Reliance Capital Limited
Q1 FY14 Earnings Conference Call
29th July 2013

SPEAKERS: Management of Reliance Capital

Moderator: Good day, ladies and gentlemen. I am Souradip Sarkar, the moderator of this call. Thank you for standing by and welcome to the Reliance Capital Limited Q1 FY14 Earnings Conference Call. For the duration of presentation, all participants' line will be in listen-only mode. Post that, we will have a Q&A session. So now without further delay, I would like to hand over the proceedings to Mr. Parag Jariwala from Macquarie Capital Securities. Thank you and over to you, Mr. Jariwala.

Parag Jariwala: Yeah thanks. Thank you and good evening everyone. We have with us the management of Reliance Capital to discuss the quarterly result. Without any further delay, I would like to hand over the call to Sam and the management team to discuss the numbers briefly and then we can go for a question and answer. Over to you, Sam.

Sam: Thank you very much, Parag. Okay. So, good evening to all of you and welcome to our Q1 FY14 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 Reliance Commercial Finance, Sundeep Sikka from Reliance Capital Asset Management, Sanjay Wadhwa, CFO of our broking and distribution business as well as Reliance Capital's CFO, Amit Bapna.

First, let me present a brief summary of our consolidated Q1 results and an update on each of our businesses. After that, we will take questions.

The total income from operations for the quarter rose by 16% to Rs. 19 billion, driven by growth in all businesses, mainly General Insurance and Asset Management. The consolidated net profit for the quarter stood at Rs. 1.3 billion, a strong growth of 194% as against the previous corresponding period. The increase in profit is driven by turnaround in the General Insurance business and significant improvement in profitability across other businesses. The net worth of Reliance Capital increased by 3% to Rs. 121 billion at the end of Q1FY14.

To support the government's objective of curbing gold imports, we suspended the sale of physical gold and gold-based investment products across businesses. We discontinued new subscriptions in Reliance Gold Savings Fund and financing against gold as a security. We remain committed to support all policy objectives of the government and the RBI.

During Q1, we have managed to improve the operating performance of our core businesses and will continue to see higher contribution from them towards the earnings mix of Reliance Capital.

In Asset Management, our mutual fund average assets and the management grew by 21% to Rs. 978 billion. We continue to maintain our market share of 12%. Profit before tax grew by 32% to Rs. 771 million, driven by higher mutual fund AUMs.

In Life Insurance, new business premium rose by 105% to Rs. 5 billion in Q1 FY14, driven by improved productivity by the agency force and higher group business. Profit increased by 196% to Rs. 565 million in the quarter. The profit does not include surplus from non-participating business, which will be appropriated to the shareholders' account later in the year.

In Commercial Finance, the total incomes for the quarter increased by 9% to Rs. 5 billion. Profit before tax rose by 25% to Rs. 830 million, driven by higher yields and improved cost efficiencies. As mentioned in the previous quarter, we have been able to improve our net interest margins to 5% in Q1 and improvement of 15 basis points over Q4 FY13.

In General Insurance business, gross written premium increased by 25% to Rs. 7 billion, higher than the industry growth rate of 17%. We achieved the profit of Rs. 102 million as against the loss of Rs. 201 million in Q1 FY13, driven by reduction in the combined ratio.

We have given detailed financials and operating parameters for each of our major businesses in our presentation and review report. I'll now go through the main highlights in each business.

Reliance Capital Asset Management manages over Rs. 1.8 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 two mutual funds in India with the market share of 12%. The average assets under management of Reliance Mutual Fund were Rs. 978 billion as of 30th of June 2013 - an increase of 21%. We increased the share of retail debt to 41% of the overall debt AUMs as on 30th of June 2013, as compared to 20% in June 2012.

The retail Gold Fund had Rs. 26 billion in AUMs and maintained the market share of 24% of the gold fund category on a sequential basis. The number of SIPs and STPs account stood at 1.3 million and are highest in the industry. For the quarter ended June 30, 2013, the Asset Management business generated income of Rs. 2 billion, an increase of 39%, driven by higher mutual fund assets and the management. And a profit before tax of Rs. 771 million, an increase of 32% over the corresponding quarter last year. Reliance Mutual Fund continues to be amongst the most profitable mutual funds in the industry.

Reliance Life Insurance continues to be amongst the leading private sector life insurance, based in terms of new business premium, with the private sector market share of 10.5%. The total premium for the quarter rose by 12% to Rs. 9 billion, driven by an increase 105% in new business premium to Rs. 5 billion.

In Q1, Reliance Life regained its position amongst the top five private sector insurance in terms of new business premium. 80% of the new individual business premium has been contributed by traditional product. Our focus continues to be medium and smaller towns and cities addressing the under and uninsured opportunity. In spite of that, we have been able to increase our average ticket size by 47% to Rs. 17,000 in the quarter. We expect to increase our ticket size as well as maintain our position amongst the top private sector insurance.

Reliance Life Insurance sold 156,000 individual policies in the quarter ended June 30, 2013 and was one of the highest in the private sector. Nearly five million individual life policies are in force as on June 30, 2013. The profit before tax for the quarter increased by 196% to Rs. 565 million. The declared results of Reliance Capital include consolidation of 48% stake in Reliance Life Insurance. The total funds under management were over Rs. 180 billion of assets as on 30th of June 2013. Reliance Life has a distribution network of over 1,100 offices across India. The number of agents was over 138,000, an increase of 12% over 31st March 2013.

Reliance Commercial Finance is amongst the leading lenders in the non-banking finance space. The disbursements for the quarter were at Rs. 17 billion. The Assets and the Management grew by 5% to Rs. 159 billion. The outstanding loan book was Rs. 136 billion and remained flat vis-à-vis March 2013. Our focus continues to be on secured asset landing to niche segments of home loans and loan against property, business loans, loans for commercial vehicles, infrastructure financing. At the end of the quarter, 100% of the book continued to be secure.

Total income for the quarter rose by 9% to Rs. 5 billion, while profits before tax increased by 25% to Rs. 830 million, driven by higher margins. The average yields on Q1 rose to 15.4%, an increase of 120 basis points over the corresponding quarter last year. The net interest margin for the quarter was 5%, an increase of 102 basis points over Q1 FY13. The cost to income ratio for the quarter dropped to 15%, an improvement of over 60 basis points. The gross NPLs were at Rs. 4 billion. This translates a 2.2% of assets under management. The coverage ratio including write-offs at the end of June 2013 stood at 59%. Excluding write-offs, the ratio was at 20%.

Reliance General Insurance is amongst the leading private sector general insurance companies in India in terms of business premium with the private sector market share of over 8%. Gross rate in premium for the quarter was Rs. 7 billion, an increase of 25%.

The business made a quarterly profit of Rs. 102 million as against the loss of 201 million in the corresponding previous period. And the combined ratio stood at 113% for the quarter as compared to 220% in Q1 FY13 and 115% in

Q4 FY13. The decline resulted from improved efficiencies and claims management and reduction, expenses and commission. Our focus in this business is to improve the combined ratio further and to optimise the product portfolio towards the profitable mix.

Reliance Securities is amongst the leading retail equity broking houses in India whilst Quant broking caters to the wholesale client segment. The focus of Reliance Securities is on its key business verticals of equity and commodity broking and wealth management. In the broking vertical, equity broking accounts increased by 4% to 718,900 and the average daily equity turnover stood at Rs. 25 billion. The number of commodity's broking accounts increased by 8% to nearly 40,500 and daily average commodity turnover of Rs. 8 billion. In Wealth Management, the AUM stood at Rs. 11 billion, an increase of 124%. For the quarter, the total income decreased by 6% to Rs. 538 million, while profit was at Rs. 4 million.

Reliance Money is amongst the leading distributors of financial products and services in India with a distribution network of over 5,600 outlets. Until sales were discontinued, Reliance Money sold over 1.5 tonnes of gold. Reliance money is one of the largest private sector partners for Western Union Money Transfer in India and handled 0.7 million money transfer transactions during the quarter, an increase of 12%. For the quarter, revenues rose by 104% to Rs. 300 million. The business made a marginal loss of Rs. 8 million reported due lower income on insurance sales.

In conclusion, I would like to say that all core businesses are on track in terms of operating performance, and have started to deliver profitable results on a consistent basis. We have submitted an application for a banking license in June. In this endeavour we intend to partner with Sumitomo Mitsui Bank and Nippon Life Insurance, two leading financial institutions from Japan. The foreign partner proposed stake between 4% and 5% stake in each in the proposed new bank whilst Reliance Capital would be the promoter subject to necessary regulatory approvals. I am very confident and certain that barring extraordinary circumstances, Reliance Capital's strategy of focusing on profitable growth will result sustainable ROEs in the range of 16-18% from its business over the next two years. Thank you very much. We can now take questions.

Moderator: Thank you so much, sir. With this we are going to start the Q&A interactive session. So I would request all the attendees and the participants, if you wish to ask any question, you may press "0" and "1" on your telephone keypad and wait for your name to be announced.

The first question from Mr. Kunal Shah from Edelweiss. You may go ahead and ask questions, please.

Kunal Shah: Yes, sir, three questions. On the consumer finance side, the increasing gross NPAs which rose from 280 to 360 crores. So if you can give which segments have contributed? Second on life insurance, if you look, the renewal premiums have come out quite significantly in the last four quarters run rate vis-à-vis the new business premium which has grown, say, more than 100-odd percent. So I just want your perspective on that. And thirdly, say, in terms of the broking and distribution. So the earnings have been very, very volatile over there. So maybe, in terms of volume if you look at it, it has been almost, say, stable to slight declining but profitability has been much lower. So what has led to decline in profit in this quarter?

Management: Good. On the commercial finance front, yes, in line with the general slowdown in the market there has been a certain amount of increase in the gross NPLs. Substantial part that has been contributed by the construction equipment and the commercial vehicles category. Especially in the segment called Crane Operators. But, in general we don't have any concern of a significant nature because many of these are in fairly young state of overdue and we believe that in a quarter's time we should be in position to solve many of those cases.

I would expect that the gross NPLs would be maintained at levels around 2% for the rest of the year. And, of course, as far as the ratio of gross NPLs is concerned, you also need to that in the light of two important issues: one, the fact is that we have intentionally kept the asset size at the same level because of the negative environment as far as capital expenditure is concerned in the country. So we've not really grown the book in a very aggressive manner because we believe it's a wrong time to grow the book. So therefore, the ratio would certainly be devoid of any denominator effect in that sense. Second factor is that we follow a 90-day norm, which is consistent with the banking norms, but unlike the other NBFC who follow either 150-day or 180-day norms. So in that context, our 180-day percentages are pretty much lower. So therefore, we don't really believe there is any serious concern on this particular point.

We have been focussing very heavily in the past three or four quarters on improving the net interest margins; and as you can see now, from a level of close to 4%, it has gone up to about 5%. Intention would be to increase the ROE from the business rather than the growth on the top line per se.

Kunal Shah: And if you can just get some colour with respect to the gross NPL, how much would be from CV/CE?

Management: See, the growth in the gross NPL from the CV and construction equipment sector is somewhere close to about 40 crores. The rest of this thing, there is hardly some 7 to 8 crores growth in the mortgages and another about 8 to 10 crores in SME. So bulk of the growth in the gross NPL absolute number has come from the commercial vehicles and construction equipment side, specifically, construction equipment, as I said the crane operators. And now we are in fairly advanced stages of solving a few of those cases. So, I suspect that we should be in a position to control the particular portfolio pretty quickly. I don't expect that to go to a concerning level at all.

Kunal Shah: And apart from the incremental out of this outstanding 360-odd crores, how much would be the overall outstanding gross NPLs on CV/CE? So 40 crores was on the incremental basis?

Management: That is right. So this is now gone up to somewhere close to about 62 crores. So it's still a very small amount, right? It used to be very, very low at about 20 crores and all that. So that has now gone from 20 odd crores to about 60 crores. So that is the key differential. But even then, you know, in terms of the overall percentage it's still fairly comfortable.

The more important factor is that we had actually stopped anticipating a certain amount of stress. We had stopped disbursing on the larger strategic kind of segment for very long time now. More than 15 months have gone when we have focused the entirely on the retail side which is, A) helping us to manage the risk and, B) improving the net interest margin. And retail sales are still happening on the vehicle side. It's only the larger trucks like medium and heavy commercial vehicles and the super strategic and strategic customers who actually got affected most. So we had scaled down that significantly over about 15 months ago. So that is really helping us manage the things.

Kunal Shah: How about the ALM? How do we see the risk of say the recent uptrend in the interest rates? How do you see impacting your margins which are at, say, 5% as of now?

Management: It should not affect us for the simple reason that we were never dependent upon short funds at all. Most of our funding dependence comes from bank loans, which all one-year plus in their maturity. And we really don't see any impact or very marginal impact because of the short-term blip that has happened because of the RBI actions. We never gained much when the rates went down, nor are we going to lose anything significant because of this blip.

Kunal Shah: So how is the ALM mismatch?

Management: We are positively mismatched in the sense that we have got more long-term funds than long-term deployments, so to that extent, there is almost zero liquidity risk as far as we are concerned.

Kunal Shah: Okay.

Anup Rau: Hi, this is Anup from Life. Okay, to your question on the renewals being lower, the renewals will be lower than last year because of decline in the new business for the last couple of years. Having said that, last year we collected 65% of our renewable base, and for Q1 at 72%. So if you look at the efficiency of collections, they have gone up. But this year, I do expect renewable collections should be low for the simple reason that the base is much lower compared to last fiscal.

Kunal Shah: Okay.

Sanjay Wadhwa: Hi, this is Sanjay. The revenues on the broking side are lower mainly on two accounts. One is the average exchange volumes. The turnover at the exchange itself is lower by 2% as compared to the previous quarter. And on top of it, we are witnessing a decrease in the delivery volumes. So we are observing a shift from deliveries and future segment into the option segment which is actually a very low margin business. So to that extent, our margins are shrinking. So due to these two reasons, the top line is lower and expense is more or less flat. That has resulted in a reduced bottom line.

Kunal Shah: Okay. No, because if you look at it, maybe in terms of income, more so, if you look at it say the overall profit which we had done in broking business, let's say, 40-odd crores for the last full year and this time if you look at it, it is hardly 40-odd lakhs. So maybe in terms of revenue and all, we are pretty much in the run rate, but it's mainly on the say the profit side wherein we have got impacted.

Management: I know, even on the revenue side, we are a little over than if you compare it with the Q1 of last year. And that is where we have taken a hit.

Kunal Shah: Okay.

Moderator: Thank you so much.

Kunal Shah: Yeah, thank you.

Moderator: Thank you, Mr. Shah. We have a question from Mr. Manish Shukla. You can go ahead and ask your question, please.

Manish Shukla: Yeah, good evening. Thanks for the opportunity. First, I would like to know what are the various gold-related products across the group which you have stopped?

Management: So if you look at from the mutual fund side where the gold is getting its product, Commercial Finance was doing some gold lending and then the distribution of gold coin was being done by the Reliance Money side.

Manish Shukla: So all of that is stopped now, is it?

Management: That is corrected, suspended for the time being.

Manish Shukla: Yeah, so just to get a sense roughly of the consolidated revenues last year, how much would be as business has contributed?

Management: On the asset management side, we have a fund which is almost 2,500 crores on which the management's fee roughly would have been on the region of 20 crores. So that fund continues, but additional subscription is stopped. So there will be on the existing fund which is there, we still continue to earn, so there is only incremental AUMs which will not come in. From the gold lending business, very insignificant because our total booked size was only 60 crores. So it is not significant. From Reliance Money's perspective, gold coin distribution, it was a thin margin business where we will eventually lose out on.

Manish Shukla: Okay, secondly on your commercial finance business, there is a decent quarter-on-quarter jump in the asset yields, could you explain what is driving that?

Management: See, it is basically because of the change in the focus that we started doing about some 15 months ago. To give you an example of the commercial vehicle side when we stopped doing the strategic kind of segment and moved into the retail, the small commercial vehicle kind of an area which has given us a huge amount of boost as far as the revenue is concerned. Second factor is, as far as the SME part and the mortgages part is concerned, we have consciously chosen to drop the average ticket size, grow more retail, go to the towns beyond the metros. We have also opened up in the past one quarter almost 18 offices which has given us virtually doubling of the geographical presence. So those are some of the things that we have made changes as far as the fundamental of the business is concerned. That has helped us considerably. Also, the margins have not increased because of the cost of funds going down, because as I explained earlier we never were dependent upon the short-term funds. So we had taken a fairly conservative view saying that we will be perfectly matched as far as the ALM is concerned. So any amount of change in the current market that you see will not affect us. So I suppose this 5% should be fairly sustainable. So we have just gone more retail, more small towns in order to improve our margins.

Manish Shukla: Sure, I get your point on liabilities side, I am talking more from the assets side; your yields have moved from 14.2 in the third quarter last year to 15.4, something has significantly changed on your asset side for your yields to jump so much in these two quarters.

Management: We have got more retail, more small town as far as the assets are concerned. So that has really helped us to improve the gross interest earnings.

Manish Shukla: Okay.

Manish Shukla: Okay, all right. My last question is on General Insurance. There is a good jump in the premium income this quarter. Is that sustainable, and what is the profitability outlook for the year as a whole?

Management: I think, General Insurance continues to grow given the huge under-penetration which exists. So I guess as awareness and technology starts to play together, there is a customer pool which is emerging. The industry has been growing now for almost like 15-20% for the last 10 to 12 quarters, so we expect that to continue. I think, for us we will grow a bit more than the industry because we want to balance with the profitability. So I think, given this fact, I certainly see the current trend to continue at least for this year.

Manish Shukla: How is it competitive intensity especially from the government insurance companies in this space in terms of pricing?

Management: Competition continues as usual. But I think, overall, people are trying to balance different objectives. So for Reliance, you know, we have been strong in motor and not so strong in the non-motor segment. So, we have to try and grow the health side to really do the balancing act. Government companies are trying to get their act together in terms of, you know, the efficiency of business, more than just the business itself.

Manish Shukla: Okay, those are my questions. Thank you.

Moderator: Thank you so much. We have one more question coming up from Mr. Santosh Singh from Espirito Santo. You may go ahead and ask your questions please.

Santosh Singh: I have a couple of questions, first on the life insurance side. In the first quarter we saw some really good numbers but what are expectations for the year? Is it sustainable or are we trying to push product before the new guidelines come and we might see a slowdown after that? Means, what do we expect for this year on the life insurance front?

Management: I think, one, the number you should look at is the WRP growth, individual WRP which is 47%. And that number is not sustainable. But we would grow at double digit and we will beat the industry every quarter. I do expect pain for the industry after September because there's always transition period; you will have some distributors who might want to move out of the profession because they will find it no longer that viable. So I do expect an industry issue in Q3 in terms of volume vis-à-vis last fiscal. But we are fairly certain that in all the four quarters we will beat the industry growth, and also for the fiscal.

Santosh Singh: Okay and second question on the commercial finance side. See, although our net interest margins have improved, again the cost-to-income ratio has again moved up. So do we expect that cost-to-income ratios again to move down from this 15.2%?

Management: See if you look at y-o-y, we are more or less at the same level. It has actually come down to a certain extent. It may be a little unfair to compare cost-to-income of Q4 versus Q1 simply because there is a certain amount of busy seasons, slack seasonality which happened between H1 and H2. I would expect this ratio to come down to a certain extent over the next couple of quarters. Having said that, a certain amount of expenditure has been incurred by us on opening new offices and virtually doubling our geographical presence, so which will bear fruit in another two quarters down the line.

Santosh Singh: Okay, yeah, these are my questions. Thank you.

Moderator: Thank you so much. The next question is from Ms. Kajal Gandhi from ICICI Direct. You may go ahead and ask your questions, please.

Kajal Gandhi: Good evening, sir. Sir, can you tell me like LAP is on segment which everybody is looking at, if you look at in terms of growth. Can you throw some light and how is this product moving?

Management: Okay, essentially we have always had a very conservative view as far as the underlying property as well as the end use is concerned. We do not do LAP against land nor do we give money for any speculative purposes as in purchase of land or anything like that. It always has to be for a certain stated business purpose that we give. So what happens in the bargain is that we do let go of a certain amount of rate of interest. So you will expect us to get slightly lower rate than what the competition in the market might be doing on the LAP side. But it gives us a huge amount of comfort in terms of the recoverability of the money and the NPA level. As far as the market itself is concerned, we are not really concentrated very heavily on one or two markets. We have taken due care to ensure that we move to the smaller towns as well and bring down our NPAs. So to that extent, the granularity of the portfolio is increasing, which would certainly stand us in good state in the long run.

Kajal Gandhi: What is the LTV in LAP?

Management: LTV in LAP would be on an average it never would be more than 45 to 50%; that too as I said is not on the basis of fallow land, it is on constructed property, which by and large about 65% of our LAP is on residential property and a substantial part of it is self-occupied.

Kajal Gandhi: Okay. And second, my question is on life insurance. As we have raised the share in this quarter, can we expect that we are planning in the near term to get it consolidated and go over 50%?

Management: No, we are not looking at increasing the direct holding above the current level immediately. We have economic interest of 74%. We currently consolidate only 48%. 26% is still held by Viscount Management Services. So we will take a decision a few quarters down the line whether we need to make that a subsidiary or not, because there will be regulatory hurdles on that.

Kajal Gandhi: Okay. Sir, what is your outlook in the industry premium growth and margins?

Management: There was a CII survey wherein the all the CEOs are asked what their estimate for growth is. I think that the average came about 5%. So that's what they believe. As far as we are concerned, we are fairly certain of double-digit growth, and, as I mentioned earlier, performing better than the market. The margins till September, you know, would continue to be around what they were last year. I think we will have to get back to what the margins would be in H2. This is how the new product guidelines pan out for distribution and sales.

Kajal Gandhi: And in case of general insurance this year, we should expect the full year should be profitable?

Management: Yeah, we are certainly looking forward to that.

Kajal Gandhi: Okay, thank you.

Moderator: Thank you so much. At this time there are no more questions from participants. I would like to hand it over back to the management for any final or closing comments. Over to you, sir.

Management: Thank you. I think obviously this quarter, Q2, will be a challenging quarter, but we expect all our business to outperform what they have done in Q1. Thank you.

Moderator: Thank you so much. Thank you, ladies and gentlemen, for joining the conference call. With this we conclude the Q1 FY14 earning conference call for Reliance Capital. You may all disconnect your lines. Thank you so much.