Ambit
Asset Management

INVESTOR COMPASS

APRIL 2022

BIG BANG(K) MERGERS

BIG BANG(K) Mergers!

In the last couple of weeks, we have seen a spate of large M&A activity in the domestic market. While the intensity of the activity does surprise us, what is even more surprising is the deal sizes and the uniformity with which they are happening across the sectors. These transactions, once approved, have the ability to alter the industry ecosystem. If year 2021 was the best for IPO's in India (in terms of proceeds ~ $16.94 billion), then year 2022 will probably be known as the year of consolidation.

Exhibit 1: Consolidation simplification

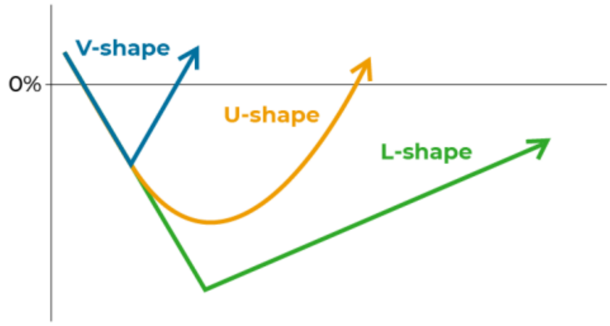
Acquirer	Target	Type	Consideration
HDFC Bank	HDFC Ltd	Reverse Merger	1.68 HDFC Bank shares for every 1 HDFC Ltd shares
Axis	Citi	Acquisition	Payment up to Rs12,325 cr ($1.6bn) to Citibank in all cash deal, only when all the assets & liabilities will be transferred.
PVR	Inox	Merger	3 shares of PVR for every 10 shares of INOX.

Source: Ambit Asset Management

While COVID led disruptions might have accelerated these transactions, it could also be attributed to increased digitization, changing regulations, continued cost pressure due to exogenous events (~2 years) and working capital squeeze. We believe this is the start of the consolidation phase in the Indian corporate sector which will continue in the near to medium term.

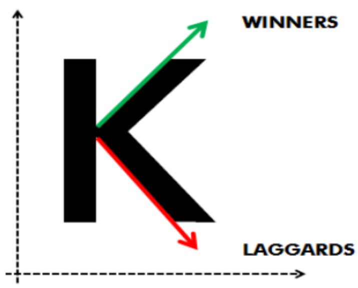
In the last couple of years, we have been iterating about the '*K' shaped* recovery (investor communication in Sep-2020) in the Indian economy and the increasing divergence between companies with winning traits (Winners) vs. the smaller fragmented players (Laggards). This is now playing out not just in terms of the organic market share gains but also in terms of the current consolidation activity.

Exhibit 2: Variety of shapes of recovery had been spoken about



Source: Ambit Asset Management

Exhibit 3: But we had a different view



Source: Ambit Asset Management

All the three major transactions announced in the last fortnight involve our portfolio companies. As a result, in this note we present our view on these transactions and how we expect our portfolio companies to be impacted.

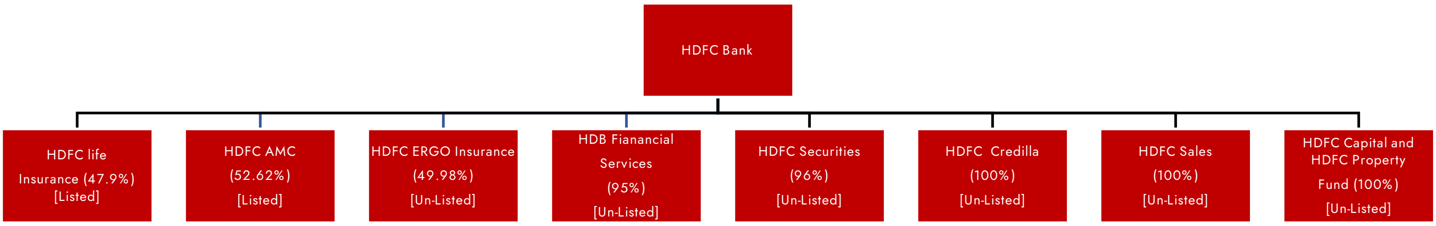
"As the son grows older, he acquires the father's business"

Reverse merger of HDFC Bank – HDFC Ltd.

In what could be the biggest merger in the financial sector in India, HDFC Limited, India's largest housing finance company, will merge into HDFC Bank, India's largest private sector bank by assets, subject to requisite approvals. Key points of the transactions are –

- While the combined entity will continue to be the second-largest lender in the country after State Bank of India; its size following the merger would be twice that of ICICI Bank, the third largest lender.
- Post the merger, HDFC Bank will be 100% owned by public shareholders, and HDFC shareholding will be extinguished when the scheme of amalgamation becoming effective
- All other HDFC Ltd subsidiaries are proposed to be HDFC Bank's subsidiaries (Refer to Exhibit: 4)

Exhibit 4: Proposed Group structure of HDFC Bank post the reverse merger



Source: Company, Ambit Asset Management

Merger Rationale

- Harmonization of Policies: Over the last few years, various regulations for banks and NBFCs have been harmonised, thereby enabling the potential merger.
- Master of your own destiny: HDFC Bank will now own the 'HDFC' brand (highlighted in our Disruption Note Vol: 3, Pg 6)
- Complete bouquet of product offerings: Ticks all the boxes in terms of completion of product offerings, product leadership in home loans as with other retail assets products.
- Cross Sell Opportunities: HDFC Bank will have the ability to cross-sell bank products to a larger customer base, and help leverage their distribution across urban, semi-urban and rural geographies.
- Real Estate Sector: Have been recovering after a weak 5-6 years pre-COVID, but as the cycle has become favourable & asset quality issues have remained benign for the Industry, it gives comfort to HDFC Bank to grow their developer loan book. Tighter Real estate regulations have resulted in increased bank participation in wholesale & retail lending.
- Balance Sheet strength: The combined balance sheet of Rs17.87tn and Rs3.3tn net worth will enable underwriting of large ticket infrastructure loans, accelerate the pace of credit growth in the economy, boost affordable housing and increase the quantum of credit to the priority sector, including credit to the agriculture sector. (Refer to Exhibit: 5)

Exhibit 5: Pro Forma Impact on Key Metrics

	HDFC BANK	HDFC	Pro Forma	Delta
Equity Shares Outstanding (# MM) [1]	554	181	742	+34%
Annualized PAT (INR Cr.) [1]	35,875	13,388	49,263	+37%
Earnings per Share (INR / Share)	c.65	c.74	c.67	+3%
Net Worth (INR Cr.) [1]	229,640	115,400	330,768	+44%
Book Value per Share (INR / Share)	414	638	446	+8%
Advances (INR Cr.) [1]	12,68,863	5,25,806	17,86,669	+42%
CAR (%) [1]	19.5%	22.4%	19.8%	+30 bps

Source: Company, Ambit Asset Management

Our thoughts on the deal

The merger will be EPS & BVPS accretive from Day 1 as HDFC's 20% ownership in HDFC Bank will be extinguished. Also, the merged entity once approved, will become an all-encompassing play on financials which includes businesses such as AMC, Life Insurance, General Insurance etc. apart from banking operations. The current merger also resolves the management succession at HDFC Ltd from a long-term view. Cost of fund & operating expense benefits will be derived on account of operating leverage & scale.

However, the transaction will have to stand the test of regulators, especially RBI and the insurance regulator IRDAI. The RBI has been mulling regulations on limiting banks' ownership stake in non-core businesses. In the near term, there will be drag on P&L due to negative carry on account of reserve requirement, higher PSL requirement & integration costs. However, more clarity shall emerge on these post regulatory approvals.

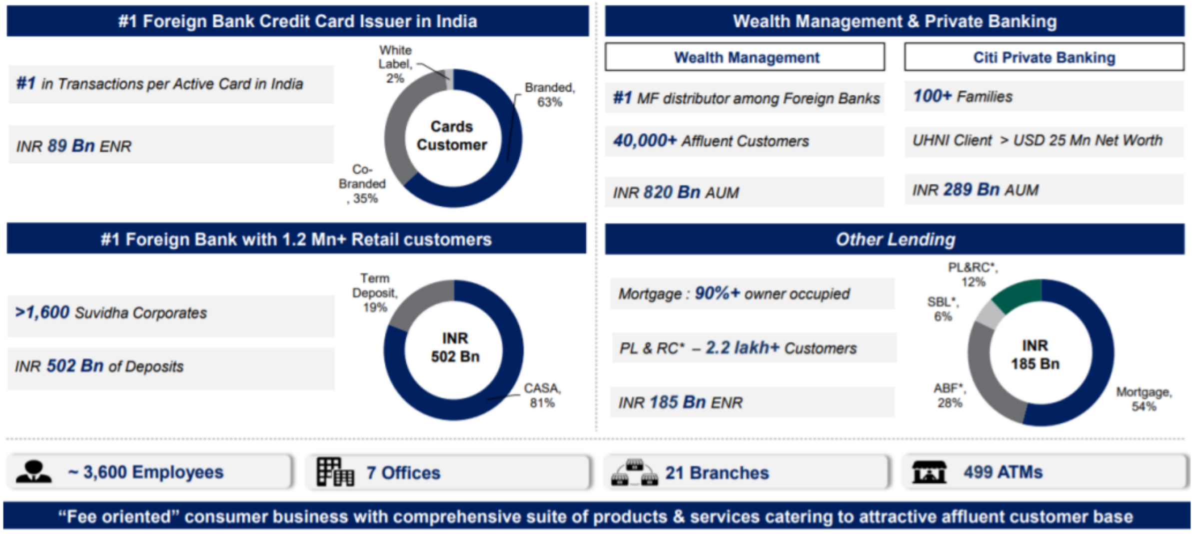
Welcome to the "CITI of Axis"

Axis Bank's acquisition of CITI Bank's consumer banking business in India

Axis Bank announced that it would be acquiring Citigroup's consumer banking business in India for ~Rs 123 billion, subject to receipt of regulatory approvals. It expects the requisite approvals to be in place in 9-12 months. The transaction comprises –

- Everything Consumer Banking i.e. credit cards, retail banking, wealth management and consumer loans.
- Citi's NBFC, Citicorp Finance (India) Ltd, comprising the asset-backed financing business, which includes commercial vehicle and construction equipment loans, as well as personal loans portfolio (Refer to Exhibit: 6)

Exhibit 6: Citi India's consumer business being acquired by Axis Bank



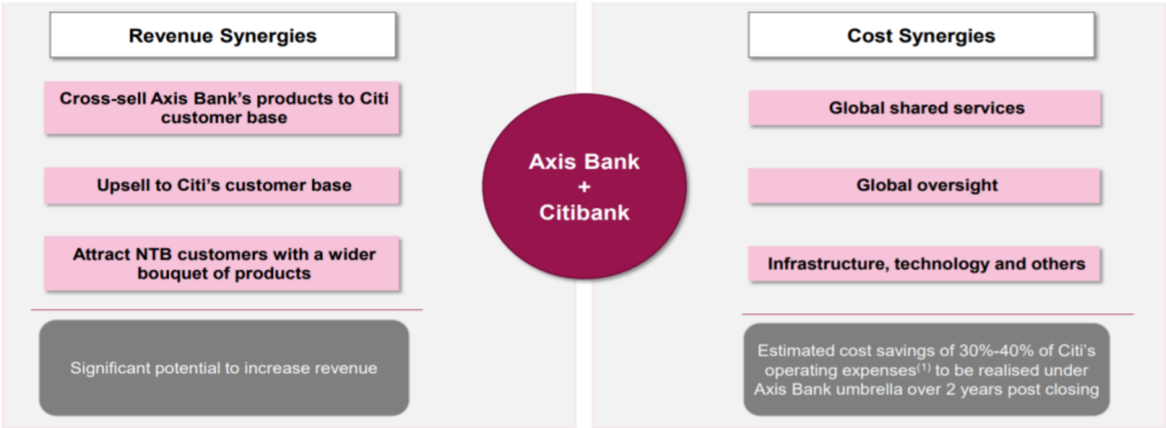
Source: Company, Ambit Asset Management

Merger Rationale

The acquisition will help Axis Bank consolidate its position amongst the private lenders (bring it closer to number three rank) and help it gain access to Citi's large and affluent customer base (in line with Axis's premiumization strategy).

- More than 80% of the customers are in the attractive age group of <45 years (high customer lifetime value). The transaction will add around 7% to the bank's deposit base (with approximately 12% increase in Current Account Savings Account (CASA) and around 4% increase in advances.
- Revenue synergies could flow from cross-sell and up-sell Axis's differentiated (Refer to Exhibit: 7)
- The Integration cost in the near term will offset the profitability but in the longer run, the cost synergy of 30-40% of Citi operating assets & cross-sell opportunity will be RoE accretive.

Exhibit 7: Synergies from the acquisition



Source: Company, Ambit Asset Management

Our thoughts on the deal

As per our view, it is a well-structured deal at a reasonable price. The acquisition is positive as Citi has one of the highest quality franchises in terms of Retail consumer banking especially Credit Cards.

The key monitorable would be Axis Bank's retention of these customers, & employees due to cultural differences. There could be operational challenges such as delay in the merger due to any regulatory challenges. Another key issue would be the integration of employees and systems.

BLOCKBUSTER Merger

Merger of PVR and INOX Leisure

PVR and INOX Leisure (two of the country's largest multiplex chains) announced an all-stock merger subject to the approval of the shareholders of both companies, respectively, and other regulatory authorities.

- Largest organized player – The combined entity will have ~1,500 screens (accounting for ~50% of multiplex screens) and ~30% share of total box office revenues.
- Consolidation was expected. But not amongst the top players – This comes as a surprise as there were media reports of a potential merger between PVR and Cinepolis India. Consolidation in the film exhibition sector (highlighted in our Disruption Note Volume 6) had started even before the pandemic hit due to weak underlying of the unorganised/single screen players. (Refer to Exhibit: 8)

Exhibit 8: Consolidation in the industry has been on-going over the past decade

Name	Screens	Value (Rs Cr)	Acquired in	Acquired from	Acquired by
SPI Cinema	76	633	2018	SPI Group	PVR
DT Cinemas	7	64	2016	DLF	Cinepolis
DT Cinemas	32	433	2016	DLF	PVR
Big Cinema	242	700	2015	Reliance MediaWorks	Carnival
Glitz Cinemas	30	90	2015	Network 18	Carnival
Broadway Cinema	10	110	2014	HDIL	Carnival
Satyam cineplexes	38	182	2014		Inox
Fun Cinemas	83	480	2014	Subhash Chandra's Essel group	Cinepolis
Cinemax	138	543	2012	Kanakia Group	PVR
Fame Cinemas	95	66.5	2010	43.28% in Shringar Cinemas Ltd	Inox
89 Cinemas	7		2006	Calcutta Cine	Inox

Source: Ambit Asset Management

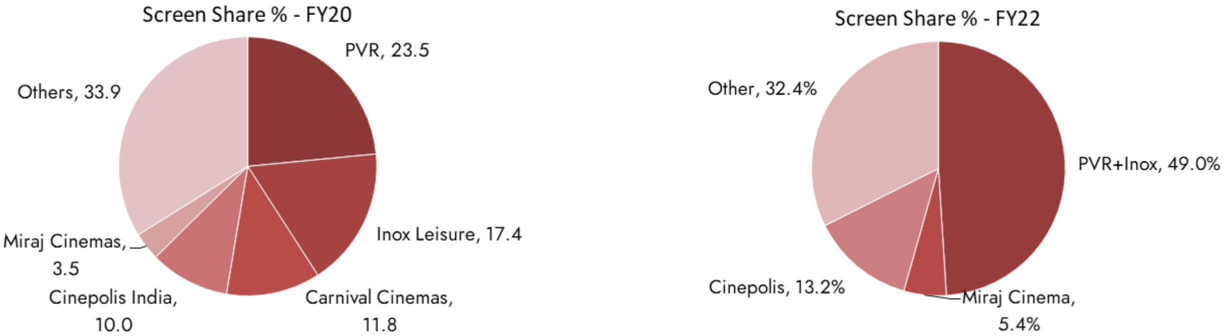
Merger Rationale

The film exhibition sector has been one of the worst impacted sectors on account of the pandemic.

- Multiplexes had to shut down and expend huge amounts on fixed costs with little/no revenue.
- The advent of OTT platforms backed by the likes of Amazon, Netflix and Disney having superior financial muscle made it imperative to achieve efficiencies for the long term survival of the film distribution business.

The merged entity would bring in enhanced productivity through scale, numerous cost optimisation opportunities, and help focus on deeper reach in newer markets while continuing to delight cinema fans with world-class experiences. Also, the company would be financially strong and grow faster together than individually. (Refer to Exhibit: 9)

Exhibit 9: Indian multiplex industry is turning into an oligopoly (top four players control ~70% of screens)



Source: Company, Ambit Asset Management

Our thoughts on the deal:

If the merger goes through, it would be beneficial for the investors as the company would gain pricing/bargaining power and accrue several cost synergies. We expect synergy benefits primarily from higher ATP/ Ad revenues and lower film hire cost/corporate expense. The combined entity will have a stronger balance sheet (net debt of 7-8 billion, Rs 400 cr monetizable assets), leading to aggressive screen expansion, especially in tier 2-3 markets.

Hurdles to the deal and changing landscape of the industry—

- The transaction would need to pass through the scrutiny of the Competition Commission of India (CCI). Given the size of the combined entity, it would have the ability to dictate market pricing far more aggressively from movie tickets and advertising rates to food and beverages.
- The combined entity might face some challenges at state government levels too (price cap witnessed in the past).
- The combined entity will have much more muscle to turn screws on the producers for better revenue and profit-sharing arrangements. It could set its own terms with property owners (with respect to leases and future space picks) and technology service providers.
- The easily availability of mobile handset and the emergence of digital gaming as the new source of entertainment for the newer generation continues to be big threats to the multiplex business.

Conclusion:

Over the past two years we have seen how K shaped recovery has been playing out as (1) M&A is stemming from business distress i.e. working capital & supply chain pressure due to exogenous factors; (2) The business paradigm has shifted – advent of technology makes it essential to reinvent to remain relevant; (3) Change in business approach: From competitors to partners in growth. With these pain points likely to increase within the business landscape, only companies with winning abilities or strong market positioning, will go on to survive and thrive in the market. At Ambit, we look for companies which have a strong leadership position and a strong balance sheet across our portfolio companies.

As swift as stable

Long term stability or agility in service?

What would you rather choose, when it comes to investing your hard-earned money?

With Ambit Asset Management, you won't have to.

While it uses its deep-dive research and disciplined approach to lend stability to your portfolio, its strong digital outreach ensures an agile and transparent service.
The result?

Consistent growth with an always-available service.

For any queries, please contact:
Umang Shah- Phone: +91 22 6623 3281, Email - aiapms@ambit.co

Ambit Investment Advisors Private Limited -
Ambit House, 449, Senapati Bapat Marg,
Lower Parel, Mumbai - 400 013

Risk Disclosure & Disclaimer

The performance of the Portfolio Manager has not been approved or recommended by SEBI nor SEBI certifies the accuracy or adequacy of the performance related information contained therein.

Ambit Investment Advisors Private Limited ("Ambit"), is a registered Portfolio Manager with Securities and Exchange Board of India vide registration number INP000005059.

This presentation / newsletter / report is strictly for information and illustrative purposes only and should not be considered to be an offer, or solicitation of an offer, to buy or sell any securities or to enter into any Portfolio Management agreements. This presentation / newsletter / report is prepared by Ambit strictly for the specified audience and is not intended for distribution to public and is not to be disseminated or circulated to any other party outside of the intended purpose. This presentation / newsletter / report may contain confidential or proprietary information and no part of this presentation / newsletter / report may be reproduced in any form without its prior written consent to Ambit. All opinions, figures, charts/graphs, estimates and data included in this presentation / newsletter / report is subject to change without notice. This document is not for public distribution and if you receive a copy of this presentation / newsletter / report and you are not the intended recipient, you should destroy this immediately. Any dissemination, copying or circulation of this communication in any form is strictly prohibited. This material should not be circulated in countries where restrictions exist on soliciting business from potential clients residing in such countries. Recipients of this material should inform themselves about and observe any such restrictions. Recipients shall be solely liable for any liability incurred by them in this regard and will indemnify Ambit for any liability it may incur in this respect.

Neither Ambit nor any of their respective affiliates or representatives make any express or implied representation or warranty as to the adequacy or accuracy of the statistical data or factual statement concerning India or its economy or make any representation as to the accuracy, completeness, reasonableness or sufficiency of any of the information contained in the presentation / newsletter / report herein, or in the case of projections, as to their attainability or the accuracy or completeness of the assumptions from which they are derived, and it is expected each prospective investor will pursue its own independent due diligence. In preparing this presentation / newsletter / report, Ambit has relied upon and assumed, without independent verification, the accuracy and completeness of information available from public sources. Accordingly, neither Ambit nor any of its affiliates, shareholders, directors, employees, agents or advisors shall be liable for any loss or damage (direct or indirect) suffered as a result of reliance upon any statements contained in, or any omission from this presentation / newsletter / report and any such liability is expressly disclaimed. Further, the information contained in this presentation / newsletter / report has not been verified by SEBI.

You are expected to take into consideration all the risk factors including financial conditions, risk-return profile, tax consequences, etc. You understand that the past performance or name of the portfolio or any similar product do not in any manner indicate surety of performance of such product or portfolio in future. You further understand that all such products are subject to various market risks, settlement risks, economical risks, political risks, business risks, and financial risks etc. and there is no assurance or guarantee that the objectives of any of the strategies of such product or portfolio will be achieved. You are expected to thoroughly go through the terms of the arrangements / agreements and understand in detail the risk-return profile of any security or product of Ambit or any other service provider before making any investment. You should also take professional / legal /tax advice before making any decision of investing or disinvesting. The investment relating to any products of Ambit may not be suited to all categories of investors. Ambit or Ambit associates may have financial or other business interests that may adversely affect the objectivity of the views contained in this presentation / newsletter / report.

Ambit does not guarantee the future performance or any level of performance relating to any products of Ambit or any other third party service provider. Investment in any product including mutual fund or in the product of third party service provider does not provide any assurance or guarantee that the objectives of the product are specifically achieved. Ambit shall not be liable for any losses that you may suffer on account of any investment or disinvestment decision based on the communication or information or recommendation received from Ambit on any product. Further Ambit shall not be liable for any loss which may have arisen by wrong or misleading instructions given by you whether orally or in writing. The name of the product does not in any manner indicate their prospects or return.

The product 'Ambit Coffee Can Portfolio' has been migrated from Ambit Capital Private Limited to Ambit Investments Advisors Private Limited.
Hence some of the information in this presentation may belong to the period when this product was managed by Ambit Capital Private Limited.
You may contact your Relationship Manager for any queries.

The performance data for coffee can product between 6th march 2017 - 19th June 2017 represents model portfolio returns. First client was onboarded on 20th June 2017. The performance data for G&C product between 1st June 2016 to 1st April 2018 also includes returns for funds managed for an advisory offshore client. Returns are calculated using TWRR method as prescribed under revised SEBI (Portfolio Managers) Regulations, 2020