

5th September 2022

Tamilnad Mercantile Bank Ltd.-Subscribe

Investment Thesis

Tamilnad Mercantile Bank (TMB) is coming out with an Initial Public Offering (IPO) on September 5th, 2022. The issue comprises of Fresh issue for the sale of 15,840,000 equity shares. Tamilnad Mercantile Bank has planned to utilize the net proceeds towards augmenting its Tier-I capital base to meet its future capital requirements. TMB is one of the oldest & leading private sector banks in India with a history of almost 101 years, established in 1921 as Nadar Bank in Thoothukudi, Tamil Nadu state. TMB has a strong portfolio of deposits and loans from a diversified client base. TMB has performed well in the past, reported a 8.1% CAGR growth in total advances to Rs 33,492 cr in FY22 from Rs 26488 cr in FY19. TMB's advances portfolio primarily consists of lending to Retail customers, agricultural customers and MSMEs ("RAM"). The RAM portfolio has enlarged at a CAGR of 12.94% from Rs 23,143 Cr in FY20 to Rs 29,521 Cr in FY22 with focus of keeping unsecured lending lower in addition strong underwriting process. TMB has frequently maintained secure lending book from 98.82% of overall loan book in FY20 to 99.17% of overall loan book in FY22. TMB has increased more concentration on lower ticket size loan book. Focus on secured lending loan mix, strong under-writing and risk management framework have helped TMB to maintain and further improve asset quality and drive growth with consistent profitability. The GNPA has reduced from 3.62% in FY20 to 1.69% in FY22. The Bank has reported a relatively lower GNPA of 1.69% as compared with best in class asset quality lowest among peer banks. The NNPA have reduced from 1.80% in FY20 to 0.95% in FY22. In FY22, GNPA as a percentage of advances in RAM portfolio is 1.45% and in corporate portfolio is 3.36% respectively. TMB has maintained PCR at 87.92% as of March 31, 2022. Total provisioning of 250Cr and total write-offs including technical/prudential write offs of Rs 2057Cr together amounting for Rs 2307Cr as on March 31, 2022. Additionally, during the year the Bank has made provisions for contingency provision for COVID-19 and other uncertainties as of March 31, 2022, total provisioning for Rs 250Cr

Revenue from business Verticals

TMB net profit has grown at a CAGR of almost 47% between the years ended March 2019 and March 2022. Its deposits increased at a CAGR of 10.5% between the year ended March 2020 and March 2022 compared with a peer median of 7.9% during this period, and advances rose 9.9%.

Particular (Rs. Cr)	FY19	FY20	FY21	FY22
Interest Earned	3,224.5	3,466.1	3,609.1	3,833.9
NII	1,230.2	1,319.5	1,537.5	1,815.2
PPoP	884.3	995.0	1,202.2	1,526.8
Net Profit	258.6	407.7	603.3	821.9
NIM	3.7%	3.6%	3.8%	4.1%
EPS(Rs.)	18.1	28.6	42.3	57.7
RoA(%)	0.7%	1.0%	1.3%	1.7%
RoE (%)	7.4%	10.7%	14.1%	16.6%

IPO Details

Issue Open Date	05 th Sept, 2022
Issue Close Date	07 th Sept, 2022
Price Band (Rs.)	Rs. 500 to Rs. 525
Issue Size (Rs in Cr)*	Rs. 832 Cr.
Issue Size (Shares)*	15,840,000 Shares
Market Lot	28 Shares
Listing Exchanges	BSE and NSE
Face Value (Rs.)	Rs. 10

* At highest price band

Key Details

Fresh Issue *	Rs. 832Cr.
Issue Type	Book Building
Book Running Lead Manager	Axis Capital Ltd., MotilalOswal Investment Advisor Ltd & SBI Capital Market Ltd.
Issue structure	QIB: 75% HNI's: 15% Retail: 10%
Credit of Shares to Demat Account	14 th Sept 2022
Issue Listing Date	15 th Sept 2022

* At highest price band

Key Business Highlights

- TMB's primary focus is in MSME, Retail and Agri. as of March 31, 2022. It 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 million as of FY22 and 4.05 million or 79.8% of its customers have been associated with the bank for a period of more than five years. TMB has a strong presence in the state of Tamil Nadu which contributes 76% of its total advances.
- TMB has traditionally focused on small ticket size loan products to MSME (37% mix), agricultural (30% mix) and retail (20% mix). 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 disbursements 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%. Apart from its home state, the bank is also focusing on diversifying its reach in already existing network including in the states of Gujarat, Maharashtra, Karnataka and Andhra Pradesh.
- Its deposits have grown at 10.5% CAGR over FY20-22. Its CASA deposits as a share of total deposits has increased from 25.9% in FY20 to 30.5% in FY22. TMB's digital banking channels facilitate a smooth transition from physical to digital usage and enhance customer experience, designed to grow their business and improve the margins. TMB's aspire is to constantly examine 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 rigorous audit procedures for sanction of the loans particularly focusing on higher value loans. Pre-disbursement approval procedure is also detailed with specific audits and procedures to be conducted in exposure of Rs 3 crore or above.

Valuation

- Over the last 3 years i.e. between FY19 and FY22, the net profit of TMB has grown from Rs258.6 cr. to Rs 821.9 cr. During the same period, the PPOP of the bank were up from Rs. 884.3 cr. to Rs. 1526.8 cr. The bank's Tier-1 capital already stands at 20.46% against the statutory requirement of 11.5%. Between FY21 and FY22, the gross NPAs fell from 3.44% to 1.69%. The CASA ratio at 30.5% has improved, although it is much lower than similar private banks
- At the upper price band, TMB is trading at 1.4x price to book value for FY22 which is at the discount as compared to peers, RoA, RoE and common equity tier one ratio for TMB at 1.7%, 16.6% and 20.4% for FY22 are the second highest among mid private banking peers and backed by its superior NIM profile at 4.1% for FY22 along with best in class asset quality lowest among peer banks with GNPA / NNPA at 1.69% / 0.95%.
- Due to RBI restrictions & guidelines, TMB is not able to expand & the expansion process is on hold, once it gets listed its door will get open for further expansion of its network. Pending legal matters can impact the price of TMB if the verdicts come against the bank, quality of business model and one of the best financial and assets quality with good return ratios profile in the mid private banking peers at reasonable valuation, we do not see these return ratios as volatile, going forward. **We recommend subscribing to the issue from a long term perspective.**

Graphs & Charts

Figure 1: Advances & YoY Adv. Growth

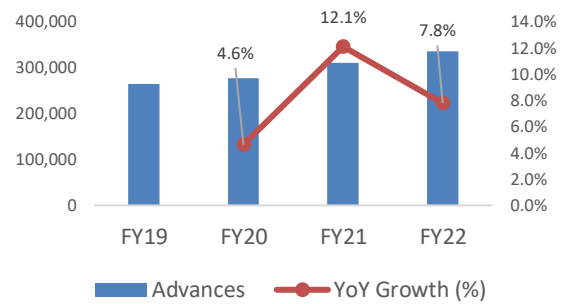


Figure 2: CASA & CASA (%)

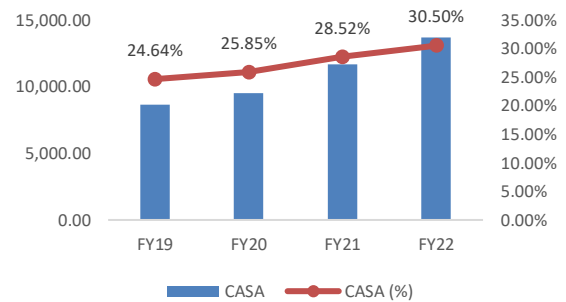


Figure 3: RoA & RoE

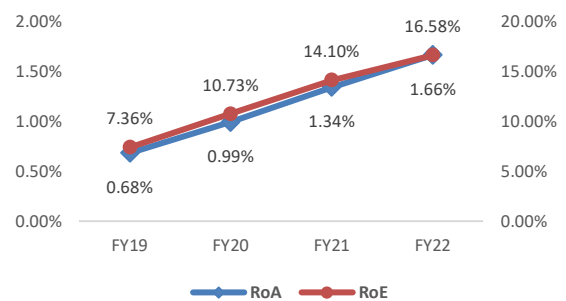
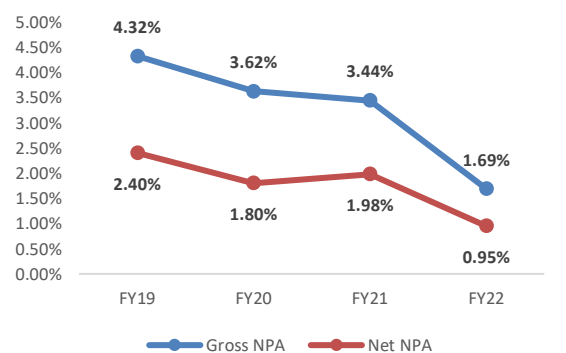


Figure 4: Gross NPA & Net NPA



Risk & Concern

- The bank is currently significantly dependent more on Retail, MSME and Agri-financing, customers and any adverse developments in these segments could adversely affect the bank's business.
- High dependence on Tamil Nadu state and rising interest rates

Peer Comparison

Particular (FY22)	TMB	CUB	CSB	DCB	FedB	KVB	KB	RBL B	SIB	IDFC First
Advances (Rs. Cr.)	33492.00	40359.00	15815.00	29096.00	144928.00	55335.00	56783.00	60022.00	59993.00	117857.80
Advance CAGR (FY20-FY22)	9.90%	9.10%	18.00%	7.10%	8.90%	9.60%	-0.20%	1.70%	-3.50%	8.26%
Deposits CAGR (FY20-FY22)	10.50%	8.10%	13.10%	6.90%	9.20%	7.80%	5.80%	16.90%	3.60%	27.35%
Net Profits (Rs. Cr.)	822.00	760.00	458.00	288.00	1890.00	673.00	509.00	-75.00	45.00	132.31
CASA / Total Deposits (%)	30.50%	32.60%	33.70%	26.80%	36.90%	34.80%	33.00%	35.30%	33.20%	49.80%
Yield on Advances (%)	9.50%	9.40%	11.20%	10.70%	7.90%	8.50%	8.80%	12.20%	8.70%	14.57%
Cost of Deposits (%)	4.90%	4.68%	4.31%	6.05%	4.28%	4.30%	4.66%	4.81%	4.75%	4.71%
NIM (%)	4.10%	3.98%	5.27%	3.56%	3.16%	3.69%	3.18%	4.40%	2.62%	5.96%
RoE (%)	16.60%	12.23%	18.98%	7.37%	10.82%	9.25%	7.40%	-0.59%	0.77%	2.92%
Gross NPA (Rs. Cr.)	571.00	1933.00	290.00	1290.00	4137.00	3431.00	2251.00	2728.00	3648.00	4469.13
Gross Npa (%)	1.70%	4.70%	1.80%	4.30%	2.80%	6.00%	3.90%	4.40%	5.90%	3.70%
Net NPA (%)	1.00%	3.00%	0.70%	2.00%	1.00%	2.30%	2.40%	1.30%	3.00%	1.53%
Book Value	374.40	83.10	152.80	130.20	91.60	95.00	228.00	209.00	28.00	33.78
Market Cap (Rs. Cr.)	8314.00	13390.00	3664.00	2930.00	25002.00	5682.00	2327.00	7323.00	1716.00	2631.86
P / BV (x)	1.40	2.00	1.40	0.70	1.30	0.70	0.30	0.60	0.30	1.44

Name	Designation
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