Reliance Capital Limited

Q1 FY15 Earnings Conference Call

14th August 2014

SPEAKERS: Management of Reliance Capital

Moderator Ladies and Gentlemen, good day and welcome to the Reliance Capital Limited Q1 FY15 Result's Conference Call, hosted by Edelweiss Securities. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference, please signal an operator by pressing '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Kunal Shah from Edelweiss Securities. Thank you and over to you.

Kunal Shah Thank you. Good evening everyone and welcome to The Reliance Capital Limited Q1 FY15 Earnings Conference Call. We have with us Mr. Sam Ghosh - CEO of Reliance Capital and the senior management team from Reliance Capital. At this point, I would like to hand over the call to Mr. Ghosh who will brief us about the results and then we can take questions. Over to you sir.

Sam Ghosh Thanks Kunal. Good evening to all of you and welcome to our Q1 earnings conference call. We have the CEOs from our businesses with us; Anup Rau from Life Insurance, Rakesh Jain from Reliance General Insurance, K.V. Srinivasan from Commercial Finance and Vikrant Gugnani from the broking & distribution segment. We are also joined by Prateek Jain, CFO of our asset management business, as well as Reliance Capital's CFO, Amit Bapna. 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 this quarter, the total income increased by 11% to Rs. 21 billion. The consolidated net profit for the period was at Rs. 1.6 billion - an increase of 23%. The net worth of Reliance Capital increased by 4% to Rs. 126 billion as on June 2014.

In the life insurance business, new business premium rose by 8% to Rs. 5.5 billion in this quarter, making us the 4th largest player in the private sector. In general insurance, Q1 gross written premium increased by 11% to Rs. 8 billion, higher than the industry growth of 5%. In terms of gross premium, we are ranked fourth in the private sector. Profit from the business rose by 138% to Rs. 243 million. In commercial finance, profit before tax rose to Rs. 836 million. We have improved our net interest margins to 5.7% vis-à-vis 5.0% in Q1 FY14. In asset management, our Mutual Fund average assets under management grew by 15% to Rs. 1.1 trillion, with a market share of 11%. Profit before tax grew by 15% to Rs. 887 million driven by improved cost efficiencies. 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; in Q1 FY15, Reliance Life Insurance maintained its position amongst the leading private sector life insurance players, with a market share of 10%. The total premium for the quarter rose by 6% to Rs. 10 billion, driven by an 8% increase in new business premium to Rs. 5.5 billion, while renewal premium rose by 5% to Rs. 4 billion. In Q1, new business premium growth moderated due to the new regulation that mandated submission of bank proof by the policyholder at the business login stage, which had a deeper impact on agency driven Insurers. We expect relaxation in this regulation for select segments of the business in the near term. In spite of this, Reliance Life maintained its position amongst the top five private sector insurers, in terms of individual WRP, at the end of the quarter. Average ticket size increased by 48% to over Rs. 25,400 in Q1 FY15. We expect to sustain the improvement in average ticket size and productivity through the year as well as maintain our position amongst the top private sector insurers. Overall persistency improved marginally to 52.4% in Q1 FY15. The business benefitted from the higher share of Agency and proprietary channels in the new business premium, which have better persistency than other channels. There was significant reduction in indicators of lower quality of business such as number of mis-selling complaints and percentage of undelivered policies Also, the business saw improvement across metrics such as a 14% increase in activation of new advisors and 18% rise in sales managers' productivity. Profit for the quarter was Rs. 344 million. Also, surplus from non-participating business was Rs. 211 million. The profits are lower than Q1 FY14 due to decline of Rs. 380 million in surrender profits. The declared results of Reliance Capital include consolidation of 48% stake in Reliance Life Insurance. Total funds under management rose to Rs. 191 billion as on June 2014 - an increase of 6%. Reliance Life Insurance has a network of over 900 offices and 89,000 distribution touch points across India.

Reliance General Insurance is amongst the top 5 private sector General insurance companies in India - in terms of business premium - with a private sector market share of 9%. The Gross Written Premium for the quarter was Rs. 8 billion - an increase of 11%. Profit increased by 138% to Rs. 243 million in the quarter. The return on equity was 11% as compared to 5.2% in Q1 FY14. The combined ratio is at 114% for the quarter as against 113% in Q1 FY14. With a large motor third party book and corresponding reserves, the combined ratio will always be above 100%, as annual upgrade of reserves will be required for the interest costs. The corresponding benefits will arise from the higher investment income.

Reliance Commercial Finance continues to be focused on secured asset lending to niche segments of mortgage, SME and Commercial Vehicle loans. The disbursements for the quarter rose by 23% to Rs. 20 billion. The assets under management grew by 10% to Rs. 175 billion. The outstanding loan book was at Rs. 139 billion - an increase of 3%. We securitised loans of Rs. 4 billion during the quarter. We have maintained our focus on higher margins and targeted superior asset quality, rather than expanding the book size. At the end of the quarter, 100% of the book continued to be secure. The total income for the quarter rose by 4% to Rs. 5.6 billion. Profit before tax rose marginally to Rs. 836 million. The profit includes a one-time negative impact of Rs. 66 million due to change in depreciation policy on adoption of the Companies Act, 2013. Excluding this exceptional item, profit would be Rs. 902 million. The return on equity was 12% for the quarter, in line with Q1 FY14. The net interest margin was 5.7%, as against 5.0% in Q1 FY14. The cost to income ratio increased to 17.0% due to the higher depreciation expense, as explained earlier, and increased employee costs, which is in line with our retail expansion during the quarter. The gross NPAs were Rs. 4.2 billion. This translates to 2.4% of the assets under management. The increase was due to a couple of high-ticket cases in the mortgages portfolio, which we expect to resolve in the near term. The coverage ratio, including write-offs, at end of June 2014 stood at 54%. Excluding write-offs, the ratio was at 16%.

Reliance Capital Asset Management manages Rs. 2.1 trillion of assets across its mutual fund, pension funds, managed accounts and offshore funds. Reliance Capital Asset Management is the largest Asset Manager in India. Reliance Mutual Fund is amongst the top mutual funds in India with a market share of 11%. The average assets under management of Reliance Mutual Fund were Rs. 1.1 trillion as on June 30, 2014 - an increase of 15%. We achieved significant improvement in fund performance, as 100% of the equity schemes beat the benchmark in the last 6 months. Retail debt comprised of 27% of the overall debt AUMs as on June 30, 2014. 19% of our total AUMs have been sourced 'outside the Top 15 cities'. The Company conducted more than 900 investor awareness programmes during the quarter, of which over 95% were held in B15 locations to improve awareness levels in smaller cities. For the quarter ended June 30, 2014, the asset management business generated an income of Rs. 2 billion. The business achieved a profit before tax of Rs. 887 million - an increase of 15% over Q1 FY14, driven by lower opex. The profit equals to a return on equity of 21% as compared to 19% in Q1 FY14. Reliance Mutual Fund continues to be amongst the most profitable mutual funds in India.

Reliance Securities is amongst the leading retail equity broking houses in India. The focus in this segment is on the key business verticals of equity and commodity broking and wealth management. The equity broking accounts increased by 2% to nearly 728,000. And the average daily equities turnover stood at Rs. 16 billion - an increase of 44%. The number of commodities broking accounts rose by 20% to over 48,000. The daily average commodities turnover declined, in line with the industry, to Rs. 3 billion. In wealth management, the assets under management stood at Rs. 8 billion - an increase of 64%. For the quarter, total income was at Rs. 390 million. The profit before tax declined to Rs. 22 million due to fall in profits from the commodity broking business. We have taken out the Quant financials from our broking business numbers as we are in the process of looking at bring in a strategic partner in the same.

Reliance Money is amongst the leading distributors of financial products and services in India with a distribution network of over 5,000 outlets. In Q1, total income decreased to Rs. 257 million, as the business was impacted by lower insurance sales and loss of income from sale of gold coins due to closure of that business. The business made a marginal loss of Rs. 15 million in Q1. Going forward, we expect to focus on catering to clients in the HNI space as well as the mass-market and mass-affluent segments.

Moving on, the Reliance Asset Reconstruction – this is in the business of acquisition, management, and resolution of distressed debt and assets. Due to increasing stress, for the first time in many years, banks aggressively sold NPAs during the first quarter. Overall, banks sold NPAs of approx. Rs. 250 billion during the quarter. Reliance ARC continued to bid for retail and SME NPLs on a 100% cash basis or using the SR route. As on June 30, 2014, assets under management rose to Rs. 9 billion as against Rs. 617 million as on June 2013. The business made a profit of Rs. 30 million during the quarter - an increase of 11%.

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 to continue the trend of profitable growth on a consistent basis. Thank you very much. We can now take questions.

Moderator Thank you very much. We will now begin the question and answer session. We have the first question is from the line of Kajal Gandhi from ICICI Direct. Please go ahead.

Kajal Gandhi Sir, we have Quant is not a subsidiary any more.

Management It is a subsidiary but since we are in the process of divesting of it, we have not put in the financials of that, or we have not attached the financials of that with the broking business. We have kept it outside.

Kajal Gandhi So you have given the separate financials for the broking subsidiaries but the consolidated P&L includes that?

Management Yes, so the consolidated P&L includes Quant, but in the presentation and the speech numbers, we were talking purely from a Retail broking side.

Kajal Gandhi Okay. Sir and can you just throw light on the recent IRDA norm of three year motor vehicles insurance policy, will that be of any well?

Management I think the real objective of IRDA is to really see that the penetration of insurance grows in our country. If you see, motor insurance of a third party is mandatory but almost half the vehicles which run on road, run without an insurance cover because most of the covers have been annual insurance policies. And for two wheelers in particular, they are low price covers so people often forget to renew. So by bringing in a long-term cover, the objective is to really have people insured for a longer duration, increase the overall penetration, as well as see to it that the social benefits are given to the claimants or the victims of road accidents seamlessly. So this should bring in greater penetration of insurance for sure.

Kajal Gandhi So you see any business growth from your side because motor vehicle is the larger portion.

Management See, this has started for only two wheelers right now and it is for third party which is a component of comprehensive insurance policy. So as of now it is an optional cover also, so we also need to see how much of the consumer really comes and opts for it because people will have to give three years premium upfront. But I see this something maybe in a quarter or two, we can obviously try to predict some growth.

Kajal Gandhi So is it that at the sales time only like we do for other insurance is the same time the three year policy will be issued?

Management Yes, so it will be an option, a person can take a one year cover or may take a three year cover.

Kajal Gandhi And when you said it is this that the third part, so is it that the other part can be taken for one year and the third party part can be taken for three years?

Management No, right now the way it is, if you take a standalone third party cover, then it will be three years which means nobody is taking the other part. So if you want to take the other part then it is one year. Having said that, IRDA has said companies can file for the own damaged portion also for three years which is subject to their approval. So this is to my mind a few months away, post that people can opt for one year or three years seamlessly.

Kajal Gandhi Okay. Sir and what is outlook now on general insurance?

Management I think general insurance outlook we will say is positive, I guess the under penetration itself is the biggest opportunity for us any uptake in the economic environment be it trucks or motor or even health and even on the commercial projects. All will have a positive bearing on the outcome of industries. So we certainly look forward to much better quarters in the future.

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

Manish Shukla First on commercial finance, there has been a decent disbursement growth during this quarter, as in how do you see the business for the rest of the year?

Management I would say broadly that we would look at anywhere between 15% to 18% growth in the disbursement. Now, we are not making any major assumption in terms of very strong pick up in terms of the capital expenditure demand so if it were to happen probably we could look at a larger opportunity in the second half but it is too early to predict that because at the ground level investments from the corporate sector have not really started picking up much. So where our growth especially is coming across is in the SME sector and the Home Loan sector where if you recollect in the past few quarters, we have made significant changes and penetration in to the smaller towns and the cluster kind of opportunities. So growth is basically coming in from that side.

As far as the Infrastructure and the Construction segment, I think we would expect some sort of demand pick up to happen only post October because during the Q2 usually the demand is muted because of the monsoons.

Manish Shukla Sure. And in terms of the on balance sheet and off balance sheet mix in commercial finance, will it change materially then what it has been in the recent past?

Management To a certain extent maybe because we would look at doing a slightly higher percentage of assets on securitized basis because that would certainly help in improving the ROE to a fair extent. But it would not be a very significant change but it will be a marginal change.

Manish Shukla Okay. And could you explain the nature of the NPLs during the quarter again?

Management See, the NPLs have been broadly, if you look at three out of the past four quarters, they have been in the region of 2.3 to 2.4, the only exception being March where we had some amount of significant success in the SME portfolio where we closed just two cases which brought the GNPA down from 2.3 to about 2. So this time the growth actually has happened or the increase in the NPAs has happened in two sectors, one – the predictable CV kind of segment which has contributed to certain extent and couple of cases in the mortgages side which have contributed to the increase. So the increase in the Commercial Vehicle side is more on the Retail side whereas the mortgage increases on account of two or three cases. Otherwise, given the fact that we have had significant success in the past of closing some of these cases which go into NPA, I do not expect that to be a worrisome factor at all.

Manish Shukla Would you expect the CV stress to continue for some more time?

Management I am seeing the increase in the gross NPA has decelerated significantly so I would expect that probably the bottom will be reached anytime soon.

Manish Shukla Okay. My next question is on Life Insurance. Mr. Ghosh mentioned that there is some change in documentation requirements of IRDA, could you please explain how things happened earlier and what changed in this quarter?

Sam Ghosh I think the issue has been that IRDA had made it mandatory for us to collect the bank details of a customer while you take the application form. So you know we have this rule for the first two months of April and May, now IRDA has given us a relief for a few months and we are expecting an order which actually does away with this requirement, I mean with the change and regulation maybe in the next month or so. So what really happens is especially for agency business given the fact that we are deeply penetrated, we have over 900 branches, there are a lot of locations, a lot of cash business just went away and that impacted us significantly especially in the first two months of the quarter.

Manish Shukla Okay**.** So since June is it a temporary relaxation or has the regulation been modified?

Sam Ghosh So it is a temporary relaxation this point in time, we made a representation to IRDA, to the Life Counsel and we are optimistic that you will get a sympathetic view and there will be a revision in the next few weeks. See, from a financial inclusion perspective, I think you have too less cash coming to the system, especially from the smaller towns. So obviously that should be the area which they have to think about.

Manish Shukla Could you give an approximate ballpark number in terms of how much of your new business origination would be cash based?

Management So, if I look at last fiscal, about 60% of my business came in through cash. Now IRDA has not stopped cash, what they have made mandatory is that customer who has got a bank account is the one who can buy policy. See, the larger issue was that there are 50 crores Life Insurance policy on only 10 crores bank account, so the insurance has reached further the banking has so you obviously have a mismatch there. So you are actually telling a customer that I would not sell you a policy unless you got a bank account. It is not that the cash is not allowed, the fact is that somebody is paying by check, you have his account details. If somebody is paying by cash, you need to get his account details. Having said that, IRDA has sympathetic view so far so they have given us time till the end of August and said that they are looking at reviewing this order, we do hope that this is revoked very shortly.

Moderator Thank you. The next question from the line of Kunal Shah. Please go ahead.

Kunal Shah Sir, if you can just give me the trend on the new business such as profit margin for this quarter.

Management We do not discuss profit margins on a quarterly basis.

Kunal Shah Yes, broadly in terms of trend, so not exactly the number.

Management So what we started doing is that our non-par business which is more profitable as a proportion of business has moved up significantly. So that has touched about 60% of our business which is the most profitable segment which is a change from the mid-40s in percentages over last year. So we are selling more non-par and lesser ULIPs and power products at this point in time.

Kunal Shah Okay, And on this Consumer Finance where we have highlighted that there is the increase in the GNPLs, particularly on account of say this some high ticket mortgages, so the significant rise maybe whatever increase is there from 2 to 2.4, was that like one or two accounts which are there?

Management See, as I said earlier, out of the increase, roughly about half of it is because of the CV book which is more Retail. The other half is basically the mortgage book, it is basically contributed by three cases and we fairly confident of resolving those.

Moderator Thank you. We have the next question from the line of Kajal Gandhi from ICICI Direct. Please go ahead.

Kajal Gandhi Just needed one explanation on what is the reason for the strong capital gains and dividend lines?

Management So finally we have exited some of our listed investments since the markets were doing well and we have exited some and we will continue to exit more of our listed and unlisted equities going forward.

Moderator Thank you. We have the next question from the line of Namesh Changani from Axis Capital. Please go ahead.

Namesh Changani Sir my question is on the consolidation of Life Insurance what you mentioned in your press release and your comments as well, so just wanted to know in the consolidated statement so where the impact has been there due to the consolidation of insurance in the books of accounts?

Management So, Life Insurance is an associate we hold 48% directly and hence it is an associate, so it has taken below in the minority interest.

Namesh Changani But continues to be in the associate, there is no consolidation as of now?

Management No, we hold 48% directly and balance 26% still continues to be held by Viscount Management.

Namesh Changani Okay. And on the trend on the insurance side, so are we seeing any pick up in ULIPs, because I have seen the ULIPs segment share has increased in this particular quarter, so are we seeing some pick up in ULIPs during this?

Management Well, ULIP as a category has seen an impact but then what we are focused on is selling traditional non-power long-term products. So like I mentioned non-par percentages have gone up, our long-term products within the 10 years have gone up significantly to over 74% of our book. So that is what our focus clearly is on, on selling long-term saving and protection plan.

Namesh Changani Okay. And on the general insurance side, you combined ratio still holds at around 114% and now most of your motor pool reserves of the losses are already over, so we when we can see this combined ratio at close to 100% levels?

Management See, I think the combined ratio will continue to remain over 100% for some time, till such time the motor as a proportion of the book moderates to about 40% or so. In the Indian environment, motor has been a growth driver for the general insurance business as well as for the Retail penetration. So that is a bit of a chicken and egg. Having said that, combined ratios should not be seen standalone, it should be seen vis-à-vis the investment income which accrues on the cash which the company has. If you really see from our asset, our investment book has moved by 30% in the last one year and that income of course comes into the company after combined ratio and on an overall basis, we have obviously more than doubled our profits. So that I think in totality should be the key driver to monitor.

Namesh Changani So basically motor insurance is contributing the maximum to the combined ratio?

Management See, what happens is combined ratio has the claims and the claims carry along with itself the interest for the period of settlement also alongside. So above the line you have claims plus interest going together as the claims cost. Whereas the fund side of investment income accrues below the line, so there is going to be a mismatch for any company which ends up doing significant amount of motor business.

Namesh Changani So sir my last question is on the investments on the consolidated book, so what is our total investing as on June?

Management It is similar to March number. We sold out roughly maybe 100 crores of listed equities, otherwise it is more or less similar but we are working towards reducing our overall investments in various listed and unlisted equities.

Namesh Changani Sir, unlisted any selling we have done during the quarter?

Management Nothing significant.

Moderator Thank you. As there are no further questions, I now hand the floor back to Mr. Kunal Shah. Over to you.

Kunal Shah Thank you the senior management team of Reliance Capital for sharing their perspective on the results and thank you all the participants for participating on the call. Thank you.

Moderator Thank you. On behalf of Edelweiss Securities Limited that concludes this Conference Call. Thank you for joining us and you may now disconnect your lines.