Reliance Capital Limited

Q3 FY16 Earnings Conference Call

21st January, 2016

SPEAKERS: Management of Reliance Capital

Moderator: Ladies and gentlemen good day and welcome to the Reliance Capital Q3 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 for an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Ashutosh Mishra from Reliance Securities. Thank you and over to you sir.

Ashutosh Mishra: Thank you Zaid. Good evening 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 3Q FY16 Earning Strategies on the key operating business going forward. We could start off with an opening remark from management, post which we can open the floor for Q&A. So over to you Mr. Ghosh.

Sam Ghosh: Thank you very much. Good evening to all of you and welcome to our Q3 FY16 earnings conference call. We have the CEOs from our business with us, Mr. K V Srinivasan from commercial finance, Mr. Rakesh Jain from Reliance General Insurance and Mr. Anup Rau from Reliance Life Insurance. Also, we have with us Mr. Manish Dhanuka - CFO of the Booking & Distribution Company, Prateek Jain - CFO of our Asset Management Business and Mr. Amit Bapna - CFO of Reliance Capital.

Let me present the brief summary of our consolidated results and an update on each of our businesses. After that we would take questions. In this quarter the total income increased by 10% to Rs. 23 billion. The consolidated net profit for the quarter increased by 10% to Rs. 2.3 billion driven by the higher profits in asset management, general insurance and commercial finance segments. The net worth of Reliance Capital increased by 10% to Rs. 145 billion as on December 2015. In the Life Insurance business, we continue to be amongst the largest pair in the private sector. Profit for the quarter was Rs. 77 million. In general insurance, we are amongst the top players in the private sector. Gross written premium increased by 1% to Rs. 7 billion. Profit from the business rose by 5% to Rs. 153 million. In Commercial Finance, assets under management increased by 19% to Rs. 219 billion. Profit before tax for the quarter rose by 1% to Rs. 1.1 billion. The return on equity rose to 17% in Q3 FY16. In asset management, our Mutual Fund average assets under management grew by 24% to Rs. 1.6 trillion, with a market share of 12%. We remain the 3rd largest player in the mutual fund industry. Profit before tax grew by 12% to Rs. 1.4 billion driven by higher mutual fund AUMs.

We have given detailed financial and operating premises for each of our major businesses in our presentation and review report. I will now go through the main highlights in each business.

In Reliance Life Insurance, New Business Premium was at Rs. 3 billion, while Renewal premium increased by 13% to Rs. 7 billion. Individual WRP decreased by 29% to Rs. 2 billion. The industry growth continued to be driven by the ULIP segment. Being an agency-driven insurer, we continue our strategy to stay away from the ULIP segment, and remain focused on the traditional product segment. Traditional products formed 80% of the Individual New Business Premium as against 76% in Q3 FY15. Further, the decision to exit tie-ups with third party distributors with poor business persistency, also contributed to the decline in individual premium. In Q3 FY16, the contribution of non-par business in Individual New Business Premium was 65%, thereby supporting margins. For the period ended December 31, 2015, NBAP margin is higher than the reported FY15 margin of 27.7%. Overall persistency rose from 53% to 57% in Q3 FY16. The business continues to focus on Agency and proprietary channels, which have better persistency. Strong renewal premium growth in the quarter, together with the persistency improvement, demonstrates our focus on improving the business quality. Profit for the quarter decreased to Rs. 77 million due to decline in surrender income and lower Individual WRP. Total funds under management rose from Rs. 155 billion as on September 2015 to Rs. 160 billion as on December 2015. Sum assured of policies in force was over Rs. 1 trillion. There are 3 million policies in force. Reliance Life Insurance has a network of over 800 offices and 120,000 distribution touch points across India. In November 2015, Nippon Life signed definitive agreements to raise its stake in Reliance Life Insurance from 26% to 49% for Rs. 23 billion, subject to regulatory approvals. The deal values the business at approximately Rs. 100 billion, with an implied EV multiple of over 3 times, which is the highest in the industry till date. The transaction is expected to close by March 2016.

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 8%. The Gross Written Premium for the quarter was Rs. 7 billion - an increase of 1%. The business continues to defocus on the third party motor business, on a standalone basis, as well as commercial vehicles. The combined ratio improved to 124% in Q3 FY16. The combined ratio for the short-tail business is approximately 100%. Also, the business had a negative impact of Rs. 129 million on account of the Chennai floods in this quarter. Our focus in this business has been to improve profitability, while maintaining our market position. For the period ended December 31, 2015, the share of non-motor business rose from 41% to 44%. Profit for the quarter increased by 5% to Rs. 153 million. The return on equity remained stable at 6% in the quarter. As on December 2015, we have the largest agency force in the private sector with over 19,300 retail agents and over 125 branches.

Reliance Commercial Finance continues to focus on secured asset lending to niche segments of mortgage, SME and Commercial Vehicle loans. Disbursements increased by 33% to Rs. 31 billion. The assets under management grew by 19% to Rs. 219 billion. The outstanding loan book rose by 23% to Rs. 169 billion. We securitised loans worth Rs. 11 billion during the quarter - an increase of 38%. At the end of the quarter, 100% of the book continued to be secured. The total income for the quarter rose by 15% to Rs. 7 billion. Profit before tax increased by 1% to Rs. 1.1 billion, despite higher opex on account of expansion in the retail network for the housing finance segment. The return on equity was 17% for the quarter, as compared to 16.3% in Q3 FY15. The net interest margin remained stable at 5.7% in Q3 FY16. The cost to income ratio improved, on a sequential basis, from 17.7% in Q2 FY16 to 16.6% for the quarter. The gross NPAs were Rs. 5.8 billion as on December 2015. The gross NPAs remained stable at 2.6% of the assets under management, on a 90 day basis. The coverage ratio, including write-offs, at end of December 2015 stood at 55%. Excluding write-offs, the ratio was at 23%.

Reliance Home Finance Limited is a 100% subsidiary of Reliance Capital and caters to the self employed segment in the mortgage sector. Housing finance, including home equity, is a key focus of our lending business. We will continue to grow our housing finance assets in a significant manner in the future. The assets under management grew by 62% to Rs. 69 billion. In Q3 FY16, disbursements increased by 23% to Rs. 9 billion. The outstanding loan book rose by 76% to Rs. 63 billion. The total income for the quarter increased by 77% to Rs. 2 billion, while profit before tax increased by 35% to Rs. 332 million. The net interest margin in the quarter remained stable at 4.3%, as we expand our portfolio more towards the lower ticket-affordable housing business. The return on equity was 15.8% for the quarter, as compared to 13.0% in Q3 FY15. The cost to income ratio improved, sequentially, from 16.0% in Q2 FY16 to 14.8% for the quarter. As on December 2015, the gross NPAs are at 0.9% as compared to 1.3% as on December 2014.

Reliance Capital Asset Management manages Rs. 2.6 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 December 2015 - an increase of 24%. The improvement was driven mainly by higher equity AUMs, which rose by 32%, and contributed 33% to the overall AAUMs, as compared to 31% as on December 2014. The number of systematic investment plan and systematic transfer plan folios rose for the sixth consecutive quarter, indicating continued participation in equities by the retail investors. For the period ended December 2015, Reliance Mutual Fund registered the highest absolute growth in retail AUMs amongst the Top 5 AMCs. As on December 2015, Reliance Mutual Fund has the highest AUM sourced ‘outside the Top 15 cities’ in the industry. The Reliance Yield Maximiser AIF Scheme II, RCAM’s real estate-focused AIF, became the first scheme in the Alternative Investment Fund industry to receive highest rating by both CRISIL and CARE. For the quarter ended December 30, 2015, the business generated an income of Rs. 3 billion - an increase of 36%. The business achieved a profit before tax of Rs. 1.4 billion - an increase of 12%. Reliance Mutual Fund continues to be amongst the most profitable mutual funds in India. Return on equity was 25% for the quarter ended December 2015. In Q3, Nippon Life Insurance signed definitive agreements to raise its stake in Reliance Capital Asset Management from 35% to 49% with an investment of Rs. 12 billion, valuing the business at Rs. 85 billion. Also, Reliance Capital Asset Management agreed to acquire Goldman Sachs Asset Management’s onshore business in India for Rs. 2.4 billion, subject to necessary regulatory approvals. Both transactions are expected to close by the end of the current fiscal.

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 768,000. And the average daily equities turnover rose by 11% to Rs. 16 billion. The number of commodities broking accounts rose by 29% to over 62,700. The daily average commodities turnover was at Rs. 3 billion - an increase of 24%. For the quarter, total income was at Rs. 539 million - an increase of 7%. The business had a profit of Rs. 9 million for the quarter - an increase of 74%.

Reliance Money is amongst the leading distributors of financial products and services in India with a distribution network of over 150 branches. In Q3 FY16, total income decreased to Rs. 141 million, due to exit from the money transfer business. Presently, 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 was close to break even in the quarter as against a loss of Rs. 107 million in Q3 FY15. We have completed the restructuring in this business and expect to turn profitable in the coming quarters. In wealth management, the assets under management stood at Rs. 21 billion - an increase of 86%.

Reliance Asset Reconstruction is in the business of acquisition, management and resolution of distressed debt and assets. As on December 2015, the assets under management rose to Rs. 13 billion - an increase of 23%. The profit before tax was Rs. 32 million for the quarter, while the return on equity remained stable at 7%. In conclusion, I would like to say that all our businesses are on track in terms of operating performance and we expect each of our businesses to continue to trend of profitable growth on a consistent basis. Thank you very much. We will now take questions.

Moderator: Thank you very much sir. Ladies and gentlemen, we will now begin with the question and answer session. The first question is from the line of Nischint Chawathe from Kotak Securities. Please go ahead.

Nischint Chawathe: Can you talk a little bit about your embedded value? I know you already made a hint on the same in your presentation. So maybe if you could talk a little bit on that, how it does more over the years, etc.?

Sam Ghosh: We have not disclosed the embedded values, so that is why we did not want to go into it. But going forward, we certainly will start from next financial year.

Nishchint Chawathe: But are you seeing somewhere in the presentation as to what multiple the deal was.

Sam Ghosh: Roughly three times so you can work it out for yourself.

Nishchint Chawathe: And just another question was on the impact of Chennai floods in the general insurance business if you can just explain that a little bit?

Management: Yes, I think we all have seen the industry, the entire industry actually coming together to pay the claims in the Chennai floods. Of course it is an estimate, the industry estimates of claims are about Rs. 4500 crores and we also have gross claims of about Rs. 80 crores and net of reinsurance the impact to us in the quarter has been about Rs. 13 crores. So catastrophic events are part of the business. Of course, they are not going to be as many as risky, but frankly it is a nature of business. So we have taken the loss. The resilience of our performance is that we had a smaller hike in the growth of our profit after taking this one-time impact.

Moderator: The next question is from the line of Saket Kapoor from Kapoor & Company, please proceed.

Saket Kapoor: Sir earlier in your conference call you hinted that in the finance and investment segment, the segment will be discontinued going forward. You were looking at wrapping it up going forward for some timeline. What is the proceeds and how it is looking?

Sam Ghosh: We are working towards reducing the exposure on the finance and investment side. Like we said it is going to take a few quarters to do that. We have begun that journey. We have looked at exiting couple of our media businesses. In the last few quarters we have exited the Big Cinema chain, we have exited our FMS business and we are working on various other investments and the corporate loan book for an exit. So it should happen over the next few quarters.

Moderator: The next question is from the line of Samir Dalal from Natwarlal Research. Please proceed.

Samir Dalal: I was just wondering you are freeing up a lot of your money by selling some of your stakes in your various investment businesses and your book value is also significantly higher than what the current market price is. Looking at that the kind of return you could get on if you buy back your own shares would probably be far higher than doing any other investment. Why aren't you looking at this option?

Sam Ghosh: Basically our aim is to grow our lending business at a significant rate so therefore by buying back we are actually reducing our book. What we are doing actually in this respect, is that we are keeping control at 51% and bring in partners in each of the business so that we remain in control of them. We can use cash deployed to grow our lending book.

Samir Dalal: And what's your capital adequacy from your lending book perspective?

Sam Ghosh: Overall Reliance Capital's capital adequacy is around 23%.

Samir Dalal: Which would mean even if you did some amount of buyback you would still have enough capital adequacy. Why not look at a buyback; you are so undervalued on that front, right?

Management: Yes we are undervalued but we will be looking at growing our lending business significantly going forward and for which we will require capital. So it doesn't make sense to buyback because it restricts you from doing further fund-raising going forward.

Management: If you look at most of the housing finance companies, they are at about 50,000 to 60,000 crores. Our housing finance company is about 7000 crores roughly, so we obviously would like to go there and that itself can go to 20,000 crores, you need over about 3,000 crores or so of capital. We feel that we can grow that business at a very fast rate in the next 12 to 18 months.

Samir Dalal: Can you give us some indicators on from where you see the growth coming for the housing finance business?

Management: Our intention is primarily to get to a level 50,000 crores in about a four years' timeframe. So that would be the way we will go forward. Obviously year-on-year growth will depend upon the opportunities that are coming across in a tactical manner so we will basically ride on the opportunities and the microeconomic conditions. But broadly the vision is to get into the top five in the category in about four years' time.

Samir Dalal: So where is the growth in the Housing Finance loan book coming from which areas of India, what sectors are they coming from and how sustainable will these growth rates be going forward if you can throw some light on that?

Management: The opportunity is pretty much in the affordable segment which is growing extremely fast in the sub-50 lakhs and sub-25 lakhs category of housing and significant amount of demand is actually coming out beyond the metros. So those are two key areas where we will be focusing upon in terms of the book growth. Second factor is that we being primarily a self-employed focused lender even in the housing finance segment, the self-employed demand for rather the amount of loans that are given out is settled by security fairly low compared to the potential. So that is one area of opportunity which we believe we have the core competency to push across.

Moderator: The next question is follow up question from the line of Saket Kapoor from Kapoor and Company. Please proceed.

Saket Kapoor: Your thrust going forward is towards the housing sector as you told in earlier statement.

Sam Ghosh: We will primarily push towards the SME sector as well as the housing sector so those are the two key drivers for our growth.

Saket Kapoor: But there is lot of glut in this housing sector as a whole. A huge inventory being piled up across the country so how are you seeing that as a growth area? What is your strategy and how do you think that will turn out to be a growth area?

Sam Ghosh: The glut in the housing stock is primarily restricted to the larger metros. There is a huge amount of demand which is really coming across and that too the glut is restricted to very large extent in the higher ticket or the superior value homes. Now there is a significant amount of shortfall in the smaller towns as well as the affordable housing segment. So on one hand, you have glut in some of the markets in the upper-end segment whereas there is a huge amount of unsatisfied demand as for housing in the other segment. So it's not that the entire market is saturated or whatever, there is a huge amount of growth and if you really look at it the amount of home as a need to be built if we have to get to the dream of 'Housing for all by 2022', I think the number of housing companies that are there today are hopefully inadequate.

Saket Kapoor: Just last delving on the point again, even for the cement companies are not showing volume pickup, the disbursements are also not getting a pace so how confident are you that this strategy would work?

Sam Ghosh: It is already working. Obviously if you look at our two-year fast track record like even last full financial year, we have grown by more than 70% and so is the case in the first three quarters of this year. So obviously the strategy which you are following is working and frankly we are not the only one. Every other housing company has been growing by leaps and bound. So there are certain markets which are surely seeing a bit of a glut at this moment but it is not a secular issue, it is a kind of cyclical issue which will play itself out because at the end of the day you will require housing for all and that's very much there.

Moderator: The next question is from the line of Nidhesh Jain from Investec. Please proceed.

Nidhesh Jain: My question is on life insurance, can you share how are you placed respect to the recently draft regulation in Insurance basis especially the open architecture in bancassurance expense of management guidelines and draft guidelines on commissions for intermediaries?

Anup Rau: I think the three points are bancassurance, expense of management and cap on commissions. On bancassurance, we are obviously very well placed because if you look at companies which don't have a large bank or not promoted by a bank. We are by far the largest so we do by default make it to the shortlist of most banks considering open architecture. Having said that I believe this will take some time because I don't think the larger banks especially the big four, which constitute about three quarters of the market will move in a hurry. But we are definitely in the shortlist in most of the banks if not in all. As far as expense of management is concerned that is going to hurt companies which have a large PAR book more than others. So here to despite not having a bank we are much better placed than most people. Our PAR book tends to be is currently as a share, below 10%. So the impact on our bottom line to that extent is going to be limited. On cap on commission, so given the fact that we are moving away from third party distribution, we don't have large brokers and corporate agents with us and most of our businesses is agency or direct, therefore, this also should not hurt us significantly.

Nidesh Jain: In bancassurance have you seen any movement or any activity?

Anup Rau: No so far none, there has been just one movement so ever since it's opened up and that does got effected recently. But then the discussions are on much earlier otherwise as you are aware there has been no movement in that space currently. I believe it will take some time and we are well positioned to take advantage of that.

Moderator: The next question is a follow up question from the line of Nischint Chawathe from Kotak Securities. Please proceed.

Nischint Chawathe: This is on the CV finance business. Can you explain a little bit as to what has really changed in the last two quarters? You seem to have changed some positioning; your yields have changed very drastically, maybe if you could just throw some light on that?

Sam Ghosh: Overall at a strategic level what we have done is that we have taken fairly strong measures to ensure the quality of underwriting is improved a lot. We have put in an analytic based rating model which has significantly helped us to reach to better decisions in terms of the approval. Second what we have done is that we have reduced the focus on the first time users, first-time buyer's kind of a market. So that has brought down the early delinquencies etc that's number one. Number two, it has also reduced the overall yield from that perspective because that is the right way because if we find that the pricing is little disproportionately lower than the risk that we are taking. We would rather cut the yield but still have a better book so which is what is the basic change which we have done.

Nischint Chawathe: In your presentation your yield on a quarter on quarter basis has gone up actually.

Sam Ghosh: Yes but what I'm saying is whatever measures that we have put into place will yield results in the coming quarters because the additional business that we have done in the last two quarters is lower than the yield book, obviously book is much larger from that perspective, number one. Number two which has happened is that the percentage of used vehicle has gone up so that will actually counterbalance this particular reduction in the NIM on the new vehicle. So these two as a combination you will find. At this moment you will see that these yields are holding up but attendant risk that we have taken as a part of the inherent portfolio has gone down.

Nischint Chawathe: Just to reconfirm your yield and CV business was 15.9% in the second quarter and this has gone up to 17.3% in the third quarter.

Sam Ghosh: Yes that would be because of two things. One is the amount of securitization that we would have done. Number two is that amount of interest reversal on fresh NPAs also would be muted so to that extent these two put together would go to the extent of increase in your yield. But what I'm saying is you will find the impact of that coming across in the next couple of 2-3 quarter because obviously our new book becomes larger and larger in relation to the total balance sheet, you will find the impact coming across.

Nischint Chawathe: But how does the securitization really change the gross yield?

Sam Ghosh: The denominator goes down because when you represent it as part of what is there on your book the excess interest spread goes and sits in the NIM.

Nishchint Chawathe: So this is a calculated yield, this is not the gross yield?

Sam Ghosh: No, if I put together all the transactions that we are doing, is it the gross yield, no. It has an impact which is coming out of the securitization.

Nishchint Chawathe: How much would the gross yield broadly be like?

Sam Ghosh: We can come back to you on this number, off hand I don't have a number which I can quote to you.

Nishchint Chawathe: And the other thing was also on the SME side, I think there also we have seen fairly sharp decline in interest rates. So is that just to do with competition or is it something else out there?

Sam Ghosh: Overall we have given a 25 basis points reduction in our PLR effective from November. So that has created a certain amount of impact in terms of the yield going down. Secondly what is also happening that there is certainly a certain amount of competition that is coming across so the yields are in general as far as the new ones are concerned will be lower than that. The third factor is that there is certain amount of agri loans, percentage of that is surely growing. I think we have got close to about 400 crores of agri loans which are there which obviously get priced at a lower level than the normal SME business to the extent of around up to 200 basis points. So all these factors put together have contributor to this. There is no single factor but it's a combination of several things.

Moderator: The next question is from the line of Ashwin Balasubramanian from HSBC. Please proceed.

Ashwin Balasubramanian: The first question was related to what will be the maximum kind of CP borrowing if I take your commercial finance and home finance book put together as a proportion of your overall borrowing and given the recent SEBI guidelines on mutual fund holdings, are you seeing any impact in terms of the rate at which you are able to raise? The second question is basically is related to your LAP portfolio so you are reporting an yield of about 15% whereas generally most players in the market the yields are around 13%. So in terms of the difference in the book what will be the nature of our Reliance Capital's book versus the rest of the market? What will be the differences there?

Management: On the commercial paper side we would have roughly 4,700 crores of commercial paper as on 31st December. On RCap it would be roughly 4,000, on the home finance side it will be roughly 600-700 crores. We don't foresee too much of impact on us because we are expecting cash flows to come in from our Nippon Life transactions that should conclude sometime in Feb and March so we will be using the proceeds to run-off the CP book at RCap level.

Sam Ghosh: As far as the LAP is concerned you would have noticed that we have not grown the book aggressively at all. In fact between last quarter and this quarter the total book has come down a little bit, simply because we would rather go for a sensible pricing and not necessarily end up cutting the rates the way what has been happening in the marketplace. So therefore we are letting go some of the volumes in order to ensure that our NIMs are protected so that's the strategy that we are following. So therefore our yields will be a little higher than what currently the market is offering. Second factor is that we have a certain sweet spot as far as the LAP book is concerned. We do not do loan against land or anything else so our yields will not be as high as what you will find in some other cases. So it's somewhere in between, we are neither at the lower-level not at the very high level. So we are in a range which is there we are able to get expected or rather expectable risks versus expectable return.

Moderator: Thank you very much. As there are no further questions I now hand the conference over to the management for closing remarks. Over to the team.

Sam Ghosh: This quarter for the company obviously has shown a profit of about 235 crores and going forward in this last quarter the number of transaction that are pending to be completed plus it's a final quarter of the year so we expect all our businesses to perform substantially better than what we have achieved in this quarter. Once is the transactions are closed, some 3,000 crores we come into Reliance Capital and will go towards paying repaying debt as well as growing at housing finance. I think overall it looks very good for Reliance Capital going forward. Thank you very much.

Moderator: Thank you very much members of management. Ladies and gentleman, on behalf of Reliance securities, that concludes today’s conference call. Thank you all for joining us and you may now disconnect your lines now.