Stock Update

The Jammu and Kashmir Bank Ltd.

November 15, 2023

The Jammu and Kashmir Bank Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Private Sector Bank	Rs. 112.8	Buy in the band of Rs. 112 – 114 & add more on dips to Rs. 99 – 101 band	Rs. 124	Rs. 135	2-3 quarters

HDFC Scrip Code	JKBANK
BSE Code	532209
NSE Code	J&KBANK
Bloomberg	JKBK IN
CMP November 14, 2023	112.8
Equity Capital (Rs Cr)	103
Face Value (Rs)	1
Equity Share O/S (Cr)	103
Market Cap (Rs Cr)	11302
Adjusted Book Value (Rs)	83.5
Avg. 52 Wk Volumes	9594922
52 Week High	118.0
52 Week Low	38.2

Share holding Pattern % (September, 2023)	
Promoters	63.41
Institutions	7.53
Non Institutions	29.06
Total	100.00

* Refer at the end for explanation on Risk Ratings

Fundamental Research Analyst
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Our Take:

The Jammu and Kashmir (JK) Bank was established in 1938 and is headquartered in Srinagar. It offers retail as well as corporate banking along with treasury services. It has a total of 1,001 branches, out of which 833 branches are in the UT of Jammu & Kashmir. The Government of Jammu & Kashmir holds 63% stake in the bank and the bank has been designated by the RBI as the exclusive agent of banking activities related to the Government of J&K and related administrative offices. This designation enables the bank to play a pivotal role in collection of taxes and implementing initiatives of the Government in the UT of J&K as well as Ladakh. The bank has a well-balanced asset mix and it has started focusing on Retail, Agriculture and MSME ("RAM") sectors which will lead to better risk diversification, increased revenues and improved margins. In recent times, the bank has done significant investment for digitization, which is expected to aid its margins in the coming quarters.

Previously, we had issued an initiating coverage report on JK Bank (link) on 14th August, 2023 with targets of Rs. 81.5 and Rs. 87.75. These were achieved on 17th August, 2023.

Valuation & Recommendation:

The balance sheets of the Indian banks (especially PSU) are their healthiest in a long time due to the steps taken by the regulator and the government to strengthen the lenders and the broader economy as a whole.

We expect the bank to grow its loan book at 14% CAGR while NII and Net profit are expected to grow at 15% and 19% CAGR respectively over FY23-25E. ROAA is estimated to improve 1% by the end of FY25E from 0.89% at the end of FY23. The asset quality should improve further from here on as collection starts stabilizing. The company is trading at 0.96xFY25E ABV, which is at a discount to its peers. Looking at the growth opportunities aided by peace and stability in the state, we believe that the earnings and valuation have a chance to expand. Resumption of dividend payout in FY23 after 7-year gap sends positive signals.

We feel that investors can buy the stock of J&K Bank in the band of Rs. 112 – 114 (0.96x FY25E ABVPS) & add more on dips to Rs. 99 – 101 band (0.85x FY25E ABVPS). We expect the base case fair value of Rs. 124 (1.05x FY25E ABVPS) and the bull case fair value of Rs. 135 (1.15x FY25E ABVPS) over the next 2-3 quarters.

Financial Summary

	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)	FY21	FY22	FY23	FY24E	FY25E
NII	1334	1204	11%	1283	4%	3771	3911	4745	5566	6329
PPP	534	483	11%	528	1%	1584	1062	1858	2346	2848
PAT	381	243	57%	326	17%	432	502	1197	1498	1689
EPS (Rs)	3.7	2.4	56%	3.2	17%	6.1	7.3	11.6	14.5	16.4
ABV						68.1	68.1	83.5	100.0	117.8
P/E (x)						18.6	21.0	9.7	7.8	6.9
P/ABV (x)						1.7	1.7	1.4	1.1	1.0
RoAA (%)						0.4%	0.4%	0.9%	1.0%	1.0%
RoAE (%)						6.5%	6.7%	13.3%	14.0%	13.7%

(Source: Company, HDFC sec)

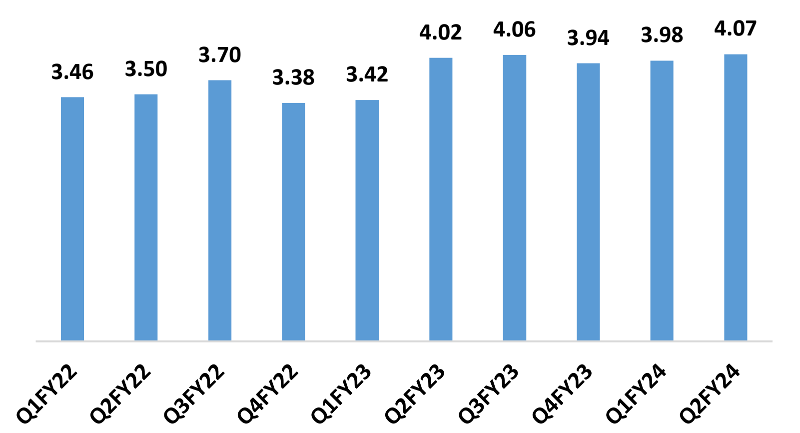
Recent Developments

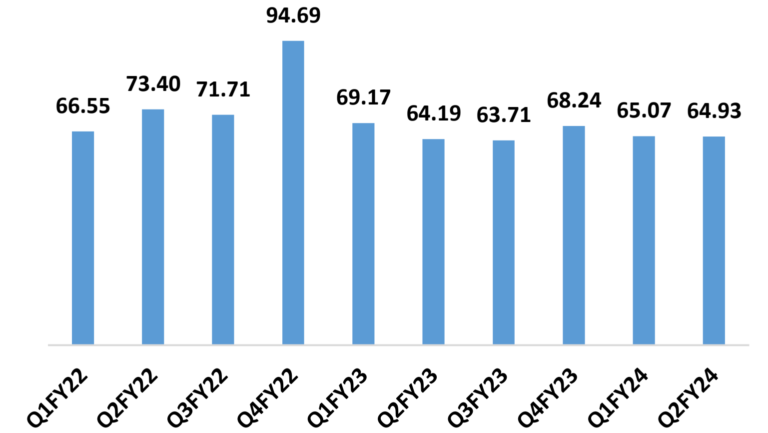
Q2FY24 Result Update:

The bank has continued with its healthy performance in Q2FY24. Its Net Interest Income (NII) stood at Rs. 1,334 crores, up 11/4% YoY/QoQ, which translates to an annualized NIM of 4.07% as against 3.98% in Q1FY24 and 4.02% in Q2FY23. Its yield on advances are up 49/20 bps and stood at 9.5%. Its cost of deposits is at 4.38%, up 71/6 bps YoY/QoQ. The bank reported other income of Rs. 190 crores, up 31% YoY but down 17% QoQ. Operating costs in the bank displayed modest growth as compared to topline, of 14/1% YoY/QoQ and stood at Rs. 990 crores. Its PPOP remained flat sequentially at Rs. 534 crores, up 11% YoY. The bank was able to control its cost to income ratio, which stood at 64.9%, which is almost flat YoY as well as QoQ. The bank reported negative credit costs which helped in aiding its profits. The net profit stood at Rs. 381 crores, up 57/17% YoY/QoQ.

On the financial performance aspect, the bank displayed healthy growth in its loan book which stood at Rs. 87,818 crores, up 18/4% YoY/QoQ. On the liability side, its total deposits stood at Rs. 1,26,590 crores, up 9/4% YoY/QoQ. Within this, its CASA balances stood at Rs. 64,049 crores, remaining flat YoY and QoQ. This is equivalent to a CASA ratio of 50.6%, down 408/268 bps YoY/QoQ. Its term deposits stood at Rs. 62,520 crores, up 19/10% YoY/QoQ. The bank has a credit-deposit ratio of 69.4% as against 64.4% in Q2FY23.

The capital adequacy ratio of the bank is at 14.53%. It has a total of 1,001 branches and 12,595 employees as of September 2023. Return on assets (annualized) is at 1.08%, up 37/14 bps YoY/QoQ.



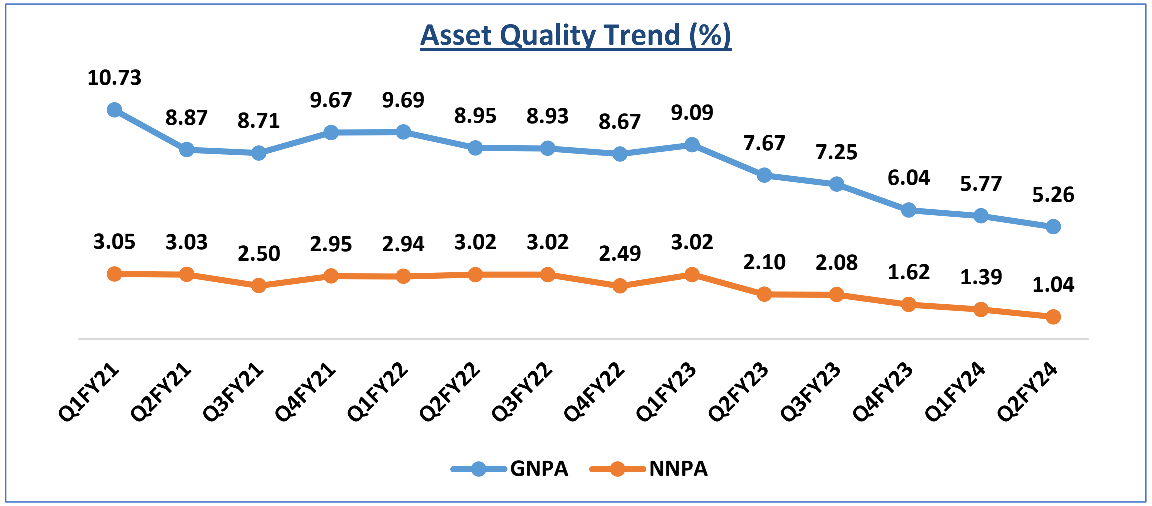


(Source: Company, HDFC sec)

Improving asset quality

Though the bank does not have asset quality ratios better than the industry, it has continued to show improvement in them, even in Q2FY24. Its GNPA ratios was as high as 8.7% in FY22, which reduced to 6% in FY23. The improvement was primarily driven by substantially higher recoveries and account upgradations during FY23 primarily from infrastructure and manufacturing sector. The slippages were high at 9.9% for FY23, but this was on account of technical issues as the bank upgraded its internal systems. In Q2FY24, the bank was able to control its slippages to 1.08% as against 10.09% in Q2FY23. It has reported GNPA of 5.26% as against 5.77% in Q1FY24 and 7.67% in Q2FY23, while it reported NNPA of 1.04% for Q2FY24, vs 1.39% in Q1FY24 and 2.1% in Q2FY23. The Provision Coverage Ratio (PCR) stood at 89.99% as against 87.55% in Q1FY24 and 85.58% in Q2FY23. Sector wise, the highest GNPA were observed in loans advanced against cash collaterals (14.81%). Manufacturing sector (12.84%) and services (10.56%).

With the improvement in the economic environment in the UT, the bank has seen an improvement in its SMA I & II accounts as well. Its total SMA book has declined from 35.7% in September 2022 to 21.4% in September 2023. Though stabilizing alongside improving macro factors, the bank's portfolio remains highly susceptible to socio-political developments in the union territory given the high regional concentration in operations.



(Source: Company, HDFC sec)

Concall Key Takeaways:

Q2FY24:

- It targets to bring down its cost to income ratio for FY24 to 60%. This ratio for Q2FY24 stood at 64.9% and the management is banking on its digital and technological initiatives to reduce its opex and thereby cooling down its cost to income ratio.
- The management has guided for annual NIMs in the range of 3.75-3.9%.
- Credit costs are expected to stay around 10bps for FY24 after which they should stabilize around 50-60bps in FY25.
- Total contingent provisions stood at Rs. 690 crores and floating provisions around Rs. 134 crores.
- The bank is targeting 18% loan growth for FY25 backed by strong demand in tourism and agriculture related activities in the home state.
- The management expects GNPA to fall to 4.5%, while NNPA are expected to go below 1%, and slippages to remain in the range of 1.25-1.5% for FY24.
- It has guided for GNPA to further reduce to 3% by the end of FY25.
- The bank does not expect any negative surprises from its restructured book going forward.

Q1FY24:

- The management expects the cost to income ratio to decline further from current level of 65.07%, backed by better leveraging of technological initiatives and high-cost employees scheduled to retire over the next 3-4 years, higher cross selling income and higher commissions from Government transactions. The bank has set a target cost to income ratio of 60% for FY24.
- The bank targets to reduce its GNPA ratios to 4.5% by the end of FY24. For this, the bank has deployed special teams for different segments of its loan books which would be focusing on recoveries from stressed accounts.
- The bank expects its deposit franchise to be supported by record number of tourists visiting the UT this year.
- Going forward, the management expects its NIMs to be supported by reduction in GNPA ratios and expanding credit-deposit ratio.
- Outside J&K, the bank wishes to expand into retail lending, specifically home loans. The target allocation of loan portfolio to rest of India is at 34%.
- The management is confident on the digitization drive that has been implemented in the bank and feel that by the end of FY24, J&K Bank would be at par with its peer banks in terms of the digital infrastructure.
- The management has clarified that it has very limited exposure to the state of Himachal Pradesh which recently experienced floods.
- The bank has set an ambitious target of earning Rs. 4,000 crores profit and achieving Rs. 4 lakh crores of business, by the end of FY28. It feels that improved technological infrastructure, motivated staff, improving macro environment, higher recoveries from written off accounts would aid the bank in achieving this target.
- The bank expects total recovery during FY24 to be around Rs. 1,500 crores which should positively impact the P&L account by Rs. 350-400 crores. It has also guided for Rs. 1,200 crores of recoveries in FY25.

Key rationale:

PSU banks well placed than Private Sector banks:

The banking sector in India seems to be witnessing a transitionary phase, wherein the margins, loan growth, and deposit mobilization are moderating. Moderation in deposit mobilization has led to a rise in deposit costs. We feel that banks with lower Credit-Deposit ratio and higher Liquidity Coverage ratio are better placed to navigate smoothly amidst this transitionary phase.

The recent Q2FY24 results were a mixed bag for PSU banks in the context of margins. J&K bank was one of the banks which reported a slight rise in its NIMs on the back of good traction in yield on advances, outweighing the increase in its cost of deposits. We like those banks who have a significant portion of their loan book linked to MCLR. This is because, this book reprices with a lag when compared to the EBLR book which reprices faster with changes in repo rates. Even though the headline inflation was high for July 2023 on the back of rising food prices, the RBI maintained its stance on the repo rates by keeping it unchanged. Going forward, if the RBI cuts repo rates, loans which are linked to EBLR will see a fall in the interest accrual while the MCLR book will only get repriced with a lag.

Further, the asset quality improvement has been witnessed across PSU banks, which has indirectly aided profitability in the form of lower credit costs. All these have translated into quarterly best RoA improvements for most PSU banks. Along with this, PSU banks have successfully lightened their balance sheet which is evident from falling risk-weighted assets portfolio. However, the point of concern is the falling market share of PSU banks in advances and deposits in the banking industry.

Healthy Traction in Advances & Deposits Franchise:

As of September 2023, the bank has reported gross advances worth Rs. 91,727 crores, up 16/4% YoY/QoQ. In terms of breakup, personal loans contributed 38% of the total book, and has grown by 16/5% YoY/QoQ. Its corporate portfolio has witnessed a healthy growth of 16/2% YoY/QoQ and stands at Rs. 28,329 crores. This makes the corporate loans account for 35% in the loan book. Though relatively new and hence small, the bank saw its credit cards portfolio grow by 25/9% YoY/QoQ, at Rs. 402 crores. The yield on advances of the bank as a while stood at 9.5% for Q2FY24, as against 9.3% in Q1FY24 and 9.01% in Q2FY23. The bank has a loan book concentrated in the UT of J&K and is taking steps to diversify while keeping J&K its primary business territory.

Off the total corporate book, 88.4% of the book is externally rated and 9.8% of the book is rated BB+ and below.

Particulars	Q2FY24	Q1FY24	Q2FY23	YoY	QoQ	Mix %
Personal Finance	34807	33076	29977	5%	16%	38%
Trade & Services	20218	18794	18543	8%	9%	22%
Manufacturing	7410	7220	6678	3%	11%	8%
Financial Markets	9783	9628	5300	2%	85%	11%
Agricultural Loans	8921	9615	8944	-7%	0%	10%
Others	10588	10069	9671	5%	9%	12%
Total	**91727**	**88402**	**79113**	**4%**	**16%**	**100%**

(Source: Company, HDFC sec)

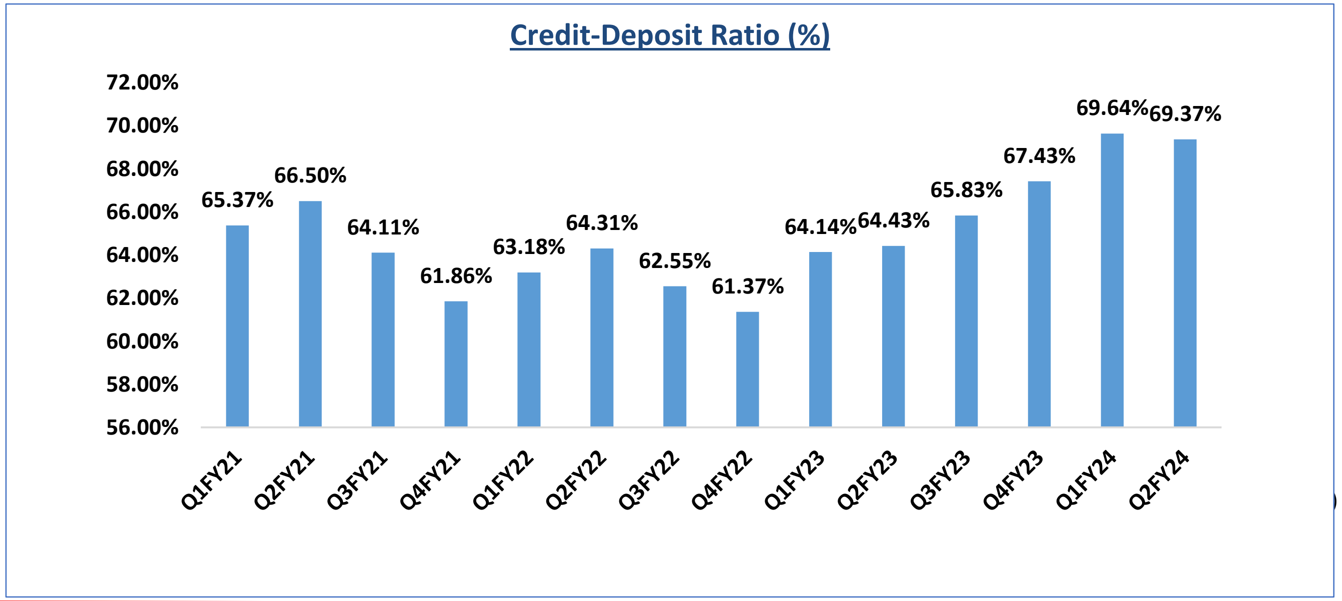
On the deposits side, the total deposits of the bank displayed healthy growth on a yearly basis. The total deposits stood at Rs. 1,26,590 crores, up 9/4% YoY/QoQ. The YoY growth in the deposit franchise was aided by healthy traction in the term deposits which stood at Rs. 62,520 crores, up 19/10% YoY/QoQ. On the other hand, CASA balances saw modest growth of 1% YoY, while falling by 1% sequentially to stand at Rs. 64,069 crores. This translates to a CASA ratio of 50.6% as of September 2023, as against 53.3% in Q1FY24 and 54.7% in Q2FY23. Though the CASA ratios have fallen for the bank, they are still superior than most of the large players in the industry. The management mentioned that the reason for the falling CASA ratio and balances was internal cannibalization on account of interest rate differentials. The cost of deposits for Q2FY24 stood at 4.38% as against 4.32% in Q1FY24 and 3.7% in Q2FY23. This increase in cost of deposits can be attributed to lower growth in CASA balances and increased competition to garner term deposits.

Particulars	Q2FY24	Q1FY24	Q2FY23	YoY (%/bps)	QoQ (%/bps)	Mix %
Savings Deposits	51198	51623	50639	-1%	1%	40%
Current Accounts	12871	13024	12640	-1%	2%	10%
Total CASA	**64069**	**64646**	**63281**	**-1%**	**1%**	**51%**
Term Deposits	62520	56652	52435	10%	19%	49%
Total	**126590**	**112145**	**122038**	**13%**	**4%**	**100%**
CASA %	50.61%	53.29%	54.69%	-408	-268	

(Source: Company, HDFC sec)

The above assets and liability franchise translate to a Credit-Deposit (C-D) Ratio of 69.4% up from 64.4% in Q2FY23. Further, the bank had a liquidity coverage ratio (LCR) of 202.4% as of FY-23. These ratios allow the bank to focus on its asset side of the balance sheet and grow the loan book, without having to worry much about the liability franchise. This is the main reason why the bank was able to report stable NIMs during the quarter, even when other banks have witnessed margin contractions in Q2FY24.

Hence, both the LCR and C-D ratios of the bank provide it ample room to tap the credit demand in the economy and can aid its NII, PPOP and profitability. Further, the bank in a press release in July 2023 disclosed that the Board has approved a plan to raise Rs. 700 crores of equity in H2FY24 and Rs. 1000 crores of Tier 2 bonds towards the end of CY23. This proposed fund-raise will further improve bank's liquidity.



Geographical Concentration but Systemic Support from Government:

As mentioned above, the bank has geographical concentration in the UT of J&K and Ladakh, it must also be factored in that the bank has a high systemic importance in the region. The bank might not be one of the largest ones in the country but is the largest bank in this region. The bank has remained cautious of expanding its operations outside J&K due to the adverse asset quality experiences it faced in the past. Though its primary operations are expected to remain focused on the union territory of J&K and Ladakh, the bank does plan to reduce its concentration risk to the UT of J&K by expanding its retail portfolio in the rest-of-India geography, with incremental branches planned for expansion in the near term.

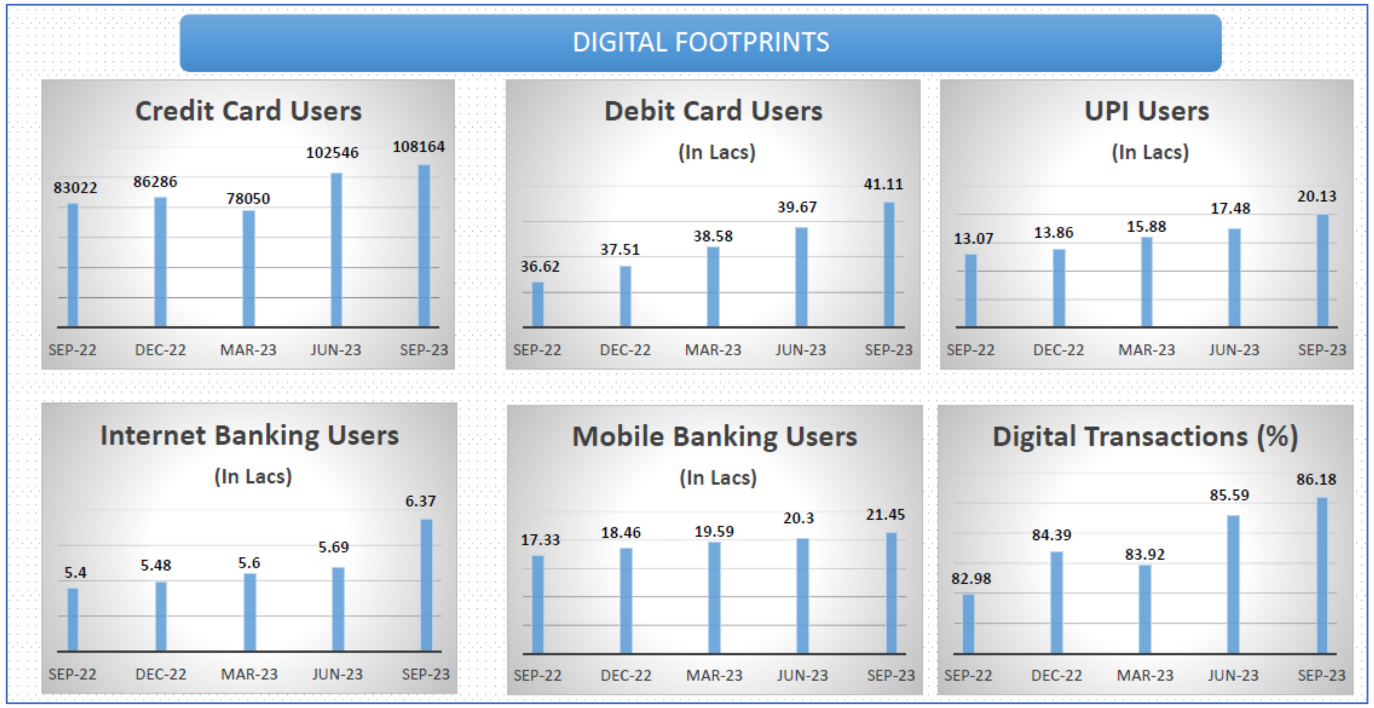
As and when needed, the Government of J&K has infused funds into the bank for the implementation of various policies. Since August 2019, the bank has received Rs. 2,000 crores of capital from the Government. The shareholding of Government of J&K in the bank has remained stable even after August 2019, when there was a change in the political status of J&K and Ladakh. In addition to Government of J&K, Government of Ladakh has a 4% shareholding in the bank. Even the Central Government is expected to potentially support the bank in the future, given the change in the political status of J&K.

Stable Investment Profile

As of September 2023, the total investment portfolio of the bank stands at 32,643 crores. The yield on investment stands at 6.73% for Q2FY24, as against 5.7% in Q2FY23. The Available for Sale (AFS) portfolio is only 14% of the mix, which has to be marked to market periodically and impacts the profitability of the bank. However, the duration of the AFS portfolio is fairly low. The bank has been active in treasury operations which aids its profitability with the help of its investment portfolios in the past. We expect the bank to reinvest the securities maturing in FY24 to be reinvested now at higher yields.

Clean up in top management by RBI:

RBI had approved the appointment of Mr. Rajesh Kumar Chibber as the Interim Chairman and MD of the bank in June 2019 after the bank suffered huge losses and allegations of fraud came up against the then Chairman of the bank. Subsequently, Mr. Baldev Prakash was appointed as the MD and CEO of the bank. He is a Chartered Accountant by profession and has over two decades of experience in the banking industry. Before joining J&K Bank, he was associated with SBI since 1991 and was serving as the Chief General Manager of Digital and Transaction Banking Marketing at SBI, Mumbai. He has significant exposure in the fields of financial control, compliance, business finance etc.



(Source: Company, HDFC sec)

Risks & Concerns

Concentrated Portfolio

Loan book of J&K Bank is concentrated in the UT of J&K and Ladakh. This exposes bank to geo-political uncertainties. Any policy decisions of the Government can have a material impact on the economies of these regions and thereby adversely affect the banking operations.

High growth rate

J&K Bank is the largest bank in the Jammu & Kashmir and Ladakh region. Any economic slowdown or market share loss could impact the current growth rate of the bank. Lower than expected AUM growth or build up in the NPAs are the key risks to our thesis.

Rising Interest rates

We witnessed a rising interest rate environment almost throughout FY23, and the cost of borrowings is rising for banks. Also, on the asset side, there is a concern of loan products being less affordable. This could impact the NIMs on account of squeeze in spread and ultimately the profitability of the company.

Asset Quality Concerns

Higher slippages than expected could have an impact on the performance of the shares of the bank. In the past, the bank has faced asset quality issues in its corporate portfolio, whereby its GNPA inflated to 11.5% as of March 2023. Slower resolution or lower realizations of the assets can have an impact on the bank's profitability.

Low Credit Ratings

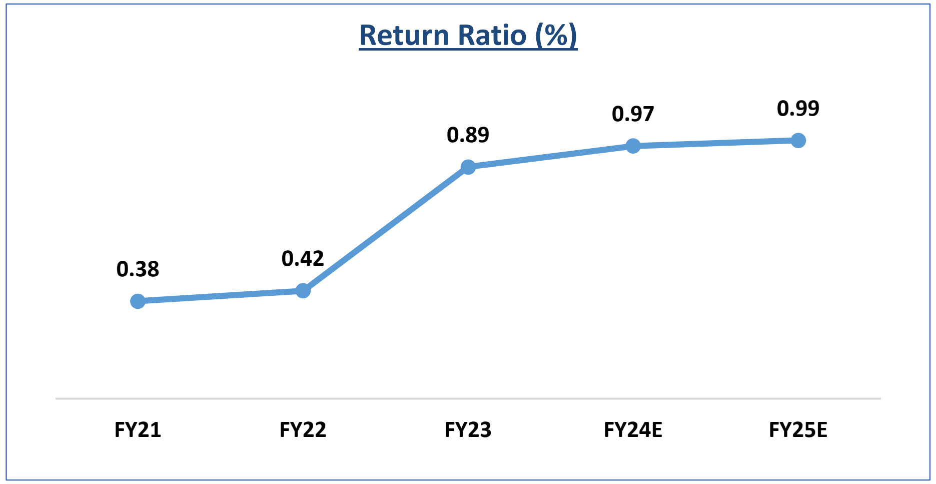
The Bank has a rating of AA- (Negative) from Brickworks Rating for Bonds and AA- (stable) from CRISIL for FDs. It is hoping to get a rating upgrade soon which will bring down its cost of funds. We shall remain watchful of any developments in this context.

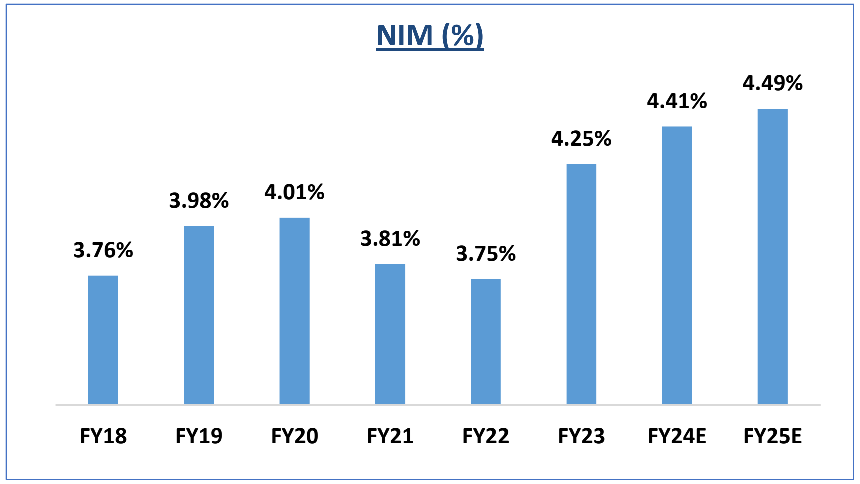
Divestment by the Government via OFS may increase the float and depress stock prices for some time.

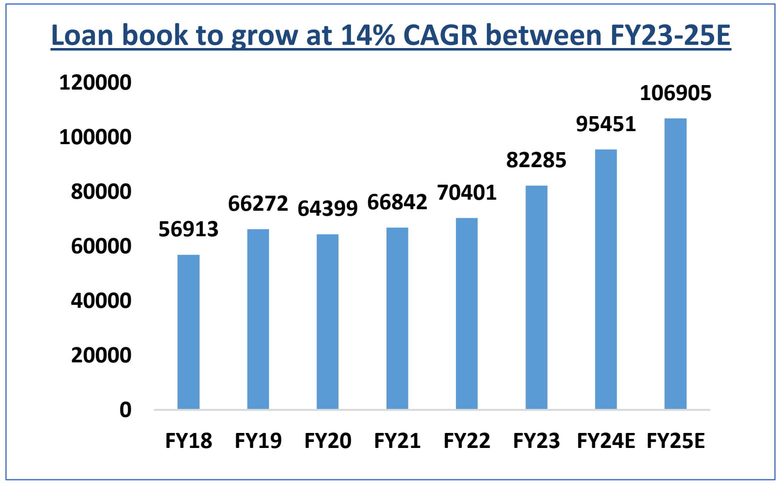
Company Background:

J&K Bank was established in 1938 and is headquartered in Srinagar. It offers retail as well as corporate banking along with treasury services. It has a total of 1,001 branches, out of which 833 branches are in the UT of Jammu & Kashmir.

The Government of Jammu & Kashmir holds 63% stake in the bank and the bank has been designated by the RBI as the exclusive agent of banking activities related to the Government of J&K and related administrative offices. This designation enables the bank to play a pivotal role in collection of taxes and implementing initiatives of the Government in the UT of J&K as well as Ladakh. As of FY21, the bank held a market share of ~65% of advances and ~63% of deposits in all scheduled commercial bank in J&K UT.







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J&K Bank Financials

Income Statement

Particulars	FY21	FY22	FY23	FY24E	FY25E
Interest Income	8111	8013	9355	11158	12628
Interest Expenses	4340	4102	4610	5592	6300
Net Interest Income	**3771**	**3911**	**4745**	**5566**	**6329**
Non interest income	692	744	757	889	981
Total Income	**4463**	**4655**	**5502**	**6455**	**7310**
Operating Expenses	2879	3593	3644	4109	4462
PPP	1584	1062	1858	2346	2848
Prov & Cont	1050	320	74	178	405
Profit Before Tax	534	743	1784	2168	2444
Tax	102	241	587	670	755
PAT	**432**	**502**	**1197**	**1498**	**1689**

Balance Sheet

Particulars	FY21	FY22	FY23	FY24E	FY25E
Share Capital	71	93	103	103	103
Reserves & Surplus	6754	8014	9840	11338	13027
Shareholder funds	**6826**	**8107**	**9943**	**11442**	**13130**
Deposits	108061	114710	122038	134422	144364
Borrowings	2015	2371	2892	3818	3742
Other Liab & Prov.	3390	5414	11089	13307	16634
SOURCES OF FUNDS	**120292**	**130602**	**145962**	**162988**	**177870**
Cash & Bank Balance	9498	8785	8879	7768	8883
Investment	30814	33835	34829	38180	40089
Advances	66842	70401	82285	95451	106905
Fixed Assets	2012	1954	2272	2499	2749
Other Assets	11126	15628	17697	19090	19243
TOTAL ASSETS	**120292**	**130602**	**145962**	**162988**	**177870**

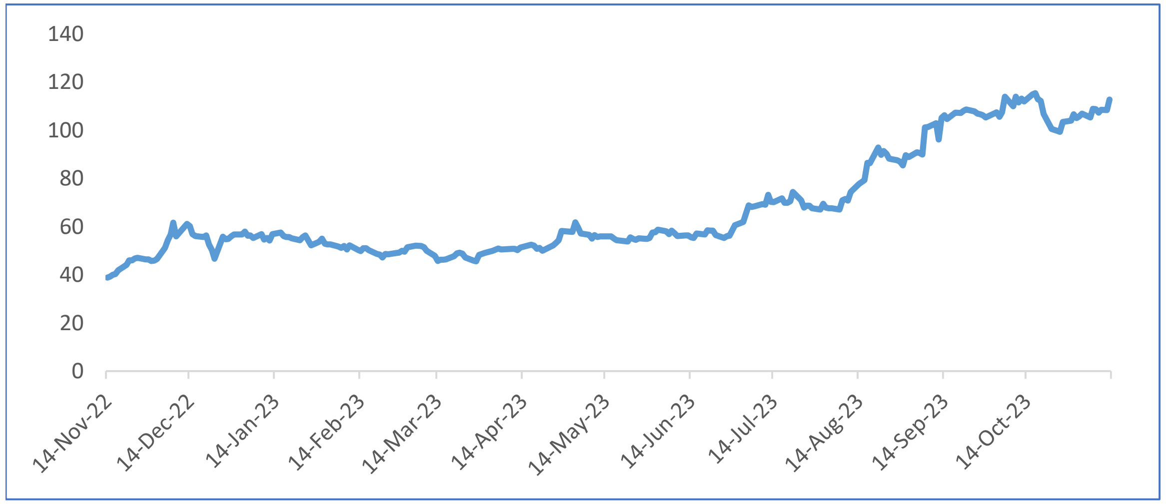
(Source: Company, HDFC sec)

Key Ratios

Particulars	FY21	FY22	FY23	FY24E	FY25E
Return Ratios					
Calc. Yield on adv	8.8%	7.9%	8.5%	8.9%	9.0%
Calc. Cost of borr	4.1%	3.6%	3.8%	4.3%	4.4%
NIM	3.8%	3.7%	4.2%	4.4%	4.5%
RoAE	6.5%	6.7%	13.3%	14.0%	13.7%
RoAA	0.4%	0.4%	0.9%	1.0%	1.0%
Asset Quality Ratios					
GNPA	9.7%	8.7%	6.0%	5.2%	4.0%
NNPA	2.9%	2.5%	1.6%	1.2%	0.9%
PCR	71.7%	73.2%	74.4%	77.2%	76.8%
Growth Ratios					
Advances	3.8%	5.3%	16.9%	16.0%	12.0%
Borrowings	10.5%	6.2%	6.4%	10.1%	7.4%
NII	1.7%	3.7%	21.3%	17.3%	13.7%
PPP	3.9%	-32.9%	74.9%	26.2%	21.4%
PAT	-137.9%	16.1%	138.7%	25.1%	12.7%

Particulars	FY21	FY22	FY23	FY24E	FY25E
Valuation Ratios					
EPS	6.1	5.4	11.6	14.5	16.4
P/E	18.6	21.0	9.7	7.8	6.9
Adj. BVPS	68.1	68.1	83.5	100.0	117.8
P/ABV	1.7	1.7	1.4	1.1	1.0
Dividend per share	0.0	0.0	0.5	1.0	1.5
Other Ratios					
Cost-Income	64.5%	77.2%	66.2%	63.7%	61.0%
CASA	56.8%	56.6%	54.1%	50.0%	47.8%
Credit-Deposit Ratio	61.9%	61.4%	67.4%	71.0%	74.1%

Price Chart



(Source: Company, HDFC sec)

Varun Nitin Manek

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HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long-term portfolio holding, if so desired. These stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise, their stock prices can take a severe beating. Overall, these stocks offer high risk high return opportunities.

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