

RESEARCH
DIVERSIFIED FINANCIALS

Impending TER regulation puts AMCs on edge

SUMMARY
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- 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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Daily macro indicators

Ticker	07-Apr	10-Apr	Chg (%)
US 10Y yield (%)	3.39	3.42	3bps
India 10Y yield (%)	7.20	7.22	2bps
USD/INR	81.90	81.99	(0.1)
Brent Crude (US\$/bbl)	85.1	84.2	(1.1)
Dow	33,485	33,587	0.3
Hang Seng	20,275	20,331	0.3
Sensex	59,833	59,847	0.0
India FII (US\$ mn)	05-Apr	06-Apr	Chg (\$ mn)
FII-D	(138.4)	37.7	176.1
FII-E	100.1	55.4	(44.7)

Source: Bank of Baroda Economics Research

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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



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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

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

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