

Analyst

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Authorisation

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IOOF Holdings (IFL)

Show me the Money (for provisions)

Recommendation
Sell (unchanged)
Price
\$5.82
Target (12 months)
\$4.39 (previously \$4.53)

GICS Sector
Diversified Financials

Expected Return

Capital growth	-24.6%
Dividend yield	8.2%
Total expected return	-16.4%

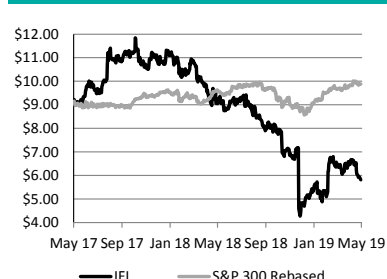
Company Data & Ratios

Enterprise value	\$2.4bn
Market cap	\$2.0bn
Issued capital	351.1m
Free float	91%
Avg. daily val. (52wk)	\$15.4m
12 month price range	\$4.195-\$9.60

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	6.31	5.27	9.39
Absolute (%)	-7.77	10.44	-38.02
Rel market (%)	-9.04	5.39	-41.35

Absolute Price



SOURCE: IRESS

ANZ Wealth P&I transaction under threat

IFL has released an update on the pending ANZ Wealth P&I acquisition, with some key negatives being the loss of income, and the potential for IFL to require APRA approval prior to deal completion:

- 1 IFL notes that if the deal isn't approved by 5 July 2019, due to recent changes to the Superannuation Industry Act, that APRA may need to approve the deal;
- 2 As ANZ has completed its Successor Fund Transfer (splitting the Life and Wealth business), there is a step-down in the Coupon rate ANZ pays to IFL, from 14.4% to 2.0% from 11 May 2019, instead of our previous end of 2019 estimate;
- 3 If the deal isn't completed by 17 October 2019, then either IFL or ANZ may terminate the transaction.

Time no longer appears on IFL's side. The income being generated is largely lost from the interest rate step down, and there are now clear time catalysts which create risk.

Majors continue to upgrade client provisions, while IFL quite

CBA is the latest to upgrade client remediation costs, moving today for a total Wealth cost/provision of \$1.7 billion (pre-tax). Each of the major banks are now above \$1 billion in provisions and refunds for Wealth. AMP currently sits at \$656m, with its last update on the matter back in February. IFL, incredulously, has only earmarked up to \$30m, with all of this just to perform the client file reviews. There is nothing, at this stage, for client refunds and we see this as a major risk and at odds with current industry trends. IFL's client file review is scheduled to finish by end of September 19.

Earnings revisions

Following IFL's update, we have downgraded our underlying EPS by -1.4%, -13.3% and -2.9% for FY19, FY20 and FY21 respectively. The earnings revision is driven by changed assumptions around the income payments from the Notes from ANZ. Following the earnings revisions our revised Price Target is \$4.39 per share (previously \$4.53) with our Sell recommendation remaining unchanged.

Earnings Forecast

Year end June 30	2018	2019e	2020e	2021e
Total revenue (\$m)	580.2	660.4	579.4	578.6
EBITDA (\$m)	271.7	311.2	215.5	211.9
NPAT (underlying) (A\$m)	152.0	159.4	102.5	102.9
NPAT (cash) (A\$m)	191.4	198.8	141.9	142.3
EPS (cash) (cps)	58.8	56.6	43.5	48.0
Cash EPS growth (%)	4.2%	-3.7%	-23.2%	10.4%
Cash PER (x)	9.9	10.3	13.4	12.1
EV/EBITDA (x)	6.5	5.7	8.2	8.3
Price/CF (x)	7.5	18.1	8.5	10.7
Dividend (€ps)	54.0	47.5	38.0	38.0
Franking (%)	100.0%	100.0%	100.0%	100.0%
Yield (%)	9.3%	8.2%	6.5%	6.5%
ROE (%)	12.1%	10.9%	8.6%	9.8%

SOURCE: BELL POTTER SECURITIES ESTIMATES

IFL is not the Steven Bradbury of Wealth

We anticipate major provisions for client refunds

CBA has upgraded its client remediation provisions as recent as today, with WBC, NAB and ANZ all providing additional monies in the last month to refund clients, primarily for fees for no service. So far the four major banks have total remediation costs (including provisions) in excess of \$1 billion each, with CBA reaching over \$1.7 billion. All four banks have provided additional provisions in the last month, which is in contrast to AMP and IFL, where their last updated figures relating to client remediation are back in February.

Figure 1 – Wealth Related Remediation Cost Summary Table

	Remediation cost (\$m)^	Advisers as @ 30 June 18	Remediation per-adviser (\$m)
CBA	1,712	1,489	1.15
ANZ	1,500	1,015	1.48
WBC	1,083	930	1.16
NAB	1,135	1,452	0.78
AMP	656	2,582	0.25
IFL	30	960	0.03

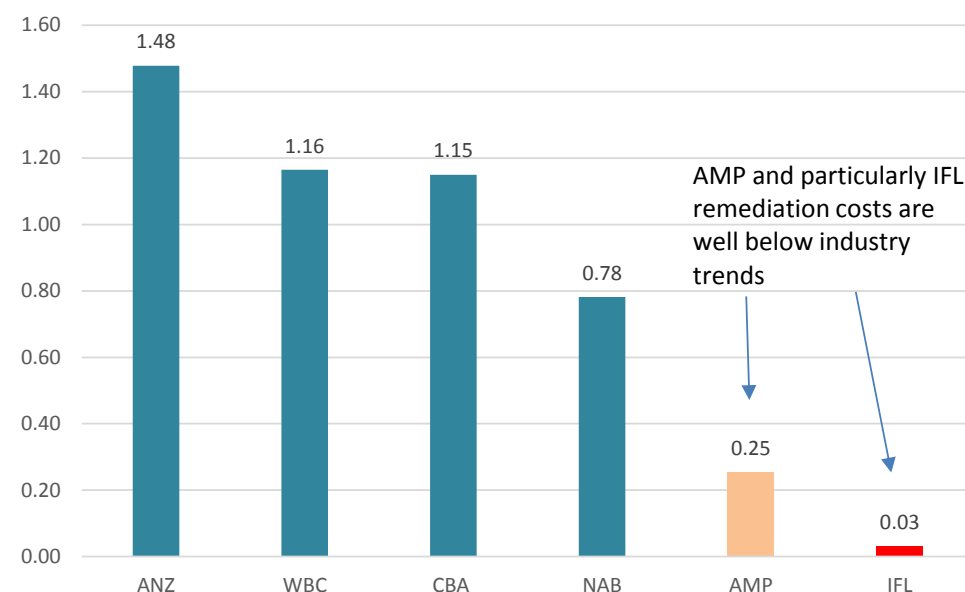
^ as @ 13 May 19 and includes cost and provisions for doing client reviews in addition to client refunds

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

IFL and AMP stand out as being below expectations

To equalise the comparison between the major players, we have taken adviser numbers from 30 June (immediately after the Royal Commission), and calculated what the cost is per an adviser. Our finding suggest the major banks have provisioned / expensed on average above \$1m per adviser, whereas AMP is a quarter of that, and IFL barely registers as a comparison (see table below). We anticipate (but have not factored in to our estimates), an increase in provisions for IFL and AMP over the coming months which could be in the hundreds of millions of dollars.

Figure 2 – Wealth Client Remediation Per Adviser (\$m)



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Quarterly FUMA and net-flows

Figure 3 - Quarterly FUMA and net-flows

	FY16	FY17	1Q	2Q	3Q	4Q	FY18	1Q	2Q	3Q	4Qe	FY19e	FY20e
	Jun-16	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Jun-19	Jun-20
Platform and Administration													
Now called Portfolio & Estate Administration*													
Quarterly reported net-flows (\$m)													
Flagship	606	1,187	364	315	346	666	1,691	285	403	183	466	1,337	1,066
Transition	-76	32	-55	-7	0	0	-62	0	0	0	0	0	0
Global One	0	0	0	0	0	0	0	0	0	0	0	0	0
Total reported net-flows	530	1,219	309	308	346	666	1,629	285	403	183	466	1,337	1,066
Pension payments	-715	-745	-195	-188	-188	-226	-797	-210	-205	-208	-249	-872	-959
Adjusted net-flows	-185	474	114	120	158	440	832	75	198	-25	218	466	107
Opening balance (\$ billion)													
Reported net-flows	0.5	1.2	0.3	0.3	0.3	0.7	1.6	0.3	0.4	0.2	0.5	1.3	1.1
Pension payments*	-0.7	-0.7	-0.2	-0.2	-0.2	-0.2	-0.8	-0.2	-0.2	-0.2	-0.2	-0.9	-1.0
Adjusted net-flows	-0.2	0.5	0.1	0.1	0.2	0.4	0.8	0.1	0.2	0.0	0.2	0.5	0.1
Market movement and other	-0.2	2.2	0.0	1.1	-0.7	1.2	1.7	0.6	-1.1	2.3	0.8	2.6	2.3
Closing balance	34.5	37.2	37.3	38.6	38.1	39.8	39.8	40.5	39.5	41.8	42.8	42.8	45.3
Advice and Distribution													
Now called Financial Advice*													
Quarterly-flows (\$m)*													
	1,284	2,963	335	525	567	2,239	3,666	-63	-471	48	-100	-586	600
IFL Advice & Distribution													
Opening balance (\$ billion)													
Net-flows	1.3	3.0	0.3	0.5	0.6	2.2	3.7	-0.1	-0.5	0.0	-0.1	-0.6	0.6
Market movement	12.2	3.9	0.0	2.3	-1.0	2.4	3.7	0.5	-3.7	3.3	1.2	1.2	3.5
Closing balance	50.0	56.8	57.2	60.0	59.6	64.1	64.1	64.6	60.4	63.7	64.8	64.8	68.9
ANZ Wealth													
Opening balance (\$ billion)													
Net-flows									17.3	16.7			
Market movement									0.0	-0.1			
Closing balance									16.7	16.7			
Total Advice & Distribution FUA (\$ billion)													
									77.1	80.4			
* Quarterly-flows include pension payments from 1Q18													
Investment Management													
Quarterly-flows (\$m)													
		398	-152	-109	-47	130	-178	-134	-186	-129	-100	-549	-400
Opening balance (\$ billion)													
Net-flows	-0.1	0.4	-0.2	-0.1	0.0	0.1	-0.2	-0.1	-0.2	-0.1	-0.1	-0.5	-0.4
Market movement	0.1	0.6	0.2	0.9	-0.2	0.7	1.6	0.4	-0.9	1.2	0.4	1.1	1.7
Closing balance	19.6	20.6	20.7	21.5	21.2	22.0	22.0	22.3	21.3	22.3	22.6	22.6	23.9
*Segment name changes took place from 2Q19													

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Valuation and earnings revisions

Sum-of-parts and DCF Methodology

Following IFL's update our revised Price Target is \$4.39 per share (previously \$4.53) based on our sum-of-the-parts and DCF valuation methodology as detailed in the Figure below.

Figure 4 - Valuation

	FY19e Cash NPAT	Multiple	Valuation (\$m)
Platforms and administration	86.7	8.0	693
Advice and distribution	77.0	6.0	462
Investment manager	37.9	12.0	455
Perennial Value Stake (at 42%)			20
Group office	-25.9	10.0	-259
ANZ Note			800
ANZ AD&G			-250
net-debt			-304
		S.O.P. Value (\$m)	1,617
		Share count (m)	351
		S.O.P. per share (\$)	4.61
		DCF value per share (\$)	4.18
		Simple Average (\$m)	4.39

SOURCE: BELL POTTER SECURITIES ESTIMATES

Earnings revisions

We have downgraded our underlying EPS by -1.4%, -13.3% and -2.9% for FY19, FY20 and FY21 respectively. The earnings revision is driven by changed assumptions around the income payments from the Notes to ANZ.

Figure 5 - Earnings revisions

Earnings Revisions	FY19e (new)	FY19e (previous)	Change	FY20e (new)	FY20e (previous)	Change	FY21e (new)	FY21e (previous)	Change
EPS (Cash) (cps)	56.6	57.4	-1.4%	43.5	50.3	-13.5%	48.0	49.4	-2.7%
Dividend (øps)	47.5	48.5	-2.1%	38.0	41.0	-7.3%	38.0	38.0	0.0%

SOURCE: BELL POTTER SECURITIES ESTIMATES

IOOF overview

Company description

IFL is the combination of IOOF, Australian Wealth (previously AWM) and Skandia (the Australian Operations). The three businesses were combined in 2009. In late 2011 IOOF continued industry consolidation with the acquisition of the listed entities DKN, PLB and later SFG. The merged group is involved in activity throughout the financial services and wealth management value chain, with the company categorised in three groups:

- Platforms and administration;
- Distribution, which includes advice and trustee services; and
- Investment management, which includes Perennial Value stake.

Investment strategy

We see risk around the fully-integrated model and the changing regulatory environment.

Risks

Key risks for the stock include:

- **Key people risk** – Similar to other wealth management businesses, the loss of any key investment personnel may result in the loss of investment mandates, which is particularly relevant for Perennial;
- **Performance risk** – Investors are wary of investment managers that charge active management fees and that have underperformed the index over a prolonged period of time. It is important for Perennial to maintain reputable performance metrics across its product offering;
- **Financial Advice risk** – On the back of Storm Financial, Managed Investment Schemes and other well-known collapses in the industry, there is an added focus on any unsavoury practices and IFL will do well to steer clear of any negative headlines;
- **Regulatory risk** - IFL is regulated by multiple agencies and any changes in the regulatory regimes under which it operates may affect the financial performance and capital requirements of the group; and
- **Market risk** – A prolonged recession, economic crisis/shock, or other factors that may lead to a sustained weak market environment have the ability to adversely affect the earnings potential of the company.
- **Acquisition risk** – The acquisition of other assets can divert management effort from the current focus of the business, and there is a risk forecast numbers relating to the target business is not fulfilled.

Interim earnings

Figure 6 - Interim earnings

INCOME STATEMENT											
Y/e June 30 (\$m)	2017	1H18	2H18	2018	1H19	2H19e	2019e	1H20e	2H20e	2020e	2021e
Underlying sales revenue	567	291	290	580	323	337	660	293	287	579	579
EBITDA	249	134	137	272	154	157	311	110	106	215	212
D&A inc. employee grant amort.	49	25	25	50	29	29	58	29	29	58	59
EBIT	199	109	112	221	125	129	254	81	77	157	153
Net Interest	-2	1	6	7	-1	-9	-10	-3	2	-1	4
Associates (e.g. Perennial Value)	4	1	1	3	0	0	1	0	0	1	1
Pre-tax profit	200	112	119	231	125	120	244	78	79	157	158
Tax	66	34	40	74	42	38	80	25	25	50	50
Operating Profit	135	78	79	157	83	81	164	53	54	107	107
Minorities (e.g. Perennial G, FI etc)	-4	-3	-3	-5	-2	-2	-5	-2	-2	-5	-5
Underlying profit	131	75	77	152	80	79	159	51	52	102	103
One-off items	-17	-47	-17	-64	-4	-11	-14	-14	-14	-28	-28
Reported net profit	117	45	60	88	77	69	145	37	38	74	75
Cash net profit	169	95	97	191	100	99	199	70	71	142	142
SEGMENTALS											
Y/e June 30	2017	1H18	2H18	2018	1H19	2H19e	2019e	1H20e	2H20e	2020e	2021e
Platform and administration											
Gross margin and other revenue (\$m)	213	106	104	210	120	113	234	115	114	229	227
Costs (\$m)	96	45	44	90	57	53	110	54	54	108	107
EBITA (\$m)	117	61	59	121	64	60	124	61	60	121	120
Closing FUM (\$ billion)	37	39	40	40	40	43	43	44	45	45	47
Average FUM (\$ billion)	36	38	39	38	40	41	40	43	45	44	46
Revenue Margin (%)	0.59%	0.56%	0.54%	0.55%	0.58%	0.55%	0.57%	0.53%	0.51%	0.52%	0.50%
Advice and distribution											
Gross margin and other revenue (\$m)	225	114	113	227	113	105	218	107	107	215	215
Costs (\$m)	149	76	73	150	75	74	149	76	74	150	150
EBITA (\$m)	116	61	62	122	60	51	110	54	54	108	111
Closing FUM (\$ billion) (Ex. ANZ)	57	60	64	64	60	65	65	67	69	69	72
Average FUM (\$ billion) (Ex. ANZ)	54	58	61	60	62	63	62	66	68	67	71
Revenue Margin (%)	0.42%	0.39%	0.37%	0.38%	0.35%	0.34%	0.35%	0.33%	0.32%	0.32%	0.31%
Trustee Services											
Gross margin and other revenue (\$m)	29	15	18	34	0	0	0	0	0	0	0
Costs (\$m)	18	10	10	20	0	0	0	0	0	0	0
EBITA (\$m)	10	5	8	13	0	0	0	0	0	0	0
Closing FUM (\$ billion)	31	35	35	35	0	0	0	0	0	0	0
Average FUM (\$ billion)	30	33	35	34	0	0	0	0	0	0	0
Group Services*											
Costs (\$m)	-38	-17	-18	-35	-18	-19	-37	-20	-21	-41	-44
Investment management*											
Gross margin and other revenue (\$m)	58	30	31	62	33	33	66	35	36	70	73
Costs (\$m)	14	6	6	11	5	6	11	7	7	13	14
EBITA (\$m)	43	25	26	50	28	27	54	28	29	57	59
Closing FUM (\$ billion)	21	21	22	22	21	23	23	23	24	24	25
Average FUM (\$ billion)	20	21	22	21	22	22	22	23	24	23	24
Revenue Margin (%)	0.29%	0.29%	0.29%	0.29%	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%
Perennial GW, FI, RE & Global*											
Gross margin and other revenue (\$m)	0	0	0	0	0	0	0	0	0	0	0
Costs (\$m)	0	0	0	0	0	0	0	0	0	0	0
EBITA (\$m)	0	0	0	0	0	0	0	0	0	0	0
Perennial Value and other income*											
Associate contribution (\$m)	4	1	1	3	0	0	1	0	0	1	1
ANZ Aligned Dealer Groups											
EBITDA (\$m)					21	39	60	-13	-17	-30	-34

* Company data coupled with BP estimates (for historicals)

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Table 1 - Financial summary

IOOF (IFL)						Target Price (A\$)	4.39				Share Price (A\$)	5.82
						Recommendation:	Sell				Market Cap (A\$m)	2,043
INCOME STATEMENT												
Y/e June 30 (\$m)	2017	2018	2019e	2020e	2021e							
Underlying sales revenue	567	580	660	579	579							
EBITDA	249	272	311	215	212							
D&A inc. employee grant amort.	49	50	58	58	59							
EBIT	199	221	254	157	153							
Net Interest	-2	7	-10	-1	4							
Associates (PV and small other)	4	3	1	1	1							
Pre-tax profit	200	231	244	157	158							
Tax	66	74	80	50	50							
Operating Profit	135	157	164	107	107							
Minorities (Perennial G, FI)	-4	-5	-5	-5	-5							
Underlying profit	131	152	159	102	103							
One-off items	-17	-64	-14	-28	-28							
Reported net profit	117	88	145	74	75							
Cash net profit	169	191	199	142	142							
CASHFLOW												
Y/e June 30 (\$m)	2017	2018	2019e	2020e	2021e							
EBITDA	249	272	311	215	212							
Change in provisions	2	52	86	-116	1							
Working capital change	1	-1	-190	178	0							
Net interest	-2	7	-10	-1	4							
Tax paid	-66	-74	-80	-50	-50							
Other	0	-3	-4	-4	-4							
Operating cashflow	183	253	113	222	162							
Capex	-1	-10	-29	-15	-15							
Investments	-5	4	0	-15	0							
Asset sales	0	0	0	0	0							
Other	0	0	0	27	23							
Investing cashflow	-6	-7	-30	-3	8							
Equity raised	37	37	37	0	0							
Dividends paid	-156	-176	-184	-139	-113							
Other	-3	-3	-7	-4	-4							
Financing cashflow	-122	-142	-155	-143	-117							
Net change in cash	55	105	-71	76	53							
Cash at end of period	208	529	73	178	180							
BALANCE SHEET												
Y/e June 30 (\$m)	2017	2018	2019e	2020e	2021e							
Cash	208	529	73	178	180							
Receivables	108	100	304	115	115							
Benefit fund cash and assets	980	1,092	1,039	1,035	1,035							
PPE	21	19	39	54	54							
Intangibles	1,396	1,349	1,319	1,283	1,243							
Other	37	43	842	42	42							
Total assets	2,751	3,131	3,616	2,707	2,670							
Payables	60	65	76	65	65							
Debt	207	0	417	0	0							
Provisions	65	116	202	86	87							
Benefit fund liabilities	934	1,036	985	985	985							
Other	125	100	102	102	102							
Total liabilities	1,391	1,318	1,782	1,238	1,239							
Shareholders' equity	1,434	1,967	1,967	1,667	1,667							
Total shareholders funds	1,360	1,813	1,834	1,469	1,432							
W/A diluted shares on issue	300	326	351	326	296							
INTERIMS												
Half end December 31 (\$m)	1H17	1H18	1H19e	1H20e	1H21e							
Sales revenue	280	291	323	293	290							
EBIT	90	109	125	81	77							
Pre tax profit	91	112	125	78	79							
Underlying profit	60	75	80	51	52							
One-off items	14	-47	-4	-14	-14							
Reported profit	74	45	77	37	38							
Interim DPS (cents)	26	27	26	19	19							
VALUATION DATA												
Y/e June 30 (\$m)	2017	2018	2019e	2020e	2021e							
Cash net profit (\$m)	169	191	199	142	142							
Cash EPS (c)	56.4	58.8	56.6	43.5	48.0							
Cash P/E (x)	10.3	9.9	10.3	13.4	12.1							
Cash EPS growth (%)	-2.3%	4.2%	-3.7%	-23.2%	10.4%							
Net profit adj (\$m)	131	152	159	102	103							
Adjusted EPS (c)	44	45	45	31	35							
EPS growth (%)	0%	1%	1%	-31%	11%							
P/E ratio (x)	13.1	12.9	12.8	18.5	16.6							
CFPS (c)	61	78	32	68	55							
Price/CF (x)	9.5	7.5	18.1	8.5	10.7							
DPS inc special(c)	53	54	48	38	38							
Yield ex special (%)	9.1%	9.3%	8.2%	6.5%	6.5%							
Franching (%)	100%	100%	100%	100%	100%							
EVEBITDA (x)	7.1	6.5	5.7	8.2	8.3							
Price/book (x)	1.3	1.0	1.1	1.3	1.2							
NTA (\$)	-0.12	1.43	1.47	0.57	0.64							
PROFITABILITY RATIOS												
Y/e June 30 (\$m)	2017	2018	2019e	2020e	2021e							
EBIT/sales (%)	35%	38%	38%	27%	26%							
ROA (ex benefit fund) (%)	11%	12%	11%	7%	9%							
Return on equity (%)	12%	12%	11%	9%	10%							
Dividend cover (x)	0.7	0.6	0.9	0.6	0.7							
Effective tax rate and NCI (%)	33%	32%	33%	32%	32%							
LIQUIDITY AND LEVERAGE RATIOS												
Y/e June 30 (\$m)	2017	2018	2019e	2020e	2021e							
Net debt/(cash) (\$m)	-1	-529	344	-178	-180							
Net debt/equity (%)	0%	-29%	19%	-12%	-13%							
SEGMENTALS												
Y/e June 30	2017	2018	2019e	2020e	2021e							
Platform and administration												
Gross margin and other revenue (\$m)	213	210	234	229	227							
Costs (\$m)	96	90	110	108	107							
EBITA (\$m)	117	121	124	121	120							
Closing FUM (\$ billion)	37	40	43	45	47							
Average FUM (\$ billion)	36	38	40	44	46							
Revenue Margin (%)	0.59%	0.55%	0.57%	0.52%	0.50%							
Advice and distribution												
Gross margin and other revenue (\$m)	225	227	218	215	215							
Costs (\$m)	149	150	149	150	150							
EBITA (\$m)	116	122	110	108	111							
Closing FUM (\$ billion)	57	64	65	69	72							
Average FUM (\$ billion)	54	60	62	67	71							
Revenue Margin (%)	0.42%	0.38%	0.35%	0.32%	0.31%							
Trustee Services												
Gross margin and other revenue (\$m)	29	34	0	0	0							
Costs (\$m)	18	20	0	0	0							
EBITA (\$m)	10	13	0	0	0							
Closing FUM (\$ billion)	31	35	0	0	0							
Average FUM (\$ billion)	30	34	0	0	0							
Group Services												
Costs (\$m)	-38	-35	-37	-41	-44							
Investment management												
Gross margin and other revenue (\$m)	58	62	66	70	73							
Costs (\$m)	14	11	11	13	14							
EBITA (\$m)	43	50	54	57	59							
Revenue Margin (%)	0.29%	0.29%	0.30%	0.30%	0.30%							
Perennial GW, FI, RE & Global												
Gross margin and other revenue (\$m)	0	0	0	0	0							
Costs (\$m)	0	0	0	0	0							
EBITA (\$m)	0	0	0	0	0							
Perennial Value and other income												
Associate contribution (\$m)	4	3	1	1	1							
ANZ Aligned Dealer Groups												
EBITDA (\$m)			60	-30	-34							

SOURCE: BELL POTTER SECURITIES ESTIMATES

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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