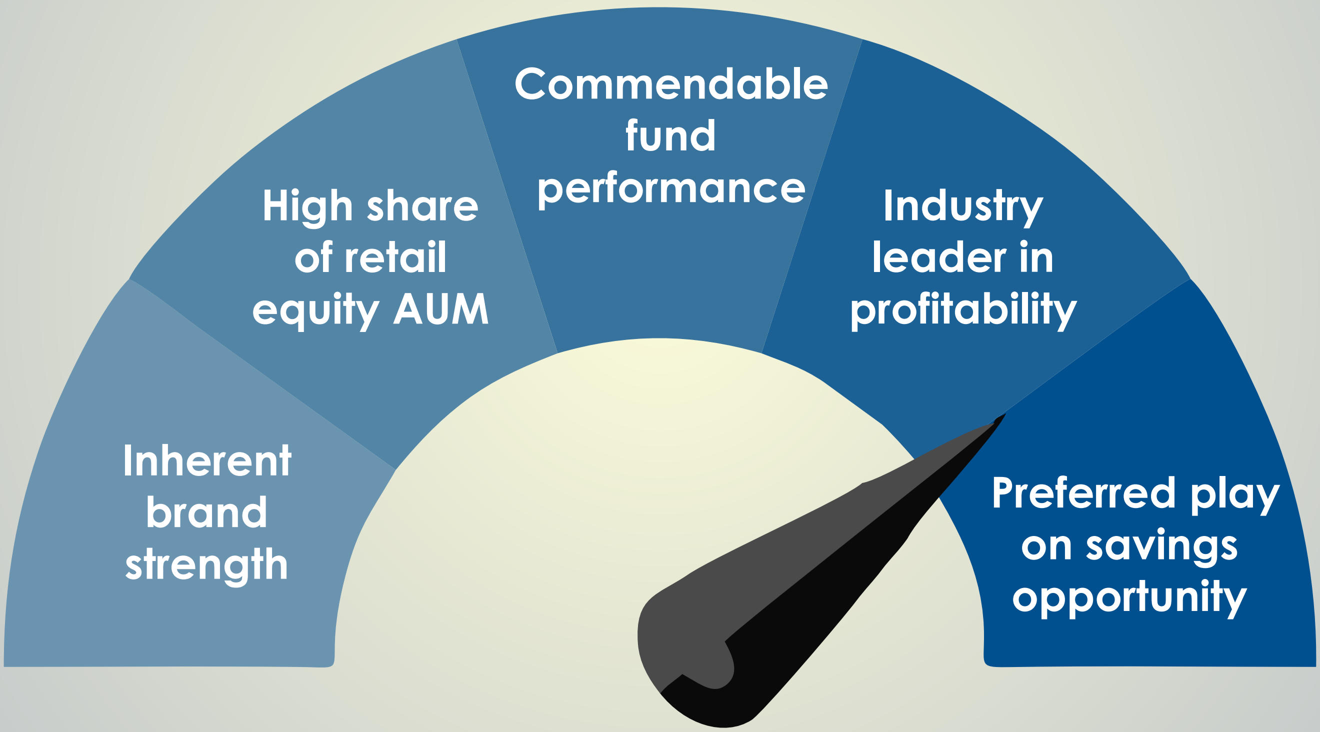
JM FINANCIAL

HDFC Asset Management Company

SIP it up!



HDFC
ASSET MANAGEMENT COMPANY LIMITED

Initiate with BUY
TP of INR 1,850
21% upside

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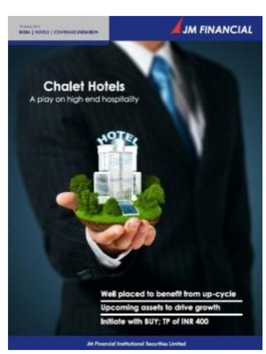

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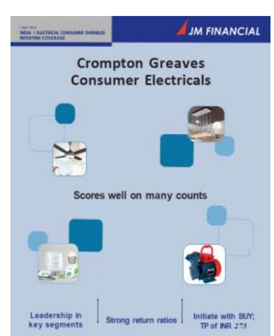

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HDFC Asset Management Company

SIP it up!

We initiate coverage on HDFC Asset Management Company (HDFCAMC) with a BUY rating and target price of INR1,850. We believe HDFCAMC's strong brand pull (benefitting from parentage), relatively higher proportion of equity assets and continued delivery on fund performance make it one of the best plays to capitalize on the financial savings opportunity in the country.

We see momentum on AUM growth sustaining (10-year CAGR of 19% overall, 31% in equity AUMs) given that 'sticky retail' equity inflows (i.e. SIP) have remained healthy despite the correction in markets in 2018, reflective of behavioural shift in retail investors as well as muted returns in physical asset classes. Recent TER guidelines, in our view, will lead to large AMCs passing on large proportion of the expense ratio cuts to distributors and thus the impact on profitability should be limited.

HDFCAMC is the industry leader on multiple metrics: a) profitability – 29bps for FY19E driven by its higher equity share b) retail AUM –15.4% market share of retail AUM (market leader) and c) distribution and brand presence. Given the long runway of growth and granular nature of business, strong distribution franchise and industry leading profitability metrics we see premium valuation multiples sustaining despite the market-linked cyclical nature of AMC valuations. Initiate with BUY.

One of the best plays on financial savings opportunity: The under penetration of mutual funds in India's savings pie is well known – MF AUM is just c.12% of GDP (vs global average of 62%). Long term AUM growth rates have been healthy (18% CAGR over last 19 years) and we see them sustaining in the future. Importantly, share of individual investors in the AUM has been inching up and the uptick in "sticky retail flows' should shield the industry from cyclical whipsaws in the market. HDFCAMC is one of our preferred plays on the financial savings opportunity

Recent TER guidelines – impact should be manageable: The impact on HDFCAMC's gross blended equity MF TER is expected to be c.24bps, of which management expects to pass on c.21bps, limiting the impact on profitability. Other TER cuts introduced in FY19 (15bps TER cut, B15 to B30) have been almost completely passed on to the distributors. At the same time, SEBI has also banned upfront commissions and commission-related expenses paid out through the AMC P&L, effective from Oct-18. This is expected to be positive to near-term profitability for the AMC, as now fresh inflows also become profitable, and could offset the TER cut to an extent. We expect operating profits (PBT, ex-other income) to grow 14% / 16% in FY20E / FY21E.

Premium valuations should sustain; initiate with BUY: HDFCAMC trades at c.29x FY21E P/E and 10% of FY19E AUM. While this optically appears rich in comparison to global AMCs, we believe the structural tailwinds in India and industry leadership position of HDFCAMC should lead to sustenance of these multiples. We expect HDFCAMC to deliver 17% earnings CAGR over FY18-21E despite a reset of industry profitability in FY20 driven by new regulations. Structurally, we expect this company to deliver 20%+ earnings growth over a cycle. We value HDFCAMC at 34 FY21E P/E resulting into a target price of INR 1,850 (+21% upside). Initiate with BUY.

Recommendation and Price Target	
Current Reco.	BUY
Current Price Target (12M)	1,850
Upside/(Downside)	21.3%

Key Data – HDFCAMC IN	
Current Market Price	INR1,525
Market cap (bn)	INR324.2/US$4.7
Free Float	13.8%
Shares in issue (mn)	210.6
3-mon avg daily val (mn)	INR157.7/US$2.3
52-week range	1,970/1,248
Sensex/Nifty	38,701/11,605
INR/US$	69.7

Price Performance			
%	1M	6M	12M
Absolute	2.5	20.2	NA
Relative*	-3.1	7.4	NA

* To the BSE Sensex

Financial Summary					(INR mn)
Y/E March	FY17	FY18	FY19E	FY20E	FY21E
Mutual Fund AUM (closing basis, INR bn)	2,303	2,917	3,354	3,969	4,740
YoY growth (%)	39%	27%	15%	18%	19%
% of equity MF AUM (closing basis)	43%	51%	47%	50%	52%
Operating Revenues (INR mn)	14,800	17,598	19,294	19,719	22,957
Total operating expenses (INR mn)	7,881	8,047	7,600	6,361	7,509
PAT (INR mn)	5,502	7,216	9,029	9,905	11,476
YoY growth (%)	15%	31%	25%	10%	16%
PAT / Avg. MF AUM (RoAUM) (%)	0.28%	0.28%	0.29%	0.27%	0.26%
RoE (%)	42.8%	40.3%	38.3%	35.6%	35.0%
EPS (INR)	27.3	34.3	42.9	47.0	54.5
P/E (x)	55.8	44.5	35.6	32.4	28.0

Source: Company data, JM Financial. Note: Valuations as of 08/Apr/2019

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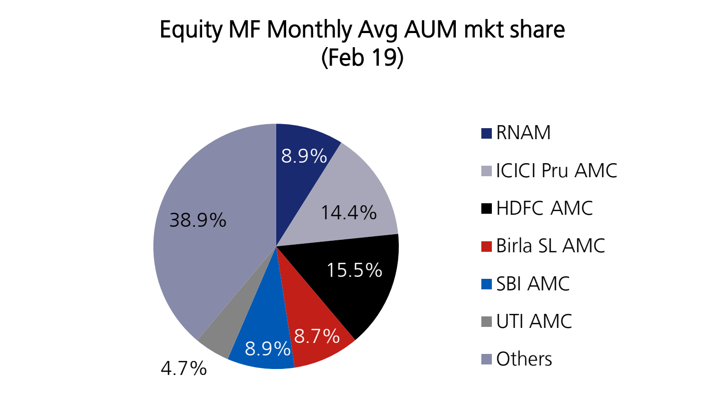
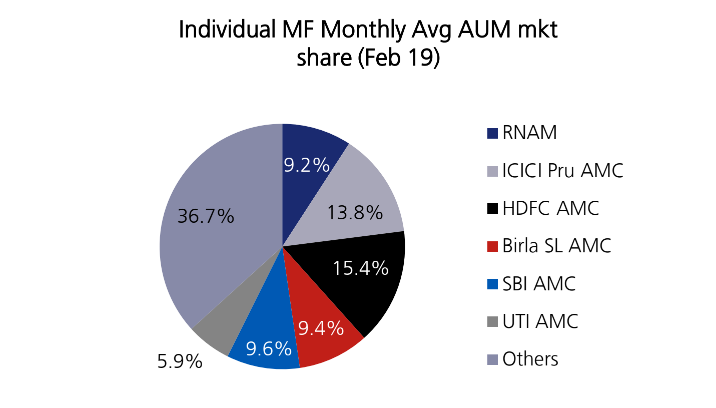
HDFCAMC - Key charts

Exhibit 1. HDFCAMC : Market leader in the equity MF segment



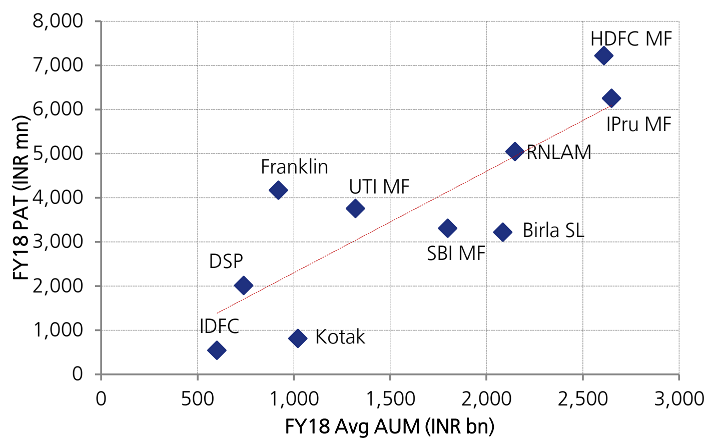
Source: AMFI, JM Financial

Exhibit 2. HDFCAMC : Market leader in individual investor segment



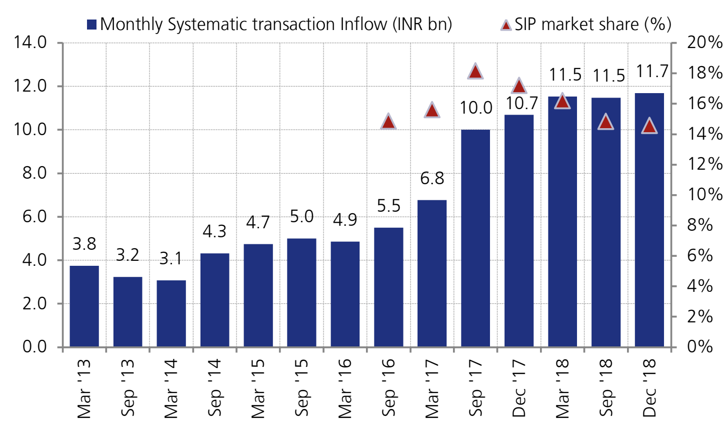
Source: AMFI, JM Financial

Exhibit 3. HDFCAMC : Largest and most profitable AMC



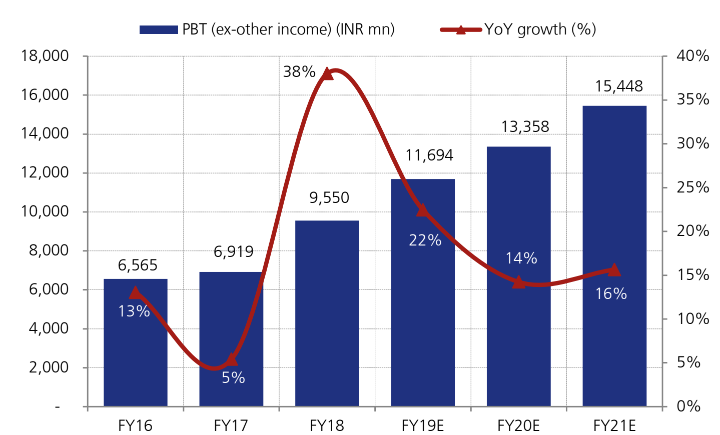
Source: Company, AMFI, JM Financial

Exhibit 4. HDFCAMC : High contribution of sticky flows



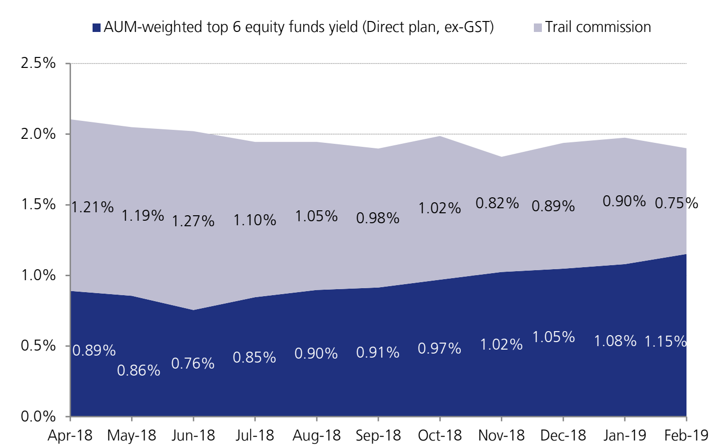
Source: Company, AMFI, JM Financial

Exhibit 5. HDFCAMC : Trends in operating profit are expected to be strong



Source: Company, JM Financial

Exhibit 6. HDFCAMC : Price hikes/ lower trail payouts may neutralise impact of TER cut



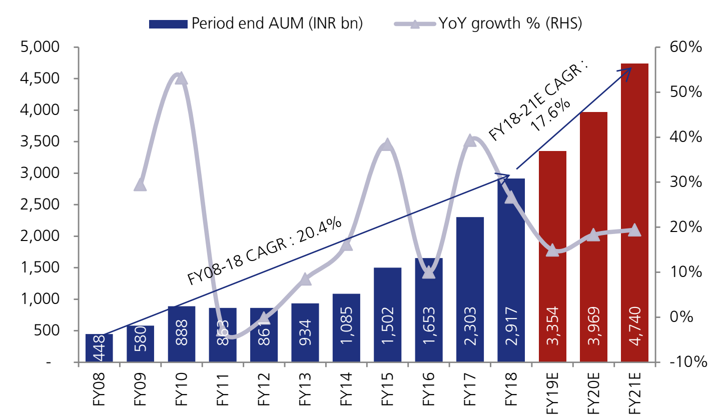
Source: Company, JM Financial

HDFCAMC – Leader on multiple key parameters

HDFCAMC is the most profitable asset management company in India in terms of net profit since FY13, with a total AUM of INR 3.37 trn as of Feb-19. Its profits have grown every year since the first full year of operations in FY02. HDFCAMC is also the largest AMC in India in terms of equity-oriented AUM, with an equity MF AUM of INR 1.54 trn, representing a market share of 15.5% (as of Feb-19). HDFCAMC's AUM has grown at a CAGR of 24.8% between Mar-14 and Feb-19.

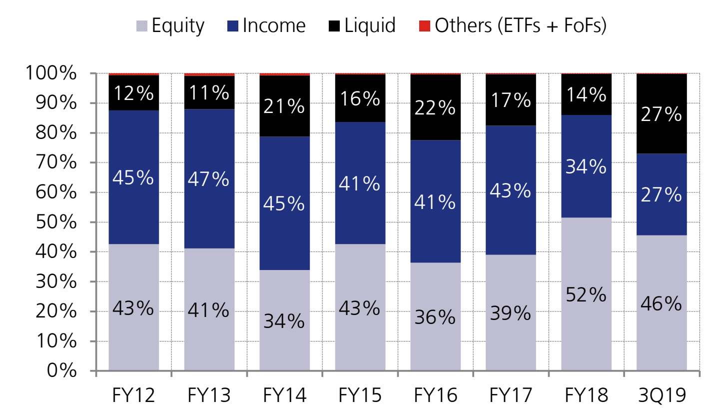
HDFCAMC's product mix is superior to that of the industry – both in terms of profitability, as well as granularity. Equity MF AUM contributes 46% to the overall mix – as against 42% for the industry (as of 3Q19). Separately, AUM generated from individuals (as opposed to institutions), contribute 59% to its overall AUM, as compared to 53% for the industry (Feb-19).

Exhibit 7. HDFCAMC : Robust long-period AUM growth



Source: AMFI, JM Financial

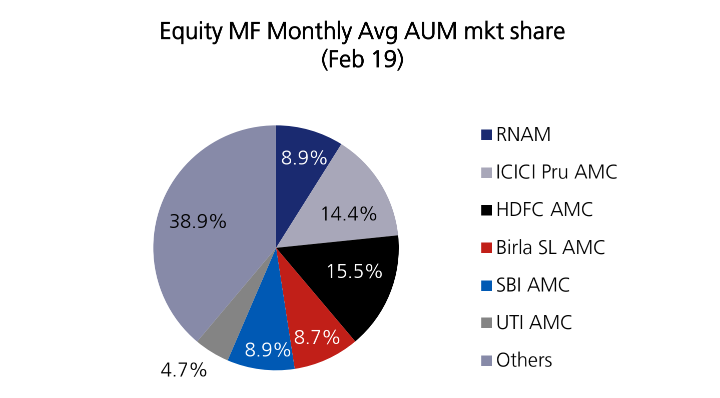
Exhibit 8. HDFCAMC : AUM mix favours equity MF schemes



Source: Company, AMFI, JM Financial

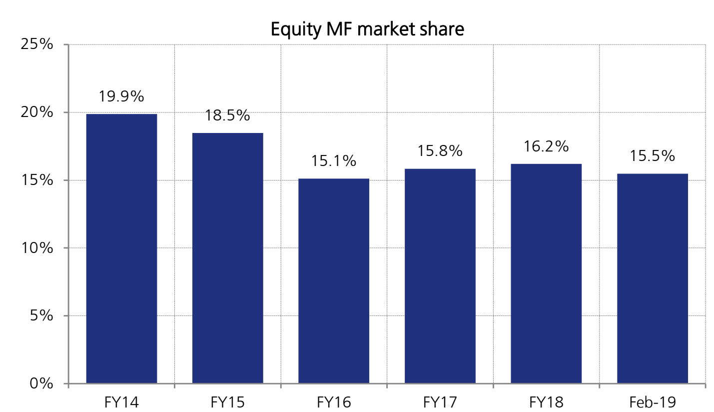
HDFCAMC has witnessed a decline in its market share in equity MFs (incl. balanced) in the recent past (Exhibit 10 below). However, it has managed to retain its market leadership in equity MFs and recent trends indicate that the decline in market share has largely been arrested.

Exhibit 9. HDFCAMC : Market leader in equity MF AUM



Source: AMFI, JM Financial

Exhibit 10. HDFCAMC : Trends in equity MF market share

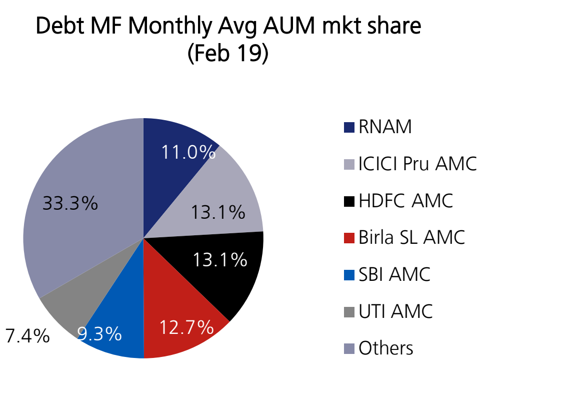


Source: Company, AMFI, JM Financial

HDFCAMC recently claimed market leadership in debt MF AUM as well in Feb-19. Its market share in debt MFs (ex-liquid) has shown a consistent improvement from 11.6% as of FY14 to 13.1% as of Feb-19. Separately, HDFCAMC is also the market leader in liquid MFs, with a market share of 14.8% (Feb-19).

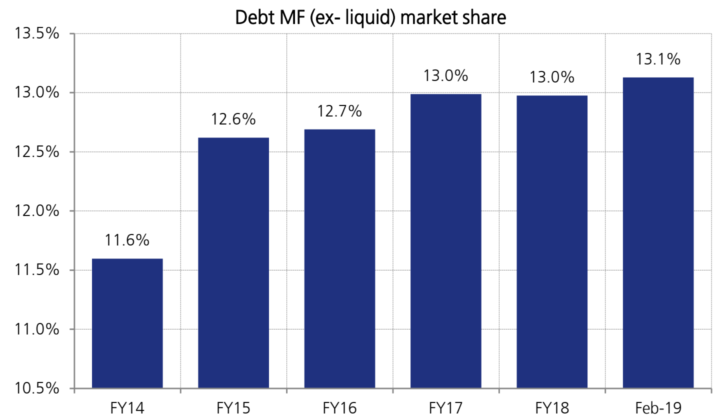
HDFCAMC's market share in debt and liquid segments has shown a significant improvement since Aug-18 - when a default by a stressed infrastructure conglomerate triggered a liquidity crisis in the debt capital market. HDFCAMC's market share in debt and liquid MF segments has risen by 68bps and 616bps, respectively since Aug-18. Market share gains in the debt segment have come at the expense of other large players like RNAM, UTI AMC and DSP AMC. The gains in the liquid segment have largely come from smaller players (outside the top 10), as the liquid MF industry segment witnessed consolidation. Market share of the top 10 players in the liquid MF segment was at 79% as of Feb-19, from 72% in Aug-18, with the gains largely accruing to HDFCAMC.

Exhibit 11. HDFCAMC : Now also the market leader in debt MF AUM (ex- liquid)



Source: AMFI, JM Financial

Exhibit 12. Debt MF market share has shown consistent improvement

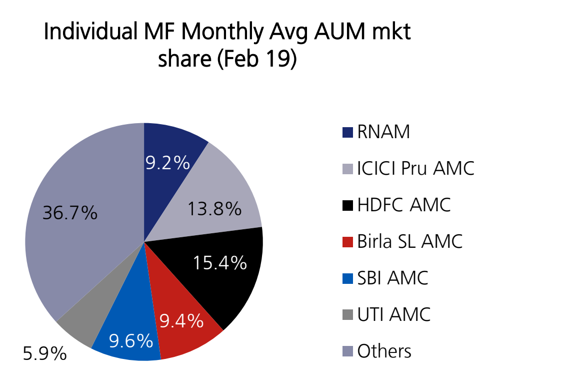


Source: Company, AMFI, JM Financial

Market leader in the retail investor segment

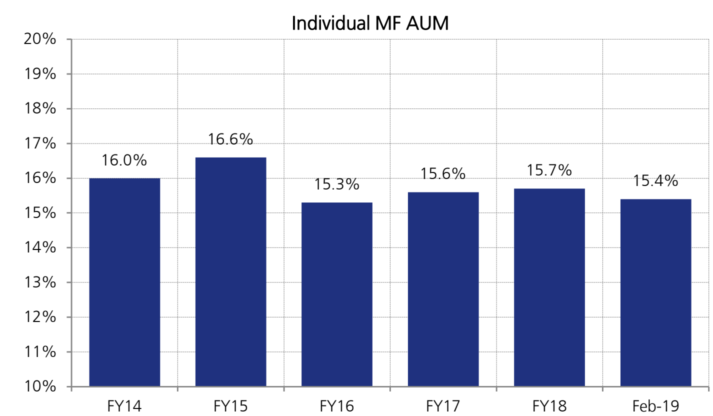
HDFCAMC is the largest player in the individual investor segment, with 15.4% market share in MF AUM sourced from individuals. AUM sourced from individuals tends to be 'stickier' as discussed in the industry segment (Exhibit 56). Although there was a sharp decline in the individual segment market share in in FY16, the market share since then has largely remained stable for HDFCAMC.

Exhibit 13. HDFCAMC : Largest player in the individual investor segment



Source: AMFI, JM Financial

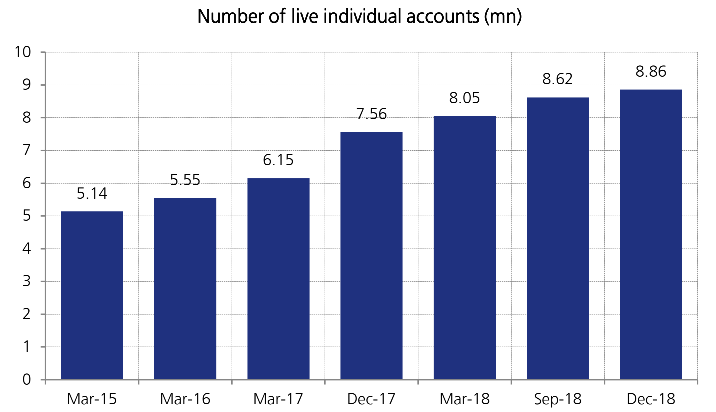
Exhibit 14. HDFCAMC : Trends in Individual MF AUM market share



Source: Company, AMFI, JM Financial

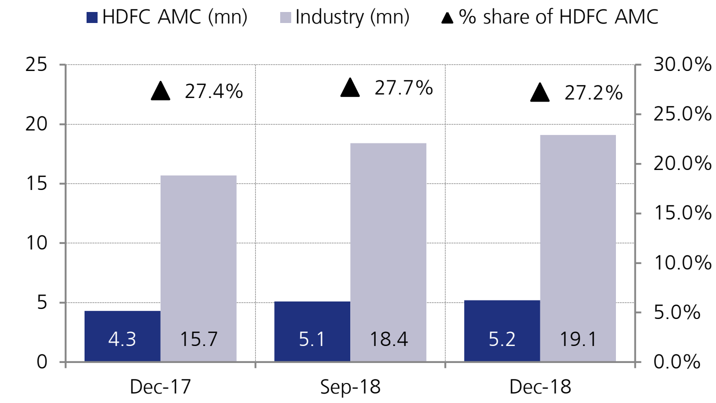
The number of live individual accounts for the AMC has grown at a CAGR of 15.6% since Mar-15, to 8.86mn as of Dec-18. Moreover, HDFCAMC accounts for 27.2% of the total number of unique investors in the Industry.

Exhibit 15. HDFCAMC : Number of live individual accounts



Source: Company, JM Financial

Exhibit 16. HDFCAMC : Number of unique individual investors



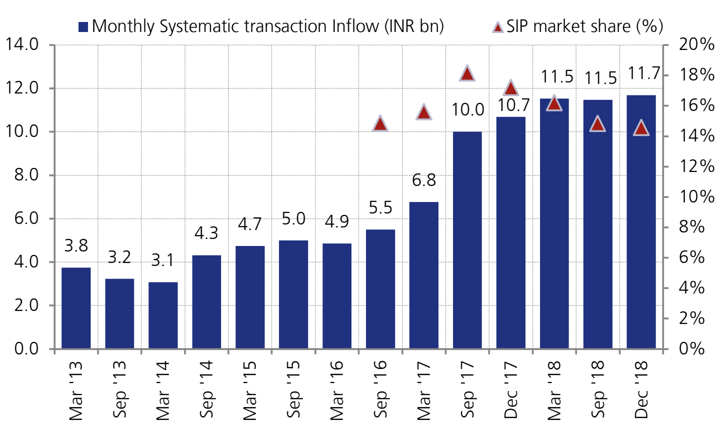
Source: Company, JM Financial

Strong SIP book setting up base for medium-term growth

A key metric to assess the 'stickiness' of the AUM is the inflow from systematic transactions (SIPs and STPs), in our view. HDFCAMC receives flows from systematic transactions of INR 11.7bn per month (as of Dec-18). Moreover, 77% of the SIP book has a tenure of over 5 years, as shown in Exhibit 18 below. SIP flows, which come from retail investors and HNIs, tend to be largely directed towards equity MFs. The current monthly flow rate from SIPs and STPs, if sustained, can add 9% to HDFCAMC's equity MF AUM on an annualised basis, by itself.

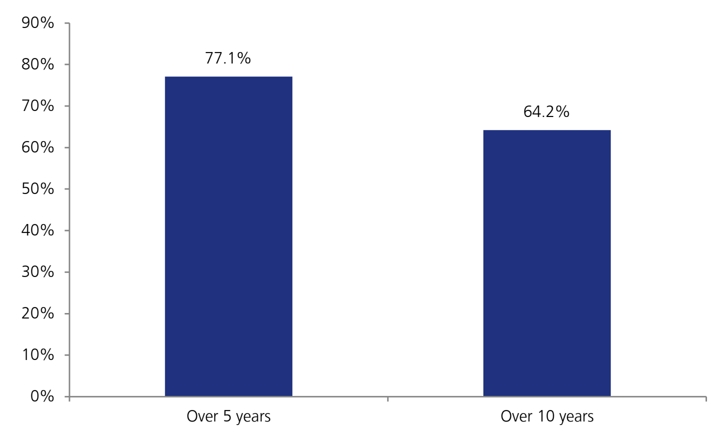
As discussed later in the industry section, SIP flows for the AMC industry, have sustained despite the recent weakness in equity MF net inflows in FY19. For HDFCAMC, flows from systematic transactions have shown a consistent improvement since Sep-14 , as shown in the Exhibit 17 below.

Exhibit 17. HDFCAMC : Total monthly flows from systematic transactions



Source: Company,AMFI, JM Financial

Exhibit 18. HDFCAMC : Long tenure SIP book – based on tenure of live SIPs

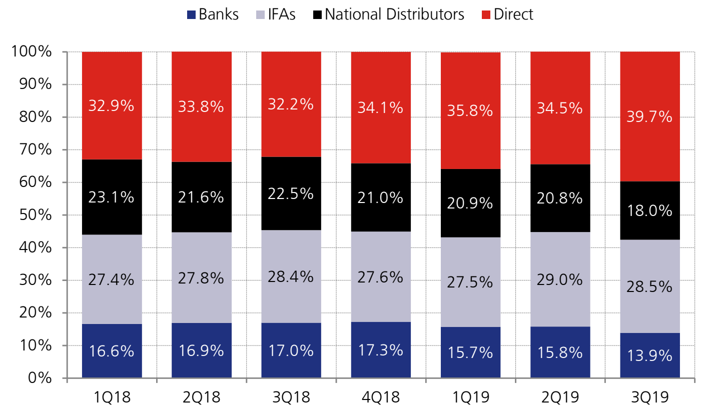


Source: Company, JM Financial

Distribution footprint that provides market access across India

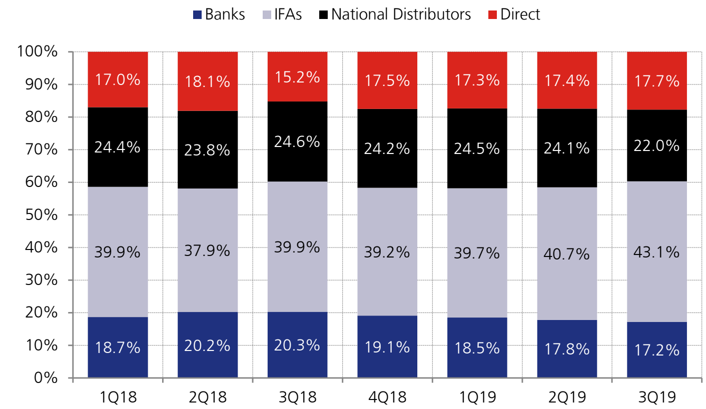
HDFCAMC's network spans across over 200 cities with 210 branches, which are supported by a strong and diversified network of over 75,000 empanelled distribution partners across India, consisting of banks, national distributors and independent financial advisors ("IFAs"). As of Dec-18, IFAs, national distributors and banks generated 28.5%, 18.0% and 13.9% of HDFCAMC's total AUM, respectively, while the remaining 39.7% was invested in direct plans. In terms of equity-oriented AUM, IFAs, national distributors and banks generated 43.1%, 22.0% and 17.2% of the equity-oriented AUM, respectively, while the remaining 17.7% was invested in direct plans.

Exhibit 19. HDFCAMC – Distribution mix : Overall AUM



Source: Company, JM Financial

Exhibit 20. HDFCAMC – Distribution mix : Equity MF AUM

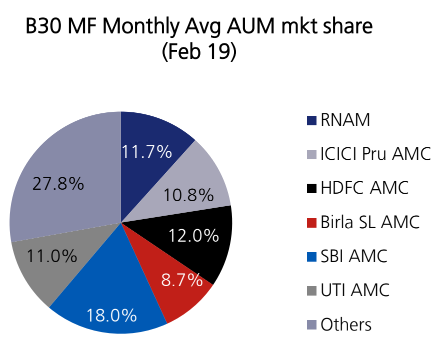


Source: Company, JM Financial

...with sizable presence in B-30 locations.

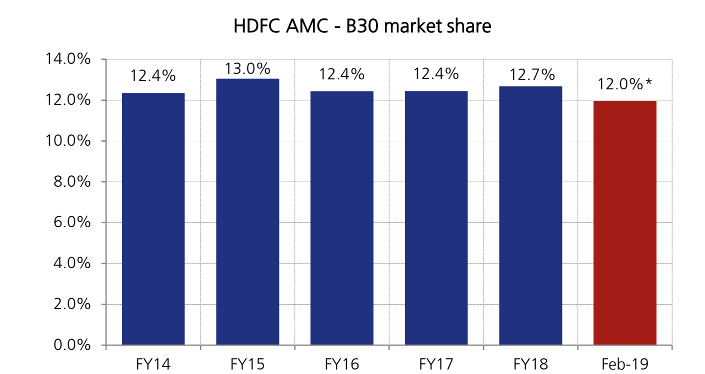
As of Dec-18, 134 of HDFCAMC's 210 branches were located in 'B-30 cities' (beyond top 30 cities). Its share of monthly average AUM from T-30 (top 30) and B-30 cities as of Feb-19 was 87% and 13%, respectively. HDFC is well positioned to capture the underpenetrated B-30 market opportunity – it is the second largest player in the B-30 segment.

Exhibit 21. HDFCAMC : Second largest player in the B30 segment (Below 30 cities)



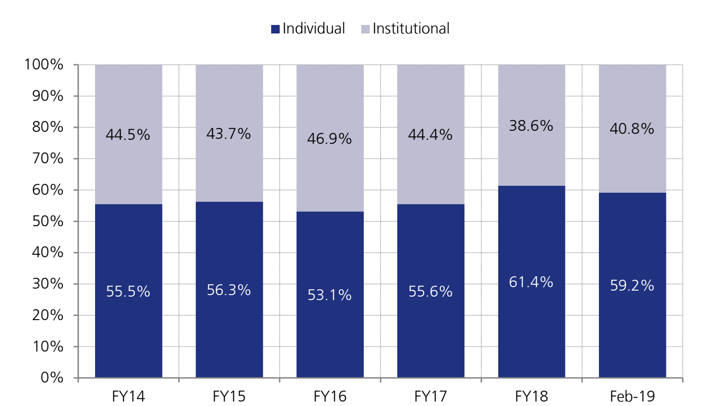
Source: AMFI, JM Financial

Exhibit 22. HDFCAMC : Trends in B15 AUM (B30 post FY18) market share



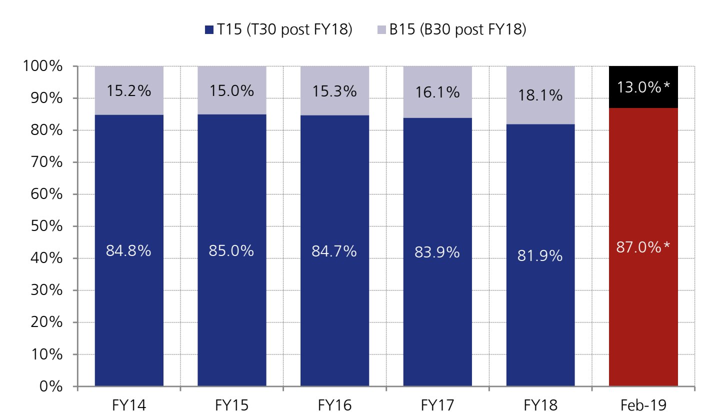
Source: Company, JM Financial *SEBI mandated that from FY19 onwards, the additional expense ratio that was chargeable for meeting the criteria of MF inflows from B15 cities will only be applicable to B30 (beyond top 30) cities. Hence, from FY19 onwards, AMCs report B30 monthly avg. AUM, instead of B15.

Exhibit 23. HDFCAMC : Split between Institutional and Individual AUM



Source: Company,AMFI. JM Financial

Exhibit 24. HDFCAMC : Split between B15 (B30 post FY18) and T15 (T30 post FY18) AUM



Source: Company, JM Financial *SEBI mandated that from FY19 onwards, the additional expense ratio that was chargeable for meeting the criteria of MF inflows from B15 cities will only be applicable to B30 (beyond top 30) cities. Hence, from FY19 onwards, AMCs report B30 monthly avg. AUM, instead of B15.

The most profitable large AMC

HDFCAMC has ranked highest in terms of profitability (measured in terms of PAT/ Avg AUM) among the top 6 AMCs for each of the last 6 years (FY13-18). HDFCAMC delivered PAT / AUM of 28bps in FY18 – which was equaled only by UTI AMC. UTI AMC has however maintained profitability at the expense of a steep fall in market share - its market share has fallen from 10.6% in FY14 to 4.7% in Feb-19.

The top 6 AMCs shown below, account for 61% of the industry's equity MF AUM and 65% of overall MF AUM (Feb-19).

Exhibit 25. FY18 Dupont Analysis : Top 6 AMCs

As a % of Closing AUM	HDFCAMC	ICICI Pru AMC	RNAM	Birla AMC	SBI AMC	UTI AMC
Core Revenues / Avg. AUM	0.67%	0.69%	0.74%	0.58%	0.69%	0.66%
Other Revenues / Avg. AUM	0.04%	0.03%	0.11%	0.02%	0.02%	0.14%
Total Revenues / Avg. AUM	0.72%	0.72%	0.84%	0.60%	0.71%	0.80%
Employee cost / Avg. AUM	0.07%	0.08%	0.11%	0.10%	0.09%	0.21%
Brokerage & comms / Avg. AUM	0.14%	0.21%	0.17%	0.17%	0.23%	0.00%
Operating cost / Avg. AUM	0.31%	0.36%	0.51%	0.37%	0.43%	0.39%
PBT / Avg. AUM	0.41%	0.36%	0.34%	0.23%	0.28%	0.41%
PAT / Avg. AUM	0.28%	0.24%	0.24%	0.16%	0.18%	0.28%
As a % of Balance sheet assets						
Core Revenues / Avg. Assets	89%	168%	69%	93%	109%	40%
Other Revenues / Avg. Assets	5%	7%	10%	3%	3%	8%
Total Revenues / Avg. Assets	94%	175%	79%	97%	112%	48%
Employee cost / Avg. Assets	9%	20%	10%	17%	14%	13%
Brokerage & comms / Avg. Assets	19%	50%	16%	27%	36%	0%
Operating cost / Avg. Assets	41%	88%	36%	60%	68%	24%
PBT / Avg. Assets	54%	88%	43%	37%	44%	25%
RoA (%)	36%	58%	23%	26%	29%	29%
Assets/Equity (x)	1.1	1.4	1.1	1.3	1.3	1.2
RoE (%)	40.3%	80.4%	25.3%	33.2%	37.0%	35.9%

Source: Company, JM Financial

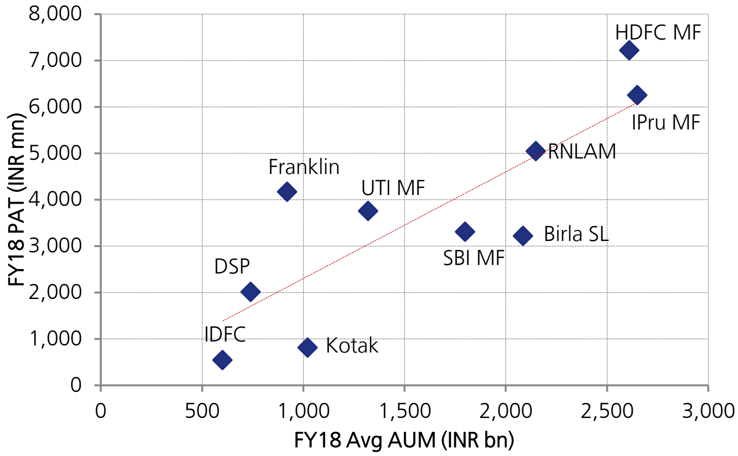
HDFCAMC also has the second highest RoE among the top 6 AMCs shown above. It has consistently delivered RoE > 40% in the FY13-18 period. HDFCAMC's superior profitability is clearly evident from the Exhibit below, which shows the FY18 profit and AUM of the top 10 AMCs.

HDFCAMC's best-in-class profitability can be attributed to:

a) **A high mix of equity MF assets in overall AUM:** HDFCAMC has maintained a higher share of equity MF assets in its mix since FY13. As of Feb-19, equity MF assets contributed 46% to HDFCAMC's overall AUM vs 41% for the industry.

b) **Operating leverage:** Operating costs (employee and other admin expenses) as a percentage of the AUM is among the lowest for HDFCAMC, as it utilizes the benefits of scale.

Exhibit 26. HDFCAMC : Largest and most profitable AMC in India



Source: Company, AMFI, JM Financial

Impact of TER cut and banning of upfront commissions

Impact of TER Cut: The TER cut notified by SEBI will come into effect from Apr-19. The new TER structure proposed by SEBI will introduce AUM slabs with progressive reduction in the maximum TER allowable (Exhibit 68 in industry section). The gross impact of this on HDFCAMC's blended equity MF TER is c.24bps as shown in the Exhibit 27 below.

Management expects to pass on the bulk of the TER cut on equity MFs (i.e. c.21bps) to distributors, limiting the net impact on the AMC's top-line to c.3bps. We remain watchful of how the TER cut is shared between the AMC and distributors. TER cuts that were brought into effect in the past year were completely passed on to distributors **a)** the 15bps cut in additional expense ratio (Jun-18) was completely passed on and **b)** the additional expense ratio that was chargeable for inflows from B-15 cities was changed to B-30 in Apr-18 - the impact of which was passed on to distributors. It remains to be seen whether AMCs (especially the large ones with higher bargaining power, like HDFCAMC), are able to pass on the bulk of the TER cut to the distributors as well.

Exhibit 27. Impact of TER cut – 24 bps on blended equity MF TER

HDFCAMC (INR mn)	Monthly avg AUM (Feb-19)	Current Regime Base TER (Regular Plan)	New regime Base TER
Equity Schemes			
HDFC Balanced Advantage Fund	3,74,573	1.76%	1.41%
HDFC Hybrid Equity Fund	2,14,204	1.76%	1.51%
HDFC Equity Fund	2,03,277	1.76%	1.52%
HDFC Mid Cap Opportunities Fund	2,01,644	1.76%	1.52%
HDFC Top 100 Fund	1,51,059	1.77%	1.56%
HDFC Equity Savings Fund	60,848	1.80%	1.68%
HDFC TaxSaver	67,277	1.79%	1.67%
HDFC Small Cap Fund	61,294	1.80%	1.68%
HDFC Capital Builder Value Fund	41,225	1.82%	1.75%
HDFC Children's Gift Fund	25,040	1.87%	1.84%
Monthly avg AUM (of above schemes)	14,00,440	1.77%	1.53%
			TER cut impact :
Equity monthly avg AUM (overall)	15,41,068		0.24%
% of equity AUM covered above	90.9%		

Source: Company, JM Financial

Impact of banning of upfront commissions: SEBI has banned the payment of upfront commissions to distributors, with effect from Oct-18. SEBI has also notified that all commissions' related expenses are to be expensed through the MF scheme P&Ls alone and not through any other route (AMC / Trustee P&Ls – a common industry practice).

AMCs generally paid out upfront commissions through the P&L of the AMC, while trail commissions were paid out through the respective schemes. The banning of upfront and the adoption of a full-trail model, will result in a decline in top-line yields of AMCs, however they will also be accompanied by a commensurate decrease in opex.

In fact, as shown in Exhibit 28 below, the adoption of a full-trail model makes the profitability of new flows at par with the rest of the AUM. Previously, new flows had negligible or even negative profitability for the AMC, as shown below.

Exhibit 28. Impact of switching to full-trail model : New flows now as profitable as rest of book

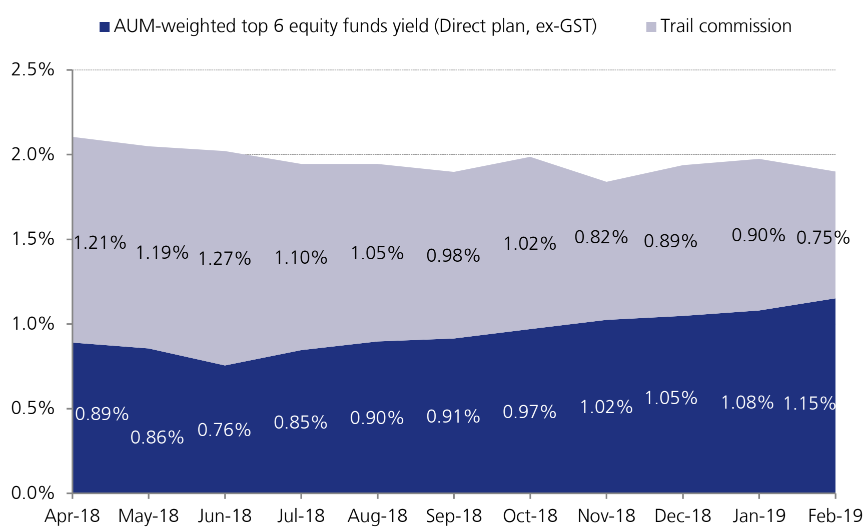
Impact of switching to full-trail model	Old regime (upfront + trail)			New regime (no upfront, full trail)		
Impact on new flows	Yr 1	Yr 2	Yr 3	Yr 1	Yr 2	Yr 3
AUM (INR)	100	100	100	100	100	100
TER (at 2% , have assumed ceteris paribus)	2.00	2.00	2.00	2.00	2.00	2.00
Trail commission (paid through scheme P&L)	1.00	1.00	1.00	1.33	1.33	1.33
Net revenue (flow through to topline)	**1.00**	**1.00**	**1.00**	**0.67**	**0.67**	**0.67**
Upfront commission (paid through AMC P&L, amortised over 1 year in old regime)	1.00	-	-	0.00	0.00	0.00
Net revenue - net of all commissions (what flows through to PBT)	**0.00**	**1.00**	**1.00**	**0.67**	**0.67**	**0.67**

Source: Company, JM Financial

Direct plan yields are going up for HDFCAMC: In the new full-trail commission model, all commission related expenses are to be paid out through the scheme P&Ls. As a result, regular and direct plans will be at par in terms of profitability (direct plan TER is equal to the difference between regular plan TER and trail commissions). Previously, this was not the case – direct plans were more profitable to AMCs as regular plans also involved pay out of an upfront commission for new flows. As a result, under the new regime, all schemes will earn net revenues as calculated from their respective direct plan TERs.

Positively, for HDFCAMC, blended direct plan TERs on their equity MF AUM has been on a secular uptrend since Jun-18 (Exhibit 29 below). Blended direct plan TER for the top 6 schemes for HDFCAMC has gone up from 0.76% in Jun-18 to 1.15% as of Feb-19. We believe the price hike taken by the AMC prior to the TER cut in FY20, may enable it to neutralise the impact on profitability from the TER cut, to a great extent.

Exhibit 29. HDFCAMC: Top 6 equity funds – Direct plan yields have gone up, while trail commissions have declined



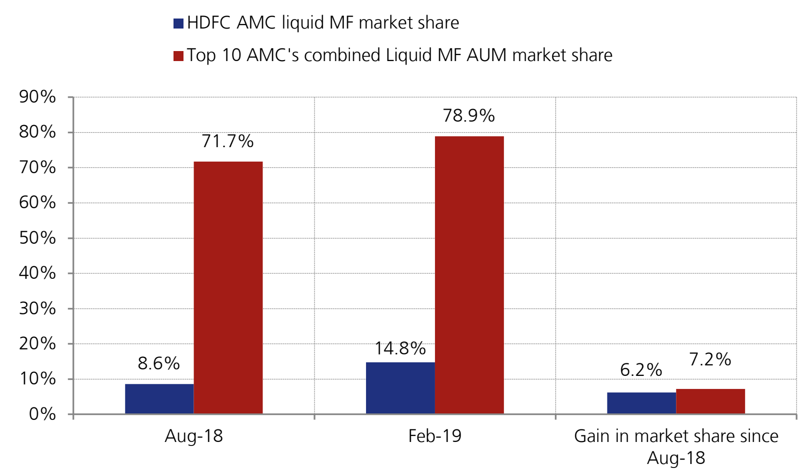
Source: Company, JM Financial *Based on analysis of top 6 equity MF schemes. The top 6 schemes account for c.80% of equity MF AUM.

Can HDFCAMC exercise pricing power in liquid MF schemes?

Since the liquidity event triggered by the default of a stressed infrastructure conglomerate in Aug-18, the Liquid MF industry has witnessed consolidation in market share. The top 10 AMCs have gained market share at the expense of smaller players. However, even among the larger players, the benefits of gain in market share have largely accrued to HDFCAMC.

As can be seen in the exhibit below, the top 10 AMCs have witnessed a 7.2% increase in market share since Aug-18. HDFCAMC alone has witnessed a 6.2% uptick in market share since Aug-18. Hence, HDFCAMC has been the single largest gainer from the consolidation in the liquid MF industry. We believe HDFCAMC's superior brand and reputation for prudent fund management in debt and liquid MFs may have a large part to play in this.

Exhibit 30. Market share gain for the top 10 AMCs has largely accrued to HDFCAMC



Source: AMFI, Company, JM Financial

An analysis of large liquid MF schemes shows that it is a highly price competitive segment. These schemes invest in short tenure sovereign and corporate debt securities, with an average duration of <91 days. This business largely caters to institutional customers, with institutions contributing 86% of overall AUM for the industry. All AMCs have priced their liquid MF schemes at 10-15bps (direct plan). Some of the smaller AMCs have priced their liquid plans in the lower end of this range, presumably to attract higher flows, as can be seen in the Exhibit below.

Exhibit 31. HDFCAMC : Has witnessed a strong uptick in its liquid MF scheme

Liquid fund schemes	Direct plan TER (Feb-19)	Monthly avg AUM (Feb-19) (INR bn)	Change in AUM since Aug-18
HDFC Liquid Fund	0.15%	780	73.8%
ICICI Prudential Liquid Fund	0.15%	629	18.4%
Reliance Liquid Fund	0.15%	430	-7.2%
Aditya Birla Liquid Fund	0.15%	585	-1.6%
UTI Liquid Cash Fund	0.12%	425	3.1%
SBI Liquid Fund	0.15%	450	-10.8%
Axis Liquid Fund	0.11%	265	-7.3%
Kotak Liquid Fund	0.15%	363	46.2%
DSP Liquidity Fund	0.10%	159	-38.7%
Franklin India Liquid Fund	0.12%	121	124.0%

Source: Company, JM Financial

We believe the liquidity event in Aug-18 may have resulted in corporates looking beyond just the price point while investing in liquid MF schemes. Prudent fund management and a superior brand may have taken precedence ever since. HDFC Liquid Fund has witnessed a disproportionate 74% increase in AUM since Aug-18, much higher than other large MFs. We believe this could indicate the beginnings of pricing power for HDFCAMC within the liquid MF segment, although whether this does fructify remains to be seen.

HDFCAMC's liquid MF Avg AUM has now reached c.60% of the size of its equity MF AUM (Feb-19 data). A 3bps increase in liquid MF direct plan TER could absorb 60% of the impact of the TER cut – If we assume the net impact on the blended equity MF yield to be c.3bps (as indicated by management). However, whether this does play out in FY20E, remains to be seen.

Experienced management team

The management team, led by Mr. Milind Barve, is well-supported by highly experienced professionals, who have in-depth industry knowledge. Each of the key business heads has been associated with the HDFC group for over 14 years.

Exhibit 32. HDFCAMC : Highly experienced management team

Person	Designation	Profile
Milind Barve	Managing Director	He is a B.Com from University of Pune and also a fellow of the Institute of Chartered Accountants of India. He was associated with HDFC in the capacity of General Manager – Treasury where he headed the treasury operations at HDFC for 14 years. He was also the head of marketing for retail deposit products and responsible for investment advisory relationships for Commonwealth Equity Fund Mutual Fund and Invesco India Growth Fund.
Prashant Jain	Chief Investment Officer	He holds a B.Tech from IIT, Kanpur and MBA from IIM, Bangalore. He is also a designated CFA from the CFA Institute, USA. He has been associated with the company for over 14 years and was appointed as CIO with effect from July, 2004. Prior to joining the company, he was associated with Zurich Asset Management Company (India) Private Limited and SBI Mutual Funds Management Private Limited.
Kiran M. Kaushik	Head, Sales and Distribution	He is a B.Com from University of Bangalore. He has been associated with the Company for over 17 years since March, 2001 and was appointed as the Head of Sales and Distribution with effect from January, 2007. Prior to joining the company, he was associated with Union Bank of India.
V. Suresh Babu	Head, Operations	He is a B.Com from University of Bangalore and is also a member of the Institute of Cost and Works Accountants of India. He has been associated with the company for over 17 years and was appointed as the Head of Operations with effect from May, 2000. Prior to joining the company, he was associated with Sundaram Newton Asset Management Company Limited and Canbank Investment Management Services Limited.
Piyush Surana	Chief Financial Officer	He holds a B.Com and LLB from the University of Jodhpur. He is also a member of the Institute of Chartered Accountants of India and certified financial planner from Financial Planning Standards Board India. He has been associated with the Company for over 6 years and was appointed as the CFO of the Company with effect from Feb- 2013. Prior to joining the Company, he was associated with Daiwa Asset Management (India) Pvt. Ltd., Shinsei Corporate Advisory Services Pvt. Ltd. and Alliance Capital Asset Management (India) Pvt. Ltd.

Source: Company, JM Financial

Scheme performance has been commendable

The exhibit below compares the performance of the top 6 equity-oriented MF schemes of HDFCAMC, in relation to their respective benchmarks. The top 6 schemes account for c.80% of HDFCAMC's equity MF AUM. As can be seen in the exhibit below, most schemes have outperformed their respective benchmarks by a significant margin.

Exhibit 33. HDFCAMC – Scheme performance of large equity oriented mutual fund schemes (as of Mar-31,2019)

	1 yr return	3yr CAGR	5yr CAGR	AUM (INR bn)*
Benchmark - NIFTY 500 TRI	9.7%	15.9%	14.4%	
HDFC Equity Fund	15.2%	17.8%	15.5%	225
HDFC TaxSaver Fund	5.7%	14.3%	13.8%	74
Benchmark - NIFTY Midcap 100 TRI	-1.9%	13.9%	17.5%	
HDFC Midcap Opportunities Fund	1.5%	15.8%	20.1%	228
Benchmark - NIFTY 100 TRI	14.0%	16.2%	13.8%	
HDFC Top100 Fund	17.2%	17.6%	14.7%	166
Benchmark - NIFTY 50 Hybrid Composite Debt 65 : 35 Index	13.1%	13.7%	11.8%	
HDFC Balanced Advantage Fund	11.6%	15.3%	15.3%	409
HDFC Hybrid Equity Fund	7.2%	13.7%	16.1%	228

Source: Company, JM Financial *Daily average as of Mar-31, 2019

Debt MF schemes inherently have lesser ability to outperform their respective benchmarks. The performance of the 4 largest debt MF schemes is tabulated below. The returns from these schemes are very close to their respective benchmarks.

Exhibit 34. HDFCAMC – Scheme performance of large debt mutual fund schemes (as of Mar-31,2019)

	1 yr return	3yr CAGR	5yr CAGR	AUM (INR bn)*
Benchmark - CRISIL Composite Bond Index	6.7%	7.7%	9.1%	
HDFC Corporate Bond Fund	7.8%	8.1%	8.7%	118
Benchmark - CRISIL Short-Term Bond Index	7.6%	7.7%	8.3%	
HDFC Credit Risk Debt Fund	5.9%	7.5%	8.7%	162
HDFC Short Term Debt Fund	7.6%	7.7%	8.4%	75
Benchmark - CRISIL Liquid Fund Index	7.6%	7.2%	7.7%	
HDFC Floating Rate Debt Fund	7.5%	7.7%	8.2%	109

Source: Company, JM Financial *Daily average as of Mar-31, 2019

How do the numbers stack up by segment?

In the exhibit below, we have summarised the break-up of HDFCAMC's overall PBT by each segment. The analysis is based on a study of a) the TER of the top 6 equity MF schemes (contributing c.80% of overall equity MF AUM), b) the top 5 debt MF schemes (contributing c.60% of debt AUM) and c) the top liquid scheme (contributing c. 90% of liquid MF AUM). These have been used to estimate the overall top-line yields of each segment, which have been tabulated below.

Based on our analysis, equity MFs will contribute c.78% of overall MF revenues for the AMC in FY19E, while debt and liquid MFs contribute c.17% and 5% respectively to MF revenues. MF revenues will contribute c.97% of overall operating revenues for the AMC in FY19E (c.99% in FY18), with the rest contributed by the PMS vertical, which had an AUM of c. INR 92bn as of Dec-18.

Exhibit 35. HDFCAMC – PBT break-up by segment

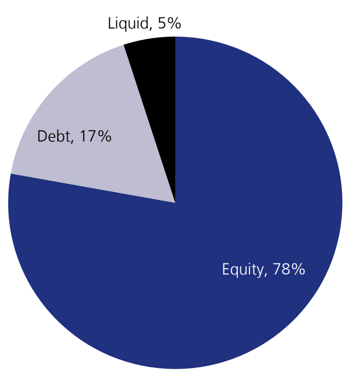
HDFCAMC	Equity	Debt	Liquid	Overall
AUM mix - average for FY19	49%	30%	21%	3,216
Net yields (average for FY19E)	**0.94%**	**0.33%**	**0.14%**	**0.58%**
Revenue per segment (INR bn) (FY19E)	14.6	3.2	0.9	18.8
MF Revenue mix (FY19E)	**78%**	**17%**	**5%**	**100%**
Product wise PBT (FY19E)	Equity	Debt	Liquid	Overall
AUM mix - average for the year (FY19E)	49%	30%	21%	3,216
Net yields (average for FY19E)	**0.94%**	**0.33%**	**0.14%**	**0.58%**
Employee expense	0.10%	0.04%	0.03%	0.07%
Admin & other expense	0.10%	0.04%	0.03%	0.07%
Marketing & commissions	0.18%*	0.02%	0.00%	0.09%
Operating PBT of MF business	**0.56%**	**0.23%**	**0.08%**	**0.36%**
PMS revenue				0.02%
Other income				0.05%
Actual PBT				**0.43%**

Source: JM Financial Estimates *Upfront commissions were applicable in FY19E up until Oct-22, 2018. From then on, AMCs have just amortised upfront commissions already paid out. We believe marketing & commissions costs would have been c.30bps of equity MF AUM on an annualised basis.

In the exhibit above, we have also tried to analyse the breakdown of overall PBT for the AMC, by segment. In our analysis, we have assumed higher employee and admin costs as % AUM for the equity segment, as this is a retail business. Similarly, marketing and commissions costs (largely upfront commissions) have also been almost entirely attributed to the equity segment. Equity MF AUM is largely sourced through distributors (83% as of Feb-19), as compared to 50% for debt MFs and 30% for liquid MFs, for the AMC.

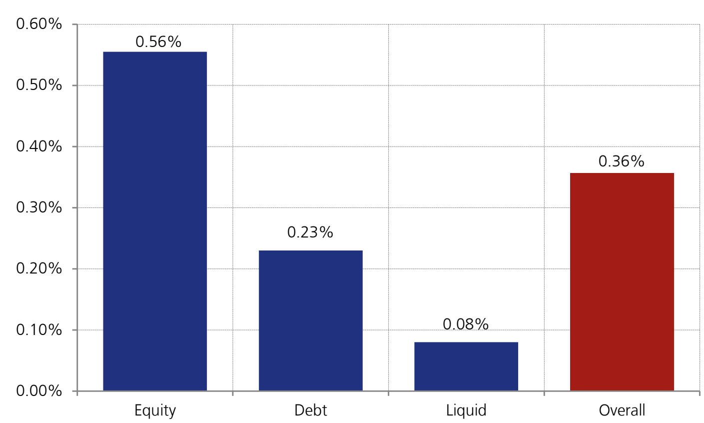
Upfront commissions paid through the AMC P&L, were banned by SEBI as of Oct-22, 2018. Hence upfront commissions were only paid out by the AMC for a little more than half the year – however, the AMC continues to amortise upfront commissions already paid out through the P&L. The AMC has a stated policy of amortising upfront commissions paid out over 12 months since receiving the respective fresh inflow. Hence, marketing and commissions costs for FY19E is c.18bps of equity MF AUM (by our estimates), although we believe that this would have been c.30bps of equity MF AUM for the full year FY19E, if the policy of paying upfront commissions had been allowed to persist. This has been explained in the footnote of Exhibit 35 above.

Exhibit 36. HDFCAMC : Revenue split of MF revenue



Source: JM Financial Estimates

Exhibit 37. HDFCAMC : PBT yields by MF segment

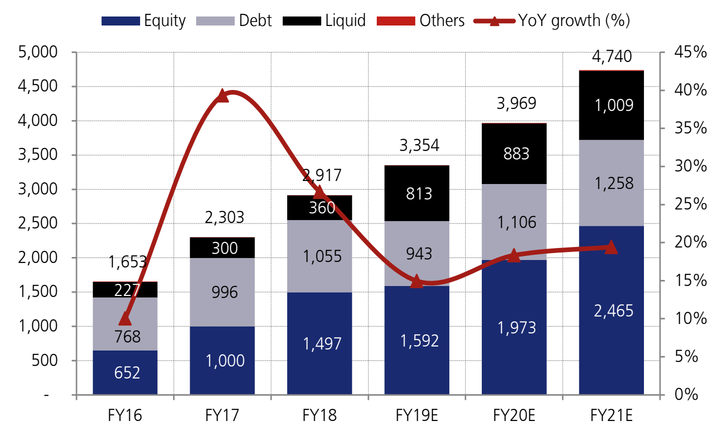


Source: JM Financial Estimates

Financials – FY20E may be a year of reset; profit growth should return to long-term trend from FY21E

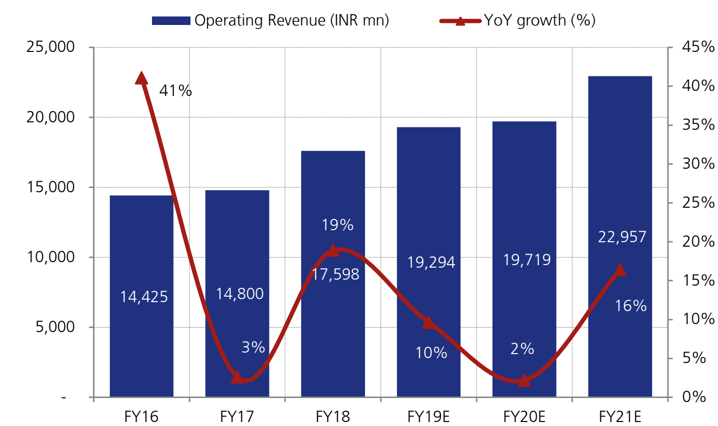
We expect HDFCAMC's AUM to clock a CAGR of c.18% over FY18-21E. We expect the equity MF assets to contribute 52% to overall AUM by FY21E (46% as of Feb-19). However, we expect the top-line to go through a period of reset in FY20E, as the AMC aligns itself to the new TER regime over the year. We build top-line growth of 2% / 16% in FY20E / FY21E vs AUM growth of 18% / 19%.

Exhibit 38. HDFCAMC : MF AUM growth



Source: AMFI, JM Financial

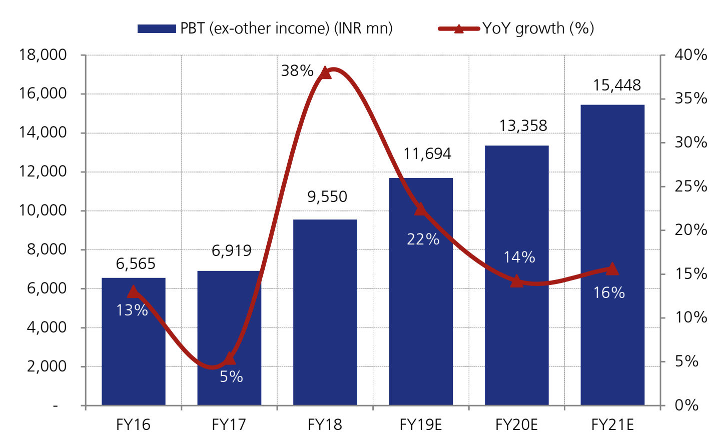
Exhibit 39. HDFCAMC : Operating Revenues



Source: Company, AMFI, JM Financial

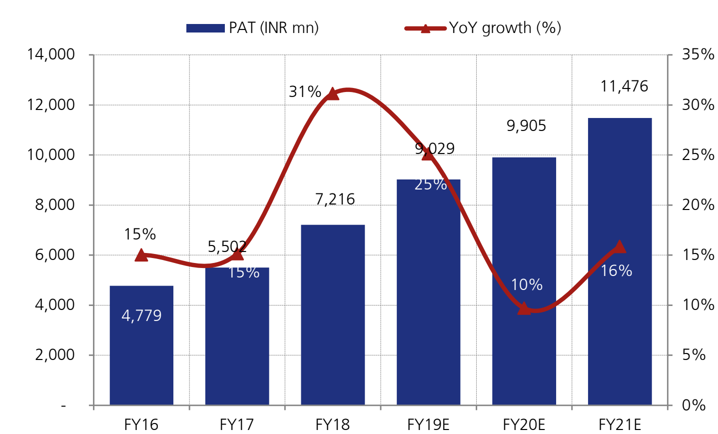
However, the flat top-line growth in FY20E may be compensated, to a large extent, by the savings from the removal of upfront commissions (brokerage and incentives expensed through the AMC's P&L). As a result, we expect operating profit (i.e. PBT ex-other income) to grow 14% / 16% over FY20E / FY21E. While the sharing of the TER cut between the distributors and the AMC remains a key monitorable going forward, we have assumed operating profit growth to be a tad slower than the growth in the overall AUM, in our estimates.

Exhibit 40. HDFCAMC : Operating profit trend



Source: AMFI, JM Financial

Exhibit 41. HDFCAMC : PAT



Source: Company, AMFI, JM Financial

Other income has grown 48% YoY in 9MFY19 to INR 1.2bn. This is largely on account of an increase in the surplus funds managed by the AMC, as well as due to an improvement in the yields on these funds managed. There are also some write-backs of provisions related to distributor loyalty programs, which SEBI has now disallowed.

We expect a moderation in other income from the high base of FY19E, and as a result we expect PAT growth to moderate to 10% in FY20E. We expect PAT growth to recover to 16% in FY21E, as the base normalises (both for the TER regime, as well as for other income).

The Dupont analysis for HDFCAMC summarising the break-up of its unit profitability is tabulate below:

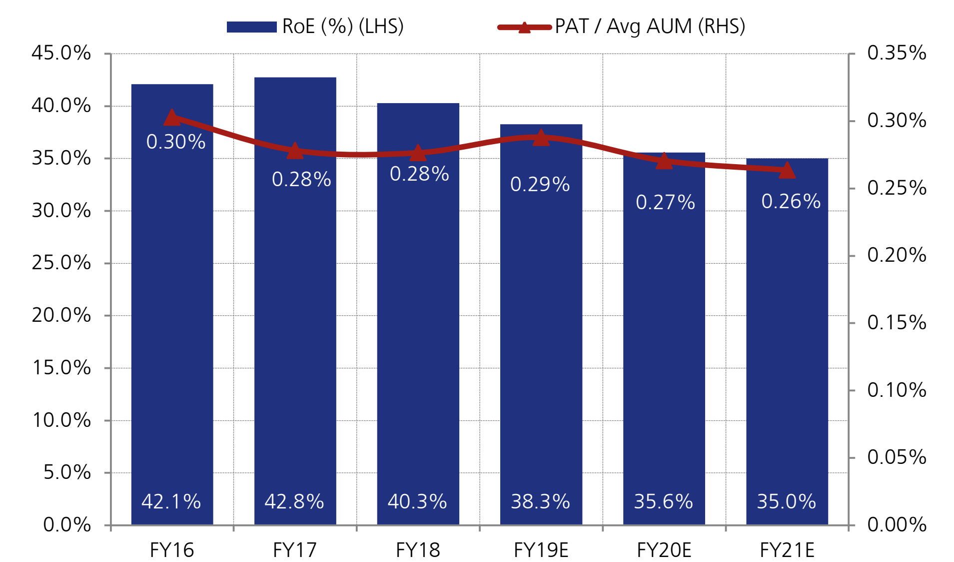
Exhibit 42. HDFCAMC: Dupont Analysis – The fall in MF fee yields (due to TER cut) is expected to be largely compensated by the decrease in commission payouts from the AMC.

As a % of Closing AUM	FY16	FY17	FY18	FY19E	FY20E	FY21E
MF Fees / Avg AUM	0.77%	0.72%	0.67%	0.60%	0.52%	0.51%
PMS Fees / Avg AUM	0.15%	0.03%	0.01%	0.02%	0.02%	0.02%
Core Revenues / Avg. AUM	**0.91%**	**0.75%**	**0.67%**	**0.61%**	**0.54%**	**0.53%**
Employee cost / Avg. AUM	0.09%	0.08%	0.07%	0.07%	0.07%	0.07%
Brokerage & comms / Avg. AUM	0.29%	0.21%	0.14%	0.08%	0.02%	0.02%
Operating cost / Avg. AUM	0.50%	0.40%	0.31%	0.24%	0.17%	0.17%
Operating PBT / Avg. AUM	**0.42%**	**0.35%**	**0.37%**	**0.37%**	**0.36%**	**0.36%**
Other Income / Avg. AUM	0.03%	0.05%	0.04%	0.06%	0.04%	0.03%
PAT / Avg. AUM	**0.30%**	**0.28%**	**0.28%**	**0.29%**	**0.27%**	**0.26%**
RoE (%)	**42.1%**	**42.8%**	**40.3%**	**38.3%**	**35.6%**	**35.0%**

Source: Company, JM Financial

We expect profitability for the AMC to moderate to 26 bps (as % of MF AUM) by FY21E, as shown above. We expect the AMC to deliver c.35% RoE over FY20E / FY21E.

Exhibit 43. HDFCAMC : Return profile



Source: Company, JM Financial

Valuation and view

We value HDFCAMC using a two-stage Gordon Growth Model. Our assumptions are tabulated below. We value HDFCAMC at 34x FY21E EPS to arrive at our TP of INR 1850 / share.

Exhibit 44. HDFCAMC : Valuation

Initial no of years	10
Growth rate for the first 10 years (%)	20%
Payout ratio for the first 10 years (%)	65%
Perpetual growth rate (%)	5%
Perpetual payout ratio (%)	80%
K1	9.6
K2	24.4
FY21E EPS (INR)	54.5
Target multiple on FY21E EPS	33.9
Fair value (rounded off)	1,850

Source: Company, JM Financial

Exhibit 45. HDFCAMC : JMFe vs Bloomberg consensus estimates

	FY19E			FY20E			FY21E		
	JMFe	BB consensus	Difference	JMFe	BB consensus	Difference	JMFe	BB consensus	Difference
PAT (INR mn)	9,029	8,813	2.5%	9,905	9,438	4.9%	11,476	11,306	1.5%
EPS (INR)	42.9	41.9	2.4%	47.0	45.0	4.6%	54.5	53.1	2.7%

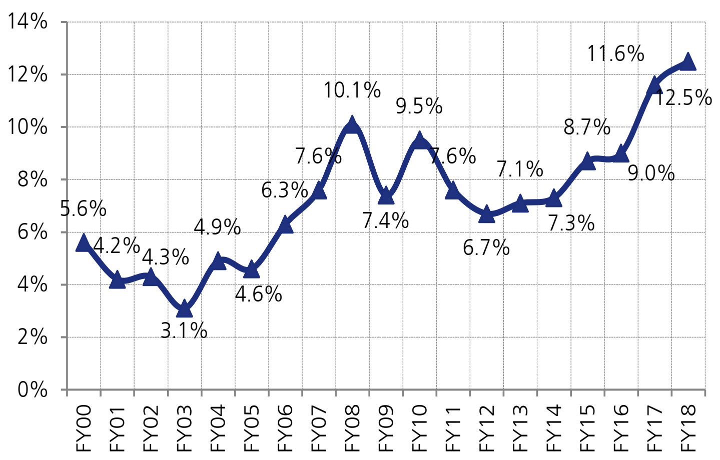
Source: JM Financial, Bloomberg

Appendix: Indian Asset Management

Structural growth opportunity well established

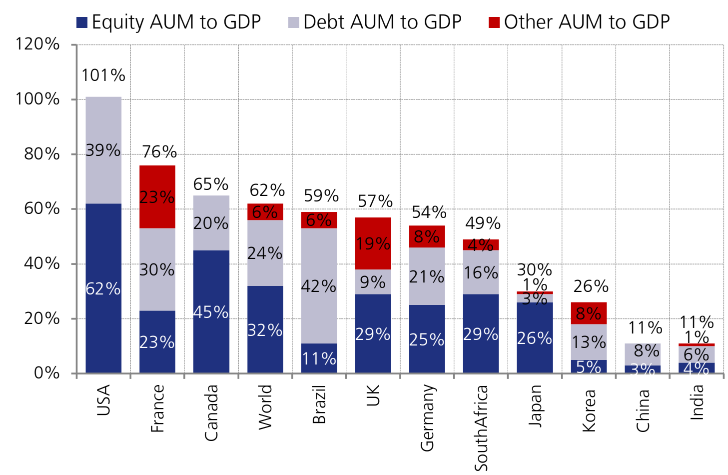
Mutual fund AUM as a percentage of GDP rose from 5.6% in FY00 to 12.5% in FY18. However, the industry still has tremendous potential for growth, considering India is a large untapped market with the favourable demographics of a young population. India's mutual fund penetration (AUM to GDP) is significantly lower than the world average of 62% and also lower than many developed economies like US (101%), France (76%), Canada (65%) and UK (57%) and even emerging economies like Brazil (59%) and South Africa (49%).

Exhibit 46. India : Mutual fund AUM as a percentage of GDP



Source: AMFI, IMF, RBI, CRISIL Research

Exhibit 47. Penetration of mutual funds lower than global average

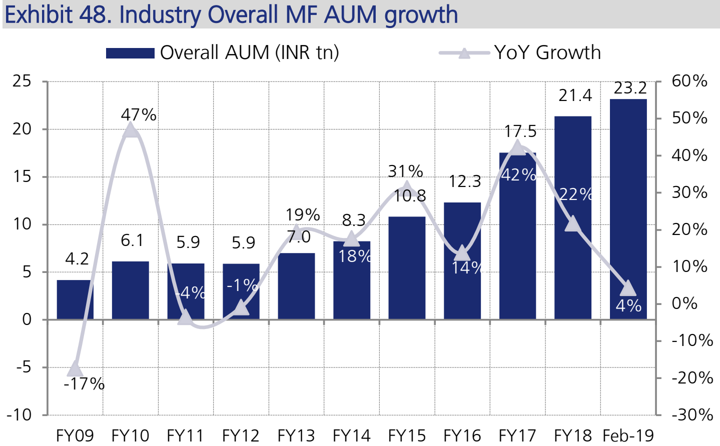


Source: IMF, IIFA, CRISIL Research, Data as of Dec-16, India: AUM data as of Mar-17 and GDP for FY17

Robust long-period-average growth in MF AUM: Despite being dependent on cyclical factors (performance of capital markets for equity and the interest rate cycle for debt); overall MF AUM growth across cycles has shown a robust performance with long-term overall MF AUM CAGR (FY09 - Feb-19) of 19% (Exhibit 49).

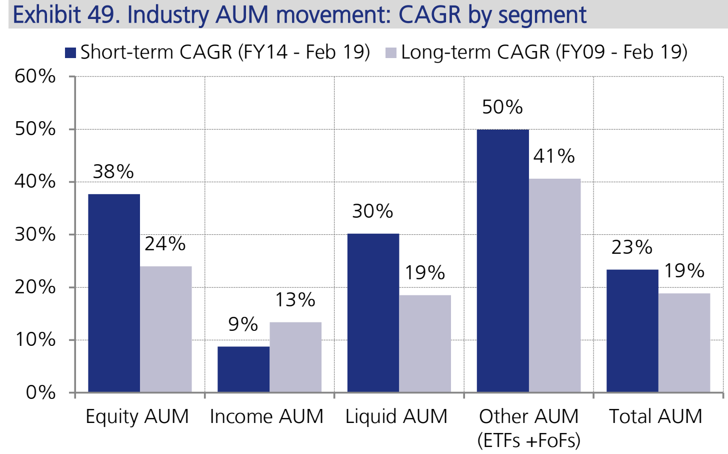
With inflation being reined in, along with the outperformance of the capital markets and measures taken by the government to formalise the economy (Jan Dhan, Aadhaar, Demonetization, etc.), mutual fund flows had taken flight over FY14-18, albeit from a low base.

Exhibit 48. Industry Overall MF AUM growth



Source: AMFI, JM Financial

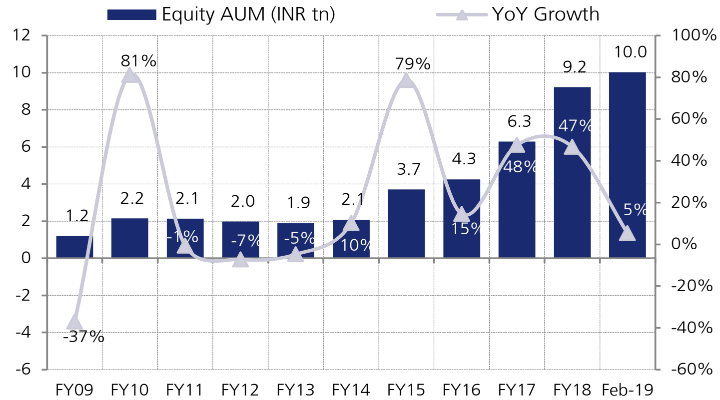
Exhibit 49. Industry AUM movement: CAGR by segment



Source: AMFI, JM Financial

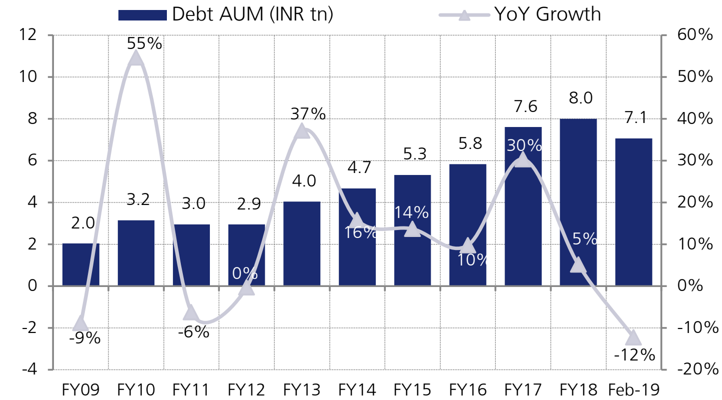
Growth softens in FYTD19: Since the beginning of FY19, increased volatility in the capital markets has resulted in a softening of MF AUM growth. While the equity MF AUM growth for the 12 months ended Feb-19 moderated to +5% YoY, debt funds were affected more, witnessing strong outflows leading to an AUM de-growth of 12% YoY for the same period. Accordingly, the debt MF AUM proportion in overall MF AUM witnessed a decline as seen in Exhibit 52.

Exhibit 50. Industry Equity MF AUM growth weakens



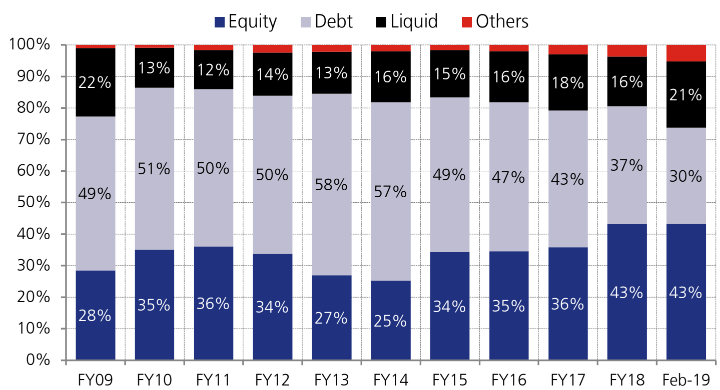
Source: AMFI, JM Financial, Equity MF AUM includes Equity + ELSS + Arbitrage + Balanced Schemes

Exhibit 51. Industry Debt MF AUM witnesses a decline



Source: AMFI, JM Financial, Debt MF AUM includes Income + Gilt + Infra Debt Schemes, excludes Liquid

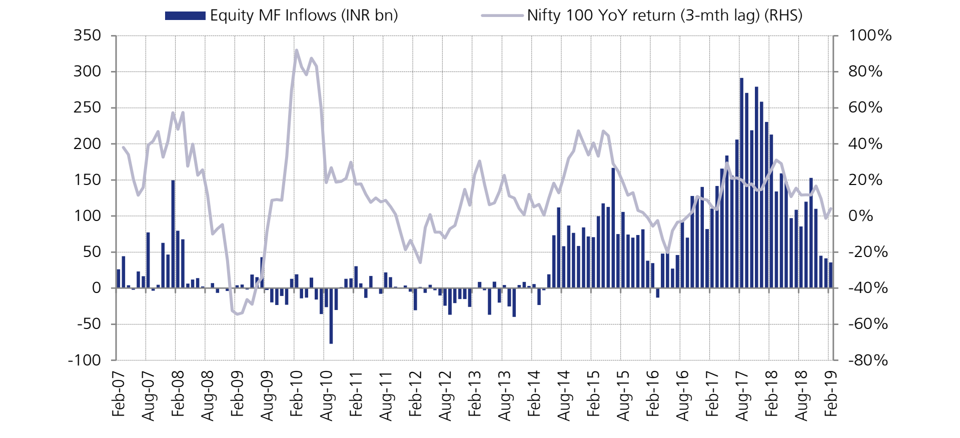
Exhibit 52. Proportion of equity and liquid AUM on a rise



Source: AMFI, JM Financial

Equity MF flows track market returns: Equity MF net inflows generally tend to track capital market returns though with a lag of a few months. In the periods wherein equity capital markets are booming, investors develop an inclination towards savings in equities which can be seen from increased equity MF flows in the months following higher capital market returns (Exhibit 53). Similarly, when the equity capital markets underperform, investors pull out from equities leading to a decrease in equity MF inflows.

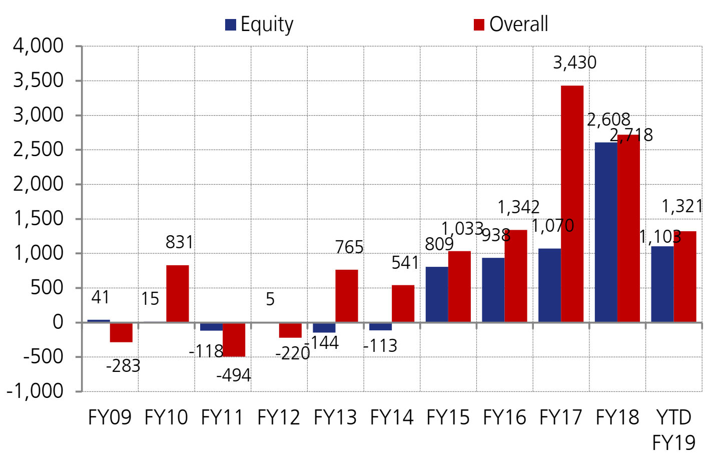
Exhibit 53. Equity MF flows track market returns



Source: AMFI, Bloomberg, JM Financial

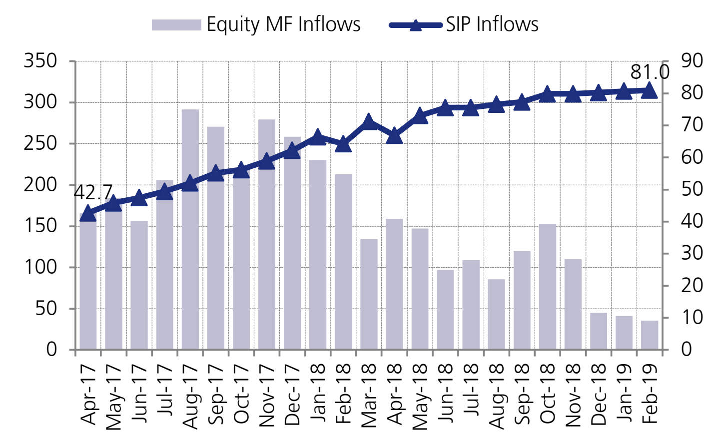
Equity inflows have weakened but sticky portions (SIPs) continue to be strong: Equity MF flows have slowed down in YTDFY19 with average monthly net inflows declining to INR 100bn as compared to the all-time high average monthly net inflows of INR 217bn over FY2018. However, SIP inflows have remained robust, netting monthly average inflows of INR 77bn over YTDFY19. Monthly SIP inflows have shown a steady uptrend (Exhibit 55) over the last few years increasing to INR 81bn for Feb-19 (+26% YoY).

Exhibit 54. Equity MF Flows have weakened recently



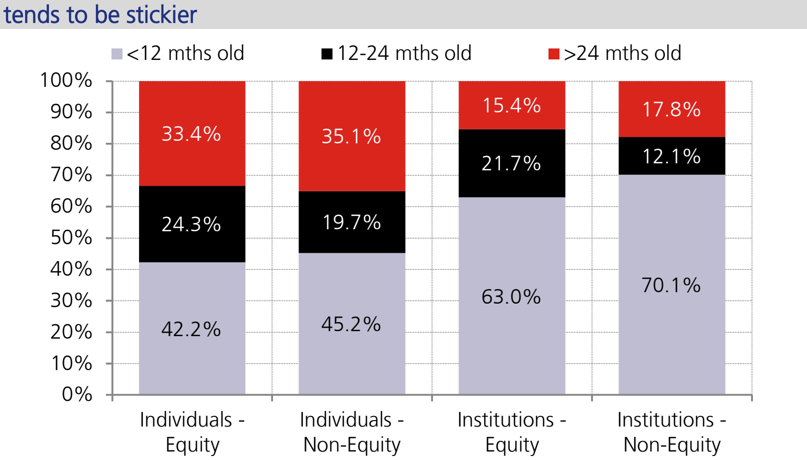
Source: AMFI, JM Financial, Equity MF flows includes Equity + ELSS + Arbitrage + Balanced Schemes

Exhibit 55. Supported by sticky SIP flows



Source: AMFI, JM Financial

Exhibit 56. Age-wise distribution of MF AUM : AUM sourced from individuals tends to be stickier



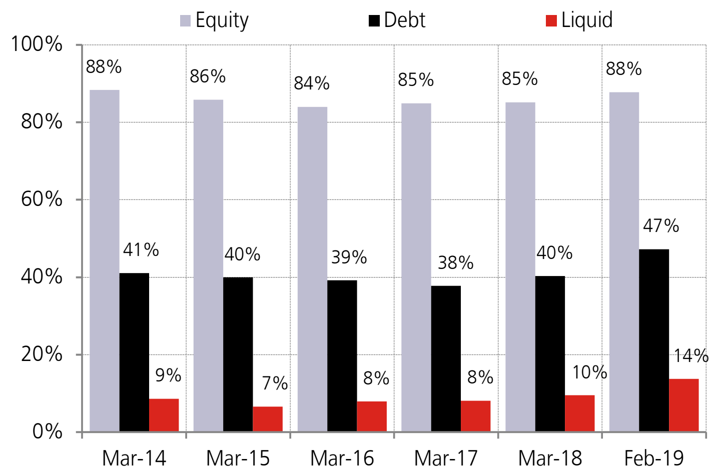
Source: Company, JM Financial

AUM sourced from individuals is stickier: Exhibit 56 above shows that AUM sourced from individuals tends to be sticker than that sourced from institutions. As shown above, 33% of AUM sourced from individuals in the equity segment and 35% of AUM sourced from them in the non-equity segment is more than 24 months old. On the other hand, the corresponding number for institutions is 15% and 18% respectively.

Debt offers an untapped opportunity

While retail penetration in equity mutual funds is high at 88% as on Feb-19, retail participation in debt and liquid funds is quite low at 47% and 14% respectively.

Exhibit 57. Retail penetration in debt and liquid funds remains low



Source: AMFI, JM Financial, Retail includes Retail investors plus HNIs

Debt funds provide higher yield potential: Debt funds generally tend to provide higher yields when compared to FD returns provided by banks.

Exhibit 58. Returns of top credit risk funds

Top Credit Risk funds	AUM (INR bn)	1-year return	3-year return
Franklin India Credit Risk Fund	73	9.30%	9.95%
ICICI Prudential Credit Risk Fund	111	7.91%	8.94%
SBI Credit Risk Fund	55	7.75%	8.67%
Reliance Credit Risk Fund	96	7.32%	8.61%
Aditya Birla Sun Life Credit Risk Fund	73	6.72%	9.14%
HDFC Credit Risk Debt Fund	162	6.59%	8.44%
Mean		**7.60%**	**8.96%**
Median		**7.54%**	**8.81%**

Source: AMFI, Company, JM Financial, Data as on 29/03/19

Exhibit 59. Returns of top liquid funds

Top Liquid funds	AUM (INR bn)	1-year return	3-year return
Franklin India Liquid Fund	90	7.69%	7.32%
Reliance Liquid Fund	303	7.61%	7.31%
Aditya Birla Sun Life Liquid Fund	517	7.60%	7.31%
ICICI Prudential Liquid Fund	458	7.52%	7.24%
SBI Liquid Fund	481	7.51%	7.19%
HDFC Liquid	634	7.45%	7.17%
Mean		**7.56%**	**7.26%**
Median		**7.56%**	**7.28%**

Source: AMFI, Company, JM Financial, Data as on 29/03/19

Exhibit 60. FD Rates of top banks

Bank FD rates	1-year	3-year
IndusInd Bank	8.00%	7.50%
Yes Bank	7.50%	7.50%
ICICI Bank	7.40%	7.40%
Kotak Bank	7.35%	7.10%
HDFC Bank	7.30%	7.40%
Axis Bank	7.30%	7.25%
SBI	6.80%	6.80%
Mean	**7.38%**	**7.28%**
Median	**7.35%**	**7.40%**

Source: Company, JM Financial, Data as on 29/03/19

Investments in debt funds benefit from lower taxation on long-term capital gains: Unlike bank FDs which are taxed at marginal income tax slab rates, long-term capital gains (for a holding period >3 years) arising out of investments in debt funds enjoy the benefit of lower taxation at 20% (with indexation benefit).

Given the higher return potential and lower tax incidence in case of debt funds, there is a significant opportunity for improvement in penetration of debt funds.

Product distribution – still agency driven; though direct route gaining traction

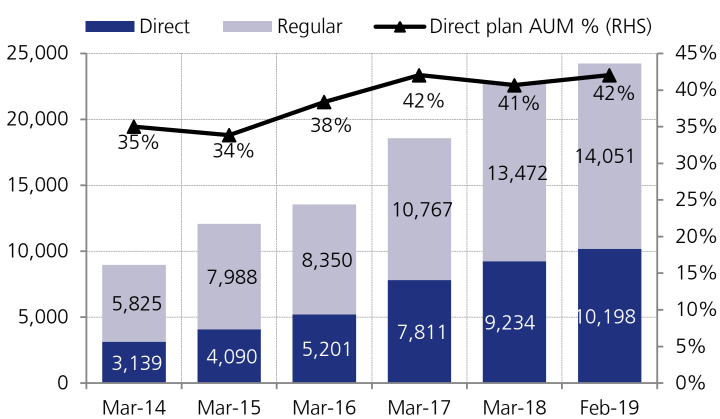
There are four main distribution channels for mutual funds in the country: a) banks, b) national distributors, c) independent financial advisors (IFAs) and d) other empanelled distributors. Given the large network and retail clientele, banks form an important channel for distribution of mutual funds.

Direct route gaining steam, boosted by the ease of access in the online channel: In 2012, SEBI mandated AMCs to provide a separate plan for direct investments (direct plans), i.e., investments not routed through a distributor. These plans were mandated to have a lower expense ratio excluding distribution expenses, commission, etc. and have since been contributing consistently to AUMs. AMCs started offering direct plans since January 2013, and investors have been quick to accept this route.

Assets under the direct plan have grown at an annualised 27.1% between March 2014 and February 2019 to INR 10.2tn. The share of direct plans' AUM has risen to 42% from 35% of the industry's AUM. The integration of user interface through online channels has provided an additional push for growth in direct-plan assets.

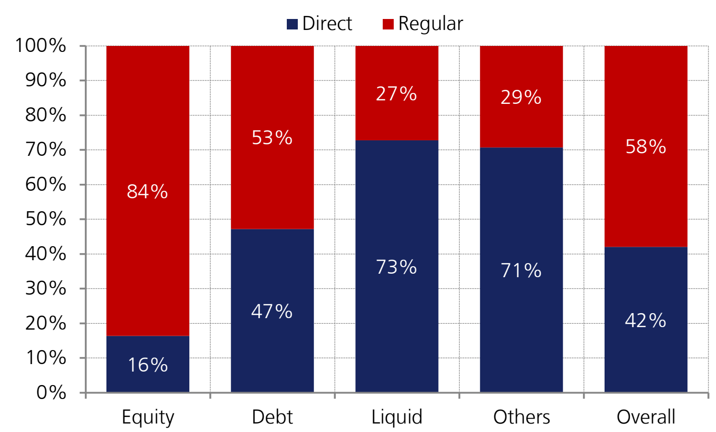
Direct route penetration for equity still low: While the direct route penetration for equity is low at 16%, the penetration in case of debt and liquid segments is quite high at 47% and 73% respectively.

Exhibit 61. Growth of AUM through direct plans



Source: AMFI, JM Financial

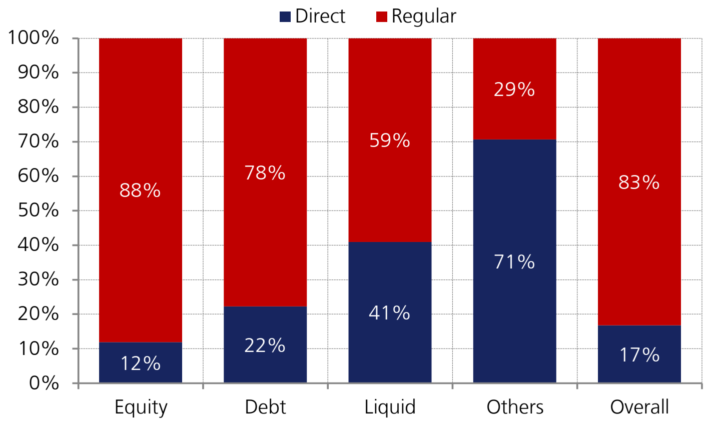
Exhibit 62. Direct penetration remains low in equity…



Source: AMFI, JM Financial, Data as on Feb-19

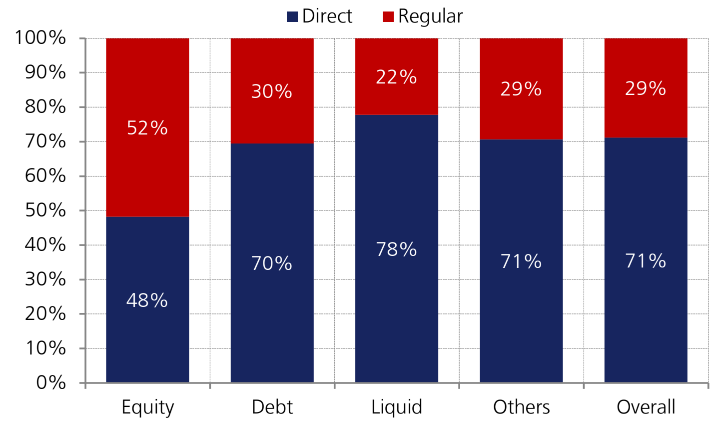
As shown in Exhibit 63, the direct route is yet to become popular with individual investors. However, institutional investors have invested a large part of their AUM (Exhibit 64) through the direct route.

Exhibit 63. Direct penetration remains low for individual investors



Source: AMFI, JM Financial, Data as on Feb-19

Exhibit 64. …While institutional investors prefer direct plans



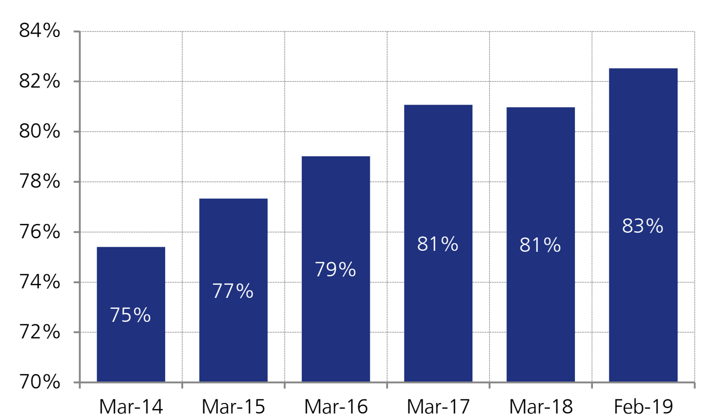
Source: AMFI, JM Financial, Data as on Feb-19

Industry to remain dominated by top AMCs

Industry profits rose 4x from INR 9.7bn in FY13 to INR 40.3bn in FY18. Moreover, profit growth outpaced AUM growth over the same period; while quarterly average assets under management (QAAUM) posted a CAGR of 24.4% over FY13-18, PAT CAGR was 32.8%. Scale is crucial for profitable survival in the industry, the top 10 funds contributed to 90% of industry PAT, while contributing 80% to Industry QAAUM in FY18. Overall, industry profitability saw a healthy uptick, with PAT yields expanding from 14bps in FY13 to 19bps in FY18. This is ostensibly a result of the healthy equity AUM growth over the same period. Of the total universe of 42 mutual fund houses, 10 reported losses in FY18, compared with 20 in FY13.

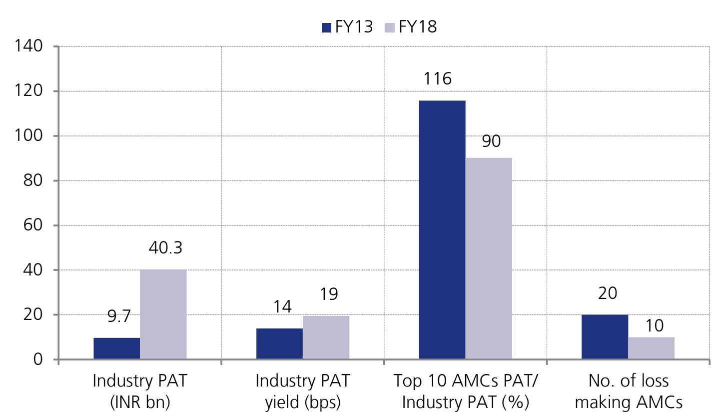
While the industry has seen an increase in the number of mutual fund players, it has also witnessed consolidation, especially the mid-sized and smaller AMCs. With profits skewed in favour of larger fund houses, the MF industry has been an active turf for M&A activity over the last 5 years. Large parts of the deals have been by way of acquisitions where players have bought out the entire stake in other AMCs. There has been a spate of exits by foreign players from the industry, stakes of who were bought out by domestic players looking to increase their market share through inorganic routes. With many small loss-making players still present, consolidation is expected to continue in the MF space.

Exhibit 65. AUM market share of top 10 AMCs have increased



Source: AMFI, JM Financial

Exhibit 66. Industry PAT remains concentrated at the top



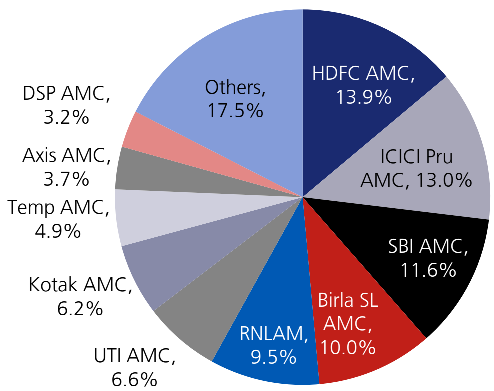
Source: Company, AMFI, JM Financial

Domestic AMCs have an edge over foreign players

Indian AMC industry continues to be dominated by domestic players (all of the top 10, with the only exception of Franklin Templeton). Domestic AMCs seem to have an edge over foreign players, especially because they have more recognisable brands, in our view. Most of these brands are banking-related (as can be seen below), but some domestic business houses have also been able to capitalise on brands built in other fields of business (Reliance, Birla).

Bank-led AMCs have 2 inherent advantages in our view: a) Brands which investors trust with their money, which these AMCs can capitalise on and b) well-established branch infrastructure – which gives them an advantage in terms of distribution.

Exhibit 67. AUM market share of Top AMCs



Source: AMFI, JM Financial, Data as on Feb-19

Recent regulatory changes

Following are the key regulatory changes made by SEBI in recent times:

a) **Additional expense ratio in B15 cities changed to B30 cities:** In Feb-18, SEBI notified that the additional expense ratio (up to 30bps) that was chargeable by MF schemes for meeting certain criteria of MF inflows from B15 (beyond top 15) cities will be applicable to B30 (beyond top 30) cities with effect from April 01, 2018.

b) **Disallowing charge of 20bps additional expense for schemes without exit load:** In 2012, SEBI had mandated that exit loads collected should go back to the respective schemes as some AMCs were using it for sales and marketing activities. However, SEBI allowed fund houses to charge an additional 20bps to every scheme in lieu of this loss to AMC revenues. Some schemes were charging this 20bps despite not charging an exit load to the schemes. In Feb-18, SEBI disallowed such mutual fund schemes (including close-ended schemes), wherein exit load is not levied, from charging the additional expense of 20bps to such a scheme.

c) **Reduction in additional expense from 20bps to 5bps:** The additional expense ratio of 20bps which SEBI had allowed AMCs to charge in lieu of exit load was reduced by 15bps to 5bps in June-18.

d) **Additional expense ratio for B30 cities to be based on retail inflows:** The additional expense ratio (up to 30bps) that was chargeable by MF schemes for raising inflows from B30 (beyond top 30) cities shall now be based on inflows from retail investors (inflows of amount upto INR 2,00,000 per transaction).

e) **Phase out of upfront commission:** SEBI came out with a circular banning payment of upfront commissions to distributors (except in case of SIPs of maximum INR 3,000 per month by first-time mutual fund investors). Moreover, SEBI also notified that all commissions and expenses are to be expensed from the MF scheme P&L alone and not through any other route (AMC / Trustee P&Ls – a common industry practice).

f) **Total expense ratio (TER) reduction:** In Sep-18, SEBI announced reduction in the maximum TER that can be charged to mutual fund schemes :

Exhibit 68. Reduction in TER for equity MF schemes – Larger schemes to face the brunt

Equity MF Scheme AUM slab (INR bn)	Maximum TER allowed (old)	Maximum TER allowed (new)	TER Impact (bps) on Slab
0-1	2.50%	2.25%	-25
1-4	2.25%	2.25%	-
4-5	2.00%	2.25%	25
5-7	2.00%	2.00%	-
7-7.5	1.75%	2.00%	25
7.5-20	1.75%	1.75%	-
20-50	1.75%	1.60%	-15
50-100	1.75%	1.50%	-25
100-150	1.75%	1.45%	-30
150-200	1.75%	1.40%	-35
200-250	1.75%	1.35%	-40
250-300	1.75%	1.30%	-45
300-350	1.75%	1.25%	-50
350-400	1.75%	1.20%	-55
400-450	1.75%	1.15%	-60
450-500	1.75%	1.10%	-65
500- onwards	1.75%	1.05%	-70

Source: Company, JM Financial # These figures exclude additional 5bps (in lieu of exit load) and additional 30bps (on meeting B30 criteria)

This is expected to have a negative impact on AMCs which operate large MF schemes (given higher TER cut for higher AUM slabs). The brunt of the impact of TER reduction is expected to be borne by equity MF schemes, which largely operate close to the current TER cap. Based on our interaction with industry players, we expect the impact on blended equity MF TER to be in the range of 20-25bps depending on size of MF schemes. Majority of this TER cut is expected to be transferred to distributors and the overall impact on PAT for AMCs is expected to be low. However, modality of TER cut-sharing and the impact of distributors' business model remain to be seen.

Regulatory overhaul may be done for the time being

We believe the above regulatory changes are positive towards increasing reach and reducing costs for retail MF investors and also to improve transparency. Further, taking into account the extent of regulatory changes made and the time required for the industry to smoothen the impact on its operations and profitability we believe that the regulator may be done with the overhaul for the time being.

Key Risks to our thesis:

- **Erosion in financial savings rate:** Indian households have increasingly been inclined towards financial savings in the recent past. Net financial savings as % of net household savings increased to 38% as of FY18, up from 31% in FY12. This has helped sustain flows into financial assets, despite a general decrease in the savings rate in the economy. Gross savings to GDP ratio has declined to 30.5% as of FY18, from 34.6% as of FY12. Erosion in the financial savings rate, triggered by outperformance of physical assets (gold / real estate) or underperformance of financial assets, or a general decrease in savings in the economy, pose a risk to our thesis.

- **Further regulatory action may be detrimental to profitability:** The past year has witnessed a significant regulatory overhaul, which has been discussed above. Taking into account the extent of regulatory changes made and the expected time required for the industry to realign to them, we believe that the regulator may be done with the overhaul for the time being. However, any further regulatory action may pose risks to our thesis.

- **Scheme performance:** Scheme performance for HDFCAMC has been commendable, as shown in Exhibits 33 and 34. However, any underperformance may have the impact of a reduction in AUM (mark-to-market impact) and may also result in outflows from schemes, denting profitability.

- **Protracted bear market in equities:** HDFCAMC's business is closely linked to the performance of debt and equity capital markets. Any prolonged underperformance of these capital markets may result in weakness in operational performance for the AMC.

Financial Tables

Income Statement (INR mn)	FY17	FY18	FY19E	FY20E	FY21E
MF Fees	14,285	17,365	18,657	18,855	21,988
PMS Fees	516	233	637	864	969
Investment Management fees	**14,800**	**17,598**	**19,294**	**19,719**	**22,957**
Total Other income	1,079	1,075	1,782	1,425	1,681
Total Revenue	**15,879**	**18,672**	**21,076**	**21,144**	**24,638**
Employee costs	1,576	1,749	2,113	2,421	2,891
Admin & Other expenses	1,473	1,712	2,265	2,769	3,388
Mktg & publicity expenses	4,713	4,472	3,096	1,039	1,091
Total Operating Expenses	**7,761**	**7,933**	**7,474**	**6,228**	**7,370**
Depreciation/Diminution in LT	120	114	126	132	139
Total Expenditure	**7,881**	**8,047**	**7,600**	**6,361**	**7,509**
PBT	**7,998**	**10,625**	**13,476**	**14,783**	**17,129**
Tax	(2,496)	(3,409)	(4,447)	(4,878)	(5,653)
Reported Profit (PAT)	**5,502**	**7,216**	**9,029**	**9,905**	**11,476**
Dividend	2,787	4,055	5,056	5,349	6,197
Retained earnings	**2,716**	**3,161**	**3,973**	**4,556**	**5,279**

Source: Company, JM Financial

Key Ratios					
As a % of Avg AUM	FY17	FY18	FY19E	FY20E	FY21E
Core Revenues / Avg. AUM	0.75%	0.67%	0.62%	0.54%	0.53%
Other Revenues / Avg. AUM	0.05%	0.04%	0.06%	0.04%	0.04%
Total Revenues / Avg. AUM	0.80%	0.72%	0.67%	0.58%	0.57%
Employee cost / Avg. AUM	0.08%	0.07%	0.07%	0.07%	0.07%
Brokerage / Avg. AUM	0.21%	0.14%	0.08%	0.02%	0.02%
Operating cost / Avg. AUM	0.40%	0.31%	0.24%	0.17%	0.17%
PBT / Avg. AUM	0.40%	0.41%	0.43%	0.40%	0.39%
PAT / Avg. AUM	0.28%	0.28%	0.29%	0.27%	0.26%
As a % of Balance sheet assets					
Core Revenues / Avg. Assets	97.9%	88.6%	74.6%	64.6%	63.8%
Other Revenues / Avg. Assets	7.1%	5.4%	6.9%	4.7%	4.7%
Total Revenues / Avg. Assets	105.1%	94.1%	81.5%	69.3%	68.5%
Employee cost / Avg. Assets	10.4%	8.8%	8.2%	7.9%	8.0%
Brokerage / Avg. Assets	27.7%	18.6%	9.7%	2.1%	1.8%
Operating cost / Avg. Assets	52.2%	40.5%	29.4%	20.8%	20.9%
PBT / Avg. Assets	52.9%	53.5%	52.1%	48.4%	47.6%
RoA (%)	36.4%	36.4%	35%	32%	32%
Avg Assets/Equity (x)	1.17	1.11	1.10	1.10	1.10
RoE (%)	42.8%	40.3%	38.3%	35.6%	35.0%

Source: Company, JM Financial

Balance Sheet (INR mn)	FY17	FY18	FY19E	FY20E	FY21E
Share capital	252	1,053	1,053	1,053	1,053
Reserves & Surplus	13,978	20,547	24,520	29,076	34,355
Net worth	**14,229**	**21,600**	**25,572**	**30,129**	**35,408**
Current Liabilities	1,758	2,098	2,412	2,895	3,474
Provisions	9	9	10	11	12
Total Liabilities	**15,996**	**23,706**	**27,995**	**33,034**	**38,893**
Net Fixed Assets	226	246	220	198	181
Non-Current investments	1,688	6,395	6,572	6,797	7,085
Total Non-current assets	**2,808**	**7,497**	**7,537**	**7,703**	**8,009**
Total Current investments	10,679	13,110	16,388	20,485	25,606
Total Current Assets	**13,188**	**16,209**	**20,458**	**25,332**	**30,885**
Total Assets	**15,996**	**23,706**	**27,995**	**33,034**	**38,893**

Source: Company, JM Financial

Growth ratios (YoY %)	FY17	FY18	FY19E	FY20E	FY21E
Inv mgmt fees	2.6%	18.9%	9.6%	2.2%	16.4%
Other income	108.3%	-0.4%	65.8%	-20.1%	18.0%
Revenue	**6.3%**	**17.6%**	**12.9%**	**0.3%**	**16.5%**
Employee cost	10.0%	11.0%	20.8%	14.6%	19.4%
Admin & other exp	7.3%	16.2%	32.3%	22.2%	22.4%
Marketing & publicity exp	-4.7%	-5.1%	-30.8%	-66.4%	5.0%
Total operating exp	0.1%	2.2%	-5.8%	-16.7%	18.3%
PBT	**12.9%**	**32.8%**	**26.8%**	**9.7%**	**15.9%**
Tax	8.3%	36.6%	30.5%	9.7%	15.9%
PAT	**15.1%**	**31.1%**	**25.1%**	**9.7%**	**15.9%**
Total Assets	**12.4%**	**48.2%**	**18.1%**	**18.0%**	**17.7%**
Equity AUM	54%	50%	6%	24%	25%
Debt AUM	12%	30%	6%	-11%	17%
Liquid AUM	33%	20%	126%	9%	14%
Other AUM	-8%	-6%	8%	17%	8%
Total AUM	**39%**	**27%**	**15%**	**18%**	**19%**

Source: Company, JM Financial

Mutual Fund AUM (INR bn)					
Closing AUM	FY17	FY18	FY19E	FY20E	FY21E
Equity	1,000	1,497	1,592	1,973	2,465
Debt	996	1,055	943	1,106	1,258
Liquid	300	360	813	883	1,009
Others	6	6	6	7	8
Total AUM	**2,303**	**2,917**	**3,354**	**3,969**	**4,740**

Source: Company, JM Financial

Valuation	FY17	FY18	FY19E	FY20E	FY21E
Shares in issue (mn)	201.3	210.6	210.6	210.6	210.6
EPS (INR)	27.3	34.3	42.9	47.0	54.5
EPS (YoY)(%)	15%	25%	25%	10%	16%
PER (x)	55.8	44.5	35.6	32.4	28.0
BV (INR)	70.7	102.6	121.5	143.1	168.2
BV (YoY)	23.6%	45.1%	18.4%	17.8%	17.5%
P/BV (x)	21.6	14.9	12.6	10.7	9.1
DPS (INR)	13.8	19.3	24.0	25.4	29.4
Div. yield (%)	0.8%	1.1%	1.3%	1.4%	1.6%

Source: Company, JM Financial

Mutual Fund AUM Mix (%)					
Based on Closing AUM	FY17	FY18	FY19E	FY20E	FY21E
Equity	43%	51%	47%	50%	52%
Debt	43%	36%	28%	28%	27%
Liquid	13%	12%	24%	22%	21%
Others	0%	0%	0%	0%	0%
Total AUM	**100%**	**100%**	**100%**	**100%**	**100%**

Source: Company, JM Financial

APPENDIX I

JM Financial Institutional Securities Limited

(formerly known as JM Financial Securities Limited)

Corporate Identity Number: U67100MH2017PLC296081

Member of BSE Ltd., National Stock Exchange of India Ltd. and Metropolitan Stock Exchange of India Ltd.

SEBI Registration Nos.: Stock Broker - INZ000163434, Research Analyst – INH000000610

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Definition of ratings	
Rating	Meaning
Buy	Total expected returns of more than 15%. Total expected return includes dividend yields.
Hold	Price expected to move in the range of 10% downside to 15% upside from the current market price.
Sell	Price expected to move downwards by more than 10%

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