

Rating Rationale

The Jammu and Kashmir Bank Limited, Srinagar

26 June 2019

Brickwork Ratings (BWR) downgrades the rating of Basel III compliant Tier II Bond issue amounting to ₹ 2000 Crores to 'BWR AA-' and also downgrades the Basel III compliant Additional Tier I Bond issue amounting to ₹ 1000 Crores to 'BWR A' of The Jammu and Kashmir Bank Limited. The Rating is placed on Credit Watch with Negative implications.

Particulars

Instrument	Issue Date	Amount ₹ Cr	Coupon	Maturity Date	ISIN	Previous Rating (June 2018)	Rating* (June 2019)
BASEL III –Tier II –Bonds	24 Mar 2017	1000 (raised ₹ 500 Cr)	9.50%	24 Jun 2022	INE168A08038	BWR AA [BWR Double A] (Outlook: Stable)	BWR AA- [BWR Double A Minus] (Credit Watch with Negative Implications) Downgrade
BASEL III –Tier II –Bonds	28 Dec 2017	1000 (raised ₹ 500 Cr)	9.25%	27 Dec 2024	INE168A08046	BWR AA [BWR Double A] (Outlook: Stable)	BWR AA- [BWR Double A Minus] (Credit Watch with Negative Implications) Downgrade
BASEL III –Additional Tier I –Bonds	14 Jun 2018	1000	10.50%	Perpetual	INE168A08061	BWR A+ [BWR A Plus] (Outlook: Stable)	BWR A [BWR A] (Credit Watch with Negative Implications) Downgrade
Total		3000	INR Three Thousand Crores Only				

* Please refer to BWR website www.brickworkratings.com/ for definition of the ratings

Rating Downgrade and Credit Watch With Negative Implications

Brickwork Ratings (BWR) downgrades the rating of The Jammu and Kashmir Bank Limited's ('J&K Bank' or 'the Bank') two issues of Basel III Compliant Tier II Bonds of ₹ 1000 Cr each and Basel III Compliant Additional Tier I bond issue of Rs.1000 Cr and places it on Credit Watch with Negative Implications.

The Rating downgrade necessarily factors in the concerns over the cessation of the last Director and Chairman/ Chief Executive Officer of the Bank prior to completion of his term and the ongoing investigations on recruitment and quality of advances during his tenure. BWR notes this as a material



development in the Bank. Given the uncertainty over the quantum of impact on the financials of the Bank, the rating is placed on Credit watch with Negative Implication

BWR shall monitor the impact of recent developments in the Bank on changes in the top management, cessation of the Director and Chairman/ Chief Executive Officer of the Bank resulting in appointment of Chairman cum Managing Director for an interim short period of 3 months. On an overall basis, any further deterioration in the asset quality as a result of the aforesaid may adversely impact the financials of the Bank going forward. BWR views this as a key monitorable for a further rating action. Appointment of full term Managing Director & Chief Executive Officer of the Bank and improving upon the Corporate Governance through better transparency and compliance shall be the other monitorable.

Rationale/Description of Key Rating Drivers/Rating sensitivities:

Brickwork Ratings have relied on J&K Bank's financial results upto Q4/ FY19, publicly available information and other information/clarifications provided by the Bank.

The Bank's asset quality continues to remain weak during FY19 as reflected through increase in Gross NPA to Rs.6221 Cr (FY18: Rs.6007 Cr) mainly from its exposure to infrastructure, metals and textile sectors. The rating is also constrained by the levels of stressed assets (GNPA + Standard Restructured assets) though improving over the previous year, increase in GNPA & NNPA levels on absolute terms over previous year FY18, anticipated impact on the Bank's performance in the event of any adversities in the valley, and challenges to register continuous asset growth in the competing landscape.

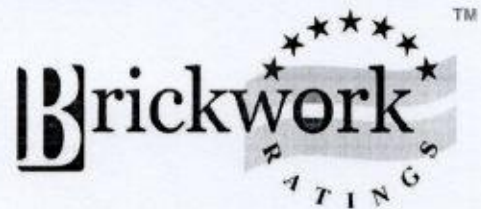
The rating also factors in the State Government of Jammu & Kashmir's (GOJK) equity stake of 59.23% in the Bank, periodic infusion of funds and its continued support, the Bank's ability to manage asset quality in a difficult environment, contain provisioning costs, maintain substantial low cost deposits, improve profits and satisfactory capital adequacy ratio.

The bank's ability to sustain its profitable performance and maintain the capital adequacy ratios as per regulatory guidelines shall be the key rating sensitivities. Deterioration in the aforesaid parameters, may adversely impact the assigned ratings.

Analytical Approach

For arriving at its ratings, BWR has applied its rating methodology as detailed in the Rating Criteria detailed below (hyperlinks provided at the end of this rationale).

The Bank's Basel III compliant bonds are subject to extant guidelines of the Reserve Bank of India (RBI) and as detailed in term sheet of respective issues. BWR considers them as Highly Complex instruments in terms of published criteria.



About the Bank

Background: The Jammu and Kashmir Bank Limited established in 1938 and became scheduled bank in 1971, functions as a universal bank in Jammu & Kashmir and generally focuses on Corporate Banking in the rest of the country. The Corporate headquarters of the Bank is located in Srinagar, Kashmir. As of March 31, 2019, it has 940 branches and 1291 ATMs.

Management: Mr. Rajesh Kumar Chhibber has been appointed as the Chairman cum Managing Director of the Bank effective from June 10, 2019 for an interim period of three months after the cessation of Mr Parvez Ahmed on June 08, 2019. Mr Chhibber has over 37 years of Banking experience and has the support of top management in taking the Bank forward. The management team comprises of two Executive Presidents and eleven Presidents, all experienced professionals. Mr P K Tickoo is the Executive President of the Bank and Mr Rakesh Gandotra is the CFO & President of the Bank

The Bank in its meeting dated June 10, 2019 post appointment of Mr Chhibber as the CMD has planned to implement proactive steps to overcome the current situation. Please refer to the link for the Press Release issued by the Bank on June 10, 2019 on the Exchange website:

<https://www.bseindia.com/xml-data/corpfiling/AttachHis/746d78f3-20bf-4ce1-8588-9a2503e040ae.pdf>

BWR Perspective

BWR believes the strategic importance of the Bank to the State, both to its business community and also its depositors shall be of utmost importance to the State and the nation. Steps initiated by the regulating machinery is an attempt to improve upon the best trade practices and cleanse of any inconvenience to the Bank. The Bank being an independent entity has adequate qualified and experienced team members on its Board as well as Management to steam through any adversities. The Bank with more than 50% of operations in the State of Jammu and Kashmir has displayed consistency to overcome issues of any adversities in the valley. Having said that, the Auditors comments on the Bank's financial performance as of March 31, 2019 and the management's guidance in the Discussion and Analysis statement on publishing of the Annual Report of the Bank as of March 31, 2019 shall clarify on the path for the Bank going forward. BWR considers the recent developments post cessation of the last CMD of the Bank could have implications on its performance, and the quantum of such impact presently remains to be uncertain.

Financial Performance

Business Performance : The Bank's business at ₹ 155,911 Cr as of March 31, 2019 has grown by 13.87% over the previous year FY18 of ₹ 136,919 Cr, during the year FY19 deposits have increased by ₹ 9633 Cr and net advances by ₹ 9359 Cr. Bank's share of corporate advances to Gross advances is 43% (FY18: 51%), followed by personal loans @ 26% (FY18: 21%), agriculture is 11% (FY18: 9%); trade and SME maintained @10% and 8% respectively; and others 2% (FY18: 1%). The Bank has maintained its dominant CASA position@ 50.7%, one of the highest amongst peers

Earnings: Bank's efforts to increase lending in advances with better yield while reducing its exposure to loans with low yield have resulted in improving the Bank's NII and NIM. Net Interest Income for the Bank during FY19 stood at ₹ 3384 Cr, compared to FY17 at ₹ 2871 Cr. Net Interest margin has improved at 3.84% (FY18: 3.65%). Non Interest Income for FY19 has increased to ₹ 813 Cr (FY18: ₹ 495 Cr), mainly from treasury/ trading income of Rs.219 Cr in Q4FY19 (Q4FY18: Rs.23 Cr), followed by miscellaneous income of Rs.122 Cr, commission of Rs.49 and insurance of Rs.14 Cr. The Bank has made provision (excluding taxes) of ₹ 1058 Cr (FY18: ₹ 1022 cr), Operating profits have increased from ₹ 1382 Cr in FY18 to ₹ 1718 cr in FY19 and the net profits increased from ₹ 203 Cr to ₹ 465 Cr. Cost to income ratio for FY19 continues to remain high at 59% (FY18: 58.94%)

Asset Quality: As of FY19, GNPA is ₹ 6221 Cr (FY18: ₹ 6007 Cr) and NNPA is ₹ 3240 Cr (FY18: ₹ 2791 Cr). The standard restructured advances has decreased from ₹ 4661 Cr in FY18 to ₹ 3250 Cr. During FY19, the Bank made recoveries amounting to ₹ 278 Cr, settlements & write off of ₹ 1815 Cr and upgradations of ₹ 657 Cr, however additions to GNPA amounted to ₹ 2965 Cr. For FY19, GNPA and NNPA ratio stands at 8.97% (FY18: 9.96%) and 4.89% (FY18: 4.9%) respectively. There is improvement in stressed asset ratio from 17.69% in FY18 to 13.65% in FY19, though is high in the industry. PCR for FY19 is 64.3% (FY18: 65.53%)

Capital Adequacy: As on March 31, 2019, the Bank's total CRAR as per BASEL III guidelines stands at 12.46% (FY18:11.42%) out of which Tier I capital adequacy ratio stood at 10.60% (FY18: 9.24%), CET-1 ratio is 9.13% after raising of Basel III Additional Tier I bonds during FY19. The Bank has improved the capital adequacy ratios and is above the regulatory requirement. The average liquidity coverage ratio of the Bank as of March 31, 2019 is 335.40% well above the regulatory requirement.

In terms of guidelines, the regulatory CRAR requirement for March 31, 2019 is 10.875% (including capital conservation buffer requirement)-, Tier I is 8.875% and CET-1 is 7.375% (including capital conservation buffer requirement of 1.875%) respectively.

The Jammu & Kashmir Bank Ltd	Audited	Audited	Audited
Key Parameters – Rs Cr	FY2017	FY2018	FY2019
Total Deposits	72,463	80,006	89,639
Deposit Growth (in %)	4.43%	10.41%	12.04%
Net Advances	49,816	56,913	66,272
Loans Growth(%)	-0.75%	14.25%	16.44%
Total Business	122,279	136,919	155,911
Business Growth (%)	2.25%	11.97%	13.87%
CASA Ratio %	51.70%	50.89%	50.70%
Profitability Ratios (%)			

RoE (%)	Negative	3.42%	7.27%
RoA (%)	Negative	0.25%	0.49%
NIM (%)	3.38%	3.65%	3.84%
Net Interest Income (NII)	2512	2871	3384
Non Interest Income	493	495	813
Operating profits	1294	1382	1718
Provisions (excluding taxes)	2800	1022	1058
PAT	-1632	203	465
Cost to Income Ratio (%)	56.92%	58.94%	59.06%
Asset Liability Profile (%)			
Loans/Deposit Ratio	68.75%	71.14%	73.93%
Gross NPAs to Gross Advances	11.20%	9.96%	8.97%
Net NPAs to Nat Advances	4.87%	4.90%	4.89%
Restructured Portfolio as a % of Gross Advances	10.34%	7.73%	4.68%
Gross NPA% + Std.Restrictured.% (Stressed Advances)	21.54%	17.69%	13.65%
Provision Coverage Ratio	66.88%	65.53%	64.30%
CRAR(%)	10.80%	11.42%	12.46%
Tier I (%)	8.70%	9.24%	10.60%
CET-I (%)	8.70%	9.24%	9.13%
AT-I (%)	0.00%	0.00%	1.47%
Tier II (%)	2.10%	2.18%	1.86%
Adjusted Book Value for FY17 & FY18 (Rs.)	67.06	60.5	60.81
GoJK Stake (%)	56.45%	59.23%	59.23%

Rating History for the last three years (including withdrawn/suspended ratings)

Sl. No	Instrument	Current Rating (June 2019)			Rating History		
		Type	Amount rated (Rs Crs)	Rating	14 Jun 2018	12 Dec 2017	16 Aug 2017
1	Basel III - Tier II -Bonds	Long term	1000 (raised ₹ 500 Cr)	BWR AA- (BWR Double A Minus) Credit Watch with Negative Implication	BWR AA (Outlook: Stable) Reaffirmed	BWR AA (Outlook: Stable) Revision	BWR AA (Outlook: Negative) Reaffirmed
2	Basel III - Tier II -Bonds	Long term	1000 (raised ₹ 500 Cr)	BWR AA- (BWR Double A Minus) Credit Watch with Negative	BWR AA (Outlook: Stable) Reaffirmed	BWR AA (Outlook: Stable) Assigned	-

				Implication			
3	Basel III - Additional Tier I - Bonds	Long term	1000	BWR A (BWR A) Credit Watch with Negative Implication	BWR A+ (Outlook: Stable) Assigned	-	-
Total			3000	INR Three Thousand Crores Only			

Hyperlink/Reference to applicable Criteria

- General Criteria
- Approach to Financial Ratios
- Complexity levels of the Rated Instruments
- Banks and Financial Institutions
- Basel III Compliant Instruments

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Note on complexity levels of the rated instrument:

BWR complexity levels are meant for educating investors. The BWR complexity levels are available at www.brickworkratings.com/download/ComplexityLevels.pdf Investors queries can be sent to info@brickworkratings.com.

About Brickwork Ratings

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