"HDFC Asset Management Company Limited Q2 FY-19 Earnings Conference Call"

October 29, 2018

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Moderator: Good day, ladies and gentlemen and a very warm welcome to the HDFC Asset Management Company Limited Q2 FY19 Earnings Conference Call hosted by Axis Capital. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Praveen Agarwal from Axis Capital. Thank you and over to you, sir.

Praveen Agarwal: Thank you, All. Hello everyone and welcome to the earnings call of HDFC AMC. We have with us Mr. Milind Barve – Managing Director; Mr. Piyush Surana – CFO and Mr Simal Kanuga - Chief Investor Relations Officer. I would request Mr. Milind to share his initial thoughts on the results post which we will open the floor for Q&A. Over to you, sir.

Milind Barve: Thank you, Praveen. Everybody welcome to this call and thank you for joining in. The presentation for the quarter ended September 30 is available on our website as well as that of the stock exchange. I hope you had time to have a quick look at it. We have just come to an end of an interesting quarter in which we did see turbulence both in equity and fixed income markets. Equity oriented mutual funds continue to see healthy flows. For the first half of the current fiscal year the industry has seen net flows in excess of over 700 billion or about Rs. 70,000 crores plus of flows.

SIP flows continue to remain stable even in difficult times and this in our opinion is definitely a very healthy sign.

Now coming to us. For the quarter ended September 30 we saw a growth of 9% to our overall AUM and 20% for our actively managed equity oriented AUM. Our market share in overall AUM and actively managed the equity oriented AUM stands at 13.3% and 16% respectively. This is more or less similar to that of the quarter ended September 2017. At a 16% market share in equity AUM we continue to remain the largest equity mutual fund manager. In terms of the asset split 51.9% of our assets are contributed by equity-oriented assets as compared to 44.4% for the industry. So, we continue to maintain a favorable asset mix.

Our key focus area is i.e. individual customer accounts continue to grow. We have seen a Year-on-Year growth of 24% in terms of the individual customer accounts. Furthermore, individual monthly average AUM now accounts for 64.5% of our total monthly average AUM. The number for the industry is 53%. We are happy to state that we continue to remain the most preferred choice of individual customers and have a market share of 15.1% of the individual monthly average assets under management.

We would also like to present some interesting data on unique customers as identified by unique permanent account numbers. As on 30 September 2018 the industry has 18.4 million unique customers. We have 5.08 million of these customers. This is almost 28%. To put it in other words, out of every 100 investors who have invested in mutual funds, 28 have invested with us.

The unique investors for the industry over the past one year have grown for the industry by 25%. As for us it has grown by 27%. Our systematic transaction book is healthy and was about Rs. 11.47 billion for the month of September 2018. In terms of market share in B30 we continue to retain our number two position. We would like to use this opportunity to give you a quick overview of the recent regulatory developments.

Firstly SEBI reduced the additional TER from 20 basis points to 5 basis points with effect from 30 May 2018. This has already been done so there was effectively a reduction of 15 basis points in the TER effective 30 May 2018. We have passed the entire impact of 15 basis points by reducing distributor commission. Hence there has been no impact on the AMC due to this change. There have been some further amendments starting from October 22 whereby the regulator has amongst many things made two or three important changes.

Firstly, they have banned upfront commissions. Secondly, all expenses related to the schemes are now mandatorily required to be debited to the scheme accounts and cannot be accounted for in the AMC. Thirdly, they have restricted the commissions on B30 only for inflows from individual customers. In our opinion this will have no impact on our margins.

SEBI has already announced new AUMs slabs or AUM base slabs for computation of TER. The effect of the same on our equity-oriented schemes is approximately 24 basis points. We intend to pass a majority of this by reducing distributor commission. In our opinion even after reduction we will continue to remain competitive.

We are happy to announce that we have recently won an equity mandate of $450 million from a reputed foreign portfolio investor of which approximately one-third has already been funded.

Let me turn to the financial results summary. Firstly transition to IND-AS. There will be some repetition here, The company has adopted the Indian accounting standards with effect from 1 April 2018. As a consequence, the financials for the period ended 30 September 2018 are prepared under these new accounting standards. The financials for the corresponding period of the previous financial year have also been restated accordingly.

As shown in slide 16 the key changes necessitated by the transition to the IND-AS relate to recognition of mark-to-market on the company's investments through the profit and loss account, a charge on account of unlisted ESOPs and consequent deffered tax adjustments. Our PAT for the quarter ended 30 September 2017 under Indian GAAP was Rs. 1677 million or Rs.

167.7 crores which has been restated to Rs. 1794 million or Rs. 179.4 crores as shown in slide 17.

Now moving to the financial highlights for the first half. We are at 30 September half way through the year: our revenues from operations for the period ended September 30, 2018 grew by 16% to reach 9516 million which is Rs. 951.6 crores from Rs. 8204 million which is Rs. 820.4 crores in the corresponding period of the previous year as shown on slide 18.

Total revenue grew by 16% to reach Rs. 10164 million from Rs. 8746 million in the corresponding period of the previous year. Total expenses were up by 12% to Rs. 4245 million and Rs. 3785 million in the corresponding period last year. Profit before tax grew by 19% to Rs. 5919 million from Rs. 4961 million for the corresponding period. And profit after tax for the period stood at Rs. 411.2 crores which is a 19% growth over Rs. 344.4 crores for the corresponding period of the previous year.

Our operating profit from the core asset management business after adjusting certain non-recurring expenses grew by 24% to Rs. 548.3 crores for the period ended September 2018 from Rs. 441.9 crores for the corresponding period of the previous year. The above adjustment is on account of estimated provision in the current quarter towards impairment of certain investments.

Now for the second quarter FY19: our revenue from operations for the quarter ended 30 September 2018 grew by 12% to reach Rs. 480.4 crores as compared to Rs. 430 crores in the corresponding quarter of the previous year. This is shown on slide 19. Total revenue grew by 30% to reach Rs. 5153 million from Rs. 4576 million in the corresponding quarter of the previous year. Total expenses were up by 13% to Rs. 2181 million from Rs. 1934 million in the corresponding quarter last year.

Profit before tax grew by 12% to Rs. 2972 million that is Rs. 297 crores from Rs. 2642 million or Rs. 264 crores for the corresponding quarter. The profit after tax for the quarter stood at Rs. 205.9 crores or Rs. 2059 million which is 15% growth over Rs. 179.8 crores or Rs. 1798 million for the corresponding quarter of the previous year.

Our operating profit from the core asset management business which is the most important parameter after adjusting the non-recurring expenses grew by 20% to Rs. 283.5 crores for the quarter ended 30 September 2018 from 236.6 crores for the corresponding quarter of the previous year. Our operating profit margin which is the operating profit as the basis points of the average AUM stood at 34 basis points for the half year ended 30 September 2018. This is on slide 20. For the corresponding period of the previous year this was 33 basis points.

These are my opening remarks. We would be now happy to take questions.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question-and-answer session.

The first question is from the line of Shubhranshu Mishra from Motilal Oswal Securities. Please go ahead.

Shubhranshu Mishra: My question today is to do with the liquid funds which have been in question over the last two, three weeks so what kind of flows have we seen in the first 15 days of October and how do we look at the flows in November and December for the liquid fund going forward?

Milind Barve: So, let me first tell you that our liquid fund which used to be averaging somewhere in the region of about Rs. 45,000 crores to Rs. 50,000 crores has reached to an unprecedented level of about Rs. 75,000 crores to Rs. 80,000 crores in the month of October. So, we have seen exceptionally strong flows in liquid funds in the current, about 25, 26 days of this month. We have gained market share, our understanding is that we have gained significant market share as people have invested in our funds because they appreciate the performance and they like the composition of the portfolio.

I would expect barring anything particularly unforeseen that we would probably retain reasonably high market share as compared to the previous quarter for the entire current quarter including November and December.

Shubhranshu Mishra: And on an industry level do you think that the flows are coming in to the liquid funds or is it just that we are gaining market share out of the rest of the players?

Milind Barve: My sense is that from the flows that went out in the month of September largely on account of quarter end considerations, advance tax payments and so on, some part, my guess is somewhere between 60% to 70% of that money has probably come back. May not be entire 100% but clearly we are seeing significantly high market share in terms of the entire liquid fund business itself.

Shubhranshu Mishra: And just to squeeze in a second question. Any of your large distributors like national distributors complaining about the entire TER which has been passed on?

Milind Barve: Obviously a reduction in commission is not welcomed by any distributor. And it is also difficult on our part to have to take these steps. But I think it would be fair and appropriate to say that the distributors have largely accepted the change because our understanding is that most of the players in the industry have also been able to do the same.

Moderator: Thank you. The next question is from the line of Rohan Advant from Multi-Act. Please go ahead.

Rohan Advant: I just wanted to understand these non-recurring expenses, if I work out the number, I think there is a Rs. 21 crores non-recurring expense in Q2 FY19. So, if you could throw some light on that?

Milind Barve: So, the non-recurring expense of Rs. 21.2 crores reflect the impairment that we have taken on one exposure that we had in the AMC balance sheet in our investment portfolio. We had some exposure to IL&FS, we have written-off more than 50% or approximately 50% of that exposure which was in the form of preference shares. After writing off that exposure our balance exposure is now only Rs. 18.8 crores in the form of preference share of IL&FS. This is in the books of the asset management company and this is only 0.7% of our total investment book as of now.

Moderator: Thank you. The next question is from the line of Amit Nanavati from Nomura Securities. Please go ahead.

Amit Nanavati: Sir, last time around we have been discussing that we intend to pass on the full TER cut to the distributors, but you want to offer different strategy for stock v/s incremental flow. So, anything that you have on that? So, on incremental flows, also is it fair to assume that 50:50 kind of pass on would be something that you are looking at or you will be looking to pass on fully?

Milind Barve: I think first of all the change in the TER has not yet been announced other than the press release from SEBI so the effective date is still unknown. But our understanding is that we should be able to pass on most of the reduction in the TER as far as the book is concerned. So, that is as far as the impact on the AUM should be reasonably small if at all there is any. That is number one as far as passing down the reduction in the TER on the AUM book of equity.

As far as the commissions on the sales are concerned, my understanding is that the industry is trying to arrive at a reasonable share of what the TER should be shared with the distributor as commission and what should be the share of the TER which should be retained by the asset management company. And I think we would largely be deciding in line with what the industry does so that we remain competitive.

My sense is that this formula of what would be paid and what would be retained might settle somewhere between 55% of the new TER to be paid as commission and 45% to be retained or it could be somewhere in the region of 55% and 60% to be paid and about 40% or 45% to be retained. I am talking broadly of what I expect where it could be settling down.

Amit Nanavati: Just one more thing on the B30 so with the recent changes basically now only individual assets will be qualified so overall our 16% B30 share that basically on a retail asset basis would be much lower, right? So, how does that change the whole economics around that?

Milind Barve: My understanding is that it does not change anything. As far as the P&L is concerned the B30 TER is a full pass through. So, basically whatever extra we pay to the distributor for bringing us the retail business from the B30 towns is what we can charge to the customers. So, it is first of all a 100% pass through.

It does not have any impact on the profit and loss account of the company. Having said that my understanding is that they are only plugging possible abuse that in case there is a corporate entity or if there is any firm or a company or a body corporate which is based in a B30 location, is also enjoying the B30 additional commission, that gets stopped.

But largely as you know this is in equity oriented schemes where predominantly flows come from retail investors. So, my sense is that, that the 16% or 15% may come down only marginally because I do not think the corporate business or any kind of institutional business is very strong in the B30. So, that is not going to make a very material impact on the percentage of the business that comes from the B30.

Amit Nanavati: Just wanted to check because in case we fail to achieve that B15 on a pure retail basis then we will not get that additional 30 basis points. In that scenario to pay out to distributor for the added cost that they might incur would become much more challenging, right?

Milind Barve: No, it is not at all like that. I just want to clarify it again. We will not be able to charge extra B30 to TER but then we will not be even paying on that additional TER. We will be basically charging whatever we pay as extra commission for getting business from B30 what we pay is what we charge as TER. If we pay less we charge less. So, it is completely neutral to the P&L of the AMCs.

Moderator: Thank you. The next question is from the line of Haresh Kapoor from IIFL Asset Management. Please go ahead.

Haresh Kapoor: Just first thing coming back to the non-recurring expenses that you mentioned - there is an Rs. 18 crores balance there. How do we kind of look at that do we kind of recognize that also as in terms of the exposure that we have to write off how you are looking at that part?

Milind Barve: No, I think we have been conservative because it is basically a function of the loss given default that we have to consider how much we want to write off but we have actually been conservative, we have actually already taken up more than 50% write down of that particular investment. So, we are now left with only a residual portion of Rs. 18.8 crores.

So, given the size of our investment book and the size of our revenue that we make we will evaluate it at the end of every quarter and if we believe that we need to make some small incremental provision we might make it. It will be something that we will take a call every quarter based on what developments are happening with that particular exposure. But right now we think we have done as what was required or even more than that. We have been conservative in taking more than 50% write down.

Haresh Kapoor: And this is to which entity of IL&FS Holding or some of the other subsidiaries? Can you please give some color on that?

Milind Barve: This is the preference share of the holding company.

Haresh Kapoor: And sir, second thing on this TER aspect I think you just mentioned that may be the sharing in terms of the commission if we say, is around 50%, 55% to 60% of TER and some part of the cut has to be borne after the notification comes out, you kind of mentioned may be 3bps or more on the AMC which may actually not be passed on but could be made up by some other opex or some mechanism which could have an impact.

So, first want to understand after that initial assessment do you kind of stand by with what you thought and second you seem to be more confident in terms of 80% could be passed on. So, what is the reason for that in particular?

Milind Barve: Yes Haresh, let me make it very clear that there are two separate things. One is the reduction in the TER on the AUM book that is going to happen as and when SEBI announces the effective date. That reduction in TER on an ongoing basis we mentioned that almost 80%, 90% or more might get passed on so they should be very minimal if any impact on the margins of the business. That is one aspect of it.

The second aspect completely different from the first one is that how do we remunerate distributors competitively for ongoing new business. On that the sharing for whatever is the TER let us say in a product if you are earning say 150 basis points or let us say 100 basis points, then our expectation currently, at least is, that the industry is now coming around to a view of having a reasonable sharing ratio and that sharing ratio might settle down somewhere between 55% and 60% of the distributable TER to be paid as commission and the remaining 40, 45 basis points to be retained by the asset management company.

So, in that, nothing has really changed from what our earlier view was. We have already implemented what is already behind us is actually the change of 15 basis points. That we have passed on 100% to by reducing the distributor commission.

Haresh Kapoor: Just for the reason that you are more confident of passing on such a higher percentage because some of the larger AMCs are obviously talking about a lower number. So, for you any reason for that because some of the other large distributors I think we heard from call from the advisors and obviously they are communicating that they will not like to take the share to that has been spoken about. So, any reason why you are more confident or just the reason as a institution that is the reason or some?

Milind Barve: I am reasonably confident about this is because the commissions that we are expecting that will remain in the business will still be very competitive vis-à-vis what other AMCs will be paying. And I think they will be within the band of what is the reasonable expectation. In fact if you look at commissions that are paid out today we cannot compete with somebody who is paying out the highest commissions in the industry.

But the commissions that we pay have to be within a certain band or an acceptable band, acceptable both to the distributor as well as to the asset management company. And we are confident that we will be within that band that will be seen as acceptable by distributors. We will communicate with the distributors and engage with them. I think the relationship is not only a matter of commission or whether you will be paying the highest or the lowest. We have to be competitive in line with what others are doing which we think we will achieve over time.

Haresh Kapoor: Just in terms of the other income side do we feel that we could maintain the same run rate even let us say for the year and for the next year also?

Milind Barve: So, there is only a small part of our investment portfolio which has a very significant mark-to-market which is our exposure to the fixed income market. So, a significant amount of our portfolio almost close to about 80% is in investments where there is no or less vulnerability to mark-to-market. Because that is held in the form of investment in liquid funds, arbitrage funds, tax free bonds and FMPs. So, here the mark-to-market risks are very low if at all there is any.

There is only about 16% of our portfolio which has exposure to debt products which are our own debt funds where there is some degree of mark-to-market. So, I would largely expect the run rate to be broadly the same unless there is a very significant change in the interest rate scenario like we did witness in the first quarter. But otherwise this quarter has kind of become normalized.

Haresh Kapoor: So, we expect the same Rs. 30 crores, Rs. 35 crores run rate in short for this?

Piyush Surana: I do not think we would like to put a number to it.

Haresh Kapoor: Last thing in terms of the mandate that we have got obviously it is very good to see this. So, any color that you want to kind of give on this and any other pipelines or any other communication that will be possible on this?

Milind Barve: No, I think it is a very significant win for us in this quarter. It is a $450 million mandate. As you expect in such large mandates we are bound by non-disclosure understanding with clients with regard to both client name as well as terms and conditions.

Moderator: Thank you. The next question is from the line of Ojasvi Khicha from SBICAP Securities. Please go ahead.

Ojasvi Khicha: My question is specific to SEBI circular where you have mentioned three key points and resultant impact of about 24 bps. So, if I understand correctly there was one more key point which was regarding the payments for direct versus regular plans so there will be like direct plans including the investments and advisory fees. So, they cannot be charged more expenses as compared to the regular plan. So, do you think it would have an impact or how much that 24 bps can go up by if we have to include impact of even that point?

Milind Barve: No, there will be no impact on the direct plan TER because the direct plan TER is actually a derivative of what the TER is. So, when you take the TER in what is called as a regular plan and when you reduce the commission payout then you come to the TER of the direct plan. So, basically there is no change in the direct plan TER so there is no question of the impact of 24 basis point being increased by any change in the TER of the direct plan.

The direct plan is a TER which is derived from the regular plan TER minus the commission that is paid to the distributors. So, I do not see any change. As far as business that comes from advisors directly in to the direct plan the advisory fee is actually paid by the client, it is paid by the customer. So, there is no question of that creating any impact on the total retention under the direct plan.

Moderator: Thank you. The next question is from the line of Nischint Chawathe from Kotak Securities. Please go ahead.

Nischint Chawathe: I am looking at slide number 10 and I am just looking at the systemic inflows and I think there was a slight dip on a Quarter-on-Quarter basis. So, am I reading like too much into it and how do you really see the trajectory here in after?

Milind Barve: Yes, so let me just explain to you that when we say systematic transaction it actually comprises SIP as well as what in India we call as the systematic transfer plan where people invest some lump sum amount and then slowly transfer it in to any equity fund they have chosen. If you think of SIP as only people who are putting new money in to our fund house equity products that book has actually grown every month and even in the month from September over June.

But the systematic transfer plan which is usually where people invest for as short period as six months or three months or twelve months in a liquid fund and then give a standing instruction to transfer that money in to a equity fund of their choice. Those are actually lumpsum amounts that sometimes when the investment period chosen is completed they tend to stop and that is why if you see a small dip or the growth is not there it is largely on account of systematic transfer plans having expired after having run through their normal course.

The SIP book where people who are signing up new SIPs will still continue to maintain, as you would have seen, a run rate of about 45,000 to 50,000 per month of new SIPs being signed every month.

Nischint Chawathe: Okay so that trend basically continues and in case we are seeing that liquid fund inflows are strong this month then I guess possibly this again even this number should possibly turned up next quarter?

Milind Barve: I think so when I say systematic transfer plan is where our customer would have chosen to invest for very short period, three months, six months where they put a lump sum. So, once that three, six months period is over may be in the current volatile environment he has not put any or new investors have not come with lump sum investments to do systematic transfer plan.

So, it is more a function of STPs as we call them, systematic transfer plans which have expired. But the momentum on new flows in terms of SIP as well as the other flows in general seems to be continuing in the month of October quite well.

Moderator: Thank you. The next question is from the line of Shiva Kumar from Unifi Capital. Please go ahead.

Shiva Kumar: Sir, going by the SEBI circular it seems the hit in terms of the TER or the reduction of TER in aggregate terms is higher for the bigger schemes compared to the smaller size scheme. And given that the bigger participants in the mutual fund industry have those larger schemes which they have seasoned over the years do you think that going forward the IFAs might actually churn their portfolio towards the smaller schemes which are handled by the smaller mutual fund players? Is that a risk for the bigger players going forward?

Milind Barve: If you ask me it is a great question. Very recently if you have seen there has been another very important circular which is already enforced from 22 October where asset management companies are required to only pay commissions in the form of trail commissions. So, first of all this is a very positive and important step taken by SEBI in helping to reduce the churn.

So, if you are an existing incumbent manager with a significant size of an existing book, your book always was vulnerable to churn or somebody paying a high 1% upfront or something higher than that and you are losing the asset.

Now all of us are going to be paying in future only trail form of commission. Now in a trail form of commission even if your fund is slightly bigger than some very small fund or a medium sized fund the difference in that trail commission will only be 15 to 20 basis points or may be little bit more than that. And for 15, 20 or 25 basis points there is no incentive for a distributor including an IFA to churn the investor from one fund to another fund.

So, the new announcement that SEBI made effective 22 actually protects everybody in the industry from churn because the churn used to happen because when there is a 1% upfront being paid as compared to earning a trail commission there was an incentive to churn as far as the distributor is concerned.

I am not trying to say that every redemption was on account of churning, not at all. Sometimes if the customer himself wants to go out from one fund to the other. But that said if you look at commission driven behavior then I think that all trail commission model will significantly reduce churn and to that extent an existing or an incumbent there would benefit from it. Also if you take the long term capital gain after one year it is still at 10%, this further disincentivises churn.

Shiva Kumar: Sir, you have given a fact that direct currently constitutes 17.4% of your total equity oriented AUM. What is the number for the entire industry if you can share?

Milind Barve: I do not have this number as it isn't published separately for equity, but my expectation is it should be somewhere similar at 15%, 16% or so.

Moderator: Thank you. The next question is from the line of Shubhranshu Mishra from Motilal Oswal Securities. Please go ahead.

Shubhranshu Mishra: Sir, my question again is about the liquid funds. Any formal or informal mandates that you are getting from the investors as to invest into any kind of specific papers or you are investing across any kind of issuances? That is the first thing. And second, what proportion of your incremental flows are going into papers which are rated below BB in the liquid funds?

Piyush Surana: BB?

Shubhranshu Mishra: May be BB or B even?

Milind Barve: First to answer your first question I do not think investors are giving any mandate about where we should be investing the funds. There is no specific mandate in any form of what we should do or how we should manage the money. It is being managed entirely based on what our investment team and fund managers decide where they need to allocate money.

I think in general we have been very competitive in the way we have been running liquid funds. We do not have exposure to BB or same which is really a long term rating so it is not really relevant in a liquid fund. But I think we are investing where there is an acceptable credit. Otherwise we are happy to stay at reasonably high levels of cash or in treasury bills.

Shubhranshu Mishra: And on slide 18 where you gave out the electronic transaction 64% is the electronic transaction. What is the split between wholesale and retail over here or may be distribution partners and retail customers here?

Milind Barve: Yes, so basically see this is really relevant more for retail business not so relevant for wholesale or institutional or corporate clients because those are very few. Effectively what we look at is of all the transactions that we do that is with any customer or distributor does with us. What percentage is coming electronically and now we are at the second quarter we are now at almost 64.2% of our transactions are coming on through some electronic platform.

Whether it is our own HDFC MF online, HDFC MF online for partners which is our distributor property or it could be coming through any other platform like whether it could be an NSE platform or BSE platform or it could be any other electronic platform run by a distribution company also. So, effectively what we monitor is how much of our transactions are electronic and physical and there we are now around at 64.2% of electronic transaction.

Moderator: Thank you. The next question is from the line of Aadesh Mehta from Ambit Capital. Please go ahead.

Aadesh Mehta: So, sir, I see that your equity AUM has grown by 20% Year-on-Year. So, how much would be the MTM impact?

Milind Barve: MTM impact Year-on-Year?

Aadesh Mehta: Yes.

Milind Barve: If you see broadly one-year benchmark returns. I will just come back to you with that.

Aadesh Mehta: Okay I have the other question. For the overseas money you raised what is the fee structure?

Milind Barve: In this particular deal that we have won of $450 million mandate as I mentioned we are guided by our contract that we cannot disclose both either the name upfront or the terms and conditions.

Aadesh Mehta: Other thing sir, this business development expenses and other expenses of around Rs. 161 odd crores is it possible to get the breakup between the marketing and distribution commission and others?

Piyush Surana: No, we do not really provide the breakup of this. As you would have noticed last quarter also however the one time charge that Milind has spoken about is in this expense.

Aadesh Mehta: The reason I am asking is even that distribution is a big cost and it is a variable cost. It is very important for me to basically understand that you will see where the net yields are evolving. So, may I request you to start disclosing this from next quarter onwards?

Milind Barve: I will tell you basically there is only upfront commission which is amortized over 12 months. That is the only thing that comes as a part of this business development which is what you are looking for which is commission. Now over a period of time that will also go away because upfront commissions are stopping only.

Aadesh Mehta: So, you are saying that over the next three, four quarters this is actually go down to zero?

Piyush Surana: It would not go down to zero because under business development expenses while a large chunk is the distributor commission, there are also other expenses like distributor training etc. So, some part of it will still remain.

Aadesh Mehta: So, that is the key question that how will this number move that once you stop giving out upfront commissions once you come on the full trail model how should we see this expense evolving forward?

Piyush Surana: This will keep coming down because what we will be left is old amortizations which will run out over a period of a year and there will be no fresh upfront coming in to this.

Milind Barve: But you are right this upfront commission which is getting amortized through this particular account head will over a period of time become zero. But this will slightly get compensated by because these people whom we are paying upfront we may have to give them a slightly higher trail going forward. So, that impact will come through the topline and not coming in to an expense form here.

Aadesh Mehta: So, sir, any idea that what could be the topline impact be and then how much could actually trickled down to the expense item as well? There will be some reclassification right whatever upfront you are giving right now that would eventually come under trail going forward?

Milind Barve: In a long run I expect this to be, not even longer run in the medium term, I expect this to be P&L neutral because effectively we are not trying to either give more commission or less commission where we will be trying to do a systematic conversion of the upfront in to a trail. We are not seeing this as some opportunity to make more margin, but we also will not be giving up margins on account of this change.

Aadesh Mehta: But sir, any reason why you are not disclosing this in terms of your distribution costs?

Milind Barve: Because it is not a single item there are many items that go into it. There are other things which you do not want to elaborate.

Aadesh Mehta: But then we do disclose that in annual report?

Milind Barve: Of course, it will be there.

Piyush Surana: Yes, it will be disclosed because in the annual report you will have the whole schedule of expenses and a lot of other expense details are disclosed there.

Aadesh Mehta: So, sir, why not quarterly?

Piyush Surana: Quarterly because we do not have the schedules here so whole lot of things which come in the annual report are not disclosed here. And in any case what Milind just said that over a period of time since this expense is going to move in to the scheme’s books where elements of this disclosure will also go down.

Milind Barve: See finally your concern with the PBT margin or what the margin in the product is going to be and all that I am saying is that the margin will get maintained it does not matter how much will get reduced from the expense and how much will get added or reduced from the topline. What our current understanding is that this change of converting upfront go in to trail will be revenue neutral. So, that should be sufficient in case of understanding the impact.

Aadesh Mehta: Sir, regarding my question did we get the numbers on MTM loss?

Simal Kanuga: Yes, the Nifty 50 is up around 10%, the midcap index is down around 5% over the last one year September over September. So, I think you can take the balance growth as the net increase.

Moderator: Thank you. The next question is from the line of Amit Jeswani from Stallion Asset. Please go ahead.

Amit Jeswani: Sir, my first question is what kind of cash on the balance sheet are we comfortable in to hold because we hold Rs. 2,600 crores of cash on the balance sheet?

Milind Barve: Yes, so there is no absolute number that the board has in mind as adequate or appropriate. We would like to maintain a reasonable size of the AMC balance sheet consistent with the growth opportunity of the overall business. That said we will certainly as we have indicated earlier there will be an engaged debate on what should be the dividend payout or what should be the payout ratio the company should follow.

At this stage it would be only fair for me to give you the indication that every year in the last few years the dividend has increased not just from the growth in profits, the dividend payout ratio also has increased.

So, this has increased from almost 40% over a period of time to almost 56% in the last year. So, it has gone from 41% to 47% to 51% and then last year in FY18 the payout ratio was 56%. So, I would expect that the board would like to consider at the right time a suitable increase in the payout ratio so that we do not maintain more cash than what we think is appropriate over a medium term.

Amit Jeswani: Sir, the new TER will apply for the incremental AUM only, right?

Milind Barve: No, the TER is going to apply for the entire existing book as well. But as we mentioned in the entire book we are currently paying trail commission and after paying trail commission we get our net fees in the form of retained fees. So, our objective is that largely to the extent of the reduction in TER we will be reducing the commission payout and we might take a very small impact on the margin after reducing the commission payout.

Amit Jeswani: Sir, and when do these rules start applying, do you have any guideline on that?

Milind Barve: No, so the SEBI in their board meeting on 18 September after that in the press release they have already announced what the revised TERs are going to be. But they have not announced the effective date when the new TERs will be applicable. And they have still not announced the applicable date from which it will first begin to start operating. So, we have no idea of when the effective date of this new TER or the reduced TER is going to be.

Moderator: Thank you. The next question is from the line of Teerth Trivedi, individual Investor. Please go ahead.

Teerth Trivedi: My question is there is a missing point of operating profit margin in press release as compared to quarter 1's press release probably bit of increase of margin?

Milind Barve: First let me just understand your question. You wanted to comment on the?

Teerth Trivedi: I was going through the quarter 1's press release there was a particular point of operating profit margin which is the operating profit at the basis point of basis point of average AUM improved to 35 basis points. It is missing in quarter 2's press release. Is it available?

Milind Barve: No, it is not in front of me but let me put it this way that we are now at the middle of the year so we thought it will be more appropriate to share a six monthly operating profit margin rather than breaking it up quarterly or so. So, as we go forward we will keep giving you a Year-to-Date operating profit margins which will help you in understanding it more clearly, rather than any quarterly trend. And these things will not show much in small quarterly trends because it is a very short period to actually come to an understanding of what is happening to operating profit margin.

So, the longer the period that we announce the operating profit margin the better it is, a more robust number. So, that is why we have chosen to announce the half yearly operating profit margin which has improved by 1 basis point from the similar six months period ending 30 September 2017.

Moderator: Thank you. The next question is from the line of Nilesh Shah from Edelweiss. Please go ahead.

Nilesh Shah: So, when you look at the financials of the scheme which you have in your website, so over there also you have in your expenses section you have a field called commission to agent. And when you look at the financials of the AMC then other expenses you have a field called brokerage incentives. So, is it correct to say that what we see on the scheme is the trail commission and what we see on the AMC is what is the existing upfront structure. Is that the correct understanding?

Milind Barve: Nilesh, you are absolutely right what you see in the scheme is essentially the trail commission. What you see in the AMC is the amortization of the upfront commission. You are absolutely right.

Nilesh Shah: So, just to understand this thing a bit more when you say amortization, can you just help me understand over the like typically what periods will you amortize on because I could not find it?

Milind Barve: We have consistently followed a policy where the upfront commission is in an equity fund as an example is written off over the next 12 months because we have a claw-back so the upfront commission is more like advanced trail so whenever the asset if it is churned out or taken out we are able to then recover the extra upfront commission that is paid up to one year.

So, that is why what I mean by amortization of upfront commission means the amount that is written off to the P&L of the upfront commission which is typically over a period of 12 months. And the reason for why it is 12 months is because this commission can be clawed back if the asset is withdrawn by the customer.

Nilesh Shah: Just to follow up on that, it is like I think you spoke about it briefly but so now that upfront commission is kind of going away for the whole industry, so is it fair to say that the commission to agents that you see on the scheme would go up and corresponding management fee will compress. Is that the way it will work out?

Milind Barve: You are broadly right, Nilesh. The management fee from the topline might come down a little bit because we will increase the trail. But in the P&L debit side on the cost side the upfront commission that is getting amortized over a period of time will actually become zero.

Nilesh Shah: Is there any other expenditure you have in your other expense field which you could argue is say not fixed or say somewhat linked to either inflows or things like that. So, just trying to get a sense of how much of your other expenditure is fixed in nature and how much is kind of variable?

Milind Barve: Actually if you ask me the commission is the only one which is variable. It used to be variable to the AUM for trail and it is variable to the gross sales as far as upfront commission. Going forward the only part that will remain will be the trail commission which will be based on the AUM which is much more consistent with our revenue recognition.

There are not much other expenses which are in fact which you could treat as variable expenses. Because the operating leverage on the business remains very strong, as we grow the business and grow the fees the expenses other than commission do not go up in the same proportion.

Nilesh Shah: Just one last thing. You mentioned something about basically assets that you already have. So, you have existing investors and you have new investors, so incrementally as you basically renegotiate with your distributors do you expect any mis-alignment between how the payout structures may look on your existing book versus new flow?

Milind Barve: No, I do not think it there will be any mis-alignment in what we are paying on the book as well as what we are paying for new business in the shortlonger term So, the basis will be that we align the commissions that we pay on the new flows as well as what we are already paying on the book over time.

Further, if we are paying the upper end of what the commissions are to a particular distributor as upfront commission he will get a similar better commission in the trail commission structure. So, over time I think we will align the payouts on the book along with the payouts on the new flows also.

Moderator: Thank you. That was the last question. I now hand the conference over to the management for their closing comments.

Milind Barve: So, once again for all of you who have been on the call, thank you very much for your interest and for being with us on this call. It has indeed been an interesting and a rewarding quarter for us.. Once again on behalf of my team and myself, I thank you very much for being on the call.

Moderator: Thank you. Ladies and gentlemen, on behalf of Axis Capital, that concludes this conference call for today. Thank you for joining us and you may now disconnect your lines.