Reliance Capital Limited

FY16 Earnings Conference Call

9th May, 2016

SPEAKERS: Management of Reliance Capital

Moderator: Ladies and gentlemen good day and welcome to the Reliance Capital Q4 FY16 Earnings Conference Call hosted by Reliance Securities. As a reminder 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 phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Ashutosh Mishra from Reliance Securities. Thank you and over to you sir.

Ashutosh Mishra: Thank you. Good morning everyone and welcome to the 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 Q4 FY16 Earnings and the strategies on the key operating business going forward. Over to you Sir.

Sam Ghosh: Thank you very much Ashutosh. Good morning to all of you and welcome to our FY16 Earnings Conference Call. We have the CEOs from our business with us, K. V. Srinivasan from Commercial Finance and Home Finance, Rakesh Jain from Reliance General Insurance, Sundeep Sikka from Reliance Asset Management, Gopkumar from our Booking & Distribution Business and we have with us also Sunil Agrawal - CFO for the Life Insurance Business and our CFO for Reliance Capital, 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 year, the total income increased by 12% to Rs. 100 billion, the consolidated net profit for the year increased by 10% to Rs. 11 billion. Core business profits were driven by higher earnings in Asset Management, General Insurance, Commercial Finance segments, while earnings in Life Insurance broking and distribution were affected due to one-off, creation of reserves and internal restructuring respectively.

The net worth of Reliance Capital increased by 12% to Rs. 154 billion as on March 2016. In February the board approved the demerger of the Commercial Finance division into a separate wholly owned subsidiary effective April 1, 2016, subject to regulatory approvals. The proposal aligns the corporate structure of on operating businesses as wholly or majority owned subsidiaries. The transfer will enhance management's focus on Reliance Commercial Finance and also provide flexibility to the company to unlock value in the future. From FY16 onwards, we have split the financial disclosure for the Commercial Finance segment into Reliance Commercial Finance and Reliance Home Finance. In Reliance Commercial Finance, assets under management increased by 7% to Rs. 152 billion. Net interest margin rose from 5.9% to 6.4% in FY16. In Reliance Home Finance, assets under management increased by 27% to Rs. 74 billion, while profit before tax for the year rose by 29% to Rs. 1.4 billion. The return on equity rose to 15.5% in FY16. In Asset Management, our mutual fund average assets under management grew by 16% to Rs. 1.6 trillion with a market share of 12%. We remain the third-largest player in the mutual fund industry. Profit before tax moved by 10% to Rs. 5 billion driven by higher mutual fund AUMs. In the Life Insurance business, we continue to be amongst the largest players in the private sector. Renewal premium rose by 11% to Rs. 28 billion in this year. FY16 NBAP margin was at 28.8% as against 27.7% in FY 15 and is the highest in the industry. In general insurance, we are amongst the top players in the private sector. Gross written premium increased by 4% to Rs. 29 billion. Profit from the business rose by 22% to Rs. 991 million.. As we have given details, financials and operating parameters for each of our major business in our presentation and review report. I will now go through the main highlights in each business.

Reliance Commercial Finance continues to focus on secured asset lending to niche segments of SME, Infrastructure financing, Loan against property, and Commercial Vehicle loans. Disbursements increased by 17% to Rs. 81 billion. The assets under management grew by 7% to Rs. 152 billion. The outstanding loan book rose by 6% to Rs. 109 billion. We securitised loans worth Rs. 38 billion during the year - an increase of 22%. At the end of the year, 100% of the book continued to be secured. The total income for the year, at Rs. 18 billion, was nearly at the same level as FY15, due to flat growth in average assets. Profit before tax declined by 7% Rs. 3 billion due to higher provisioning charges and marginal rise in operating expenses. The return on equity for the year was stable at 15%. The net interest margin rose from 5.9% to 6.4% in FY16. The cost to income ratio remained flat at 18% for the year. The gross NPAs were Rs. 4.8 billion as on March 2016, i.e. 3.1% of the assets under management. Excluding the Commercial Vehicles portfolio of Rs. 13 billion, the NPAs were Rs. 3.4 billion i.e. 2.7% of the assets under management, on a 90 day basis. As the Commercial Vehicle industry remains under stress, the business intends to continue to reduce our exposure in this segment. The coverage ratio, including write-offs, at end of March 2016 stood at 59%. Excluding write-offs, the ratio was at 22%.

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 27% to Rs. 74 billion. In FY16, disbursements increased by 13% to Rs. 39 billion. The outstanding loan book rose by 34% to Rs. 68 billion. The total income for the year increased by 59% to Rs. 8 billion, while profit before tax increased by 29% to Rs. 1.4 billion. The net interest margin for the year remained stable at 4.4%, as we continue to expand our portfolio towards the lower ticket-affordable housing business. The return on equity was 16.5% for the year, as compared to 13.9% in FY15. The cost to income ratio rose marginally from 15.1% to 15.5% for the year as the company made investments towards expanding its scale and operations. As on March 2016, the gross NPAs remained flat at 0.9%. The coverage ratio, including write-offs, at end of March 2016 stood at 35%. Excluding write-offs, the ratio was at 24%.

Reliance Capital Asset Management manages Rs. 2.9 trillion of assets across its mutual fund, pension funds, managed accounts, offshore funds and alternative investment funds. Reliance Capital 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 12%. The average assets under management of Reliance Mutual Fund were Rs. 1.6 trillion as on March 2016 - an increase of 16%. The number of systematic investment plan and systematic transfer plan folios rose by 15% to 1.5 million, indicating continued participation in equities by the retail investors. For the year ended March 2016, Reliance Mutual Fund registered the highest absolute growth in retail AUMs amongst the Top 5 asset management companies. As on March 2016, Reliance Mutual Fund has the highest AUM sourced 'outside the Top 15 cities' in the industry. For the year ended March 31, 2016, equity assets rose to 32% of the total average assets under management vis-à-vis 29% for the corresponding previous period. Despite flat-to-negative markets, income for the year ended March 31, 2016, increased by 38% to Rs. 13 billion, driven by the change in product mix and contribution from other asset classes. The business achieved a profit before tax of Rs. 5 billion - an increase of 10%. Reliance Mutual Fund continues to be amongst the most profitable mutual funds in India. Return on equity was 25% for the year ended March 2016. The business continues its strategy to expand its global presence through the launch of the India Equity Mid-Small Cap Fund for Korean investors in partnership with Samsung Asset Management. Also, the business made a foray in the European markets through the launch of the UCITs Equity Fund. The closure of the Goldman Sachs acquisition in Q1 FY17 will enable Reliance Mutual Fund to become the largest ETF player in India. In the Alternative Investment Fund, the company has reached the total commitment size of approx. Rs. 10 billion. In Q4, Reliance Capital completed the transaction for receipt of approx. Rs. 12 billion from Nippon Life Insurance for additional 14% stake sale in Reliance Capital Asset Management. The transaction pegs the valuation of Reliance Capital Asset Management at over Rs. 85 billion, the highest valuation till date for any asset management company in the country. Pursuant to this transaction, Reliance Capital Asset Management will be renamed Reliance Nippon Life Asset Management, once the necessary formalities are completed.

In the Life Insurance business, New Business Premium was Rs. 16 billion, while Renewal premium increased by 11% to Rs. 28 billion. Individual WRP decreased by 26% to Rs. 9 billion. The industry growth continued to be driven by the ULIP segment. Being an agency-driven insurer, we continue to stay focused on the traditional product segment. Traditional products formed 81% of the Individual New Business Premium as against 77% in FY15. Further, we have changed the channel mix, reducing the share of third party distributors from over 20% in FY15 to mid-teens in FY16. The fall in business from this channel also contributed to the decline in individual premium. In FY16, the contribution of non-par business in Individual New Business Premium was 69%, thereby supporting margins. For the period ended March 31, 2016, NBAP margin was at 28.8%, highest amongst private life insurers. Overall persistency rose from 57% to 60% in FY16. The business continues to focus on Agency and proprietary channels, which have better persistency. Strong growth in renewal premium, along with higher persistency, demonstrates our emphasis on improving the business quality. The business had a loss of Rs. 2 billion in FY16 due to strengthening of reserves. In accordance to the regulatory changes, as a measure of conservatism, we have consciously decided to make a one-time exceptional increase in our reserves. Also, improvement in persistency in the non-par segment has led to increased reserving requirements. Total funds under management were at Rs. 160 billion as on March 2016. Sum assured of policies in force was over Rs. 1 trillion. There are 3 million policies in force. There is a network of over 800 offices and 140,000 distribution touch points across India. The business employs the Traditional method for calculation of Embedded Value. As on March 2016, the embedded value was Rs. 28 billion. In March 2016, Nippon Life acquired 23% additional stake in Reliance Nippon Life Insurance for Rs. 23 billion. The deal values the business at approx. Rs. 100 billion, with an implied EV multiple of over 3 times, which is the highest in the industry till date. In line with the new shareholding, Reliance Life Insurance has been renamed as Reliance Nippon Life Insurance. Reliance Nippon Life Insurance initiated distribution tie-ups with over 8 institutions in the bancassurance space. Also, we are in active discussion with more players to expand this channel further. We expect the channel to make a meaningful contribution to the premium growth in the coming quarters.

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%. The Gross Written Premium for the year was Rs. 29 billion - an increase of 4%. The business continues to defocus on the third party motor business, on a standalone basis, as well as commercial vehicles. Premium from the standalone third party business declined by 50% in FY16, as compared to positive double-digit growth for the industry. The combined ratio remained at 121% in FY16. The combined ratio for the short-tail business is approximately 100%. With the planned reduction in the motor third party business, we expect the ratio to trend downwards in the coming year. Our focus in this business has been to improve profitability, while maintaining our market position. Profit for the year increased by 22% to Rs. 991 million. For the year ended March 31, 2016, the return on equity rose to 9%. As on March 2016, we have the largest agency force in the private sector with over 20,500 retail agents and more than 125 branches. In Q4, Reliance General Insurance has concluded distribution tie-ups with 13 financial institutions. Also, the company aligned itself with seven automotive manufacturers. These partnerships will provide a significant impetus to the business growth in the coming quarters.

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 3% to nearly 775,000. And the average daily equities turnover rose by 9% to Rs. 19 billion. Our market share in the retail equities segment rose from 1.6% to 2% in FY16. The number of commodities broking accounts rose by 18% to over 64,200. The daily average commodities turnover was over Rs. 3 billion - an increase of 17%. For the year, total income remained stable at Rs. 2 billion. The business had a loss of Rs. 637 million for the year as it foreclosed a lease rental arrangement by making a full and final settlement. The current and future lease charges have been taken in Q4. The business is expected to turn profitable from Q1 FY17 onwards.

Reliance Money is amongst the leading distributors of financial products and services in India with a distribution network of over 150 branches. In FY16, total income decreased to Rs. 661 million, due to exit from the money transfer business. Also, the Company is focused solely on the distribution of our insurance and mutual fund products, as compared to selling all third-party products in the past. The business had a loss of Rs. 275 million in FY16. We have completed the restructuring in this business and expect to turn profitable from Q1 FY17 onwards. In wealth management, the assets under management stood at nearly Rs. 26 billion - an increase of 87%.

Reliance Asset Reconstruction is in the business of acquisition, management and resolution of the stressed debt and assets. As on March 2016, the assets under management rose to Rs. 15 billion - an increase of 37%. The profit before tax was Rs. 145 million for the year - an increase of 19%. The business achieved a higher return on equity of 7% as against 6% in FY15.

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. Board of directors has proposed a dividend of Rs. 10 per share. Thank you very much. We can now take questions.

Moderator: Thank you very much. Ladies and gentlemen we will now begin the question and answer session. We will take the first question from the line of Nidhesh Jain from Investec. Please go ahead.

Nidesh Jain: My question is on creation of these reserves, if you can give some more clarity what is the nature of these provisions and what the actual regulatory change it has happened on account of that you have to make these provisions in Life Insurance business?

Sunil Agrawal: There are two lines of businesses, one is participating and one is non-participating. As far as participating business is concerned, there is a draft regulation which is on expenses of management which says that any overrun has to be charged to the shareholders account. So we have proactively made those provisions in FY16. As far as non-participating business is concerned, we have followed a conservative approach of improving our reserving looking at the positive experience on account of persistency. So these two numbers adding together has created a reserve and led to a P&L debit.

Nidesh Jain: If you can share some light on the bank assurance talks that you are having with banks. Are they PSU banks or private banks and any light on that?

Sunil Agrawal: At the moment the eight banks that we have tied up with are not really big banks. They are very small banks and are largely private banks. But we are also in talks with most of the private banks and we look forward to tie up with them and we are also engaging with lot of PSU banks. So as of now, we have nothing to say much about the PSU banks, but these eight banks are largely regional level banks and we hope to get a decent top line in the coming years to these eight relationships that we have tied up with.

Nidesh Jain: You have already tied up with these eight banks and you are the only partner or it's in the form of open architecture?

Sunil Agrawal: We are the only partners and in some of them we are one of the partners. The process is currently under regulatory approval. So maybe in the next 3 to 4 months we should get a decent top line from these tie-ups.

Moderator: The next question is from the line of Ashwin Balasubramaniam from HSBC Asset Management. Please go ahead.

Ashwin Balasubramaniam: I have couple of questions related to commercial and Home Finance business. First with regard to the commercial front, this is if I look on a Q-o-Q basis the yields in the LAP segment have gone up. I believe there is some restatement because anyway the Home Finance business is now being shown separate. But even if I take up a weighted average the yields appear to gone up on a Q-o-Q basis which seems to be a little bit different from the trends of the other NBFCs have shown so just wanted to get some light on, is it a change in customer profile which is driving that? And the second question on the Home Finance business, so if I look at your AUM and disbursement numbers, the prepayment rates actually seem to be quite on the higher side so just wanted to get some color on that as well.

K.V. Srinivasan: The change in the Commercial Finance segment LAP yields are primarily because we've split the disclosure between the home and the Commercial Finance businesses. So there is no change in the customers' segment, if you put the two together they will find that they are more or less the same. Having said that definitely we have focused more upon the bottom line as far as the LAP business is concerned rather than trying to grow the top line. We have kind of held the book a little flat given our risk perception on the real estate situation itself. And secondly we are pretty much focused upon getting only those transactions which are bottom line making sense for us. So we haven't grown the book but they are concentrated primarily upon the profitability of that segment. As far as your Home Finance is concerned, yes the fact is that the prepayment ratios across the industry are in the 20s and I don't think we are an exception to that rule as well. So you do have a situation where the smaller players' ratios would look a little worse simply because of the book buildup is not yet at the same levels of the very large entity.

Ashwin Balasubramaniam: This prepayment being on higher side is happening both on the Home Loans as well as on the LAP or primarily on the LAP?

K.V. Srinivasan: It is higher on the Home Finance side. In case of LAP the guideline change which RBI brought across, it's only applicable for the individual. So fortunately we only have over 25% of our LAP customers being individual, the rest of them are private limited companies, etc., where the prepayment penalty can still be applicable. So the churn ratio is much higher in respect of the Home Finance bill there is no prepayment penalty irrespective of the Constitution.

Moderator: We have the next question from the line of Nischint Chawathe from Kotak Securities. Please go ahead.

Nischint Chawathe: Just one micro question and this is on broking and distribution. Can you give me the reason why there was a loss this year?

B. Gopkumar: We had a lease/rental arrangement which was due for next two years, we foreclosed it this year so hence we have taken this quarter that hit. We also have enough provisioning now in the sense that we have taken the provisioning in terms of our variable pay also this year. To that extent we have cleaned up our P&L.

Moderator: The next question is from the line of Ashwini Agarwal from Ashmore Investment Advisors. Please go ahead.

Ashwini Agarwal: Now that you have divided your Home Loans business into Commercial Finance and into Home Loans. How would you differentiate between LAP in the Commercial Finance business versus LAP in the Home Loans business? Is it just a historical context and over a period of time all the LAP loans in Commercial Finance will disappear?

K.V. Srinivasan: LAP is primarily a Commercial Finance product so therefore a substantial part which is the largest portion of LAP will continue to get booked in Commercial Finance. In respect of Home Finance, the mother products are basically Home Loans and Construction Finance but LAP you have a cushion from a regulatory perspective of booking a certain amount of LAP in the Home Finance business. So to that extent certain amount of minority portion of LAP will continue to get booked in the Home Finance business. But having said that there is no bar on either of the entities doing the LAP business but clearly the products which are only Home Finance company-oriented business will be the Home Loans and Construction Finance. LAP is something that will be shared across the two entities primarily on a 70-30 basis, 70% going to Commercial Finance, not more than 30% going to Home Finance.

Ashwini Agarwal: And what about Construction Finance because that's the other line item?

K.V. Srinivasan: Construction Finance is essentially a Home Finance company product and that will continue to get booked in Home Finance, so that broadly what it is. So historically if you see some Construction Finance portfolio in the Commercial Finance book that is something that will get run off.

Ashwini Agarwal: On a consolidated basis you seem to have a couple of one-offs, one is creation of reserves in the Insurance business and the other is one-time payments in the Equity Broking business. Are these the only two one-offs or are there anything else in the whole consolidated number that could be treated as one-offs?

Sunil Agrawal: No these are the only two which we have openly disclosed and Sam has spoken about it in his comments as well.

Ashwini Agarwal: The total amount across the two items is how much?

Sunil Agrawal: Reserving and this put together will be around 250 crores.

Ashwini Agarwal: Are you comfortable with your the loan loss coverage ratios or do you expect to increase them in the current financial year?

K.V. Srinivasan: Coverage ratio is also primarily concerned about how quickly we are able to resolve the NPAs. What happens is we have a period based percentage of provisioning that we follow. So when a loan becomes an NPA then there is a certain amount of provisioning then over a period of time the provisioning coverage on a per loan basis increases. So if we are able to close off most of the NPAs in infancy then the coverage ratio will always be little lower. If we get stuck in a particular case then recovery ratio automatically improves. So a 22%-23%, not more than 25% is something which is very comfortable as far as I'm concerned because it basically tells us of our capability to close NPA loans and settle them quickly. If I get stuck the ratio will increase.

Moderator: The next question is from the line of Vidha Bhatra from ICRA. Please go ahead.

Vidha Bhatra: My question is on Asset Reconstruction Company. You have mentioned that the focus is on SME and retail. If you can give us the flavor on what is SME and retail, is it LAP, is it CV portfolio? Broadly what is the average or median resolution period and IRRs that you are generating from this book?

Sam Ghosh: On the ARC business, on the retail side it's mainly education loans and there is also Retail Housing portfolio.

Vidha Bhatra: Education and Housing?

Sam Ghosh: Yes main focus and on the SME portfolio it's a diverse number of business, primarily machinery loans. And resolution times normally for the education loans is taking is about 6 to 12 months for the housing is taking is up to 1.5 to 2 years and SMEs normally takes about 2+ years for us. But you will find that 30% of the book has been resolved annually.

Vidha Bhatra: And what are the IRR because ROE will be a lagged.

Sam Ghosh: Yes it will be lagged. ROEs will be lower because the balance sheet is not leveraged enough but as we go along we'll leverage the balance should because it is well-capitalized and you will see an improvement in ROE moving up to somewhere in the 15% to 20% range. And IRR is the roughly 20%-25% near that.

Vidha Bhatra: And in LAP business you said you have kind of kept the book stagnant so is it pressure on the credit side or it's the yield side pressure that has led to this?

K.V. Srinivasan: One is of course our reading of the market is that the real estate situation should take some more time to improve so till then we will exercise reasonable amount of caution on taking fresh exposures, number one. Number two, we are also not aping the market in terms of the pricing because we believe that pricing has to be in line with the risk of inherent into a product so which current market prices are not in our area of comfort. So we only do that amount of business which make sense from our perspective, we are not there before interested in growing the top line.

Vidha Bhatra: If we were to look at the cross-sell for the financing business, what percentage of your fresh disbursements would be as a result of cross-sell in any….

K.V. Srinivasan: If I look at cross-sell and up-sell put together, it is roughly in the region of around 22% to 23% of my total AUM.

Vidha Bhatra: What is up-sell?

Sam Ghosh: Up-sell is basically same product being sold to the existing customer; cross-sell is different product being sold to a same customer.

Vidha Bhatra: And do you see that percentage moving up?

K.V. Srinivasan: I think at this present moment 23%-24% is pretty healthy. To grow this beyond this would require us to develop a greater amount of risk appetite and current economic environment does not permit us to do so where in boom times maybe this can actually increase a little more.

Vidha Bhatra: But when you say cross-sell, are you saying that you have lot of customers in your AMC business.

K.V. Srinivasan: No, regulatorily it is not possible for our businesses to share customer databases, so therefore when I say cross-sell I only mean cross-sell of let us say you're an existing LAP customer, if I sell you a vehicle that's called cross-sell. It is within the same entities customer base. What we also do is let us say when we talked about cross-sell they also include the bundled insurance that we are able to sell in respect of mortgage products or SME products so that is also included.

Moderator: We will take the next question from the line of Namesh Chhangani from Ambit Investment. Please go ahead.

Namesh Chhangani: My question is related to your core investment companies. In the last con call you have stated that you intend to make a co-investment company of Reliance Capital. So any timeline related to this, by what time you want to intend to do that? Secondly what would be the impact on the investments as well as the loan sitting in the standalone book?

Sam Ghosh: I will answer the first bit. The first bit is that we have obviously gone to SEBI for approval and the stock exchanges and I think the approval should come through soon and then it will go to approve demerger schemes so we will go to the court. So we expect that completion of the demerger of Reliance Commercial Finance will take about September and then we have also simultaneously start the process for application as a CIC with RBI that also will take about 3 months. So we expect that about January to March quarter we should become a CIC.

Namesh Chhangani: By end of this year?

Sam Ghosh: Yes in the last quarter. Part of the demerger process is that the loan portfolio will move down to a separate legal entity and we will comply with all the norms which are applicable for CIC and should have that completed by the end of this financial year.

Namesh Chhangani: So will those loans which was sitting in the standalone which are the corporate loans, they will run down or you will include them in the Commercial Finance division which you've created separately now or the new subsidiary which you have created?

Sam Ghosh: No it will be run down.

Namesh Chhangani: Among the non-core investments how much is there now in the books and from where it has come down to what level?

Sam Ghosh: On the non-core investments would be around 2,000 crores on the investment side.

Namesh Chhangani: In the loan side is there any?

Sam Ghosh: No.

Moderator: The next question is from the line of Nischint Chawathe from Kotak Securities. Please go ahead.

Nischint Chawathe: I was just looking at the movement in your balance sheet and maybe if you could just explain broadly how some of the more important components have moved on the asset side?

Sam Ghosh: The primary impact on the consolidated balance sheet is due to consolidation of Reliance Life. So now because it's a 51% subsidiary which it earlier wasn't because we were holding our stakes through an SPV since it's a 51% subsidiary need to consolidate the balance sheet which includes the funds under management at Reliance Life and that's why the consolidated assets have moved up substantially in this year.

Nischint Chawathe: And loans and advances?

Sam Ghosh: Loans and advances are similar as last year.

Moderator: Thank you. As there are no further questions from the participants, I now hand the conference over to Mr. Ashutosh Mishra for closing comments.

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

Moderator: Thank you. Ladies and gentleman, on behalf of Reliance Securities Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.