

Healthy fundamentals at reasonable valuations...

About the Company: Tamilnad Mercantile Bank (TMB) is one of the oldest and leading old private sector banks in India, with a history of close to a 100 years.

- It primarily focuses on RAM segment (i.e. retail, agriculture and MSME), which constitutes ~88% of total advances as of March 2022
- TMB has built a strong presence in Tamil Nadu, with 369 branches and 949 ATMs as of March 2022. Total branches are 509 of which 247 are in semi-urban, 106 in rural, 76 in metro and 80 in urban areas

Key triggers/Highlights:

- The bank has ~100 year's legacy with ~80% of its customers associated with the bank for more than five years. The focus on low cost CASA deposits is expected to keep borrowing cost lower
- Focus on new geographies coupled with southern states to accelerate growth
- TMB focuses on increasing its digital footprint, which, in turn, has improved its operational processes, which has reduced costs resulting in improving profitability
- The bank has 369 branches, 949 ATMs in Tamil Nadu with a share of ~75% in total business

What should investors do? TMB is one of the oldest private sector banks in India with a consistent financial performance and healthy asset quality. At the upper end of the price band, the bank is valued at ~1.35x P/BV (post issue) as on March 31, 2022 which looks reasonable. However, a change in management and pending legal proceeding in relation to shareholding remain risks

- We assign **Subscribe only for long term** rating to the IPO

Key risk & concerns

- Total ~37.7% of paid up equity share capital is subject to legal proceedings, which are pending in various forums
- Significant regional concentration in southern India i.e. Tamil Nadu
- Current MD & CEO's tenure to end before the issue opens though RBI has accepted the appointment of the new MD & CEO



Particulars

Issue details

Issue opens	5th September 2022
Issue Closes	7th September 2022
Issue Size	₹792-832 crore
Fresh Issue	₹832 crore
Price Band	₹500 - 525
No. of Shares on offer (in cr)	1.58
QIB (%)	75
Retail (%)	10
Min Lot Size	28

Shareholding Pattern (%)

Shareholding pattern	Pre-issue	Post issue
Promoter group	0.00	0.00
Public	100.00	100.00

Objects of issue

The Bank proposes to utilize the Net Proceeds towards augmenting its Tier I capital base to meet its future capital requirements.

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Key Financial Summary

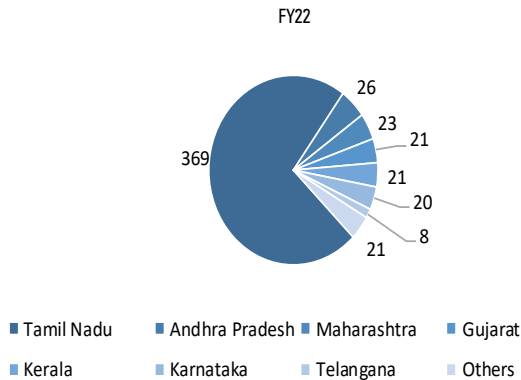
₹ crore	FY20	FY21	FY22	CAGR FY20-22
NII	1319.5	1537.5	1815.2	17.3%
PAT	407.7	603.3	821.9	42.0%
EPS	28.6	42.3	57.7	42.0%
BVPS	279.3	321.4	374.4	15.8%
ROA %	1.0	1.3	1.7	
ROE %	10.7	14.1	16.6	
P/E	18.4	12.4	9.1	
P/BV	1.9	1.6	1.4*	

Source: RHP, ICICI Direct Research * BVPS is calculated on post issue basis

Company Background

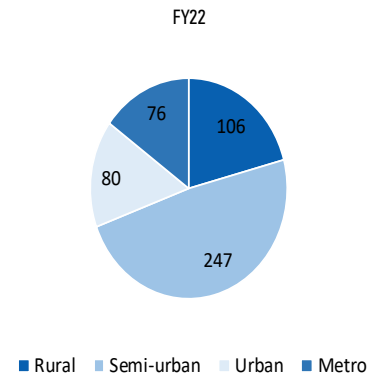
Tamilnad Mercantile Bank (TMB) is one of the oldest and leading old private sector banks in India with a history of ~100 years. TMB was incorporated as ‘Nadar Bank Ltd’ in 1921 while its name was changed to ‘Tamilnad Mercantile Bank Ltd’ in 1962. They received their license to carry on banking business from the RBI in 1962. It is headquartered at Thoothukudi, Tamil Nadu, India and have built a strong presence in Tamil Nadu, with 369 branches, 949 ATMs and 255 cash recycler machines as of March 31, 2022. TMB offer a wide range of banking and financial services primarily to micro, small and medium enterprises (MSME), agricultural and retail customers (RAM). As of March 31, 2022, the bank has 509 branches, of which 106 are in rural, 247 in semi-urban, 80 in urban and 76 in metropolitan centres.

Exhibit 1: Branch distribution



Source: RHP, ICICI Direct Research

Exhibit 2: Branch presence mix



Source: RHP, ICICI Direct Research

The bank’s overall customer base is ~50.8 lakh as of March 31, 2022 growing at a CAGR of 4.4% in FY20-22) while ~80% of its customers have been associated with the bank for more than five years. This has contributed ~77.9% to its deposits base and 64.9% to its advances as of March 2022. TMB had the second highest PAT for FY22 among its peers while RoAs were also higher at 1.7% vs. median 0.8% for peers.

The bank’s deposits have grown at 10.5% while its advances grew at 9.9% CAGR. As of March 31, 2022, its deposits and advances portfolio in Tamil Nadu have contributed 75.1% to total business. Other than Tamil Nadu, TMB is present in 15 other states and four union territories of India. Apart from Tamil Nadu, they have sizable presence in Maharashtra, Gujarat, Karnataka and Andhra Pradesh with a presence across 90 branches, 125 ATMs and 18 CRMs.

TMB primarily offer loans to MSME customers operating in manufacturing, trading and services sector. During FY20, FY21 and FY22, MSMEs contributed 37.9%, 39.1% and 37.4%, respectively, to total advances (grew at a CAGR of 8.6% in FY20-22). In the agriculture segment, the bank primarily offers loans to individual farmers, group of farmers and agricultural corporates. During FY20, FY21 and FY22, agricultural customers contributed 24.8%, 27.4% and 29.7%, respectively, to total advances (grew at a CAGR of 19.7% in FY20-22). In the retail segment, the bank offers home loans, personal loans, auto loans, educational loans as well as security backed loans. During FY20, FY21 and FY22, retail segment contributed 19.3%, 20.6% and 20.4%, respectively, to total advances (grew at a CAGR of 12.5% in FY20-22). Apart from RAM segment, the bank also offers working capital, term financial, trade financial, structured finance services, foreign exchange business funding in domestic and foreign currencies. During FY20, FY21 and FY22, corporate segment contributed 18.0%, 12.9% and 12.5%, respectively, to total advances (grew at 8.89% CAGR in FY20-22).

Exhibit 3: Product offerings

Parameter (₹ crore)	MSMEs	Agriculture	Retail	Corporate
Portfolio size - FY20 / FY22	₹ 10706 / ₹ 12615	₹ 6995 / ₹ 10023	₹ 5442 / ₹ 6882	₹ 5093 / ₹ 4228
CAGR (FY20-FY22)	8.6%	19.7%	12.5%	-8.9%
ATS (₹ lakhs)	18.9	1.3	4.7	56.7
as a % of total advances	37.4%	29.7%	20.4%	12.5%
Product Description	Typically working capital requirement loans with flexible security conditions	Short term crop loans, machinery loan	Home loans, LAP, Vehicle loans, Personal Loans, Education loans	Loans for working capital, term trade financial, structured services, foreign exchange business funding
Target Industries	Textile, timber, engineering, health-hospitality, food processing	Agriculture	Individuals	Textile, infrastructure, power, iron & steel and other industries
Security and limit	Tangible and marketable collateral of at least 50% of loan value	As per RBI Circular, no security for loans upto ₹ 1.6 lakhs	Immoveable property / hypothecated vehicle	-
Loan product names	TMB Vyapari, Traders & Services Loan, TMB MSME Credit, TMB Pharma Trade Finance Scheme, TMB LAP, TMB Mahalir	Kisan Credit Card, TMB Dhall Mill, TMB Rice Mill	TMB Home Loan, TMB Affordable Home Loan, TMB Home Loan for NRI, TMB Personal Loan	-

Source: RHP, ICICI Direct Research

Exhibit 4: Loan category

Loan Category (as % of total loans)	FY20	FY21	FY22	CAGR
Upto ₹ 1 lacs	13.6%	9.9%	9.5%	-8.6%
Above ₹ 1 lac and up to ₹ 5 lacs	9.9%	16.4%	17.3%	44.5%
Above ₹ 5 lacs and up to ₹ 10 lacs	6.5%	7.3%	7.3%	15.6%
Above ₹ 10 lacs and up to ₹ 25 lacs	15.1%	16.1%	16.6%	14.9%
Above ₹ 25 lacs	54.9%	50.4%	49.3%	3.6%

Source: RHP, ICICI Direct Research

TMB's deposits consists of term deposits, recurring deposits, savings bank and current bank accounts among others. Total deposits of bank have increased at a CAGR of 10.5% in FY20-22. CASA contributed 30.5% to total deposits and have grown with a CAGR of 20%. Retail term deposits contributed ~87.1% to total term deposits and have grown at a CAGR of 10.5% from FY20-22.

Exhibit 5: Renewal rates of term deposits

Term deposit category	FY20	FY21	FY22
Up to ₹ 15 lacs	79.9%	78.3%	78.0%
Above ₹ 15 lacs below ₹ 100 lacs	78.3%	79.1%	78.9%
Above ₹ 100 lacs	33.0%	41.4%	32.0%

Source: RHP, ICICI Direct Research

Peer comparison

Exhibit 6: Peer Comparison

Parameters (FY22)	TMB	CUB	CSB	DCB	Federal Bank	KVB	Karnataka Bank	RBL bank	SIB
Yields on advances	9.5%	9.4%	11.2%	10.7%	7.9%	8.5%	8.8%	12.2%	8.7%
Cost of Deposits	4.9%	4.7%	4.3%	6.1%	4.3%	4.3%	4.7%	4.8%	4.8%
NIMs	4.1%	4.0%	5.3%	3.6%	3.2%	3.7%	3.2%	4.4%	2.6%
CI ratio	42.1%	40.4%	50.5%	55.4%	59.9%	53.2%	52.6%	56.9%	64.1%
PAT margins	17.7%	15.6%	17.6%	7.3%	12.0%	10.6%	7.2%	-0.1%	0.1%
Credit cost / total assets	0.3%	1.0%	0.3%	0.9%	0.5%	0.9%	0.9%	2.7%	1.3%
Credit cost / total assets (avg FY20-22)	0.7%	1.3%	0.6%	0.9%	0.7%	1.4%	1.3%	2.5%	1.5%
ROA	1.7%	1.3%	1.9%	0.7%	0.9%	0.9%	0.6%	-0.1%	0.1%
ROE	16.6%	12.2%	19.0%	7.4%	10.8%	9.3%	7.4%	-0.6%	0.8%
Tier I capital	20.4%	19.8%	24.4%	15.8%	14.4%	17.5%	12.7%	16.2%	13.2%
GNPA (₹ crore)	570.9	1933.2	289.5	1289.9	4136.7	3431.0	2250.8	2728.4	3648.1
GNPA (%)	1.7%	4.7%	1.8%	4.3%	2.8%	6.0%	3.9%	4.4%	5.9%
NNPA (₹ crore)	317.6	1191.1	107.0	573.2	1392.6	1260.8	1377.0	806.6	1777.8
NNPA (%)	1.0%	3.0%	0.7%	2.0%	1.0%	2.3%	2.4%	1.3%	3.0%
PCR (%)	87.9%	64.0%	89.7%	67.8%	65.5%	80.3%	73.5%	70.4%	69.6%

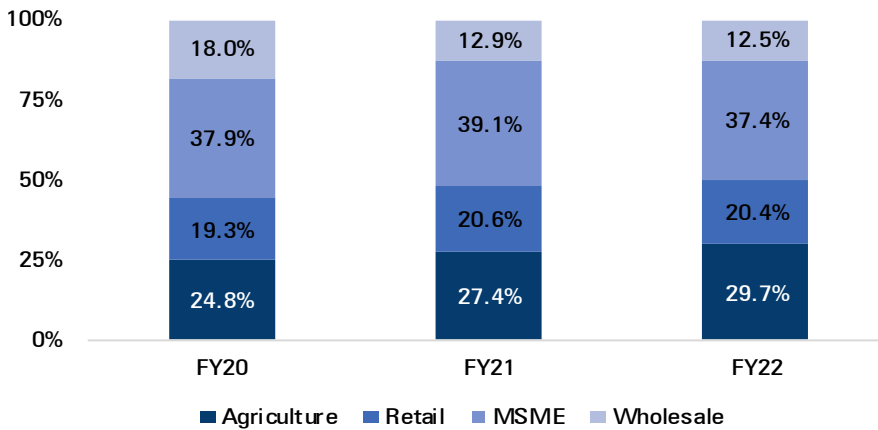
Source: RHP, ICICI Direct Research

Investment Rationale

Advances with focus on MSME, agriculture & retail segments

The bank has traditionally focused on small ticket size loan products to MSME customers, agricultural and retail customers. Its advances portfolio consists of a wide basket of retail finance and small ticket size MSME finance products. Advances to RAM segment represent ~88.1% of total advances as of March 31, 2022. TMB has dedicated branches at Thoothukudi and Chennai in Tamil Nadu, and at Surat, Gujarat to cater to the requirements of MSME customers in these regions. RAM business has consistently increased over FY20-22 at a CAGR of 12.9%.

Exhibit 7: Banks focus on RAM segment visible in business mix

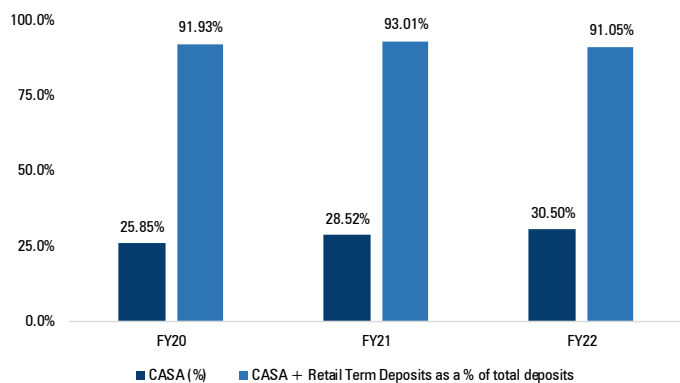


Source: RHP, ICICI Direct Research

Consistently growing deposit base with focus on retail CASA

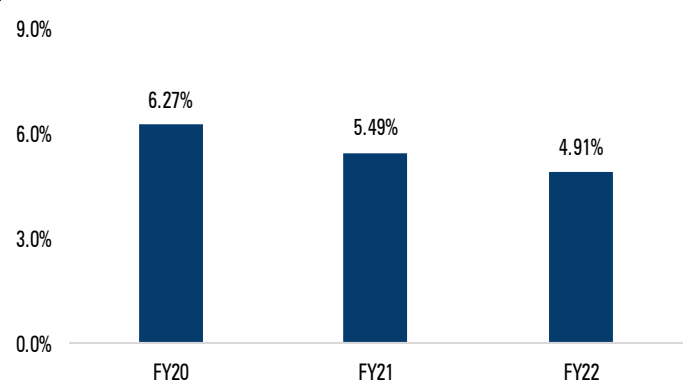
TMB has adopted a customer-first approach, with an emphasis on customer relationships. Apart from individual segment, the bank has focused on account sourcing on value based CASA products. During FY20-22, the deposits base has increased at 10.46% CAGR vs. peer median of 7.9%. Its CASA base is diversified and has low concentration with 2.9% of deposits from top 20 deposit holders and 4.8% deposits from top 50 depositors as of March 31, 2022. Its cost of deposits, calculated on average of fortnightly deposit balance, has been reduced from 6.3% in FY20 to 4.9% in FY22. However, as at March 31, 2020, 2021 and 2022, CASA and retail term deposits comprise 91.1% of total deposits.

Exhibit 8: Focus on low cost of funds



Source: RHP, ICICI Direct Research

Exhibit 9: Trend in cost of deposit

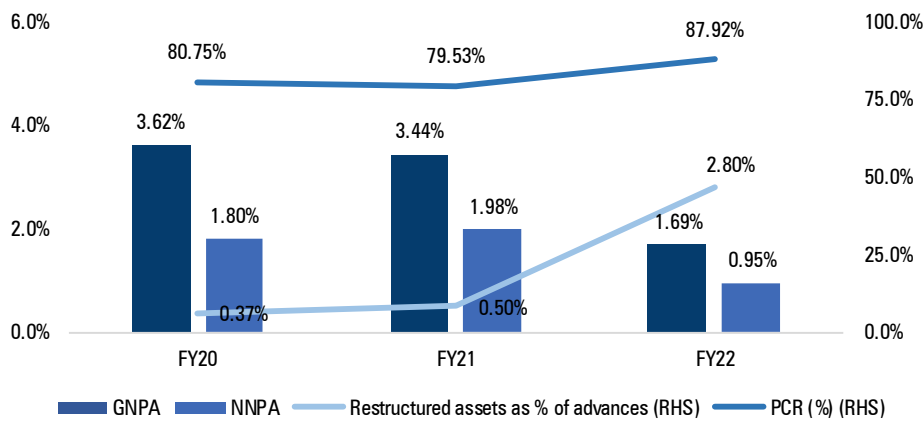


Source: RHP, ICICI Direct Research

Strong asset quality and underwriting practices

TMB’s focus on secured granular loan products and strong under-writing and risk management framework has helped to maintain and further improve asset quality. The bank focuses on selective lending and limits their exposure to certain industries and sectors as a part of strategy to monitor concentration risk. TMB has reported a relatively lower GNPA of 1.7% compared to 4.4% for peers (median) as of FY22 and NNPA have reduced from 1.8% in FY20 to 0.95% in FY22. In FY22, GNPA in RAM portfolio was at 1.5% while in the corporate segment it was 3.4%. TMB has a low customer concentration in terms of average ticket size. The average ticket size has remained in the range of ₹ 3.1 lakh to ₹ 3.4 lakh during FY20-22. The bank has maintained PCR at 87.9% as of March 31, 2022. As of March 31, 2022, the bank has 59.5% of outstanding loan value with less than 12-month tenure including working capital facilities renewable annually, 17.45% of its outstanding loan value with a tenure of 12-60 months and 23.1% with a tenure of more than 60 months.

Exhibit 10: Asset quality comparable with peers



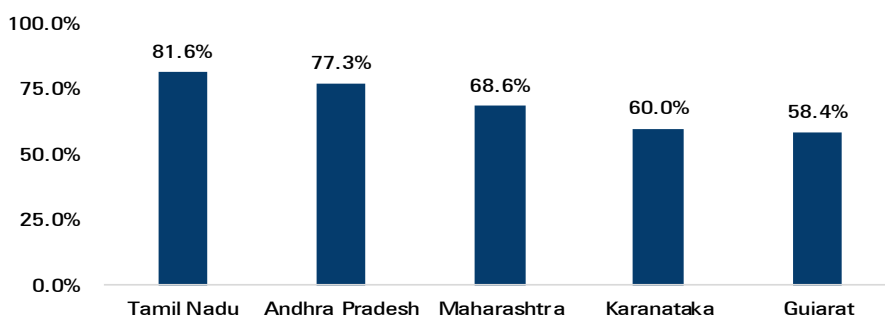
Source: RHP, ICICI Direct Research

Strong legacy and loyal customer base

The bank has a history of almost 100 years and have established as a well-recognised scheduled commercial bank having a strong network of branches, ATMs and CRMs across several states of South India including Tamil Nadu being a home state, along with Maharashtra, Gujarat, Karnataka, and Andhra Pradesh, which has enabled them to maintain a strong customer base. As of March 31, 2020, 2021 and 2022, the bank had 46.6 lakh, 49.1 lakh and 50.8 lakh customers, respectively, which grew at a CAGR of 4.36% from FY20-22.

Large portions of existing customers have been associated with the bank for more than five years specifically in Tamil Nadu, Andhra Pradesh, Maharashtra, Karnataka and Gujarat contributing 81.61%, 77.33%, 68.55%, 59.96% and 58.44% of total customer base in each of these states, respectively, as of March 31, 2022. With a focus on increasing its existing customer base, the bank has introduced various alternate banking channels such as ATMs, CRMs, internet banking, mobile banking, E-Lobbies, PoS, banking and debit & credit cards. TMB introduced internet banking to its customers in 2008 through TMB Econnect and utility payment facility, which enabled customers to pay bills for cable operators/DTH operators, electricity services, mobile phone utility services, other utilities and tax services.

Exhibit 11: Customers associated with bank for >5 years (FY22)



Source: RHP, ICICI Direct Research

Strong presence in Tamil Nadu with focus to increase presence in other strategic regions

Since incorporation, TMB has built a strong and trusted network of customers in Tamil Nadu. As of March 31, 2020, 2021 and 2022, deposits and advances in Tamil Nadu contributed to 75.9%, 76.3% and 75.1%, respectively, of total business. As of March 31, 2022, 85% of overall customer base, contributing deposits and advances in the Tamil Nadu. Apart from home state Tamil Nadu, the bank's focus on diversifying its reach in existing network including in Gujarat, Maharashtra, Karnataka and Andhra Pradesh. As of March 31, 2022, total business, including deposits and advances portfolios, in Tamil Nadu, Maharashtra, Andhra Pradesh, Karnataka and Gujarat contributed 75.06%, 5.78%, 3.67%, 3.47% and 2.91% to total business.

Exhibit 12: Top five states in deposits

States	FY22	as % of total deposits
Tamil Nadu	33305.6	74.1%
Maharashtra	2888.97	6.4%
Karnataka	1742.82	3.9%
Andhra Pradesh	1208.33	2.7%
Gujarat	994.56	2.2%

Source: RHP, ICICI Direct Research

Exhibit 13: Top five states in advances

States	FY22	as % of total advances
Tamil Nadu	25755.3	76.3%
Maharashtra	1659.4	4.9%
Karnataka	1675.8	5.0%
Andhra Pradesh	1295.2	3.8%
Gujarat	986.2	2.9%

Source: RHP, ICICI Direct Research

Key risks and concerns

Ongoing legal proceedings pending at various forums

Total ~37.7% of banks paid up equity share capital or 5.376 crore equity shares are subject to outstanding legal proceedings, which are pending at various forums and, in connection with which, proceedings against bank have been initiated by various regulatory authorities, including RBI, Directorate of Enforcement, some of whom have imposed and sought to impose penalties on the bank in the past. The bank cannot assure that these matters will be resolved in a timely manner or at all and any adverse developments in such proceedings could result in the imposition of injunctions or penalties or requirement to incur significant costs to contest any of which could have a material impact on the reputation, business, financial condition and results of operation.

Change in management

Current MD and CEO, KV Rama Moorthy's term will get over on September 3, 2022. Mr Krishnan Sankarasubramaniam (a retired banker) has been approved by the RBI as new MD and CEO with effect from September 4, 2022 for a term of three years. He was earlier associated with Indian Bank, Syndicate Bank (which was merged into Canara Bank) and Punjab & Sind Bank.

Significant concentration in Tamil Nadu

The bank has regional concentration in southern India, especially Tamil Nadu. Any adverse change in economic, political, or geographical conditions of Tamil Nadu and other states in which the bank operate can impact its results of operations. As of March 31, 2020, 2021 and 2022, deposits and advances in Tamil Nadu contributed to 75.9%, 76.3% and 75.1% of total business, respectively. Concentration in southern India, and specifically in Tamil Nadu, exposes them to many adverse economic or political circumstances in the region compared to other public and private sector banks that have a more diversified national presence.

Financial Summary

Exhibit 14: Profit & Loss Statement			(₹ crore)
₹ crore	FY20	FY21	FY22
Interest Earned	3466.1	3609.1	3833.9
Interest Expense	2146.6	2071.5	2018.6
Nil	1319.5	1537.5	1815.2
Other Income	526.4	644.3	822.6
Total Income	1845.9	2181.9	2637.8
Operating expense	850.9	979.7	1111.0
Operating Profit	995.0	1202.2	1526.8
Provisions	587.3	598.9	704.9
Net Profit	407.7	603.3	821.9

Source: RHP, ICICI Direct Research

Exhibit 15: Balance Sheet			(₹ crore)
₹ crore	FY20	FY21	FY22
Assets			
Cash balances	3736.6	2705.1	3852.0
Investments	9467.3	11703.2	13035.5
Advances	27715.8	31069.6	33491.5
Fixed Assets	128.5	137.2	210.8
Other Assets	1710.7	1912.1	2268.6
Total	42758.8	47527.2	52858.5
Equity & Liabilities			
Capital	142.5	142.5	142.5
Reserves & Surplus	3837.1	4437.5	5193.2
Networth	3979.6	4580.0	5335.7
Deposits	36825.0	40970.4	44933.1
Borrowings	324.0	-	-
Other Liabilities and Provisions	1630.1	1976.8	2589.7
Total	42758.8	47527.2	52858.5

Source: RHP, ICICI Direct Research

Exhibit 16: Key Ratios			
	FY20	FY21	FY22
No. of shares (crore)	14.3	14.3	14.3
BV (₹)	279.3	321.4	374.4
EPS (₹)	28.6	42.3	57.7
P/E (x)	18.4	12.4	9.1
P/BV	1.9	1.6	1.4*
RoA (%)	1.0	1.3	1.7
RoE (%)	10.7	14.1	16.6

Source: RHP, ICICI Direct Research * BVPS is calculated on post issue basis

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