



“HDFC Asset Management Company Limited Q3
FY19 Earnings Conference Call”

January 21, 2019



MANAGEMENT: **MR. MILIND BARVE – MANAGING DIRECTOR**
MR. PIYUSH SURANA – CHIEF FINANCIAL OFFICER
MR. SIMAL KANUGA – CHIEF INVESTOR RELATIONS
OFFICER

MODERATOR: **MR. VISHAL GOYAL – UBS SECURITIES**

Moderator: Ladies and gentlemen, good day and welcome to HDFC Asset Management Company Limited Q3 FY19 Earnings Conference Call, hosted by UBS Securities India Pvt. Ltd. As a reminder, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call please signal for an operator by pressing '*' then '0' on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Vishal Goyal from UBS Securities. Thank you and over to you, sir.

Vishal Goyal: Thank you. Good morning, everyone. Welcome to this earnings call of HDFC Asset Management Company. We have with us Mr. Milind Barve – Managing Director, Mr. Piyush Surana – Chief Financial Officer, Mr. Simal Kanuga – Chief Investor Relations Officer to discuss the quarterly results. I would request Mr. Barve to take us through the key highlights of the quarter. Post which we will open the floor for Q&A. Over to you, sir.

Simal Kanuga: Thanks, Vishal. I will just kind of give highlights and then we have both Milind and Piyush here to take questions, if any.

So, good evening, everybody. Thank you very much, once again, for joining in. We have uploaded our results as well as presentation on hdfcfund.com as well as BSE and NSE website. Let us start off with an update on the industry.

The industry AUM for the quarter moved up from Rs. 22 trillion to Rs. 22.9 trillion. The flows in equity oriented schemes were more or less similar to that of quarter ended September 2018. Debt funds lost further Rs. 478 billion during the quarter. Liquid funds saw net inflows of Rs. 425 billion as compared to outflows of Rs. 711 billion in quarter ended September 2018.

There is enough and more news in terms of flows into equities. The industry has seen flows to the tune of INR 1 trillion for the first nine months of the current financial year, which in our opinion is healthy. The pace of flows is slowing down and the impending central election and the uncertainty around it may lead to tepid flows for the next few months. This does not concern us much. What we are excited about is continued growth in retail AUM as well as number of customers. SIP book continues to swell and is now over Rs. 80 billion. This means industry is well geared to see flows of nearly Rs. 1 trillion from SIPs over the next 12 months.

Now, coming to us. We have seen a sizable growth in our AUM during the course of this quarter. We are happy to state that we have become the largest mutual fund manager during the quarter that went by. Our market share in terms of overall AUM has risen to 14.4% of the industry, this was 13.3% as of September 2018. This gain in share is due to significant flows into our liquid funds. The quarter that went by also saw reallocation amongst liquid funds. Industry AUM in liquid funds rose by Rs. 515 billion during the quarter. As against that our liquid fund AUM grew by Rs. 332 billion, that is a market share of 64% in the growth of liquid fund AUM. Our market share in actively managed equity oriented AUM continues to be remain stable at 16%. There has been a small change in our product mix due to significant flows into our liquid funds, while we

continue to maintain our market share in actively managed equity-oriented funds. Equity, as a percentage of total AUM is at 48% as compared to 44.8% for the industry. We continue to focus on our retail business.

AUM from individual investors is at 61.8%, which is materially higher than the industry at 54%. We continue to have a leadership position in terms of market share and assets of individual investors. In terms of unique investors identified by Income Tax Permanent Account Number, we have a market share of 27%, that is more than one in four mutual fund investors has invested with us. Our systematic transaction book is now over Rs. 11 billion in terms of monthly flows, with 64% plus signing up for more than 10 years.

Our distribution mix continues to be well diversified. IFAs now contribute to over 43% of our equity AUM. We continue to be second largest in terms of B30 AUM market share. Over 71% of the total non-systematic transactions that we did during the course of December quarter were done electronically. If we consider or add up the systematic transactions, the number would be well over 90%.

On regulatory front, SEBI has notified 1st April, 2019, as the date for applicability of the new TER slabs. As mentioned on our last call, we intend to pass a majority of reduction in TER by reducing distribution commission. To reiterate, we do not see any material impact on our earnings due to this reduction. The regulator has effected ban on upfront commissions with effect from 22nd October, 2018. The regulator has also mandated scheme related expenses to be paid out only from schemes books and not from the books of the asset management company.

Now, we move on to financials. Before we go into specifics, there is change in accounting for certain set of expenses starting 22nd October, 2018. This is on account of SEBI circular banning upfront commissions as well as making it mandatory for all scheme related expenses to be necessarily debited to the scheme's accounts. All commissions, by whatever name called, need to be paid out of the schemes. The AMC is now not allowed to pay any of these expenses. Over time this would result in lower revenue in books of accounts of the AMC, with similar reduction in expenses.

In terms of financial results, for the quarter ended December 2018 over quarter ended December 2017, net profit for the quarter ended December 2018 is Rs. 2,433 million, as against Rs. 1,951 million, a growth of 25%. Operating profit grew by 21%. Profit before tax grew by 29%. For the nine months ended December 2018 over nine months ended December 2017, net profit for December 2018 is Rs. 6,544 million, as against Rs. 5,395 million, a growth of 21%. Operating profit grew by 20%. Profit before tax grew by 23%. Our operating profit margin as a basis points of AUM now is at 35, so we are at 35 basis point points of AUM in terms of operating profit.

So that is where we would want to take a pause. I have Milind and Piyush both here to take questions, if any. Rio, you can open the floor for questions.

- Moderator:** Sure, thank you very much. We will now begin with the question-and-answer session. We have the first question from the line of Haresh Kapoor from IIFL Asset Management. Please go ahead.
- Haresh Kapoor:** Sir, a couple of things. First is, if you could just give some color on what you have done with the IL&FS exposure? Last quarter you had around Rs. 18 crores pending in your book and you had indicated that you would provide Rs. 18 crores if required in this quarter. So what is the update on that?
- Milind Barve:** We had mentioned last time that we had a Rs. 40 crores exposure to preference shares of the holding company in IL&FS. Based on our assessment of the realizability of that money, we had taken an impairment of about Rs. 21.2 crores. Then subject to discussion with auditor we have to reassess what we believe is a realizable amount and what and how and over what period of time should we have these write-downs going forward. What we have assessed is that we believe that a further impairment of about Rs. 9 crores is what would be appropriate for this quarter, and accordingly in this quarter we have taken a Rs. 9 crores write-down or impairment of assets. This leaves us with barely Rs. 9 crores of amount outstanding against the IL&FS preference share. There is technically still no default on the preference share between the dividend payable by them in March 2018 was already received in the month of May. So we will now calibrate any further write-downs based on how we see, it is still a developing situation and how we feel the loss given default will emerge over the rest of the period.
- Haresh Kapoor:** So, Rs. 9 crores is provided under which line item?
- Piyush Surana:** Other expenses.
- Milind Barve:** It is part of the other expenses. What we are left with, as I mentioned, is only another Rs. 9 crores out of the Rs. 40 crores.
- Piyush Surana:** Which is 0.3% of our books.
- Milind Barve:** So this is barely 0.3% of our investment book.
- Haresh Kapoor:** Sure. Sir, second thing, if you could just talk about there is some other income jump also in this quarter, what has led to this and what is the reason? Because even QonQ basis it has moved up from Rs. 35 crores to Rs. 55 crores, could you just talk about what has really happened there?
- Milind Barve:** Yes, the reason for the increase in the other income are two or three, one of it is that as my colleague just mentioned, SEBI does not permit asset management companies to have loyalty programs which are associated with distributor sales targets. So, accordingly, last year we had provided for an amount of almost up to Rs. 18 crores, which was proposed to be spent on a loyalty program for last year. This year in lieu with what has been prescribed by SEBI, there is no provision for such loyalty program. So, the cost of that program in the last financial year's nine months numbers is about Rs. 18 crores while that for the corresponding nine months this year is 0. So that is one reason. The second is that we have...

- Piyush Surana:** Just to clarify a little bit here, in the other income there was Rs. 9 crores of previous year's provision which was written back and that was added to the other income.
- Milind Barve:** The second thing is that, overall if you see the surplus funds that are managed or which belong to the asset management company, have gone up by about Rs. 590 crores or about close to 31%. So naturally about a 31% increase in the revenue is bound to happen simply because total amount of money that we were managing has indeed gone up by 31%. So, A, it reflects increase in the amount of money that has been managed within the AMC's proprietary funds. Number two, there is a write-back of about Rs. 8 crores provision, if you compare it with there is an Rs. 18 crores cost which has been saved this year and there is an Rs. 8 crores write-back of last year's expenses which has come as other income this year. And the third thing is that the overall return on our portfolio has improved by about 25 basis points.
- Haresh Kapoor:** So you are saying first is the Rs. 18 crores number that was there last year which is not this year...
- Milind Barve:** No, as far as other income is concerned it is basically a 30% increase in the total amount of surplus that we now manage, that has contributed to the increase in the revenue from that corpus. That is number one.
- Haresh Kapoor:** No, I am talking about the Rs. 9 crores and Rs. 18 crores number that you mentioned.
- Milind Barve:** That is in the expense.
- Piyush Surana:** Rs. 9 crores is in other income.
- Milind Barve:** If you are asking about other income, it is only the question of about Rs. 9 crores which was reversed, which was provided for last year's loyalty program which we are not going to spend this year. So there is a Rs. 9 of reversal that has come, and because it pertains to the previous year it is added into the other income. That is one reason. So the amount by which other income has gone up is Rs. 9 crores. Number two, and more importantly, the surplus that the company managed on an average for nine months period has gone up by about Rs. 590 crores, which is a 30% growth in the total surplus with the AMC and that has contributed materially to the increase in the other income. Third is, overall productivity of other income in terms of the overall yield on the other income has gone up by 25 basis point, which has also contributed to a higher increase in the other income.
- Haresh Kapoor:** Sir, just on the expense line item, obviously you spoke about last quarter and this quarter IL&FS impact, but even if I look at the employee expense on a QonQ basis is down by almost 8% to 10%. And even the other expense line item is down pretty sharply, so could you just talk about this also a little bit, what is really happening and the reason for this?
- Milind Barve:** I will first take up the employee benefit expenses. The employee benefit expenses is based on assessment of what we believe variable pay would be and based on the number of employee workforce that we intend to employ during the course of the year. Now, given where we are at the

nine months phase, we are able to make the assessment we believe more accurately than what we would have done at the six month period or the first quarter. And accordingly what has changed in the numbers is basically the variable pay that we would have provided last year as versus the variable pay that we are providing for this year, there would be some change in the amount that has been calibrated for the current year. That is the reason why you will see that it looks almost flattish or with no change. It is really the impact of the variable pay. That is number one. Number two, you mentioned about the other expenses, business development other expenses which has gone down. Now, that is on account of three reasons, one is, as I mentioned just a minute before, because in the last nine months period there was an expense item of Rs. 18 crores on account of a loyalty program, that program is no longer there in the other expenses and now this year that amount corresponding to Rs. 18 crores now stands close to 0. That is number one. Number two, we had other sort of borrowing expenses which were charged to the AMC's P&L last year, this was about an amount of close to Rs. 13 crores, this year the corresponding amount is less than Rs. 1 crores, so there is material savings in that.

Piyush Surana:

And third is, we also had some scheme launch expenses of around Rs. 21 crores last year, the number for that is just Rs. 4 crores this year. So, this along with the fact that after the 22nd October circular, expenses have not come to the AMC and we have had to debit them to the schemes. So, even for the period of November, December, those expenses have also reduced in the AMC's P&L.

Haresh Kapoor:

Thanks for the year-on-year comparison, but incrementally what I was just trying to understand is also on the QonQ number, because Rs. 160 crores last quarter compared to Rs. 110 crores this quarter, I understand Rs. 10 crores difference will be because of IL&FS impact, so that makes it Rs. 120 crores for this quarter, but there is a Rs. 40 crores difference. So, for that Rs. 40 crores difference should I assume that the whole Rs. 40 crores is because of the movement to trail, or what is the other variable?

Piyush Surana:

Let me take you through it. The IL&FS you pointed out, that is one. So, in the previous number there is the additional IL&FS number this time, besides that what is also been happening is there is a drop in the amortizations. You would remember that on the previous call we had said that upfront commissions, the advance trail that we pay, that is amortized over a period of 12 months. Now, last year we had seen very strong sales so there was a large amount of brokerage which was being amortized. Now, gradually as sales have reduced that amortization amount has been dropping off. So there has been a reduction in the amortization of brokerage. Besides that, the other things that I just pointed out earlier, all of them put together have basically contributed to this effect.

Haresh Kapoor:

And any indication in terms of the trail impact on the P&L, if you could, because just on a QonQ basis it will help us getting a better indication?

Milind Barve:

Harish, I will just tell you how it works. When you have a ban on upfront commission what happens is that distributors who are paid upfront commission, the upfront commission has stopped with effect from 22nd October, it has been replaced by a slightly higher amount of trail

commissions being paid. Now, the reason you see some positive impact in this quarter is typically when you pay upfront commission it is amortized over a 12 month period. Now, however, the trail that has been increased has not been increased by equivalent amount, it has been increased in such a way that the cost of the additional trail, let me repeat, the cost of the additional trail will effectively get amortized over a 36 month period. So, for example, if somebody was getting paid 1% upfront, his trail has been increased by 30 basis points or 33 basis points. So, earlier you were getting an impact of 1% divided by 12, now you are getting an impact of 33 basis points divided by 12. So, actually it is beneficial to the asset management company in terms of savings of the upfront commission hitting the AMC P&L within 12 months period.

Haresh Kapoor:

Sir, and one last quick thing on terms of the negotiations that we are having for next year, in terms of the expense ratio, etc. So, you have spoke about 80%, 90% where you will get passed, but obviously the market participants, as we keep on talking to them more, they are still talking about a lot of negotiations and the number to be significantly lower in terms of the impact that we will take on your books. So, could you just give an update if there is any change of thought than what has been communicated previously? And how things stand currently?

Milind Barve:

As we had indicated in our last call and in our previous presentation as well, we estimate approximate impact on our equity margins to be somewhere in the region of 24 basis points as a result of this new circular coming into effect with effect from 1st April. We believe that we should be in a position to pass on at least 21 or 22 basis points out of this 24 basis points by way of a reduction in the commission paid out to the distributors. And that position has not changed. So, we believe that we should be able to do it because we understand that the entire industry is going to be passing on the impact of the lower TER by way of reducing commission.

Moderator:

Thank you. We have the next question from the line of Vivek Joshi from Bandar Boonch Capital. Please go ahead.

Vivek Joshi:

This results are like quite stupendous, so a quick question is that, you have explained the drop in other expenses and all. But just to understand, if we assume static AUM, like what is the quarter ending, can we multiply this by 4 to get an annual picture or it will be lower than this, for the net profit number?

Milind Barve:

I wish I could answer that question, we are not providing guidance on anything on March 2019. But we do believe that we should be able to maintain margins.

Vivek Joshi:

So this is the stable margin, like I am just trying to understand the factors which have gone off, like the loyalty programs and all, they are just gone for good as per the current...?

Milind Barve:

That is right, there is a regulation in place which does not allow loyalty programs to be conducted by asset management companies, and therefore there is no question of having one.

Moderator:

Thank you. We have the next question from the line of Prashant Rane from Exclusive Advisors. Please go ahead.

Prashant Rane: I would like to see, I mean, I can see from your presentation the actively managed AUM, year-on-year there is a change of 3% whereas your individual investor base has gone up by 12%. So, how do we relate these two numbers? Like your individual investor base is going up but at the same time the actively managed AUM is also not showing that kind of a number. So can you please explain this?

Milind Barve: See, if you look at the industry growth in the nine months, it was barely 7.5%. So, I think what we have seen is that we continue to get good traction from small investors and therefore you will find that we have been able to overall maintain the market share quarter-on-quarter. In the past, as far as December 2017 is concerned, our market share was 17.1%, which is now 16% as of now, but that 16% has now stabilized from September quarter and December quarter 2018. So what we are seeing is that we have been able to maintain a stable market share of close to 16%. This market share is slightly lower than the 17.1% market share that we had earlier one year back. And that's why on a year-on-year basis you are seeing the growth of only 3%.

Moderator: Thank you. We have the next question from the line of Amit Nanavati from Nomura Securities. Please go ahead.

Amit Nanavati: Sir, just few questions, more longer-term based. Broadly, so we see these fintech companies coming up and doing good work for the likes of ET Money, Paytm, which in some sense will reduce your own need to invest lot more in a direct platform as they drive the direct platform for you. So, if you can talk about the profitability, if it comes through say a fintech company versus you having to invest in that platform and ensuring that there is enough pull from investors? Secondly, if you can talk about the whole, so I see that IFAs share has increased over the last one year, 3%, 4%, how in terms of the TER cut that you would be discussing with them, how are the banks taking in and versus how are the IFAs responding to it? And also in terms if you can explain how has been the HNI versus individual behavior in terms of flows or redemptions in the last three, six months in particular?

Milind Barve: I think you asked a number of questions. The first question you asked about fintech companies, if you ask me, we genuinely believe in encouraging fintech companies as they become, we do not want to be like providing, supporting only one platform. Basically we believe that given the penetration and the reach that mutual fund industry needs to achieve, we need multiple fintech platforms to be providing feeds to us. And I think there will be over a period of time a reasonable competition amongst all of these who will provide access to mutual fund industry products, in general I am saying. And I think we would encourage all of them. So we are effectively on a number of platforms, whether it is Paytm, we are already there, we are already there on ET Money, we are already there on the BSE platform, we are there on the NSE platform. So we will continue to engage with these platforms which will become source for us to be able for providing access to our products from the retail investors. I do believe that over a period of time these platforms will become more and more important and will provide the benefit of convenience of working on these platforms and also giving us the larger reach for our products. So we would continue to engage and be available on these platforms, no matter a number of these companies will come up. So, as

such, over a period of time this will happen, it may happen at a slightly slower pace initially, but as things catch up these things will move quite rapidly.

Secondly, the IFA share has increased marginally, and over a period of time we do not read too much into it, sometimes the share of some banks or some national distributors change. So we are happy that the IFA share has increased from 40% to 43%, because that actually gives us more diversity of the sources from where we are able to access money. But that is not necessarily a long-term trend that we see of a particular source of money increasing or decreasing consistently over a period of time, I do not see that happening.

We have already started engagement with our distribution community, this is your third question, about how the distribution commission reduction will be taken up. We believe that almost every player in the industry is going to reduce the commission, distribution post the applicability of the new SEBI circular takes effect. So in that sense we are doing no different, we are not doing something which is different from any other market participant from the mutual fund industry is doing. And we believe that we will calibrate this reduction well across products and across distribution people who in such a way that we will be able to achieve a pass through of about 21 or 22 basis points out of the 24 basis points. So engagement has already started. Obviously, we believe that we will be able to achieve what we are setting out to do, which is reduce the impact of that SEBI circular by reducing the commission.

The last question you asked about behavior of HNI versus retail, I think it is generally true that if there is a market which is not clearly going in a particular direction or if there are events like state elections or central government elections coming up, you see a little bit of tentativeness amongst the HNI investing community. But the retail investing community which is predominantly participating in mutual funds through SIP method, they remain resilient and their money continues to come.

Amit Nanavati:

So, on the HNI versus individual, a good part of the flows of FY17-18 did come in from HNI as well. And when you see, SIP has become a culture now and to that extent one is little less worried about individual behavior. But when you see redemptions picking up, HNI is a segment where one starts worrying. So just wanted to check if that seems to be ticking up or not. And on the fintech, basically, what I wanted to more clarify was, does the cost structure or the breakeven versus a regular plan, and when you say direct and regular has similar profitability today because you have to invest a lot more, does having a fintech now coming up in a big way change that course and makes it much faster profitable?

Milind Barve:

First on the fintech, firstly, the margins on whether we get business directly or through a distributor, they remain absolutely the same. So, there is no material additional cost that is incurred on fintech. We already have given the size of our profit & loss account, there is sufficient room without having material impact to continue to invest on our own properties like HDFC MF online, which continues to remain very popular. And we continue to get a fair bit of traffic on our own website. And this does not even effect our profit & loss account in any material way, we will

continue to make that investment to attract money on our own platform. Apart from that other platform money we will continue to engage with them so that we remain available on those platforms. Over a period of time it is correct to assume over a long period of time as the flow of money from platform increases it reduces transaction cost apart from ensuring accuracy and convenience to customer it reduces transaction cost because transactions happen electronically, so there is no paper work, there is no cost associated paper, there is no data entry of the forms that come in for processing and so on.

Moderator: Thank you. Our next question is from the line of Rohan Advant from Multiact. Please go ahead.

Rohan Advant: Sir, my question is regarding a comment you made earlier that as we move from upfront to trail there is a change in the amortization period and we used to amortize upfront over 12 months and now it is for 36 months. So, I did not understand that bit, if you could throw some more light on that.

Milind Barve: I will explain it by giving you an example. So, if you get a new flow and you pay an upfront commission of 1% you will pay 1% and then as per the accounting policy we have to write off that 1% over 12 months. This is what was done in the past and therefore there was a charge of this amortization even for the past sales that we were doing, it continues to happen. Now the upfront has stopped, now what have we done for distributors who have lost their upfront commission, we have compensated them by paying higher trail. Now, this higher trail on a monthly impact is much smaller than what the upfront commission would have been, because trail is paid as long as the asset stay with you a monthly basis. And the trail of upfront of 1% approximately is substituted by trail of 0.3% payable per annum. So, the monthly impact of paying 33, 34 basis point is much smaller than the monthly impact of paying 1%, because it was 1% divided by 12, and this 33 basis point is the increase that we have made. So that impact is made over next 12 months, but it is 33 divided by 12 versus 100 basis point divided by 12.

Rohan Advant: But this 33 basis point of incremental trail is forever, or it is for only first three years?

Milind Barve: See, we are entitled to change or recalibrate the trail at the discretion of the AMC, right now we have provided this trail which is actually changeable any time. Having said that, we would expect the trails to remain fairly stable, except the reductions that we will be required to be done when the reduced TER takes into effect.

Moderator: Thank you. Our next question is from the line of Yash Nerurkar from PPFAS Mutual Fund. Please go ahead.

Yash Nerurkar: With whatever the changes in the TER is going to be effective from next year April, so just wanted to know about the fact that let's say for instance there is a particular distributor, right now he would be pushing the schemes of larger mutual funds. But once all these mutual funds come at par in terms of the total expense ratio, would the market shares be affected post that?

- Milind Barve:** So, we believe that will not be the case because fundamentally our understanding is that our share in the sales will be driven more by performance of our fund, and of course the overall state of the market. But flows are dependent more on performance and I think it is reasonable to believe that distribution community will recommend products based on performance first and only then there will be a question of how much commission we will pay. Having said that, even for funds which are reasonably large in size, we expect that we will be reasonably competitive, it is not that we are going to be outside a certain range. See, in any case we believe that commission payouts to distributors have to be within a certain range which is reasonably competitive. It is not that you have to highest paying within the range, you have to be in the range, as long as you are in the range that should be fine. But what is always important is that our offering should always be backed by sound investment performance which is more critical to getting new business and not just the commission.
- Moderator:** Thank you. Our next question is from the line of Parmeshwaran S from JM financial. Please go ahead.
- Parmeshwaran S:** Sir, could you please tell us what is the current amortization component in the other expense line so that we can understand how this line will stabilize going forward? And second question, when the TER cut kicks in, if we expect to pass on say 21 bps of the 24 bps, do we expect that in combination with the upfront and trail, do we expect that profitability will be slightly higher than we were seeing before?
- Piyush Surana:** So, we would not be giving out specific numbers on this. But suffice it to say that the amortization is gradually going to keep running out because up till next October the 12 month cycle will get completed. And as you know, after October 22nd no fresh up-fronts are being paid on which amortization would build up. Having said that, what we can tell you is we got around Rs. 60 crores, Rs. 70 crores odd amortization pending which needs to be amortized over the rest of the period.
- Parmeshwaran S:** And the second part, sir, if we view it in combination with the TER cut and the way we expect to pass most of it on, do we expect profitability to expand than what we were seeing earlier?
- Piyush Surana:** So, what might happen for a period of time is that the amortizations would keep running out, but what will also happen is that the revenue will keep dropping gradually because the expenses on new sales would start building up in the funds. Milind just took you through this whole business of the trail, so that will lead to a dip in the revenue. So, both our revenue and our expense will go down.
- Milind Barve:** Yes, to be careful if you are just tracking number to number in your model, I think you have to be careful that because the expenses of the scheme are now charged to the scheme first, the revenue to be received by the AMC will optically be lower. But you have to keep in mind that correspondingly the expenses which come to the AMC will also be lower. I think what is more important is that as we have showcased that for the nine months of December 2019, we have been able to actually improve the operating profit margin from 34 basis points last year to 35 basis

points. I just wanted to highlight one thing that the 35 basis points margin, which is an improvement of 1 basis point, is after taking a Rs. 30 crores mark down of investment in IL&FS preference share, which is after taking the impairment. If I would have not taken the Rs. 30 crores impairment of IL&FS preference share, the operating profit margin for the nine months of 31st December, 2018, would have been 36 basis points as compared to 34 basis points. So it is there in the footnote of our presentation, if you see. We have said on the face of it, it looks like 35 basis point improvement gone from 34 basis points, which is an improvement of 1 basis point. But if I take the Rs. 30 crores impairment we have taken and if I take the impact of that out from this number, then the operating profit margin would have gone up to 36 basis points from 34 basis points. Just to tell you, while this operating profit margin may optically look like 1 or 2 basis points, it is on an average AUM of Rs. 3.16 lakh crores. So, 1 basis point saving gives you a savings of Rs. 31 crores annually, and 2 basis point gives you Rs. 62 crores savings on an annual basis for a 12 months period. Pro-rata to that, we have got the benefit over a nine months period. I think this is a very important part of what we have presented today.

Moderator: Thank you. Our next question is from the line of Shubranshu Mishra from Motilal Oswal Financial Services. Please go ahead.

Shubranshu Mishra: Thank you for the opportunity, Sir. Congratulations on the good set of numbers. My first question is, again, I am taking a leaf from the previous questions on the upfront commissions. Now, we have trail so how is your captive banker going to look going forward? Because if that is also going to come up in your trails and the national distributors who would be giving you sizable AUM, are we going to see a sizable shift, are their preferences going to shift to other products, maybe say ULIP which could give them the RMs at HDFC Bank a better incentive? How do you look at the product penetration or product push, specifically at HDFC Bank, given it is the captive? And also large national distributors like NJ Invest versus say a product like ULIP?

Milind Barve: Now, let me tell you first things first, see this is now a change in the regulation, so everybody has to realign themselves towards the new regulations permit asset management companies to pay. This is not something that has been devised by any single particular fund house. And I am extremely confident that whether it is a bank or whether it is a national distributor, whoever it is, whatever model is there it gets recalibrated to get aligned to the new prescription from SEBI. So there may be a period of time where there is an adjustment time during which people shift from an upfront plus trail to a full trail, but that is only a matter of time before everybody readjusts. Number two, I would like to say that I think over a period of time mutual fund and its place in the portfolio of a retail investor has now become a reality. And I do not think any distribution community will want to shift away from what is generally accepted as an investment product and simply sell people into whether it is ULIP or other insurance products, that is a flawed argument. For example, even without the upfront commission, or let me put it the other way, the upfront commission that was being paid is anyway not even remotely comparable with the commissions paid by ULIPs, so in any case people now understand the complete and very clear distinction between a ULIP product versus a mutual fund. So, according to me, this distinction, this method of paying or shift in paying

from upfront plus trail to only trail is not going to change what the distributor decides to sell. Because in our mind it is not going to make a difference to what the customer is willing to buy.

Shubranshu Mishra: Sure. And my second question pertains to your cost of acquisition at a T30 location versus a B30 location for a retail customer, what would be the difference?

Milind Barve: Actually the cost of acquisition is in a way neutral as far as the AMC is concerned, because when you acquire a new customer in a B30 location now we are allowed to pay certain higher commissions which are allowed to be charged as a part of the scheme expenses. So we do pay higher commissions in the form of trail now to distributors in the B30 towns. But that does not impact the margins of the product because those additional cost is allowed to be charged as an additional charge to the overall scheme itself. And that is why the margins that we make on B30 as well as or what we make or what we call T30 is the same. But however, I would like to add that it is indeed important and the matter of pride for us that we are number two in the business of small towns, because we do see substantial growth. And in the past we have seen that the growth rate in smaller towns when it was first B15 which is now B30, the growth rate was actually higher than the larger towns. So, it is an interesting market place where the small towns do have a role to play. And it is important to be a meaningfully good player in that space.

Moderator: Thank you. Next we have a follow-up question from Prashant Rane from Exclusive Advisors. Please go ahead.

Prashant Rane: Some of the broking community is talking about around 25% reduction in income in terms of mutual fund distribution after 1st April when the new SEBI regulation comes in. So, can you just explain this? And if indeed that would also reduce your expenses in that proportion also? Thank you.

Milind Barve: **It is difficult to give a number** which in the form of percentages which describes what will be the fall, but at the end of the day one has to realize that the customer is going to pay less in terms of cost to anybody. So, that is what is going to be reduction on the cost. It would be very difficult to comment on the impact on any one particular distribution because it depends on who the distributor is, how much is the amount that he is selling of a particular fund, whether that fund is of a particular size, and most importantly, what might be the possible amount of reduction on each fund. So it will not be possible to actually give a number or predict a number at overall distributor level what is going to be the percentage fall.

Prashant Rane: Can you explain that regulation and how it will impact you?

Milind Barve: We expect that there will be an overall shift downwards in the commissions that are being paid to distributors by all fund houses. To that extent it is unfortunate but realistic to assume that all distributors will take some reduction in their overall incomes. And that is what is going to happen. We are also going to take a part of the reduction in TER, as we have said the impact is 24 basis points, what we will pass out might be 21 or 22 basis points. So, I think this is an exercise that we

believe the entire industry will be doing and I think we will be no exception to what others are doing.

Moderator: Thank you. Our next question is from the line of Madhukar Laddha from HDFC Securities. Please go ahead.

Madhukar Laddha: Hi Sir, congratulations on a good quarter. You mentioned that basically now with the changed rules we are just adding to trail commission the upfront commission divide by 3. Now, does that mean that your trail commission forever goes up by that much amount or does the trail commission fall off after the third year?

Milind Barve: Not necessarily, that is what I said when I answered an earlier question. Right now we are committing the trail and our working assumption is that this will happen for three years. After three years it is possible that the trail might come down. But it is difficult at this stage to make a commitment. See, you have to keep in mind that the AUMs in the future will also continue to grow and the TER that will become applicable will be different three years later than it is today. So it will be very difficult for us to make a prediction about what the commission payout will be on a three years forward basis.

Madhukar Laddha: But as of now does it mean that we are adding it? And for the fourth year also it would be like the equated trail commission as of now? I understand that after three years the AUM grows up, the TER comes down, so those changes will take place.

Milind Barve: So it will be reasonable to expect that there will be probably some review of the trail commission after three years, because that is the understanding that upfront was paid to receive funds for three year period. And that is how it will be. But I think as I said, it will be very difficult to comment anything about the future and that also we are talking about the fourth year.

Piyush Surana: And Madhukar, one more thing you need to remember is that this additional trail is only fresh sales. So when you take a weighted average of the book it will be the existing book and this incremental fresh sales, which is actually going to affect.

Moderator: Thank you. Our next question is from the line of Ishan Kashyap from Allegro Capital. Please go ahead. We will move to the next question, the next question is from Pallavi Deshpande from Smartkarma. Please go ahead.

Pallavi Deshpande: Sir, just wanted to understand what you just said in the previous question about the trail commissions. So, the trail commission is only going to be on the new book or also on the existing book?

Milind Barve: No, let us understand one thing, we talked about the trail commission in two context, one is the reduction that we have to do that when the new TER comes into effect, that will be on the entire book. Number two, as my colleague was explaining that now going forward we cannot pay any upfront commission, we have to pay only in the form of trail. So, those of whom we were... I must

tell you one thing, there were a number of distributors who were already on the full trail model, so nothing changes for them. But those who are getting paid upfront we will now have compensated the upfront by giving a slightly higher trail. Now that trail is not paid on the book, it is paid on the new business that they bring, because we are substituting the upfront commission which was paid also on the new business.

Pallavi Deshpande: So, just understanding this, so the existing distributors who were on trail just continue as they are, so what would be the share of distributors who are on trail already?

Milind Barve: In fact, it is very common to believe that the significant amount of the IFA community is already on full trail. It is also true that some of the national distributors and some banks were also shifting, in the process of shifting or already shifted to the full trail model. However, there were certainly some banks and a smaller portion of national distributors and some small distributors who were also taking upfront commission.

Moderator: Thank you very much. We will take that that as the last question. I would now like to hand the conference back to the management for closing comments.

Milind Barve: Just would like to thank you all for being on the call. I think we have just announced the set of numbers which I hope you find interesting. Once again, thank you for your interest and thank you for your questions. Thank you.

Moderator: Thank you very much. On behalf of UBS Securities, that concludes this conference. Thank you for joining us, ladies & gentlemen. You may now disconnect your lines.