CRISIL
Ratings

Rating Rationale

March 23, 2022 | Mumbai

Tamilnad Mercantile Bank Limited

Rating Reaffirmed

Rating Action

Rs.1000 Crore Certificate of Deposits	**CRISIL A1+ (Reaffirmed)**

1 crore = 10 million
Refer to Annexure for Details of Instruments & Bank Facilities

Detailed Rationale
CRISIL Ratings has reaffirmed its 'CRISIL A1+' rating on the certificates of deposit of Tamilnad Mercantile Bank Limited (TMB).

The rating continues to reflect adequate capitalisation and above average profitability. These strengths are partially offset by average asset quality, a small scale of operations with high concentration in Tamil Nadu, an average resource profile and exposure to risks arising from an ownership dispute.

The bank has adequate capitalisation for its current and planned scale of operations. The Tier 1 and overall capital adequacy ratios (CRAR) stood at 17.9% and 18.9 respectively as on September 30, 2021. The networth coverage for net non-performing assets (NPAs) improved to 8.7 times as on September 30, 2021 from 7.5 times as on March 31, 2021. The bank also has plans of an initial public offering (IPO), initially planned for fiscal 2022, which is now expected in Q1 FY23, which would further bolster capitalisation.

Overall profitability remains comfortable, with overall net interest margin (NIM) of 4.04% and average pre-provisioning operating profitability of average assets at 2.9% (annualised) during the first half of fiscal 2022. Further, return on assets (RoA) was 1.60% (annualised). As on September 30, 2021, the provision coverage ratio (PCR) was 45.95% as against PCR of 43.42% as on March 31, 2021(without technical write-off)

Asset quality has improved after being impacted due to the Covid-19 pandemic that disrupted cash flows of several borrowers. The reported gross NPAs (GNPAs) stood at 3.3% as on September 30, 2021, as against 3.4% as on March 31, 2021. Overall restructured advances stood at 2.7% of total advances as on September 30, 2021. The bank largely lends to medium, small and micro enterprises (MSME) and retail borrowers who carry high inherent risks. In the first half of fiscal 2022, bank has disbursed Rs 31.66 crore of loans under ECLGS (Emergency Credit Line Guarantee Scheme). The overall MSME loans (38%) followed by agriculture loans (29%) and retail loans (21%) book comprised 88% of the overall advances. These loans are largely backed by good quality collateral and thus loss given default is expected to be limited.

The resource profile remains adequate with cost of deposits improving to 4.9% for the first half of fiscal 2022 from around 5.3% for fiscal 2021. The CASA (current account and savings account) ratio has improved to 27.89% as on September 30, 2021, from around 27.24% as on March 31, 2021. The CASA growth is largely on account of high liquidity maintained since March 31, 2020, on account of a loan moratorium announced on Yes Bank. Sustainability of the overall CASA percentage level on a growing business will be an overall indicator of improved resources.

Analytical Approach
For arriving at the rating, CRISIL Ratings has evaluated the standalone business and financial risk profiles of TMB.

Key Rating Drivers & Detailed Description
Strengths:

- **Adequate capitalisation**
  Tier I and overall CARs have been more than 12% (17.9% and 18.9%, respectively, with a networth of Rs 4,906 crore, as on September 30, 2021). Historically, the capital position was supported by internal cash accrual and below-industry-average growth in business. The networth coverage for net NPAs stood at 8.7 times as on September 30, 2021.

  The bank's annual general meeting (AGM) held in October 2020 passed a resolution to go for an IPO in fiscal 2022. This was to be done during the second half of the fiscal, however it has gotten delayed and is now expected to be done during the first quarter of fiscal 2023. The bank expects to raise Rs 1,000-1,500 crore, most of which should be fresh issue. This will boost the networth significantly.

- **Above-average profitability**
  Overall profitability remains comfortable with overall NIM at 3.1-3.4% over the past several fiscals. Average pre provisioning operating profitability has been at 2.2-2.9% of average assets during the past 3-4 fiscals on account of

steady margins and stable costs. The overall average RoA between fiscals 2016 and 2021 stood at 0.8% (1.3% during the first half of fiscal 2022). The bank maintains a PCR of 40-55% on a steady-state basis; the current level of provisioning is expected to be adequate for the MSME and retail asset classes wherein the loss given default is limited as a significant amount of the exposure is backed by collateral and can be recovered by selling the underlying secured assets after the loans become doubtful assets. As on September 30, 2021, the PCR was 46% against a PCR of 43% as on March 31, 2021.

Weaknesses:

- **Average asset quality**
  The reported GNPA stood at 3.3%, as on September 30, 2021, as against 3.4% as on March 31, 2021. The overall restructured advances was 2.69% of the overall advances as on September 30, 2021. The bank largely lends to MSME and retail borrowers who have high inherent risks. The improvement in GNPA is primarily due to the regional recovery focusing on recovering the dues as business activities have opened up and the customers' cash flows have improved. The GNPAs are expected to remain at similar levels as on March 31, 2022. In the first half of fiscal 2022, bank has disbursed Rs 31.66 crore of loans under ECLGS scheme.

  Since fiscal 2018, the bank has started focusing on MSME, retail and gold advances. It understands the MSME and small business segment well in Tamil Nadu regions of Madurai, Sivakasi, Thoothukudi and other regions. This lending is largely done to small textile, construction, manufacturing, food and beverages units. The overall loan book comprised of MSME loans (38%) followed by agriculture loans (29%) and retail loans (21%) as on September 30, 2021. While the overall composition for corporate advances has declined from 21% as on March 31, 2017, to 11% as on September 30, 2021, the other asset classes has improved significantly. Asset quality should remain exposed to inherent political, social, economic and environmental risks on account of exposure to small borrowers.

- **Average resource profile**
  The deposit base of Rs 41,022 crore as on September 30, 2021. Further, CASA deposits ratio stood at around 27.3% as on September 30, 2021, against around 28.5% as on March 31, 2021. Until fiscal 2016, the proportion of CASA deposits was lower than that of peers; however, post demonetisation, CASA deposits have improved. The CASA growth is also on account of the high liquidity maintained since March 31, 2020, following the loan moratorium announced on Yes Bank during March 2020. Being already beefed up with high liquidity and low credit demand, the bank did not require high fixed deposits, as a result of which it lowered the rates on such deposits significantly during previous fiscal, while maintaining the overall CASA offerings at competitive rates. This is in line with the overall deposit base of the other old private sector banks, which have also witnessed improvement in the CASA ratio during this period. Sustainability of the overall CASA percentage levels on a growing business will be an overall indicator of an improved resource profile. The resource base largely comprises of retail deposits, with limited bulk deposits at 6.81% of the overall deposits as on September 30, 2021. The bank will continue to focus on improving the CASA ratio by getting local government departments to open such deposits with it.

- **Small scale of operations, driven by regional and product concentration**
  Overall deposits and advances were Rs 41,022 crore and Rs 31,598 crore, respectively, as on September 30, 2021. This forms around 0.3% of the entire banking industry market share. Operations remain concentrated in Tamil Nadu with overall 73% of the branches, 76% of the advances and 75% of the deposits based in the state. The focus is expected to remain within the same region over the medium term. While the bank benefits from its established track record in its core geography, limited presence in the rest of India could constrain overall growth.

  Within the overall advances mix, the bank has high concentration in MSME loans (38%) followed by Agriculture loans (29%) and retail loans (21%). It expects to focus on these segments with growth of over 15% per fiscal in the retail segment, led by housing and around 15% in the other segments during fiscal 2023.

- **Exposure to risks arising from the dispute over ownership**
  The ownership dispute has carried on for the last several years. The bank conducted its AGM in October 2020 during which it passed a resolution for raising funds through an IPO, which is likely to be done during the first quarter of fiscal 2023. Although the board has approved the IPO, the prolonged adjudication of cases related to this dispute is a constraint. Hence, issues relating to shareholding and ownership of the bank will remain key monitorables.

Liquidity: Strong
The liquidity coverage ratio stood at 183.16% as on September 30, 2021. The bank maintains an excess statutory liquidity ratio (SLR) of 4-5% on a steady-state basis. As on December 31, 2021 the excess SLR ratio was around 10.75%.

Rating Sensitivity factors
Downward factors
- A decline in the capital adequacy ratio for Tier 1 capital to below 11.5%
- A significant increase in credit costs, leading to deterioration in profitability

About the Bank
TMB is a small, private sector bank with an asset base of Rs 50,398 crore as on December 31, 2021. The bank was established in 1921 by Nadar Mahajana Sangam, a society set up for the welfare of the Nadar community. Headquartered in Thoothukudi, TMB is largely present in south India with 509 branches as on December 31, 2021.

Gross advances and deposits were Rs 31,598 crore and Rs 41,022 crore, respectively, as on September 30, 2021. GNPAs improved to 3.3% as on September 30, 2021, from 3.4% as on March 31, 2021.

Key Financial Indicators: As on / for the period ended March 31

Particulars		H1FY22	2021	2020	2019
Total assets	Rs crore	48,870	47,527	42759	40,533
Total income (net of interest expense)	Rs crore	1229	2182	1846	1,640
Profit after tax	Rs crore	392	603	408	259
Gross NPA	%	3.3	3.4	3.6	4.3
Overall capital adequacy ratio	%	18.9	18.9	16.7	16.2
Return on assets	%	1.3*	0.9	0.8	0.7

**Annualised*

Any other information: Not applicable

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Annexure - Details of Instrument(s)

ISIN	Name of Instrument	Date of Allotment	Coupon Rate (%)	Maturity Date	Issue Size (Rs. Cr)	Complexity Level	Rating Assigned with Outlook
NA	Certificate of Deposits	NA	NA	7 to 365 Days	1000	Simple	CRISIL A1+

Annexure - Rating History for last 3 Years

	Current			2022 (History)		2021		2020		2019		Start of 2019
Instrument	**Type**	**Outstanding Amount**	**Rating**	**Date**	**Rating**	**Date**	**Rating**	**Date**	**Rating**	**Date**	**Rating**	**Rating**
Certificate of Deposits	ST	1000.0	CRISIL A1+		--	30-03-21	CRISIL A1+	31-03-20	CRISIL A1+	26-03-19	CRISIL A1+	CRISIL A1+

All amounts are in Rs.Cr.

Criteria Details

Links to related criteria
Rating Criteria for Banks and Financial Institutions
CRISILs Criteria for rating short term debt

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