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FIRST LIGHT

16 March 2020

RESEARCH

[Sector Report] Diversified Financials: AMCs

Low-levered, high-ROE and dividend-payout plays

BOB Economics Research | Trade

Trade deficit narrows

SUMMARY

Diversified Financials: AMCs

Asset management companies (AMC) are a play on the growing financialisation of savings in India. This trend coupled with rising penetration of MF products will drive retail flows and aid an estimated 12% CAGR in industry AUM over FY19-FY22. Working capital requirements have eased with trail-based commissions, enabling stronger operating cash flows. High ROE and low leverage make select AMCs an attractive proposition in the financials space. Initiate with BUY on HDFC AMC (43% ROE, 1x leverage in FY22E); SELL on NAM.

Click here **for the full report.**

India Economics: Trade

India's trade deficit narrowed to US$ 9.9bn in Feb'20 from US$ 15.2bn in Jan'20 as oil, electronic and capital goods imports came-off on MoM basis. Exports of engineering goods, chemicals and oil accelerated. Notably, non-oil-non-gold imports are showing a trend reversal in Q4 indicating economic growth has bottomed out. The recent decline in oil prices will ensure that CAD as % of GDP moderates further in FY21. This will support INR which has come under pressure. We expect it to revert to 70-72/$ in FY21.

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TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Bajaj Finance	Buy	5,200
Cipla	Buy	570
Eicher Motors	Buy	25,000
Petronet LNG	Buy	400
Reliance Industries	Buy	1,860

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	2,870
Greenply Industries	Buy	205
Laurus Labs	Buy	510
Transport Corp	Buy	355
Ashok Leyland	Sell	64

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	0.80	(7bps)	(77bps)	(183bps)
India 10Y yield (%)	6.24	11bps	(21bps)	(113bps)
USD/INR	74.22	(0.8)	(4.1)	(7.0)
Brent Crude (US$/bbl)	33.22	(7.2)	(37.6)	(50.6)
Dow	21,201	(10.0)	(27.6)	(17.5)
Shanghai	2,923	(1.5)	1.1	(2.2)
Sensex	32,778	(8.2)	(20.0)	(13.2)
India FII (US$ mn)	**11 Mar**	**MTD**	**CYTD**	**FYTD**
FII-D	(1,077.1)	(1,199.5)	(2,766.6)	177.6
FII-E	(472.0)	(2,666.6)	(879.6)	6,509.6

Source: Bank of Baroda Economics Research

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DIVERSIFIED FINANCIALS

13 March 2020

AMCs: Low-levered, high-ROE and dividend-payout plays

Asset management companies (AMC) are a play on the growing financialisation of savings in India. This trend coupled with rising penetration of MF products will drive retail flows and aid an estimated 12% CAGR in industry AUM over FY19-FY22. Working capital requirements have eased with trail-based commissions, enabling stronger operating cash flows. High ROE and low leverage make select AMCs an attractive proposition in the financials space. Initiate with BUY on HDFC AMC (43% ROE, 1x leverage in FY22E); SELL on NAM.

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Retail flows to drive AUM growth: A structural shift by Indian investors from physical savings in real estate and gold towards financial savings, wider distribution of mutual fund products, and an enabling regulatory landscape are likely to bolster retail investment flows in the near-to-medium term. We expect a 12% CAGR in average AUM for the MF industry over FY19-FY22 to Rs 37tn (EOP).

Higher equity proportion to propel industry earnings: Robust long-term returns and rising appetite for equity funds, is expected to aid an equity AUM CAGR of 12% over FY19-FY22 to Rs 17tn – forming 46% of industry assets from 44% currently even as the mix of debt funds declines to 43% from 48%. We expect 17%+ CAGR in both revenue and profit for the industry during FY19-FY22 underpinned by a rising share of high-yield equity business and better pricing power over distributors.

Stronger pricing power to aid cash flows: With the full-trail model of commissions since mid-2018, commissions to distributors declined 7% in FY19 to Rs 80bn. Commissions could drop a further 10% in FY20, before stabilising in FY21. The resultant reduction in AMC working capital requirements will bolster operating cash flows and dividend payouts. Given the low levered nature of business and high dividend payouts, we expect high ROEs.

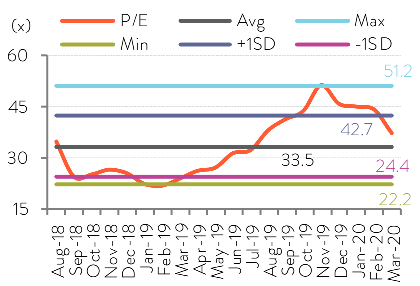
Recommendations: We initiate coverage on HDFC Asset Management (HDFC AMC) with BUY (Mar'21 TP Rs 3,470) and Nippon Life India Asset Management (NAM) with SELL (TP Rs 280). HDFC AMC's consistent market leadership (14% share in AAUM), trusted brand, diversified distribution, and rising share of profitable equity flows (19% CAGR FY19-FY22E) position it as a strong play on the sector. Our SELL rating on NAM stems from likely below-industry AAUM growth (6% CAGR) and a high cost structure, making for a tightrope walk between profitability and market share gains.

RECOMMENDATION SNAPSHOT

Ticker	Price	Target	Rating
HDFCAMC IN	2,681	3,470	BUY
NAM IN	304	280	SELL

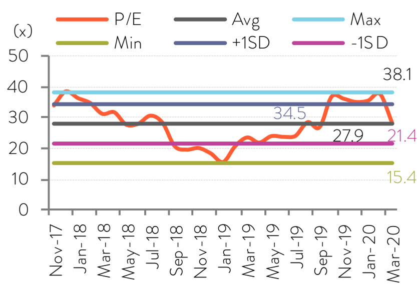
Price & Target in Rupees

HDFC AMC – ONE -YEAR FWD P/E



Source: Bloomberg, BOBCAPS Research

NAM – ONE-YEAR FORWARD P/E



Source: Bloomberg, BOBCAPS Research

TRADE

13 March 2020

Trade deficit narrows

India's trade deficit narrowed to US$ 9.9bn in Feb'20 from US$ 15.2bn in Jan'20 as oil, electronic and capital goods imports came-off on MoM basis. Exports of engineering goods, chemicals and oil accelerated. Notably, non-oil-non-gold imports are showing a trend reversal in Q4 indicating economic growth has bottomed out. The recent decline in oil prices will ensure that CAD as % of GDP moderates further in FY21. This will support INR which has come under pressure. We expect it to revert to 70-72/$ in FY21.

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Exports see an uptick: Exports rose by 2.9% in Feb'20 versus (-) 1.7% decline in Jan'20 led by higher engineering goods at 8.7% versus (-) 4% in Jan'20 and chemicals at 16.3% versus 2.5% in Jan'20. Oil exports also rose sharply by 10.1% compared with 2.9% in Jan'20. On the other hand, decline in exports of gems and jewellery further accelerated. Agriculture exports also declined, albeit less sharply than Jan'20. On FYTD basis, exports are down by (-) 1.6% compared with 9.9% increase seen in FYTD19. With outbreak of COVID-19, we expect global demand and thus exports to remain subdued in the near-term.

Import growth picks up: After falling for 8-straight months, imports increased by 2.5% in Feb'20 compared with (-) 0.7% in Jan'20. Oil imports rose by 14.3% in Feb'20 (15.3% in Jan'20). Gold imports continued to decline, albeit at a slower pace of (-) 8.3% compared with (-) 31.5% in Jan'20. Non-oil-non-gold imports fell by (-) 0.9% in Feb'20 compared with (-) 5.8% in FYTD20 showing a trend reversal indicating economic growth has bottomed out. Capital goods imports inched up to 7.6%, pearls and precious stones to 13.2% and agricultural products to 28.8%. However, demand is likely to come-off temporarily on the back of dent in consumer sentiment due to COVID-19.

Trade deficit narrows, outlook positive: India's trade deficit narrowed to US$ 9.9bn from US$ 15.2bn in Dec'19 led by US$ 1.7bn MoM increase in exports and (-) US$ 3.6bn MoM decline in imports. On MoM basis oil, electronic and capital goods imports decelerated the most. Oil imports are likely to further decelerate as oil prices have fallen by (-) 36% in Mar'20. Non-oil imports are also likely to show a moderate increase as domestic demand remains muted. Hence, we expect CAD at 0.6% of GDP in FY21 compared with 0.9% in FY20. This should support INR which is expected to recover to 70-72/$.

KEY HIGHLIGHTS

- Exports increase by 2.9% in Feb'20 versus by (-) 1.7% in Jan'20.
- Import growth also picks up to 2.5% versus at a slower pace at (-) 0.7% in Jan'20.
- Trade deficit narrows to US$ 9.9bn compared with US$ 15.2bn in Jan'20.

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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