12 October 2020

# IIFL Wealth

*ARR model to be the torchbearer; prepared for an upside; Buy*

Rating: **BUY**
Target Price: Rs1,193
Share Price: Rs 931

| Key data | IIFLWAM IN |
|---|---|
| 52-week high / low | Rs1,606 / 685 |
| Sensex / Nifty | 40594 / 11931 |
| 3-m average volume | $0.6m |
| Market cap | Rs 81bn / $1105.4m |
| Shares outstanding | 88m |

| Shareholding pattern (%) | June'20 | Mar'20 | Dec'19 |
|---|---|---|---|
| Promoters | 22.9 | 22.9 | 24.1 |
| *- of which, Pledged* | - | - | - |
| Free Float | 77.1 | 77.1 | 75.9 |
| - Foreign Institutions | 20.1 | 20.1 | 18.8 |
| - Domestic Institutions | 45.9 | 45.9 | 45.5 |
| - Public | 11.1 | 11.1 | 11.6 |

Relative price performance


*Source: Bloomberg*

**Of the big guns in the wealth business, IIFL Wealth is moving ahead with its stable ARR model, harnessing the vast growth potential in an under-penetrated wealth industry. Its business growth comes organically and through acquisitions. Its hallmark is low attrition rates (clients and RMs) even in a volatile environment. Higher dividend payouts render it attractive to shareholders**.

**ARR major growth driver, IIFL One is the focus**. The ARR is the major growth driver, which is independent of transactions and would provide stable income streams. The share of ARR in AUM rose from 33% in FY16 to 40% in FY20 and is expected to go up to 55% by FY23. Within ARR, IIFL One is the focus; we expect it to clock a 49% CAGR over FY20-23 to Rs590bn (FY20: Rs177bn), constituting 38% of ARR AUM.

**Alternative investment-driven AMC business growth.** AIF-induced AMC AUM grew from Rs54bn in FY16 to Rs220bn in FY20 and is expected to clock a 37% CAGR over FY20-23 to Rs559bn. Similarly, AMC revenue is expected to register a 30% CAGR over FY20-23 to Rs3.2bn. Product launches and senior hires over the last two years are expected to drive growth.

**Strong growth.** Fresh money from existing clients and a few acquisitions in the last few years have augmented growth. The recent LTCM acquisition raised AUM by ~Rs100bn. The number of relevant families rose from ~3,200 in FY17 to 6,215 at end-Q1 FY21.

**Lower attrition of RMs, clients.** The company has 71 team leaders and 245 relationship managers; the former's attrition rate over FY17-20 averaged 3.7%, with no attrition in Q1 FY21. Over FY17-20, the company lost fewer than 2.5% customers per annum with an AUM loss of less than 1%.

**Valuation.** We initiate coverage on IIFL Wealth with a Buy rating, at a target of Rs1,193, implying 28% potential. We value it using a P/E multiple and assign 20x on FY23e earnings. **Risks:** Volatile capital markets, higher attrition rate of TL's, regulatory issues.

| Key financials (YE Mar) | FY19 | FY20 | FY21e | FY22e | FY23e |
|---|---|---|---|---|---|
| Total income (Rsm) | 10,667 | 8,509 | 9,471 | 11,013 | 12,999 |
| Operating expenses (Rsm) | 5,297 | 5,644 | 5,209 | 5,506 | 5,980 |
| Net profit (Rsm) | 3,838 | 2,064 | 3,191 | 4,123 | 5,256 |
| EPS (Rs) | 44.4 | 23.4 | 36.2 | 46.8 | 59.6 |
| DPS (Rs) | 10 | 20 | 56 | 36 | 46 |
| Cost to income (%) | 50% | 66% | 55% | 50% | 46% |
| Operating expenses/ Avg. assets | 5% | 5% | 4% | 4% | 4% |
| RoE (%) | 16% | 7% | 11% | 14% | 18% |
| RoA (%) | 4% | 2% | 2% | 3% | 3% |
| Dividend payout (%) | 22% | 83% | 150% | 75% | 75% |

*Source: Company, Anand Rathi Research*

**Mohit Mangal**
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# IIFL Wealth

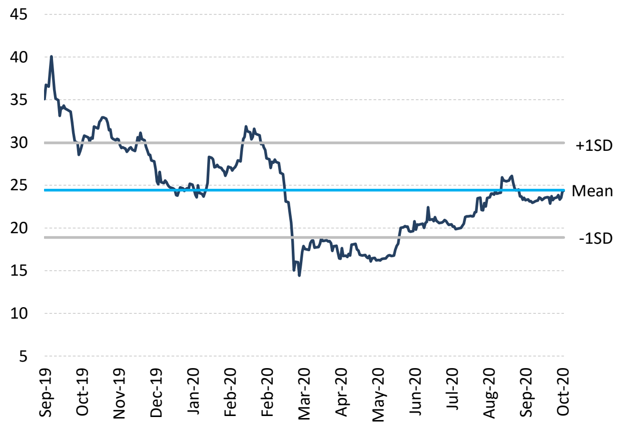
# Quick Glance – Financials and Valuations

## Fig 1 – Income statement (Rsm)

| Year-end: Mar | FY19 | FY20 | FY21e | FY22e | FY23e |
|---|---|---|---|---|---|
| Total income | 10,667 | 8,509 | 9,471 | 11,013 | 12,999 |
| *YoY growth* | *2%* | *-20%* | *11%* | *16%* | *18%* |
| Recurring revenue | 4,437 | 5,345 | 5,674 | 7,303 | 9,406 |
| IIFL One revenue | 145 | 349 | 704 | 1,193 | 1,851 |
| AMC revenue | 803 | 1,465 | 1,728 | 2,337 | 3,199 |
| Non-recurring revenue | 5,794 | 3,855 | 3,098 | 2,975 | 2,822 |
| Other income | 435 | (691) | 700 | 735 | 772 |
| Operating costs | 5,297 | 5,644 | 5,209 | 5,506 | 5,980 |
| Employee costs | 3,367 | 3,847 | 3,855 | 3,910 | 4,186 |
| Admin and other expenses | 1,930 | 1,798 | 1,354 | 1,597 | 1,794 |
| Profit before tax | 5,370 | 2,864 | 4,262 | 5,506 | 7,020 |
| Tax | 1,532 | 800 | 1,071 | 1,383 | 1,763 |
| PAT | 3,838 | 2,064 | 3,191 | 4,123 | 5,256 |
| *YoY growth* | *4%* | *-46%* | *55%* | *29%* | *27%* |

*Source: Company, Anand Rathi Research*

## Fig 4 – One-year-forward price-to-book



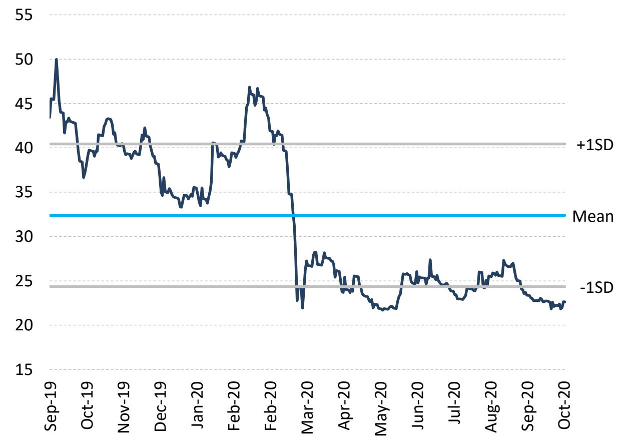

*Source: Bloomberg, Anand Rathi Research*

## Fig 2 – Balance sheet (Rsm)

| Year-end: Mar | FY19 | FY20 | FY21e | FY22e | FY23e |
|---|---|---|---|---|---|
| Cash and bank balance | 2,774 | 11,787 | 9,279 | 16,415 | 22,684 |
| Receivables | 7,205 | 3,600 | 3,534 | 3,524 | 3,250 |
| Loans | 49,665 | 36,319 | 40,407 | 54,025 | 71,068 |
| Investment | 30,526 | 65,124 | 66,427 | 67,755 | 69,111 |
| Property plant and equip | 616 | 2,988 | 3,688 | 3,903 | 4,122 |
| Other financial assets | 524 | 4,384 | 4,472 | 4,561 | 4,652 |
| **Total Assets** | **97,803** | **130,208** | **132,019** | **154,550** | **179,406** |
| Payables | 1,361 | 3,042 | 5,019 | 8,196 | 12,200 |
| Debt Securities | 43,495 | 54,261 | 56,624 | 67,343 | 79,014 |
| Borrowings | 11,834 | 28,499 | 29,740 | 35,370 | 41,500 |
| Subordinated Liabilities | 5,701 | 5,620 | 5,865 | 7,415 | 8,700 |
| **Total Liabilities** | **68,699** | **100,293** | **103,955** | **125,455** | **148,998** |
| **Equity** | **29,104** | **29,915** | **28,064** | **29,095** | **30,409** |
| **Total Liab. and Equity** | **97,803** | **130,208** | **132,019** | **154,550** | **179,406** |

*Source: Company, Anand Rathi Research*

## Fig 5 – One-year-forward price-to-earnings



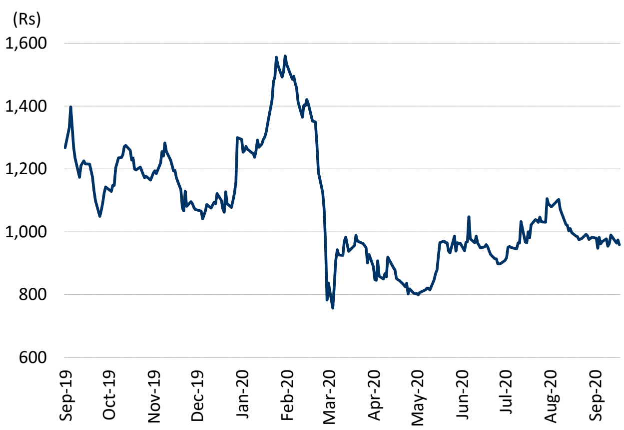

*Source: Bloomberg, Anand Rathi Research*

## Fig 3 – Ratio analysis %

| Year-end: Mar | FY19 | FY20 | FY21e | FY22e | FY23e |
|---|---|---|---|---|---|
| Cost to Income | 49.7% | 66.3% | 55.0% | 50.0% | 46.0% |
| Operating expenses/ Avg. assets | 5.5% | 5.0% | 4.0% | 3.8% | 3.6% |
| Operating PBT margin | 48.2% | 38.6% | 40.6% | 46.4% | 51.1% |
| Net profit margin | 36.0% | 24.3% | 33.7% | 37.4% | 40.4% |
| Employee cost/ Total costs | 63.6% | 68.1% | 74.0% | 71.0% | 70.0% |
| Employee cost/ Avg. assets | 3.5% | 3.4% | 2.9% | 2.7% | 2.5% |
| Return on avg. Assets (ROAA) | 4.0% | 1.8% | 2.4% | 2.9% | 3.1% |
| Return on avg equity (ROAE) | 16.1% | 7.0% | 11.0% | 14.4% | 17.7% |
| Dividend per share | 10 | 20 | 56 | 36 | 46 |
| EPS | 44.4 | 23.4 | 36.2 | 46.8 | 59.6 |
| Book value per share | 337.0 | 339.5 | 318.5 | 330.2 | 345.1 |
| Dividend payout | 22% | 83% | 150% | 75% | 75% |
| Implied P/E | NA | NA | 32.9 | 25.5 | 20.0 |

*Source: Company, Anand Rathi Research*

## Fig 6 – Price movement




*Source: Bloomberg*

# Investment Rationale

### Robust business model; de-risking with presence of both, fee paying and transactionary income

IIFL Wealth has a robust business model with focus on annual recurring revenue (ARR) from the traditional broker-distributor transaction model. The ARR model is stable and non-cyclical which is the primary reason for the company to focus on it. Within ARR, the focus is on the IIFL One and the AIF driven AMC business. The ARR AUM (excl. custody) clocked a 39% CAGR over FY15-20 to ~Rs626bn. The recurring AUM share in total AUM is increasing, from 22% in FY15 to 40% in FY20. Ahead, we expect the share of ARR AUM to increase to 55% by FY23.

The model is de-risked as the company earns revenue through either a fee paying mode (independent of transactions) or transactions based. With an increase in UHNI's and HNI's in India coupled with increasing focus on wealth management (through use of traditional as well as alternatives asset classes), the company is well positioned for business growth.

### Meaningful acquisitions as well as focus on organic growth

The company has done acquisitions over the last few years. Recently, it acquired L&T's Capital Market (LTCM) business that added Rs100bn to its AUM. Other prominent was the acquisition of Wealth Advisors in 2018 that had assets of about Rs110bn. Apart from inorganic growth, the company also focuses on new money flow from the existing clients.

### AMC business gaining traction, focus evident through senior hires

The AMC business is important with primary focus on AIF (70%+ of the AMC AUM). For investors, AIF is a diversification tool as in general they have in the past maintained low correlations with standard assets. It provides varied services such as private equity, public equity, structured credit and real estate. Within these, it regularly crafts new strategies, which augurs well for clients' interests. The company's keen focus on asset management can be gauged from senior management hires over the last two years. In Aug'18 it hired as the AMC's CIO Anup Maheshwari, who has over two decades' industry experience. Also, it set up a structured credit vertical by hiring senior people from the industry in FY19. The AUM increased from Rs54bn in FY16 to ~Rs220bn in FY20, with AIF increasing from Rs41bn to ~Rs160bn. We expect the AMC AUM to clock a 37% CAGR over FY20-23 to Rs559bn.

### Strong balance sheet; higher dividend payout positive

The healthy business growth coupled with strong profitability over the years led to a strong financial profile. The AUM (excl. double-counting) clocked a 22% CAGR over FY15-20 to Rs1.4trn. By FY23, we expect AUM to cross Rs2.5trn as we forecast it to clock a 23% CAGR over FY20-23. The company's net profit registered a 36% CAGR over FY15-19, falling 46% y/y in FY20, on expected lines as the business model was being altered. However, the expected increase in the share of ARR assets (with comparatively higher yields) and cost rationalisation would lead to net profit clocking a 37% CAGR over FY20-23. This would result in the RoAE more than doubling, from 7% in FY20 to 18% at end-FY23. The company maintained cash and cash equivalents of ~Rs12bn at end FY20.

The company's stated dividend policy is to pay 50-75% of its annual profits as dividends. Since the dividend policy is clear, it is beneficial to investors who wish for regular dividends.

### Low attrition rate reflects strong internal process, goodwill

The wealth business is primarily relationship-driven and therefore the team leader's (TL) role is important. Over 60% of the TLs have been employed with the company for at least five years. The TL attrition rate over FY17-20 averaged 3.7%, with no attrition in Q1 FY21. At end-Q1 FY21, there were 71 team leaders and 245 RMs, totalling 316. The company on-boarded seven TLs and 37 RMs from the LTCM acquisition.

The lower TL attrition is evident on client attrition. During FY17-20, the company on average lost fewer than 2.5% of its clients per annum. These clients, moreover, contributed to less than 1% of AUM, which means the effect was minimal.

# Wealth management industry in India – An overview!

### Asia (ex Japan) forecasted to grow at a faster pace over next five years.

Global personal financial wealth clocked a 6.1% CAGR over FY13-19 to $226.4trn. North America constituted 44% of global wealth in 2019 followed by Western Europe (21%) and Asia excl. Japan (19%). Over the next five years, the global growth can clock 1.4%-4.5% CAGR. The growth in North America is expected to be muted; however Asia (excl. Japan) is expected to grow the fastest, 5.1% in the worst case and 7.4% in the best case. Within Asia, India and China are expected to be in the forefront. (Annexure for more details – Pg 30)

### Strong growth of HNIs in India.

In India, the number of high net-worth (>$1m) individuals (HNIs) clocked a 21.8% CAGR over 2014-19 to ~0.3m. Globally, however, the number of HNIs grew 5%. Ahead, over 2019-24 the number of HNIs in India and globally is expected to come at CAGRs of respectively 11.6% and 5%. The proportion of Indian in global HNIs increased from 0.3% in 2014 to 0.6% in 2019 and is expected to touch 0.8% by 2024. The number of UHNIs (>$30m) globally clocked a 5.3% CAGR over 2014-19; India's UHNIs grew 14.4%. Indian UHNIs are estimated to clock a higher 11.6% CAGR over 2019-24 than global UHNIs at 4.8%. The share of UHNIs globally increased from 0.8% in 2014 to 1.2% in 2019 and is expected to touch 1.6% in 2024. (Annexure for more details – Pg 31)

### Growth in income levels of wealthy individuals.

The number of Indians with more than Rs10m gross total income grew 17% compounded over FY14-19 to ~0.1m. Similarly, the number of individuals earning over Rs5m clocked a 20% CAGR over FY14-19 to ~0.3m. Besides the increase in number of individuals, the income held by them also rose rapidly. The total income of individuals with a gross income of more than Rs10m grew 19% compounded over FY14-19 to Rs2.7trn. Similarly, the total income of individuals with gross incomes of over Rs5m clocked a 20% CAGR over FY14-19 to Rs4.1trn. (Annexure for more details – Pg 32)

### Financial assets gaining traction.

The wealth of individuals in India registered an 11% CAGR over FY15-19 to Rs430trn (~$6trn). Financial assets constituted ~61% of individuals' wealth, indicating greater financialisation of savings. Financial assets clocked a 13% CAGR; physical assets a 9% CAGR. The share of physical assets declined from ~43% to ~39%. The total wealth of individuals is expected to rise to ~$11.5trn by FY24 (Rs800trn at the present exchange rate), a 13% CAGR; financial assets are expected to grow to $7.6trn at a 15% CAGR. (Annexure for more details – Pg 33)

### The Mutual Fund sector evolving.

With greater awareness among investors, the mutual-fund sector has evolved over the years. Sector-level AUM clocked a 16% CAGR over FY12-20 to Rs23trn. Similarly, the quarterly average assets under management (QAAUM) recorded a 21% CAGR over FY12-20 to Rs27trn.

(Annexure for more details – Pg 33-36)

### Alternative investments - strong trend in AIF inflows.

SEBI introduced the Alternative-Investment Fund (AIF) regime in 2012 so that investors could invest in alternative-asset classes such as private equity (PE), venture capital, infrastructure & real estate, private credit and hedge funds. In FY20, total commitments were Rs3.7trn (cumulative) and Rs1.5trn was invested. Funds raised were Rs1.9trn. This shows that India is an attractive destination for AIFs. Long-term sustainable growth is one of the key factors attracting private equity to the country. (Annexure for more details – Pg 38)

### India's PMS AUM growth in early double digits.

The AUM of PMS (excluding PFs) registered an 11% CAGR over FY14-FY20 (16% over FY14-19). Growth would have been higher, however, if the 11% decline in FY20 (due to stock-market volatility) is excluded. Non-discretionary products recorded a 19% CAGR over FY14-20. Similarly, advisory fees have seen a 5% CAGR over FY14-20. (Annexure for more details – Pg 39)

# Decoding business dynamics

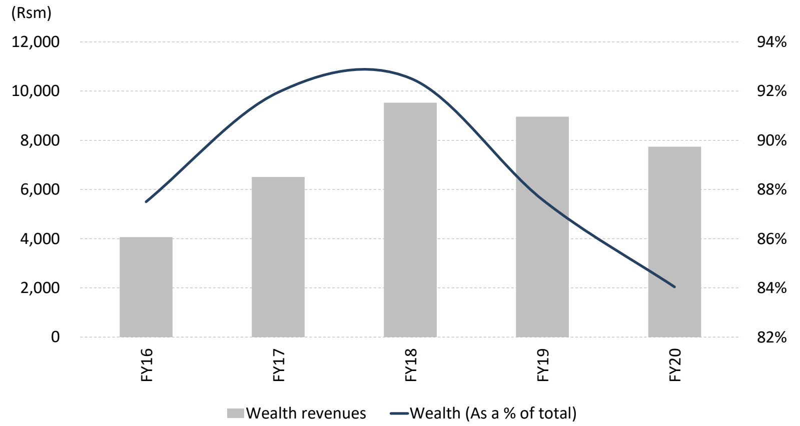
IIFL Wealth provides investment management services to UHNIs and HNIs with the aim of generating stable returns from a diversified portfolio. The businesses can be broadly classified into two parts: (i) Wealth business and (ii) AMC business. Major business lines include:

- **Discretionary and non-discretionary multi-asset-class PMS.** "Discretionary" is managing investments where decisions to buy or sell are made at the portfolio manager's discretion. "Non-discretionary" is where clients instruct portfolio manager regarding which trades to execute
- Distribution of financial products across asset classes
- Broking solutions for debt, equity, real estate, commodities and currency
- **Credit solutions**: The loan book is collateralized against clients' investments with IIFL Wealth. The loan book is usually 2-4% of AUM. No sales/distribution costs as all loans are sourced by the wealth management RMs.
- Estate and succession planning

### Wealth business still a major portion; AMC business gaining traction

WM is the major source of revenue: 84% of revenues at end-FY20 (88% at end-FY16). WM revenues are derived from PMS, distribution of mutual funds, managed accounts, structured products, etc. The wealth revenues clocked an 18% CAGR over FY16-20 to Rs7.7bn. The WM AUM increased from Rs590bn in FY16 to ~Rs1.3trn in FY20, with mutual funds distributed rising from Rs261bn to Rs464bn. Apart from its core business, the company is also into asset management, which is gaining traction. IIFL's asset management is primarily managing pooled funds under various structures such as alternative-investment funds (AIF), portfolio-management services and mutual funds. AIF is important to the asset-management business since it constitutes 70%+ of total AUM.

**Fig 7 – Core wealth revenue share in total is still majority**




*Source: Company report, Anand Rathi Research*

### Alternative investments, a key focus area in the AMC business

The company's focus is on alternative investments unlike other AMCs, which focus on mutual funds. The main business propositions are private equity, public equity, structured credit and real estate. Moreover, the company regularly crafts new strategies, which augurs well for clients' interests and results in enhancing its AUM. For example, it recently launched a mutli-asset 'long' fund on the product platform. Moreover, there is evaluation of other product ideas such as a quant fund, an asset-allocation fund, etc. The company has broadened its distribution network across the country, with 134 empanelled partners for PMS and AIF.

Its AUM of Rs220bn broadly consists of private equity (Rs88bn), public equity (Rs73bn), credit (Rs21bn) and real estate (Rs38bn). Alternative assets are considered a good tool of diversification as in general they have in the past maintained low correlations with standard assets.

The company's keen focus on asset management can be gauged from senior management hires over the last two years. In Aug'18 it hired Anup Maheshwari as the AMC's CIO who has over two decades' industry experience. Also, it set up a structured credit vertical by hiring senior people from the industry in FY19.

**Fig 8 – AMC strategy**

| | | | | |
|---|---|---|---|---|
| Private Equity (Rs88bn) | Seed Stage | Early Stage | Mid Stage | Pre-IPO |
| Public Equity (Rs73bn) | Diversified (UCITS and Domestic Funds) | Concentrated | Thematic | Long short |
| Credit (Rs21bn) | Liquid Funds | Structured Credit | Distressed credit | Infrastructure |
| Real Estate (Rs38bn) | Residential Debt | Residential Equity | Commercial | |
| Total AUM Rs219bn | | | | |

*Source: Company report, Anand Rathi research. The above data is for FY20*

The major business has been re-grouped into two parts: (i) ARR business (ii) Transactionary business.

**ARR business:** IIFL Wealth swiftly moved to focusing on an annual recurring revenue (ARR) model from the traditional broker-distributor transaction model. As the name suggests, this is essentially a recurring revenue stream earned on assets distributed. This renders such revenues stable and non-cyclical, which is an advantage especially in volatile times as this income streams is independent of transaction volumes. The ARR business model can be categorised into four major parts:

- **IIFL One:** The business in IIFL One can be broadly classified into two: discretionary PMS, non-discretionary PMS.
- **IIFL AMC:** The focus is on alternative investments unlike other AMCs, which focus on mutual funds. The main business propositions are private equity, public equity, structured credit and real estate. Moreover, the company regularly crafts new strategies, which augurs well for clients' interests and results in enhancing its AUM.
- **Third party managed funds:** It is the combination of trail commission on (i) mutual funds distributed and (ii) managed accounts distributed.
- **NBFC business:** The existing wealth clients need short-term liquidity to meet business needs. The NBFC arm lends against these clients' portfolio. Moreover, its loan-to-value (LTV) is restricted to 40-50%.

Due to low LTV and the loan book being collateralized against existing client investments, there has been no credit loss since inception.

**Fig 9 – Snapshot of ARR business**

| Rs m except yields | FY16 | FY17 | FY18 | FY19 | FY20 |
|---|---|---|---|---|---|
| **Recurring revenues** | **1,079** | **2,392** | **3,670** | **4,437** | **5,345** |
| Fees on PMS- Discretionary/Non- Discretionary (IIFL One) | 2 | 10 | 36 | 145 | 349 |
| Management Fees on funds managed by IIFL AMC | 221 | 467 | 481 | 803 | 1,465 |
| Total trail commission on third party managed funds | 856 | 816 | 1,090 | 1,267 | 1,195 |
| Trail commission on Mutual fund Distributed | 828 | 760 | 987 | 1,009 | 874 |
| Trail commission on Managed Accounts Distributed | 28 | 57 | 103 | 258 | 321 |
| NII on loans | 0 | 1,098 | 2,063 | 2,222 | 2,337 |
| | | | | | |
| **ARR assets** | **211,440** | **298,521** | **448,519** | **582,698** | **625,949** |
| Discretionary/Non- discretionary/ Advisory (IIFL One) | 739 | 2,872 | 16,656 | 87,144 | 177,203 |
| Funds managed by IIFL AMC | 54,555 | 89,388 | 133,949 | 207,726 | 219,395 |
| Third party managed funds | 156,147 | 170,111 | 230,764 | 239,846 | 193,990 |
| Mutual funds distributed | 143,030 | 154,000 | 204,780 | 192,490 | 155,760 |
| Managed accounts distributed | 13,120 | 16,110 | 25,980 | 47,360 | 38,230 |
| Loans | - | 36,150 | 67,151 | 47,983 | 35,360 |
| | | | | | |
| **Yield on AUM (Overall)** | **0.83%** | **0.98%** | **1.04%** | **0.82%** | **0.67%** |
| **Yield on AUM (Recurring)** | **0.65%** | **0.94%** | **0.98%** | **0.86%** | **0.88%** |
| Fees on PMS- Discretionary/Non- Discretionary (IIFL One) | 0.53% | 0.54% | 0.37% | 0.28% | 0.26% |
| Management Fees on funds managed by IIFL AMC | 0.53% | 0.65% | 0.43% | 0.47% | 0.69% |
| Total trail commission on third party managed funds | 0.69% | 0.50% | 0.54% | 0.54% | 0.55% |
| Mutual funds | 1.16% | 0.51% | 0.55% | 0.51% | 0.50% |
| Managed funds | 0.43% | 0.39% | 0.49% | 0.70% | 0.75% |
| Yields on loans | NA | 6.08% | 3.99% | 3.86% | 5.61% |

*Source: Company report, Anand Rathi Research*

### IIFL One, a key focus area within the ARR model

The IIFL One platform introduced by the company institutionalises a range of investment options. The business in IIFL One can be broadly classified into two: discretionary PMS, non-discretionary PMS.

- **Discretionary PMS (IIFL One Mandate**): For clients' needs and goals, a customised investment framework is created for each client specifying broad asset allocation and instrument selection. However, for any change in instrument selection (within the mandate), a clients' consent is not required. Charges are primarily in an 'All-in-One-fee' structure, where a client agrees to pay a single fee, typically between 1% and 1.5% on AUM, including third-party mutual fund fees and IIFL Wealth's fees. The All-in-One fee is for discretionary PMS only. At end-Q1 FY21, it constituted ~20% of the total IIFL One AUM (Rs37bn).
- **Non-discretionary PMS (IIFL One Consult)**: For clients' needs and goals a customized investment framework is created for each client specifying broad asset allocation and instrument selection. However for any change in instrument selection, a client's consent is required. The fee charged in this model is based on a percentage of the AUM, typically between 0.5% and 1%. At end-Q1 FY21, it constituted ~35% of the total IIFL One AUM (Rs70bn).

Three major benefits brought about this platform.

- The company does not earn any commissions from the manufacturer (the fund-management company) but rather earns a contracted fee from a client. This is a stable source of revenue by providing customised discretionary services to clients (based on requirements). Moreover, RMs would not have motivation (higher commissions) to push a particular product/offering. Instead, it would be neutral to all services available under the umbrella. The company continues to invest in products and services in IIFL One that would further enhance this proposition to clients.

- The client fee insulates earnings avenues from regulatory intervention. SEBI amended the mutual-fund regulations in which lower TER were implemented with effect from 1st Apr'19.
- Global and Indian regulators encourage contracted fees from clients as opposed to distribution fees from the originator.

## NBFC arm's support to business, crucial

In 2016, IIFL Wealth acquired a non-deposit-taking NBFC, Chephis Capital Markets (capitalisation set at Rs9bn), and renamed it IIFL Wealth Finance. The latter primarily lends to existing wealth clients against its existing portfolio. The prime objective is to provide short-term liquidity to meet business needs. Moreover, its loan-to-value (LTV) is restricted to 40-50%. Due to low LTV and the loan book being collateralized against existing client investments, there has been no credit loss since inception.

For IIFL Wealth, this is an attractive proposition as RMs provide the services; hence, no additional costs. The loan book is usually 2-4% of AUM. The funding for such lending is primarily raised via structured notes issued to existing clients. Overall it's a closed loop, set up as an enabler to allow clients to avail of all financial services under one roof.

**Transactionary**. The non-recurring revenue consists primarily of brokerage (direct equity/ commodities/currencies/fixed income) and other revenue (transactional or syndicated). With upfront commission no longer in the business model, we see a decline in such revenues in FY20. Moreover, these revenues primarily depend on transaction volumes.

**Fig 10 – Snapshot of transactionary business**

| Rs m | FY16 | FY17 | FY18 | FY19 | FY20 |
|---|---|---|---|---|---|
| **Transactionary revenues** | **3,559** | **4,687** | **6,618** | **5,794** | **3,855** |
| Brokerage income | 1,564 | 1,597 | 1,336 | 1,814 | 1,389 |
| Direct stocks | 376 | 467 | 666 | 382 | 358 |
| Structured notes & bonds | 1,188 | 1,130 | 670 | 1,432 | 1,031 |
| Other brokerage/Syndications | 630 | 279 | 460 | 394 | 2,466 |
| | | | | | |
| **Transactionary assets** | **433,607** | **685,402** | **860,908** | **972,200** | **943,023** |
| Brokerage income assets | 260,823 | 363,228 | 432,955 | 433,873 | 476,494 |
| Direct stocks | 89,670 | 174,247 | 255,242 | 275,751 | 220,878 |
| Structured notes & bonds | 171,153 | 188,981 | 177,713 | 158,122 | 255,616 |
| Third party managed funds | 158,708 | 234,726 | 275,355 | 310,452 | 253,368 |
| Mutual Funds in Regular Code | 104,255 | 130,692 | 124,259 | 129,761 | 94,908 |
| Third Party Managed funds on which upfront commissions have been earned in previous years | 54,453 | 104,034 | 151,096 | 180,691 | 158,460 |
| Mutual funds - Direct code/ Feeders | 14,076 | 87,449 | 152,598 | 227,875 | 213,161 |

*Source: Company report, Anand Rathi Research*

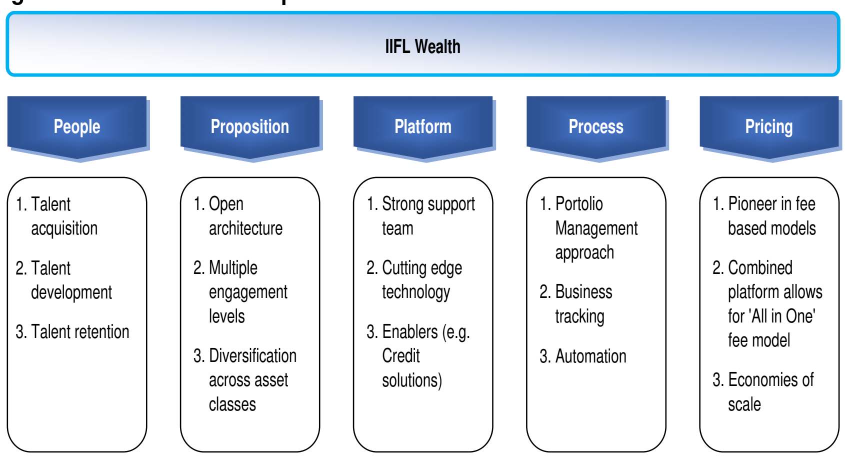
# Why IIFL Wealth?

### Unique positioning, capital preservation is core of investment strategy

IIFL Wealth has consistently been one of the top operators in the industry. Its policy is based on five pillars: People, Proposition, Platform, Process and Pricing. It continues to invest heavily in employee training to provide one of the best industry services to clients (low TL attrition, People), innovative products with diversification across asset classes (Proposition), time-tested effective services with technological support and key enablers such as integrated lending solutions (Platforms), robust internal processes with stringent control mechanisms (Process) and options of fee-based models and brokerage and allied services (Pricing).

Its core strategy is aimed at capital preservation while enhancing wealth portfolios through optimum returns. Its target clientele are risk-averse investors interested in steady, above-inflation returns with least volatility and risk. The reason is that these investors have already taken risks in their businesses and would want the money managed under the wealth outfit to be protected against market volatility.

**Fig 11 – IIFL Wealth – Chief pillars**




*Source: Company report, Anand Rathi Research*

### Consistently ranked among the top three

AUM in India's wealth-management sector (the top-20 firms) registered a 32% CAGR over 2015-19 to $232bn. IIFL Wealth is the third-largest in the wealth-management industry (by AUM), a position it has maintained in the last few years. Kotak Bank is the largest, followed by ICICI Bank Private Banking. The top four accounted for 50% of the combined AUM of the top 20. IIFL Wealth is the only pure wealth-management firm in the top 4, with a clear focus on UHNI/HNI clients; for the others the wealth-management business is an enabler to the larger banking business and has a broader focus on various client segments.

**Fig 12 – Indian wealth management - IIFL Wealth in the top three**

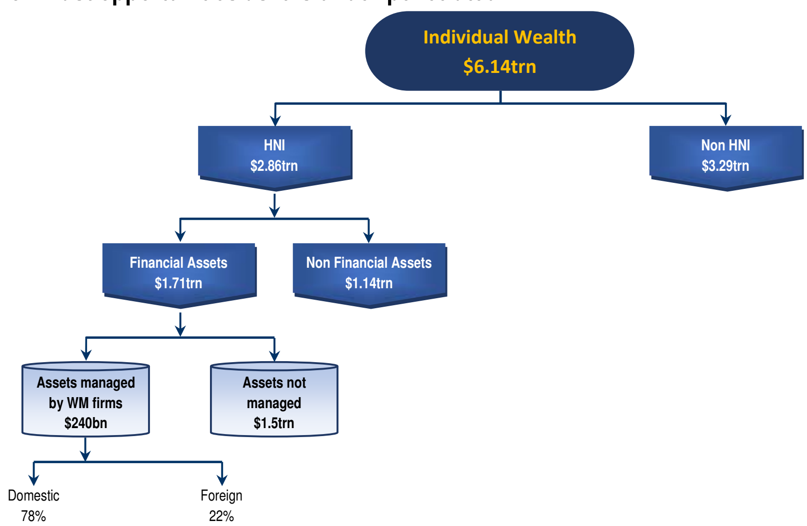
| $ bn | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|
| Kotak Wealth Management | 9.6 | 15.3 | 29.6 | 33.6 | 38.6 |
| ICICI Bank Private Banking [2] | 7.6 | 8.5 | 11.2 | 24.4 | 30.9 |
| IIFL Wealth [1] | 8.6 | 14.8 | 17.7 | 22.2 | 23.7 |
| Axis Bank Burgundy [1 3] | NA | 8.2 | 12.7 | 18.6 | 21.9 |
| **Top 4** | **25.8** | **46.8** | **71.2** | **98.8** | **115.1** |
| **Top 20** | **77.5** | **103.7** | **169.3** | **191.7** | **231.7** |

*Source: Asian Private Banker, Anand Rathi Research*
*Note: Top 20 totals are as on 31st Dec*
[1] Data provided by bank / wealth manager
[2] ICICI Bank Private Banking: AUM inclusive of mortgages
[3] Axis Bank Burgundy: AUM for 2018 was listed as $12.78bn and only included clients with more than Rs5cr in AUM with the bank

## Huge scope: Under-penetration in managing wealth

The total wealth of HNIs in India is $2.9trn. Of this, ~60% ($1.7trn) is in financial assets. However, only 14% of these assets (~$240bn) are managed by wealth mangers (WM); the rest are self-managed. This presents a huge opportunity for formal industry players to continue penetrating the market further. Of this $240 billion, IIFL Wealth's market-share is ~10%.

**Fig 13 – Vast opportunities as it is under-penetrated**

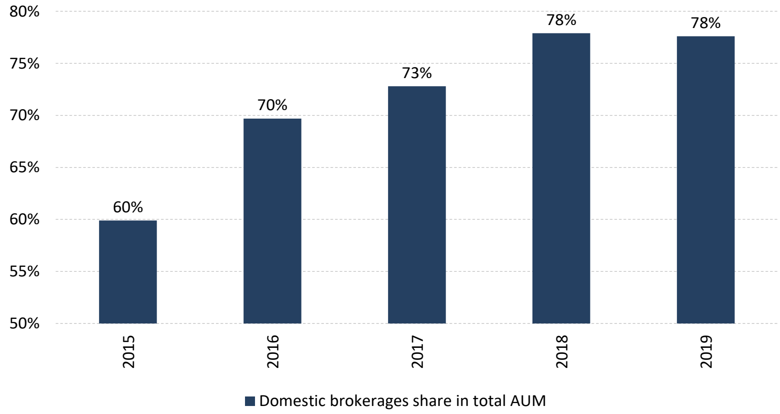



*Source: Company, Anand Rathi Research*

## Domestic WM firms increasing their share

The share of domestic firms in India's wealth-management business increased every single year over the last few years, from 60% in 2015 to 78% in 2019. This shows that HNIs have greater confidence in domestic firms managing their wealth.

**Fig 14 – Domestic companies' share in wealth management is increasing**




*Source: Asian Private Banker*

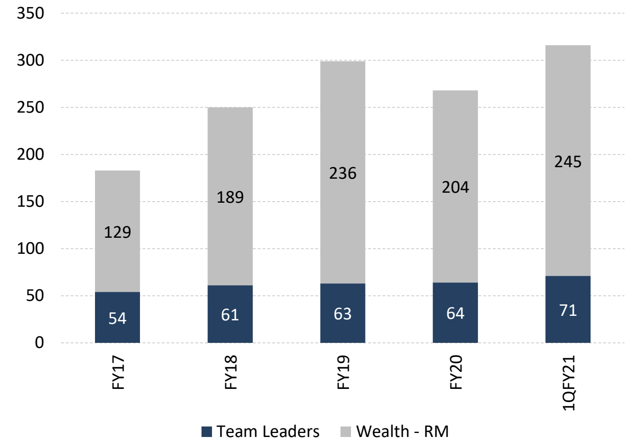
# Low attrition, increase in relevant families positive

### Team leaders, key to growth; low attrition rate, crucial . . .

The wealth business is primarily relationship-driven and requires the RMs to work closely with clients in understanding their risk appetite, return expectations and liquidity requirements. The broader industry sees client attrition if there are servicing gaps or if a senior RM leaves the company. The company has hired several senior RMs over the last 2-3 years, which should help grow the client base and is a positive.

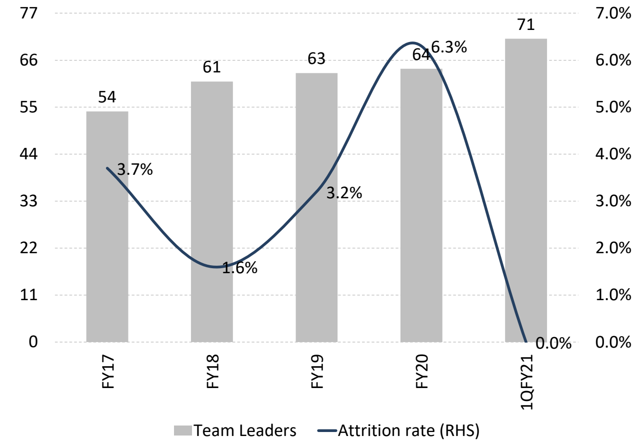
At IIFL Wealth, the RMs are organized into teams, each led by a senior team leader (TL) who is usually a senior RM with significant experience in the industry. Over 60% of the team leaders at IIFL Wealth have been with the company for at least five years. The TL attrition rate over FY17-20 averaged 3.7%, with no attrition in Q1 FY21. At end-Q1 FY21, there were 71 team leaders and 245 RMs, totalling 316. The company on-boarded seven TLs and 37 RMs from the LTCM acquisition.

**Fig 15 – RMs divided into teams**




*Source: Company report, Anand Rathi Research*

**Fig 16 – Low attrition rate in TLs**

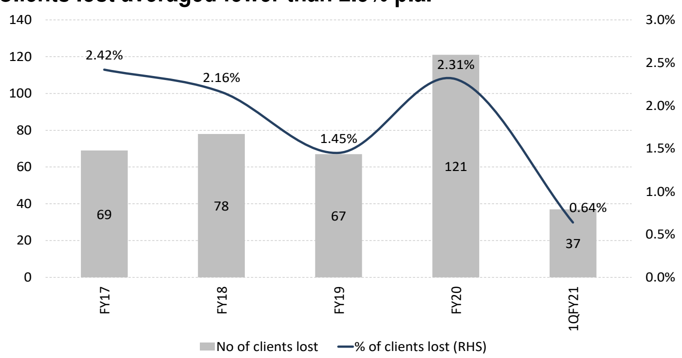



*Source: Company report, Anand Rathi Research*

### . . . reflected even in better client retention

The impact of the high retention rate of employees is reflected in the client attrition rate. During FY17-20, the company on average lost fewer than 2.5% of its clients per annum. These clients, moreover, contributed to less than 1% of AUM, which means the effect was minimal.

**Fig 17 – Clients lost averaged fewer than 2.5% p.a.**

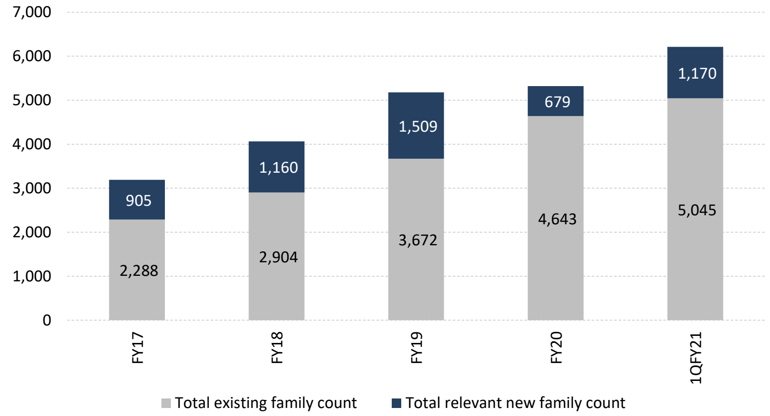



*Source: Company report, Anand Rathi Research*

## Strong growth in relevant families

The number of relevant families (with over Rs10m AUM excl. custody assets) rose from ~3,200 in FY17 to ~5,300 at end-Q4 FY20. The LTCM acquisition gave the company more than 900 families in Q1 FY21, the quarter ending with 6,215 families. On average, 18% of AUM came from new families during FY17-19, dropping to 9% in FY20 amidst volatile markets. In Q1 FY21, this figure was 8.4%.

**Fig 18 – The number of relevant families has consistently increased each year**




*Source: Company report, Anand Rathi Research*

# Regulations change; IIFL Wealth already prepared

From time to time SEBI has been introducing regulations that directly affect the wealth management business across industry players. However, IIFL Wealth was already prepared. The company had already moved (in 2017) to the trail-commission model for all distribution commissions from mutual funds (exception: closed-end funds). Similarly, for all managed accounts, commissions earned were on the trail model with effect from 1st Apr'19. Moreover, even for AIFs, commission was on the trail basis although upfront commissions could be earned according to regulatory norms. Thus, the company that had been advocating the change had already altering its business model. (Annexure for more details – Pg 40,41)

### Why "fee paying" is more suitable than "upfront" in the long term

We have assumed a model portfolio of Rs100, where 20% of a client's portfolio is invested in mutual funds, 30% in managed accounts (PMS plus AIF), 30% in bonds and structured products, and 20% directly in stocks. We evaluate the earnings over five years on both the platforms.

In an upfront model, a wealth-management company earns 2.5% on the churn and new flows plus transaction charges (10bps assumed). Also, on investing directly in stocks the company doesn't earn any income. The new flows are assumed to be 5% a year from the second year. Portfolio gains are assumed at 7%.

In the fee-paying/recurring-revenue model, the company earns on the entire portfolio. We have assumed it at 0.5% fee income plus transaction charges (10bps assumed). The new flows are assumed to be 5% a year from the second year. Portfolio gains are assumed at 7%.

Based on a five-year analysis, it can be concluded that the fee-paying/ recurring-revenue model brings in 4-5bps higher income than the upfront model.

**Fig 19 – Upfront vs Fee paying**

| | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 |
|---|---|---|---|---|---|
| Upfront | 0.50% | 0.59% | 0.58% | 0.56% | 0.55% |
| Fee paying | 0.60% | 0.63% | 0.62% | 0.61% | 0.60% |

*Source: Anand Rathi Research*

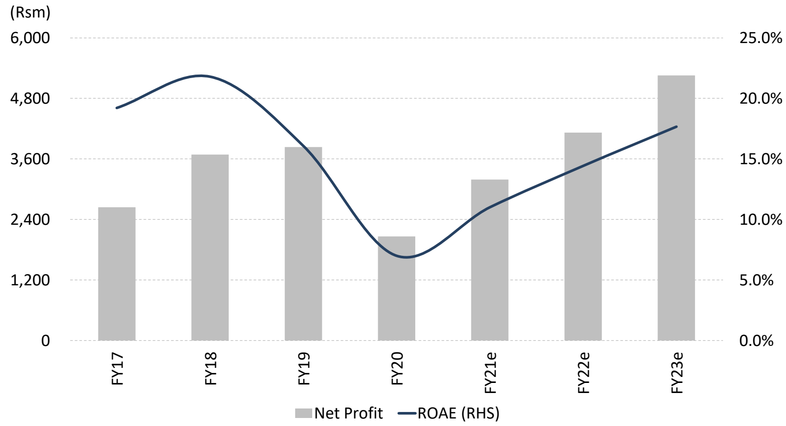
# Future growth & prospects

### Net income to grow 37% CAGR over FY20-23E

The company's net profit registered a 36% CAGR over FY15-19, declining 46% y/y in FY20, on expected lines as the business model was being altered. However, the expected increase in the share of ARR assets (with comparatively higher yields) and cost rationalisation would lead to net profit clocking a 37% CAGR over FY20-23. This would result in the RoAE more than doubling, from 7% in FY20 to 18% at end-FY23.

The net income growth is expected because of two reasons: 1) AUM growth and 2) Rationalisation of costs

**Fig 20 – Rebound in return ratios**



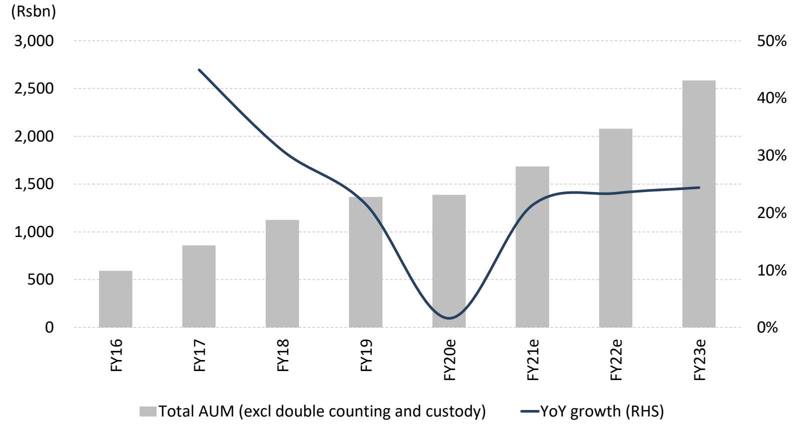

*Source: Company report, Anand Rathi Research*

### AUM growth expected to clock a 23% CAGR over FY20-23

IIFL Wealth's AUM (ARR + transaction assets) recorded a 24% CAGR over FY15-20 to Rs1.6trn. Excl. double-counting, a 22% CAGR over FY15-20 was seen, to Rs1.4trn. By FY23, we expect AUM to cross Rs2.5trn as we forecast it to clock a 23% CAGR over FY20-23.

The company's shift in focus to recurring revenue-earning assets (55% of AUMs by FY20-23 from 40% in FY20) augurs well for the long run. AUM growth was a meagre 2% in FY20 (excl. double counting) following 22-45% annual growth over FY17-19. Net new money (inflows) were 7% of opening AUMs in FY20 following 14-36% growth over FY17-19. Its AUMs delivered 12% and 6% MTM growth in respectively FY18 and FY19 but reported a 12% loss in FY20 owing to market volatility brought on by Covid'19. Thus, AUM growth depends on MTM performance, which is unpredictable and volatile. In Q1 FY21, the company reported net new money of Rs9bn, inorganic growth of Rs99bn (the LTCM acquisition) and reported a positive MTM performance.

**Fig 21 – AUM growth expected at a 23% CAGR over FY20-23**




*Source: Company report, Anand Rathi Research*

## Inorganic growth, part of strategy; L&T Capital Markets acquisition, the latest in the list

IIFL Wealth has been strategising to grow inorganically by acquiring companies regularly. It acquired L&T's Capital Market (LTCM) business for Rs2.3bn plus LTCM's available cash balance. The acquisition is of only the sales and product segments of the business (the operations and corporate functions were excluded from the deal).

The company acquired L&T's wealth business owing to

- Cultural fit between the two companies.
- According to management, yields earned by the L&T wealth division could be increased further by 10-15bps, which made it logical to acquire and thus an attractive business proposition.
- L&T's wealth business bought ~Rs100bn, of which about 55-60% is ARR, the rest was transactional. Thus, the company has a readymade ARR pool which can be further enhanced with its own proposition.

Ahead, it will explore opportunities to acquire companies that can strengthen its position in the wealth-management arena. However, it maintained that it would be selective in acquisitions, depending on size and cultural fit.

**Fig 22 – Inorganic growth timeline**

| 2011 | 2013 | 2016 | 2018 | 2018 | 2019 |
|---|---|---|---|---|---|
| **Acquired** 'Finest Wealth Managers' Pune | **Acquired** an asset management company and a private equity firm | **Acquired** an NBFC, Chephis Capital, and renamed it IIFL Wealth Finance | **Acquired** Wealth Advisors India, Chennai, for Rs2.35bn | **Acquired** Altiore Advisors, Bengaluru for Rs92m | **Acquired** sales and products of L&T Finance Holdings' wealth management business for Rs2.3bn (excl. the corporate and operational segments) |
| **Rationale** Added Rs17bn to its AUM | **Rationale** Launch of zero fixed fees; only success-fee based AIF | **Rationale** The NBFC arm provides loans against securities to meet business requirements. It is a major part of recurring revenues | **Rationale** Strong operations in southern India. In Sep'18, it had assets of ~Rs110bn, with 1,275 clients. | **Rationale** The online platform integrates technology and data that allows customers to effectively manage their net worth by providing consolidated data across managers | **Rationale** AUM of Rs100bn and ~35 RMs with over half of its AUM coming from ARR, with a cultural fit |

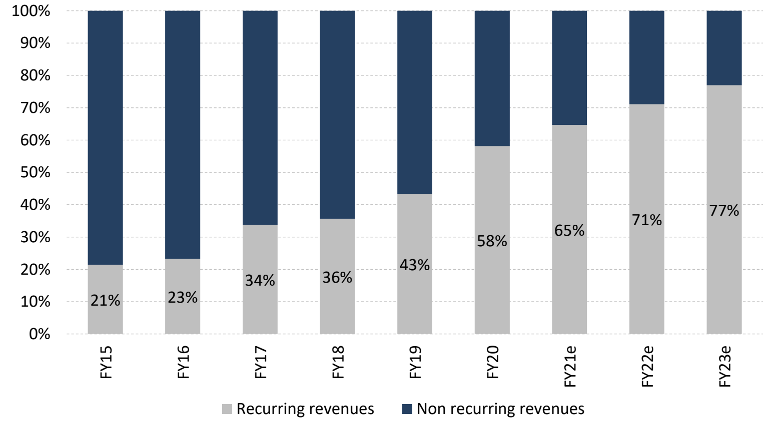
*Source: Company report, Anand Rathi research*

## ARR model, the chief focus area, future growth driver; non-recurring revenue from a smaller pie

The company's focus is to increase its ARR bucket every year. The share of ARR revenues in total revenues (excl. other income) has risen substantially in the last few years (from 21% in FY15 to 43% in FY19 and 58% in FY20). We expect the share of ARR to increase further to 77% by FY23. ARR clocked a 47% CAGR over FY15-20 to Rs5.3bn, and we expect a 21% CAGR over FY20-23.

The non-recurring revenue is primarily dependent on transaction volumes. With upfront commission no longer in the business model, we see a decline in such revenues in FY20. Ahead, we expect a 10% decline over FY20-23.

**Fig 23 – ARR revenue in total revenues is increasing**



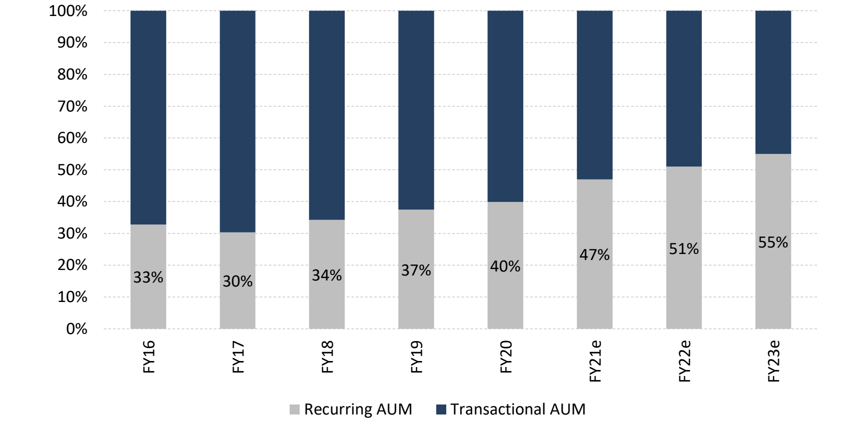

*Source: Company report, Anand Rathi Research*

The ARR AUM (excl. custody) clocked a 39% CAGR over FY15-20 to ~Rs626bn. The recurring AUM share in total AUM is increasing, from 22% in FY15 to 40% in FY20 (excl. custody). In FY20, funds managed by the IIFL AMC constituted ~35% of ARR AUM (averaging 30% over FY15-20) followed by IIFL One assets at 28% (averaging 10% over FY16-20), third-party-managed funds comprising 31% of ARR AUM (averaging 55% over FY15-20); the remaining 6% was from the loan book of the NBFC arm (averaging 10% over FY17-20). Ahead, we expect the share of ARR AUM to increase to 55% by FY23.

Transaction/brokerage assets clocked a 17% CAGR over FY15-20 to ~Rs943bn. The share of non-recurring AUM in total AUM is declining, from 78% in FY15 to 60% in FY20 (excl. custody). Ahead, we expect the share of transaction/brokerage in total AUM to fall to 45% by FY23.

Thus, as the company focuses on recurring assets and on its ability to generate sustainable revenues, the proportion of non-recurring assets is expected to shrink. However, the company maintains that even in the long term, the non-recurring segment would still be a part of the business as there would be a clientele base favouring the transaction structure.

**Fig 24 – Share of ARR AUM in total is increasing**

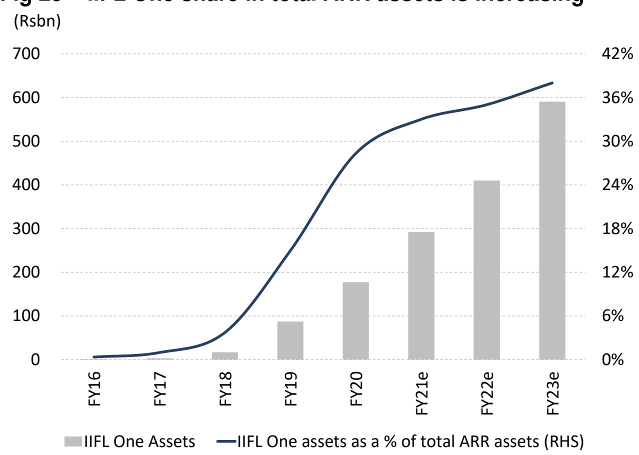



*Source: Company report, Anand Rathi Research*

### IIFL One, the key enabler of future growth

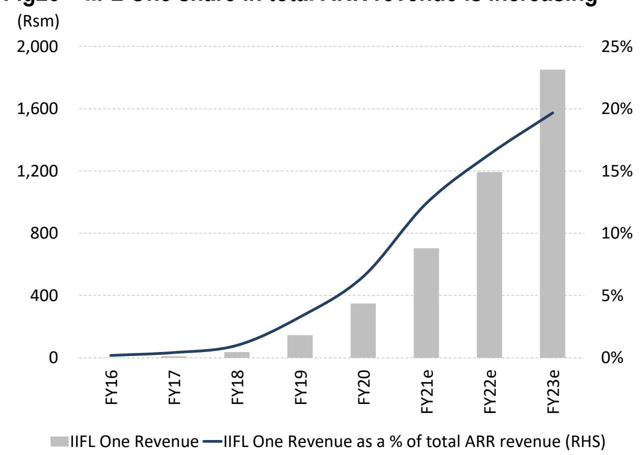
The assets under IIFL One doubled annually in FY20 to Rs177bn, indicating that clients are ready to pay within this proposition owing to the transparent fee structure. We expect IIFL One AUM to clock a 49% CAGR over FY20-23 to Rs590bn, constituting 38% of ARR AUM. The company reported a yield of 26bps on IIFL One in FY20. It maintains that the yield on IIFL One is higher, at around 40bps, as 15-20% of IIFL One's assets are not chargeable since they are classified as 'stocks in basket'.

**Fig 25 – IIFL One share in total ARR assets is increasing**




*Source: Company report, Anand Rathi Research*

**Fig26 – IIFL One share in total ARR revenue is increasing**



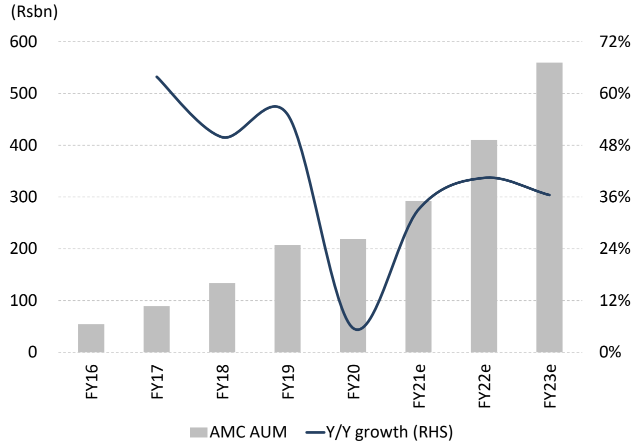

*Source: Company report, Anand Rathi Research*

### Alternatives business expected to grow further

AIFs constitute 70%+ of the AMC AUM. The AUM increased from Rs54bn in FY16 to ~Rs220bn in FY20, with AIF increasing from Rs41bn to Rs160bn. We expect the AMC AUM to clock a 37% CAGR over FY20-23 to Rs559bn.

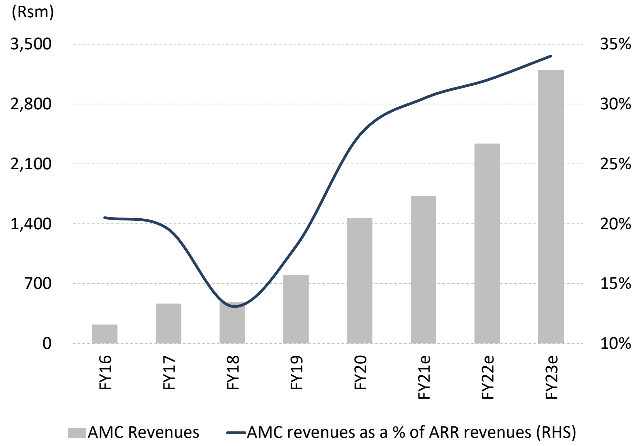
AMC revenues clocked a 58% CAGR over FY15-20 to Rs1.5bn. Ahead, with more business we expect it to clock a 30% CAGR over FY20-23 to Rs3.2bn.

**Fig 27 – Asset management AUM expected to register strong growth**




*Source: Company report, Anand Rathi Research*

**Fig 28 – Share of AMC revenues in total ARR revenue is increasing**

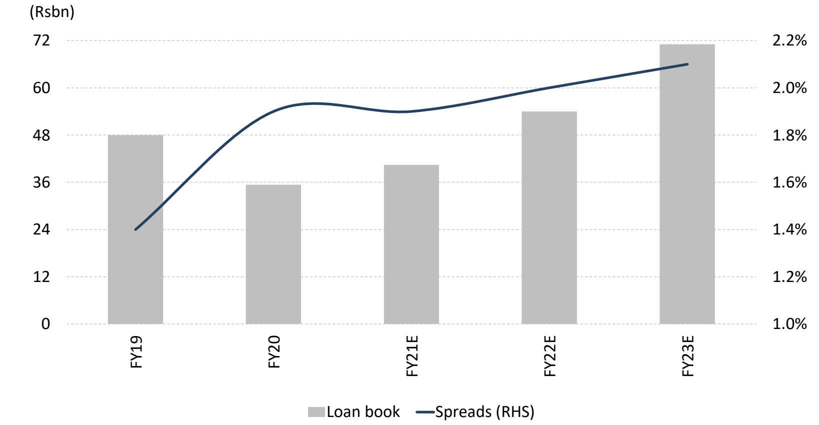



*Source: Company report, Anand Rathi Research*

## NBFC loan book to clock 25% CAGR over FY20-23

At end-FY20, the loan book was ~Rs35bn, declining in the last three years. However, as the AUM expands, we anticipate the NBFC book to increase over the forecast period. The loan book is expected to clock a 25% CAGR over FY20-23 to Rs71bn (~2.8% of AUM).

**Fig 29 – Loan book expected to grow faster in the forecast period**



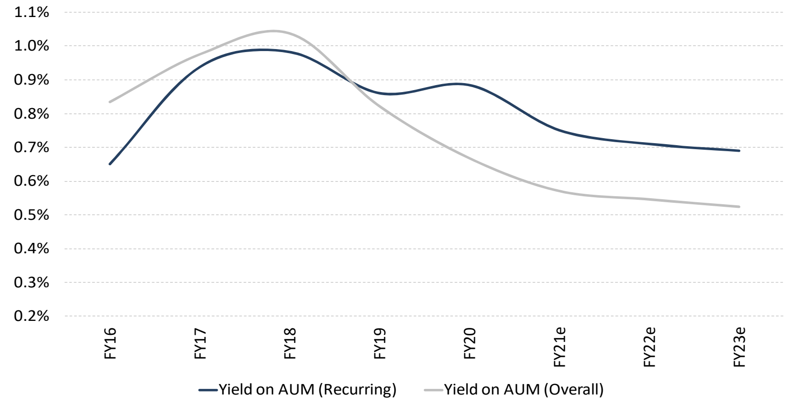

*Source: Company report, Anand Rathi Research*

## Yields expected to soften

We expect the yields to moderate as the company moved away from the traditional upfront model to a primarily recurring-revenue model with a clear focus on IIFL One.

The yield on overall AUM fell from 83bps at end-FY16 to 67bps at end-FY20, which we expect to fall further to 52bps by FY23. However, this moderation is on expected lines and the company intends to increase its AUM to boost its revenue growth.

**Fig 30 – Yields expected to soften**



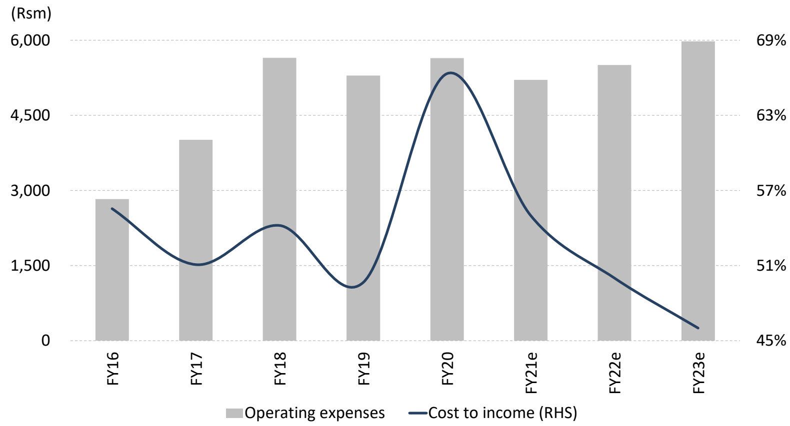

*Source: Company report, Anand Rathi Research*

## Ahead, cost-to-income to ease further

The cost-to-income ratio averaged 55% over FY15-20. In FY20, costs jumped considerably. On expected lines, due to the rise in employee costs the cost-to-income ratio was 66%. Higher employee expenses stemmed from ESOPs to new employees, especially new hires in the asset-management business, and the retention-bonus program as the company was changing its business model.

However, we expect costs ahead to decline due to admin and employee cost rationalisations. In Q1 FY21, the cost-to-income ratio had already declined to 54%. Employee costs (fixed plus variable) are expected to hold at ~Rs3.8bn-4.1bn over the forecast years. Moreover, the focus would be to control administrative and other expenses.

**Fig31 – Cost-to-income to decline further over the next 2-3 years**

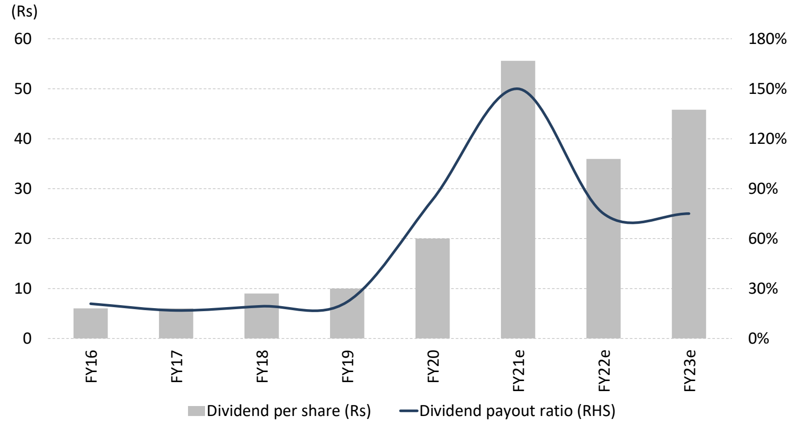



*Source: Company report, Anand Rathi Research*

## Higher and stable dividends boost investor confidence

The company's stated dividend policy is to pay 50-75% of its annual profits as dividends. In FY20, it announced interim dividends of Rs10 a share in Oct'19 and Jan'20 each. In Aug'20, it announced a one-time special dividend of Rs40. Since the dividend policy is clear, it is beneficial to investors who wish for regular dividends. We expect a dividend-payout ratio of 75% each in FY22 and FY23.

**Fig 32 – Consistent dividend is the company's policy**




*Source: Company report, Anand Rathi Research*

# Valuation

We value IIFL Wealth at 20x FY23e EPS to arrive at a price target of Rs1,193, which implies 28% potential from the ruling Rs931. At present, the stock trades at ~16x FY23e EPS. We are positive on the company for its (i) niche position in the under-penetrated wealth-management business, (ii) innovative products, (iii) strong TL-lead RM team, (iv) low attrition of clients and TLs and (v) long-term growth potential.

No core wealth-management firms are listed on the bourses as such a business is embedded in the structure of large banks. The closest comparable businesses are asset management: HDFC AMC and Reliance Nippon AMC. Globally, Schroder's, Blackrock and Charles Schwab are in the wealth-management business.

**Fig 33 – Relative valuation**

| Name of the Company | M Cap ($ m) | P/E (x) | | | P/B (x) | | | RoE (%) | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | FY21e | FY22e | FY23e | FY21e | FY22e | FY23e | FY18 | FY19 | FY20 |
| HDFC Asset Management Co. | 6,688 | 38.2 | 33.4 | 28.8 | 10.7 | 9.5 | 8.2 | 38.7 | 35.0 | 35.6 |
| Nippon Life India Asset Management | 2,243 | 31.8 | 28.0 | 24.5 | 6.1 | 5.8 | 5.6 | 21.5 | 19.7 | 16.1 |
| IIFL Wealth Management | 1,105 | 25.7 | 19.9 | 15.6 | 2.9 | 2.8 | 2.7 | 21.8 | 16.1 | 7.0 |
| Name of the Company | | | | | | | | | | |
| | | FY20e | FY21e | FY22e | FY20e | FY21e | FY22e | FY17 | FY18 | FY19 |
| Blackrock | 93,845 | 20.3 | 18.4 | 16.7 | 2.8 | 2.7 | 2.5 | 16.3 | 13.4 | 13.6 |
| Charles Schwab Corp, The | 71,676 | 18.1 | 21.0 | 20.2 | 1.9 | 1.8 | 1.7 | 14.9 | 19.9 | 19.2 |
| Schroders PLC | 9,735 | 16.1 | 15.0 | 14.1 | 1.9 | 2.2 | 2.1 | 18.0 | 14.3 | 13.4 |

*Source: Bloomberg, Anand Rathi Research*

### Scenario analysis – Base, Bear and Bull

We have prepared bull and bear scenarios. The bull case assumes 28% AUM growth; the bear case, 10%. Our base case assumption is 23% AUM growth.

**Bull case**

We have assumed AUM to clock a 28% CAGR over FY20-23 (vs. 23% for the base case). We expect a 14% CAGR over FY20-23 in revenues (excl. others) to Rs13.5bn (vs. Rs12.2bn for the base case). The cost-to-income ratio is similar to that of the base case. Net profit is expected to register a 41% CAGR over FY20-23 to Rs5.8bn (vs. Rs5.3bn for the base case).

In the bull case, we value the company at Rs1,653 (25x FY23e EPS), 78% up from the current price.

**Bear case**

We have assumed AUM clocking a 10% CAGR over FY20-23 (vs. 23% for the base case). We expect revenues to be flat (excl. others) to Rs9.2bn over FY20-23 (vs. Rs12.2bn for the base case). The cost-to-income ratio is similar to that of the base case. Net profit is expected to record a 24% CAGR over FY20-23 to Rs4bn (vs. Rs5.3bn for the base case).

In the bear case, we value the company at Rs.674 (15x FY23e EPS), 28% down from the current price.

**Fig 34 – Bull case**

| (Rs m) | FY19 | FY20 | FY21e | FY22e | FY23e |
|---|---|---|---|---|---|
| AUM | 1,366,006 | 1,387,916 | 1,762,653 | 2,256,196 | 2,910,493 |
| *Y/Y growth* | | *2* | *27* | *28* | *29* |
| Revenues | 10,231 | 9,200 | 8,997 | 10,981 | 13,551 |
| *Yield (bps)* | | *0.67* | *0.57* | *0.55* | *0.52* |
| PBT | 5,370 | 2,864 | 4,372 | 5,883 | 7,779 |
| *Expenses (%)* | *48* | *69* | *51* | *46* | *43* |
| PAT | 3,838 | 2,064 | 3,274 | 4,405 | 5,825 |
| *Tax rate (%)* | *28.5* | *27.9* | *25.1* | *25.1* | *25.1* |
| EPS | 44.44 | 23.43 | 37.15 | 49.99 | 66.10 |
| **Target PE multiple (FY23e)** | **25** | | | | |
| **Target price (Rs)** | **1,653** | | | | |
| **Upside (%)** | ***78*** | | | | |

*Source: Anand Rathi Research*

**Fig 35 – Bear case**

| (Rs m) | FY19 | FY20 | FY21e | FY22e | FY23e |
|---|---|---|---|---|---|
| AUM | 1,366,006 | 1,387,916 | 1,512,828 | 1,664,111 | 1,847,164 |
| *Y/Y growth* | | *2* | *9* | *10* | *11* |
| Revenues | 10,231 | 9,200 | 8,284 | 8,681 | 9,209 |
| *Yield (bps)* | | *0.67* | *0.57* | *0.55* | *0.52* |
| PBT | 5,370 | 2,864 | 4,025 | 4,651 | 5,287 |
| *Expenses (%)* | *48* | *69* | *51* | *46* | *43* |
| PAT | 3,838 | 2,064 | 3,014 | 3,482 | 3,959 |
| *Tax rate (%)* | *28.5* | *27.9* | *25.1* | *25.1* | *25.1* |
| EPS | 44.44 | 23.43 | 34.20 | 39.52 | 44.92 |
| **Target PE multiple (FY23e)** | **15** | | | | |
| **Target price (Rs)** | **674** | | | | |
| **Upside (%)** | **-28** | | | | |

*Source: Anand Rathi Research*

## Key risks

- **Volatile capital markets affecting net flows, AUM growth:** Volatility in capital markets persist especially after the uncertainty due to Covid'19. This could lead to abnormal losses/profits in client portfolios. Coupled with a drop in new wealth creation, this may slow the speed of estimated growth in the overall wealth industry, which may result in slower AUM growth for IIFL Wealth.

- **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 conversion of clients to this proposition may be slower than expected; also pricing pressures may arise as other competitors also move to similar models.

- **Great dependence on senior team leaders:** The company is dependent on senior team leaders to retain and expand the client base over the long term. Any large attrition in team leaders may lead to a corresponding increase in client attrition.

- **Regulatory issues:** Many regulatory changes have been introduced in the last few years, altering the dynamics of the business. SEBI has compulsorily changed MF commissions from upfront to trail, which though beneficial in the long run, has led to lower revenues and even lower pay-outs to RMs in the short term. Moreover, any further changes may harm the company's growth.

# Structure and key terms

The erstwhile IIFL Group comprised three businesses, which have now been hived off into separate listed entity:

- IIFL Finance
- IIFL Wealth Management and
- IIFL Securities.

Fig 36 – IIFL – At a glance


*Source: Company*

## Major terms

- **Annual recurring revenue (ARR):** This is essentially the total of client fees and distribution-based trail commissions along with net interest income (NII) earned on the NBFC book. As the word suggests, it offers an annual income stream and is earned irrespective of the number of transactions.
- **Custody assets:** These are promoter assets in the depository. They are in general dormant and provide no yield on an ongoing basis.
- **Double-counted assets**: AMC funds distributed by the wealth management team
- **Trail commission:** Recurring fees paid by the manufacturer to a distributor until an investment is withdrawn.
- **Upfront commission:** A one-time payment to a distributor by a mutual fund on selling a fund scheme to an investor.
- **Discretionary PMS:** The client consent is not required for each transaction; decisions are made by an investment manager on behalf of clients.
- **Non-discretionary PMS:** The client is involved at every step of portfolio management. The investment manager merely follows a client's instructions.
- **QAAUM:** The figure of quarterly average assets under management**.**
- **Managed funds:** PMS and AIF together are categorized as managed funds.

# About IIFL Wealth

IIFL Wealth is one of the fastest growing private wealth management firms in India with an AUM greater than USD25bn *(as at 30th June 2020)*. The company serves highly specialized and sophisticated needs of high net worth and ultra-high net worth individuals, affluent families, family offices and institutional clients through a comprehensive range of tailored wealth management solutions.

## Key management

**Promoter & Non-Executive Director Nirmal Jain.** Rank-holder chartered accountant and cost accountant. Has a PGDM (post-graduate diploma in management) from The Indian Institute of Management (IIM), Ahmedabad. Under his leadership, the brand has attained a pivotal position, dominant and diversified in financial services.

**Promoter & Non-Executive Director R. Venkataraman.** Bachelors in Electronics and Electrical Communications Engineering from IIT, Kharagpur. Has a PGDM from the IIM, Bengaluru. Held senior managerial positions in ICICI, including ICICI Securities, its investment banking joint-venture with J P Morgan, USA, and Barclays. Was Assistant Vice-President, (private equity) G E Capital Services India. Varied experience of more than 28 years in financial services

**Chairman and Independent Director Nilesh Vikamsey** is a senior partner at Khimji Kunverji & Co. Was President of the ICAI. B.Com., R.A. Podar College, Mumbai. Chartered accountant; diploma in information systems audit from the ICAI.

**Promoter, Managing Director and CEO Karan Bhagat** was previously Senior Vice-President, Kotak Mahindra Wealth Management. Over two decades' experience in financial services. B.Com, St. Xavier's College, Kolkata; Master's in Finance from IIM, Bengaluru.

**Co-founder and Non-Executive Director Yatin Shah** focuses on the wealth practice besides client services, marketing and client experience. More than two decades' experience in financial services across equity research and private wealth management. MS, Finance, Caas Business School, France.

**CIO, IIFL AMC, Anup Maheshwari** is responsible for devising strategies for the AMC business growth. For over two decades was CIO, DSP Investment Managers Pvt. Ltd. Was associated with HSBC Asset Management (India) Pvt. Ltd. and Merrill Lynch India Equities Fund (Mauritius). Graduated from Sydenham College, Mumbai; Master's, IIM, Lucknow.

**Chief Operating Officer Anshuman Maheswary** is responsible for designing and implementing business strategies besides setting comprehensive goals for performance and growth. More than 20 years' experience in management consulting. B.Com. St. Xavier's College, Kolkata; Master's, Strategy & Finance, IIM, Bengaluru.

**Executive Director Anirudha Taparia** is responsible for the wealth practice across business verticals and regions. More than two decades' experience in financial services across consumer, commercial and private banking. B.Com. Shri Ram College of Commerce, Delhi; PGDM, Finance, Symbiosis, Pune.

# Annexure

## Wealth management business in India

### Asia in a bright spot, globally

Growth of personal financial assets in western countries has stagnated. In Asian countries, however, these are growing faster along with better growth forecasts. These, coupled with rising millionaires, will drive growth in the global wealth-management segment. Within Asia, India and China are expected to be in the forefront.

### North America growth restrained; Asia forecast to be the torch-bearer

Global personal financial wealth clocked a 6.1% CAGR over FY13-19 to $226.4trn. *(Source: BCG)* In 2019, it grew 10% y/y. North America constituted 44% of global wealth in 2019 followed by Western Europe (21%) and Asia excl. Japan (19%). North America's personal financial wealth clocked a 5.4% CAGR over 2013-19. Western Europe and Asia excl. Japan clocked respectively 4.1% and 11.5% CAGRs over 2013-19.

According to BCG, three scenarios have been forecast for global wealth over 2019-24. Scenario 1 (a quick rebound) a 4.5% CAGR to $282trn; Scenario 2 (slow recovery) a 3.2% CAGR to $265trn; Scenario 3 (lasting damage) a 1.4% CAGR to $243trn.

All regions will have similar scenarios. Even in the best case, North America will clock a 3.7% CAGR over 2019-24, whereas in the worst case it is expected to decline 0.6%. On the other hand, Asia (excl. Japan) is expected to grow the fastest, 5.1% in the worst case and 7.4% in the best case. Thus, Asia is the focus for all global wealth-management companies. In all scenarios, Asia (excl. Japan) will replace Western Europe and occupy the second position across the globe.

BCG estimates the covid'19-triggered recession and volatile markets could shrink global wealth by $16trn, a 7% drop, and would cut into growth for five years. During the 2008 financial crisis, wealth shrank by $10trn, or 7.9%. Leading financial institutions say that Covid'19-related volatility led to clients being cautious, concerned as they are with wealth preservation and re-balancing portfolios. Moreover, this is an opportunity for wealth managers to expand their businesses as people have become aware that wealth-management firms have advantages in better assessing market-related risks owing to the experience and talented pool of wealth managers.

### Strong growth in HNIs in India

In India, the number of high net-worth (>$1m) individuals (HNIs) clocked a 21.8% CAGR over 2014-19 to ~0.3m. *(Source: Global Data Wealth Insight 2020 by Knight Frank)*. Globally, however, the number of HNIs grew 5%. Ahead, over 2019-24 the number of HNIs in India and globally is expected to come at CAGRs of respectively 11.6% and 5%. The proportion of Indian in global HNIs increased from 0.3% in 2014 to 0.6% in 2019 and is expected to touch 0.8% by 2024. The number of UHNIs (>$30m) globally clocked a 5.3% CAGR over 2014-19; India's UHNIs grew 14.4%. Indian UHNIs are estimated to clock a higher 11.6% CAGR over 2019-24 than global UHNIs at 4.8%. The share of UHNIs globally increased from 0.8% in 2014 to 1.2% in 2019 and is expected to touch 1.6% in 2024. The rise in HNIs over the years in India has been for various reasons: (i) competitive wages, (ii) favourable economic growth and (iii) increase in entrepreneurs.

The growth in wealth management would also be driven by the rise in financial savings over the past few years.

**Fig 37 – The number of HNIs in India is rising faster than the global average**

| | HNIs ( $1m+) | | | | % CAGR | | UHNIs ( $30m+) | | | | % CAGR | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2014 | 2018 | 2019 | 2024 | 2014-19 | 2019-24 | 2014 | 2018 | 2019 | 2024 | 2014-19 | 2019-24 |
| **World** | **39,404,042** | **46,903,189** | **49,951,390** | **63,850,414** | *4.9* | *5.0* | **396,368** | **482,176** | **513,244** | **649,331** | *5.3* | *4.8* |
| Africa | 242,765 | 290,396 | 302,360 | 400,612 | *4.5* | *5.8* | 4,070 | 4,428 | 4,501 | 5,934 | *2.0* | *5.7* |
| **Asia** | **8,896,337** | **12,424,494** | **13,766,435** | **19,118,434** | ***9.1*** | ***6.8*** | **69,528** | **91,547** | **103,335** | **148,758** | ***8.2*** | ***7.6*** |
| Australasia | 1,267,597 | 1,662,208 | 1,776,379 | 2,377,618 | *7.0* | *6.0* | 4,510 | 5,726 | 5,931 | 7,724 | *5.6* | *5.4* |
| Europe | 11,020,004 | 13,129,452 | 13,449,998 | 17,882,760 | *4.1* | *5.9* | 97,031 | 106,164 | 110,846 | 135,966 | *2.7* | *4.2* |
| Latin America | 1,044,941 | 1,049,214 | 1,060,600 | 1,232,445 | *0.3* | *3.0* | 15,981 | 14,148 | 14,190 | 16,536 | *-2.3* | *3.1* |
| Middle East | 801,878 | 1,095,018 | 1,138,544 | 1,357,098 | *7.3* | *3.6* | 10,043 | 14,169 | 14,178 | 16,581 | *7.1* | *3.2* |
| North America | 15,525,673 | 16,631,344 | 17,809,103 | 20,688,860 | *2.8* | *3.0* | 183,236 | 235,989 | 249,900 | 305,064 | *6.4* | *4.1* |
| | | | | | | | | | | | | |
| Russia | 604,847 | 621,063 | 647,971 | 792,587 | *1.4* | *4.1* | 11,969 | 10,005 | 10,363 | 12,768 | *-2.8* | *4.3* |
| Argentina | 90,861 | 99,523 | 89,384 | 85,954 | *-0.3* | *-0.8* | 971 | 880 | 831 | 799 | *-3.1* | *-0.8* |
| Australia | 1,087,620 | 1,440,070 | 1,546,203 | 2,068,583 | *7.3* | *6.0* | 2,820 | 3,610 | 3,796 | 4,881 | *6.1* | *5.2* |
| Brazil | 355,138 | 328,930 | 332,556 | 400,405 | *-1.3* | *3.8* | 5,800 | 4,776 | 4,812 | 5,794 | *-3.7* | *3.8* |
| Canada | 1,113,383 | 1,252,778 | 1,352,560 | 2,168,570 | *4.0* | *9.9* | 7,705 | 8,857 | 9,325 | 11,928 | *3.9* | *5.0* |
| China | 4,814,145 | 6,770,632 | 7,351,168 | 11,587,891 | *8.8* | *9.5* | 41,167 | 53,695 | 61,587 | 97,082 | *8.4* | *9.5* |
| Egypt | 44,827 | 47,030 | 57,686 | 95,819 | *5.2* | *10.7* | 740 | 670 | 764 | 1,269 | *0.6* | *10.7* |
| France | 1,795,652 | 2,106,033 | 2,120,079 | 2,805,689 | *3.4* | *5.8* | 17,524 | 17,399 | 18,776 | 22,728 | *1.4* | *3.9* |
| Germany | 1,679,363 | 2,220,557 | 2,208,163 | 2,675,328 | *5.6* | *3.9* | 18,490 | 22,884 | 23,078 | 26,819 | *4.5* | *3.1* |
| Greece | 127,508 | 125,587 | 124,770 | 148,360 | *-0.4* | *3.5* | 1,000 | 1,018 | 1,040 | 1,237 | *0.8* | *3.5* |
| Hong Kong | 273,744 | 556,173 | 609,938 | 728,323 | *17.4* | *3.6* | 2,482 | 2,990 | 2,737 | 2,883 | *2.0* | *1.0* |
| Hungary | 21,451 | 26,951 | 25,772 | 27,321 | *3.7* | *1.2* | 173 | 218 | 186 | 197 | *1.5* | *1.2* |
| **India** | **108,712** | **276,320** | **291,274** | **503,762** | ***21.8*** | ***11.6*** | **3,061** | **5,974** | **5,986** | **10,354** | ***14.4*** | ***11.6*** |
| Indonesia | 13,884 | 20,737 | 21,049 | 33,057 | *8.7* | *9.4* | 495 | 686 | 675 | 1,060 | *6.4* | *9.4* |
| Ireland | 67,559 | 95,584 | 100,446 | 134,413 | *8.3* | *6.0* | 1,033 | 1,324 | 1,343 | 1,572 | *5.4* | *3.2* |
| Italy | 1,484,981 | 1,399,179 | 1,455,492 | 1,972,163 | *-0.4* | *6.3* | 10,637 | 8,862 | 10,701 | 12,508 | *0.1* | *3.2* |
| Japan | 2,279,834 | 3,037,058 | 3,652,774 | 4,103,207 | *9.9* | *2.4* | 11,705 | 14,537 | 17,013 | 19,110 | *7.8* | *2.4* |
| Kenya | 800 | 3,399 | 2,900 | 3,369 | *29.4* | *3.0* | 16 | 48 | 42 | 48 | *21.3* | *2.7* |
| Malaysia | 15,594 | 19,183 | 20,452 | 37,900 | *5.6* | *13.1* | 547 | 661 | 675 | 913 | *4.3* | *6.2* |
| Mexico | 297,567 | 303,719 | 315,505 | 382,630 | *1.2* | *3.9* | 3,964 | 3,874 | 3,790 | 4,596 | *-0.9* | *3.9* |
| Monaco | 18,772 | 19,573 | 19,723 | 20,257 | *1.0* | *0.5* | 304 | 329 | 335 | 344 | *2.0* | *0.5* |
| New Zealand | 164,830 | 197,685 | 204,991 | 281,412 | *4.5* | *6.5* | 1,413 | 1,796 | 1,812 | 2,485 | *5.1* | *6.5* |
| Nigeria | 36,290 | 34,911 | 40,142 | 45,405 | *2.0* | *2.5* | 613 | 630 | 724 | 819 | *3.4* | *2.5* |
| Philippines | 10,214 | 15,054 | 16,974 | 20,195 | *10.7* | *3.5* | 406 | 523 | 569 | 677 | *7.0* | *3.5* |
| Poland | 43,101 | 46,094 | 53,465 | 68,898 | *4.4* | *5.2* | 518 | 604 | 649 | 836 | *4.6* | *5.2* |
| Romania | 34,708 | 55,313 | 55,889 | 79,215 | *10.0* | *7.2* | 230 | 294 | 276 | 392 | *3.7* | *7.3* |
| Russia | 489,305 | 484,393 | 504,551 | 623,002 | *0.6* | *4.3* | 10,517 | 8,593 | 8,924 | 11,019 | *-3.2* | *4.3* |
| Saudi Arabia | 149,269 | 270,863 | 272,417 | 279,334 | *12.8* | *0.5* | 2,033 | 5,099 | 5,100 | 5,230 | *20.2* | *0.5* |
| Singapore | 197,643 | 256,569 | 269,027 | 362,802 | *6.4* | *6.2* | 2,462 | 3,019 | 3,306 | 4,258 | *6.1* | *5.2* |
| South Africa | 70,436 | 88,040 | 87,421 | 109,368 | *4.4* | *4.6* | 1,014 | 1,060 | 1,033 | 1,293 | *0.4* | *4.6* |
| South Korea | 693,793 | 904,089 | 920,090 | 1,021,631 | *5.8* | *2.1* | 3,752 | 4,809 | 5,847 | 6,482 | *9.3* | *2.1* |
| Spain | 917,789 | 1,039,615 | 1,043,772 | 1,290,977 | *2.6* | *4.3* | 6,693 | 6,546 | 6,475 | 8,008 | *-0.7* | *4.3* |
| Sweden | 348,783 | 427,113 | 450,302 | 618,222 | *5.2* | *6.5* | 4,636 | 5,159 | 5,174 | 7,606 | *2.2* | *8.0* |
| Switzerland | 810,780 | 905,753 | 932,962 | 1,046,380 | *2.8* | *2.3* | 6,712 | 8,149 | 8,395 | 9,790 | *4.6* | *3.1* |
| Taiwan | 401,112 | 412,681 | 464,385 | 523,824 | *3.0* | *2.4* | 1,782 | 1,910 | 2,172 | 2,450 | *4.0* | *2.4* |
| Tanzania | 3,000 | 5,118 | 5,553 | 8,532 | *13.1* | *9.0* | 61 | 109 | 114 | 175 | *13.3* | *8.9* |
| Thailand | 15,823 | 24,182 | 26,344 | 28,264 | *10.7* | *1.4* | 489 | 840 | 912 | 979 | *13.3* | *1.4* |
| Turkey | 163,704 | 161,564 | 164,938 | 183,162 | *0.2* | *2.1* | 2,025 | 1,827 | 1,913 | 2,336 | *-1.1* | *4.1* |
| Uganda | 126 | 146 | 137 | 170 | *1.7* | *4.4* | 4 | 5 | 5 | 6 | *4.6* | *3.7* |
| UAE | 145,433 | 182,768 | 197,565 | 238,834 | *6.3* | *3.9* | 1,471 | 1,604 | 1,681 | 2,079 | *2.7* | *4.3* |
| UK | 1,886,849 | 2,168,557 | 2,240,146 | 3,734,949 | *3.5* | *10.8* | 13,763 | 13,870 | 14,367 | 18,818 | *0.9* | *5.5* |
| US | 14,412,290 | 15,378,566 | 16,456,543 | 18,520,290 | *2.7* | *2.4* | 175,531 | 227,132 | 240,575 | 293,136 | *6.5* | *4.0* |
| Vietnam | 11,337 | 23,014 | 25,727 | 42,324 | *17.8* | *10.5* | 142 | 427 | 458 | 753 | *26.4* | *10.5* |

*Source: Global Data Wealth Insight 2020 – Knight Frank*

## Growth in income levels of wealthy individuals

The number of Indians with more than Rs10m gross total income grew 17% compounded over FY14-19 to ~0.1m. Similarly, the number of individuals earning over Rs5m clocked a 20% CAGR over FY14-19 to ~0.3m.

Besides the increase in number of individuals, the income held by them also rose rapidly. The total income of individuals with gross incomes of more than Rs10m grew 19% compounded over FY14-19 to Rs2.7trn. Similarly, the total income of individuals with gross incomes of over Rs5m clocked a 20% CAGR over FY14-19 to Rs4.1trn.

**Fig 38 – The number of higher income individuals (>5m, >50m) has risen fast in the last few years**

| | 2013-14 | | 2014-15 | | 2015-16 | | 2016-17 | | 2017-18 | | 2018-19 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Gross income | Individuals | Share | Individuals | Share | Individuals | Share | Individuals | Share | Individuals | Share | Individuals | Share |
| 0-1m | 31,564,274 | 94.0 | 34,072,125 | 93.3 | 37,789,189 | 92.8 | 42,523,287 | 91.7 | 42,150,817 | 90.3 | 49,708,404 | 90.0 |
| 1m-5m | 1,896,222 | 5.6 | 2,293,678 | 6.3 | 2,773,879 | 6.8 | 3,647,961 | 7.9 | 4,271,859 | 9.2 | 5,244,781 | 9.5 |
| 5m-10m | 80,720 | 0.2 | 98,815 | 0.3 | 116,901 | 0.3 | 140,830 | 0.3 | 171,094 | 0.4 | 209,345 | 0.4 |
| 10m-50m | 40,883 | 0.1 | 45,027 | 0.1 | 55,331 | 0.1 | 62,759 | 0.1 | 74,983 | 0.2 | 89,793 | 0.2 |
| 50m-100m | 2,224 | 0.0 | 2,338 | 0.0 | 3,020 | 0.0 | 3,330 | 0.0 | 4,201 | 0.0 | 5,132 | 0.0 |
| 100m-1000m | 944 | 0.0 | 1,028 | 0.0 | 1,447 | 0.0 | 1,656 | 0.0 | 2,099 | 0.0 | 2,687 | 0.0 |
| 1,000m-5,000m | 27 | 0.0 | 23 | 0.0 | 32 | 0.0 | 38 | 0.0 | 61 | 0.0 | 77 | 0.0 |
| | **33,585,294** | | **36,513,034** | | **40,739,799** | | **46,379,861** | | **46,675,114** | | **55,260,219** | |
| | | | | | | | | | | | | |
| >100m | 971 | | 1,051 | | 1,479 | | 1,694 | | 2,160 | | 2,764 | |
| >50m | 3,195 | | 3,389 | | 4,499 | | 5,024 | | 6,361 | | 7,896 | |
| >5m | 124,798 | | 147,231 | | 176,731 | | 208,613 | | 252,438 | | 307,034 | |
| >1m | 2,021,020 | | 2,440,909 | | 2,950,610 | | 3,856,574 | | 4,524,297 | | 5,551,815 | |
| | | | | | | | | | | | | |
| Y/Y growth % | | | | | | | | | | | | |
| >100m | | | 8.2 | | 40.7 | | 14.5 | | 27.5 | | 28.0 | |
| >50m | | | 6.1 | | 32.8 | | 11.7 | | 26.6 | | 24.1 | |
| >5m | | | 18.0 | | 20.0 | | 18.0 | | 21.0 | | 21.6 | |
| >1m | | | 20.8 | | 20.9 | | 30.7 | | 17.3 | | 22.7 | |

*Source: Income-tax Department, Anand Rathi Research*

**Fig 39 – The wealth possessed by wealthy individuals has grown markedly**

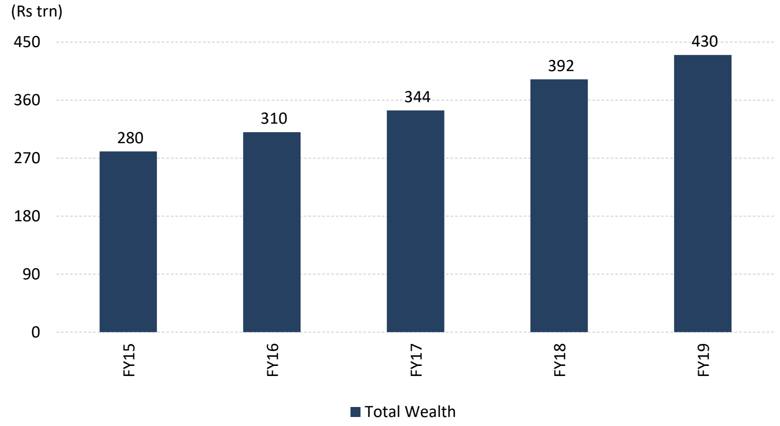
| In Rs bn (except share) | 2013-14 | | 2014-15 | | 2015-16 | | 2016-17 | | 2017-18 | | 2018-19 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Gross income | Individuals | Share | Individuals | Share | Individuals | Share | Individuals | Share | Individuals | Share | Individuals | Share |
| 0-1m | 10,218 | 67.6 | 11,735 | 65.8 | 14,189 | 66.7 | 16,354 | 64.8 | 17,578 | 62.4 | 21,140 | 61.9 |
| 1m-5m | 3,240 | 21.4 | 3,958 | 22.2 | 4,748 | 22.3 | 6,130 | 24.3 | 7,234 | 25.7 | 8,913 | 26.1 |
| 5m-10m | 549 | 3.6 | 673 | 3.8 | 800 | 3.8 | 965 | 3.8 | 1,174 | 4.2 | 1,417 | 4.1 |
| 10m-50m | 733 | 4.8 | 808 | 4.5 | 1,002 | 4.7 | 1,130 | 4.5 | 1,345 | 4.8 | 1,611 | 4.7 |
| 50m-100m | 149 | 1.0 | 157 | 0.9 | 203 | 1.0 | 224 | 0.9 | 283 | 1.0 | 348 | 1.0 |
| 100m-1,000m | 188 | 1.2 | 207 | 1.2 | 288 | 1.4 | 342 | 1.4 | 435 | 1.5 | 564 | 1.7 |
| 1,000-5,000m | 48 | 0.3 | 293 | 1.6 | 49 | 0.2 | 94 | 0.4 | 119 | 0.4 | 155 | 0.5 |
| | **15,124** | | **17,831** | | **21,280** | | **25,240** | | **28,168** | | **34,149** | |
| | | | | | | | | | | | | |
| >100m | 235 | | 500 | | 337 | | 436 | | 555 | | 719 | |
| >50m | 385 | | 657 | | 541 | | 661 | | 838 | | 1,067 | |
| >5m | 1,667 | | 2,138 | | 2,342 | | 2,755 | | 3,357 | | 4,096 | |
| >1m | 4,907 | | 6,096 | | 7,090 | | 8,886 | | 10,591 | | 13,009 | |
| | | | | | | | | | | | | |
| Y/Y growth % | | | | | | | | | | | | |
| >100m | | | 112.5 | | -32.6 | | 29.3 | | 27.1 | | 29.7 | |
| >50m | | | 70.8 | | -17.7 | | 22.2 | | 26.9 | | 27.4 | |
| >5m | | | 28.2 | | 9.6 | | 17.6 | | 21.8 | | 22.0 | |
| >1m | | | 24.2 | | 16.3 | | 25.3 | | 19.2 | | 22.8 | |

*Source: Income-tax Department, Anand Rathi Research*

## Financial assets gaining traction

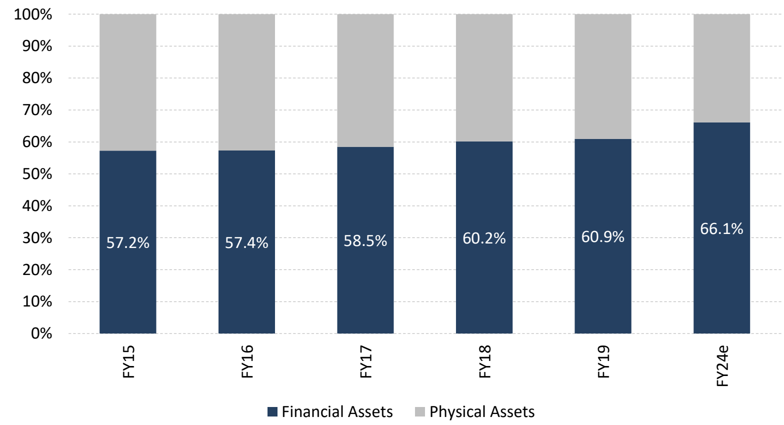
The wealth of individuals in India registered an 11% CAGR over FY15-19 to Rs430trn (~$6trn). Financial assets constituted ~61% of individuals' wealth, indicating greater financialisation of savings. Financial assets clocked a 13% CAGR; physical assets a 9% CAGR. The share of physical assets declined from ~43% to ~39%. The total wealth of individuals is expected to rise to ~$11.5trn by FY24 (Rs800trn at the present exchange rate), a 13% CAGR; financial assets are expected to grow to $7.6trn at a 15% CAGR.

**Fig 40 – Individual wealth recorded an 11% CAGR over FY15-19**




*Source: Karvy Wealth*

**Fig 41 – Financial assets have been rising**

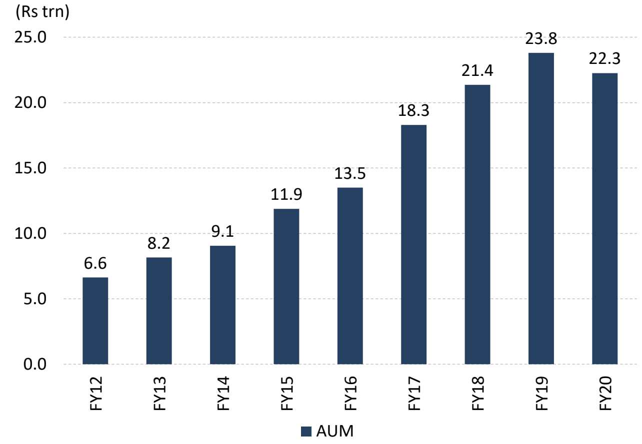



*Source: Karvy Wealth*

## The Mutual Fund sector: evolving

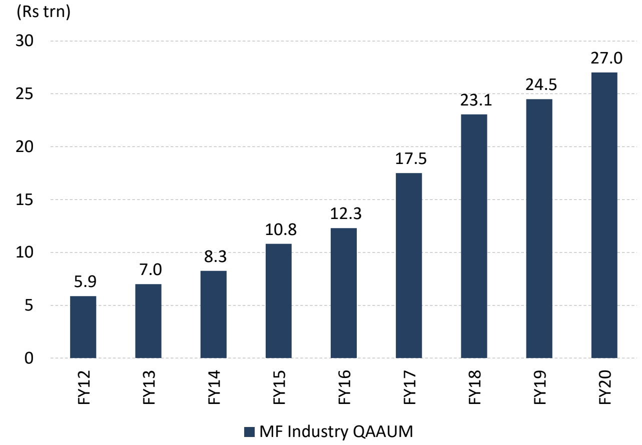
With greater awareness among investors, the mutual-fund sector has evolved over the years. Sector-level AUM clocked a 16% CAGR over FY12-20 to Rs23trn. Similarly, the quarterly average assets under management (QAAUM) recorded a 21% CAGR over FY12-20 to Rs27trn. One of the reasons is that individuals prefer to invest amounts monthly leading to an increase in systematic investments. At end-Jun'20, 32.3m systematic-investment-plan (SIP) accounts had been registered, through which investments in mutual-fund schemes are made regularly.

**Fig 42– Mutual funds have become popular investment**



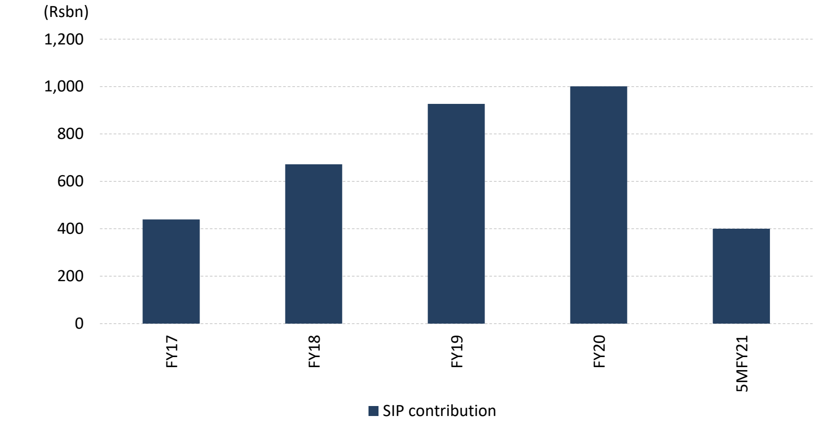

Source: AMFI

**Fig 43 – QAAUM has grown steadily over the last few years**




Source: AMFI

**Fig 44 – SIP inflows have grown faster**

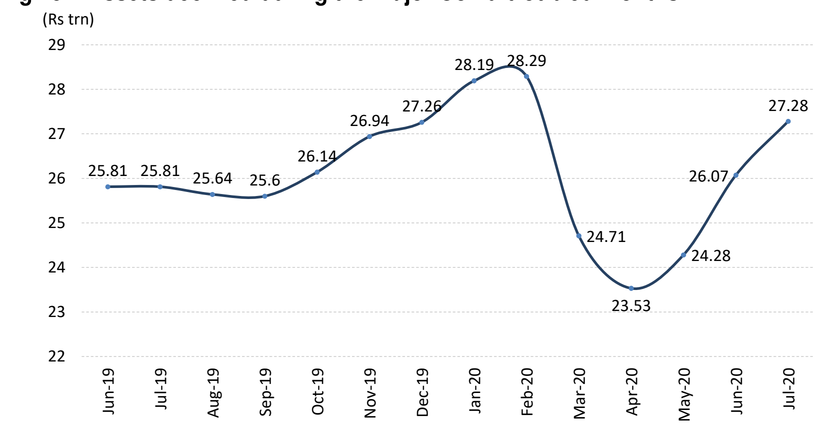



Source: AMFI

## Covid impact

The Covid-19-epidemic-caused turbulence in the Indian economy resulted in assets managed by the mutual fund sector over Mar-May'20 declining m/m due to redemptions. In June, however, they rebounded as restrictions were eased and the lockdown was lifted in many parts of the country.

**Fig 45 – Assets declined during the major Covid-troubled months**

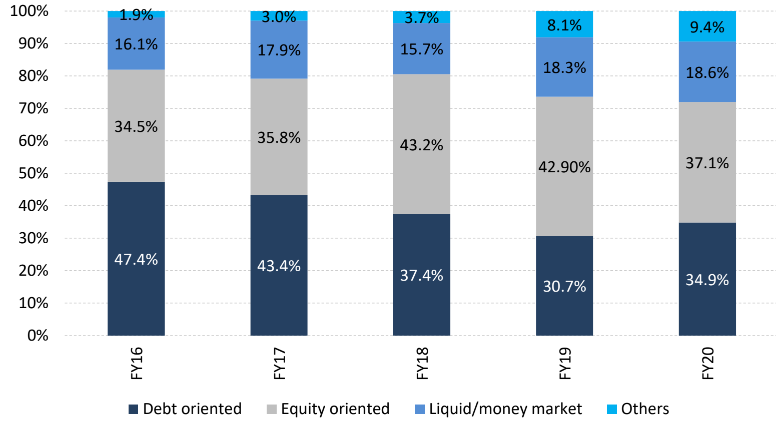



Source: AMFI

## Composition of schemes

The AUM of the mutual-fund sector in India clocked a 15.9% CAGR over FY16-20, with equity AUM at an 18% CAGR. This was because of greater investor awareness and falling returns from other asset classes such as fixed deposits, gold and real estate. In the mutual-fund sector a significant shift in the shares of asset classes has been seen. The share of equity rose from 34.5% of AUM in FY16 to 43% in FY19 but fell to 37% at end-FY20.

**Fig 46 – Increase in share of equity with a blip in FY20**

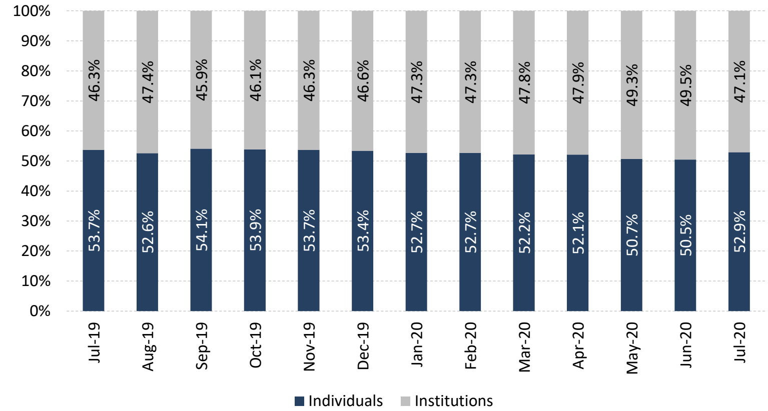



*Source: AMFI*

## Individual vs. institution composition; now almost equal participation

At end-Jun'20, the proportions of individual and institutional investors were 50.5% and 49.5% respectively, the former figure shrinking ~200bps from Feb'20's 52.7%.

**Fig 47 – Composition of Mutual Fund assets, by investor type**

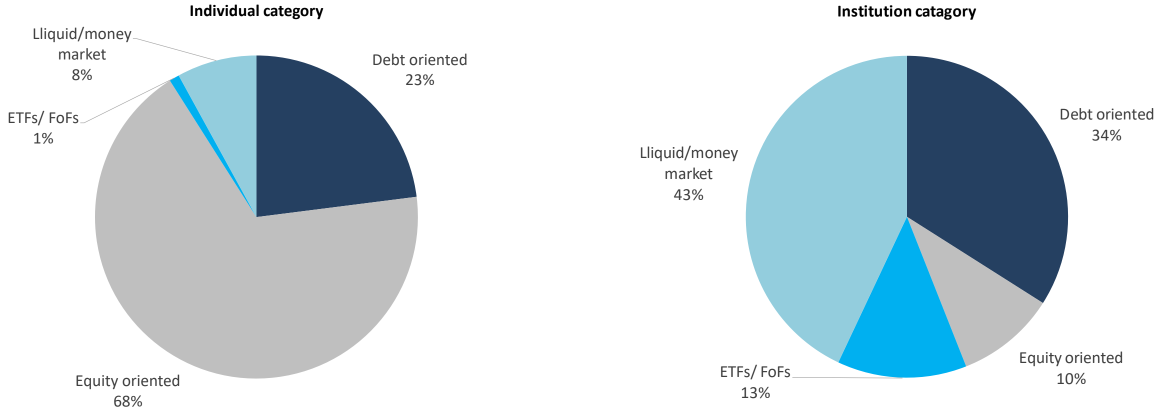



*Source: AMFI*

## Individual investor holdings higher in equity-oriented schemes; institutions geared toward liquid schemes

At end-Jun'20, 68% of individual holdings in mutual funds were in equity-oriented schemes, 23% in debt-oriented schemes. Such holdings in ETFs were inconsequential; in the liquid market it was 8%. Contrastingly, institutional holdings in liquid instruments were 43%; in equity-oriented funds the figure was 10%.

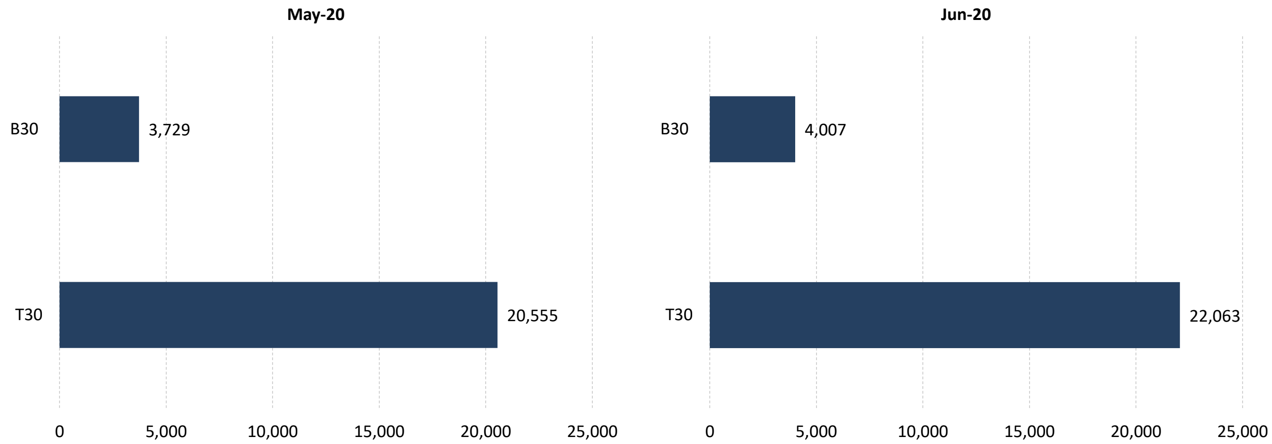
## Fig48 – Composition of investor holdings – Jun'20




*Source: AMFI*

Over 80% of assets are located in T30 region, which underlines opportunities in the B30 region and even in other regions.

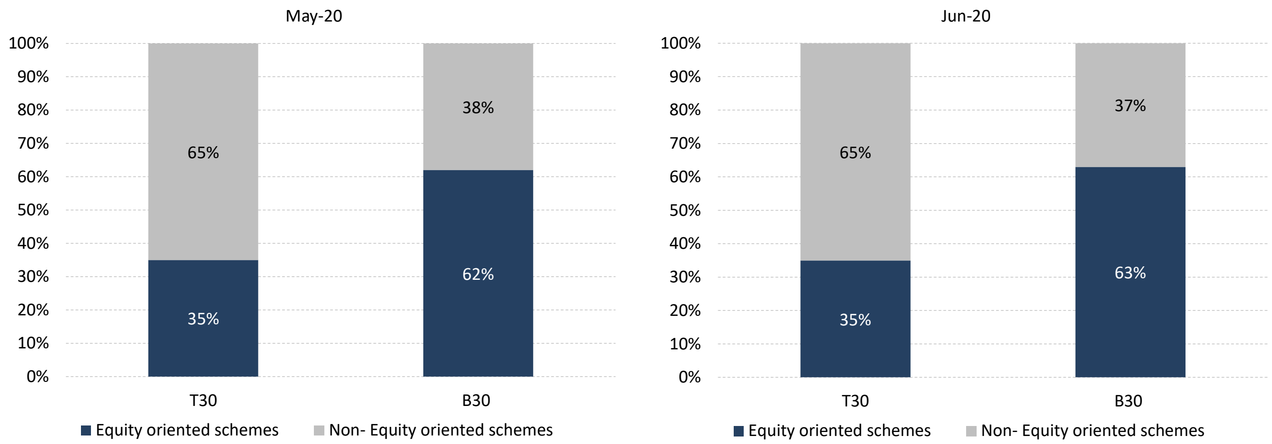
## Fig 49 – Asset composition, by region




*Source: AMFI*

~35% of T30 assets are invested in equity schemes, 65% in non-equity-oriented schemes. In contrast, over 60% of assets in the B30 region are in equity schemes, the rest in non-equity-oriented schemes.

## Fig 50 – Equity vs. non- equity schemes, by region

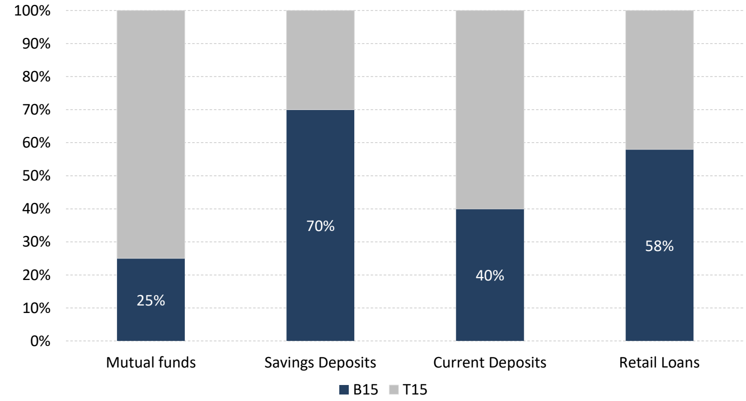



*Source: AMFI*

## B15 regions under-penetrated with respect to mutual funds compared to other financial products

The B15 regions contribution to AUM rose from ~13% in FY13 to ~25% in FY19. However, despite recent growth, mutual-fund penetration in B15 regions continues to be low when compared to other savings products. Current & savings deposits and retail loans have seen deeper penetration than mutual funds.

**Fig 51 – Mutual funds are under-penetrated compared to other financial products**




*Sources: RBI, AMFI, Karvy*
*Note: (i) Data for retail loans as on Mar'18; All other data for FY19.*
*(ii) T15 refers to the Top-15 geographical locations in India. B15 refers to the locations beyond the Top-15*

## The Rs100trn industry opportunity, Rs32trn individual opportunity

The mutual-fund sector has the potential to grow to Rs100tn by FY24, ie, ~4x from levels now. This is based on its under-penetration in B30 cities and in comparison with other financial services in India such as banking and insurance. According to BCG, this is possible if there is a huge leap in these three factors:

- An investor base from 20m to 100m, a 5x increase.
- Adding ~0.4m channel partners and building a sustainable distribution network
- Equity to constitute >50% of AUM (vs. 45% now).

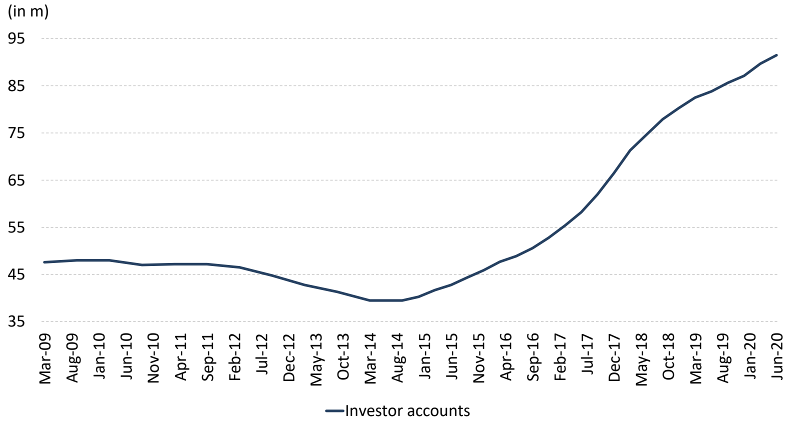
At present, the investor base and distribution reach are largely concentrated in metros and tier-1 cities, reflected in the ~75% share of T15 cities in overall industry AUM. Thus, a wider customer base would be possible only if B100 cities are targeted, not just B30 cities.

The share of individual financial wealth in AUM is expected to register an 18% CAGR to Rs32trn by FY24 (from Rs13.8trn in FY19).

## The number of investor accounts has helped business growth

The number of investor accounts registered a 17% CAGR over 2014-19 to 87m. The industry added 0.7m in 2019. However, the total investor growth rate fell to 8.5% compared to an average 21% growth rate over the preceding three years.

**Fig 52 – The number of investor accounts has increased at a strong pace**




*Source: AMFI Note: Accounts refer to a folio. An investor may have multiple accounts in a single fund or across funds*

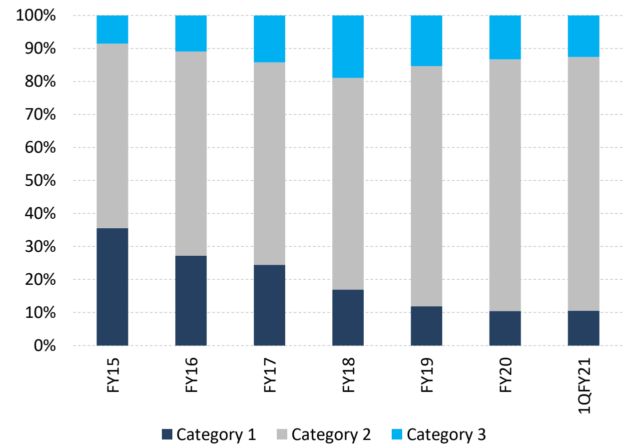
## Alternative investments - strong trend in AIF inflows

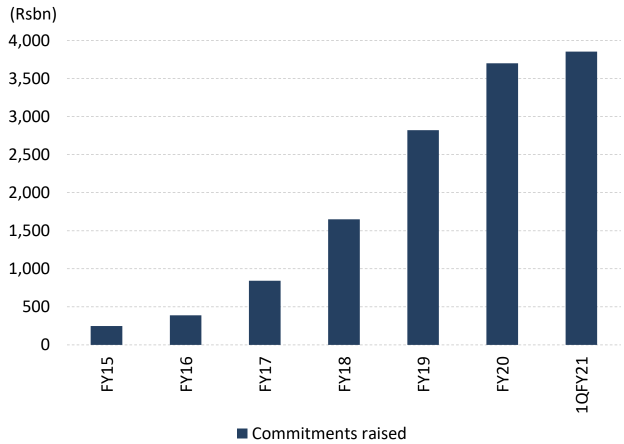
SEBI introduced the Alternative-Investment Fund (AIF) regime in 2012 so that investors could invest in alternative-asset classes such as private equity (PE), venture capital, infrastructure & real estate, private credit and hedge funds. According to SEBI statistics, AIFs have grown strongly in the past few years.

AIFs have three categories. Category I covers venture-capital funds, SME funds, social-venture funds, infrastructure funds, etc. Growth, however, was significant in Category 2 and Category 3. Category II covers real-estate funds, private-equity funds, funds for distressed assets, etc.; Category III covers hedge funds, private investment in public equity (PIPE) funds, etc.

In FY20, total commitments were Rs3.7trn (cumulative) and Rs1.5trn was invested. Funds raised were Rs1.9trn. This shows that India is an attractive destination for AIFs. For global fund managers, India is the second destination in Asia after China. Long-term sustainable growth is one of the key factors attracting private equity to the country.

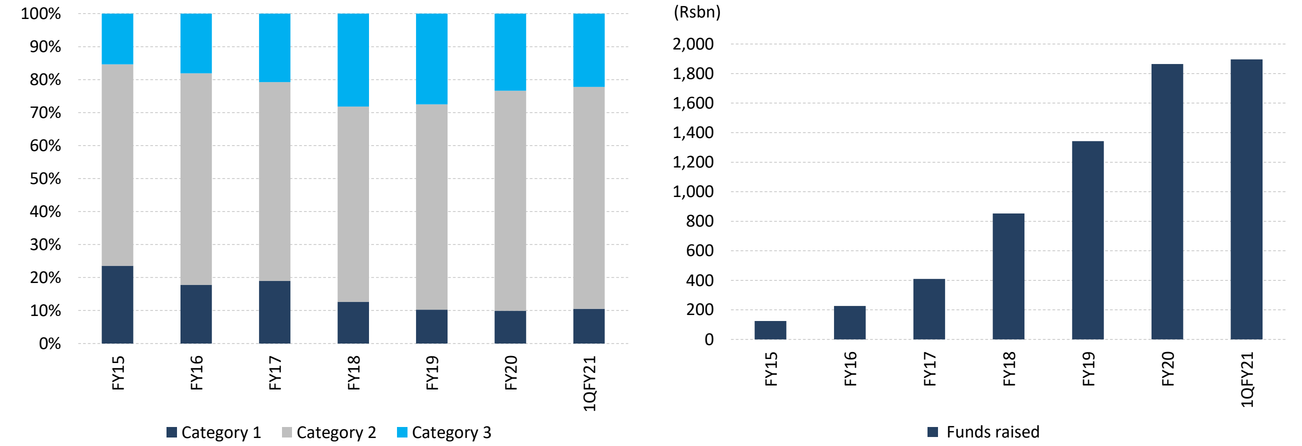
**Fig 53 – Commitments raised**



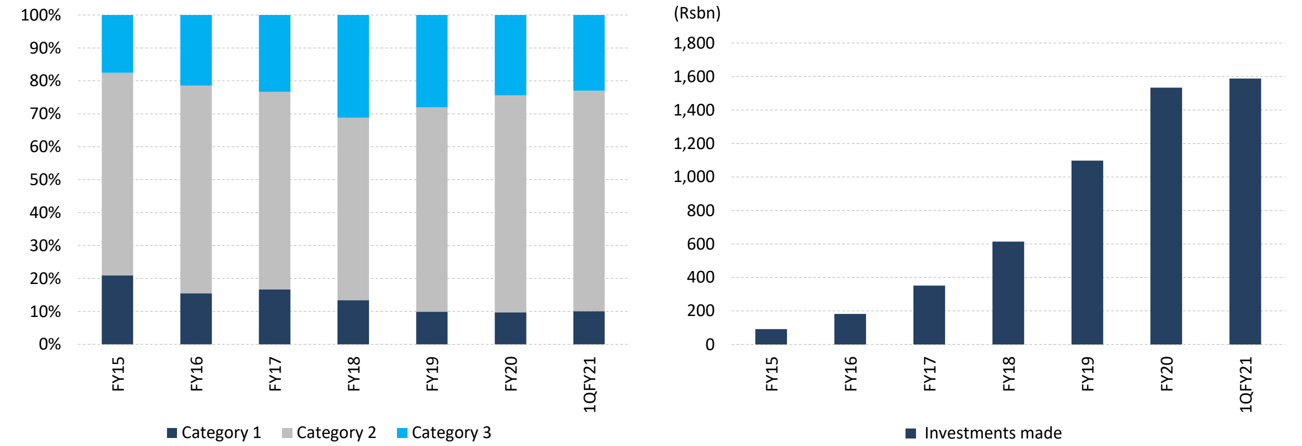

*Source: SEBI, Anand Rathi Research Note: The above figures are based on cumulative data*

**Fig 46 – Funds raised**




Source: SEBI, Anand Rathi Research Note: The above figures are based on cumulative data

**Fig 47 – Investments made**

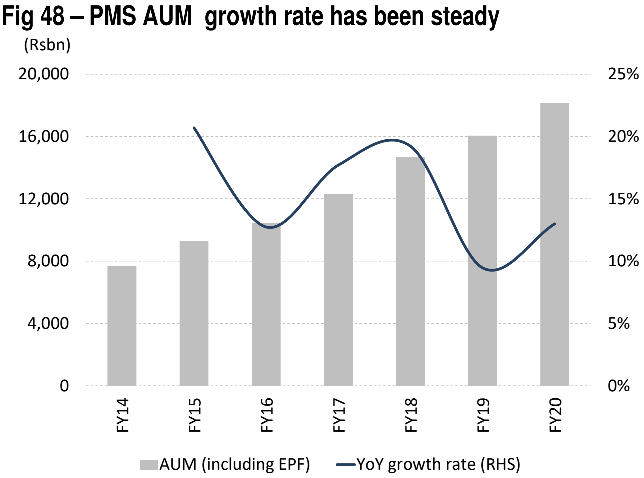



Source: SEBI, Anand Rathi Research Note: The above figures are based on cumulative data

## India's PMS AUM growth in early double digits

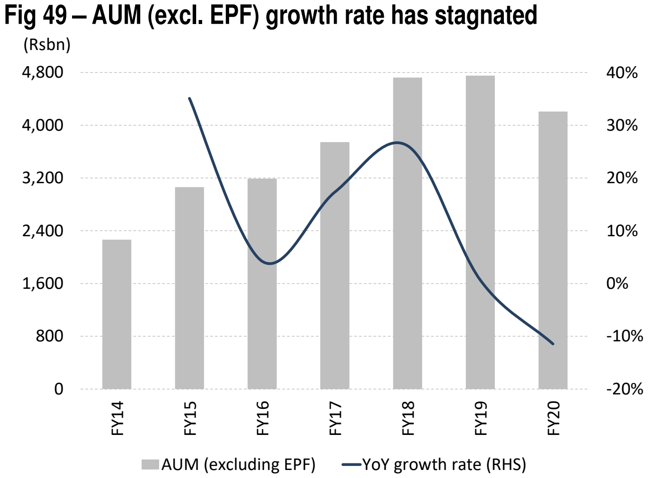
The AUM of PMS (excluding PFs) registered an 11% CAGR over FY14-FY20 (16% over FY14-19). Growth would have been higher, however, if the 11% decline in FY20 (due to stock-market volatility) is excluded. Non-discretionary products recorded a 19% CAGR over FY14-20. Similarly, advisory fees have seen a 5% CAGR over FY14-20.

**Fig 48 – PMS AUM growth rate has been steady**




Source: SEBI, Anand Rathi Research

**Fig 49 – AUM (excl. EPF) growth rate has stagnated**

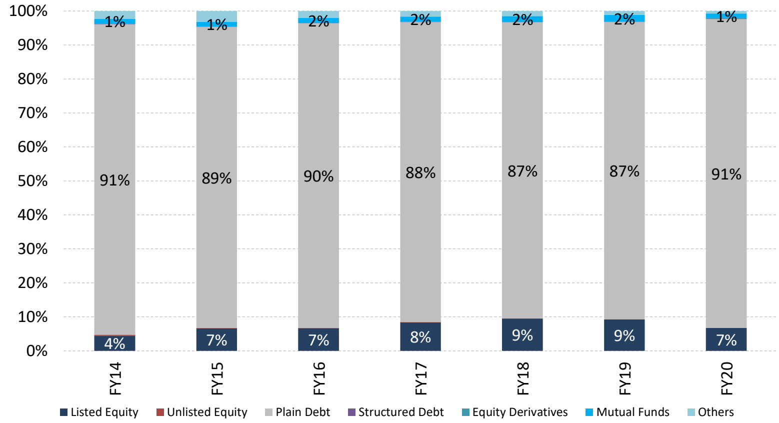



Source: SEBI, Anand Rathi Research

## Share of listed equities increases whereas debt in PMS AUM declines

The share of listed equities in AUM increased from 4% in FY14 to 9% in FY19 but declined to 7% in FY20. Similarly, the share of debt fell from 91% in FY14 to 87% in FY19 but inched up to 91% in FY20.

**Fig 50 – PMS AUM composition**




*Source: SEBI, Anand Rathi Research*

## Major regulations affecting the wealth industry:

- In Oct'18, SEBI announced a ban on upfront commissions paid by AMCs for all mutual-fund schemes and mandated the adoption of the full trail fee model. It excluded SIPs, however, from this. Moreover, all fees and expenses charged on a direct plan could not exceed those of a regular plan.
- In Mar'19, SEBI tightened rules regarding upfronting trail commissions paid to distributors on registering SIPs only to first-time investors. The upfront trail commission would be up to 1% payable yearly in advance, for a maximum of three years. The upfront trail commission paid would be restricted to SIPs of up to Rs3,000 a month per scheme for someone investing in mutual funds for the first time.

  Moreover, the upfront trail commissions would be paid from the AMC's books and amortised daily to the scheme over the period for which the payment had been made. SEBI had earlier allowed an additional total expense ratio (TER) of 30bps to attract retail investments from beyond the top-30 cities. It has now defined the term 'retail investor' from beyond the top-30 cities as one who invests Rs0.2m per transaction.
- With effect from 1st Apr'19, SEBI lowered the TER, which, although beneficial to customers, had a revenue effect on wealth-management companies.

**Fig 51 – Older TER**

| AUM slabs | Equity-oriented schemes % | Debt-oriented schemes % | Exchange-traded funds (ETFs, incl.gold ETFs) / Index funds % | Fund of Funds (FoF) domestic and foreign |
|---|---|---|---|---|
| Up to Rs1bn | 2.50 | 2.25 | 1.50 | Maximum 2.5% including the TER of underlying schemes |
| Next Rs3bn | 2.25 | 2.00 | 1.50 | |
| Next Rs3bn | 2.00 | 1.75 | 1.50 | |
| On balance AUM | 1.75 | 1.50 | 1.50 | |

*Source: SEBI*

**Fig 52 – New TER**

| AUM slabs (Rs bn) | Equity TER % | Other-than-equity TER % |
|---|---|---|
| 0 - 5 | 2.25 | 2.00 |
| 5 - 7.5 | 2.00 | 1.75 |
| 7.5 - 20 | 1.75 | 1.50 |
| 20-50 | 1.60 | 1.35 |
| 50 - 100 | 1.50 | 1.25 |
| 100 - 500 | TER reduction of 0.05% for every increase of Rs50bn AUM or part thereof | TER reduction of 0.05% for every increase of Rs50bn AUM or part thereof |
| >500 | 1.05 | 0.80 |

*Source: SEBI*

- In Nov'19, SEBI doubled the minimum investment limit for PMS clients to Rs5m. Besides, the base net-worth requirement for PMS was increased to Rs50m (from Rs20m earlier), giving portfolio managers three years to meet the enhanced requirement. Moreover, the regulator mandated that portfolio managers not invest more than 25% of their AUM in unlisted securities.
- In Jan'20, SEBI introduced a 'time-weighted rate of return' in reporting performance in discretionary PMS. Ancillary charges such as for broking and demat services from the associate arms of the PMS provider were capped at 20%.
- In Feb'20 (effective 1st Oct'20), SEBI prohibited PMS providers from paying upfront commissions to distributors, only allowing trail commissions to be received. SEBI also introduced a 'direct' option to PMS investors who did not wish to invest through distributors, which would exclude distribution fees. However, PMS providers could continue to charge annual fees, as percent of an investor's corpus.
- In Sep'20, SEBI announced that investment advisers must ensure segregation of advisory and distribution activities at the client level. Under the assets under advice (AUA) mode, maximum fees to be charged would not exceed 2.5% of AUA p.a. per client across all services offered by the investing agent. In the fixed-fee mode, maximum fees to be charged would not exceed Rs125,000 p.a. per client across all services.

## Trail method, better and meritorious . . .

The SEBI ban on upfront commissions or on upfronting trail commissions in mutual funds would stop the high churn in mutual-fund portfolios and increase the tenure of investments in mutual funds. AMCs used to pay (1–1.5%) higher upfront commissions, especially on business from B-30 cities. With this ban, the mutual fund sector had to compulsorily adopt to the full trail model of commission in all schemes.

We believe that this is an important regulation change as it aligns incentives of RMs, equalising them for all products. Second, there is no major motivation to sell only one type of product as RMs would get similar payouts on all products offered. The trail method impact on the company's financials is being seen in FY20; however, stable growth is expected ahead.

## . . . and even bans upfront distributor commissions in PMS

In Feb'20, SEBI announced that PMSs could not charge upfront fees to customers directly or indirectly (effective 1st Oct'20). Moreover, a 'direct' option for PMS investors was introduced where the distributor channel would not be included and customers could save on distribution fees.

Moreover, PMS providers could charge a maximum exit load of 3% in the first year of investment, 2% in the second year and 1% in the third year. Ancillary charges for broking and demat services (associate arms of PMS providers) would be capped at 20%. However, SEBI clarified that annual fees could be charged to customers.

In Jan'20, SEBI announced the use of the 'time-weighted rate of return' method to report discretionary PMS performances. The reporting norms were tightened for portfolio managers. PMS providers have to consider cash and their holdings in liquid funds while reporting performances and performances must be reported net of fees and taxes. Also, the PMS manager had to disclose in the marketing material any change of investment approach that could affect client portfolios.

We believe that, with the rule change, SEBI is trying to render the PMS structure similar to the mutual-fund structure. Moreover, PMS providers will go with the fee-paying model.

## Appendix

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|---|---|---|---|
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