Update

SECTOR: BANKING

Jammu & Kashmir Bank

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,736	JKBK IN
	REUTERS CODE
S&P CNX: 3,676	JKBK.BO

Equity Shares (m)	48.5
52-Week Range	564/306
1,6,12 Rel.Perf.(%)	14/-2/-49
M.Cap. (Rs b)	23.6
M.Cap. (US$ b)	0.5

13 October 2006

Buy

Previous Recommendation: Buy

Rs486

YEAR END	NET INCOME (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	CAR (%)	ROE (%)	ROA (%)	P/ABV RATIO
3/06A	7,969	1,769	36.5	53.7	13.3	1.3	12.1	10.3	0.7	1.4
3/07E	9,590	2,702	55.7	52.8	8.7	1.2	12.1	14.2	1.0	1.2
3/08E	11,703	3,352	69.1	24.1	7.0	1.0	10.6	15.6	1.1	1.1

- **Restructuring over; profitable growth will follow:** J&K Bank has shifted focus in favor of growth within the state. With increased invesments, the state's economy is likely to provide significant growth opportunities. Further margins are much higher in the state for J&K Bank as compared to its business outside the state. The bank is re-aligning its strategy to shift the ratio of business mix within J&K state and outside J&K state from 40:60 to 50:50.
- **2QFY07 margins improve; will sustain:** The increased focus on in-state operations and redemption of high cost deposits have resulted in margins improving to 3.5% (2.9% in 1Q) and are likely to sustain. In 2QFY07, NII grew by 19% in line with estimates while profit growth of 53% was much better than estimates. Loans grew by 18%.
- **Fee income initiatives appear to be paying off well:** By virtue of its near monopoly status, J&K Bank is targeting big fee-based revenues from within the state. It is also the sole banker to the J&K government. The bank aims to achieve 35%-40% fee income growth in FY07. Further, the bank is a sizeable distributor of third-party products (mutual funds and insurance); it offers bill payments services and cash management services.
- **Valuations attractive; strong re-rating candidate:** J&K Bank is set to scale up rapidly from hereon - has good asset quality and is also adequately capitalized. On back of higher margins, we expect return ratios to improve over the next couple of fiscals. The stock has underperformed the Sensex by 48% and Bankex by 24% over the last 12 months. With better earnings visibility, we are raising our target price, valuing the bank at 1.4xFY08 BV, thereby assigning a target of Rs659 (upside of 36%). Reiterate **Buy**.

QUARTERLY PERFORMANCE (Rs Million)

Y/E MARCH	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Interest Income	4,278	4,168	4,148	4,468	4,547	4,621	5,144	5,749	17,063	20,060
Interest Expenses	2,773	2,532	2,538	2,582	2,760	2,688	3,135	3,623	10,425	12,205
Net Interest Income	**1,505**	**1,636**	**1,610**	**1,887**	**1,786**	**1,933**	**2,009**	**2,126**	**6,637**	**7,855**
% Change (Y-o-Y)	*5.8*	*5.9*	*0.7*	*35.1*	*18.7*	*18.2*	*24.8*	*12.7*	*11.3*	*18.3*
Other Income	225	267	319	522	272	404	383	677	1,332	1,735
Net Income	**1,730**	**1,903**	**1,929**	**2,408**	**2,058**	**2,337**	**2,392**	**2,803**	**7,970**	**9,590**
Operating Expenses	767	835	868	982	829	908	1,007	1,186	3,453	3,930
Operating Profit	**962**	**1,068**	**1,061**	**1,426**	**1,229**	**1,429**	**1,385**	**1,617**	**4,517**	**5,660**
% Change (Y-o-Y)	*-16.5*	*37.8*	*8.3*	*95.2*	*27.7*	*33.8*	*30.5*	*13.4*	*22.2*	*25.3*
Prov. & Contingencies	311	298	274	1,015	346	249	411	795	1,899	1,800
Profit before Tax	**651**	**770**	**787**	**411**	**884**	**1,180**	**974**	**822**	**2,619**	**3,860**
Provision for Taxes	167	220	280	183	260	340	292	266	850	1,158
Net Profit	**484**	**550**	**507**	**228**	**624**	**840**	**682**	**556**	**1,769**	**2,702**
% Change (Y-o-Y)	*2.6*	*n.a.*	*-29.6*	*-50.3*	*28.8*	*52.8*	*34.6*	*144.1*	*53.7*	*52.8*
Cost to Income	*44.4*	*43.9*	*45.0*	*40.8*	*40.3*	*38.9*	*42.1*	*42.3*	*43.3*	*41.0*
Int.Expense/Int. Earned	*64.8*	*60.8*	*61.2*	*57.8*	*60.7*	*58.2*	*60.9*	*63.0*	*61.1*	*60.8*
Cost to Net Int.Income	*51.0*	*51.0*	*53.9*	*52.1*	*46.4*	*47.0*	*50.1*	*55.8*	*52.0*	*50.0*

E: MOSt Estimates

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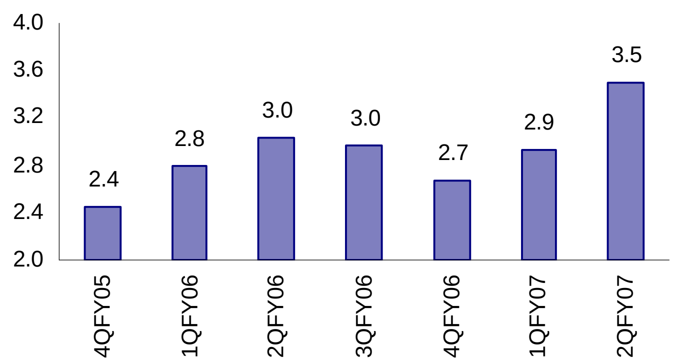
J&K Bank reported 53% YoY net profit growth in 2QFY07 due to a significant improvement in margins. CASA improved to 41% in 2QFY07 from 33% in 2QFY06. Other income increased by 51% YoY to Rs404m led by improving fee-based income (up 81% YoY) and also due to treasury profits of Rs128m in 2QFY07 (from Rs19m in 2QFY06). Asset quality remained unchanged sequentially (net NPAs at 0.7% and provisions at 72%). Overall growth was strong across parameters and we expect this trend to continue.

Margins improve due to improving asset yields and redemption of high-cost deposits

Margins have improved by 57bp QoQ on back of improving asset yields and redemption of high-cost deposits. Strong improvement was noted in yield on advances (up by 50bp QoQ to 9.6%) due to changing the business mix in favor of J&K state (46% business in J&K state compared with 42% in FY06) and re-pricing of assets post 100bp hike in lending rate in 1QFY07.

Furthermore, the bank has been consciously redeeming its high-cost deposits in favor of low cost J&K state-sourced deposits resulting in rising proportion of CASA, which has also led to some improvement in margins. Currently, CASA from within the state of J&K is at 57% compared to outside J&K state CASA at ~34% and blended total CASA at 41%.

TREND IN NIMS OVER LAST 7 QUARTERS (%)



Source: Company / Motilal Oswal

J&K state deposit growth of 23% YoY, while overall deposit growth of only 4% YoY

While, deposits from within the state of J&K are up by 23% YoY in 2QFY07, overall deposits are up by only 4% YoY due to the redemption of high cost deposits in favor of low cost deposits and also due to changing strategy of sourcing more retail/low-cost deposits from within the state than out of the state. This has resulted in a subdued growth in total deposits YoY.

Advance growth of 18%, with focus on lending within the state of J&K

Advances are up by 18% YoY. Return of normalcy in the state of J&K and resulting investments (public and private) has led to focus on lending within the state, wherein yields are higher (~10.7%) versus outside the state of J&K, where the bank is largely a consortium lender. Management has clearly indicated that the uptick in state economy will result in higher business volumes going forward. Management is targeting a 15% deposit growth and 25% advances growth for FY07.

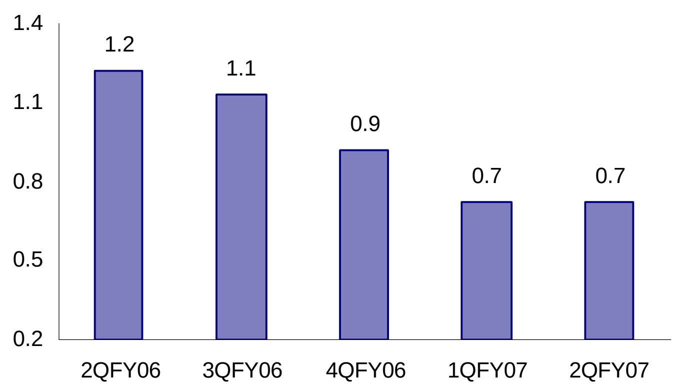
Other income continues to grow

Other income increased by 51% YoY to Rs404m, led by improving other income, ex-treasury income (up 81% YoY) and also due to treasury profits of Rs128m in 2QFY07 (from Rs19m in 2QFY06). Management continues to focus on selling third-party products and the rising advances book is also leading to a rise in L/C & B/G business.

Asset quality continues to remain at 1QFY07 levels

Asset quality remained largely unchanged sequentially (gross NPAs at 2.6% and net NPAs at 0.7%) although marginal increase on absolute basis QoQ was reported on account of one large account (Escorts Finance) classified as an NPA. The NPA coverage ratio is up at 72.1%, up from 54.6% in 2QFY06, aimed at international standards of 80% over one year.

NET NPA ON A DECLINING TREND (%)



Source: Company / Motilal Oswal

Restructuring nearly over

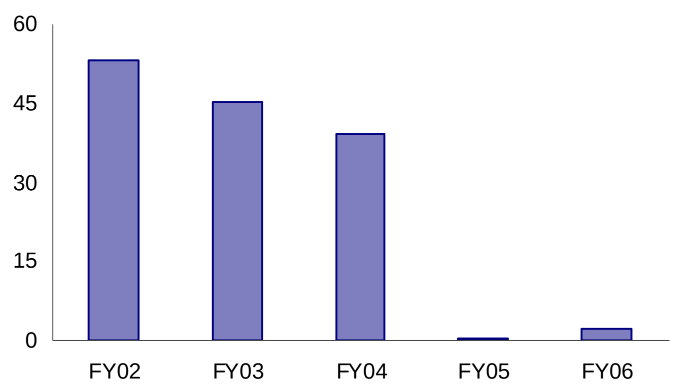
There were two key issues plauging the growth for J&K Bank - investment book losses and high-cost deposits resulting in lower margins. During the course of last couple of years, the bank has taken corrective steps to remedy this and has been successful — its investment book is now largely de-risked and the high-cost deposits are being increasingly replaced with CASA deposits. We believe that the stage is now set for the bank to deliver strong earnings growth on back of steady volume growth and improving margins leading to improving return ratios.

End to investment book woes

Over the last few years, growth prospects at the bank were hit badly owing to the bank's investment book earning negative returns; in FY05 the J&K Bank's treasury portfolio took a cumulative hit of Rs4b on reduced treasury gains and (mark-to-market) MTM losses — i.e. overall FY05 net profit stood at just Rs1.2b. The impact was felt in few quarters in FY06 also.

Consequent to these losses, aggressive measures to reduce the overall duration of its investment portfolio were adopted. The bank sold long-dated securities, even at a loss, and substituted them with shorter duration T-bills. This process is now nearly complete, with the current investment duration below two years versus 4-5 years a year ago.

CONTRIBUTION FROM TREASURY AS A % OF PBT



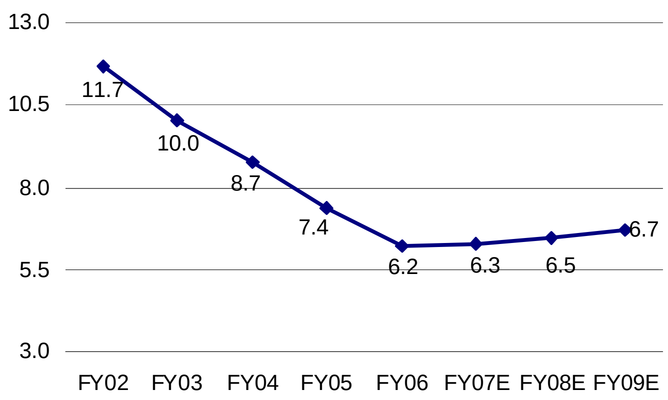
Source: Company/ Motilal Oswal Securities

While the bank's SLR portfolio is out of the woods, its non-SLR continues to be face some challenges. However, with the yields declining, even this portfolio is at breakeven levels. Nevertheless, the management has guided that it might exit this portfolio by the end of FY07. This should completely de-risk the investment book.

With 62% of investments under HTM and a MTM cushion up to 8.1bp, treasury operations have now been brought under control. During the past one year, the bank has unwound over Rs15b from its securities portfolio and diverted them into loans.

We note that the current investment book yields at 6.3% are near the bottom. Going ahead, we expect yields to improve, as incremental investments will yield higher. Also, the bank is considering raising the duration of the portfolio which will also result in higher investment yields, in turn positive for margins of the bank.

YIELDS ON INVESTMENT AT ITS LOWEST (%)

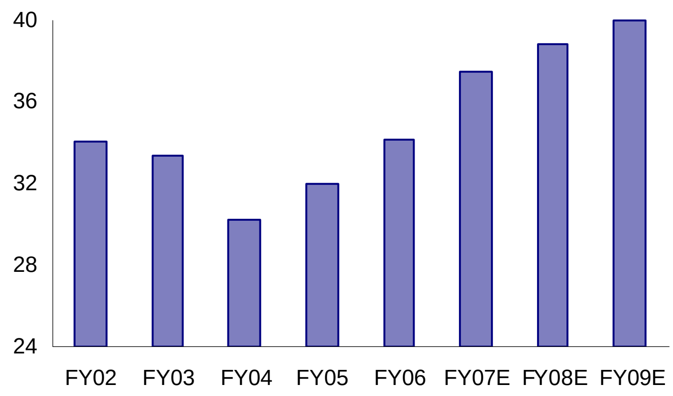


Source: Company/ Motilal Oswal Securities

Low-cost deposits replace high-cost wholesale deposits

J&K Bank's strategy of meeting business targets with high-cost corporate term deposits (was as high as 68% of total deposits; down to 45% now) led to a severe rise in the cost of funds, and was the main reason for margin declines in FY05 and FY06. Also, these term deposits were usually procured in a lumpy manner i.e. bunched at the end of a financial year. This created deployment problems for at least a couple of quarters thereafter. The bank has been unwinding almost all corporate deposits and replacing it with low-cost deposits to bring down the cost of its funds and enhance margins.

RISING CASA WILL IMPROVE MARGINS (%)



Source: Company/ Motilal Oswal Securities

Margins appear to be improving on back of higher incremental lending in J&K stake

FY04-FY06 margins took a beating owing to:

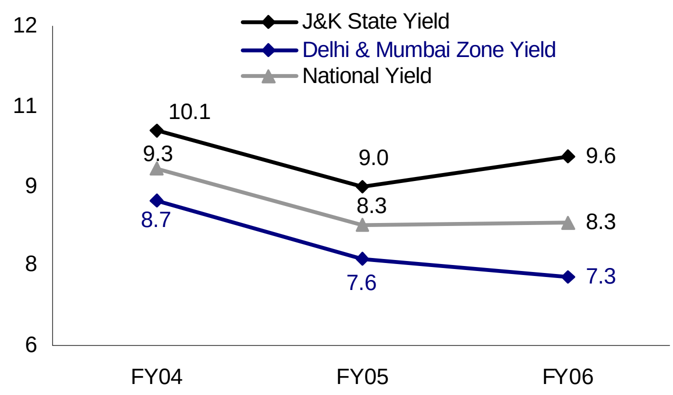
- Being a small bank with a large part of its portfolio in consortium lending (average yields of 8.0%-8.5%) outside the state, asset re-pricing as a means to improve margins was not an exercisable option.
- Further, what exacerbated the problem of declining margins was incremental deposit mobilization being used in low-yielding short-term instruments such as call money lending.
- The strategy of meeting business targets with high-cost corporate term deposits led to a severe problem of high cost of funds. This led to margins being squeezed.

J&K Bank had earlier adopted a strategy of mobilizing low-cost deposits (55% in FY06 from within J&K state) and targeting most of the lending (largely consortium) outside the state. This worked well in the 90s due to the state's poor appetite for credit, and facilitated J&K Bank's entry into corporate lending outside J&K state. However, with corporate yields trending down (the bank has also suffered disintermediation-driven yield loss); the bank has changed its focus within the state which is witnessing strong growth and lending rates are also relatively higher.

Focus shifting back to the state

Of the total loans, ~30% of the bank's lending is within the state of J&K. The bank has a market share of 67% in the state in lending business. With increased investments in the state coupled with economic stability and strong GDP growth, the overall growth momentum in the J&K economy is likely to remain strong over the next few years. The bank has renewed its focus to grab a significant share of the new emerging opportunities within the state. The bank also generate yields of 10.5-11% within the state (as compared to 7-8% outside the state and current yields for J&K Bank of 8.5%)

IN-STATE AND OUTSIDE STATE LOAN YIELDS (%)



Source: Company/ Motilal Oswal Securities

J&K Bank's current strategy is to target the higher end of the yield spectrum within the state – SME, retail (mostly commercial vehicles) and horticulture. We believe the bank can pull this off considering its extensive presence in the state as well as due to a resurgent economy.

Simultaneously, with much of the downward re-pricing of corporate loans being over, overall yields are likely to have stabilized by now. Further, increase in the lending rate by 100bp in 1QFY07 will result in higher lending yields going forward.

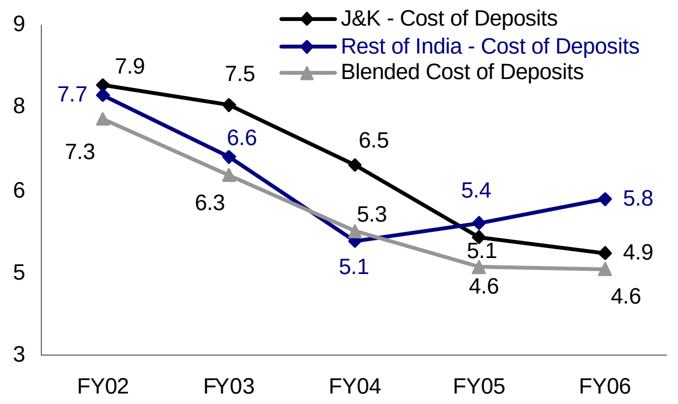
On deposits too...focus within the state

The bank's earlier strategy of meeting business targets with high-cost bulk deposits led to margin squeeze. To address this anomaly, the bank has adopted two corrective measures:

- Wholesale (corporate) deposits (~45% of total versus 68% in FY05 and FY06) will be collected only at the corporate office level so that branches do not compete for them. This will allow branches to focus on retail deposits to meet their business targets.
- Sourcing higher number of deposits from within the state. Currently, about 58% of deposits are raised from the state, which has shown about 18% growth; almost 80% of the bank's incremental deposits are sourced from the state. Currently, the bank's CASA ratio within the state stands at 55% compared with 37% overall. Higher CASA and retail deposits will lower costs.

Consequently, the cost of deposits declined to 4.55% in FY06 from 4.61% in FY05. This was largely because of deposit mix changes that were reflected in the CASA ratio, improving to 34% in FY06 from 32% in FY05 and further to 37% in 1QFY07 (target 40% by end-FY07).

COST OF DEPOSITS (%)

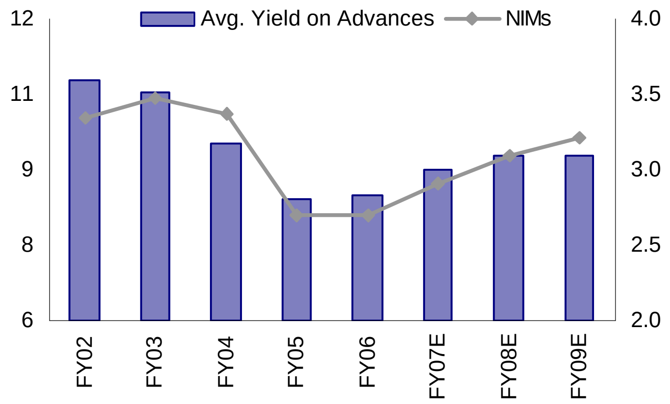


Source: Company/ Motilal Oswal Securities

Margin improvement already visible

As the bank has taken corrective steps for yield erosion and funding costs, NIMs have already started moving up after a sharp decline in last couple of years.

IMPROVING YIELDS AND NIMS

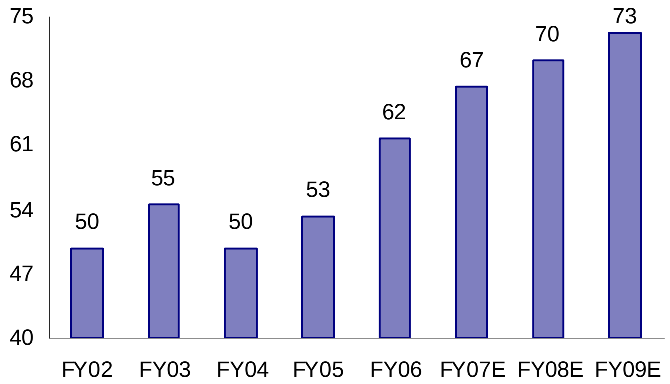


Source: Company/ Motilal Oswal Securities

C-D ratio improves from its lows

Reducing the focus of growth in bulk deposits, downsizing the investment book and improved prospects for loans have resulted in the C-D ratio steadily improving, thereby proving beneficial for interest margins. While overall C-D ratio (all-India, for J&K Bank) is at 61%, C-D ratio in the state of J&K is at a low of ~35%. Given the huge investments directed into the state and rising per capita incomes, the bank is well positioned to improve upon its lending in the state and hence improve its C-D ratio, which in turn will also improve its margins going forward.

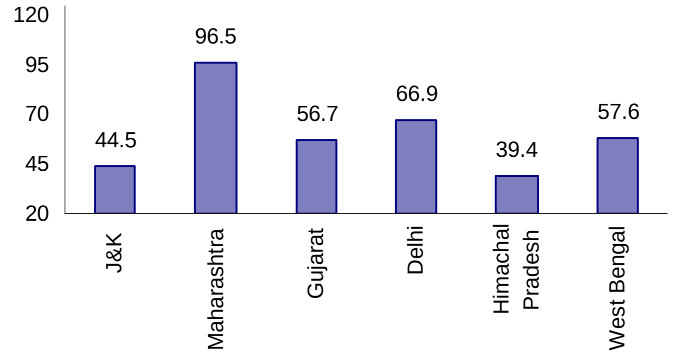
C-D RATIO ON A RISING TREND



Source: Company/ Motilal Oswal Securities

Also, if one were to consider the C-D ratio in J&K state and other developed states, J&K state records an abysmally low ratio at 45% compared with 97% for Maharashtra, 67% for Delhi and 57% for Gujarat. With various entities (public and private) announcing investments in J&K state, we believe the latter is close to witnessing a credit boom. This could lead to a multiplier effect resulting in higher per-capita incomes and subsequent rise in retail credit demand. Such a scenario bodes well for J&K Bank, which has almost 85% share in the total branch network of all commerical banks in the state. Moreover, there is a move by the bank to open new branches within the state rather than outside, thus allowing it get further market share.

C-D RATIOS OF VARIOUS STATES JUNE-06 (%)

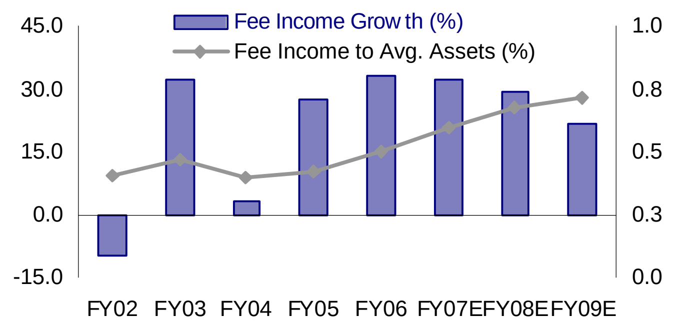


Source: Company/ Motilal Oswal Securities

Fee income initiatives appear to be paying off well

Fee income is a function of the technology employed, the depth of franchise, product range and government business. While J&K Bank had franchise and technology, it lagged product range, but is currently making rapid strides in this area. The bank has been proactive in opening branches at suitable locations, a necessity to generate income from non-fund sources. Currently, the bank is a big distributor of third-party products (mutual funds and insurance); it has also bill payment services and cash management services. The bank aims to achieve growth of 35%-40% in fee income in FY07.

FEE INCOME TO AVG. ASSETS RISING



Source: Company/ Motilal Oswal Securities

Other avenues for fee income generation

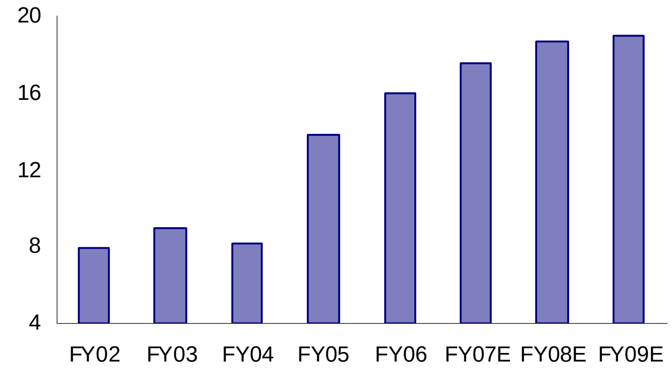
Government business on a strong footing

There have been apprehensions with respect to the bank's government businesses. Concerns over this (constituting 8%-10% of the bank's loan book) also have been dispelled as J&K Bank has a long-standing relationship with the state government. Moreover, with the state economy growing robustly, the fee-oriented government business (e.g. tax collections) is also expected to increase.

Investment banker to the state government

J&K Bank currently does not have investment banking skills, a medium the state uses to develop projects within the state. As a result, the state ties up with other private sector banks. Hence, J&K Bank has recently tied up with another new generation private sector bank for loan syndication for the state government. We believe that the government business and the investment banking business hold plenty of scope for the bank in terms of generating fee-based income ahead.

FEE INCOMES TO GROW IN IMPORTANCE TO TOTAL INCOME



Source: Company/ Motilal Oswal Securities

Growing investments in the state bodes well

The state's credit demand is now moving northward and likely to improve significantly further. While credit appetite and absorption in J&K state is limited, so is the average ticket size of advances. This has meant that bank's business model walks on two legs — low-volume-high margin lending in J&K state and high-volume-low margin business in the rest of the country. Given the resource fungibility and their existing network outside, it has been easy to straddle both the markets in line with the extant business requirements. This has been one of the key advantages that no other bank has enjoyed in the country. Currently, 30% of the lending is within the state, with the balance outside the state. The bank's management, keeping in mind the scenario of the evolving in-state economy, has decided to change the in-state:our-of-state mix to 50:50 from 30:70.

- J&K's credit demand has now increased and likely to increase significantly further.
- Out of state "specialist" focus

LENDING STRATEGY UNDERGOING CHANGE

	WITHIN J&K	OUTSIDE J&K
Current Lending	30	70
Targeted Pattern	50	50
Primary Clientele focus	Horticulture, SME, Retail	Corporates
Style	High margin, low-volume business	low margin, high-volume busin.

Source: Company/ Motilal Oswal Securities

Substantial Central and state government investments

The Prime Minister's reconstruction package of Rs240bn for J&K state, spread over three years and started in April 2005, is expected to change the state's economic and infrastructure complexion. Out of this, Rs160bn is to be spent on for power projects alone. International agencies are also contributing funds to a certain extent. The purpose of this package is to rebuild the state, which has been emasculated by 15 years of insurgency.

INVESTMENTS IN J&K STATE (RS B)

AGENCY	INVESTMENT PROPOSED
Central government (PM's package)	240
World Bank	35
Asian Development Bank	25
Private Investors (Videocon, Reliance , Mahindras, etc)	120

Source: Company/ Motilal Oswal Securities

The PMO's package is earmarked for specific projects and is part of the Union Budget. The implementation plan has been carefully thought out. An Economic Reconstruction Agency has been formed that has a sunset clause and is not a part of the Central or state bureaucracy. Thus, delays and leakages that characterize many of these projects would be minimized, if not eliminated.

With near-normalcy being restored in the troubled state, the private sector is also participating in a big way. Alongside these investments, the catalysts driving private sector investments into the state are the package of incentives offered by the state and Centre. These are a whole host of tax exemptions and capital subsidies that serve as boosters.

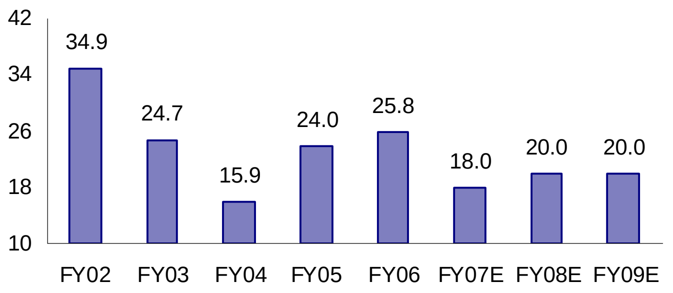
Per-capita income increasing

The state's economy has been adversely impacted by the increase in militancy over the last 10 years. In recent years there has been an improvement in the unstable scenario — relations with the neighboring countries have improved. This is evident from the state's per-capita income, which has grown by 6% in FY06 to Rs16,190. The state's GSDP (gross state domestic product) too has been growing over the last three years with advance estimates indicating GSDP growth of 10% YoY in FY06. With expectations of these conditions to improve further, the state can witness very strong economic momentum in years to come.

J&K Bank, a big beneficiary

The rising per capita income and higher investments into the state, would translate into greater demand for credit by both corporates and individuals, which bodes well for the bank. The Central government's contribution to the state's reconstruction package is routed through the state government, and J&K Bank is the sole banker to the state. Implementation of the package also incorporates increased banking requirements of the corporates and contractors. J&K Bank has 60% market share for deposits in the state and a strong presence in J&K with ~395 branches (including ECs). The process can generate significant floats for the bank.

LOAN BOOK GROWING (%)



Source: Company/ Motilal Oswal Securities

Out of state "specialist" focus

Management admits that although within the state of J&K, the bank's presence is dominant; it lacks a presence outside the state. So in addition to the usual large chunk of corporate business, which is low-margin high volume and invariably occurring in a consortium, J&K Bank has decided to experiment with knowledge banking. J&K Bank intends to convert one branch each in Chennai, Kochi and Mumbai to specialized branches handling the leather, spices and castor oil businesses respectively.

Depending on how this strategy would evolve, outside of its home state, J&K Bank can potentially become a niche banker. This move will pay off for the bank by creating an identity for it outside of J&K.

Among few "private sector" banks to have new branch license permit

J&K Bank has currently 517 branches nationwide. Of these 517 branches, ~120 branches are outside the state of J&K. J&K Bank is one of the few banks to have received new licenses (40) in the current fiscal from the RBI for opening new branches. Management is targeting to open branches in the ratio of 3:1 (for every 3 branches in J&K state, one branch will be opened outside the state) going forward.

J&K Bank has a unique advantage within the state, with a significant (40% of the total branches of all banks) number of branches within the J&K state. We believe that this feature allows the bank to virtually control banking activities within the state and leverage this to improve return ratios.

DATA AS OF JUNE 2006 (RS B)

	BR. (NOS)	DEP.	CR.
J&K State	**862**	**191**	**85**
of which SBI & Associates	125	34	9
of which Nationalized Banks	146	30	12
of which Regional Rural Banks	241	11	3
of which Other SCBs (Private)	350	116	61
of which J&K Bank (excluding ECs)	**342**	**112**	**57**
Market Share of J&K Bank (except RRB's) -%	55	62	69
Market Share of J&K Bank v/s all banks -%	40	59	67

BR: Branches *Source: Company/ Motilal Oswal Securities*

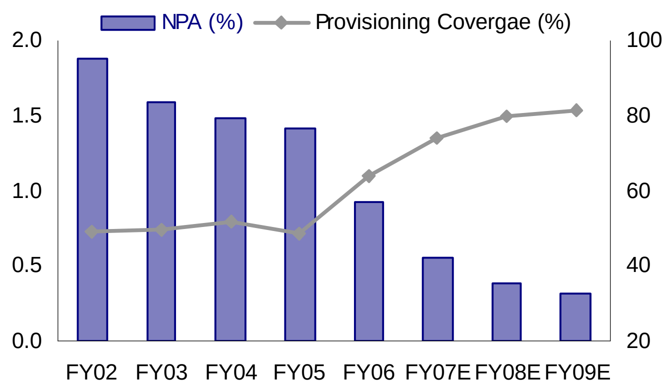
Improving financials

a) Sound asset quality with provisions closer to the target

Asset quality of the bank was never a deterrent, and currently its net NPL is at 0.7%, and likely to be around 0.5% by the end of FY07. The bank's bad assets are mostly outside J&K, arising from large corporates. Even during periods of supreme militancy, asset quality of the bank within J&K state was undisturbed because of the bank's phenomenal presence in the state.

The greatest achievement, in the course of the last one year, has been to become a financially stronger and more stable bank. The direct indication of this is the increase in NPA coverage ratio, from a low level of 50% in FY05 to 64% in FY06 and further to 72% in 1QFY07. To achieve this, provisioning levels have been hiked by almost 200%, and it is targeted to go up to 80% within the next one year. This increase in provisioning allowance for probable impairments and poor quality of assets has made the bank stronger. As a result of the high level of provisioning, which could have otherwise been shown as profits, the bank's net NPA is less than 1%. Management believes that until the bank reaches internationally accepted levels of provisioning, it would be prudent to increase provisions rather than pay out profits.

NPA AND PROVISIONING

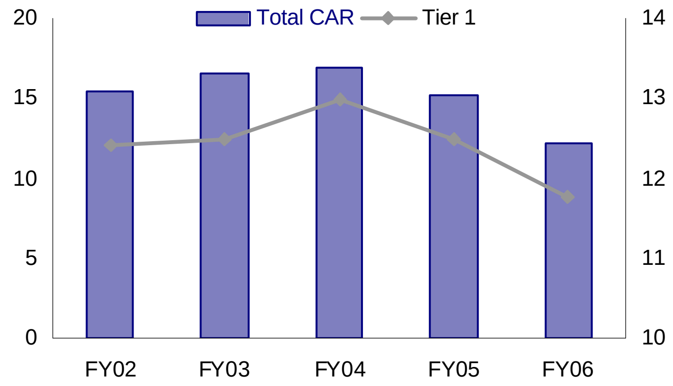


Source: Company/ Motilal Oswal Securities

b) Adequate capital; Tier 2 largely unexplored

J&K Bank's current capital adequacy of 12.7% is robust enough to take care of Basel II capital deficiencies and growth for at least another 12-18 months. What is relevant here is that Tier II itself is low at 0.4%, leaving enough room for the bank to raise capital for growth.

CAR - ADEQUATE FOR GROWTH

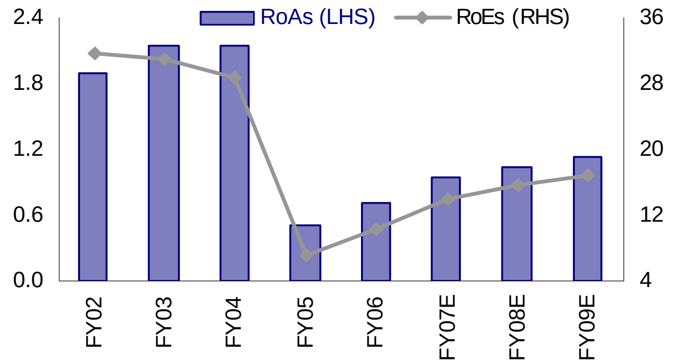


Source: Company/ Motilal Oswal Securities

c) Return ratios will likely improve

Return ratios (RoAs and RoEs) fell during FY05 and FY06 due to decline in the bank's earnings. The decline owed its reasons to the extremely high cost of funds the bank incurred on account of wholesale mobilizations, which depressed margins and also due to high concentration of treasury income to PBT, which took a U-turn in FY05 and FY06. However, we believe the worst is now behind and bank's changing strategy of lending within J&K state (high yields), coupled with shedding of wholesale deposits in lieu of low-cost deposits will result in better margins going forward.

IMPROVING RETURN RATIOS



Source: Company/ Motilal Oswal Securities

DU PONT ANALYSIS OF ROA (%)

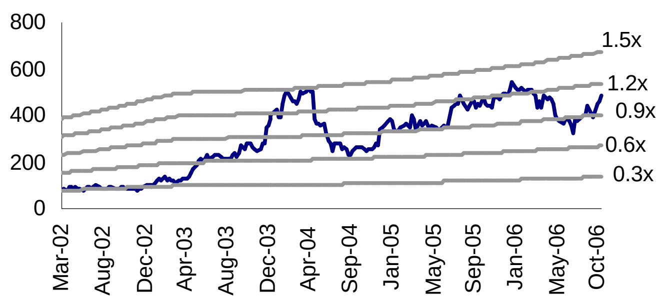
J&K BANK	FY04	FY05	FY06	FY07E	FY08E	FY09E
NII/ avg assets	3.3	2.6	2.6	2.9	3.1	3.2
Fee inc./ avg assets	0.4	0.4	0.5	0.6	0.7	0.8
Trea. Inc./avg assets	1.2	0.0	0.0	0.0	0.0	0.0
Total rev./avg assets	4.9	3.0	3.1	3.5	3.8	4.0
Opex/avg assets	1.5	1.4	1.4	1.4	1.5	1.6
-Exp Costs	0.9	0.8	0.8	0.8	0.8	0.8
-Other Opex	0.7	0.6	0.6	0.7	0.7	0.8
Op. profits/avg assets	3.3	1.6	1.8	2.1	2.3	2.4
Loan-loss-prov./avg assets	0.2	0.2	0.4	0.2	0.3	0.3
Other provisions/avg assets	0.1	0.9	0.4	0.4	0.5	0.5
Tax/avg assets	0.9	0.1	0.3	0.4	0.5	0.5
ROAA	2.1	0.4	0.6	1.0	1.1	1.2
Leverage (x)	13.4	14.0	14.7	14.4	14.3	14.4
ROAE	28.7	6.2	8.9	14.2	15.6	16.9

Source: Company/ Motilal Oswal Securities

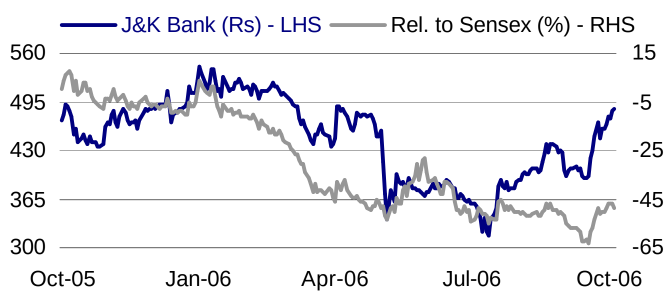
Valuations attractive; strong re-rating candidate

J&K Bank is set to scale up rapidly from hereon - has good asset quality and is also adequately capitalized. On back of higher margins, we expect return ratios to improve over the next couple of fiscals. The stock has underperformed the Sensex by 48% and Bankex by 24% over the last 12 months.With better earnings visibility, we are raising our target price, valuing the bank at 1.4xFY08 BV, thereby assigning a target of Rs659 (upside of 36%). Reiterate **Buy**.

ROLLING P/BV BAND



STOCK PERFORMANCE (1 YEAR)



Source: Company/ Motilal Oswal Securities

INCOME STATEMENT (Rs Million)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Interest Income	15,492	17,063	20,060	23,620	27,640
Interest Expended	9,530	10,425	12,205	14,197	16,387
Net Interest Income	**5,962**	**6,637**	**7,855**	**9,422**	**11,253**
Change (%)	*-3.8*	*11.3*	*18.3*	*20.0*	*19.4*
Other Income	961	1,332	1,735	2,280	2,754
Net Income	**6,924**	**7,969**	**9,590**	**11,703**	**14,008**
Change (%)	*-24.9*	*15.1*	*20.3*	*22.0*	*19.7*
Operating Expenses	3,228	3,453	3,930	4,714	5,595
Operating Income	**3,696**	**4,517**	**5,660**	**6,989**	**8,413**
Change (%)	*-41.2*	*22.2*	*25.3*	*23.5*	*20.4*
Other Provisions	2,336	1,905	1,800	2,200	2,500
PBT	**1,359**	**2,611**	**3,860**	**4,789**	**5,913**
Tax	209	843	1,158	1,437	1,774
Tax Rate (%)	*15.3*	*32.3*	*30.0*	*30.0*	*30.0*
PAT	**1,151**	**1,769**	**2,702**	**3,352**	**4,139**
Change (%)	*-71.7*	*53.7*	*52.8*	*24.1*	*23.5*
Proposed Dividend	439	442	558	669	781

BALANCE SHEET (Rs Million)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Capital	485	485	485	485	485
Reserves & Surplus	16,169	17,510	19,654	22,337	25,695
Net Worth	**16,654**	**17,995**	**20,139**	**22,822**	**26,180**
Deposits	**216,450**	**234,846**	**253,634**	**291,679**	**335,431**
Change (%)	*16.0*	*8.5*	*8.0*	*15.0*	*15.0*
Borrowings	4,065	3,509	3,860	4,246	4,671
Other Liabilities & Prov.	7,633	8,135	8,542	8,969	9,418
Total Liabilities	**244,802**	**264,486**	**286,176**	**327,717**	**375,700**
Current Assets	31,783	22,874	22,217	24,472	26,126
Investments	90,892	90,020	85,519	89,795	94,285
Change (%)	7.6	-1.0	-5.0	5.0	5.0
Advances	115,171	144,831	170,901	205,081	246,097
Change (%)	*24.0*	*25.8*	*18.0*	*20.0*	*20.0*
Net Fixed Assets	2,024	1,946	2,244	2,544	2,784
Other Assets	4,931	4,814	5,296	5,825	6,408
Total Assets	**244,802**	**264,486**	**286,176**	**327,717**	**375,700**

ASSUMPTIONS (%)

Deposit Growth	16.0	8.5	8.0	15.0	15.0
Advances Growth	24.0	25.8	18.0	20.0	20.0
Investments Growth	7.6	-1.0	-5.0	5.0	5.0
Dividend	80.0	80.0	100.0	120.0	140.0
CRR	5.0	5.0	5.0	5.0	5.0

E: MOSt Estimates

RATIOS

Y/E MARCH	2005	2006	2007E	2008E	2009E
Spreads Analysis (%)					
Avg. Yield - Earning Assets	7.0	6.9	7.4	7.7	7.9
Avg. Cost-Int. Bear. Liab.	4.6	4.5	4.9	5.1	5.2
Interest Spread	2.4	2.4	2.5	2.6	2.7
Net Interest Margin	2.7	2.7	2.9	3.1	3.2
Profitability Ratios (%)					
RoE	7.1	10.3	14.2	15.6	16.9
RoA	0.5	0.7	1.0	1.1	1.2
Int. Expended/Int.Earned	61.5	61.1	60.8	60.1	59.3
Other Inc./Net Income	13.9	16.7	18.1	19.5	19.7
Efficiency Ratios (%)					
Op. Exps./Net Income	46.6	43.3	41.0	40.3	39.9
Empl. Cost/Op. Exps.	55.4	55.7	53.6	53.2	52.1
Busi. per Empl. (Rs m)	48.3	52.0	55.8	61.0	69.1
NP per Empl. (Rs lac)	1.7	2.6	3.8	4.4	5.3
Asset-Liability Profile (%)					
Adv./Deposit Ratio	53.2	61.7	67.4	70.3	73.4
Invest./Deposit Ratio	42.0	38.3	33.7	30.8	28.1
G-Sec/Invest. Ratio	64.4	71.0	71.0	71.0	71.0
Gross NPAs to Adv.	2.7	2.5	2.1	1.9	1.7
Net NPAs to Adv.	1.4	0.9	0.5	0.4	0.3
CAR	15.2	12.1	12.1	10.6	10.8
Tier 1	*12.5*	*11.8*	*11.3*	*9.8*	*9.5*

VALUATION

Book Value (Rs)	343.4	371.1	415.3	470.6	539.9
Price-BV (x)	1.4	1.3	1.2	1.0	0.9
Adjusted BV (Rs)	321.6	353.1	402.8	460.5	530.0
Price-ABV (x)	1.5	1.4	1.2	1.1	0.9
EPS (Rs)	23.7	36.5	55.7	69.1	85.4
EPS Growth (%)	-71.7	53.7	52.8	24.1	23.5
Price-Earnings (x)	20.5	13.3	8.7	7.0	5.7
OPS (Rs)	76.2	93.1	116.7	144.1	173.5
OPS Growth (%)	-41.2	22.2	25.3	23.5	20.4
Price-OP (x)	6.4	5.2	4.2	3.4	2.8

E: MOSt Estimates

N O T E S

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Disclosure of Interest Statement	Jammu & Kashmir Bank
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No