

DIVERSIFIED FINANCIALS

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Impending TER regulation puts AMC's on edge

- SEBI's March meeting showcased its firm intent to regulate fees charged to MF investors, sending tremors through the AMC industry
- AMC stocks under coverage have corrected 13-24% post the regulator's initial decision to review fees in December
- Per our worst-case analysis, a 25bps cut in base TER of equity AUM could slash AMC net profit by 30-35%

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SEBI firm on TER review: On 23 Dec 2022, SEBI had announced a review of the total expense ratio (TER) on mutual funds, sending the AMC sector reeling, with stocks under coverage correcting 13-24% since the announcement. In a follow-up, the regulator during its recent March meeting reiterated plans to release comprehensive TER guidelines with an emphasis on transparency for investors. The SEBI chief further opined that fees should be levied at the asset (debt, equity), not scheme, level and that charges such as brokerage paid by AMCs must be a part of TER.

Equity schemes could see cut in fees: Our industry interactions suggest that any TER cut would be restricted to active equity schemes as non-equity schemes are already in the lower yield bracket. Among listed AMCs, the weighted average regular base TER of active equity schemes is the lowest for HDFC AMC at 1.5%, followed by Nippon AMC at 1.6%, and ABSL AMC as well as UTI AMC at ~1.7%. These players have respective active equity AUM of Rs 2.1tn, Rs 1.1tn, Rs 1.0tn and Rs 0.7tn as of Dec'22. The expense ratio was last cut by the regulator four years ago. Any further reduction or inclusion of expenses in the base ratio would take a toll on AMC margins.

Scenario analysis indicates sizeable hit to profits: Our scenario analysis of TER cuts for active regular equity schemes of the four aforementioned players indicates that (i) a 25bps cut in base TER that is fully absorbed by AMCs (i.e., no pass-along to distributors) would cause net profits to decline in the range of 30-35%, and (ii) a 10bps cut in base TER would lead to a 12-14% profit decline.

However, if 50% of the burden is passed on to distributors, the decline in AMC net profit would halve to 15-18% and 6-7% in each of these scenarios respectively. Our analysis assumes AUM at current levels and no change to the TER for non-equity schemes.

Recommendation snapshot

Ticker	Price	Target	Rating
ABSLAMC IN	332	488	HOLD
HDFCAMC IN	1,751	2,310	BUY
NAM IN	215	347	BUY
UTIAM IN	664	983	BUY

Price & Target in Rupees | Price as of 10 Apr 2023



Profit headwinds from potential TER cut

Our industry interactions suggest that any TER cut would be restricted to active equity schemes as non-equity schemes are already in the lower yield bracket. Among listed AMC's, the weighted average regular base TER of active equity schemes is the lowest for HDFC AMC at 1.5%, followed by Nippon AMC at 1.6%, and ABSL AMC as well as UTI AMC at ~1.7%.

We have conducted a scenario analysis (Fig 1) of active regular equity schemes for the four listed players, assuming TER cuts of 25bps and 10bps, varying levels of cost pass-through to distributors, AUM at current levels and unchanged TER for non-equity schemes. Our key findings:

- A 25bps cut in base TER would cause net profit to decline in the range of 30-35% if the burden is fully absorbed by the AMC (i.e., no pass-along to distributors), and 15-18% if half the burden is passed on.
- A 10bps cut in base TER would lead to a 12-14% net profit decline when fully borne by AMC's and a 6-7% decline if split equally with distributors.

Fig 1 – Scenario analysis: Adverse TER regulation could hit AMC profits

Particulars	Nippon AMC		UTI AMC		HDFC AMC		ABSL AMC	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Active Equity Base TER (%)	1.61		1.65		1.49		1.67	
Base case								
Equity AUM (Rs bn)	1,518	1,685	1,134	1,304	2,550	2,856	1,372	1,509
Equity management fees (Rs mn)	11,387	12,303	8,618	9,911	19,382	21,136	9,605	10,113
Net profit (Rs mn)	8,177	9,091	6,061	6,963	16,067	17,610	7,136	7,837
Assuming 25bps cut in Base TER (%)	1.36	1.36	1.40	1.40	1.24	1.24	1.42	1.42
100% absorbed by the company								
Equity management fees (Rs mn)	7,592	8,090	5,783	6,651	13,006	13,996	6,175	6,340
Net profit (Rs mn)	5,338	5,939	3,941	4,524	11,298	12,268	4,570	5,015
Decline in net profit (%)	(34.7)	(34.7)	(35.0)	(35.0)	(29.7)	(30.3)	(36.0)	(36.0)
50% absorbed by the company								
Equity management fees (Rs mn)	9,490	10,196	7,200	8,281	16,194	17,566	7,890	8,226
Net profit (Rs mn)	6,757	7,515	5,001	5,743	13,682	14,939	5,853	6,426
Decline in net profit (%)	(17.4)	(17.3)	(17.5)	(17.5)	(14.8)	(15.2)	(18.0)	(18.0)
Assuming 10bps cut in Base TER (%)	1.51	1.51	1.55	1.55	1.39	1.39	1.57	1.57
100% absorbed by the company								
Equity management fees (Rs mn)	9,869	10,618	7,484	8,607	16,832	18,280	8,233	8,604
Net profit (Rs mn)	7,041	7,830	5,213	5,987	14,159	15,473	6,110	6,708
Decline in net profit (%)	(13.9)	(13.9)	(14.0)	(14.0)	(11.9)	(12.1)	(14.4)	(14.4)
50% absorbed by the company								
Equity management fees (Rs mn)	10,628	11,460	8,051	9,259	18,107	19,708	8,919	9,358
Net profit (Rs mn)	7,609	8,460	5,637	6,475	15,113	16,541	6,623	7,273
Decline in net profit (%)	(6.9)	(6.9)	(7.0)	(7.0)	(5.9)	(6.1)	(7.2)	(7.2)

Source: Company, BOBCAPS Research

Fig 2 – HDFC AMC currently has the lowest base TER in active equity schemes

As of Dec'22	Active equity schemes	
	Base TER (%)	AUM (Rs tn)
Nippon AMC	1.61	1.08
UTI AMC	1.65	0.68
HDFC AMC	1.49	2.12
ABSL AMC	1.67	0.97

Source: Company, BOBCAPS Research

Fig 3 – TER constituents**TER is composed of:**

- Base TER
- Additional expenses not exceeding 0.30% of daily net assets of the scheme in terms of Regulation 52(6A)(b) of SEBI (Mutual Funds) Regulations, 1996
- Additional expenses not exceeding 0.05% of daily net assets of the scheme (0.20% till 29 May 2018) in terms of Regulation 52(6A)(c) of SEBI (Mutual Funds) Regulations, 1996
- Goods & Services Tax or GST (currently 18%)

Source: BOBCAPS Research

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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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