

Reliance Nippon Life Asset Management (RNAM IN)

Target Price **Rs315.0**
 Current Price **Rs247.6**
 % Upside **27%**

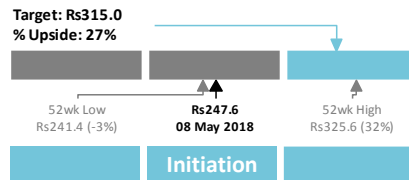
Well Positioned to Capture the Mutual Fund Story in India

Capital Markets

India

08 May 2018

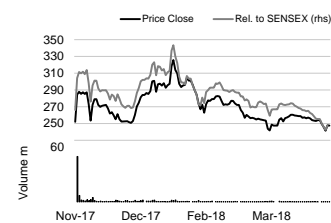
BUY



Basic Share Information

Market cap	Rs151.5b / US\$2.26b
Daily traded value (3mth)	US\$0.68m
Shares outstanding	612.0m
Free float	14%
Foreign Shareholding	46%
1 yr high	Rs325.6
1 yr low	Rs241.4

Price/Volume



Source: Bloomberg

	1mth	3mth	12mth
Absolute	-3.7%	-10.8%	%
Absolute USD	-6.8%	-14.6%	%
Relative to SENSEX	-8.4%	-13.1%	%

Net Yields Should Rise Driven by Increase in Equity AUM

Summary: Reliance Nippon Asset Management (RNAM) is amongst the top four asset management companies by mutual fund AAUM as of March 2018 and is the only listed asset management company in India. The industry has been going through rapid expansion over the last couple of years and RNAM has been one of the beneficiaries with its AUM growing at 21% during FY3/16–18. This was mainly led by financialization of assets in India, which we think would continue given government focus and massive investor education initiatives. RNAM is well placed to take advantage given its presence across India and its strength with the Independent Financial Advisor (IFA) channel. Also, the company runs one of the most efficient asset management companies with one of the highest net yields. We expect an AUM CAGR of 15% for the company and a NP CAGR of 16% over FY3/19–21. Hence, we initiate with a BUY recommendation on the stock.

Target Price and Catalyst: We value RNAM using a dividend discount model and arrive at a target valuation of Rs192.6bn, implying a target FY3/21 P/E of 23.4x and FY3/21 valuation/AAUM multiple of 5.2%. Increase in proportion of equity as a percentage of total AUM would be the key catalyst for the stock as it would lead to increase in charging ability of the mutual fund.

Earnings: RNAM has seen an increase in its proportion of equity AUM to 36% as of March 2018 compared to around 27% as of March 2017. Given equity funds have higher investment management fees compared to debt and liquid funds, higher equity proportion is likely to increase the net yield (net profit as a percentage of average AUM). Thus, while we expect mutual fund AUM CAGR for RNAM of 15% over FY3/19–21, we forecast an even higher rate of NP CAGR of 16% over this period.

Valuation: We value RNAM using a dividend discount model and arrive at a target valuation of Rs192.6bn for RNAM, implying a FY3/21 PE of 23.4x and a FY3/21 valuation/AAUM multiple of 5.2%. The main risk to our target price is any adverse movement in equity markets as it would impact the overall mutual fund industry and RNAM would also get impacted.

	Mar-17A	Mar-18A	Mar-19E	Mar-20E	Mar-21E	Trend
Total turnover (Rsm)	14,359	18,150	19,922	22,753	26,010	▬ ▬ ▬ ▬ ▬
Operating profit (Rsm)	5,772	7,260	8,401	9,809	11,467	▬ ▬ ▬ ▬ ▬
Pre-tax profit (Rsm)	5,813	7,260	8,401	9,809	11,467	▬ ▬ ▬ ▬ ▬
Net income to ord equity (Rsm)	4,028	5,220	6,040	7,053	8,245	▬ ▬ ▬ ▬ ▬
Net profit growth	1.6%	29.6%	15.7%	16.8%	16.9%	▬ ▬ ▬ ▬ ▬
P/E (x)	0.71	29.02	25.08	21.48	18.37	▬ ▬ ▬ ▬ ▬
P/B (x)	0.15	6.62	6.29	5.94	5.58	▬ ▬ ▬ ▬ ▬
ROE	22.2%	25.2%	25.7%	28.5%	31.3%	▬ ▬ ▬ ▬ ▬
Dividend yield	104.5%	2.9%	3.2%	3.7%	4.4%	▬ ▬ ▬ ▬ ▬
EPS HTI New (Rs)	349.6	8.5	9.9	11.5	13.5	▬ ▬ ▬ ▬ ▬
Consensus EPS (Rs)		8.54	10.57	12.97		▬ ▬ ▬ ▬ ▬
HTI EPS vs Consensus	na	(0.1%)	(6.6%)	(11.1%)	na	▬ ▬ ▬ ▬ ▬

Source: Company data, Bloomberg, HTI estimates

Click [here](#) to download the working model

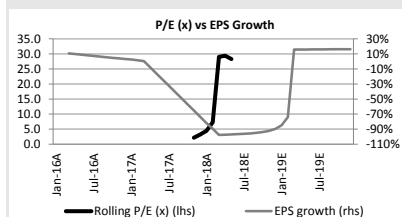
Hitesh Gulati, CFA
 Haitong International Research Ltd
 hitesh.gulati@htisec.com

Santosh Singh CFA
 Haitong International Research Ltd
 santosh.singh@htisec.com

Hong Kong Office (852) 2899 7090
 Tokyo Office (81) 3 3560 9300
 London Office (44) 20 7397 2700
 New York Office (1) 212 867 7300
 Mumbai Office (91) 22 43156839

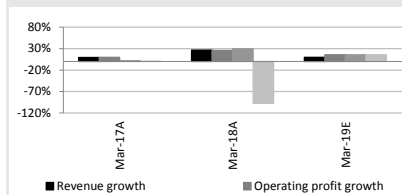
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Valuation



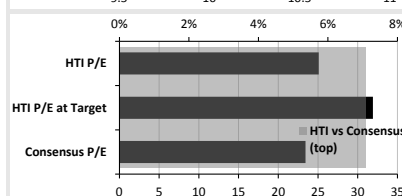
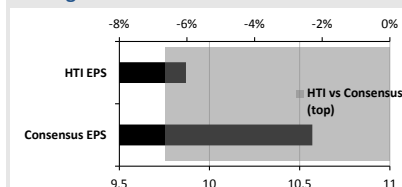
Source: Company data, Bloomberg, HTI estimates

Earnings Trends



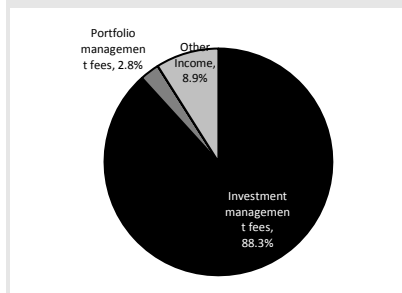
Source: Company data, Bloomberg, HTI estimates

Earnings: HTI vs Consensus



Source: Company data, Bloomberg, HTI estimates

Sales Breakdown



Source: Company data

Investment Thesis

BUY

► Financial savings of households in India should increase and within financial savings, capital markets investments are gaining traction. Over the past two years, the household allocation to shares and debentures has increased from 2% in FY3/15 to 10% in FY3/17 (based on CRISIL research where FY3/17 numbers are based on preliminary estimates). RNAM is the fourth largest by mutual fund AAUM as of March 2018 mutual fund in India (as per AMFI) with mutual fund AAUM of Rs2.2trn as of March 2018 and should benefit from this trend

► As of March 2018, RNAM had the highest percentage share of retail assets in the country with a total market share of around 14% among asset management companies in India, according to AMFI. Retail average assets under management (AAUM) has grown faster than total AAUM resulting in increased contribution of retail AAUM to total AAUM from 25% as of March 2017 to 30.5% as of March 2018 (compared to 24% for the industry)

► RNAM also had one of the highest total mutual fund MAAUM (monthly average assets under management) among all asset management companies in India from beyond top 15 locations, as of March 2018, according to AMFI. These assets have grown at 38% YoY over the one year from March 2017 to March 2018

► RNAM had increased the proportion of equity AUM to 36% as of March 2018 compared to 27% as of March 2017. Given equity funds have higher investment management fees compared to debt and liquid funds, higher equity proportion is likely to increase the gross yield (revenues as a percentage of average AUM)

► Multi-channel distribution network: RNAM has built a diversified distribution network with high proportion of direct selling (45% of monthly AUM as of March 2018)

Company Snapshot

Reliance Nippon Life Asset Management Company is one of the largest asset management companies in India, managing total AUM of Rs3.96trn as of March 2018. It is promoted by Reliance Capital (RCAP IN) (with business interests including in asset management and mutual funds, life, health and general insurance, commercial and home finance, stock broking, wealth management services, distribution of financial products, asset reconstruction and proprietary investments) and Nippon Life Insurance Company (one of the leading private life insurers in Japan with assets of approximately US\$577bn, as of 31 March 2017). RNAM started its mutual fund operations in 1995 as the asset manager for Reliance Mutual Fund and managed QAAUM (Quarterly Average Assets Under Management) of Rs2.26trn and 8.1mn investor folios, as of March 2018. It has a pan-India network of 282 locations and approximately 65,300 distributors including banks, financial institutions, national distributors and independent financial advisors (“IFAs”), as of March 2018.

Key Investment Metrics

Revenue Growth

Low Medium **High**

Management fees recorded a CAGR of 23% over FY3/16–18; we expect management fee to post a CAGR of 15% over FY3/19–21, mainly driven by slower growth in average AUM, which we also expect deliver 15% CAGR over FY3/19–21.

Profit Margins

Low Medium **High**

We expect operating margin to improve from 40% in FY3/18 to 44.1% in FY3/21, mainly driven by slower increase in employee costs. We expect net profit margin to improve from 28.8% in FY3/18 to 31.7% in FY3/21.

Shareholder Returns

Low Medium **High**

We expect ROE to improve from 25.2% in FY3/18 to 31.3% in FY3/21.

Balance Sheet Risks

High Medium **Low**

Asset management companies work on asset light model given that the main source of revenue is fee business collected from management of assets. The statutory requirement for balance sheet net worth is minimal at Rs500mn.

Barriers to Entry

Low Medium **High**

Brand recall with customer and distribution play a big part in setting up a successful asset management company. While many foreign players tried to penetrate the Indian AMC industry, most of them have been unsuccessful given their global brand did not have the same recall with the customer as the Indian domestic names.

International Exposure/Breakdown

High Medium **Low**

The company has negligible international exposure.

FX Exposure

High Medium **Low**

RNAM has negligible foreign currency exposure.

Corporate Governance

Low Medium **High**

The company's reporting of financials is in line with accepted standards.

Our Model Assumptions

We expect asset management fee to grow at a CAGR of 15% over FY3/19–21

Profit & Loss (Rsm)	Mar-17A	Mar-18A	Mar-19E	Mar-20E	Mar-21E
Asset management fee	13,075	15,860	18,239	20,975	24,121
Net fees and commission	13,075	15,860	18,239	20,975	24,121
Total turnover	14,359	18,150	19,922	22,753	26,010
Commission and fee expense	(2,594)	(3,090)	(3,554)	(4,087)	(4,700)
Total operating income	11,765	15,060	16,369	18,666	21,310
Compensation costs	(1,957)	(2,300)	(2,703)	(3,178)	(3,735)
Other operating costs	(4,036)	(5,500)	(5,265)	(5,679)	(6,108)
Total operating costs	(5,993)	(7,800)	(7,968)	(8,857)	(9,843)
Operating profit	5,772	7,260	8,401	9,809	11,467
Pre-tax profit	5,813	7,260	8,401	9,809	11,467
Net income to ord equity	4,028	5,220	6,040	7,053	8,245

Source: Company, HTI estimates

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✓ **Key P/L Takeaway**

We expect the net yield to improve from 21bps in FY3/18 to 22bps in FY3/21

Management fees recorded a CAGR of 23% over FY3/16–18; we expect management fee to post a CAGR of 15% over FY3/19–21, mainly driven by slower growth in average AUM, which we also expect deliver 15% CAGR over FY3/19–21.

We expect slower growth in employee compensation due to operating efficiency.

Our Model Assumptions

Increase in intangible assets FY3/17 is due to the intangible assets created on account of acquisition of asset management rights of Goldman Sachs' schemes pursuant to the acquisition of its ETF business

Balance Sheet (Rsm)	Mar-17A	Mar-18A	Mar-19E	Mar-20E	Mar-21E
Accounts receivable	432	410	410	410	410
Total investments	17,191	22,650	23,858	25,269	26,918
Tangible fixed assets	87	120	120	120	120
Intangible assets	2,425	2,200	2,200	2,200	2,200
Other assets	380	300	300	300	300
Total assets	20,513	25,680	26,888	28,299	29,948
Accounts payable	1,083	1,150	1,150	1,150	1,150
Other liabilities	504	1,660	1,660	1,660	1,660
Total liabilities	1,587	2,810	2,810	2,810	2,810
Common stocks	115	6,120	6,120	6,120	6,120
Other reserves	18,511	16,750	17,958	19,369	21,018
Shareholders' equity	18,626	22,870	24,078	25,489	27,138
Other equity	300	-	-	-	-
Total equity	18,926	22,870	24,078	25,489	27,138
Total liabilities & shareholders' equity	20,513	25,680	26,888	28,299	29,948

Source: Company, HTI estimates

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Key B/S Takeaway

The equity has increased in FY3/18 owing to profits and issue of fresh equity worth Rs6.17bn

Increase in intangible assets in FY3/17 is due to the intangible assets created on account of acquisition of asset management rights of Goldman Sachs' schemes pursuant to the acquisition of ETF business of Goldman Sachs Asset Management (India) Private Limited.

The equity has increased in FY3/18 owing to profits and issue of fresh equity worth Rs6.17bn.

Our Model Assumptions

Per Share Data	Mar-17A	Mar-18A	Mar-19E	Mar-20E	Mar-21E
EPS (Rs)	349.6	8.5	9.9	11.5	13.5
FDEPS (Rs)	349.6	8.5	9.9	11.5	13.5
Revenue per share (Rs)	1,246	30	33	37	42
BVPS (Rs)	1,617	37	39	42	44
DPS (Rs)	258.8	7.2	7.9	9.2	10.8
Shares in issue (million)	11.5	612.0	612.0	612.0	612.0
Year end adjusted shares in issue (m)	11.5	612.0	612.0	612.0	612.0
Key Ratios	Mar-17A	Mar-18A	Mar-19E	Mar-20E	Mar-21E
Valuation Measures					
P/E (x)	0.71	29.02	25.08	21.48	18.37
P/B (x)	0.15	6.62	6.29	5.94	5.58
Dividend yield	104.5%	2.9%	3.2%	3.7%	4.4%
Growth					
Revenue growth	9.3%	26.4%	9.8%	14.2%	14.3%
Operating profit growth	9.7%	25.8%	15.7%	16.8%	16.9%
Net profit growth	1.6%	29.6%	15.7%	16.8%	16.9%
Margins					
Operating margin	40.2%	40.0%	42.2%	43.1%	44.1%
Pretax profit margin	40.5%	40.0%	42.2%	43.1%	44.1%
Tax rate	30.7%	28.1%	28.1%	28.1%	28.1%
Net profit margin	28.0%	28.8%	30.3%	31.0%	31.7%
Key Ratios					
ROE	22.2%	25.2%	25.7%	28.5%	31.3%
ROA	20.2%	22.6%	23.0%	25.6%	28.3%
ROA (excl client assets)	20.2%	22.6%	23.0%	25.6%	28.3%
Sales/avg assets	0.72	0.79	0.76	0.82	0.89
Credit analysis					
Avg assets/avg equity (x)	1.10	1.11	1.12	1.11	1.11
Avg assets (excl client assets) /avg equity (x)	1.10	1.11	1.12	1.11	1.11

Source: Company, HTI estimates

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We expect operating profit margin to improve from 40% in FY3/18 to 44.1% in FY3/21

We expect ROE to improve from 25.2% in FY3/18 to 31.3% in FY3/21

✓ **Key Driver Takeaway**

We expect operating profit margin to improve to 44.1% in FY3/21, mainly driven by improvement in operating efficiency, and slower growth in employee costs

We expect operating profit margin to improve to 44.1% in FY3/21, mainly driven by improvement in operating efficiency, and slower growth in employee costs.

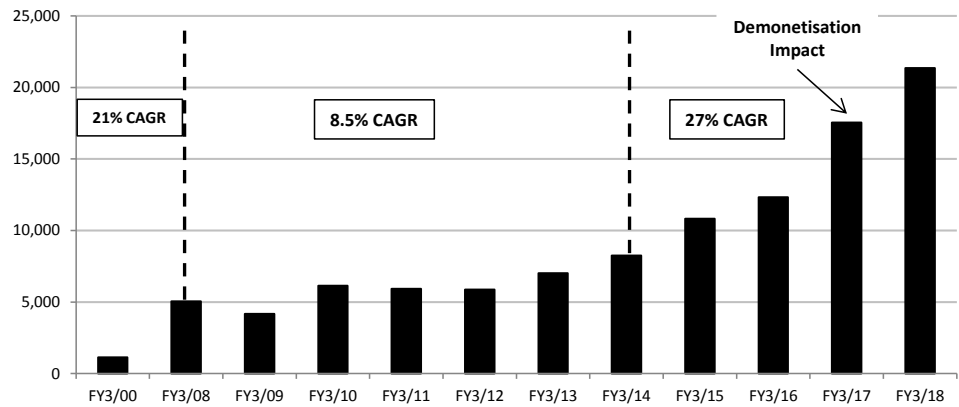
We expect ROE to improve from 25.2% in FY3/18 to 31.3% in FY3/21.

India's asset management industry has gone through a purple patch over the past couple of years supported by demonetization with a CAGR for AUM of 27% over the March 2014 – March 2018

Overview of Asset Management Industry in India

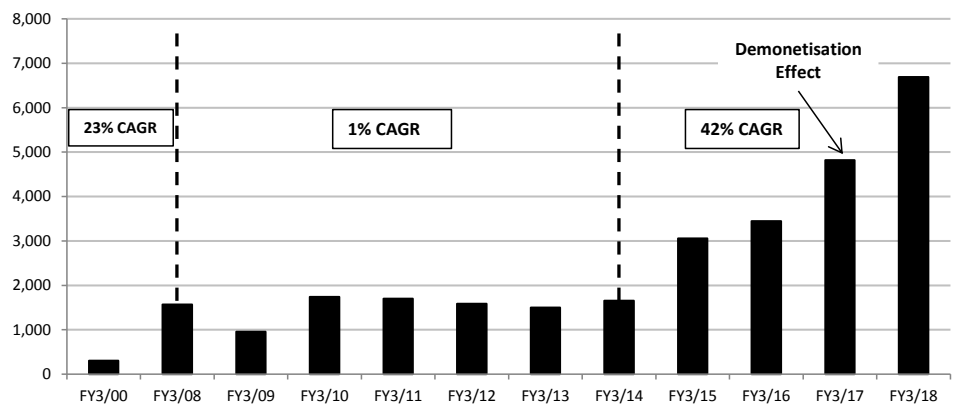
Indian asset management industry is going through a purple patch over the last couple of years which got a further boost post demonetization with the industry AUM clocking 27% CAGR over the three years to FY3/18. Equity AUMs for the asset management industry posted 42% CAGR over this period of time. The total AAUM for the industry touched almost US\$300bn and the equity AAUM has moved up to US\$130bn.

Total AAUM for Asset Management Firms in India (Rs bn)



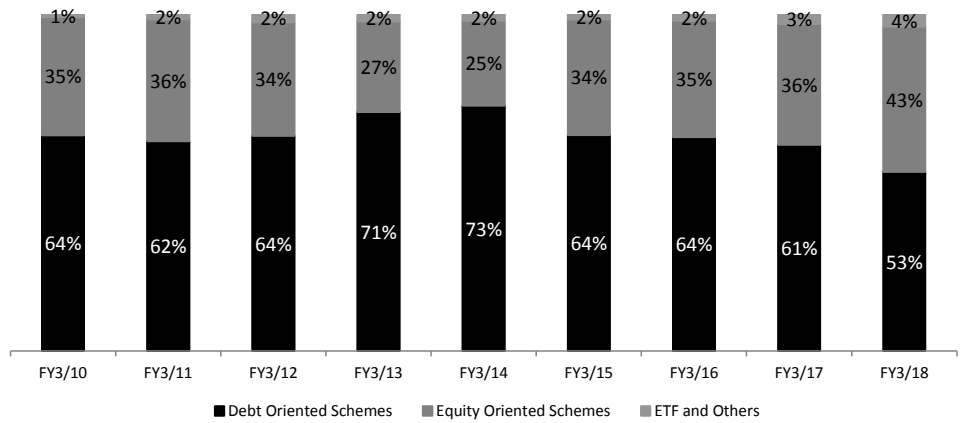
Source: AMFI [Association of Mutual Funds in India]
 Note: AAUM = Average Assets Under Management

Total Equity AAUM for Asset Management Firms in India (in Rs bn)



Source: AMFI

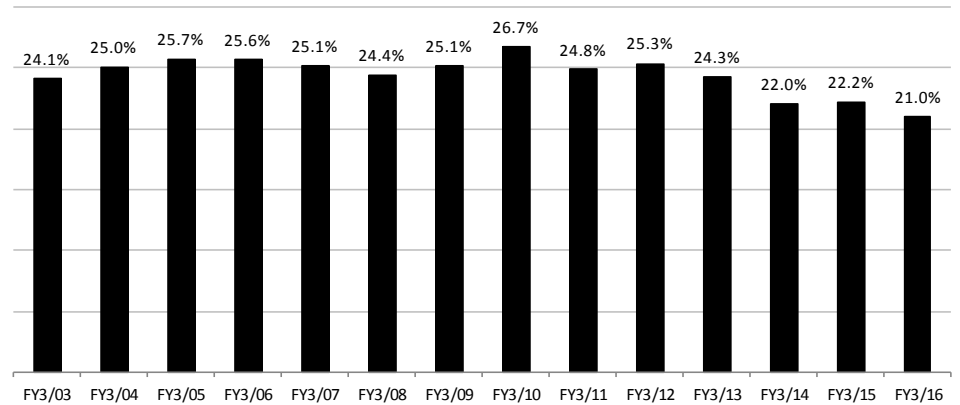
Total MAAUM Split



Source: CEIC Database

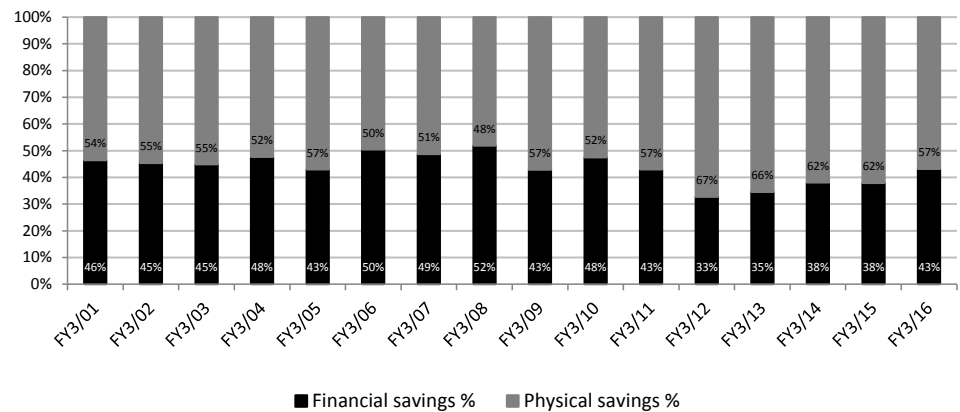
This has been mainly driven by the fact that the household saving moving into financial savings.

Household Savings (As A Percentage of GDP) in India



Source: RBI

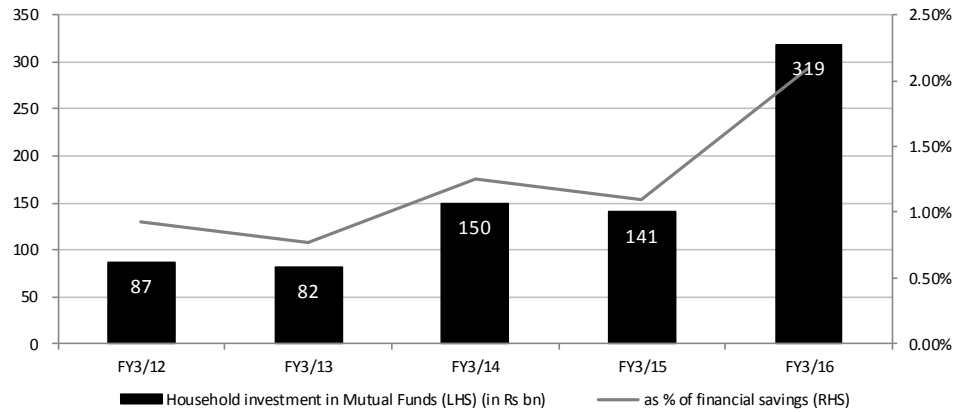
Financial and Physical Savings as a Percentage of Household Savings in India



Source: RBI

We believe that this movement of household savings into financial savings is structural in nature given the government focus and its intentions of making the system more transparent, which in turn means that real estate and gold which were main competitors of financial savings may not remain that attractive

Household Savings in Mutual Funds

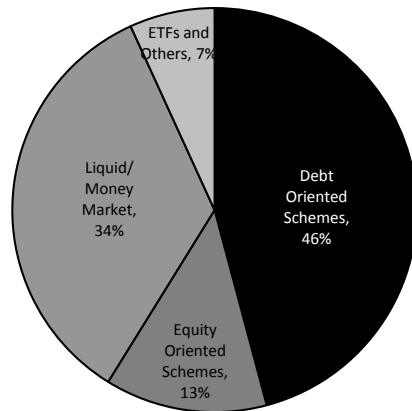


Source: RBI (Reserve Bank of India)

Is Increasing Participation in Mutual Funds Trend Structural or Cyclical?

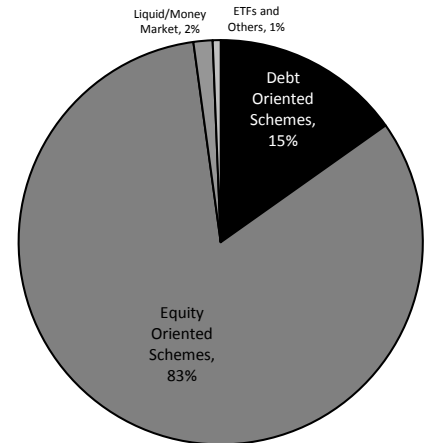
Looking at the history of the Indian asset management industry, we have noted a sharp growth for asset managers when equity markets were brisk, but we also saw a six-year lull in AUM growth (from FY3/08 to FY3/14 because of downturn in financial markets in FY3/08). The asset management industry has shown a high correlation with the equity markets because retail investors view mutual funds as a proxy for stock investment.

Breakdown of Corporate Investor Financial Instrument Holdings in India (March 2018)



Source: AMFI

Breakdown of Retail Investor Financial Instrument Holdings in India (March 2018)



Source: AMFI

About 83% of retail investors financial instrument holdings were equity-oriented as of end-FY3/18

We do not believe that the current pace of growth in India’s mutual fund industry is sustainable. However, we see asset managers as a growth segment over the long term because we believe the financialization of household savings is structural in nature.

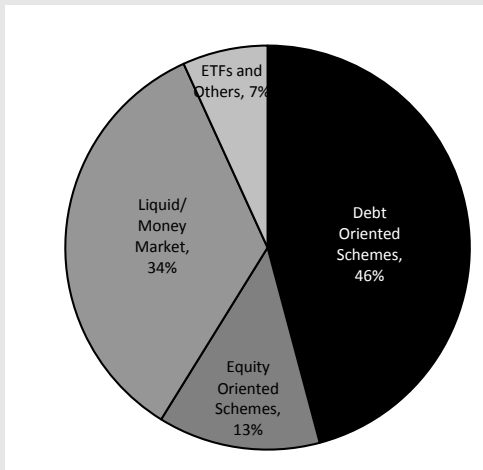
If we assume that a) Indian GDP can grow at 8% year on year in line with IMF forecasts, b) total savings increases to 20% of GDP in line with the earlier average, c) the proportion of financial savings within total savings moves up to 30%, and d) Mutual Fund industry is able to retain its share within financial savings then we may see the mutual fund industry growing by 13% YoY and reach Rs65trn in the next 10 years.

Individual investors primarily hold equity-oriented schemes while institutions hold liquid and debt oriented schemes. Around 83% of retail investor assets are held in equity oriented

About 83% of retail investors financial instrument holdings were equity-oriented as of end-FY3/18

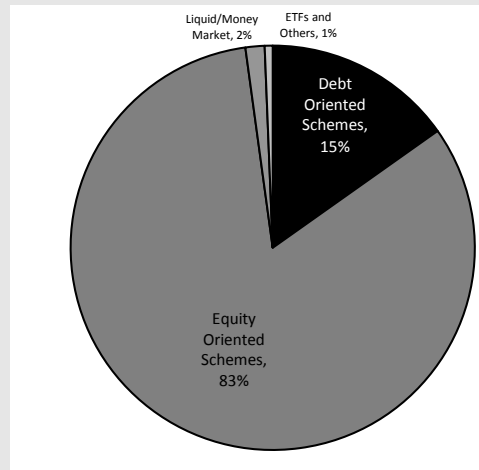
schemes. About 80% of institutional assets are held in liquid / money market schemes and debt – oriented schemes.

Breakdown of Corporate Investor Financial Instrument Holdings in India (March 2018)



Source: AMFI

Breakdown of Retail Investor Financial Instrument Holdings in India (March 2018)

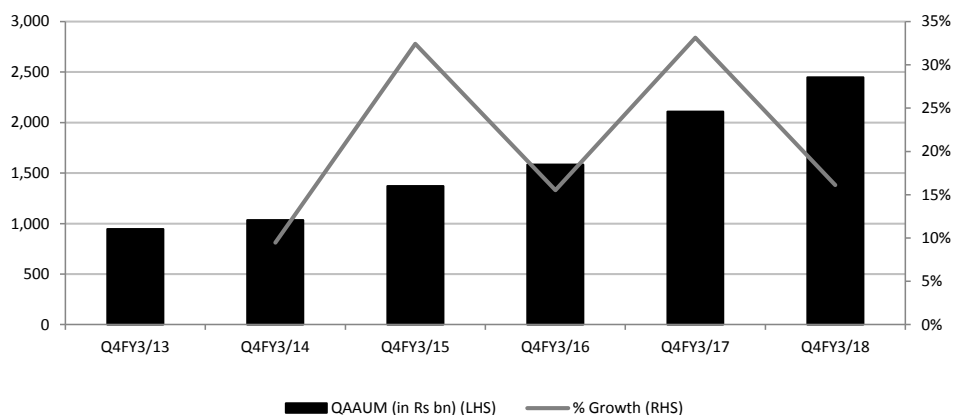


Source: AMFI

RNAM is one of the Largest Asset Management Companies in India

Financial savings of households in India should increase and within financial savings, capital markets investments are gaining traction. Over the past two years, the household allocation to shares and debentures has increased from 2% in FY3/15 to 10% in FY3/17 (based on CRISIL research where FY3/17 is based on preliminary estimates). RNAM is the fourth largest mutual fund in India with mutual fund AAUM of Rs2.2trn as of March 2018 and should benefit from this trend.

Quarterly Average AUM for RNAM

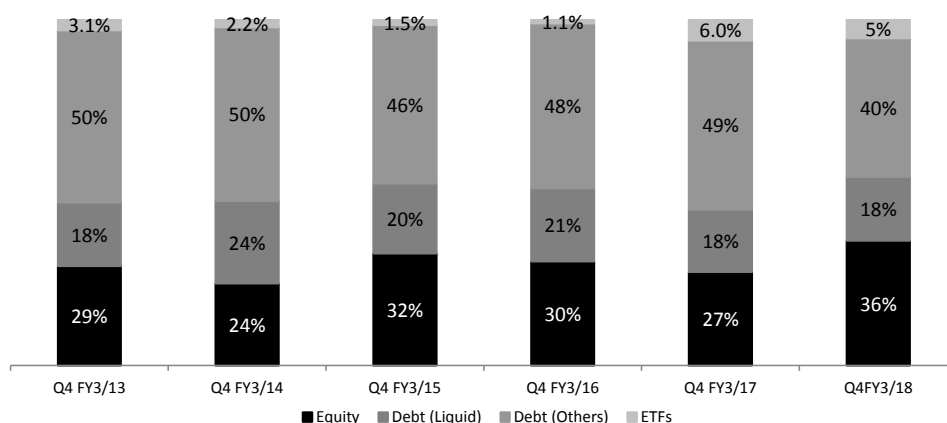


Source: Company data

Superior Growth in Equity Segment

Reliance AMC has been able to increase its equity proportion from 29% as of March 2013 to 36% as of March 2018.

Quarterly AAUM for RNAM



Source: Company data. Note. MAAUM for Q4FY18 from AMFI

The expense ratio for more actively managed tends to be higher. Thus the expense ratio in equity schemes is higher than that of debt and liquid schemes (see table below). Thus increasing proportion of equity in total AUM would result in higher gross yield (revenue as a percentage of average AUM) for RNAM going forward.

Expense ratio in equity schemes is higher than that of debt and liquid schemes

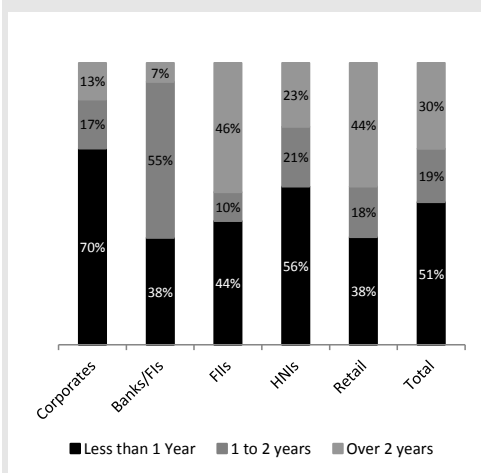
Average Expense Ratio for Regular Mutual Funds for RNAM

Category	Equity	Debt-Liquid	Debt-Other
FY3/13	2.49%	0.32%	1.59%
FY3/14	2.52%	0.33%	1.53%
FY3/15	2.52%	0.30%	1.51%
FY3/16	2.51%	0.27%	1.45%
FY3/17	2.44%	0.26%	1.44%

Source: Company data

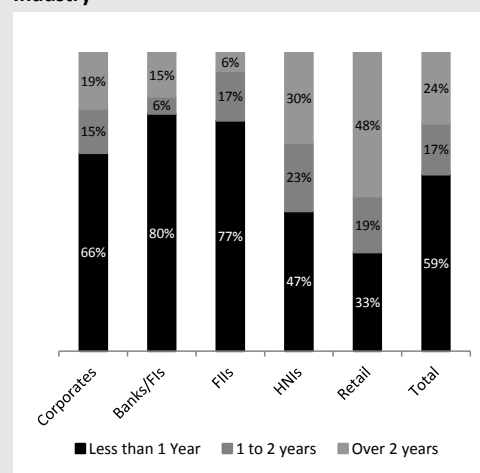
Equity funds typically have a higher average holding period than debt mutual funds. As of March 2018, of the total equity funds AUM, nearly 30% had been held for over two years, while 19% had been held for a period between 1 to 2 years. In comparison, assets held for over two years and between one to two years accounted for 24% and 17%, respectively, of the non-equity AUM. The main reason behind this trend is the difference in the primary investor base for the two segments. Individual investors (including HNIs) are the main investor segment for equity schemes while the institutional investor segment dominates the debt scheme AUM.

Holding Analysis of Equity Schemes Across Investor Groups (as of March 2018) for the Industry



Source: AMFI

Holding Analysis of Non-Equity Schemes Across Investor Groups (as of March 2018) for the Industry



Source: AMFI

Retail AUM for RNAM clocked a CAGR of 51% over March 2013–March 2018, which has led to an increase in proportion of retail AUM from 10% as of March 2013 to 30% as of March 2018

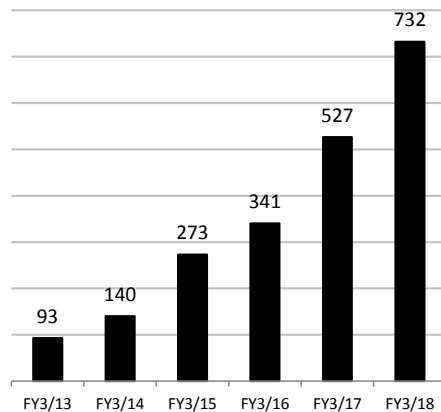
Strong Focus On Retail

According to ICRA, in India, the retail investors’ MAAUM grew significantly by 163% from March 2014 to June 2017 from Rs1.63trn to Rs4.28trn. As of March 2018, the MAAUM of retail investors managed by RNAM was Rs732bn, which was the largest among asset management companies in India according to AMFI.

Retail AUM for RNAM has grown at a CAGR of 51% over March 2013–March 2018, which has led to an increase in proportion of retail AUM from 10% as of March 2013 to 30% as of March 2018.

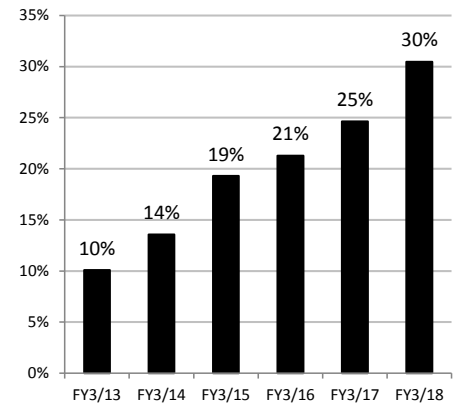
Reliance AMC has the highest proportion of retail investors at 30% compared to its peers compared to average 24% for the industry

Retail AAUM (in Rs bn) for RNAM



Source: Company data, AMFI

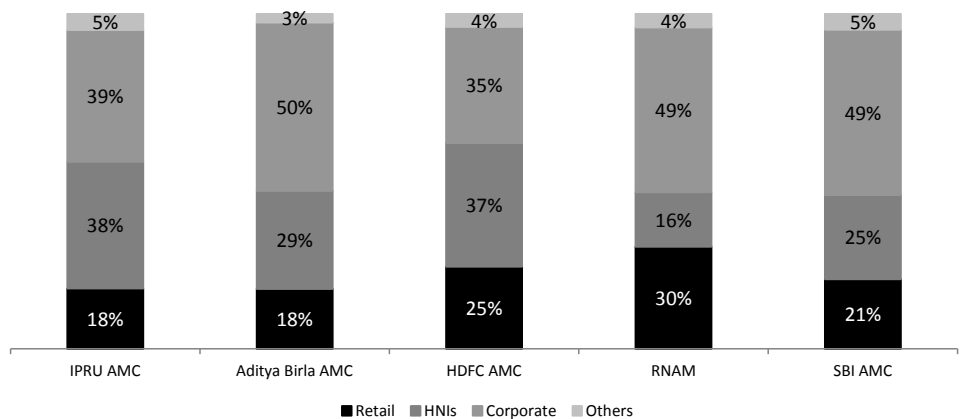
Retail as Percentage of AAUM for RNAM



Source: Company data, AMFI

Reliance AMC has the highest proportion of retail investors at 30.5% as of March 2018 compared to its peers.

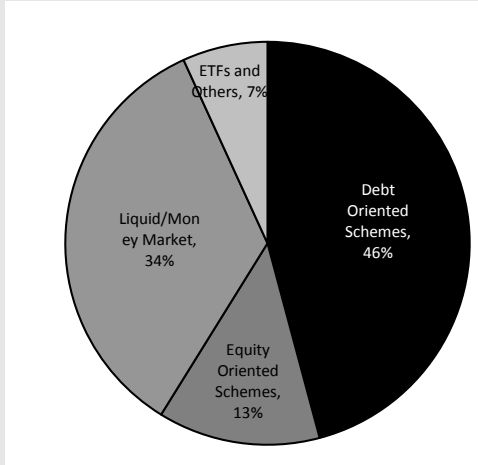
MAAUM Split Based On Investor Type (as of March 2018)



Source: AMFI. Note MAAUM: Monthly Average Assets Under Management

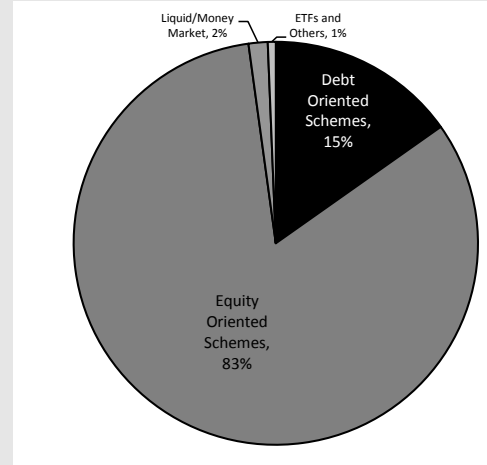
Retail investors AUM is considered stickier than the Institutional category. Also individual investors are the main investor segment for equity schemes and accounting for nearly 83% of the average AUM (according to AMFI). Similarly, the institutional investor segment dominates the debt scheme AUM, accounting for about 80% of the AAUM.

Composition of Institutions Investor Holdings as of March 2018 for the Industry



Source: AMFI

Composition of Retail Investor Holdings as of March 2018 for the Industry



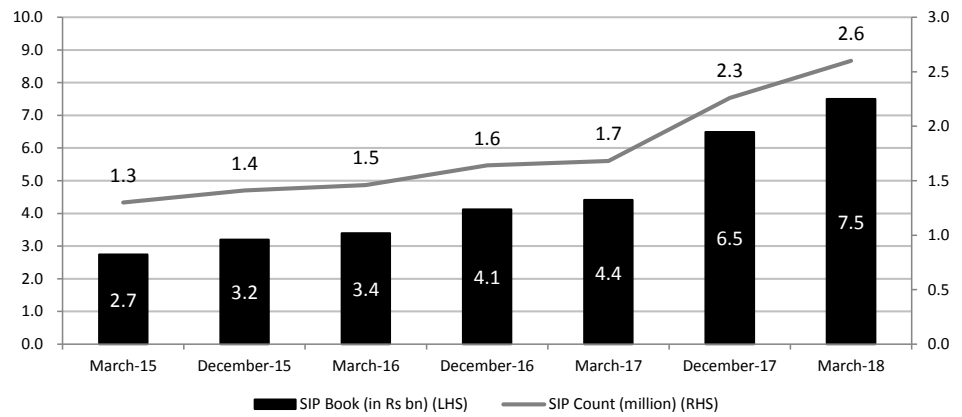
Source: AMFI

For RNAM, SIP book has more than doubled in the last two years from Rs3.4bn as of March 2016 to Rs7.5bn as of March 2018, and now comprises of 2.6mn SIP accounts from 1.5mn SIP accounts in March 2016. At the same time the ticket size per account has increased from Rs2,326 in March 2016 to Rs2,885 in March 2018. For new SIP, the ticket size has increased from Rs2,863 in December 2015 to Rs3,613 in March 2018.

SIP Book for RNAM has been growing strongly

For RNAM, SIP book has more than doubled in the last two years from Rs3.4bn as of March 2016 to Rs7.5bn as of March 2018, and now comprises of 2.6mn SIP accounts from 1.5mn SIP accounts in March 2016. At the same time the ticket size per account has increased from Rs2,326 in March 2016 to Rs2,885 in March 2018. For new SIP, the ticket size has increased from Rs2,863 in December 2015 to Rs3,613 in March 2018.

SIP Book (in Rs bn) (LHS) and SIP Count (in mn) (RHS) for RNAM



Source: Company data

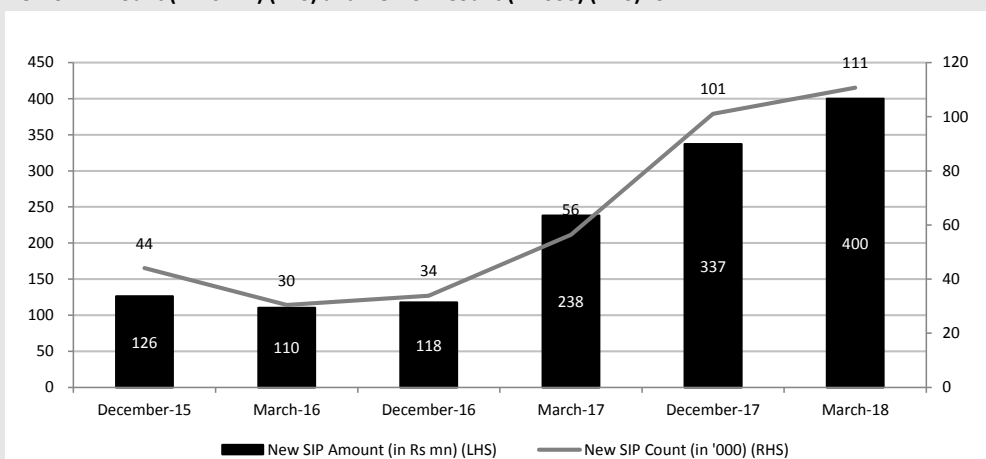
Branch Network (as of December 2017) for RNAM

Region	New	Current	Total
East	16	32	48
North	45	49	94
South	15	36	51
West	13	55	68
Total	89	172	261

Source: Company data

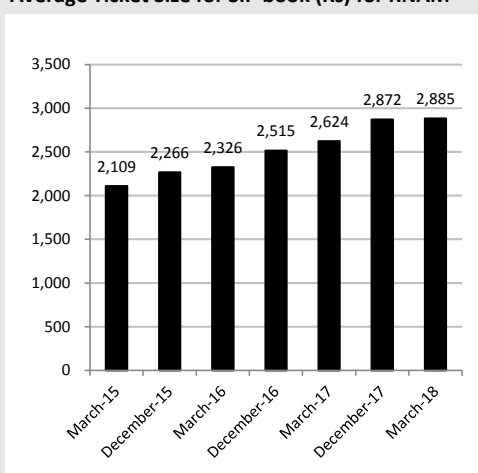
For new SIP, the ticket size has increased from Rs2,863 in December 2015 to Rs3,613 in March 2018

New SIP Amount (in Rs mn) (LHS) and New SIP Count (in '000) (RHS) for RNAM



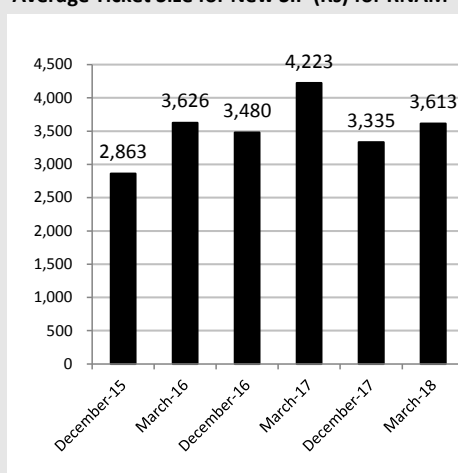
Source: Company data

Average Ticket Size for SIP book (Rs) for RNAM



Source: Company data

Average Ticket Size for New SIP (Rs) for RNAM



Source: Company data

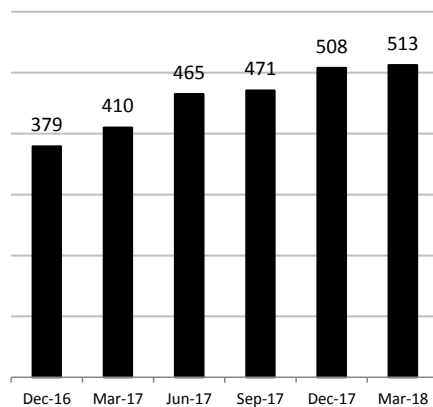
PAN India presence with high focus on B15 Locations

RNAM has a pan India presence across 282 locations in India which is the highest in the AMC industry (including new 120 locations added in FY3/18). According to the company, 84 out of these 120 locations added are in states with AUM/GDP ratio of less than 10%.

The B-15 MAAUM in India increased from Rs1.4trn as of March 2014 to Rs5.1trn in March 2018 (as per AMFI) at a CAGR of 38% over the four year period. The advantage of catering to B15 locations is that the majority of B15 revenue is from individual or retail investors (see chart below). RNAM has one of the highest concentrations in B15 cities with B15 AAUM as a percentage of total AAUM at 21.3% compared to 18.8% average for the industry.

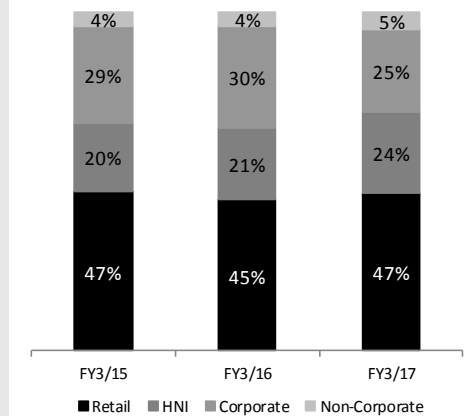
It also has a separate business vertical, which focuses on developing business with PSU banks to leverage rural network for widespread distribution of our products.

B15MAAUM (in Rs bn) for RNAM



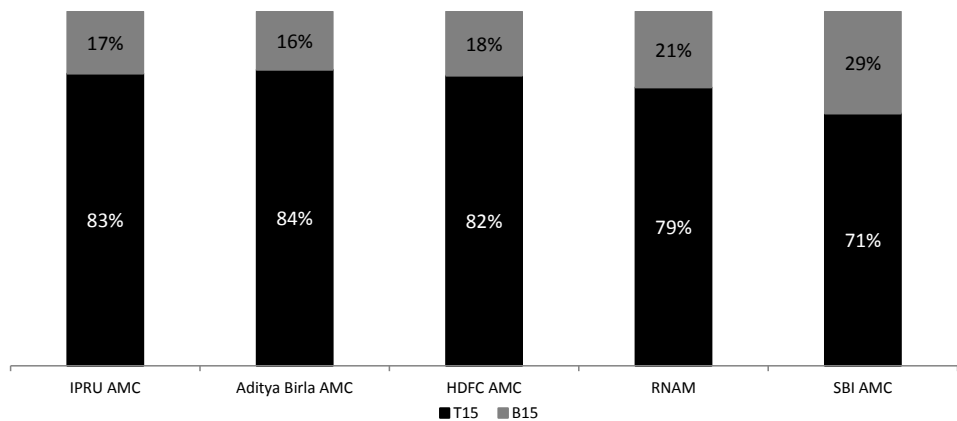
Source: Company data, AMFI

Trends in B15 AAUM for Industry



Source: AMFI

AUM (monthly AUM) Split Based on T15 and B15 Cities As Categorized by AMFI as of March 2018



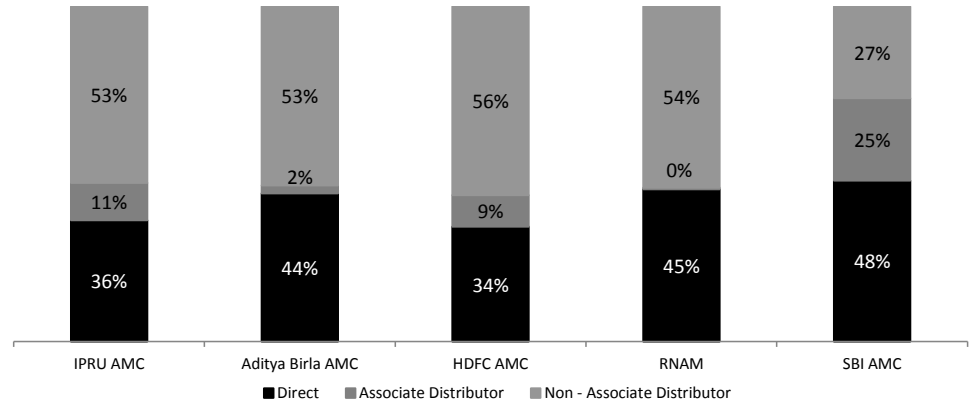
Source: AMFI

Well diversified Distribution Network

RNAM has built a diversified distribution network with high proportion of direct selling (45% of AUM as of March 2018). As of March 2018, RNAM's AUM (monthly average excluding direct AUM and institutional AUM) split by distribution channel was approximately 33% through banks, 48% through IFAs and 19% through national distributors. Overall as of March 2018, RNAM had tie-ups with approximately 65,300 distributors including banks, financial institutions, IFAs, national distributors and online platforms.

RNAM has built a diversified distribution network with high proportion of direct selling (45% of AUM as of March 2018)

Distribution Split for top 5 AMCs (as of March 2018)



Source: AMFI

Top 10 Distributors for Reliance AMC for FY3/17 (in Rs mn)

Name	Total Commission and Expenses	Gross In Flows	Average AUM FY3/17	Distributor's AAUM as % of Total AAUM FY3/17	Commission as % of Distributor's AAUM
NJ India Invest	786	115,251	62,166	2.9%	1.3%
Indusind Bank	303	13,340	11,403	0.5%	2.7%
HDFC Bank limited	286	93,677	43,858	2.1%	0.7%
IIFL Wealth Management Limited	224	101,766	33,081	1.6%	0.7%
Kotak Mahindra Bank limited	181	24,206	23,488	1.1%	0.8%
ICICI Bank Limited	157	12,143	17,635	0.8%	0.9%
Prudent Corporate Advisory Services	139	8,954	13,400	0.6%	1.0%
Citibank N.A	128	25,372	23,006	1.1%	0.6%
ICICI Securities Limited	102	13,269	16,532	0.8%	0.6%
Bajaj Capital	93	7,471	11,362	0.5%	0.8%
% of Total	50%				
Total of all Distributors	4,801	Total Commissions Paid / Distributors AAUM			0.42%

Source: Company data

Benchmarking With Peer AMCs

Financial Highlights of Top AMCs in India (as of FY3/17)

(in Rs mn unless stated)	HDFC AMC	IPRU AMC	RNAM		Aditya Birla AMC	SBI AMC
			FY3/17	FY3/18		
Average Mutual Fund AUM (in Rs bn)	2,460	2,430	2,109	2,449	1,953	1,570
Revenue	15,879	13,497	14,359	18,150	10,145	7,781
PBT	7,998	7,347	5,813	7,260	3,371	3,297
PBT (without Investment Income)	7,116	6,884	4,529	4,970	2,960	2,921
PAT	5,503	4,805	4,028	5,220	2,232	2,241
Networth	14,229	7,332	18,504	22,870	9,416	9,416
Gross Yield	65	56	68	74	52	50
Net Yield	22	20	19	21	11	14
RoE	43%	70%	24%	25%	25%	25%
Market Cap / FY18 AAUM (%)	n/a	n/a	6.4%	6.4%	n/a	n/a

Source: Company data

Gross Yield of Top 5 Mutual Funds in India (in bps)

Gross Yield	FY3/14	FY3/15	FY3/16	FY3/17	FY3/18	Average
HDFC AMC	77	64	82	65	n/a	72
IPRU AMC	51	57	61	56	n/a	56
RNAM	75	70	83	68	74	74
Aditya Birla AMC	58	46	50	52	n/a	51
SBI AMC	61	60	52	50	n/a	56
Average Gross Yield	65	59	65	58	n/a	62

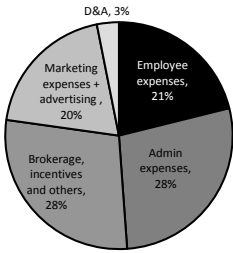
Source: Company data

Net Yield of top 5 Mutual Funds in India (in bps)

Net Yield	FY3/14	FY3/15	FY3/16	FY3/17	FY3/18	Average
HDFC AMC	31	25	26	22	n/a	26
IPRU AMC	17	17	19	20	n/a	18
RNAM	29	26	25	19	21	24
Aditya Birla AMC	12	9	14	11	n/a	12
SBI AMC	24	22	15	14	n/a	19
Average Net Yield	23	20	20	17	n/a	20

Source: Company data

Expenses Breakup for RNAM (FY3/18)

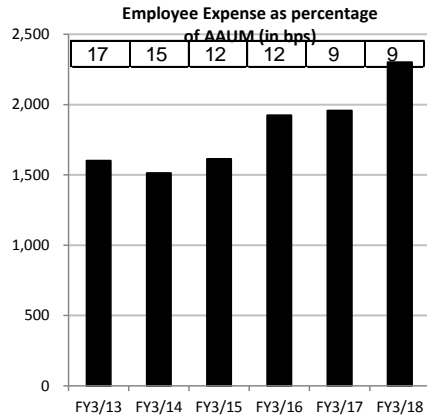


Source: Company data

Breakup of Expenses

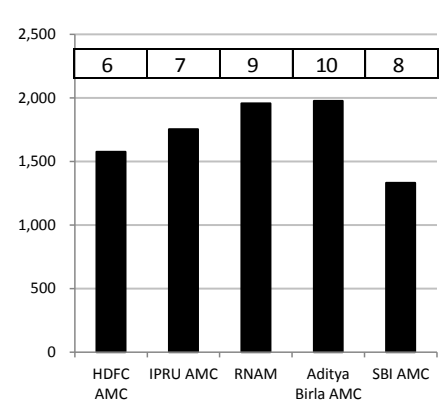
RNAM has improved its employee expense as percentage of AAUM from 17bps in FY3/13 to 9bps in FY3/18, but it still has one of the highest employee expenses among the top 5 AMCs, both in absolute terms and as percentage of AAUM.

Employee Expenses for RNAM



Source: Company data

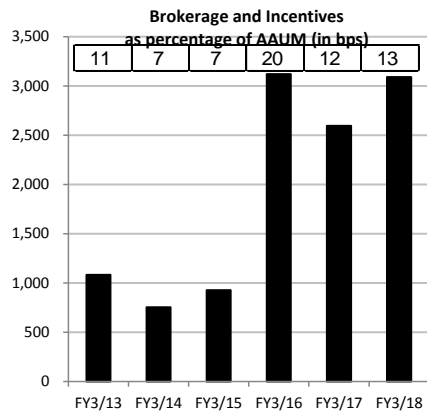
Employee Expenses for Top AMCs (FY3/17)



Source: Company data

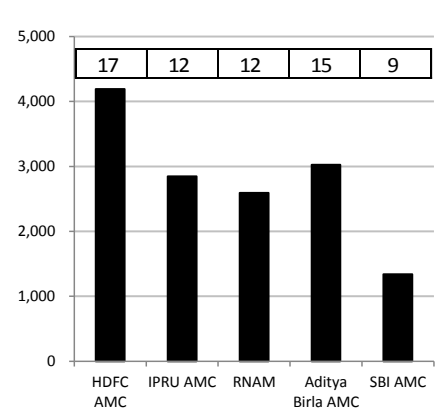
During FY3/16, brokerage and incentives shot up by almost 230% primarily due to a change in accounting practices. Until FY3/15, charges associated with brokerage and incentives were recovered from the respective schemes and had no effect on profit and loss. However, from FY3/16, RNAM started booking such expenditure in profit and loss and accordingly a higher fee was charged to the respective schemes. However it is still one of the lowest among top AMCs at 12bps (as percentage of AAUM) as of FY3/17.

Brokerage and Incentives for RNAM



Source: Company data

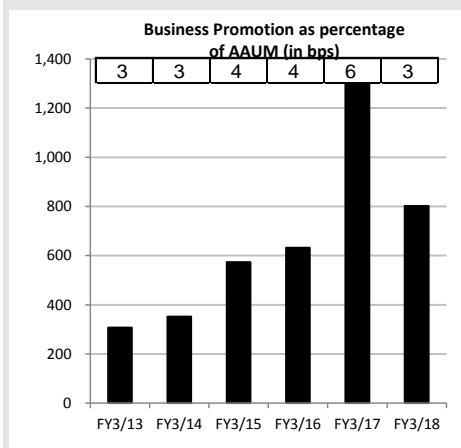
Brokerage and Incentives for Top AMCs (FY3/17)



Source: Company data

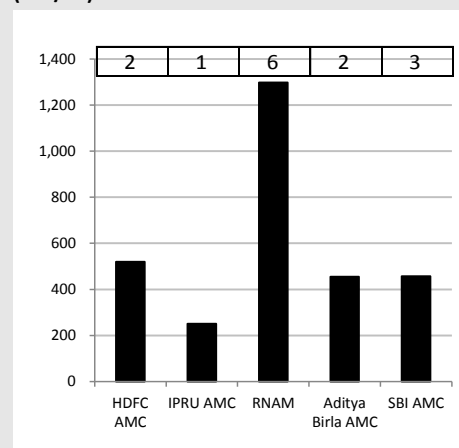
Owing to increasing size, and in order to acquire market share, RNAM incurs the highest business promotion expenses among top 5 AMCs at 6bps (as percentage of AAUM).

Business Promotion Expenses for RNAM



Source: Company data

Business Promotion Expenses for Top AMCs (FY3/17)



Source: Company data

Valuation

In our view, asset management companies can be valued using a dividend discount model given the high dividend payout ratios exhibited by them (owing to minimal reinvestment needs). In our model, we have built in an AUM growth for RNAM of 15% over FY3/19–30. We assume the dividend payout ratio for RNAM to be 80% over FY3/19–30 (dividend payout ratio for RNAM in FY3/18 was around 85%).

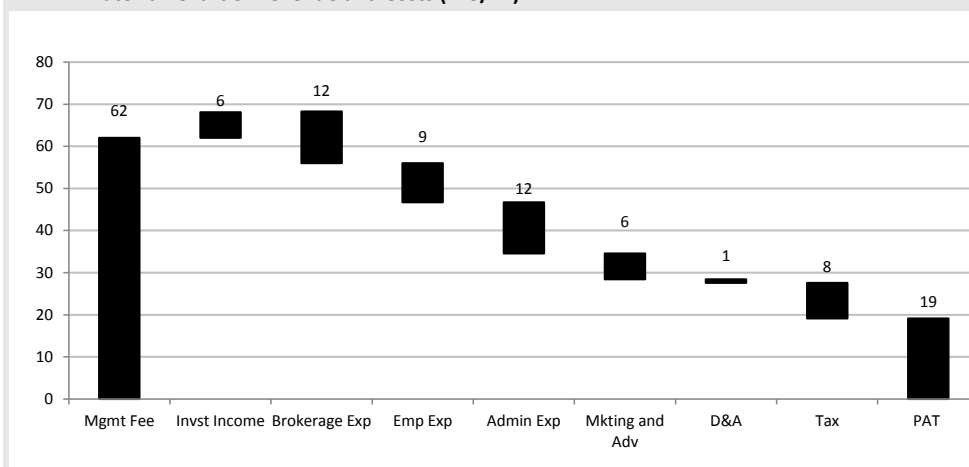
In FY3/18, equity AUM as a percentage of total AUM for RNAM improved to 30.5% from 27% in FY3/17. Hence, we expect the gross yield and net yield to improve from FY3/18 levels.

Dividend payout ratio for RNAM

(in Rs mn)	FY3/17	FY3/18	FY3/19E	FY3/20E
PAT	4,028	5,220	6,040	7,053
Dividend	2,477	3,672	4,015	4,688
Dividend Tax	504	749	817	954
Dividend + DDT	2,981	4,421	4,832	5,642
Payout Ratio	74%	85%	80%	80%

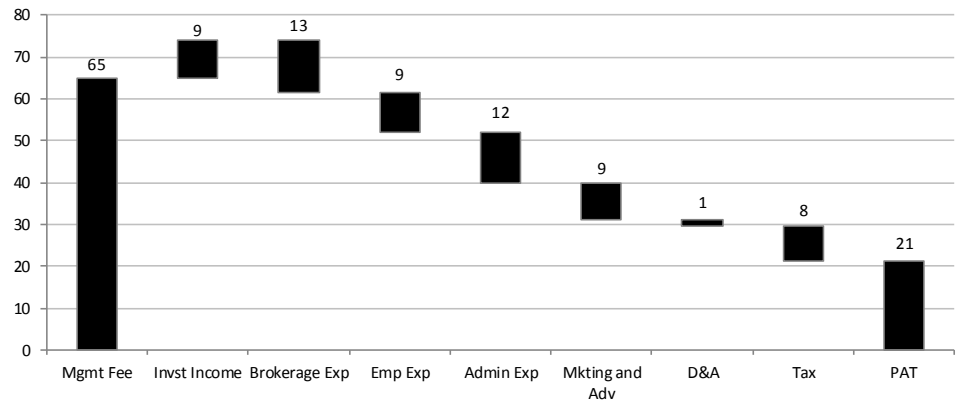
Source: Company data

RNAM: Waterfall Chart of Revenue and Costs (FY3/17)



Source: Company data

RNAM: Waterfall Chart of Revenue and Costs (FY3/18)



Source: Company data

We arrive at a target valuation of Rs192.6bn for RNAM, implying a FY3/21 P/E of 23x and FY3/21 valuation/AAUM multiple of 5.2%.

Valuation Summary for RNAM

(in Rs bn)

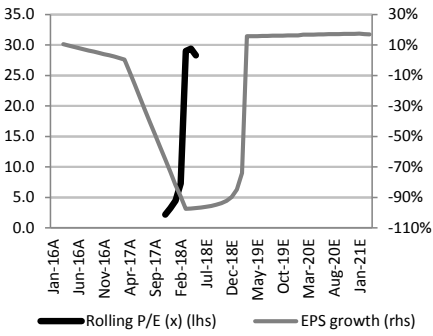
Year	FY3/18	FY3/19	FY3/20	FY3/21	FY3/22	FY3/23	FY3/24	FY3/25	FY3/26	FY3/27	FY3/28	FY3/29	FY3/30	TV
PAT	5.2	6.0	7.1	8.2	9.5	10.9	12.5	14.4	16.6	19.1	21.9	25.2	29.0	30.5
% growth	30%	16%	17%	17%	15%	15%	15%	15%	15%	15%	15%	15%	15%	5%
Dividend Payout Ratio	85%	80%	80%	80%	80%	80%	80%	80%	80%	80%	80%	80%	80%	90%
Dividends				6.6	7.6	8.7	10.0	11.5	13.3	15.3	17.5	20.2	23.2	27.4
PV				5.9	6.0	6.2	6.4	6.5	6.7	6.9	7.1	7.3	7.5	126
Valuation (Rs bn)		192.6												
Shares (in mn)		612												
Target price (Rs)		315												
Target Valuation /AUM (FY3/21)		5.2%												
Target PE (FY3/21)		23.4												

Source: HTI Estimates

Main Risks to Our Rating, Target Price and Estimates

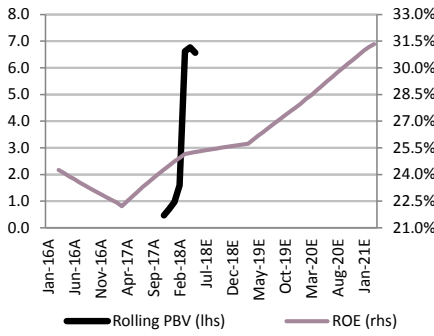
- Future revenue and profit are largely dependent on the growth, value and composition of AUM of the schemes managed by them, which may decline due to declines in the Indian equity markets, changes in interest rates and defaults and withdrawals or fund exits in response to changes in market conditions or poor investment performance.
- Change in regulatory policies
- Heavy reliance on third-party distribution channels and other intermediaries can adversely affect their business

P/E (x) vs EPS Growth (%)



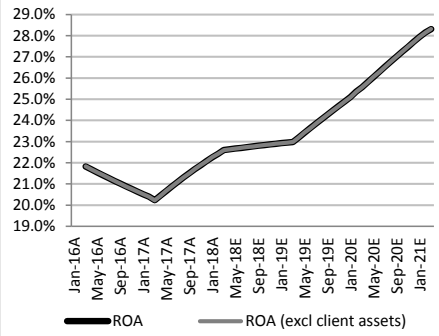
Source: Company data, Bloomberg, HTI estimates

P/B (x) vs ROE



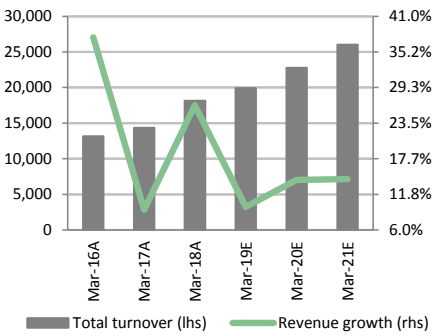
Source: Company data, Bloomberg, HTI estimates

ROA



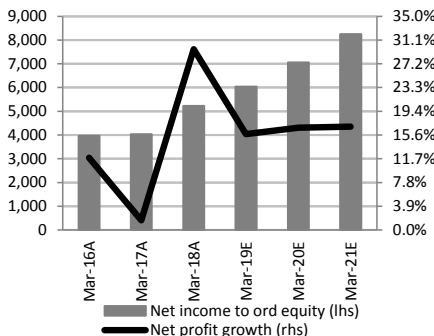
Source: Company data, Bloomberg, HTI estimates

Turnover and Growth



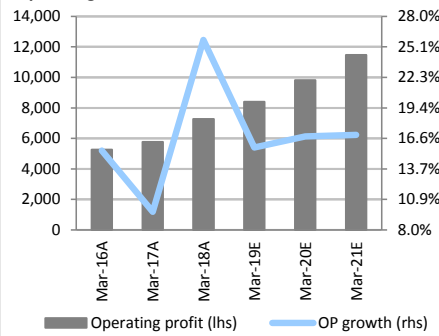
Source: Company data, Bloomberg, HTI estimates

Net Profit and Growth



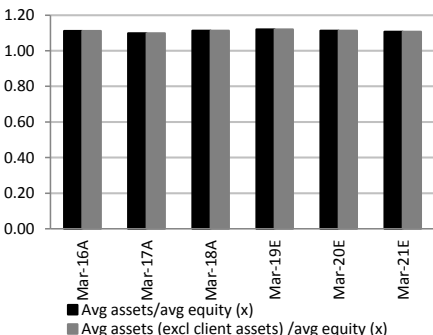
Source: Company data, Bloomberg, HTI estimates

Operating Profit and OP Growth



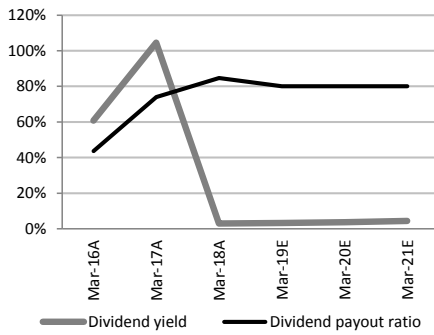
Source: Company data, Bloomberg, HTI estimates

Assets / Equity



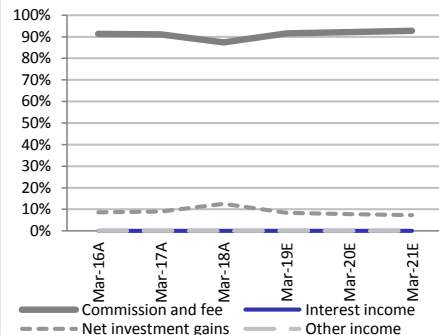
Source: Company data, Bloomberg, HTI estimates

Dividend Payout and Yield



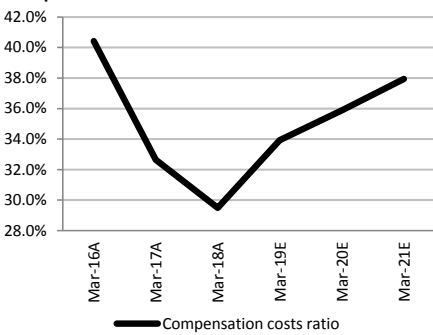
Source: Company data, Bloomberg, HTI estimates

Income Mix



Source: Company data, Bloomberg, HTI estimates

Compensation Cost Ratio



Source: Company data, Bloomberg, HTI estimates

Revenue Growth

Management fees recorded a CAGR of 23% over FY3/16–18; we expect management fee to post a CAGR of 15% over FY3/19–21, mainly driven by slower growth in average AUM, which we also expect deliver 15% CAGR over FY3/19–21.

Profit Margins

We expect operating margin to improve from 40% in FY3/18 to 44.1% in FY3/21, mainly driven by slower increase in employee costs. We expect net profit margin to improve from 28.8% in FY3/18 to 31.7% in FY3/21.

Shareholder Returns

We expect ROE to improve from 25.2% in FY3/18 to 31.3% in FY3/21.

Balance Sheet Risks

Asset management companies work on asset light model given that the main source of revenue is fee business collected from management of assets. The statutory requirement for balance sheet net worth is minimal at Rs500mn.

Key Takeaway

The key risk to our target price is any adverse movement in equity markets as it will impact the overall mutual fund industry and RNAM will also get impacted

Investment Thesis – Target Price – Share Price Catalysts

Reliance Nippon Asset management company (RNAM) is amongst the top four by Mutual Fund AAUM as of March 2018 and the only listed asset management company in India. The industry has been going through rapid expansion over the last couple of years and RNAM has been one of the beneficiaries of that with its AUM growing at 21% during FY3/16–18. This is mainly led by financialization of assets in India, which we think would continue given government focus and massive investor education initiatives. RNAM is well placed to take advantage of that given its presence across India and its strength with the Independent Financial Advisor (IFA) channel. Also, the company runs one of the most efficient asset management companies with one of the highest net yields. We expect an AUM CAGR of 15% for the company and a NP CAGR of 16% over FY3/19–21. Hence, we initiate with a BUY recommendation on the stock. Hence, we initiate with a BUY recommendation on the stock. We value RNAM using a dividend discount model and arrive at a target valuation of Rs192.6bn for RNAM, implying a target FY3/21 PE of 23.4x and FY3/21 valuation/AAUM multiple of 5.2%. Increase in proportion of equity as a percentage of total AUM is the key catalyst for the stock as it would lead to increase in charging ability of the mutual fund.

APPENDIX

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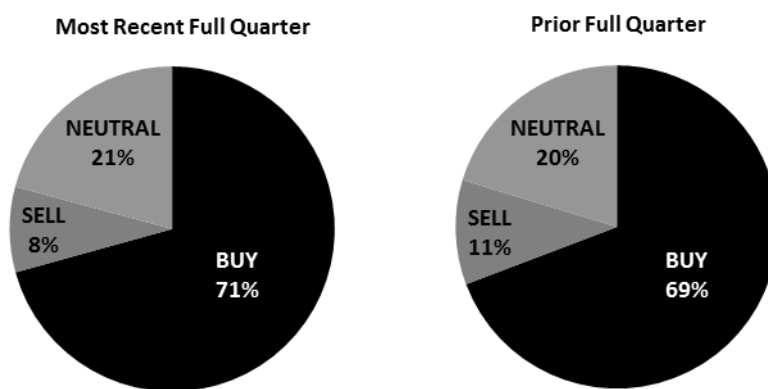
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BUY ≥ 15% absolute upside performance expected within the next 12 months

SELL ≥ 15% absolute downside performance expected within the next 12 months

NEUTRAL: A stock under coverage with insufficient upside or downside to justify a BUY or SELL rating. For purposes only of FINRA/NYSE ratings distribution rules, our Neutral rating falls into a hold rating category.

Rating Distribution



Haitong International Equity Research Ratings Distribution, as of March 31, 2018

	BUY	Neutral (hold)	SELL
HTI Equity Research Coverage	71%	21%	8%
IB clients*	6%	3%	4%

*Percentage of investment banking clients in each rating category.

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Recommendation Chart



Date	Recommendation	Target (Rs)	Price (Rs)
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2018-05-08

Source: Company data Bloomberg, HTI estimates

Definitions for Key Investment Metrics

Business Growth

This is the metric which matches the top line in our report.

Business profit

This is the metric which best represents operating profit in our report

Shareholder Returns

Return on Equity

Balance Sheet Risk

Net Debt to Equity