"Reliance Capital Q2 Financial Year 2015 Earnings Conference Call"

November 17, 2014

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Moderator: Ladies and gentlemen good day and welcome to the Reliance Capital Q2 FY 2015, Earnings Conference Call hosted by Macquarie Capital Securities India Private Limited. As a reminder all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference call 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. Parag Jariwala from Macquarie Capital Securities. Thank you and over to you, Mr. Jariwala!

Parag Jariwala: Thanks Mallika and good morning all of you. We have with us Mr. Sam Ghosh, CEO Reliance Capital and his team. At this point in time I hand over the call to Mr. Sam Ghosh. Post his opening remarks we can start Q&A. Thanks.

Sam Ghosh: Good evening to all of you and welcome to our Q2 earnings conference call. We have the CEOs from our businesses with us; Anup Rau from Life Insurance, Rakesh Jain from Reliance General Insurance, K.V. Srinivasan from Commercial Finance and Sundeep Sikka from our asset management business. We are also joined by Sanjay Wadhwa, CFO of the broking & distribution segment, as well as Reliance Capital's CFO, Amit Bapna.

Let me present a brief summary of our consolidated results and an update on each of our businesses. After that, we will take questions. In this quarter, the total income increased by 12% to Rs. 21 billion. The consolidated net profit for the period was at Rs. 2.2 billion - an increase of 20%.The net worth of Reliance Capital increased by 4% to Rs. 129 billion as on September 2014.

In the life insurance business, New business premium rose by 15% to Rs. 6 billion in this quarter. We continue to be the 4th largest player in the private sector. In general insurance, Q2 Gross written premium increased by 11% to Rs. 6.5 billion. In terms of gross premium, we are amongst the top five players in the private sector. Profit from the business rose by 53% to Rs. 248 million. In commercial finance, Profit before tax rose by 5% to Rs. 954 million. We have improved our net interest margins to 5.5% vis-à-vis 5.3% in Q2 FY14. In asset management, Our Mutual Fund average assets under management grew by 31% to Rs. 1.2 trillion, with a market share of 12%. We remain the 3rd largest player in the mutual fund industry. Profit before tax grew by 71% to Rs. 1.1 billion driven by higher mutual fund AUMs and improved cost efficiencies. We have given detailed financials and operating parameters for each of our major businesses in our presentation and review report.

I will now go through the main highlights in each business:

Reliance Life Insurance: In Q2 FY15, Reliance Life Insurance continued to be the 4th largest player in the private sector, with a market share of 8%. In Q2, sales of ULIPs gained momentum, driven by robust capital markets. Due to lower expense structure, there has been very limited impact on new business premium growth for agency driven insurers. Further, the regulations mandate submission of bank proof by the policyholder at the business login stage. This change continues to have an unfavourable impact on the agency driven insurers. In spite of this, Reliance Life's total premium for the quarter rose by 11% to Rs. 12 billion, driven by a 15% increase in new business premium to Rs. 6 billion, while renewal premium rose by 8% to Rs. 6 billion. Average ticket size increased by 39% to over Rs. 27,300 in the quarter. On a sequential basis, the number of policies sold rose by 4% in the quarter. We expect to sustain the improvement across both metrics in the near term. Overall persistency improved to 53% in Q2 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 H1 FY15, our continued emphasis on a favourable product mix has led to a rise in the contribution of non-par business in Individual New Business Premium, to over 60%. Premiums from policies with tenure of 10 years and above rose to 74% of the Individual NBP, as compared to 55% 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. 529 million. The profits are lower than Q2 FY14 due to decline in surrender profits. The declared results of Reliance Capital include consolidation of 48% stake in Reliance Life Insurance. Total funds under management rose to Rs. 189 billion as on September 2014 - an increase of 8%. Reliance Life Insurance has a network of over 900 offices and over 90,000 distribution touch points across India.

Reliance General Insurance: 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 7%. The Gross Written Premium for the quarter was Rs. 6.5 billion - an increase of 11%. Profit increased by 53% to Rs. 248 million in the quarter. The return on equity was 11% as compared to 8% in Q2 FY14. The combined ratio for the quarter is at 120%, similar to Q2 FY14. The combined ratio for the short-tail business is at 99%. The combined ratio for the long-tail business is at 161%. The short-tail business is expected to remain below 100%, while the long-tail business will be above 100% as reserves have to be upgraded regularly for the interest costs. Therefore, looking at the long-tail combined ratio, excluding the investment income, is not correct.

Reliance Commercial Finance: 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 rose by 31% to Rs. 26 billion. The assets under management grew by 16% to Rs. 187 billion. The outstanding loan book was at Rs. 141 billion - an increase of 6%. We securitised loans of Rs. 18 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 8% to Rs. 6 billion. Profit before tax increased by 5% to Rs. 954 million. The return on equity was 13.5% for the quarter, vis-à-vis 12% in Q1 FY15. The net interest margin was 5.5%, as against 5.3% in Q2 FY14. The cost to income ratio was in line with Q1 FY15 at 16.9%. The gross NPAs were Rs. 4.4 billion. This translates to 2.4% of the assets under management. The Commercial Vehicles' segment continued to be under stress, while there was improvement in the performance of the SME assets. The coverage ratio, including write-offs, at end of September 2014 stood at 55%. Excluding write-offs, the ratio was at 19%

Reliance Capital Asset Management: Reliance Capital Asset Management manages Rs. 2.2 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 12%. The average assets under management of Reliance Mutual Fund were Rs. 1.2 trillion as on September 30, 2014 - an increase of 31%. The equity schemes have shown an impressive improvement in performance as 100% of the schemes have beaten the benchmark in the 6-months as well as one-year time frame. Retail debt comprised of 28% of the overall debt AUMs as on September 30, 2014. 20% of our total AUMs have been sourced 'outside the Top 15 cities'. The Company conducted nearly 600 investor awareness programmes during the quarter, of which over 90% were held in these locations to improve awareness levels in smaller cities. During the quarter, the Company launched the Reliance Japan Equity Fund. It is a first-of-its-kind offering, focusing exclusively on the Japanese markets. For the quarter ended September 30, 2014, the asset management business generated an income of Rs. 2 billion - an increase of 20%.The business achieved a profit before tax of Rs. 1 billion - an increase of 71% over Q2 FY14. The profit equals to a return on equity of 23% as compared to 16% in Q2 FY14. Reliance Mutual Fund continues to be amongst the most profitable mutual funds in India.

Broking businesses: Reliance Securities is amongst the leading retail equity broking houses in India. The focus in this segment is on the key business verticals of equity and commodity broking and wealth management. The equity broking accounts increased by 2% to over 735,600. And the average daily equities turnover stood at Rs. 18 billion - an increase of 28%. The number of commodities broking accounts rose by 18% to over 48,500. The daily average commodities turnover rose by 5% to Rs. 3 billion. For the quarter, total income was at Rs. 455 million - an increase of 25%.The profit before tax rose by 115% to Rs. 50 million driven by higher volumes, primarily in the equities segment.

Reliance Money: Reliance Money is amongst the leading distributors of financial products and services in India with a distribution network of over 4,600 outlets. In wealth management, the assets under management stood at Rs. 10 billion - an increase of 32%. In Q2, total income decreased to Rs. 259 million, as the business was impacted by the exit from the insurance broking business and loss of income from sale of gold coins due to closure of that business. The business made a loss of Rs. 49 million in Q2 as the Company is in the process of realigning the distribution of its insurance products to Reliance Life and Reliance General Insurance.Going forward, we will focus on catering to clients in the HNI space as well as the mass-market and mass-affluent segments.

Reliance Asset Reconstruction: Reliance Asset Reconstruction is in the business of acquisition, management and resolution of distressed debt and assets. Banks sold NPAs of approx. Rs. 70 billion during the quarter. Reliance ARC continued to bid for retail and SME NPLs on a 100% cash basis or using the SR route. As on September 30, 2014, assets under management rose to Rs. 11 billion as against Rs. 732 million as on September 2013. The business made a profit of Rs. 27 million during the quarter.

In conclusion, I would like to say that, All core businesses are on track in terms of operating performance, and we expect each of our businesses to continue the trend of profitable growth on a consistent basis.

Thank you very much. We can now take questions.

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Moderator: Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Rohan Juneja from Seawolf Capital, please go ahead.

Rohan Juneja: Hi, can you just give us some kind of guidance that you all have for your consumer finance loan book and how much do you all think you can grow over the next 12 months?

K.V. Srinivasan: Broadly, the growth will track the growth of loans in the economy as a whole. Now with hopes of revival of the economy and higher GDP growth we would expect loan growth to be in the region of around 15%, so I think we will be broadly in line with that.

Rohan Juneja: And with the net interest margin that you all reported in this quarter?

K.V. Srinivasan: Yes, we would like to keep it within the same range, maybe plus minus 15 to 20 basis points.

Moderator: The next question is from the line of Kajal Gandhi from ICICI Direct, please go ahead.

Kajal Gandhi: Sir, I wanted to know this quarter we had transferred in the life insurance business profit from policy holders to shareholders, so in spite of that the number is quite low, I think the expectations were higher if we look at the last quarter, Q2 last year and second question is about if what is the basic reason for our AMC profit being so high?

Anup Rau: Answering your first question there are two parts to this, yes we did transfer profits but you have to attend that the surrender profits have gone down for industry this year, so while the profit for H1 last year was 192 Crores it was 87 Crores this year for H1 and the deduction is on account of reduction in surrender profit, the other profits continue to track well. Also, I want to make a point that if you look at margins for example, our margins are positive over last year and we are probably one of the few companies to do that, so our margins this year are in excess of 25% compared to about 23% for the whole fiscal last year. So we continue to track well on new business margins at this point in time.

Kajal Gandhi: Sir if you can quantify what is the impact of surrender profits?

Anup Rau: I think our profits at this point in time have been more or less flat the only difference on account of surrender on a year-on-year basis.

Kajal Gandhi: Sir what is the guidance on the growth on new business that you are seeing?

Anup Rau: The industry currently is negative 10.5% for H1, I don’t expect the industry to be positive for the fiscal, and I think it will continue to be negative. I think the growth will largely come from ULIPs and bank promoted companies, in case you are talking about Reliance we do expect to track, be flattish till end of January given the fact that you have couple of artificial spikes last year on account of scarcity closures given that there were products which were getting withdrawn but we would be year-on-year positive by the end of the fiscal. We will outperform the industry growth.

Sundeep Sikka: On the AMC, I think broadly the increase in profit is because of the asset mix that we have been working on over the years, equity AUM has almost gone up very high and overall grown by more than 50%, liquid has been coming down, debt has been increasing and if you look at it overall realization in the last quarter have moved up from 60 basis points to 69 basis points, so that is the big change and a lot of cost efficiencies come in basically on the distribution and other parts of the organization are also showing results.

Kajal Gandhi: Is it that this quarter the equity AUM rises mainly on account of price rise, it is because the market share I understand has not gone up for Reliance Capital?

Sundeep Sikka: It is a mix for MTM as well as I think while the gross sales are also at all time high, so for which the results will be seen in the subsequent quarter.

Sundeep Sikka: Anything on the cost side, the costs are on the lower side or is it anything on that?

Sundeep Sikka: As I mentioned the cost efficiencies now come in to play, a lot of the distribution because as you are aware we basically, one of our primary channels is IFS which both adds to the persistency as well as the cost of acquisition is lower, so basically cost of acquisition is coming down, operational cost is coming down and also the use of technology and slowly focus on online business also is going to be adding to the profitability in the times to come.

Sundeep Sikka: Sir one more question on the broking side, you have not seen a significant increase in your equity volumes whereas the industry and market is quite significantly up from quarter-on-quarter basis, so what is the reason for that?

Sanjay Wadhwa: No, our volumes are also almost up by almost 30% which is fairly in line with the industry growth.

Moderator: The next question is from the line of Manish Shukla from Deutsche Bank, please go ahead.

Manish Shukla: Good morning, thank you for the opportunity, first on life insurance, if we were to look at individual WRP either for the quarter or the first half it is effectively flat year-on-year compared to if you see most of the top 5 players have shown double digit kind of growth, is it anything in particular which is dragging Reliance Life Insurance versus the top players?

Anup Rau: Individual WRP we are up about 1.3% in H1, now I am not sure how you are saying all the top 5 players have shown growth because except for three bank-promoted companies everyone else has declined in case you look at the IRDA disclosures and the industry is down by 10.5%, everyone including LIC is negative. Only three companies have shown double digit growth and that is on the back of ULIPs and the fact that the bank franchise has been delivering for them, if you look all other agency companies they have shown a significant decline and decline in well over double digit including LIC.

Manish Shukla: The other point you mentioned is that the year-on-year decline on life insurance profits almost all of it could be attributed to surrender profit; does that mean this trend could actually play out for the full year as well where the full year is down?

Anup Rau: Yes, it will play out for the full year. I think we will have to rebase these numbers for the first half and then look at growth from this fiscal onwards.

Manish Shukla: Whatever so to say the damage on account of lower surrenders I think that should play out this year right?

Anup Rau: That should play out this year, like I mentioned the profits will be rebased to that extent and then should see growth on that number going ahead fiscal on fiscal.

Manish Shukla: Next on General Insurance Sam did allude to the combined ratio, could you please again explain the reason for the increased quarter-on-quarter in the combined ratio?

Rakesh Jain: The combined ratio has got a component of the third party which is actually the interest which we pay on the third party claims during the settlement. What happen is the interest which we pay gets accounted along with the claims cost and that adds to the claims ratio and overall the combined ratio whereas the corresponding investment income lies below the line, so what is happening in our case has been that in the last few years our motor is almost 60-70% of the book and to that extent the interest outgo on the third party claims is very significant. If you offset that interest on the claims paid and the interest which we earn on the funds we have then it neutralizes significantly. Further the short-term book which we have which is other than the third party if you see is within 100 combined, so you know if you really see from a mixed perspective we are actually running two types of book a short tail and a long tail book. The short tail of course accrues completely within 12 months and continues to be break even to little bit profitable. The third party I think we will work on efficiencies and keep improving, but overall the investment income continues to be robust which is why you see the overall profits are up by 53%.

Manish Shukla: The base also had the third party motor pool which we don’t have this time.

Rakesh Jain: Yes but the third party motor pool the liability still continues with us.

Manish Shukla: The interest cost gets paid in the same quarter as the claims or it gets paid with the lag?

Rakesh Jain: What happens the book gets reviewed actuarially from time to time and the impact of claims outgo through interest cost gets reviewed and appropriately you keep on adding to the reserves, so it is a continuous exercise, what we generally like to see is that the accrual on the investment should be higher or more than the accrual on the interest outgo on claims, that is how you really manage the book. The book generally takes three, four years to kind of get settled, ideally at this stage we would be settling claims which are three, four years old that is where the balance keeps on happening.

Manish Shukla: On commercial finance you have an AUM growth of about 16% and margins are up almost 20 basis points year-on-year, yet the NIA growth is only 4% and PBT growth is 5%, could you explain what is happening there?

K.V. Srinivasan: That is because of the success that we have had in much higher level of securitization if you notice that we have actually done a substantial amount of securitization. The income which is arising out of securitization goes in to a different line.

Manish Shukla: But the, PBT should capture that right?

K.V. Srinivasan: PBT should capture that obviously but then there has been a certain amount of increase in the amount of provisioning that you do, so that is accounted for, I would have expected the profit to have gone up a bit by another 5% but that got accounted for through higher amount of provisioning that we made.

Manish Shukla: No sir just to understand the difference between AUM growth and profit growth which exist, do you think that gap would narrow or it will remain where we are right now?

K.V. Srinivasan: The gap will obviously narrow because once your NPL or rather the credit losses that you book are under control or become flattish this issue should be taken care of, now that also is a factor of the economy and so on and so forth, as we see improvement there we would expect much sharper increase in the profitability as compared to the book.

Manish Shukla: Last question on asset management during Q2 which probably one was the best quarters in many years for fund flows for the industry their opex is down in absolute terms quarter-on-quarter, what is deciding that and is there room for you to cut your opex further?

Sundeep Sikka: Is there room, yes there is a little more room, definitely there are lot of inefficiencies, overall the industry I think which we believe which will over a period of time need to be addressed but is there a substantial room, no there is not a very high, every quarter the opex will keep coming down.

Manish Shukla: That is what I was wondering absolute basis cost falling, I can understand the efficiency in terms of cost to income but if your absolute costs are coming down?

Sundeep Sikka: It cannot be a quarter-on-quarter story I think normally in the day to day operations I mean inefficiencies creep in which has to be addressed regularly but there will not be a scope like this every quarter.

Moderator: The next question is from the line of Kunal Shah from Edelweiss Securities, please go ahead.

Nilesh: Hi, this is Nilesh here, just wanted to get some sense, Anup on the persistency trends and the initiatives that we are taking to improve that?

Anup Rau: So if you look our persistency has gone up over last year, we see a couple of fundamental changes, one is we are acting higher ticket prize policies and then there is direct correlation between the ticket size and persistency. Second high persistency channels such as agency and proprietary channels are gaining an increasing share in the proportion of our business. I think these should things would have an impact on the persistency in the quarter coming ahead.

Nilesh: In terms of portfolio today in terms of split between ULIP par and non par component?

Anup Rau: For H1 ULIP is 26%, traditional is 74% and non par is 63%.

Nilesh: Is this post the ILIP going out, 63% is pure guaranteed products?

Anup Rau: Yes they are guaranteed products.

Nilesh: So as a percentage of networth that seems to be quite high, is there a limit that we are catering to that number.

Anup Rau: In case you are talking about guarantee returns I think the policy tenures range from 5 to 15 years and then we are able to hedge those risks and margins are quite robust and strong as far as those products are concerned, so we would look at ULIPs being sub 15-20% in that range and traditional going up to 80%, otherwise non par will continue to be significant will be in the range of 70%, that is going to be our strategy.

Nilesh: So blended margins should be inching midteens effectively?

Anup Rau: Our margins are pretty high, they are about 25% currently.

Nilesh: And that is largely because of non par?

Anup Rau: Absolutely.

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

Nischint Chawathe: Can you share the complete break up of the loan book in terms of assets because I guess you have mentioned three or four asset classes, you have not mentioned all?

Amit Bapna: It is there in the presentation but I will read out to you anyway. Overall if you look at it the home loans is about 17%, LAP and SME are 29 each, commercial vehicles would be around 12% and rest of it would basically be short term inventory financing and old auto loan book

Nischint Chawathe: This totals to 87.

Amit Bapna: The inventory finance book is about another 4%, infrastructure would be another 6% that kind of makes it about 97-98%, auto loans versus used car loans will be around 2-3%.

Nischint Chawathe: The other question pertains to the life business, I see that there is a fairly large increase in the average ticket size of the business, would it be possible for you to maybe just give some color on that maybe give ticket size across all the three segments for the last year and this year just for us to get a color on what is happening?

Anup Rau: Our ticket size currently is about 25,000 for all channels except for direct channels where it is excess of 40,000 that is where we are and in most channels we have growth in ticket size ranging from 25% going up to 60%.

Nischint Chawathe: I wanted to say in terms of par, non par?

Anup Rau: Like I mentioned we are largely selling non par so our non par ticket size is reflective of our total ticket size, ULIP our ticket size is obviously slightly high but that is not a category that we are really focusing on.

Nischint Chawathe: Would that be fair to say that the increase in ticket size that you would have seen on a year-on-year basis would be primarily on account of ULIPs and ticket size on non par would be stable, par and non par would be stable?

Anup Rau: ULIPs are slightly higher but then the increase in ticket size in non par and par is as high as that on ULIP on percentage basis, ULIPs have traditionally been higher in terms of ticket sizes, we are talking about percentage growth which is more or less same for all categories.

Moderator: Next question is from the Nilesh from Edelweiss Securities, please go ahead.

Nilesh: On the margins of 25% on the life business now this is three months, what is the assumption there?

Anup Rau: These are based on long term expense assumptions, these are pre overrun measures.

Nilesh: Where are we in terms of assumptions what is the expected break even, which year are we heading at?

Anup Rau: If you are talking about long term assumptions we expect that to be met in the next two years.

Nilesh: Basically about 65% is non par so obviously the margins on that would be upwards of 30%.

Anup Rau: High 30s.

Nilesh: Would ULIP would still be in the mid teens?

Anup Rau: No ULIPs would be much lower for any of our agency businesses, we will be lucky to get low single digit margins on ULIPs.

Moderator: The next question is from the line of Parag Jariwala. Please go ahead.

Parag Jariwala: Sir, if you see in terms of your lending book, your yield on assets has actually gone up quarter-on-quarter from 15.4%, margins surprisingly have kind of corrected. So, I think the cost of funds have not increased that much as compared to this.

Sanjay Wadhwa: See the cost of fund and increase in the yield is more or less knocking off. Actually speaking there is a very little difference. What has really happened is that the amount of equity has come down because what we have really done is to take full credit in terms of whatever non-lending assets, which are there in the book, which is basically of fixed assets and so on and so forth. So to that extent the margins have come down a bit. It is more like an internal accounting adjustment which has resulted in that. So that is basically the reason. Otherwise broadly you will see it is flat.

Parag Jariwala: Sir, is there any changes in terms of the assets you securitized so is there any changes in yields over last one year? Will that remain more or less flat or it is improving because you know what we are hearing is that demand from banks is going to be less because their growth is lower plus they have given a lot of exemption in terms of RIDF and new infrastructure bonds, etc.?

Sanjay Wadhwa: See what has happened is that the demand for priority sector loans has gone down, but conversely the demand for non-priority sector has gone up because as you rightly said because the RIDF credit and other things the need to buy out priority sector assets is less but at the same time since advances growth is low and since the bank do want to have a better growth in the advances on their balance sheet the demand for non-priority has gone up. So, from our perspective, we have been actually be able to securitize about 70% to 80% more than what we did in the same period last year. Overall we are quite happy in this situation and what has also happened in the result is the mix of the assets that you sell has changed from primarily vehicles and home loans to LAP and other larger SME assets. So to that extent the margin at which we are able to securitize has actually gone up.

Parag Jariwala: That is very good. Thanks that is it from my side.

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

Parag Jariwala: Thanks everyone. I think Sam you can make your closing remarks and then we can conclude.

Sam Ghosh: Thanks Parag. Just to say that all the businesses in Q2 had performed much better in terms of income as well as in terms of profitability obviously in the life business we know the reasons the surrender profits have come down but business profits will still need to go up and going forward I think for Q3 and Q4 obviously we expect that since the markets seem to be doing better we expect all our businesses to continue performing the way they have been performing in the last few quarters and hopefully the year should be much better than the last financial year. Thanks.

Moderator: Thank you very much Sir. Ladies and gentlemen on behalf of Macquarie Capital Securities that concludes this conference. Thank you for joining us. You may now disconnect your lines.