Dimensional Securities Pvt. Ltd.

JAMMU & KASHMIR BANK

Date : 16th March, 2015

Recommendation : Accumulate
CMP : 107
Target Price : 125

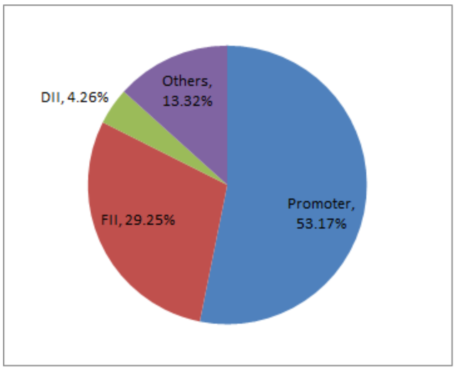
MARKET DATA

Fig. in ₹ (in Cr.) except Ratios	
Equity (Subscribed)	48
Reserve	6082
Price/Book Value Ratio	0.8
EPS-Unit Curr. (TTM)	11.2
Market Price (16/03/2015)	106.5
P/E Ratio (TTM)	9.5
52 Week High (16/05/2014)	199.5
52 Week Low (19/02/2015)	104.0
Market Capitalisation	5163

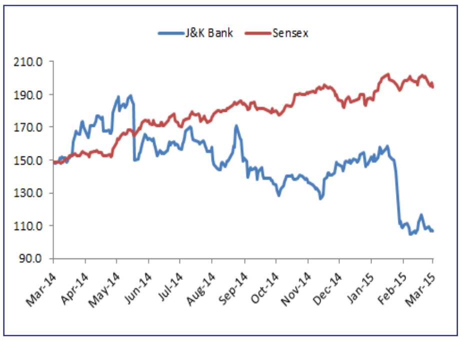
AVERAGE TURNOVER ('000)

BSE	565.8
NSE	1858.7

SHARE HOLDING PATTERN



ONE YEAR PRICE PERFORMANCE



Bunty Chawla (Research Analyst)
bunty.chawla@dimensional.in
91-22-66545231

Company Description:-

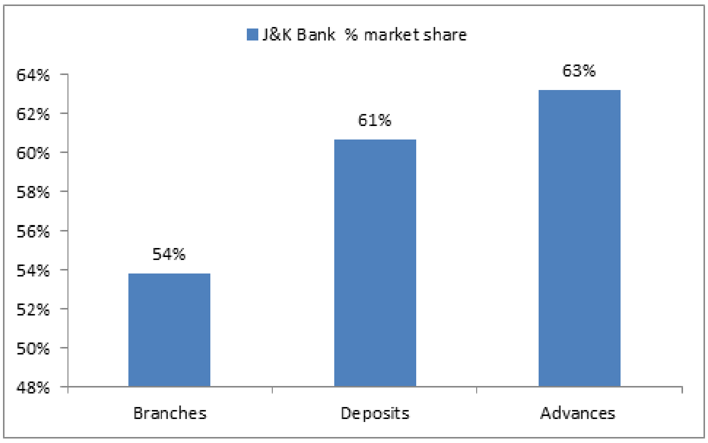
Jammu & Kashmir Bank (J&K Bank) is the only private sector bank appointed by RBI as its agent in the state of J&K to carry on the general banking business (collection of taxes) of the central government. Also, it is the only private sector bank with the state government's majority holding (53%). The Bank, incorporated in 1938, has a track record of uninterrupted profits and dividends for four decades. The bank came out with an IPO in 1998 of 1.8mn shares at ₹70 each (FV 10).

Investment Rationale:-

- **Market leadership in J&K state:**

  J&K Bank has the leadership in the state with a network of 659 branches which comprises ~54% of total branches and 719 ATMs. Also, it dominates the region with 63% market share in total advances and 61% market share in total deposits in the state as of end of September 2014.

  It has branches in every block in the state. Also, it has 7.5 mn account holders which represent 87% of adult population in the state. With deep penetration and dominant presence in the state, bank can fill up the credit gap. In FY14, J&K state accounted for 0.83% of India's GDP, and yet it absorbs only 0.33% of total national credit.

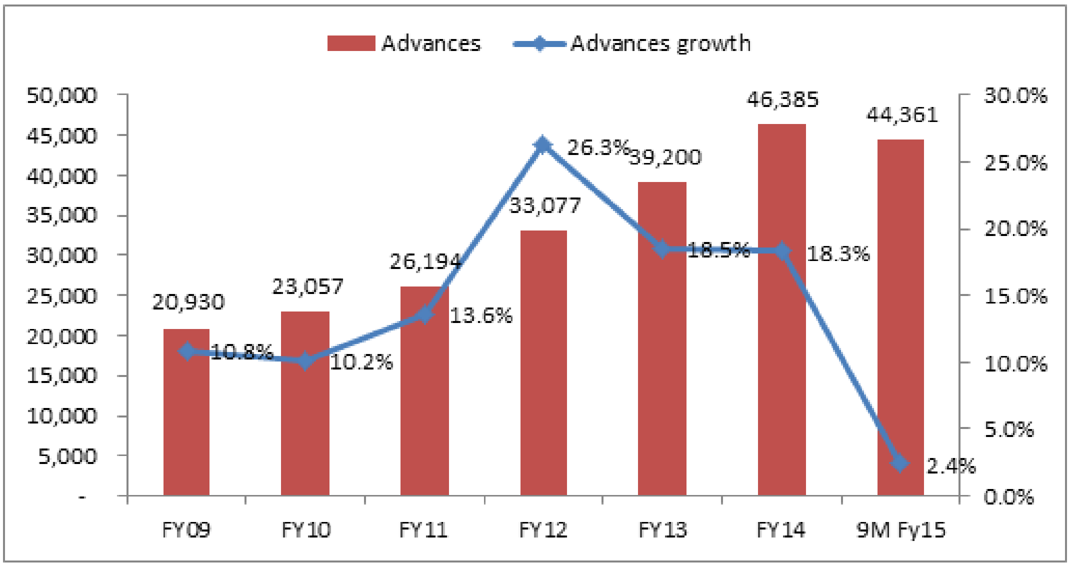


- **Business growth to improve in years ahead:**

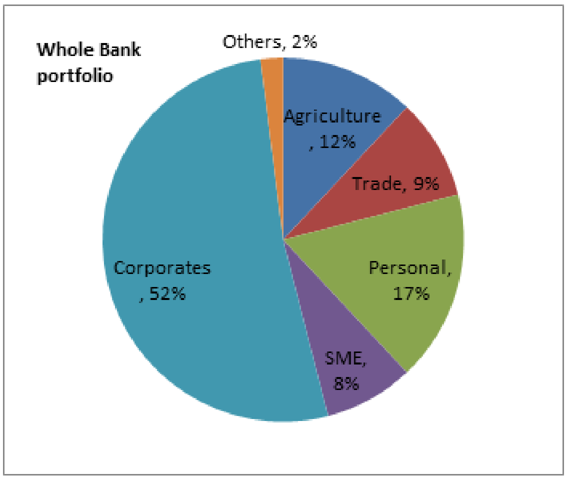
  J&K bank has reported loan growth at 17% CAGR over a 5 year period (FY09-14) with focus within the state of J&K. At the end of Q3 FY15, Loan book is split into 48% : 52% within J&K : outside J&K as against 40% :60% in FY12. Bank guided for 60% : 40% split within J&K : outside J&K in next 2-3 years. In 9M FY15, loan growth has been subdued due to macro-economic slowdown.

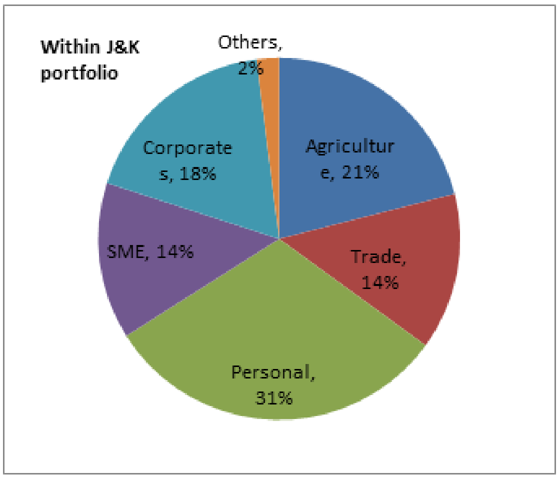
  We believe the bank has a niche presence and better understanding of operations in the state of J&K which differentiates it from other banks. We expect a higher credit growth going ahead as the credit off take is higher in J&K as it remains an underserved territory.

  Management has guided for loan growth of 25% within J&K led by infrastructure development and 12-15% outside J&K with improvement in GDP growth and pick up in the investment cycle.

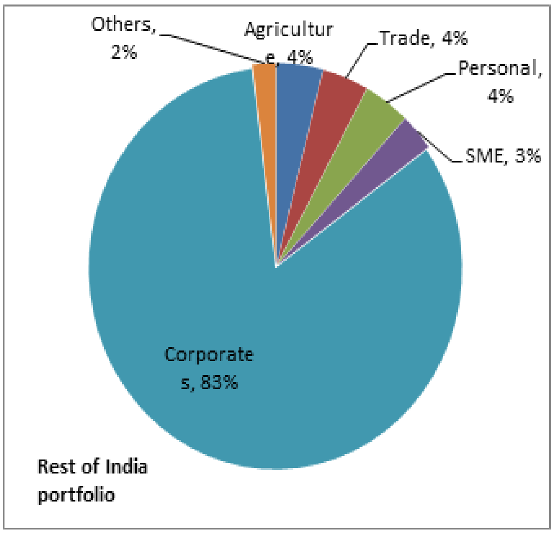


Bank's loan book is divided into J&K state and rest of India. Its loan book is diversified into Corporate, Personal, Agriculture, Trade, SME and others.



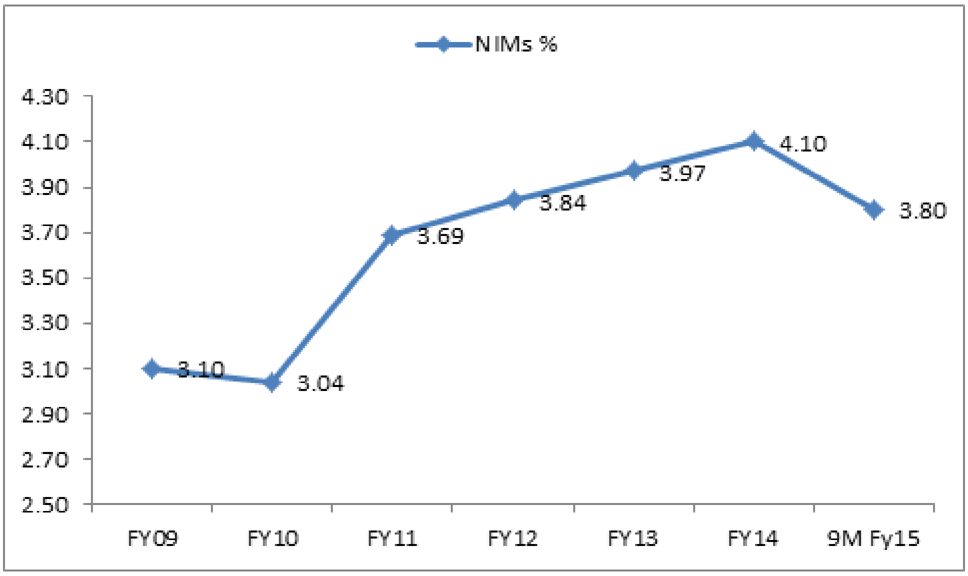


Sector	Type of Loans
Agriculture	Mostly food growers, predominantly fruit (apple) growers
Trade	Importer of food grains, poultry etc
Personal	Home loans, consumer durables, car and two-wheelers loans
SME	Handicrafts and allied activity, small to medium size exporters
Government	Overdraft facility and term loans
Corporates	Working capital loans (hotels, transport operators etc) & term loan facilities



- **Margins improvement over a period:**
  Strong deposit franchise and focus (increase lending) towards J&K state will support margins going ahead. Bank earns NIMs of 5.5 - 6% within the state and 2 - 2.5% outside the state. NIMs have improved from 3.1% in FY09 to 4.1% in FY14.

  Although due to interest reversal, NIMs have declined to 3.8% in 9M FY15. We believe with the improvement in asset quality in years ahead, margins should improve or remain stable.

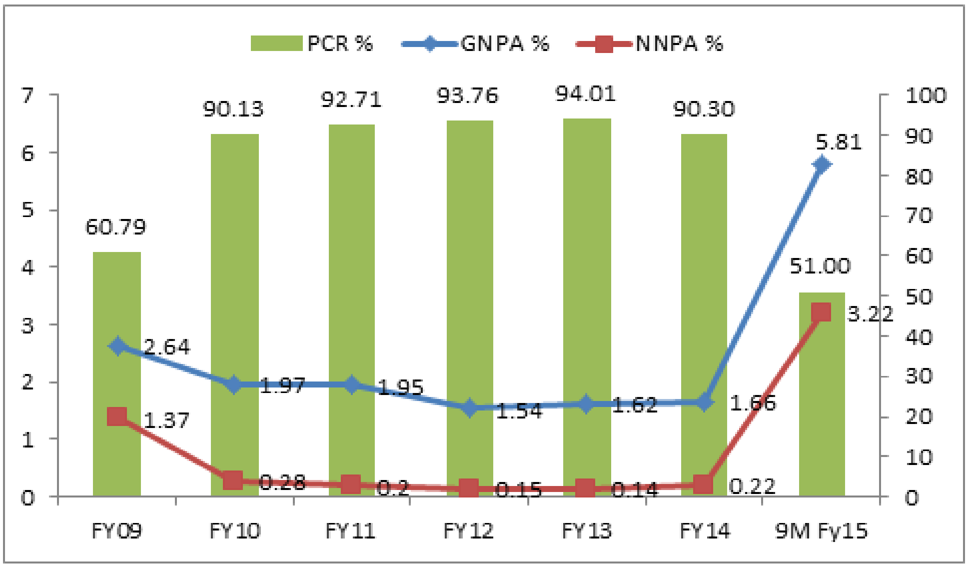


- **Asset quality better till FY14, impacted in FY15:**
  Till FY14, asset quality has improved or has been stable at net NPA of 0.2% due to best PCR in the industry at 90%. However, in 9M FY15, GNPA increased from 1.7% to 5.8% due to high slippages from the corporate group outside J&K state. Also, due to the floods in J&K state, restructured assets increased from 1575 cr in FY14 to 1804 cr in Q3 FY15. Also, PCR declined to 51% in FY15. Asset quality issue will remain for the next 2 quarters with exposure of Bhushan steel of ₹400 cr and restructuring related to the J&K floods remain at around ₹200-250 cr.

  Within J&K state, bank has major exposure towards personal loan (31%) which comprises of car loan and housing loan to the state and central government employees (holding salary accounts).

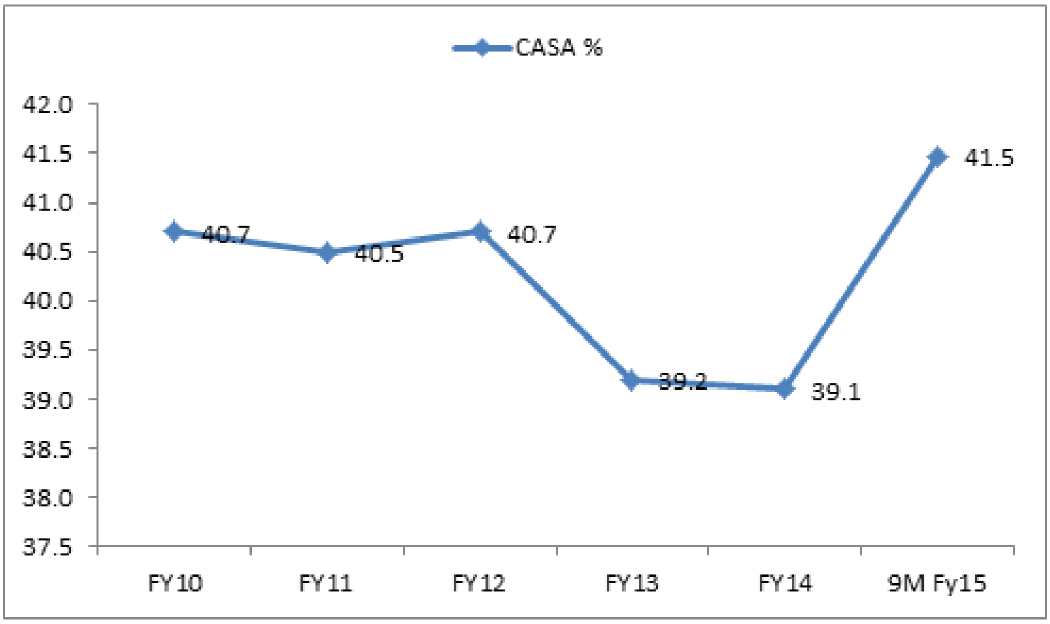
  Outside J&K state, bank has major exposure towards corporate (83%) which are top rated companies. Bank's policy is to lend only to AA & AAA rated Corporates outside J&K state at a relatively lower yields.

  We believe over a longer period horizon, asset quality should improve with economy uptick. Also, bank has not booked profit on sale of bonds till Q3 FY15, we expect profit booking will be utilized to improve the PCR in Q4 FY15.

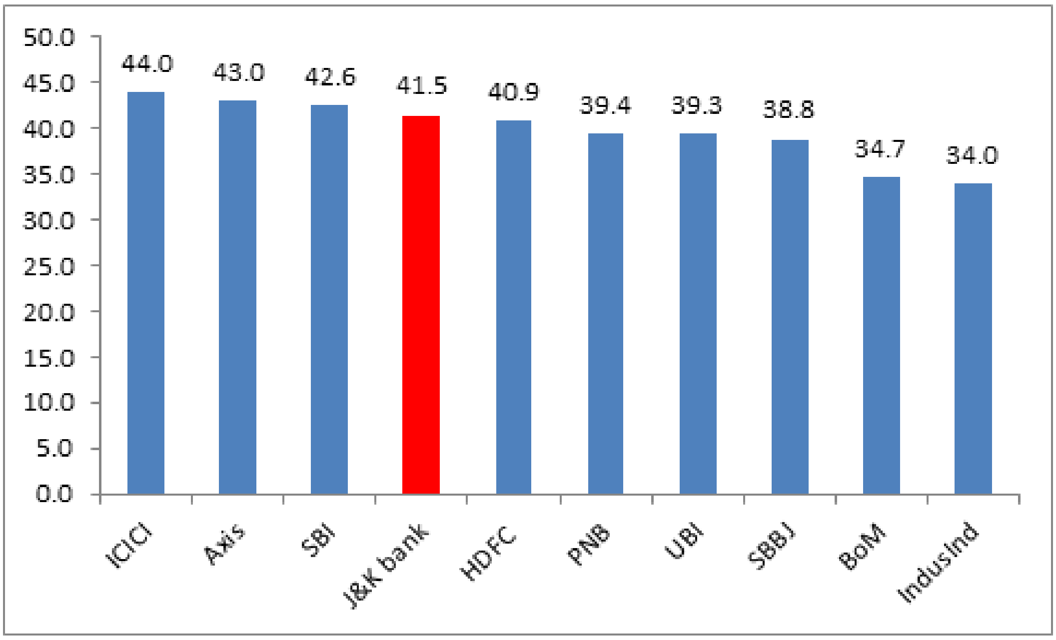


- **CASA ratio best among the banking industry:**

With 54% market share in total branches in the J&K state, bank has garnered high CASA deposits due to strong brand and better quality services within the state. The state accounts for 61% of total deposits, of which 52% are contributed by CASA deposits. Bank handles revenue and expenditure of the state government and holds salary accounts of state government employees as it is the banker to the state government. This has resulted in high CASA deposits.



Bank has CASA ratio of more than 40% which is among the top 10 banks in the banking industry. Also, due to leadership in J&K state, it has been able to manage high CASA ratio over a period.



➤ **Dividend yields better at CMP:**

Dividend payout historically has been more than 20% for the bank. Thus with expected FY15E EPS of ₹12.6, Dividend per share comes to 2.5 and Yield on CMP results in 2.3%

	FY10	FY11	FY12	FY13	FY14	FY15E
EPS	10.6	12.7	16.6	21.8	24.4	12.6
DPS	2.2	2.6	3.4	5.0	5.0	2.5
Payout %	20.8%	20.5%	20.5%	22.9%	20.5%	20%
Yield %	3.2%	3.0%	3.7%	4.2%	3.2%	2.3%

➤ **CAR adequate at 12.8% with Tier I at 11.4%**

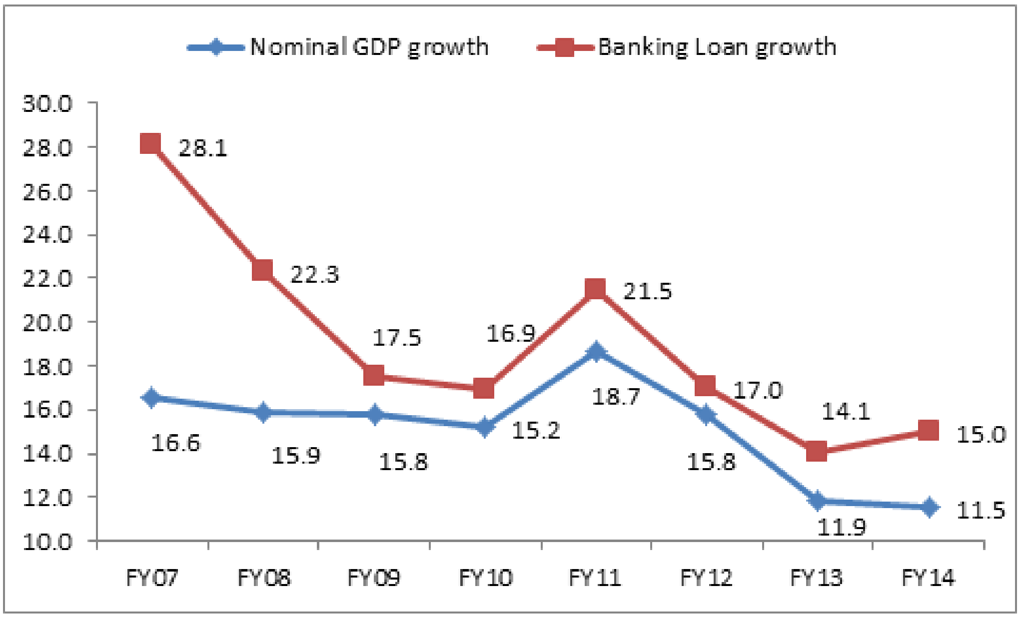
Bank is adequately capitalized with tier I at 11.4% thus with improvement in GDP growth in rest of India and business improvement in J&K state along with establishment of government formation, it can grow at better pace than the industry. Also, the bank has not raised any equity capital in last decade along with better return on equity of 22-23%

Industry View:-

RBI has cut the repo and reverse repo by 25bps each outside the policy on 15th Jan and 4th March 2015. However, all the PSU and private banks have not passed on the benefit by decreasing the base rates by 25-50bps. We expect the banks to be pressured into reducing the rates going ahead, as the deposit costs have been reduced due to decline in deposit rates. We anticipate a better credit growth owing to decrease in deposit rates. We believe the private banks will be able to report better credit growth than the industry average as these are adequately capitalized, the working capital demand in the industry remains and overall the consumption remains better.

In the RBI policy dated 4th March 2015, the reasons for the rate cut were A) Inflationary pressures (measured by changes in the consumer price index) have been easing, since July 2014. B) Also, the path of inflation, while below the expected trajectory, has been consistent. C) Inflation has been lower than expected due to sharp decline in prices of vegetables and fruits since September 2014 and has receded pressures in respect of cereals and the large fall in international commodity prices, particularly crude oil. Although the concerns on increasing food prices domestically due to supply side issues still prevail.

During 9M FY15 the system credit growth was 10.4% YoY as against 14.4% YoY as compared to the same period last year. We expect the pace of credit growth to improve going ahead as the decline in rate will boost credit growth momentum. We also expect a better growth in segments like Infrastructure, power and housing finance where the governments focus is higher.



Dimensional Securities Pvt. Ltd.

Financial Performance: -

Amount (₹ in Cr.)

Particulars	Dec-14	Dec-13	% YoY	Sep-14	%QoQ	9M FY15	9M FY14	% YoY
Interest Income	1,750	1,716	2%	1,799	-3%	5,316	4,989	7%
Interest Expenses	1,111	1,069	4%	1,107	0%	3,348	3,006	11%
Net Interest Income	639	647	-1%	692	-8%	1,968	1,983	-1%
Other Income	100	88	14%	85	18%	315	279	13%
Fee Income	53	49	6%	45	18%	143	146	-2%
Total Income	739	734	1%	777	-5%	2,284	2,262	1%
Operating Expenses	358	293	22%	344	4%	1,024	844	21%
Employee	232	188	23%	228	2%	665	540	23%
Others	127	105	20%	117	9%	358	304	18%
Operating Profits before provisions	381	441	-14%	432	-12%	1,260	1,418	-11%
Exceptional Items	-	-		-		-	-	
Total Provisions	220	(5)	-4891%	168	32%	635	87	627%
PBT	160	446	-64%	265	-39%	625	1,331	-53%
Taxes	56	124	-55%	92	-40%	219	399	-45%
PAT	105	321	-67%	172	-39%	407	932	-56%
EPS	2.2	6.6	-67%	3.6	-39%	8.4	19.2	-56%
Asset Quality								
GNPA Rs. Cr	2,658	725	267%	2,187	22%	2,658	725	267%
NNPA Rs. Cr	1,428	97	1374%	1,109	29%	1,428	97	1374%
GNPA %	5.8	1.7	410	4.7	110	5.8	1.7	410
NNPA %	3.2	0.2	300	2.5	70	3.2	0.2	300
PCR % Calculated	46.3	86.6	-4037	49.3	-305	46.3	86.6	-4037
PCR % Reported	51.0	90.2	-3920	54.9	-390	51.0	92.1	-4110
Slippages *	576	148	291%	377	53%	2,115	344	515%
Slippage Ratio % *	5.20	1.36	384	3.35	185	6.36	1.06	530
Restructured assets	1,804	1,416	27%	1,269	42%	1,804	1,416	27%
Restructured assets % of advances	4.07	3.27	80	2.82	125	4.07	3.27	80
Fresh Restructuring	503	137	266%	130	286%	639	424	51%
Credit Cost %	1.99	-0.04	203	1.49	50	1.91	0.27	164
Stressed Assets % of Advances	7.27	3.47	380	5.32	195	7.27	3.47	380

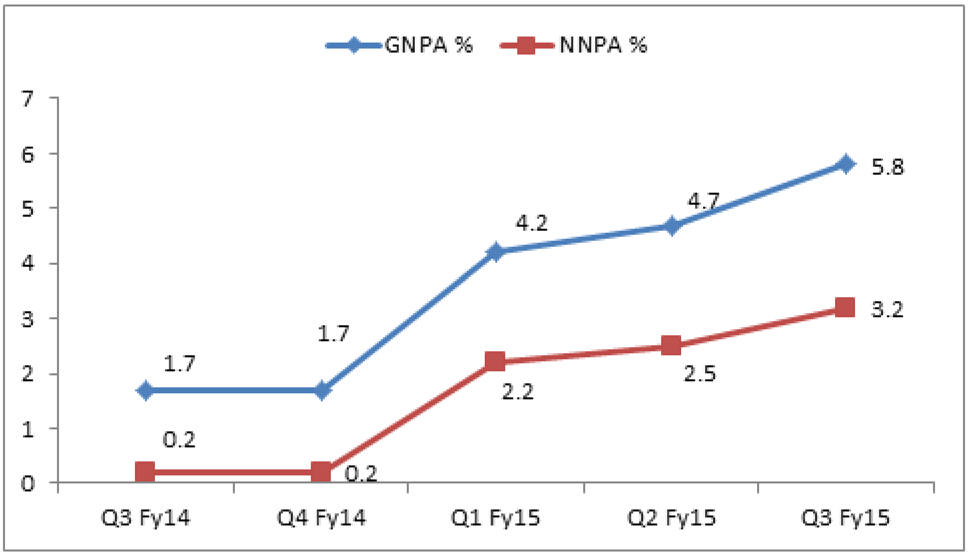
Dimensional Securities Pvt. Ltd.

Ratios :

Ratios %	Dec-14	Dec-13	% YoY	Sep-14	%QoQ	9M FY15	9M FY14	% YoY
Fees to Advances *	0.47	0.46	2	0.40	8	0.43	0.45	-2
Cost to Income ratio	48.48	39.94	854	44.34	414	44.82	37.31	750
Tax Rate	34.67	27.88	679	34.92	-25	34.95	29.99	497
Loan/Deposit	69.42	68.59	83	71.57	-216	69.42	68.59	83
CASA % *	41.5	38.8	270	39.7	180	41.5	38.8	270
CAR (Basel III) %	12.78	13.01	-23	12.66	12	12.78	13.01	-23
Tier I %	11.37	11.35	2	11.27	10	11.37	11.35	2
Tier II %	1.41	1.66	-25	1.39	2	1.41	1.66	-25
Opex to Loan book	3.23	2.71	52	3.06	17	3.08	2.60	48
Quarterly NIMs *	3.70	4.00	-30	4.00	-30	3.77	4.18	-41
BV-Calculated	126	120	6%	124	2%	126	120	6%
Adjusted Networth	4,702	5,700	-17%	4,918	-4%	4,702	5,700	-17%
Adj. BV	97	118	-17%	101	-4%	97	118	-17%
Balance Sheet								
Capital	49	49	0%	49	0%	49	49	0%
Net Worth	6,131	5,797	6%	6,026	2%	6,131	5,797	6%
FV	1	1		1		1	1	
Deposits	63,906	63,157	1%	62,972	1%	63,906	63,157	1%
Investments	24,616	22,714	8%	23,626	4%	24,616	22,714	8%
Loans	44,361	43,318	2%	45,072	-2%	44,361	43,318	2%

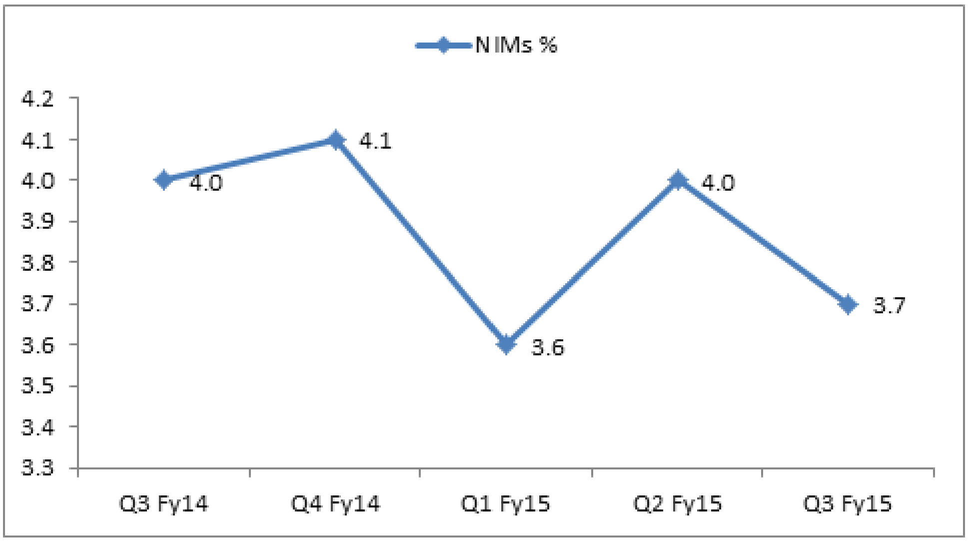
Asset quality deteriorated; concerns persist for next 2 quarters

Asset quality deteriorated further, mainly from the corporate book as one large shipping a/c of ₹180 cr slipped into NPA (under CDR process for Banks), non-fund based lending (₹60 cr) against L.C which was fraudulent and one Mumbai based realty account (₹400 cr) slipped to NPA. Management guidance remains grim for the next two quarters as fallout from the corporate book under consortium lending remains under risk. Restructuring was also high as a result of flood impacted accounts and further restructuring is expected in Q4 of range of ₹200 - 300cr.



Interest reversals led margins down

NIMs declined by 35bps QoQ to 3.66% due to higher slippages and concessions on fresh lending under flood relief restructuring. Also subdued loan growth of ~2% impacted NII which declined by 1% YoY. Operating profits was further impacted (down 14% YoY and 12% QoQ) on lower treasury gains and high operating expenses. Management expects NIMs to bounce back as lending focus has been back on J&K state which has higher margins.



Dimensional Securities Pvt. Ltd.

RISKS:-

- Political disturbance and terrorism risk could impact the business growth in future.
- Slowdown in the economy along with inflation concerns could impact lending outside J&K state.
- Higher slippages due to high delinquencies could lead to increase in the credit cost impacting bottom line.

CONCERNS:-

- **Floods impacted the J&K state thus impacting the J&K bank the most. However, due to huge claim settlement by insurance companies, bank need to restructure around ₹800cr accounts as against expectations of ₹3,000 - 4,000cr.**
- **Banks dependence on large corporates outside J&K state for lending resulted in high slippages. However management is now focusing more within J&K state.**
- **CD ratio is low as compared to banking industry. Bank is expanding deeper into J&K state and targets 1000 branches (at present ~700) within J&K state in next 3 years which should support improvement in CD ratio.**
- **PSL targets achievement seems to be difficult. Portfolio within J&K state comprises 70% of PSL thus loan growth higher within J&K state as compared to rest of India would support PSL targets going forward.**

Profit & Loss Statement

Amount (₹ in Cr.)

Particulars	FY14	FY15E	FY16E	FY17E	FY18E
Interest Earned	6,767	7,109	7,802	8,783	9,788
Interest expended	4,083	4,248	4,557	5,062	5,596
Net Interest Income	2,685	2,861	3,245	3,721	4,191
Other Income	390	429	494	568	653
NII+ Other Inc.	3,075	3,290	3,739	4,288	4,844
Employees Cost	744	881	971	1,063	1,200
Op, Admin & Other exp	431	600	674	738	834
Profit Before Provision & Cont	1,900	1,810	2,094	2,487	2,810
Provisions & Contingencies	148	877	847	650	374
PBT	1,752	933	1,246	1,838	2,436
Provision for Tax	569	317	424	625	828
PAT	1,183	616	823	1,213	1,608

BALANCE SHEET

Amount (₹ in Cr.)

Particulars	FY14	FY15E	FY16E	FY17E	FY18E
SOURCES OF FUNDS :					
Capital	49	49	49	49	49
Reserves Total	5,675	6,277	7,082	8,270	9,847
Deposits	69,336	72,803	83,723	96,281	110,724
Borrowings	1,765	2,240	2,542	2,924	3,362
Other Liabilities & Provisions	1,795	2,672	3,519	4,169	4,543
TOTAL LIABILITIES	**78,620**	**84,040**	**96,916**	**111,693**	**128,524**
APPLICATION OF FUNDS :					
Cash & Balances with RBI	3,046	2,895	3,357	4,164	5,029
Balances with Banks & money at Call	1,168	2,369	2,747	3,407	4,115
Investments	26,195	28,291	32,251	36,767	41,914
Advances	46,385	48,704	56,496	64,971	74,717
Fixed Assets	534	606	702	811	935
Other Assets	1,292	1,176	1,362	1,574	1,815
TOTAL ASSETS	**78,620**	**84,040**	**96,916**	**111,693**	**128,524**

Dimensional Securities Pvt. Ltd.

Ratios Analysis:

Particulars	FY14	FY15E	FY16E	FY17E	FY18E
Spread Analysis					
Yield on Advances	11.5%	11.1%	11.0%	10.5%	10.0%
Cost of Funds	5.8%	5.6%	5.4%	5.2%	5.0%
Net Interest Margin	3.7%	3.6%	3.7%	3.7%	3.6%
Profitability Ratio					
RoE, %	22.3%	10.2%	12.2%	15.7%	17.7%
RoA, %	1.6%	0.8%	0.9%	1.2%	1.3%
Interest Expense/Interest Income	60.3%	59.8%	58.4%	57.6%	57.2%
Non-Interest Income/Total Income	12.7%	13.0%	13.2%	13.2%	13.5%
Efficiency Ratio					
Cost/Income	38.2%	45.0%	44.0%	42.0%	42.0%
Employee Cost/Operating Expenses	63.3%	59.5%	59.0%	59.0%	59.0%
Asset Liability Ratio					
Credit/Deposit	66.9%	66.9%	67.5%	67.5%	67.5%
CASA/Deposit	39.1%	39.0%	39.5%	40.0%	40.0%
Investment/Deposits	37.8%	38.9%	38.5%	38.2%	37.9%
Valuation Ratio					
Book Value (Adjusted), Rs.	115.9	104.0	125.7	152.5	187.6
EPS, Rs.	24.4	12.7	17.0	25.0	33.2
Dividend, Rs.	5.0	2.5	3.0	4.5	5.5
P/BV, x	0.2	1.0	0.8	0.7	0.6
P/E, x	0.9	8.4	6.3	4.3	3.2

*Adjusted = Networth - NNPA

RoA Tree Analysis

Particulars	FY12	FY13	FY14	FY15E	FY16E	FY17E	FY18E
Interest Earned	8.73%	9.30%	9.00%	8.74%	8.62%	8.42%	8.15%
Interest expended	5.41%	5.79%	5.43%	5.22%	5.04%	4.85%	4.66%
Net Interest Income	3.32%	3.51%	3.57%	3.52%	3.59%	3.57%	3.49%
Other Income	0.60%	0.73%	0.52%	0.53%	0.55%	0.54%	0.54%
NII+ Other Inc.	3.92%	4.24%	4.09%	4.05%	4.13%	4.11%	4.03%
Employees Cost	0.94%	0.99%	0.99%	1.08%	1.07%	1.02%	1.00%
Op, Admin & Other exp	0.51%	0.51%	0.57%	0.74%	0.75%	0.71%	0.69%
Profit Before Provision & Cont	2.47%	2.74%	2.53%	2.23%	2.31%	2.38%	2.34%
Provisions & Contingencies	0.31%	0.43%	0.20%	1.08%	0.94%	0.62%	0.31%
PBT	2.17%	2.31%	2.33%	1.15%	1.38%	1.76%	2.03%
Provision for Tax	0.72%	0.71%	0.76%	0.39%	0.47%	0.60%	0.69%
PAT	***1.45%***	***1.60%***	***1.57%***	***0.76%***	***0.91%***	***1.16%***	***1.34%***

OUTLOOK & VALUATION:-

J&K Bank is perceived as an operationally risky bank as it operates in a sensitive region as compared to other banks. Also, loan book grew at a slow pace at 2% YoY in 9M Fy15 however; management intends to grow faster than the industry with increasing focus towards J&K bank due to improvement in tourism and governments focus on infrastructure development in J&K state.

We expect loan book to grow better than the industry at 15% CAGR (FY15-18) with key ratios to improve at previous levels: a) RoA from 0.8% to 1.35% by Fy18, b) RoE from 10% to 18% by FY18.

At CMP Rs.107 J&K Bank is trading at P/B multiple of 0.8x its FY16E Adj.BV of Rs.125.7 and 0.7x its FY17E Adj.BV of Rs.152.5. With gradual increase in return ratios we believe the valuations should improve from current levels of 0.8X. We initiate coverage with a ACCUMULATE rating and target price Rs.125 (1x FY16E Adj.BV of Rs.125) with investment horizon of 12 months and an upside potential of 17%.

Price Book Value (Forward)