

Rating: Subscribe

Issue Offer

Fresh Issue of up to 15,840,000 Equity Shares aggregating up to INR 832 cr

Issue Summary

Price Band (INR)	500-525
Face Value (INR)	10
Implied Market Cap (INR Cr)	8,313
Market Lot	28
Issue Opens on	Sept 5, 2022
Issue Close on	Sept 7, 2022
No. of share pre-issue	142,511,454
No. of share post issue	158,351,454
Listing	NSE & BSE

Issue Break-up (%)

QIB Portion	75
NIB Portion	15
Retail Portion	10

Book Running Lead Managers

Axis Capital Ltd

Motilal Oswal Investment Advisors Ltd

SBI Capital Markets Ltd

Registrar

Link Intime India Pvt Ltd

Shareholding Pattern

	Pre-Issue	Post-Issue
Promoters	NIL	NIL
Public	100%	100%

Objects of the offer

To comply with RBI's listing norms

Augmenting the tier I capital requirements

General Corporate purpose

Tamilnad Mercantile Bank (TMB) was incorporated in 1921, is one of the leading private sector bank in India, with a history of close to 100 years. To comply with RBI norms, bank is coming out with an IPO of INR 832 cr (all via fresh issue of equity shares), as RBI has restricted the bank from opening new branches. It has a strong base in Tamil Nadu which constitutes ~75% of its total business. The bank has presence across 16 states and 4 UTs. As of Mar'22, it has served 5.08 mn customers of which, ~79.8% of customers have been associated with the bank for a period of >5 years. Bank has well diversified portfolio with focused into RAM (Retail, Agri and MSME) segment which constitutes ~87% of the total advances. It has Advances book of INR 33,748 cr, with deposits base of INR 44,933 cr as on FY22. The bank has a network of 509 branches and 1,141 ATMs. Out of these 509 branches, 76 branches are in metro, 80 branches are in urban, 247 branches are in semi-urban and 106 are in rural areas.

A focused RAM segment player: TMB's portfolio primarily consists of RAM segment which together constitutes ~87% of the advances, with Retail at ~20%, Agri at ~30% and MSME at ~37%. Share of RAM segment has increased from 76% in FY19 to 87% as on FY22 and going ahead bank will continue to focus into this segment. RAM portfolio has increased at a CAGR of 13% over FY19-22 at INR 29,521 cr as on FY22. ~99.2% of the portfolio is secured in nature. Total advances of the bank increased by 8% CAGR over FY19-22 at INR 33,748 cr and ~77% of the portfolio qualifies for the PSLC. Average ticket size remained in the range of 0.31-0.34 mn during the last 3 years.

Deposits increasing steadily with focus on growing CASA base: Total deposits of the bank increased at a CAGR of 9% over the period of FY19-22 at INR 44,933 cr as on FY22. CASA ratio increased consistently from 24.6% in FY19 to 30.5% as on FY22. Deposit of the bank is well diversified and granular in nature as CASA + retail term deposits share of the bank increased from 88.3% in FY19 to 91.1% in FY22. Cost of deposits witnessed strong improvement as its has declined from 6.3% in FY20 to 4.9% in FY22.

Margins improved due to lower deposits cost: NIM increased from 3.65% in FY19 to 4.1% in FY22, largely led by strong improvement witnessed in cost of deposits. Overall yield of the bank declined from 10.1% in FY19 to 9.5% in FY22. Bank's higher focus into RAM segment and steady increase into CD ratio will support the margins ahead. Entire book of the bank is on floating basis with Repo linked book at ~65%, 8% - T-bills and rest is MCLR linked.

Asset quality improved; credit cost stood lower: GNPA/NNPA ratio of the bank declined from 3.4%/2% in FY21 to 1.7%/1% in FY22. Credit cost declined from 1.5% in FY20 to 0.6% in FY22 and it is expected to remain <1% in FY23.

Valuation and view: At the upper price band of INR 525, the issue has been offered at 1.3x FY22 P/BV (post-issue), which we believe is reasonable, considering its consistent financial performance with strong return ratio. TMB has long credit history in banking sector and loan book of the bank growing steadily with improving liability franchise. Bank has reported meaningful improvement in asset quality with moderating credit cost due to its long customer relationship, focus on secured lending and strong underwriting practices. Considering all these factors, we recommend investors to 'Subscribe' for this issue. However, outstanding legal proceedings regarding 37.7% of the bank's equity share capital will be an overhang for the IPO.

Story in charts



Source: Company, Arihant Research

Asset quality improved; credit cost stood lower: Bank's strong customer relationship, focus on secured granular loan products and strong underwriting and risk management framework has helped to maintain and further improve the asset quality. GNPA/NNPA ratio of the bank declined from 3.4%/2% in FY21 to 1.7%/1% in FY22. Credit cost declined from 1.5% in FY20 to 0.6% in FY22 and it is expected to remain <1% in FY23. Restructured book of the bank stood at INR 944 cr (INR 620 cr in MSME, INR 240 cr in Retail and rest in Corporate & Others) or 2.8% of the advances. The bank holds a 10.3% provision towards restructured advances.

Bank has strong presence in Tamil Nadu and focusing to increase presence in other strategic regions: Since its incorporation, TMB has built a strong and trusted network of customers in the State of Tamil Nadu. As of Mar'22, its deposits and advances in the state of Tamil Nadu contributed 75.06% of the total business and 4.32 mn customers base (85% of total customer base). Apart from its home state, Tamil Nadu, the bank focuses on diversifying its reach in TMB's already existing network including in the states of Gujarat, Maharashtra, Karnataka and Andhra Pradesh. As of Mar'22, its businesses, including the deposits and advances portfolios, in the state of Tamil Nadu, Maharashtra, Andhra Pradesh, Karnataka and Gujarat contributed 75.06%, 5.78%, 3.67%, 3.47% and 2.91% to the Total Business.

Consistent financial performance: NII of the bank increased by 18% YoY to INR 1,815 cr during FY22, driven by 8% growth in net advances and 33bps expansion in NIM at 4.1%. NIM expansion was largely due to 59bps decline in cost of deposits at 4.9%. Yield on advances during FY22 declined by 20bps YoY at 9.5%. Cost to income ratio of the bank reduced from 46.1% in FY20 to 42.1% in FY22. PAT of the bank increased by 42% CAGR from INR 408 cr in FY20 to INR 822 cr in FY22.

Also, Bank has reported consistent improvement in return ratio with RoA increasing from 1% in FY20 to 1.7% in FY22 and RoE has increased from 10.7% in FY20 to 16.6% in FY22. Bank has one of the high capital adequacy ratio at 22.1%, which will further improve post IPO.

Key Risks:

- Geographical concentration risk in Tamil Nadu as it has higher share at 75% of the total business.
- Any substantial increase in NPAs.
- 37.73% of the Bank's paid up equity share capital or 53.76 mn Equity Shares are subject to outstanding legal proceedings which are pending at various forums and, in connection with which, proceedings against the Bank 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 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 require it to incur significant costs to contest any of which could have a material impact on its reputation, business, financial condition and results of operation.

Exhibit 9: Break-up of the loan book

Advances (in cr.)	FY19	FY20	FY21	FY22
Agri	6077	6,995	8,646	10,023
% of total Advances	22.5%	24.8%	27.4%	29.7%
Retail	4535	5,442	6,496	6,882
% of total Advances	16.8%	19.3%	20.6%	20.4%
SME	10083	10,706	12,326	12,615
% of total Advances	37.3%	37.9%	39.1%	37.4%
Wholesale	6323	5,093	4,074	4,228
% of total Advances	23.4%	18.0%	12.9%	12.5%
Total	27,018	28,236	31,541	33,748

Exhibit 10: Peer-group comparison (Financials are as on FY22)

in cr.	CMP	Mcap	Advances	Deposits	PAT	GNPA (%)	NNPA (%)
TMB [^]	525	8,313	33,748	44,933	822	1.7	1.0
City Union Bank	180	13,313	41,156	47,690	760	4.7	3.0
DCB Bank	94	2,933	29,096	34,692	288	4.3	2.0
Federal Bank	113	24,411	144,928	181,701	1,890	2.8	1.0
Karur Vysya Bank	68	5,467	55,335	68,676	673	6.0	2.3
Karnataka Bank	75	2,335	56,783	80,387	509	3.9	2.4

[^] at upper price band

in cr.	NIM (%)	CAR (%)	CASA (%)	RoA (%)	RoE (%)	CTI (%)	BV	P/BV
TMB	4.1	22.1	30.5	1.7	16.6	42.1	374	1.4
City Union Bank	4.0	20.9	32.6	1.4	12.3	40.4	89	2.0
DCB Bank	3.6	18.9	26.8	0.7	7.9	56.0	130	0.7
Federal Bank	3.2	15.8	36.9	0.9	10.9	59.9	89	1.3
Karur Vysya Bank	3.7	19.5	34.8	0.9	8.9	53.2	95	0.7
Karnataka Bank	3.2	15.7	33.0	0.6	7.4	52.6	228	0.3

Source: Company, Arianth Research

Exhibit 11: Board details

Board of Directors	Description
K.V. Rama Moorthy	K.V. Rama Moorthy is a MD & CEO of the Bank. He has over 40 years of banking experience, including in Bank of Baroda and as an Executive Director in United Bank of India. Prior to joining the bank, he was Executive Director in United Bank of India till 2017.
Krishnan Sankarasubramaniam*	Krishnan Sankarasubramaniam: The Board, pursuant to its resolution has appointed Krishnan Sankarasubramaniam as the Managing Director & CEO with effect from September 4, 2022. Prior to joining the Bank, he was associated with Indian Bank, Syndicate Bank (which was merged into Canara Bank) and Punjab and Sind Bank. *The term of K V Rama Moorthy is due to end on September 3, 2022. Krishnan Sankarasubramaniam has been approved by the RBI, pursuant to its letter of approval dated August 18, 2022, for appointment as the Managing Director & CEO with effect from September 4, 2022 for a term of 3 years.
Niranjan Sankar	Niranjan Sankar A is the Non-Executive Director of the Bank. He has over 22 years of experience in small scale undertakings.
S R Ashok	S R Ashok is the Non-Executive Director of the Bank. He is a doctor by profession and presently serves at the Thoothukudi Medical College Hospital.
Asok Kumar P C G	Asok Kumar P C G is the Non-Executive Director of the Bank. He has over 25 years of experience investing in the stock market.
Nirranjan Kani D N	Nirranjan Kani D N is the Non-Executive Director of the Bank. He is a director in VVD & Sons Pvt Ltd.
Prakash Chandra Panda	Prakash Chandra Panda is the company secretary of the Bank. He joined the Bank on April 17, 2017. He has 12 years of experience in the Secretarial, Legal and Listed companies.
P.A. Krishnan	P A Krishnan is the Chief Financial Officer of the Bank. He joined the Bank on August 3, 2021. He has 35 years of experience in the banking industry. He was previously the General Manager and CFO of Indian Bank.

Exhibit 12: Key Financials

Income Statement			
(Rs.Cr)	FY20	FY21	FY22
Interest Income	3,466	3,609	3,834
Interest Expenses	2,147	2,072	2,019
Net Interest Income	1,320	1,538	1,815
Other Income	526	644	823
Operating Income	1,846	2,182	2,638
Operating Expenses	851	980	1,111
Operating Profit	995	1,202	1,527
Provisions and Contingencies	587	599	705
Profit After Tax	408	603	822

Balance Sheet			
(Rs. cr)	FY20	FY21	FY22
LIABILITIES			
Capital	143	143	143
Reserves & Surplus	3,837	4,437	5,193
Deposits	36,825	40,970	44,933
Borrowings	324	-	-
Other liabilities & provisions	1,630	1,977	2,590
Total Liabilities	42,759	47,527	52,858
ASSETS			
Cash and Balance with RBI	1,414	1,680	2,113
Balance with Banks	2,322	1,025	1,739
Investments	9,467	11,703	13,035
Advances	27,716	31,070	33,492
Fixed assets	128	137	211
Other assets	1,711	1,912	2,269
Total Assets	42,759	47,527	52,858

Ratio Analysis			
Particulars	FY20	FY21	FY22
Per Share Data (Rs.)			
EPS	28.6	42.3	57.7
Book Value per share	279.3	321.4	374.4
Adjusted Book Value	244.3	278.3	352.1
Asset Quality			
Gross NPAs (%)	3.6%	3.4%	1.7%
Net NPAs (%)	1.8%	2.0%	1.0%
Slippages ratio (%)	2.0%	1.9%	1.5%
Credit cost (%)	1.6%	1.4%	0.6%
PCR (%)	80.8%	79.5%	87.9%
Other ratios (%)			
Yield	10.2%	9.7%	9.5%
Cost of Deposits	6.3%	5.5%	4.9%
NIM	3.6%	3.8%	4.1%
CASA	25.8%	28.5%	30.5%
Cost to Income	46.1%	44.9%	42.1%
CD-ratio (%)	75.3%	75.8%	74.5%
CRAR (%)	16.7%	18.9%	22.1%
Return Ratios (%)			
ROA	1.0%	1.3%	1.7%
ROE	10.7%	14.1%	16.6%
Valuation (x) @ upper price band			
P/E	18.4	12.4	9.1
P/ABV	1.9	1.6	1.4
P/BV	2.1	1.9	1.5

Arihant Research DeskEmail: instresearch@arihantcapital.com

Tel. : 022-42254800

Head Office	Registered Office
#1011, Solitaire Corporate Park Building No. 10, 1 st Floor Andheri Ghatkopar Link Road Chakala, Andheri (E) Mumbai – 400093 Tel: (91-22) 42254800 Fax: (91-22) 42254880	Arihant House E-5 Ratlam Kothi Indore - 452003, (M.P.) Tel: (91-731) 3016100 Fax: (91-731) 3016199

Stock Rating Scale	Absolute Return
BUY	>20%
ACCUMULATE	12% to 20%
HOLD	5% to 12%
NEUTRAL	-5% to 5%
REDUCE	-5% to -12%
SELL	<-12%

Research Analyst Registration No.	Contact	Website	Email Id
INH000002764	SMS: 'Arihant' to 56677	www.arihantcapital.com	instresearch@arihantcapital.com

Disclaimer: This document has been prepared by Arihant Capital Markets Ltd. This document does not constitute an offer or solicitation for the purchase and sale of any financial instrument by Arihant. This document has been prepared and issued on the basis of publicly available information, internally developed data and other sources believed to be reliable. Whilst meticulous care has been taken to ensure that the facts stated are accurate and opinions given are fair and reasonable, neither the analyst nor any employee of our company is in any way is responsible for its contents and nor is its accuracy or completeness guaranteed. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. The user assumes the entire risk of any use made of this information. Arihant may trade in investments, which are the subject of this document or in related investments and may have acted upon or used the information contained in this document or the research or the analysis on which it is based, before its publication. This is just a suggestion and Arihant will not be responsible for any profit or loss arising out of the decision taken by the reader of this document. Affiliates of Arihant may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report. No matter contained in this document may be reproduced or copied without the consent of the firm.

Arihant Capital Markets Ltd.
1011, Solitaire Corporate park, Building No. 10, 1st Floor,
Andheri Ghatkopar Link Road, Chakala, Andheri (E)
Tel. 022-42254800 Fax. 022-42254880