15 January 2019

Jammu & Kashmir Bank

Restructured loans in home state, stable; upgrading to a Buy

Rating: **Buy**
Target Price: ₹64
Share Price: ₹42

With its contracting stressed pipeline, steady repayments from the large restructured book and focus on lending in its home state, we believe J&K Bank's core operating parameters will gradually improve. Given the recent fall in the stock price, we alter our recommendation to a Buy.

Focus on granularity in the loan book. Management aims to expand its footprint across the state through branch expansion and growing the state's loan book faster than the overall loan book. Keeping in mind this strategy, we expect medium-term growth to come in the mid-teens. Besides, with 11.6% capital adequacy (tier-1: 9.8%), the bank is adequately capitalised for short-term mid-teen loan growth. If, however, the loan book grows above 20% (as intended by management), additional capital would require to be raised.

NIM to expand, cost-income to be high. We expect NIM to gradually expand from current levels because of a) aggressive lending in its home state where it can charge a higher interest rate, (b) its strong liability franchise and (c) expected lower slippages. However, we expect the cost-income ratio to be high in the short term on account of the vigorous branch expansion plans in the home state.

Restructured book doing well. In the last 12 months, after emerging from the moratorium period, limited stress and steady repayment are seen in the restructured book from the home state. Management retains a positive outlook on this portfolio and does not expect any negative surprises from it. This offers assurance that the risk is probably not as bad as it was initially perceived, given the performance of the restructured loans in other banks.

Valuation. Our Jan'20 target (₹64) is based on the two-stage DDM model. This implies a ~0.6x P/ABV multiple on its FY21e book. **Risks:** Downside: Lumpy delinquencies from the restructured book; unrest in the home state.

Key financials (YE Mar)	FY17	FY18	FY19e	FY20e	FY21e
Net interest income (₹ m)	25,119	28,708	34,136	39,361	46,404
Pre-provisioning profit (₹ m)	12,943	13,819	15,533	18,169	22,894
Provisions (₹ m)	28,003	12,609	10,474	9,553	10,986
PAT (₹ m)	-16,323	2,027	3,389	5,773	7,978
EPS (₹)	-31.3	3.6	6.1	10.4	14.3
NIM (%)	3.4	3.7	3.9	4.0	4.1
Cost-income (%)	56.9	58.9	60.8	59.6	56.4
RoE (%)	-27.0	3.4	5.4	8.7	11.1
RoA (%)	-2.0	0.2	0.4	0.5	0.6
Advances growth (%)	-0.8	14.2	16.5	15.0	15.0
GNPA (%)	11.3	10.0	9.8	9.1	8.0
CAR (%)	10.8	11.4	10.8	10.5	10.2
P / E (x)	-1.3	11.0	6.6	3.9	2.8
P / BV (x)	0.4	0.4	0.3	0.3	0.3
P / ABV (x)	0.5	0.5	0.5	0.4	0.4

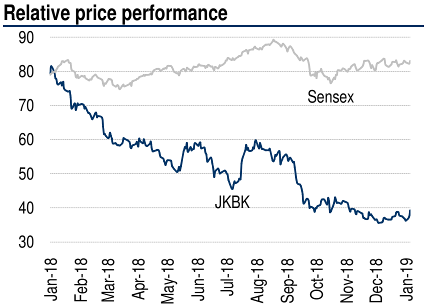
Source: Company, Anand Rathi Research

Key data	JKBK IN / JKBK.BO
52-week high / low	₹83 / 35
Sensex / Nifty	36318 / 10887
3-m average volume	$0.4m
Market cap	₹22bn / $307.7m
Shares outstanding	557m

Shareholding pattern (%)	Dec'18	Sep'18	Jun '18
Promoters	59.2	59.2	59.2
- of which, Pledged	-	-	-
Free float	40.8	40.8	40.8
- Foreign institutions	15.6	16.2	16.0
- Domestic institutions	7.8	8.2	8.4
- Public	17.5	16.4	16.5

Estimates revision (%)	FY19e	FY20e
NII	5.8	9.2
EPS	(4.9)	(2.2)
RoE	(3.8)	(2.3)

Relative price performance



Source: Bloomberg

Yuvraj Choudhary, CFA
Research Analyst

Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY17	FY18	FY19e	FY20e	FY21e
Net interest income	25,119	28,708	34,136	39,361	46,404
NII growth (%)	*-7.3*	*14.3*	*18.9*	*15.3*	*17.9*
Non-interest income	4,929	4,953	5,505	5,589	6,153
Income	30,048	33,661	39,641	44,950	52,557
Income growth (%)	*-6.5*	*12.0*	*17.8*	*13.4*	*16.9*
Operating expenses	17,105	19,842	24,108	26,780	29,662
PPOP	12,943	13,819	15,533	18,169	22,894
PPOP growth (%)	*-22.4*	*6.8*	*12.4*	*17.0*	*26.0*
Provisions	28,003	12,609	10,474	9,553	10,986
PBT	-15,060	1,210	5,058	8,616	11,908
Tax	1,263	-818	1,669	2,843	3,930
PAT	-16,323	2,027	3,389	5,773	7,978
PAT growth (%)	*P2L*	*L2P*	*67.2*	*70.3*	*38.2*
FDEPS (₹ / sh)	-31.3	3.6	6.1	10.4	14.3
DPS (₹ / sh)	0.0	0.0	1.3	2.1	2.9

Source: Company, Anand Rathi Research

Fig 4 – Price-to-book band

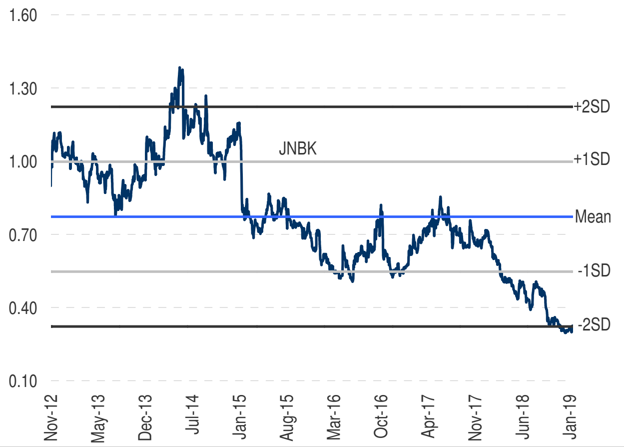
Source: Bloomberg, Anand Rathi Research

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY17	FY18	FY19e	FY20e	FY21e
Share capital	521	557	557	557	557
Reserves & surplus	56,243	61,055	63,631	68,018	74,082
Deposits	724,631	800,065	896,073	1,003,602	1,124,034
Borrowings	12,760	16,283	35,823	53,735	75,229
Minority interests	0	0	0	0	0
Total liabilities	**820,187**	**896,876**	**1,032,560**	**1,159,837**	**1,304,609**
Advances	498,161	569,128	663,034	762,489	876,862
Investments	212,909	188,800	226,560	249,216	274,138
Cash & bank bal	53,859	82,529	76,394	79,706	83,265
Fixed & other assets	55,257	56,420	66,571	68,426	70,344
Total assets	**820,187**	**896,876**	**1,032,560**	**1,159,837**	**1,304,609**
No. of shares (m)	521	557	557	557	557
Deposits growth (%)	*4.4*	*10.4*	*12.0*	*12.0*	*12.0*
Advances growth (%)	*-0.8*	*14.2*	*16.5*	*15.0*	*15.0*

Source: Company, Anand Rathi Research

Fig 5 – One-year-forward price-to-bookvalue



Source: Bloomberg, Anand Rathi Research

Fig 3 – Ratio analysis (%)

Year-end: Mar	FY17	FY18	FY19e	FY20e	FY21e
NIM	3.4	3.7	3.9	4.0	4.1
Other inc. / total inc.	16.4	14.7	13.9	12.4	11.7
Cost-income	56.9	58.9	60.8	59.6	56.4
Provision coverage	57.1	53.5	61.3	63.6	62.8
Dividend payout	0.0	0.0	24.0	24.0	24.0
Credit-deposit	68.7	71.1	74.0	76.0	78.0
Investment-deposit	29.4	23.6	25.3	24.8	24.4
Gross NPA	11.3	10.0	9.8	9.1	8.0
Net NPA	4.9	4.9	4.0	3.5	3.2
BV (₹)	108.9	110.6	115.2	123.1	134.0
Adj. BV (₹)	76.3	75.5	81.9	89.6	99.3
CAR	10.8	11.4	10.8	10.5	10.2
- Tier 1	8.7	9.2	8.6	8.3	8.0
RoE	-27.0	3.4	5.4	8.7	11.1
RoA	-2.0	0.2	0.4	0.5	0.6

Source: Company, Anand Rathi Research

Fig 6 – Price movement

Source: Bloomberg

Key Highlights

Conference-call takeaways

Guidance for FY19

- 20% loan growth (25% in J&K)
- ~50% CASA
- 9% GNPA, 4.5% NNPA
- 65% PCR
- 3.75% NIM
- 1.5—1.75% credit cost
- 58% C/I ratio
- 0.4% RoA
- 5% RoE
- The bank expects to receive ₹3bn-4bn from the PNB MetLife listing (*from the previous conference call*)

Loan book

- The bank is aiming to expand its footprint in its home state through branch expansion.
- Management has stated that no new exposure would be taken in the corporate segment and growth outside the home state would come from retail, agri and the MSME (RAM) segments.

Fig 7 – Segment-wise results

	FY16	FY17	FY18	Q1 FY19	Q2 FY19	Q3 FY19
Gross advances book - Rest of India (% of loan book)						
Farm	2.1	0.5	0.5	1.0	0.9	0.9
Trade	2.1	2.0	1.4	1.4	1.4	1.4
Retail	1.6	1.5	1.9	1.9	1.9	1.9
SME	1.0	1.0	0.9	1.0	0.9	0.9
Corporate	44.5	45.5	42.1	41.3	40.8	41.3
Others	0.5	0.5	0.5	1.0	0.9	0.9
% Advances, RoI	**51.7**	**51.2**	**47.3**	**47.5**	**46.9**	**47.5**
Gross advances book - J&K (% of loan book)						
Farm	9.2	8.8	9.0	8.9	9.0	8.4
Trade	7.2	7.8	8.4	8.4	8.0	7.9
Retail	16.9	17.1	20.0	19.9	20.7	21.0
SME	6.3	6.3	6.8	7.3	7.4	7.4
Corporate	7.7	7.3	7.4	6.8	6.4	6.3
Others	1.0	1.5	1.1	1.0	1.6	1.6
% Advances, J&K	**48.3**	**48.8**	**52.7**	**52.5**	**53.1**	**52.5**
Total Advances	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Company, Anand Rathi Research

Asset quality

- IL&FS exposure
  - ₹10bn has already been classified as NPA: ₹8.83bn on the holding company, ₹300m on IL&FS Financial Services and ₹840m on the MP Border CheckPost.

  - The accounts have been secured against First *Paripassu* charge on the common pool of the asset.
  - 15% provision has been made against the above accounts.
  - Exposure of ₹2.85bn towards its subsidiaries are still standard and these accounts are regularly servicing their debt.
  - Standard accounts: TN Power (₹930m), Road Infra Development - Rajasthan (₹320m) and Chenani-Nashri Tunnel (₹1.6bn).

- Other stressed book: 5:25 - ₹1bn and S4A - ₹976m (Hindustan Construction).
- Of the current ₹37.9bn standard restructured book, ₹37bn standard exposure is to the rehabilitation book from the home state. Management says that the accounts are doing well and does not see any negative surprises from them.
- The moratorium on restructured accounts from the home state ended in Dec'17. These accounts would be re-classified out of the restructured book by Dec'19. However, the bank now has the option to write back the provisions (₹1.8bn) created against these accounts.
- Management guided to ~1.5% credit cost for FY20.

Fig 8 – Movement of GNPA

(₹ m)	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY18	Q2 FY18	Q3 FY18
Opening balance	56,406	59,829	62,321	60,067	62,417	60,677
Slippages	4,804	3,711	17,477	7,699	2,520	10,286
Gross slippage ratio (%)	***3.7***	***2.6***	***12.3***	***5.1***	***1.6***	***6.3***
Reductions	1,382	1,219	19,731	5,349	4,260	2,365
Upgrades	435	340	366	4,669	739	841
Write-offs	11	61	18,415	10	45	113
Recoveries	935	818	949	670	3,476	1,411
Closing balance	**59,829**	**62,321**	**60,067**	**62,417**	**60,677**	**68,597**
GNPA (%)	*10.9*	*10.1*	*10.0*	*9.8*	*9.0*	*9.9*
Stressed assets (%)	***22.6***	***19.9***	***18.2***	***16.7***	***15.2***	***15.8***

Source: Company, Anand Rathi Research

Quarterly snapshot

Fig 9 – Income statement

(₹ m)	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY18	Q2 FY18	Q3 FY18
Interest income	16,664	16,830	15,917	17,629	18,401	20,027
Interest expense	9,438	9,028	9,359	9,837	10,482	11,211
NII	**7,226**	**7,802**	**6,558**	**7,792**	**7,919**	**8,816**
Y/Y growth (%)	*12.7*	*33.8*	*0.1*	*9.4*	*9.6*	*13.0*
Non-interest income	1,050	1,078	1,723	1,344	1,113	1,635
Trading profits	26	(20)	226	92	(259)	108
Total Income	**8,277**	**8,880**	**8,280**	**9,135**	**9,031**	**10,451**
Y/Y growth (%)	*7.2*	*26.2*	*6.2*	*11.1*	*9.1*	*17.7*
Operating expenses	4,635	5,053	5,616	5,638	5,604	6,202
Of which, Staff costs	3,080	3,278	3,479	3,752	3,675	4,078
PPOP	**3,642**	**3,827**	**2,665**	**3,497**	**3,427**	**4,249**
Y/Y growth (%)	*-3.0*	*30.6*	*-3.6*	*-5.1*	*-5.9*	*11.0*
Total Provisions	2,429	2,501	2,511	2,550	1,724	2,528
PBT	**1,213**	**1,326**	**154**	**947**	**1,704**	**1,721**
Tax	497	602	(131)	421	765	684
PAT	**716**	**725**	**284**	**526**	**938**	**1,038**
Y/Y growth (%)	*NM*	*NM*	*NM*	*74*	*31*	*43*

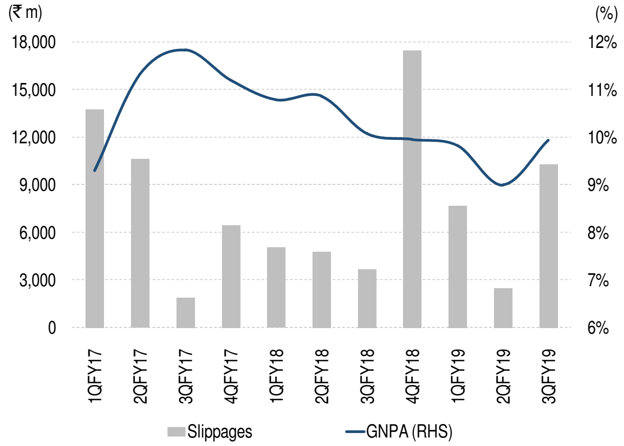
Source: Company, Anand Rathi Research

Fig 10 – Balance sheet

(₹ m)	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY18	Q2 FY18	Q3 FY18
Equity capital	557	557	557	557	557	557
Reserves & Surplus	59,973	60,661	61,055	61,581	62,519	63,556
Deposits	703,846	731,551	800,065	774,196	814,292	862,103
Borrowings	11,305	40,045	16,283	36,227	41,377	33,815
Other Liabilities	17,924	17,832	18,916	18,370	22,162	23,498
Equity and Liabilities	**793,605**	**850,645**	**896,876**	**890,931**	**940,906**	**983,529**
Deposits y/y growth (%)	*0.7*	*-1.4*	*10.4*	*7.9*	*15.7*	*17.8*
Deposits q/q growth (%)	*-1.9*	*3.9*	*9.4*	*-3.2*	*5.2*	*5.9*
Assets						
Cash and cash balance	40,682	33,188	82,529	34,789	38,102	41,090
Advances	513,413	579,287	569,128	598,411	636,912	650,268
Investments	189,054	184,959	188,800	201,016	205,422	228,287
Other Assets	50,456	53,212	56,420	56,716	60,470	63,884
Total Assets	**793,605**	**850,645**	**896,876**	**890,931**	**940,906**	**983,529**
Advances y/y growth (%)	*8.0*	*28.5*	*14.2*	*22.8*	*24.1*	*12.3*
Advances q/q growth (%)	*5.4*	*12.8*	*-1.8*	*5.1*	*6.4*	*2.1*

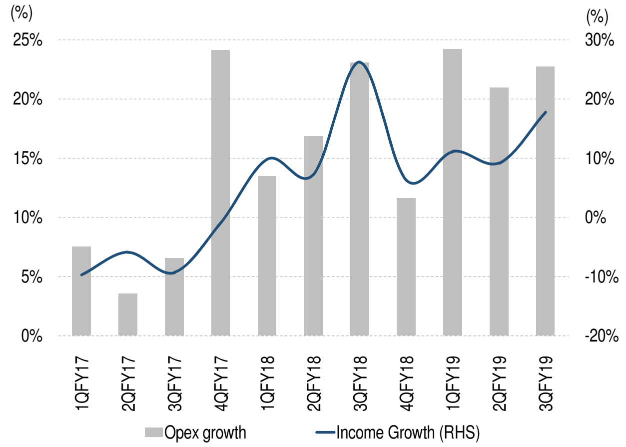
Source: Company, Anand Rathi Research

Fig 11 – GNPA vs. Slippages



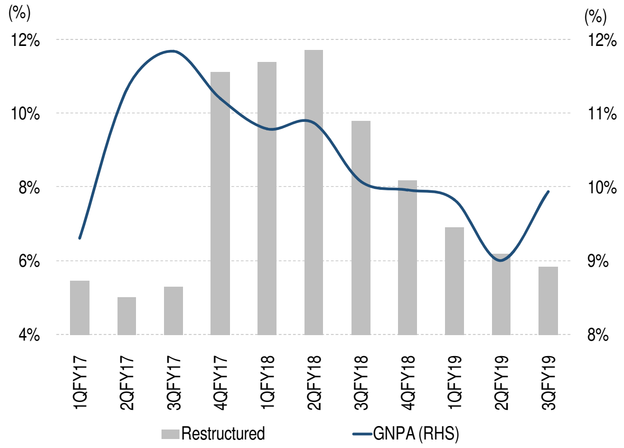
Source: Company, Anand Rathi Research

Fig 12 – Income vs. Opex growth



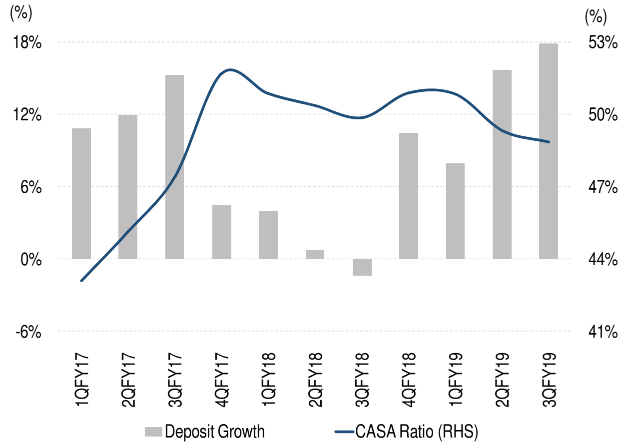
Source: Company, Anand Rathi Research

Fig 13 – GNPA vs Restructured



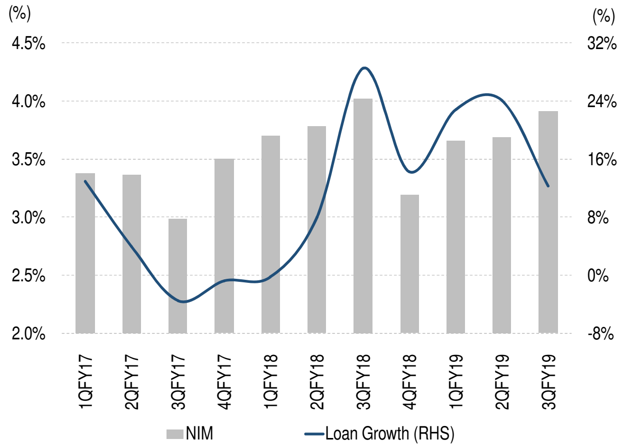
Source: Company, Anand Rathi Research

Fig 14 – Deposit growth vs CASA



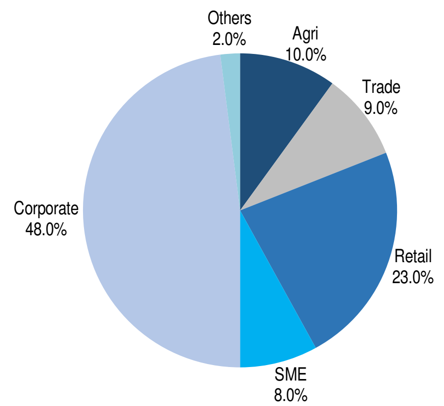
Source: Company, Anand Rathi Research

Fig 15 – NIM vs. Advances



Source: Company, Anand Rathi Research

Fig 16 – Loan book break-up



Source: Company, Anand Rathi Research

Valuation

Our Jan'20 target (₹64) is based on the two-stage DDM model. This implies a ~0.6x P/ABV multiple on its FY21e book.

Fig 17 – Change in estimates

	FY19e			FY20e		
	New	Old	Chg %	New	Old	Chg %
Net Interest Income (₹ m)	34,136	32,266	5.8	39,361	36,036	9.2
EPS (₹)	6.1	6.4	(4.9)	10.4	10.6	(2.2)
RoE (%)	5.4	5.6	(3.8)	8.7	8.9	(2.3)

Source: Anand Rathi Research

Risks

- Lumpy slippages from the standard restructured book could lead to volatile asset quality.
- Unrest in the state.

Appendix

Analyst Certification

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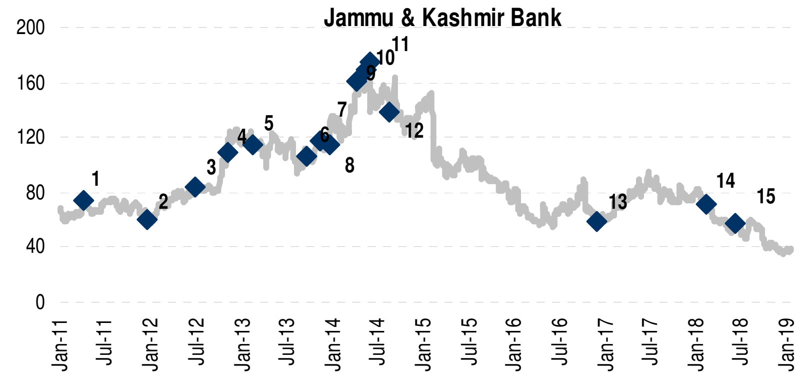
Important Disclosures on subject companies

Rating and Target Price History (as of 15 January 2019)



	Date	Rating	TP (₹)	Share Price (₹)
1	04-Apr-11	Buy	113	87
2	14-Dec-11	Buy	94	73
3	28-Jun-12	Buy	130	95
4	01-Nov-12	Buy	146	123
5	05-Feb-13	Buy	161	139
6	20-Sep-13	Buy	137	114
7	11-Nov-13	Buy	150	130
8	16-Dec-13	Buy	156	125
9	09-Apr-14	Sell	156	166
10	16-May-14	Hold	196	180
11	26-May-14	Buy	214	183
12	18-Aug-14	Buy	182	147
13	23-Nov-16	Sell	43	58
14	08-Feb-18	Hold	79	71
15	04-Jun-18	Hold	64	57

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Analysts' ratings and the corresponding expected returns take into account our definitions of Large Caps (>US$1bn) and Mid/Small Caps (<US$1bn) as described in the Ratings Table below:

Ratings Guide (12 months)

	Buy	Hold	Sell
Large Caps (>US$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US$1bn)	>25%	5-25%	<5%

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