20th August, 2022

Tamilnad Mercantile Bank
V.E. Road, Thoothukudi,
Tamil Nadu - 628002

Kind Attn.: Mr. Prakash Chandra Panda, Company Secretary

Dear Sir,
Re.: **Proposed initial public offering of equity shares (the "Offer") by Tamilnad Mercantile Bank (the "Bank")** (**the "Issue"**)

We refer to your e-mail/ request dated 8th July, 2022 regarding the content provided to you for your internal use by CRISIL Research as part of your subscription to its Industry Research on the following industry:

- *CRISIL Research – Banking Industry in India* as of August 2022 (the "**Report**")

As requested by you, we accord our no objection and give consent to your reproducing content (hereinafter referred to as `Material') available to you as part of the above subscription in the draft red herring prospectus ("**DRHP**") to be filed with Securities and Exchange Board of India ("**SEBI**") and the stock exchanges where the Issue is proposed to be listed (the "**Stock Exchanges**"), the red herring prospectus ("**RHP**") and the prospectus ("**Prospectus**") to be filed with the Registrar of Companies ("**RoC**"), Tamil Nadu, at Chennai, SEBI and the Stock Exchanges or any other document to be issued or filed in relation to the Offer (collectively, the "**Offer Documents**"), subject to the following:

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We confirm that we are an independent agency and are not in any manner related to the Bank, its directors or key managerial personnel.

Given below is the disclaimer to be used in the Issue Documents.

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We also give our consent to include this letter of consent and the Report as part of the section titled "Material Contracts and Documents for Inspection" in the DRHP, RHP and Prospectus which will be available to the public for inspection.

We understand that this letter does not impose any obligation on the Bank or the book running lead managers ("**BRLMs**") to include in the Offer Documents all or any part of the Material with respect to which consent for dislosure is being granted pursuant to this letter provided that the Bank complies with the other terms of this letter.

This letter may be relied and shared by the Bank, with the BRLMs and advisers concerned in relation to the Offer. This letter may also be shared by the Bank with SEBI, the stock exchanges and the RoC pursuant to sections 26 and 32 of the Companies Act, 2013 and the rules thereunder, each as amended, or any such other governmental or regulatory authority as may be required in connection with the Offer or pursuant to an order passed by an authority.

We confirm that we are not and have not been engaged or interested in the formation or promotion or management of the Bank.

We undertake to inform the Bank and the BRLMs promptly, in writing of any changes, within our knowledge, to the above information until the date when the equity shares commence trading on the Stock Exchanges. In the absence of such communication from us, the BRLMs and the legal advisors each to the Bank and the BRLMs can assume the above information should be considered as updated information and that there is no change to the above information until the Equity Shares commence trading on the Stock Exchanges pursuant to the Offer. We agree to keep strictly confidential, the non- public information relating to the Issue until such time that: (A) such disclosure by us is approved by the Bank; or (B) such disclosure is required by law or regulation; or (C) such information is already in public domain or comes into public domain through no fault of ours.

For CRISIL Limited

Suresh

CRISIL Limited Mumbai

Mr. Suresh Krishnamurthy
Senior Director

Research

Banking Industry in India

(August 2022)

Overview of the Indian economy

Review and outlook of India's gross domestic product (GDP)

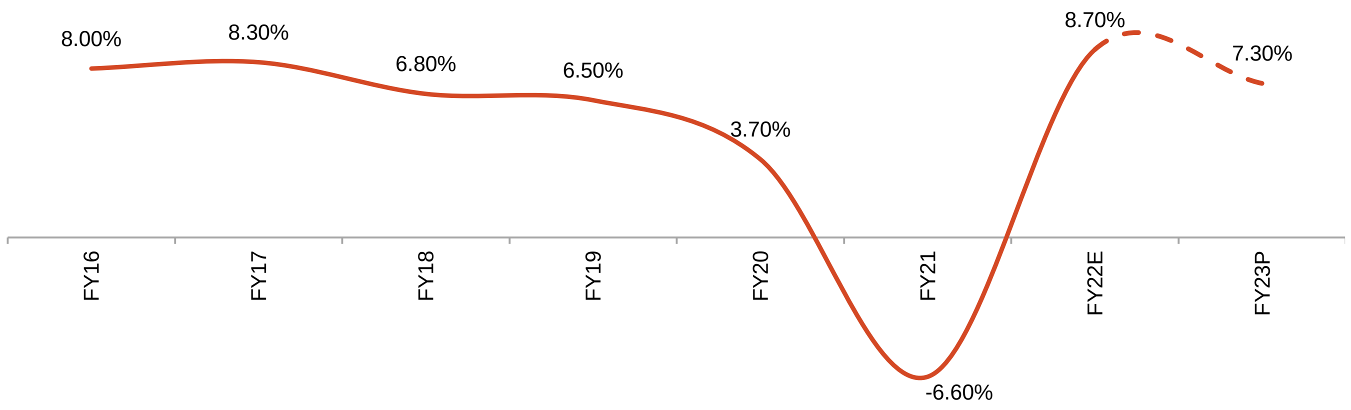
India's real GDP is estimated to have grown at 8.70% in fiscal 2022 — largely a reflection of a lower base (economy had shrunk 6.60% in fiscal 2021). The estimate for real GDP in absolute terms is at Rs 147,700,000 million marginally higher than the Rs 147,500,000 million estimated earlier, suggesting that the downside from the omicron variant has been mild. Given the large output loss in the previous fiscal, GDP is still 1.80% above pre-pandemic levels (fiscal 2020).

Private final consumption expenditure (PFCE) — the largest demand-side driver — was hitherto estimated to be lagging the pre-pandemic level. It is now estimated to have recovered some of the lost ground. At Rs 83,600,000 million in fiscal 2022, PFCE is 1.20% above the fiscal 2020 level of Rs 82,600,000 million. However, given that PFCE growth still trails overall GDP growth, its share in GDP was lower compared with fiscal 2020, suggesting that consumption recovery is expected to be gradual because of headwinds such as high inflation and limited government support.

On the supply side, performance of the manufacturing sector stands out. At 9.80%, manufacturing GDP grew the most compared with other supply-side components — to above the pre-pandemic level. To some extent, this reflects a sharper focus on goods and away from services due to the pandemic. The latter, especially contact-intensive services, are still reeling under the pandemic's impact, trailing 10.90% below the fiscal 2020 levels. On the other hand, agriculture is expected to maintain a healthy growth momentum — growing 3.30% in fiscal 2022 (same as fiscal 2021).

Further, after factoring in slowing global growth, persistently high crude prices, and rising domestic interest rates, CRISIL Research expects India's real GDP growth for fiscal 2023 at 7.30%, with risk tilted to the downside.

GDP change % on-year



Note: E - provisional estimates, P - projected

Source: National Statistical Office (NSO), CRISIL Research

Macroeconomic outlook

Macro variable	FY21	FY22E	FY23P	Rationale for outlook
Real GDP (%, y-o-y)	-6.60	8.70	7.30	Downside risks to GDP growth have risen owing to surging commodity prices and global supply disruptions. That said, improving growth in contact-based services and pickup in investments will drive growth
Consumer price index (CPI) inflation (%, y-o-y)	6.20	5.50	6.80	CPI inflation is expected to rise to 6.80%, on average, this fiscal compared with 5.50% in the previous year. Inflationary pressures are rising and becoming broad-based, driven by elevated commodity prices and persistent supply shocks A wide-ranging surge in prices of food, energy and industrial commodities has raised cost pressures for Indian producers further, marking the second year of elevated input costs. Producers will try to pass on these cost pressures to consumers, which will raise core inflation
Current account balance/ GDP (%)	0.90	-1.60	-3.00	India's trade and current account deficits are expected to widen in fiscal 2023 as imports of crude and commodities remain sticky, exports slow in response to slowing global growth, and import prices rise faster than export prices Surging international commodity prices, in particular crude oil, will drive import compared with growth owing to the impact on global growth
Rs/$	72.80	76.50	78.00	The rupee is likely to depreciate further due to higher energy prices, widening current account deficit, and rate hikes by the United States (US) Fed resulting in capital outflow. However, with the Reserve Bank of India's (RBI) intervention in the forex markets assisting in managing volatility, a sharp depreciation in the rupee may be avoided though it could face volatility in the near term so long as geopolitical tensions persist

Note: P – projected, E – estimates

Source: RBI, NSO, CRISIL Research

India's GDP rebounded sharper than other countries

India was one of the fastest-growing economies in the world pre-Covid-19. Over the past few years (before the pandemic's onset), India's macroeconomic situation had seen gradual improvement. The twin deficits (current account and fiscal) were narrowing, and the growth-inflation mix was improving, and durably so. The government adopted an inflation-targeting framework to provide an institutional mechanism for inflation control, while modernising central banking. Although real GDP growth in 2021 was affected by Covid-19, it estimated to have risen to 8.70% in fiscal 2022. The GDP in fiscal 2023 is projected to be at 7.30%, with risks tilted to the downside.

Real GDP change (% y-o-y)

Country	2015	2016	2017	2018	2019	2020	2021	2022	2023	Trend
China	7.04	6.85	6.95	6.75	5.95	2.24	8.11	4.37	5.07	
Germany	1.49	2.23	2.68	1.09	1.06	-4.57	2.89	2.10	2.72	
India*	8.00	8.26	6.80	6.45	3.74	-6.60	8.70	7.30	6.50	
Indonesia	4.88	5.03	5.07	5.17	5.02	-2.07	3.69	5.41	6.00	
Japan	1.56	0.75	1.68	0.58	-0.24	-4.51	1.62	2.39	2.32	
Korea, Repulic	2.81	2.95	3.16	2.91	2.24	-0.85	4.02	2.54	2.94	
Malaysia	5.09	4.45	5.81	4.84	4.44	-5.65	3.13	5.61	5.50	
Thailand	3.13	3.44	4.18	4.22	2.15	-6.20	1.57	3.33	4.29	
United Kingdom	2.62	2.26	2.13	1.65	1.67	-9.27	7.44	3.75	1.20	
United States	2.71	1.67	2.26	2.92	2.29	-3.40	5.67	3.71	2.25	

Note: Forecast for the calendar year, while for India, it is fiscal year, i.e., 2021= fiscal 2022; 2022= fiscal 2023
Source: IMF, S&P Global Ratings, CRISIL, MoSPI

Banking

The Reserve Bank of India (RBI), which is the country's central banking authority, regulates and supervises the banking sector. Over the years, the banking sector has undergone a number of reforms aimed at promoting a diversified, efficient and competitive financial market, besides giving operational freedom to banks:

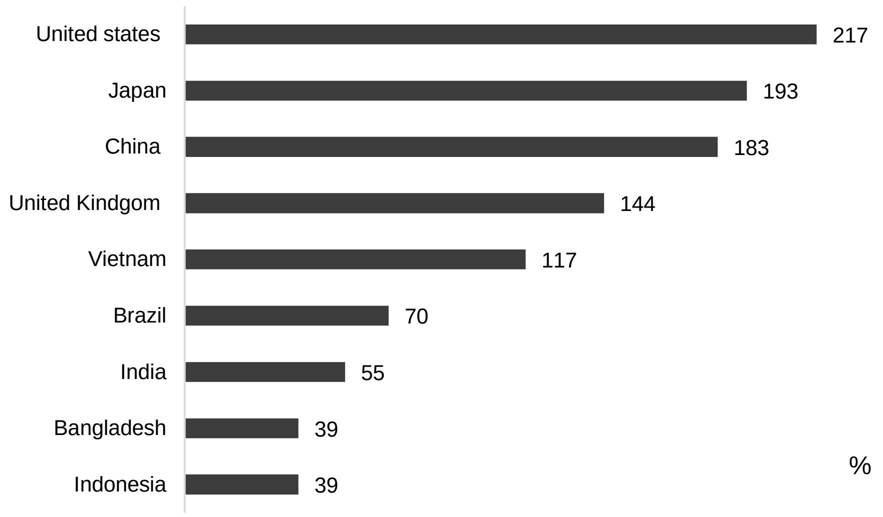
1) Merging public sector banks
2) Introducing the Prompt Corrective Action (PCA) framework
3) Refining supervisory practices
4) Tightening risk weights/provisioning norms (for sectors witnessing high credit growth)
5) Introducing best international practices and norms such as Basel III
6) Issuing guidelines to deal with overall asset-liability mismatches
7) Bringing greater market discipline through higher-than-stipulated capitalisation level
8) Deregulating interest rate and scaling down statutory pre-emptions
9) Providing timely support measures to the financial sector

These measures have cumulatively strengthened the banking system, engendered confidence in depositors, and aided overall financial stability.

Under-penetration of the Indian banking sector provides opportunities

The Indian banking sector is significantly under-penetrated, which provides immense opportunities for banks and other financial institutions. The domestic bank credit-to-private sector as % to gross domestic product (GDP)stood at 55% as of 2020.

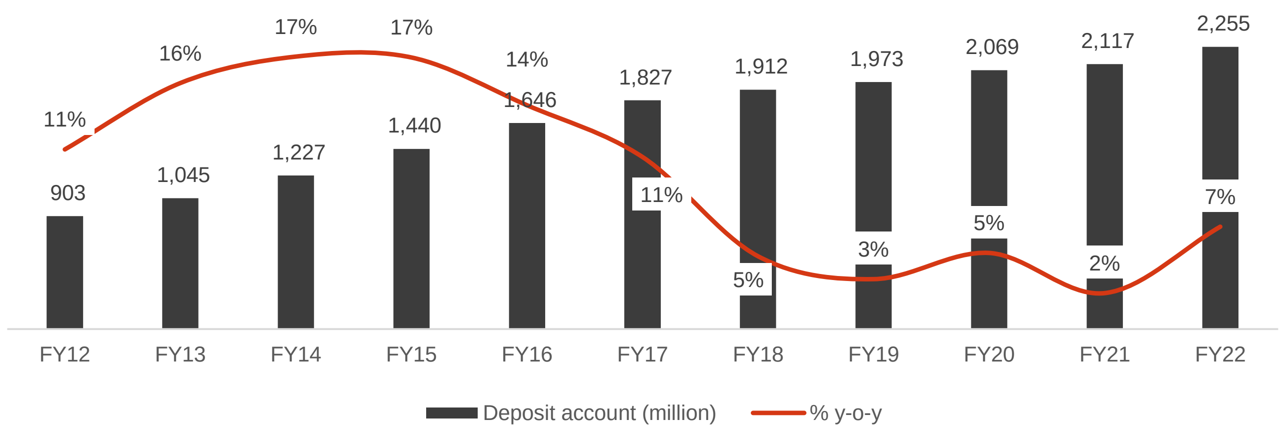
Domestic credit to private sector (% of GDP) as of 2020



Source: World Bank

Financial inclusion has been one of the key priorities of the government as well as banks over the past decade. Pradhan Mantri Jan Dhan Yojana (PMJDY), launched in August 2014, is aimed at ensuring affordable access to financial services — banking/savings and deposit accounts, remittances, credit, insurance, and pension. PMJDY focuses on household coverage, while the earlier schemes focused on coverage of villages. It aims to extend banking facilities to all within a reasonable distance in each sub-service area (consisting of 1,000-1,500 households) across India. As on March 31, 2022, 450 million PMJDY accounts had been opened; of these, 67% were in rural and semi-urban areas with aggregate deposit of Rs 1,665,000 million.

Growth in number of deposit accounts (including current, savings, term and others) in scheduled commercial banks

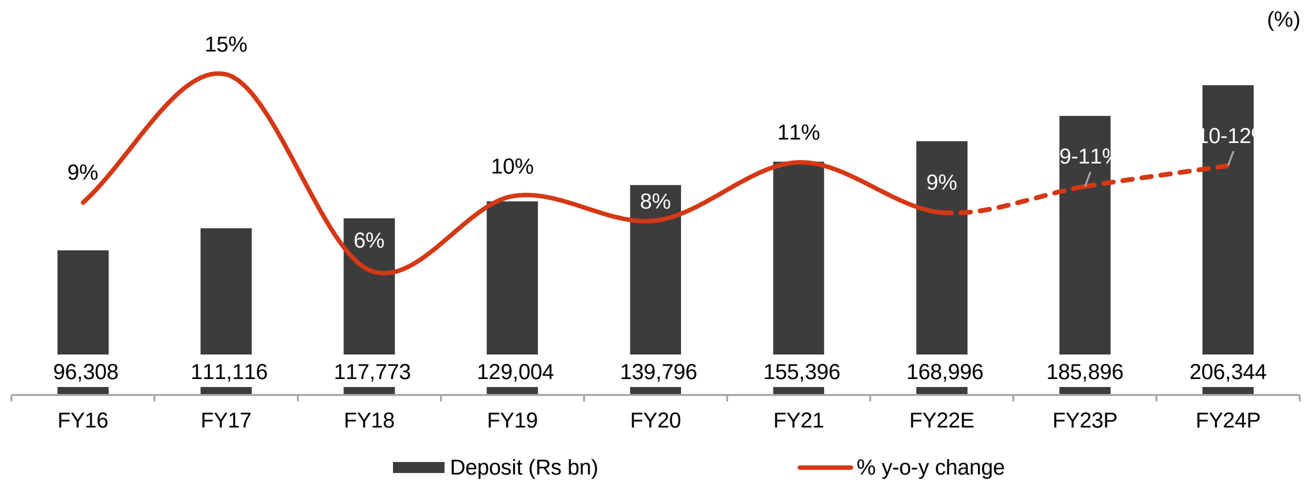


Source: RBI. CRISIL Research

Deposits to grow at a healthy rate of 9-11% during fiscal 2023

The banking sector enjoyed a healthy deposit compound annual growth rate (CAGR) of ~10% between fiscals 2016-21. With the outbreak of Covid-19 in fiscal 2021, conserving money became a priority and households reduced their private consumption, leading to 11% deposit growth in the fiscal. Further, the weighted-average domestic term deposit rate declined 80 basis points (bps) from 6.07% in April 2020 to 5.28% in March 2021. With the RBI keeping it stance accommodative and policy rates unchanged for the entire fiscal 2022, the weighted-average term deposit rate declined a further 25 bps to 5.03% as of March 2022. During the monetary policy meeting in April 2022, the RBI signaled a gradual removal of the accommodative policy — it increased the policy repo rate by 40 bps in May 2022 and 50 bps in June 2022. CRISIL Research expects deposits to grow 9-11% during fiscal 2023, driven by an expected hike in policy rates by an additional 75 bps the fiscal, pushing the repo rate 50 bps above the pre-pandemic level by fiscal-end, and banks, in turn, transmitting the hike by increasing deposit rates.

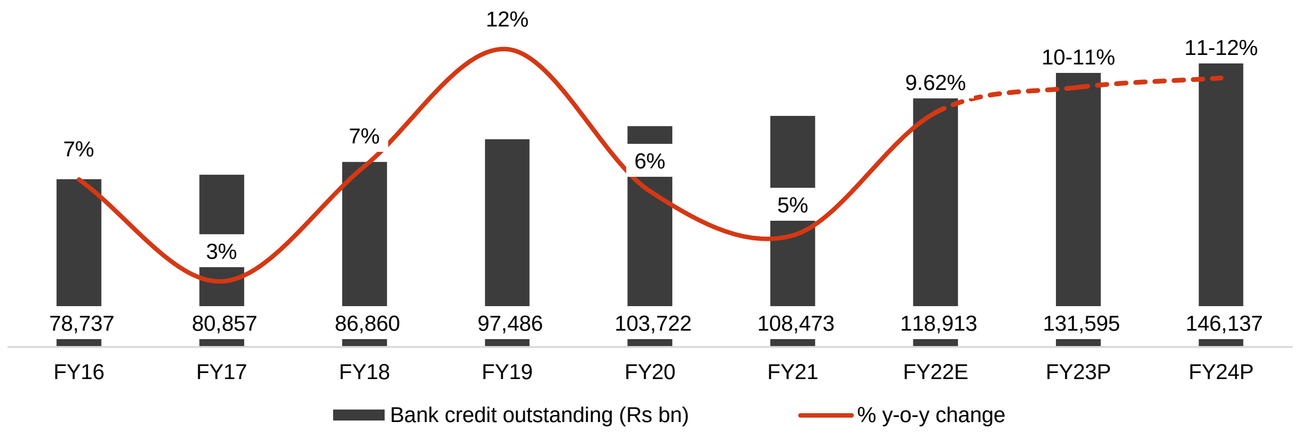
Deposits (Rs billion) and % on-year change in India



E: Estimated, P: Projected
Source: RBI, CRISIL Research

Credit growth to continue at 10-11% during fiscal 2023

Bank credit outstanding and % on-year change



Note:1. Credit deployment data published by the RBI has undergone revision with effect from January 2021. Hence, comparable numbers for the previous fiscal have been revised accordingly.
2. Bank credit outstanding includes international and food credit for the coverage period.

E: Estimated, P: Projected
Source: RBI, CRISIL Research

In fiscal 2021, the Indian economy witnessed the sharpest contraction since Independence, due to the onset of the pandemic and imposition of a nationwide lockdown. To help deal with the impact of the pandemic, the government and the RBI took several initiatives to provide relief to borrowers. While the impact was significant in the first half of fiscal 2021, faster-than-expected revival led to moderate credit growth of 4.6% in fiscal 2021. The most significant initiatives included the Rs 3,000,000 million (revised upwards to Rs 5,000,000 million) Emergency Credit Line Guarantee Scheme (ECLGS); provision of loan moratorium; and option of restructuring loans to corporates, micro, small and medium enterprises (MSMEs), and individual borrowers under the restructuring framework (One-time restructuring - OTR 1.0 and 2.0).

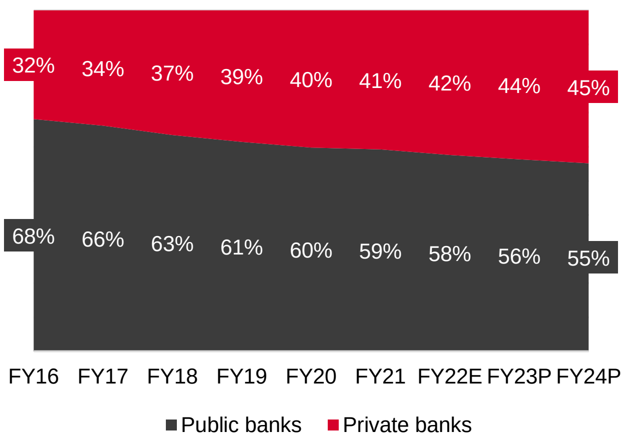
In the first half of fiscal 2022, the second wave of the pandemic forced both borrowers and lenders to tread cautiously, leading to muted growth in bank credit. Growth picked up in the third quarter of fiscal 2022, and with a mild third wave, the momentum continued in the fourth quarter supported by pent-up and festive season demand. Further, the amount sanctioned under the ECLGS aggregated to Rs 3,320,000 million and disbursement aggregated to Rs 2,590,000 million as of April 2022. The scheme has primarily aided the MSMEs to obtain credit from the banking sector and revive business activities. CRISIL Research expects bank credit to grow 10-11% during fiscal 2023, driven by the retail and agriculture segments and supported by recovery in services and industrial credit.

Private banks to continue to outpace public banks in credit growth in the medium term

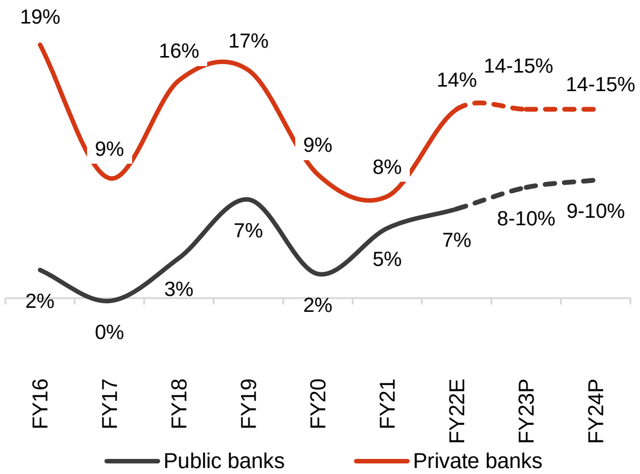
Traditionally, public banks have accounted for the major proportion of the banking credit outstanding. However, low profitability, a weak capital position, low operational efficiency and an increase in stressed loans in the past few years led to slowdown in their loan growth. As a result, public banks gradually lost market share to private banks, which were relatively well capitalised and had a higher degree of operational efficiency. Public banks, which accounted for 71% share in credit outstanding in fiscal 2015, accounted for only 58% share in fiscal 2022.

A partial economic slowdown resulted in lower credit growth in fiscal 2020 for both public and private banks. In fiscal 2021, growth for public banks stood at 5%, while private banks were able to grow 8% due to better capital buffers and increased focus on retail segment. Therefore, the latter gained further market share. As merged banks focus on integration and banks placed under corrective action come out of the PCA framework, credit growth of public banks is expected to lag that of private banks in the medium term. In fiscal 2022, private banks' focus on credit growth, especially in the retail segments, aided them to grow at a healthy double-digit rate of 14%. Growth at public banks also picked up to 7%. CRISIL Research expects credit growth of 8-10% at public banks and 14-15% at private banks during fiscal 2023.

Bank group-wise share in credit outstanding



Bank group-wise % on-year change in credit outstanding



E: Estimated, P: Projected
Source: RBI, company reports, CRISIL Research

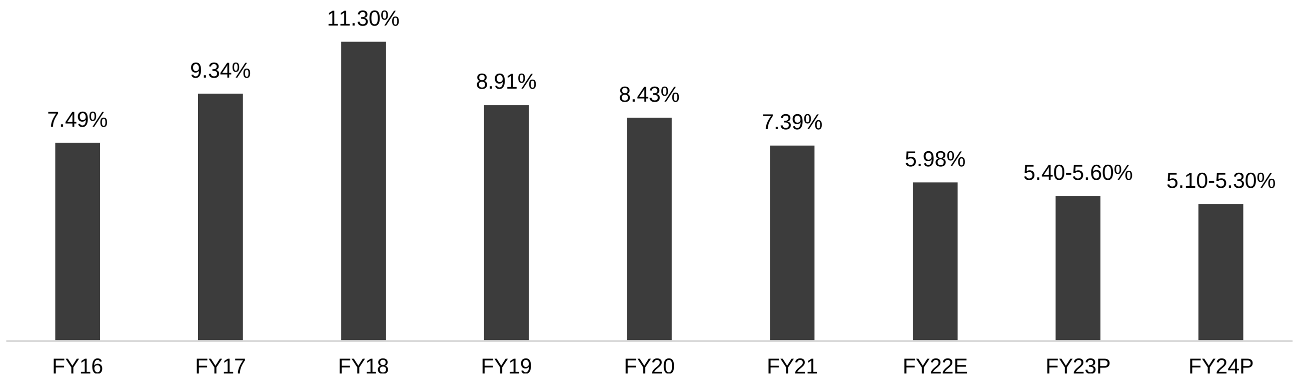
Merging banks: In fiscal 2019, public banks picked up growth because of improving asset quality and capital infusion by the government, which, in turn, improved the capital position of a number of banks and helped most PCA banks come out of the framework. Also, operational efficiency improved due to economies of scale after the SBI group merger (April 2017).

After the merger of Bank of Baroda-Dena Bank-Vijaya Bank (April 2019), the Ministry of Finance announced the next round of public bank mergers by consolidating 10 banks into four banks (merging banks) with effect from April 1, 2020. These are Punjab National Bank with Oriental Bank of Commerce and United Bank, Union Bank of India with Corporation Bank and Andhra Bank, Canara Bank with Syndicate Bank, and Indian Bank with Allahabad Bank. This exercise of consolidating public banks aided in improving operating efficiency with economies of scale and is expected to help in speedier resolution of assets in the long run.

Gross non-performing assets (GNPA) of banks to improve to 5.4-5.6% in fiscal 2023

The pandemic resulted in one of the worst economic declines in decades. Airlines, hospitality, travel, gems and jewelry, auto dealers, and real estate were hit the hardest, given the discretionary nature of these sectors. Both collections and disbursements were impacted significantly in the first half of fiscal 2021. However, with measures taken by the government and the RBI assisting in containing the deterioration in asset quality, overall GNPA ended the fiscal at 7.4%.

GNPA of scheduled commercial banks (%)



E: Estimated, P: Projected
Source: RBI, company reports, CRISIL Research

The RBI announced a host of measures to enhance liquidity, ease financial market conditions, address cash flow concerns, and improve market sentiment following a near-halt in economic activity. The measures such as loan repayment moratorium provided relief to borrowers until August 2020 and loan restructuring framework helped customers who were financially impacted by the pandemic in the rest of fiscal 2021. These relief measures helped contain asset quality deterioration.

About 0.9% of the total credit outstanding was restructured as of March 2021 under the one-time restructuring framework (OTR 1.0), which was significantly lower than earlier estimates. In the case of public banks, the majority of the restructuring came from the corporate sector. In the case of large and mid-size private sector banks, the proportion of retail assets in total restructuring (invoked + implemented) was relatively high.

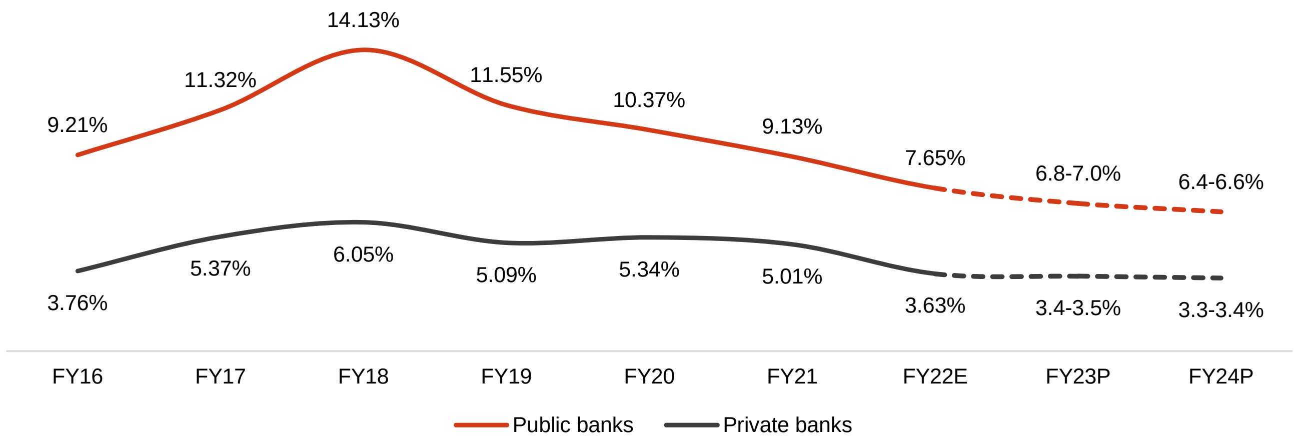
The RBI announced the restructuring framework (OTR 2.0) in May 2021, during the second wave of the pandemic. This framework saw better response from corporate borrowers —the window for application ended on September 30, 2021 (with the last date to implement the restructuring for banks being December 31, 2021). CRISIL Research estimates the overall restructuring (OTR 1.0 and 2.0) to have ranged between 1.50% and 1.80% of the loans outstanding as of March 2022.

Given the restructuring took place in fiscals 2021 and 2022 and the estimated tenure of the restructuring is around two years, CRISIL Research believes the behavior of such portfolios would be clear after fiscal 2023. GNPA of both private and public banks improved in fiscal 2022 on account of reduction in fresh slippages and improvement in upgrades and recoveries. GNPA of scheduled commercial banks stood at a six-year low of ~6% as of March 2022. CRISIL Research expects the bank's asset quality to improve further to 5.40-5.60% in fiscal 2023, primarily on account of lower slippages and expectation of recoveries via the NCLT and National Asset Reconstruction Company Ltd (NARCL) route.

GNPA of both public and private banks to improve this fiscal

GNPA of public banks started declining since 2019 due to resolution of stressed assets. As of March 2021, GNPA of these banks reduced almost 130 bps to 9.13% due to support from asset classification standstill, moratorium and restructuring. In case of private sector banks, the GNPAs have remained in range of 5-6% between fiscal 2017-21. And similar trend observed in public banks, the asset quality of private banks improved to 3.63% as of March 2022 with better recoveries across segment, especially, in industrial and agriculture segment. Further, the restructuring framework 2.0 announced in May 2021 on account of stress amid the second wave of the pandemic provided an option to stressed individual, corporate and MSME borrowers to restructure their loans. This along with an increase in credit guarantees under the ECLGS to Rs 5,000,000 million and the extension of ECLGS timelines to March 31, 2023, in the Union Budget 2022-23, has assisted in containing the deterioration of asset quality. CRISIL Research expects the momentum to continue this fiscal with improvement in asset quality across lenders.

GNPA of public and private banks (%)



E: Estimated, P: Projected
Source: RBI, company reports, CRISIL Research

The setting up of NARCL or the 'bad bank' will also help resolve the stressed asset scenario. Banks have finalised a loan of Rs 1,500,000 – 2,000,000 million, which is to be transferred to NARCL in a phased manner. Of this, about 15 bad-loan accounts aggregating to ~Rs. 500,000 million will be transferred in the first phase. However, recovery from these loan accounts is a key monitorable.

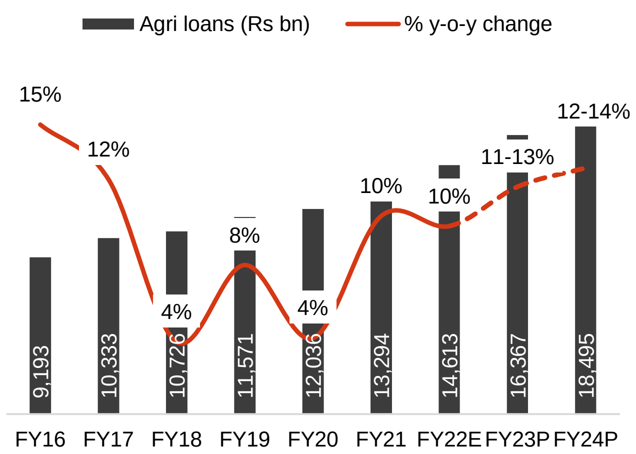
Product-wise

Agri-loans to increase at healthy pace in fiscal 2023

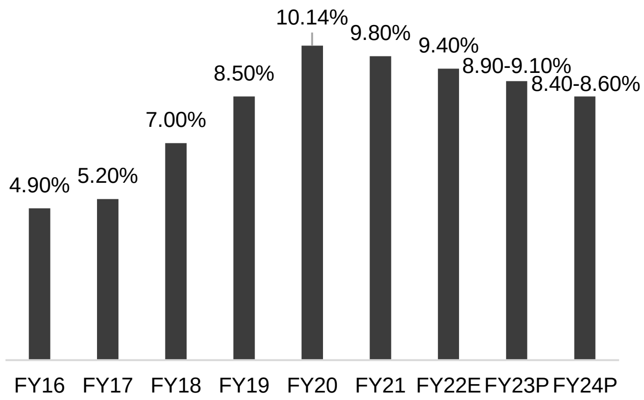
Loans outstanding for agriculture and allied activities (collectively agri-loans) in India logged 8% CAGR between fiscals 2016 and 2021, supported by a good monsoon and higher banking penetration. In fiscal 2018, though, farm loan waiver by many states led to a deceleration in growth to 4% on-year. But, in fiscal 2019, the pace picked up again to 8% over a low base amid banks' priority sector lending (PSL) targets and a normal monsoon.

A normal monsoon in fiscal 2021 offset the impact of the pandemic as well. However, the pandemic affected allied activities such as horticulture and cash crops because of lower exports. Nevertheless, as of March 2021, agri-loans rose a sharp 10% on-year. In fiscal 2022, due to higher food-grain and horticulture production, elevated prices of crops such as cotton, and support from the agriculture fund, agri-credit grew ~10%, with loans outstanding of banks at Rs 14,613,489 million. CRISIL Research expects agri-credit to grow 11-13% during fiscal 2023, supported by PSL targets, expected higher food-grain production, an increase in commodity prices, and an increase in the agri-credit target to Rs 18,000,000 million this fiscal from Rs 16,500,000 million during fiscal 2022. Further, continued government focus on agri-allied sectors via schemes such as the agri-infrastructure fund and linking KCC to animal husbandry and fisheries will also support credit growth.

Credit outstanding and % on-year change



GNPA of Agri-financing (%)



Note: Credit deployment data published by the RBI has undergone revision with effect from January 2021. Hence, comparable numbers for the previous fiscal have been revised accordingly.
E: Estimated, P: Projected

Source: RBI, CRISIL Research

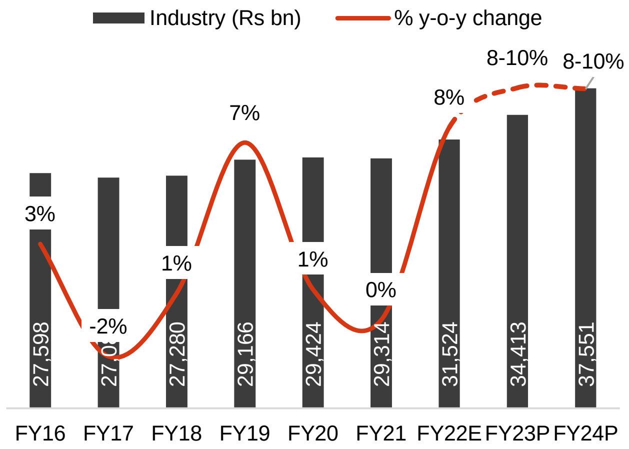
GNPA of agri-loans surged to 10.14% in fiscal 2020. The pandemic had limited impact on the sector in fiscal 2021, with GNPA range-bound at 9.80%. In fiscal 2022, GNPA declined to 9.40%, owing to initiatives such as one-time settlement of loans by SBI. Further, an increase in profits has supported farmers in repaying loans on time. CRISIL Research expects asset quality to improve ~50 bps on-year this fiscal on expectations of a normal monsoon and higher on-year profitability in kharif crops.

Industrial credit to continue growing in fiscals 2023 and 2024

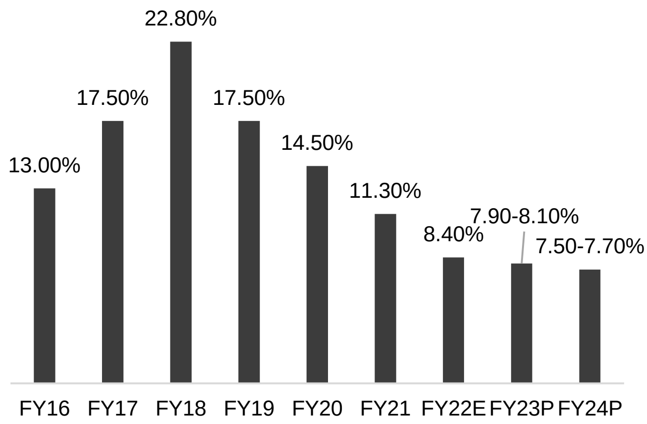
Credit to industry witnessed muted or a marginal growth at 1% CAGR between fiscals 2016 and 2021 owing to asset quality concerns. However, it rose sharply in fiscal 2019, led by lending to the infrastructure segment.

In fiscal 2021, though, credit growth weakened as most underlying sectors, such as chemicals, engineering, and construction, were significantly affected amid demand challenges heaped by the pandemic, with credit outstanding in several sectors declining 6-8% on-year. In fiscal 2022, industry credit grew ~8% supported by the textile, construction, engineering and food processing segments and partially offset by de-growth in the basic metals and metal products segment on account of an increase in metal prices, which helped companies generate higher revenues and, in turn, deleverage balance sheets during the last two fiscals. CRISIL Research expects the recovery in industrial credit to continue, with growth in a range of 8-10% during fiscals 2023 and 2024.The government's Production-Linked Incentive scheme, which is a concerted push to drive manufacturing with greater focus on large employment-generating and export-oriented sectors, is a positive for industry and is likely to aid credit growth over the medium term.

Credit outstanding of industry loans at banks and % on-year change



GNPA of industry segment (%)



Note: Credit deployment data published by the RBI has undergone revision with effect from January 2021. Hence, comparable numbers for the previous fiscal have been revised accordingly.

E: Estimated, P: Projected
Source: RBI, company reports, CRISIL Research

GNPA for industrial credit declined in fiscal 2021, due to the resolution of stressed assets via NCLT and the restructuring framework 1.0. Further, the RBI's announcement of the restructuring framework 2.0 in May 2021, during the second wave of the pandemic, provided stressed corporate and MSME borrowers with an option to restructure their loans. Lower slippages from large corporate accounts, higher recovery or write-offs, and lower credit costs helped improve asset quality.

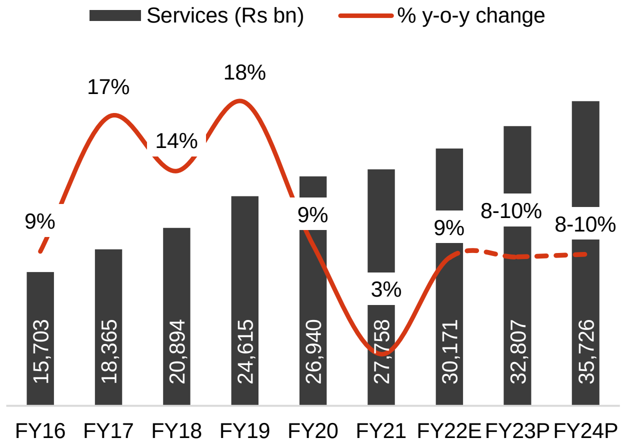
Credit growth in services segment to remain range- bound

Credit to the services segment logged 12% CAGR between fiscals 2016-21, driven by lending to NBFCs which registered 18% CAGR. Credit growth to the NBFC segment was muted during fiscal 2021 due to the onset of the pandemic, which affected the country's economy, and stressed assets in certain non-bank segments.

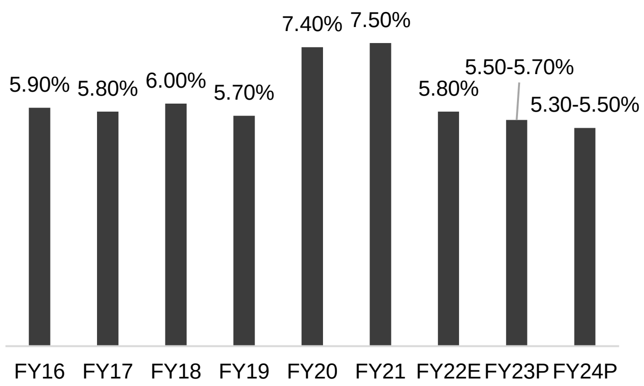
Given that one-third of the services sector lending in the bank portfolio is towards NBFCs, portfolio quality and credit growth of underlying NBFC assets are also a key monitorable. NBFC credit has grown at 18% CAGR from fiscals 2016-21. However, post the muted credit growth in fiscal 2021, lenders were cautious in funding NBFCs owing to asset quality concerns. Hence, credit growth in lending to NBFCs was at ~11% in fiscal 2022 on account of a lower base coupled with banks cautiously extending credit to NBFCs serving less stressed segments.

Services segment credit is estimated to grow 8-10% on-year during fiscals 2023 and 2024, driven by lending towards the NBFC and trade segments. The RBI's ECLGS incentive helped in revival of this sector from pandemic-induced stress. As of April 2022, loans sanctioned under this scheme crossed Rs 3,320,000 million (of total Rs 5,000,000 million), with ~66% of the guarantees issued (as % of loans sanctioned).

Credit outstanding of services loans at banks and % on-year change



GNPA % of services segment



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P: Projected, E: Estimated
Source: RBI, Company Reports, CRISIL Research

The Covid-19 disruption, lockdowns and sluggish economic activity significantly affected the services sectors, such as transport operators, tourism, hospitality, and trade. Since the government provided one-time restructuring schemes 1.0 and 2.0 in August 2020 and May 2021, respectively, ECLGS to MSMEs, this helped improve the asset-quality in fiscal 2022 to 5.80%. CRISIL Research expects the services sector GNPA to at 5.50-5.70% in fiscal 2023 and 5.30-5.50% in fiscal 2024.

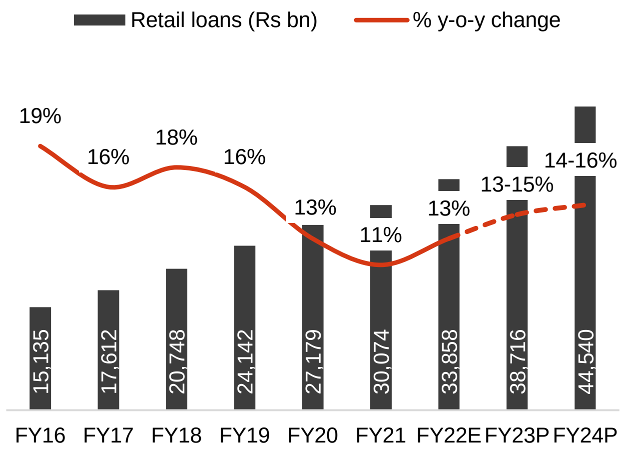
Retail segment to continue healthy double-digit growth in fiscal 2023 and 2024

Banking credit to the retail segment recorded 15% CAGR between fiscals 2016 and 2021. However, during the first half of fiscal 2021, retail loan exposure of banks to the housing and auto segments declined due to the pandemic. Nevertheless, it picked up faster than expected in the second half, helping post healthy credit growth of 11% by fiscal 2021-end. The growth was driven by improved affordability on account of low interest rates and stamp duty cuts announced by state governments in retail housing segments.

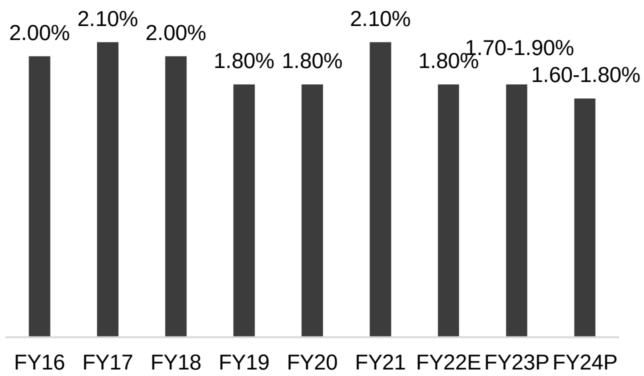
With the RBI keeping its stance accommodative during fiscal 2022, interest rates for housing loans continued to be at a historical low during fiscal 2022 (starting from 6.50%). This helped retail housing and overall retail credit grow at 13% on year. Further, despite an expected increase in property prices and policy rates rising by an additional 75 bps over 90 bps in first quarter of this fiscal, overall affordability is likely to remain favorable. Given this and healthy momentum in housing demand, CRISIL Research expects housing credit to grow at 14-16% in fiscal 2023.

Credit to the overall retail segment is expected to lead the growth of the banking sector, increasing at 13-15% on-year fiscals 2023 and 14-16% on-year during 2024 supported by healthy growth in housing, consumer durable, gold and other personal loans segments.

Credit outstanding of retail loans at banks and % on-year change



GNPA % of retail segment



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Source: RBI, Company Reports, CRISIL Research

GNPA of retail loans was at 1.80% in fiscal 2020. Because of the Covid-19 fallout and deterioration in asset quality in the segment, GNPA increased to 2.10% as of March 2021. GNPA spiked further in the first quarter of fiscal 2022 due to the second wave. However, loan restructuring under the one-time restructuring 2.0 announced by the RBI in May 2021 contained further deterioration. Improvement in economic activities and the mild third wave in the fourth quarter also helped, pushing the GNPA back to pre-Covid levels at 1.80% as of fiscal 2022.

Retail housing loans to witness healthy double-digit credit growth in fiscal 2023

Home loans outstanding of banks was Rs 16,844,240 million as of March 2022, almost double the figure five years ago. The segment recorded a healthy 14% CAGR over fiscals 2016-21. However, in fiscal 2021, the pace slowed, led by moderation in credit growth following the pandemic.

Large-scale migration of labour back to their hometowns / villages during the nationwide lockdown, and subsequent uncertainty regarding project execution, affected buyer sentiment for under-construction projects. Also, incomes were impacted, especially in the first half of fiscal 2021. However, there was a faster-than-envisaged revival in the second half of fiscal 2021, with the RBI, along with the Centre and state governments, providing impetus. In the case of housing / real estate, demand, which had touched a low during the lockdown, revived faster than expected in the second half, since:

- Real estate developers offered discounts and/or freebies
- Maharashtra and Karnataka cut stamp duty on real estate
- Moratorium and one-time restructuring (OTR 1.0 and 2.0) offered under the RBI's Resolution Framework for borrowers under stress due to pandemic
- Banks and non-banks slashed housing loan interest rates to historical lows

Further, in fiscal 2022, the second wave impacted disbursements in the first quarter, which led to a 40-60% decline in disbursement vis-a-vis fourth quarter of fiscal 2021. However, numerous factors supported credit growth in the balance fiscal 2022, namely:

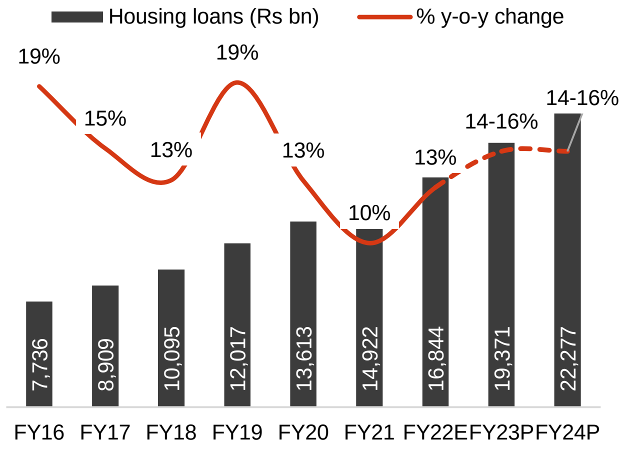
- Income levels of salaried customers largely being intact
- The accommodative stance of central banks during the fiscal, translating into historically low interest rates, starting from 6.50%
- Borrowers hastened their decision to own a house due to favorable affordability

These factors helped overall retail housing loans at banks grow at a healthy 13% during fiscal 2022.

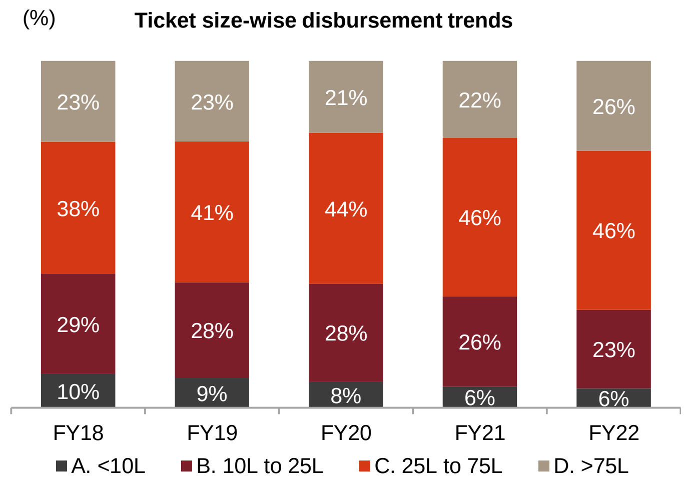
On the assets front, the share of the top 10[1]cities are more than 40% in terms of outstanding retail housing finance loans. CRISIL Research expects demand growth for the top 10 cities at 5-10% in fiscal 2023, following an estimated growth of 33-38% in fiscal 2022 (which was on account of a low base of fiscal 2021 and degrowth in the real estate segment for the past few years). This, coupled with expected growth of 6-10% in capital values and incremental construction under Pradhan Mantri Awas Yojana (PMAY), will support estimated housing loan growth of 14-16% during fiscal 2023.

[1]Top 10 cities include Ahmedabad, Bangalore, Chandigarh, Chennai, Hyderabad, Kochi, Kolkata, Mumbai, NCR and Pune

Credit outstanding of housing loans of banks and % on-year change



Ticket sizes wise disbursement trend of housing loans



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Source: RBI, Company reports, Credit Bureau, Industry, CRISIL Research

The housing finance segment has grown at healthy pace in the past decade due to multiple long-term factors, which are expected to drive long-term growth in the future as well:

1. **Urbanisation:** Urbanisation is a key growth driver for India since it leads to faster infrastructure development, job creation, development of modern consumer services, and the city's ability to mobilise savings. The share of the urban population has been consistently rising over the years and is estimated to have reached 35% by 2020 from 31% in 2011, spurring more demand. Urbanisation has a twin impact on housing demand – it increases the number of nuclear families, leading to the formation of more urban households, and reduces the area requirement per household.

2. **Nuclearisation:** Nuclearisation refers to the formation of multiple single families out of one large joint family; each of these families live in separate houses, while the ancestral house may be retained or partitioned to buy new houses. Nuclearisation in urban areas is primarily driven by the changing lifestyle, rising individualism, changing social/cultural attitudes, and increased mobility of labour in search of better employment. CRISIL Research expects these trends to continue in future.

3. **Increasing finance penetration:** Deepening penetration of finance is also expected to support growth of the industry. Rising demand for housing in tier 2 and 3 cities, and a subsequent surge in construction, have intensified the focus of financiers on these geographies. There is considerable improvement in finance coverage in rural areas as well on the back of the government's efforts to provide housing for all. However, operational challenges such as timely collection of payments, smaller ticket size and higher delinquencies than the urban markets will continue to oppose rural expansion.

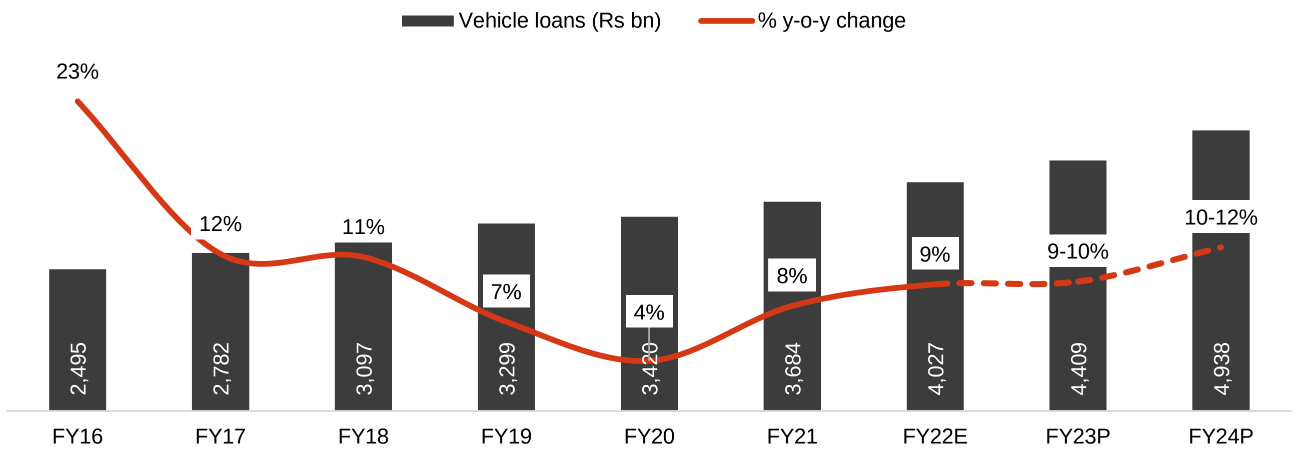
4. **Government support:** Though the above factors drive the overall housing finance market, the affordable housing segment is specifically driven by government schemes and support. Over the past decade, the government has announced several initiatives for the affordable housing segment. Along with PMJDY, housing specific schemes such as PMAY, Credit Linked Subsidy Scheme and Atal Mission for Rejuvenation and Urban Transformation, rationalisation of risk weights for home loans, and other initiatives have helped housing finance growth, especially in the affordable segment.

Vehicle loans segment to rise 9-10% in fiscal 2023

Vehicle loans outstanding of banks was Rs 4,026,675 million as of March 2022, with the segment posting a healthy 8% CAGR over fiscals 2016 to 2021. Demand had taken a hit in fiscal 2021 and had remained muted for few segments in fiscal 2022 as well, due to the stress induced by the two Covid-19 waves. Credit growth in fiscal 2023 will be supported by the continued rise in vehicle prices, healthy offtake from the domestic front and the easing chip shortage which will ensure the industry to post healthy growth.

On asset front, we expect pickup in vehicles sales volumes and improved loans-to-value (LTVs) across segments in this fiscal, resulting in overall disbursement growing by 14-16%. In return, CRISIL Research expects the vehicle loan book to grow by 9-10% in fiscal 2023.

Credit outstanding of vehicle loans at banks and % on-year change



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P: Projected, E: Estimated

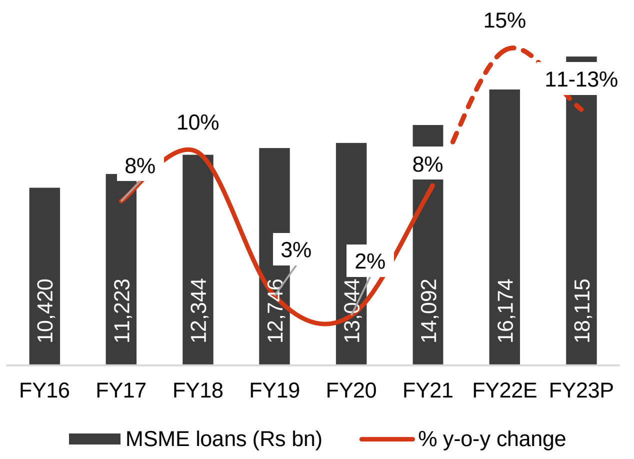
Source: RBI, Company reports, CRISIL Research

MSMEs credit to grow at a healthy rate of 11-13% during fiscal 2023

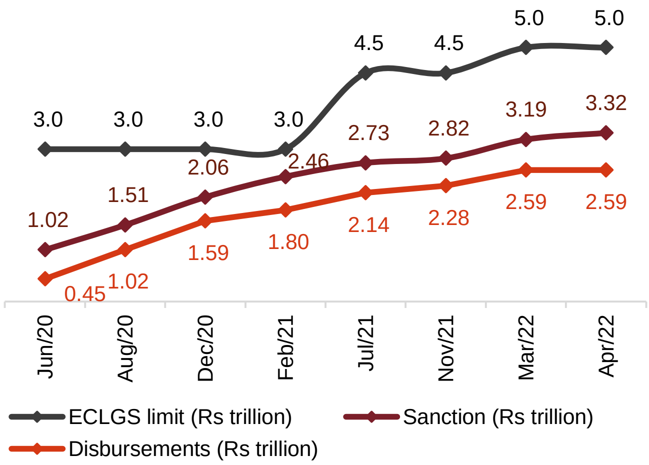
As per the revised definition, a firm with investments under Rs 500 million and turnover under Rs 2500 million is called an MSME. The first and second waves in fiscal 2021 and the first quarter of fiscal 2022, respectively, hit the segment hard. With the sectors close linkage to economic activities, the magnitude of the impact was significant due to frequent lockdowns and restrictions, which affected demand and supply, and hence profitability across most sectors. This necessitated relief measures, which were promptly announced by the government in the form of the ECLGS in fiscal 2021, which was reviewed on a timely basis to reduce impact on the sector. However, most of the disbursements under the scheme were by banks (among which private-sector banks showed greater proclivity than public-sector banks for utilising ECLGS), leading to credit growth of 8% in fiscal 2021.

The second wave impacted the MSME segment again, leading to muted growth in the first half of fiscal 2022 on account of disruption in business activity due to localised lockdowns. With the hit to the economy in the first quarter, the government extended the ECLGS, then ending in June 2021, to September 2021 (currently extended till March 31, 2023). This supported the sector to revive from degrowth in the first quarter of fiscal 2022, with banks posting a sequential growth in their MSME book at the end of the second quarter. Revival of economic activity, strong export and domestic support, coupled with a mild third wave, helped banking MSME credit clock healthy double-digit growth of 15% during fiscal 2022. CRISIL Research expects banks to continue credit growth at 11-13% in fiscal 2023.

Credit outstanding of MSME loans at banks, and % on-year change



ECLGS progress so far…



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Source: RBI, Company reports, CRISIL Research

MSMEs have been key contributors to growth to the Indian economy. With ~63.40 million, the sector is the second largest employment generator in the economy after agriculture, employing over 120 million people. Globally too, MSMEs are engines of growth, driving employment as well as revenue generation. As per the Central Statistics Office (CSO), the MSME gross value added (GVA) by MSME accounts for 33.50% of India's total GVA and 30.27% of India's GDP as of fiscal 2019. However, credit to MSMEs contributes to only 14% of total banking credit outstanding, indicating a wide mismatch and an opportunity for lenders.

In the past decade, the government has prioritised the MSME sector by launching key schemes and systems such as CLSS, National Manufacturing Competitiveness Programme, Credit Guarantee schemes, and TReDS. With increasing MSMEs, small finance banks and recently, fintech lenders, have been pivotal to their credit needs and are likely to aid further growth over the long term.

Make in India: 'Make in India' was initiated in 2014 with the objective of facilitating investment, improving manufacturing infrastructure and enhancing skill development. While there is no provision for providing financial assistance to companies manufacturing products under the initiative, supportive policy actions can create the right ecosystem for incremental investment over the long term. Under the initiative, the government has identified 27 key sectors including textile and apparel, electronics system design and manufacturing, leather and footwear, gems and jewelry, and tourism and hospitality services. Many of these sectors are largely driven by MSMEs directly or through job works/contract manufacturing.

Global trade: The changing axis of international trade and opportunities in exports has partially supported growth in local manufacturing, with the impact seen in pockets of MSME-led sectors. For instance, the trade tension between the United States (US) and China has partially supported exports from India to the US in the past few quarters. In addition, recent geo-political tension between Russia and Ukraine has impacted commodity prices across energy and metal verticals since fourth quarter of fiscal 2022. This has directly impacted input prices for most manufacturing sectors. With inflationary situation, volume moderation is observed across several sectors thereby limiting ability of companies to pass on price increase. This in turn will negatively impact margins this fiscal.

Over the medium term, any step towards free trade agreements with major export destinations such as the European Union or the US can create huge business potential for local manufacturing, thus benefiting MSME clusters involved in apparel manufacturing.

E-commerce: The Indian e-commerce sector has had a phenomenal run in the past decade. The sector has grown on the back of rising internet penetration, improved visibility and brand penetration, increasing awareness of online shopping, and lucrative deals offered by well-established players and start-ups. With regulatory vigilance and announced policy changes in the sector, participation of a wider seller base is expected on online marketplaces. By going digital on these platforms, MSMEs can build their credentials and penetrate deeper into tier 2 cities and beyond. In fact, more than 0.60 million sellers (most of which are entrepreneurs and MSMEs) are already offering their products through various ecommerce websites. With greater visibility, MSMEs can improve geographical reach and accessibility and also enable funding availability with better diversified sales mix.

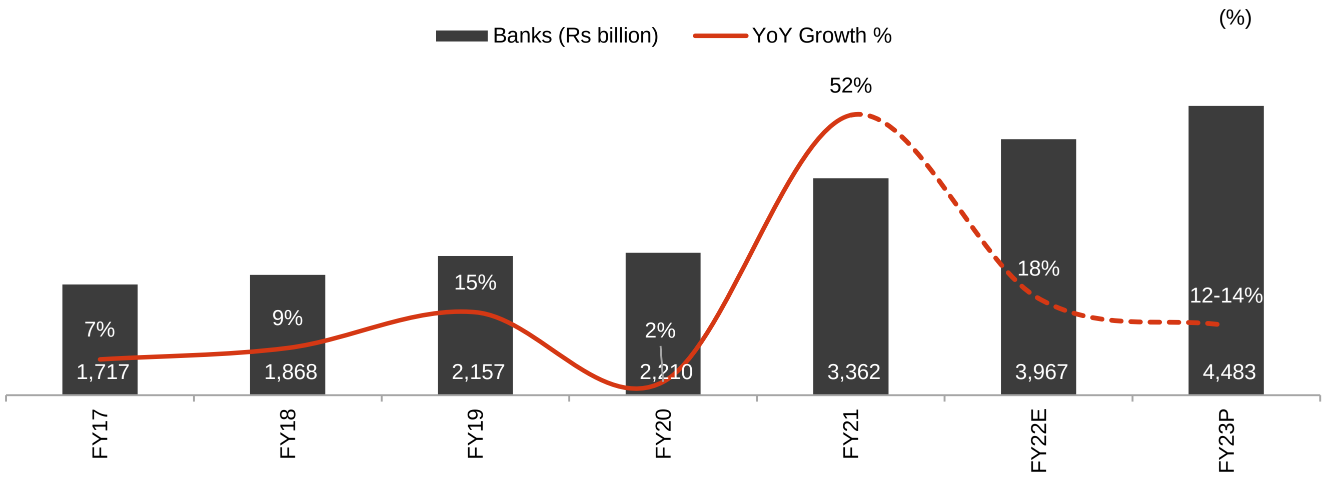
Gold loans credit growth to normalise in fiscal 2023 at 12-14%

Amid the Covid-19-induced economic uncertainty, gold loans – debt raised using gold as a collateral – came to the rescue of needy individuals and even small businesses. The primary reasons for increasing gold loans are: 1) an increase in gold prices by ~30% during fiscal 2021; 2) a higher loan-to-value (LTV) of up to 90% allowed for banks; 3) liquidity crunch due to the pandemic; and 4) lenders' reluctance to give unsecured loans due to risk aversion.

Banks have aggressively expanded their gold loan portfolio with the RBI announcement on increasing LTVs up to 90%. Lower interest rates and longer tenure loans have also helped banks gain share from NBFCs whose book also grew at a healthy but slower pace compared with banks.

At an overall level, bank gold loan assets under management have grown at 16% CAGR from fiscals 2016-21. With outbreak of pandemic, the book has shown extraordinary ~52% growth in fiscal 2021 followed by 18% growth in fiscal 2022 due to the higher base. CRISIL Research expects growth in the gold segment to normalise at 12-14% during fiscal 2023.

Credit outstanding of gold loans of banks, and % on-year change



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Source: RBI, CRISIL Research

Key recent developments in the banking sector

Announcements	Impact
Risk-weighted assets – October 2020 / April 2022	Individual housing loans were assigned risk weights on the basis of ticket size and LTV ratio before October 2020. Based on the RBI circular of October 16, 2020, risk weights were re-assigned only based on LTV. The initial guidelines indicated this will be applicable to all new housing loans sanctioned till March 31, 2022. As on April 8, 2022, though, the extension was revised up to March 31, 2023 Housing loans above Rs 7.50 million benefits the most, since risk weights for these loans reduce to 35% from 50%. Lenders may use this benefit to lower cost of lending to mid- and high-ticket properties. Additionally, this increases credit in market owing to their lower capital adequacy requirement (due to new lower risk weights)
ECLGS	In May 2020, ECLGS was announced as part of the Atmanirbhar Bharat Package, with the objective of helping businesses including MSMEs meet their operational liabilities and resume businesses. As of April 2022, loans sanctioned under the scheme crossed Rs 3,320,000 million (of Rs 5,000,000 million), with about 66% of the guarantees issued for loans sanctioned to MSMEs, and the disbursement aggregated Rs 2,590,000 million. In Union budget 2022-23, the allocation under ECLGS was increased from Rs 4,500,000 million to Rs 5,000,000 million, and the timeline for sanctions has been extended till March 2023. The enhancement of Rs 500,000 million is earmarked exclusively for hospitality and related enterprises The scheme has helped the MSME segments who were severely affected due to pandemic induced disruptions to start of business activities. Further, as per the disclosures provided in the RBIs Financial Stability Report, almost 11.06 million micro small and medium enterprises with guarantee's aggerating to Rs 1,741,570 million benefitted from the scheme as of November 12, 2021
Repo rate cut	The Monetary Policy Committee (MPC) of the RBI reduced the policy repo rate (key policy rate at which the central bank lends to commercial banks) by 75 bps from 5.15% in October 2019 to 4.4% in March 2020. In May 2020, the MPC, to further ease financial conditions and facilitate the flow of funds at affordable rates, reduced the policy repo rate by another 40 bps to 4.0%. This is the lowest compared with 4.75% in 2009 during the global financial crisis. The rates were unchanged until May 2022 with the first repo hike of 40 bps followed by a 50 bps hike in June 2022. CRISIL Research further expects the rates to increase 75 bps this fiscal, bringing the repo rate 50 bps above pre-pandemic levels by the end of this fiscal. This in turn will lead to rise in yield on advances and cost of funds for both banks and NBFCs and consequently for the borrowers as the lender's pass on increase in cost to borrowers.
Moratorium	The central bank aimed to give borrowers a breather by allowing moratorium on existing loans in February 2020 during March 1 – May 31, 2020. The moratorium provides for deferment of principal and interest, and not waiver of loans, for three months. To address cash flow concerns following a near-halt in economic activity in May 2020, the MPC extended the

Announcements	Impact
	moratorium from June 1 to August 31. While these measures supported all borrowers, self-employed retail and MSME borrowers benefitted significantly. This not only eased financial stress caused by the pandemic, but also built confidence in such extraordinary times.
Resolution Framework (OTR 1.0 and 2.0)	To provide relief to borrowers facing difficulties due to Covid-19, the RBI enabled lenders to implement a restructuring plan to eligible corporate exposures and personal loans, subject to conditions, in August 2020. Further boundary conditions, in the form of financial parameters and sector-specific parameters, were prescribed on the basis of recommendation of an expert committee constituted for the purpose. OTR 1.0 scheme witnessed only 0.9% of credit outstanding restructured by banks. Further, on account of disruptions due to second wave of pandemic in first quarter of fiscal 2022, the RBI announced Resolution Framework 2.0 (OTR 2.0) in May 2021 to provide relief to customers. The restructuring framework 2.0 witnessed better response from corporate borrowers. CRISIL Research estimates the overall restructuring (OTR 1.0 and 2.0) to range between 1.50% and 1.80% of the loans outstanding as of March 2022.

Source: RBI, CRISIL Research

Economy of Tamil Nadu

Tamil Nadu — a leading industrialised state in India

Tamil Nadu is located on the southeast coast of the country, it is bordered by Andhra Pradesh in the north, Karnataka and Kerala in the west, the Indian Ocean in the south, and the Bay of Bengal in the east. The state topped the composite ranking of the Good Governance Index (GGI) in 2019, followed by Maharashtra and Karnataka.

Historically an agricultural state, Tamil Nadu has transformed into an industrialisation hub. It has a diversified manufacturing sector and leads in several industries such as automobiles and auto components, engineering, pharmaceuticals, garments, textiles, leather products, chemicals and plastics. The state is well-known for cotton ginning, spinning, and weaving. Tamil Nadu is also one of the fastest growing states, with continued focus on MSME and textile industry.

Tamil Nadu's Gross State Value Added (GSVA) at current prices rose at a CAGR of 11% over fiscals 2017-22 compared with the country-wide 9% CAGR. The tertiary sector is the biggest contributor (~54%) to the state's GSVA, followed by the secondary sector (33%). The primary sector's share (agriculture and allied activities, and mining and quarrying) has slipped to ~13% over decades.

Some of the major initiatives taken by the state government to promote Tamil Nadu as an investment destination are as follows:

Industry

- In the state budget announced on March 18,2022 following announcements were made:
- announcement of new program to develop various clusters of micro enterprises
- New industrial parks to be set up in five districts.
- Direct government procurement of innovative manufactured products up to Rs 0.50 million will be permitted to support the startups.
- Plans for a new Footwear and Leather Industry Development Policy
- In September 2021, the Minister for Rural Industries, announced a proposal for the establishment of four industrial estates across Tamil Nadu to ensure balanced growth across the state. The industrial estates will be developed by the Tamil Nadu Small Industries Development Corporation (Tansidco) at Manapparai in Tiruchirappalli district, Kaverirajapuram in Thiruvallur district, Kodur in Chengalpattu district and Sakkimangalam in Madurai district, across a total of 394 acres at a project cost of Rs 2,180 million and which is expected to generate 7,000 jobs.
- The state introduced the Industrial Policy 2021 to achieve an annual growth rate of 15% in the manufacturing sector, attract investments worth Rs 10,000,000 million and create employment opportunities for 2 million people by 2025
- In February 2021, Flipkart signed a memorandum of understanding (MoU) with the Tamil Nadu MSME Trade and Investment Promotion Bureau to bring local artisans, weavers, craftsmen, and small and mid-sized enterprises into the e-commerce marketplace
- In December 2020, Tamil Nadu announced that France will sign an MoU with Tamil Nadu's Industrial Guidance and Export Promotion Bureau and the Indo-French Chamber of Commerce and Industry to facilitate mutual investments and to promote ease of doing business

- In 2019, the chief minister launched the Tamil Nadu New Integrated Textile Policy, 2019

Infrastructure

- In the state budget announced on March 18, 2022 following announcements were made:
- A special fund of Rs 1,000 million to be set up to build public infrastructure for export.
- Regional start-up hubs will be set up in three districts.
- In August 2021, the state government announced the Chief Minister Road Improvement Scheme to widen roads connecting the taluk headquarters and the district headquarters in the next 10 years. The government will spend Rs. 3,200 million in fiscal 2022 to widen roads to two-lanes and four-lanes to facilitate free movement of traffic.
- In September 2021, the state government announced that the 144-km Coimbatore metro rail project will be completed at a cost of Rs 63,000 million through Coimbatore Trichy Road, Avinashi Road, Sathyamangalam Road, Mettupalayam Road, and Corporation Roads
- In February 2021, Prime Minister Narendra Modi flagged off the Chennai Metro Rail Phase-1 extension from Washermanpet to Wimco Nagar, built at a cost of Rs 37,700 million. The 9.05-kms extension of the Chennai Metro will connect North Chennai with the airport and Chennai Central Railway Station. He also inaugurated the fourth railway line between Chennai Beach and Attipattu. The 22.1-km stretch, constructed at a cost of Rs 2,930 million, passes through Chennai and Thiruvallur districts
- The government has proposed the Tamil Nadu Urban Flagship Investment Programme to support the state in developing urban and environmental infrastructure. The programme will cost of Rs 81,560 million and will be financed with assistance from the Asian Development Bank. Further, 179 projects worth Rs 8,600,000 million relating to Tamil Nadu have been included in the National Infrastructure Pipeline. These projects will be implemented over the next five years (2020-25)
- Comprehensive Road Infrastructure Development Programme (CRIDP) is a flagship scheme to upgrade road infrastructure in the state. Under the Union Budget 2020-21, Rs 55,000 million has been allocated to this scheme

Employment

- The Tamil Nadu Government in July 2022 has signed 60 MoUs to bring in a cumulative investment worth Rs. 1,250,000 million and offer 74,898 jobs. In the last one year, the State had attracted investment worth Rs.2,200,000 million (from 192 MoUs signed)
- Tamil Nadu organised its second Global Investor Meet on January 23 and 24, 2019. The state surpassed the targeted investment and attracted Rs 3,400,000 million investment in 12 sectors, including automobile, textiles, and renewable energy. 146 MoUs were signed to generate 1.05 million job opportunities

Social

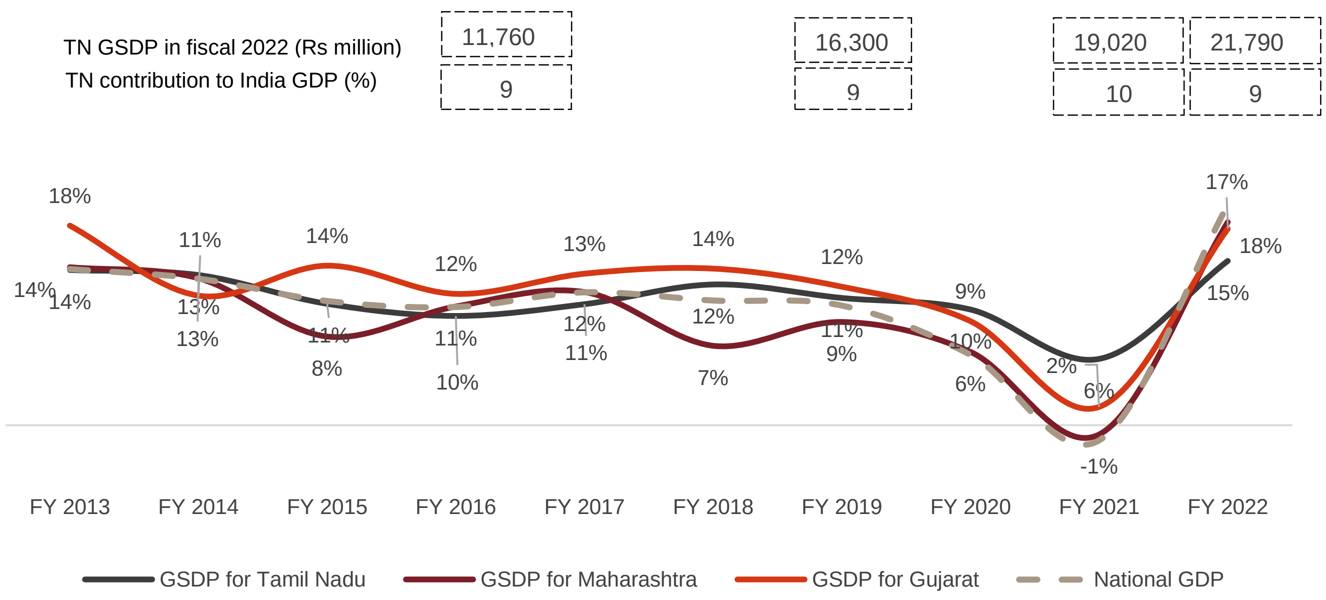
- In May 2022, M Madhiventhan, the State Tourism Minister, made a bunch of tourism-related announcements:
- Construction of a Spiritual and Cultural Eco- Park on the East Coast Road, in collaboration with the Department of Hindu Religious and Charitable Endowments Department (HR and CE) for Rs 15 million

- Every year, in partnership with the state horticulture department, a summer festival including flower, fruit, vegetable, and palm goods exhibition and show would be held in Chennai for Rs 2.50 million
- In Chengalpattu, the Poondi reservoir and the Kolavai Lake will be developed as a tourist destination with activities, including water sports, boat rides, adventure activities, and bird watching decks
- The Asian Development Bank-assisted Tourism Development Project is currently under implementation and a sum of Rs. 908.5 million ($12.89 million) has been provided in the Budget Estimates of 2020-21.
- Tamil Nadu ranked second in terms of foreign tourist arrivals and first in terms of domestic tourist arrivals in 2020. The foreign tourist arrivals reached 1.23 million, while domestic tourist arrivals were 140.65 million.

Tamil Nadu ranks second after Maharashtra in GSDP

Tamil Nadu's GSDP contribution to national GDP was reported to be ~9% in fiscal 2022, after growing at 15% in fiscal 2022. The state has consistently ranked second after Maharashtra in GSDP, supported by steady performance of all three sectors — primary, secondary, and services. The primary sector grew 12% in fiscal 2022, and services 15% (which included real estate). The secondary sector grew 15%; its two key components manufacturing, and construction grew 15% each. The state's GSDP increased at a CAGR of 11% over fiscals 2017-22.This exceeded the national GDP CAGR, which rose at a CAGR of 9% over the same period. During the same period, Gujarat reported 11% growth and Maharashtra reported 8% growth.

Tamil Nadu's GSDP has seen a steady growth (at current prices)

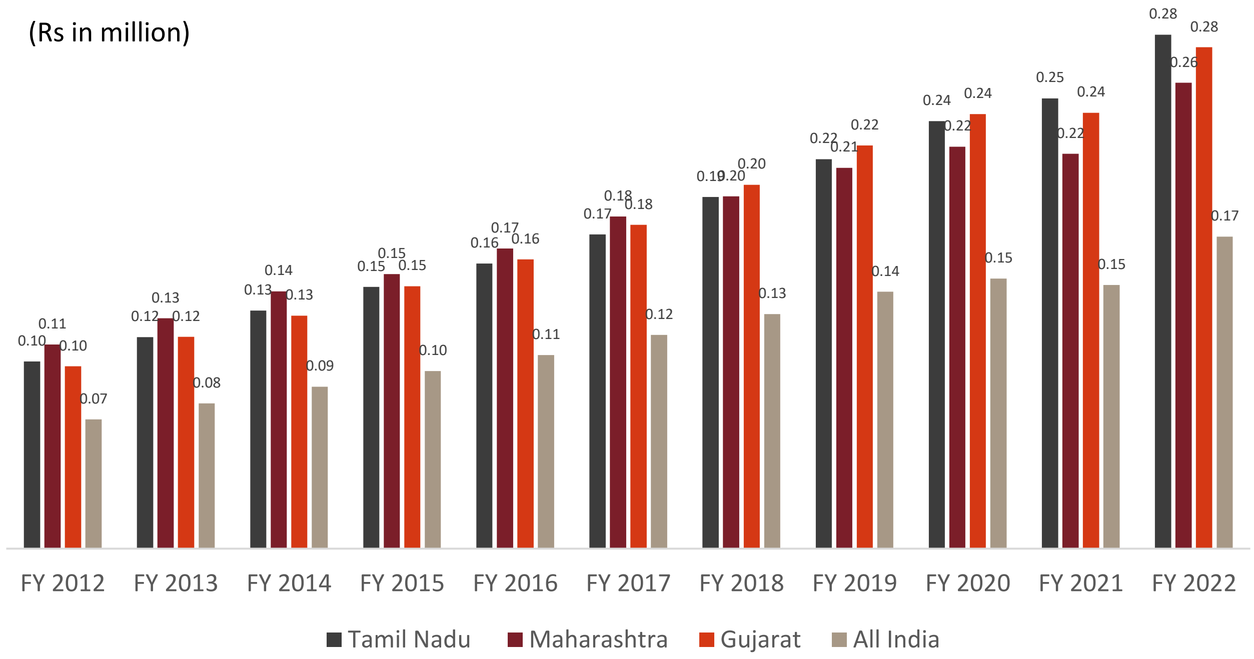


Source: MoSPI, CRISIL Research

With growing GSDP, per capita income also grew steadily (at current prices)

The state's per capita income has been increasing since fiscal 2012. Despite a decline in overall GSDP in fiscal 2021, Tamil Nadu's GSDP and per capita income increased. In fact, its GSDP increase was higher compared with Maharashtra and Gujarat in fiscal 2021. Slower population growth rate and increasing GSDP contributed significantly to the state's higher per capita income compared with all-India figures. In fiscal 2022, Tamil Nadu's per capital GSDP grew at 14%. The growth momentum has sustained, albeit slower compared with all-India growth, which was at 18%.

Tamil Nadu has the highest per capita GDSP at current prices among industrialised states



Source: MOSPI, CRISIL Research

Banking in Tamil Nadu

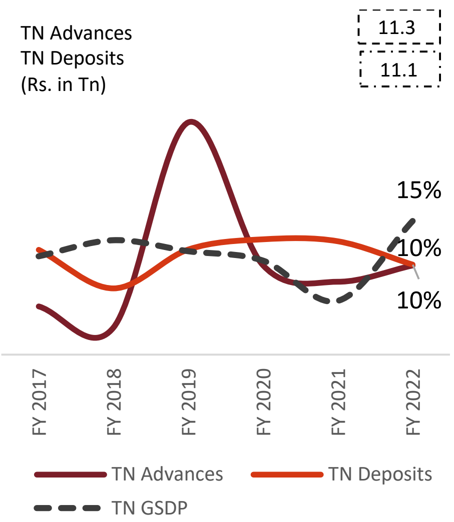
Increased savings has a direct impact on lending capabilities and overall GDP growth

Increased deposits with banks act a low-cost source of funds for the bank's lending activities. This allows the bank to charge a comparatively low rate of Interest, and hence, passing on cost benefit to the borrower. This borrowing allows businesses to borrow for growth and expansion, thereby boosting economic growth and GDP.

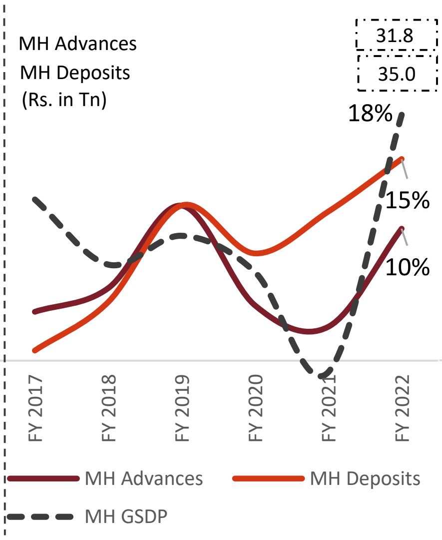
There appears to be a positive correlation between GDP, advances and deposits for the state. Tamil Nadu's and Gujarat's deposits increased at 10% and 9% respectively in fiscal 2022, whereas Maharashtra's growth was 600 bps higher at 15%. In terms of advances growth in fiscal 2022, Gujarat displayed highest growth, i.e.,12%, followed by Tamil Nadu and Maharashtra which grew at 10% each.

Advances and deposits growth mirrors the GSDP trend till fiscal 2021

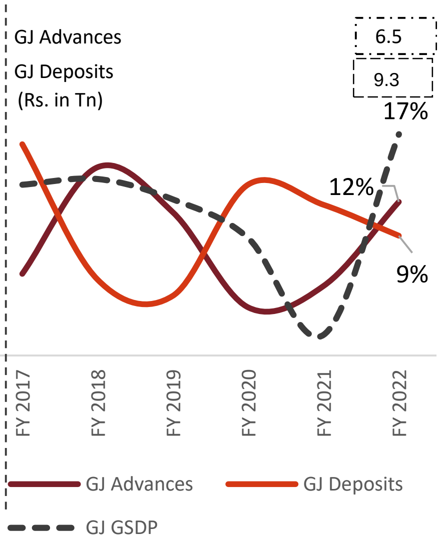
Tamil Nadu Advances and Deposits growth



Maharashtra Advances and Deposits growth



Gujarat Advances and Deposits growth

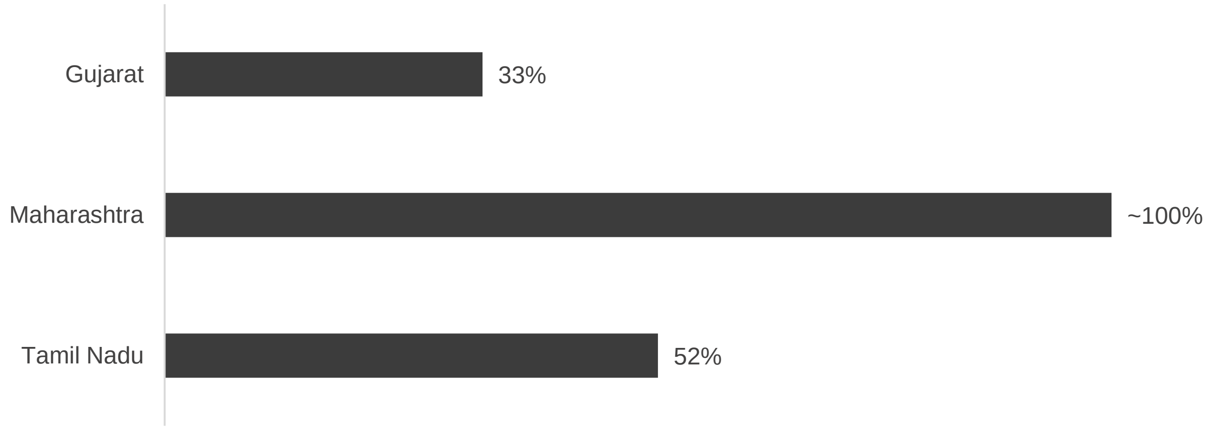


Source: MoSPI, CRISIL Research

Lower bank credit-to-GDP ratio indicates potential for further lending in the state

Tamil Nadu is under-penetrated, which presents an opportunity for further growth in GDP funded by bank loans. Its bank credit to GDP stood at 52% compared with ~100% in case Maharashtra and 33% for Gujarat during fiscal 2022.

Bank credit-to-GDP as a % for the top industrialised states as of fiscal 2022 (Current GSDP)

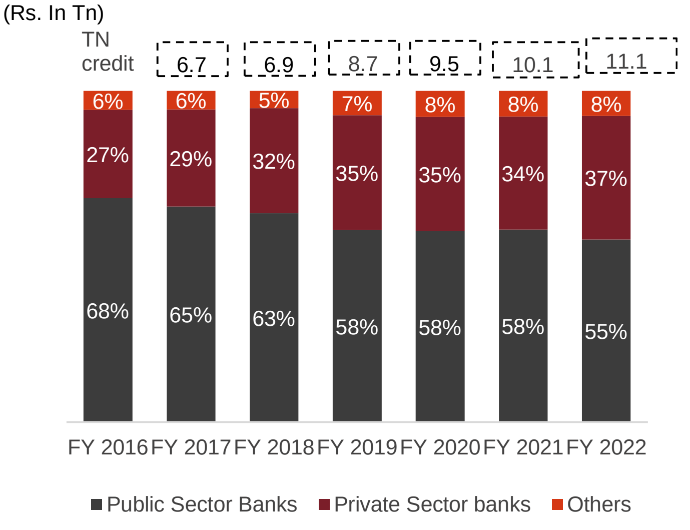


Source: RBI

Public sector banks dominate the state's lending portfolio

Tamil Nadu's bank credit had been increasing at a faster pace compared with All India Credit till fiscal 2021. In fiscal 2022, the state's bank credit increased 10% as against All India Credit, which rose 11%. Public sector banks accounted for 55% of total funding; down from 68% in fiscal 2016. On the other hand, private banks have been gaining share.

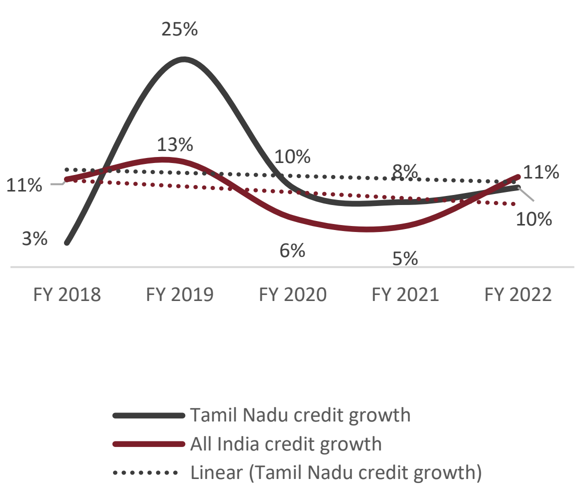
Public banks contribute majority in Tamil Nadu's lending mix



Note: Others include foreign and small finance banks

Source: RBI

Average growth over the last 5 years is in line with all India credit



Source: RBI

In fiscal 2022, retail (housing, vehicle, education and other personal loans) accounted for ~25% of the overall credit, followed by industry (24%), agriculture (21%), and services (17%). By sector, credit to agriculture has grown at a robust rate thanks to various government initiatives and schemes. Notably, growth has been higher compared with the all-India growth in agricultural credit. Retail has also been growing at a steady rate.

Segmental share in credit

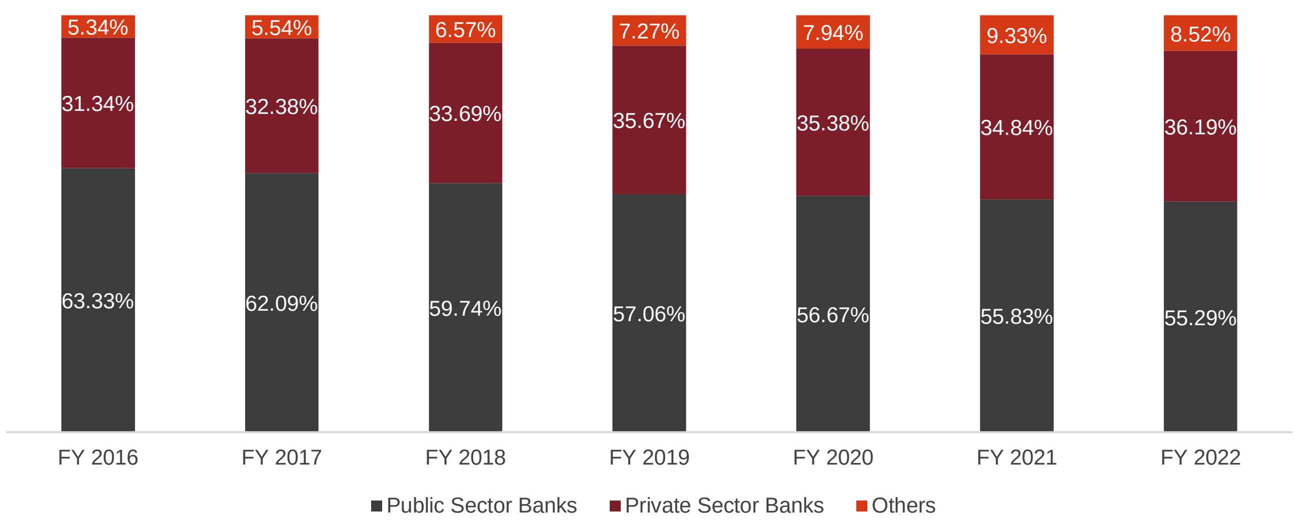
	Tamil Nadu			All India		
	Mar-20	Mar-21	Mar-22	Mar-20	Mar-21	Mar-22
Agriculture	**18.11%**	**20.85%**	**21.35%**	**11.51%**	**12.00%**	**12.26%**
Industry	**26.67%**	**24.27%**	**23.58%**	**31.46%**	**28.86%**	**27.31%**
Services	**18.35%**	**17.66%**	**17.37%**	**20.30%**	**20.33%**	**19.21%**
Transport operators	2.27%	1.84%	1.62%	2.18%	2.13%	1.90%
Professional and other services	6.21%	5.66%	5.26%	7.90%	7.42%	7.14%
Trade	9.88%	10.16%	10.49%	10.22%	10.78%	10.17%
Retail	**24.03%**	**25.14%**	**25.00%**	**24.35%**	**26.29%**	**27.67%**
Housing	11.10%	11.56%	11.50%	12.88%	13.77%	14.13%
Vehicle	1.94%	2.06%	2.04%	2.53%	2.92%	3.07%
Education	1.67%	1.48%	1.33%	0.79%	0.73%	0.71%
Personal credit cards	1.88%	1.72%	1.62%	1.25%	1.28%	1.33%
Other personal loans	7.38%	8.24%	8.41%	6.79%	7.45%	8.21%
Others	**12.84%**	**12.08%**	**12.70%**	**12.38%**	**12.52%**	**13.55%**

Source: RBI

Mirroring the trend of advances, public sector holds majority share in deposits as well, though reducing every year

Deposits with banks in Tamil Nadu rose increase of 11% in fiscal 2022 over fiscal 2021. Public sector banks hold the majority share (~55%) at present, though private banks have been gaining share over the past few years because of the attractive rate of interest offered by them.

Public sector banks hold the majority of deposits



Note: Others include foreign banks, regional rural banks and small finance banks

Source: RBI

Company profile and peer comparison

Business profile

Tamilnad Mercantile Bank Limited (TMB) is a bank headquartered at Thoothukudi (Tamil Nadu, India). It is one of the oldest and leading old private sector banks in India, with a history of close to 100 years. The bank reported deposits of Rs 4,49,300 million and advances of Rs 3,34,900 million as of March 2022.

During fiscals 2020-22, TMB's deposits increased at a healthy CAGR of 10.46% (compared with peer median:7.90%), falls in top five amongst its peers; while its advances increased at a CAGR of 9.93% (compared with peer median: 8.00%). The company's current account and savings account deposits to total deposits are also competitive among peers at 30.50%.

TMBs net profits increased at a CAGR of 41.99% during fiscal 2020-22, with the bank reporting second highest net profit at Rs. 8,200 million during fiscal 2022 amongst the peers

Peer comparison for advances and deposits

Parameters (FY22)	Tamilnad Mercentile Bank	City Union Bank	Catholic Syrian bank	DCB	Federal Bank	Karur Vysya Bank	Karnataka Bank	RBL Bank	South Indian Bank
Deposits (Rs Million)	4,49,331	4,76,897	2,01,883	3,46,917	18,17,006	6,86,763	8,03,868	7,90,065	8,91,421
CASA/Total deposits	30.50%	32.56%	33.66%	26.75%	36.94%	34.81%	33.00%	35.29%	33.21%
Advances (Rs Million)	3,34,915	4,03,585	1,58,147	2,90,958	14,49,283	5,53,346	5,67,831	6,00,218	5,99,934
Deposits CAGR FY20-22	10.46%	8.07%	13.07%	6.88%	9.23%	7.82%	5.82%	16.90%	3.61%
Advances CAGR FY20-22	9.93%	9.07%	17.96%	7.14%	8.87%	9.56%	-0.2%	1.71%	-3.51%
Net profit (Rs Million)	8,219.09	7,601.65	4,584.90	2,875.10	18,898.20	6,732.70	5,086.10	-747.40	449.80
Net profit CAGR FY20-22	41.99%	26.30%	not meaningful	-7.76%	10.68%	69.25%	-6.62%	not meaningful	-34.42%

Note: CASA – Current account and savings accounts
Note: All the financials are on standalone basis
Peers in the industry report includes all listed Old private sector bank with total business size of at least Rs. 2,00,000 million
Source: Company reports, CRISIL Research

TMB currently offers competitive interest rates in most time buckets for term deposits. Even in savings accounts, TMB offers competitive interest rate.

Fixed deposit rate comparison (as of July2022) (for general public, below Rs 20 million)

Time bucket	Tamilnad Mercentile Bank	City Union Bank	Catholic Syrian bank	DCB	Federal Bank	Karur Vysya Bank	Karnataka a Bank	RBL Bank	South Indian Bank
7-14 days	2.75%	4.00%	3.00%	4.80%	2.75%	3.25%	3.40%	3.25%	2.65%
15-30 days	3.50%	4.10%	3.00%	4.80%	2.75%	3.25%	3.40%	3.75%	2.65%
31-45 days	3.50%	4.10%	3.00%	4.80%	3.25%	3.25%	3.40%	3.75%	3.25%
46-90 days	3.75%	4.15%	3.00%	4.80%	3.75%	3.50%	4.90%	4.00%	3.25%
91-120 days	4.50%	4.20%	3.50%	5.50%	4.00%	3.75%	5.00%	4.50%	4.10%
121-180 days	4.50%	4.20%	3.50%	5.50%	4.25%	4.00%	5.00%	4.50%	4.10%
181-270 days	5.00%	4.25%	4.25%	5.70%	4.60%	4.75%	5.00%	5.00%	4.40%
271-less than 1 year	5.00%	4.75%	4.25%	5.70%	4.75%	5.00%	5.00%	5.25%	4.75%
1 year to less than 2 years	5.40%	5.25%	5.50%	5.75%	5.60%	5.55%	5.35%	6.25%	5.30%
2 years to less than 3 years	5.60%	5.30%	5.75%	6.60%	5.75%	5.60%	5.50%	6.50%	5.30%
3 years to less than 5 years	5.60%	5.25%	5.75%	6.60%	5.75%	5.60%	5.50%	6.30%	5.50%
5 years and above	5.60%	5.25%	6.00%	6.60%	5.75%	6.00%	5.50%	5.75%	5.80%

Note: Peers in the industry report includes all listed old private sector bank with total business size of at least Rs 2,00,000 million

Source: Company report, CRISIL Research

Financial profile

NIMs for TMB improved from 3.80% in fiscal 2021 to 4.10% in fiscal 2022 i.e., by 30 bps due to reduction in cost borrowings by 60 bps. This was on account of RBI maintaining accommodative stance for policy rates. The yields on the other hand, fell by meagre 20 bps, resulting in improved NIMs. The bank reported low cost-to-income ratio of 42.12% compared with 52.90% for its peers (median). During fiscal 2022, TMB reported 17.70% in net profit margin, which was the highest among its peers.

Operating profitability of TMB and its peers

Parameters (FY22)	Tamilnad Mercentile Bank	City Union Bank	Catholic Syrian bank	DCB	Federal Bank	Karur Vysya Bank	Karnataka a Bank	RBL	South Indian Bank
Yield on advances	9.45%	9.36%	11.21%	10.71%	7.92%	8.47%	8.84%	12.22%	8.73%
Cost of deposits	4.91%	4.68%	4.31%	6.05%	4.28%	4.30%	4.66%	4.81%	4.75%
Net interest margins	4.10%	3.98%	5.27%	3.56%	3.16%	3.69%	3.18%	4.40%	2.62%
Cost-to-income	42.12%	40.37%	50.51%	55.40%	59.89%	53.20%	52.57%	56.90%	64.10%
Net profit margin	17.65%	15.62%	17.60%	7.30%	12.00%	10.60%	7.21%	-0.10%	0.10%

Note: Peers in the industry report include all listed old private sector banks with Total Business size of at least Rs 2,00,000 million

Note: All the financials are on standalone basis

Yield on advances: Interest earned on advances in current year / average (current year advances, previous year advances)

Cost of deposits: Interest expense on deposits in current year / average (current year deposits, previous year deposits)

Net interest margin: Net interest income in current year / average (current year interest earning assets excluding gross NPA, previous year interest earning assets excluding gross NPA)

Cost-to-income: Operating expenses in current year / (total income – interest expense) in current year

Net profit margin: Profit after tax in current year / total income in current year

Source: Company reports, CRISIL Research

In fiscal 2022, TMB also reported a comparatively low credit cost ratio of 0.27%. The company's return on assets (RoA) was at 1.66% compared with peers that have a median RoA of 0.80%. The trend is similar in the Return on Equity ratio, where the company outperformed peers at 16.58% in fiscal 2022, while its peers reported a median of 8.30%. TMB is also well-capitalised with a tier-1 capital adequacy ratio of 20.44%.

Profitability of TMB and its peers

Parameters (FY22)	Tamilnad Mercentile Bank	City Union Bank	Catholic Syrian bank	DCB	Federal Bank	Karur Vysya Bank	Karnataka Bank	RBL	South Indian Bank
Credit costs/total assets	0.27%	1.00%	0.30%	0.91%	0.50%	0.90%	0.90%	2.70%	1.30%
Credit costs/total assets (FY20-22 avg)	0.68%	1.30%	0.60%	0.90%	0.70%	1.40%	1.30%	2.50%	1.50%
Return on assets	1.66%	1.32%	1.88%	0.68%	0.89%	0.87%	0.57%	-0.07%	0.05%
Return on assets (FY20-22 avg)	1.32%	1.16%	1.00%	0.82%	0.88%	0.57%	0.62%	0.35%	0.07%
Return on equity	16.58%	12.23%	18.98%	7.37%	10.82%	9.25%	7.40%	-0.59%	0.77%
Return on equity (FY20-22 avg)	13.17%	10.76%	10.28%	9.44%	10.79%	6.05%	9.05%	3.16%	1.33%
Tier-1 capital adequacy ratio	20.44%	19.80%	24.40%	15.80%	14.40%	17.50%	12.70%	16.20%	13.20%

Note: Peers in the industry report includes all listed Old Private Sector Bank with Total Business size of at least Rs 2,00,000 million

Note: All the financials are on standalone basis

Source: Company reports, CRISIL Research

In fiscal 2022, TMB reported a low GNPA of 1.69% compared with 4.40% for its peers (median). Its NNPA is also comparatively low at 0.95%, while its peers clocked a median of 2.10%. At 87.92%, the bank also had the second-highest provision coverage ratio among peers.

Asset quality and PCR of TMB and its peers

Parameters (FY22)	Tamilnad Mercentile Bank	City Union Bank	Catholic Syrian bank	DCB	Federal Bank	Karur Vysya Bank	Karnataka Bank	RBL Bank	South Indian Bank
Gross non-performing assets (GNPA) (Rs. Million)	5,709.23	19,331.80	2,895.10	12,899.30	41,367.40	34,310.40	22,508.20	27,283.90	36,480.90
GNPA	1.69%	4.70%	1.81%	4.32%	2.80%	5.96%	3.90%	4.40%	5.90%
Net non-performing assets (NNPA) (Rs. Million)	3,175.80	11,911.00	1,070.00	5,732.30	13,926.20	12,607.90	13,769.70	8,065.60	17,777.70
NNPA	0.95%	2.95%	0.68%	1.97%	0.96%	2.28%	2.42%	1.34%	2.97%
Provision coverage ratio (PCR)	87.92%	64.00%	89.70%	67.84%	65.54%	80.27%	73.47%	70.40%	69.55%

Note: Peers in the industry report includes all listed old private sector bank with total business size of at least Rs. 2,00,000 million

Note: All the financials are on standalone basis

Source: Company reports, CRISIL Research

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CRISIL expresses no opinion on the achievability of the forecasts given to it. The assumptions used in their preparation, as CRISIL has been explained, are based on the management's present expectation of both - the most likely set of future business events and circumstances, and the management's course of action related to them. It is usually the case that some events and circumstances do not occur as expected or are not anticipated. Therefore, actual results during the forecast period may differ from the forecast and such differences may be material.

No investigation of the company's claim to title of assets has been made for the purpose of this valuation and the company's claim to such rights has been assumed to be valid. No consideration has been given to liens or encumbrances against the assets, beyond the loans disclosed in the accounts. Therefore, no responsibility is assumed for matters of a legal nature. The fee for the report is not contingent upon the results reported.