CRISIL
Ratings

# Rating Rationale

June 16, 2023 | Mumbai

# Tamilnad Mercantile Bank Limited

*'CRISIL A+/Stable' assigned to Fixed Deposits; 'CRISIL A1+' assigned to Short Term Fixed Deposits*

**Rating Action**

| | |
|---|---|
| **Rs.15000 Crore Fixed Deposits** | **CRISIL A+/Stable (Assigned)** |
| **Rs.25000 Crore Short Term Fixed Deposits** | **CRISIL A1+ (Assigned)** |
| **Rs.1000 Crore Certificate of Deposits** | **CRISIL A1+ (Reaffirmed)** |

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

**Detailed Rationale**

CRISIL Ratings has assigned its '**CRISIL A+/Stable/CRISIL A1+**' ratings to Rs.15,000 crore fixed deposits and Rs.25000 crore short term fixed deposits of Tamilnad Mercantile Bank Limited (TMB) and reaffirmed its 'CRISIL A1+' rating on the certificates of deposits.

The ratings on FD programmes of banks factor in better access to systemic liquidity, in the form of access to call money markets and the liquidity adjustment facility of the Reserve Bank of India (RBI). Such external liquidity support, the RBI's oversight over banks and the deposit guarantees up to a certain quantum provided by the Deposit Insurance and Credit Guarantee Corporation (DICGC) instill confidence among depositors and will reduce the probability of a run on deposits in case of any downside rating action on the long-term rating on the bank. Moreover, banks enjoy systemic support as indicated by the demonstrated track record of the regulator stepping in to safeguard the interests of depositors.

The fixed deposit ratings on TMB also factors in the granularity of the deposit base with the top 30 depositors constituting around 9.0% of deposit base as on March 31, 2023; comfortable roll over rates of around 43% and the staggered maturity profile of deposits.

The rating continues to reflect the bank's adequate capitalisation, moderate asset quality and above-average profitability. These strengths are partially offset by small scale of operations, high geographic concentration, average resource profile and exposure to risks arising from an ownership dispute.

**Analytical Approach**

CRISIL Ratings has considered the standalone business and financial risk profiles of TMB

**Key Rating Drivers & Detailed Description**

**Strengths:**

*** Adequate capitalisation**

The banks' capital profile remained comfortable with its Tier I and overall CARs at 24.6% and 26.3% respectively as on March 31, 2023, well above 12%. In fiscal 2023, the bank opened its IPO with fresh issuance of Rs 807.8 crore in September 2022. This boosted networth from Rs 5,336 crore as on March 31, 2022, to Rs 6,928 crore as on March 31, 2023. The networth coverage for net NPAs stood at 30.1 times as on March 31, 2023, as against 16.8 times as on March 31, 2022.

*** Moderate asset quality**

Asset quality has improved after being impacted owing to the Covid-19 pandemic that disrupted cash flows of borrowers. The reported gross NPAs (GNPAs) stood at 1.4% as on March 31, 2023, as against 3.1% as on December 31, 2021. The improvement was primarily owing to regional recovery focusing on recovering dues as business activity opened up and the cash flows of customers improved. The bank has also been able to leverage its relationship with customers for recovering the dues. The GNPAs are expected to remain at similar levels in the near term.

Overall restructured advances stood at 2.1% of total advances as on March 31, 2023. Since fiscal 2018, the bank started focusing on MSME, retail and gold advances. The bank's underwriting process now focuses on the MSME and small business segments in Madurai, Sivakasi, Thoothukudi and other regions in Tamil Nadu. This lending is largely done to small textile, construction, manufacturing, food and beverages units. The overall loan book comprised MSME loans (35-37%) followed by agriculture loans (29-31%) and retail loans (22-25%) as on March 31, 2023. These loans are largely backed by good quality collateral. While the overall composition for corporate advances fell to 12.8% as on March 31, 2023, from 13.4% as on September 30, 2022, that for the other asset classes have improved significantly.

Nevertheless, asset quality will remain exposed to inherent political, social, economic and environmental risks on account of exposure to small borrowers and the same remains a key monitorable.

*** Above-average profitability**
The overall profitability of the bank remains comfortable. It has been supported by overall NIM of 3.1-3.4% over the past several fiscals with improvement seen during previous two fiscals to around 3.6-4.0%. In addition, the operating costs of the bank has remained low at an average of around 2.1% over the past five fiscals. Hence, the 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.

However, in the past, the overall earnings profile was constrained due to elevated credit costs. The credit costs had peaked at 1.6% during the pandemic which had resulted in the ROAs dropping to 0.9% for fiscal 2021. Nevertheless, with the improvement in the credit costs (0.3% for fiscal 2023), the earnings profile has also improved with ROA at 1.9% for fiscal 2023. The bank maintains a PCR of 40-55% on a steady-state basis (55.9% as on March 31, 2023) and this is expected to be adequate for the MSME and retail asset classes, wherein a significant amount of the banks' exposure is backed by collateral and can be recovered by selling the underlying secured assets after the loans become substandard/doubtful assets.

**Weaknesses**
*** Average resource profile**
The deposit base stood at Rs 47,766.5 crore as on March 31, 2023. Further, CASA deposits ratio stood at 28.8% as on March 31, 2023, against 30.5% as on March 31, 2022. 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 in March 2020. Being already beefed up with high liquidity and low credit demand, the bank did not require large fixed deposits, as a result of which it lowered the rates on such deposits significantly during previous fiscals while maintaining the overall CASA offerings at competitive rates. This is in line with the overall deposit base of other old private sector banks, which have witnessed improvement in the CASA ratio during this period. Sustainability of the overall CASA percentage level on a growing business will be an overall indicator of an improved resource profile. The resource base largely consists of retail deposits with limited bulk deposits at 12.6% of the overall deposits as on March 31, 2023. 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 47,776.5 crore and Rs 37,582 crore, respectively, as on March 31, 2023. This forms around 0.3% of the entire banking industry market share. Operations remain concentrated in Tamil Nadu with 72.8% of the branches, 78.1% of the advances and 76.6% of the deposits based in the state. The focus is likely 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 a high concentration of MSME loans (35-37%) followed by agriculture loans (29-31%) and retail loans (22-25%). 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 in fiscal 2024.

* **Exposure to risks arising from the dispute over ownership**
The ownership dispute has been carrying on for the past several years. Although fiscal 2023 saw the bank holding its ninety-eighth, ninety-ninth and hundredth annual general meeting as well as the bank opening its 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.

**<u>Liquidity: Strong</u>**
The liquidity coverage ratio stood at 207.5% as on March 31, 2023. The bank maintains an excess statutory liquidity ratio (SLR) of 10-11% on a steady-state basis. As on March 31, 2023, the excess SLR ratio was around 10%.

**<u>Outlook: Stable</u>**
CRISIL Ratings believes TMB's capitalisation will remain adequate to meet its business growth and manage its asset-quality related risk.

**<u>Rating Sensitivity Factors</u>**
**Upward Factors**
- Overall GNPA is maintained at below 3% on a steady state basis
- The banks profitability is sustained at the current level

**Downward Factors**
- Decline in the CAR for tier 1 capital below 12.5%
- Significant increase in credit cost leading to decline in profitability

**<u>About the Bank</u>**
TMB is a small, private sector bank with an asset base of Rs 57,895 crore as on March 31, 2023. The bank was set up in 1921 by ten visionaries of the Nadar Community. Headquartered in Thoothukudi, TMB is largely present in south India with 530 branches as on March 31, 2023.

Gross advances and deposits were Rs 37,582 crore and Rs 47,766.5 crore, respectively, as on March 31, 2023. GNPAs improved to 1.4% as on March 31, 2023, from 3.1% as on December 31, 2021.

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

| Particulars | Unit | 2023 | 2022 | 2021 | 2020 | 2019 |
|---|---|---|---|---|---|---|
| Total assets | Rs crore | 57,895 | 52,858 | 47,527 | 42759 | 40,533 |
| Total income (net of interest expense) | Rs crore | 2,723 | 2638 | 2182 | 1846 | 1,640 |
| Profit after tax | Rs crore | 1029 | 832 | 603 | 408 | 259 |
| Gross NPA | % | 1.4 | 1.7 | 3.4 | 3.6 | 4.3 |
| Overall capital adequacy ratio | % | 26.3 | 22.1 | 18.9 | 16.7 | 16.2 |
| Return on assets | % | 1.9 | 1.5 | 0.9 | 0.8 | 0.7 |

**Any other information**: Not applicable

**Note on complexity levels of the rated instrument:**
CRISIL Ratings` complexity levels are assigned to various types of financial instruments and are included (where applicable) in the 'Annexure - Details of Instrument' in this Rating Rationale.

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**Annexure - Details of Instrument(s)**

| ISIN | Name of instrument | Date of allotment | Coupon rate (%) | Maturity date | Issue size (Rs.Crore) | Complexity level | Rating assigned with outlook |
|---|---|---|---|---|---|---|---|
| NA | Fixed Deposits | NA | NA | NA | 15,000 | Simple | CRISIL A+/Stable |
| NA | Short Term Fixed Deposits | NA | NA | 7-365 days | 25,000 | Simple | CRISIL A1+ |
| NA | Certificates of deposit | NA | NA | 7-365 days | 1000 | Simple | CRISIL A1+ |

**Annexure - Rating History for last 3 Years**

| | Current | | | 2023 (History) | | 2022 | | 2021 | | 2020 | | Start of 2020 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Instrument | Type | Outstanding Amount | Rating | Date | Rating | Date | Rating | Date | Rating | Date | Rating | Rating |
| Certificate of Deposits | ST | 1000.0 | CRISIL A1+ | 22-03-23 | CRISIL A1+ | 23-03-22 | CRISIL A1+ | 30-03-21 | CRISIL A1+ | 31-03-20 | CRISIL A1+ | CRISIL A1+ |
| Fixed Deposits | LT | 15000.0 | CRISIL A+/Stable | | -- | | -- | | -- | | -- | -- |
| Short Term Fixed Deposits | ST | 25000.0 | 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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