

January 14, 2019

Q3FY19 Result Update

☑ Change in Estimates | ☑ Target | ■ Reco

Change in Estimates

	Current		Previous	
	FY20E	FY21E	FY20E	FY21E
Rating	BUY		BUY	
Target Price	76		94	
NII (Rs. m)	37,946	43,688	36,291	41,666
% Chng.			4.6	4.9
Op. Profit (Rs. m)	16,278	18,342	16,934	19,480
% Chng.			(3.9)	(5.8)
EPS (Rs.)	11.4	14.9	14.1	16.3
% Chng.			(19.1)	(8.4)

Key Financials

	FY18	FY19E	FY20E	FY21E
NII (Rs m)	28,708	32,893	37,946	43,688
Op. Profit (Rs m)	13,819	14,599	16,278	18,342
PAT (Rs m)	2,027	3,800	6,341	8,302
EPS (Rs.)	3.8	6.8	11.4	14.9
Gr. (%)	(111.6)	81.5	66.9	30.9
DPS (Rs.)	-	0.5	0.8	0.8
Yield (%)	-	1.3	2.0	2.0
NIM (%)	3.6	3.7	3.8	3.9
RoAE (%)	3.4	6.0	9.3	11.1
RoAA (%)	0.2	0.4	0.6	0.7
P/BV (x)	0.4	0.4	0.3	0.3
P/ABV (x)	0.8	0.7	0.5	0.4
PE (x)	9.9	5.5	3.3	2.5
CAR (%)	11.4	9.9	9.3	8.8

Key Data

JKBK.BO | JKBK IN

52-W High / Low	Rs.83 / Rs.35
Sensex / Nifty	35,854 / 10,738
Market Cap	Rs.21bn / \$ 294m
Shares Outstanding	557m
3M Avg. Daily Value	Rs.50.5m

Shareholding Pattern (%)

Promoter's	59.23
Foreign	15.57
Domestic Institution	7.75
Public & Others	17.45
Promoter Pledge (Rs bn)	

Stock Performance (%)

	1M	6M	12M
Absolute	4.9	(22.2)	(54.1)
Relative	5.2	(20.7)	(55.8)

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Gradual improvement in core performance

Quick Pointers:

- Recognized 70% of the IL&FS exposure mainly towards Holdco & immediate subsidiaries, while rest portion is servicing
- Strong margin improvement on back of higher yields partly due to booking of interest income from impaired assets

JKBK's earnings of Rs1.03bn (PL:1.07bn) were in-line with expectations as provisions were flattish as envisaged on back of provisions on IL&FS exposure. Core operating performance was encouraging with beat from NII which grew by 13% as bank booked some interest back on impaired assets helping NIMs improvement. Bank's J&K state restructured which has been the point of concern can be fully upgraded in Dec'19 but has been performing well and management expects no slippages. Valuation of 0.5x on Sep-20 ABV is undemanding given the loan growth & margins, liabilities franchise and limited asset quality impact. Even adjusting for some slippages from J&K RSA, valuation remain at comfort levels with only capital being constraint. Retain BUY with revised TP of Rs76 (from Rs94) based on 0.9x Sep-20 ABV.

- Continued improvement in core performance:** Bank's NII growth of 13% YoY has been improving from last few quarters on back of lower strain of interest reversals, interest booking on impaired assets and better loan growth towards high margin segments. Although, core PPOP growth of 8% YoY was offset by high opex growth from last few quarters as bank continues to provide on wage revision, gratuity and invests in technology & branch outlets in deeper parts of J&K. Bank expects such opex will be curtailed over next two years and is mainly focusing on C/I ratio measurement.
- Loan growth moderates but for J&K state strong:** Overall gross loan growth moderated to 11% YoY as bank grew non-J&K state book at much slower rate in lieu to conserve capital and focus on growing retail assets or towards existing corporate relationships. Bank will continue to grow the J&K state book at much faster rate of 20-25% towards Agri/Horticulture/Personal loans/state govt employee related loans which should help margins.
- Slippages one-off from IL&FS exposure:** Bank reported slippages of Rs10.0bn which were mostly from the IL&FS exposure towards the holdco and immediate subsidiaries but still have small part exposure as standard. Bank provided 15% provision on the exposure keeping credit cost elevated and if required bank from time to time will do higher provisions. Bank's J&K state restructured book is seeing stable trends with NPAs <1% of o/s book and hence bank is confident of upgrading to standard from impaired by Dec'19.
- Capital will restrict growth but B/s better positioned:** Bank holds decent PCR of 56% (66% in technical w.off) and provisions will be on back of ageing of NPAs only as incremental stress is lower. Business wise, strategy of growing in J&K state, de-focusing on corporate book and better margins makes bank's position strong but Tier-I of 9.8% should restrict growth levels.

Exhibit 1: Much better core performance with gradual earnings recovery

Better repricing of loans led to robust interest income growth; however, deposit growth coupled with 6bps rise in CoF moderated NII growth

Other income stood out; led by treasury gains, strong fee growth

High sequential jump in provisions due to multi-fold increase in slippages

Advance growth were in line, led by 20%+ growth in J&K book

Shoot up in GNPA due to IL&FS slippages of 10bn

Capital adequacy maintained around 12%; capital infusion from PNB Metlife stake sale would aid further

(Rs m)	Q3FY19	Q3FY18	YoY gr. (%)	Q2FY19	QoQ gr. (%)
Interest Income	20,027	16,830	19.0	18,401	8.8
Interest Expended	11,211	9,028	24.2	10,482	7.0
Net interest income (NII)	8,816	7,802	13.0	7,919	11.3
Treasury income	108	(20)	(629.9)	(259)	NA
Other income	1,635	1,078	51.7	1,112	47.0
Total income	10,451	8,880	17.7	9,031	15.7
Operating expenses	6,202	5,053	22.8	5,604	10.7
-Staff expenses	4,078	3,278	24.4	3,675	11.0
-Other expenses	2,124	1,774	19.7	1,929	10.1
Operating profit	4,249	3,827	11.0	3,427	24.0
Core operating profit	4,141	3,848	7.6	3,685	12.4
Total provisions	2,528	2,501	1.1	1,724	46.7
Profit before tax	1,721	1,326	29.8	1,703	1.1
Tax	684	602	13.6	765	(10.7)
Profit after tax	1,038	725	43.2	938	10.7
Balance sheet (Rs mn)					
Deposits	8,62,103	7,31,551	17.8	8,14,292	5.9
Advances	6,50,268	5,79,287	12.3	6,36,912	2.1
Profitability ratios (%)					
Yield on Advances	9.2	9.0	21 bps	9.0	25 bps
Cost of Funds	5.0	4.9	6 bps	4.9	7 bps
NIM	3.9	4.0	(11) bps	3.7	22 bps
RoaA	0.4	0.4	7 bps	0.4	3 bps
RoaE	6.3	4.8	152 bps	6.0	32 bps
Asset Quality (%)					
Gross NPL (Rs mn)	68,597	62,321	10.1	60,877	12.7
Net NPL (Rs mn)	30,492	24,877	22.6	24,888	22.5
Gross NPL ratio	9.9	10.1	(14) bps	9.0	94 bps
Net NPL ratio	4.7	4.3	40 bps	3.9	78 bps
Coverage ratio (calc)	56.3	60.1	(375) bps	59.1	(279) bps
Business & Other Ratios (%)					
Low-cost deposit mix	48.9	49.9	(101) bps	49.3	(48) bps
Cost-income ratio	59.3	56.9	245 bps	62.1	(271) bps
Non int. inc / total income	15.6	12.1	351 bps	12.3	333 bps
Credit deposit ratio	75.4	79.2	(376) bps	78.2	(279) bps
CAR	11.6	10.9	76 bps	12.0	(39) bps
Tier-I	9.8	8.5	129 bps	10.2	(33) bps

Source: Company, PL

Key Q3FY19 Concall Highlights

Business Growth Outlook:

- Bank retains its focus on retail segment and should further propelling as its de-focuses on corporate segment exposure except for existing relationships. Bank continued its guidance of 20% YoY loan growth with business turnover of Rs2.5 trillion by FY22 and earnings of Rs20.0bn.
- Bank management highlighted that growth in J&K state has been stable and good, and therefore would prefer incremental corporate exposure, if any on opportunistic basis. However, bank is also open to pounce on short term opportunity for treasury gains. Within retail, bank is targeting tourism, horticulture, Govt employee personal loans.

Opex:

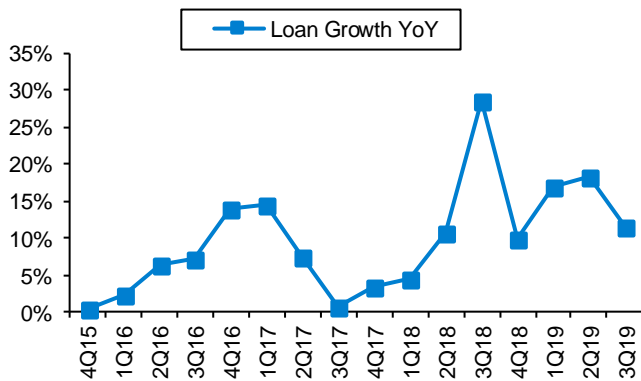
- Bank attributed sustained rise in operating expenses to wage revision norms, investment towards digitalization and expenses towards building CASA. Overall, bank expects to bring down its cost to income ratio around 50% by FY22 (currently 59%).

Asset Quality:

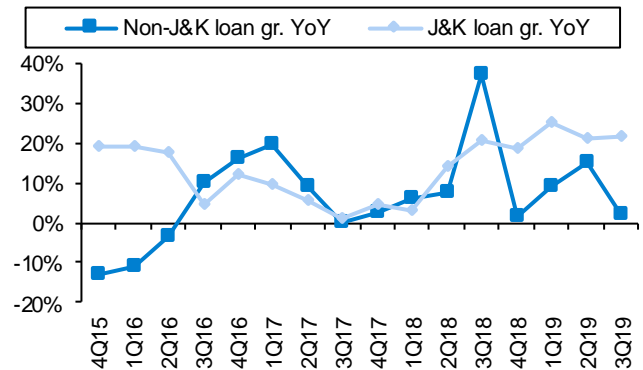
- Slippages and IL&FS exposure** – Bank saw slippages of Rs10.0 mainly led by partly recognizing exposure towards IL&FS while part of exposure (Rs3.5bn – to Chenani Nashri Tunnel & TN Power Project) remains standard in the books. Bank has done 15% provision on the NPA exposure and may do need based provisions as development form in the exposure.
- Restructured book** – Bank's J&K state RSA book of Rs37.0bn (5.0% of loans) is behaving well with NPAs of <1% of O/s and should not see any slippages going ahead. Accounts can be classified as standard from Dec'19 as all accounts are out moratorium and servicing interest, while bank has option to reverse provision which it has not taken as yet.
- Credit cost guidance** - Bank management expects credit cost to continue at 1.5-1.7% in FY19 and 1.5% in FY20 due to ageing of NPA and improvement in PCR. Credit cost should come off <1% by FY22 helping earnings recovery.

Capital:

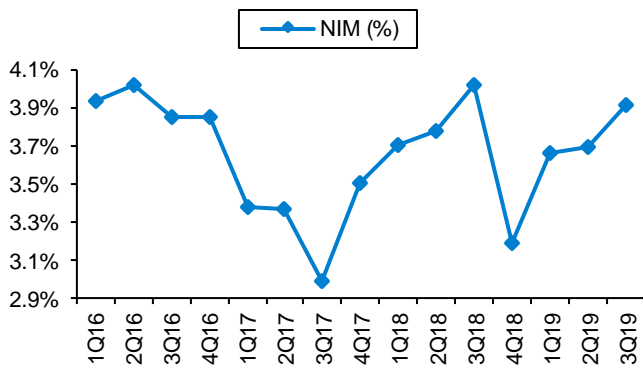
- Tier I stands at 9.8% which should restrict loan growth and hence bank will grow assets requiring lower RWA mainly in retail. Further, to fuel growth, bank expects to meet capital needs via stake sale in PNB Metlife (5% stake) which could materialize in next 3-6 months.

Exhibit 2: Loan growth slowed on cautious stance in non-J&K loans...


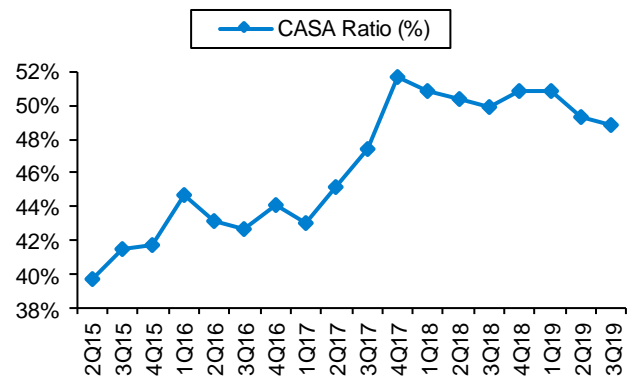
Source: Company, PL

Exhibit 3: ...although J&K state loan book has continued to see robust loan growth


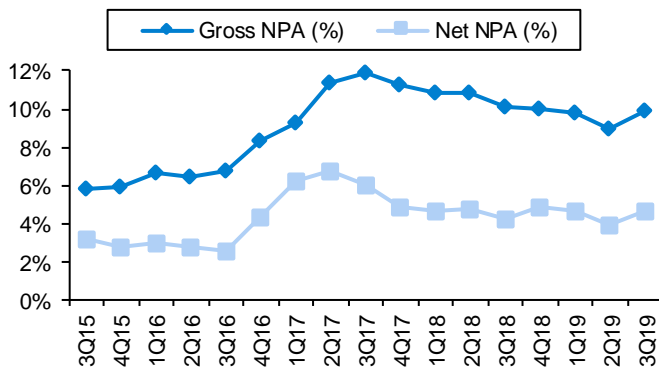
Source: Company, PL

Exhibit 4: NIMs improved on interest booking and better yields


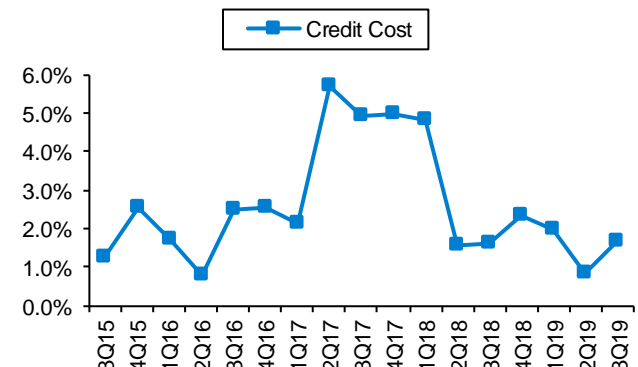
Source: Company, PL

Exhibit 5: CASA ratio has come off from 50% mark on higher TDs growth mainly in outside J&K


Source: Company, PL

Exhibit 6: Asset quality higher due to one-off slippage...


Source: Company, PL

Exhibit 7: ...however PCR was maintained above 65%


Source: Company, PL

Exhibit 8: Slippages from rest of India portfolio

Stressed assets for J&K	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19
Add: Additions	13,774	10,625	1,910	6,476	5,055	4,804	3,711	17,477	7,699	2,520	10,286
Less: Reductions	10,311	945	1,591	3,025	8,649	1,382	1,219	19,731	5,349	10,907	2,365
Gross NPA - Closing	47,149	56,830	57,149	60,000	56,406	59,829	62,321	60,067	62,417	60,877	68,597
Gross NPA % of loans	9.3%	11.3%	11.8%	11.2%	10.8%	10.9%	10.1%	10.0%	9.8%	9.1%	10.0%
Total Std restructured assets	32,474	32,463	32,490	55,398	55,537	57,524	56,731	46,614	41,292	39,483	37,986
Restructured during qtr.	761	392	102	33,537	2,231	2,515	2,542	4,066	2,908	2,453	1,967
O/s Restructuring for J&K State		24,670	21,315	44,000	45,000	45,000	47,940	41,176	42,205	43,398	42,109
Total Restructured Book		57,133	53,804	63,820	64,154	66,123	67,145	61,330	60,875	58,476	57,047
Restructured assets as % of loans	6.6%	6.8%	7.2%	12.8%	13.2%	12.9%	11.6%	10.8%	10.2%	9.2%	8.8%

Source: Company, PL

Exhibit 9: Change in estimates table – We slightly increase margins but adjust to higher opex and credit cost for FY20

Rs (mn)	Old			Revised			% Change		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Net interest income	32,179	36,291	43,790	32,893	37,946	43,688	2.2	4.6	(0.2)
Operating profit	15,332	16,934	18,445	14,599	16,278	18,342	(4.8)	(3.9)	(0.6)
Net profit	3,902	7,837	8,378	3,800	6,341	8,302	(2.6)	(19.1)	(0.9)
EPS, Rs.	7.0	14.1	15.0	6.8	11.4	14.9	(2.6)	(19.1)	(0.9)
ABV per share, Rs.	64.3	81.5	94.8	55.0	73.4	92.4	(14.4)	(9.9)	(2.5)
Price target, Rs.		94			76			(19.6)	
Recommendation		BUY			BUY				

Source: Company, PL

Exhibit 10: Valuation Table – We revise our TP to Rs76 (from Rs94) based on 0.9x Sep-20 ABV

PT calculation and upside	
Terminal growth	5.0%
Market risk premium	6.3%
Risk-free rate	8.0%
Adjusted beta	1.05
Cost of equity	14.6%
Fair price - P/ABV, Rs	76
Target P/ABV (x)	0.9
Target P/E (x)	5.8
Current price, Rs	38
Upside (%)	102%

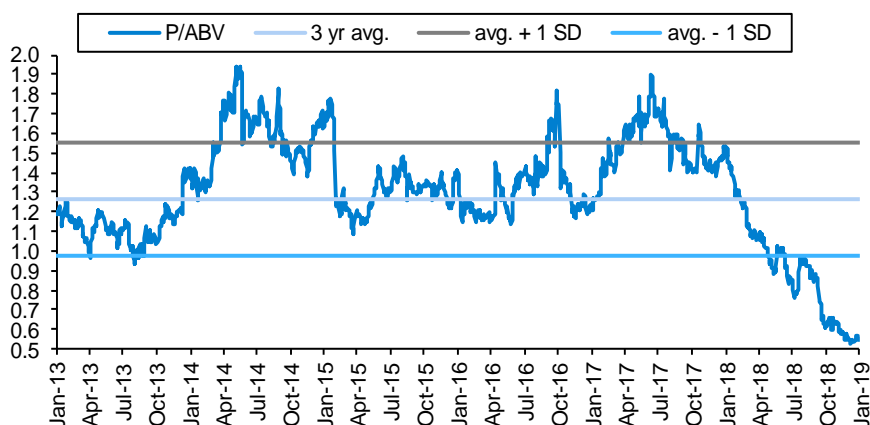
Source: Company, PL

Exhibit 11: Return ratios should gradually improve on loan growth, improving margins and adequate PCR

ROAE decomposition	2014	2015	2016	2017	2018	2019E	2020E	2021E
NIM/Assets	3.6%	3.6%	3.7%	3.3%	3.6%	3.7%	3.8%	3.9%
Fees/Assets	0.4%	0.6%	0.5%	0.5%	0.6%	0.6%	0.5%	0.5%
Inv. Profits/Assets	0.1%	0.2%	0.2%	0.2%	0.1%	0.1%	0.1%	0.1%
Net revenues/Assets	4.2%	4.4%	4.4%	4.0%	4.2%	4.3%	4.4%	4.5%
Opex/Assets	-1.6%	-1.9%	-2.1%	-2.3%	-2.5%	-2.7%	-2.8%	-2.8%
Provisions/Assets	-0.2%	-1.4%	-1.3%	-3.7%	-1.6%	-1.1%	-0.8%	-0.6%
Taxes/Assets	-0.8%	-0.4%	-0.4%	-0.2%	0.1%	-0.1%	-0.2%	-0.2%
Costs/Assets	-2.6%	-3.7%	-3.9%	-6.2%	-3.9%	-3.9%	-3.7%	-3.7%
ROAA	1.6%	0.7%	0.6%	-2.2%	0.3%	0.4%	0.6%	0.7%
Equity/Assets	7.2%	8.0%	8.7%	8.1%	7.4%	7.1%	6.8%	6.6%
ROAE	22.3%	8.6%	6.6%	-28.5%	3.8%	6.7%	10.3%	12.1%

Source: Company, PL

Exhibit 12: One year forward P/ABV trends – Valuations at cheaper levels



Source: Company, PL

Income Statement (Rs. m)

Y/e Mar	FY18	FY19E	FY20E	FY21E
Int. Earned from Adv.	49,777	59,280	69,719	81,616
Int. Earned from invt.	14,316	15,391	16,525	16,296
Others	4	3	1	2
Total Interest Income	66,214	76,137	87,822	99,649
Interest Expenses	37,506	43,244	49,876	55,962
Net Interest Income	28,708	32,893	37,946	43,688
Growth(%)	12.0	14.1	14.6	14.4
Non Interest Income	4,953	5,498	6,048	6,653
Net Total Income	33,661	38,391	43,993	50,340
Growth(%)	(0.9)	14.7	15.0	13.2
Employee Expenses	12,869	15,571	17,907	20,593
Other Expenses	6,008	7,209	8,507	10,038
Operating Expenses	19,842	23,792	27,716	31,998
Operating Profit	13,819	14,599	16,278	18,342
Growth(%)	6.8	5.6	11.5	12.7
NPA Provision	12,227	9,571	7,225	6,731
Total Provisions	12,609	9,533	7,823	7,273
PBT	1,210	5,066	8,455	11,069
Tax Provision	(818)	1,267	2,114	2,767
Effective tax rate (%)	(67.6)	25.0	25.0	25.0
PAT	2,027	3,800	6,341	8,302
Growth(%)	(112.4)	87.4	66.9	30.9

Balance Sheet (Rs. m)

Y/e Mar	FY18	FY19E	FY20E	FY21E
Face value	1	1	1	1
No. of equity shares	557	557	557	557
Equity	557	557	557	557
Networth	61,612	65,076	70,913	78,710
Growth(%)	8.5	5.6	9.0	11.0
Adj. Networth to NNPA's	27,911	28,088	23,677	20,915
Deposits	800,065	892,072	999,121	1,119,016
Growth(%)	10.4	11.5	12.0	12.0
CASA Deposits	407,146	446,036	503,058	565,103
% of total deposits	50.9	50.0	50.4	50.5
Total Liabilities	896,876	1,010,320	1,128,556	1,262,401
Net Advances	569,128	665,879	779,079	903,731
Growth(%)	14.2	17.0	17.0	16.0
Investments	188,800	228,613	223,820	222,319
Total Assets	896,876	1,010,320	1,128,556	1,262,401
Growth (%)	9.4	12.6	11.7	11.9

Asset Quality

Y/e Mar	FY18	FY19E	FY20E	FY21E
Gross NPAs (Rs m)	60,067	63,384	57,374	53,930
Net NPAs (Rs m)	27,911	28,088	23,677	20,915
Gr. NPAs to Gross Adv.(%)	10.0	9.0	7.1	5.8
Net NPAs to Net Adv. (%)	4.9	4.2	3.0	2.3
NPA Coverage %	53.5	55.7	58.7	61.2

Profitability (%)

Y/e Mar	FY18	FY19E	FY20E	FY21E
NIM	3.6	3.7	3.8	3.9
RoAA	0.2	0.4	0.6	0.7
RoAE	3.4	6.0	9.3	11.1
Tier I	9.2	9.0	8.4	8.1
CRAR	11.4	9.9	9.3	8.8

Source: Company Data, PL Research

Quarterly Financials (Rs. m)

Y/e Mar	Q4FY18	Q1FY19	Q2FY19	Q3FY19
Interest Income	15,917	17,629	18,401	20,027
Interest Expenses	9,359	9,837	10,482	11,211
Net Interest Income	6,558	7,792	7,919	8,816
YoY growth (%)	(8.5)	1.6	11.1	24.2
CEB	562	502	548	594
Treasury	-	-	-	-
Non Interest Income	1,723	1,344	1,112	1,635
Total Income	17,640	18,973	19,513	21,662
Employee Expenses	3,479	3,752	3,675	4,078
Other expenses	2,137	1,886	1,929	2,124
Operating Expenses	5,616	5,638	5,604	6,202
Operating Profit	2,665	3,498	3,427	4,249
YoY growth (%)	(3.6)	(5.1)	(5.9)	11.0
Core Operating Profits	-	-	-	-
NPA Provision	3,395	2,901	1,300	2,653
Others Provisions	2,511	2,550	1,724	2,528
Total Provisions	2,511	2,550	1,724	2,528
Profit Before Tax	154	947	1,703	1,721
Tax	(131)	421	765	684
PAT	284	526	938	1,038
YoY growth (%)	(105.1)	74.3	30.9	43.2
Deposits	800,065	774,196	814,292	862,103
YoY growth (%)	10.4	7.9	15.7	17.8
Advances	569,128	598,411	636,912	650,268
YoY growth (%)	14.2	22.8	24.1	12.3

Key Ratios

Y/e Mar	FY18	FY19E	FY20E	FY21E
CMP (Rs)	37	37	37	37
EPS (Rs)	3.8	6.8	11.4	14.9
Book Value (Rs)	99	105	116	130
Adj. BV (70%)(Rs)	49	55	73	92
P/E (x)	9.9	5.5	3.3	2.5
P/BV (x)	0.4	0.4	0.3	0.3
P/ABV (x)	0.8	0.7	0.5	0.4
DPS (Rs)	-	0.5	0.8	0.8
Dividend Payout Ratio (%)	-	7.3	6.6	5.0
Dividend Yield (%)	-	1.3	2.0	2.0

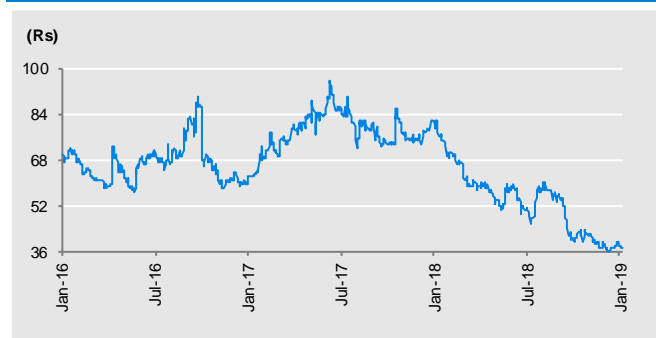
Efficiency

Y/e Mar	FY18	FY19E	FY20E	FY21E
Cost-Income Ratio (%)	58.9	62.0	63.0	63.6
C-D Ratio (%)	71.1	74.6	78.0	80.8
Business per Emp. (Rs m)	135	152	172	194
Profit per Emp. (Rs lacs)	2	4	6	8
Business per Branch (Rs m)	1,574	1,781	2,021	2,286
Profit per Branch (Rs m)	2	4	7	9

Du-Pont

Y/e Mar	FY18	FY19E	FY20E	FY21E
NII	3.58	3.68	3.77	3.87
Total Income	4.19	4.29	4.37	4.46
Operating Expenses	2.47	2.66	2.75	2.84
PPoP	1.72	1.63	1.62	1.63
Total provisions	1.57	1.07	0.78	0.64
RoAA	0.25	0.42	0.63	0.74
RoAE	3.84	6.67	10.29	12.13

Source: Company Data, PL Research

Price Chart
Recommendation History


No.	Date	Rating	TP (Rs.)	Share Price (Rs.)
1	3-Feb-18	BUY	112	69
2	13-Apr-18	BUY	112	59
3	4-Jun-18	BUY	100	56
4	10-Jul-18	BUY	100	51
5	27-Jul-18	BUY	94	54
6	5-Oct-18	BUY	94	40
7	7-Jan-19	BUY	94	38

Analyst Coverage Universe

Sr. No.	CompanyName	Rating	TP (Rs)	Share Price (Rs)
1	Axis Bank	Accumulate	681	637
2	Bank of Baroda	BUY	161	123
3	Bank of India	Reduce	89	106
4	Federal Bank	BUY	102	95
5	HDFC Bank	BUY	2,310	2,121
6	HDFC Standard Life Insurance Company	BUY	440	393
7	ICICI Bank	BUY	415	368
8	ICICI Prudential Life Insurance Company	BUY	507	320
9	IDFC Bank	Accumulate	55	46
10	IndusInd Bank	BUY	1,765	1,602
11	Jammu & Kashmir Bank	BUY	94	38
12	Kotak Mahindra Bank	Hold	1,291	1,247
13	Max Financial Services	BUY	629	436
14	Punjab National Bank	Hold	79	81
15	SBI Life Insurance Company	BUY	779	602
16	South Indian Bank	BUY	22	15
17	State Bank of India	BUY	355	296
18	Union Bank of India	Reduce	79	91
19	YES Bank	Accumulate	231	187

PL's Recommendation Nomenclature (Absolute Performance)

Buy	: > 15%
Accumulate	: 5% to 15%
Hold	: +5% to -5%
Reduce	: -5% to -15%
Sell	: < -15%
Not Rated (NR)	: No specific call on the stock
Under Review (UR)	: Rating likely to change shortly



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