

Diversified Financials

India

Sector View: **Attractive** NIFTY-50: **24,142**

July 02, 2024

AMCs and RTAs: In beta mode

We upgrade the earnings of AMCs/RTAs, given the recent returns/flows. In our view, the fund performance-led re-rating of HDFC (retain REDUCE) and Nippon (downgrade to REDUCE) has likely run its course, even as earnings momentum could continue and is built into our assumptions. ABSL (retain ADD) and UTI (retain REDUCE) trade at a material discount (~40%) to HDFC and Nippon but are yet to show a meaningful turnaround in fund performance. We like CAMS and Kfin (both REDUCE) for their stable, predictable RTA operations and fast-growing non-MF emerging businesses, but find their valuations full.

AMCs: Lack of meaningful mispricing limits ideas

We incorporate recent market performance and net flow trends and refresh earnings for FY2025-27E. Across AMCs, we see earnings upgrades by up 3-8% over FY2025-27E. We expect stronger equity AUM and earnings growth for HDFC AMC and Nippon, given the superior fund performance tailwinds. Both have built a strong SIP book and are led by a range of well-performing funds, which we build into our AUM growth assumptions (Exhibit 2). However, valuations reflect this, with HDFC/Nippon trading at a 50-60% premium to the broader markets and ABSL/UTI (Exhibit 3-5). For ABSL/UTI, performance revival in mainstream fund categories still remains the key monitorable for a stronger investment case. Between the two, we prefer ABSL due to its comparatively better performance trends and higher SIP contribution.

Fund flow trends: More of the same

June flows for a sample set indicate strong flow momentum, led by gains in the first week. Barring one month of impact (Mar-2024), flows continue to be strong in small/mid-cap and sectoral/thematic funds, whereas large-cap remains relatively subdued (Exhibit 9-10). There is likely to be heightened performance chasing in select categories/funds, given the strong retail willingness to invest. However, the history of previous winners suggests that performance reversal is equally vicious (Exhibit 8). Hence, even as the overall industry remains in a good position to attract household savings, leaders and laggards keep changing. Across the listed AMCs for the sample of five categories we track, there remains a wide gap between HDFC (led by balanced and flexi) and Nippon (led by large and flexi cap), garnering much stronger flows compared to ABSL and UTI (Exhibit 11-12).

RTAs: Well-positioned given MF tailwinds and new growth drivers

RTAs are a direct play on the MF industry, along with different revenue diversification approaches for CAMS and Kfin. Compared with AMCs, RTAs offer stronger operating leverage but come with elevated fee pressure, given the revenue concentration from large clients. In the medium term, non-MF businesses can offer growth optionalities, which we believe are partly priced in. We retain REDUCE on both given full valuations, valuing both companies at ~35X June 2026 earnings with ~20% earnings growth over FY2025-27E.

Company data and valuation summary

Company	Rating	Upside	EPS CAGR		PE (X)		Equity AUM CAGR	
		(%)	2024-26E	2025E	2026E	2019-24	2025-26E	
ABSL	ADD	10	9	22	20	10	16	
HDFC	REDUCE	(0)	15	38	33	19	21	
Nippon	REDUCE	(2)	12	33	30	18	20	
UTI	REDUCE	2	(3)	22	21	13	13	
CAMS	REDUCE	1	19	39	35	21	21	
Kfin	REDUCE	3	20	40	34	27	21	

Source: Bloomberg, Company data, Kotak Institutional Equities estimates

Prices in this report are based on the market close of July 01, 2024

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AMCs: Lack of attractive investment ideas; downgrade Nippon to REDUCE

- ▶ Forward valuations of AMCs indicate strong rerating for companies delivering stronger core earnings growth, ultimately boiling down to growth outperformance, led by stronger fund performance. Despite stronger markets benefitting AUM growth for all AMCs, markets do not reward this in terms of earnings multiples, in our view.
- ▶ We like the earnings quality and growth potential of AMCs & RTAs in general, but current entry valuations require higher dependence on supportive markets/flows. Fund performance-backed ideas (HDFC/Nippon) delivered strong returns in the past 12 months, whereas players with weaker performance (ABSL/UTI) have seen relatively weaker returns.
- ▶ AMCs trade at a 40-50% premium to broader markets. While AMCs enjoy attractive traits such as strong cash conversion, high degree of predictability and growth runway, P&L of AMCs are exposed to occasional market drawdowns with the expense flexibility to offset the impact and hence premium of broader markets offers a useful check on the valuations.
- ▶ Following the strong re-rating in the past 12 months, we have revised the stance to a more neutral view on both HDFC (moved to REDUCE previous quarter) and Nippon (downgrade to REDUCE with this note). While superior fund performance for both will continue to drive stronger flow share, we assume 3Y equity AUM CAGR of ~20% for HDFC/Nippon compared to 15/13% for ABSL/UTI. While both ABSL and UTI have relatively reasonable valuations, we prefer ABSL (retain ADD), given relatively better fund performance and stronger SIP contribution to flows and AUM.

RTAs: Good businesses at full valuations

- ▶ CAMS (~70%) and Kfin (~100%) have delivered strong returns in the past year, led by: (1) strong growth in overall (~35% yoy) and equity (~55% yoy) MF AUM; (2) growth tailwinds in non-MF businesses such as alternatives, issuer solutions and KYC registration; and (3) operating leverage driving margin improvement and earnings growth. While the stocks have done well, the core characteristics of the industry remain unchanged, i.e., a duopoly industry with large entry barriers, along with high operational risks involved in switching vendors.
- ▶ These benefits are outweighed by high revenue concentration, leading to pricing power being skewed toward AMCs. In the mid- to long-term, there is also uncertainty around how higher the share of direct investing, along with passives, will influence the dependence on transfer agents. We see revenue and client diversification as the only way to build scale and strengthen the business model against secular yield pressure facing the asset management industry (sensitivity: 6-8% revenue decline on 10% higher yield compression).

AMC & RTA stocks trade in the range of 20-33X FY2026E EPS

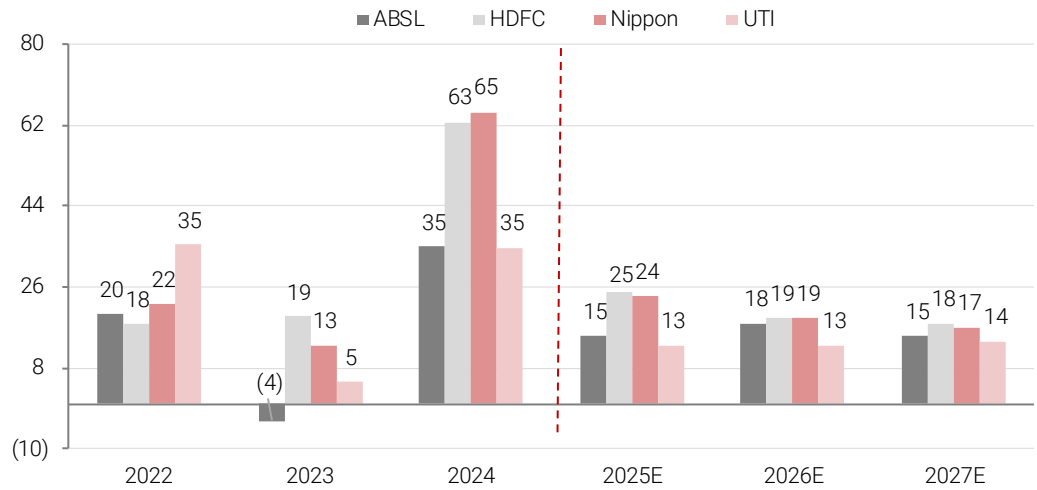
Exhibit 1: Valuation summary of India asset managers, March fiscal year-ends, 2025-27E

	Rating		CMP (Rs)	FV (Rs)		Upside (%)	New EPS (Rs)			Change in EPS (%)			EPS CAGR			PE (X)			Core PBT/AAUM (bps)			Equity AUM CAGR	
	Old	New		Old	New		2025E	2026E	2027E	2025E	2026E	2027E	2025-27E	2025E	2026E	2027E	2025E	2026E	2027E	2019-24	2024-26E		
AMCs																							
ABSL	ADD	ADD	636	610	700	10	29	32	35	5	8	7	9	22	20	18	26	25	24	10	16		
HDFC	REDUCE	REDUCE	4,017	3,650	4,000	(0)	106	122	138	2	7	6	15	38	33	29	37	36	35	19	21		
Nippon	ADD	REDUCE	663	580	700	6	20	22	25	6	5	5	12	33	30	27	27	26	25	18	20		
UTI	REDUCE	REDUCE	1,034	950	1,050	2	46	50	54	2	6	5	(3)	22	21	19	15	15	14	13	13		
RTAs																							
CAMS	REDUCE	REDUCE	3,665	3,200	3,700	1	94	105	121	8	4	3	19	39	35	30	na	na	na	21	21		
Kfin	REDUCE	REDUCE	730	700	750	3	18	21	25	5	4	3	20	40	34	29	na	na	na	27	21		

Source: Company, Kotak Institutional Equities estimates

Our forecasts build relatively moderate equity AUM growth expectations

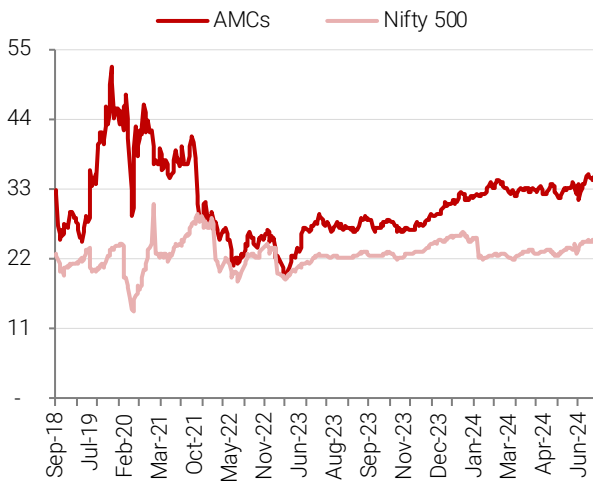
Exhibit 2: Growth in equity AUM growth yoy, March fiscal year-ends, 2022-27E (%)



Source: AMFI, Kotak Institutional Equities estimates

AMCs trade at ~35X 1Y forward earnings

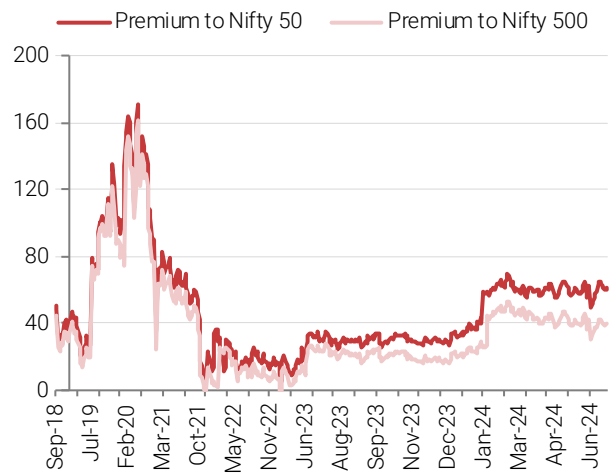
Exhibit 3: 1Y forward PE (consensus), 2018-24 (X)



Source: Bloomberg, Kotak Institutional Equities

Valuation premium of AMCs has expanded to 50-60%

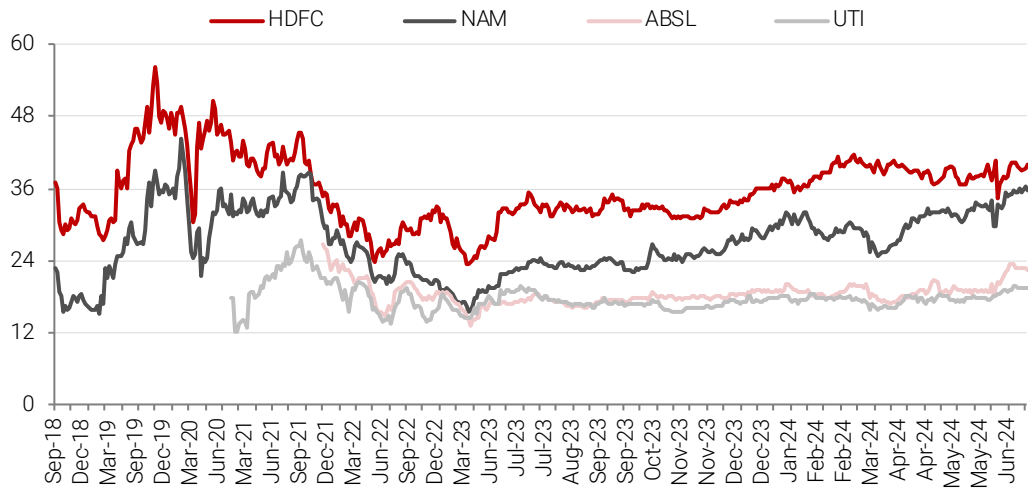
Exhibit 4: AMC valuation premium to broader markets, (%)



Source: Bloomberg, Kotak Institutional Equities

AMC stocks have re-rated in the past 12 months

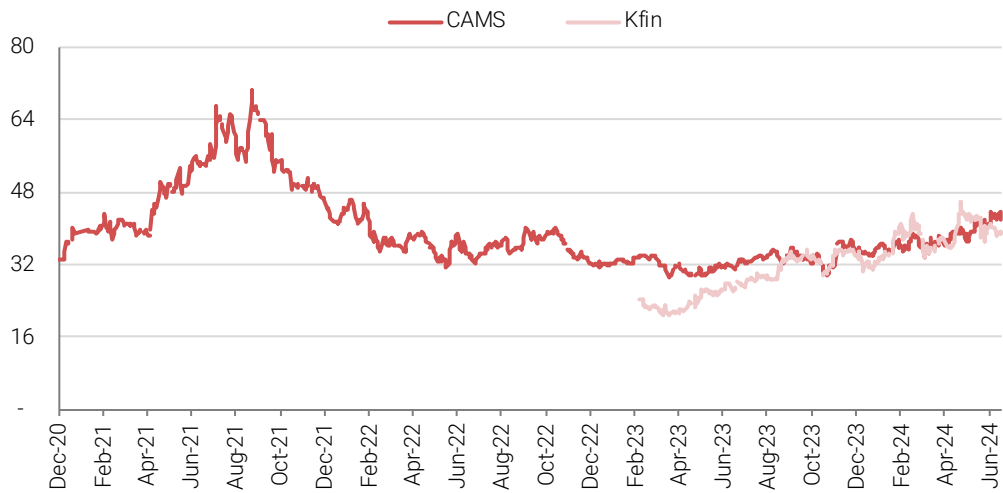
Exhibit 5: 1Y forward PE (consensus), September 2018-June 2024 (X)



Source: Bloomberg, Kotak Institutional Equities

Both CAMS and Kfin have re-rated in the past 12 months

Exhibit 6: 12M forward PE, December 2020-June 2024 (X)



Source: Bloomberg, Kotak Institutional Equities

Reverse valuations suggest high valuations for non-MF businesses as well

Exhibit 7: Breakdown of revenue, EBIT and PAT for MF/non-MF business, March fiscal year-end, 2026E (Rs mn)

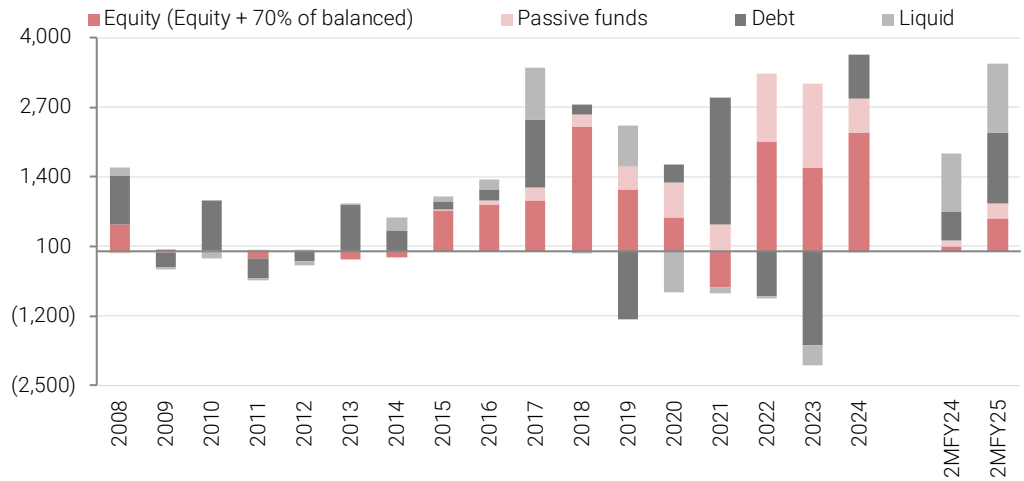
	CAMS	KFIN	Comments
Mutual fund RTA			
Revenues	13,316	9,096	Includes issuer solutions for Kfin
EBIT	5,593	3,820	
<i>EBIT margin (%)</i>	42	42	Approximate EBIT margin (assumption)
PAT	4,195	2,865	
Assumed fair value PE (X)	33	33	
Value (Rs bn)	138	95	
Non-RTA			
Revenues	2,355	2,101	
EBIT	975	681	
<i>EBIT margin (%)</i>	41	32	
PAT	731	511	
Implied value (Rs bn)	32	23	
Implied PE (X)	44	46	Implied PE for non-RTA businesses
Implied Price/Sales (X)	14	11	
Overall			
Revenues	15,671	11,196	
EBIT	6,567	4,501	
<i>EBIT margin (%)</i>	42	40	
PAT	5,188	3,673	
Market cap. (Rs bn)	180	126	
Cash/investment (Rs bn)	9	8	

Source: Company, Kotak Institutional Equities estimates

Mutual fund flow trends

FY2024 likely to close as one of the strongest years of mutual fund flows

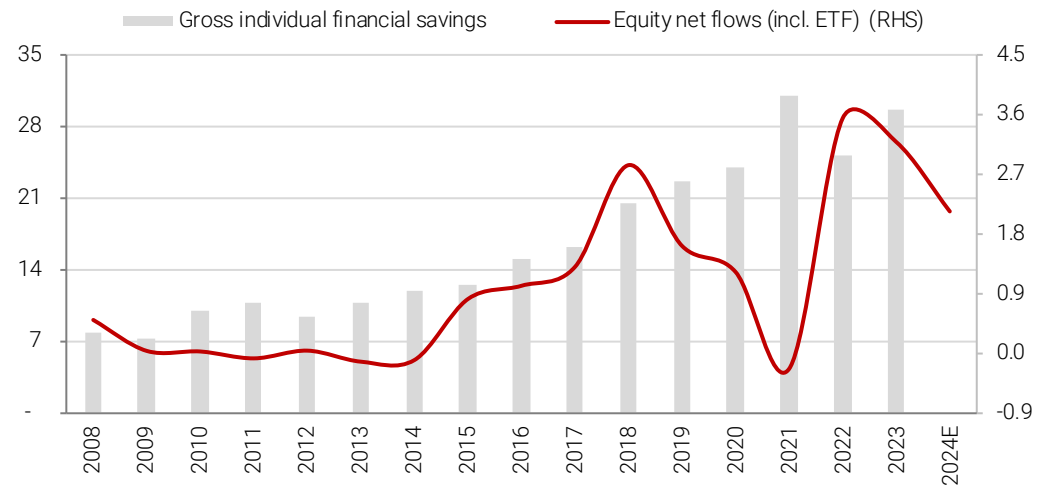
Exhibit 8: Net inflows across categories, March fiscal year-ends, 2008-24 (Rs bn)



Source: AMFI, Kotak Institutional Equities

Equity net inflows have loosely tracked gross individual financial savings in India with some lead/lag

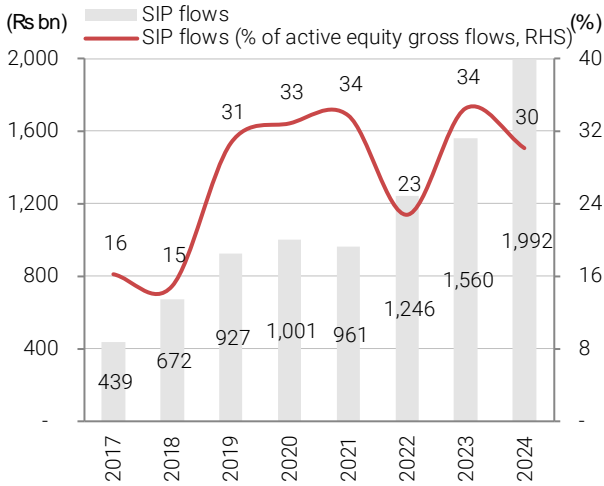
Exhibit 9: Gross individual financial savings compared with net equity flows (Rs tn)



Source: RBI, AMFI, Kotak Institutional Equities

Share of SIP flows in overall flows on the rise

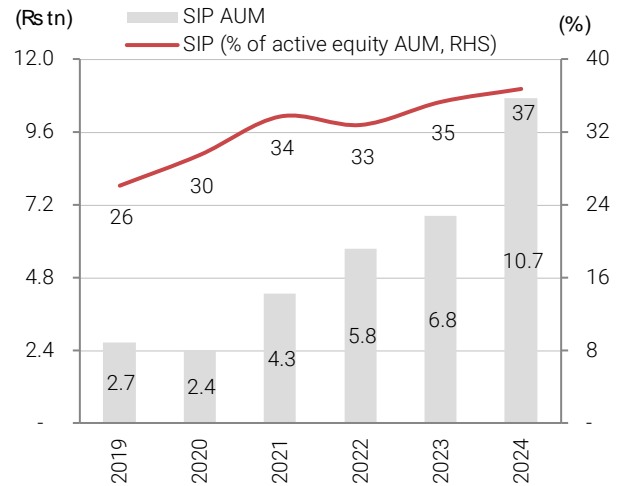
Exhibit 10: IP gross flows and as % of equity gross flows, March fiscal year-ends, 2017-24



Source: AMFI, Kotak Institutional Equities

SIP AUM comprises nearly one-third of equity AUM

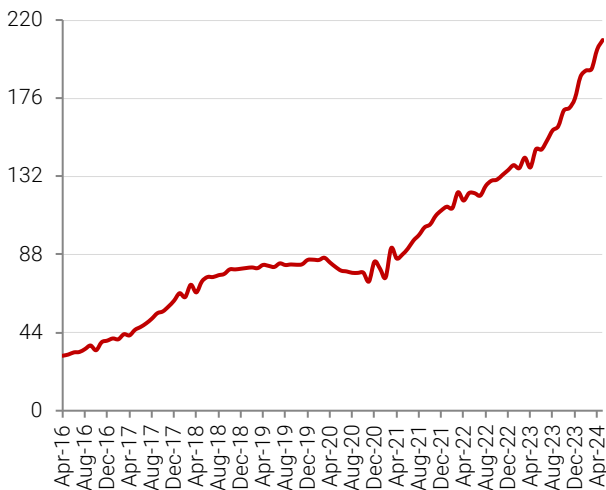
Exhibit 11: SIP AUM and as % of equity AUM, March fiscal year-ends, 2019-24



Source: AMFI, Kotak Institutional Equities

Monthly SIP gross flows have been increasing consistently

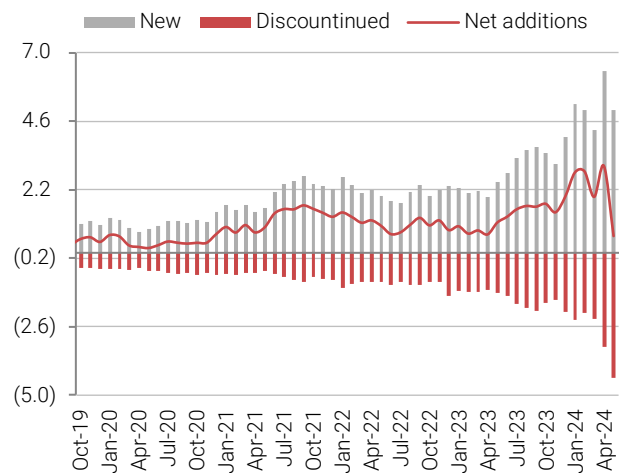
Exhibit 12: Monthly SIP flows, 2016-24 (Rs bn)



Source: AMFI, Kotak Institutional Equities

Monthly new SIP registrations have been strong post Covid

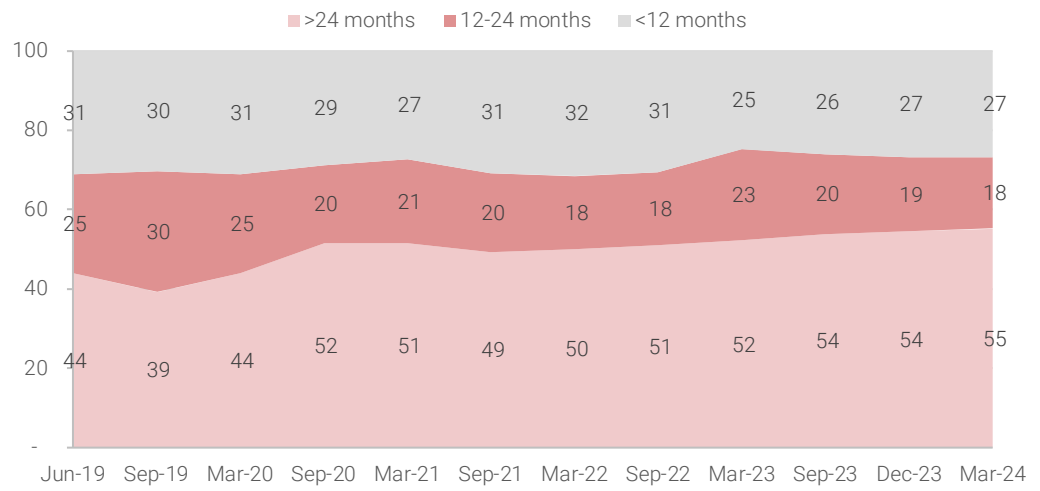
Exhibit 13: SIP registration, 2019-24 (# mn)



Source: AMFI, Kotak Institutional Equities

Share of equity AUM invested for more than 2 years has increased in the last few years

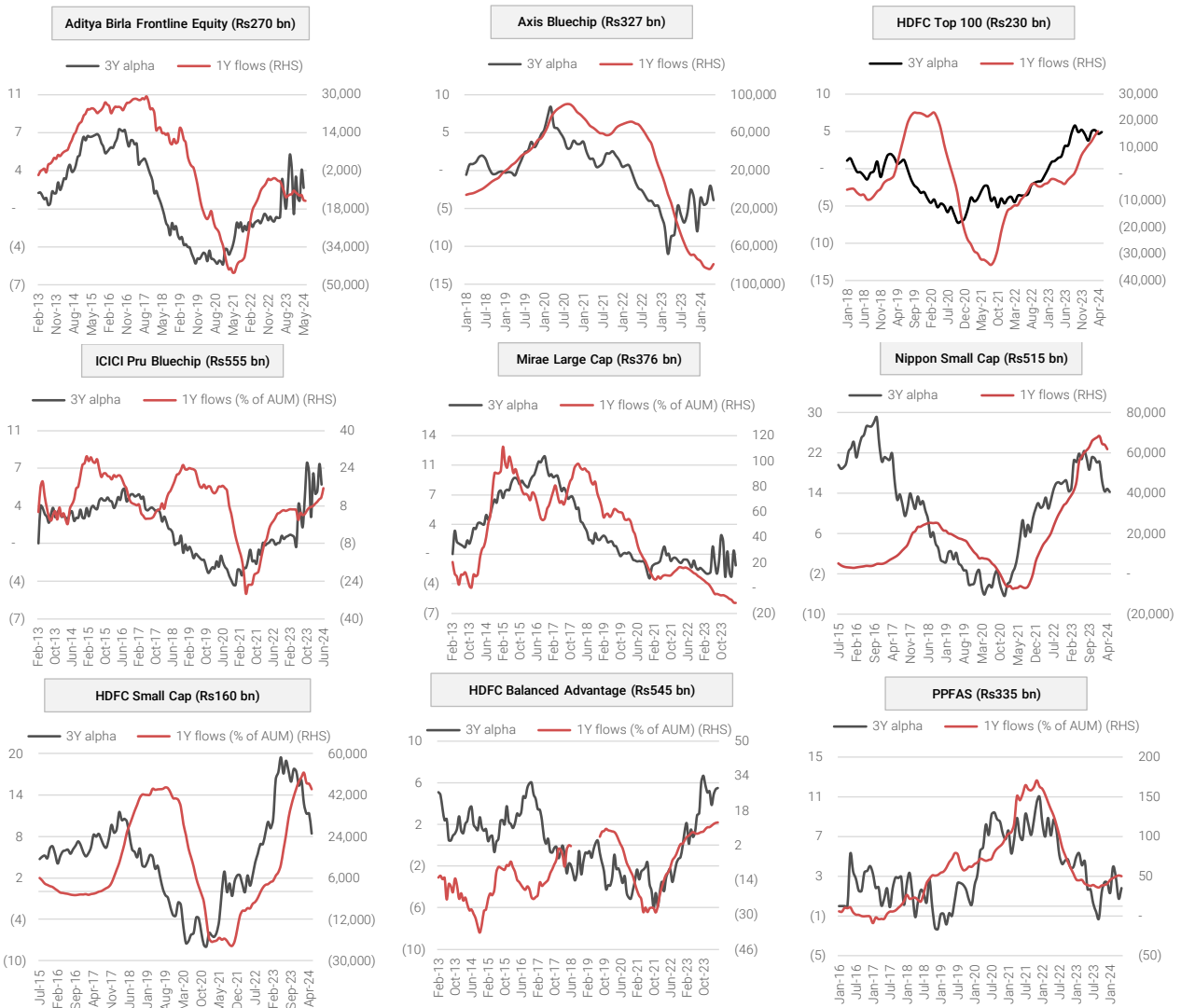
Exhibit 14: Age-wise breakdown of equity AUM for retail/HNI, June 2019-March 2024 (%)



Source: AMFI, Kotak Institutional Equities

Reasonably strong correlation between alpha and net flows

Exhibit 15: Fund alpha and calculated 1Y trailing flows (as % of opening AUM)



Note:

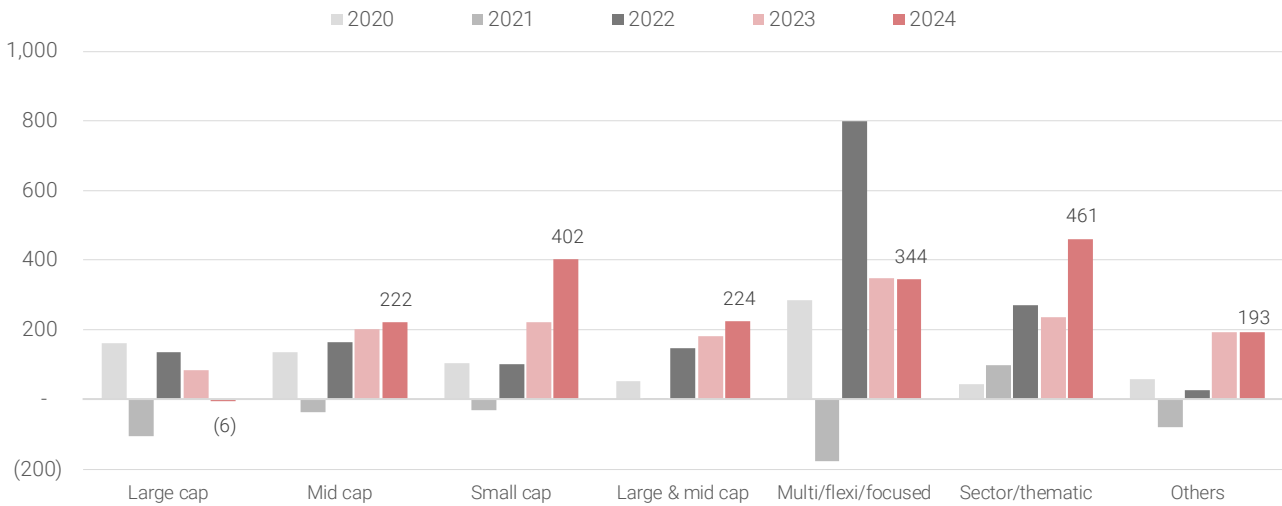
(1) To calculate alpha, we have used total return indices like Nifty-50 for large-cap funds, Nifty Mid-cap for mid-cap and Nifty-100 for flexi cap and other funds.

Source: AMFI, Kotak Institutional Equities

Recent flow trends in small and mid-cap funds

SMID funds have seen strong inflows over FY2023-24

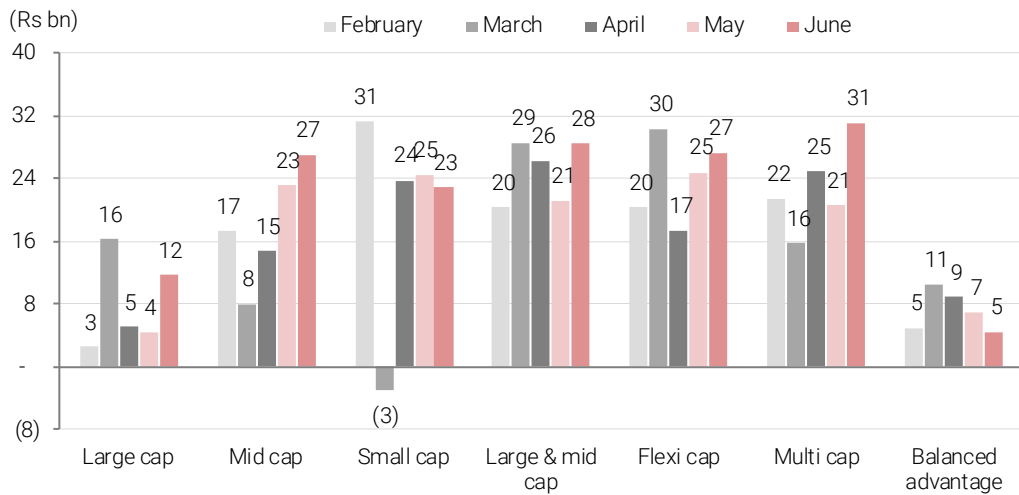
Exhibit 16: Net inflows across fund categories, March fiscal year-ends, 2020-24 (Rs bn)



Source: AMFI, Kotak Institutional Equities

Flows remain strong in small/midcap but also improve in other few categories like large-mid, flexi and multi

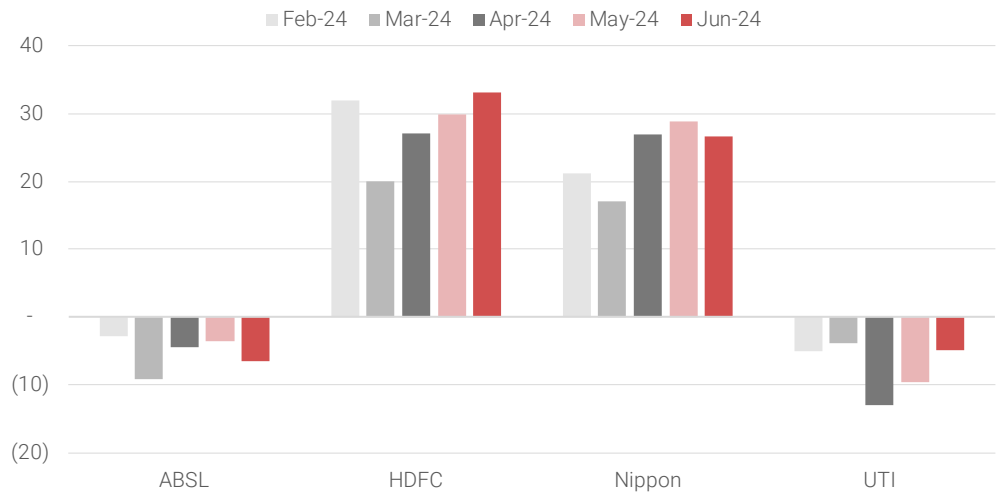
Exhibit 17: Industry net inflows across select categories, February-March 2024 (Rs bn)



Source: AMFI, Kotak Institutional Equities

HDFC and Nippon continue to attract much larger flows

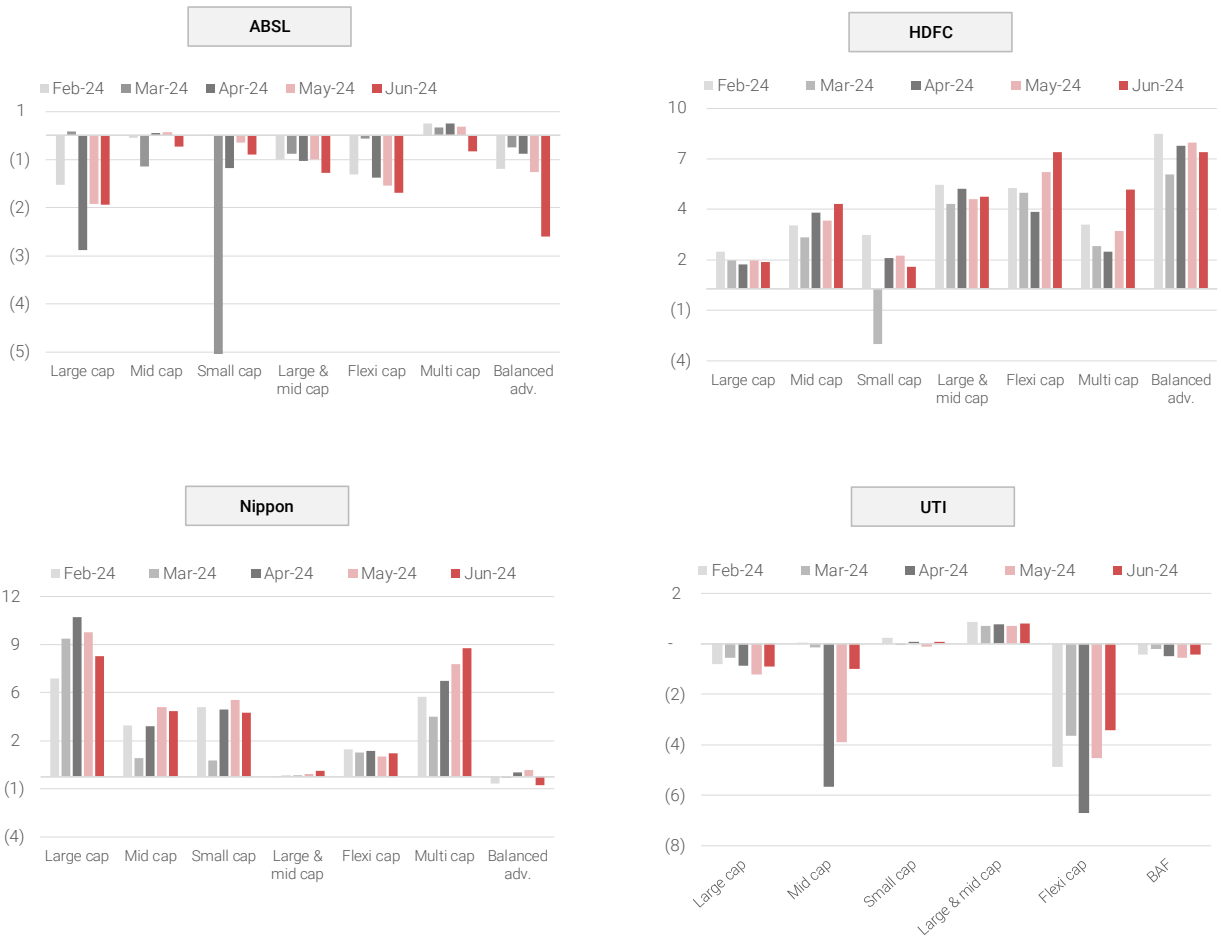
Exhibit 18: Monthly flows, February-Jun 2024 (Rs bn)



Source: AMFI, Kotak Institutional Equities

HDFC and Nippon continue to see stronger spread across multiple categories

Exhibit 19: Net inflows for listed AMC's across select categories, February-June 2024 (Rs mn)



Source: AMFI, Kotak Institutional Equities

Fund performance trends

HDFC AMC: Strong fund performance in 1/3/5Y buckets

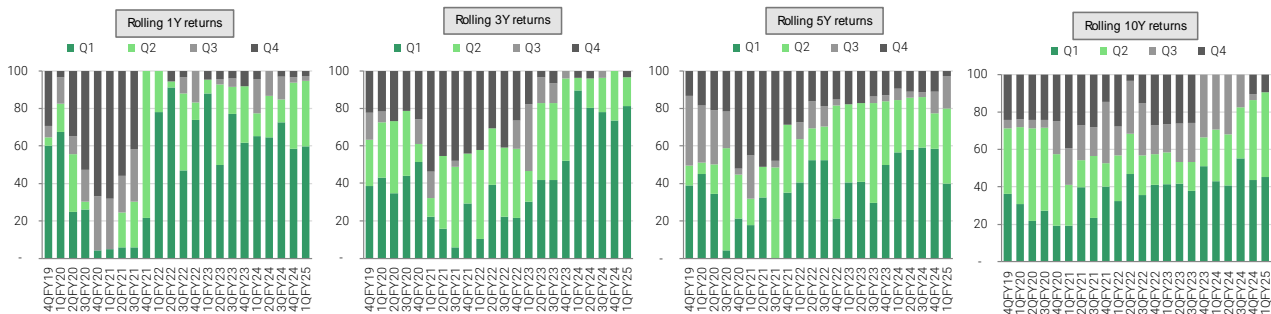
Exhibit 20: Share of active equity AUM (covering ~80% of active equity AUM across quartiles of performance) (%)



Source: AMFI, Kotak Institutional Equities

Nippon AMC: Improved fund performance in 1/3/5Y

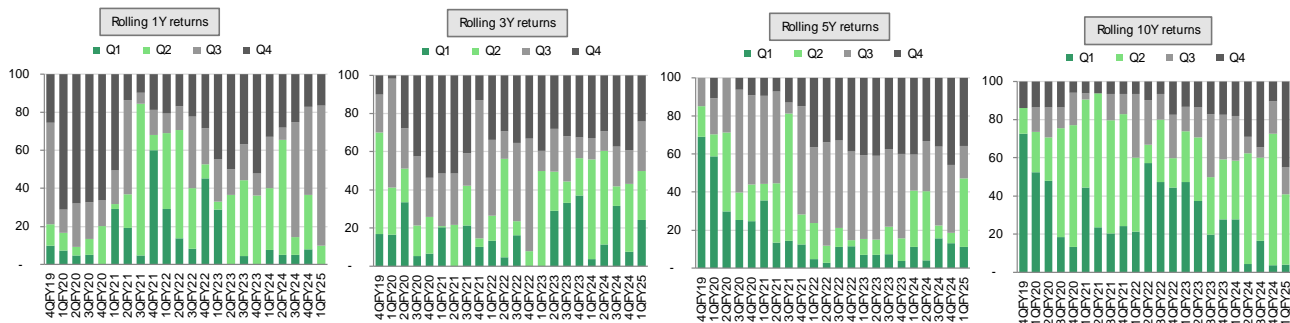
Exhibit 21: Share of active equity AUM (covering ~80% of active equity AUM across quartiles of performance) (%)



Source: AMFI, Kotak Institutional Equities

ABSL AMC: Fund performance is weak in 1Y and 5Y, while 3Y remains volatile

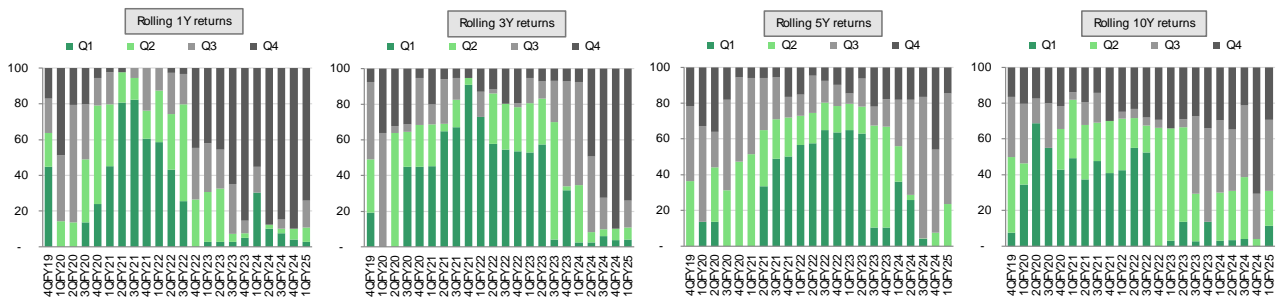
Exhibit 22: Share of active equity AUM (covering ~80% of active equity AUM across quartiles of performance) (%)



Source: AMFI, Kotak Institutional Equities

UTI AMC: Fund performance has become weaker in recent quarters

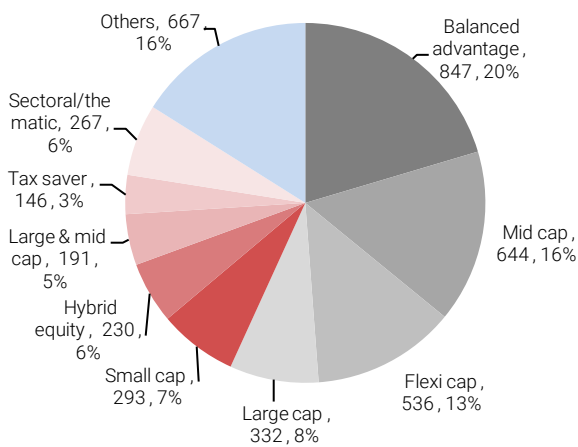
Exhibit 23: Share of active equity AUM (covering ~80% of active equity AUM across quartiles of performance) (%)



Source: AMFI, Kotak Institutional Equities

HDFC: Small and midcap funds contribute ~25% of equity AUM

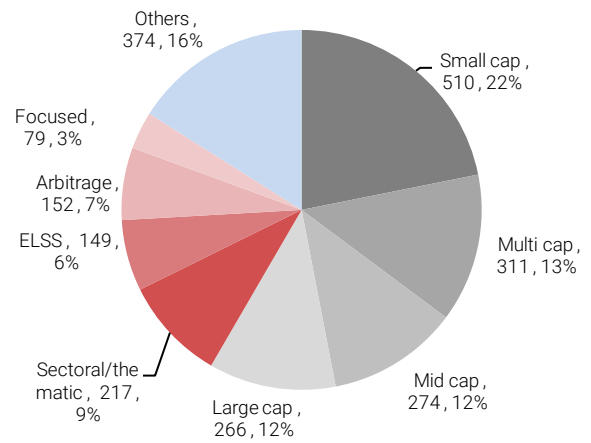
Exhibit 24: Equity AUM mix, May 2024 (Rs bn)



Source: Company, Kotak Institutional Equities

Nippon: Small and midcap funds contribute ~35% of equity AUM

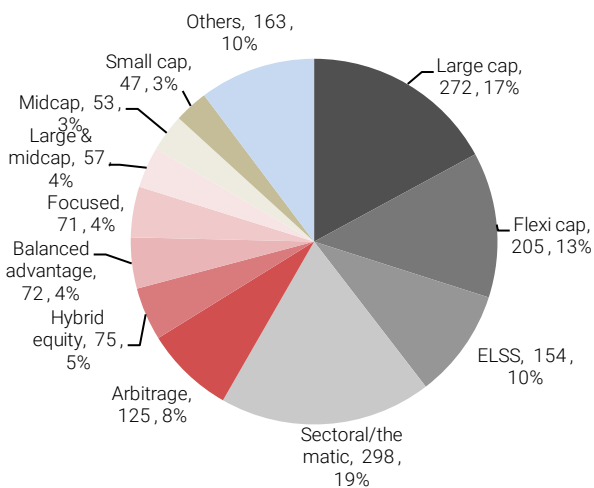
Exhibit 25: Equity AUM mix, December 2023 (Rs bn)



Source: Company, Kotak Institutional Equities

ABSL: Small and mid-cap funds contribute <10% of equity AUM

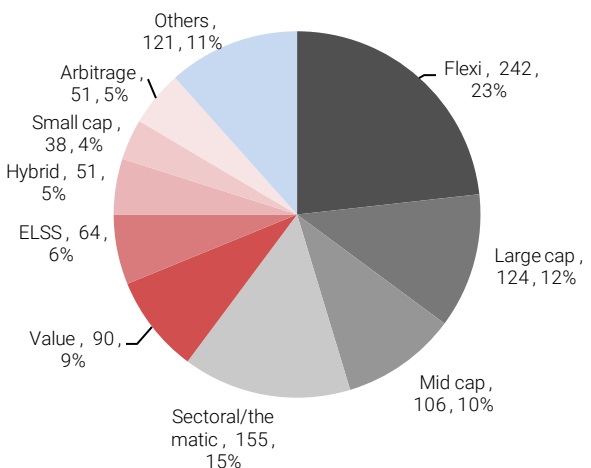
Exhibit 26: Equity AUM mix, May 2024 (Rs bn)



Source: Company, Kotak Institutional Equities

UTI: Small and mid-cap funds contribute ~15% of equity AUM

Exhibit 27: Equity AUM mix, May 2024 (Rs bn)



Source: Company, Kotak Institutional Equities

Market share gains for HDFC and Nippon in past 12 months

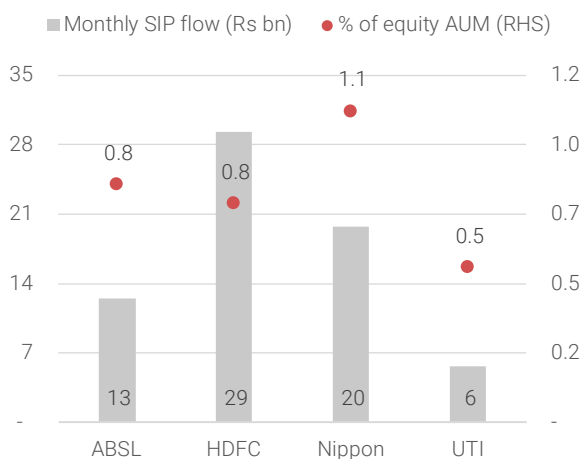
Exhibit 28: Equity-oriented AUM market share, March fiscal year-ends, 2014-25 (%)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2MFY25
Market share in equity oriented MAAUM												
Aditya Birla Sun Life	6.0	7.2	7.7	8.7	9.2	8.8	7.7	7.2	6.4	5.5	4.8	4.7
Axis AMC	1.5	2.3	3.1	3.3	3.6	4.6	6.8	8.0	8.4	7.1	5.6	5.4
Bandhan AMC	4.0	3.8	2.9	2.2	2.1	2.2	2.6	2.0	1.6	1.5	1.6	1.6
Canara Robeco	-	-	-	0.8	0.7	0.9	1.1	1.6	2.3	2.7	2.6	2.5
DSP Mutual Fund	4.5	4.1	3.7	4.4	4.4	3.9	3.9	4.1	3.8	3.4	3.1	3.2
Franklin Templeton	7.1	6.8	7.5	7.5	5.6	5.2	4.3	3.7	2.8	2.6	2.5	2.5
HDFC AMC	19.9	18.5	15.1	15.8	16.2	15.6	14.4	13.0	11.4	12.2	12.9	12.9
ICICI Prudential AMC	11.2	13.5	14.2	15.2	15.0	14.3	13.5	12.5	12.4	13.0	13.2	13.1
Kotak AMC	1.8	2.5	3.2	3.7	4.7	5.1	6.4	6.7	7.0	7.0	7.2	7.3
Mirae AMC	0.3	0.5	0.7	1.2	1.5	2.2	3.5	4.7	4.9	4.9	4.4	4.2
Nippon Life India AMC	12.3	12.2	11.2	9.7	9.2	8.9	7.4	6.9	6.3	6.4	6.8	7.0
PPFAS	-	-	-	0.1	0.1	0.2	0.3	0.6	1.1	1.5	2.0	2.0
Quant	-	-	-	0.0	0.0	0.0	0.0	0.0	0.3	0.8	1.9	2.2
SBI AMC	7.3	6.1	7.0	8.0	7.9	8.9	9.7	10.2	12.0	12.6	12.8	12.7
Tata AMC	2.2	2.0	2.5	2.1	1.7	2.3	2.3	2.5	2.9	2.8	2.8	2.8
UTI AMC	10.6	8.7	7.4	6.3	4.8	4.7	4.4	4.8	4.8	4.5	3.9	3.8
Total of above players	88.8	88.1	86.4	89.1	86.9	87.5	88.3	88.5	88.5	88.6	88.1	87.9
Top 10	85.2	83.3	80.2	82.7	80.7	79.9	78.5	78.0	77.4	76.6	74.7	74.3
Others	11.2	11.9	13.6	10.9	13.1	12.5	11.7	11.5	11.5	11.4	11.9	12.1

Source: AMFI, Kotak Institutional Equities

Strong SIP flows for HDFC and Nippon

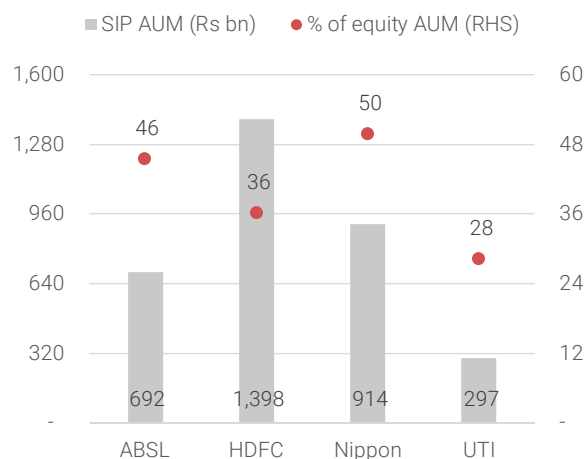
Exhibit 29: Monthly SIP and as % of equity AUM, March 2024



Source: Company, Kotak Institutional Equities

UTI has the lowest contribution of SIP flows and AUM

Exhibit 30: SIP AUM and as % of equity AUM, March 2024



Source: Company, Kotak Institutional Equities

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Ratings and other definitions/identifiers

Definitions of ratings

BUY. We expect this stock to deliver more than 15% returns over the next 12 months.

ADD. We expect this stock to deliver 5-15% returns over the next 12 months.

REDUCE. We expect this stock to deliver -5+5% returns over the next 12 months.

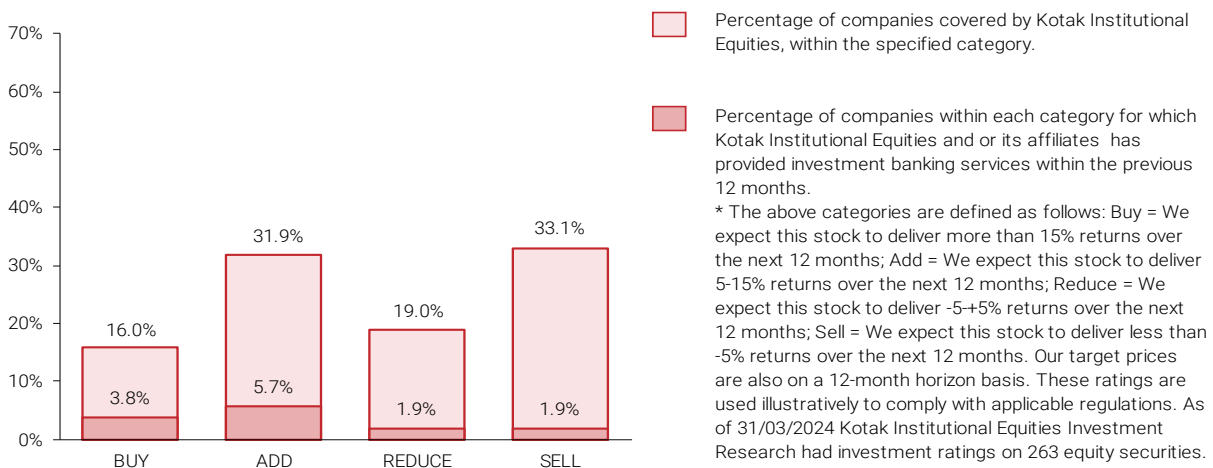
SELL. We expect this stock to deliver <-5% returns over the next 12 months.

Our Fair Value estimates are also on a 12-month horizon basis.

Our Ratings System does not take into account short-term volatility in stock prices related to movements in the market. Hence, a particular Rating may not strictly be in accordance with the Rating System at all times.

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Source: Kotak Institutional Equities

As of March 31, 2024

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