

Asset Management Companies (AMCs) in India – Listing & Valuation

AMC listing trend may pick-up if India goes onto becoming \$5 trillion economy by 2024

This paper discusses relevant macroeconomic trends, KPIs, valuation methods, and multiples for AMC businesses

September 2019

Foreword

If India is successful in becoming a \$5 trillion economy in the next five years, amongst many other things, even capital markets and asset management industry could see a positive tectonic shift in the next decade.

There has been a lot of noise that the world is moving “out” of active management and “into” passive management. This may hold true for a developed market nation like the US. However, everything that holds true for a developed market nation may not hold true for an emerging market nation like India. India’s asset management industry is at a very nascent stage when we compare to a mature market like the US.

In this paper, we have discussed an overview of asset management companies (AMCs), top AMCs in India, trends and events which led to a recent listing in India and methods to value such businesses along with current valuation and financial performance of Indian AMCs and a comparison with US-listed asset managers.

We note that “a lot has to happen” in the Indian asset management industry in decades to come before active portfolio management hits “upper circuit” in any kind of proportions near to what we are currently seeing in the US. **One trend in times to come could be more asset managers taking the IPO route in India to provide liquidity to existing investors** and create a more prominent and visible brand name for their asset management company.



“Our economy was at approximately \$ 1.85 trillion when we formed the Government in 2014. Within 5 years it has reached \$ 2.7 trillion. Hence, it is well within our capacity to reach the \$ 5 trillion in the next few years....”

- Nirmala Sitharaman, Minister of Finance, India Budget Speech 2019-20 while laying down her ‘vision for the decade’.



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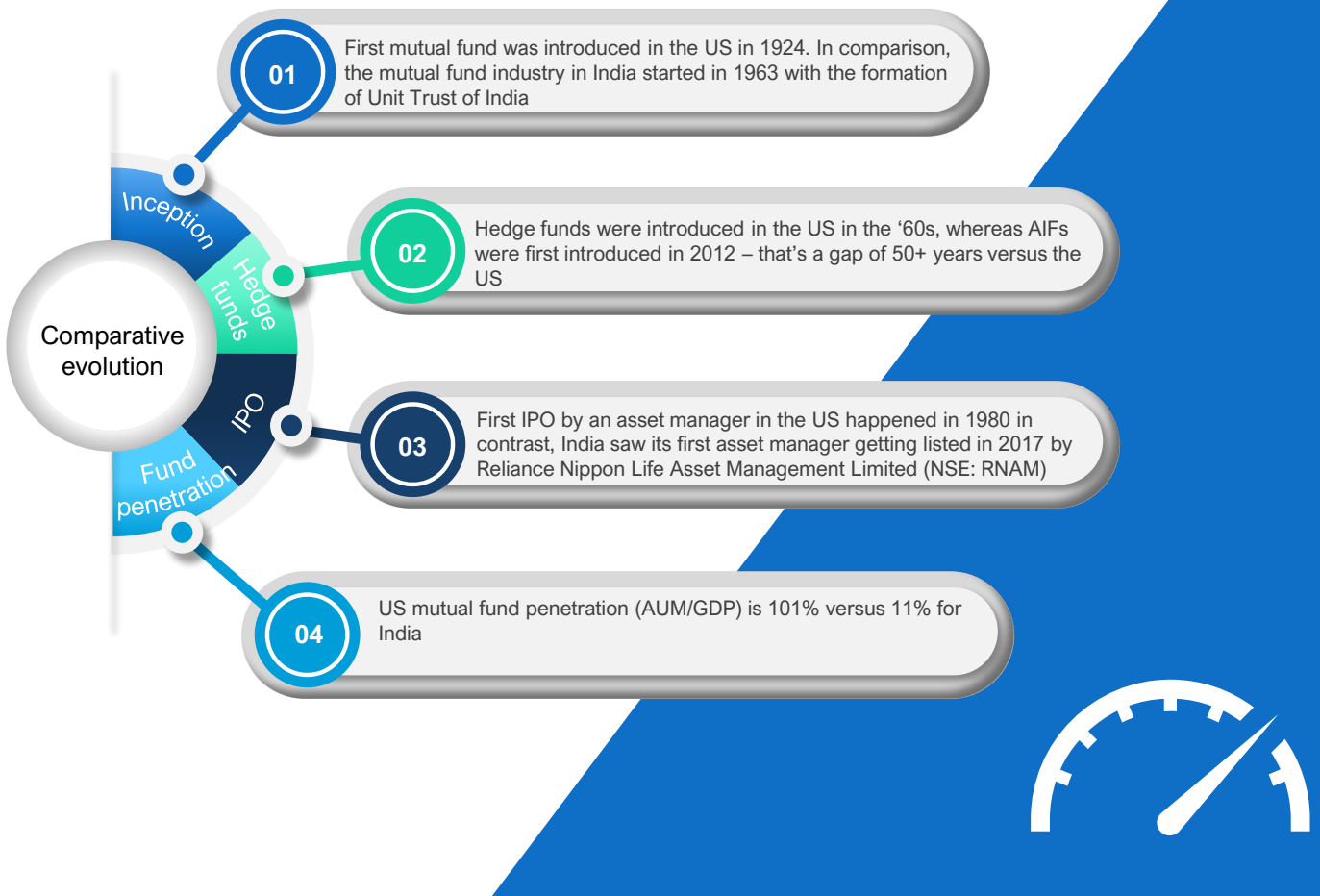
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India's asset management industry is at a very nascent stage when we compare to a mature market like the US. Let us see a few numbers to put this into perspective:

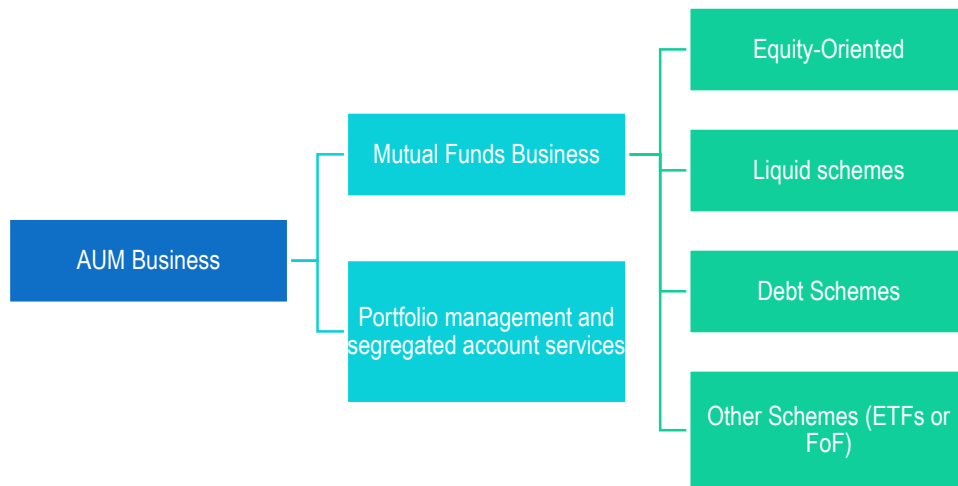
- First mutual fund was introduced in the US in 1924 - MFS Massachusetts Investors Fund (MITTX). In comparison, the mutual fund industry in India started in 1963 with the formation of Unit Trust of India, at the initiative of the Government of India and Reserve Bank of India. However, 1987 marked the entry of non-UTI, public sector mutual funds set up by public sector banks and Life Insurance Corporation of India (LIC) and General Insurance Corporation of India (GIC); that's almost a gap of 65 years versus the US
- By the time India saw its first mutual fund in the 80s, the US had already moved up the ladder to alternative assets like hedge funds. Hedge funds were introduced in the US in the '60s and were a sophisticated asset class by the '80s. In the Indian context, the nearest comparable asset class to hedge funds of the US are the Alternative Investment Funds (AIFs). AIFs were first introduced in 2012 – that's a gap of 50+ years versus the US
- First initial public offering (IPO) by an asset manager in the US happened in 1980 by State Street Corporation (NYSE: STT), and India saw its first asset manager getting listed in 2017 by Reliance Nippon Life Asset Management Limited (NSE: RNAM) – that's a gap of 37 years versus the US
- US mutual fund penetration (AUM/GDP) is 101% versus 11% for India and US has several listed AMC's with more trillion dollars of AUM versus India's entire mutual fund industry's (listed + unlisted) AUM is currently standing at c.USD 370 Bn

India's AMCs evolution timeline compared to the US



- The Asset management companies in India majorly provide two types of services: Mutual Fund Services and Portfolio Management Services (PMS)

Business model of AMCs



AMC companies offer their customers access to their products and services through an extensive multi-channel sales and distribution network comprising banks, national distributors and independent financial advisers (IFAs).

These companies generate a substantial amount of revenue from investment management fees that are charged as a percentage of annual average asset under management (“AAAUM” or “AUM”).

Growth in AUM is a function of volume and price. In other words, AUM is “number of units” multiplied by “net asset value (NAV)”. Volume increases with an increase in net inflows (net of redemptions) which can take the route of either one-time lump sum inflow or via periodic systematic investment plan (SIP). Price or NAV increase when the prices of the underlying assets which are held by the AMC, increase.



Top AMC players in India

- There are around 43 AMCs providing traditional mutual fund offerings with a combined AUM of approximately INR 25.5 trillion (USD 370 Bn) as of Apr-Jun 2019 based on the average AUM data. Top five AMCs roughly constitute 60% of the overall market size with HDFC Mutual Fund being the largest AMC with INR 362.5 trillion (USD 52.7 Bn) representing 14% market share.
- Currently, two of these asset managers are listed: Reliance Nippon Life Asset Management Limited (NSE: RNAM) was listed in November 2017, and HDFC Asset Management Company Ltd (NSE: HDFCAMC) was listed in August 2018.

- Total 43 AMC providing MFs
- combined AUM of approximately INR 25.5 trillion (USD 370 Bn)
- Top five AMCs roughly constitute 60% of the overall market size



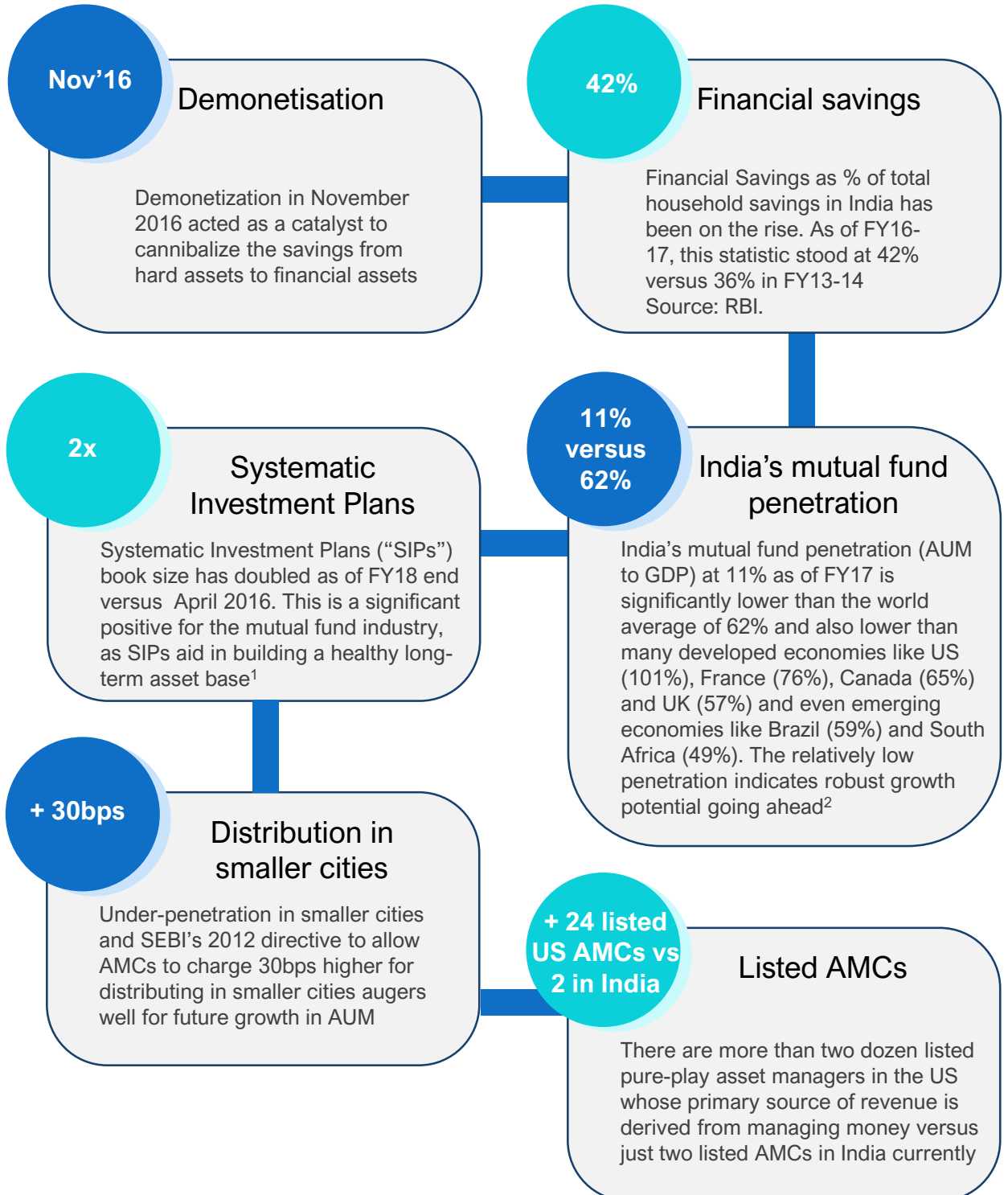
Average Assets under Management (AAUM)					
Serial No	Mutual Fund Name	Listed / Unlisted	Avg AUM (INR Bn)	Avg AUM (USD Bn)	% Mkt Share
1	HDFC Mutual Fund	Listed	3,625.4	52.7	14.2%
2	ICICI Prudential Mutual Fund	Unlisted	3,372.9	49.0	13.2%
3	SBI Mutual Fund	Unlisted	3,075.3	44.7	12.1%
4	Aditya Birla Sun Life Mutual Fund	Unlisted	2,539.7	36.9	10.0%
5	Reliance Mutual Fund	Listed	2,225.8	32.4	8.7%
Total - Top 5 MFs			14,839.0	215.7	58.2%
.....					
42	ITI Mutual Fund	Unlisted	0.7	0.0	0.0%
43	Sahara Mutual Fund	Unlisted	0.5	0.0	0.0%
Total - All MFs			25,505.9	370.7	100.0%

Source: AUM data as of Apr-Jun 2019 sourced from AFMI



Trends and Data in Indian AMC sector which could fuel more AMCs going for IPO in future

It is essential to analyse the events and macro trends which could have possibly helped two of the largest AMCs in India going for IPO in a span of the last two years:



Source:

¹HDFC AMC red herring prospectus https://www.sebi.gov.in/filings/public-issues/jul-2018/hdfc-asset-management-company-limited_39627.html

²Source – HDFC AMC red herring prospectus https://www.sebi.gov.in/filings/public-issues/jul-2018/hdfc-asset-management-company-limited_39627.html

Key Performing Indicators for valuing an AMC

- **Size of AUM:** The higher the size of AUM, the better it is, for it results in higher fees.
- **Weighted average management fees:** An AMC which is able to charge higher management fees will generate higher revenues and profits on the same asset base.
- **Product mix:** **Debt** schemes tend to have a lower management fee versus **equity** schemes and hence AUMs with higher % derived from equity schemes tend to have higher valuation multiples versus other similar AMCs with lower equity AUM. Further, higher AUM from **liquid schemes** as % of total AUM tend to attract lower valuation multiples versus other similar AMCs with lower AUM from liquid schemes
- **Monthly and annual SIP flows:** Regular flow of investments through systematic investment plans (SIPs) show investors' belief in the AMC's ability to generate consistent returns which provide certainty to the future profitability of the company.
- **SIP AUM as a per cent of equity AUM:** Systematic investments mean a steady flow of assets to an AMC. A higher share of SIP AUM in the total equity AUM leads to predictable cash flows for the AMC.
- **Distribution channels:** Higher customer reach through distribution and channel partners tend to have higher valuations versus another AMC with lower out-reach

Valuation approaches and methodologies

- Broadly, three approaches are used for valuing AMCs:
 - **Income approach:** Under the income approach, one or both of the following methodologies are used to value an AMC: a) discounted cash flow (DCF) methodology, b) Price-earnings capitalization method (PECV)
 - **Market approach:** Under the market approach, both comparable companies (CoCo), as well as comparable transactions (CoTrans), are widely used to value AMCs. Valuation multiples like EV as % of AUM, EV/EBITDA are most relevant for evaluating an AMC business. AMCs with higher asset balances, fee structures, and profit margins typically attract higher AUM multiples in the marketplace.
 - **Statistical approach:** There are few statistical approaches like HUBERMAN and BERK/GREEN, which are also used to value asset managers. These two approaches use the dividend discount model and simple cross-sectional model, respectively. These methods can be used to validate the output under the income/market approach
- We have analysed valuations in the sector and have also made a comparison with international peers. We have looked into the following valuation metrics and evaluated against drivers like the size of AUM, revenue as % AUM, EBITDA margin and net profit margin:
 - Mkt Cap / AUM & EV / AUM expressed as percentage
 - P/E and P/BV multiples
 - EV/EBITDA multiples



Top Indian AMCs - Valuation multiples and financial KPIs

Fundamental Data and Valuation KPIs

INR Bn	AAUM	Mkt Cap	EV	Rev as % of AUM	EBITDA margin	Net Profit Margin	Mkt Cap / AUM	EV/ AUM	P/E	P/BV	EV/ EBITDA
Top 5 Indian AMCs											
Mean	2,967.8	316.0	301.1	0.64%	58.5%	33.8%	9.9%	9.5%	38.6x	10.7x	24.1x
Median	3,075.3	316.0	301.1	0.63%	58.5%	31.2%	9.9%	9.5%	38.6x	10.7x	24.1x
High	3,625.4	492.9	468.8	0.74%	72.7%	47.3%	13.6%	12.9%	48.5x	16.0x	30.0x
Low	2,225.8	139.0	133.5	0.55%	44.3%	25.5%	6.2%	6.0%	28.6x	5.4x	18.3x

Notes:

1. Source: Financial data for unlisted AMCs sourced from red herring prospectus of HDFC AMC, dated Jul 2018. Latest company filings used for listed AMCs. AUM data sourced from AMFI Apr-Jun 2019
2. HDFC and Reliance AMCs are the only listed AMCs in India, and hence relevant valuation ratios have been calculated based on market price data of these two AMCs only
3. Market prices as of 21 July 2019. AAUM as of Apr-Jun 2019

Key observations:

- Revenue as % AAUM for the median of Top 5 AMCs is 0.63% with a minimum of 0.55% and a maximum of 0.74%.
- The net profit margin for these five AMCs is having a median of 31% and is ranging between 25-47%
- Valuation ratios of P/BV, EV/EBITDA and Mkt Cap as % AUM are being driven by a combination of the size of AUM, the contribution of equity schemes and margin earned in the business. P/BV ratio is trading in a wide range of 5-15x. Similarly, Mkt Cap as % AUM is also trading in a wide range of 6-14%

Comparison with International peers - Valuation multiples and financial KPIs

Median values for financial data and valuation KPIs

USD Bn	AAUM	Mkt Cap	Rev as % of AUM	EBITDA margin	Net Profit Margin	Mkt Cap / AUM	EV/AUM	P/E	P/BV	EV/ EBITDA	
Large Indian AMCs	44.7	4.6	4.4	0.6%	58.5%	31.2%	9.9%	9.5%	38.6x	10.7x	24.1x
Large Listed AMCs - US	1,197.8	22.4	14.4	0.4%	30.3%	17.6%	1.1%	1.1%	11.9x	1.8x	8.3x
Mid-Size Listed AMCs - US	119.0	3.3	3.5	0.5%	26.5%	15.6%	2.0%	1.7%	15.7x	3.6x	10.2x
Small-Size Listed AMCs - US	21.3	0.5	0.2	0.7%	22.6%	11.0%	1.5%	1.1%	9.6x	1.7x	2.7x

Notes:

1. Source: Company filings and stock exchange data

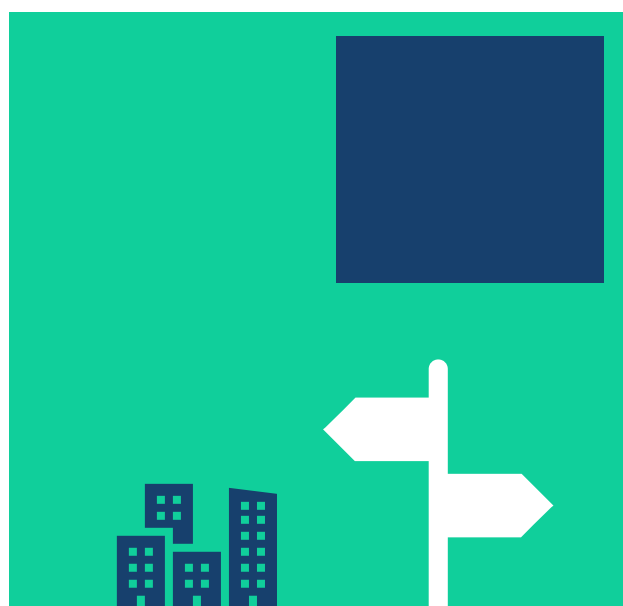
2. US AUM data as per the latest available data which is either June 2019 or March 2019 or September 2018. Indian AUM data sourced from AMFI Apr-Jun 2019

3. Market prices as of 21 July 2019

There are more than two dozen listed asset managers in the US whose primary business is managing money. Beyond such asset managers, there are several others whose principal focus is private equity / direct lending / structured credit products. In our analysis, we have only included asset managers who majorly deal in managing money.

Equity oriented AUM for the US AMCs considered in the above analysis is around 50% which is broadly in line with top Indian AMCs having equity-oriented schemes between 40-50%

We identified 23 listed asset managers in the US and divided into “Large”, “Mid-Size” and “Small-Size” asset managers using market capitalization (<USD 1 Bn as Small-Size, Between USD 1-10 Bn as Mid-Size and >USD 10 Bn as Large).



Key observations:

India's large AMCs have a median AUM of USD 45 Bn and Mkt Cap of USD 4.4Bn. In terms of AUM, India's large AMCs falls between the small and mid-size listed AMCs of the US and in terms of Mkt Cap, the same falls between small and medium-sized US-listed AMCs.

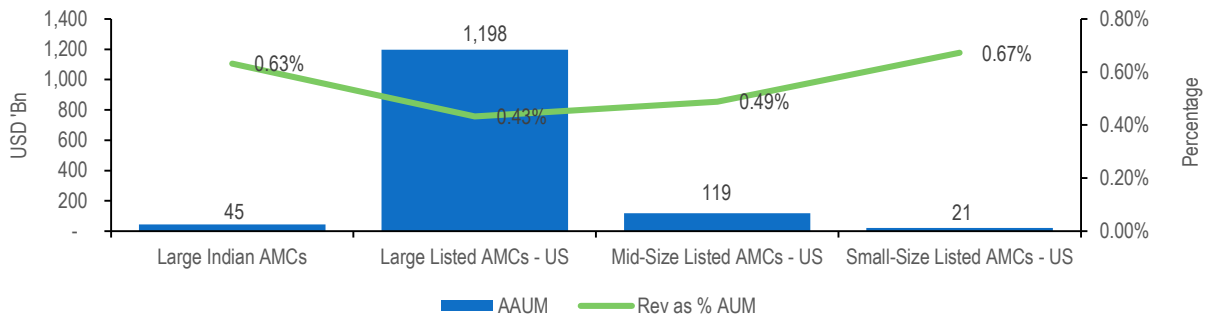
The net profit margin for the US asset managers measured by median numbers of the three sub-segment noted above ranges between 10-18% versus +30% margin for large Indian AMCs

US asset managers valuation as measured by Mkt Cap / AUM is between 1-2% versus 10% for Indian AMCs



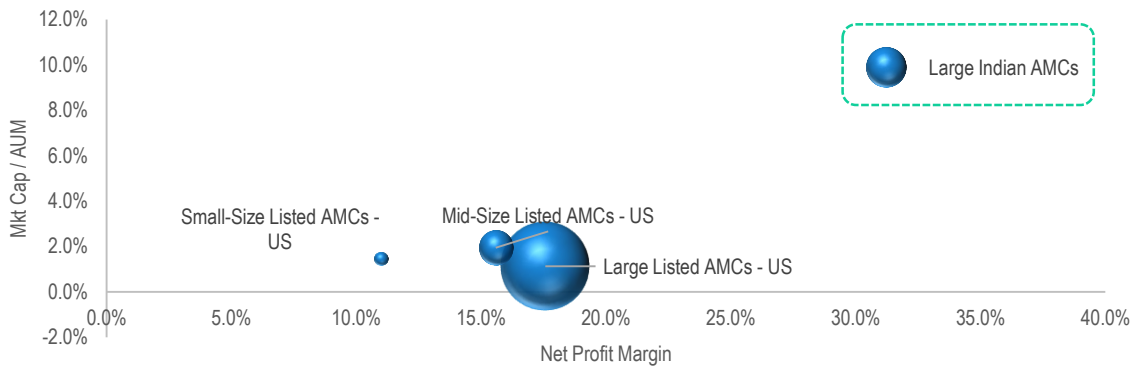
Comparison with International peers - Valuation multiples and financial KPIs

Comparison of AAUM and Rev as % of AAUM



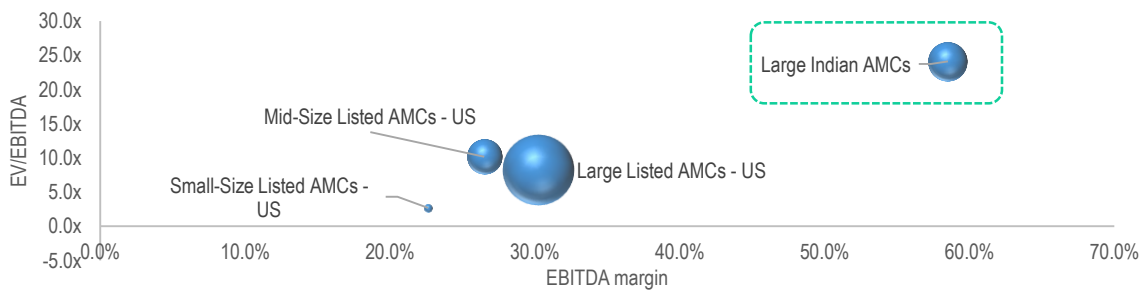
Source: Company filings and NSE/BSE/NYSE/NASDAQ data. US AUM data as per the latest available data which is either June 2019 or March 2019 or September 2018. Indian AUM data sourced from AMFI Apr-Jun 2019. Market prices as of 21 July 2019

Analysis of Mkt Cap / AUM and Net Margin



Source: Company filings and NSE/BSE/NYSE/NASDAQ data. US AUM data as per the latest available data which is either June 2019 or March 2019 or September 2018. Indian AUM data sourced from AMFI Apr-Jun 2019. Market prices as of 21 July 2019

Analysis of EV/EBITDA and EBITDA Margin



Source: Company filings and NSE/BSE/NYSE/NASDAQ data. US AUM data as per the latest available data which is either June 2019 or March 2019 or September 2018. Indian AUM data sourced from AMFI Apr-Jun 2019. Market prices as of 21 July 2019



Indian Government is focused on making India a USD 5 trillion economy in the next five years. This will require a higher investment rate and increase in consumption to mobilize all the sectors along with a supportive fiscal and monetary policy. Mutual fund assets as a percentage of GDP is fairly low versus the global average. If the economy moves in the direction as per Indian Government's vision, mutual fund assets could have a tectonic shift in the next decade. This could incentivize more asset managers to go for IPO. Valuation for the Indian asset managers has been more compelling when compared to the US peers partly driven by an early stage of active management wave in India versus mature passive management in the developed countries like the US. This could act as a boost for the listing of AMCs in India in years to come!



Reference Material:





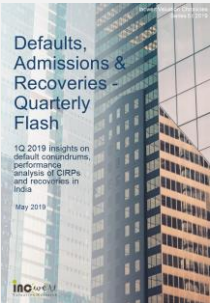


- Association of Mutual Funds in India (AMFI)
- RBI
- India Budget Speech 2019-20
- NSE, BSE, NYSE, NASDAQ
- Red herring prospectus of HDFC AMC and Reliance Nippon Life Asset Management Limited
- Company filings and other publicly available information
- Incwert analysis

Photo credit:

- Unsplash.com

Incwert Valuation Chronicles
(click the image to download the file)



<p>Equity risk premium in India - Jan 2019</p> 	<p>Valuation challenges in AIF (Pg. 69-80) - Feb 2019</p> 	<p>Perspective on valuation of DVRs - Mar 2019</p> 	<p>Junk bond valuation - Apr 2019</p> 
<p>IBC Quarterly Flash - May 2019</p> 	<p>Rule 11UA valuation - Jun 2019</p> 	<p>IBC Quarterly Flash - Aug 2019</p> 	

Management | Advisory Board



Sunit Khandelwal
Director

Sunit has worked across a range of sectors such as Infrastructure, real estate, FMCG, retail, engineering, clean energy, healthcare, IT/ ITeS, and other manufacturing industries.

Qualifications:

Chartered Accountant (ICAI)
B.Com (Hon.) – St. Xavier's College
Registered Valuer with IBBI

Sunit has an overall experience of over 13 years in valuation advisory, transaction advisory and M&A advisory.

As a valuation professional, Sunit has undertaken valuation of businesses for transactions, fund raising, strategic decision making, and corporate restructuring. He has also undertaken valuation of intangible assets, option valuation, litigation support, private equity portfolio valuation and valuation for reporting purposes such as purchase price allocation and impairment test under IFRS and Indian GAAP.

In past he has worked with KPMG India (as Associate Director), BDO, Grant Thornton, KPMG UK, and DBDBS a boutique M&A advisory firm.

Sunit is also an active speaker on valuation at National Institute of Finance Management (NIFM).



Punit Khandelwal
Director

Punit has worked across leveraged loans, distressed debt, insolvency/ bankruptcy situations and high-yield asset classes.

Qualifications:

Chartered Accountant (ICAI)
Chartered Financial Analyst (ICFAI)
CFA Level 2 (US)
MS in Finance (ICFAI)
B.Com (Hons.) – St Xavier's College
Registered Valuer with IBBI

Punit brings with him 15 years of experience in sell-side and buy-side advisory across equity and fixed income. He has worked on several bespoke valuations and lent research support to dozens of asset managers/investment bankers/brokers/consulting firms across the globe.

In the fixed income segment, he worked as a fundamental analyst across the capital structure: leveraged loans, distressed debt, insolvency/bankruptcy situations and high-yield asset classes. He has also helped sell-side & consulting firms increase their market presence by coming up with thematic and white label papers.

He started his career as an analyst with Zacks Investment Research & then was a part of a UK based CLO manager's research team. Then he moved on to set up research practices for couple of startups before moving onto become Global Head of Research at Southerland and then finally co-founded Incwert.



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