

Initiating Coverage

Sector	Ratings
Bank	Buy
Current Price	Target
Rs.69	Rs.101
Potential upside	Holding
46%	12 months

Stock Information

Sensex/Nifty	65,344/19,356
Bloomberg	J&KBK:IN
Equity shares (Cr)	103.15
52-wk High/Low (Rs)	71.20/25.80
Face value (Rs)	1
M-Cap (Rs Cr)	6,673
2-wk Avg Volume (Qty)	13,854,305

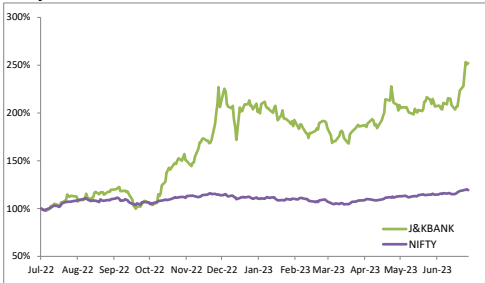
Financial Summary (Rs.cr.)

Year Ended	FY23	FY24E	FY25E
NII	4,745	4,926	5,205
NIM (%)	3.9	3.7	3.9
PPOP	1,858	2,098	2,397
PAT	1,197	1,307	1,500
BV (Rs.)	96	110	126
PBV (x)	0.72	0.63	0.55
ROE (%)	13.27	12.25	12.29
ROA (%)	0.87	0.86	0.90
GNPA (x)	6.04	4.75	4.50
NNPA (x)	1.62	1.55	1.50

Shareholding Pattern (%)

	Sep-22	Dec-22	Mar-23
Promoter	68.0	68.0	63.4
Public	29.0	27.2	31.7
Others	2.9	4.7	4.9

Nifty Vs J&KBANK



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Jammu & Kashmir Bank (J&KBANK)

11th July 2023

J&K Bank, established in 1938, is headquartered in Srinagar. The government of Jammu & Kashmir and Ladakh holds a majority shareholding of 63% as on March 31, 2023. It offers retail banking, corporate banking, and treasury operations.

We are initiating coverage on J&K Bank Ltd. with a Buy rating, supported by the following rationale: a) J&K Bank has a comfortable liquidity position (200%) with a strong retail deposit base. It aims to boost advances and NIM through adjustments in credit-deposit and liquidity ratios. b) As the largest bank in J&K and Ladakh, J&K Bank plays a crucial role in the financial ecosystem. It expects continued support from the state government and increased involvement from the central government post the political status change in 2019. c) Approximately Rs.8,000cr worth of dated securities will be redeemed and reinvested at higher yields, improving the yield on J&K Bank's investment portfolio. d) J&K Bank plans to sell its 3% stake in PNB-Metlife India Insurance company, expecting to generate Rs.360-375cr (~5.50% of the current m-cap) this optionality will further enhance shareholders' value. e) After seven years of hiatus, the Bank has recommended a 50% dividend for FY23, marking the resumption of dividends.

Based on the outlined investment thesis, we anticipate a potential re-rating in the stock of J&K Bank. At the CMP Rs. 69, the stock is trading at a PBV multiple of 0.72x based on its FY23 book value. We believe the stock deserves a higher PBV multiple of at least 0.80x for its FY25E book value against its 10-year historical average of 0.65x. With this we arrive at our target price of Rs.101, thereby providing a potential upside of 46%.

Strong Liquidity Position – J&K Bank boasts a comfortable liquidity position (200%) backed by a robust retail deposit base. This provides a solid foundation for the bank's growth prospects and risk management capabilities.

Growth Potential – The bank has the opportunity to drive future growth by strategically managing its credit-deposit ratio and liquidity ratio. A slight adjustment in these ratios can enhance loan disbursements, leading to an expansion in the NIM without incurring additional costs.

Favorable Investment Portfolio – J&K Bank's investment portfolio includes approximately Rs.35,000cr, of which Rs.8,000cr worth of dated securities set to be redeemed in FY24. The reinvestment of these funds at higher yields is projected to improve the yield on the bank's investment portfolio, thereby enhancing profitability (NII and NIM)

Stake Sale in PNB-Metlife – J&K Bank has appointed a merchant banker for the sale of its 3% stake in PNB-Metlife India Insurance Company. This transaction is anticipated to yield Rs.360-375cr, equivalent to ~5.50% of the bank's current market-cap. This will further enhance shareholders' value over.

Key Risk: a) Higher slippages pose a significant risk to J&K Bank's earnings and asset quality. b) The bank's corporate portfolio has shown high slippages, resulting in elevated GNPA of 11.5% in FY23, with large NPAs undergoing slow resolution in courts. c) With a high regional concentration in operations, the bank's portfolio is susceptible to socio-political developments in the union territory, as 73% of advances and 87% of deposits are in J&K and Ladakh. d) Weak economy and central bank policies may adversely impact the bank's profitability.

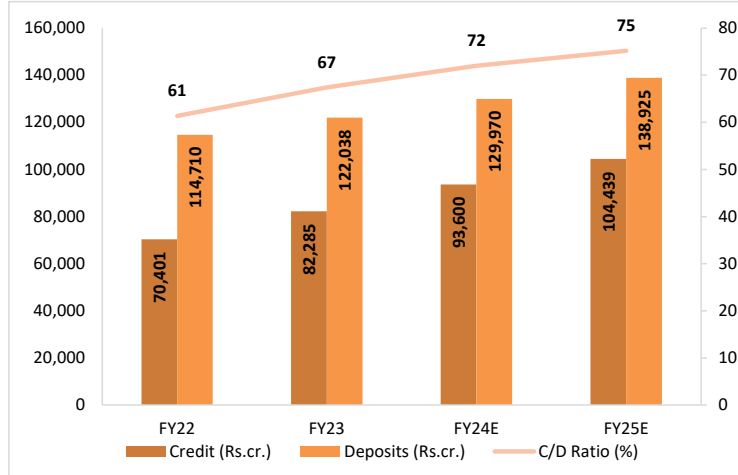
INVESTMENT RATIONALE

Strong Liquidity Position: Leveraging Multiple Levers

The bank's liquidity position, as measured by the Liquidity Coverage Ratio (LCR), is robust and comfortable at 200%, supported by a strong retail deposit base. J&K Bank boasts one of the highest Current Account and Savings Account (CASA) ratios in the industry at 54.1%. This LCR ratio provides a solid foundation for the bank's projected growth and enhances its risk management capabilities. Additionally, the bank's relatively lower Credit-Deposit Ratio (C/D ratio) presents an opportunity to strategically manage future growth. With a C/D ratio of 67.4%, the bank has sufficient room on the liability side. Even if it improves to 72-75% in the next two years, there is ample opportunity for Net Interest Income (NII) to grow. We estimate the C/D ratio to improve to 72% and 75.2% in FY24E and FY25E, respectively.

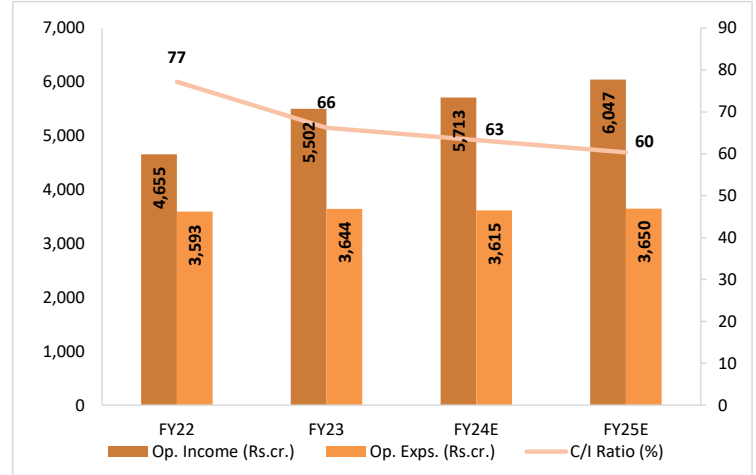
The growth of J&K Bank will be driven by a focus on loan disbursement and a reduction in the LCR Ratio. We anticipate that the bank's advances will see a significant increase, even without a specific emphasis on its liability side resources. By utilizing these two levers, we estimate that the bank's advances will rise from Rs. 82,285cr in FY23 to Rs. 104,439cr in FY25E, reflecting an annualized growth rate of 12.7%.

Exhibit 1: Credit, Deposits and C/D Ratio



Source: Company, Systematix PCG Research

Exhibit 2: Operating Income, Operating Expenses and C/I Ratio



Source: Company, Systematix PCG Research

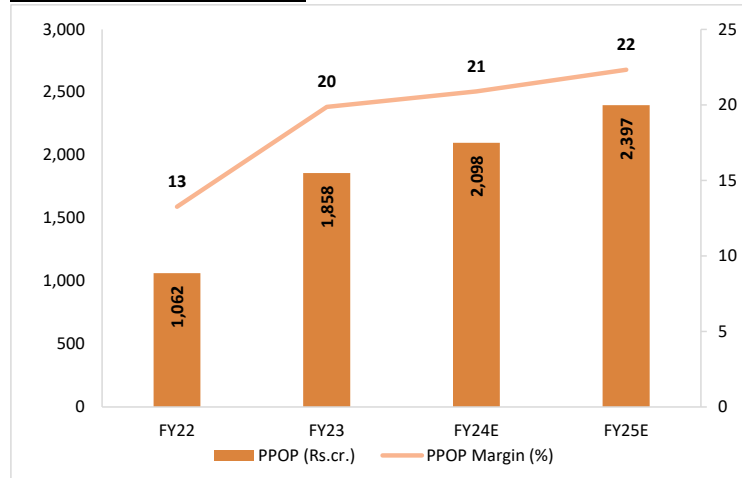
The growth in advances without a corresponding increase in deposit costs provides several benefits to the bank's overall profitability. These include:

- Increase in Pre-Provision Operating Profit (PPOP) and PPOP margin.
- Decrease in operating expenses and the Cost-to-Income (C/I) ratio.
- Increase in net profit and net profit margin.

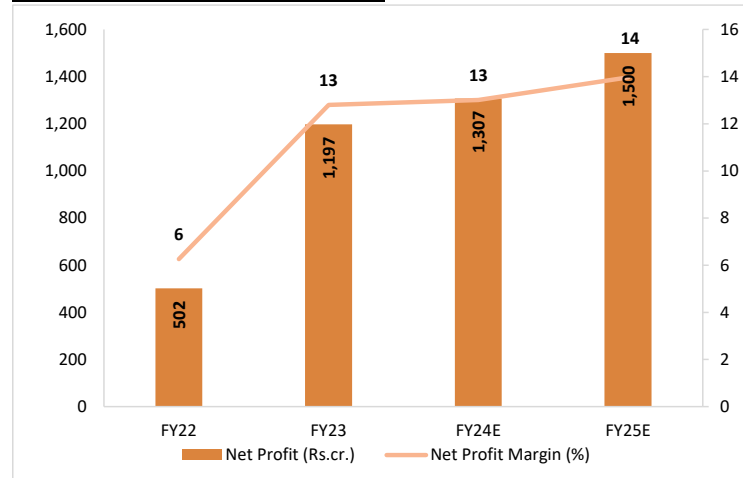
During the period of FY23-25E, we estimate the following outcomes:

- PPOP to grow at a CAGR of 13.6%.
- Improvement in PPOP margin by approximately 250 basis points (bps).
- Total operating expenses to remain flat.
- Reduction in the C/I ratio by around 585 bps.
- Net profit to grow at a CAGR of 12%.
- Improvement in net profit margin by approximately 120 bps.

These projections indicate the positive impact of advancing loans while effectively managing deposit costs, resulting in enhanced profitability for J&K Bank.

Exhibit 3: PPOP and PPOP Margin

Source: Company, Systematix PCG Research

Exhibit 4: Net Profit and Net Profit Margin

Source: Company, Systematix PCG Research

Robust Investment Portfolio: Driving Growth Prospects

J&K Bank's robust investment portfolio, valued at Rs. 34,829cr as of March 31, 2023, presents an opportunity to drive profitability. With Rs. 8,000cr worth of dated securities set to be redeemed in FY24, the bank plans to strategically reinvest these funds in higher-yielding options.

By capitalizing on the potential for higher yields, J&K Bank aims to bolster the overall yield on its investment portfolio. This move is expected to have a positive impact on the bank's NII and NIM, contributing to enhanced profitability.

The bank's proactive approach in optimizing returns from its investments reflects its commitment to maximizing profitability and capitalizing on market conditions. By leveraging its investment portfolio effectively, J&K Bank seeks to unlock additional value and strengthen its financial performance.

Capitalizing on PNB-MetLife Investments

J&K Bank currently holds a 3.03% stake in PNB-MetLife India Insurance Company as of March 31, 2022. During Q4FY23, the bank appointed a merchant banker to explore the possibility of selling this investment. The insurance company is valued between Rs. 12,000-13,000cr, which translates into an investment of Rs. 360-375cr for J&K Bank against its book value of Rs. 60cr.

This transaction is expected to generate Rs. 300-315cr of profit, which is approximately 5.5% of the bank's current market capitalization, providing an additional capital inflow. This optionality will further enhance shareholders' value over and above the current valuations of the company.

The valuation of the stake in PNB-MetLife India Insurance Company is reassuring based on historical data. In March 2019, J&K Bank sold a 2.04% stake in the insurance company to Oman India Fund for Rs. 185cr, valuing the company at Rs.9,000cr. From then until FY22, the insurance company experienced a 15.4% CAGR in turnover, while its net worth only grew by 3.5%.

It is important to note that the insurance industry is a long-term investment, and during the initial years, the turnover provides a more accurate picture of the company's growth, market penetration, and market share compared to the growth of its net worth, which tends to be at a slower pace.

Considering these factors, we find comfort in the current valuation of J&K Bank's stake in PNB-MetLife India Insurance Company.

Exhibit 5: PNB-MetLife Key Financials

Details (Rs.cr.)	Turnover	Networth
FY19	4,777.20	1,218.55
FY20	5,506.96	1,307.28
FY21	6,032.82	1,417.35
FY22	7,348.26	1,349.94
CAGR FY19-FY22	15.4%	3.5%

Source: PNB-MetLife, Systematix PCG Research

Resumption of Dividends

The resumption of dividends by J&K Bank after a seven-year gap is a positive development. The bank's recommendation of a dividend of 50% of the face value for FY23 demonstrates improved financial performance and a commitment to providing returns to shareholders. This move is likely to enhance investor confidence and highlight the bank's focus on creating value for its shareholders.

Management Transformation: J&K Bank Empowers Growth with New Leadership

In the past, J&K Bank suffered from severe mismanagement as a result of lax loan sanctioning practices, leading to significant losses for the bank. In June 2019, following allegations of fraud against the previous Chairman, the Reserve Bank of India approved the appointment of Mr. Rajesh Kumar Chibber as interim Chairman and Managing Director of J&K Bank.

Additionally, in December 2021, Mr. Baldev Prakash assumed the role of Managing Director and CEO at J&K Bank. Mr. Prakash brings with him extensive banking experience, having joined State Bank of India (SBI) in 1991. Throughout his career, he has held various positions in both small and large branches of SBI. Prior to joining J&K Bank, Mr. Prakash served as the Chief General Manager of Digital and Transaction Banking Marketing at SBI, Mumbai.

Furthermore, Mr. Pratik Punjabi was appointed as the Chief Financial Officer (CFO) of the bank, effective from July 1, 2022. With a Chartered Accountant qualification from ICAI, Mr. Punjabi brings over two decades of experience in the banking and finance industry, having worked with private and international banks as well as finance companies. His expertise lies in areas such as Financial Control, Financial Compliance, MIS, Strategy, Business Finance, Branch Profitability Analysis, Setting-up systems, Process studies, and project viability evaluations, with a focus on contemporary finance practices.

The appointment of these professionals in key leadership positions bodes well for the bank and addresses concerns surrounding its previous operational practices. We anticipate positive changes in the bank's lending policy, increased focus on portfolio granularity, enhanced risk management systems, improved transparency, and strengthened corporate governance. These developments are expected to drive the bank towards a more efficient and sustainable future.

KEY RISK

- Higher slippages for the bank will be a major risk to the overall earnings which in turn will adversely impact the bank's asset quality.
- The bank's corporate portfolio has exhibited high slippages in the past and despite marginal improvement, had an elevated GNPA of 11.5% in FY23. Most of the large NPAs are at various stages of settlements in courts which would get resolved slowly.
- The bank's portfolio remains highly susceptible to socio-political developments in the union territory given the high regional concentration in operations. Of the total advances 73%, and of the total deposits 87% were in the union territory of J&K and Ladakh.
- The weak economic environment and policy decisions by the central bank are expected to have an adverse impact on the company's profitability.

RECOMMENDATION

J&K Bank, headquartered in Srinagar, was established in 1938. The government of Jammu & Kashmir and Ladakh holds the majority shareholding of 63% in the bank as on 31st March 2023. It is a publicly held bank engaged in providing a wide range of banking services including Retail Banking, Corporate Banking and Treasury Operations. It is the only Private Sector Bank in the country assigned with responsibility of convening State/UT Level Bankers' Committee (SLBC/UTLBC) meetings. We initiate coverage on J&K Bank Ltd. with a buy rating supported by following rationale:

- a) Bank has two levers to play for its future growth viz. credit-deposit ratio and liquidity coverage ratio. The bank's liquidity position is quite comfortable (200%), supported by a strong retail deposit base. It has a relatively lower credit-deposit ratio of 67% as on 31st March 2023. A small tweak in these two ratios would boost the advances which in turn will provide ample opportunity for the NIM to grow, without increasing the overall cost.
- b) Been the largest bank in the J&K and Ladakh region, the bank plays pivotal role in the overall financial eco-system of these two-union territories. We expect continued support from the government of J&K and Ladakh. Moreso, after a change in the political status of J&K in 2019, the central government's involvement and support cannot be ruled out.
- d) Of the total Rs.35,000cr investments, approx. Rs.8,000cr worth dated securities are to be redeemed in the current fiscal year, which will get reinvested at higher yields, thereby improving yield on the investment portfolio.
- e) Appointment of merchant banker for the Bank's 3% stake sale in PNB-Metlife India Insurance company. This investment, upon offloading, will fetch Rs.360-375cr which is ~5.50% of the current market capitalization. This optionality will further enhance shareholders' value over and above the current valuations of the company.
- f) Resumption of the dividends after seven long years. The Bank has recommended a dividend of 50% of the face value for FY23.

Based on the above key investment thesis we expect re-rating in the stock. At CMP Rs.69, the stock is available at 0.72x PBV multiple of its FY23 book-value. We assign a higher PBV multiple of 0.80x (against its 10-year average of 0.65x) to the bank's FY25E book-value and **initiate coverage on J&K Bank with a buy rating and a price target of Rs. 101, with an upside potential of 46%.**

Management Guidance for FY24

- Credit growth ~15%
- NIMs ~3.75%
- CASA ~55%
- Cost to Income ~60%
- RoA ~0.90%
- RoE ~14%
- GNPA ~4.50%
- NNPA ~1.50%

Further, the management in their most recent interview (on 10th July 2023 on ET Now) has guided for a net profit of Rs.4,000cr in next four years.

COMPANY BACKGROUND

Jammu & Kashmir Bank (J&K Bank) is a prominent Indian banking company, offering a comprehensive range of services including Retail Banking, Corporate Banking, and Treasury Operations. It is the sole Private Sector Bank in the country responsible for convening State/UT Level Bankers' Committee meetings.

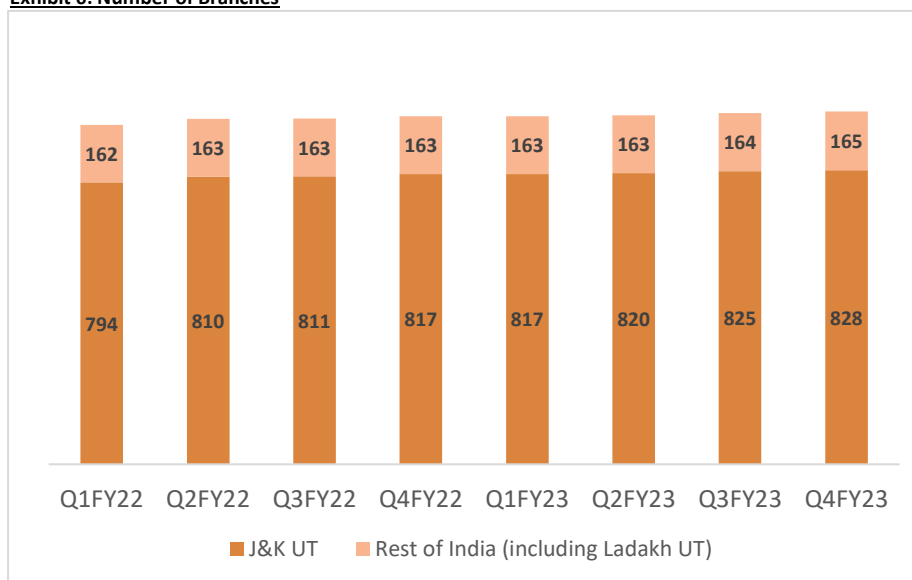
As of March 31, 2023, the Government of Jammu & Kashmir and Ladakh holds a majority shareholding of 63% in the bank. With a widespread presence, J&K Bank operates through 993 business units and 1,386 ATMs across 18 states and 4 UTs. Of these, 798 business units are in J&K, 35 in Ladakh, and 124 outside these regions.

J&K Bank holds a unique and dominant position in Jammu and Kashmir as the exclusive agent designated by the Reserve Bank of India for banking activities related to the Government of Jammu and Kashmir and its institutions. The bank plays a vital role in collecting tax revenues for the central government and collaborates with the UT Government of J&K & Ladakh in implementing flagship initiatives. With leading market shares in advances, deposits, and branches, J&K Bank serves various customer segments, including government employees, farmers, artisans, public sector organizations, and corporate clients. Additionally, the bank offers a wide range of retail credit products tailored to the specific needs of the people of Jammu and Kashmir.

The bank, being the major financial player in the UT of Jammu and Kashmir holds a leading market share of advances (64.84%), deposits (63.92%) and branches (39.3%) of all the scheduled commercial banks operating in the J&K UT as of March 31, 2021.

The bank holds 3.03% stake in the PNB-Metlife India Insurance company as on 31st March 2022.

Exhibit 6: Number of Branches



Source: Investor Presentation, Systematix PCG Research

FINANCIAL STATEMENT

Consolidated Income Statement (Rs.cr.)	FY22	FY23	FY24E	FY25E
Interest Income	8,013	9,355	10,042	10,735
Less: Interest Expense	4,102	4,610	5,116	5,530
Net Interest Income	3,911	4,745	4,926	5,205
Other Income	744	757	787	842
Operating Income	4,655	5,502	5,713	6,047
Employee Cost	2,672	2,704	2,760	2,787
Other Operating Expenses	921	940	855	863
Total Operating Expenses	3,593	3,644	3,615	3,650
Pre-Provision Operating Profit (PPOP)	1,062	1,858	2,098	2,397
Provisions & Contingencies	320	74	151	161
Profit Before Tax	743	1,784	1,947	2,236
Taxes	241	587	641	735
Profit After Tax (PAT)	502	1,197	1,307	1,500

Consolidated Balance Sheet (Rs.cr.)				
Fixed Assets	1,954	2,272	2,385	2,516
Investments	33,835	34,829	35,568	34,465
Loans & Advances	70,401	82,285	93,600	104,439
Cash and cash equivalents	1,395	7,794	4,806	3,455
Bal. with banks and money at call & short notice	7,390	1,085	2,008	2,684
Other assets	15,628	17,697	21,060	25,483
Total Assets	130,602	145,962	159,427	173,041

Equity Capital	93	103	103	103
Reserves & Surplus	8,014	9,840	11,283	12,919
Networth	8,107	9,943	11,386	13,023
Deposits	114,710	122,038	129,970	138,925
Borrowings	2,371	2,892	3,095	3,339
Other liabilities & provisions	5,414	11,089	14,976	17,755
Total Liabilities	130,602	145,962	159,427	173,041

Basic Ratios (Rs.)	FY22	FY23	FY24E	FY25E
EPS	5.38	11.61	12.67	14.54
Growth (%)	-11.2	115.9	9.1	14.8
Book Value	87	96	110	126
Growth (%)	1.5	10.9	14.5	14.4
Valuation Ratios				
P/E	12.89	5.97	5.47	4.77
P/BV	0.80	0.72	0.63	0.55
ROE (%)	6.7	13.3	12.3	12.3
ROA (%)	0.4	0.9	0.9	0.9
Spreads (%)				
Yield on Loans	8.3	8.9	9.0	8.8
Cost of Funds	3.7	3.8	4.0	4.0
NIM	3.5	3.9	3.7	3.9
Asset Quality (%)				
Gross NPA	8.7	6.0	4.8	4.5
Net NPA	2.5	1.6	1.6	1.5
Efficiency Ratio (%)				
C/D Ratio	61.4	67.4	72.0	75.2
CASA Ratio	56.6	54.1	54.7	55.4
C/I Ratio	77.2	66.2	63.3	60.4
Margin (%)				
PPOP Margin	13.3	19.9	20.9	22.3
PAT Margin	6.3	12.8	13.0	14.0
Growth Ratio (%)				
Credit Growth	5.3	16.9	13.8	11.6
Deposit Growth	6.2	6.4	6.5	6.9
Int. Income	-1.2	16.7	7.3	6.9
Int. Expenses	-5.5	12.4	11.0	8.1
NII	3.7	21.3	3.8	5.7
PPOP	-32.9	74.9	12.9	14.2

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Analyst holding in the stock (%)	None
Served as an officer, director or employee	No

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EXPLANATION TO RATINGS: BUY: $TP > 15\%$; ACCUMULATE: $5\% < TP < 15\%$; HOLD: $-5\% < TP < 5\%$; REDUCE: $-15\% < TP < -5\%$; SELL: $TP < -15\%$

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