

IPO Analysis-

Reliance Nippon Life Asset Management Ltd (RNLAM)

By,

Dhanyakumar M H,

*Special Thanks to **Disha Luthra** for reviewing the report.*

The Indian Mutual Fund Industry

In 1963, the Indian mutual funds industry commenced operations with the formation of the Unit Trust of India (“UTI”) by an Act of Parliament. For over twenty-five years, UTI remained the only player in the mutual funds industry and as per the Association of Mutual Funds of India, its AUM increased from ₹250 million in 1965, to ₹67 billion in 1988. In 1987, public sector financial companies entered the mutual fund industry. Prominent entrants included the State Bank of India, which promoted the first non-UTI mutual fund, the SBI Mutual Fund in June 1987. The total AUM of the mutual fund industry increased to ₹470 billion by the end of 1993.

In 1993, the mutual fund industry opened up to the private sector. The first mutual fund regulations were formalized in 1993, in the form of the SEBI (Mutual Fund) Regulations, which were later substituted by more comprehensive and revised Mutual Fund Regulations in 1996. During the period from 1993 to 2003, the number of mutual fund houses increased with many foreign mutual fund houses also entering the industry. By the end of January 2003, there were 33 mutual funds or Asset Management Companies (“AMC”) with total assets of ₹1.22 trillion.

In February 2003, following the repeal of the Unit Trust of India Act 1963, UTI was bifurcated into two separate entities, the Specified Undertaking of the Unit Trust of India and the UTI Mutual Fund. Since then the mutual fund industry has witnessed a healthy growth, supported by various regulatory measures as well as investor education initiatives, reaching an AUM of ₹17.5 trillion as of March 31, 2017, up from ₹3.3 trillion as of March 31, 2007, reporting a compounded annual growth rate (“CAGR”) of 18% over this ten-year period. The Indian mutual fund industry is expected to cross the ₹20 trillion threshold in the current financial year, and a reported AUM of ₹19.5 trillion in June 2017.

Mutual Funds:

A mutual fund is a professionally-managed investment scheme that raises capital or investment from a group of people and uses that pooled capital to invest in different types of securities such as equities, bonds, money market instruments and/or other securities. Mutual funds can be classified under various categories, based on their structure, investment style and the investment objective.

Key Large Players in industry:

As of June 2017, there are 41 active AMCs operating in the market comprising of 7 entities sponsored by public sector banks, 2 entities sponsored by financial institutions, 25 AMCs sponsored by the private sector and other financial companies and 7 entities sponsored by foreign players (including joint ventures). In addition, one AMC is yet to start operations. Despite the increase in the number of players, the Indian mutual fund industry remains concentrated with the **ten largest AMCs contributing over 80% of the industry's total AUM** from the financial year 2015 to the financial year 2017. **ICICI Prudential AMC, HDFC AMC, Reliance AMC, Birla Sun Life AMC and SBI Funds Management** are the five largest AMCs, together contributing 57% of the quarterly average assets under management ("QAAUM") for the quarter ending March 31, 2017 and June 30, 2017.

The following table sets forth the Top Ten AMCs on a QAAUM basis:

QAAUM for Various AMCs	March 2017		June 2017	
	₹ trillion)	%	₹ trillion)	%
Top Five AMCs				
ICICI Prudential AMC	2.43	13.3	2.60	13.3
HDFC AMC	2.37	13.0	2.53	13.0
Reliance Nippon Life AMC	2.11	11.5	2.23	11.4
Birla Sun Life AMC	1.95	10.7	2.06	10.5
SBI Funds Management	1.57	8.6	1.69	8.6
Total QAAUM for Top Five AMCs	10.43	57.0	11.11	56.9
Next Five AMCs				
UTI AMC	1.37	7.5	1.45	7.4
Kotak Mahindra AMC	0.92	5.0	1.01	5.2
Franklin Templeton AMC	0.82	4.5	0.91	4.6
DSP BlackRock Investment Managers	0.64	3.5	0.71	3.6
IDFC AMC	0.61	3.3	0.64	3.3
Total QAAUM for Next Five AMCs	4.35	23.8	4.72	24.2
QAAUM for Top Ten AMCs	14.79	80.8	15.83	81.1

Company In Focus – Reliance Nippon Life AMC:

The firm started mutual fund operations in 1995 as the asset manager for Reliance Mutual Fund.

it is involved in managing:

- (i) Mutual funds (including ETFs)
- (ii) Managed accounts, including portfolio management services, alternative investment funds ("AIFs") and pension funds
- (iii) Offshore funds and advisory mandates.

RNLAM is ranked the **third largest** asset management company, in terms of mutual fund quarterly average AUM ("QAAUM") with a market share of **11.4%**, as of June 30, 2017, according to ICRA. RNLAM managed QAAUM of ₹2,229.64 billion and 7.01 million investor folios, as of June 30, 2017.

The firm managed 55 open-ended mutual fund schemes including 16 ETFs and 174 closed ended schemes for Reliance Mutual Fund as of June 30, 2017. It has a pan-India network of 171 branches and approximately 58,000 distributors including banks, financial institutions, national distributors and independent financial advisors ("IFAs"), as of June 30, 2017.

Promoting Groups:

1. Reliance Capital Limited (Anil Ambani group) holds 46.57%
2. Nippon Life Insurance Company holds 49.00%
3. Valiant Mauritius Partners FDI Ltd holds 1.86%
4. IIFL Funds holds 2.59%

Strengths:

1. **Leading Asset management company with strong credentials:** Being the third largest firm by AUM, it is expected to benefit from the economies of scale and lower marketing and distribution cost. The firm has posted good growth figures in the past. Total revenues and profit after tax have increased between the financial years 2013 to 2017, by a CAGR of 22.2%, 18.2% and 15.0%, respectively. RNLAM is expected to benefit from the Nippon Life tag in overseas operations as an advantage of a strong parent company.
2. **Multi-Channel Distribution Network:** In India, the firm has a pan-India network of 171 branches, of which 132 branches are in B15 locations, and approximately 58,000 distributors as of June 30, 2017. The firm has setup subsidiaries in Singapore and Mauritius and a representative office in Dubai.
3. **Offers a comprehensive suite of products** (across mutual funds and ETFs, managed accounts and offshore funds and advisory mandates) catering to requirements of investors with varied risk profiles and time-horizons.
4. **Focus on Customer Centricity and Innovation:** Superior customer service is an integral part of the RNLAM value proposition to its investors. The firm believes that innovation, an easy and simple on-boarding process, efficient service delivery and robust grievance redressal processes are the key elements of this service value proposition.

Risks:

1. Future revenue and profit are largely dependent on the growth, value and composition of the AUM of the schemes managed. Management fees are charged usually as a percentage of Asset Under Management (AUM). Any downturn in the equity market and fluctuations in interest rate, will dent the earnings of company.
2. Intense competition in the industry may reduce profitability and market share.
3. The firm proposes to utilize the net proceeds to undertake acquisitions for which targets have not been identified (Funds ear marked – ₹1650 million).
4. Firm to lend ₹1250 million to Reliance AIF, a subsidiary of RNLAM to invest under category II or category III funds.
5. Retaining senior investment professionals and other personnel will be the major factor.

Offer Details:

1. **Fresh Issue** – Up to 24.48 million shares
2. **Offer for Sale:**

- I. Reliance Capital – up to 11.23 million shares
- II. Nippon Life - up to 25.48 million shares
3. Issue Type: 100% Book Built Issue IPO
4. Offer Size: ₹154224 million
5. Face Value: ₹5 per equity share
6. Price Band: ₹247 – ₹252 per equity share
7. Minimum Order Quantity Retail: 59 shares and in multiples thereof
8. Maximum Bid amount for Retail: ₹2 lakhs
9. Listing: NSE & BSE

Utilization of Net proceeds from IPO:

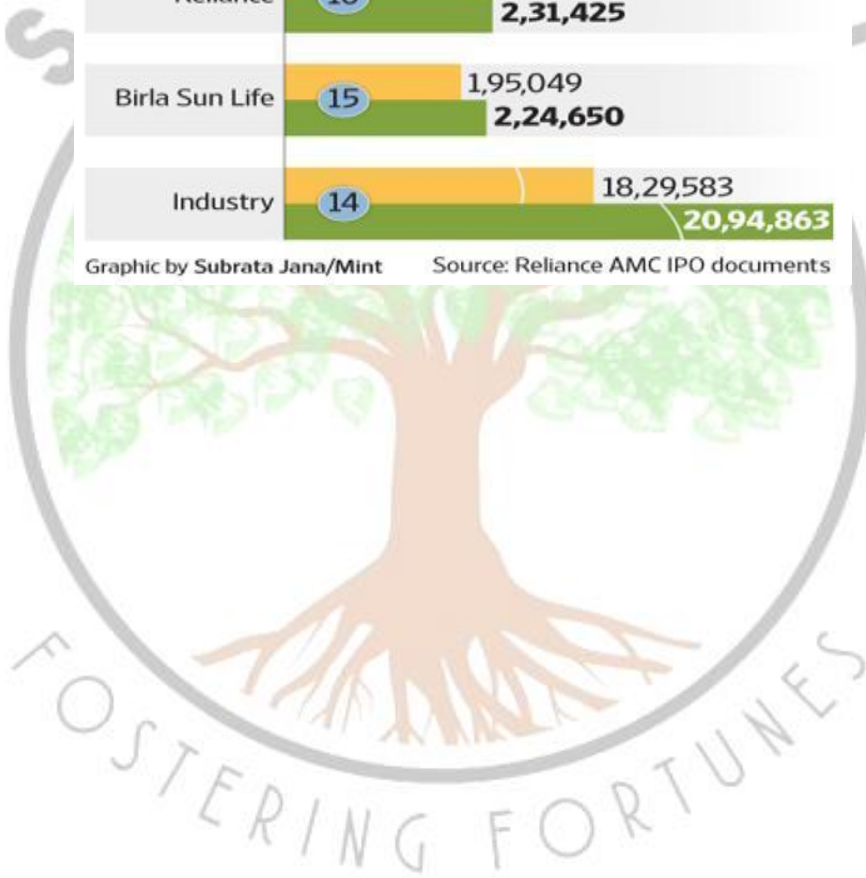
Sl. No.	Particulars	Amount (₹ in million)
1	Setting up new branches and relocating certain existing branches (150 new branches and 54 relocating branches)	383.06
2	Upgrading the IT system	406.45
3	Advertising, marketing and brand building activities	720.92
4	Lending to our subsidiary (Reliance AIF) for investment of continuing interest in the new AIF schemes managed by Reliance AIF	1,250.00
5	Investing towards our continuing interest in new mutual fund schemes managed by us	1,000.00
6	Funding inorganic growth and strategic initiatives	1,650.00
7	General corporate purposes	Remaining amount

Snippet from Livemint editorial on growth of top 4 AUMS:



SIPPING GROWTH?

Reliance Nippon Life Asset Management Co. will have the first-mover advantage with its initial public offering but it would need to keep up its growth trajectory to justify valuation.



Financial Statement Analysis:

Summary of Assets and Liabilities as stated in DHRP:

(₹ in Millions)

	As at 30 June 2017	As at 31 March 2017	As at 31 March 2016	As at 31 March 2015	As at 31 March 2014
EQUITY AND LIABILITIES					
Shareholders' funds					
Share capital	415.20	415.20	415.20	412.70	112.70
Reserves and surplus	16,119.50	18,287.81	17,234.79	14,774.78	15,269.58
	16,534.70	18,703.01	17,649.99	15,187.48	15,382.28
Non current liabilities					
Long - term provisions	130.12	112.12	74.41	32.12	23.51
	130.12	112.12	74.41	32.12	23.51
Current liabilities					
Trade payables					
Outstanding dues of MSMED	-	-	-	-	-
Outsd. dues of crd. other than MSMED	886.39	1,031.67	588.54	860.76	740.75
Other current liabilities	1,226.85	254.45	511.76	455.46	633.36
Short - term provisions	133.59	96.85	33.21	94.15	32.18
	2,246.83	1,382.97	1,133.51	1,410.37	1,406.29
TOTAL	18,911.65	20,198.10	18,857.91	16,629.97	16,812.08
ASSETS					
Non-current assets					
Fixed assets					
Property plant and equipment	91.69	84.81	83.35	42.30	111.83
Intangible assets	2,356.27	2,424.53	33.59	26.72	25.58
Non - current investments	6,265.03	6,366.51	5,615.96	4,338.96	3,240.06
Deferred tax assets	61.54	75.87	122.12	121.28	112.14
Long - term loans and advances	1,638.38	1,368.94	3,763.96	2,942.46	1,195.22
Other non - current assets	72.91	72.91	72.37	39.37	36.64
	10,485.82	10,393.57	9,691.35	7,511.09	4,721.47
Current assets					
Current investments	1,655.77	3,371.15	3,641.20	4,110.08	4,296.22
Trade receivables	574.48	406.49	469.95	155.78	93.61
Cash and bank balance	378.18	47.42	418.27	242.87	310.62
Short - term loans and advances	5,428.04	5,709.40	4,492.44	4,442.16	7,257.42
Other current assets	389.36	270.07	144.70	167.99	132.74
	8,425.83	9,804.53	9,166.56	9,118.88	12,090.61
TOTAL	18,911.65	20,198.10	18,857.91	16,629.97	16,812.08

Summary of Income Statement as stated in DHRP:

(₹ in Millions)

	Quarter Ended 30 June 2017	Year Ended 31 March 201	Year Ended 31 March 2016	Year Ended 31 March 201	Year Ended 31 March 2014	Year Ended 31 March 2013
Income						
Revenue from operations - management fees	3,536.11	12,696.34	11,641.97	8,218.47	6,618.05	5,899.82
Other income	245.41	1,308.04	1,068.73	1,082.68	1,222.21	1,226.92
Total revenue	3,781.52	14,004.38	12,710.70	9,301.15	7,840.26	7,126.74
Expenditure						
Employee benefits expenditure	569.53	1,815.62	1,818.05	1,510.88	1,367.36	1,325.23
Administrative and other expenditure	726.05	2,430.95	2,057.43	1,759.97	1,578.65	1,176.24
Marketing and publicity expenditure	1,147.71	3,758.22	3,630.18	1,438.65	1,083.01	1,367.08
Depreciation and amortization	81.24	178.48	42.31	67.86	141.01	78.41
Diminution in value of long term investments	-	-	-	-	-	6.33
Total expenditure	2,524.53	8,183.27	7,547.97	4,777.36	4,170.03	3,953.29
Profit before tax and exceptional items	1,256.99	5,821.11	5,162.23	4,523.79	3,670.23	3,173.45
Exceptional items	-	-	4.03	1.68	57.57	556.41
Profit before tax	1,256.99	5,821.11	5,158.20	4,522.11	3,612.66	2,617.04
Income tax expenditure						
Current tax (Net of MAT credit entitlement)	(408.30)	(1,719.16)	(1,257.80)	(1,022.00)	(666.79)	(612.13)
MAT credit asset	-	-	289.60	418.95	398.58	304.41
MAT credit utilised	-	-	(289.60)	(418.95)	(398.58)	(304.41)
Deferred tax	(14.32)	(46.25)	0.84	(4.17)	77.14	(15.31)
Profit after tax	834.37	4,055.70	3,901.24	3,495.94	3,023.01	1,989.60
Basic and diluted earning per share of ₹10 each	72.43	350.18	338.32	316.21	273.80	179.21
Diluted earning per share of ₹10 each	72.43	350.18	338.32	315.83	272.54	178.27

Source for Note: DRHP

Income Statement expressed in terms of common size:

	Q1FY2018	FY2017	FY2016	FY2015	FY2014	FY2013
Income						
Revenue from operations - management fees	93.51%	90.66%	91.59%	88.36%	84.41%	82.78%
Other Income	6.49%	9.34%	8.41%	11.64%	15.59%	17.22%
Total income	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
Expenditure						
Employee	22.56%	22.19%	24.09%	31.63%	32.79%	33.52%
Administrative	28.76%	29.71%	27.26%	36.84%	37.86%	29.75%
Marketing	45.46%	45.93%	48.09%	30.11%	25.97%	34.58%
Depreciation	3.22%	2.18%	0.56%	1.42%	3.38%	1.98%
Total Expenditure	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
PAT Margin	23.60%	31.94%	33.51%	42.54%	45.68%	33.72%

Observations:

- Pros:
 - Increasing contribution from management fees – directly proportional to AUM and equity market growth
 - Increase in EPS
- Cons
 - PAT margin has seen declining trend from FY14 to FY17
 - Marketing Expenses in FY16 is almost 1.5X times FY15

Growth Analysis

In ₹ millions	FY2017	FY2013	CAGR
AUM	36,25,500	16,00,450	22.68%
Total income	14,004.38	7,126.74	18.40%
PAT	4,055.70	1,989.60	19.49%

The firm has shown a healthy AUM growth between FY13-17 clocking a 22.3% CAGR, however total income (management fee + other income) has been slower at 18.40% CAGR. Also, profitability growth has fared better compared to total income at 19.49% CAGR. Growth in AUM does not fully translate into earnings growth. A close look at the numbers reveals a possible higher share of debt products compared to equity products and a downward pressure on fees. Growth in PAT also reduced from 12% between FY15 to FY16 to a mere 4% between FY16 to FY17. Given that FY17 proved to be a “bull” year, this shows the firm's inability to capitalize on favourable macros.

Group Companies:

RNLAM is a part of the Anil Ambani empire which includes the debt laden Reliance Communications, Reliance Infra and its financial service company Reliance Home Finance and Reliance Capital, which are trading at lower values compared to peers in the industry. No doubt, the brand value of Reliance, led by Anil Ambani is at the rock-bottom currently. To note, almost all the IPO's from this house plunged post listing in the secondary market.

Valuation of company and Conclusion:

The price band given for RNLAM is ₹247-252 per share. At the higher bracket of ₹252, the company's market cap would be ₹154220 million which leads to a PE multiple of 39.5x and 38x based on FY16 and FY17 earnings. The company gets the first mover advantage, for it has no listed peers to compare the multiple.

If we consider the market cap as a percentage of the AUM, as on 31st Mar 2017, RNLAM is valued at 4.25%. If we consider this logic, the firm's valuation will be highly sensitive to fluctuation in its AUM and a downturn in the market valuations remains a key risk factor.

Investors should consider their risk appetite before making any investment in AUM companies, as their income and market cap both are directly linked with the value of the assets they manage, which essentially is very sensitive. Considering the proposed use of net proceeds, opening new branches and extensive marketing would lead to increase in its customer base and over the quarters, AUM would see a healthy growth provided the overall macro-economic factors support the trend.