

## Tamilnad Mercantile Bank Ltd.

Recommendation	Subscribe		BACKGROUND																																															
<b>Price Band</b>	Rs. 500 – Rs. 525		<p>TMB is an old generation private bank having primary focus on MSME, Agri and Retail. TMB has 509 branches mainly in semi-urban areas of Tamil Nadu which contributes to 76% of its total advances. TMB has a sticky customer base owing to its century old legacy and strong regional brand. TMB has the highest ROA among old generation private banking peers at 1.66% for FY22. This is backed by its superior NIM profile at 4.1% along with prudent underwriting practices which have restricted GNPA / NNPA at 1.69% / 0.95% (lowest among peer banks).</p> <p><b>Details and Objects of the Issue</b></p> <p>The public issue consists of fresh issue of Rs. 832 Cr to augment Tier 1 capital for future growth. More importantly, TMB was barred by RBI from expanding branches since June 2019 due to non-fulfillment of certain requirements pertaining to its share capital structure. RBI had instructed the bank that it shall lift the ban subsequent to listing of the bank.</p> <p><b>Investment Rationale</b></p> <ul style="list-style-type: none"> <li>• Strong legacy, loyal customer base</li> <li>• Granular loan book has led to strong NIMs</li> <li>• Robust underwriting practices reflecting in superior asset quality</li> </ul> <p><b>Valuation and Recommendation</b></p> <p>TMB has demonstrated strong track record of successfully growing and managing a granular portfolio with superior asset quality metrics. TMB stands out among the old generation private banking peers on most metrics. We believe TMB can sustain ROA at around 1.5% levels in coming years on the back of stable NIM at around ~4.0% levels and decline in credit cost to below 1%. TMB is being offered at 1.35x FY22 BV which is at a slight discount to peer banks having similar return ratio profile. Although pending legal issues regarding the bank's share capital shall continue to be a hangover; considering the quality of business, top quartile earnings profile in the banking industry and reasonable valuations, we rate the issue as 'Subscribe'.</p>																																															
<b>Bidding Date</b>	5 - 7 September																																																	
<b>Book Running Lead Manager</b>	Axis Cap, Motilal Oswal, SBI Cap																																																	
<b>Registrar</b>	Link Intime																																																	
<b>Sector</b>	Banks																																																	
<b>Minimum Retail Application- Detail At Cut off Price</b>																																																		
Number of Shares (bid lot)	28																																																	
Minimum Application Money	Rs. 14,700																																																	
Payment Mode	ASBA																																																	
<b>Financials (Rs Cr)</b>																																																		
	<b>FY21</b>	<b>FY22</b>																																																
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PAT	603	822																																																
<b>Valuations</b>																																																		
	<b>At Upper Band</b>																																																	
Market Cap (Rs. Cr)	8313																																																	
EPS*	51.9																																																	
BVPS*	389																																																	
P/E *	10.1																																																	
P/B *	1.3																																																	
*calculated on FY22, post IPO basis																																																		
<b>Post Issue Shareholding Pattern</b>																																																		
Promoters	0%																																																	
Public	100%																																																	
<b>Offer structure for different categories</b>																																																		
QIB (Including Mutual Fund)	75%																																																	
Non-Institutional Investors	15%																																																	
Retail	10%																																																	
Post Issue Equity (in Rs Cr)	158.4																																																	
Issue Size (Rs in cr)	832																																																	
Face Value (Rs)	10																																																	
<p><b>Jehan Bhadha (+91 22 6273 8174)</b>                      Research Analyst                      jehankersi.bhadha@nirmalbang.com</p>																																																		
<table border="1"> <thead> <tr> <th>Financial Snapshot</th> <th>FY20</th> <th>FY21</th> <th>FY22</th> </tr> </thead> <tbody> <tr> <td>Net Interest Income</td> <td>1320</td> <td>1538</td> <td>1815</td> </tr> <tr> <td><i>Growth</i></td> <td><i>7%</i></td> <td><i>17%</i></td> <td><i>18%</i></td> </tr> <tr> <td>Pre Provisioning Profit</td> <td>995</td> <td>1202</td> <td>1527</td> </tr> <tr> <td><i>Growth</i></td> <td><i>13%</i></td> <td><i>21%</i></td> <td><i>27%</i></td> </tr> <tr> <td>PAT</td> <td>408</td> <td>603</td> <td>822</td> </tr> <tr> <td><i>Growth</i></td> <td><i>58%</i></td> <td><i>48%</i></td> <td><i>36%</i></td> </tr> <tr> <td>BVPS</td> <td>279</td> <td>321</td> <td>374</td> </tr> <tr> <td>ROA</td> <td>1.0%</td> <td>1.3%</td> <td>1.6%</td> </tr> <tr> <td>ROE</td> <td>10.7%</td> <td>14.1%</td> <td>16.6%</td> </tr> <tr> <td>P/E</td> <td>18.4</td> <td>12.4</td> <td>10.1 #</td> </tr> <tr> <td>P/BV</td> <td>1.9</td> <td>1.6</td> <td>1.3 #</td> </tr> </tbody> </table> <p>Source: Company, NBRR                      # Diluted (Post IPO)</p>			Financial Snapshot	FY20	FY21	FY22	Net Interest Income	1320	1538	1815	<i>Growth</i>	<i>7%</i>	<i>17%</i>	<i>18%</i>	Pre Provisioning Profit	995	1202	1527	<i>Growth</i>	<i>13%</i>	<i>21%</i>	<i>27%</i>	PAT	408	603	822	<i>Growth</i>	<i>58%</i>	<i>48%</i>	<i>36%</i>	BVPS	279	321	374	ROA	1.0%	1.3%	1.6%	ROE	10.7%	14.1%	16.6%	P/E	18.4	12.4	10.1 #	P/BV	1.9	1.6	1.3 #
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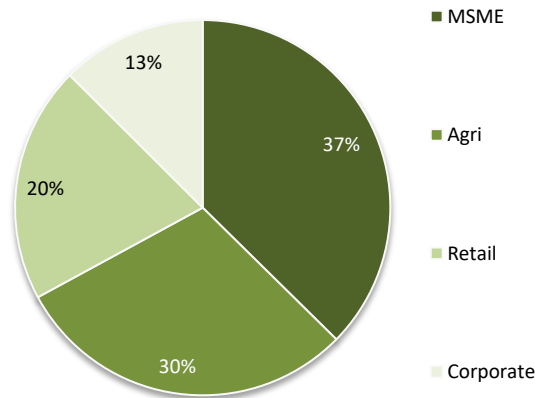
## Tamilnad Mercantile Bank Ltd.

### Company Background

TMB is an old generation private bank and was incorporated in 1921. TMB's primary focus is in MSME, Retail and Agri. As of March 31, 2022, TMB has 509 branches, of which 106 branches are in rural, 247 in semi-urban, 80 in urban and 76 in metropolitan centres. TMB has a strong presence in the state of Tamil Nadu which contributes 76% of its total advances. TMB's customer base stands at 50.8 lac as of March 31, 2022 and 40.5 lac or 80% of the customers have been associated with TMB for a period of more than five years.

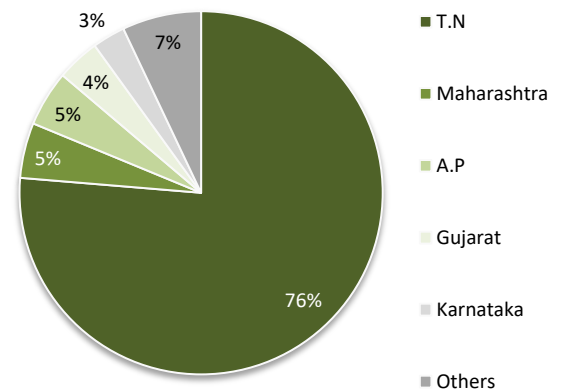
TMB has delivered the highest ROA among old generation private banking peers at 1.66% for FY22. This is backed by its superior NIM profile at 4.10% for FY22 along with best in class asset quality with GNPA / NNPA at 1.69% / 0.95% (lowest among peer banks).

**AUM Mix FY22 (Segmental)**



Source: Company

**AUM Mix FY22 (Geography wise)**



Source: Company, NBRR

### Investment Rationale

#### Strong legacy, loyal customer base

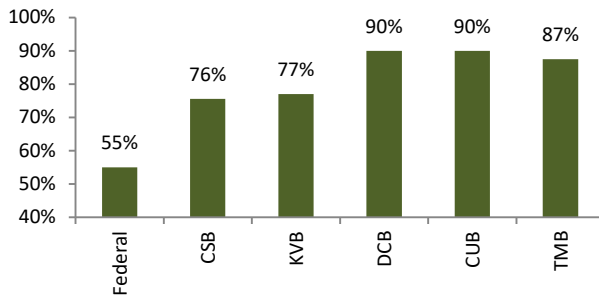
With over 100 years of history, TMB has established itself as a well-recognized scheduled commercial bank having a strong network of branches, ATMs and CRMs across several states of South India which forms over 85% of its advances. Being a well-established bank amongst the trading and small business community of Tamil Nadu, the bank has a sticky customer base. Further, 80% of the customers have been associated with TMB for a period of more than five years.

## Tamilnad Mercantile Bank Ltd.

### Granular loan book has led to strong NIMs and return ratios for TMB

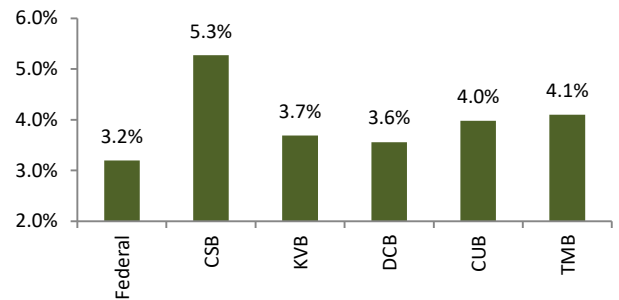
TMB has traditionally focused on small ticket size loan products to MSME (37% mix), agricultural (30% mix) and retail (20% mix) customers for its growth. TMB's focus is on understanding the needs and expectations of its customers, particularly in the RAM (Retail, Agri, MSME) space and adopting strategies 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. TMB has dedicated branches at Thoothukudi and Chennai in Tamil Nadu, and at Surat in Gujarat to cater to the requirements of MSME customers in these regions. Further, these dedicated branches act as facilitators for MSME customers with a focus on improving its loan processing timelines and faster disbursals to benefit the MSME customers. This targeted granular (lowest average ticket size among all peer banks) approach has resulted in TMB commanding superior NIMs of 4.1%.

#### Share of RAM (Retail, Agri, MSME) in Advances (FY22)



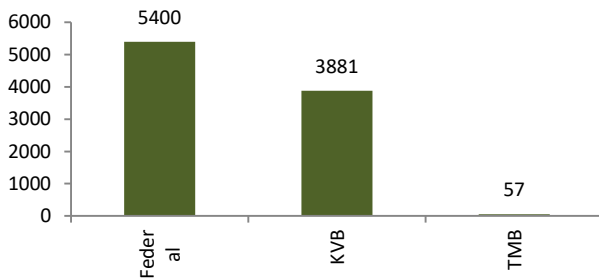
Source: Company, NBRR

#### Net Interest Margin (FY22)



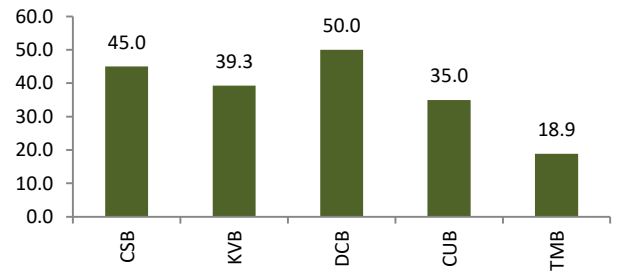
Source: Company, NBRR \*CSB NIMs appear much higher as ~40% of advances constitute gold loans

#### Corporate Loans: Avg. Ticket Size (Rs. Lacs)



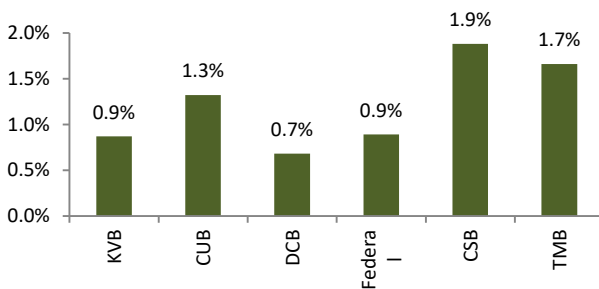
Source: Company, NBRR

#### MSME Loans: Avg. Ticket Size (Rs. Lacs)



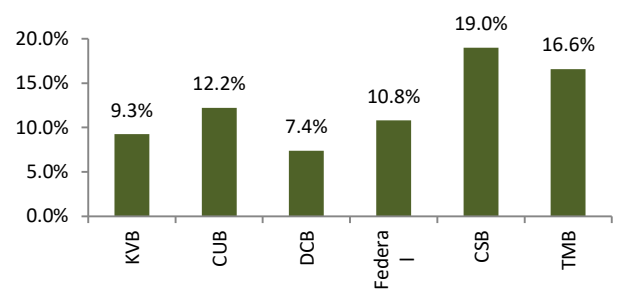
Source: Company, NBRR

#### RoA (FY22)



Source: Company, NBRR

#### RoE (FY22)



Source: Company, NBRR

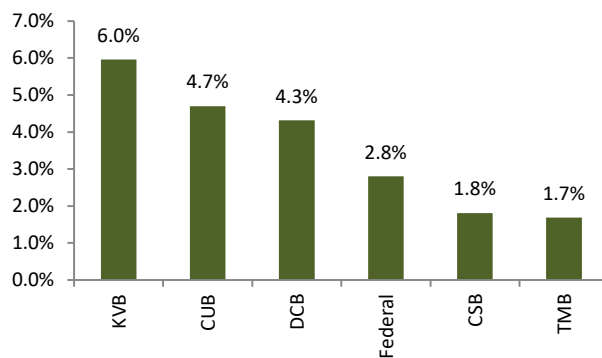
\*CSB's ROA/ROE appears high due to one offs like lower opex & nil credit costs during FY22

## Tamilnad Mercantile Bank Ltd.

### Robust underwriting practices reflecting in superior asset quality

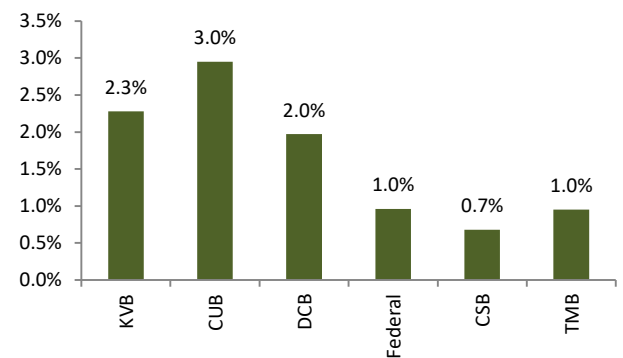
Focus on secured granular loan products, strong under-writing and risk management framework has helped TMB to maintain its asset quality at satisfactory levels. TMB focuses on selective lending and limits its exposure to certain industries and sectors as a part of its strategy to monitor concentration risk. TMB's GNPA has reduced from 3.6% in FY20 to 1.7% in FY22, lower compared to peers. GNPA in RAM portfolio stands at 1.45% while in Corporate portfolio stands at 3.36%. NNPA has also reduced from 1.80% in FY20 to 0.95% in FY22.

**GNPA (FY22)**



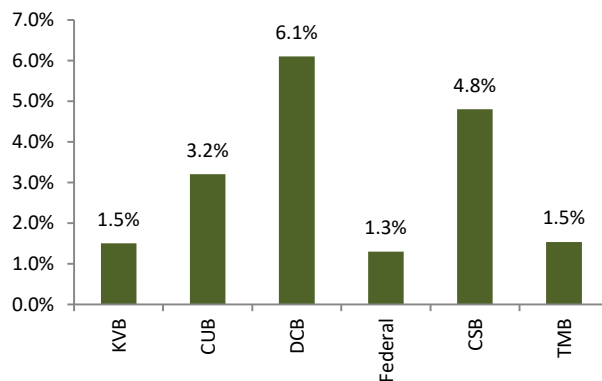
Source: Company, NBRR

**NNPA (FY22)**



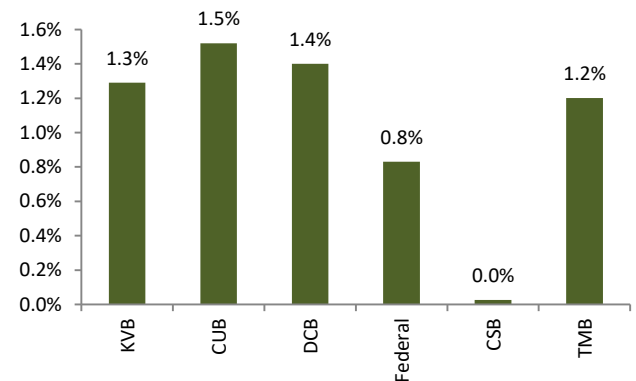
Source: Company, NBRR

**Slippage Ratio (FY22)**



Source: Company, NBRR

**Credit Cost (FY22)**



Source: Company, NBRR

## Tamilnad Mercantile Bank Ltd.

### Key Risks

**Pending legal issues pertaining to substantial portion of TMB's share capital:** 37.73% of TMB's 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 TMB have been initiated by various regulatory authorities, including the RBI, the Directorate of Enforcement, some of whom have imposed and sought to impose penalties on TMB in the past. The legal proceedings are primarily arising out of a transfer of 95,418 Equity Shares on May 13, 2007, subsequent transfers of equity shares on December 26, 2011 and June 11, 2012 and a bonus issuance on May 26, 2016 in the ratio of 1:500. Such legal proceedings include challenges to the validity of the transfers themselves, allegations of mismanagement on the part of TMB in connection with such transfers, allegations that the transferees were not fit and proper persons, and that the transfers were effected in the absence of requisite approvals from the RBI. We believe there could be a possibility that RBI permits the disputed equity shares to be released from the escrow account on condition that they be sold by existing shareholders. This could lead to substantial supply of shares by legacy investors upon listing which could impact the stock price negatively. Also other adverse developments in above mentioned proceedings could result in imposition of penalties or require TMB to incur significant costs to contest any of which could have a material impact on TMB's reputation, business and financial condition.

**Regional Dependence on the state of Tamil Nadu:** TMB faces concentration risk with 76% of advances constituting Tamil Nadu. Thus, any major change in the regional environment due to natural calamities or state policies can impact TMB.

### Valuation and Recommendation

TMB has demonstrated strong track record of successfully growing and managing a granular portfolio with superior asset quality metrics. TMB stands out among old generation private banking peers on most metrics. We believe TMB can sustain ROA at around 1.5% levels in coming years on the back of stable NIM at around ~4.0% levels and decline in credit cost to below 1%. TMB is being offered at 1.4x FY22 BV which is at a slight discount to peer banks having similar return ratio profile. Although pending legal issues regarding the bank's share capital shall continue to be a hangover; considering the quality of business, top quartile earnings profile in the banking industry and reasonable valuations, we rate the issue as 'Subscribe'.

### Peer Comparison

	Old generation Pvt Banks				TMB
	Federal	CUB	CSB	Avg	
<b>As on FY22</b>					
Loan Book (Rs cr)	1,44,928	40,359	15,815	67,034	33,492
Loan CAGR FY20-22	9%	9%	18%	12%	10%
Tier 1	14.4%	19.8%	24.4%	19.5%	20.4%
CASA	36.9%	32.6%	33.7%	34.4%	30.5%
NIM	3.2%	4.0%	5.3%	4.1%	4.1%
Cost/Income	59.9%	40.4%	50.5%	50.3%	42.1%
GNPA	2.8%	4.7%	1.8%	3.1%	1.7%
NNPA	1.0%	3.0%	0.7%	1.5%	1.0%
Restructured Book	2.2%	5.0%	0.5%	2.6%	2.8%
ROA FY22	0.9%	1.3%	1.9%	1.4%	1.7%
ROE FY22	10.8%	12.2%	19.0%	14.0%	16.6%
P/BV FY22 (x)	1.31	2.02	1.38	<b>1.57</b>	1.40
P/BV FY22 (x) Post IPO					1.35

Source: Companies, NBRR

## Tamilnad Mercantile Bank Ltd.

## Financials

P&L (Rs. Crs)	FY20	FY21	FY22	Bal. Sheet (Rs. Crs)	FY20	FY21	FY22
Interest earned	3,466	3,609	3,834	Equity capital	143	143	143
Interest expended	2,147	2,072	2,019	Reserves & surplus	3,837	4,437	5,193
<b>NII</b>	<b>1,320</b>	<b>1,538</b>	<b>1,815</b>	Net worth	3,980	4,580	5,336
Non interest income	526	644	823	Deposits	36,825	40,970	44,933
<b>Total income</b>	<b>1,846</b>	<b>2,182</b>	<b>2,638</b>	(of which CASA)	9,518	11,685	13,705
<b>Growth</b>	<b>12%</b>	<b>18%</b>	<b>21%</b>	Borrowings	324	0	0
Total Opex	851	980	1,111	Other liab and prov	1,630	1,977	2,590
<i>Growth</i>	<i>12%</i>	<i>15%</i>	<i>13%</i>	Total liabilities	38,779	42,947	47,523
Staff costs	436	560	616	<b>Total liab and equity</b>	<b>42,759</b>	<b>47,527</b>	<b>52,858</b>
Other Op Exp	415	419	495	Cash and bank bal	2,322	1,025	1,739
<b>Profit before prov</b>	<b>995</b>	<b>1,202</b>	<b>1,527</b>	Bal. with RBI	1,414	1,680	2,113
<b>Growth</b>	<b>13%</b>	<b>21%</b>	<b>27%</b>	Investments	9,467	11,703	13,035
Provisions	410	404	402	Net Advances	27,716	31,070	33,492
<i>Growth</i>		<i>-2%</i>	<i>0%</i>	<i>Growth</i>	<i>5%</i>	<i>12%</i>	<i>8%</i>
Profit before tax	585	798	1,125	Other assets	1,839	2,049	2,479
Taxes	177	195	303	<b>Total assets</b>	<b>42,759</b>	<b>47,527</b>	<b>52,858</b>
<b>Net profit</b>	<b>408</b>	<b>603</b>	<b>822</b>				
<b>Growth</b>	<b>-54%</b>	<b>48%</b>	<b>36%</b>				
				<b>Asset Quality</b>	<b>FY20</b>	<b>FY21</b>	<b>FY22</b>
<b>Key Ratios</b>	<b>FY20</b>	<b>FY21</b>	<b>FY22</b>	GNPA	1,021	1,085	571
Yield on Advances	10.2%	9.7%	9.5%	GNPA ratio	3.6%	3.4%	1.7%
Yield on Tot Assets	9.6%	8.9%	8.7%	NNPA	497	614	318
Cost of Borrowings	6.3%	5.5%	4.9%	NNPA ratio	1.8%	2.0%	1.0%
Spread	3.92%	4.17%	4.55%	PCR (Calculated)	51%	43%	44%
NIM	3.64%	3.77%	4.10%	Credit Cost	1.5%	1.4%	1.2%
<b>Profitability Ratios</b>	<b>FY20</b>	<b>FY21</b>	<b>FY22</b>	<b>Balance Sheet Ratios</b>	<b>FY20</b>	<b>FY21</b>	<b>FY22</b>
Cost / Income Ratio	46.1%	44.9%	42.1%	CD Ratio	75.3%	75.8%	74.5%
ROE	10.7%	14.1%	16.6%	CASA	25.8%	28.5%	30.5%
ROA	0.98%	1.34%	1.64%	CAR	16.7%	18.9%	22.1%
				Tier - 1	15.9%	17.9%	20.4%
<b>Per Share Data</b>	<b>FY20</b>	<b>FY21</b>	<b>FY22</b>	<b>Valuation Ratios</b>	<b>FY20</b>	<b>FY21</b>	<b>FY22</b>
EPS	28.6	42.3	51.9 #	P/E	18.4	12.4	10.1 #
BVPS	279	321	389 #	P/BV	1.9	1.6	1.3 #
Adjusted BVPS	244	278	367 #	P/ABV	2.1	1.9	1.4 #

Source: Company data, NBRR

# Post IPO basis

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