In Q2, the total income increased by 108% to Rs. 49 billion. The consolidated net profit for the quarter rose by 31% to Rs. 3.3 billion, prior to strengthening of reserves in Reliance General Insurance. Post that, the net profit increased by 1% to Rs. 2.5 billion. Core profits were driven by higher earnings in Asset Management, General Insurance, Broking & Distribution and the lending businesses. Life Insurance business had a break even quarter as against a profit of Rs. 151 million in Q2 FY16. The net worth of Reliance Capital increased by 11% to Rs. 159 billion as on September 2016. In asset management, our Mutual Fund average assets under management grew by 20% to over Rs. 1.8 trillion, with a market share of 11.2%. We remain the 3rd largest player in the mutual fund industry. Profit before tax grew by 21% to Rs. 1.5 billion driven by higher debt AUMs. In Reliance Commercial Finance, assets under management increased by 9% to Rs. 157 billion. Profit before tax was higher by 4% at Rs. 739 million. In Reliance Home Finance, assets under management increased by 42% to Rs. 92 billion. Profit before tax for the quarter rose by 4% to Rs. 318 million. In general insurance, we are amongst the top four players in the private sector.

Gross written premium increased by 116% to Rs. 14.5 billion. Profit from the business rose by 11% to Rs. 333 million. In the life insurance business, embedded value for the business rose by 12%, from Rs. 28 billion as on March 2016 to Rs. 31 billion as on September 2016. Persistency improved from 56% to 61% for the quarter ended September 2016. We have given detailed financials and operating parameters for each of our major businesses in our presentation and review report. I will now go through the main highlights in each business.

Reliance Nippon Life Asset Management manages Rs. 3.2 trillion of assets across its mutual fund, pension funds, managed accounts, offshore funds and alternative investment funds. Reliance Nippon Life Asset Management is the largest Asset Manager in India. Reliance Mutual Fund is amongst the top three mutual funds in India, with a market share of 11.2%. The average assets under management of Reliance Mutual Fund were Rs. 1.8 trillion as on September 2016 - an increase of 20%. The number of systematic investment plan and systematic transfer plan folios rose by 11% to over 1.5 million, indicating continued participation in equities by the retail investors, despite challenging market conditions. As on September 2016, Reliance Mutual Fund has the highest AUM sourced 'outside the Top 15 cities' amongst private sector asset management companies. Total income for the quarter ended September 30, 2016, increased by 14% to Rs. 4 billion. The business achieved a profit before tax of Rs. 1.5 billion - an increase of 21%. Reliance Mutual Fund continues to be amongst the most profitable mutual funds in India. For the quarter, return on equity was stable at 25%.

Reliance Commercial Finance, currently a division of Reliance Capital, continues to focus on secured asset lending to niche segments of SME, Infrastructure financing, Loan against property, and Commercial Vehicle loans. As mentioned earlier, we are progressing with the demerger of the business into a separate 100% subsidiary, and we expect to complete the process by November 30, 2016. The assets under management grew by 9% to Rs. 157 billion. The outstanding loan book rose by 10% to Rs. 113 billion. Disbursements decreased by 24% to Rs. 16 billion due to poor capex offtake and a conscious decision to be conservative in the LAP segment. We securitised loans worth Rs. 12 billion during the quarter - an increase of 7%. At the end of the quarter, 100% of the book continued to be secured. The total income for the quarter increased by 8% to Rs. 5 billion. Profit before tax rose by 4% Rs. 739 million driven by higher asset growth and lower operating costs. The net interest margin rose from 6.3% to 6.5% in Q2 FY17, supported by lower funding costs. In Q2, the cost to income ratio improved from 18.4% to 16.4%. The return on equity for the quarter declined from 14.8% to 11.6%. The gross NPAs were Rs. 5.7 billion as on September 2016, and were flat as against June 2016. On a 90 day basis, gross NPAs are 3.6% of the assets under management. The increase in NPAs vis-à-vis September 2015 was due to higher stress in the Infrastructure lending, and Commercial Vehicles segments. The coverage ratio, including write-offs, at end of September 2016 stood at 57%. Excluding write-offs, the ratio was at 19%.

Reliance Home Finance Limited is a 100% subsidiary of Reliance Capital and caters to the self employed segment in the mortgage sector. We will continue to grow our housing finance assets in a significant manner in the future. The assets under management grew by 42% to Rs. 92 billion. The outstanding loan book rose by 35% to Rs. 79 billion. In Q2 FY17, disbursements increased by 109% to Rs. 16 billion. The total income for the quarter increased by 33% to Rs. 2.7 billion. The profit before tax rose by 4% to Rs. 318 million. The cost to income ratio rose marginally from 16.0% in Q2 FY16 to 16.4% for the quarter, as the company continues to invest towards expanding its scale and operations. The net interest margin for the quarter remained stable at 3.6% vis-à-vis Q1 FY17, as we expand our portfolio towards the lower ticket-affordable housing business. The return on equity declined to 14.1% for the quarter, as compared to 15.8% in Q2 FY16, due to higher operating expenses and marginal increase in gross NPAs. As on September 2016, the gross NPAs were at 1.2%, as compared to 0.9% as on September 2015, due to a one-off case in the Construction Finance segment, which we expect to resolve in the current quarter. The coverage ratio, including write-offs, at end of September 2016 stood at 28%. Excluding write-offs, the ratio was at 21%.

Reliance General Insurance is amongst the top private sector General insurance companies in India - in terms of gross premium - with a private sector market share of 7.2%. The Gross Written Premium for the quarter rose by 116% to Rs. 14.5 billion. The increase by primarily driven by higher premium from the Crop Insurance segment, which contributed Rs. 7.7 billion in premium. The business continues to defocus on the third party motor business, on a standalone basis, as well as commercial vehicles. Premium from preferred segments such as private cars, two wheelers, commercial lines and travel continued to grow in line or better than the industry. The combined ratio was stable at 122% for the quarter. The combined ratio for the short-tail business was below 100%. Going forward, with the planned reduction in the motor third party business, we expect the ratio to improve further. Our focus in this business has been to improve profitability, while maintaining our market position. Profit for the quarter increased by 11% to Rs. 333 million. The profit includes the impact of Rs. 738 million on account of strengthening of IBNR reserves. For the quarter ended September 30, 2016, the return on equity remained stable at 12%. As on September 2016, we have the largest agency force in the private sector with over 22,500 retail agents and 125 branches. In Q2, Reliance General Insurance became the second insurer in the industry to raise subordinated debt, amounting to over Rs. 2 billion. The solvency ratio improved to 1.81 as against the regulatory minimum of 1.5. In Q2, Reliance General Insurance concluded distribution tie-ups with key institutions, including Andhra Bank, Catholic Syrian Bank and Air Asia. Also, the company aligned itself with nine automotive manufacturers. The Company is under discussion with several other institutions for similar tie-ups. These partnerships will provide a significant impetus to the business growth in the coming quarters.

New Business Premium was Rs. 3 billion, while Renewal premium increased by 10% to Rs. 7 billion. Individual WRP decreased by 33% to Rs. 1.6 billion. The industry growth continued to be driven by ULIP products. Being an agency-driven insurer, we continue to stay focused on the traditional product segment, which formed 84% of the Individual New Business Premium in Q2 FY17. Also, we continued to stay focused on our strategy of creating a larger base of active advisors, instead of depending upon a few high performers. Overall persistency rose sharply from 56% to 61% in Q2 FY17. The business continues to focus on Agency and proprietary channels, which have better persistency. Continued growth in renewal premium, along with higher persistency, demonstrates our emphasis on improving the business quality. The business posted a marginal profit in the quarter, in line with Q1 FY17. The Embedded Value as on September 30, 2016, was Rs. 31 billion - an increase of 12% as against March 2016. Total funds under management rose by 5% to Rs. 163 billion as on September 2016.Sum assured of policies in force was Rs. 966 billion. There are 3 million policies in force. There is a network of over 760 offices and approximately 79,000 active advisors across India. Reliance Nippon Life Insurance has successfully commenced relationship with over 8 financial institutions in the bancassurance space. Also, we are in active discussion with more players in the sphere of Schedule Commercial Banks, foreign banks and regional rural banks, to expand this channel further. With support from the bancassurance channel, higher persistency and better agency productivity, we expect to improve the profitability and regain market share in the private sector.

Reliance Securities is amongst the leading retail equity broking houses in India. Also, it is amongst the leading distributors of financial products and services in India, with a network of nearly 80 branches. The focus in this segment is on the key business verticals of broking, distribution and wealth management. The equity broking accounts increased by 3% to over 786,800. And the average daily equities turnover rose by 50% to Rs. 26 billion. The number of commodities broking accounts rose by 11% to over 68,100. The daily average commodities turnover was Rs. 5 billion - an increase of 13%. In wealth management, the assets under management stood at Rs. 32 billion - an increase of 65%. For the quarter, total income increased by 5% at Rs. 791 million. The business had a profit of Rs. 206 million for the quarter as against a profit of Rs. 4 million in Q2 FY16. Going forward, we expect to continue the trend of profitability.

Reliance Asset Reconstruction is in the business of acquisition, management and resolution of distressed debt and assets. As on September 2016, the assets under management rose to Rs. 14 billion - an increase of 14%. The profit before tax rose by 58% to Rs. 65 million on account of higher recoveries. Return on equity improved from 7% in Q2 FY16 to 12% in this quarter. We expect to accelerate the acquisitions in the coming quarters with improving market conditions and asset sales by the banks.

In conclusion, I would like to say that all core businesses are on track in terms of operating performance and we expect each of our businesses will continue the trend of profitable growth on a consistent basis. Thank you very much. We can now have questions.

Moderator: Thank you. We will now begin the question-and-answer session. We have the first question from the line of Lalit Kumar from MCA management. Please go ahead.

Lalit Kumar: Can you the claims incurred and benefits paid has jumped up significantly from 45 million to 190 million on a Y-o-Y basis can you just throw some light on it on what claims with the asset and from which particular segment of it constitute more.

Management: In the last Q2, we did not consolidate life insurance as a subsidiary so we were doing only associate consolidation, which is equity pickup. Hence, you are seeing a large jump.

Lalit Kumar: Correct me if I am wrong on a segment of its what does finance and investment constitute what ware all the activities that constitute because I am seeing on 26813 Crores of assets been put up you are able to generate the revenue of only 487 Crores which is less than a meager 1% of segment revenue been constituted. So can you just throw some light on that as well?

Management: So the finance and investment activity is actually the holding company balance sheet, which is basically investments into all our subsidiaries, associates, proprietary investments, etc., so you will not have very large incomes and profits, because these are investments into our own companies.

Moderator: Thank you. We will take the next question from the line of Nishchint Chawathe from Kotak Securities. Please go ahead.

Nishchint Chawathe: Can you just take us through the EV walk for the first-half; I believe you have reported a 12% growth in EV in the last six months.

Management: The EV has gone up largely due to our improvement largely on account of persistency and reduction of expenses during H1.

Nishchint Chawathe: And how much was the operating ROE be if I try to annualize it.

Management: About the half of the increase would be due to the increase in operating ROE.

Nishchint Chawathe: Moving onto the NBFC business what was the weighted average and marginal cost of borrowing?

Management: Weighted average marginal cost of borrowings was in the region of 9.6% to 9.7% or so.

Nishchint Chawathe: This is a marginal cost of borrowing?

Management: That is right.

Nishchint Chawathe: And average on balance sheet.

Management: Which broadly tracks the base rate plus about 20, 25 basis points.

Management: And the average would be around 10% growth of historical number.

Nishchint Chawathe: And you have been doing any bond issuance in this quarter?

Management: Yes we did our 2000 crores private placement this quarter.

Nishchint Chawathe: If you can share the yield on books.

Management: This was at 9%.

Nishchint Chawathe: This is for the housing business right.

Management: No, this is for the NBFC business.

Nishchint Chawathe: Just on the incremental yields if you could share on the developer and in the housing finance business if you could share the incremental yields on developer finance in LAP?

Management: Developer finance are high ticket size of loan, about 10 Crores, while the yields are about 16.3% on an average.

Nishchint Chawathe: That is average but incrementally what you would have done over last year.

Management: Incremental, it is around the same it is flattish as about 16.3% to 16.4%.

Nishchint Chawathe: And LAP.

Management: LAP the yield that we are getting is roughly about 13%.

Nishchint Chawathe: On an incremental basis.

Management: Yes on an incremental basis.

Nishchint Chawathe: Again in housing finance why is it so that the earnings growth is sort of little weak at about 4% or so?

Management: See that is because the mix of housing loans. Home loans has actually gone up overtime and since we are aggressively grown the book in the past few quarters and you will notice the growth rate has been almost 50% for fairly two past quarters, the cost of that is usually front ended, while the yield occurs over a period of time, so therefore, in housing, you always will see increased cost first and then the yield to pick in few quarters later so that the case that we are currently going through.

Nishchint Chawathe: So to clarify what you essentially are saying is that the upfront fees and the upfront expenses are booked in the particular quarter is the reason there is a little bit a drag, which you are growing very fast.

Sam Ghosh: Because the housing loan per se is slightly low margin business so the cost getting front-ended will create that amount of drag, but it even sought over the period of time.

Nishchint Chawathe: And in the NBFC business how should I read the decline in disbursements?

Management: For the past six quarters, we have gone a little slow on the LAP side because there has been a significant amount of pricing pressure in the market as well as we do not like the kind of risk profile of the borrowers who are coming across. So, we had taken a call sometime in February 2015 to go a little slow. So, in the last six quarters, the book has actually declined but I think probably we are now seeing the bottom of that cycle, so I guess in the next couple of quarters, we should see some sort of a revival in the scenario and better growth in the LAP segment going forward. Also, what we have done is that, as a conscious strategy, we have also been going very slow on the commercial vehicle segment. As you are aware, we have had some amount of stress in the commercial vehicle segment. So, we have been de-growing those segments and they, put together, would account for the disbursement being a little low.

Nishchint Chawathe: Now that the incremental borrowing cost kind of has come down a little bit and will possibly continue to come down over next couple of quarters would you look at an option where you would possibly look at a slightly different segment in LAP where your yields are lower but may be a ticket size is higher or in the sense that from a 16% yield may be to a kind of a 12%, 13% kind of a yield segment there possibly we have a higher ticket sizes and higher volumes?

Management: Well, higher ticket sizes primarily at this moment, we need to watch it more from a risk perspective rather from a return perspective. As I said, if the risk is coming down to acceptable levels, we will start to grow the book in a very aggressive manner. More than the yields, I think the risk parameters that are today currently in our mind. But having said that, when the cost of fund goes down, the yields which the borrower expect also would go down so, I do not think from a net interest margin perspective, there will be dramatic change.

Nishchint Chawathe: Let me put this a little differently. What I was trying to say is that would you want to really shift segments in terms of trying to say that I am okay with the lower margin but I do not mind taking a lower risk kind of a business?

Management: We have been taking fairly conservative risks anyway and as Ravindra mentioned a few minutes ago the marginal yield on the LAP portfolio is about 13% only. So marginal basis, we are not doing 16% In LAP, the marginal is around 13% so it is not that we are taking higher risk on the LAP. At 16%, that is dangerous.

Nishchint Chawathe: And just one final question on the combined ratio in GI why is it that has gone up on a Q-o-Q basis?

Management: I think Q-o-Q first quarter is always positive because there is a concentration of corporate business on April 1, which obviously we will see the lot of reinsurance income, but if you compare it with the last year's quarters in like-to-like that we are at a stable 122% and this is also after taking the impact of about 74 Crores of additional reserve strengthening on IBNR which we did. So I think if you exclude there is the additional impact, which would have been, have much better quarter. Overall I think it has been the growth has been good, I think. The other segments of business other than vehicles have been strong and I think the diversification has increased our overall income which was able to even take care of this exceptional 74 Crores.

Nishchint Chawathe: Just one last question I forgot to ask on the life business what would be your margins?

Management: Margins are roughly 28%.

Nishchint Chawathe: Thank you very much and all the best.

Moderator: Thank you. We will take the next question from the line of Manish Shukla from Deutsche Bank. Please go ahead.

Manish Shukla: Good morning everyone and thank you for the opportunity. Now between RHF and RCF both have three segments common which is LAP, construction finance and SME so on an incremental basis both historical and incremental what kind of business gets booked in which entity across these three segments?

Management: What we have decided is the construction finance will be going into RHF. SME remains as part of Reliance Commercial Finance and LAP will be basically sourced by one team and booked in both the businesses for the time being.

Manish Shukla: But then within RHF, is there a theoretical cap that you want to put on how much LAP and construction finance are comfortable with?

Management: Yes, there are clear-cut national housing bank guidelines on this so we just need to adhere to that.

Manish Shukla: Once the RCF subsidirization happens what will be the residual loan plus investments and borrowings on the parent book after the RCF becomes a full subsidiary?

Management: We will have investments in corporate loan book of around 7000 to 8000 Crores and we will have to try and reduce that to certain extent because we want to become a CIC by March.

Manish Shukla: By March itself.

Management: Yes we get the CIC before March so we will reduce all third party exposures.

Manish Shukla: You mentioned about the contraction in slowdown in disbursement growth but the book itself for RCF has contracted Q-o-Q both loan book and AUM, what explains that if there was since?

Management: The same explanation which I had given which is primarily that we have gone a little slow on the fairly slow on the LAP side. The book has degrown and the defocusing on the commercial vehicles segment, which we have been falling for the first few quarters so, these two have contributed primarily.

Manish Shukla: So if we were to try and think of growth 12 months or six months forward for both RCF and RHF on book basis what is the kind of book growth that you expect separately on the two entities?

Management: As far as the SME business is concerned, we have been growing that significantly and also our supply chain business etc., have been doing fairly well so these two will be the primary growth driver from RCF perspective and on the RHF of course clearly home loans is going to be has been our focus for the past few quarters any which way home loans and affordable housing that is going to continue significantly. So growth drivers on the RHF side will be the housing and the affordable housing businesses and on the RCF side will be SME, supply chain and the retail infrastructure.

Manish Shukla: But on a book basis would you still expect a mid to high teens growth on RCF this year or you expect?

Management: Yes

Manish Shukla: One question on general insurance in the business mix the component of others has gone up is that entirely the Pradan Mandhri Yojana?

Management: Yes.

Manish Shukla: So in value terms it is as big is it?

Management: Yes it is actually a very path breaking scheme for the entire industry this will lead to an attrition of close to about 18,000 Crores and you will see most of the companies in quarter two because quarter two coincides with the Kharif season and this is where the majority of the revenues will accrue. So I think Reliance General Insurance appropriate to its market share has also done the business and it is just that it is there is no base affect perhaps it stands out this year going forward obviously this will neutralize significantly.

Manish Shukla: Just to understand it, it is an annual single premium product right?

Management: See actually there are two seasons in India in cropping one is the Kharif and the other is the winter crops which is Rabi but Kharif is almost 80% of the premiums another 20% will accrue in quarter four.

Manish Shukla: Thank you. Those were my questions.

Moderator: Thank you. We will take the next question from the line of Vikas Garg from L&T Mutual Fund. Please go ahead.

Vikas Garg: First part of the question has been answered already in terms of the timeframe for converting to what CIC. Just a bit of a clarification over there, when you say that by March 2017 you would become the CIC so does it mean that you would get the CIC you would get registered with RBI as a CIC by March 2017 or will it be that you would start adhering to the rules the applicable rules for CIC from March 2017 and then you would apply for the license from RBI?

Management: I think what will happen is see by November 30, we would have hived off our commercial finance division from Reliance Capital into the separate subsidiary. After that, we will immediately put an application to RBI so we expect that the approval should come through by the month of March.

Vikas Garg: Secondly the number which you mentioned earlier of around 5000 to 7000 Crores of loan book that would be retained at the standalone parent company level post becoming a CIC so that includes the total loan book and the investment or investment book would be separate as compared?

Management: All put together because everything will have to be only group exposure everything put together would be around 7000 – 8000. I am not considering our investments and our subsidiaries also see that is obviously separate that is another 10,000 Crores.

Vikas Garg: So 7000 - 8000 Crores would be the total investment plus the loan book, which would be pertaining to the group companies only, and you cannot have any other loans, which is not pertaining to our group company at all under CIC regulation.

Management: Yes.

Vikas Garg: So just out of curiosity would there be any kind of a branding or some of the companies possibly that could come under growth in under the new CIC regime?

Management: No we are not looking on any other.

Vikas Garg: Thank you very much.

Moderator: Thank you. Next question is from the line of Pranav Tendulkar from Forefront Capital. Please go ahead.

Pranav Tendulkar: My question is once you become a CIC what all subsidiaries you will list separately or they would not be listed or how you plan to do it?

Management: Currently we are in the process of getting our housing finance company listed. We do not have immediate plans to list any other company as we speak, but when the time is right, we will consider appropriately.

Pranav Tendulkar: I have one more question so recently there was a India Ratings paper floating which said that whichever Indian insurance companies have completed 10 years of operations could actually be mandatorily told to list their insurance arms am I correct in reading that circular?

Management: The draft guidelines we are waiting obviously for that but in between IRDA chairman came in some newspaper to say that it may not be compulsory; it will be optional so we do not know. Let us wait and see. Also it is unlikely the ten-year timeframe is going to get mandated there, so we have some recent discussions on that one, so it continues to remain a draft.

Pranav Tendulkar: Sir in your housing finance company can you just tell me the profile of current book how much is salaried or all is self employed?

Management: See typically if you take the case of affordable housing, we have got a mix of salaried and self-employed both. But if you take the case of normal home loans which are not affordable housing, you have more focus on self-employed side compared to the salaried side. In terms of percentages, it would be 70-30.

Pranav Tendulkar: So 70 is self employed you are saying in current book?

Management: Yes.

Pranav Tendulkar: Sir any idea about how much is disbursement in housing loans this quarter and same quarter last year?

Management: For the incremental disbursement you are referring to, we have grown by almost 2x of what we have done in the last quarter but again there was a base effect.

Pranav Tendulkar: So there is no slow down in housing loans you are saying.

Management: On a lower base, we did not see any slowdown..

Pranav Tendulkar: Sir in housing I went through your presentation but I could not find in housing finance how much the GNPA and slippages this quarter any rough idea?

Management: There was certain slippage. There was certain accounts on the construction finance front which one of them would stand resolve this quarter itself. GNPAs have gone up marginally at about 1.2%, which was 0.9% over the same period last year.

Pranav Tendulkar: Slippage numbers this quarter so which is the incremental classification into GNPA is that number available in housing?

Management: That will be around 30 Crores.

Pranav Tendulkar: And in commercial finance?

Management: In commercial finance the rupee slippages was about 7 Crores.

Pranav Tendulkar: Thanks a lot.

Moderator: Thank you. That was the last question I now hand the conference over to Mr. Asutosh Mishra for his closing comments. Over to you Sir!

Asutosh Mishra: Thank you everyone for participating in the call and thanks to the management for giving their perspective on the operating business. Thank you.

Moderator: Thank you. On behalf of Reliance Securities Limited that concludes this conference. Thank you for joining us. You may now disconnect your lines.