

Jammu & Kashmir Bank

Business growth recovering; asset quality remains key

June 04, 2018

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Rating	BUY
Price	Rs56
Target Price	Rs100
Implied Upside	78.6%
Sensex	35,227
Nifty	10,696

(Prices as on June 01, 2018)

Trading data

Market Cap. (Rs bn)	31.4
Shares o/s (m)	557.0
3M Avg. Daily value (Rs m)	31.5

Major shareholders

Promoters	59.23%
Foreign	15.99%
Domestic Inst.	8.16%
Public & Other	16.62%

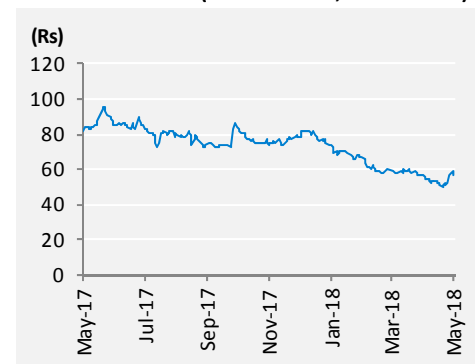
Stock Performance

(%)	1M	6M	12M
Absolute	(1.2)	(24.2)	(33.0)
Relative	(1.4)	(31.5)	(46.2)

How we differ from Consensus

EPS (Rs)	PL	Cons.	% Diff.
2019	10.4	8.6	20.8
2020	16.1	11.9	36.0

Price Performance (RIC: JKBK.BO, BB: JKBK IN)



Source: Bloomberg

JKBK's earnings was lower than expected on flat NII on higher interest reversals despite loan growth of 10% YoY and lower of cost of funds on better CASA. Asset quality was stable on sale to ARC on slippages from the restructured book largely from non-J&K state. J&K restructured book also saw some slippages on account of RBI divergence noted in few accounts (large borrowal) leading to interest reversals but rest of the book is functioning well and if the same continues bank could likely witness significant addition to NII (7% of loans under J&K restructuring) and if there are any resolutions in IBC referred loan assets. We believe, better PCR, improving NIMs and recovery in loan growth augurs well and hence we retain BUY with revised TP of Rs100 (down from Rs112) based on 1.2x Mar-20ABV.

- **NII growth impacted by high interest reversals:** Bank's NII was flat YoY despite lower cost of funds as CASA mix remained stable. Loan growth was decent but interest reversals were high leading to lower margins of 3.19% down 83bps QoQ, but management expects it to remain at 3.5% in FY19. PPOP was slightly impacted by higher opex which management attributed to change in gratuity rules, but bank saw some recoveries from NPA which led to high other income.
- **Loan growth was led by J&K state:** Loan growth was better at 10% YoY led by J&K state while non J&K saw flat growth. In J&K, growth came in from retail, trade, SME and in non-J&K, growth was partly impacted as bank sold 3 large steel a/cs to ARC. However, bank expects loan book to remain strong in FY19 at 20% with J&K book growing at 30% YoY.
- **Asset quality expected to improve and thus improve return ratios:** Overall asset quality was stable despite high slippages largely from non J&K restructured book and sold loans to ARC on cash basis and held high provisions. J&K restructured book seems to be operating well with good repayments and if the same continues we should witness significant addition improvement in NII (7% of loans under J&K restructuring) and if any resolutions in IBC referred loan assets. Bank expects credit cost to remain low at 100bps in FY19 taking PCR (incl TWO) to 65-70% and thus improving RoA/RoE to 0.5%/6.0%.

Key financials (Y/e March)	2017	2018	2019E	2020E
Net interest income	25,119	28,708	32,785	36,616
Growth (%)	(7.3)	14.3	14.2	11.7
Operating profit	12,943	13,819	16,362	18,396
PAT	(16,323)	2,027	5,785	8,993
EPS (Rs)	(32.4)	3.8	10.4	16.1
Growth (%)	(478.1)	(111.6)	176.3	55.4
Net DPS (Rs)	—	—	0.5	0.8

Profitability & Valuation	2017	2018	2019E	2020E
NIM (%)	3.10	3.34	3.41	3.35
RoAE (%)	(27.0)	3.4	9.0	12.6
RoAA (%)	(2.01)	0.24	0.60	0.82
P / BV (x)	0.6	0.6	0.5	0.5
P / ABV (x)	1.1	1.1	0.9	0.7
PE (x)	(1.7)	15.0	5.4	3.5
Net dividend yield (%)	—	—	0.9	1.3

Source: Company Data; PL Research

Exhibit 1: Earnings were impacted by high interest reversals and continued provisioning

	(Rs m)	Q4FY18	Q4FY17	YoY gr. (%)	Q3FY18	QoQ gr. (%)
<i>NII growth was flat on higher interest reversals despite decent loan growth</i>	Interest Income	15,917	16,782	(5.2)	16,830	(5.4)
	Interest Expended	9,359	10,232	(8.5)	9,028	3.7
	Net interest income (NII)	6,558	6,550	0.1	7,802	(15.9)
	Treasury income	226	229	(1.4)	(20)	NA
	Other income	1,723	1,245	38.3	1,078	59.8
<i>Provisions remained high at 2.4% on annualised basis on high slippages</i>	Total income	8,280	7,795	6.2	8,880	(6.8)
	Operating expenses	5,616	5,032	11.6	5,053	11.1
	-Staff expenses	3,479	2,997	16.1	3,278	6.1
	-Other expenses	2,137	2,035	5.0	1,774	20.4
	Operating profit	2,665	2,764	(3.6)	3,827	(30.4)
	Core operating profit	2,438	2,764	(11.8)	3,848	(36.6)
	Total provisions	2,511	7,683	(67.3)	2,501	0.4
	Profit before tax	154	(4,919)	NA	1,326	(88.4)
	Tax	(131)	624	NA	602	(121.7)
	Profit after tax	284	(5,543)	NA	725	(60.8)
<i>Loan growth was decent led by J&K book mainly in retail, trade and SME, while non J&K book growth was flat</i>	Balance sheet (Rs mn)					
	Deposits	8,00,065	7,24,631	10.4	7,31,551	9.4
	Advances	5,69,128	4,98,161	14.2	5,79,287	(1.8)
<i>NIMs deteriorated on high interest reversals despite benefit from reduced CoF</i>	Profitability ratios (%)					
	Yield on Advances	7.8	9.3	(142) bps	9.0	(118) bps
	Cost of Funds	4.8	5.7	(96) bps	4.9	(17) bps
	NIM	3.2	3.5	(31) bps	4.0	(83) bps
	RoaA	0.1	(2.7)	281 bps	0.4	NA
	RoaE	1.9	(40.2)	4,208 bps	4.8	NA
<i>Slippages were high which mainly came from restructured book which largely pertained to non J&K State</i>	Asset Quality (%)					
	Gross NPL (Rs mn)	60,067	60,000	0.1	62,321	(3.6)
	Net NPL (Rs mn)	27,911	24,254	15.1	24,877	12.2
	Gross NPL ratio	10.0	11.2	(128) bps	10.1	(12) bps
	Net NPL ratio	4.9	4.9	3 bps	4.3	61 bps
	Coverage ratio (calc)	53.5	59.6	(604) bps	60.1	(655) bps
	Business & Other Ratios (%)					
	Low-cost deposit mix	50.9	51.7	(81) bps	49.9	102 bps
	Cost-income ratio	67.8	64.5	327 bps	56.9	1,092 bps
	Non int. inc / total income	20.8	16.0	483 bps	12.1	866 bps
	Credit deposit ratio	71.1	68.7	239 bps	79.2	(805) bps
	CAR	11.4	10.8	62 bps	10.9	55 bps
	Tier-I	9.2	8.7	54 bps	8.5	70 bps

Source: Company Data, PL Research

Key Q4FY18 Concall Highlights

Business growth:

- **Advances** - Gross loan growth was ~10% YoY led by growth in J&K loan book. Growth in J&K State continues to be focused in retail mainly in housing, trade and SME, while in non J&K state it is in better rated corporate. **Outlook** – Bank guides overall book to grow at 20% with J&K book growing at 30% in FY19.
- **Liabilities** - CASA Ratio improved by 102bps QoQ to ~51% partly due to unusual increase in government deposits on CA side. **Outlook:** Bank aims to grow deposits at 20% mainly led by CASA and retail TD. It expects CASA Ratio to be at 50% for FY19.

Margins

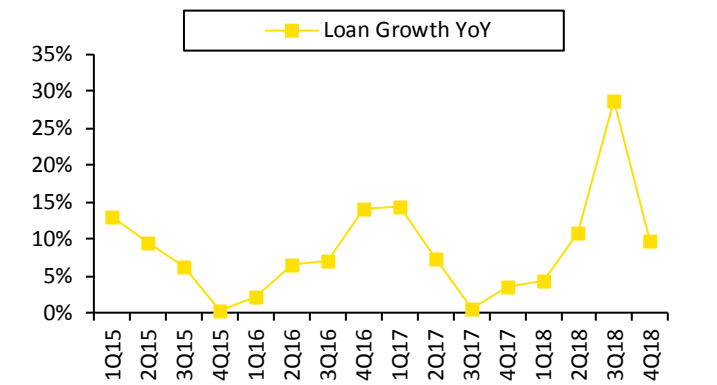
- Margins have deteriorated by 83bps QoQ to 3.19% mainly on interest reversals of Rs1bn. **Outlook** – Management maintains margin guidance of 3.5% for FY19 on liability management.

Asset Quality/Credit cost

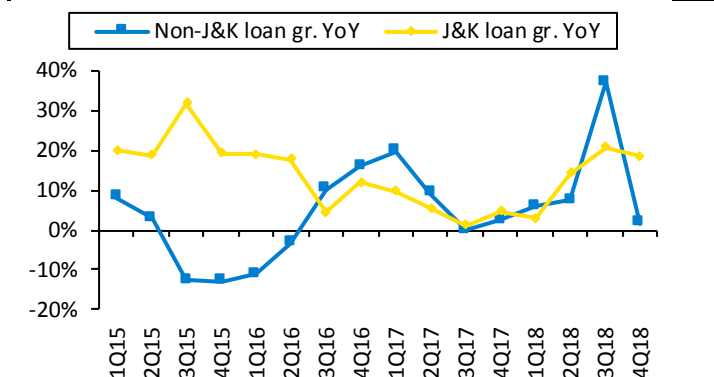
- **Slippages** – Bank witnessed slippages of Rs17.5bn of which 84% came from restructured book. Slippages came largely from non J&K State restructured book from sectors such as telecom, power and gems and jewellery. **Outlook:** Bank expects slippages to be low next year and GNPA/NNPA to be below 7%/4% in FY19.
- **J&K state Restructured Book** – J&K state restructured book reduced to Rs41.2bn as Rs5.0bn slipped into NPA on certain divergence with RBI on classification of large borrowal a/c under package and certain weak a/c in real estate A/c and another trading A/c which were under package. Bank expects no major slippages to come from the book and assured of regular servicing in these accounts.
- **NCLT cases** – Bank has exposure of Rs24.9bn to NCLT cases of which it has made provision of Rs18.8bn (~76%) on the same. Bank expects decent recoveries from these cases via resolutions.
- **ARC Sale** – Bank has sold 3 large steel A/cs having exposure of Rs15bn to ARC. It held provision of Rs9.67bn and sold Rs9.0bn to ARC on cash basis which has led to additional provisions buffer of Rs3.71bn and shall lead to write backs one these a/c resolve in very near term.
- **Credit Cost – Outlook:** Bank expects credit cost to be 100bps for FY19 and PCR to be maintained at 65-70%.

Others

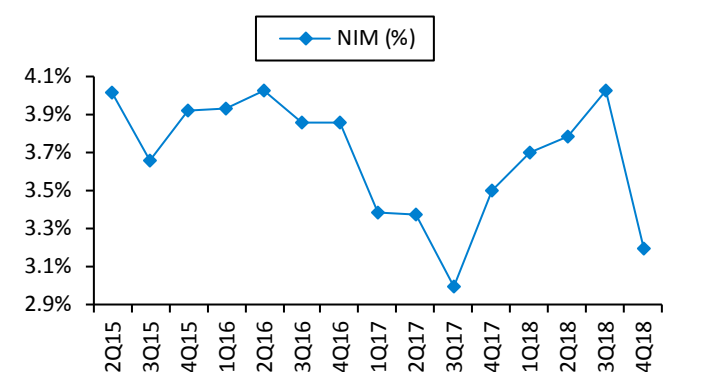
- **Capital** – Bank expects to raise capital via QIP amounting Rs5bn in 2Q19 and decide on raising Tier II bonds if required after the proposed listing of Met Life.

Exhibit 2: Loan growth was decent at ~10% level


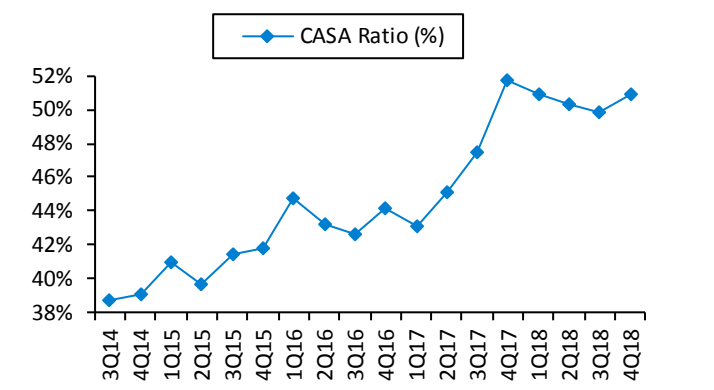
Source: Company Data, PL Research

Exhibit 3: J&K Book continues to grow better while non J&K book saw some dip


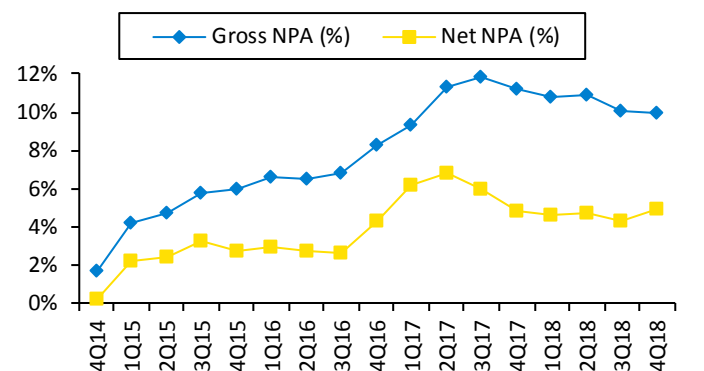
Source: Company Data, PL Research

Exhibit 4: NIMs deteriorated mainly on interest reversals despite lower CoF


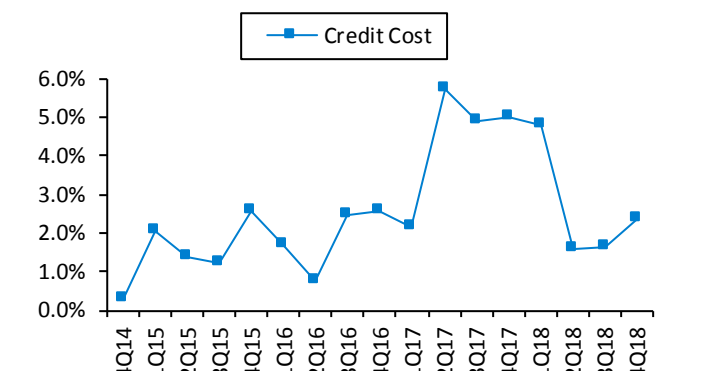
Source: Company Data, PL Research

Exhibit 5: CASA ratio slightly improved on one-off CA growth


Source: Company Data, PL Research

Exhibit 6: Asset quality was stable despite high slippages on high write-offs


Source: Company Data, PL Research

Exhibit 7: ...but credit cost continued to remain high keeping PCR at 53.5% (65.8% incl technical)


Source: Company Data, PL Research

Exhibit 8: Level of stress seems to be coming down from restructured book

Stressed assets for J&K	3Q15	4Q15	1Q16	2Q16	3Q16	4Q16	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18
Add: Additions	5,765	4,112	3,699	2,023	3,312	14,798	13,774	10,625	1,910	6,476	5,055	4,804	3,711	17,477
Less: Reductions	1,055	3,050	1,395	1,151	734	4,507	10,311	945	1,591	3,025	8,649	1,382	1,219	19,731
Gross NPA - Closing	26,579	27,641	29,945	30,817	33,395	43,686	47,149	56,830	57,149	60,000	56,406	59,829	62,321	60,067
Gross NPA % of loans	5.8%	6.0%	6.6%	6.5%	6.8%	8.3%	9.3%	11.3%	11.8%	11.2%	10.8%	10.9%	10.1%	10.0%
Total Std restructured assets	18,043	24,673	25,054	24,862	25,048	32,354	32,474	32,463	32,490	55,398	55,537	57,524	56,731	46,614
Restructured during qtr.	5,029	7,130	262	192	0	2,441	761	392	102	33,537	2,231	2,515	2,542	4,066
O/s Restructuring for J&K State								24,670	21,315	44,000	45,000	45,000	47,940	41,176
Total Restructured Book								57,133	53,804	63,820	64,154	66,123	67,145	61,330
Restructured assets as % of loans	4.1%	5.5%	5.8%	5.4%	5.4%	6.4%	6.6%	6.8%	7.2%	12.8%	13.2%	12.9%	11.6%	10.8%

Source: Company Data, PL Research

Exhibit 9: Change in earnings estimates – We have tweaked business growth, yields and credit cost

(Rs mn)	Old		Revised		% Change	
	FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
NII	33,335	37,619	32,785	36,616	(1.6)	(2.7)
Operating profit	16,796	19,059	16,362	18,396	(2.6)	(3.5)
Net profit	6,267	8,907	5,786	8,994	(7.7)	1.0
EPS (Rs)	11.3	16.0	10.4	16.1	(7.7)	1.0
ABVPS (Rs)	68.3	90.6	64.9	86.2	(4.9)	(4.8)
Price target (Rs)	112		100		(10.6)	
Recommendation	BUY		BUY			

Source: Company Data, PL Research

Exhibit 10: Valuation Table – We revise our TP to Rs100 (from Rs112) based on 1.2x P/ABV Mar-20E on rollover basis

PT calculation and upside	
Fair price - EVA	82
Fair price - P/ABV	118
Average of the two	100
Target P/ABV	1.2
Target P/E	6.2
Current price, Rs	56
Upside (%)	77%
Dividend yield (%)	1%
Total return (%)	79%

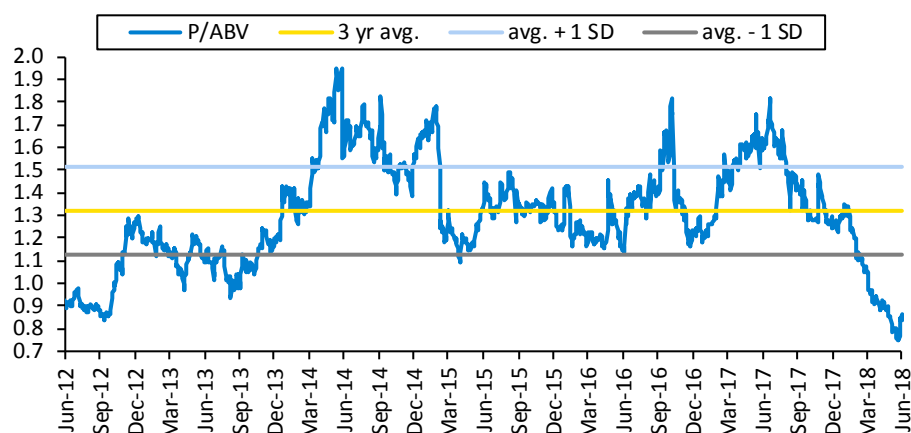
Source: Company Data, PL Research

Exhibit 11: Return ratios to improve on back improved margins with gradual improvement on back of lowering credit cost

ROAE decomposition	2013	2014	2015	2016	2017	2018E	2019E	2020E
NIM/Assets	3.6%	3.6%	3.6%	3.7%	3.3%	3.6%	3.6%	3.6%
Fees/Assets	0.5%	0.4%	0.6%	0.5%	0.5%	0.6%	0.5%	0.5%
Inv. Profits/Assets	0.2%	0.1%	0.2%	0.2%	0.2%	0.1%	0.1%	0.1%
Net revenues/Assets	4.3%	4.2%	4.4%	4.4%	4.0%	4.2%	4.2%	4.1%
Opex/Assets	-1.5%	-1.6%	-1.9%	-2.1%	-2.3%	-2.5%	-2.4%	-2.4%
Provisions/Assets	-0.4%	-0.2%	-1.4%	-1.3%	-3.7%	-1.6%	-1.0%	-0.7%
Taxes/Assets	-0.7%	-0.8%	-0.4%	-0.4%	-0.2%	0.1%	-0.2%	-0.3%
Costs/Assets	-2.7%	-2.6%	-3.7%	-3.9%	-6.2%	-3.9%	-3.6%	-3.4%
ROAA	1.6%	1.6%	0.7%	0.6%	-2.2%	0.3%	0.6%	0.8%
Equity/Assets	6.9%	7.2%	8.0%	8.7%	8.1%	7.4%	7.1%	6.9%
ROAE	23.6%	22.3%	8.6%	6.6%	-28.5%	3.8%	9.4%	12.6%

Source: Company Data, PL Research

Exhibit 12: One year forward P/ABV trends



Source: Company Data, PL Research

Income Statement (Rs m)

Y/e March	2017	2018	2019E	2020E
Int. Earned from Adv.	47,844	49,777	58,933	68,336
Int. Earned from Invt.	17,826	14,316	15,192	16,601
Others	1,188	2,121	2,415	2,723
Total Interest Income	66,858	66,214	76,540	87,660
Interest expense	41,739	37,506	43,755	51,044
NII	25,119	28,708	32,785	36,616
Growth (%)	(7.3)	14.3	14.2	11.7
Treasury Income	1,367	494	519	545
NTNII	3,561	4,459	4,880	5,394
Non Interest Income	4,929	4,953	5,399	5,939
Total Income	71,787	71,167	81,939	93,598
Growth (%)	(2.3)	(0.9)	15.1	14.2
Operating Expense	17,105	19,842	21,822	24,159
Operating Profit	12,943	13,819	16,362	18,396
Growth (%)	(22.4)	6.8	18.4	12.4
NPA Provisions	21,159	12,227	7,754	5,816
Investment Provisions	552	154	—	—
Total Provisions	28,003	12,609	8,648	6,404
PBT	(15,060)	1,210	7,715	11,992
Tax Provisions	1,263	(818)	1,930	2,999
Effective Tax Rate (%)	(8.4)	(67.6)	25.0	25.0
PAT	(16,323)	2,027	5,785	8,993
Growth (%)	(492.3)	(112.4)	185.4	55.4

Balance Sheet (Rs m)

Y/e March	2017	2018	2019E	2020E
Par Value	1	1	1	1
No. of equity shares	521	557	557	557
Equity	521	557	557	557
Networth	56,765	61,612	67,062	75,551
Adj. Networth	32,511	33,701	42,520	54,379
Deposits	724,631	800,065	920,075	1,039,684
Growth (%)	4.4	10.4	15.0	13.0
Low Cost deposits	374,602	407,146	460,037	523,481
% of total deposits	51.7	50.9	50.0	50.4
Total Liabilities	820,187	896,876	1,025,734	1,158,873
Net Advances	498,161	569,128	671,570	782,380
Growth (%)	(0.8)	14.2	18.0	16.5
Investments	212,909	188,800	231,660	242,061
Total Assets	820,187	896,876	1,025,734	1,158,873

Source: Company Data, PL Research.

Quarterly Financials (Rs m)

Y/e March	Q1FY18	Q2FY18	Q3FY18	Q4FY18
Interest Income	16,803	16,664	16,830	15,917
Interest Expense	9,681	9,438	9,028	9,359
Net Interest Income	7,122	7,226	7,802	6,558
Non Interest Income	1,102	1,050	1,078	1,723
CEB	471	475	516	562
Treasury	263	26	(20)	226
Net Total Income	8,224	8,277	8,880	8,280
Operating Expenses	4,539	4,635	5,053	5,616
Employee Expenses	3,032	3,080	3,278	3,479
Other Expenses	1,508	1,555	1,774	2,137
Operating Profit	3,685	3,642	3,827	2,665
Core Operating Profit	3,422	3,616	3,848	2,438
Provisions	5,168	2,429	2,501	2,511
Loan loss provisions	5,517	2,290	2,501	1,829
Investment Depreciation	(333)	—	—	485
Profit before tax	(1,483)	1,213	1,326	154
Tax	(1,785)	497	602	(131)
PAT before EO	302	716	725	284
Extraordinary item	—	—	—	—
PAT	302	716	725	284

Key Ratios

Y/e March	2017	2018	2019E	2020E
CMP (Rs)	56	56	56	56
Equity Shrs. Os. (m)	521	557	557	557
Market Cap (Rs m)	29,411	31,415	31,415	31,415
M/Cap to AUM (%)	3.6	3.5	3.1	2.7
EPS (Rs)	(32.4)	3.8	10.4	16.1
Book Value (Rs)	97	99	109	124
Adj. BV (100%) (Rs)	50	49	65	86
P/E (x)	(1.7)	15.0	5.4	3.5
P/BV (x)	0.6	0.6	0.5	0.5
P/ABV (x)	1.1	1.1	0.9	0.7
DPS (Rs)	—	—	0.5	0.8
Dividend Yield (%)	—	—	0.9	1.3

Profitability (%)

Y/e March	2017	2018	2019E	2020E
NIM	3.1	3.3	3.4	3.4
RoAA	(2.0)	0.2	0.6	0.8
RoAE	(27.0)	3.4	9.0	12.6

Efficiency

Y/e March	2017	2018	2019E	2020E
Cost-Income Ratio (%)	56.9	58.9	57.1	56.8
C-D Ratio (%)	68.7	71.1	73.0	75.3
Business per Emp. (Rs m)	86	84	84	84
Profit per Emp. (Rs lacs)	(11.5)	1.2	3.1	4.1
Business per Branch (Rs m)	763	684	636	582
Profit per Branch (Rs m)	(10)	1	2	3

Asset Quality

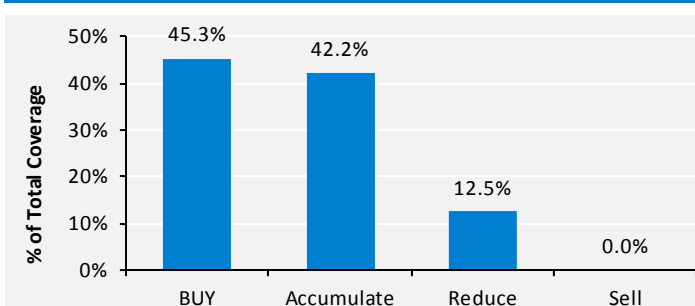
Y/e March	2017	2018	2019E	2020E
Gross NPAs (Rs m)	60,000	60,067	56,413	51,848
Net NPAs (Rs m)	24,254	27,911	24,542	21,173
Gr. NPAs to Gross Adv. (%)	11.3	10.0	8.0	6.4
Net NPAs to Net Adv. (%)	4.9	4.9	3.7	2.7
NPA Coverage (%)	59.6	53.5	56.5	59.2

Source: Company Data, PL Research.

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Rating Distribution of Research Coverage**PL's Recommendation Nomenclature**

BUY	: Over 15% Outperformance to Sensex over 12-months
Accumulate	: Outperformance to Sensex over 12-months
Reduce	: Underperformance to Sensex over 12-months
Sell	: Over 15% underperformance to Sensex over 12-months
Trading Buy	: Over 10% absolute upside in 1-month
Trading Sell	: Over 10% absolute decline in 1-month
Not Rated (NR)	: No specific call on the stock
Under Review (UR)	: Rating likely to change shortly

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