

SELL

TP: Rs 210 | ▼ 22%

**NIPPON LIFE INDIA
 ASSET MANAGEMENT**

Diversified Financials

28 July 2020

Margins contract as opex normalises

Nippon Life Asset Management (NAM) reported a Rs 250bn sequential increase in Q1FY21 AUM, largely due to the MTM effect. Lower AUM in Q4FY20 had a lag effect on investment income – this coupled with normalising opex led to EBITDA and PBT margin contraction. We cut FY21/FY22 EPS estimates by 10%/9% as the high-yielding equity business is likely to clock muted growth. Rolling valuations over, our Jun'21 TP remains unchanged at Rs 210 – maintain SELL.

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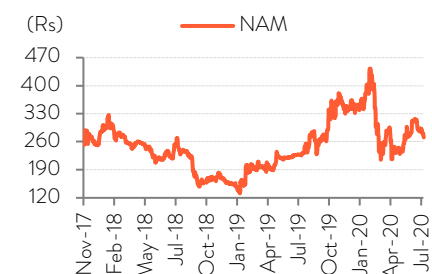
AUM increased largely due to MTM: AUM (end of period) increased ~Rs 250bn on a sequential basis in Q1, primarily due to the mark-to-market (MTM) effect, and not redemptions. Though SIP flows were steady at Rs 7bn, we expect the high-yielding equity business to slow down in the wake of Covid-19. We also argue that gaining market share in debt looks difficult for NAM given FY19-FY20 debt write-offs.

Ticker/Price	NAM IN/Rs 270
Market cap	US\$ 2.2bn
Shares o/s	612mn
3M ADV	US\$ 4.8mn
52wk high/low	Rs 453/Rs 208
Promoter/FPI/DII	76%/6%/6%

Source: NSE

Contraction in EBITDA and PBT margins: As argued earlier, we believe NAM has exhausted its opex control levers in Q4FY20. In Q1, investment income decreased 28% YoY to Rs 2.3bn largely due to the lag effect of reduced AUM in Q4FY20. Opex declined slower than investment income at 26% YoY, leading to a 100bps YoY increase in cost-to-core income ratio. EBITDA margin and PBT margin contracted by 100bps and 320bps YoY respectively. PAT grew 24% YoY to Rs 1.6bn, largely driven by other income of Rs 1bn.

STOCK PERFORMANCE



Source: NSE

Maintain SELL: Not only will gaining market share in debt prove challenging, but we believe NAM also faces a tough balancing act to add equity market share and maintain profitability. We retain our SELL rating with a Jun'21 TP of Rs 210 (unchanged), as we cut our FY21/FY22 earnings estimates by 10%/9% to bake in the pandemic impact.

KEY FINANCIALS

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Core PBT (Rs mn)	5,290	5,696	5,047	6,229	7,610
Core PBT (YoY)	6.1	7.7	(11.4)	23.4	22.2
Adj. net profit (Rs mn)	4,871	4,158	5,255	6,213	7,324
EPS (Rs)	8.0	6.8	8.6	10.2	12.0
P/E (x)	34.0	39.8	31.5	26.6	22.6
MCap/AAAUM (%)	6.9	7.9	7.5	6.8	5.9
RoAAAUM (in bp)	20.4	19.9	23.8	25.4	26.1
ROE (%)	19.7	16.1	19.9	22.8	25.9

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q4FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
Total income	3,362	3,604	(6.7)	1,496	124.8
Operating Expenses	1,248	1,705	(26.8)	1,129	10.5
EBITDA	1,084	1,546	(29.9)	1,617	(33.0)
Core PBT	966	1,452	(33.5)	1,523	(36.6)
Other income	1,031	353	192.0	(1,249)	(182.5)
PBT	1,997	1,805	10.6	274	NM
Tax	436	549	(20.7)	232	87.6
Net Profit (ex-MI)	1,561	1,256	24.3	41	NM

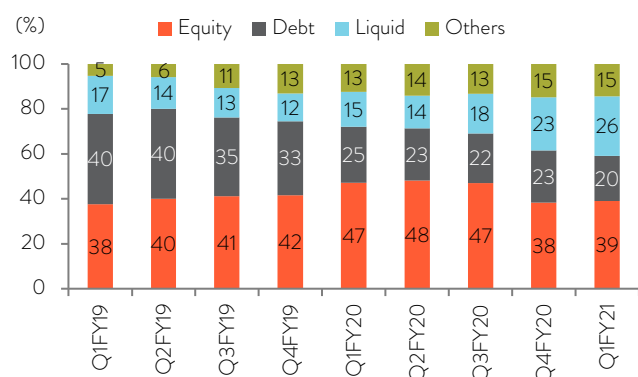
Source: Company, BOBCAPS Research

FIG 2 – ESTIMATES VS. ACTUALS

(Rs mn)	Q1FY21E	Q1FY21A	Variation (%)
Total income	3,583	3,362	(6.2)
YoY (%)	(0.6)	(6.7)	-
Operating Expenses	1,437	1,248	(13.2)
EBITDA	1,651	1,084	(34.4)
YoY (%)	6.8	(29.9)	-
Depreciation	40	105	162.5
Finance Costs	18	13	(28.0)
Core PBT	1,594	966	(39.4)
YoY (%)	9.7	(33.5)	-
Other income	495	1,031	108.2
PBT	2,089	1,997	(4.4)
YoY (%)	15.7	10.6	-
Tax	526	436	(17.3)
Tax Rate (%)	25.2	21.8	-
Net Profit (ex MI)	1,562	1,561	(0.1)
YoY (%)	24.4	24.3	-

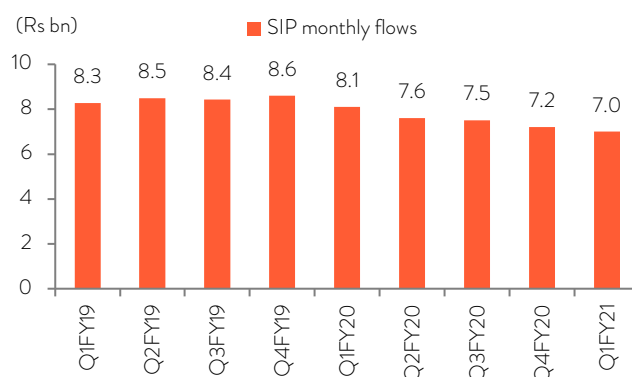
Source: Company, BOBCAPS Research

FIG 3 – AUM INCREASED LARGELY DUE TO MTM EFFECT



Source: Company, BOBCAPS Research

FIG 4 – SIP FLOWS STEADY; DIP DUE TO RECLASSIFICATION



Source: Company, BOBCAPS Research

FIG 5 – DETAILED QUARTERLY PERFORMANCE

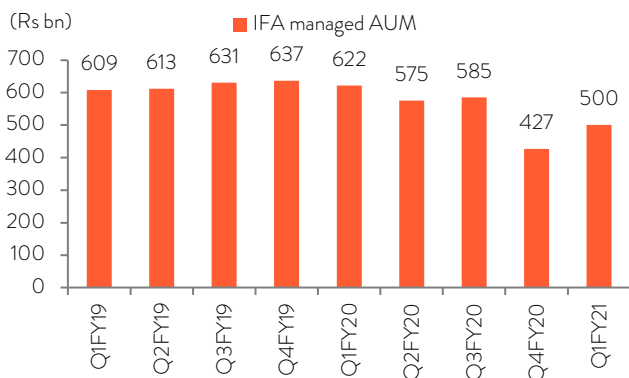
	FY19				FY20				FY21	Variation (%)	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	QoQ	YoY
Profit and Loss (Rs mn)											
Total income	4,100	4,240	4,040	3,975	3,604	3,226	3,606	1,496	3,362	124.8	(6.7)
Operating Expenses	2,430	2,533	2,317	2,018	1,705	1,551	1,560	1,129	1,248	10.5	(26.8)
EBITDA	1,350	1,378	1,182	1,415	1,546	1,451	1,471	1,617	1,084	(33.0)	(29.9)
Depreciation	80	87	90	(164)	76	76	91	89	105	18.0	37.8
Finance Costs	0	0	0	0	17	16	19	5	13	173.9	(26.7)
Core PBT	1,270	1,292	1,092	1,578	1,452	1,359	1,361	1,523	966	(36.6)	(33.5)
Other income	320	329	541	543	353	224	575	(1,249)	1,031	(182.5)	192.0
PBT	1,590	1,620	1,633	2,121	1,805	1,583	1,936	274	1,997	NM	10.6
Tax	500	490	536	604	549	216	443	232	436	87.6	(20.7)
Net Profit (ex MI)	1,090	1,131	1,097	1,517	1,256	1,367	1,493	41	1,561	NM	24.3
Ratios (Calc, %)											
Cost to core income ratio	64.3	64.8	66.2	58.8	52.5	51.7	51.5	41.1	53.5	1,240bps	106bps
EBITDA Margin	35.7	35.2	33.8	41.2	47.5	48.3	48.5	58.9	46.5	(1,240bps)	(106bps)
Core PBT Margin	33.6	33.0	31.2	46.0	44.7	45.3	44.9	55.5	41.4	(1,404bps)	(323bps)
RoAAUM	0.18	0.19	0.19	0.22	0.23	0.27	0.30	0.02	0.36	34bps	13bps
AUM (EOP)											
Total AUM	2,318	2,238	2,272	2,278	2,025	1,886	1,997	1,635	1,881	15.0	(7.1)
Equity	871	894	933	945	954	907	939	625	732	17.1	(23.2)
Debt	930	896	797	752	505	438	442	383	380	(0.7)	(24.8)
Liquid	392	317	298	280	312	273	352	384	496	29.2	59.2
Others	125	131	244	301	254	268	265	244	273	12.0	7.5
Other details											
No of Branches	298	298	299	300	294	290	290	290	290	0	(4)
Empanelled distributors	68,187	70,827	72,203	73,000	74,100	75,400	75,600	76,200	76,900	700	2,800
SIP Monthly flows (Rs bn)	8.3	8.5	8.4	8.6	8.1	7.6	7.5	7.2	7.0	(2.8)	(13.6)
SIP transactions (mn)	2.8	2.9	2.9	3.1	3.2	3.2	3.3	3.2	3.4	6.3	6.3

Source: Company, BOBCAPS Research

Earnings call highlights

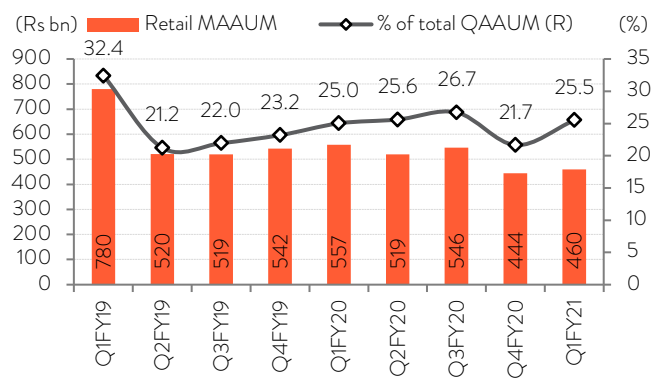
- Added 120 institutional investors and ~0.2mn retail folios in Q1FY21 (or ~3,500 investor folios per day despite branch closure)
- ETF investor folios rose by ~117,000
- Clocked a new SIP every 22 seconds and a new digital transaction every 7 seconds
- Added 650 IFAs
- Shares 50-70% of fees with distributors
- Equity assets contribute 70-75% of overall fees
- Debt funds contribute 35-40% to other income; balance from equity MTM
- SIP reclassification shows actual cash inflows
- AUM growth in Q1 was due to MTM impact
- Employee expense had a one-time adjustment in Q4FY20; hence the increase in Q1
- FY21 expense would roughly match annualised Q1 expenses
- Fees and commissions are upfront costs for close-ended funds
- Average net yield is 46bps (annualised)
- Should not see any negative surprises in credit risk funds in near term
- In May, NAM board decided that all schemes will make fresh investments only in AA- &-above rated issuers

FIG 6 – MTM GAINS ON IFA-MANAGED AUM...



Source: Company, BOBCAPS Research

FIG 7 – ...AND RETAIL AUM (LARGELY EQUITY)



Source: Company, BOBCAPS Research

Valuation methodology

NAM is trading at 26.6x/22.6x FY22E/FY23E EPS for an estimated ROE of 22.8%/25.9%. We believe the company is a play on the financialisation of savings in India. However, due to legacy brand issues and multiple debt write-downs during FY19-FY20, we think debt AAUM is unlikely to retrace to market share levels seen pre-IL&FS.

Further, given NAM's increasing reliance on independent financial advisors (IFA) to source equity flows, we expect revenue realisations to be lower (at ~61bps) than the average of the top-10 AMCs. A high opex structure due to increased costs towards rebranding, marketing and ESOPs would dampen ~50% of revenue realisations. Core PBT yields could thus remain range-bound at 33-35bps, with PAT yields at 25bps over FY21-FY23 propped up by a benign tax rate. In our view, the company faces a tough balancing act between profitability and market share gains, with one coming at the expense of the other.

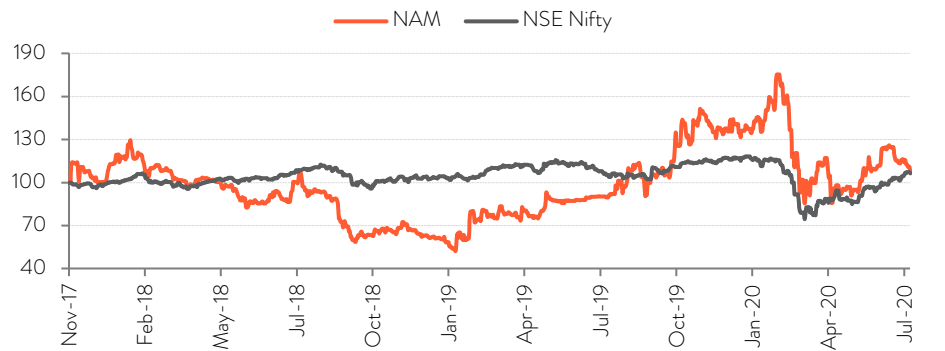
We cut FY21/FY22 EPS estimates by 10%/9% given the negative impact of Covid-19 on the high-yielding equity business. Rolling valuations over, our Jun'21 target price remains unchanged at Rs 210 – maintain SELL. We have arrived at our target price using a three-stage dividend discount model (DDM). Our key assumptions remain unchanged as follows: cost of equity of 14.0% (risk-free rate of 7.75% and beta of 1.2x), with average growth of ~15% in the five-year explicit period and terminal growth of 10%.

FIG 8 – REVISED ESTIMATES

(Rs bn)	Old			New			Change (%)		
	FY21	FY22	FY23	FY21	FY22	FY23	FY21	FY22	FY23
Total income	14	16	17	13	15	17	(8.3)	(7.9)	0.0
Operating Expenses	6	7	7	6	7	7	(6.8)	(6.9)	0.0
EBITDA	6	7	8	5	6	8	(12.6)	(11.1)	0.0
Core PBT	6	7	8	5	6	8	(13.2)	(11.5)	0.0
Other income	2	2	2	2	2	2	0.0	0.0	0.0
PBT	8	9	10	7	8	10	(9.8)	(8.9)	0.0
Tax	2	2	2	2	2	2	(9.8)	(8.9)	0.0
Net Profit	6	7	7	5	6	7	(9.8)	(8.9)	0.0
AAUM	2,357	2,699	2,806	2,211	2,450	2,806	(6.2)	(9.2)	0.0
RoAAUM (bps)	25	25	26	24	25	26	(95bps)	9bps	0bps

Source: Company, BOBCAPS Research

FIG 9 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- Any further regulation on trail commissions could hamper equity flows from IFAs.
- Additional risky debt exposure could lead to loss of trust in the new brand too.
- Fund alpha underperformance could fuel redemptions, especially in T30 cities and among HNIs.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Investment management fees	14,787	12,030	11,318	13,030	14,912
YoY (%)	(7.1)	(18.6)	(5.9)	15.1	14.4
Operating expenses	9,396	5,945	6,025	6,547	7,038
Core operating profits	5,391	6,085	5,293	6,483	7,874
Core operating profits growth (%)	5.8	12.9	(13.0)	22.5	21.4
Depreciation and Interest	101	389	246	254	263
Core PBT	5,290	5,696	5,047	6,229	7,610
Core PBT growth (%)	6.1	7.7	(11.4)	23.4	22.2
Other income	1,713	(98)	1,979	2,078	2,182
PBT	7,002	5,598	7,025	8,307	9,792
PBT growth (%)	6.8	(20.1)	25.5	18.2	17.9
Tax	2,132	1,441	1,770	2,093	2,468
Tax rate (%)	30.4	25.7	25.2	25.2	25.2
Reported PAT	4,871	4,158	5,255	6,213	7,324

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Equity capital	6,120	6,121	6,121	6,121	6,121
Reserves & surplus	19,580	19,809	20,635	21,612	22,764
Net worth	25,700	25,931	26,757	27,733	28,885
Borrowings	0	0	0	0	0
Other liabilities & provisions	2,058	2,878	2,950	3,023	3,099
Total liabilities and equities	27,758	28,808	29,706	30,757	31,984
Cash & bank balance	18,328	23,479	24,162	24,989	25,982
Fixed & Other assets	2,568	3,256	3,419	3,590	3,769
Total assets	27,758	28,808	29,706	30,757	31,984

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
EPS	8.0	6.8	8.6	10.2	12.0
Dividend per share	6.0	4.7	6.0	7.1	8.4
Book value per share	42.0	42.4	43.7	45.3	47.2

Source: Company, BOBCAPS Research

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
P/E	34.0	39.8	31.5	26.6	22.6
P/BV	6.4	6.4	6.2	6.0	5.7
Dividend yield (%)	2.2	1.7	2.2	2.6	3.1

DuPont Analysis (Bps of AAAUM)

Y/E 31 Mar (bps of AAAUM)	FY19A	FY20A	FY21E	FY22E	FY23E
Operating income	61.9	57.7	51.2	53.2	53.1
Operating expenses	39.3	28.5	27.3	26.7	25.1
EBITDA	22.6	29.2	23.9	26.5	28.1
Depreciation and Others	0.4	1.9	1.1	1.0	0.9
Core PBT	22.2	27.3	22.8	25.4	27.1
Other income	7.2	(0.5)	9.0	8.5	7.8
PBT	29.3	26.9	31.8	33.9	34.9
Tax	8.9	6.9	8.0	8.5	8.8
ROAAAUM	20.4	19.9	23.8	25.4	26.1

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Investment management fees	(7.1)	(18.6)	(5.9)	15.1	14.4
Core operating profit	5.8	12.9	(13.0)	22.5	21.4
EPS	6.5	(14.7)	26.4	18.2	17.9
Profitability & Return ratios (%)					
Operating income to total income	89.6	100.8	85.1	86.2	87.2
Cost to Core income ratio	63.5	49.4	53.2	50.2	47.2
EBITDA margin	36.5	50.6	46.8	49.8	52.8
Core PBT margin	35.8	47.3	44.6	47.8	51.0
PBT margin (on total income)	42.4	46.9	52.8	55.0	57.3
ROE	19.7	16.1	19.9	22.8	25.9
Dividend payout ratio	90.9	82.7	84.3	84.3	84.3

Annual Average AUM

Y/E 31 Mar (Rs bn)	FY19A	FY20A	FY21E	FY22E	FY23E
AAAUM (Rs Bn)	2,388	2,084	2,211	2,450	2,806
YoY Growth (%)	1.3	(12.7)	6.1	10.8	14.5
% of AAAUM					
Equity	37.9	43.6	44.7	45.9	46.6
Debt	37.1	22.6	22.3	22.2	21.8
Liquid	17.9	20.0	19.8	19.7	19.3
Others	7.1	13.8	13.1	12.3	12.3

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

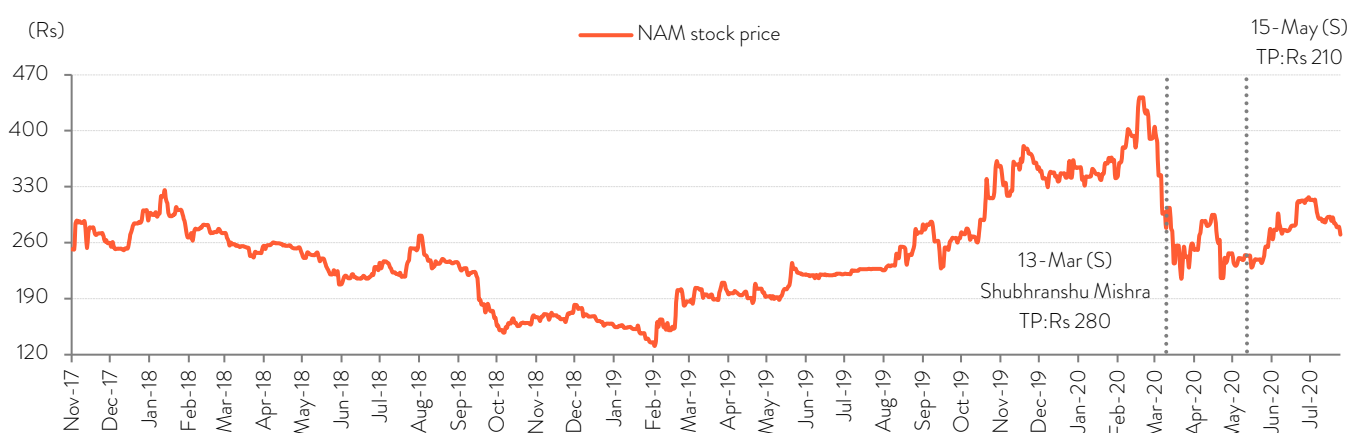
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): NIPPON LIFE INDIA ASSET MANAGEMENT (NAM IN)



B – Buy, A – Add, R – Reduce, S – Sell

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