

Three-way merger getting closer...

About the stock: IDFC Ltd is registered with RBI as NBFC - Investments. Besides banking, it also has investments in diverse businesses such as asset management, and infrastructure debt fund.

- It received a license from RBI to set up a bank in 2014
- IDFC AMC has an AUM of ₹126335 crore

About event: IDFC Bank's board announced a merger with two group companies

- In-principle approval of merger with IDFC Ltd and IDFC Financial Holdings
- Board has constituted committee to work upon terms of proposed merger
- Unlocking of value of IDFC Ltd as it was trading at holding company discount

What should investors do? IDFC Ltd has jumped over 11% with the reverse merger news coming in; while in the past one year, the stock has increased over 50%. We believe that 'in-principle' approval is one step closer to materialisation of merger event but there is uncertainty about the timeframe in which this can happen.

- We rate IDFC Ltd to HOLD from BUY as discounting of merger seems to have already materialised.

Target Price and Valuation: In our SoTP, IDFC First Bank is valued at ~1.6x FY23E ABV and AMC business at 4% of AAUM to arrive at a revised target price of ₹ 70 per share for IDFC Ltd post 40% holding company discount.

Impact on IDFC First Bank: The whole process of reverse merger could be undertaken in following ways;

- IDFC Ltd to exit AMC business and proceeds from sale to be distributed as one-time dividend. Post this, reverse merger with the bank wherein swap ratio is anticipated to remain neutral with only change in shareholder pattern
- IDFC Ltd to exit from AMC business and reverse merger to be undertaken with additional capital ploughed in the bank. In such scenario, swap ratio will be higher (to account for additional capital inflow) and the transaction will be win-win for both entities as it will strengthen bank's balance sheet

Key triggers for future price performance:

- Unlocking of value which has been trading at a holding company discount
- Reduced complexity due to single entity structure

Alternate Stock Idea: Apart from IDFC Ltd, we also like Muthoot Finance.

- Muthoot Finance is a leading gold financier in India with overall AUM of ₹60918 crore as on September 2021.
- BUY with a target price of ₹ 1920

SOTP - Valuation

Holding	Multiplier	Stake	Parameter	Value
IDFC First Bank	1.6x FY23E ABV	37%	Networth	13691
IDFC AMC	4% of AUM	100%	AUM	5040
				18731
Hold Co discount				40%
IDFC Limited				11238
Per Share Value				70



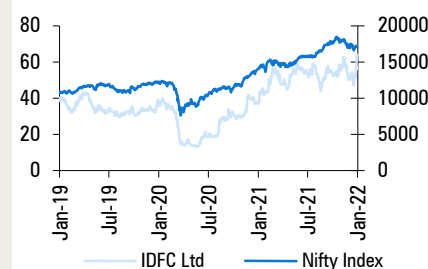
Particulars

	Amount
Market Capitalisation	₹ 10169 crore
Networth	₹ 9266 crore
52 week H/L	65/37
Face value	₹ 10
Equity Capital	₹ 1596

Shareholding pattern

in %	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
Promoter	0.0	0.0	0.0	0.0	0.0
DII	8.3	7.7	8.0	7.2	6.2
FII	29.7	29.9	24.8	24.3	24.3
Others	62.1	62.5	67.3	68.5	69.5

Price Chart



Risk to our call

- **Key Risk:** 1) Excessive delay in materialisation of merger; 2) Higher than expected valuation for AMC business

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Reverse merger to unlock value

- As the five-year lock-in period ended, it paved the way for IDFC to exit as promoter of the bank. Recently, IDFC First Bank has given "in-principle" approval of a merger with IDFC Ltd and IDFC Financial Holding Company
- The board has also constituted and authorised a committee namely 'capital raise and corporate restructuring committee', to work on the terms of proposed merger including finalising the scheme, valuation, hiring advisors, etc
- The proposed restructuring is subject to the approval of the board of directors, shareholders, creditors, statutory and regulatory approvals of the respective entities

Exhibit 1: IDFC AMC AUM breakup

	FY19	FY20	FY21	Q2FY22
Equity AUM	21995	29609	24987	30620
Debt AUM	35756	63698	76412	85668
Liquid AUM	11496	10586	13379	10047
Total AUM	69248	103893	114777	126335
Revenue	277	306.1	371.1	106.4
%of AUM	0.40%	0.29%	0.32%	0.08%
OPEX	210.4	198.7	178.8	44.2
PAT	43.7	79.4	144	46.7
%of AUM	0.06%	0.08%	0.13%	0.04%

Source: Company, ICICI Direct Research

Exhibit 2: IDFC First Bank Financials

Key Financials	FY19	FY20	FY21	Q2FY22
NII	3,199	6,076	7,380	2,272
Net profit (₹ crore)	(1,944)	(2,864)	452	152
EPS (₹)*	(4.1)	(5.0)	0.8	1.0
P/E (x)	NM	NM	77.8	50.4
ABV (₹)	35.7	30.2	28.1	33.2
P/ABV (x)	1.7	2.1	2.2	1.5
RoA (%)	(1.2)	(1.6)	0.3	0.4
RoE (%)	(10.7)	(15.8)	2.7	3.0

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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