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Rating Information

Price (₹)	739
Target Price (₹)	977
Target Date	30 th Sep'11
Target Set On	10 th Jan'11
Implied yrs of growth (DCF)	10
Fair Value (ERoE)	977
Fair Value (DDM)	385
Ind Benchmark	BSE Bankex
Model Portfolio Position	

Stock Information

Market Cap (₹ bn)	35.9
Free Float (%)	47%
52 Wk H/L (₹)	938/540
Avg Daily Volume	90,465
Avg Daily Value (₹ Mn)	68
Equity Cap (₹ Mn)	485
Face Value (₹)	10
Bloomberg Code	J&KBK IN

Ownership

	Recent	3M %	12M %
Promoters	53.2	0.0	0.0
DII	3.9	0.8	0.9
FII	24.4	-5.5	-5.8
Public	18.5	4.7	4.9

Price %

	1M%	3M%	12M%
Absolute	-2.8	-3.5	27.5
Vs Industry	3.9	11.0	7.9
Dena Bank	-9.9	-10.3	18.3
Andhra Bank	-7.7	-17.1	25.3

Consolidated Quarterly EPS forecast

₹/Share	1Q	2Q	3Q	4Q
EPS (10A)	24.1	27.7	28.9	24.8
EPS (11E)	30.0	33.7	31.1	31.2

Jammu & Kashmir Bank Limited

Initiating Note

Regular Coverage

Absolute : LONG
Relative : Overweight
32% upside in 9 months

Two in One: The RBI and SBI of "Paradise on Earth"

Financials

Jammu & Kashmir Bank Limited (J&K Bank) is a regional monopoly enjoying structural advantages like lowest cost of funds and the legislative status of being the Banker to the Jammu & Kashmir (J&K) State. Its diversified lending portfolio with 50% exposure outside J&K State and ~20% exposure to J&K Government and its employees inspires confidence in the future growth potential of J&K Bank. We expect a 32% upside in J&K Bank over 9 months and initiate coverage with an absolute LONG and relative Overweight rating. Our Excess Return on Equity (ERoE) based Target Price (TP) of ₹ 977/share assumes 10 years of growth, cost of equity of 14.6% and terminal growth of 3%.

Structural Advantages of Cost of Funds and Monopoly Status in J&K driven by "Reserve Bank" Status of J&K Bank: J&K Bank enjoys the lowest cost of deposits of ~5-5.5% among its peers due to its functional equivalence of being the Reserve Bank of J&K. This has also led to monopoly status within J&K in the form of 87% share of advances and 70% share of total deposits in J&K.

Successful Business Consolidation post the FY05 MTM losses resulting in ~100% NPA Coverage: J&K Bank has successfully consolidated its business post FY05 by a combination of increased lending within J&K, focus on retail deposits and higher working capital to term loans. This has led to higher provisioning coverage of 95.5% and an improvement in the Net Non Performing Assets (NNPAs) from 1.0% in 2004 to 0.0% in H2FY11.

Lending inside J&K State + High Growth Potential outside J&K State = Stable ~15% Advances CAGR from 2010 to 2013: J&K Bank has achieved impressive NIMs of ~3-3.5% alongwith a 30% EPS CAGR from 2006 to 2010 by following a two pronged strategy of lending inside J&K State (a high yield, low volume business) focused on retail and SME segments involved in agriculture and handicrafts, and lending outside J&K State (a low yield, high volume business) focused on Large Corporate Groups like Tata, Birla and Reliance. We expect that the diversified business mix and several capex focused Government Schemes will lead to 3 year CAGR of ~15% in Loans & Advances.

Attractive Valuations in the Banking Space along with Strong Fundamentals: J&K Bank's attractive position in the banking space on a FY12 RoE to FY11 P/B basis is accentuated by its impressive efficiency and profitability measures compared to its peers. It is currently trading at median valuations on TTM P/BV and TTM P/E basis and we consider the target TTM P/BV and TTM P/E multiples of 1.3x and 7.7x to be achievable given the historical trading ranges.

Concern on Recent Change of Leadership and Managing Growth in Loans and Advances: The key challenge before J&K Bank is to ramp up its loans and advances given its relative failure in the past few quarters and the recent change of leadership from Dr. Haseeb Drabu to Mr. Mustaq Ahmad.

Consolidated Financials

₹ Mn YE Mar	FY10E	FY11E	FY12E	FY13E
Net Int Income	11,193	14,291	15,306	17,683
Non Int Income	4,162	3,185	3,159	3,628
Operating Costs	5,774	6,750	7,447	8,462
Provisioning Costs	1,666	1,574	1,107	1,297
Net Profit	5,124	6,111	6,641	7,740
Total Equity	30,105	34,539	39,519	45,324
Deposits	3,72,372	4,29,264	4,92,568	5,65,206
Borrowings	11,002	11,659	12,659	13,659
Loans & Advances	2,30,572	2,53,076	3,01,664	3,49,489
Investments	1,39,563	1,78,309	1,96,820	2,17,253
Cash	46,142	42,761	43,733	53,669
₹ Per Share	FY10E	FY11E	FY12E	FY13E
Earnings (FD)	106	126	137	160
Book Value	621	712	815	935
Dividends	22	27	29	34
P/E (x)	7.0	5.8	5.4	4.6
P/B (x)	1.2	1.0	0.9	0.8
NIM (%)	3.3%	3.6%	3.3%	3.3%
Operating Costs (%)	1.7%	1.7%	1.6%	1.6%
Provisions (%)	0.5%	0.4%	0.2%	0.2%
ROA (%)	1.3%	1.3%	1.3%	1.3%
Leverage (x)	12.7	12.8	12.8	12.8
ROE (%)	18%	19%	18%	18%



Diversified Lending Portfolio of J&K Bank

Company Snapshot

How we differ from Consensus

		Equirus	Consensus	% Diff	Comment
EPS	FY11E	126.0	124.6	1%	Our projections for FY12E are lower than consensus since we have considered a lower pass through of the interest cost increase in FY12E.
	FY12E	136.9	144.9	-6%	
Sales	FY11E	14,291	17,943	-20%	
	FY12E	15,306	20,494	-25%	
PAT	FY11E	6,111	6,212	-2%	
	FY12E	6,641	7,235	-8%	

Our Key Investment arguments:

- **Structural Advantages of Cost of Funds and Monopoly Status in J&K driven by “Reserve Bank” Status of J&K Bank:** J&K Bank enjoys the lowest cost of deposits of ~5-5.5% among its peers due to its functional equivalence of being the Reserve Bank of J&K. This has also led to monopoly status within J&K in the form of 87% share of advances and 70% share of total deposits in J&K.
- **Successful Business Consolidation post the FY05 MTM losses resulting in ~100% NPA Coverage:** J&K Bank has successfully consolidated its business post FY05 by a combination of increased lending within J&K, focus on retail deposits and higher working capital to term loans. This has led to higher provisioning coverage and an improvement in the Net Non Performing Assets (NNPAs) from 1.0% in 2004 to 0.0% in H2FY11.
- **Lending inside J&K State + High Growth Potential outside J&K State = Stable ~14% EPS CAGR from 2010 to 2013:** J&K Bank has achieved impressive NIMs of ~3-3.5% alongwith a 30% EPS CAGR from 2006 to 2010 by following a two pronged strategy of lending inside J&K State (a high yield, low volume business) focused on retail and SME segments involved in agriculture and handicrafts, and lending outside J&K State (a low yield, high volume business) focused on Large Corporate Groups like Tata, Birla and Reliance. We expect that the diversified business mix and several capex focused Government Schemes will lead to 3 year CAGRs of ~13% and ~15% in Loans & Advances and EPS respectively.

Risk to Our View

Future Growth in Loans and Advances, Credit Crisis in J&K which could impact the near term liquidity of the bank

Comparable Valuation			Mkt Cap (₹ bn)	Price Target	Target Date	EPS			P/E			BPS		P/B			RoE			Div Yield	
Company	Reco.	CMP				FY10	FY11E	FY12E	FY10	FY11E	FY12E	FY10	FY11E	FY10	FY11E	FY10	FY11E	FY12E	FY10	FY11E	FY10
J&K Bank	Long	739	35.9	977	Sep 2011	106	126	137	7.0	5.8	5.4	621	1.0	18.2%	18.9%	17.9%	3.0%	3.7%			
Andhra Bank	Long	136	65.7	220	Sep 2011	22	26	31	6.3	5.2	4.4	91	1.2	25.9%	25.9%	24.8%	3.7%	3.7%			
Dena Bank	NR	104	29.7	N.R	N.R	17	20	24	6.1	5.1	4.3	82	1.1	21.6%	22.3%	21.6%	1.8%	2.5%			

Key Triggers

- Higher than expected growth of Loans and Advances, Increase in Allocation of Government Spending to J&K State and Higher Dividend Payout Ratios

Sensitivity to Key Variables	% Change	% Impact on FY11 EPS	%Impact on FY12 EPS
Growth of Loans and Advances	-5%	-0.2	-0.8
NIM	-5%	-4.5	-5.7
Yield on Investments	-5%	-1.7	-3.6

DCF Valuations & Assumptions

Rf	Ke	WACC	Term. Growth	RoE in Terminal Yr
8%	14.6%	6.1%	3.0%	15.0%

	FY11E	FY12E	FY13-15E	FY16-20E
NII Growth	27.7%	7.1%	8.5%	8.5%
NIM (%)	3.6%	3.3%	3.2%	2.8%
Dividend Payout	25.0%	25.0%	25.0%	25.0%
RoE	18.9%	17.9%	17.1%	15.3%

	1	2	5	10
Years of strong growth				
Valuation as on date (₹)	1001	1049	953	885
Valuation as of 30 th Sep'11	1105	1159	1052	977

Based on EROE, considering 10 years of 13% CAGR growth in Loans and Advances and 10% CAGR growth in EPS along with average ROE of ~17%, we derive current fair value of ₹ 885 and 30th Sep 2011 fair value of ₹ 977.

Company Description:

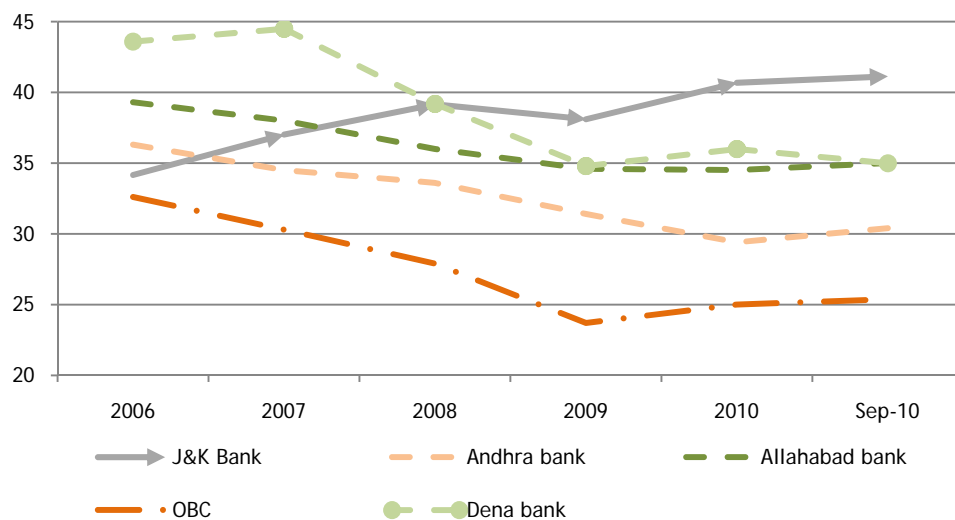
J&K Bank, incorporated in 1938 is designated as RBI's agent for banking business. It has enjoyed four decades of uninterrupted profitability and dividends and is rated P1+ by S&P. It is present throughout J&K state with 426 branches out of a total of 536 branches within J&K and 254 ATMs within J&K. It has a virtual monopoly in the form of 87% share of advances and 70% share of deposits. The bank offers stock broking services through J&K Financial Services and has an insurance joint venture with Metlife International apart from being a stakeholder in J&K Grameen Bank.

Investment Rationale

A. Structural Advantages of Cost of Funds and Monopoly Status in J&K driven by “Reserve Bank” Status of J&K Bank

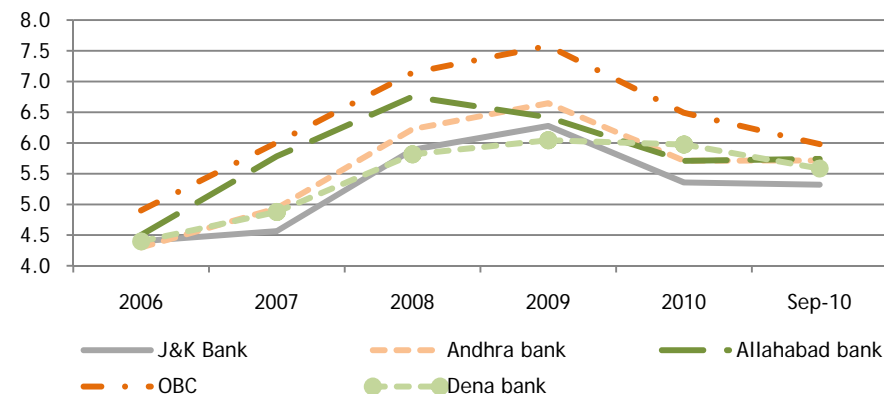
- Unique Bank by way of being the Banker to the Government of Jammu & Kashmir (GoJK) while the same function is carried out by the Reserve Bank of India (RBI) for all the other Indian States
- Reserve Bank Status along with Monopoly in J&K State (87% share in advances and 70% share in deposits in J&K) leading to strong possibility of systemic support for meeting its payment obligations in the event of distress
- Possibility of systemic support to be a huge sentiment booster regarding soundness and solvency of the bank among retail and institutional investors
- Reflected in easy availability of resources and a high CASA/Total Deposit Levels leading to lowest Cost of Funds among other regional peers

Exhibit 1: Highest CASA/Deposit Levels > 40% among regional peers...



Source: Annual Reports, Bloomberg, Company Disclosures

Exhibit 2: ...Leading to the Lowest Cost of Funds

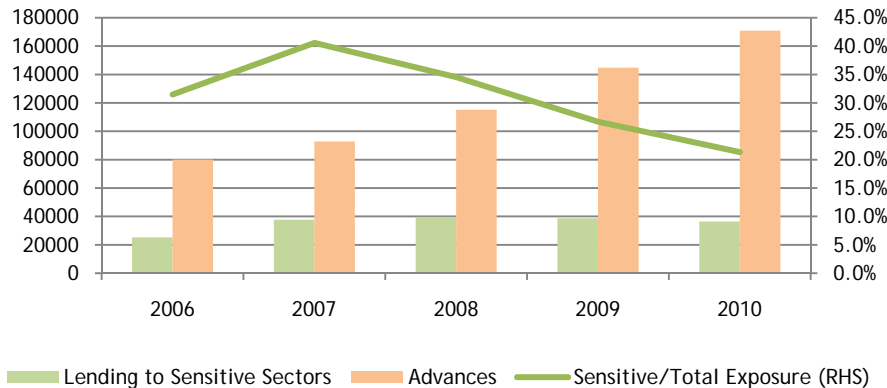


Source: Annual Reports, Bloomberg, Company Disclosures

B. Successful Business Consolidation post the FY05 MTM losses resulting in ~100% NPA Coverage and best in industry efficiency and profitability

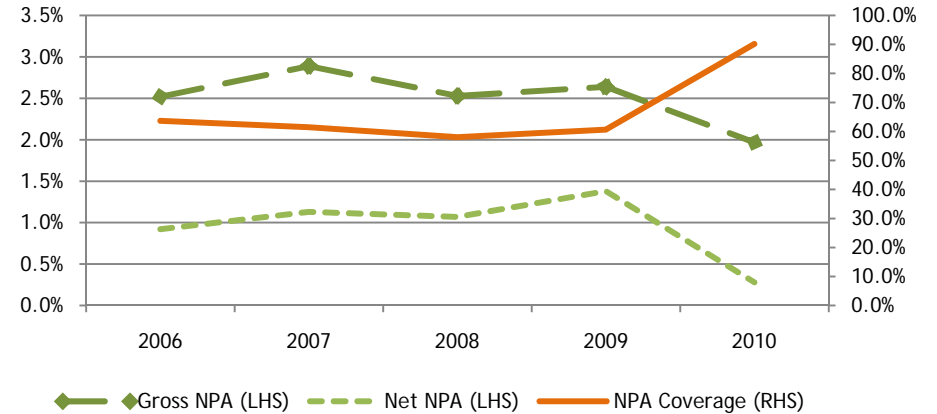
- 72% drop in PAT and EPS in FY05 due to a high Mark to Market (MTM) loss in a hardening interest rate environment on account of high allocation in Available for Sale (AFS) category
- Successfully consolidated the business from FY05 to FY10 and resurrected the EPS from ₹ 23.7/share to ₹ 105.7/share at a CAGR of 35%
- Followed a strategy of:
 - increasing lending exposure within J&K State which has higher margins (evident in the change of the mix from 34:66 in FY04 to 51:49 Within J&K State/Outside J&K State Lending in FY10) along with reduction in exposure to sensitive sectors (like Real Estate, Capital Markets and Commodities) leading to improvement in asset quality

Exhibit 3: Strategy of reducing lending to sensitive sectors as a %age of total exposure



Source: Equirus Securities, Annual Reports

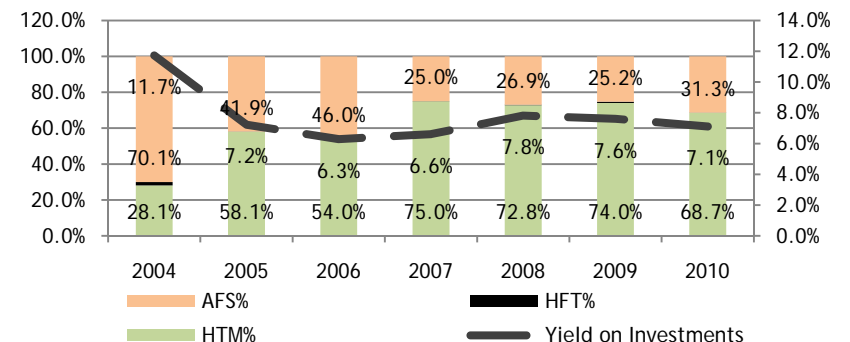
Exhibit 4: Evident in Declining Gross/Net NPAs alongwith the highest NPA Coverage in India leading to Superior Asset Quality



Source: Annual Reports, Equirus Securities

- operate as a corporate bank outside J&K State in Rest of India and aim at quicker repricing by focusing on higher Working Capital Exposure than consortium and term loans,
- maintaining higher proportion of Held to Maturity (HTM) securities in the Investment Portfolio (changed from 28% in FY04 to 69% in FY10),

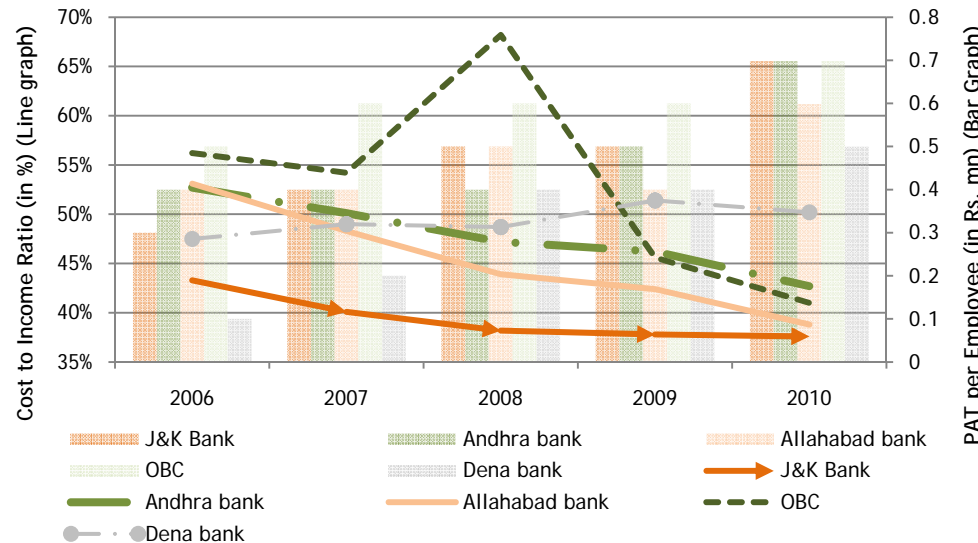
Exhibit 5: A much sounder Investment Portfolio this time around due to higher focus on HTM securities



Source: Equirus Securities, Annual Reports

- d) focused on increasing low cost deposits, higher maturity of liabilities and higher operating efficiencies (in the form of lower cost to income and higher PAT per employee)

Exhibit 6: One of the most efficient banks among the peers...

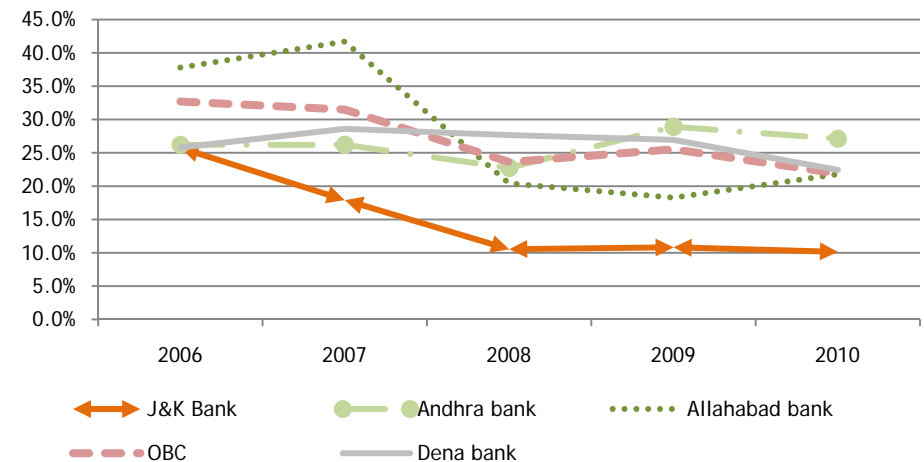


Source: Equirus Securities, Company Disclosures

C. Lending inside J&K State + High Growth Potential outside J&K State = Stable ~15% Advances CAGR from 2010 to 2013

- Lower Lending Growth of J&K Bank with a 5 yr CAGR of ~12% compared to CAGR of ~25% for regional peers due to focus on increasing assets within J&K State, higher provisioning and efficiency improvements

Exhibit 7: Slower Lending Growth than peers



Source: Equirus Securities, Company Disclosures, Annual Reports

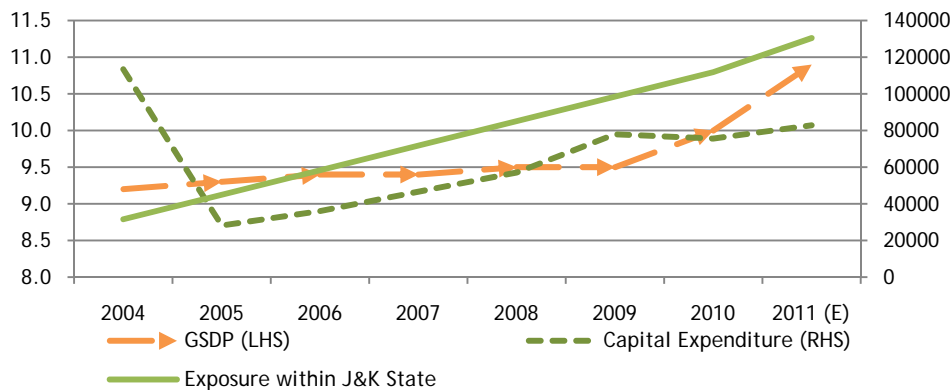
- Currently enjoys the highest NPA coverage in India and one of the lowest cost of funds along with a renewed focus post H1FY11 on growth of loans and advances
- Two major lending themes of Within J&K State and Outside J&K State

1. Within J&K State

- Focus on lending to State and its employees, individuals and SMEs involved in trade, handicrafts, saffron, horticulture (apples mainly), agriculture and tourism as shown in the higher proportion of Within J&K State lending
- More than ~40% of the advances in the J&K state to the State Government and its employees which improves the asset quality and leads to lower default rates
- Innovative lending schemes and economy specific products like All Purpose Agri Term Loan, Apple Advances Scheme, Dastakar Finance, Craft Development Finance, Saffron Scheme and Giri Finance

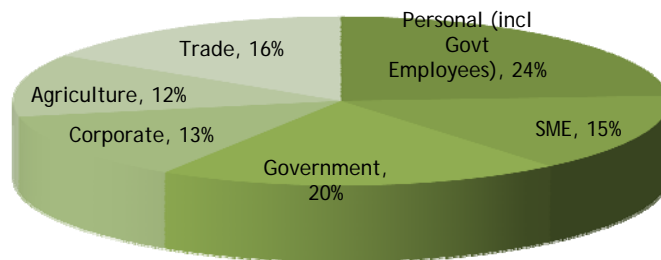
- Growth in SGDP, increasing capex allocations in State Budget, low base of J&K GDP to lead to higher organic growth opportunities in J&K State
- Have considered a lower growth rate for Within J&K State Lending due to the key advantage of cost of funds which makes wholesale lending outside J&K State an easier proposition (especially in an expansionary credit environment where the credit growth has picked up by ~30% in the past 2 months)

Exhibit 8: Growth in State GDP and Capital Expenditure



Source: Equirus Securities

Exhibit 9: Sector-Wise Advances within J&K State as on Sep 2010

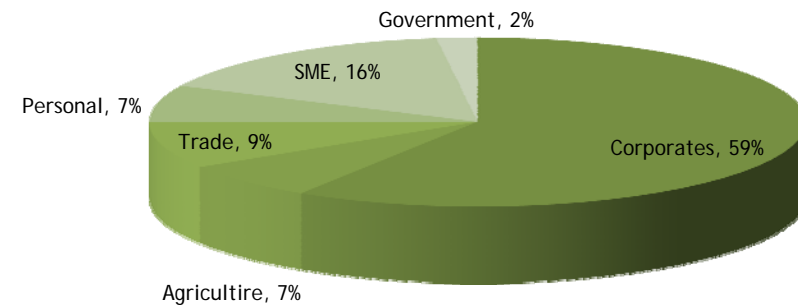


Source: Equirus Securities, Company Disclosures

2. Outside J&K State

- Majorly comprises of corporate finance to large corporates like Reliance, Tata and Birla and project finance to hydro power and roads sector for infrastructure creation within the state

Exhibit 10: Sector-Wise Advances outside J&K State



Source: Equirus Securities, Company Disclosures

- Expect a steady growth of ~18% in Loans and Advances from H1FY11 to FY13 with higher growth contribution from outside J&K State given the current strong position of the bank in terms of high CASA, low cost of funds and 95.5% NPA coverage.

Exhibit 11: Steady ~18% Growth in Loans Advances from H1FY11 to FY13

Growth in Loans & Advances	Sep-10	Mar-11	Sep-11	Mar-12	Sep-12	Mar-13
Loans & Advances	231,833	253,076	276,291	301,664	323,122	349,489
Annualized Growth%	1.1%	19.2%	19.2%	19.2%	14.7%	17.0%
Within J&K State	120,553	130,390	141,030	152,538	161,828	175,033
Annualized Growth%	16.2%	17.0%	17.0%	17.0%	12.6%	17.0%
Outside J&K State	111,280	122,686	135,261	149,126	161,294	174,456
Annualized Growth%	-12.2%	21.6%	21.6%	21.6%	17.0%	17.0%

Forecast: Key Assumptions & Sensitivity

Key Assumptions

The key assumptions related to growth of assets and liabilities, profitability, proportion of productive assets and the capital structure are as follows:

Exhibit 12: Key Assumptions

Key Assumptions	2008	2010	2011	2012	2014	2016	2019	2020
Growth in Loans and Advances	10.6%	10.2%	9.8%	19.2%	6.1%	14.7%	6.2%	17.0%
Yields on Advances	10.4%	10.6%	10.8%	11.8%	10.6%	10.6%	10.6%	10.7%
Within J&K State Business			51.5%	50.6%	49.1%	49.1%	48.1%	48.1%
Outside J&K State Business			48.5%	49.4%	50.9%	50.9%	51.9%	51.9%
Cost of Funds	5.9%	5.4%	5.4%	6.4%	5.5%	5.4%	5.4%	5.4%
NIM%	3.11%	3.26%	3.57%	3.29%	3.18%	2.97%	2.64%	2.54%
Cost/Productive Assets	1.5%	1.7%	1.7%	1.6%	1.5%	1.4%	1.2%	1.2%
Yield on Investments	6.7%	5.7%	6.6%	6.7%	6.2%	6.2%	6.2%	6.2%
Provisions/Productive Assets	1.1%	1.3%	1.2%	0.9%	0.9%	0.9%	0.9%	0.8%
Productive Assets/Total Assets	0.84	0.87	0.89	0.90	0.84	0.82	0.76	0.76
Deposit Growth	13.5%	12.9%	14.2%	14.3%	14.3%	14.3%	14.3%	14.3%
CAR (Equity/Total Advances)*	12.2%	13.1%	13.6%	13.1%	13.9%	13.4%	13.6%	12.9%

*CAR = Capital Adequacy Ratio (calculated as per definition and different from Reported CAR)

Source: Equirus Securities

Growth of Assets and Liabilities

- **Growth in Loans and Advances:** J&K Bank has experienced muted growth in Loans and Advances in H1FY11 due to the cautious outlook of the bank regarding the economic recovery. Given the current positioning of the bank in terms of its adequate capitalization, low cost of funds and the focus of the management on growth in loans and advances, we have assumed a high growth in the coming quarters leading to a high growth of 19.2% for H2FY11 (after low growth in H1FY11) and 19.2% for FY12. We have considered slowdowns in asset growth in 2014 and 2019 due to the cyclical nature of the industry.
- **Growth in deposits:** J&K enjoys the status of the Reserve bank of Kashmir and we expect this to reflect in consistent ~14% annual growth of deposits.
- **Business Mix Within J&K and Outside J&K State:** We have considered slightly higher growth in the Outside J&K State Portfolio due to the relative low cost advantage,

challenges in identifying quality credit Within J&K State and ease in ramping up corporate assets Outside J&K State.

Profitability Parameters

- **Yield on Advances:** We expect a slight increase in yields on advances in the coming quarters due to the increasing interest rate environment and yields to stabilize around 10.6% in the long run given the business mix between Within and Outside J&K State.
- **Cost of Funds:** We expect a slight increase in the cost of funds in the coming year which is in line with the expectation of increasing interest rates and then stabilize them around 5.5% on account of the inherent advantage of low cost deposits.
- **Yield on Investments:** The yield on investments have been conservatively projected in the coming quarters due to the increasing interest rate environment and have then maintained a consistent level slightly below the past mean level.
- **Provisions/Productive Assets:** The provisions are expected to be slightly lower than past levels given the high NPA coverage levels and stabilize around 0.75%.
- **Productive Assets/Total Assets:** The proportion of Productive Assets/Total Assets drops gradually from 0.90 in 2012 to 0.76 in 2020 due to the high levels of cash and the assumptions related to conservative growth.

Capital Structure

- **Capital Adequacy Ratio (CAR):** We expect a stable CAR level of 12-13% and do not expect a fall in the same which may occur in case of higher growth of loans and advances and this may be an upside risk in the future.

Sensitivity Analysis

We have carried out sensitivity on the key variables affecting the FY11 EPS and valuation of J&K Bank.

Exhibit 13: Sensitivity Analysis on FY11 EPS and Valuation

Sensitivity	Base Case	Change	% Impact on Periodic EPS	% Impact on Valuation
Growth in Loans and Advances				
FY11	9.8%	-5%	-0.2%	-0.8%
FY12	19.2%	-5%	-0.8%	-1.4%
FY13-FY15	12.2%	-5%	-1.9%	-2.6%
FY16-FY20	13.5%	-5%	-4.1%	-4.5%
Net Interest Margin				
FY11	3.54%	-5%	-4.5%	-0.5%
FY12	3.29%	-5%	-5.7%	-0.1%
FY13-FY15	3.17%	-5%	-4.4%	-0.2%
FY16-FY20	2.80%	-5%	-4.2%	-4.2%
Yield on Investments				
FY11	6.38%	-5%	-1.7%	-0.2%
FY12	6.75%	-5%	-3.6%	-0.1%
FY13-FY15	6.27%	-5%	-3.3%	-0.2%
FY16-FY20	6.25%	-5%	-3.4%	-3.4%

Source: Equirus Securities

The valuations are most sensitive to Growth in Loans and Advances and we have been conservative in assuming this variable for future projections.

Investment Risk & Concerns

Growth in Loans and Advances

J&K Bank has experienced a relatively lower growth of loans and advances in the form of a CAGR of ~15% from FY05 to FY10 compared to 20-25% in the same period for other peers. It has experienced muted growth of 0.6% in Loans and Advances in H1FY11 due to the cautious outlook of the bank regarding the economic recovery.

Given the current positioning of the bank in terms of its adequate capitalization, low cost of funds, low base of loans and advances and the focus of the management on growth in loans and advances, we expect a higher growth in H2FY11 and FY12.

Recent Change in Management

There has been a recent change at the top in J&K Bank with Dr. Haseeb Drabu, former Economic Advisor to the State and J&K's top notch economist being replaced by Mustaq Ahmad, a long serving employee of J&K Bank who has risen from the ranks and joined J&K Bank in 1972. Dr. Drabu's tenure was expected to end in Sep 2011 and the early replacement has led to concerns regarding the near term performance and asset growth within the bank.

However, it is to be noted that J&K Bank is managed by the state and is not expected to be over influenced by a single individual. It had struggled in H1FY11 to ramp up its asset book even under Dr. Drabu's leadership.

Presence in a terrorist affected region

J&K Bank is located in a sensitive area with high terrorist threats and this may affect the day to day operations of the bank. This may also affect the long term development of the state.

We observe that the bank has enjoyed four decades of uninterrupted profitability and dividends, making it one of the most consistent companies in India. It is also important to understand that we have considered conservative growth of loans and advances and in case of a sustained terror attack or war, the bank will benefit from higher financial allocations from the state and we expect it to grow its loans and advances by lending to J&K State Departments and Outside J&K State in such a scenario.

Corporate Governance

- Auditors:** K B Sharma & Co., Verma Associates, O P Garg & Co., K K Goel & Associates and P.C.Pindal & Co. are among the firms eligible for the panel of statutory central auditors of public sector banks for FY10.
- Board of Directors:** The Board of Directors comprises of 12 directors. There are 3 Executive Directors, 9 Non Executive (8 Independent) Directors comprising IAS Officers and Senior State Officials of J&K.
- Change of Management:** There has been a recent change in the Chairman and CEO of J&K Bank and Dr. Haseeb Drabu has been replaced by Mustaq Ahmad, a long serving employee of J&K Bank who has risen from the ranks. Dr. Drabu was also the Chief Economic Advisor to the state and he was mainly responsible for the strong business consolidation of J&K Bank from 2005 to 2010. He resigned in August 2010 while his tenor was expected to end in September 2011.
- Past Fiascos:** J&K Bank suffered severe MTM losses in FY05 and underwent a long period (FY05-FY09) of consolidation wherein it focused on improving its profitability, efficiency and asset quality. It also changed its asset growth strategy by increasing its exposure to Within J&K State and reducing exposure to sensitive sectors Outside J&K State. This has led to a superior asset quality and coverage in the form of 0.0% Net NPAs and 95.5% NPA coverage. It suffered the MTM losses mainly due to a very high proportion of AFS and HFT category on investments. Its current investment book comprises ~70% HTM category and is expected to yield a stable return on investments.

Competitor Analysis

We have compared the Return on Equity (RoE) Trees of Public Sector Banks including Andhra Bank, Allahabad Bank, Oriental Bank of Commerce and Dena Bank due to the common element of being a regional play and similar size and scale of operations.

Exhibit 14: RoE Trees of J&K Bank and its peers

RoE Tree of J&K Bank	2007	2008	2009	2010	Sep-10
Yield on Average Interest Earning Assets	7.9%	9.3%	10.1%	8.9%	9.1%
Cost of Funds	4.6%	5.9%	6.3%	5.4%	5.2%
Net Interest Income	7,679	8,104	9,838	11,193	7,384
Net Interest Margin (A)	3.2%	3.1%	3.4%	3.3%	3.8%
Operating Costs (B)	1.4%	1.5%	1.6%	1.7%	1.7%
Provisions & Contingencies (C)	1.2%	1.1%	1.2%	1.3%	1.4%
Income on Int Earning assets (D) = (A) + (B) + (C)	0.6%	0.4%	0.6%	0.3%	0.7%
Productivity Index (E)	0.87	0.85	0.84	0.86	0.88
Other Income (F)	0.6%	0.8%	0.7%	1.0%	0.8%
Return on Assets (G) = (D) * (E) + (F)	1.0%	1.2%	1.2%	1.3%	1.4%
Leverage	14.5	14.2	14.3	14.2	13.9
Return on Equity	14.4%	16.7%	16.6%	18.2%	19.5%
Reported CAR	13.2%	12.8%	14.5%	15.9%	15.6%

RoE Tree of Andhra Bank	2007	2008	2009	2010	Sep-10
Yield on Average Interest Earning Assets	8.8%	9.4%	9.8%	9.2%	9.9%
Cost of Funds	4.9%	6.2%	6.6%	5.7%	5.5%
Net Interest Income	14,175	14,199	16,269	21,947	15,195
Net Interest Margin (A)	3.7%	3.1%	3.0%	3.2%	3.9%
Operating Costs (B)	2.5%	2.1%	2.0%	2.0%	2.2%
Provisions & Contingencies (C)	1.0%	1.1%	1.2%	1.1%	1.2%
Income on Int Earning assets (D) = (A) + (B) + (C)	0.2%	0.0%	-0.2%	0.1%	0.6%
Productivity Index (E)	0.86	0.88	0.88	0.87	0.85
Other Income (F)	1.0%	1.1%	1.2%	1.2%	0.4%
Return on Assets (G) = (D) * (E) + (F)	1.2%	1.1%	1.0%	1.3%	1.4%
Leverage	14.6	16.3	18.1	19.7	20.5

Return on Equity	17.8%	18.0%	18.9%	26.0%	28.3%
Reported CAR	11.3%	11.6%	13.2%	13.9%	

RoE Tree of Allahabad Bank	2007	2008	2009	2010	Sep-10
Yield on Average Interest Earning Assets	9.1%	9.4%	9.1%	8.4%	8.7%
Cost of Funds	5.8%	6.8%	6.4%	5.7%	5.5%
Net Interest Income	17,521	17,808	21,589	26,538	18,195
Net Interest Margin (A)	3.3%	2.7%	2.7%	2.7%	3.1%
Operating Costs (B)	1.9%	1.7%	1.7%	1.6%	1.7%
Provisions & Contingencies (C)	0.6%	0.8%	1.4%	1.4%	1.3%
Income on Int Earning assets (D) = (A) + (B) + (C)	0.7%	0.2%	-0.5%	-0.3%	0.2%
Productivity Index (E)	0.87	0.88	0.89	0.90	0.91
Other Income (F)	0.6%	1.2%	1.3%	1.4%	1.0%
Return on Assets (G) = (D) * (E) + (F)	1.2%	1.3%	0.9%	1.1%	1.2%
Leverage	14.8	15.1	15.8	16.9	17.5
Return on Equity	18.2%	19.9%	13.8%	18.9%	20.7%
Reported CAR	12.5%	12.0%	13.1%	13.6%	

RoE Tree of Oriental Bank of Commerce	2007	2008	2009	2010	Sep-10
Yield on Average Interest Earning Assets	9.0%	9.6%	10.1%	9.5%	9.6%
Cost of Funds	6.0%	7.1%	7.7%	6.6%	8.9%
Net Interest Income	16,913	16,710	19,965	29,074	21,344
Net Interest Margin (A)	3.0%	2.3%	2.3%	2.7%	3.5%
Operating Costs (B)	1.7%	1.5%	1.6%	1.6%	1.5%
Provisions & Contingencies (C)	1.3%	1.2%	0.9%	1.2%	1.4%
Income on Int Earning assets (D) = (A) + (B) + (C)	0.0%	-0.4%	-0.2%	-0.1%	0.5%
Productivity Index (E)	0.86	0.87	0.86	0.87	0.86
Other Income (F)	0.9%	0.8%	1.1%	1.0%	0.6%
Return on Assets (G) = (D) * (E) + (F)	0.9%	0.4%	0.9%	0.9%	1.1%
Leverage	12.3	14.5	15.4	16.0	17.1
Return on Equity	10.8%	6.2%	13.5%	14.5%	18.5%
Reported CAR	12.5%	12.1%	13.0%	12.5%	

RoE Tree of Dena Bank	2007	2008	2009	2010	Sep-10
Yield on Average Interest Earning Assets	8.5%	9.0%	9.3%	8.7%	8.9%
Cost of Funds	4.5%	5.8%	6.0%	6.0%	5.6%
Net Interest Income	8,554	8,929	10,644	11,000	8,258
Net Interest Margin (A)	3.4%	3.0%	2.9%	2.4%	3.2%
Operating Costs (B)	2.5%	2.2%	2.1%	1.8%	1.9%
Provisions & Contingencies (C)	1.6%	1.2%	0.5%	0.3%	0.5%
Income on Int Earning assets (D) = (A) + (B) + (C)	-0.6%	-0.4%	0.3%	0.2%	0.8%
Productivity Index (E)	0.86	0.86	0.86	0.87	0.89
Other Income (F)	1.4%	1.3%	1.0%	1.1%	0.8%
Return on Assets (G) = (D) * (E) + (F)	0.7%	1.0%	1.0%	1.0%	1.0%
Leverage	20.5	21.3	21.9	22.2	21.3
Return on Equity	14.2%	21.8%	21.3%	21.4%	21.8%
Reported CAR	11.5%	11.1%	12.0%	12.8%	

Conclusion

The yields of all the above banks are comparable in the range of 8.5% to 10.5% and J&K Bank has maintained a consistent cost advantage in the form of lower cost of funds and operating costs. The RoE of J&K Bank has further scope of improvement by way of higher leverage and asset growth. We expect it to be able to attain this growth due to its superior asset quality, cost of funds and management focus on asset growth.

Valuation

We have valued J&K Bank on the basis of EROE basis and have also carried out a relative Price to Book (P/B) to Return on Equity (RoE) analysis on FY10 P/B to FY11 RoE and FY11 P/B to FY12 RoE bases.

Excess Return on Equity Basis

We have assumed a cost of equity of 14.6%, a 10 year growth period and a terminal growth of 3%. We have assumed the variables as per the rationale provided in the Assumptions Section. The Projected RoE Tree of J&K Bank on the basis of these assumptions can be seen in the following exhibit.

Exhibit 15: Consistent RoEs from FY11-FY20

Projected RoE Tree of J&K Bank	2011	2012	2014	2016	2018	2020
Yield on Productive Assets	9.2%	9.8%	8.9%	9.0%	9.1%	9.1%
Cost of Funds	5.4%	6.4%	5.5%	5.4%	5.4%	5.4%
Net Interest Income	14,291	15,306	18,703	21,862	27,436	29,363
Net Interest Margin (A)	3.6%	3.3%	3.2%	3.0%	2.9%	2.5%
Operating Costs (B)	1.7%	1.6%	1.5%	1.4%	1.3%	1.2%
Provisions & Contingencies ©	1.2%	0.9%	0.9%	0.9%	0.9%	0.8%
Income on Int Earning assets (D) = (A) + (B) + ©	0.7%	0.7%	0.7%	0.7%	0.7%	0.5%
Productivity Index (E)	0.88	0.89	0.86	0.83	0.81	0.76
Other Income (F)	0.7%	0.6%	0.6%	0.6%	0.5%	0.5%
Return on Assets (G) = (D) * (E) + (F)	1.34%	1.28%	1.22%	1.11%	1.08%	0.91%
Leverage	13.8	14.1	14.1	14.4	14.8	15.5
Return on Equity	18.0%	17.9%	17.1%	16.0%	15.9%	14.2%

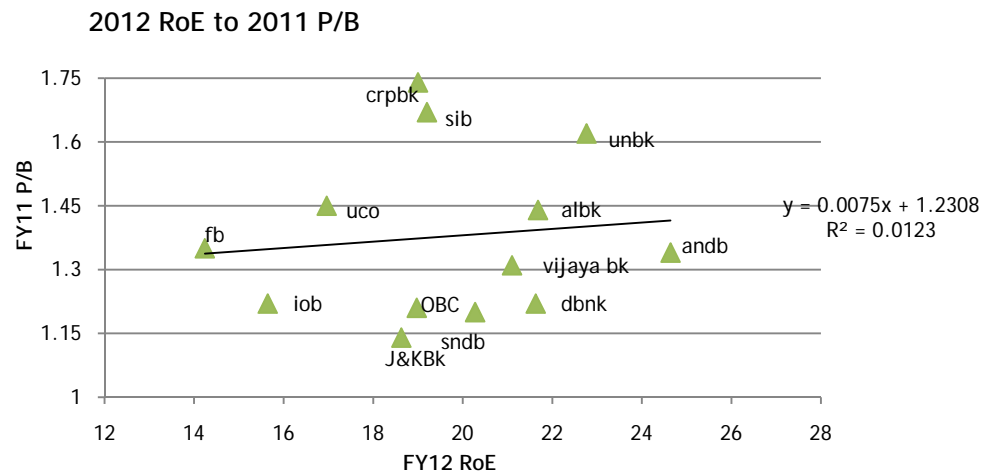
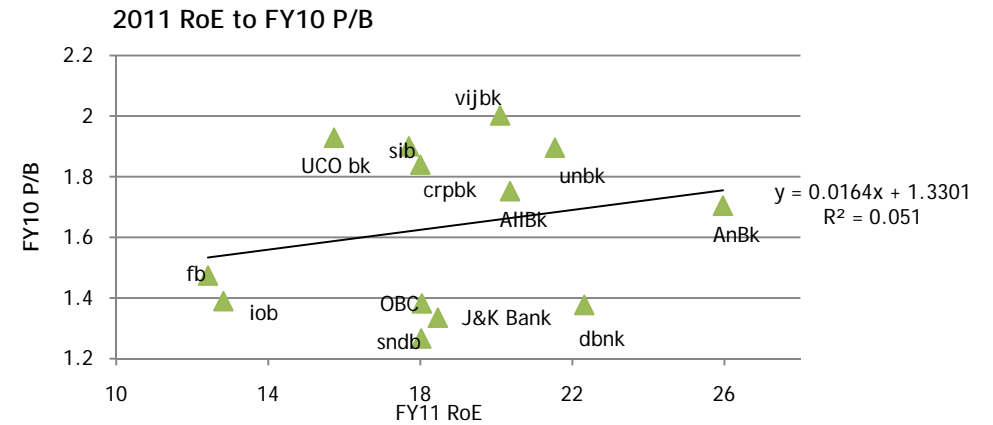
P/B to RoE Analysis: A Relative Approach

We have plotted the comparable public sector banks on their Returns on Equity and Price/Book multiples to depict the current market valuations on these parameters. These charts are indicating a very low R square due to the inclusion of different kinds of banks in terms of their sizes and political environments.

It can be noticed that J&K Bank is attractively valued on the basis of both 2011 RoE to 2010 P/BV and 2012 RoE to 2011 P/BV. This is because of the inability of the bank to

expand its loans and advances at a rapid pace from FY06 to FY10 as compared to its competition

Exhibit 16: P/B to RoE Approach on FY11 and FY12 basis



The band charts in Exhibits 17 and 18 indicate that J&K Bank is trading at median valuations of TTM P/E<7x and TTM P/B<1.2x. We expect the target multiples of TTM PE of 8.3x and TTM P/B of 1.4x to be achieved given the past trading multiples (it has

consistently traded above TTM P/B of 1.3x and TTM P/E of 7.7x as can be seen in Exhibit 19), robust asset quality and efficiency measures of the bank.

Exhibit 17: TTM P/E vs. 2 year forward EPS Growth

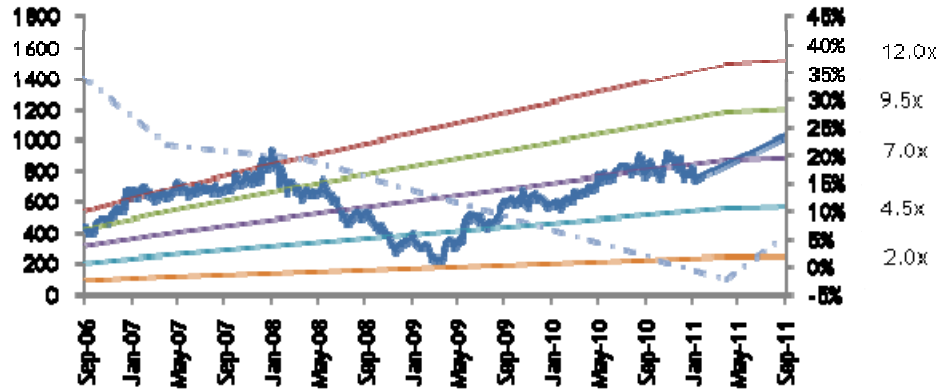
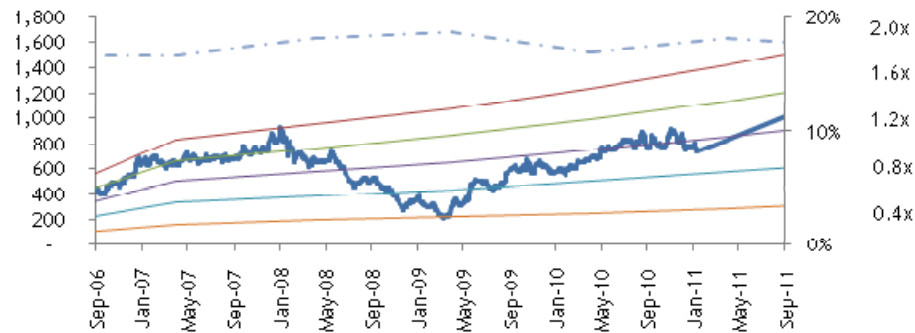
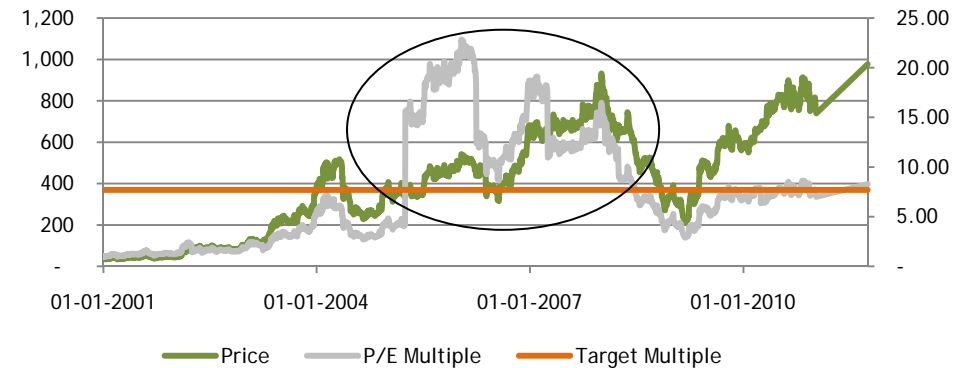
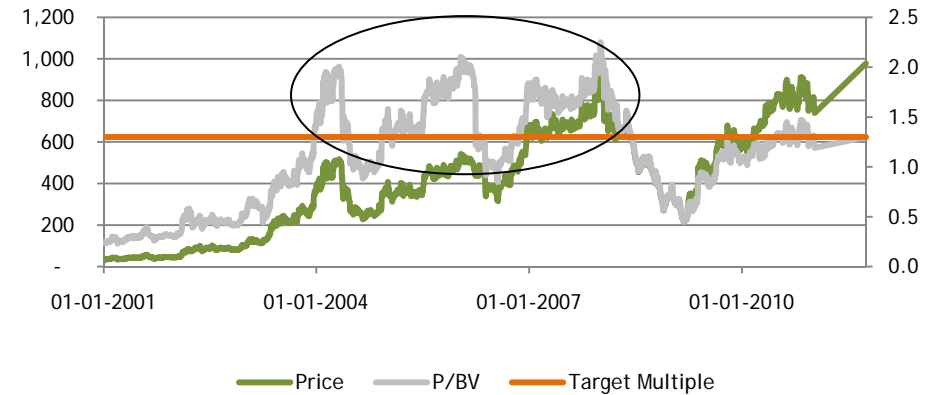


Exhibit 18: TTM P/B vs. 2 year forward RoE



Source: Bloomberg, Equirus Securities

Exhibit 19: TTM P/B and TTM P/E Multiples indicating that bank has traded above target multiple for substantial periods in the past...



Annexure 1: Company Overview

How does the company make money?

The company undertakes banking operations and makes money by way of conducting normal banking operations wherein it raises capital by accepting deposits and borrowing money at a particular rate, say, cost of funds and deploys the same in investments and advances at a higher rate, say, yield on productive assets apart from maintaining a certain proportion in cash for its liquidity requirements. It makes money out of the spread between cost of funds and productive assets. It is governed by RBI and follows the regulations applicable to banks.

Key Management profile

Mushtaq Ahmad, Chairman and Chief Executive Officer

Mr. Mushtaq Ahmad has recently been appointed as the Chairman and CEO after the resignation of Dr. Haseeb Drabu who was also the Chief Economic Advisor to the State. Mr. Ahmad has a distinguishing career of 36 years as a prudent banker. He joined the Bank in 1972 as Probationary Officer (PO). Mushtaq Ahmad lays great emphasis on talent search, human resources development, skill enhancement, besides team building. His person makes an ideal blend of specialized knowledge and practical experience in almost all the critical fields of contemporary banking.

Ashok Mehta, Executive Director and Chief Operating Officer

Mr. Mehta has a longstanding association with the Bank, dating back to 1972 and has served Bank's hierarchy in various executive capacities as a part of Bank's Corporate Management Team. Mr. Mehta has been instrumental in setting up of the joint insurance venture with MetLife International, USA and has played a key role in forging ties with Bajaj Allianz General Insurance Co. and MetLife India Insurance Co. Ltd. for distribution of Non-Life and Life Insurance Products.

Abdul Majid Mir, Executive Director and Chief Financial Officer

Mr. Abdul Majid Mir, Executive Director of our Bank, has more than 37 years of experience in banking. He has special knowledge and practical experience in the fields of Finance, Credit, Trade Finance, Foreign Exchange, Treasury, Corporate and Retail Banking, Deposits & Liability Management & Risk Management.

Special Features of J&K Bank

The special features of J&K Bank are aimed at highlighting the difference between J&K Bank and other states.

- **Only public sector bank with a State Ownership**
The GoJK runs the J&K Bank and this is a unique ownership pattern given that all the other Public Sector Banks are owned by Central Government. The decisions regarding the appointment of senior management and the bank operations are made by the Board of Directors. The State Government has the right to appoint at most 4 directors or one third of the total directors not exceed 4 directors. Currently they have appointed one State Government Nominee.
- **Only Bank to be the State Banker**
J&K Bank has been designated as the State Banker as per the legislature and is engaged in the function otherwise carried out by the RBI for other states. It is expected to receive systemic support for meeting its payment obligations in the event of distress.
- **Monopoly status in J&K**
J&K Bank enjoys a monopoly status in J&K in the form of 87% share of advances and 70% share of deposits. This is due to the state wide presence in the form of 426 branches and 254 ATMs. It is expected to be one of the prime beneficiaries from future growth in SGDP and capital allocations to the State.

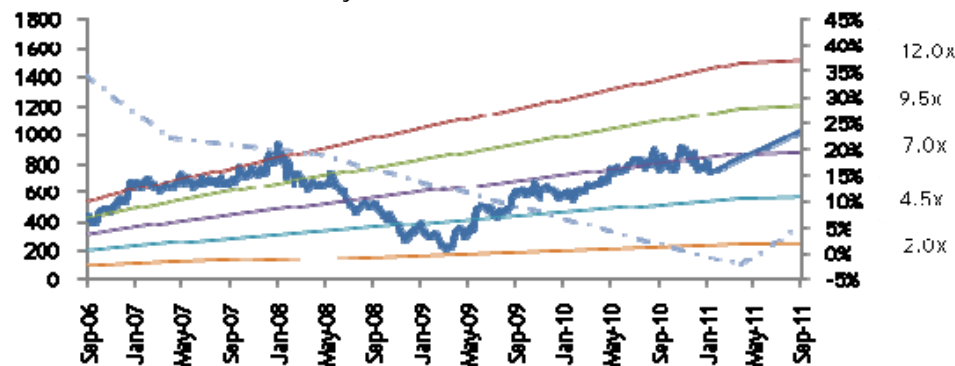
Consolidated Quarterly Earnings Forecast and Key Drivers

₹ in Mn	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	FY10	FY11E	FY12E	FY13E
Net Interest Income	2,660	2,519	2,935	3,087	3,658	3,726	3,435	3,472	3,623	3,707	3,913	4,063	11,193	14,291	15,306	17,683
Operating and Other Expenses	1,252	1,318	1,447	1,757	1,712	1,627	1,699	1,712	1,776	1,810	1,899	1,963	5,774	6,750	7,447	8,462
Pre-Provision Income	1,408	1,201	1,488	1,330	1,946	2,100	1,889	1,910	1,992	2,039	2,152	2,235	5,420	7,542	7,859	9,221
Provision & Write Off	803	166	307	390	701	388	237	248	259	270	282	295	1,666	1,574	1,107	1,297
Other Income	1,175	1,012	958	1,017	937	745	756	747	663	805	831	859	4,162	3,185	3,159	3,628
Profit Before Taxes	1,772	2,048	2,138	1,957	2,182	2,456	2,254	2,260	2,252	2,433	2,563	2,665	7,916	9,152	9,912	11,552
Tax	592	705	738	757	729	823	744	746	743	803	846	879	2,792	3,042	3,271	3,812
Reported PAT	1,180	1,343	1,400	1,200	1,454	1,633	1,510	1,514	1,509	1,630	1,717	1,785	5,124	6,111	6,641	7,740
EPS (₹)	24	28	29	25	30	34	31	31	31	34	35	37	106	126	137	160
Key Drivers																
Yield on Productive Assets	9.6%	9.0%	8.8%	8.5%	9.0%	9.0%	8.9%	9.4%	9.7%	9.8%	9.8%	9.9%	8.9%	9.2%	9.8%	9.2%
Cost of Funds	6.1%	6.0%	5.5%	5.1%	5.2%	5.3%	5.5%	6.0%	6.2%	6.5%	6.5%	6.5%	5.4%	6.4%	5.8%	5.5%
NIM	3.3%	3.0%	3.4%	3.4%	3.8%	3.7%	3.4%	3.3%	3.3%	3.3%	3.3%	3.3%	3.3%	3.6%	3.3%	3.3%
Growth in Loans and Advances	-1.5%	2.4%	-1.5%	10.9%	-0.1%	0.6%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	10.2%	9.8%	19.2%	15.9%
Other income/NII	44.3%	40.2%	32.6%	32.9%	25.6%	20.0%	22.0%	21.5%	18.3%	21.7%	21.2%	21.1%	37.2%	22.3%	20.6%	20.5%
Sequential Growth (%)																
Net Interest Income	6%	-5%	17%	5%	18%	2%	-8%	1%	4%	2%	6%	4%				
Operating Expenses	-5%	5%	10%	21%	-3%	-5%	4%	1%	4%	2%	5%	3%				
Other Income	16%	-13%	-5%	6%	-8%	-21%	1%	-1%	-11%	21%	3%	3%				
Provisions and Contingencies	24%	-79%	86%	27%	80%	-45%	-39%	4%	4%	4%	4%	4%				
EPS	49%	15%	4%	-14%	21%	12%	-8%	0%	0%	8%	5%	4%				
Yearly Growth (%)																
Net Interest Income					38%	48%	17%	12%	-1%	-1%	14%	17%	12%	28%	7%	16%
Operating Expenses					37%	23%	17%	-3%	4%	11%	12%	15%	23%	17%	10%	14%
Other Income					-19%	-26%	-21%	-27%	-29%	8%	10%	15%	70%	-23%	-1%	15%
Provisions and Contingencies					-13%	135%	-23%	-37%	-63%	-30%	19%	19%	17%	-6%	-30%	17%
EPS					24%	22%	8%	26%	4%	0%	14%	18%	25%	19%	9%	17%
Margin (%)																
NIM	3.3%	3.0%	3.4%	3.4%	3.8%	3.7%	3.4%	3.3%	3.3%	3.3%	3.3%	3.3%	3.3%	3.6%	3.3%	3.3%
Pre-Provision Income Margin	53%	48%	51%	43%	53%	56%	55%	55%	55%	55%	55%	55%	48%	53%	51%	52%
Provision and Write Off %	30%	7%	10%	13%	19%	10%	7%	7%	7%	7%	7%	7%	15%	11%	7%	7%
PAT	44%	53%	48%	39%	40%	44%	44%	44%	42%	44%	44%	44%	46%	43%	43%	44%

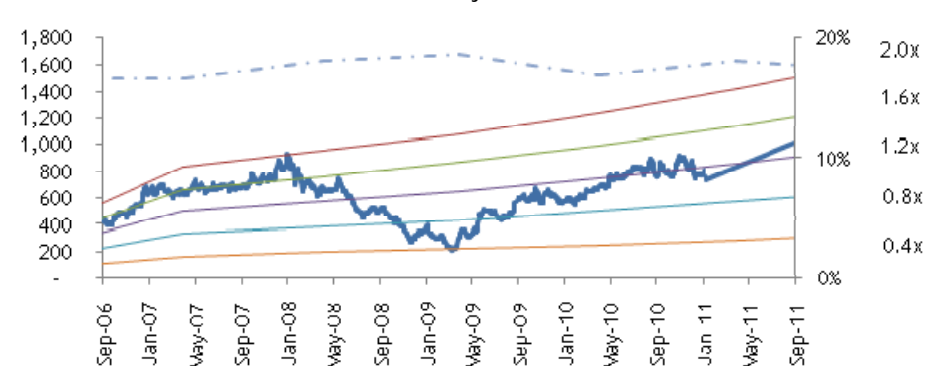
Consolidated Financials

P&L	FY10	FY11E	FY12E	FY13E	Balance Sheet	FY10	FY11E	FY12E	FY13E	Cash Flow	FY10	FY11E	FY12E	FY13E
Net Interest Income	11,193	14,291	15,306	17,683	Equity Capital	485	485	485	485	Net Profit	5,124	6,111	6,641	7,740
Operating Exp	5,774	6,750	7,447	8,462	Reserve	29,620	34,054	39,034	44,839	Depreciation	369	303	559	505
Pre-Provision Income	5,420	7,542	7,859	9,221	Networth	30,105	34,539	39,519	45,324	Changes in Deposits	42,331	56,893	63,303	72,639
Provision & Write Off	1,666	1,574	1,107	1,297	Deposits	3,72,372	4,29,264	4,92,568	5,65,206	Changes in Borrowings	1,036	657	1,000	1,000
Other Income	4,162	3,185	3,159	3,628	Borrowing	11,002	11,659	12,659	13,659	Changes in Investments	32,199	38,747	18,511	20,432
Profit Before Taxes	7,916	9,152	9,912	11,552	Other Liab & Prov	11,990	10,519	10,946	11,390	Changes in Loans & Adv	21,268	22,504	48,588	47,825
Tax	2,792	9,152	9,912	11,552	Total Liabilities	4,25,468	4,85,980	5,55,692	6,35,580	Changes in Others	2,919	-421	2,427	2,444
Reported PAT	5,124	6,111	6,641	7,740	Net Fixed Assets	2,041	3,634	3,275	2,970	Net Cash from Ops	1,05,246	1,24,794	1,41,029	1,52,585
EPS (₹)	105.6	126.0	136.9	159.6	Loans and Advances	2,30,572	2,53,076	3,01,664	3,49,489	Net Cash from Investing	-416	-1,895	-200	-200
DPS (₹)	22.0	26.9	29.3	34.1	Investments	1,39,563	1,78,309	1,96,820	2,17,253	Net Cash from Financing	-1,248	-1,677	-1,660	-1,935
CEPS (₹)	113.3	132.3	148.5	170.0	Cash and Cash Equivalents	3,70,135	4,31,386	4,98,484	5,66,741	Cash Generation	1,03,582	1,21,221	1,39,169	1,50,450
FCFEPS (₹)	-136.2	-69.7	20.0	204.9	Total Assets	3,772	4,865	5,523	7,150	Ending Cash Balance	46,142	42,761	43,733	53,669
BVPS (₹)	621	712	815	935	Cash	46,142	42,761	43,733	53,669	RoE (%)	18%	19%	18%	18%
NII Growth	14%	28%	7%	16%	Total Assets	4,25,468	4,85,980	5,55,692	6,35,580	RoA(%)	1.2%	1.3%	1.3%	1.3%
PAT Growth (%)	25%	19%	9%	17%	Advances/Deposits	62%	59%	61%	62%	CAR(%)	13%	14%	13%	13%
EPS Growth (%)	25%	19%	9%	17%	Asset/Equity	14.13	14.07	14.06	14.02	Div Payout (%)	21%	25%	25%	25%
BVPS Growth	14.78%	14.73%	14.42%	14.69%	GNPA	2.0%	2.0%	2.0%	2.0%	P/E	7.0	5.8	5.4	4.6
Dividend Gr. (%)	30%	22%	9%	17%	NNPA	0.2%	0.2%	0.2%	0.2%	P/BV	1.2	1.0	0.9	0.8
Tax Rate (%)	35%	33%	33%	33%	NPA Coverage	90%	100%	100%	100%	Div Yield(%)	3.0%	3.7%	4.0%	4.6%

TTM P/E to 2 year forward EPS Growth



TTM P/B to 2 year forward RoE



Historical Consolidated Financials

P&L	FY07	FY08	FY09	FY10	Balance Sheet	FY07	FY08	FY09	FY10	Cash Flow	FY07	FY08	FY09	FY10
Net Interest Income	7,679	8,104	10,003	11,193	Equity Capital	485	485	485	485	Net Profit	2,745	3,600	4,098	5,124
Operating Exp	3,724	4,036	4,709	5,774	Reserve	19,602	22,323	25,744	29,620	Depreciation	0	322	325	369
Pre-Provision Income	4,285	4,068	5,294	5,420	Networth	20,087	22,808	26,229	30,105	Changes in Deposits	17,097	33,990	44,108	42,331
Provision & Write Off	23%	17%	18%	18%	Deposits	2,51,943	2,85,933	3,30,041	3,72,372	Changes in Borrowings	3,563	1,316	2,448	1,036
Other Income	1,602	2,450	2,614	4,162	Borrowing	6,202	7,518	9,966	11,002	Changes in Investments	-16,017	13,655	19,787	32,199
Profit Before Taxes	4,152	5,760	6,321	7,916	Other Liab & Prov	8,233	11,020	10,697	11,990	Changes in Loans & Adv	25,968	18,027	20,478	21,268
Tax	1,407	2,160	2,223	2,792	Total Liabilities	2,86,466	3,27,560	3,76,933	4,25,468	Changes in Others	-1,904	3,880	335	2,919
Reported PAT	2,745	3,600	4,098	5,124	Net Fixed Assets	1,835	1,920	1,994	2,041	Net Cash from Ops	31,453	56,895	71,250	84,147
EPS (₹)	56.6	74.2	84.5	105.7	Loans and Advances	1,70,799	1,88,826	2,09,304	2,30,572	Net Cash from Investing	113	-408	-399	-416
DPS (₹)	11.5	15.5	16.9	22.0	Investments	73,922	87,577	1,07,363	1,39,563	Net Cash from Financing	-652	-598	-959	-1,248
CEPS (₹)	290.0	409.1	494.5	113.3	Cash and Cash Equivalents	36,138	44,372	52,748	46,142	Cash Generation	30,913	55,889	69,892	82,484
FCFEPS (₹)	273.5	169.8	172.7	-136.2	Total Assets	2,86,466	3,27,560	3,76,932	4,25,468	Ending Cash Balance	36,138	44,372	52,748	46,142
BVPS (₹)	414	476	541	621	Cash	36,138	44,372	52,748	46,142	RoE (%)	14%	17%	17%	18%
NII Growth	16%	6%	21%	14%	Total Assets	2,86,466	3,27,560	3,76,932	4,25,468	RoA(%)	1.1%	1.4%	1.4%	1.5%
PAT Growth (%)	55%	31%	14%	25%	Advances/Deposits	68%	66%	63%	62%	CAR(%)	12%	12%	13%	13%
EPS Growth (%)	55%	31%	14%	25%	Asset/Equity	14.26	14.19	14.37	14.13	Div Payout (%)	24%	24%	23%	24%
BVPS Growth	12%	15%	14%	15%	GNPA	2.89%	2.53%	2.64%	1.97%	P/E	13.0	9.9	8.7	7.0
Dividend Gr. (%)	44%	35%	9%	30%	NNPA	1.13%	1.08%	1.37%	0.28%	P/BV	1.8	1.6	1.4	1.2
Tax Rate (%)	34%	37%	35%	35%	NPA Coverage	61.43%	58.05%	48.59%	90.13%	Div Yield(%)	1.6%	2.1%	2.3%	3.0%
					Tier I Capital*	12.6%	12.1%	12.8%	11.9%					
					Tier II Capital*	0.6%	0.7%	0.7%	2..9%					

*Basel I Figures



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- SHORT: \geq 5% downside over investment horizon
- NEUTRAL: Trading range of -4% to +14%

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- OVERWEIGHT: Likely to outperform the benchmark by at least 5% over investment horizon
- NEUTRAL: likely to perform in line with the benchmark
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Target Period of minimum 3 months to maximum 12 months with target date either on last day of nearest September or March month falling within the Target Period.

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