



“HDFC Asset Management Company 4Q FY2019 Earnings Conference Call”

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Moderator: Ladies and gentlemen, good day and welcome to the HFDC Asset Management Company 4Q FY2019 Earnings Conference Call, hosted by JM Financial. 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 an operator by pressing “*” then “0” on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Sameer Bhise from JM Financial. Thank you and over to you, Sir!

Sameer Bhise: Thank you Aman. Good evening everyone. Welcome to HDFC Asset Management Company’s 4Q FY2019 call. To discuss the results, we have Mr. Milind Barve, Managing Director, Mr. Piyush Surana, Chief Financial Officer, and Mr. Simal Kanuga, Chief Investor Relations Officer of the company. May I now request, Simal to just brief us on the numbers and then we can go ahead. Over to you Simal!

Simal Kanuga: Thank you Sameer. Thanks team JM for hosting this call. Good evening everyone. We will as usual start with the quick overview of the quarter and the year that has gone by. We have Milind and Piyush both here who will take questions thereafter.

The presentation that we can refer to has been uploaded on our website as well as that of the exchanges.

In terms of the industry, the MF industry, the AUM grew by over 11% during the financial year 2018-2019. Equity oriented schemes saw net inflows to the tune of Rs.1.18 trillion. The quarter ended March of 2019 saw equity flows of approximately Rs.178 billion. The industry continues to see further shift to individual investors in terms of percentage of overall AUM.

The SIP book for the industry now stands at Rs.80 billion that is in terms of monthly inflows. So during the month of March, we saw over Rs.80 billion coming in through Systematic Investment Plan into the industry as a whole.

In terms of our business, the total AUM as of March 31, 2019 was Rs.3.44 trillion of which 48% is in equity oriented assets and balance 52% in non-equity oriented assets. We now enjoy a trust of over 5.3 million unique investors across 9.1 million live accounts.

During the financial year that went by our overall AUM grew by 18% and equity oriented AUM grew by 13%. Market share in terms of overall AUM now is at 14.5% while that in actively managed equity oriented AUM is at 16.2%. This means that we continue to retain our leadership position in total AUM as well as actively managed equity oriented AUM.

We continue to be the most preferred choice of individual investor with market share of 15.4% in individual AUM. In terms of number of unique investor our market share has actually grown and now it is 28%. Our systematic transaction book continues to remain stable. We saw an inflow of

over Rs.11.8 billion during March 2019 through systematic transaction. This came across 3.38 million customer accounts.

Our distribution mix as always has been highly diversified. We continue to retain our number two spot in terms of B30 AUM. Before we dive into financials, we would like to remind you of SEBI's October 22, 2018 circular wherein the regulator has prohibited payment of upfront commission and has further mandated that all scheme related expenses including distributor commission shall have to be paid by the scheme and not the asset management company. As a result, our expenses have decreased since scheme related expenses are now borne directly by the schemes. As a consequence of this, expenses now being borne by the scheme, the investment management fee they pay to the company will reduce by commensurate amount.

The financials for the year March 31, 2019 have been prepared in accordance with Ind-As. Accordingly financials for the previous year which were prepared under GAAP have been adjusted for comparative purposes.

In terms of numbers for financial year March 2019 we have reported a PAT of Rs.9306 million, so that is 930.6 Crores, a growth of 31% over the previous financial year. Our operating profit from core asset management business was at 12331 million that is 1233 Crores, a growth of 30%. PBT was 13747 million, a growth of 30%.

In terms of quarter ended March over March 2019 versus March 2018 we have reported a PAT of Rs.2762 million, a growth of 61% over the same quarter of the previous financial year. Operating profit from core asset management business was Rs.3634 million, a growth of 48%. PBT was Rs.4146 million, a growth of 50%.

We would like to definitely reiterate the fact that it would not be prudent to compare revenues due to changes effected by SEBI circular dated October 22, 2018. We would also want to kind of repeat this during the course of FY2018-2019 we have fully provided for our exposure in preference shares of IL&FS. We had exposure of Rs.400 million, 40 Crores to this particular investment in the books of the Asset Management Company. We had already provided approximately Rs.300 million in the first nine months of the current financial year, and have provided for the balance in the quarter that just went by.

Our operating profit margin as the basis points of the AUM now stands at 37 basis points. This was 34 basis points for the financial year 2017-2018. We have further increased our dividend payout ratio. As compared to 56% for the financial year 2017-2018, the payout ratio for the year that just ended has now gone up to 66%. This includes an interim dividend that we paid in March of Rs.12 per share and the Board today has recommended a final dividend of Rs.12 per share, which is subject to shareholder approval.

We will now leave the floor open to questions. I have both Milind and Piyush here and they will be happy to take any questions that you may have.

Moderator: Thank you very much. Ladies and gentlemen we will now begin the question and answer session. The first question is from the line of Subhanshu Mishra from BOB Capital Markets. Please go ahead.

Subhanshu Mishra: Thank you for the opportunity. Congratulations on a good quarter. A couple of questions; the first question is with respect of liquid funds that we see inflow in the first quarter of... (inaudible)

Moderator: Sir, I am sorry, we will have to move to the next question Sir. We request you to join the question queue and reconnect Sir. Thank you. The next question is from the line of Amit Nanawati from Nomura. Please go ahead.

Amit Nanawati: Just wanted to check on one thing, basically your core EBITDA if I look at in 4Q it has been exceptionally strong at 40-basis points and this is in context where in the past two quarters because of liquid flow your equity mix has declined, and there has been some benefit of removal of upfront commissions as well. And that will take some time to flow into real commissions, but just wanted to understand what portion of your flow or your equity stocks would already be on a full trail model before these upfront commissions were removed?

Milind Barve: Thank you for your question. I just want to clarify that even before the upfront commission was banned, roughly about a third of the flows or the AUM were on a full trail model. The other flows and the AUM as well had some element of upfront commission on it. The upfront commission is not consistently maintained at 1% it is sometimes a little lower, that was the breakup between full trail and upfront plus trail before the change happened. As you are aware, now the entire AUM as well as the new flow will come on full trail basis.

Amit Nanawati: Sir, basically over the next two years as your entire stock gets replaced by a new flow which will be only trail model, and ignoring the TER cut that has happened from April 1, what is the kind of benefit that you would have gained in the last two quarters or what is the normalization one should expect in the next one to two years?

Milind Barve: Very roughly speaking the benefit we get from the upfront commission is as follows: We have been charging the upfront commission to the P&L over a period of 12 months basis, so whatever upfront we were paying, we were dividing it by 12 and we were taking a charge earlier. Now there are no upfront payments at all, but there is a continuing charge of the upfront that we had already paid before October 22, 2018. That charge will get rundown by let's say by October 2019. After that we will only have the trail commissions. So say by September full month and few days of October we will benefit from the savings on the upfront commissions, which is currently hitting the P&L. Just to complete the answer on an average basis, let me give you more as an example. If somebody was paid 1% upfront commission, now we are not paying that 1% anymore. However, The trail fee has been increased by about 30 or 33 basis points approximately.

- Amit Nanawati:** The question rather was that since you will have benefit accruing till October, but the normalization of that 30 BPS now flowing into trail that will also happen over the next two years, right? So to that extent what is the kind of normalization in the revenue drop one should look at?
- Milind Barve:** That is already happening from the October 23 and even now also, because the higher trail fee is not something that is going to come after October. The higher trail fee has already been made effective right from October 22, itself.
- Amit Nanawati:** That is going to be only on the new flows that would be, right? Or not on the stock, which is already there sitting?
- Milind Barve:** On the stock that is already with us, we would have already paid upfront, so there is nothing more to be paid, so there is going to be no such P&L impact. In fact, the benefit will accrue till September after that it will remain constant. Cost will not go up after that.
- Amit Nanawati:** Secondly, I wanted to check, if you can detail us in terms of the TER cut, what has been shared both in terms of stock and flow separately?
- Milind Barve:** The TER as we had mentioned is about 24 basis points or 25 basis points impact on our equity AUM and one or two other debt funds. The impact that we have totally was about 25 basis points. We have now, effective from April 1, already passed on close to about 21.5 basis points to 22 basis points approximately so we will be taking an impact on the book of about 3.5 basis points to 4 basis points on the equity portion of the AUM which we have already factored. But in the same breath let me also mention that as you would have seen that our operating profit margin has seen a meaningful expansion in this current year, so what we expect is to be able to absorb the 4 basis points as a part of what we are already planning to do and which we had mentioned almost two quarters back when this new regulation was announced.
- Amit Nanawati:** And even on the flow it is just 3 basis points to 4 basis points of absorption?
- Milind Barve:** Flow is not connected with the book. Whatever we were paying as trail, that will get dropped by 21 basis points or 22 basis points approximately. The flow has a separate pricing model itself where there is basically a certain percentage of the TER being paid as the commission, now as you know, it is only the trail commission. So, approximately in every product whatever is the TER anywhere between on an average 60 to 65 percent is shared with the distributor and 35 to 40 percent is retained by the AMC. I have given you an approximate number. This is the average at the company level. At each distributor level it will be different.
- Amit Nanawati:** That is about it. Thank you.
- Moderator:** Thank you. The next question is from the line of Aman Shah from Jeetay Investments. Please go ahead.

Aman Shah: Thank you for taking my question. My question is here in India where we say equity AUM as a percentage of GDP is around 6% while we also have FII investment, which is roughly around 25% of GDP, so my question is when we have institutional ownership of equity is at around 30% to 32% do we see adoption of passive funds in India over the next five to eight years increasing like because we have in even in U.S. where the institutional ownership is 60% of GDP equity ownership there the large amount of funds are still passive oriented?

Milind Barve: Thank you for that question. Our view very clearly is that in India the retail investors are absolute return seekers and Indian fund industry including our fund house has been able to beat the benchmark over three and five years with a reasonable margin and even in the one year we have a number of funds which have beaten the benchmark. So whether it is the industry or us where the fund performance is beating the benchmark the case or the rationale for investors to put money in passive funds or index funds or ETFs does not exist and this is also borne by the fact that since the ETFs were launched in India the share of the ETFs in the total business has been fairly small. It is less than 5% or 8% of the total equity AUM of the industry, and also is predominantly invested by one large institutional investor, which is the EPFO. So we still believe that the Indian markets, Indian fund managers will continue to deliver outperformance over their benchmarks so investing in benchmarks yet indices like ETFs we do not see that as a threat at all right now.

Aman Shah: Thank you.

Moderator: Thank you very much. The next question is from the line of Ritwik Sheth from Deep Finance. Please go ahead.

Ritwik Sheth: Thanks for the opportunity. Sir, is it possible to quantify the impact of the SEBI circular in the current quarter since it was the first full quarter where the expenses were lower?

Milind Barve: We have already mentioned almost two quarters back that when the announcement was made, we had calibrated what will be the impact on our AUM at that time. It was 24 basis points. Now the AUM has gone up from the two quarters back, so it is 25 basis points.

Ritwik Sheth: No. Sir, I am talking about the lower expenses in the quarter because of no upfront commissioning?

Piyush Surana: We cannot quantify it in terms of numbers because there are a number of things happening. One, there is the expenses moving from the books of the AMC into the books of the schemes and these are expenses which are besides the commissions, even the scheme related expenses are shifting. That is one. The other thing is this whole amortization cycle which is running down, the effect of that is also there. So we would not be able to specifically quantify the effect in this quarter.

Ritwik Sheth: That is it from my side. Thank you.

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

Madhukar Ladha: Thank you for taking my questions. Congratulations on a good set of numbers. My first question is given that you mentioned that you are passing around 21 BPS, 22 BPS to distributors are we not risking the distributor backlash especially when it comes to banks and national distributors, the large distributors who can then kind of advice churns to their clients? So your thoughts on that. And my second question is it seems that the profitability on the incremental flows if it stays with us for a longer period of time, is lesser than the previous model where we pay the certain amount upfront and the scale was lot lower so how do you guys think of it and what would you prefer if you had the options?

Milind Barve: Two questions; the first question was I think you had asked about the distributor backlash. I think we understand that almost every asset management company that we are speaking to is going to do the same thing, which is passing on the reduction in the TER in the form of reduction in the commission payout, so in that sense we believe we are not doing something unique or different from what most of the other players and certainly some of the larger players are doing. Having said that at the end of the day, our commissions will still remain reasonably competitive as compared to what our peers will be paying and we also believe that if our fund performance is competitive we should be able to get and retain the market share that we have, leadership we have, particularly in the equity AUM business. The second question was- it is true that we were paying upfront commissions but the overall commissions that we were paying where we were paying upfront commission, was also making the business vulnerable to change because the upfront commission was getting clawed back only for the first 12 months, which means that if an investor came for 13 to 14 months there was an upfront commission hit plus the trail fee was paid. So now there is a clear saving. There are two ways in which we benefit. One is that the savings in the upfront which is an obvious saving. The trail will continue to be, the advantage of why the new proposed method is better is because it is consistent with the assets staying with us as a part of the AUM that we will continue to earn the fee and proportionately we will be paying to the distributor. In the past if there were assets, which went out and some assets did go out after the first 12 months then the total cost of that money will give us almost very little or any margin because of the upfront charge already being paid and we were not able to recover it once the 12 months were over. So on balance we are happy with the full trail model. It will take an extremely long time before it will start showing up in the margin reduction if at all, it will see the business benefits from two drivers; equity AUM benefits from A), the growth in the AUM because of valuation game in which the costs do not increase or change. The second driver of growth is the new business flows. Now the new business flows will probably if that is material then that would impact the margins in the future because the new business flows are priced slightly higher than the book AUM. But if the new flows are indeed very strong then the way I would put it, it is a good problem to have as compared to less flows. And in our case, we benefit from having a very large book, so for us the book is as valuable or more valuable than just necessarily looking at the flow.

- Madhukar Ladha:** Just one followup, can you give some colour on the age of the book? So what part of the equity AUM is more than one year old, two year old, and let us say three year old and how is the three year old book has been over the period of time?
- Milind Barve:** Unfortunately, we do not have the immediate data. See, the book changes everyday in terms of because of new flows are coming in everyday and every month, so that would be something that will remain fairly dynamic. I would say the average life of an investment when it stays with us is measured by the way of measuring the redemptions when they go out, is roughly about close to about two years. It is little over two years.
- Madhukar Ladha:** So in that sense on an average the new method is still more profitable because you have amortized the upfront over a period of three years that is what you have done?
- Milind Barve:** We actually are fine with the new method because it is simply consistent to the assets staying with us. We are not paying for one year money.
- Madhukar Ladha:** Thank you. Best of luck for the future.
- Moderator:** Thank you. The next question is from the line of Rohan Advant from Multi-Act. Please go ahead.
- Rohan Advant:** Thanks for the opportunity. Sir, my first question was regarding an understanding on the impact of TER starting this April, you said there would be a 4 basis points to 5 basis points absorption that we have to do, is this on the Q4 base of our operating profit to AUM or FY2019 base of operating profit to AUM, because the profitability seems to have improved significantly in Q4?
- Milind Barve:** There are two drivers. As you have noticed that the profitability in terms of operating margins has already expanded, so that has created the room for us to absorb the margin fall that will happen, so that margin fall will start getting reflected from the first quarter but we believe that our margins will still be able to, sort of, use the operating leverage from the businesses that we have because our employee and other fixed costs will grow at a very, very low rate. So this is a business of scale and it has a tremendously positive impact on economies of scale. My CFO is pointing out the 4 basis points or 5 basis point is on the equity AUM, which is roughly 48% of the total AUM. The impact on the entire business will be proportionately hardly 2 basis points to 2.5 basis points.
- Rohan Advant:** Sir, my second question was regarding trail commissions, what would be the differential between the trail commissions on existing books versus new flows?
- Milind Barve:** That varies from every distributor. So, we do not have a number which will show you, which can actually tell you how much is the exact difference between new flows and the book pricing.
- Rohan Advant:** Sir, the reason I asked this question was are the new rules going to reduce the switching that is being done by distributors and create more stickiness to our flows in your opinion?

Milind Barve: We do believe so very much because there is now no commercial incentive for a distributor. We do not first of all believe that it is always the distributor who is making or inducing the churn, many distributors are extremely high quality and believe in long-term investing, but if at all there was anything that the investor did to create higher commissions in the upfront regime then that does not matter. So now we do not expect that people will move from product A to B simply for there is a small differential in the trail commission. It is not compelling enough for anybody to advice a churn just to get some differential trail commissions.

Rohan Advant: Sir, my last question was that larger schemes will now have more TER and vice versa. So would we incentivize the channel to push smaller schemes and have impact on us because we have a large number of large schemes?

Milind Barve: I would say firstly the channels we believe are very professional and I think the first criteria for them to recommend the fund is investment performance more than the small differential in the TER or the trail fee. In one sense, if the TER is lower on a larger fund, it is actually more advantageous to the investor to invest in a larger fund, but if you have investment performance which is competitive then the distributor is more incentivized to recommend because he has his own reputation and relationship at risk, so he will clearly want to recommend something which is in his view is appropriate to the customer and also has competitive investment performance.

Rohan Advant: Got it. Those were my questions. Thanks for taking them. All the best for the future.

Moderator: Thank you. The next question is from the line of Aadesh Mehta from Ambit Capital. Please go ahead.

Aadesh Mehta: Sir, we have seen that in March the inflows have almost doubled in equity schemes. Are we seeing that sustaining, already 26 days have passed in April?

Milind Barve: We would not be able to comment on anything in April, A) because the data for the industry is not available, but yes if you have seen the industry numbers they were about 4000 and 5000 in January-February, it was 5000 in January and 4000 in February. They improved to about 8000 on a consolidated basis in March. So it is difficult. We do not have industry numbers in the middle of the month.

Aadesh Mehta: But internally are we seeing at least for us that trend sustaining?

Milind Barve: It is difficult to say. I mean obviously there are a number of factors. It is the state of the market, we have an election, which is around the corner, and so I think it is reasonable to expect some sensitiveness on investors to hold back or defer decisions for a short period of time. So we believe that people even if they redeem, they have the money and will come back into the markets because that we do not see a very clear avenue that that money is shifting to.

Aadesh Mehta: Thank you.

- Moderator:** Thank you. The next question is from the line of Arjun Asher from Envision Capital. Please go ahead.
- Arjun Asher:** What have been the trends in net flows in equity for you, for the past three years?
- Milind Barve:** Last three years?
- Arjun Asher:** Yes, three financial years, what have been the trends in net flows into equity?
- Milind Barve:** So let me put it this way that we have been able to maintain our equity market share around 16%. It was 16.8% last year, it was 16.2% that is a combination of investment performance, that is a valuation gain as well as net flows. We do not disclose net flows separately for the AMC because these are not published by any of our competitive players, our peers as well.
- Arjun Asher:** But overall are you satisfied with the extent of penetration of equity, mutual fund product in the country for the last three to five years versus the trailing three to five years before that?
- Milind Barve:** Certainly if you look at the flows over a larger period of about five to eight years, before 2014-2015 the trend of flows was actually negative 11000 and 14000 Crores but from 2014-2015 that turned positive of the order of almost 80000 Crores went to 85000 Crores then to 93000 Crores and then the year before the March 2019, which is March 2017-2018 it went to a staggering 240000 Crores. I think what we will see in this year the industry number has come down from 240000 Crores, which I would treat more as an aberration year it is largely driven by the demonetization effect. This year the industry has cumulatively done 119000 Crores of new flows in equity products. When I refer to equity, I am referring only to actively managed equity funds, not ETFs. So that flows have been 119000 Crores which is a run rate of roughly 10000 Crores a month and I think it is kind of normalized from that extremely high number of 20000 Crores a month, which was the previous year.
- Arjun Asher:** In our equity AUM what percentage of our exposure would be to large caps because you have variety of schemes and the portfolio was disclosed but you would have a collated rough estimate?
- Milind Barve:** We have large cap fund, which is called the HDFC top 100 which is about 16000 Crores in terms of total AUM. See mid and small is about 27000 Crores and others are either in multicap or large cap.
- Arjun Asher:** Thank you Sir. That is all from my side.
- Moderator:** Thank you. The next question is from the line of Nitin Rao from Alfa Ideas. Please go ahead.
- Nitin Rao:** Thank you for allowing me to ask a question. Sir, my question is related to the distribution channel. I notice that in last year the banking channel which includes HDFC Bank and other banks accounted for 27% or 28% of our distribution network and this year it has come down to

let us say 22% and the share of direct has gone up from 34% odd to 38%. Do you see this trend to play out in the coming years as well and you envisage a scenario where direct can account as much as 50% going forward?

Milind Barve: First to answer the question on the direct business, it has gone on a total AUM basis from 34% to 38%, this is the total AUM which includes the liquid fund. As far as the banks are concerned, it is 14% and it was earlier 17%, so there is a little fall in the bank's contribution. This is all banks consolidated. So, as far as HDFC Bank is concerned, they remain roughly around 8.6%. So it is not big fall.

Nitin Rao: Sir, do you see the share of direct going up? What I mean to say is, is this the trend that you see playing out in the next coming years? That is my question.

Milind Barve: Yes. We do see the trend of direct increasing. More and more people are becoming aware of the lower cost as direct plans and are opting for it. It is also being to some extent recommended or being triggered through the advisory channel who are recommending direct plans. The other source of this direct flows comes from people who are buying other product online and people who are walking into our branches, but I would say the recommendations from the advisors to buy into the direct plan is a large contributor followed by the participation or buying into our products through online.

Nitin Rao: Thank you Sir.

Moderator: Thank you. Ladies and gentlemen the next question is from the line of Laxmi Narayanan from Catamaran. Please go ahead.

Laxmi Narayanan: Couple of questions from my side. First question is in terms of your branch expansion, what has been the expansion in the last one year? Second question is pertaining to other investment products such as AIF if you want to really expand and AIF and PMS how large it is? The third question is you mentioned 37 BPS on total AUM. How do you split between equity and debt? These are my three questions.

Milind Barve: Your first question was on branches. We have 210 branches. Just to tell you that the previous year we added almost 35 to 40 new branches. In the last year we have not added to new branches, but in the current year as part of our business plan we propose to add 18 branches, so we usually look at some of the business parameters surrounding the industry and our own business and then we plan to add branches usually in small locations or new towns and sometimes very rarely additional in to the metros. So that is as far as the branch is concerned. The AIF and PMS business, we do have a PMS business. It is not a very large part of our offering. We do have a separately managed business under the PMS which is where we manage international mandates. The total PMS business including international mandate is almost 9500 Crores. So we are not in AIFs right now and we do not have any immediate plans to be in AIF, but the PMS which includes international mandates is of the order of about 9000 Crores. Is ADIA considered here ??

Laxmi Narayanan: Third question is regarding the profitability of debt and equity because you gave a 37 BPS overall?

Milind Barve: The profitability on equity is almost two times of that of debt. We do not disclose margins on each group of products but debt is almost half as profitable as equities and that is why we believe equity is the core business which is more revenue earning.

Laxmi Narayanan: Thank you so much.

Moderator: Thank you very much. Ladies and gentlemen that would be our last question for today. I now hand the conference over to Mr. Sameer Bhise for closing comments. Thank you and over to you Sir!

Sameer Bhise: Thank you very much. On behalf of JM Financial I would like to thank the management of HDFC Asset Management for joining us the call today. Thank you.

Milind Barve: Thank you everyone.

Moderator: Thank you. On behalf of JM Financial Services that concludes this conference. Thank you for joining us. You may now disconnect your lines.