Season of Mergers

Indian companies are aggressively pursuing growth

Season of mergers

PHOTOS: SANJAY BORADE

The spate of mergers over the last few weeks, with more in the pipeline, spells good news as corporates build scale and pursue growth

Deepak Parekh, the architect who laid the foundation of India's largest financial conglomerate and who crafted one of India's most respected groups under the HDFC brand, does not believe in leaving anything to chance. A board meeting ahead of making a formal announcement of the mega merger of the two jewels in the group, HDFC with HDFC Bank was held at 7:30 am on 4th April. Around five to six members attended, others being unable to join for various reasons. The meeting was to bring about a finality to all the discussions held in total secret for the last few weeks. Within an hour HDFC decided to merge itself with HDFC Bank, its progeny and within minutes the decision was conveyed to the stock exchanges.

Of course, speculation had been rife about the possible merger for a number of years. HDFC was a mortgage company, a specialised NBFC and it was logical that it should be merged with the bank. *Business India* had in its cover feature 'All fired up' (dated 4-15 April, 2001) raised the issue of a possible merger with the bank. Parekh at that time had said: "Not feasible in the near future because of multiple regulatory, taxation and foreign investment constraints and there are varying FDI and FII investment norms for housing, insurance, mutual funds and banking." Again, in our cover story 'A Grand Slam' (dated 28 September-9 October, 2005), Parekh had reiterated the same argument, remarking that he would require ₹10,000 crore for purchasing government bonds to meet the SLR requirements (RBI's mandate that a certain percentage of deposits and incremental deposits have to be held by the bank in government securities). "We need to borrow to lend, not to buy government paper," he had said, pointing out it was better to grow two strong organisations. "The regulatory environment has to encourage mergers."

However, the final announcement

Spate of large number takeovers mergers and acquisitions

Date	Company	Tranferee	Transferor	Event	Consider-ation	Payment	Rationale
13.12.21	Shriram Group	Shriram Transport (renamed as Shriram Finance)	Shriram Capital Shriram Citi Union and its subsidiary Shriram Housing	Amalgamation	share swap	Shriram City Union will merge with Shriram Transport get 1.55 shares of Shtriram Transport for 1 share 2) Shriram Capital will merge with Shriram Transport 0,09738805 shares of Shriram Transport for evey 1 share held. SCL which is the principal company will effectively get 1:1 share of Shriram transportt and 1.5 share of Shriram Transport for every one share held in Shriram CitiUnion	Creation of a large NBFC Simplification of structure ₹1.5 trn assets Diversified Lending One combined data base enabling leverage of anaytics and predctive analysis Unified Platform While insurnace will be separate companies the group will be able to get eveyone
14.02.22	ASK Investment Managers	Blackstone	Advent Asit Kotecha	Takeover			
26.03.22	PVR	PVR	Inox Leisure	Merger	share swap	3 shares of PVR for every 10 share held in Inox 3 shares of PVR for every 10 shares of Inox	Consolidation for long term sustainability To counter competition from OTT players Unification of 2 large players will give better bargaining power other ancilliary activities can be explored
30.03.22	Axis Bank	Axis Bank	1)Citibank Consumer Business from Citibank 2)NBFC Consumer Business from Citicorp Finance (India) LTd	Takeover	Cash Payment	₹12,350 crore	Axis bank gets access to Citi's credit card business and wealth management business and 2mn customers Deposit base of Rs 50200 crore
04.04.22	HDFC group	HDFC Bank	HDFC Investments and HDFC Holdings will be merged in HDFC and HDFC will thereafter be merged with HDFC Bank	Amalgamation		shareholders of HDFC will get 42 shares of the bank for every 25 share held in HDFC	Create one of the largest banks in India Larger balance sheet size will allow it to underwrite bigger ticket size loans. HDFC assets as on 31.12.21: HDFC Bank assets – HDFC Holdings & HDFC Investments – will see the total assets of the Bank go up to Rs25.61 lakh crore. This will allow it to underwrite bigger ticket size loans and increase its existing 61 million customer base. The Bank's lower cost of funds will help it grow the housing portfolio. HDFC Bank's unsecured assets will come down.

They are overhauling their portfolios through M&A, by focussing on profit pools of the future in areas such as digital, renewables, electric vehicles, and fintech
– Darius Pandole

caught the media totally off guard. This was indeed surprising not only because of the large number of key people in both organisations but also because there were nearly two dozen marquee investment bankers involved as advisors for both institutions. There were nine investment bankers each advising the corporation and the bank and another two investment bankers, Bank of America Merrill Lynch and Morgan Stanley India, providing the fairness report to the corporation and the bank respectively. Like in a large legal battle, both sides keep lawyers and solicitors on a retainer basis, and both these organisations had taken the best investment bankers as advisors. Parekh himself is known as an ace dealmaker and has helped sort out quite a few vexatious issues amongst companies. Besides the bankers there were lawyers and solicitors engaged in thrashing out the legal niceties of the proposal. Given the huge number of people, one would have expected an inkling of the impeding merger. But it was not so. This really mirrored the good governance standards set by the group across all its group companies.

Regulations harmonised

Had the environment really become so favourable that the merger of equals, as Parekh commented, became a win-win situation for all? Explaining the reason for the merger Deepak Parekh said: "Over the last few years, various regulations for banks and NBFCs have been harmonised, thereby enabling the potential merger. Further, the resulting larger balance sheet would allow 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."

Many feel that with the RBI directly overseeing NBFCs, especially large ones, this would soon narrow the difference between NBFCs and banks. "It would not be surprising that in the months to come the RBI would not just expect NBFCs to operate like banks but may insist on their getting banking licences or merging with smaller banks," says Deven Choksey founder and MD of KR Choksey Shares and Securities, a well-respected brokerage house. The merger was effected through a share swap ratio and involved a two-step process. First, the two 100 per cent held subsidiaries, HDFC Investments and HDFC Holdings, would be merged with the bank and thereafter, HDFC would be merged with the bank.

"The proposed transaction ticks all the right boxes in terms of completion of product offerings, product leadership in home loans as with other retail assets products, distribution strength and a customer base that can be leveraged to cross-sell a complete suite of financial products," said Shashidhar Jagdishan, 55, MD and CEO at HDFC Bank since 2020. Jagdishan took over from Aditya Puri, the longest serving CEO.

The merger will result in the creation of a huge bank with an asset size of nearly ₹26 lakh crore. It would also reduce HDFC Bank's proportion of unsecured assets as HDFC loans were totally secured. The bank will also now be able to grow its housing loan book. HDFC's loans to home buyers were largely to middle and low-income class borrowers. Higher income class borrowers accounted for around 43 per cent. The average size of the loan was ₹32.4 lakh. The bank would earlier source loans for HDFC and HDFC in turn would securitise the assets borrowed from the bank. The origination of loans from HDFC Bank accounted for nearly 38 per cent of total loans. The size of the book would also allow the bank to lend more aggressively for longer duration loans, including infrastructure projects. The average tenure of housing loans in HDFC is around 11 years. Mismatch between assets and liabilities can thus be reduced. Until now the bank has largely been lending to corporates and SMEs for meeting their working capital requirements.

There are multiple factors guiding each M&A transaction. High corporate governance coupled with high compliance standards is one
– RM Vishaka, MD and CEO, India First Insurance

"It is a transformational deal," says Darius Pandole, MD and CEO, PE & Equity AIFs, JM Financial limited. A veteran in the financial field, Pandole adds: "FY22 has got off to a

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strong start. Besides the PVR-Inox Leisure and HDFC-HDFC Bank deals, the past two years have, interestingly, seen a large number of first-time buyers of companies in India. Many of them see acquisitions as a way of getting ahead of disruption in a fast-paced market. Typically, this new breed of acquirers is buying to build scale rapidly, enter new geographies, add new lines of business, or deliver a full omnichannel experience to customers."

Share markets cheered the announcement, with both HDFC and HDFC Bank shares moving up. As against the close of ₹2,450 on 3 April, the shares made an intraday high of ₹2,850 on a huge spurt in volumes of ₹283 crore on the BSE. HDFC Bank shares likewise spurted to ₹1,721 (intraday high) as against the previous session's close of ₹1,506. However, post the announcement, the shares of both HDFC and HDFC Bank have been in correction mode. One reason given by brokers is that mutual funds and institutions are in the process of realigning their portfolio to meet SEBI's guidelines. SEBI prescribes an exposure limit of 10 per cent in a single company. Once the merger takes place, the combined market cap would probably cross the scheme's limit and hence alignment would be required.

The combined market cap of the merged entity, a fortnight after the merger announcement, at ₹11.67 lakh crore will be more than twice that of its nearest competitor ICICI Bank at ₹5.29 lakh crore and SBI's market cap of ₹4.61 crore. The value of the combined entity will be short of the combined market cap of the other three banks, SBI, ICICI Bank and Axis Bank which has a market cap of ₹2.46 crore. In the overall pecking order post the merger, HDFC Bank will be ranked third after Reliance Industries which has a market cap of ₹18.82 crore and TCS at ₹13.24 crore.

Given the complexities involved in the creation of one of the largest banks in India, it will be at least 12-18 months before the transaction fructifies. Earlier, another large merger of a similar kind was seen when ICICI (the development institution) was merged with ICICI Bank.

Spate of mergers

The sheer size of the merger of HDFC eclipsed some of the larger M&A which had taken place over the last few weeks. The takeover of Citibank's retail division housed in two companies, Citibank NA India and Citibank Finance (India) Ltd by Axis Bank took place on 30 March, 2022. The retail business bought as a going concern involved credit cards, mortgages and wealth management. The division catered to 1.2 million customers. Asset backed loans and SMEs were sold for ₹2,325 crore. The AUM of private banking was ₹28,900 crore, mortgage lending ₹18,500 crore, deposits ₹50,200 crore and the largest AUM was ₹82,000 crore. There were several advantages the takeover would offer. It would place Axis amongst the top three card players, and three largest AUM in the private banking segment. An 18-month transition period has been kept to allow onboarding

The corporate balance sheet is strong. Optimism is high. Companies with higher risk appetite and ambition to grow fast will weigh M&A opportunities

CHANDRESH NIGAM
MD & CEO, Axis Bank Mutual Fund

of Citibank's customers to Axis Bank platforms. Post the expected completion of the transaction the Citi brand would be allowed to be used till September 2024.

Amitabh Chaudhry, MD and CEO Axis Bank, an engineer from BITS Pilani with a post graduate in business management from IIAM, engineered the deal. Once done it could place the bank in a different league. Chaudhry, who was earlier with Bank of America, Infosys and HDFC Life in a leadership role, could change the image of Axis Bank which was earlier known as UTI Bank. The major challenge would of course be to provide customers of Citi with the same experience enjoyed at Citibank. Convincing some Citibank customers to onboard Axis is indeed a big challenge. The biggest being to convince customers who see having an account at Citi, a foreign bank, as a status symbol. And convince the staff with whom the customers have developed an affinity, to retain them.

There are, of course, various reasons for the rise in the pace of mergers

AJAY GARG
Founder & MD, Equirus Capital

Healthcare could be another sector which could see consolidation, going forward

S. RANGANATHAN
Chief Research, LK Pandey Securities

In the case of Axis Bank, it is clearly
the inorganic route. In the case of HDFC, it was more of a strategic fit. RM Vishaka, MD and CEO, India First Insurance a company promoted by the Bank of Baroda says: "There are multiple factors guiding each M&A transaction. High corporate governance coupled with high compliance standards is one. A lapse in any one company could mar the reputation of the group. Simplification of group structure is another. Sometimes, mergers are done more for prestigious reasons while a few are done to pursue growth and are a strategic fit. Each transaction has its own logic."

The Shriram Group's inter se merger is clearly done for simplification of the group structure and to allow all financial products, whether in mortgage, gold loans, old and new truck finance, tractor finance, two- and three-wheelers – to all be in one company. The merger involved the merger of Shriram Capital (unlisted) post the divestment of its insurance arm and advisory arm and Shriram Citi Union (market cap: ₹11,000 crore) and its subsidiary Shriram Housing with Shriram Transport (a listed entity with a market cap of ₹31,400 crore). The merger would see a simplification of structure besides becoming a ₹50,000-plus NBFC with all consumer money needs under one roof.

In wealth management, which is attracting a lot of attention, we have seen various deals happening. Blackstone took 74 per cent in the ASK group, a leading portfolio management Service (PMS) provider with an estimated AUM of ₹80,000 crore as on 31 December, 2021. It bought a stake from another equity player, Advent, and one of the promoters, Asit Kotecha. Bain Capital, likewise, bought a little under 25 per cent stake in IIFL Wealth Management (market cap: ₹15,830 crore) from General Atlantic and Prem Wasta's company.

Big will grow bigger

There are, of course, various reasons for the rise in the pace of mergers. Ajay Garg, Founder and MD of Equirus Capital, a full-service investment banker, explains: "Many corporates over the last few years have deleveraged and have a stronger balance sheet.
growth, given the problems in setting up greenfield projects. The heightened prices in the markets, allow them to use shares as a currency." He adds: "This is the best time for companies to realign their portfolio of businesses."

Some with similar businesses are already taking steps to merge their companies. Mindtree's Chandresh Nigam, Axis Bank Mutual Fund MD and CEO agrees: "The corporate balance sheet is strong. Optimism is high. Companies with higher risk appetite and ambition to grow fast will weigh M&A opportunities."

"Big will definitely grow bigger but it is not just scaling up in India," says Deven Choksey. "Their horizon is the universe and they are benchmarking their size against companies in the global markets. HDFC-HDFC Bank may well aim to build assets of over ₹50 lakh crore in the next three to four years." Choksey foresees that "size in
more in the banking segment which will see net interest margins shrinking to 2-3 per cent from 4-5 per cent. Costs will have to be brought down, productivity improved on one side and gaining volumes to grow." Corporate lending going ahead may also become difficult given their demand for competitive rates.

In the IT space one M&A in the making concerns the merger of Mindtree with L&T Infotech. Mindtree was acquired by L&T through a hostile bid in 2019. The merger, if it goes through, would place the combined entity amongst the top six IT firms.

In some cases, mergers have been guided more by the need to survive through consolidation. A case in point is PVR's merger with Inox Leisure. The virtual shutdown of theatres during the pandemic saw companies in the entertainment distribution sector suffering badly. Instead of competing against each other Inox Leisure thought it prudent to join hands, reckoning that unification may give them better bargaining power. In a share swap ratio, the shareholders in Inox will get three shares for every 10 shares held. The merged entities, which have been facing problems due to the mushrooming of OTT mobile apps, could at a future date also look at producing content in a bid to diversify their revenue stream. Currently the income comes from ticket sales and eatables sold in the theatres.

In the entertainment segment a large transaction will also be seen in the Sony-Zee merger, which is likely to be closed by the end of this year.

Private equity players are also contributing towards the rapid pace of M&A in a big way. Some through exits with secondary sales to other private companies. Temasek-backed Crompton Greaves Consumer took a majority stake, 55 per cent, in Butterfly Gandhimathi Appliances for ₹1,380 crore. Earlier, Crompton Greaves Consumer (carved out from Crompton Greaves) had seen private players Advent and Temasek playing a major part in scaling up the fans business of the company. While it was a leader in fans, its venture into brown goods had not yielded the desired result. And Butterfly Gandhimathi, known for its cooking utensils range, made a strategic fit and is a strong player in South India and to some extent in West India. While Advent had exited CG Consumers at more than 5.5x gains, Temasek has stayed on and is now scaling up the business through diversification in the kitchen appliance area.

Cement is another sector ripe for M&A
Abijit Tare
MD & CEO, Motilal Oswal Investment Advisors

"Cement is another sector ripe for M&A," says Abijit Tare, MD and CEO, Motilal Oswal Investment Advisors. Tare, a CA, has been with Motilal Oswal group for the past 17 years and reasons that with cement capacity which was hovering around 68 per cent in the past, now running at 85 per cent, companies will continue to seek growth, organic or inorganic.

Right decision

Tare had given his views before the news about Holcim, the global cement giant's decision to sell, was made public. After taking over Ambuja Cement and ACC, the company, due to its global compulsions of investing in other markets, did not invest sufficiently in building capacity at the pace at which other competitors did. UltraTech, which has grown largely through mergers, is now the biggest player. Shree Cement, Dalmia Cement – all have invested through building capacities and in the case of the latter, through merging its group companies. All have grown and these regional players have become pan-India players. If Holcim had waited, its capacity would have become relatively smaller, behind other Indian players. It has, in a way, taken the right decision to cash out. Were it to sell its 65 mtpa the acquirer would easily become the number two player.

Both JSW Steel and Adani have interests in infrastructure. For JSW, which has a small cement capacity, taking over Holcim's interest in India makes sense. This also applies to Adani, which is in construction and property development. Besides infrastructure, cement would make a natural fit. The government's focus on infrastructure and the rapid development of roads, ports and housing, would ensure enough demand. The exit by Holcim and the entry of a new player of scale could spark off another consolidation round with the other large companies vying to build scale inorganically. Those under 10 million tonnes will be wooed for sure.

"Healthcare could be another sector which could see consolidation, going forward,' comments S Ranganathan, Chief Research, LK Pandey Securities.' We have seen it so far only in specific pockets of the sector like hospitals and diagnostics."

As sectors, one could see it across industry, as corporates will also be restructuring their portfolios. "They are overhauling their portfolios through M&A, by focussing on profit pools of the future in areas such as digital, renewables, electric vehicles, and fintech," says Darius Pandole. "To fund these moves and manage their portfolios, they are pruning ownership in legacy assets or in subscale positions that could be more valuable in another parent's hands. For example, old line, diversified groups such as the Tata Group, Mahindra Group, etc, have demonstrated considerable success in completing multiple acquisitions."

Whatever the reason for undertaking M&A, there is no doubt the robust pipeline will ensure plenty of deals coming the way of investment bankers. Several start-ups which are coming of age, will also be contributing more than their fair share to ownership change. Some of the new fintech companies which have recently listed, may offer good opportunity for newcomers wanting to get in the finance space. Many private equity firms which have used IPOs to exit, leaving the public holding the can, so to say, may, given the attractive valuations, come in to buy out the remaining private equity players. For investment bankers – and not just the 20 bankers who were associated with the HDFC-HDFC Bank deal – 2022 may well see a bumper harvest of M&A. ◆

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