BOBCAPS
TRUST | INNOVATION | EXCELLENCE

BUY
TP: Rs 2,277 | ⮝ 36%

IIFL WEALTH | Diversified Financials | 02 September 2022

NDR takeaways – Spotlight on recurring revenue and new clients

- **Management focused on driving recurring income and net fund flows to scale the business and curb cyclicality**
- **Phygital model planned for Rs 50mn-250mn clientele and physical meetings for Rs 250mn+ bracket; Rs 500mn+ targeted for advisory**
- **Maintain BUY given strong, sticky client base, favourable industry drivers and low valuations; TP unchanged at Rs 2,277**

Mohit Mangal
research@bobcaps.in

Takeaways from roadshow with Karan Bhagat, the Founder, MD & CEO of IIFL Wealth:

Focus on ARR, net flows: IIFL Wealth has successfully scaled its annual recurring revenue (ARR) business over the last three years and aims to have 80-85% of its topline from recurring streams vs. 68-72% currently. Net flows totalled ~Rs 60bn in Q1FY23, but management expects to close the year relatively higher given quarterly deviations. We forecast net flows (net new money) of Rs 340bn/Rs 405bn/Rs 452bn by end-FY23/FY24/FY25 with AUM reaching Rs 3.1tn/Rs 3.8tn/Rs 4.5tn.

Cyclicity to reduce further: Cyclicity has reduced and the company aims to further smooth revenue flows by building up ARR, ensuring a favourable asset mix of both debt and equity, and garnering traction in the alternate investment space.

Thrust on mid-market category: The Rs 50mn-250mn mid-market client category is typically dominated by distribution whereas IIFL Wealth's Rs 250mn-500mn business is a mix of distribution and advisory. Those above Rs 500mn are targeted to eventually move towards advisory services. The company is entering the Rs 50mn-250mn arena in Apr'23 and intends to service the space in the phygital (physical + digital) mode, thereby potentially doubling the span of control from 30 clients to 50-60. Management believes its Rs 250mn+ client base will favour physical meetings.

Growing client awareness: Clients above Rs 250mn (potential to become Rs 500mn in three years) now have clear expectations of delivery and are moving towards advisory services. Also, investments are increasingly being directed toward direct plans.

Low attrition: Per management, attrition is low in the company's senior relationship and investment teams. The focus is on replacing departures with the right candidates so that clients stay connected to the platform. Attrition on the client side is also low.

Maintain BUY: IIFL Wealth is trading at 18x FY24E EPS and appears undervalued. We retain BUY with a TP of Rs 2,277 set at 25x FY24E EPS – a 10% premium to the 3Y average given a robust model, strong fundamentals and supportive macro climate.

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	IIFLWAM IN/Rs 1,678
Market cap	US$ 1.9bn
Free float	77%
3M ADV	US$ 0.8mn
52wk high/low	Rs 1,908/Rs 1,236
Promoter/FPI/DII	23%/22%/3%

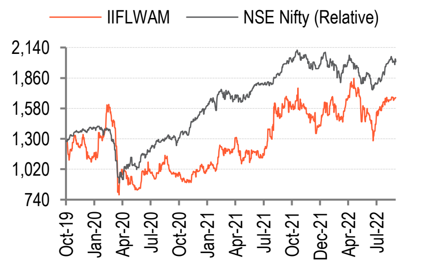
Source: NSE | Price as of 1 Sep 2022

Key financials

Y/E 31 Mar (Rs mn)	FY22P	FY23E	FY24E
PBT (Rs mn)	7,513	9,271	10,947
PBT growth (%)	54.9	23.4	18.1
Adj. net profit (Rs mn)	5,818	6,954	8,210
EPS (Rs)	64.1	77.1	91.1
Consensus EPS (Rs)	64.1	77.0	89.0
P/E (x)	26.2	21.8	18.4
MCap/AUM (%)	5.8	4.9	4.0
ROE (%)	20.0	22.7	25.5

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

Stock performance



Source: NSE

Key roadshow takeaways

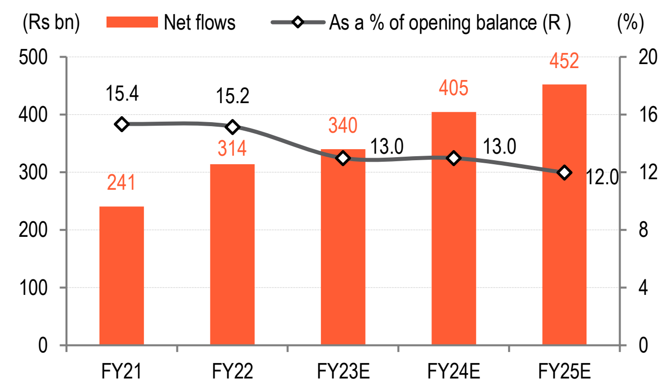
Wealth AUM to grow 20-25%

India's wealth management industry has grown rapidly over the last 3-4 years in terms of the number of markets and clients, product innovation and monetisation events. IIFL Wealth sees the potential to service 225-250k families with aggregate wealth of US$ 3.5mn-4mn. Target markets have swelled from the conventional top 10-12 cities to 20-25 cities. Clients are now looking beyond traditional asset classes and have a better understanding of asset allocation.

IIFL Wealth's assets under management (AUM) is influenced by both net flows and mark-to-market (MTM) gains/losses. In Q1FY23, the company had ~Rs 60bn of flows against its estimate of Rs 70bn-75bn, but management's annual expectations remain intact considering quarterly deviations. AUM is fairly insulated against MTM losses, being broadly comprised of 40-45% equity and 55-60% debt. In India, MTM gains across portfolios has held steady in the region of 9-9.5% of AUM, with fixed income at 7.5-8% and equities at 11-12%. Thus, the company believes it has the ability to grow AUM by 20-25%.

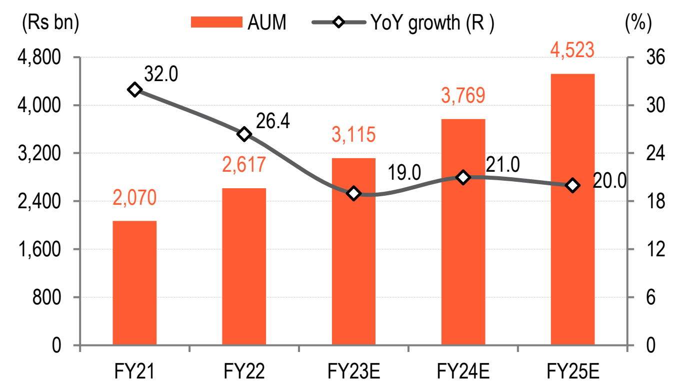
We expect IIFL Wealth to have net flows (net new money) of Rs 340bn/Rs 405bn/ Rs 452bn by end-FY23/FY24/FY25 with AUM reaching Rs 3.1tn/Rs 3.8tn/Rs 4.5tn.

Fig 1 – Net flows expected to grow steadily



Source: Company, BOBCAPS Research

Fig 2 – Stable AUM growth



Source: Company, BOBCAPS Research

Reduction in business cyclicality

Business cyclicity has reduced and IIFL Wealth is continuing with its efforts to smooth out income flows in the following ways:

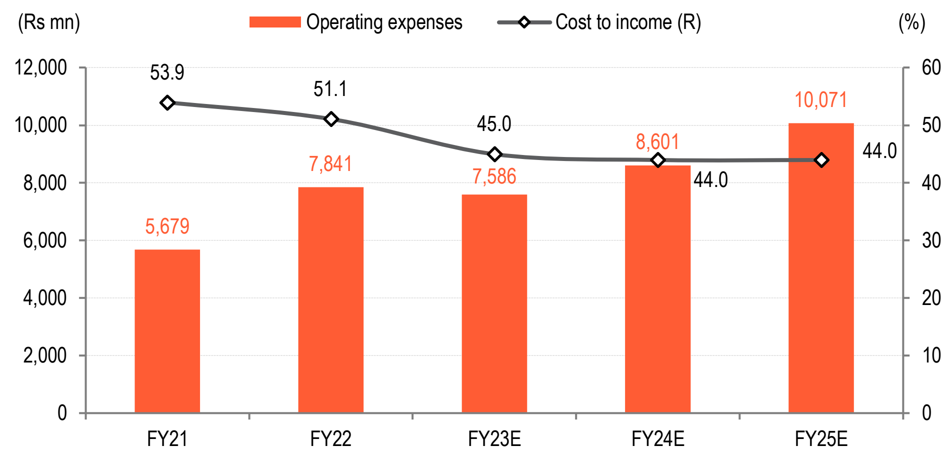
- **Increase in ARR:** The proportion of cyclical business has reduced considerably in the last 3-4 years, with ARR now contributing 68-72% of revenue vs.43% in FY19. The company is targeting a steady rise in ARR share to 80-85%.
- **Building a favourable asset mix:** IIFL Wealth has become equally active in the fixed income space as in equities over the last 3-4 years. That said, flows are currently slightly biased toward the fixed income side in the near term given that markets have run up rather quickly.

- **Targeting the alternate space:** Alternate investments have had good traction, and the company could see more net flows in the debt and listed equity space in FY23. In terms of revenue yield, most of the alternate businesses – be it structured products or fixed income or equity – offer retention ratios in the range of 70-75bps (worst case 65bps). Institutional mandates, which form a part of listed equity pools, offer a 30-35bps retention ratio. Management also anticipates 10-15bps of carry income which is not included in the 70-75bps yield.

Operating leverage to boost profitability

Management expects a cost-to-income (C/I) ratio of 44-45%, with employee cost at 32-34% and other costs typically at 11-12%. The company believes the C/I ratio can reduce by 2.5-3ppt on account of better productivity and a larger span of control, sans any reduction in employee compensation. We have baked in a 45% C/I vs. official guidance of 44% for FY23, which will reduce to 44% in FY25 vs. 51% in FY22.

Fig 3 – C/I ratio in 44-45% range



Source: Company, BOBCAPS Research

Targeting mid-market clients

Per management, clientele in the Rs 250mn+ bracket (potential to become Rs 500mn in three years) now have defined expectations of delivery and are moving towards advisory services. Also, their investments are increasingly being directed toward direct plans. Clients in the mid-market Rs 50mn-250mn category are largely aspiring for private vs. priority banking products. Nevertheless, they offer vast potential due to the large number of professionals being added into the category and low competition levels. Competition in the form of priority banks remains focused on current/savings accounts, insurance, and salary accounts, leaving the field open for players such as IIFL Wealth.

The mid-market Rs 50mn-250mn client category is typically dominated by distribution whereas IIFL Wealth's Rs 250mn-500mn business is a mix of distribution and advisory. Those above Rs 500mn are targeted to eventually move towards advisory services. The company is entering the Rs 50mn-250mn arena in Apr'23 and intends to service the space in the phygital (physical + digital) mode, thereby potentially doubling the span of control from 30 clients to 50-60. Management believes its Rs 250mn+ client base will favour physical meetings.

Attrition low

According to management, attrition is low in the company's senior relationship and investment teams. The focus is on replacing departures with the right candidates so that clients stay connected to the platform. Attrition on the client side is also low with minimal loss of AUM on this front, indicating customer satisfaction.

Organic route to growth

IIFL Wealth is not averse to acquisitions and has done so historically. Indeed, the Mumbai Angels acquisition is underway and will be completed once SEBI approval likely comes through over the next 45-60 days. However, management's intention is to grow organically with the right systems and processes in place.

Opportunities in account aggregation and accredited space

An account aggregator helps individuals securely and digitally access and share information from a financial institution in which they have an account with any other regulated financial institution in the aggregator network. Data cannot be shared without the consent of the individual. IIFL Wealth will benefit from this as it gets a holistic view of the customer in terms of assets and liabilities.

Management believes the accredited investor space will pick up only over the next 5-7 years. It estimates that there are ~150 or 200 accredited investors, of which the company has opened accounts for about half of them. Account aggregation is expected to gather pace faster than the accredited investor space.

Insulated against regulations

Per regulations, wealth management firms can only book commission upfront on the distribution of alternative investment funds (AIF). Outside of that, portfolio management services (PMS) and mutual funds have fully moved to commissions on trail basis. IIFL Wealth had already migrated its AIF-based income to trail fees and thus remains well within regulatory requirements.

Other takeaways

- The company's multi-asset strategy has scaled up quickly and should see further growth ahead. Good investment teams across multiple classes increase the probability of IIFL Wealth being in the top 20-25 percentile of wealth managers.
- The company is managing its fourth structured credit fund, each Rs 10bn-15bn in size. It will launch an infrastructure debt fund soon
- Any change in dividend policy towards buybacks instead of dividend payout will be decided at the board level. However, management remains receptive to the idea.

Valuation methodology

IIFL Wealth is trading at 18x FY24E EPS and appears undervalued, in our view. We reiterate our BUY rating with an unchanged TP of Rs 2,277 (36% upside) based on 25x FY24E EPS – a 10% premium to the stock's three-year average given a robust model, strong fundamentals and supportive macro factors. The company has maintained a niche position in the under-penetrated wealth management business, enjoys a track record of innovative wealth products and has a strong team leader-driven model that boasts of low attrition at both, the client and team level.

Key risks

Key downside risks to our estimates are:

- **Goodwill risk:** IIFL Wealth's business is built on the goodwill of existing clients with new clients being acquired by word of mouth. Any change in the company's reputation due to a customer's bad experience can result in loss of goodwill, thereby hampering its ability to acquire new clients or even leading to attrition among existing ones.

- **Volatile capital markets:** Volatility in capital markets persists, especially after the uncertainty due to Covid-19 and recent geopolitical tensions. This could lead to abnormal losses/profits in client portfolios. Coupled with a drop in new wealth creation, this may slow the pace of estimated growth in the wealth industry, which may result in slower AUM growth for IIFL Wealth. As per management, a 20% fall in the benchmark can result in an 8-12% decline in AUM.

- **Growth in IIFL One assets may be slower than anticipated:** IIFL Wealth has been a pioneer in pushing for the shift to a recurring revenue model, spearheaded by the IIFL One proposition where revenue is earned as fees from clients rather than commissions from mutual funds. However, the speed of client conversion to this proposition may be slower than expected. Also, pricing pressures may arise as other competitors move to similar models.

- **High dependence on senior team leaders:** IIFL Wealth is dependent on senior team leaders (TL), bankers and relationship managers to retain and expand the client base over the long term. Any substantial TL attrition may lead to a corresponding increase in client attrition or may even slow AUM growth.

- **Regulatory issues:** Many regulatory changes have been introduced in the last few years, altering the dynamics of the business (for example, change in commission earned from upfront to trail). Any further changes can affect the income earned by the company.

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22P	FY23E	FY24E	FY25E
Recurring revenue	5,830	9,120	12,257	14,747	17,888
Non-recurring revenue	3,325	4,862	3,800	4,000	4,200
Other income	1,374	1,372	800	800	800
Total income	10,529	15,354	16,857	19,547	22,888
Operating expenses	5,679	7,841	7,586	8,601	10,071
PBT	4,849	7,513	9,271	10,947	12,817
PBT growth (%)	69.3	54.9	23.4	18.1	17.1
Tax	1,156	1,696	2,318	2,737	3,204
Tax rate (%)	23.8	22.6	25.0	25.0	25.0
Reported PAT	3,693	5,818	6,954	8,210	9,613

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22P	FY23E	FY24E	FY25E
Equity capital	176	177	177	177	177
Reserves & surplus	28,102	29,798	31,189	32,831	34,754
Net worth	28,278	29,976	31,366	33,008	34,931
Total debt	47,385	58,250	69,317	80,105	91,604
Other liab. & provisions	40,014	49,145	48,874	52,928	56,676
Total liabilities & equities	87,399	1,07,395	1,18,191	1,33,033	1,48,279
Cash & bank balance	7,882	10,222	13,208	15,474	16,333
Fixed & Other assets	79,518	97,173	1,04,983	1,17,559	1,31,946
Total assets	87,399	1,07,395	1,18,191	1,33,033	1,48,279

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22P	FY23E	FY24E	FY25E
EPS	41.8	64.1	77.1	91.1	106.7
Dividend per share	70.0	55.0	61.7	72.9	85.3
Book value per share	319.9	332.6	348.0	366.2	387.6

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22P	FY23E	FY24E	FY25E
P/E	40.2	26.2	21.8	18.4	15.7
P/BV	5.2	5.0	4.8	4.6	4.3
Dividend yield (%)	4.2	3.3	3.7	4.3	5.1

DuPont Analysis

Y/E 31 Mar (bps of	FY21A	FY22P	FY23E	FY24E	FY25E
Operating income	50.3	59.7	56.0	54.5	53.3
Operating expenses	31.2	33.5	26.5	25.0	24.3
Other income	7.5	5.9	2.8	2.3	1.9
PBT	26.6	32.1	32.3	31.8	30.9
Tax	6.4	7.2	8.1	8.0	7.7

Ratio Analysis

Y/E 31 Mar	FY21A	FY22P	FY23E	FY24E	FY25E
YoY growth (%)					
PBT	69.3	54.9	23.4	18.1	17.1
EPS	82.9	53.5	20.4	18.1	17.1
Profitability & Return ratios (%)					
Operating to Total income	87.0	91.1	95.3	95.9	96.5
Cost to Income ratio	53.9	51.1	45.0	44.0	44.0
PBT margin	46.1	48.9	55.0	56.0	56.0
ROE	12.7	20.0	22.7	25.5	28.3
Dividend payout ratio	167.6	85.8	80.0	80.0	80.0

Source: Company, BOBCAPS Research

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

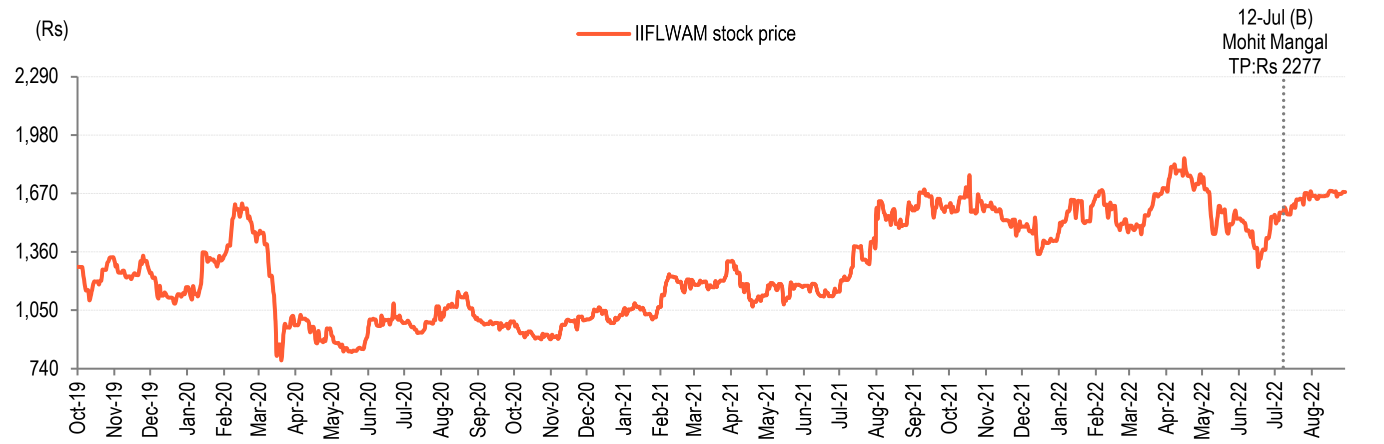
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): IIFL WEALTH (IIFLWAM IN)



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

Rating distribution

As of 31 August 2022, out of 119 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 67 have BUY ratings, 30 have HOLD ratings, 5 are rated ADD*, 1 is rated REDUCE* and 16 are rated SELL. Of these, 2 companies rated BUY and 1 rated ADD have been investment banking clients in the last 12 months. (*Our ADD and REDUCE ratings are in the process of being migrated to the new recommendation structure.)

Analyst certification

The research analyst(s) authoring this report hereby certifies that (1) all of the views expressed in this research report accurately reflect his/her personal views about the subject company or companies and its or their securities, and (2) no part of his/her compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) in this report. Analysts are not registered as research analysts by FINRA and are not associated persons of BOBCAPS.

General disclaimers

BOBCAPS is engaged in the business of Stock Broking and Investment Banking. BOBCAPS is a member of the National Stock Exchange of India Limited and BSE Limited and is also a SEBI-registered Category I Merchant Banker. BOBCAPS is a wholly owned subsidiary of Bank of Baroda which has its various subsidiaries engaged in the businesses of stock broking, lending, asset management, life insurance, health insurance and wealth management, among others.

BOBCAPS's activities have neither been suspended nor has it defaulted with any stock exchange authority with whom it has been registered in the last five years. BOBCAPS has not been debarred from doing business by any stock exchange or SEBI or any other authority. No disciplinary action has been taken by any regulatory authority against BOBCAPS affecting its equity research analysis activities.

BOBCAPS has obtained registration as a Research Entity under SEBI (Research Analysts) Regulations, 2014, having registration No.: INH000000040 valid till 03 February 2025. BOBCAPS is also a SEBI-registered intermediary for the broking business having SEBI Single Registration Certificate No.: INZ000159332 dated 20 November 2017. BOBCAPS CIN Number: U65999MH1996GOI098009.

BOBCAPS prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, BOBCAPS prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover.

Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additionally, other important information regarding our relationships with the company or companies that are the subject of this material is provided herein.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of BOBCAPS's clients. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice.

The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. BOBCAPS does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment in certain transactions — including those involving futures, options, and other derivatives as well as non-investment-grade securities —that give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only. We endeavour to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so.

We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have "long" or "short" positions in, act as principal in, and buy or sell the securities or derivatives thereof of companies mentioned herein and may from time to time add to or dispose of any such securities (or investment). We and our affiliates may assume an underwriting commitment in the securities of companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis, and may also perform or seek to perform investment banking or advisory services for or relating to these companies and may also be represented in the supervisory board or any other committee of these companies.

For the purpose of calculating whether BOBCAPS and its affiliates hold, beneficially own, or control, including the right to vote for directors, one per cent or more of the equity shares of the subject company, the holdings of the issuer of the research report is also included.

BOBCAPS and its non-US affiliates may, to the extent permissible under applicable laws, have acted on or used this research to the extent that it relates to non-US issuers, prior to or immediately following its publication. Foreign currency denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of or income derived from the investment. In addition, investors in securities such as ADRs, the value of which are influenced by foreign currencies, effectively assume currency risk. In addition, options involve risks and are not suitable for all investors. Please ensure that you have read and understood the Risk disclosure document before entering into any derivative transactions.

In the US, this material is only for Qualified Institutional Buyers as defined under rule 144(a) of the Securities Act, 1933. No part of this document may be distributed in Canada or used by private customers in the United Kingdom.

No part of this material may be (1) copied, photocopied, or duplicated in any form by any means or (2) redistributed without BOBCAPS's prior written consent.

Company-specific disclosures under SEBI (Research Analysts) Regulations, 2014

The research analyst(s) or his/her relatives do not have any material conflict of interest at the time of publication of this research report.

BOBCAPS or its research analyst(s) or his/her relatives do not have any financial interest in the subject company. BOBCAPS or its research analyst(s) or his/her relatives do not have actual/beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

The research analyst(s) has not received any compensation from the subject company or third party in the past 12 months in connection with research report/activities. Compensation of the research analyst(s) is not based on any specific merchant banking, investment banking or brokerage service transactions.

BOBCAPS or its research analyst(s) is not engaged in any market making activities for the subject company.

The research analyst(s) has not served as an officer, director or employee of the subject company.

BOBCAPS or its associates may have material conflict of interest at the time of publication of this research report.

BOBCAPS's associates may have financial interest in the subject company. BOBCAPS's associates may hold actual / beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

BOBCAPS or its associates may have managed or co-managed a public offering of securities for the subject company or may have been mandated by the subject company for any other assignment in the past 12 months.

BOBCAPS may have received compensation from the subject company in the past 12 months. BOBCAPS may from time to time solicit or perform investment banking services for the subject company. BOBCAPS or its associates may have received compensation from the subject company in the past 12 months for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory services in a merger or specific transaction. BOBCAPS or its associates may have received compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past 12 months.