

LVB-IBHF merger

LVB-IBHF merger positive for shareholders; will it pass RBI test?

The board of Lakshmi Vilas Bank (LVB) has approved the merger with the Indiabulls Housing Finance (IBHF) with the proposed swap ratio of 14 shares of IBHF for every 100 shares of LVB. It works out to be a ~32% premium considering the prevailing market price of LVB and IBHF. Sharp appreciation in LVB's share to the tune of ~35% since Mar 27 is also factoring this development.

Rs	CMP	SWAP	Value	Premium for deal
IBHF	829	14	11,606	
LVB	88	100	8,800	32%

We view this proposed scheme of amalgamation as a much needed relief for LVB shareholders as the bank is in the fragile financial position and was expected to come under the RBI's PCA norms in coming quarters. The bank has been reporting loss over the last five quarters and cumulative loss stood at Rs12,911 mn (~2.5 % of its business size of Rs550 bn). Owing to continued trend of loss making, its CAR ratio reduced to 7.6% with Tier I at 5.6% by Q3FY19 just marginally above the regulatory requirement of 5.5%. GNPA/NNPA at 14%/7.6% stood worst among private sector banks and close peers.

On the other hand, IBHF is in strong financial position (C/I at ~12%, GNPA at ~0.8%) and have AUM size of Rs1,200 bn (growing ~25% YoY) which is more than double the business size of LVB. So the proposed amalgamation is the win-win situation for both companies' shareholders. IBHF will get access to banking platform, essentially the liability franchise which is a big positive for the organization especially after the IL&FS crises which squeezed the liquidity of NBFCs. Thus the move is likely to reduce the cost of funds for IBHF. Since LVB is a regional bank with around 60% of branches locating in Tamilnadu, this would remain a challenge for merger entity to shot up the pace of deposits accretion and fund the strong growth. Major factor we see in this deal is providing longevity to IBHF's business model as it will skewed from NBFC to bank.

Meanwhile, the key overhang to remain is the RBI approval to this deal. Will the RBI transfer the banking license to combined entity as it would remain the NBFC driven business due to more than triple the size of IBHF's assets to LVB. In all earlier deals be it IDFC Bank- Capital First, IndusB – BFI or Bandhan Bank – Gruh Finance, bank remained the major player, while it is opposite in this deal. In addition, IBHF has significant exposure to real estate sector (~20%) and had been rejected for banking license once in 2013 by the RBI. Meanwhile, the recent RBI's guideline in 2016 eased some norms to NBFCs like sector exposure for the merger with banks. Overall we see this merger a positive development for shareholders and the merger entity would have the strong fundamentals. Meanwhile, the RBI's approval will remain key overhang for this deal. We expects BVPS of Rs423 of the merger entity which is around 1.4% accretive on book value basis. Thus we assign 'Neutral' rating and investors are recommended to 'Hold' IBHF stock.

	BVPS (Rs)	NW (Rs mn)	No. of shares
LVB	67	21,396	320
IBHF	417	177,920	427
Merged Entity	423	199,316	471
Accretive	1.4%		

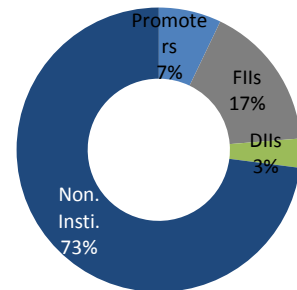
If the central bank clears this deal, we would expect more this type of deals in the coming future. We see some small banks like Karnataka Bank, South Indian Bank, Karur Vysya Bank, which are even trading discount to LVB, as the best potential acquisition targets.

Merger Update - Neutral

LVB

CMP	Rs88
52 week H/L	Rs122/55
Face value	Rs10
Mar. Cap.	Rs28 bn
Loan Book	Rs241 bn
Assets	Rs372 bn
BVPS	Rs67
Sector	Banking

LVB,s Shareholding Pattern



IBHF

CMP	Rs829
52 week H/L	Rs1,397/576
Face value	Rs2
Mar. Cap.	Rs354 bn
Loan Book	Rs1,243 bn
Assets	Rs1,287 bn
BVPS	Rs417
Merger entity	Rs423
Sector	NBFC

IBHF,s Shareholding Pattern

