Reliance Capital Limited

Q3 FY15 Earnings Conference Call

12th February, 2015

SPEAKERS: Management of Reliance Capital

Moderator: Ladies and gentlemen, good day and welcome to the Reliance Capital Q3 FY 2015 Earnings Conference Call, hosted by Motilal Oswal 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 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. Sunesh Khanna from Motilal Oswal Securities. Thank you and over to you Mr. Khanna!

Sunesh Khanna: Good evening everyone and welcome to Reliance Capital Limited 3Q FY 2015 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. Sam Ghosh who will brief us about the results subsequent to which we can open the floor for question and answers. Over to you Sir!

Sam Ghosh: Thanks Sunesh. Good evening to all of you and welcome to you our Q3 earnings conference call. We have with us Sundeep Sikka, CEO of Reliance Capital Asset Management business, Sandip Parikh, CFO from our Commercial Finance segment. Also we have Sunil Agrawal, CFO, Reliance Life Insurance, Hemant Jain, CFO of our General Insurance business, while Sanjay Wadhwa, CFO of our Broking and Distribution business, is on call. Also, we have with us, CFO of Reliance Capital, Amit Bapna.

Let me present a brief summary of our consolidated results and an update on each of our business, 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. 2.1 billion - an increase of 28%. The net worth of Reliance Capital increased by 5% to Rs. 132 billion as on December 2014. In the Life Insurance business, new business premium rose by 8% to Rs. 4 Billion in this quarter. On individual WRP basis, we continue to be the fifth largest player in the private sector. Profit increased by 45% Rs. 395 million. In General Insurance, Q3 gross written premium increased by 10% to Rs. 7 billion. In terms of gross premium, we are amongst the top five players in the private sector. Profit from the business rose by 37% to Rs. 145 million. In Commercial Finance, the profit before tax rose by 6% Rs. 1.1 billion. We have improved our net interest margin to 5.8% vis-à-vis 5.6% in Q3 FY 2014. In Asset Management, our Mutual Fund average asset from the management grew by 23% to Rs.1.3 trillion with the market share of 11.4%. We remain the third largest share in the mutual fund industry. Profit before tax grew by 49% to Rs. 1.3 billion driven by higher mutual fund AUMs mainly on the equity side. We have given detailed financial and operating parameters for each of our businesses in our presentation and review report. I will now go through the main highlights in each business.

In Q3 FY15, Reliance Life Insurance continued to be the 5th largest player in the private sector, in terms of Individual WRP. In Q3, surging capital markets continued to aid ULIP sales. However, due to lower expense structure, there has been very limited impact on new business premium growth for agency driven insurers. Also, the product withdrawal-related scarcity spikes in FY14 resulted in a growth challenge for the sector, particularly agency driven insurers, in FY15. In spite of this, Reliance Life's total premium for the quarter rose by 8% to Rs. 11 billion, driven by an 8% increase in new business premium to Rs. 4 billion, while renewal premium rose by 9% to Rs. 6 billion. Average ticket size increased by 28% to over Rs. 26,200 in the quarter. On a sequential basis, the number of policies sold rose by 6% in the quarter. We expect to sustain the improvement across both metrics in the near term. Overall persistency was 59% in Q3 FY15. Agency persistency continues to be at approx. 65%. The business continues to focus on improving the share of Agency and proprietary channels in the overall business mix, which have better persistency than other channels. In the period ended December 31, 2014, we have maintained the contribution of non-par business in Individual New Business Premium to over 65%, due to which, our NBAP margins are one of the highest in the industry. Premiums from policies with tenure of 10 years and above rose to over 70% of the Individual NBP, as compared to 53% in the corresponding period in FY14. The above indicators will have a positive impact on our profitability in the medium term as well as lead to better persistency. Profit for the quarter was Rs. 395 million - an increase of 45%. The declared results of Reliance Capital include consolidation of 48% stake in Reliance Life Insurance. Total funds under management rose to Rs. 186 billion as on December 2014 - an increase of 3%. Reliance Life Insurance has a network of over 900 offices and over 115,000 distribution touch points across India.

Reliance General Insurance is amongst the top 5 private sector General insurance companies in India - in terms of gross premium - with a private sector market share of 8%. The Gross Written Premium for the quarter was Rs. 6.6 billion - an increase of 10%. Profit increased by 37% to Rs. 145 million in the quarter. The return on equity was 6% as compared to 5% in Q3 FY14. The combined ratio for the quarter is at 126%, similar to Q3 FY14. The combined ratio was high for the quarter due to an exceptional reversal of excess premium collected on a retail health policy in FY2008, and higher claim ratio on account of catastrophic events during this year. We expect the combined ratio for the short-tail business to be lower than 100% on a normalised basis.

Reliance Commercial Finance continues to focus on secured asset lending to niche segments of mortgage, SME and Commercial Vehicle loans. The disbursements for the quarter were at Rs. 24 billion. The assets under management grew by 13% to Rs. 185 billion. The outstanding loan book rose marginally to Rs. 138 billion. We securitised loans of Rs. 8 billion during the quarter. We have maintained our focus on higher margins and superior asset quality in a challenging environment. At the end of the quarter, 100% of the book continued to be secure. The total income for the quarter rose by 2% to Rs. 6 billion. Profit before tax increased by 6% to Rs. 1.1 billion. The return on equity was 16.3% for the quarter, vis-à-vis 14.6% in Q3 FY14. The net interest margin was 5.8%, as against 5.6% in Q3 FY14. The cost to income ratio improved from 16.9% in Q2 FY15 to 15.5% in Q3 FY15. The gross NPAs were Rs. 4.6 billion as the Commercial Vehicles' segment continued to be under stress. The gross NPAs are 2.5% of the assets under management. The coverage ratio, including write-offs, at end of December 2014 stood at 55%. Excluding write-offs, the ratio was at 19%.

Reliance Capital Asset Management manages Rs. 2.3 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 three mutual funds in India, with a market share of 11.4%. The average assets under management of Reliance Mutual Fund were Rs. 1.3 trillion as on December 2014 - an increase of 23%. The equity schemes have shown an impressive improvement in performance as nearly 100% of the schemes have beaten the benchmark in the one-year time frame. Equity AAUMs comprised of 31% of the overall AAUMs as on December 31, 2014 as compared to 23% as on December 2013. In the last six months, we have launched five closed ended equity funds and a Retirement Fund, and mobilised close to Rs. 25 billion through new equity offerings. 20% of our total AUMs have been sourced 'outside the Top 15 cities'. The Company conducted more than 700 investor awareness programmes during the quarter, covering nearly 25,000 participants. For the quarter ended December 31, 2014, the asset management business generated an income of Rs. 2.5 billion - an increase of 33%. The business achieved a profit before tax of Rs. 1.3 billion - an increase of 49% over Q3 FY14. The profit equals to a return on equity of 27% as compared to 19% in Q3 FY14. Reliance Mutual Fund continues to be amongst the most profitable mutual funds in India. In November 2014, we signed an agreement with our partners Nippon Life Insurance, whereby they will raise their stake in Reliance Capital Asset Management from 26% to 35%, with an option to increase it further by 14%, in tranches. Nippon Life will invest Rs. 6.6 billion for the 9% stake. The transaction represents the largest FDI in the Indian MF sector till date and values the business at Rs. 73 billion. The Boards of Directors of both companies have approved the transaction, subject to necessary regulatory approvals.

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 over 745,000. And the average daily equities turnover stood at Rs. 15 billion - an increase of 15%. The number of commodities broking accounts rose by 16% to over 48,600. The daily average commodities turnover was at Rs. 3 billion. For the quarter, total income was at Rs. 502 million - an increase of 92%. The profit before tax was Rs. 5 million as against a loss of Rs. 98 million in Q3 FY14.

Reliance Money is amongst the leading distributors of financial products and services in India with a distribution network of over 170 branches. In wealth management, the assets under management stood at Rs. 12 billion - an increase of 152%. In Q3, total income decreased to Rs. 229 million, as the business was impacted by the exit from the insurance broking and sale of gold coins businesses. The business made a loss of Rs. 107 million in Q3. Distribution of insurance products peaks in the last quarter, which will help to offset these losses. The Company has begun to focus solely on the distribution of our insurance and mutual fund products, as compared to selling all third-party products in the past.

Reliance Asset Reconstruction is in the business of acquisition, management and resolution of distressed debt and assets. Reliance ARC continued to bid for retail and SME NPLs on a 100% cash basis or using the SR route. As on December 2014, assets under management increased by 61% to Rs. 11 billion. The profit before tax rose by 139% to Rs. 39 million in Q3 FY15.

In conclusion, I would like to say that our focus remains on strengthening our core businesses and divesting the non-core investments. 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. Also it is our pleasure to announce that in January 2015 we received the shareholder's approval for preferential allotment of 7 million shares to Sumitomo Mitsui Trust Bank, Japan's leading bank and largest financial institution. Sumitomo Mitsui Trust Bank will invest Rs.3.7 billion for initial stake of 2.8% in Reliance Capital. We expect to keep all necessary approvals in this quarter.

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. Our first question is from the line of Rohan Juneja from Seawolf Capital. Please go ahead.

Rohan Juneja: Hi Sam. Can you give us some color on your non-core portfolio and how much longer you are going to take to wind the whole thing down and earlier you all have mentioned 18 months spread and also some color on was the gain booked in this quarter on any investment sold in between October and December?

Sam Ghosh: First, I will say that we are obviously working towards exiting all our non-core investments and this, as you have said, will take us another 12 months to 18 months and we are still sticking to that target, March 31, 2016 or by September 2016 latest, we are trying to exit all of them. **Second,** we have booked a capital gain of almost 35 crores at Reliance Capital and our subsidiaries have booked another Rs. 60 crores of capital gains in their investments. At a consolidated level, capital gains are approx. 100 crores.

Rohan Juneja: Just given obviously because the investment portfolio is going to be winding, can you or have you all thought about any kind of guidance around what Reliance Capital as a company will make in net profit for September 2016?

Sam Ghosh: Basically I cannot give forward looking guidance but I think our intention is that we will exit all our non-core investments and that should give us a slight upside in terms of our total book size.

Rohan Juneja: Thank you.

Moderator: Thank you. Our next question is from the line of Subhankar Ojha from SKS Capital and Research. Please go ahead.

Subhankar Ojha: Sir I missed out these numbers, the capital gain at the consolidated level you said 120?

Sam Ghosh: No, capital gains and dividend income put together across all our businesses is roughly 119 Crores.

Subhankar Ojha: Thank you.

Moderator: Thank you. Our next question is from the line of Manish Shukla from Deutsche Bank. Please go ahead.

Manish Shukla: First on asset management, after having prolonged period of cost cutting sequentially, there is a good jump in opex in asset management. Is there any one-off?

Sam Ghosh: There is no one off. I think, overall, the market conditions have been better and while there was no major cost cutting in the past, basically we were working on the productivity and the efficiency and that is showing in the results now.

Manish Shukla: So will this cost rate be normalized?

Sam Ghosh: I think from a cost point of view, we don't see any major change in costs going forward other than the variable cost.

Manish Shukla: Okay. On the general insurance business, the combined ratio, over the last six months, has gone from 114 to 126. How much of that is one off in nature and how much of that will take time, I mean June was 114 and today we are at 126?

Sam Ghosh: I think we have to split this and that is why we will start showing you the difference between the short tail and long tail classes. In the long tail classes, combined ratio will always be above 150% while the short tail will be close to 100%. Also, in the current quarter, we had a couple of exceptional claims due to catastrophic events such as J&K floods and Hudhud cyclone, that had a negative impact on the combined ratio.Apart from that, we had to take some exceptional hit on account of one of the health insurance product sold in FY2008. We had to take some reversal of that premium in the current quarter so because of these two elements, the combined ratio in the quarter has increased. **I**t is a one off kind of a quarter and on a sustainable basis, it should be somewhere around 115.

Manish Shukla: What would be the preferred or steady state mix between long tail and short tail business?

Sam Ghosh: See if you look at going forward as long as we start reducing our motor third party business that is only long tail part of the business, you are right. So, our focus continues to moderate that and increase the commercial lines of business, which is mainly short tail. So, 3/4th of the book will be a short tail going forward and approx. 1/4th will be long tail.

Manish Shukla: Lastly, on commercial finance, sequentially the AUM has actually declined marginally but it is a decline nonetheless that is a bit surprising?

Sundeep Sikka: Yes, in the current quarter, we had only about 24 billion of disbursement while now since the book is at the steady state, you have those kind of run offs also happening both on the preclosure as well as your normal closure. I mean, quarter-on-quarter, there may be slight pressure which you have seen this quarter on the preclosure, so the AUM is almost flat this time.

Manish Shukla: So what is your expectation of disbursement growth over the next year or so?

Sam Ghosh: We expect approx. 15% to 20% growth year-on-year.

Manish Shukla: Thank you very much.

Moderator: A next question is from the line of Sunesh Khanna from Motilal Oswal Securities. Please go ahead.

Sunesh Khanna: Given the higher repayment rate that we are having on the consumer finance book, can you give some kind of guidance in terms of what is the kind of growth we are looking over next 12 months on the commercial finance business?

Sam Ghosh: AUM could grow at about 10% to 12%. If the market condition looks better, we could expect a 15% growth of AUM.

Sunesh Khanna: Sir can you also give some colour on the construction finance business as to what are we doing there and how are we different from other players in that segment?

Sam Ghosh: In the construction finance business, one of the typical things is that we do not fund the large players at all and neither have we participated in any of the Tier I cities. Basically, our focus has been more into Tier II and Tier III cities wherein these builders build a small projects of 5 Crores to 10 Crores and we are his only funder in those kind of projects. So do we take our call on a big guys in cities like Bombay, Delhi and all, of course no. But we have moved into Tier II and III cities. Also, the focus of this going forward is to grow our housing finance business, so that will be the focus area. Also, this is the book where you will be able to convert the business into retail loans, once the project is at a slightly advanced stage.

Sunesh Khanna: Sir, also given the way we are aggressively growing our LAP book, just wanted to check on the LAP side, because due to severe competition, incremental yields are coming down and also there has been some cases of reportedly stress emerging also, so how are we placed on the LAP side?

Sam Ghosh: On the incremental yield side, yes, there are pressures on the yield but we are still able to manage yields of 13% - 14%. As far as the quality is concerned, we are not facing that stress because historically, we have done LTVs of anywhere between 35% and 60% only with an average LTV of hardly 50% on overall pool. So in that sense, from a repayment point of view, we are not seeing that kind of a stress in our book.

Sunesh Agarwal: Also Sir, there has been marginal increase in the gross NPLs to 2.5%, any specific thing or is it just a function of a low growth?

Sam Ghosh: It is a function of low growth and also, slight increase in the commercial vehicle pool. So, there is slight increase on that which is basically contributing so that to moving from 2.4 to 2.5% of the gross NPLs.

Sunesh Agarwal: Okay so the stress continues in the commercial vehicle side?

Sam Ghosh: Yes.

Sunesh Agarwal: Any sense when can we expect to exit out of this down cycle on the CV side?

Sam Ghosh: If you look at our book size. Earlier, we used to have 20% CV, now we are at about 12%. Our focus has moved towards housing finance and SMEs and LAP.

Sunesh Agarwal: Thank you Sir.

Moderator: We have a next question which is a follow-up question from the line of Rohan Juneja from Seawolf Capital. Please go ahead.

Rohan Juneja: I may have missed this view, could you tell us how much we expect commercial finance book to grow going forward just because the repayments were high this quarter and the book decline right?

Sam Ghosh: Yes, on a steady basis 15% to 20%.

Rohan Juneja: Just one last question I know this is the follow to my first question which is on the investment portfolio, you all also have once the investment portfolio runs off, you will also have some savings on the, on your debt cost is that correct?

Sam Ghosh: Yes, correct.

Rohan Juneja: Thank you.

Moderator: Our next question is from the line of Namesh Changani from Axis Capital. Please go ahead.

Namesh Changani: My question is on commercial finance business so what we have noticed is that the net margins have improved and that is primarily what we believe is due to cost saving on the cost of one side, so what is the primary reason for that whether we have altered our borrowing mix and second is what we have seen that there is a significant increase in the securitized portfolio versus say last five six quarters so any guidance on that, how you are looking at the securitization fees going ahead?

Sam Ghosh: Yes, as you will see, there is a fall of cost of funds almost from, about 11% to approx. 10.6%. We have been able to borrow from bank at better rates plus there is a change in mix on the overall debt, between bank and the non-bank funds.

Namesh Changani: Could you share what is the total borrowing and the mix between that this year compared to say last year?

Sam Ghosh: We would be currently at round about 75%-25% between bank and non-bank. 75% of the total borrowings would be from bank loans and 25% of the borrowings would be non-bank.

Namesh Changani: What would be it year back?

Sam Ghosh: It would be round about 80-20.

Namesh Changani: On the securitization piece?

Sam Ghosh: If you see year on year, our basic strategy has been that we were securitizing round about 20% of our book and which we have now increased it to say may be round about 22%-23%. Going forward, we will try to maintain this kind of ratio between on book and off book mix.

Namesh Changani: In your comments I have heard that LAP the yields are somewhere close to 13½% wherein the presentation it is like 15-odd% yield which you mentioned?

Sam Ghosh: It is a mix of what my overall book yields and what are the incremental yields in this segment. What I was trying to explain is the new business yield would be in the range of 13 – 14, while the overall book would be still yielding 15-16% yields.

Namesh Changani: On the future growth plan, what I have seen is, you are considering the some new lines of businesses so what, in which segment we are planning to enrich, could you just throw some light into this?

Sam Ghosh: Our thinking was that we want to grow the housing finance business. There is huge opportunity especially in Tier II, Tier III and Tier IV towns, and obviously SME will continue to be our key focus. Those are the two main areas of growth, one is housing finance company and the other is SME.

Namesh Changani: Sir this SME typically non-collateralized loan?

Sam Ghosh: No, they are all collateralized, fully secured.

Namesh Changani: Thank you very much.

Moderator: As there are no further questions I now hand the conference over to Mr. Sunesh Khanna for closing comments. Over to you, Sir!

Sunesh Khanna: I would like to thank the Senior Management team of Reliance Capital for sharing their perspective on the results and would like to thank you all for participating on the call. Thanks a lot.

Moderator: Ladies and gentlemen, on behalf of Motilal Oswal Securities that concludes the conference call. Thank you for joining us. You may now disconnect your lines.