PhillipCapital

Asset Management Companies

Temporary blip in a long-term structural story

16 Jun 2020

INDIA | AMCs | Initiating Coverage

"Financialization" of savings is a big structural change in India's economy. With the current covid crisis expected to start a new NPA cycle, we find AMCs an attractive play with limited balance-sheet risks. While the current market correction is likely to have a negative impact on equity AUM growth and profitability, the long-term growth story is still intact. The sector will continue to benefit from migration of household savings towards mutual funds from physical assets and bank deposits. While comparison to the GFC crisis may not be entirely correct, based on past evidence, we do not anticipate significant outflow from equity MFs. Resilience of SIP flows in the last two months gives us further comfort. While the monthly run rate of new SIPs registered has declined from 1.2mn in January 2020 to 0.75mn in April 2020, the SIP discontinuation run-rate is still stable at 0.5mn.

An asset manager's moat lies in its brand and reputation; this is evident from the fact that in the last 10 years, the market share of top 5 players has increased by 6pp – from 51% in March 2010 to 57% in March 2020. As players with strong brand equity and brand recall tend to gain market share in tougher times, consolidation of assets within top few players will continue for some time, we reckon. We initiate coverage on HDFCAMC and NAM with a BUY rating. Our investment rational:

HDFC Asset Management Company (HDFCAMC) is the largest and most profitable AMC in India. Strong brand equity (strong parentage), a well-diversified distribution channel, and focus on the high-margin and sticky business of retail/equity will help HDFCAMC to capture the long-term growth opportunity in India's mutual fund industry, in our view. An underpenetrated market, recurring revenue model, high RoE, and positive operating cash flow makes it a compelling investment opportunity.

We see significant growth prospects from B30 cities; of a total 221 branches, c.65% are located in B30 markets, providing sufficient distribution network to tap opportunities from smaller cities. As of March 2020, HDFCAMC had the second-highest AUM market share in B30 markets (11.9%) behind SBIMF. However, AUM sourced from B30 locations accounts for only 13% of total AUM compared to 16% for the industry. Individual AUM per branch for HDFCAMC (Rs 2.7bn) from B30 locations is much lower than competitors such as SBIMF (Rs 5.3bn) and Aditya Birla MF (Rs 5.4bn). Improvement in branch productivity in B30 cities could significantly augment AUM growth for HDFCAMC, in our view. We initiate coverage for HDFCAMC with a BUY rating and a target of Rs 3,100.

Nippon Life India Asset Management Limited's assets under management declined 22% in the first half of FY20, as its debt fund declined, mainly due to erstwhile promoter group-related issues. However, after Nippon Life Insurance's acquisition of 75% stake in NAM from the previous promoters and rebranding of mutual funds to *Nippon India Mutual Fund*, flows stabilized. AUM increased 17% to Rs 2.2tn as of Feb 2020 (pre-covid) from Rs 1.9tn in Sep 2019. We believe that after rebranding, AUM will stabilize; also, strong distribution network, especially in B30 cities, should help flows.

NAM traditionally had an asset mix with higher proportion of debt (FY17: 49%) and institutional investors (FY17: 58%), but the recent decline in debt and liquid AUMs from corporate investors has changed asset mix towards individual and equity. As AUMs stabilise, operating leverage will drive ROEs. We initiate NAM with a BUY rating and a TP of Rs 350.

Key risks: A significant decline in the equity market and any additional regulatory changes that could impact revenue.

Companies

HDFC Asset Management Company

Reco	BUY
CMP, Rs	2,591
Target Price, Rs	3,100
Upside (%)	20%

Nippon Life India Asset Management Limited

Reco	BUY
CMP, Rs	273
Target Price, Rs	350
Upside (%)	28%

KEY FINANCIALS

HDFC AMC	FY20	FY21E	FY22E
Net Profit (Rs bn)	12.6	12.6	14.7
% growth	36%	0%	17%
EPS (Rs)	59	59	69
DPS (Rs)	28	32	40
ROE (%)	35.6%	30.8%	33.1%
P/E (x)	43.9	43.8	37.6
Div Yield	1.1%	1.2%	1.5%

KEY FINANCIALS

NAM	FY20	FY21E	FY22E
Net Profit (Rs bn)	4.2	5.3	6.1
% growth	-15%	27%	16%
EPS (Rs)	6.8	8.6	10.0
DPS (Rs)	5.0	6.0	7.0
ROE (%)	16.1%	19.8%	21.6%
P/E (x)	40.5	31.8	27.4
Div Yield	1.8%	2.2%	2.5%

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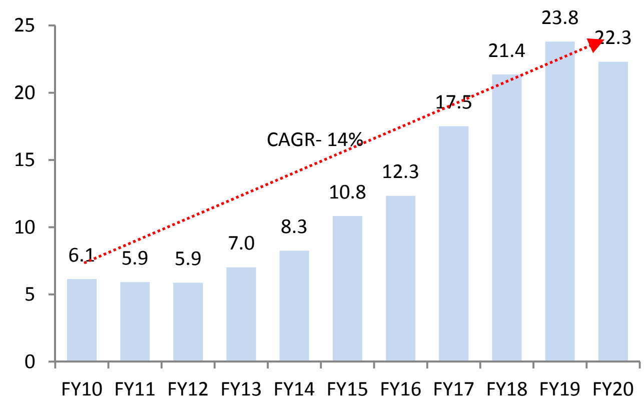
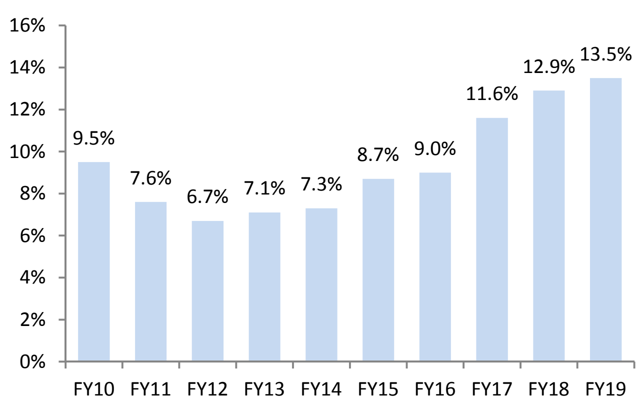
Growth story unfettered by current crisis

The Indian mutual fund industry has come a long way in the last 10 years, post GFC. Assets under management (AUMs) grew c.3.5x from Rs 6.1tn as of March 2010 to Rs 22.3tn as of March 2020 (Feb 2020: Rs 28.3tn). Growth has been particularly strong after demonetisation in FY16 due to strong inflows and investment performance. Mutual fund penetration (AUM to GDP) rose from a low of 6.7% in FY12 to c.13% as of FY19. However, recent market correction because of COVID19 crisis raises an important question about the sustainability of the growth story of the Indian asset-management business and mutual funds gaining wallet share in the financialization of savings that gained traction over the last few years.

Mutual funds AUM growth (Rs tn)



AUM as a % of GDP

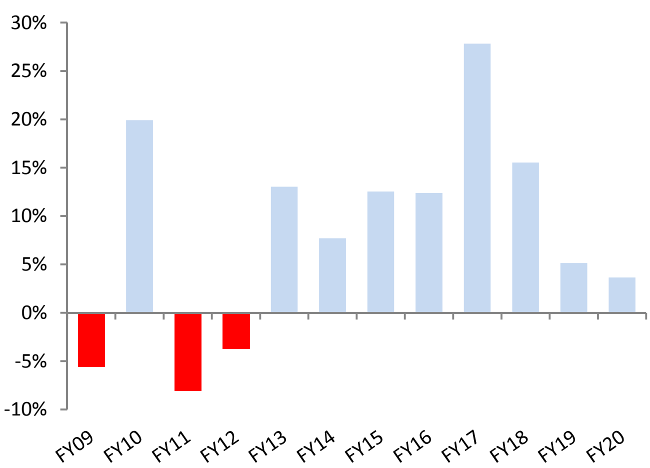


Source: AMFI, PhillipCapital India Research

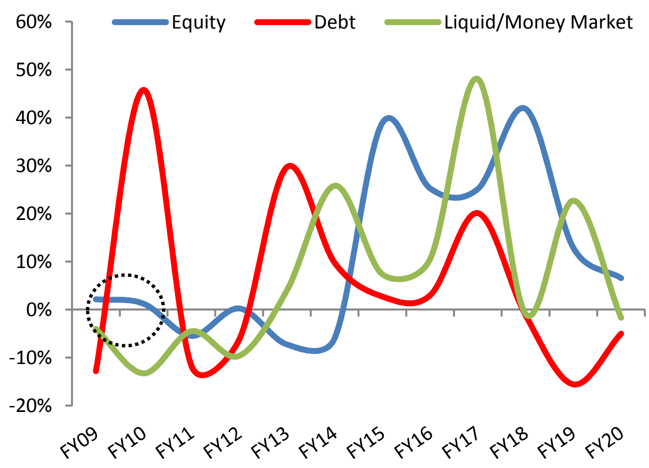
We believe that the industry continues to have tremendous potential for growth, considering a large untapped market with favourable demographics of a young population. However, in the near term, flow is likely to remain volatile and lower than the last 4-5 years' average. Our key arguments are:

1) **Historical evidence suggests large-scale redemption is unlikely:** Over the last 10 years, the mutual fund industry has seen an annual net outflow in just three years. Even during the peak of GFC in FY09, net outflow was just c.6% of opening AUM. Outflows were mainly from debt and liquid funds, which bounced back strongly in FY10 (see chart below). Equity fund flows were relatively stable in FY09 and FY10. In the last 10 years, equity funds saw the worst annual net outflow of c.6-7% in FY13 and FY14.

Net flows as a % of opening AUM



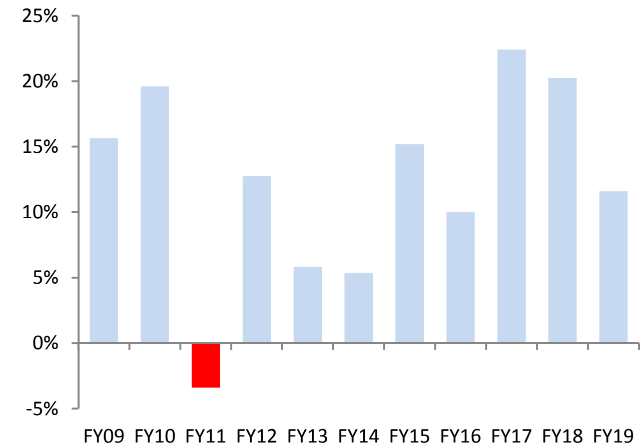
Net flows by asset as a % of opening AUM



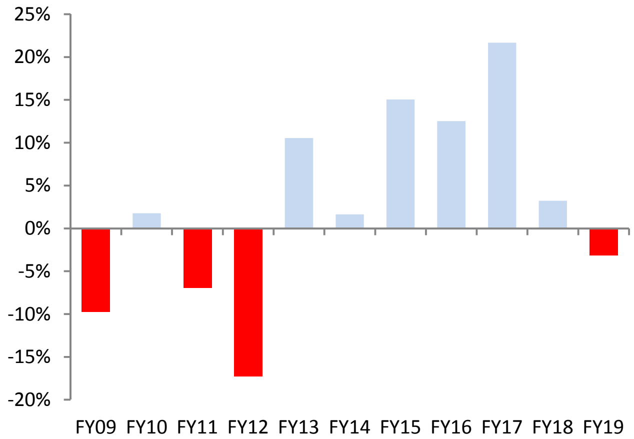
Source: AMFI, PhillipCapital India Research

Further, fund flows of HDFCAMC have been relatively stable in the last 10 years, with net outflow in just one year (FY11). Fund flow for NAM, however, has been rather volatile, mainly because of their asset mix, as historically, NAM has been a debt-and-institutional-heavy business, which has higher flow volatility vs. retail equity flows.

Net resources mobilised by HDFCAMC as a % of opening AUM



Net resources mobilised by NAM as a % of opening AUM



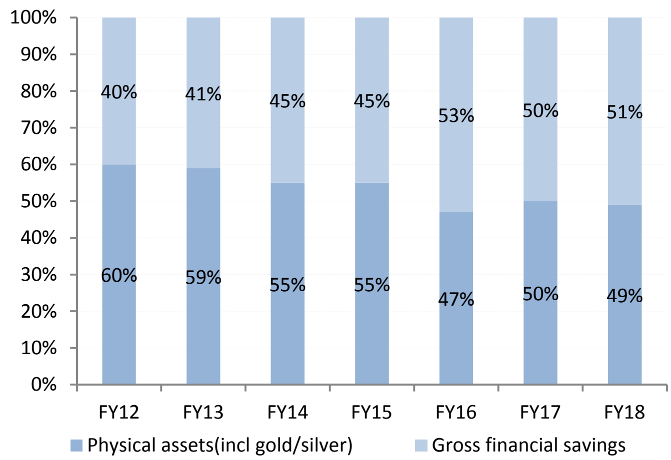
Source: SEBI, PhillipCapital India Research

2) Low interest rate to continue to provide tailwinds

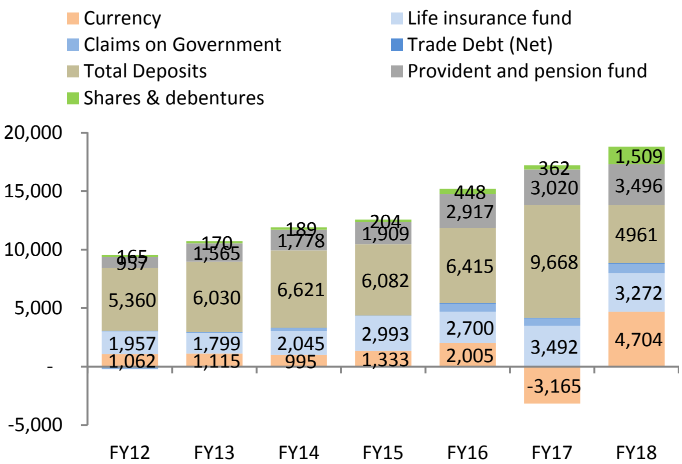
Low interest rates bode well for mutual fund flows, as money moves from low interest rate deposits towards higher yielding products. Savings in India, historically, have been allocated towards physical assets, but with (1) the government's strong stance against black money, (2) diminishing attractiveness of real estate and gold, and (3) improvement in financial education among households, savings are now increasingly shifting towards financial assets.

Within financial assets, the highest allocation traditionally has been to deposits. However, growing equity markets and declining interest rates have resulted in a significant jump in investments into capital markets in recent years, with household allocation to shares and debentures increasing to 8% in FY18 from just 2% in FY15.

Share of financial savings



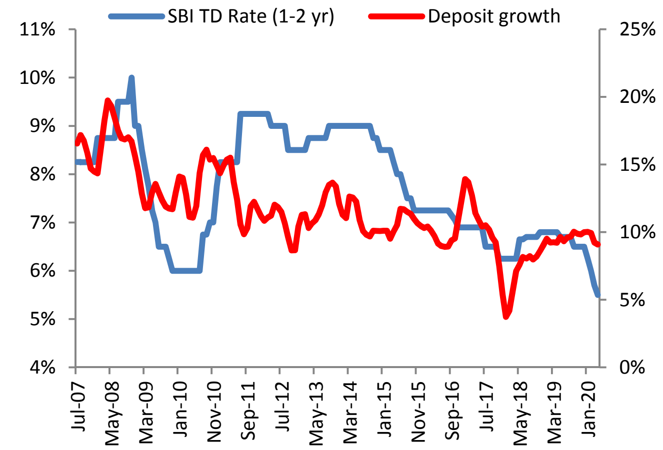
Share of financial savings



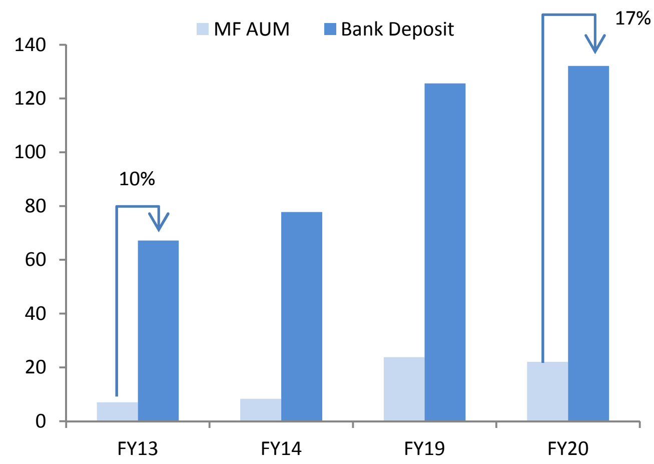
Source: RBI, PhillipCapital India Research

With deposit rates in India on a structural decline, mutual funds are expected to become an attractive investment option. We would expect increasing allocation of financial savings towards capital markets and mutual funds to continue.

Deposit rate vs. deposit growth



Mutual fund AUMs reducing the gap with bank deposits



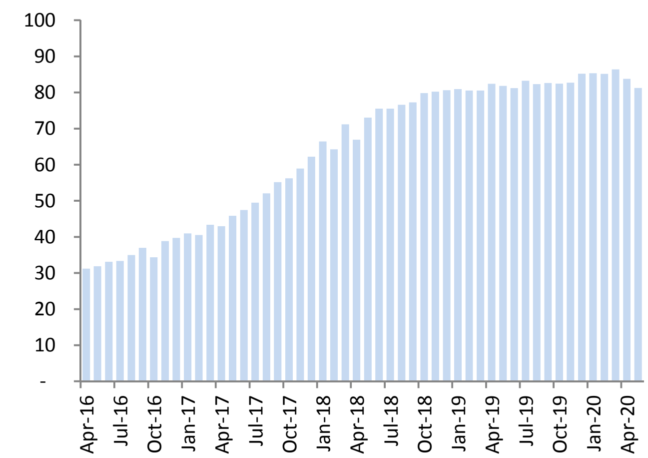
Source: RBI, SBI, PhillipCapital India Research

3) Systematic Investment Plans (SIPs) have been resilient

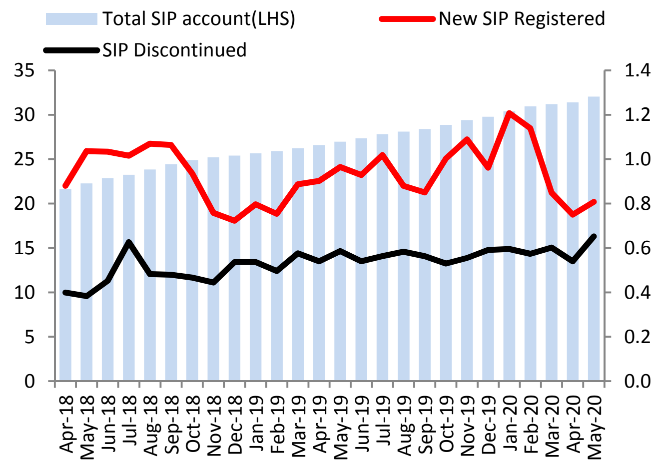
Systematic wealth accumulation has gained significance, recently, especially among individual investors. The SIP book size increased to Rs 86.4bn as of March 2020 from Rs 31.2bn as of April 2016. SIP AUM now account for 41% of total equity AUM, up from 37% a year ago. This shows the reliability of SIP flows and is a huge positive for the mutual fund industry, as SIPs aid in building a healthy long-term asset base.

In the last two months, while 'new SIPs registered' has declined significantly (because of the lockdown) discontinued SIPs have been stable.

Monthly SIP contributions (Rs bn)



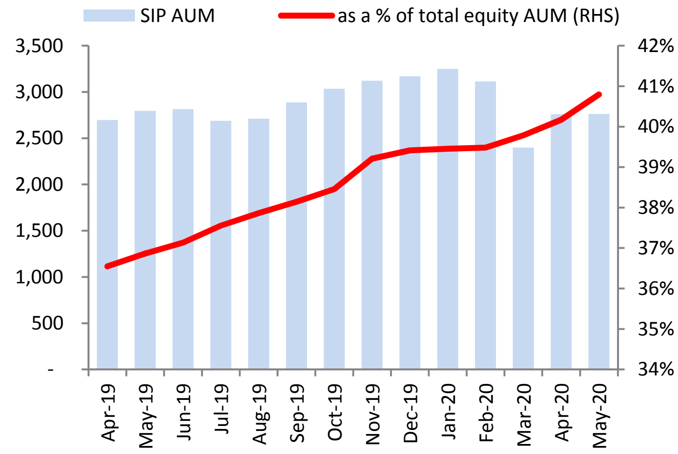
SIP account movement



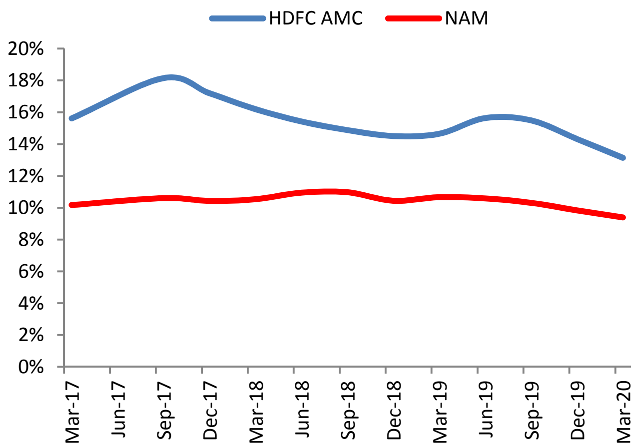
Source: AMFI, PhillipCapital India Research

HDFC AMC continues to remain a market leader in SIPs, but its market share has declined slightly in recent months. NAM is holding its market share.

SIP AUM (Rs bn)



SIP market share for HDFCAMC and NAM



Source: AMFI, Company Presentation, PhillipCapital India Research

4) Mutual funds remain one of the most tax-efficient products

There has been an increasing shift towards tax-efficient financial investments such as PPFs (no tax) and shares/debentures (lower tax on long-term capital gains). Over FY12-18, flows into PPFs and equity/debentures grew by 24% and 45%, respectively, while those in deposits + currency and insurance grew by 7% and 9%. Despite strong flows into shares and debentures, overall share of this in total HH gross financial savings remains small at 8%, and, hence, we believe it has a long-term growth potential.

Return and tax applicable for various asset classes

Asset Class	Risk	Tenure	Liquidity	Return	Tax
Direct Equity	High	No Tenure	High	Nifty 5 Yr CAGR: 5%	STCG-15% LTCG-10%
Real Estate	High	No Tenure	Low	5 yr CAGR: 6%	STCG-Added to Income LTCG-20% (indexation)
Gold	Moderate	No Tenure	High	5 yr CAGR: 12%	STCG-Added to Income LTCG-20% (indexation)
PPF	No Risk	15 Years	Limited	7.5%	EEE
Deposit	Low	7 days to 10 years	Limited	5%-7%	Gets added to Income
NPS	Moderate	Up to age of 60 Yrs	Limited	8%-10%	EEE
Equity MF	Moderate-High	No Tenure	High	5 yr annualised return: 6.2%*	STCG-15% LTCG-10% above Rs 0.1mn gain
Debt MF	Moderate-High	No Tenure	High	5 yr annualised return: 7.9%*	STCG-Income based LTCG-20% (indexation)

Source: PhillipCapital India Research
* AUM weighted average of 164 equity fund; ** AUM weighted average of 156 debt (ex-liquid) funds

Recurring revenue model provides cushion to inflow cyclicality

Asset management business is generally perceived to be high-beta and cyclical, with negative impact on profitability because of outflows and negative market movement, but a recurring revenue model and cost discipline in bad times provides a cushion to this cyclicality.

As shown in the table below, in the last 12 years (since FY08) we had eight years where either there was net outflow or negative investment performance, however HDFCAMC's PBT growth continues to remain stable. NAM's profitability has been slightly volatile, especially in the last two years, largely because of erstwhile promoter-related issues. Also, AMCs with stronger brand equity tend to gain market share during bad times.

AMCs PBT growth has weak correlation to flows and market performance

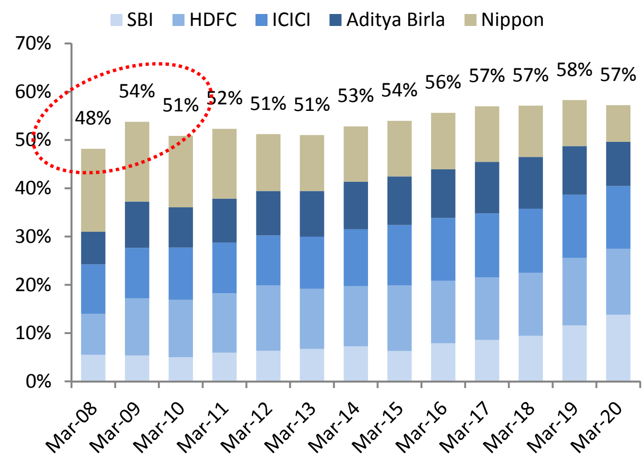
	Industry (as a % of opening AUM)			HDFC AMC			RNAM		
	Net Flow (Total AUM)	Equity Flow	Market Movement	AUM Growth	Revenue Growth	PBT Growth	AUM Growth	Revenue Growth	PBT Growth
FY08	47%	40%	3%	63%	71%	74%	91%	86%	91%
FY09	-6%	2%	-39%	25%	41%	14%	-11%	18%	24%
FY10	20%	1%	80%	52%	39%	56%	36%	47%	58%
FY11	-8%	-5%	5%	2%	9%	12%	-8%	7%	14%
FY12	-4%	0%	-7%	1%	1%	7%	-23%	-8%	6%
FY13	13%	-7%	3%	9%	14%	17%	21%	11%	-24%
FY14	8%	-6%	16%	9%	15%	17%	9%	9%	49%
FY15	13%	39%	40%	36%	18%	19%	32%	19%	16%
FY16	12%	25%	-11%	18%	40%	14%	16%	37%	12%
FY17	28%	25%	21%	25%	6%	13%	33%	10%	17%
FY18	16%	42%	6%	35%	18%	32%	16%	25%	21%
FY19	5%	13%	-2%	18%	12%	30%	-5%	-9%	-3%
FY20	4%	7%	-25%	8%	2%	20%	-30%	-25%	-18%

Source: AMFI, Annual Report, PhillipCapital India Research

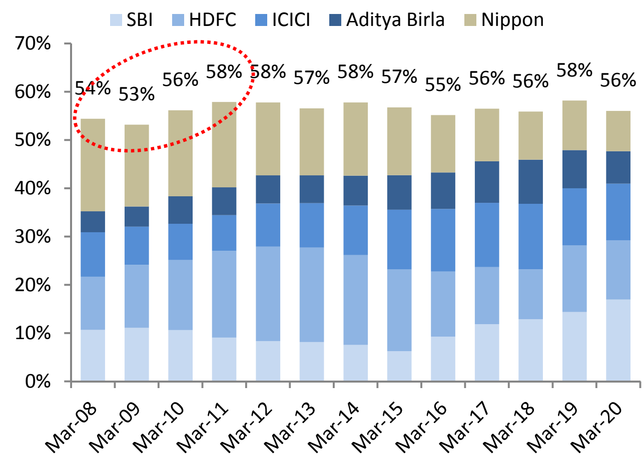
Better brands benefit in tougher times

Stronger brands tend to gain market share during tough times. After GFC, the market share of the top-5 players (SBI MF, HDFCAMC, ICICIPRU, Aditya Birla and NAM) increased by c.4pp from 48% in FY08 to 52% in FY11 (see chart below). Increase in market share was more evident in equity funds, where market share increased by 5pp from 53% in FY09 to 58% in FY11.

Market share movement of top-5 players – total



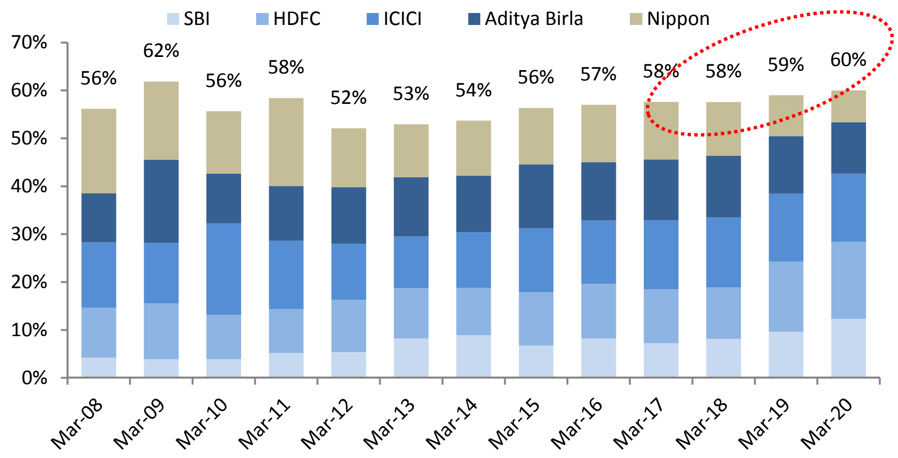
Market share of top-5 players – equity



Source: AMFI, PhillipCapital India Research

Market share in debt funds, however, declined as other players such as UTI, Franklin, IDFC and LIC gained market share. However, post credit even in FY19 (ILFS) market share of these top-5 players increased by 2pp from 58% in March 2018 to 60% in March 2020. Further, even among larger players, HDFC AMC has been the biggest beneficiary. We believe HDFCAMC's superior brand and reputation for prudent fund management will continue to help it to maintain its leadership position.

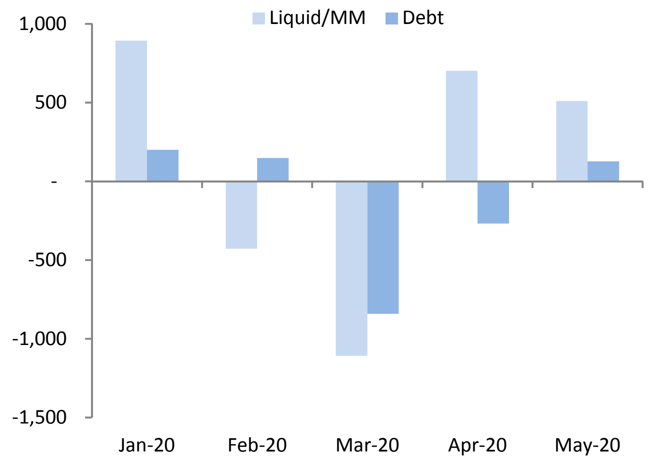
Market share of top-5 players – debt



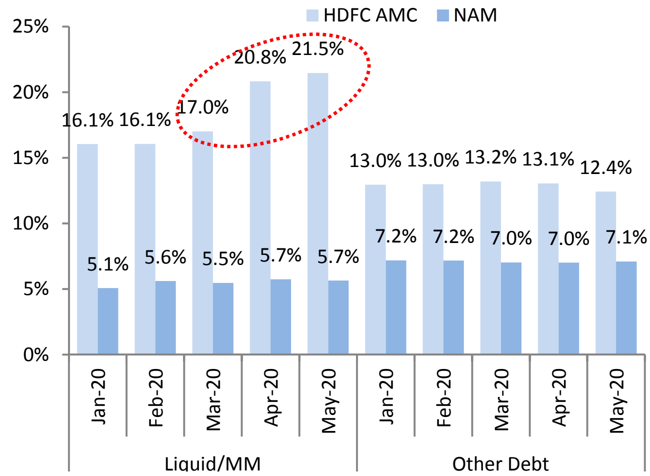
Source: AMFI, PhillipCapital India Research

HDFCAMC gains market share due to flight to safety: Both debt and liquid funds have seen higher outflows in March 2020 due to Covid and the winding up of a few credit-risk funds by one of the AMCs (see chart below). However, both liquid and debt funds bounced back in subsequent months, as banks continue to cut deposit rates. We believe AMCs with stronger brand equity would benefit and gain market share. HDFCAMC's market share in liquid funds increased by c.4.5pp in April/May (see chart below). We believe that consolidation of assets with few stronger players (due to flight to safety) will also give them some pricing power.

Net flows from liquid/MM and debt funds



Market share HDFCAMC and NAM



Source: AMFI, PhillipCapital India Research

Recent board resolution by NAM should provide some confidence: NAM has recently approved a board resolution to not invest in any debt paper below AA. We believe that such a stance would help it to gain investors' confidence and aid in mobilizing funds. In the table below, we present asset allocation and liquidity of top debt funds for both HDFC AMC and NAM. As shown in the table below, a large part of the investments by these funds are in AAA/sovereign or cash, hence we do not see any liquidity pressure in these funds.

HDFC AMC Debt Fund

			Asset allocation				Rating
Fund	AUM	Asset in top 10 Holding	GOV	Cash	Corporate bond	Others	AAA/SOV/A1+/Cash
HDFC Low Duration Fund	14,519	19%	25%	20%	54%	1%	81%
HDFC Credit Risk Debt Fund	14,249	25%	15%	3%	82%	0%	29%
HDFC Corporate Bond Fund	13,052	40%	17%	4%	79%	0%	100%
HDFC Short Term Debt Fund	11,680	22%	28%	2%	68%	2%	86%
HDFC Floating Rate Debt Fund	10,483	34%	29%	19%	51%	1%	85%
HDFC Ultra Short Term Fund	9,120	18%	9%	26%	58%	6%	99%
HDFC Banking and PSU Debt Fund-2014	5,060	32%	58%	1%	41%	0%	75%
HDFC Hybrid Debt Fund	2,554	58%	37%	24%	36%	3%	36%
HDFC Medium Term Debt Fund	1,411	49%	34%	0%	63%	3%	49%

Source: Factsheets, PhillipCapital India Research

NAM AMC Debt Fund

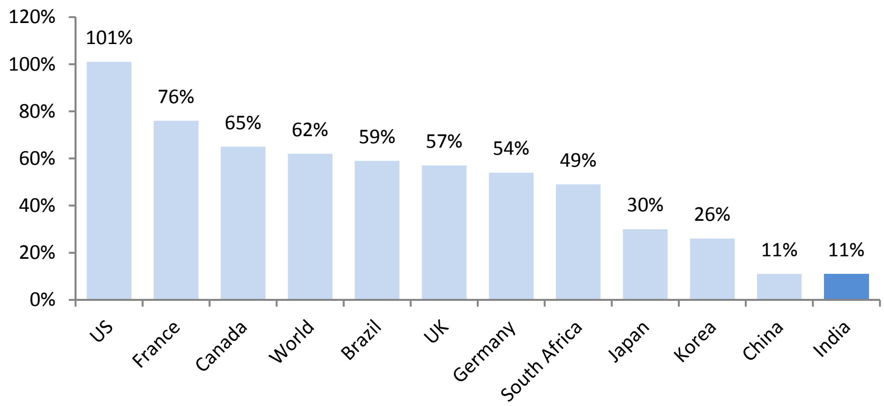
			Asset allocation				Rating
Fund	AUM	Asset in top 10 Holding	GOV	Cash	Corporate bond	Others	AAA/SOV/A1+/Cash
Nippon India Floating rate Fund	7,766	47%	27%	3%	59%	11%	100%
Nippon India Short Term Fund	7,487	43%	24%	7%	58%	11%	91%
Nippon India Money Market Fund	4,957	49%	11%	20%	69%	0%	100%
Nippon India Banking & PSU Debt	4,703	56%	9%	1%	87%	3%	100%
Nippon India Low duration Fund	4,124	47%	5%	7%	82%	6%	73%
Nippon India Credit Risk Fund	3,666	61%	0%	4%	92%	4%	6%
Nippon India Ultra short duration	1,333	64%	0%	17%	69%	14%	29%
Nippon India Strategic Debt Fund	1,151	67%		10%	90%	0%	17%
Nippon India Hybrid bond Fund	1,008	70%		3%	70%	27%	5%

Source: Factsheets, PhillipCapital India Research

Future growth outlook and opportunity

India's mutual fund penetration (AUM to GDP) is significantly lower than the world average of 62%, and also lower than many developed economies such as the US (101%), France (76%), Canada (65%), and the UK (57%). It is lower than some emerging economies, too, such as Brazil (59%) and South Africa (49%). Low penetration of mutual funds in India is also evident from the equity mutual fund AUM to market cap ratio of 4% vs. Germany's 51%, 42% in the US, 27% in the UK, and 26% in Brazil. We believe that the industry has tremendous potential for growth, considering that India is a large untapped market with favourable demographics.

Penetration of mutual funds is lower than the global average, but likely to improve



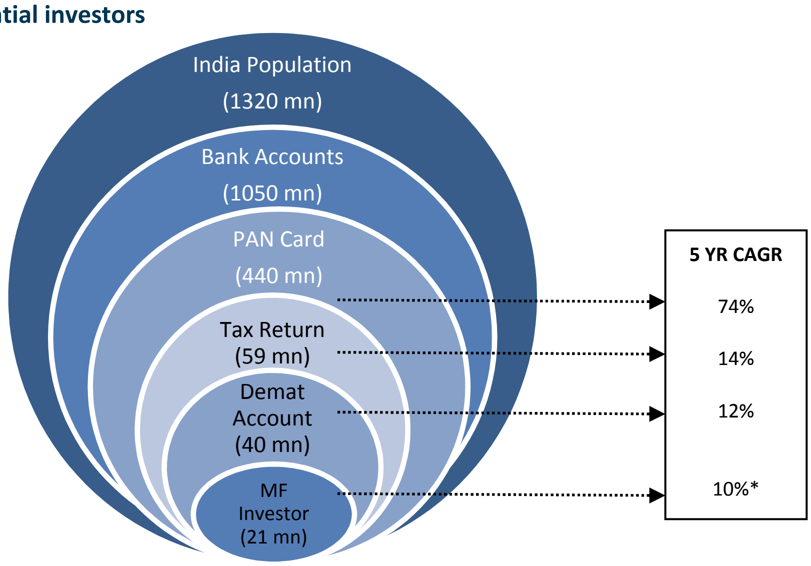
Source: Company Presentation, PhillipCapital India Research

In this section, we try to identify the opportunity and growth potential of the mutual fund industry. We see the growth potential for AMCs in India coming from two different sources: (1) Increasing penetration within potential investors, and (2) gaining wallet share of the savings market. We believe both these approaches provide immense growth opportunity for AMCs.

Opportunity size in terms of potential investors

As of March 2020, India had around 21mn unique mutual-fund investors, while it had c.1bn bank accounts. We understand that not all bank accounts will be potential MF customers (given the duplicity and higher Jan Dhan accounts), hence we look at PAN cards, the tax return filed, and the number of demat accounts to get a sense of potential customers.

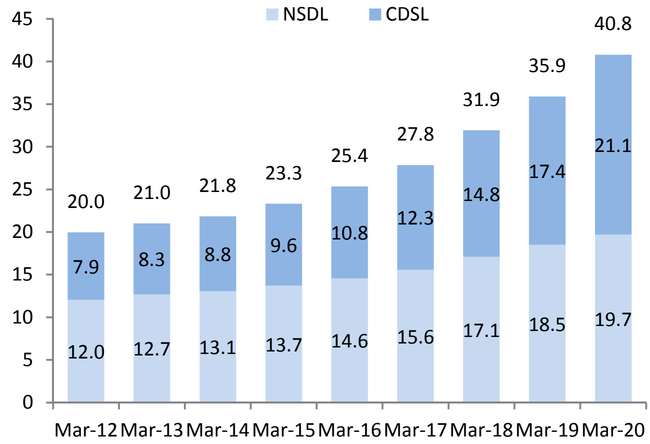
Identifying potential investors



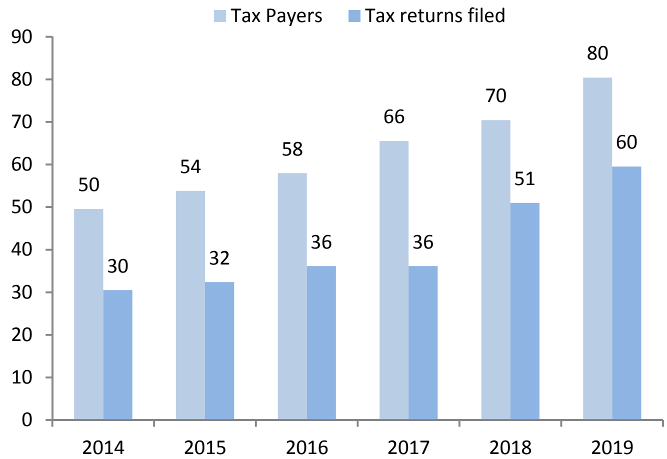
Source: PhillipCapital India Research; *-2-year CAGR

While the number of PAN cards in India is 440mn, the number of tax returns filed and demat accounts are 59mn and 40mn, respectively. Hence, even on conservative estimates, assuming all tax returnee and demat account holders as potential MF investors, penetration of MF investors is just 50%. In addition to this, the potential investor base (tax returns filings and demat account holders) is increasing at 14%/12% respectively (five-year CAGR).

Demat account holders (mn)



Tax payers (mn)



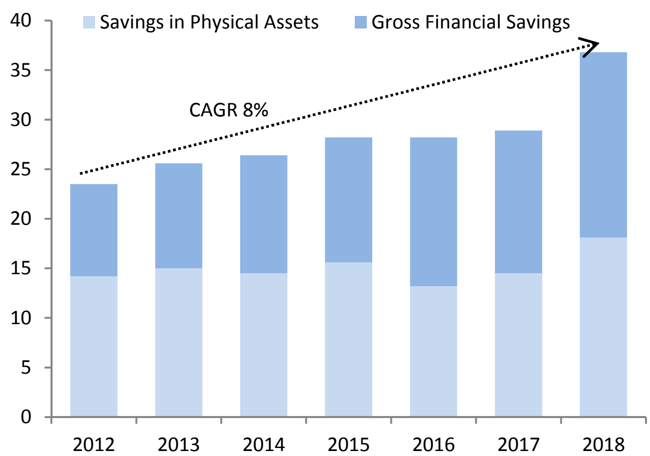
Source: IT, NSDL, CDSL, PhillipCapital India Research

We believe there may be potential investors who have PAN cards and may not be filing tax returns. The number of tax payers whose tax has been deducted at source and may not have filed returns is c.80mn. Assuming 25% of PAN card holders (on a conservative basis), i.e., around 100mn, are potential customers, penetration declines to c.20%.

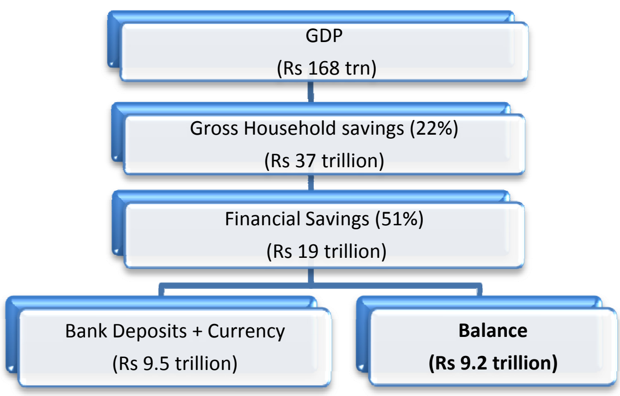
Opportunity size in terms of wallet share of financial savings

India's gross household savings CAGR is 8%. As of FY18, gross household savings for India was c.Rs 37tn, a large part of which was allocated towards physical assets such as real estate, gold, and silver (see chart below). Of the financial savings, about half goes towards deposits and currency, even after which there is a huge opportunity to capture the rest Rs 9tn (c.35% of industry AUM). Hence, increasing allocation towards financial assets and higher wallet share within financial asset allocation provides another huge opportunity for the industry, in our view.

Gross household savings (Rs tn)



The opportunity size



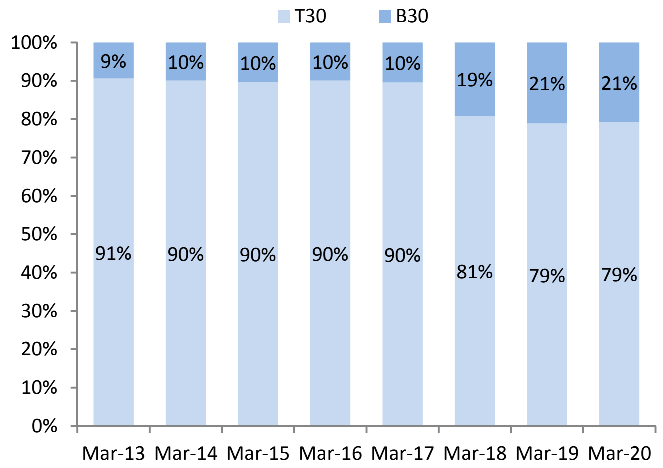
Source: RBI, PhillipCapital India Research

Smaller cities offer enormous potential for growth

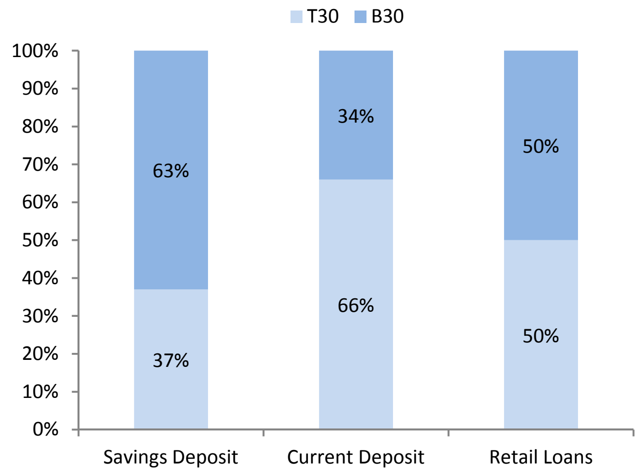
In order to increase penetration, SEBI relabelled regions from T15 and B15 to T30 and B30. Growth for B30 registered even faster growth than B15, with its contribution to AUMs increasing from 9% in FY13 to touch 21% in FY20.

However, despite recent growth, mutual fund penetration in B30 continues to be low, when compared to other savings products. Only 21% of mutual fund AUM comes from B30, as opposed to c.65% for savings deposits, c.50% for retail loans, and c.35% for current deposits. Hence, we believe B30 cities provide enormous growth potential ahead.

T30 vs. B30 – Mutual fund



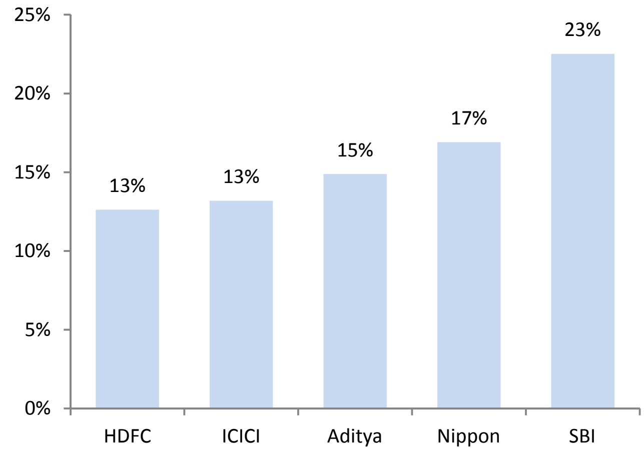
T30 vs. B30 – Other financial products



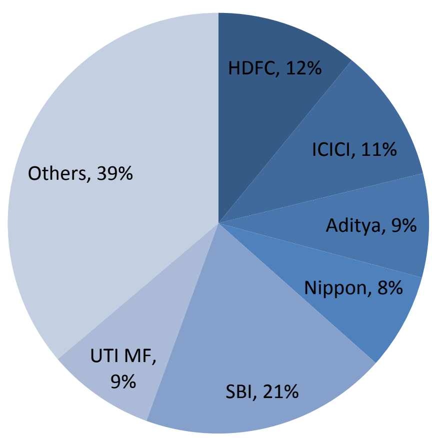
Source: AMFI,RBI, PhillipCapital India Research

SBIMF holds a leadership position in B30 markets due to its wider distribution reach through SBI branches, with around 23% of SBI AUM sourced from the B30 market. HDFCAMC's market share in B30 is around 12% and just 13% of its AUM is sourced from the B30 market, less than NAM, which sources 17% of its AUM from B30 cities and holds 8% market share.

B30 AUM as a % of total AUM



B30 AUM market share

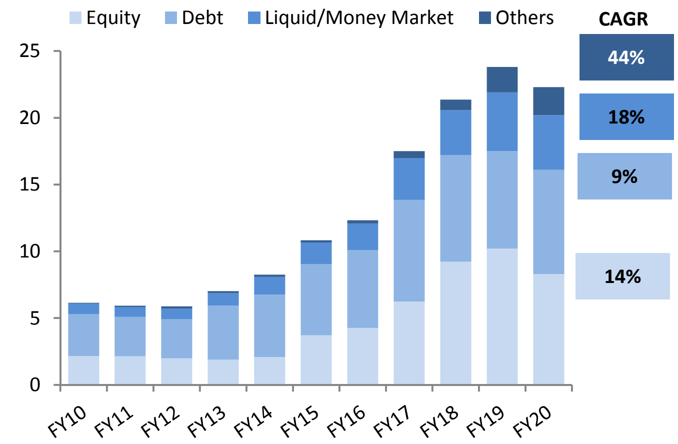


Source: AMFI, PhillipCapital India Research

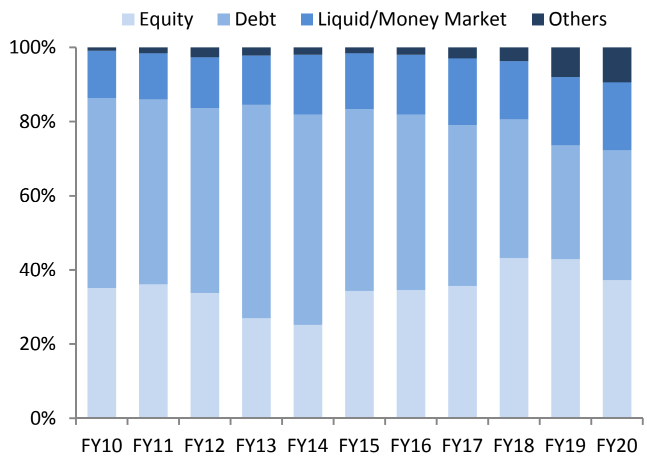
Equity + retail = Key recipe for growth

Equity AUM as a proportion of total AUM increased from 25% in March 2014 to 37% in March 2020, before reaching a high of 43% in March 2019, seeing a CAGR of 14% over the last 10 years (see chart below). Growth in equity AUM can be attributed to increasing awareness, financialization of savings, and rise in SIP. During the same period, the share of debt-oriented schemes declined to 35% in FY20 from 57% in FY14, as allocation towards liquid/money market increased.

AUM by segment



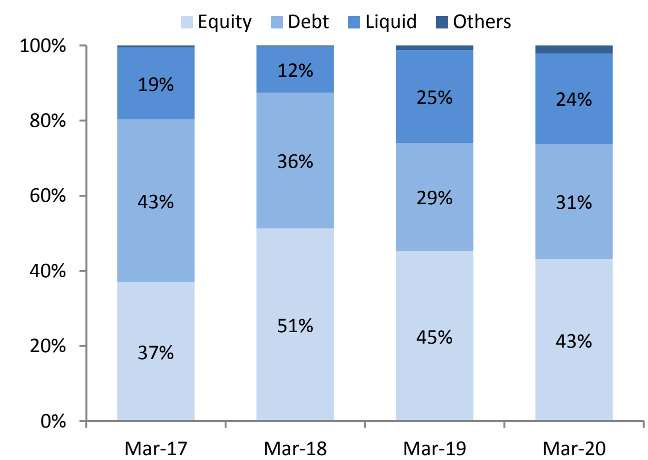
HDFC AMC: Opex breakup as a % of AUM



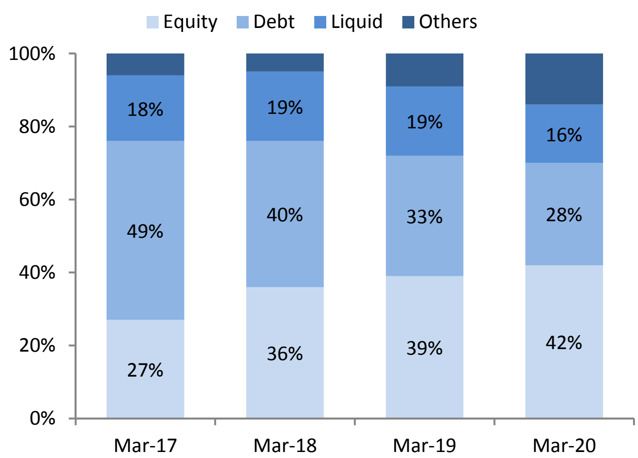
Source: AMFI, PhillipCapital India Research estimates

HDFC AMC has traditionally been an equity-heavy asset manager while NAM had higher debt AUM, but a decline in debt AUM due to credit events in FY19 and erstwhile promoter-related issues, shifted NAM's asset mix towards equities (see chart below). As of March 2020, equity contributes 42% of NAM AUM, up from 27% in March 2017. Higher proportion of equity will result in higher gross margins.

AUM by segment – HDFC AMC



AUM by segment - NAM

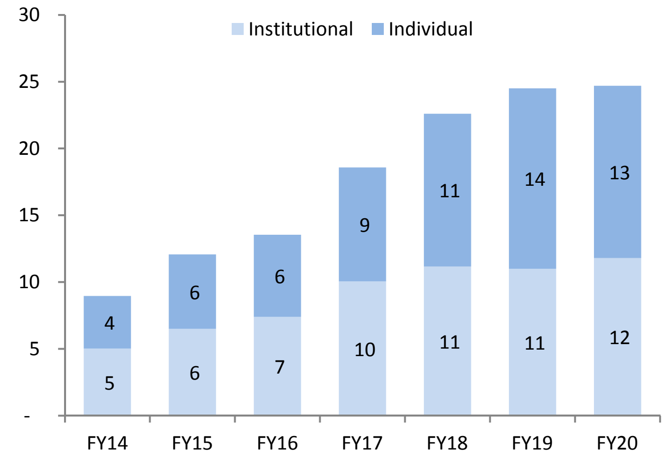


Source: Company data, PhillipCapital India Research estimates

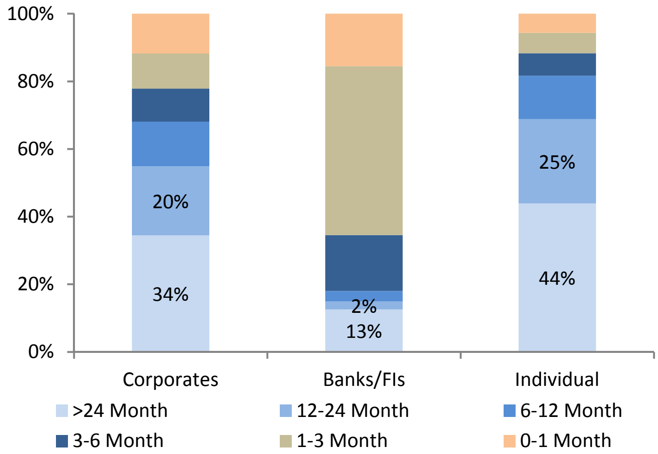
Individual investors' AUM outpace institutional segment

Majority of the industry's assets historically were held by institutional investors, mainly by corporates. However, the share of institutional investments gradually decreased to 48% as of March 2020 from 56% in FY14. This decline in share of institutional investments was largely because of a surge in the investments of individual investors, which grew at a CAGR of 21% during the period to Rs 13.5tn compared with 15% CAGR growth of institutional investments.

Individual investments outpaced institutional investments



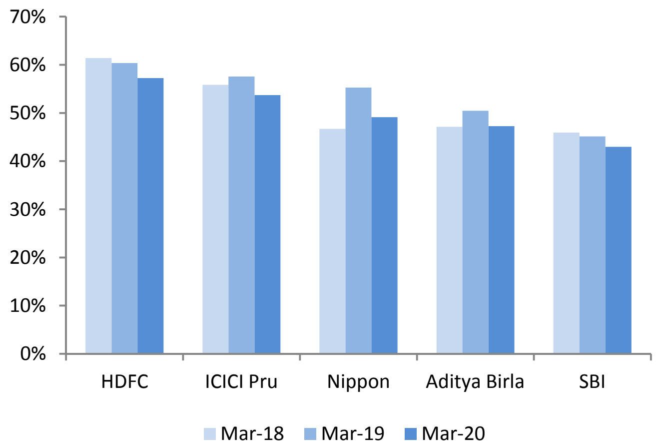
Holding period by investor type



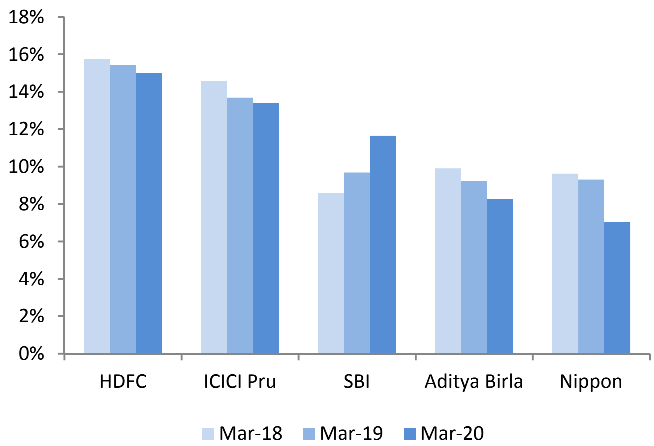
Source: AMFI, PhillipCapital India Research estimates

Individual investments come with longevity; they are mainly invested in equities and are held for longer durations. Growth in individual investments can be attributable to the SIP mode of investing that has gained traction over the last few years. AUMs accumulated through this mode tend to be held for longer durations. Such sticky AUMs are important for AMCs, since it accounts for longevity as well as regularity in inflows.

Share of individual AUM as a % of total AUM



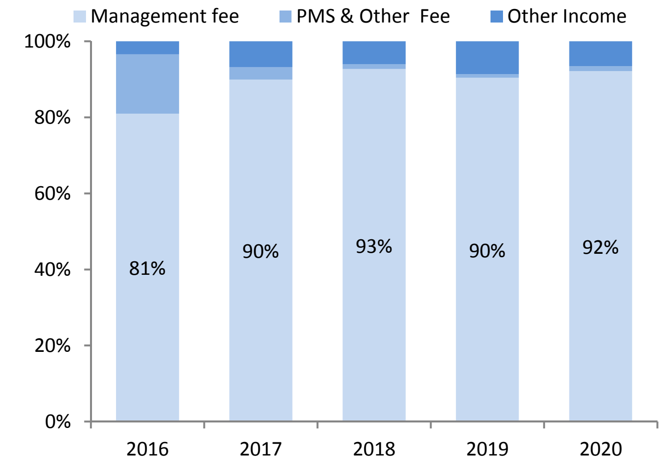
Market share in individual AUM



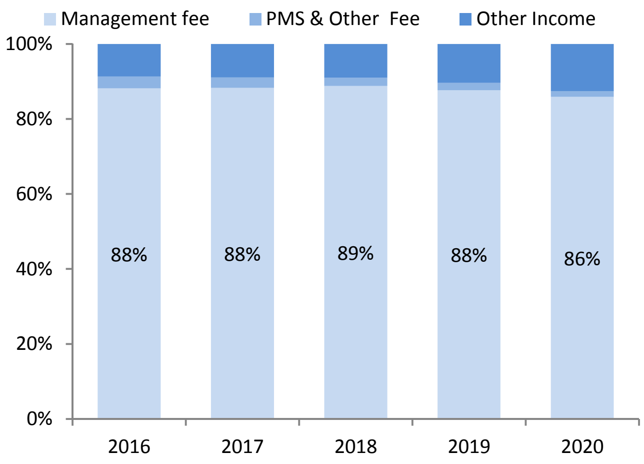
Source: Company data, PhillipCapital India Research estimates

Recurring revenue model: AMCs generate a substantial portion of their revenue from investment management fees that they charge their customers as a percentage of AAAUM. Investment management fees constitute around 90% of total revenue (see chart below). Portfolio management fee and fees charged for other advisory services constitute another 1-2% of revenue while other income consisting largely of interest and dividend income generated from AMCs' own investment book investment assets contribute the rest.

Revenue by source – HDFC AMC



Revenue by source - NAM



Source: Company data, PhillipCapital India Research estimates

Equity-oriented schemes have higher management fees compared with non-equity-oriented schemes. Management fee margin for equity schemes is more than double that of debt schemes (see table below). Margins for a liquid scheme are lower, so higher proportion of equity AUMs leads to higher revenue growth.

Management fee by asset class

bps	Equity	Debt	Liquid
Total Expense Ratio	179	103	30
Less Agents commission	(55)	(60)	(10)
Less Other expenses	(14)	(3)	(3)
Less GST	(16)	(5)	(01)
Management fee	**94**	**35**	**16**

Source: PhillipCapital India Research

Equity funds contribute a significant part of AMCs' revenues. We estimate equity funds to contribute to c.74%/75% of MF revenues for HDFC AMC/NAM in FY20 (see table below), while debt/liquid MFs contribute 18%/19% and 4%/6%.

Revenue by asset class

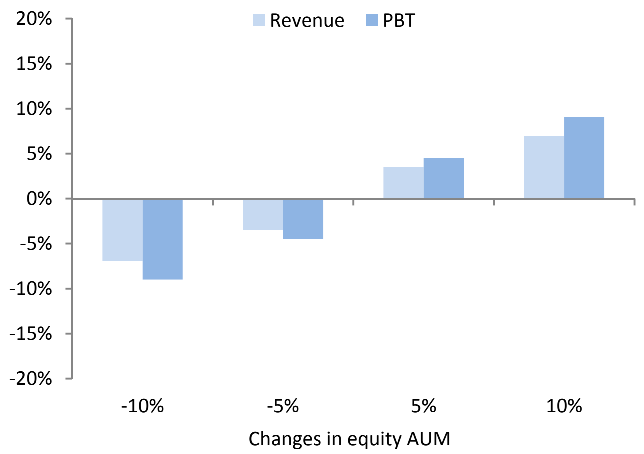
HDFCAMC	AAUM(Rs bn)	Yield (bps)	Revenue(Rs mn)	% Contribution
Equity	1,657	90	14,909	75%
Debt	1,040	35	3,639	18%
Liquid	926	12	1,111	6%
Others	66	15	100	1%
Total	**3,688**	**54**	**19,759**	**100%**

NAM	AAUM(Rs bn)	Yield (bps)	Revenue(Rs mn)	% Contribution
Equity	892	90	8,024	74%
Debt	601	35	2,103	19%
Liquid	318	12	382	4%
Others	276	12	331	3%
Total	**2,086**	**52**	**10,839**	**100%**

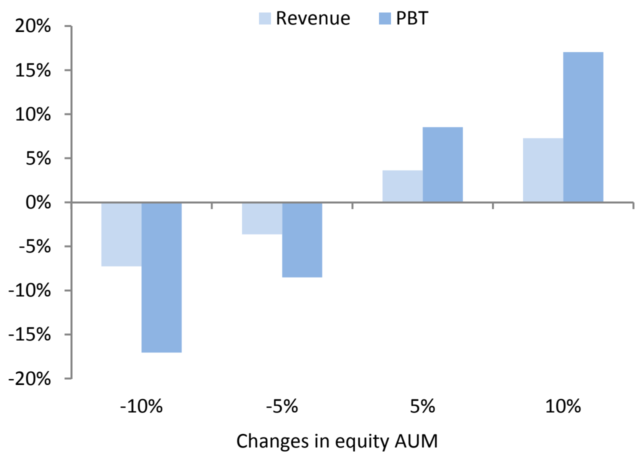
Source: PhillipCapital India Research

Hence, adverse equity markets can reduce the value of the AUM and adversely affect revenue. In the table below, we present sensitivity of AMCs' revenue and profit for every +/-5% market movement.

Revenue and PBT sensitivity to equity AUM: HDFC AMC



Revenue and PBT sensitivity to equity AUM: NAM



Source: Company data, PhillipCapital India Research estimates

NAM has higher sensitivity towards equity AUMs compared to HDFCAMC, as visible in the chart above. This is largely because of higher operating expenses.

Management fee margin is expected to decline going forward:
SEBI, in October 2018, made a few key changes regarding total expense ratio (TER) and commission expenses, which had a significant impact on the MF industry.

Firstly, SEBI implemented a complete ban on upfront commissions to distributors. While this is a step in the right direction to address the issue of mis-selling, distributors' incomes took a hit. In order to compensate them, AMCs increased their trail commissions, which led to lower margins for flow compared to the back book. We believe that as the back book is replaced by new assets, management fee margins will decline gradually. Also, any scheme-related expenses (marketing and advertisements) now need to be expensed on the scheme's books instead of asset managers. While this would have an impact on fee margins, profitability would not be hit, as operating margins would increase.

Secondly, SEBI cut TER charges by c.25bps (from 1st April 2019) to lower expenses for unit-holders. Under the new method for charging TER, slabs were tweaked resulting in TER cut by c.25bps (see table below).

TER: Under old method

AUM Slab	Equity	Debt
Up to Rs 1bn	2.50%	2.25%
Next Rs 3bn	2.25%	2.00%
Next Rs 3bn	2.00%	1.75%
On balance AUM	1.75%	1.50%

TER: Under new method

AUM Slab	Equity	Debt
Up to Rs 5bn	2.25%	2.00%
Next Rs 2.5bn	2.00%	1.75%
Next Rs 12.5bn	1.75%	1.50%
Next Rs 30bn	1.60%	1.35%
Next Rs 50bn	1.50%	1.25%
Next Rs 400bn	5bps reduction for additional Rs 50bn AUM	5bps reduction for additional Rs 50bn AUM
On balance AUM	1.05%	0.80%

Source: Company data, PhillipCapital India Research estimates

However, most of the TER cuts have been passed on to distributors, resulting in minimal margin impact. Commission (calculated as difference between TERs of regular and direct plan) declined for major funds in 1H20, but increased marginally in 2H20 (see table below).

TER and commission movement

HDFC Funds	1HFY19		2HFY19		1HFY20		2HFY20	
	TER	Commission	TER	Commission	TER	Commission	TER	Commission
HDFC Balanced	210	105	216	99	173	58	168	66
HDFC Hybrid Equity	204	111	205	91	177	61	175	65
HDFC Equity	207	91	206	76	180	54	179	55
HDFC Midcap opportunity	217	101	214	100	184	68	183	99
HDFC Credit risk	165	81	163	54	144	42	145	41

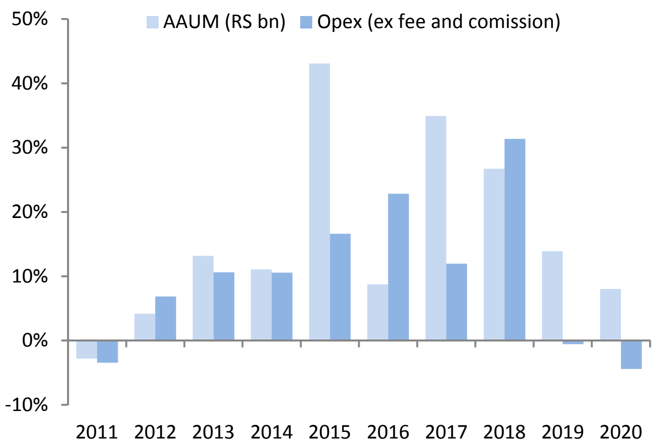
Source: Scheme half yearly statement

Operating leverage to drive ROE

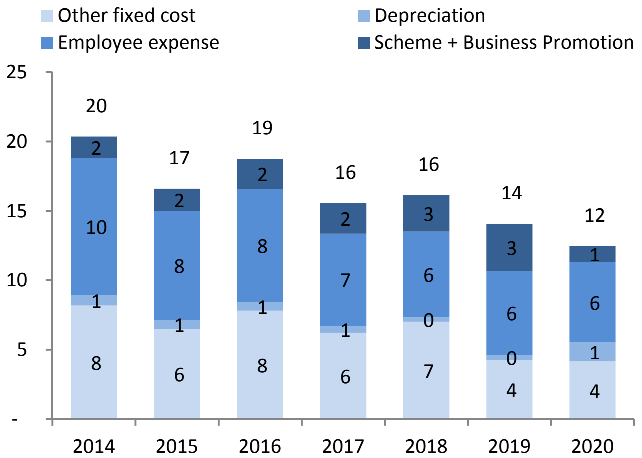
One of the key characteristics embedded in the asset-management business model is its high operating leverage, as a moderate increase in AUM does not significantly impact its cost structure. Revenue model linked to AUM results in revenue growth being tied to market performance. Hence, a well-run asset manager can accumulate assets and generate profits more rapidly than it has to grow its cost base. However, profits could also decline faster than costs in declining markets. In this section, we try to look at the cost structure of the players to get a sense of their operating leverage and any scope of cost optimisation in the current scenario.

Operating expenses (excluding commissions) for HDFC AMC have seen a CAGR of 10% over the last 10 years, post GFC, compared to 15% AUM growth during the same period. Operating expenses (excluding commissions) as percentage of average AUMs declined from 20bps in FY14 to touch only 12bps in FY20.

HDFC AMC AUM growth vs. opex (ex-commission) growth



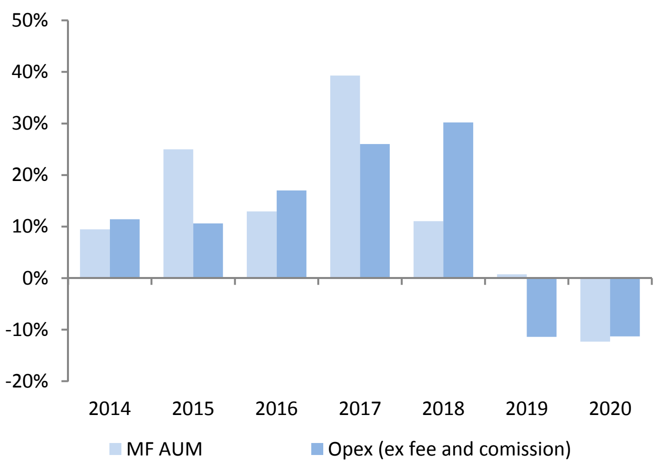
HDFC AMC: Opex breakup as a % of AUM



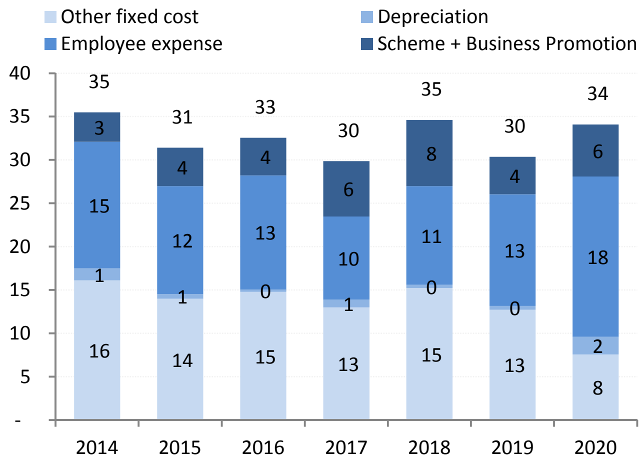
Source: Company data, PhillipCapital India Research estimates

Similarly, for NAM, operating expenses (excluding commissions) have seen a CAGR of 9% compared with 11% AUM growth since FY13. However, operating expenses (excluding commissions) as a percentage of average AUMs for NAM remained flat during the period, mainly due to a sharp decline in AUMs in FY20.

NAM-AUM growth vs. opex (ex-commission) growth



NAM: Opex breakup as a % of AUM



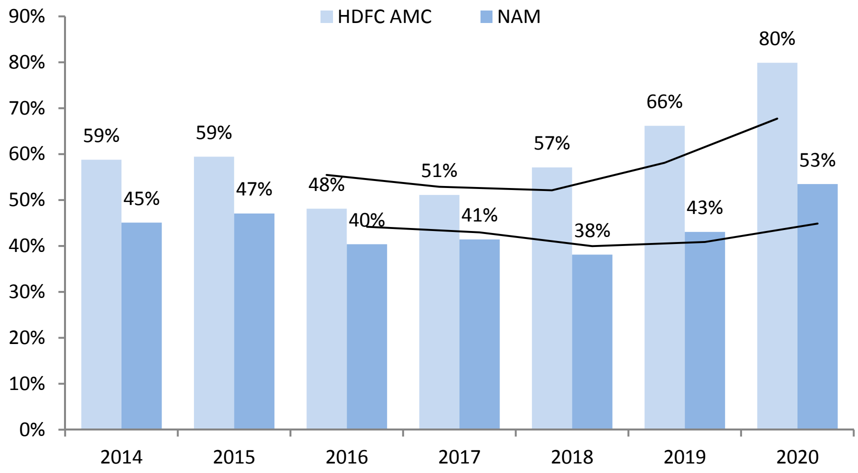
Source: Company data, PhillipCapital India Research estimates

Further, as shown in the charts above, employee expenses contribute c.50% of the operating expenses. While for HDFC AMC employees, cost as a % AUM declined from

10bps in FY14 to 6bps in FY20, for NAM it has increased to 18bps from 13bps largely because of a decline in AUM in FY20. However, variable component in employee expenses is 25% for HDFC AMC and 33% for NAM. Hence, we believe both HDFC AMC and NAM have enough levers to offset part of revenue loss due to the recent market correction.

EBIT margin for both HDFC AMC and NAM has increased over the last five years. Increase in margins for HDFC AMC, however, has been substantial, increasing to 80% from 48%. Difference between EBIT margin of HDFC AMC and NAM has increased to 27% as of FY20 from 8% in FY16.

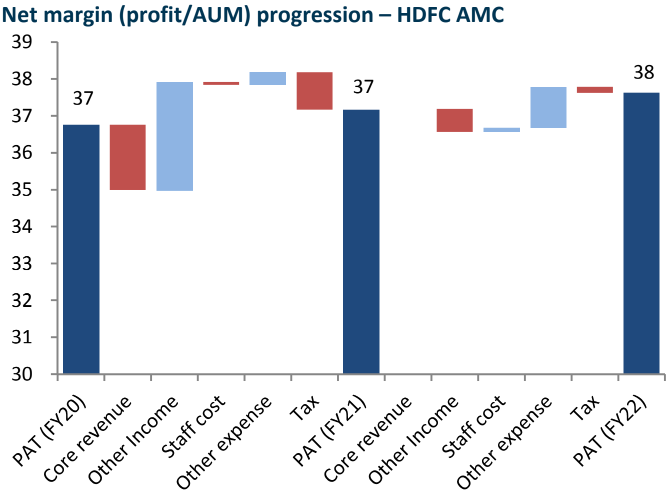
EBIT margin progression



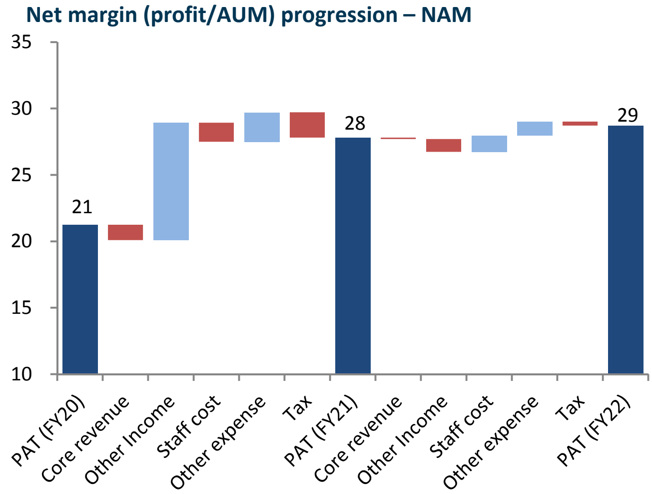
Source: Company, PhillipCapital India Research

Hence, benefit of operating leverage looks limited for HDFC AMC, in our view, while NAM could continue to benefit as operating leverage play out. We expect expenses as percentage of AUM to improve to 11bps (12bps in FY20) for HDFC AMC and 27bps (34bps in FY20) for NAM in FY22. As a result, we expect net margin for HDFCAMC to remain stable at 38bps in FY22 (37bps in FY20). For NAM, we expect net margin to improve to 29bps in FY22 (21bps in FY20), largely because of other income and operating leverage.

Net margin (profit/AUM) progression – HDFC AMC



Net margin (profit/AUM) progression – NAM



Source: PhillipCapital India Research

Performance is an important factor…

Investment performance is one of the key criteria determining flows into a mutual fund in the near term. As shown in the table below, investment performance of some of the key funds for both HDFC AMC and NAM have not been great.

Equity and balance funds

HDFC AMC	AUM	1 Year		3 Year		5 Year	
June 2020	Rs bn	Fund	Benchmark	Fund	Benchmark	Fund	Benchmark
HDFC Balanced advantage	34.9	-18.3	-3.9	-1.4	5.4	5.7	7.4
HDFC Mid-Cap Opportunities Fund	18.9	-16.9	-20.0	-3.7	-6.7	5.6	3.8
HDFC Equity Fund	18.1	-24.5	-15.9	-2.8	-0.1	4.0	5.6
HDFC Hybrid Equity fund	16.1	-13.7	-3.9	0.12	5.4	6.4	7.4
HDFC Top 100 Fund	15.0	-23.5	-15.3	-1.8	1.6	4.6	6.0

Source: Factsheets, PhillipCapital India Research

NAM	AUM	1 Year		3 Year		5 Year	
June 2020	Rs bn	Fund	Benchmark	Fund	Benchmark	Fund	Benchmark
Nippon India large cap fund	9.8	-23.5	-16.0	-1.6	1.4	4.6	5.8
Nippon India multi cap fund	7.2	-29.3	-15.7	-5.1	0.1	0.5	5.8
Nippon India small cap fund	7.4	-18.2	-17.9	-3.7	-7.8	8.7	3.2
Nippon India growth fund	5.8	-15.1	-15.9	-1.5	-4.6	5.5	5.6

Source: Factsheets, PhillipCapital India Research

Debt Funds

Performance of debt schemes has been better for both HDFCAMC and NAM, as top schemes outperformed the benchmark index for most of the period.

Debt Funds

HDFC AMC	AUM	1 Year		3 Year		5 Year	
June 2020	Rs bn	Fund	Benchmark	Fund	Benchmark	Fund	Benchmark
HDFC Corporate Bond Fund	15.8	11.4	10.7	8.6	7.9	9.0	8.5
HDFC Short Term Debt Fund	10.4	10.7	10.5	8.4	8.0	8.6	8.4
HDFC Credit Risk Debt Fund	6.3	7.5	9.4	6.9	8.0	8.6	8.7
HDFC Banking and PSU Debt Fund	6.2	10.8	11.0	8.3	7.7	8.9	8.2

Source: Factsheets, PhillipCapital India Research

NAM	AUM	1 Year		3 Year		5 Year	
June 2020	Rs bn	Fund	Benchmark	Fund	Benchmark	Fund	Benchmark
Nippon India Short-term	6.3	10.4	10.5	7.9	8.0	8.6	8.4
Nippon India Banking & PSU Debt Fund	5.3	12.4	11.0	8.8	7.7	9.1	8.2
Nippon India Credit Risk Fund	1.8	-9.7	9.4	0.4	8.0	4.2	8.7
Nippon India Dynamic Bond	0.7	11.8	13.0	7.3	8.0	9.1	9.1

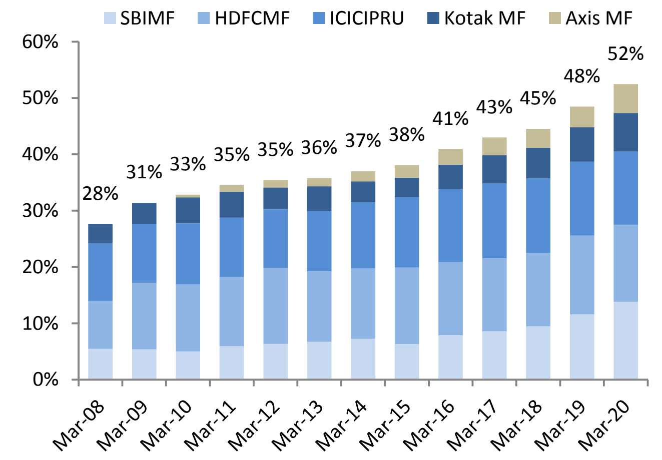
Source: Factsheets, PhillipCapital India Research

…however, there are other factors as well…

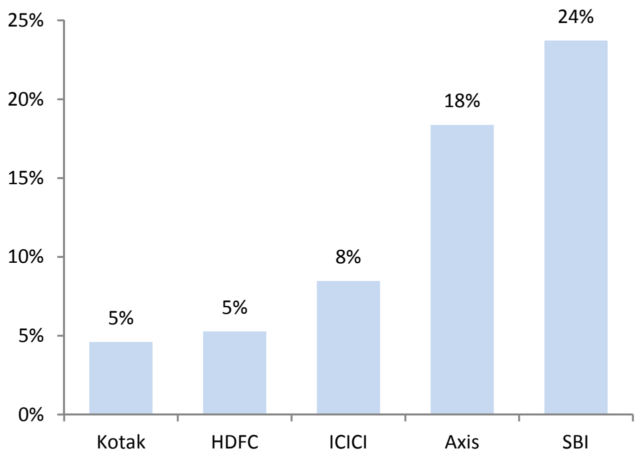
Our interaction with several industry participants suggests that apart from investment performance, distribution scale, reputation of promoter, brand recall, and stability in performance play a significant role in attracting fresh inflow. This is evident from the fact that the bank-promoted AMCs (SBI, HDFC, ICICI, Axis, and Kotak) increased their market share to 52% as of March 2020 from 28% as of March 2008.

However, if we look at AUMs sourced by associate distributors for these AMCs, HDFCAMC seems to be less dependent on the HDFC group network with only 5% of business sourced from associate distributors, suggesting that HDFCAMC is not overly dependent on the HDFC group distribution network but has built a strong distribution network over the years. On the other hand, SBI sources c.24% of its AUM from associate brokers.

Market share of bank-led AMCs



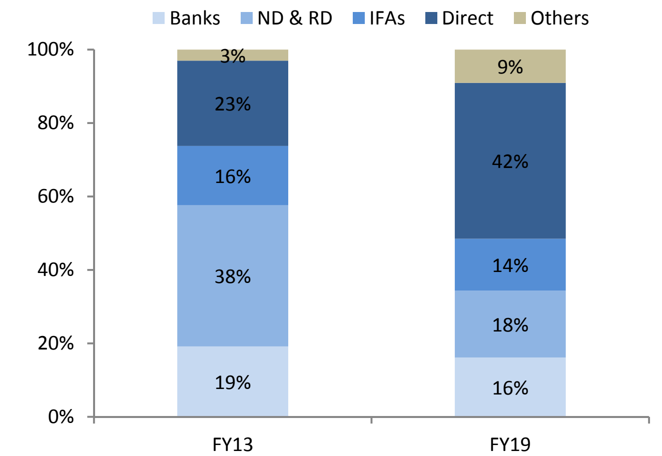
AUM sourced through associate distributors



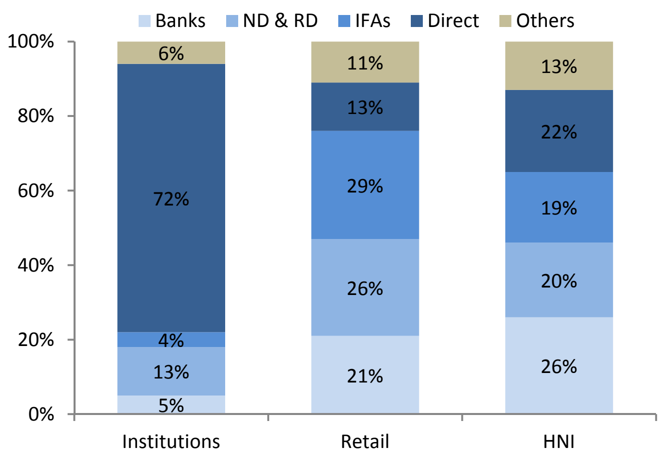
Source: AMFI, PhillipCapital India Research

Retail is still a high-touch model: While contribution of the direct channel grew from 23% in FY13 to 42% as of FY19, this was largely due to institutional money, as a majority of directly sourced AUMs are from institutional investors. Retail and HNI investors continue to be dependent on a high-touch model and have 13% and 22% share respectively from the direct channel. While selling through the direct channel is desirable (given slightly better margins), third-party distributors are essential for wider coverage and faster penetration, especially for retail and HNI investors.

Industry AUM by the channel



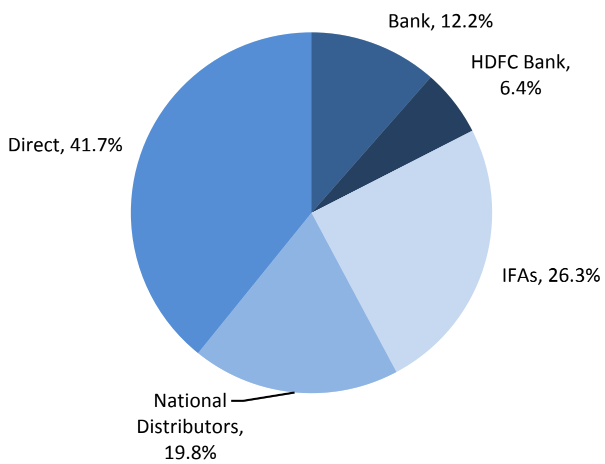
Channel mix by investor segment (FY19)



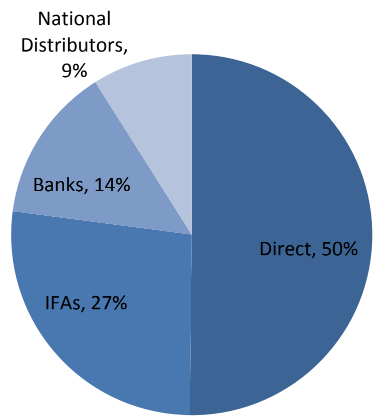
Source: AMFI, PhillipCapital India Research

Both HDFC AMC and Nippon have a wide distribution channel. As of March 2020, around 42% and 50% of AUMs for HDFC AMC and Nippon were contributed through the direct channel (see charts below). The banking channel contributes around 19% and 14% for HDFC AMC and NAM. HDFCAMC has higher share coming from national distributors (20%) compared to Nippon (9%) which has IFA driven distribution.

Distribution channel: HDFC AMC (total AUM)



Distribution channel: Nippon AMC (total AUM)



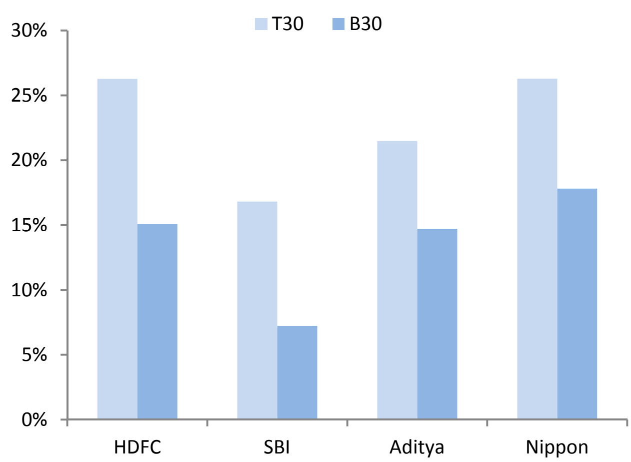
Source: Company Presentation, PhillipCapital India Research

Branch strategy and productivity

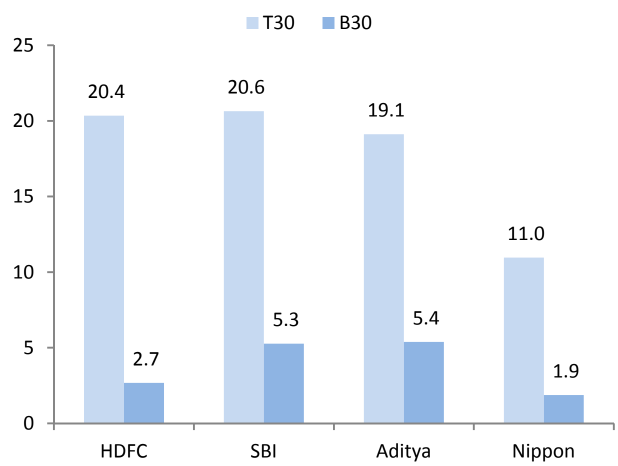
Retail and HNI investors have higher dependence on distributors; this trend is more visible in B30 cities. AUM sourced through the direct channel in B30 cities is around 14% compared to 23% for T30 cities. Investors in B30 cities, as a result, would require a high-touch model, therefore, better branch presence.

While HDFCAMC has higher AUM per branch in T30 cities compared to peers, it has lower AUM in B30 cities, suggesting scope for improving branch productivity. Nippon's AUM per branch is the lowest among peers, which can be to a decline in its overall AUM in the past 12-18 months. However, with ownership change and new brand identity, business recovery is on track. We see significant potential to increase productivity for Nippon.

AUM sourced through the direct channel



Retail and HNI AUM per branch (Rs bn)



Source: Company Presentation, PhillipCapital India Research

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INDIA | AMC | Initiating Coverage

16 June 2020

HDFC Asset Management Company (HDFCAMC) is the largest and most profitable AMC in India. We believe these factors will help HDFC AMC to capture the long-term growth opportunity in India's mutual fund industry: (1) Strong brand equity (strong parentage), (2) well-diversified distribution channel, and (3) focus on high-margin and sticky business of retail equity. Underpenetrated market, recurring revenue model, high RoE, and positive operating cash flow make it a compelling investment opportunity. We initiate coverage with a BUY rating and a target of Rs 3,100.

Key investment arguments

- **Market share gains to continue:** Over the last 10 years, HDFCAMC has clocked 15% CAGR in its AUM, while its market share increased to 13.7% as of March 2020 from 11.9% in March 2010. An AMC's brand and reputation plays an important role in asset allocation, so HDFCAMC gains market share in difficult and volatile times, especially in segments such as liquid funds where its market share increased by 4.5% in April/May 2020, as one AMC wound down six of its debt funds. We believe HDFCAMC will be a key beneficiary and will continue to gain market share under the current volatile market.

- **Superior product mix**: HDFCAMC's strategy has been to focus on individual customers, as they tend to favour equity-oriented schemes generating higher management fee and have longer holding periods. As of March 2020, AUMs sourced from individual investors constituted 57% of total AUMs compared with 52% for the industry. The company also had the highest market share of 15% in individual assets. Over the years, it has built a strong pipeline of systematic, steady, and predictable flows to the AUM. As of March 2020, it had 13% market share in SIPs with monthly SIP flow at Rs 11.3bn.

- **Excellent distribution franchise**: HDFCAMC has built a robust distribution franchise over the years, including 221 branches and 70k+ empanelled distribution partners. Even with the strong branch network of HDFC group at its disposal, it sourced just 5.6% of its AUM from associate brokers compared to 24% by SBIMF. Increasing digitization and emergence of FinTech platforms have gradually increase the share of direct schemes to AUM. As of March 2020, 48% of AUMs were sourced through the direct channel, up from 34% in March 2018.

- **Focus on smaller cities:** HDFC AMC has the second-highest AUM market share in B30 markets at 11.9%, behind SBI AMC. However, AUMs sourced from B30 locations accounts only for 13% of total AUMs compared to 16% for the industry. AUM per branch for the company from B30 locations is much lower compared to competitors such as SBI and Aditya Birla MF. Of the company's total 221 branches, c.65% were located in B30 markets. Hence, we believe the company has sufficient distribution network to tap opportunities from smaller cities which are expected to see stronger growth.

- **Operating leverage and high pay-out to drive RoE**: HDFCAMC has been reaping the benefits of operating leverage with operating expenses (ex-commissions) as percentage of average AUM declining from 20bps in FY14 to only 12bps in FY20. While we see limited benefits ahead, this, along with high dividend pay-out, will continue to drive RoE, which we see increasing to 33% by FY22 before declining to 30% in FY21.

- **Valuation**: At current levels, the stock trades at a P/E of 38x on FY22 earnings; we value it on 45x March 2022 P/E, backed by DCF, assuming 10-years earnings growth of 14% and CoE of 11%. We initiate coverage on HDFC AMC with a BUY rating and a target of Rs 3,100.

BUY (Initiate)
CMP RS 2591
TARGET RS 3100 (+20%)

COMPANY DATA

O/S SHARES (MN) :	213
MARKET CAP (RSBN) :	551
MARKET CAP (USDBN) :	7.3
52 - WK HI/LO (RS) :	3844 / 1780
LIQUIDITY 3M (USDMN) :	15.5
PAR VALUE (RS) :	5

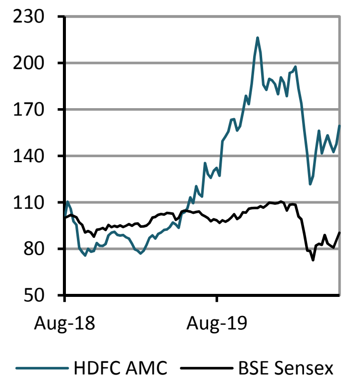
SHARE HOLDING PATTERN, %

	Mar 20	Dec 19
PROMOTERS :	79.6	79.7
FII / NRI :	8.2	8.3
FI / MF :	1.2	0.8
NON PRO :	3.7	3.9
PUBLIC & OTHERS :	7.3	7.4

KEY FINANCIALS

Rs mn	FY20E	FY21E	FY22E
Net Profit (Rs bn)	12.6	12.6	14.7
% growth	36%	0%	17%
EPS (Rs)	59	59	69
DPS (Rs)	28	32	40
ROE (%)	35.6%	30.8%	33.1%
P/E (x)	43.7	43.6	37.4
Div Yield	1.1%	1.2%	1.5%

PRICE VS. SENSEX



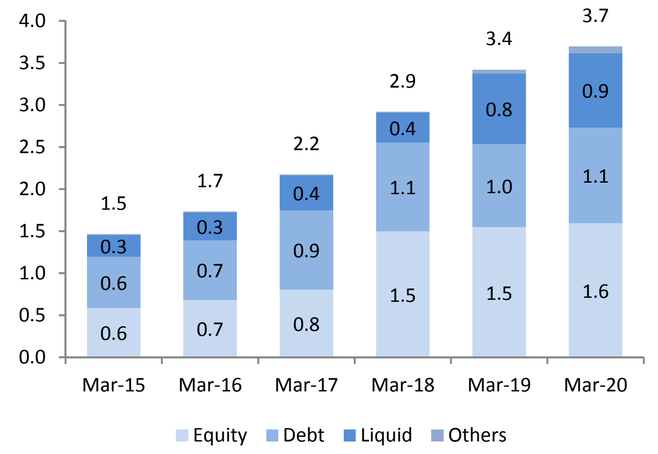
Source: Phillip Capital India Research

Sujal Kumar, Research Analyst

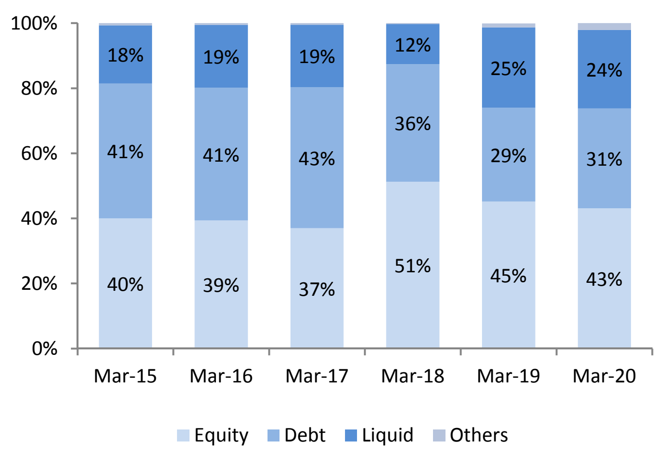
Manish Agarwalla, Research Analyst

Key charts

HDFCAMC: Overall MF average AUM (Rs tn)

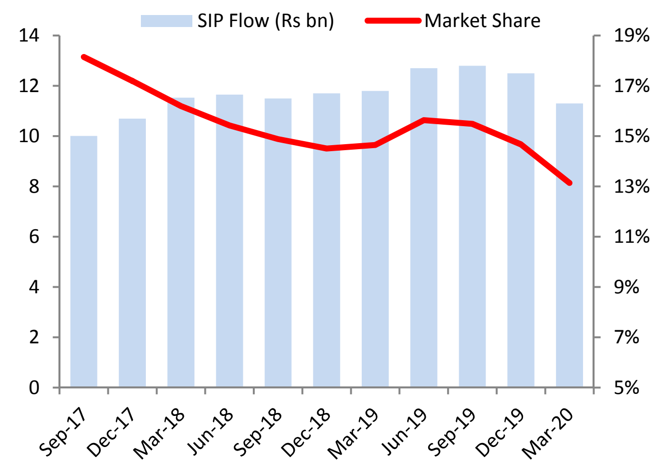


HDFCAMC: Overall average AUM mix (%)

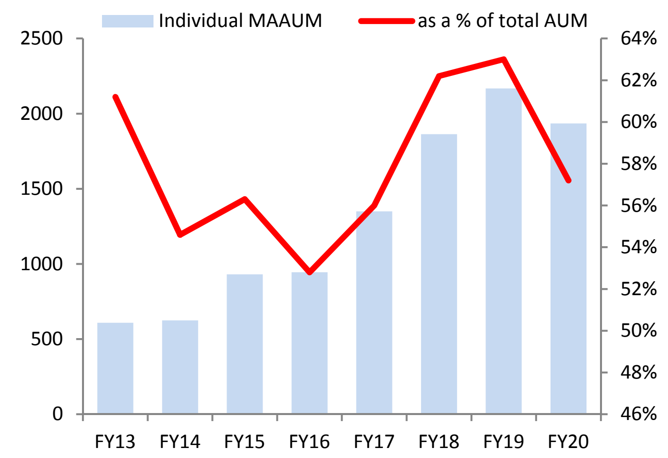


Source: Company Presentation, PhillipCapital India Research

SIP monthly flow

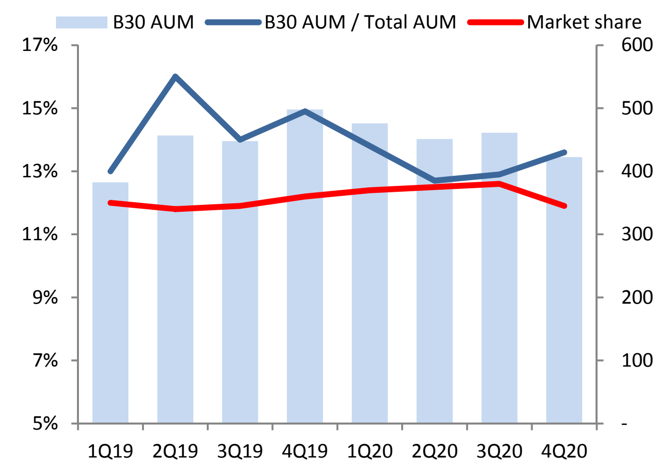


Individual MAAUM

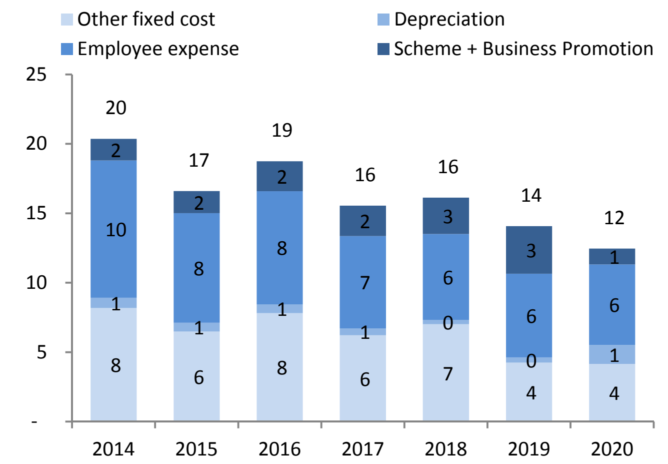


Source: Company Presentation, PhillipCapital India Research

AUM sourced through B30 market



Opex as a% of AUM



Source: Company Presentation, PhillipCapital India Research

Financials

Assets under management

Y/E Mar, Rs bn	FY19	FY20	FY21e	FY22e
Mutual Fund	3,342	3,106	3,548	4,113
PMS	98	85	98	112
Total AUM	**3,439**	**3,191**	**3,646**	**4,225**

Source: Company, PhillipCapital India Research Estimates

Assets under management by asset class

Y/E Mar, Rs bn	FY19	FY20	FY21e	FY22e
Equity	1,607	1,190	1,359	1,575
Debt	969	1,019	1,164	1,349
Liquid	722	845	965	1,119
Others	43	53	60	70
Total AUM	3,342	3,106	3,548	4,113

Source: Company, PhillipCapital India Research Estimates

Income Statement

Y/E Mar, Rs mn	FY19	FY20	FY21e	FY22e
Investment Management Fee	18,954	19,804	18,964	21,834
PMS and Advisory	198	228	228	263
Other Income	1,816	1,402	2,396	2,555
Total Revenue	**20,968**	**21,434**	**21,589**	**24,651**
Employee Expense	2,063	2,147	2,150	2,431
Brokerage and commission Expense	2,403	209	103	-
Other Expense	2,627	2,044	1,970	2,058
Depreciation and Amortization	129	504	504	504
Total Expense	**7,221**	**4,904**	**4,726**	**4,992**
Profit Before Tax	**13,747**	**16,531**	**16,863**	**19,659**
Tax	4,453	3,906	4,216	4,915
Net Profit	**9,294**	**12,624**	**12,647**	**14,744**

Balance Sheet

Y/E Mar, Rs bn	FY19	FY20e	FY21e	FY22e
Share Capital	1,063	1,064	1,064	1,064
Reserves and Surplus	29,644	39,229	40,640	46,192
Total	**30,707**	**40,293**	**41,704**	**47,256**
Financial Liabilities	1,131	2,251	1,886	1,784
Non-Financial Liabilities	384	542	542	542
Total Liability + Equity	**32,222**	**43,086**	**44,133**	**49,582**
Assets				
Non-Financial Assets	1,243.5	2,464.5	3,208.1	4,052.0
Investments	29,350	39,445	40,292	44,733
Other financial assets	1,629	1,176	632	796
Total Assets	**32,222**	**43,086**	**44,132**	**49,581**

Source: Company, PhillipCapital India Research Estimates

Valuation Ratios

	FY19	FY20	FY21e	FY22e
Earnings and Valuation Ratios				
RoE (%)	35%	36%	31%	33%
EPS (Rs.)	44	59	59	69
Dividend per share (Rs.)	24	28	32	40
Book Value (Rs.)	152	202	207	233
Dividend Payout Ratio (%)	55%	47%	54%	58%
P/E	59	44	44	37
P/B	17	13	12	11
Price/AUM	16%	17%	15%	13%
Dividend Yield (%)	0.9%	1.1%	1.2%	1.5%

Operating Ratio

As a % of avg AUM	FY19	FY20	FY21e	FY22e
Management Fee/Avg AUM	60	60	55	55
PMS and Advisory/Avg AUM	1	1	1	1
Core revenue/Avg AUM	**60**	**60**	**56**	**56**
Other Revenue/Avg AUM	6	4	7	6
Total Revenue/Avg AUM	**66**	**65**	**63**	**63**
Staff cost /Avg AUM	6	6	6	6
Other expense/Avg AUM	16	8	8	7
PBT/Avg AUM	43	50	49	50
PAT/Avg AUM	29	38	37	37

As a % of avg Asset	FY19	FY20	FY21e	FY22e
Management Fee/Avg Asset	67%	53%	43%	47%
PMS and Advisory/Avg Asset	1%	1%	1%	1%
Core revenue/Avg Asset	**67%**	**53%**	**44%**	**47%**
Other Revenue/Avg Asset	6%	4%	5%	5%
Total Revenue/Avg Asset	**74%**	**57%**	**50%**	**53%**
Staff cost /Avg Asset	7%	6%	5%	5%
Other expense/Avg Asset	18%	7%	6%	5%
PBT/Avg Asset	48%	44%	39%	42%
RoA	33%	34%	29%	31%
Leverage	1.1	1.1	1.1	1.1
RoE	35%	36%	31%	33%

Growth Ratio	FY19	FY20	FY21e	FY22e
AUM (%)	8.9%	4.3%	3.1%	15.1%
Asset (%)	30.5%	33.7%	2.4%	12.3%
Networth (%)	36.2%	31.2%	3.5%	13.3%
Management fee (%)	9.3%	4.5%	-4.2%	15.1%
PMS & Advisory Fee (%)	-15.0%	15.3%	0.1%	15.0%
Staff Cost (%)	10.8%	4.1%	0.1%	13.1%
Operating Expenses (%)	-17.5%	-46.6%	-6.5%	-0.6%
Profit Before Tax (%)	29.9%	20.2%	2.0%	16.6%
Net profit (%)	29.6%	35.8%	0.2%	16.6%

INSTITUTIONAL EQUITY RESEARCH

PhillipCapital

Nippon Life Asset Management (NAM IN)

Gaining lost ground in a new avatar

INDIA | AMC | Initiating Coverage

16 June 2020

Nippon India AMC's assets under management declined by 28% in FY20 mainly due to erstwhile promoter group-related issues. However, after a change in ownership and a rebranding exercise, NAM has been gaining lost ground. We believe that a strong distribution network, especially in B30 cities, will aid flows after rebranding. Stabilising flows, along with operating leverage, will drive ROEs. We initiate RNAM with a BUY rating and a target of Rs 350.

Key investment arguments

- **Gaining lost ground:** A decline in AUM for NAM in the first half of FY20 was mainly due to a fall in fixed-income assets, mainly attributable to corporate and HNI investors. However, post Nippon Life Insurance's acquisition of 75% stake in RNAM from previous promoters and rebranding of mutual funds to "Nippon India Mutual Fund", flows have stabilized. AUMs increased 17% from Rs 1.9tn in Sep 2019 to Rs 2.2tn as of Feb 2010 (pre-covid). We believe post rebranding, the Nippon Life brand is likely to aid better inflows. Also, Nippon Life's global presence should help NAM to increase its overseas funds. Further, the board has decided to make fresh investments (through the primary or secondary market) only in AA and above-rated issuers in all NIMF's schemes. We believe this would help the company to regain confidence from corporate and HNI investors.
- **Strong distribution network**: Over the years, RNAM has built a strong distribution network across India in over 290 locations through its c.189 branches, of which c.65% of its branches are in B30 cities and 261 distribution partners. In the absence of a bank promoter, the company has developed strong IFA (independent financial advisor) network of over 76,000 IFAs.
- **Growth opportunities from B30 cities**: NAM has built a strong presence in the B30 market, with c.17% of its AUMs sourced from B30 cities (vs. 15% for the industry) through a large distribution network of IFAs. With over 65% of its 189 branches in B30 cities, we see huge growth potential for NAM, as its AUM per branch is lower than the industry average.
- **Product mix shift towards sticky and high-margin business:** Traditionally, NAM had a higher proportion of debt (49% as of FY17) and institutional investment (58% as of FY17), but a recent decline in debt and liquid AUM from corporate investors have changed asset mix towards individual and equity. As of March 2020, individual investors accounts for 49% of total AUM and equity constitutes 42% of AUM.
- **Operating leverage to drive RoE:** NAM's operating expenses (ex-commissions) are much higher than peers, especially after AUMs declined in FY20. Its opex (ex-commissions) has remained flat in the last six years, compared to an 8bps decline for HDFCAMC. However, with AUMs stabilizing after rebranding, we expect NAM to materially benefit from operating leverage and expect opex as a % to AUM to decline by 7bps over the next two years to touch 27bps; thus, we estimate NAM to report 22% RoE in FY22, higher than 16% in FY20.

Valuation: Historically, NAM has been trading at a discount to HDFCAMC, mainly due to its low RoE profile and asset mix. However, post rebranding, we see significant scope of an improvement in NAM's ROE, as AUMs stabilise and operating leverage plays out. Hence, we believe discount to HDFCAMC may reduce. At the current level, the stock trades at a P/E of 29x FY22 earnings; we value the stock at 34x March 2022 P/E, backed by our DCF, assuming 10-year earnings growth of 17% and CoE of 12%. We initiate coverage on NAM with a BUY rating and a target of Rs 350.

BUY (Initiate)

CMP RS 273

TARGET RS 350 (+28%)

COMPANY DATA

O/S SHARES (MN) :	612
MARKET CAP (RSBN) :	167
MARKET CAP (USDBN) :	2.2
52 - WK HI/LO (RS) :	453 / 208
LIQUIDITY 3M (USDMN) :	0.6
PAR VALUE (RS) :	10

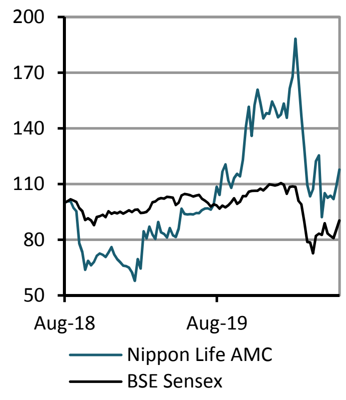
SHARE HOLDING PATTERN, %

	Mar 20	Dec 19
PROMOTERS :	75.9	75.9
FII / NRI :	8.0	8.5
FI / MF :	3.9	3.4
NON PRO :	3.3	3.8
PUBLIC & OTHERS :	8.8	8.3

KEY FINANCIALS

Rs mn	FY20	FY21E	FY22E
Net Profit (Rs bn)	4.2	5.3	6.1
% growth	-15%	27%	16%
EPS (Rs)	6.8	8.6	10.0
DPS (Rs)	5.0	6.0	7.0
ROE (%)	16.1%	19.8%	21.6%
P/E (x)	40.5	31.8	27.4
Div Yield	1.8%	2.2%	2.5%

PRICE VS. SENSEX



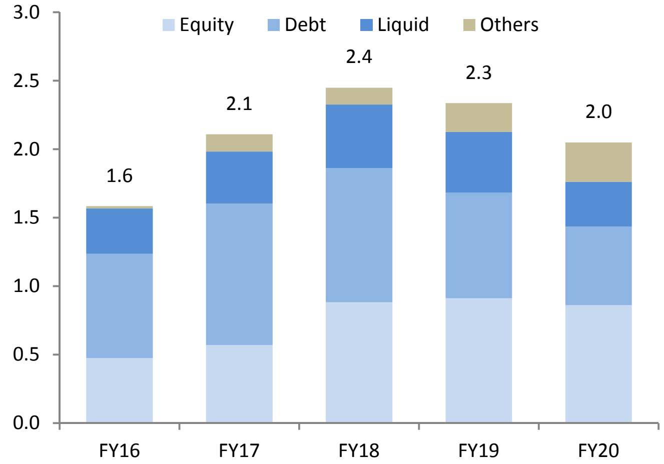
Source: Phillip Capital India Research

Sujal Kumar, Research Analyst

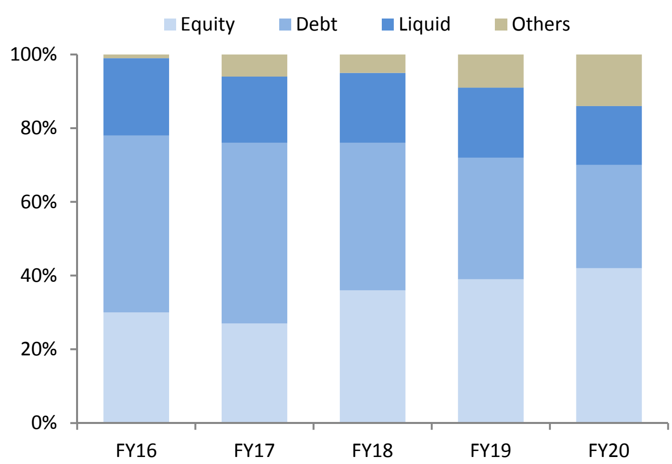
Manish Agarwalla, Research Analyst

Key charts

NAM: Overall MF average AUM (Rs tn)

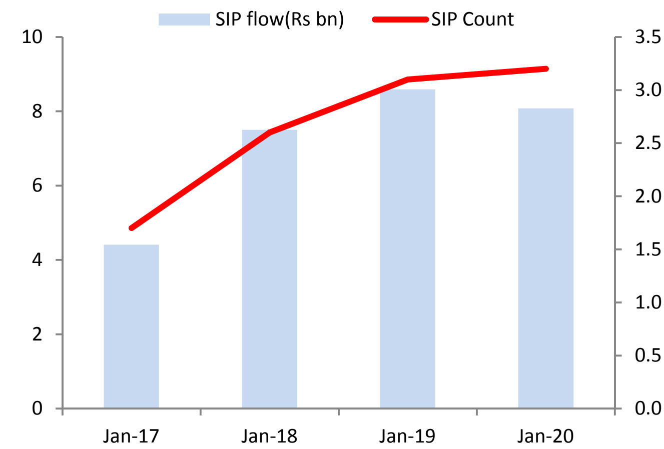


NAM: Overall average AUM mix (%)

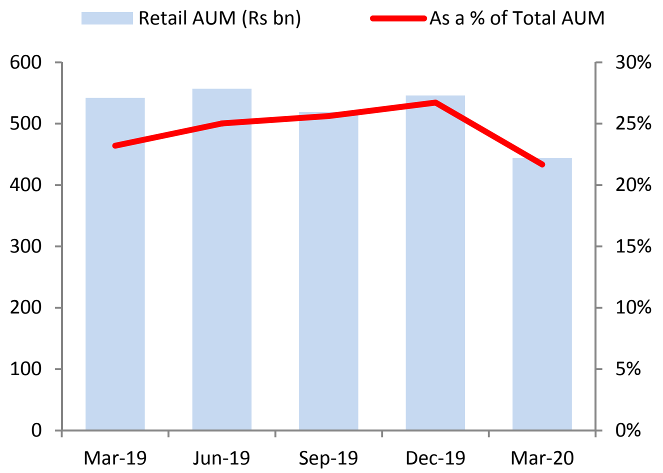


Source: Company Presentation, PhillipCapital India Research

SIP monthly flow

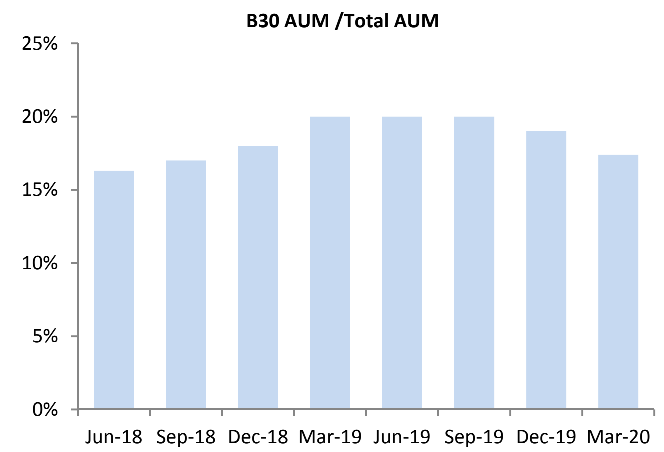


Individual MAAUM

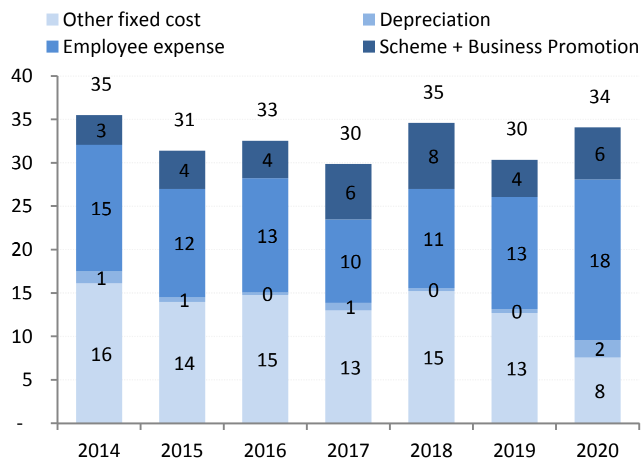


Source: Company Presentation, PhillipCapital India Research

B30 AUM



Opex as a % of AUM



Source: Company Presentation, PhillipCapital India Research

Financials

Asset under Management

Y/E Mar, Rs bn	FY19	FY20	FY21e	FY22e
Mutual Fund	2,278	1,635	1,880	2,162
Managed accounts	1,944	917	992	1,073
Total AUM	**4,222**	**2,552**	**2,872**	**3,235**

Source: Company, PhillipCapital India Research Estimates

Asset under Management by asset class

Y/E Mar, Rs bn	FY19	FY20	FY21e	FY22e
Equity	888	687	790	908
Debt	752	458	526	605
Liquid	433	262	301	346
Others	205	229	263	303
Total AUM	**2,278**	**1,635**	**1,880**	**2,162**

Source: Company, PhillipCapital India Research Estimates

Income Statement

Y/E Mar, Rs mn	FY19	FY20	FY21e	FY22e
Investment Management Fee	14,464	11,815	10,546	11,925
PMS and Advisory	322	215	239	258
Other Income	1,713	-98	1,600	1,800
Total Revenue	**16,499**	**11,932**	**12,384**	**13,984**
Employee Expense	2,935	3,024	2,912	3,168
Brokerage and commission Expense	2,583	705	293	264
Other Expense	3,878	2,274	1,798	2,045
Depreciation and Amortization	101	333	333	333
Total Expense	**9,497**	**6,334**	**5,336**	**5,809**
Profit Before Tax	**7,002**	**5,598**	**7,048**	**8,175**
Tax	2,132	1,441	1,762	2,044
Net Profit	**4,871**	**4,158**	**5,286**	**6,131**

Balance Sheet

Y/E Mar, Rs mn	FY19	FY20e	FY21e	FY22e
Share Capital	6,120	6,121	6,121	6,121
Reserves and Surplus	19,580	19,809	21,423	23,148
Total	**25,700**	**25,931**	**27,545**	**29,269**
Provisions	435	393	471	565
Trade payables	474	677	677	677
Other current liabilities	1,150	1,808	1,808	1,808
Total Liability + Equity	**27,758**	**28,808**	**30,501**	**32,320**
Assets				
Fixed assets	2,568	3,256	3,256	3,256
Other non financial assets	1,587	1,190	1,013	830
Investments	12,900	18,846	20,460	22,185
Other financial assets	10,704	5,517	5,772	6,049
Total Assets	**27,758**	**28,808**	**30,501**	**32,320**

Source: Company, PhillipCapital India Research Estimates

Valuation Ratios

	FY19	FY20	FY21e	FY22e
Earnings and Valuation Ratios				
RoE (%)	19.5%	16.1%	19.8%	21.6%
EPS (Rs.)	8.0	6.8	8.6	10.0
Dividend per share (Rs.)	6.0	5.0	6.0	7.0
Book Value (Rs.)	42.0	42.4	45.0	47.8
Dividend Payout Ratio (%)	75%	74%	69%	70%
P/E	34.6	40.5	31.8	27.4
P/B	6.5	6.5	6.1	5.8
Price/AUM	7.4	10.3	9.0	7.8
Dividend Yield (%)	2.2%	1.8%	2.2%	2.5%

Operating Ratio

As a % of avg AUM	FY19	FY20	FY21e	FY22e
Management Fee/Avg AUM	64	60	60	59
PMS and Advisory/Avg AUM	1	1	1	1
Core revenue/Avg AUM	**65**	**61**	**61**	**60**
Other Revenue/Avg AUM	8	0	9	9
Total Revenue/Avg AUM	**73**	**61**	**70**	**69**
Staff cost /Avg AUM	13	15	17	16
Other expense/Avg AUM	29	17	14	13
PBT/Avg AUM	31	29	40	40
PAT/Avg AUM	**21**	**21**	**30**	**30**

As a % of avg Asset	FY19	FY20	FY21e	FY22e
Management Fee/Avg Asset	53%	42%	36%	38%
PMS and Advisory/Avg Asset	1%	1%	1%	1%
Core revenue/Avg Asset	**54%**	**43%**	**36%**	**39%**
Other Revenue/Avg Asset	6%	0%	5%	6%
Total Revenue/Avg Asset	**60%**	**42%**	**42%**	**45%**
Staff cost /Avg Asset	11%	11%	10%	10%
Other expense/Avg Asset	24%	12%	8%	8%
PBT/Avg Asset	25%	20%	24%	26%
RoA	18%	15%	18%	20%
Leverage	1.1	1.1	1.1	1.1
RoE	20%	16%	20%	22%

Growth Ratio	FY19	FY20	FY21e	FY22e
AUM (%)	0.4%	-13.8%	-10.2%	15.0%
Asset (%)	2.0%	3.8%	5.9%	6.0%
Networth (%)	8.7%	0.9%	6.2%	6.3%
Management fee (%)	-6.8%	-18.3%	-10.7%	13.1%
PMS & Advisory Fee (%)	-17.7%	-33.4%	11.2%	8.2%
Staff Cost (%)	14.1%	3.0%	-3.7%	8.8%
Operating Expenses (%)	-22.0%	-49.5%	-26.8%	8.9%
Profit Before Tax (%)	301.9%	-20.1%	25.9%	16.0%
Net profit (%)	-26.7%	-14.6%	27.1%	16.0%

Appendix- Key management personnel

HDFC Asset Management Limited

Mr. Milind Barve (MD) has been an Executive Director of the Company since July 4, 2000. He has a bachelor's degree in Commerce from the University of Poona and is also a fellow of the Institute of Chartered Accountants of India. He has been associated with HDFC in the capacity of General Manager-Treasury, where he headed the treasury operations at HDFC for 14 years and was responsible for management of HDFC's treasury portfolio and raising funds from financial institutions and capital markets. He was also the head of marketing for retail deposit products and was responsible for investment advisory relationships for the Commonwealth Equity Fund Mutual Fund and the Invesco India Growth Fund.

Mr. Prashant Jain (CIO) holds a bachelor's degree in Technology from the Indian Institute of Technology, Kanpur and a post graduate diploma in Management from the Indian Institute of Management, Bangalore. He is also a designated Chartered Financial Analyst from the Chartered Financial Analyst Institute, USA. He has been associated with the Company for over 14 years since June 20, 2003 and was appointed as its Chief Investment Officer with effect from July 1, 2004. Prior to joining HDFC AMC, he was associated with Zurich Asset Management Company (India) Private and SBI Mutual Funds Management Private.

Mr. Piyush Surana (CFO) has been associated with the Company for over 6 years and was appointed as the Chief Financial Officer with effect from February 25, 2013. Prior to this, he was associated with Daiwa Asset Management (India) Private, Shinsei Corporate Advisory Services Private and Alliance Capital Asset Management (India) Private

Nippon Life India Asset Management Limited

Mr. Sundeep Sikka (ED & CEO) has held both Vice-Chairman and Chairman Positions of the industrial body AMFI (Association of Mutual Funds in India). He joined NAM India in 2003 and has handled various positions through which he has been instrumental in building domestic and international operations of the company.

Mr. Manish Gunwani (CIO Equity) is graduated from IIT Chennai with a B.Tech and has a Post Graduate Diploma in Management from IIM Bangalore. Manish has over 21 years of work experience primarily in equities spanning roles in equity research and fund management. He has also co-founded a technology company in the document management space.

Mr. Amit Tripathi (CIO Fixed income) has more than 20 years of experience in Financial Services. He has been with NIMF for around 14 years and in that time, he has evolved into a stellar portfolio manager, combining experience across the yield curve, with robust credit evaluation skills.

Mr. Prateek Jain (CFO) has over 16 years of experience in finance. Prior to this, he worked with AIG Global Asset Management Company as CFO & Head Risk Management. He has also been associated with organizations like Howden Insurance Brokers India Pvt Ltd. and ICICI Lombard General Insurance Company Ltd.

Rating Methodology

We rate stock on absolute return basis. Our target price for the stocks has an investment horizon of one year. We have different threshold for large market capitalisation stock and Mid/small market capitalisation stock. The categorisation of stock based on market capitalisation is as per the SEBI requirement.

Large cap stocks

Rating	Criteria	Definition
BUY	>= +10%	Target price is equal to or more than 10% of current market price
NEUTRAL	-10% > to < +10%	Target price is less than +10% but more than -10%
SELL	<= -10%	Target price is less than or equal to -10%.

Mid cap and Small cap stocks

Rating	Criteria	Definition
BUY	>= +15%	Target price is equal to or more than 15% of current market price
NEUTRAL	-15% > to < +15%	Target price is less than +15% but more than -15%
SELL	<= -15%	Target price is less than or equal to -15%.

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