

TAMILNAD MERCANTILE BANK LIMITED



Tamilnad Mercantile Bank Ltd

Issue Opens On
September 05, 2022

Issue Closes On
September 07, 2022

Price Band (INR)
500-525

Issue Size (INR Mn)
7,920-8,316

Rating
NEUTRAL

Tamilnad Mercantile Bank (TMB) is one of India's oldest private sector banks, established in 1921. It provides a wide range of banking and financial services to retail consumers, micro, small, and medium companies (MSMEs), and others. TMB has a robust portfolio of advances and deposits from a diverse customer base which includes retail, agricultural, and MSMEs. As of March 31, 2022, the bank has a strong branch network of 509 branches and a total customer base of 5.08 mn. It is head quartered at Thoothukudi, Tamil Nadu, India. The bank has built a strong presence in the state of Tamil Nadu, with 369 branches and 949 automated teller machines (ATMs) and 255 cash recycler machines (CRMs) as of March 31, 2022. Besides Tamil Nadu, TMB has a sizable presence in the states of Maharashtra, Gujarat, Karnataka, and Andhra Pradesh with presence across 90 branches and 125 ATMs and 18 CRMs as of March 31, 2022.

OFFER STRUCTURE

Particulars	IPO Details
No. of shares under IPO (#)	15.8 Mn
Net offer (# shares)	15.8 Mn
Price band (INR)	500-525
Post issue MCAP (INR Mn.)	79,176-83,135

Source: IPO Prospectus

Indicative Timetable	
Offer Closing Date	September 07, 2022
Finalization of Basis of Allotment with Stock Exchange	On or about 12 th Sept' 2022
Initiation of Refunds	On or about 13 th Sept' 2022
Credit of Equity Shares to Demat accounts	On or about 14 th Sept' 2022
Commencement of Trading of Eq.shares on NSE	On or about 15 th Sept' 2022

Source: IPO Prospectus

Issue	# Shares	INR in Mn	%
QIB	1,18,80,000	6,237	75%
NIB	23,76,000	1,247	15%
Retail	15,84,000	832	10%
Net Offer	1,58,40,000	8,316	100%

Source: IPO Prospectus

Objects of the Offer: The net proceeds will be utilized for the following purpose		
To utilize the Net Proceeds towards augmenting its Tier-I capital base to meet its future capital requirements		
The Gross Proceeds from the Offer will also be used towards meeting the expenses in relation to the Offer		
To receive the benefits of listing the Equity Shares on the Stock Exchanges.		
Shareholding Pattern	Pre-Issue (%)	Post-Issue (%)
Promoters & Promoters Group	0.0%	0.0%
Others	100.0%	100.0%
Total	100.0%	100.0%

Source: IPO Prospectus

Particulars (In INR Mn)*	FY20	FY21	FY22
NII	13,195	15,375	18,152
PPOP	9,950	12,022	15,268
PAT	4,077	6,033	8,219
EPS (INR per share)	28.6	42.3	57.7
Book Value (INR per share)	279.3	321.4	374.4
NIM (%)	3.6	3.8	4.1
ROA (%)	1.0	1.3	1.7
ROE (%)	10.7	14.1	16.6

Source: IPO Prospectus, * Restated Statement

Tamilnad Mercantile Bank Ltd

Company Overview

Tamilnad Mercantile Bank Ltd is one of the oldest and leading old private sector banks in India, with a history of almost 100 years. The bank offers a wide range of banking and financial services primarily to Micro, Small and Medium Enterprises (MSME), Agricultural and Retail customers. As of March 31, 2022, the bank has 509 branches, of which 106 branches are in rural, 247 in semi-urban, 80 in urban and 76 in metropolitan centres. Its overall customer base is approximately 5.08 mn as of March 31, 2022, and 4.05 mn or 79.8% of its customers has been associated with the bank for a period of more than five years and has contributed to INR 350,142 mn or 77.9% to its deposits and INR 219,022 mn or 64.9% to its advances portfolios as of March 2022. TMB had the second highest Net Profit for FY22 amongst its Peers, and its Return on Assets was also higher at 1.66% compared to a median 0.8% for its Peers for FY22.

TMB was incorporated as 'Nadar Bank Limited' in 1921, and its name was changed to 'Tamilnad Mercantile Bank Ltd' in 1962. The bank received its license to carry on banking business from the Reserve Bank of India (RBI) in 1962. Since its incorporation, having head quartered at Thoothukudi, Tamil Nadu, India, it has built a strong presence in the state of Tamil Nadu, with 369 branches and 949 automated teller machines (ATMs) and 255 cash recycler machines (CRMs) as of March 31, 2022. Bank's deposits have grown at a healthy pace of 10.5% CAGR (compared to a median of its peers: 7.9%), while its advances grew at 9.9% CAGR (compared to a median of its peers: 8.0%). As of March 31, 2022, its deposits and advances portfolio in Tamil Nadu has contributed 75.1% to its Total Business.

The bank also focuses on diversifying its growth in other high-growth regions of India, which will help increase its network and client base. Besides Tamil Nadu, TMB is present in 15 different states and four union territories of India. Apart from Tamil Nadu, it has a sizable presence in Maharashtra, Gujarat, Karnataka, and Andhra Pradesh, with a presence across 90 branches and 125 ATMs and 18 CRMs as of March 31, 2022. It has also been consistently growing its customer base from approximately 4.7 mn as of March 31, 2020, to approximately 5.1 mn as of March 31, 2022, at a CAGR of 4.4% from FY20-FY22. It has built a strong portfolio of advances and deposits across its customer base.

Business Portfolio:

Advances: The bank's advances portfolio primarily consists of lending to (a) Retail customers; (b) agricultural customers and (c) MSMEs (RAM).

- a) **MSMEs:** The bank primarily offers various loan products to its MSME customers in the manufacturing, trading and services sectors. These loans are typically in the form of working capital requirements, flexible security conditions, and loans for establishing and enhancing businesses. TMB focuses on units in industries with which it is familiar, such as textiles, timber, engineering, healthcare, hospitality, and food processing. It considers all viable proposals in the MSME sector unless any government/regulator prohibits the activity. During FY20, FY21 & FY22, MSMEs contributed 37.9%, 39.1% and 37.4%, respectively, to its total advances with a CAGR of 8.6% from March 31, 2020, to March 31, 2022.
- b) **Agricultural customers:** TMB primarily offers loan products to individual farmers, groups of farmers and agricultural corporates. It provides a range of loans to agricultural customers to cater for their personal and business needs, such as short-term crop loans and loans to meet various financial requirements such as purchasing machinery with specific terms and conditions. As of March 31, 2022, TMB had a network of 353 rural and semi-urban branches, constituting 69.4% of its total branch network, enabling it to focus on agricultural customers. Besides its loan products, the bank provides farmers with a 'Kisan Credit Card'. During FY20, FY21 & FY22, agricultural customers contributed 24.8%, 27.4% and 29.7%, respectively, to its total advances with a CAGR of 19.7% from March 31, 2020, to March 31, 2022.
- c) **Retail customers:** The bank primarily offers home loans, personal loans, auto loans, educational loans, as well as security-backed loans of various types to its retail customers. During FY20, FY21 & FY22, retail customers contributed 19.3%, 20.6% and 20.4%, respectively, to its total advances with a CAGR of 12.5% from March 31, 2020, to March 31, 2022. The bank offers long-term housing loans, 'TMB Home Loans' catering to various housing requirements of individuals ranging from purchase, construction and renovations. In vehicle loans, the bank offers a variety of secured loans under its vehicle loan portfolio for personal and commercial purposes. TMB Personal Loan schemes assist individuals in meeting their various family and personal needs. In particular, for meeting short-term credit needs for the purchase of consumer durables. TMB Educational Loan schemes offer financial support to eligible students for pursuing higher education as determined by the institution/organization offering the educational course.
- d) **Corporate customers:** a) TMB offers various kinds of loans to corporates, in textiles and other industries, with its assortment of banking products and services, including working capital, term financial, trade finance, structured finance services, and foreign exchange business funding in domestic and foreign currencies. During FY20, FY21 & FY22, corporate customers contributed 18.0%, 12.9% and 12.5%, respectively, to its total advances with a CAGR of (8.9%) from March 31, 2020, to March 31, 2022. This is in line with its strategy to move focus away from corporate customers in favour of RAM.
- e) **Secured and un-secured lending:** With focus on keeping risk relatively lower, in addition to its strong underwriting processes, TMB has consistently maintained and further increased its secured lending from 98.8% of the bank's overall advances in FY20 to 99.2% of its overall advances in FY22. TMB's un-secured lending portfolio's contribution has declined from 1.2% or INR 3,328 mn of overall advances as on March 31, 2020, to 0.7% or INR 2,172 mn as on March 31, 2021, and increased to 0.8% or INR 2,799 mn as on March 31, 2022.

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Business Portfolio:

Deposits: The deposits portfolio consists of term deposits, recurring deposits, savings bank and current bank accounts amongst others. Total deposits of the bank has increased at a CAGR of 10.5% from INR 368,250 mn in FY20 to INR 449,331 mn in FY22. During FY20 & FY22, its current account savings accounts (CASA) contributed INR 95,181 mn or 25.8%, and INR 137,052 mn or 30.5% respectively to its total deposits and has grown with a CAGR of 20.0% from March 31, 2020 to March 31, 2022. Further, during the FY20 and FY22, retail term deposits contributed INR 243,362 mn or 89.1%, and INR 272,049 mn or 87.1% respectively to its total term deposits and has grown with a CAGR of 10.5% from March 31, 2020 to March 31, 2022. The deposit growth rate has been one of the top five amongst its Peers in the industry with a growth rate of 10.5% for FY20-FY22.

Deposit Products:

- **Savings Bank Account:** TMB offers various kinds of savings bank accounts to customers depending on their requirements. Below are details of certain of savings bank accounts offered to its customers:
 1. TMB Ordinary Savings Bank Account caters to resident individuals and HUFs. It offers a cheque book facility for customers basis a certain monthly average balance requirement.
 2. TMB Premium Savings Bank Account caters to resident individuals (sole or joint) and HUFs and offers a personal accident cover of up to INR 200,000.
 3. TMB Dynamic Youth Savings Bank Account caters to youth aged between the ages of 17 to 35 years. The minimum account balance requirement in this kind of account is INR 1,000.
 4. TMB Royal Savings Bank Account targets resident individuals (single or joint) and HUFs.
 5. TMB Classic Salary Savings Bank Account caters to individuals above the age of 18 years with a minimum take-home salary of INR 5,000, employees of the State or Central government, PSUs, semi government organizations, urban development authorities, educational institutions, universities, charitable institutions, trusts, multi-national companies, public limited companies, selected private limited companies, all SME classified accounts and partnership firms.
 6. TMB Visa Savings Bank Account has the minimum account balance requirement of INR 5,000. This type of account also offers an auto-sweep facility into a term deposit.
 7. Simple Savings Bank Accounts scheme caters to all individuals and there is no restriction on the age or the stipulation of income of the account holder.
 8. TMB-Little Super Star Savings Bank Account caters to minors between 10 and 18 years of age. The minimum account balance requirement is INR 250.
 9. TMB Happy Family Banking Account has been initiated with the objective of getting the accounts of all the members of the family tree of the existing customers and bringing more new family accounts to the bank.
- **Current Account:**
 1. TMB General Current Account has a minimum account balance requirement of INR 10,000 for customers in metro cities, INR 10,000 for customers in urban and semi-urban areas and INR 1,000 for customers in rural areas.
 2. Super Flexi Current Account offers its customers unlimited free transactions. This account also offers a personalized account number selection.

TMB's share from CASA deposits has increased from INR 95,181 mn or 25.8% in FY20 to INR 137,052 mn or 30.5% in FY22 at a CAGR of 20.0% in the past three Fiscals.

Other Deposit products:

- Fixed Deposit Account includes a deposit made with a one-time lump sum payment of the principal amount.
- TMB Muthukuvial Deposit includes a one-time lump sum payment of the principal amount. The interest is compounded depending on the period of the deposit.
- TMB 20:20 Deposit includes a deposit of a minimum amount of INR 1,000. The period of deposit is limited to 20 months and 20 days only.
- TMB Pearl Deposit is a deposit with an inbuilt compounding of interest and facility to withdraw the compounded interest once in 3 months, 6 months, 9 months or 12 months.
- Tax Savings Deposits (Malligai Tax Saving Deposit & Mullai Tax Saving Deposit) caters to individuals and HUFs. Joint deposits are permitted. However, the tax benefit is availed by the first holder only.
- Basic Recurring Deposit includes a monthly payment of the specified amount in sums of INR 10 or in multiples on INR 10.
- TMB Kids Recurring Deposit includes a minimum monthly deposit of a specified amount.
- TMB Siranjeevi Recurring Deposit caters to individuals between the ages of 18 years to 59 years. This is a recurring deposit scheme with a life insurance cover.

Fee Based Products:

TMB offers various fee-based products including issuing debit cards, credit cards, general insurance, life insurance, online bill payment services, depository services, government schemes and e-stamping to its existing as well as new customers. It also provide payment banking services like RTGS, NEFT, IMPS, cardless cash through ATMs, bill payment services for utilities, telephone, mobile payment / recharging, DTH recharges etc. The bank has introduced individual targets to increase income arising through cards, locker system, PoS machine and any third-party products. It also provides corporate net banking services under the category of transaction banking.

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Business Portfolio:

Value added services:

Value Added Services include offering services such as WhatsApp Banking, DigiLobby, Fee Pay, Internet Banking, Mobile Banking, Insurance services, amongst other services. It offers a convenient and secure application, TMB DigiLobby, for its customers to view all their account balances & transactions on their mobile device for each customer id. The bank also has a comprehensive integrated online fee payment system, TMB Fee Pay, for educational institutions, which enables educational institutions to collect their fees from students through multiple modes.

Corporate Products:

TMB offers various commercial banking products to its customers including Current Account Facilities, online services such as Internet Banking, and SMS alerts and Foreign Exchange services. It also provides various kinds of loans such as TMB Pharma Finance, TMB Genset, etc. to cater to the needs of its customers. It offers other services including E-Tax Payment, online fee payment, Online Bill Payment, Forex Services and Demat Services.

Treasury Operations:

The treasury operations focuses on the management of its funds, maintenance of statutory reserves (cash reserve ratio and statutory liquidity ratio), asset liability gaps, interest rate risks, liquidity positions, investments and trading activities. They also manage trades in equity and forex instruments, utilize arbitrage opportunities available across markets and also provide crucial market related inputs in the banks's asset liability management. TMB invests in various instruments such as treasury bills, commercial papers, certificate of deposits, mutual funds, debentures and other products.

Performance Under Priority Sector Lending:

The bank's priority sector advances include advances for agricultural, MSME, educational, housing, renewable energy, and social infrastructure sectors. As on March 31, 2020, March 31, 2021, and March 31, 2022, its lending to 131 priority sectors constituted 66.3%, 71.5%, and 72.6%, respectively to the total gross advances.

Distribution:

TMB delivers its products and services to its customers through its branches and alternative delivery channels, primarily through CRMs, ATMs, E-Lobbies and PoS. TMB's Pan-India distribution has allowed the bank to offer its customers a differentiated and customized product offering that is well suited for their banking needs and requirements. As on March 31, 2022, it has approximately 509 branches, 282 CRMs, 1,141 ATMs, 101 E-Lobbies and 4,792 PoS across India. The bank also provides facilities through various digital channels such as internet banking, mobile banking, and online payment through debit/credit cards.

Tamilnad Mercantile Bank Ltd

INVESTMENT RATIONALE

Rich heritage, a dedicated customer base, and an emphasis on enhancing the servicing framework:

The bank has been operating since 1921 and has a strong history of almost 100 years in banking sector. TMB has built itself as a well-recognized scheduled commercial bank with a strong network of branches, ATMs, and CRMs spanning various states in South India, including its native state of Tamil Nadu, as well as Maharashtra, Gujarat, Karnataka, and Andhra Pradesh, ensuring it to maintain a strong customer base. The bank's customers have seen a growth of 4.4% from March 31, 2020, to March 31, 2022. The large portions of its existing customers have been associated for more than five years, specifically in Tamil Nadu, Andhra Pradesh, Maharashtra, Karnataka and Gujarat. The bank has consistently worked towards developing long-term relationships with its customers based on its knowledge of local needs and experience in the sector. With a focus on increasing its existing customer base, TMB has introduced various alternate banking channels such as ATMs, CRMs, internet banking, mobile banking, E-Lobbies, Point of Sales (PoS), banking and debit and credit cards. The largest branch is in Mandvi, Mumbai, contributing 2.6% to its Total Business as of March 31, 2022. One of the oldest branches of the bank is in Sivakasi, Tamil Nadu, which was started in 1942 and contributes 1.8% to its Total Business as of March 31, 2022.

Strong hold in Tamil Nadu, with plans to expand into other strategic regions:

The bank has built a strong and trusted network of customers in the State of Tamil Nadu. As of March 31, 2022, TMB had 4.3 mn customers, 85.0% of its overall customer base, contributing to its deposits and advances portfolios in the State of Tamil Nadu. Tamil Nadu is one of the fastest growing states, with a continued focus on the MSME and textile industry, with GSVA at current prices growing at a CAGR of 11% over FY17-22 against the country-wide growth of 9%. Tamil Nadu is underpenetrated, which presents an opportunity for further growth in GDP funded by bank loans. TMB is also focused on diversifying its reach in its existing network, including in Gujarat, Maharashtra, Karnataka and Andhra Pradesh. As of March 31, 2022, its businesses, including the deposits and advances portfolios, in the state of Tamil Nadu, Maharashtra, Andhra Pradesh, Karnataka and Gujarat contributed 75.1%, 5.8%, 3.7%, 3.5% and 2.9% to its Total Business. TMB focuses on increasing its market share in these states, more specifically in its home state, where it is located across 369 branches, 949 ATMs, 255 CRMs, 91 E-Lobbies, and 3,939 PoS as of March 31, 2022, which has therefore, benefited the bank and will help it further enhance its customer base and increase business operations.

Advances with focus on MSME, agricultural and retail segments:

TMB is traditionally focused on small ticket size loan products to MSMEs and agricultural and retail customers for its growth. The advances portfolio comprises a broad basket of retail finance and small-sized MSME finance products. Its focus is on understanding the needs and expectations of its customers, particularly in the RAM space and adopting strategies to target these customer segments for its growth. TMB leverages its presence in semi-urban and rural regions where it is located to attract more customers in the RAM segment. The bank has structured loan products available to meet the financial requirements of its MSME customers, which aids in growing the MSME customer base across all places. The RAM business has seen a growth of 12.9% CAGR over the last three years. The advances to the RAM segment represent 88.1% of its net advances as of March 31, 2022. The bank believes in developing a socially inclusive model, focusing on bringing customers in the underserved sectors into the banking mainstream. Therefore, its focus has been on enhancing its RAM mix to help the bank gain market share in Tamil Nadu and other regions.

Consistent deposit growth, with a focus on low-cost retail CASA:

TMB has adopted a customer-first approach, with an emphasis on customer relationships. It is focused on account sourcing on value-based CASA products and has started following a segmental approach to CASA growth by introducing segment-wise CASA products. During the last three Fiscals, the overall deposits base has increased from INR 368,250 mn in FY20 to INR 449,331 mn in FY22, owing to an increase in both term deposits and CASA deposits. Its CASA deposits as a share of total deposits have increased from 25.8% in FY20 to 30.5% in FY22, with a CAGR of 20.0% from FY20 to FY22. The CASA portfolio is diversified and has low concentration, with 2.9% deposits from its top 20 deposit holders and 4.7% deposits from its top 50 depositors as of March 31, 2022. TMB's cost of deposits has been reduced from 6.3% in FY20 to 5.5% in FY21 to 4.9% in FY22. In addition, the bank continuously strives to increase reliance for transactions on digital channels, which are more cost-effective than physical channels. Its digital banking channels enable a smooth transition from physical to digital usage and enhance customer experience, designed to grow the business and improve its margins.

Sturdy asset quality, underwriting practices, and risk management policies and procedures:

TMB's strong customer understanding, focus on secured granular loan products, and strong underwriting and risk management framework have helped the bank to maintain and further improve asset quality and drive its growth with consistent profitability. The bank focuses on selective lending and limits its exposure to specific industries and sectors as a part of its strategy to monitor concentration risk. The GNPA for the bank has reduced from 3.6% in FY20 to 1.7% in FY22. TMB has reported a relatively lower GNPA of 1.7% compared with 4.4% for its Peers (median) as of FY22. The average ticket size has remained in the range of INR 0.31 mn to 0.34 mn during the last three Fiscals. The bank maintained its PCR at 87.9% as of March 31, 2022. It has made total provisioning of INR 2,496 mn and total write-offs, including technical/prudential write-offs of INR 20,571 mn together, amounting to INR 23,068 mn as of March 31, 2022. Additionally, during the year, TMB has made provisions for contingency provisions for COVID-19 and other uncertainties. As of March 31, 2022, it made total provisioning for INR 2,500 mn. To maintain and improve its asset quality, the bank follows specific processes prior to loan approval and during the loan's tenure, depending on the loan's ticket size.

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INVESTMENT RATIONALE

Consistent financial performance:

TMB's diversified portfolio, increasing market penetration across rural and semi-urban regions and focus on asset quality have enabled it to ensure consistent financial performance over the years. The bank also focuses on increasing its digital footprint, which has improved the operational processes that have reduced its costs and resulted in enhancing its profitability. The total income increased at a CAGR of 8.0%, from INR 39,925 mn in FY20 to INR 46,564 mn in FY22. The bank's NIM has consistently grown over the years, increasing from 3.6% to 4.1% from FY20 to FY22 at a CAGR of 6.1%. The cost-to-income ratio has reduced from 46.1% in FY20 to 42.1% in FY22 at a CAGR of (4.4)%. PAT of TMB increased at a CAGR of 42.0% from INR 4,077 mn in FY20 to INR 8,219 mn in FY22. ROE increased at a CAGR of 24.3%, from 10.7% in FY20 to 16.6% in FY22. ROA rose by a CAGR of 29.5%, from 1.0% in FY20 to 1.7% in FY22. Return on Assets was higher at 1.7% compared to a median of 0.8% for its Peers for FY22. In terms of a Return on Equity, TMB had a ratio of 16.6% in FY22, as compared to its Peers, who reported a median of 8.3%.

Bank managed professionally, with an experienced senior management team and board of directors:

The Board of Directors comprises 11 directors and two nominee directors appointed by the RBI. The 11 directors include its Managing Director and Chief Executive Officer and ten Non-Executive directors, of whom six are Independent Directors, one of whom is a woman Director. They bring substantial experience and independent directors with diverse expertise in sectors such as banking, law, business administration, and other finance streams such as accounting and auditing. In addition, its senior management team's capabilities, reputation, extensive network of industry relationships, and wide-ranging experience in the finance and banking industry are critical to its strategy to grow, modernise, and develop further.

Tamilnad Mercantile Bank Ltd

Future Growth Strategies

Focus on strengthening the deposit and advance product portfolios:

TMB has higher growth potential in geographies where it exists, such as in the State of Tamil Nadu and Gujarat, which has lower bank credit to GDP ratios that are indicative of opportunities for banks and with its presence in the rural and semi-urban markets, the bank is well positioned to continue attracting a higher proportion of RAM customers. The long terms growth strategy is aligned to the RBI guidelines of Priority Sector Lending (PSL), which encourages inclusive lending policies targeted at retail customers from weaker sections, agriculture and MSME customers covered under the priority sector. The bank focuses on boosting the RAM loan book through SME loans, house loans, car loans, personal loans, Loan Against Property (LAP) and pensioner's loans, jewel loans, agricultural loans and good quality loans, and mid-corporate segment loans on a selective basis.

It will continuously focus on exploring and introducing new and customized fee-based products in connection with its centenary anniversary and strategies in addition to its existing products. The bank will also focus on improving the experience of already available products and more tie-ups with strategically identified third parties and leveraging its deep market expertise and relationships to leverage cross-selling opportunities, grow deposits, improve the advances sector-wise and increase its fee-based income.

The bank aims to expand the branch-wise targets by opening new Retail Assets Central Processing Centres (RACPCs) with dedicated home loan sales teams posted at these locations to drive further home loan portfolio growth. TMB is focused on diversifying its product portfolio to gain more customers and increase its market share. It will continue to expand its relationship banking facilities to grow its network. The bank intends to focus more on fee-based products. It is also promoting investments in sovereign gold bonds floated by the RBI. It aims to mobilise the opening of new accounts under the Atal Pension Yojana and National Pension Schemes.

The bank has been specifically focused on increasing its retail term deposit base by introducing specific programs. Its branches are focused on growing retail deposits by catering to the needs of its existing customers and introducing products beneficial to each customer type. It also aims to increase its CASA accounts by sourcing new accounts on value-based CASA accounts and augment CASA deposits by revamping its existing CASA products to cater to segment growth.

Technology transformation to improve efficiency and customer experience:

The increased availability of internet access and connectivity across India requires a comprehensive technology-driven strategy to proactively develop new methods of reaching its customers and running its businesses. The bank's technology-driven strategy is focused on acquiring new customers by enhancing customer experience through its digital interfaces. Its technology focus is also intended to improve its loan approval capabilities, reduce the overall turnaround time, and maintain and develop long-term customer relationships. TMB invests in technology to improve its customers' experience, offering them a range of products tailored to their financial needs. It constantly aims to upgrade its systems to match its customer demands and satisfy the needs of its diverse customer base. The bank aims to foster continued investment and innovation towards improved network security technology and architecture by adopting the "phygital" approach to sustainable and scalable growth. TMB provides a range of options for customers to access their accounts, including internet banking and mobile banking. In addition, it is exploring investment in technology platforms which provide early warning signals for stressed assets, and in customer relationship management systems, peripheral systems which would integrate its systems with that of various business partners for origination and other operational functions, and alternate channels.

Seek to strengthen asset quality:

The bank aims to continuously monitor and improve asset quality by focusing on secured advances, high loan-to-value ratio, diversification across loan book tenures, low concentration across branches and more stringent audit procedures for sanctioning the loans, explicitly focusing on higher value loans. It conducts various audit processes, such as stock audits on working capital facilities, with exposure of INR 30.0 mn or above in both fund and non-fund-based accounts. TMB also intend to reduce its NPAs by continuing to offer various schemes of settlement to address the issues faced explicitly by small ticket borrowers. Further, it proposes to boost NPA recovery through one-time settlements and monitoring of small value NPA accounts. It will continue to focus on establishing and maintaining comprehensive strategies to achieve NPA targets by operating a dedicated credit recovery department and a region-wise cluster-based oversight mechanism. It will maintain provisions to account for any NPA and write-offs, including technical/prudential write-offs.

Tamilnad Mercantile Bank Ltd

Key Strengths

- With nearly 100 years of experience, it has a long track record.
- TMB has a strong presence in Tamil Nadu and consistent focus to expand presence in strategic regions.
- It has a diversified and loyal customer base in retail, MSMEs, and agricultural segments.
- The bank has seen a consistently growing customer deposit base with a focus on low-cost retail CASA.
- It has a proven financial performance track record with continuously improving asset quality.

Key Risks

- TMB is widespread in southern India, particularly Tamil Nadu. Any adverse change in the economic, political, or geographical conditions of Tamil Nadu and the other states in which it operates will have an influence on the company's earnings.
- 37.7% of its paid-up equity share capital, or 53.8 mn Equity Shares are the subject of pending legal processes at various forums, and proceedings against the Bank have been initiated by various regulatory authorities, including the RBI and the Directorate of Enforcement, some of whom have levied and sought to impose penalties on it in the past.
- TMB has issued notices and begun various recovery processes against defaulting borrowers in accordance with the SARFAESI Act, and failure by such borrowers to repay the outstanding borrowings in accordance with such notices and proceedings may have a negative impact on its business.
- The bank is vulnerable to operational risks such as fraud, petty theft, negligence, and embezzlement by its staff or customers, which could negatively impact its operating results and financial health.
- The bank has received and may in the future receive multiple anonymous whistle blower complaints, which may adversely affect its reputation.
- The bank is subject to strict regulatory requirements and prudential standards, and failure to comply with such laws, regulations, and standards may have a negative impact on its business.
- TMB's contingent liabilities exceed its net worth, which, if they materialize, may adversely affect its results of operations, financial condition and cash flows.
- The bank is supervised and inspected by authorities such as the RBI. Any negative RBI observations or noncompliance with RBI inspections/observations or other regulatory requirements may have a negative impact on its business and financial situation.
- It is required to maintain CRR and SLR and capital adequacy ratios and any increase in these requirements could materially and adversely affect its business.

Tamilnad Mercantile Bank Ltd

Outlook and Valuation:

TMB is one of the oldest banks in India, with a history of almost 100 years in the private sector. As of March 31, 2022, the loan book stands at INR 334,915 mn; the total assets stood at INR 518,524 mn. The bank is well capitalized, with a capital adequacy ratio of 20.4% as of March 31, 2022. The company has built a strong presence in Tamil Nadu with a 75.1% contribution to the total business. The bank plans to expand its branches once the restrictions of listing is lifted by RBI. The bank's objective of the offer is a) to utilize the Net Proceeds towards augmenting its Tier-I capital base to meet its future capital requirements; b) also to use proceeds towards meeting the expenses of the offer, and c) to receive the benefits of listing the equity shares on stock exchanges.

TMB's IPO size is INR 8,316 Mn. The price band of the issue is INR 500-525. On the upper price band of INR 525 and Book Value of INR 374.4 for FY22, the P/B ratio works out to be 1.4x. The ROA/ROE for the bank stood at 1.7%/ 16.6% respectively in FY22 which is better than the its peers with median of 0.8%/ 8.3%, respectively. We believe the current valuation reflects the premium for outperforming peers across all financial parameters. However, we remain cautious regarding higher geographical & low-ticket size concentration and also the bank's ongoing dispute. **As a result, we recommend that Tamilnad Mercantile Bank IPO be rated 'NEUTRAL'.**

Peer Comparison:

TMB reported low cost-to-income ratio of 42.1% compared with 52.9% for its peers (median). In FY22, TMB reported 17.7% in net profit margin, which was the highest among its peers. TMB also registered a comparatively low credit cost ratio of 0.27%. The bank's return on assets (RoA) was at 1.7% compared with peers that have a median RoA of 0.8%. The trend is similar in the Return on Equity ratio, where the bank outperformed peers at 16.6% in FY22, while its peers reported a median of 8.3%. TMB has been consistently outperforming its peers across all the financial parameters which is reflected in the valuation of the bank.

As per the bank's prospectus, comparison of accounting ratios with listed industry peers:

Name of the company	Face Value (INR per share)	Market Cap (INR Mn)	Net Profit for FY22 (INR in Mn)	ROA (%)	RoNW for FY22 (%)	Basic EPS for FY22 (INR)	NAV (INR per share)	P/B for FY22 (x)
Tamilnad Mercantile Bank Ltd	10.0	83,135	8,219	1.7	15.4	57.7	375.4	1.4
Peer Group								
South Indian Bank Ltd	1.0	17,160	450	0.1	0.8	0.2	28.0	0.3
City Union Bank Ltd	1.0	133,125	7,602	1.3	11.5	10.3	89.1	2.1
CSB Bank Ltd	10.0	37,473	4,585	1.9	17.3	26.4	152.8	1.7
DCB Bank Ltd	10.0	28,833	2,875	0.7	7.1	9.3	130.2	0.7
Federal Bank Ltd	2.0	252,553	18,898	0.9	10.2	9.5	91.6	1.3
Karur Vysya Bank Ltd	2.0	54,998	6,733	0.9	8.9	8.4	95.0	0.8
Karnataka Bank Ltd	10.0	22,927	5,086	0.6	7.2	16.4	228.0	0.3
RBL Ltd	10.0	73,021	(747)	(0.1)	(1.3)	(2.8)	209.0	0.6

Source: IPO Prospectus

Note:*Considering the upper price band

Tamilnad Mercantile Bank Ltd

Financials:

Income Statement (INR Mn)	FY20	FY21	FY22
Net Interest Income	13,195	15,375	18,152
Other income	5,264	6,443	8,226
Operating expenses	8,509	9,797	11,110
Pre-Provisioning Operating Profits	9,950	12,022	15,268
Provision & Contingencies	5,873	5,989	7,049
PBT	4,077	6,033	8,219
Tax	65	67	70
PAT	4,077	6,033	8,219
EPS (INR)	28.6	42.3	57.7

Source: IPO Prospectus, KRChoksey Research

Balance Sheet (INR Mn)	FY20	FY21	FY22
Capital & Liabilities			
Share capital	1,425	1,425	1,425
Reserves and Surplus	38,371	44,375	51,932
Deposits	3,68,250	4,09,704	4,49,331
Borrowings	3,240	0	0
Other Liabilities & Provisions	16,301	19,768	25,897
Total	4,27,588	4,75,272	5,28,585
Assets			
Cash and Bank balances with RBI	14,144	16,803	21,131
Balances with banks and Money at Call and Short Notice	23,221	10,248	17,389
Investments	94,673	1,17,032	1,30,355
Advances	2,77,158	3,10,696	3,34,915
Fixed Assets	1,285	1,372	2,108
Other Assets	17,107	19,121	22,686
Total	4,27,588	4,75,272	5,28,585

Source: IPO Prospectus, KRChoksey Research

Tamilnad Mercantile Bank Ltd

ANALYST CERTIFICATION:

I, Priyanka Baliga [M.Com, BMS (Finance)], Research Analyst, author and the name subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect my views about the subject issuer(s) or securities. I also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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