"IIFL Wealth Management Limited Q1 FY20 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the IIFL Wealth Management Limited Q1 FY20 Earnings Conference Call.

As a reminder, all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference, please signal an operator by pressing '*' then '0' on your touch-tone phone. Please note that this conference is being recorded.

We have with us on the call today the management of IIFL Wealth Management represented by Mr. Karan Bhagat, Mr. Anshuman Maheshwary, Mr. Mihir Nanavati, and Mr. Pavan Manghnani. I will now hand the conference over to Mr. Anshuman Maheshwary. Thank you and over to you, sir.

Anshuman Maheshwary: Good afternoon everyone. Thank you for joining the call. What we will do today is over the next 45 minutes to an hour, we will split the call over three parts. The first part, we will have a walk-through of the quarterly financial performance and where the numbers stand vis-a-vis last quarter and last year. The second part, Karan will give an overall view on the business performance and outlook over the wealth and asset management business and then we will open up for questions and answers. With that, let me ask Mihir to start with the overall financial performance update.

Mihir Nanavati: To update the financial performance for the quarter ended June 30, 2019, IIFL Wealth Management Limited reported a consolidated profit after tax of Rs. 61 crores, down 27% Q-on-Q and down 48% YOY; total income of Rs. 217 crores, down 12% Q-on-Q and down 26% YOY; and this has to be seen in the context where annual recurring revenue increased to 129 crores from 100 crores YOY, an increase of 29% and from 125 to 129 over the previous quarter, reporting a gain of 3% or increase of 3%. However, the transactional or brokerage revenue declined to 82 crores from 191 crores YOY and from 120 crores to 82 crores Q-on-Q representing a reduction of 31%. Total expenses declined by 11% to 127 crores on YOY basis and 8% on quarter-on-quarter basis. Profit before tax declined by 40% YOY to 90 crores and by 29% on Q-on-Q basis.

This has to be seen in the context of two specific developments. a) Global and domestic headwinds in financial markets, and despite that we have been able to grow our AUM by 6000 crores for the quarter and that includes 5000 crores of recurring revenue as such. b) Our philosophy of capital preservation has held us in good stead, and in this challenging market conditions, IIFL-ONE which is our new advisory platform which aims to institutionalize a range of investment options for clients under a competitive and transparent fee structure, and through this initiative, the aim to redefine client engagement for wealth management in India. We believe we will strongly drive our growth for the next few years with this platform.

With this, I hand over to Karan to take you through an overview of business and financials for the quarter and in the period.

Karan Bhagat: From a capital markets and NBFCs standpoint, the last 12 to 18 months have been extremely challenging. IIFL Wealth, however, since March of last year has been conservatively positioned not only for its own balance sheet but most importantly for its clients. Our asset allocation for our clients continues to be predominantly in the form of fixed income; within fixed income, predominantly between AAA and sovereign papers. With the result that both our balance sheet as well as our client portfolios continued to be well protected through the entire period of 12 to 16 months.

Our continued focus would be to aim at ensuring the objective of capital preservation and wealth preservation as opposed to shorter-term approach of wealth creation for our clients. As we go forward, we believe the industry will consolidate in multiple ways. The first consolidation will essentially help us attract more and more relationship managers to our fold. Our ability to retain and recruit new talent has never been stronger than what we have seen over the last 3 to 4 months. Our client attrition ratios continue to be below 1% to 1.5%. Most of our portfolios continue to be fairly fairly immune to a large amount of volatility, and broadly speaking, asset allocation has been in the region of 55% to 60% in the form of fixed income and 40% to 45% in the form of equity.

As we go forward, we continue to focus on a very high level of engagement with clients, a 24x7 service, and ensuring that attrition of clients continues to be as low as possible. On market share in terms of net new money coming into the industry continues to be fairly high. Among all the large transactions were essentially new clients, have ended up with large amounts of money on account of monetization of their businesses. We continue to maintain a 65% to 70% market share in that segment.

As we go forward, we want to continue being ahead of the curve, both in terms of business models as well as product innovation. On business models, we believe the industry is at a very very important curve where the industry is kind of going to get massively redefined in the form of a registered investment advisor as opposed to the conventional broker distributor.

Over the last decade or so, wealth manager's fee structures have been defined through the broker-dealer relationship with the client as opposed to that of a registered investment advisor. With the launch of IIFL-ONE 6 months back, we have taken a firm footing forward in order to redefine our fee engagement with clients in the form of advisory. The big benefit we have had over the last decade is our engagement with clients has always been that in the form of an adviser's relationship. The fee, however, has been driven on a broker-distributor model. As we make this transformation, we need to make two or three important changes which we have made over the last 3 to 6 months.

The most important change which is required to make is recognition of revenues from an upfront to a trail basis. For all products of all forms and natures including all alternate products as well as portfolio management schemes and mutual funds even though not required by the regulator. As a firm, we have taken a decision to move to an all-trail model effective 1st of April this year.

In the short term, it obviously causes a little bit of a revenue mismatch especially on a comparable basis to last year, as all products sold on the alternates and PMS platform which were recognized for a longer period of time in the previous year now get recognized only on a trail basis. Just to give a sense of what that number looks like, for the last year, our gross sales on alternates and PMS were in the region of 12,500 to 13,000 crores resulting in an upfront revenue of roundabout 320 crores. Accounted on a pure trail basis, the same revenue would fall to 60 crores for last year, and assuming the same revenue pass through the same profit & loss account for last year with no changes, the last year's profit after tax on a comparable basis from 384 odd crores would fall to 210 crores for last year. This is a one-time change and essentially in a sense resets our PAT base to 210 crores for last year as opposed to 385 crores.

In categorization of our revenues, we are clubbing our revenues going forward into two distinct parts. The first part being referred to as ARR essentially annual recurring revenue and as the word denotes it is essentially revenue which is recurring provided the assets we have on 1st April retain through 31st of March next year. The annual recurring revenue over the last 8 to 12 quarters has seen a huge amount of stability, both in terms of stickiness as well as in terms of retention. The retention on the ARR asset typically tends to be a fair constant, and barring events like we saw the reduction of TER, it really has not seen any kind of seasonality to the capital market itself.

The transaction income is a function of the ARR itself and typically tends to be in the region of 25% to 35% of the ARR assets. In our case, the transaction income is spread across asset classes, fixed income, equity, a little bit of syndication. Referral fees essentially accounts for our transaction fees on the business side. So, ARR essentially in a sense would not be fairly volatile on a quarterly basis. Transaction income also doesn't tend to be massively volatile but could swing between 20% to 40% of our ARR income depending on the capital markets for that specific quarter.

The large amount of volatility which was coming on accounted for the AIF and PMS on an upfront basis will no longer be there going forward and hence the volatility in yields on a quarter-to-quarter basis would significantly reduce going forward. This is the model we intend to adopt.

The challenges going forward in this model essentially need a very strong education and a very strong buying from all the relationship managers of the firm. We need to re-effectively design our dashboards; our dashboards both to our clients as well as to our relationship managers. The KRA for our relationship managers moves away from revenue and goes to assets. We have invested the best part of our last 24 months in educating our relationship managers of the benefits of this. We have also spent a lot of our time on clients over the last 2-1/2 to 3 months on educating them about our benefits and their benefits most importantly on moving to a structure like this. I am pleased to say that there is a massive acceptance across the board for a structure like this and both clients as well as relationship managers see inherent benefits of moving to an advisory model like this and building more durable as well as scalable model in times to come.

On the product side, we continue to invest. Innovation continues to be a cornerstone for us. Product ends up being fairly important in our business. More often than not, we get access to a lot of new clients through our product platform and that is something we continue to focus on a lot as we go forward.

On the asset management side, our alternate business continues to grow. We are now close to roundabout $3.5 billion on the alternate asset management side. Our pre-IPO fund which was close to roundabout $1.5 billion in spite of being really large in size has been able to do a phenomenally commendable job in terms of managing its portfolio. On the listed side which is nearly 55% to 60% of the overall fund, we have been able to do extremely well. In spite of a challenging market over the last 15 to 18 months, the portfolio continues to run on a positive IRR of 14% to 15% on account of selectively selecting in fact the entire portion into a good quality select large caps. As we go forward, we look forward to building that business also and continuing to innovate on the product side.

With that, pretty much we would move forward to the Q&A and would request the operator to open the line for questions & answers.

Moderator: We will now begin with the question & answer session. The first question is from the line of Rohit Mohan from Centrum Broking. Please go ahead.

Rohit Mohan: How much time would you guys think that you will be able to get back to the revenues that you were doing in 2018-19? Since that model is completely moved into an advisory model, what is the plan or maybe even more than what you guys were telling?

Karan Bhagat: I think the way to look at it is the ARR assets which is essentially going to be the determinant of our ability to move back to revenues should see ideally disproportionate growth over the first 2-1/2 years because assets which were earlier locked in into alternates and portfolio management schemes or even mutual funds where we have already received revenue will come up for maturity over the next 36 months in practically equal installments. As those assets move into ARR asset, it continues to add into the revenue. In addition to the net new money coming on account of net new flows moving into ARR asset, it should further get accentuated by the older assets moving into that segment. We strongly believe towards the end of the current year which is quarter 4, we should be towards the same run rate in terms of profit after tax as we had towards the last year, and towards the end of next year, potentially end up being at a much higher trajectory of growth compared to our last year's profit after tax.

So, to answer your question, I think the exit PAT for quarter 4 in the current year should more or less get us back to the same numbers as last year.

Moderator: The next question is from the line of Umang Shah from SAIF Partners. Please go ahead.

Umang Shah: If you could update us with the timelines for the IPO of the wealth business or when it gets listed?

Karan Bhagat: Basically, I think the NSE and BSE approvals have come through roundabout 3 days back. We would expect the SEBI approval over the next week or so. Post that, there are some procedural advertisements in the newspapers and so on and so forth. So, I think around the 5th to 8th September is the likely date for the listing.

Umang Shah: Karan, you mentioned that on the AMC side, you are moving to all trail-based revenue recognition, moving away from the upfront; so, on the distribution side, is it a similar case or do we have some upfront income on the distribution side as well?

Karan Bhagat: No, the asset management was always fully on trail, Umang. On the distribution side, we have moved to full trail also.

Umang Shah: Some data-keeping questions. You have classified mutual funds under transactional or brokerage assets in your deck. Isn't that part of annual recurring revenue assets?

Karan Bhagat: Those are essentially mutual funds which are either sitting in direct plans on which we are not making anything on a recurring basis because they have got invested in the direct plan or they are mutual funds where we have already received upfront earlier and as and when they mature and move toward trail model, they will move to the ARR portion of asset. Our mutual funds are roundabout 52,000 crores, would be kind of broken up roundabout 20,000 odd crores in the ARR bucket and roundabout 32,000 crores on the transactional bucket. But as time goes by, we will keep moving more and more from the transactional bucket to the ARR bucket.

Umang Shah: Karan, if you could give us some commentary on what you mean by managed assets and custody assets?

Karan Bhagat: Custody assets are essentially structurally kind of promoter assets sitting in our depositary. They effectively don't yield us anything on an ongoing basis. Effectively, in that sense, are dormant and effectively including that, either is representing in total assets or including that in our retention calculations, can spoil the numbers on a yearly or quarterly basis because they really don't represent any significant amount of revenue to us.

Umang Shah: What about managed assets, Karan?

Karan Bhagat: Managed assets are nothing but managed accounts. They are distinct from mutual funds in the form that they represent alternative investments and PMS put together.

Umang Shah: But you classify managed accounts separately from PMS and AIF. What are these exactly? I didn't understand this very well, Karan.

Karan Bhagat: Managed accounts are AIF.

Umang Shah: Last question, Karan. If you could help us with the trajectory of the yields. We are at 62 bps. Do you see this settling in here? Do you see this going up? Some commentary on the yields.

Karan Bhagat: As I was saying earlier, I think the yields on the ARR assets I expect it to be fairly constant and not extremely kind of driven by quarterly capital market movements. Directionally, I think on the yields, it will be kind of broken up into in the longer-term basis in the following way. You will have approximately roundabout the recurring revenue earning asset settling at in the region of roundabout 70 to 75 basis points as scale builds up as compared to the 83-84 basis points right now. On the transaction revenues, it will end up being roundabout very similar 35-40 basis points as what we are seeing today. You will no longer see the 80-90 basis points because that also had its own component of the upfront revenue recognition happening on account of the sale of the AIF and PMS. So, transaction revenues typically will be in the region of 30 to 40 basis points and the ARR revenue will be in the region of 70 to 75 basis points. But the important thing to understand between the two is the ARR retention is on stock and the transaction revenue is on flow. So, the ARR revenue tends to be substantially higher over a period of time because it kind of repeats itself on the stock of assets as opposed to the transaction revenue which repeats itself on the flow of assets. If you see the flow of assets, it typically tends to be in the region of 15% to 20% of the existing opening stock. So, effectively transaction revenue would tend to become relatively smaller percentage as compared to the ARR revenue.

Moderator: The next question is from the line of Shivakumar. Please go ahead.

Shivakumar: Karan, what explains the steep rise in employee expenses on a sequential basis?

Karan Bhagat: On Q-on-Q, I have given in the footnotes. Quarter 1 and quarter 2 of last year, there was a large part of our variable expenses got covered in Q1 and Q2 on account of the same larger amount of transaction income being booked in quarter 1 and quarter 2. In quarter 4, there is a one-time variable bonus provision reversal of 25 crores. Ex of that, the expenses have actually come down in terms of employee costs. It has come down from 85 crores of quarter 4 to 81 crores in quarter 1 of the current year.

Shivakumar: Going forward in this year, do you expect to add on to the team or this will stay at these levels?

Karan Bhagat: We continue to add on to the team, but at the same time, we have got some bit of flexibility in terms of improving productivity. So, our sales team generally speaking is fairly productive, but I think there is a scope of 5% to 7% improvement in terms of productivity across the firm in terms of employee costs which I think will kind of get offset by the new hires we have. So, I don't expect too much of an aberration in terms of the average where we are in terms of employee cost. So, what is currently 81 crores will more or less kind of be within the -5 to the current range through the year because it is not about a 5% to 10% reduction in the existing cost on account of productivity, will be offset by the new recruitment we do.

Shivakumar: Karan, would you endeavor to convert these 97,000 transactional assets into ARR assets even during this year? While incremental assets add on to the ARR assets, you would also look to convert the transaction into ARR assets, right? So, what's the target you have in mind? How much of it can be converted to ARR?

Karan Bhagat: If you see globally, actually there is no private wealth firm which would have 100% in ARR, but typically the split in terms of assets ends up being in the region of 75:25 with 75% in ARR and roundabout 25% in transaction. I think the revenue breakup typically should end up being closer to 70% in the form of ARR revenues and 30% in the form of transaction revenues. As we go along, I think of the assets net of custody, we would push to have roundabout 75% of that in ARR which effectively means in a year like this, from a starting point of 58,000 crores, we would ideally like to push towards 80,000 to 85,000 crore number on the ARR assets.

The best way to look at it is for the current year and the next two years, we would like to see a disproportionate growth in ARR assets which essentially would mean roundabout 15 odd percent coming from net new money and another 15 odd percent getting converted from the older assets. So, the first 2 to 2-1/2 years, we would like to see nearly 30% growth in the ARR assets. I think post that, it will be settled down at 15% to 20%.

Shivakumar: In terms of yield, you were saying that you would again reach the same yield at which we exited FY19 which was 74 bps in Q4 FY19. Do you think it is a realistic assumption to make that over the course of the year again at Q4 FY20, you will get back to the 70-75 bps yield?

Karan Bhagat: I didn't say the same yield, I said the same exit profit after tax to reach the same 395 crore PAT number.

Shivakumar: Okay, you were talking about absolute number.

Karan Bhagat: So, the yield might be slightly lower because the asset base will be larger, but as I said earlier, I think the yield on the ARR assets, I expect it to be in the region of 75 basis points as contrasted to the 84 basis points which we are seeing right now and the transactional brokerage yield will more or less remain where it is.

Shivakumar: So, for FY20, you are still confident that you will get to the mark at which you exited FY19 for the full year, 384 crores, right?

Karan Bhagat: Yeah, if you actually see the breakup on the yields on the recurring revenue assets from FY19 quarter 1 and even if you go back even before that all the way to now, there is hardly any volatility in the yield itself. So, the yield typically ends up being in the region of 80 to 90 basis points which I am saying as we move towards IIFL-ONE which is charging the client a fee, I would expect the 5 to 7 basis points compression.

Moderator: The next question is from the line of Dipayan Kothari from Edelweiss. Please go ahead.

Dipayan Kothari: My question is with respect to the loan book which for the last two to three quarters has been on the similar range in terms of the size of the book and it is a very large contributor of your wealth revenue as a percentage. In fact, the percentage has gone up. I just wanted to understand the outlook of yours for this business, you plan to scale it up, and how you see it going forward?

Karan Bhagat: Our loan book is a fairly unique loan book in a way. Our loan book essentially is not a pure pure loan book. It is essentially set up as a loan against shares book for our clients to draw against their investments with us. So, the loan book for us would typically tend to be in the region of 3% to 4% of the assets we manage. For example, on our AUM base of roundabout 1,40,000 crores today, 3% would be in the region of roundabout 4000 to 4200 odd crores. In extremely buoyant capital markets, this could move to 4% but that's the range it would more or less maintain, 3% to 4% of the assets we manage. Now, it is unique in a way because there is no sales employee on the NBFC side at all. Our total employee strength is practically 3 people there. The entire distribution cost for that book essentially fits with the wealth management relationship manager, as he is the one who is essentially on kind of a complementary function originating the loan from the wealth client. Our asset side is only to our wealth management clients. Similarly, our liabilities side also is only from our wealth management clients where essentially our entire liability is from NCDs raised from our wealth clients.

Our lending rates continue to be fairly competitive as they are absolutely collateralized against very very liquid investments. So, our lending rates even today continue to be in the region of 10.75 to 11. Our borrowing cost which effectively is through NCDs from our clients typically tends today to be in the region of 9 to 9.25 and that is the broad profile we would intend to continue. As a result, our NPA for the last 11 years ever since we started this business is absolutely zero. So, in a sense, it is a decent business. From a longer-term perspective, if I were to look at our retention of 75 basis points, the way I see the retention getting split is roundabout 50 basis points coming through management fees and trail, roundabout 15 basis points coming from transaction income, and 10 basis points from the lending income. That's the way it will get split. In the shorter end, it might be roundabout close to 15 basis points from lending, 15 basis points to 20 basis points from transaction, and 40 to 45 basis points from fees. Broadly speaking, in the longer end, roundabout 20% of your income would be from lending.

Moderator: The next question is from the line of Nagraj Chandrasekar from Laburnum Capital. Please go ahead.

Nagraj Chandrasekar: Two questions. One is, could you talk a little bit about the yields on IIFL-ONE because it looks like they are not all bagged literally from the blended yield on ARR. I think there is a 5 to 7 basis points compression. So, what is the attraction to us of moving more folks into IIFL-ONE? Could you also give us some color on why the ARR assets would be expected to increase so significantly in the next 1 to 2 years? Are you very confident of pivoting assets that are in the non-ARR pool into a specific set of high-yield ARR assets where you see visibility?

And finally on the cost side, on the basis of what you are saying, if you increase the employee pool 5% to 7% every year and assume a similar base salary increase, then is it fair to say that we should assume operating cost increase at low double digits and that hopefully AUM growth and therefore revenues grow at, at least that pace ideally more?

Karan Bhagat: I will take the first question which is the increase in the retention on the IIFL-ONE. IIFL-ONE retention essentially is kind of broken up into two platforms. One is the non-discretionary and the second is the discretionary. On the non-discretionary, I think we will end up at a blended basis of roundabout 45 to 50 basis points. Discretionary, we will end up at 10 to 15 basis points higher. So, it will be in the region of 55 to 60 basis points. You are fairly right in saying there is not a massive difference from the ARR on the trail-bearing assets. I think the movement into IIFL-ONE is not only a function of the retention but it has got three big other advantages. I think the most important advantage is it puts us on the client side of the table as opposed to the manufacturer side of the table. The client sees it as a much more cohesive relationship because irrespective of the product he is buying or the product he is selling, our fee remains the same and therefore, the incentive or disincentive to offer any product goes away totally. Second and equally important is the fact that the regulator globally and also in India ideally wants you to earn more and more from the contracted fee with the client as opposed to earning a distribution fee from the manufacturer. So, the advisory fee/the discretionary fee you earn from the client is relatively insulated from regulatory intervention as compared to the distribution fee you earn from the manufacturer.

For example, our mutual fund trail on a Q-on-Q basis was 27 crores a quarter. With the reduction of TER from 1st April, the mutual fund trail on a Q-on-Q basis has dropped to 22 crores. It is a small reduction but it has happened on account of the regulator reducing the TER. So, from distribution commission perspective from the manufacturer, there can always be a little bit of regulatory intervention. So, IIFL-ONE in a sense is a more powerful and durable model or a relationship with the client as well as it is not going to be subject to regulatory intervention.

So, from a 10-year perspective, if you ask me, I would prefer to have more or less a larger part of our revenues coming from IIFL-ONE even compared to the trail revenues coming from the manufacturer. So, from a descending order perspective, I would say the highest form of revenue would be the ARR revenue coming from the client followed by the ARR revenue coming from the manufacturer followed by a lending revenue finally followed by our transaction revenues. That's the order in which I would kind of go. From an operating cost perspective from your question, I think operating cost moving up by 7% to 8% every year is a fair assumption. Employee cost, as I said earlier, I think for the first year and a half may end up remaining flattish. Post that, it will see another 10% odd growth. Currently, obviously our cost to income ratios for the current year will look a little spiked, but broadly given the growth in assets, we should be able to get our cost to income ratios back in the region of 45 odd percent relative to our growth in assets as well as revenues.

Moderator: We will move to the next question. The next question is from the line of Parag from White Oak Capital. Please go ahead.

Parag Jariwala: My question is, is the transactional AUM, we have around 97,000 odd crores. You think that slowly will move to the ARR, but in an environment like this in the market, don't you think that the nature of this asset, as they mature and going to ARR may go under a change like probably a structured or a managed account kind of a guy may prefer debt that can break down your game. I am asking this question mainly because we are already in the change mode and this scenario can have a reasonable impact on our profitability.

Karan Bhagat: Actually the ARR revenue is not a function of equity or debt. It is actually slightly different from what you are saying. It is actually a movement from the more relatively slightly more complicated managed account to a simpler debt or a mutual fund product.

For example, in the IIFL-ONE platform, the clients are not really making a distinction on the fee whether you are buying the most complicated equity product or you are relatively buying the most simplest debt product. On the mutual fund side, most of the mutual funds are open ended and our blended retention is coming to 40-50 basis points on a mix of debt and equity. If all of the money moves to liquid funds for example over the next 2-1/2 years post exit from the transactional assets, obviously then it is going to impact our ARR retention in a meaningful way. But that is really a very very difficult scenario to kind of think through. At the very least, clients end up doing things like arbitrage or medium-term funds where also the retention ends up being in the region of 20-25 basis points.

So, I think if the market remains extremely-extremely pessimistic for the next 2-1/2 to 3 years, on a blended basis points, you might see a 5 to 10 basis points reduction in the ARR revenue on a trail basis. On the IIFL-ONE side, it shouldn't make too much of a difference. On the trail revenues from the manufacturer, if your mix goes extremely into safe conservative liquid funds only, then you might see a bit of impact on the ARR trail revenue received from mutual funds.

Parag Jariwala: To an earlier question where you were saying that 70% and 30% is the ratio between ARR and transactional. Whenever you kind of attain that mix, within transaction, I think what will remain would be largely a direct and the structured notes, etc. Most of the mutual fund….

Karan Bhagat: Transaction income even from like as we speak today is now only essentially representing income on stocks, bonds, a little bit of referral income, syndication of loans, could be referral for corporate finance transactions. All of that is what comes into transaction income. The only thing which we have to kind of appreciate a bit is our transaction income is not essentially coming from clients who are coming to us only for purely brokerage.

For example, we would not have more 1 or 2 clients who are doing only equity broking with us. Our entire transaction income is coming from clients who have their wealth management relationships with us. So, typically our transaction income a) will be a subset of our ARR income and b) it would be a mix between multiple asset classes. For example, let us say, in the last quarter, a large part of our transaction income would be coming from bonds as opposed to stocks.

Parag Jariwala: Lastly, Karan, if you can just talk about SEBI. There was a discussion in newspaper article about putting a cap on the fees of PMS distribution, etc.

Karan Bhagat: That will not affect us because we have already moved to that. We are already on a trail basis. What the article basically says is at the very most, it might restrict the TER of PMS similar to that of mutual funds and also move on a trail basis as opposed to an upfront commission basis, and I think that will also happen for alternative investment funds at some point in time, but from our perspective, that's a decision we have already taken from 1st April. So, in that sense, it really doesn't make any tangible impact on us. Post the impact, what you are already seeing.

Moderator: The next question is from the line of Onkarpreet Jutla from Edelweiss. Please go ahead.

Onkarpreet Jutla: The first question from my side is on the cost. Your total cost for Q1 has come down substantially, but if you see the biggest change, it has come by way of variable employee cost reduction. So, where do you see the trajectory for fixed cost for this year and how much do you think would be the variable cost required for this year?

Karan Bhagat: Variable cost for the current year given the adjustment in the revenues one time, the way we would look at our employee cost would be broadly for the year it would kind of be in the region of 55% to 56% of our revenues which would kind of include the fixed as well as the saleable portion. Obviously, the variable provisioning on a Q-on-Q basis comes in as and when we essentially hit a revenue number which essentially accounts for an employee cost which leaves the buffer to attain the 55% to 56%. That's the way to kind of budget that. For the first quarter specifically, the revenue for the current quarter doesn't really require a bonus provisioning in that sense. From a fixed cost perspective, as I told you earlier, I think I would push for a similar number to a 5% to 6% lower number for the next 4 quarters.

Onkarpreet Jutla: In terms of your asset management business, out of this 19,000 crores of assets, obviously there would be distribution cost which would have been paid to external distributor. Now, from an AMC perspective, do you think that the management fee or tariff in your AIF which will come through, how much that would be the part of revenue for this entity in current financial year?

Karan Bhagat: We have a net retention of around 67-68 basis points on our drawn down AUM. For example, roundabout 21,000 crores, our management fee accruing on the 21,000 crores post payment of distribution cost will be roundabout 140 crores for the year on a running basis.

Onkarpreet Jutla: Do you think that number will be a bigger contributor to P&L this year as compared to wealth management, right? This quarter it is 38 crores, right?

Karan Bhagat: Relative to wealth management in proportion or by itself standalone?

Onkarpreet Jutla: Relative to client proportion.

Karan Bhagat: Client proportion, it might be slightly larger, very marginally.

Onkarpreet Jutla: We are already in August now. How do you see even Q2 panning out and maybe want to give your guidance for revenues this year?

Karan Bhagat: As I said earlier, from a revenue perspective as well as from profit perspective, there is obviously going to be revenues on a re-stated basis from 1067 of last year essentially adjusting for the adjustment of upfront and trail falls to 810 crores for last year. From there on, as I told you earlier, I think from both the revenue and asset prospective, we would see roundabout 15% to 20% growth in asset and potentially a 15% growth in revenues. In year 1, 2, and 3, there might be a further 10% increase in asset growth on account of assets moving from the earlier variation to the ARR version. So, I would push for a 25% to 30% growth in assets and a 15% to 20% growth in revenues with a revised revenue base of 810 crores for last year.

Onkarpreet Jutla: My last question is on the regulatory changes. I think there are new SEBI draft guidelines which have come up which restrict where and all PMS can invest. So, on your proposition of IIFL-ONE, do you see any changes which you intend to do? Because apparently they can't be investing in unlisted paper and all those things.

Karan Bhagat: We actually don't invest from IIFL-ONE PMS into unlisted papers. Unlisted paper needs to happen from the client directly. It is not part of the IIFL-ONE mandate.

Moderator: The next question is from the line of Vikas Sharda from NTAsset. Please go ahead.

Vikas Sharda: One question on the balance sheet side. The investments of 4200 crores looks like pretty big. Is it particularly for this quarter or likely to remain?

Karan Bhagat: No, it is just for this quarter. It is basically a G-Sec. Because we are sitting on a surplus amount of cash, it is not likely to remain.

Vikas Sharda: So, accordingly, the borrowings will also come down?

Karan Bhagat: Actually, it is a CBLO instrument. So, the borrowing is also again the G-Sec itself.

Vikas Sharda: You mentioned previously that typically the wealth management companies globally have 75% of assets in ARR and 25% in transaction. Is that correct?

Karan Bhagat: Broadly, yes, 70:30 to 75:25, that's the range.

Vikas Sharda: But the yield on the ARR is almost twice or maybe you can say 70% to 80% higher than the transactional. Then, the revenue mix will become like 85:15?

Karan Bhagat: Broadly, in the steady-state basis, yes, including the lending, yes, 80:20. I will just try and explain this point for another second. Essentially, your ARR is on the stock. If you have 70% hypothetically in let us say ARR assets, 70% into let us say 0.5% hypothetically and plus the lending you take 65 basis points, is essentially your yield on the stock. On the remaining 30%, your yield itself on the stock will be lower because the entire asset is not getting churned every year. So, the blended yield will be in the region of 30 to 40 basis points. So, effectively from a revenue perspective, I think you will end up at roundabout as I said earlier, 50 to 55 basis points on fees, 10 odd basis points to 15 basis points on account of transactions, and 10 to 15 basis points of lending revenue. Now, whether that is exactly 20% or 15%, out of the 75, I am saying transaction will be roundabout 10 to 15 basis points.

On a steady-state basis, 15 basis points. For us, it might be roundabout 20 basis points in the current year.

Moderator: The next question is from the line of Nischint Chawathe from Kotak Securities. Please go ahead.

Nischint Chawathe: Two questions. One is, if you could give some guidance in terms of the pace at which you are looking at growth in the advisory business, essentially IIFL-ONE business and the other thing if you could kind of just give some color in terms of how the recurring fees would move as the ratio of IIFL-ONE kind of increases over time?

Karan Bhagat: From an asset growth perspective, I think the first 3 years, we would expect a slightly more disproportionate growth. I think it will be a combination of roundabout 15% being added by net new money coming in and another 15% on account of the old money maturing, so effectively would guide towards a 25% to 30% growth in ARR assets for the remaining 2-1/2 years. So, this year plus another 2 years, you would push for a 25% to 30% growth in ARR assets. From there on, it should stream down to 15% to 20%. From a revenue addition perspective, it will add a revenue growth of close to roundabout 15% to 20% every year.

Nischint Chawathe: I am saying that the yields on this particular segment would be lower. If I really look at it today, your yields on this segment is relatively lower as compared to the yield in the recurring revenue segment.

Karan Bhagat: How you are saying that? Sorry, Nischint, I am not getting your question. It is similar, right?

Nischint Chawathe: Anyway, I will take the specific numbers offline.

In terms of the asset management business, if you could explain a little bit. I would guess that this is obviously a relatively new business, and what is the kind of trajectory of business that one can really expect going forward?

Karan Bhagat: Four specific strategies on the asset management side which we have kind of focused on. One has obviously been the listed equity space which obviously post Anup joining has kind of picked up in a very distinct way. On the listed equity side now in forms of either PMS or specific customized mandate, we would have close to roundabout 5500 to 6000 odd crores. Second broader strategy is on the unlisted equity side which would range from early stage all the way to lead stage including the pre-IPO kind of funds. That is spread across 4 funds, the largest being the pre-IPO fund which would totally account for roundabout 12,500 odd crores. The third strategy is on the real estate fund side. That today would be roundabout close to 3000 odd crores of which roundabout 2100 crores we have fund raised last year which is more or less still sitting 80% uninvested. And fourth is a small private credit fund which we have just raised over the last 4 to 5 months which is a size of roundabout 1500 odd crores. These are the four strategies we have on the asset management side.

We may potentially look at adding one strategy on the long-short side. We are discussing with the team. If that happens, we will potentially add a strategy there. Within this piece, we would look at building strategies which can at least become $1 billion plus and we would look at it only and only once we can get the right team in place for each of these strategies. So, overall if you look at globally, alternates maximum roundabout 6 to 7 strategies. As we build out, we will keep exploring and I think within each of these, we have the ability to scale each of these strategies to at least 2 to 3 billion each. Of that, our unlisted equity business already we are close to roundabout 1.5 to 1.6 billion; listed would be getting close to 1 billion.

Nischint Chawathe: I know you are obviously doing a lot of expense control this year. Do you think you are investing sufficiently in this or maybe the investment phase in this business really kind of starts playing out maybe a year down the line or so?

Karan Bhagat: No, we have to continue investment. I think that goes by without saying because from my experience, the best time to build market share has been in 2009, 2013, and now. So, I think that is something which we can't get away from. It is always going to be a catch-22. The two things which we can't run away from investing in are people and technology. I don't think so those are the two things we are going to shy away from. Having said that, half the battle in terms of costs will be awareness to reduce the cost. So, I think there is a little bit of cost control with kind of a rationalization which automatically comes in and second obviously is a large degree in terms of improvement in terms of productivity which on the sales side for us is not too much. On the non-sales side of the business, I think we can do a little better. That is where the measures are and as I said earlier, I think technology and a little bit of new relationship managers to the firm will kind of takeoff a little bit of the cost we save. There will be cost saving but it is not going to be the sole determinant of the driver of the business.

Nischint Chawathe: Since we are getting listed, two questions. One is, in terms of what kind of dilution or basically ESOP dilution should we expect on a year-on-year basis, let us say for the next 3 to 4 years? And what kind of a dividend payout should we really expect?

Karan Bhagat: Both are board decisions, but broadly, I can give you from a directional perspective. From an ESOP perspective, I think for the last 6 to 8 months, for all the new joinees who have joint in, we have not yet been able to allot ESOPs because of the process of demerger. So, I think in the first year which is the next year, there may be a larger quantum of dilution in terms of ESOPs. The exact quantum itself is not frozen, but we have had 2 or 3 very senior hires over the last 6 to 8 months. The P&L impact of that is kind of well factored in but the dilution in the first year might be to the extent of roundabout 3% to 3.5% on account of ESOPs.

Going forward, I think on a yearly basis, it would be sub 1% in the form of ESOPs in terms of dilution. Having said that, I think now everything pretty much passes through the profit-loss account by virtue of Ind-AS. In terms of dividends itself, I think we are kind of overcapitalized right now. So, effectively, in terms of the excess cash which we are currently sitting on which would be in the region of 550 600 crores. We would be keeping our eyes and ears open for interesting acquisition opportunities if they come by over the next 12 to 15 months. Going forward, for our ongoing profits, I think the board is discussing and recommending a fairly aggressive dividend policy. We would look at definitely north of 60% to 65% of our ongoing profits to be declared as dividends.

Nischint Chawathe: Are you looking at any acquisition at this stage if you can share anything?

Karan Bhagat: We are always evaluating. I think there are not too many interesting acquisition opportunities. There are three or four in the country. We are in discussion with all. We may be able to close one over the next couple of weeks, and as and when we are towards the closure point, we will kind of keep all of you updated.

Nischint Chawathe: Will this be a share swap?

Karan Bhagat: Not really. We are not looking at necessarily doing a share swap. It depends honestly on the size of the acquisition and the kind of multiple we are paying to acquire the business, but the one we are closer to doing is not a share swap.

Nischint Chawathe: It may be a cash one?

Karan Bhagat: It may be a cash one, and honestly we are also sitting on a little bit of excess cash. So, unless we are getting a really sweet deal because of share swap, we would be more inclined to get the best deal but with payment of cash.

Moderator: The next question is from the line of Kush from Mahindra Mutual Fund. Please go ahead.

Kush: I just wanted to understand out of 4200 crores worth investments, how much would be into corporate bonds?

Karan Bhagat: I think corporate bonds would be next to negligible. We would have some investments on perpetuals but they are essentially perpetuals hedged against structures issued to clients. Our investment in corporate bonds would be below 50 crores or 100 crores or some number like that. It will be really really small. And there is no corporate bond which we actually carry on our profit & loss account at all. If at all it is bought, it would be sold within 2 to 3 days to clients.

Kush: I was just going through wealth finances balance sheet as on March '19. I think we had some exposure to a financial arm of a troubled group. Is that something in the lines of the perpetual bond which we have because I think that is something which we have assigned to an NCD which IIFL Wealth Finance has issued. Is that something on the similar lines?

Karan Bhagat: Which one are you talking about?

Kush: Exposure to RCAP, I think we have something over there.

Karan Bhagat: That is essentially an optionality issued through clients and Reliance Capital essentially managing the optionality on the structured note. That entire structure is actually protected by 1.1x liquid margin given to us as a broker. I think we have 140 crores structured note option issuance to Reliance Capital of which we would have close to roundabout 110 crores of liquid debt mutual fund cover assigned to it on a one-on-one basis. So, the net exposure really to the group would be roundabout 30 odd crores.

Kush: One suggestion if I may. If you can add a couple of slides on IIFL Wealth Finance.

Karan Bhagat: We will do that. We will try and do that ASAP and send it across over the next 3 to 4 days.

Moderator: We have one last question in queue. This is from the line of Umang Shah from SAIF Partners. Please go ahead.

Umang Shah: Karan, you mentioned in IIFL-ONE, there is a discretionary piece and a non-discretionary piece. What is the difference between these two?

Karan Bhagat: In both the cases, the client essentially needs to construct something called an investment portfolio statement which essentially broadly defines his objective; how much debt he wants? how much equity he wants? what to do within the debt? what to do within equity, and so on and so forth. The big difference between discretionary and non-discretionary is under both we need to operate within the mandate except in non-discretionary for every change in instrument selection, we need to go back to the client. In discretionary, as long as we are within the mandate and there is no change in the mandate, for every change in instrument selection, we don't need to go back to the client. So, discretionary essentially means it is at our discretion within the mandate. Non-discretionary essentially means we need to go back to the client every time for decision making. That's the big difference between the two.

Moderator: We will take that as the last question. I would now like to hand the conference back to the management team for closing comments.

Karan Bhagat: We will work on a few things and potentially update a few of the FAQs over the next 3 to 4 days and put it up on the website and look forward to the next conference call. Thank you.

Moderator: On behalf of IIFL Wealth Management Limited, that concludes this conference. Thank you for joining us, ladies and gentlemen. You may now disconnect your lines.