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IOOF Holdings (IFL)

Upgrade to Buy

Recommendation

Buy (Hold)

Price

\$9.98

Target (12 months)

\$11.10 (previously \$10.90)

Expected Return

Capital growth	11.2%
Dividend yield	5.3%
Total expected return	16.5%

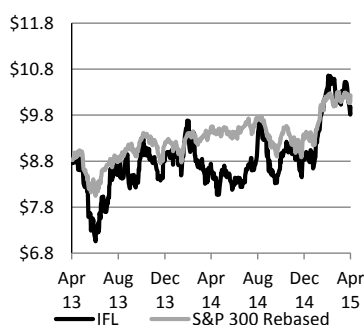
Company Data & Ratios

Enterprise value	\$3.0b
Market cap	\$3.0b
Issued capital	300.1m
Free float	88%
Avg. daily val. (52wk)	\$11.2m
12 month price range	\$8.01 - \$10.73
GICS sector	Diversified Financials

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	10.19	8.76	8.65
Absolute (%)	-2.06	13.93	15.38
Rel market (%)	-1.68	2.23	6.71

Absolute Price



SOURCE: IRESS

Attractive proposition

We revisit IFL following a solid March quarter net-flow and FUMA update, which includes strong mark-to-market gains. We have upgraded our recommendation from a Hold to a Buy for the following reasons:

- The business is displaying strong organic growth in the key divisions of Platforms and Advice & Distribution;
- There remains meaningful synergies to be extracted from the SFG acquisition;
- The share price has fallen and Price Target increased since we downgraded to a Hold; and
- We believe the current low interest rate environment remains generally supportive of wealth managers.

March quarter FUMA and net-flow highlights

IFL's closing Funds Under Management and Administration (FUMA) grew from \$118.7 billion at the end of December 2014 to \$125.4 billion at the end of March 2015. The strong growth in FUMA was primarily attributable to strong market gains but also from positive net-flows. Net-flows in Advice and Distribution was aided by a strong contribution from SFG.

Earnings revisions

We have slightly upgraded our Cash EPS by 1.6%, 1.1% and 0.9% for FY15, FY16 and FY17 respectively. The upgrades follow stronger mark-to-markets than we were anticipating. We have increased our Price Target to \$11.10 per share (previously \$10.90) based on our sum-of-the-parts and DCF valuation methodology detailed on page three of the report. Our revised recommendation is Buy (previously Hold).

Earnings Forecast

Year end June 30	2014	2015e	2016e	2017e
Total revenue (\$m)	426.4	593.4	656.9	709.5
EBITDA (\$m)	174.6	249.3	297.1	321.4
NPAT (underlying) (A\$m)	98.7	149.4	185.8	206.2
NPAT (cash) (A\$m)	123.0	173.9	208.5	226.9
EPS (cash) (cps)	53	61	69	76
Cash EPS growth (%)	13%	14%	15%	9%
Cash PER (x)	18.8	16.5	14.4	13.2
EV/EBITDA (x)	17.2	12.0	10.1	9.3
Price/CF (x)	18.3	15.3	13.4	12.4
Dividend (eps)	48	53	61	66
Yield (%)	4.8%	5.3%	6.1%	6.6%
ROE (%)	15.1%	15.9%	15.0%	16.1%
Franking (%)	100.0%	100.0%	100.0%	100.0%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Platform net-flows remain robust

Key March Quarterly Highlights

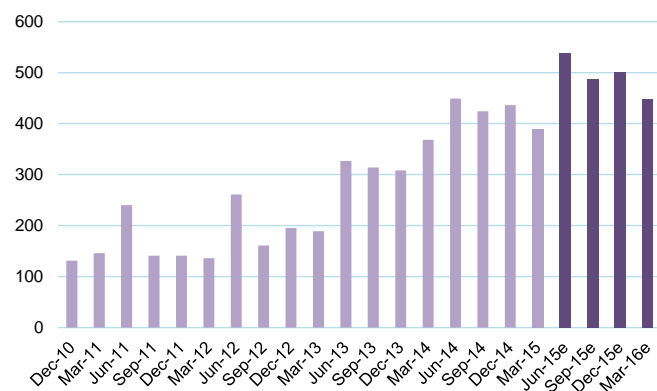
- Platform net-flows of \$343m vs our \$372m estimate;
- Closing Platform FUA of \$35.7 billion, 0.6% below our \$35.9 billion estimate;
- Advice and Distribution flows of \$308m (ex-SFG) vs our \$386m estimate; and
- Negative Investment Management net-flows of \$359m.

Figure 1 - Quarterly FUM and net-flows

	FY13				FY14				FY15e				FY16e			
	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	
Platform and Administration																
Quarterly-flows (\$m)																
Flagship	872	314	308	368	449	1,439	424	436	389	539	1,788	488	501	447	620	2,056
Transition	-258	-84	26	-40	-59	-157	-4	-38	-45	-50	-137	-30	-32	-38	-43	-143
Global One	-352	-85	-67	-94	-16	-262	0	0	0	0	0	0	0	0	0	0
Total	262	145	267	234	374	1,020	420	398	344	489	1,651	458	469	409	577	1,913
Opening balance (\$ billion)	23.3	28.5	30.0	30.9	31.2	28.5	31.9	32.4	33.6	35.7	31.9	36.6	37.6	38.5	39.5	36.6
Net-flows	0.3	0.1	0.3	0.2	0.4	1.0	0.4	0.4	0.3	0.5	1.7	0.5	0.5	0.4	0.6	1.9
Market movement and other	4.9	1.4	0.6	0.0	0.4	2.4	0.1	0.8	1.7	0.5	3.1	0.5	0.5	0.5	0.5	2.0
Closing balance	28.5	30.0	30.9	31.2	31.9	31.9	32.4	33.6	35.7	36.6	36.6	37.6	38.5	39.5	40.6	40.6
Advice and Distribution (ex SFG)																
Quarterly-flows (\$m)	464	139	110	193	392	834	285	381	255	470	1,391	314	419	281	564	1,578
Opening balance (\$ billion)	26.3	30.2	31.3	31.7	31.9	30.2	32.6	32.6	34.0	35.6	32.6	36.5	37.3	38.2	39.0	36.5
Net-flows	0.5	0.1	0.1	0.2	0.4	0.8	0.3	0.4	0.3	0.5	1.4	0.3	0.4	0.3	0.6	1.6
Market movement	3.4	0.9	0.3	0.0	0.3	1.6	-0.3	1.0	1.3	0.5	2.5	0.5	0.5	0.5	0.5	2.0
Closing balance	30.2	31.3	31.7	31.9	32.6	32.6	34.0	35.6	36.5	36.5	37.3	38.2	39.0	40.1	40.1	40.1

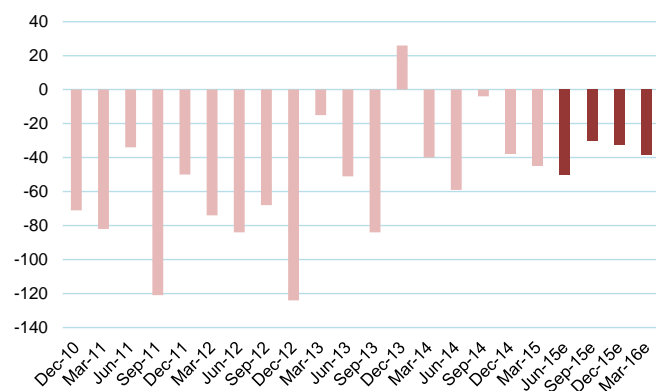
SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 2 - Flagship platform net-flows (\$m)



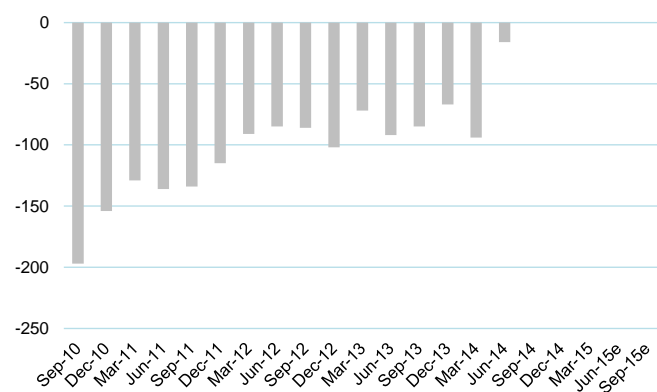
SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 3 - Transition platforms net-flows (\$m)



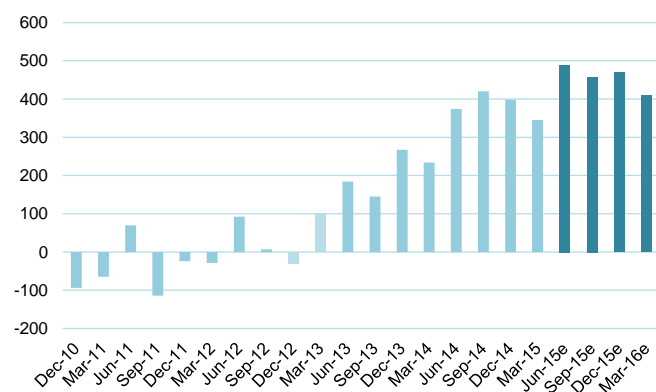
SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 4 - GlobalOne platform net-flows (\$m)



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 5 - Total platform net-flows (\$m)



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Valuation and earnings revisions

Sum-Of-The Parts and DCF methodology updated

We have increased our Price Target to \$11.10 per share (previously \$10.90) based on our sum-of-the-parts and DCF valuation methodology as detailed in the Figure below. The Price Target increase is primarily driven by our earnings revisions noted below.

Figure 6 - Valuation

	FY15e Cash NPAT	Multiple	Valuation (\$m)
Platforms and administration	94.6	16.0	1,514
Advice and distribution	27.4	15.0	411
Investment manager	24.5	16.0	391
Perennial (ex P. Value) 60%	9.2	15.0	83
Perennial Value Stake (at 42%)	10.0	15.0	149
Trustee	6.8	15.0	103
Adjusted SFG and cost out			790
Group office	-26.0	10.0	-260
Net-cash			-54
		S.O.P. Value (\$m)	3,127
		Share count (m)	300
		S.O.P. per share (\$)	10.42
		DCF value per share (\$)	11.76
		Simple average of two (\$)	11.09

SOURCE: BELL POTTER SECURITIES ESTIMATES

Earnings revisions

We have slightly upgraded our Cash EPS by 1.6%, 1.1% and 0.9% for FY15, FY16 and FY17 respectively. The upgrades follow stronger mark-to-markets than we were anticipating.

Figure 7 - Earnings revisions

Earnings Revisions	FY15e (new)	FY15e (previous)	Change	FY16e (new)	FY16e (previous)	Change	FY17e (new)	FY17e (previous)	Change
EPS (Cash) (cps)	60.7	59.7	1.6%	69.5	68.7	1.1%	75.6	74.9	0.9%
Dividend (cps)	53.0	52.0	1.9%	61.0	60.0	1.7%	66.0	65.0	1.5%

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.

Platforms and administration is the largest contributor to the Group, accounting for over half of earnings.

Investment strategy

We like the wealth management sector, and believe the business is in a good position as the revenue drivers gain traction through higher FUM, net-flows and a more favourable asset-mix.

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.

Interim Earnings

Figure 8 - Interim Earnings

INCOME STATEMENT									
Y/e June 30 (\$m)	1H14	1H14	2014	1H15	1H15e	2015e	1H16e	1H16e	2016e
Underlying sales revenue	212	214	426	288	306	593	320	337	657
EBITDA	86	89	175	116	134	249	141	156	297
D&A inc. employee grant amort.	18	17	35	18	18	36	17	17	34
EBIT	68	72	140	98	116	213	123	139	263
Net Interest	0	0	0	-2	-3	-5	-3	-2	-5
Associates (e.g. Perennial Value)	4	4	7	3	4	7	4	4	8
Pre-tax profit	72	75	147	99	117	215	125	141	266
Tax	21	17	38	25	30	55	33	37	70
Operating Profit	51	59	109	74	86	160	92	104	196
Minorities (e.g. Perennial G, FI etc)	-5	-6	-10	-6	-5	-11	-5	-5	-10
Underlying profit	46	53	99	68	81	149	87	99	186
One-off items	2	0	3	0	0	0	0	0	0
Reported net profit	48	53	101	68	81	149	87	99	186
Cash net profit	58	65	123	81	93	174	99	110	209
SEGMENTALS									
Y/e June 30	1H14	1H14	2014	1H15	1H15e	2015e	1H16e	1H16e	2016e
Platform and administration									
Gross margin and other revenue (\$m)	103	106	209	111	116	226	124	129	253
Costs (\$m)	45	45	90	46	49	95	52	54	106
EBITA (\$m)	59	61	120	64	67	131	72	75	146
Closing FUM (\$ billion)	31	32	32	34	37	37	39	41	41
Average FUM (\$ billion)	30	31	31	33	35	34	38	40	39
Revenue Margin (%)	0.69%	0.67%	0.68%	0.67%	0.66%	0.67%	0.66%	0.65%	0.66%
Advice and distribution									
Gross margin and other revenue (\$m)	54	53	107	58	61	119	65	68	133
Costs (\$m)	37	38	75	39	42	81	44	46	90
EBITA (\$m)	17	15	32	19	20	38	21	22	42
Closing FUM (\$ billion)	32	33	33	34	37	37	38	40	40
Average FUM (\$ billion)	31	32	32	33	35	34	37	39	38
Revenue Margin (%)	0.35%	0.33%	0.34%	0.35%	0.35%	0.35%	0.35%	0.35%	0.35%
Trustee Services									
Gross margin and other revenue (\$m)	13	13	26	13	14	27	15	15	30
Costs (\$m)	8	8	16	9	9	18	10	10	20
EBITA (\$m)	5	4	10	5	5	10	5	5	11
Closing FUM (\$ billion)	30	26	26	26	29	29	30	30	30
Average FUM (\$ billion)	31	26	26	26	27	27	29	30	30
Group Services*									
Costs (\$m)	-19	-16	-35	-19	-17	-36	-20	-18	-38
Investment management*									
Gross margin and other revenue (\$m)	26	27	52	27	29	56	31	32	64
Costs (\$m)	9	10	19	11	11	22	12	13	25
EBITA (\$m)	16	17	33	16	18	34	19	20	39
Closing FUM (\$ billion)	14	14	14	15	17	17	18	18	18
Average FUM (\$ billion)	13	14	14	15	16	16	17	18	18
Revenue Margin (%)	0.38%	0.38%	0.38%	0.36%	0.36%	0.36%	0.36%	0.36%	0.36%
Perennial GW, FI, RE & Global*									
Gross margin and other revenue (\$m)	16	15	31	12	12	24	12	13	25
Costs (\$m)	8	8	17	6	6	11	6	6	12
EBITA (\$m)	8	7	15	6	6	13	7	7	13
Perennial Value*									
Associate contribution (\$m)	4	2	6	3	4	7	4	4	8
Total Perennial closing FUM (\$b)	17.6	17.0	17.0	16.0	16.6	16.6	17.3	18.0	18.0
Total Perennial average FUM (\$b)	16.8	17.3	17.0	16.5	16.3	16.4	17.0	17.7	17.3

* Company data coupled with BP estimates (for historicals)

SOURCE: COMPANY DATA AND 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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