



Rating Rationale

9 July 2020

The Jammu and Kashmir Bank Limited

Brickwork Ratings reaffirms 'BWR AA-/A/' rating on Jammu and Kashmir Bank Ltd while placing the outlook on Negative

Particulars:

Borrowing Type	Amount (Rs Cr)		Tenure	Rating*	
	Previous	Present		Previous (June 2019)	Present
Basel III Tier II Bonds	1000	1000	Long Term	BWR AA - Credit Watch with Negative Implications	BWR AA- Negative (Reaffirmed)
Basel III Tier II Bonds	1000	1000	Long Term	BWR AA - Credit Watch with Negative Implications	BWR AA- Negative (Reaffirmed)
Basel III Additional Tier I Bonds	1000	1000	Long Term	BWR A Credit Watch with Negative Implications	BWR A Negative (Reaffirmed)
Total	3000	3000	INR Three Thousand Crores Only		

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

**Details of bonds are provided in Annexure – I

RATING ACTION/OUTLOOK

Brickwork Ratings (BWR) reaffirms '**BWR AA-'/Negative** to the Basel III Tier II bonds and '**BWR A'/Negative** to the Basel III Additional Tier I bonds of the Jammu and Kashmir Bank Ltd (J&K bank or the bank), as tabulated above.

Rationale/Description of Key Rating Drivers/Rating sensitivities:

BWR has principally relied on audited financials up to FY20, publicly available information and information/clarifications provided by the bank.



The rating, inter alia, factors in J&K bank's strong support from the government of Jammu and Kashmir (Govt of J&K), comfortable resource profile and adequate capitalisation. The ratings are, however, constrained by the average asset quality and earnings profile, along with the regional concentration of the bank.

The Negative outlook is mainly on account of an expected continued pressure on the bank's asset quality and profitability in the near term, mainly due to the impact on collections and recovery from loan assets, on account of the slowdown in the economy due to the COVID-19 pandemic, mainly in the SME, retail and trade finance product segments, which is an industry-wide issue. The rating outlook is resolved from "Credit watch with Negative implications", on account of an improved stability at the board and top management of the J&K bank.

Description of Key Rating Drivers

Credit Strengths:

- **Strong support from Govt of J&K:** The Jammu and Kashmir Bank Ltd, which was founded in 1938 and commenced operations in 1939, is the first state-owned bank by the Govt of J&K, with a shareholding of 68% as of 31 March 2020. (As a union territory since 31 October 2019, Jammu and Kashmir falls under the purview of the central government. However, there is no clarity on any impending change in the shareholding of J&K bank.) The bank benefits from the support received from the Govt of J&K, considering its majority shareholding and the importance of the bank in its regions of operation in Jammu and Kashmir (J&K) and Ladakh, given its strong market position and penetration in these territories. The Govt of J&K, has consistently infused capital into the bank, including the recent equity infusion of Rs 500 Cr in March 2020 and Rs 500 Cr of planned infusion in FY21. BWR takes comfort from the strategic importance of the bank to the union territories and the demonstrated capital support from the Govt of J&K on an ongoing basis.
- **Comfortable resource profile:** J&K bank has a comfortable resource profile because of its stable deposit base, with over 90% of deposits from J&K and Ladakh, where the bank has a strong market penetration. The share of the low-cost Current Account and Savings Account (CASA) deposits in total deposits was high, at 53.7%, as on 31 March 2020; this was one of the highest among its peers. The term deposits of the bank are primarily from retail depositors at ~85%, and the contribution of bulk deposits was limited to only ~ 15%, as on 31 March 2020. The cost of deposits remained stable over the period at ~ 4.96% as of FY20, compared with 4.9% as of FY19. The borrowings of the bank were limited to only 2% of the balance sheet size, at Rs 2019 Cr as on 31 March 2020, reducing from Rs 2624 Cr as on 31 March 2019, due to the repayment of bonds.
- **Adequate capitalisation:** The capitalisation profile of J&K bank was adequate, with Common Equity Tier I (CET-I) at 8.4%, Tier I at 9.9% and Capital to Risk Weighted Assets Ratio (CRAR)



at 11.4%, which were above the minimum regulatory limits (minimum CET-I [including Capital Conservation Buffer] at 7.375% , Tier I at 8.875%, CRAR at 10.875% as of March 2020). The Govt of J&K has infused Rs 500 Cr of capital in March 2020, placing the net worth of the bank at Rs 6393 Cr as of 31 March 2020. The bank expects further capital infusion of Rs 500 Cr through the Govt of J&K in FY21. Additionally, the infusion of capital into J&K bank through the sale of its equity stake in Metlife at fair value, is planned for FY21. However, the net worth coverage for the net Non-Performing Assets (NPA) of the bank was low, at 35.1%, as on 31 March 2020.

Credit Risks:

- **Average asset quality:** The asset quality of the bank was average, with the gross NPA increasing to 11.0% as on 31 March 2020, compared with 9% as on 31 March 2019. The increase in the gross NPA was due to slippages in the non-corporate loan portfolio from the second quarter of the financial year, due to the socio-political issues in J&K resulting in a lockdown for approximately three months in the union territories. The bank was also previously impacted from the slippages in the high-ticket corporate loan portfolio. However, the bank has substantially reduced its restructured book from ~Rs.5000 Cr, over the last three financial years, to Rs.480 Cr as on 31 March 2020, thereby displaying its ability to wedge through difficult circumstances while maintaining business growth. Moreover, the bank is consciously reducing its exposure on corporate lending and focusing on better yielding granular retail loans, which stood at 30% of advances as of 31 March 2020.

However, due to the economic slowdown on account of the COVID-19 pandemic, retail low-income borrower segments, self-employed professionals and MSME businesses, among others, are expected to be impacted. For J&K bank, 50% of loan book exposures were to retail loans, SME & trade finance segments as of 31 March 2020. Cash flows from these segments may experience potential stress, and hence, impact asset quality. J&K bank's ability to manage asset quality as it scales business across product segments will be a key rating monitorable over the medium term.

- **Average earnings profile:** J&K bank has reported a loss in FY20 of Rs 1139.4 Cr due to increased loan loss provisioning and interest reversals on account of the slippage to NPAs in FY 20. The bank has fully provided for large-ticket NPAs such as IL&FS (Rs 884 Cr), among others, and additionally provided 5%, as per RBI guidelines in March 2020, towards a loan moratorium, increasing the provision coverage ratio (excluding write-off) to 68% as of 31 March 2020, from 45.5% as of 31 March 2019. The Return on Assets (ROA) and Return on Equity (ROE) were at -1.1% and -19.96%, respectively, for the period. However, the operating profits and Net Interest Margin (NIM) have remained stable, with reported NIM at 3.9% for FY20. While the bank has made significant provisioning and has a good track record on recovery, the extent of impact on profitability due to incremental provisioning, on account of COVID-19, will remain a key monitorable.



- **Regional concentration and challenging operating environment:** J&K bank has 63% of its advances, and 90% of its deposits from J&K and Ladakh, indicating a regional concentration in the bank's business operations. In addition, business diversification of the bank in the rest of India is limited due to the bank's strategy to reduce its corporate loan book and increase its focus on retail loans from J&K and Ladakh. Additionally, owing to the regional concentration of the bank, natural calamities and socio-political disturbances make the operating environment challenging for the bank. However, the bank has managed these challenges through taking corrective timely measures and with adequate support from the government and regulatory bodies.

Analytical Approach

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

Additional Tier-I Instruments (under Basel III)

The differentiating features of non-equity Tier-I capital instruments (under Basel III) are the discretionary payment of coupons by the bank, and principal write-down upon breach of a pre-specified trigger. These features increase the risk attributes of non-equity Tier-I instruments over those of Tier-II instruments under Basel III. To factor in these risks, BWR notches down the rating on these instruments from the bank's Tier-II bonds. The rating on J&K bank's Tier-I bonds (under Basel III) has, therefore, been lowered by two notches from its Tier-II bonds (under Basel III) rating. The factor on which the rating of Tier-I capital instruments (under Basel III) are lowered, are due to the weak profitability of the J&K bank as of 31 March 2020. However, the revenue reserves of the bank are comfortable and the bank is ensuring timely coupon payments.

RATING SENSITIVITIES

The Jammu and Kashmir bank's ability to grow profitably and improve the asset quality while maintaining deposits and capitalisation will be key rating sensitivity factors.

Positive: The rating may be revised upwards if the Jammu and Kashmir bank shows steady and strong growth, while also improving in terms of asset quality and profitability.

Negative: The rating outlook may be revised to Negative if Jammu and Kashmir bank's performance is lower than expectations in terms of asset quality, profitability and capital adequacy.

Coronavirus disease (COVID-19), declared a pandemic by the World Health Organization (WHO), has become a full-blown crisis globally, including in India. COVID-19 has impacted the domestic economy of India as the nation had gone into a lockdown from 24 March 2020 onwards (later converted to partial lockdown in various states). As per BWR, financial institutions, mainly those lending to retail low-income borrower segments, could be the most impacted. The 6-month moratorium announced by the Reserve Bank of India, on interest and principal on bank debt, will provide some cushion to the lending community to realign its collection mechanism and operations during this period. However, lenders' ability to ensure credit discipline among borrowers, as the 6-month moratorium ends, and to collect accumulated interest and principal dues on a timely basis, after this period will be a key monitorable.



BWR is actively engaging with its clients on a continuous basis and taking updates on the impact of its operations and liquidity situation. BWR will take appropriate rating actions as and when it deems necessary and will publish the same.

Liquidity Profile: Adequate

The bank's liquidity profile was comfortable, with a reported average Liquidity Coverage Ratio (LCR) for the quarter ended 31 December 2019 at 262%, which is well above the prescribed minimum requirement of 80% (restored to 90% by 1 October 2020 and to 100% by 1 April 2021). (The LCR is calculated by dividing the bank's stock of HQLA by its total net cash outflows over a 30-day stress period.)

About the Company

The Jammu & Kashmir Bank, headquartered in Srinagar, was founded in 1938 and commenced operations in 1939; it is the first state-owned bank by the Government of Jammu & Kashmir, with a shareholding of 68.2% as of 31 March 2020. The bank received the scheduled bank status in 1971 and was declared an A class bank by the RBI in 1976. The bank benefits from the systemic support received from the Govt of J&K, considering the importance of the bank in its regions of operation in J&K and Ladakh, for creating an unchallenged market position and market penetration in those territories.

As of 31 March 2020, the bank had a total asset size of Rs 1,08,872 Cr, business of Rs 1,62,187 Cr, network of 955 branches and 1354 ATMs. The net advances were at Rs 64,399 Cr, with 38% of corporate loans, 30% of retail loans, 11% of agriculture loans, 10% of trade loans, 9% of SME and 2% of other products.

Financial Performance

Key Parameters – Rs Cr	Unit	FY2018	FY2019	FY2020
		Audited	Audited	Audited
Total assets	Rs Crore	89688	101406	108872.1
Net worth	Rs Crore	6161	6626	6393.48
Total income (net of interest expenses)	Rs Crore	3366	4197	4253
Profit after tax	Rs Crore	203	465	-1139
Gross NPA	%	10.0%	9.0%	11.0%
Overall capital adequacy ratio	%	11.4%	12.5%	11.4%
Return on assets (annualized)	%	0.3%	0.5%	-1.1%

NON-COOPERATION WITH PREVIOUS CREDIT RATING AGENCY IF ANY: Nil

RATING HISTORY FOR THE PREVIOUS THREE YEARS [including withdrawal and suspended]

Facility/ Instrument ^{t**}	Rating History for the past 3 years											
	Current Rating (June 2020)			2019 (26 June 2019)			2018 (14 June 2018)			2017 (12 Dec 2017)		
	Type	Amount (Rs Cr)	Rating	Type	Amount (Rs Cr)	Rating	Type	Amount (Rs Cr)	Rating	Type	Amount (Rs Cr)	Rating
Basel III Tier II Bonds	Long Term	1000 (raised Rs 500 Cr)	BWR AA-/Negative (Reaffirmation)	Long Term	1000	BWR AA-/Credit Watch with Negative Implication	Long Term	1000	BWR AA / Stable	Long Term	1000	BWR AA / Stable
Basel III Tier II Bonds	Long Term	1000 (raised Rs 500 Cr)	BWR AA-/Negative (Reaffirmation)	Long Term	1000	BWR AA-/Credit Watch with Negative Implication	Long Term	1000	BWR AA / Stable	Long Term	1000	BWR AA / Stable
Basel III Additional Tier I Bonds	Long Term	1000	BWR A/Negative (Reaffirmation)	Long Term	1000	BWR A /Credit Watch with Negative Implication	Long Term	1000	BWR A+ / Stable	NA	NA	NA
Total		3000		INR Three Thousand Crores Only								

Hyperlink/Reference to applicable Criteria

- [General Criteria](#)
- [Approach to Financial Ratios](#)
- [Banks and Financial Institutions](#)
- [Basel III Compliant Instruments](#)



For any other criteria obtain hyperlinks from website

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ANNEXURE I
Details of Bonds rated by BWR

Particulars	ISIN	Issue size in Rs Cr	Date of Issue	Maturity Date
Basel III Tier 2	INE168A08038	1000 (raised Rs 500 Cr)	24-Mar-17	24-Jun-22
Basel III Tier 2 - Series A	INE168A08046	1000 (raised Rs 500 Cr)	28-Dec-17	27-Dec-24
Basel III AT-1	INE168A08061	1000	14-Jun-18	perpetual

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