Asset Management

SEBI notifies significant changes to TER structure

JM FINANCIAL

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Company	Reco.	TP	Previous TP
RNAM	BUY	INR 275	INR 330

In its board meeting held today, SEBI has notified reductions in the maximum TER that can be charged to mutual fund schemes. The regulator has also notified that all commissions and expenses are to be expensed from the MF schemes alone and not through any other route (AMC/Trustee P&Ls – a common industry practice). Moreover, AMCs will no longer be allowed to pay out upfront commissions (except for certain relaxations in the case of SIPs). While the move is a positive step towards increasing reach and reducing costs for retail MF investors and also improves transparency, it has a negative impact on profitability for AMCs. We believe there will be a period of growth/profitability reset as the industry reconfigures to the new cost structure. We expect the brunt of the impact to be borne in equity MF schemes (which are heavily dependent on distributors, with direct plan accounting for only 17% for the industry). Moreover, as shown in Exhibit 1 below, the cut in TER is larger for larger MF schemes. We have cut our PAT estimates for RNAM by 7% / 15% in FY19/FY20E, as a result of the fee yield compression from TER cut.

Brunt of TER cut to be borne by larger schemes : As shown in Exhibit 1 below, larger TER cuts have been handed out for large MF schemes. This is expected to have a negative impact on AMCs which operate large MF schemes. Equity MF schemes with AUM above INR 20bn, will have to reduce their TER by 15-70bps. The brunt of the impact of TER reduction is expected to be borne by equity MF schemes, which largely operate close to the current TER cap of 2.1%. This is mainly because they are heavily dependent on commission payouts to distributors (83% of industry equity AUM is sourced through distributors as of Aug-18).

Blended TER for Equity MF schemes could reduce by 20-35bps : We have analysed the larger equity MF schemes, comprising 70-90% of Equity MF AUMs of HDFC AMC, Birla SL AMC and RNAM. Our analysis suggests that blended equity MF TER for RNAM/ Birla SL AMC could reduce by c.24bps / 28bps, whereas the impact would be higher for HDFC AMC (UNRATED), as it operates several large equity MF schemes (5 of its schemes are above INR 150bn in AUM forming 75% of equity AUM).

AMCs with higher direct-plan AUM contribution to benefit : AMCs with stronger contribution of direct plan AUMs are expected to be better off, as they are less reliant on upfront commission payouts. Moreover, overall fee yields will be less detrimentally impacted from the TER cuts for AMCs with high direct-plan contribution. Direct plan as a % overall equity MF AUM was 19 % / 16% / 21% for HDFC AMC, RNAM and Birla SL AMC as of Aug-18.

Withdrawal of upfront commissions could lead to higher trail payouts? While management fee yields for AMCs will come under pressure as a result of the reductions in TER, we believe the withdrawal of upfront commissions could result in higher trail payouts as the AMCs could face backlash from distributors. Moreover, AMCs will have to expense all the trail commission payouts through the P&Ls of the schemes alone (and not through AMC P&Ls as was prevalent earlier). We believe, that the reduction in the allowable TERs, coupled with higher trail payouts could result in further compression in yields for AMCs. We expect management fee yields for RNAM to reduce by 9 / 19bps in FY19E/ FY20E (impact on FY19E is only for half year).

Revision in earnings, target price : We expect management fee yields for RNAM to reduce by 9 / 19bps in FY19E/ FY20E (impact on FY19E is only for half year). As a result, we have cut our earnings estimates for RNAM by 7% / 15% for FY19E / FY20E arising from the compression in management fee yields. We cut our target price for RNAM to INR 275 (from INR 330 previously), valuing the company at 27x FY20E EPS.

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Key Charts

Exhibit 1. Reduction in TER for equity MF schemes – Larger schemes to face the brunt

Equity MF Scheme AUM (INR bn)	Maximum TER allowed (old)	Maximum TER allowed (new)	TER Impact (bps)
0-1	2.50%	2.25%	-25
1-4	2.25%	2.25%	-
4-5	2.00%	2.25%	25
5-7	2.00%	2.00%	-
7-7.5	1.75%	2.00%	25
7.5-20	1.75%	1.75%	-
20-50	1.75%	1.60%	-15
50-100	1.75%	1.50%	-25
100-150	1.75%	1.45%	-30
150-200	1.75%	1.40%	-35
200-250	1.75%	1.35%	-40
250-300	1.75%	1.30%	-45
300-350	1.75%	1.25%	-50
350-400	1.75%	1.20%	-55
400-450	1.75%	1.15%	-60
450-500	1.75%	1.10%	-65
500- onwards	1.75%	1.05%	-70

Source: Company, JM Financial # These figures exclude additional 5bps (in lieu of exit load) and additional 30bps (on meeting B30 criteria)

Exhibit 2. RNAM : Revision in earnings estimates

	EPS (INR)		Consol. PAT (INR mn)	
	FY 19E	FY 20E	FY 19E	FY 20E
Revised Estimates	9.1	10.1	5,591	6,209
Previous Estimates	9.8	11.9	6,017	7,309
Change New vs old	-7%	-15%	-7%	-15%

Source: Company, JM Financial

Exhibit 3. RNAM : Impact of reduction in TER on major Equity MF schemes

Reliance MF	Monthly avg AUM (INR mn)	Existing TER (incl. tax)	Existing TER - Net of tax (i.e. adjusting for 18% GST)	New regime (without additional 35bps)	New regime (net of tax) (with B30 adjustment and additional 5bps)*
Major Equity MF Schemes					
Reliance Vision Fund	32,135	2.17%	1.84%	1.60%	1.69%
Reliance Growth Fund	69,264	2.10%	1.78%	1.50%	1.55%
Reliance Focused Equity Fund	45,125	2.24%	1.90%	1.60%	1.75%
Reliance Small Cap Fund	73,016	2.31%	1.96%	1.50%	1.71%
Reliance Value Fund	33,197	2.22%	1.88%	1.60%	1.73%
Reliance Multi Cap Fund	99,695	2.16%	1.83%	1.50%	1.58%
Reliance Equity Hybrid Fund	1,42,760	2.26%	1.92%	1.45%	1.62%
Reliance Equity Savings Fund	26,281	2.09%	1.77%	1.60%	1.65%
Reliance Banking Fund	30,984	2.16%	1.83%	1.60%	1.68%
Reliance Pharma Fund	24,143	2.42%	2.05%	1.60%	1.90%
Reliance Tax Saver (ELSS) Fund	1,02,633	2.28%	1.93%	1.45%	1.63%
Monthly avg AUM (of above schemes)	**6,79,233**	**2.22%**	**1.89%**	**1.51%**	**1.65%**
Total Equity monthly avg. AUM (August)	9,34,915				
% of equity AUM covered by above schemes	72.7%				

Source: Company, JM Financial * Additional 5 bps (in lieu of exit load) + upto 30bps on meeting B30 AUM / gross inflow criteria

Exhibit 4. HDFC AMC : Impact of reduction in TER on major Equity MF schemes

HDFC MF	Monthly avg AUM (INR mn)	Existing TER (incl. tax)	Existing TER - Net of tax (i.e. adjusting for 18% GST)	New regime (without additional 35bps)	New regime (net of tax) (with B30 adjustment and additional 5bps)*
Major Equity MF Schemes					
HDFC Balanced Advantage Fund	3,84,883	2.25%	1.91%	1.20%	1.36%
HDFC Hybrid Equity Fund	2,28,866	1.95%	1.65%	1.35%	1.40%
HDFC Equity Fund	2,21,684	2.06%	1.75%	1.35%	1.40%
HDFC Mid Cap Opportunities Fund	2,15,573	2.11%	1.79%	1.35%	1.40%
HDFC Top 100 Fund	1,54,820	2.02%	1.71%	1.40%	1.45%
HDFC Equity Savings Fund	74,990	1.94%	1.64%	1.50%	1.55%
HDFC TaxSaver	71,072	2.11%	1.79%	1.50%	1.55%
HDFC Small Cap Fund	48,161	2.14%	1.81%	1.60%	1.66%
HDFC Capital Builder Value Fund	37,090	2.31%	1.96%	1.60%	1.81%
HDFC Children's Gift Fund	23,843	2.22%	1.88%	1.60%	1.73%
Monthly avg AUM (of above schemes)	**14,60,982**	**2.10%**	**1.78%**	**1.35%**	**1.43%**
Total Equity monthly avg. AUM (August)	16,09,300				
% of equity AUM covered by above schemes	90.8%				

Source: Company, JM Financial * Additional 5 bps (in lieu of exit load) + upto 30bps on meeting B30 AUM / gross inflow criteria

Exhibit 5. Birla SL AMC : Impact of reduction in TER on major Equity MF schemes

ABSL MF	Monthly avg AUM (INR mn)	Existing TER (incl. tax)	Existing TER - Net of tax (i.e. adjusting for 18% GST)	New regime (without additional 35bps)	New regime (net of tax) (with B30 adjustment and additional 5bps)*
Major Equity MF Schemes					
Aditya Birla Sun Life Tax Relief '96	67,427	2.26%	1.92%	1.50%	1.67%
Aditya Birla Sun Life Balanced Advantage Fund	32,429	2.38%	2.02%	1.60%	1.87%
Aditya Birla Sun Life Equity Hybrid '95 Fund	1,48,738	2.29%	1.94%	1.45%	1.64%
Aditya Birla Sun Life Frontline Equity Fund	2,15,350	2.18%	1.85%	1.35%	1.45%
Aditya Birla Sun Life Focused Equity Fund	42,431	2.36%	2.00%	1.60%	1.85%
Aditya Birla Sun Life Equity Fund	99,984	2.24%	1.90%	1.50%	1.65%
Aditya Birla Sun Life Equity Advantage Fund	64,304	2.35%	1.99%	1.50%	1.74%
Aditya Birla Sun Life MNC Fund	35,435	2.29%	1.94%	1.60%	1.79%
Aditya Birla Sun Life Midcap Fund	23,563	2.40%	2.03%	1.60%	1.88%
Aditya Birla Sun Life Small Cap Fund	22,751	2.42%	2.05%	1.60%	1.90%
Aditya Birla Sun Life Pure Value Fund	41,463	2.35%	1.99%	1.60%	1.84%
Monthly avg AUM (of above schemes)	7,93,874	2.27%	1.93%	1.47%	1.65%
Total Equity monthly avg. AUM (August)	9,35,314				
% of equity AUM covered by above schemes	84.9%				

Source: Company, JM Financial * Additional 5 bps (in lieu of exit load) + upto 30bps on meeting B30 AUM / gross inflow criteria

APPENDIX I

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