CLSA
ASIA-PACIFIC MARKETS

Corporate Access Forum 2007

J&K Bank: From Consolidation to Growth

MAY 21 – 25

Singapore

J&K Bank

Structure of Presentation

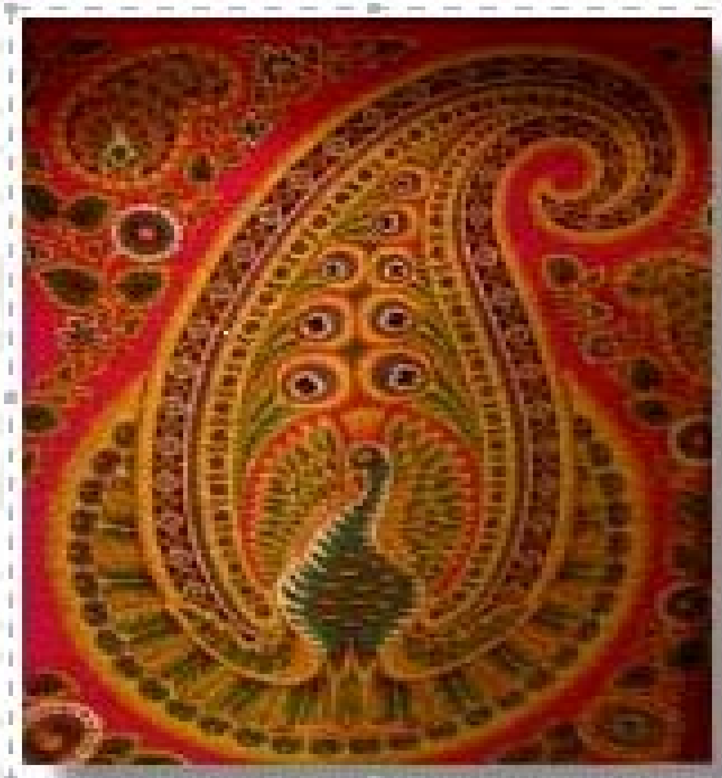
- Profile of the Bank
- Plan & Strategy of Change
- Performance and Outcome
- Potential of Growth
- Perspective and Macro-economic Context

Basic facts

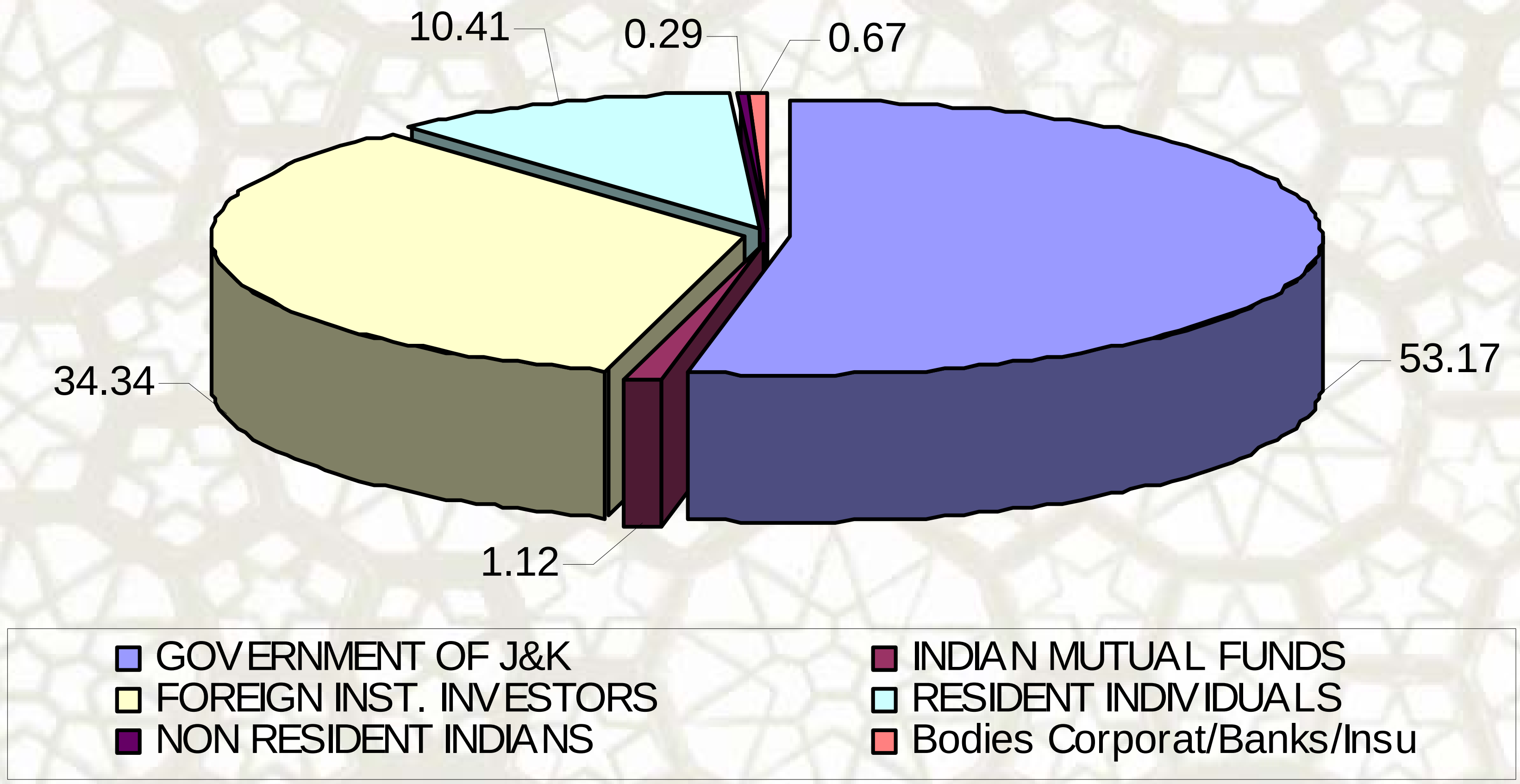
- Incorporated in 1938 as a limited liability company
- Listed on National stock exchange (NSE) and Bombay stock exchange (BSE)
- 53 per cent owned by J&K Government
- Rated "P1 +" by Standard and Poor-CRISIL: highest degree of safety
- Four decades of uninterrupted profitability and dividends

One of a Kind

- Private sector bank despite government's majority holding
- Sole banker and lender of last resort to the Government of J & K
- Only private sector bank designated as RBI's agent for banking business
- Carries out banking business of the central government
- Collects taxes for Central Board of Direct Taxes in J & K



Shareholding Pattern



As on March 2, 2007

Infrastructure

- Fastest growing bank with 525 branches
- 98 per cent business computerized
- Anywhere, Tele-banking and SWIFT
- Internet, SMS and Mobile Banking
- Globally connected ATM network
- Mobile ATM Service
- Global Access Debit & Credit Cards
- Live on RTGS System of RBI

Other Services:

- Insurance joint venture with MetLife International
    - Distributor of:
    - Life Insurance products of MetLife
- Distributorship of Bajaj Allianze General Insurance
- Providing Depository Services
- Offering Stock Broking Services
- Collection Agent for utility services

Plan

New business strategy

- **Two legged business model:**
  - Increase lending in J&K, which is
    - high margin, low volume
  - target niche lending in rest of the country, to
    - Improve margins and build volumes
  - Universal Bank in J&K
  - Specialist bank in rest of the country

New Strategy : Analytics

- Operating in a “closed” economy:
    - limited Leakages
    - lending akin to reserve money
- More lending within the state:
    - more incomes are generated
    - low cost saving deposits
- Virtuous cycle of lending and saving
    - liquidity remains within the bank’s system, giving:
    - Rising yields
    - Better margins
    - Higher profitability

Operational aspects

- A change in composition of advances
  - In terms of geography – from ROI to J&K
  - In terms of asset types – from low margin to high margin
- A greater focus on liability management
  - Increase low cost retail deposits
  - Increase the maturity structure
- A more focused balance sheet

Carving a niche, nationally

- Nationally, lending in consortium to large corporates
  - Reduces margins
- To improve margins focus on:
- Under-serviced areas with high turnover
- Specialised sectoral lending
- Specialist branch chain – leather, grains, spices
- Re-pricing
- A universal bank in J&K and a specialist bank outside

New business initiatives

- Innovative financial products
- Monetizing the Bank's branch network
- Third party product distribution
- Investment banking
- Venture capital financing
- Channel financing

New financial products

- Mismatch between growth sources and credit supply
- High growth and yield areas under-serviced in terms of credit
- Major sectors like horticulture still financed informally
- Artisan economy not financed

Third party products

- Make branch network a distribution channel for financial products
- Reduce incentive for major banks to enter J&K
- Beef up non-interest incomes
- Reduce income volatility
- Make assets sweat harder
- Improve business per branch per person

Investment banking

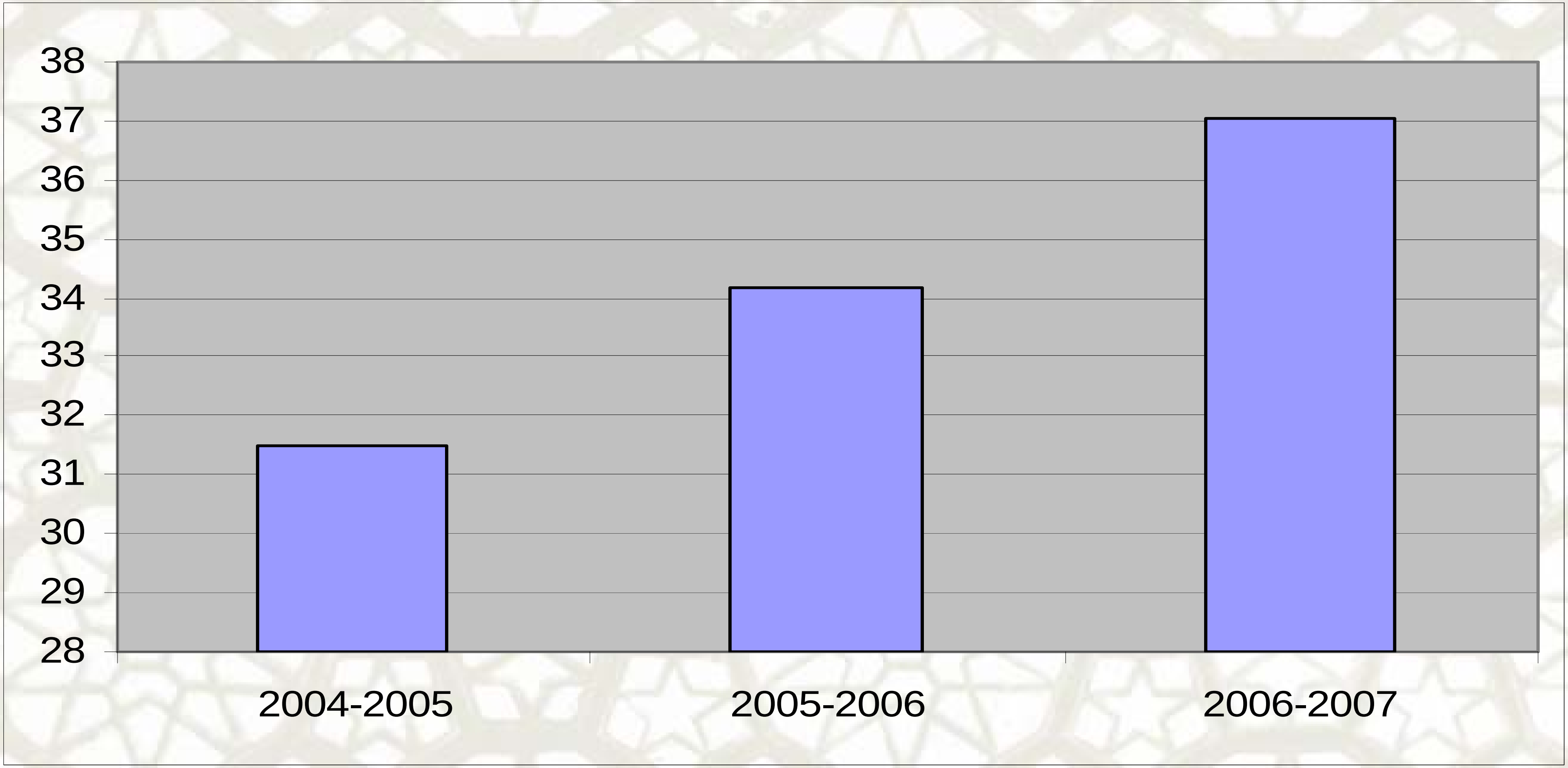
- Leveraging our core competence of domain and geographical expertise, and having
- J&K Government a captive client
  - State Government investing $240 billion in power over four years
  - Mandated to take Power Development Corporation public

Organizational restructuring

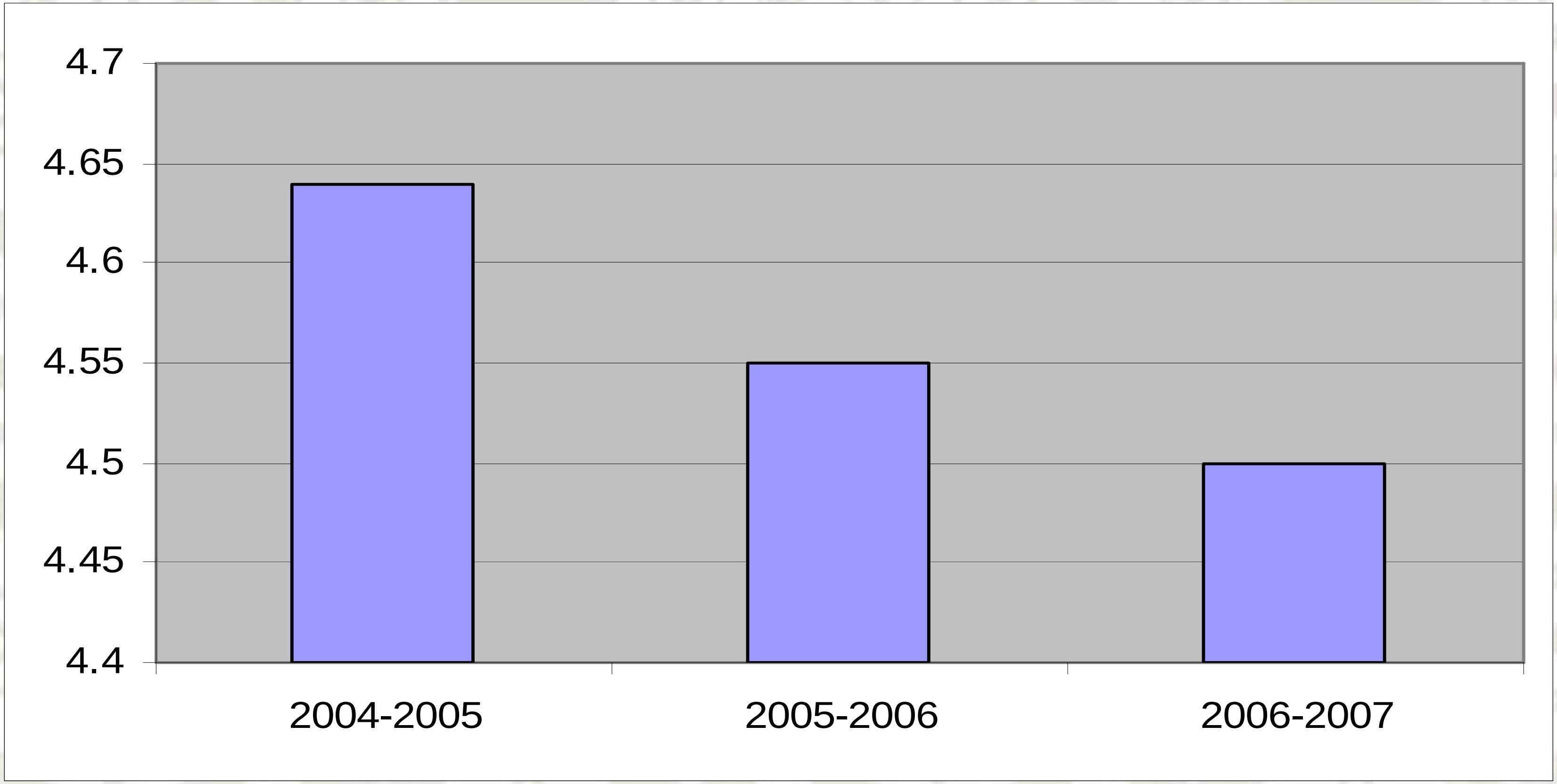
- Aligned people strategy to business strategy
- New business processes aligned to changing banking environment
- Performance based variable pay introduced
- Business centric organisational structure created
- Brand Strategist and visual makeover done
- Re-designing its visual brand image and give it a very distinctive and contemporary bank personality

Performance

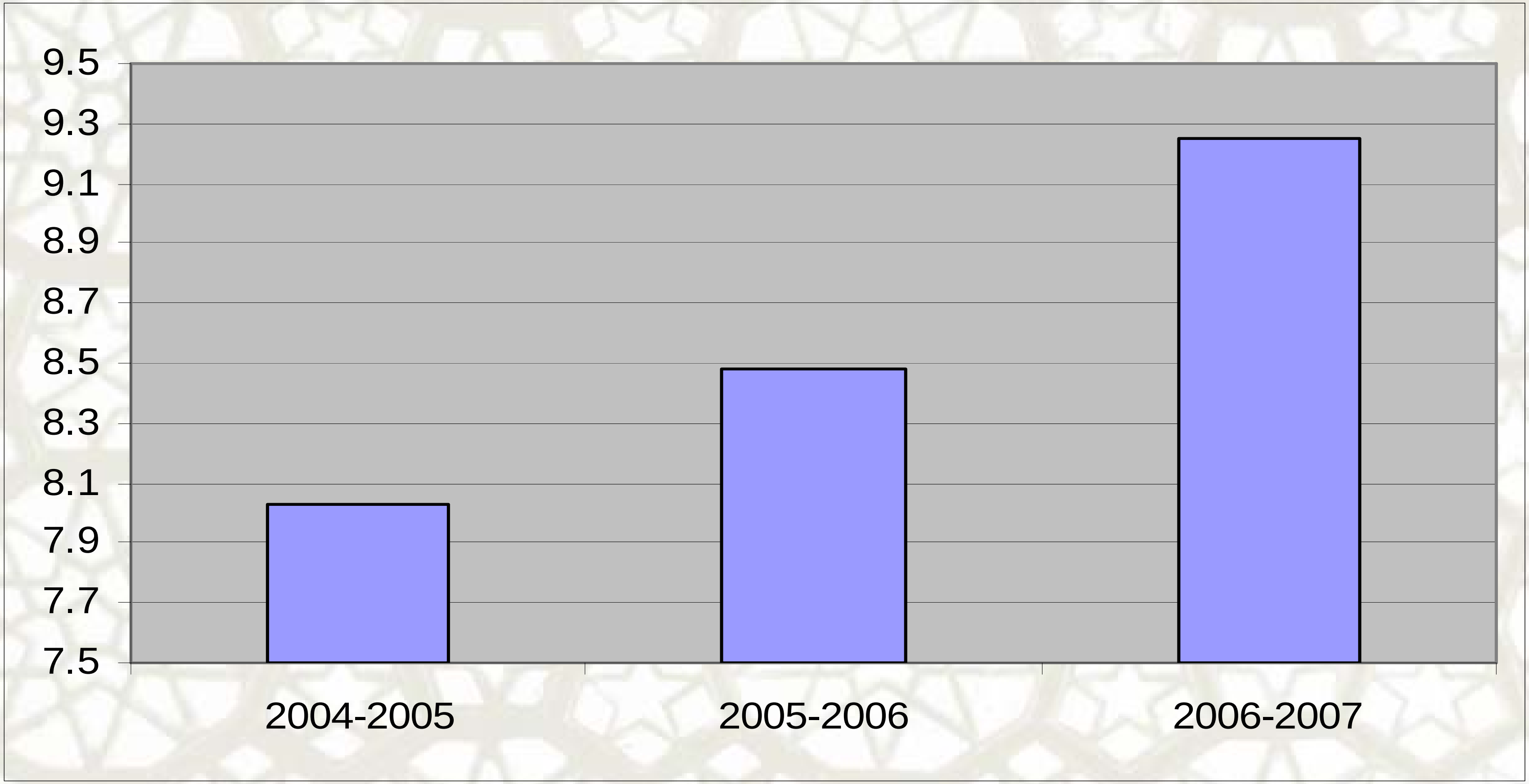
Better liability structure



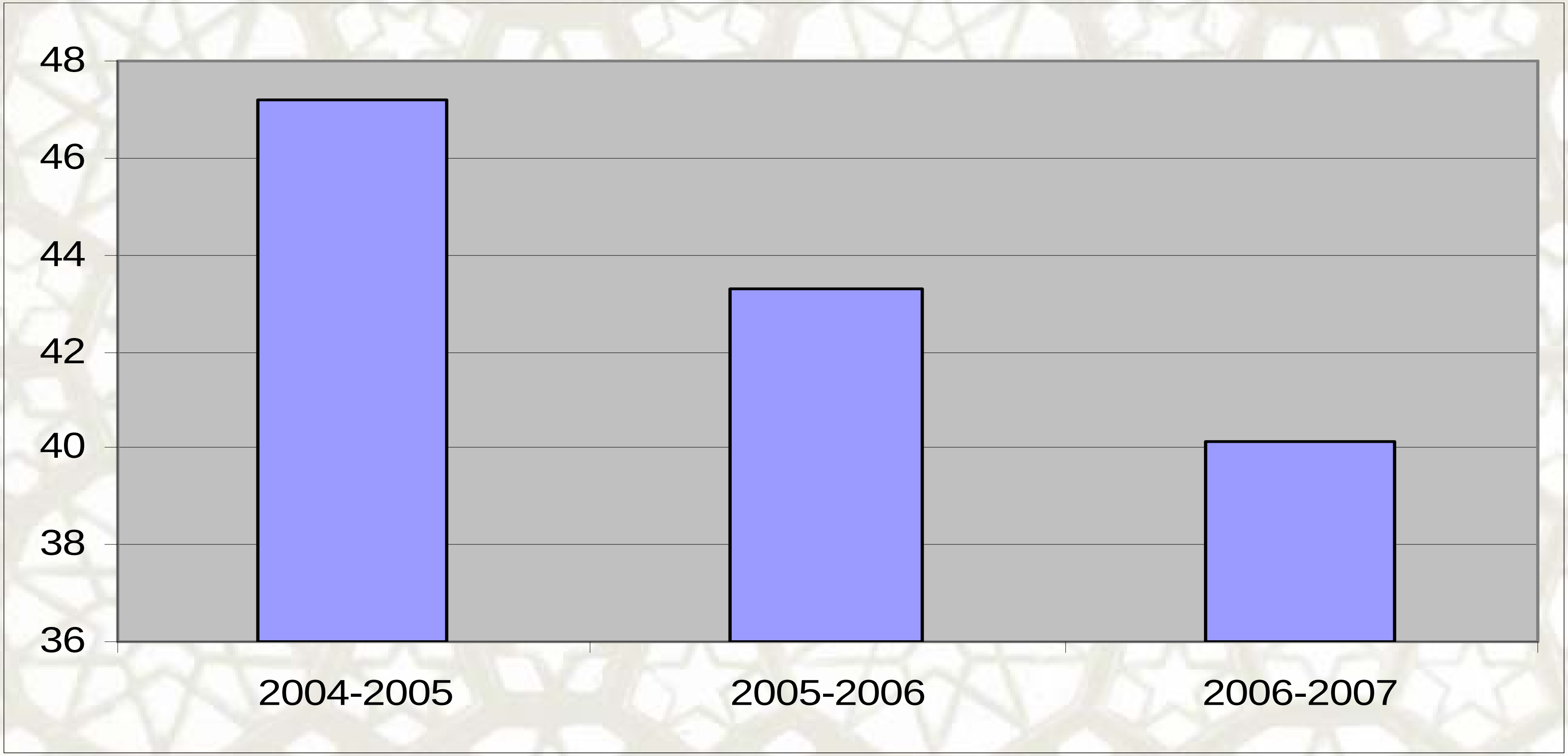
Cost of Deposits



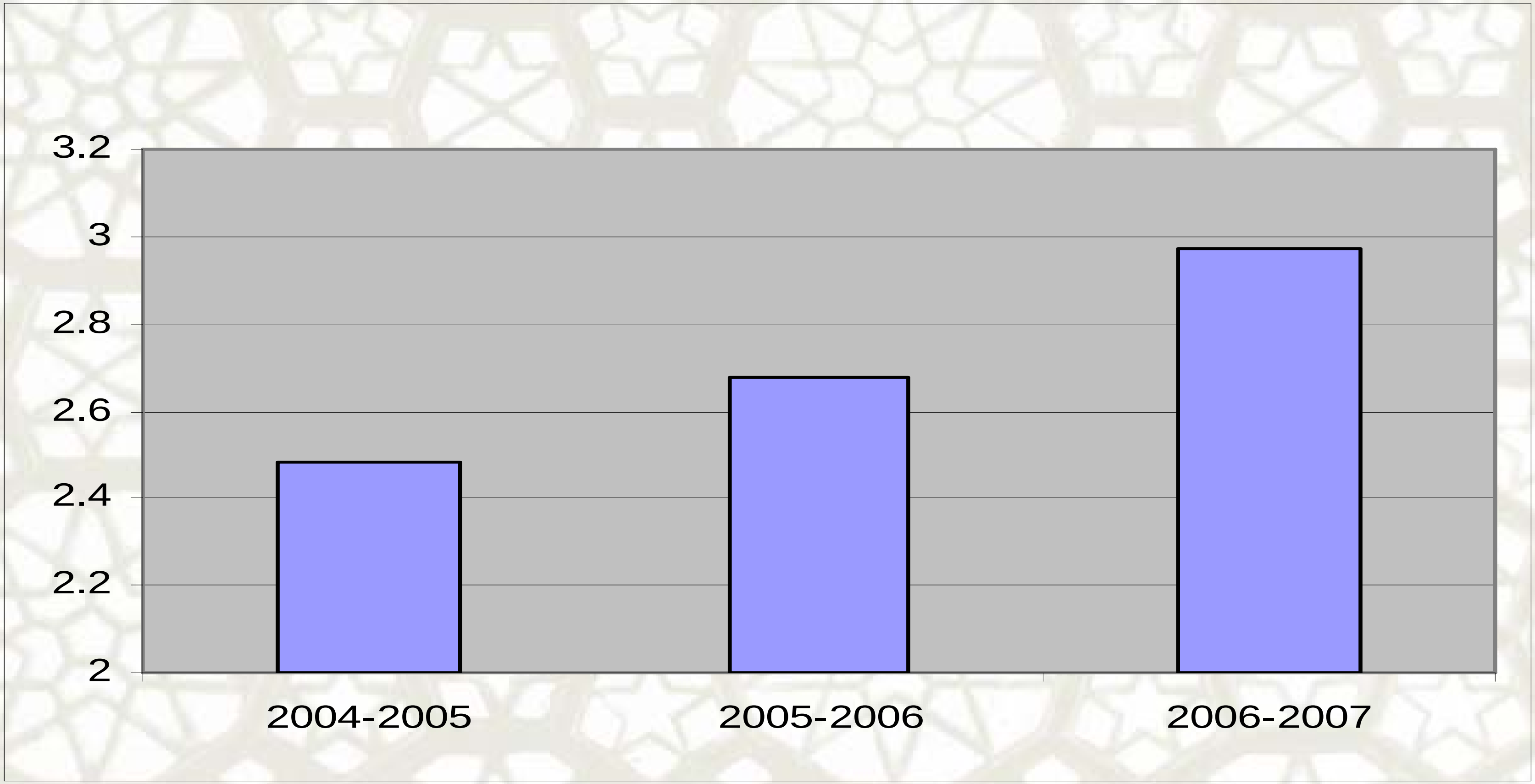
Higher Asset pricing



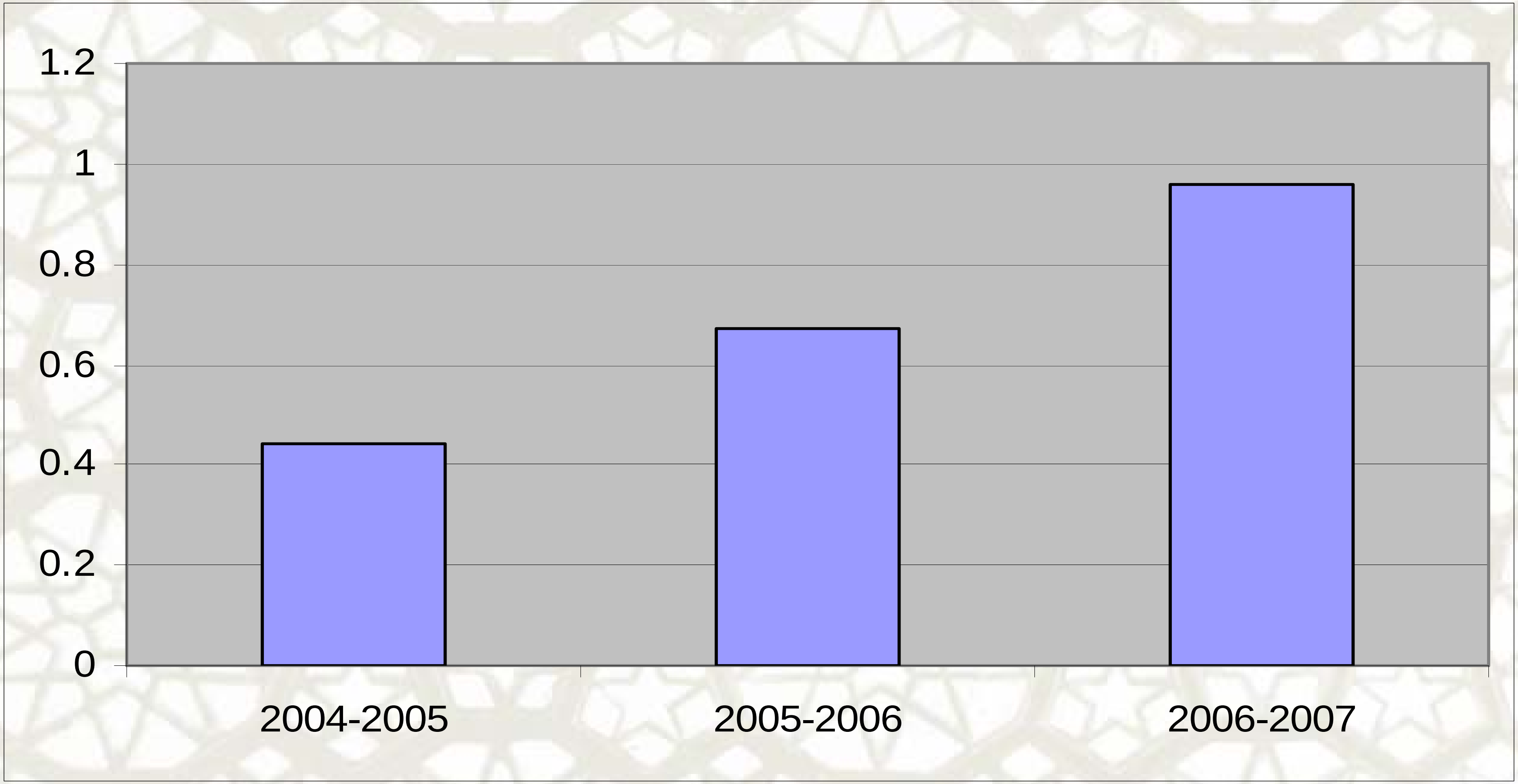
Cost to income ratio



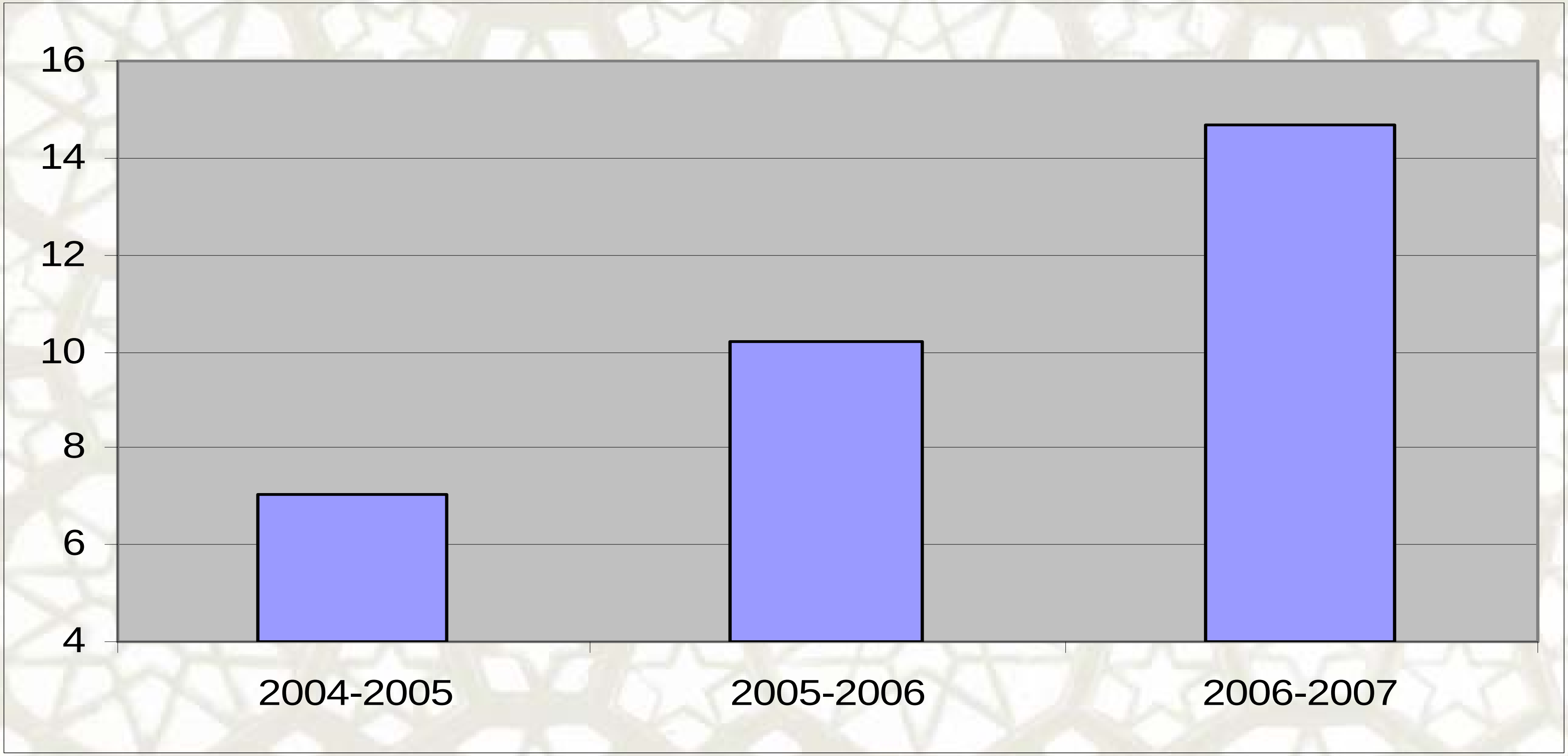
Rising margin



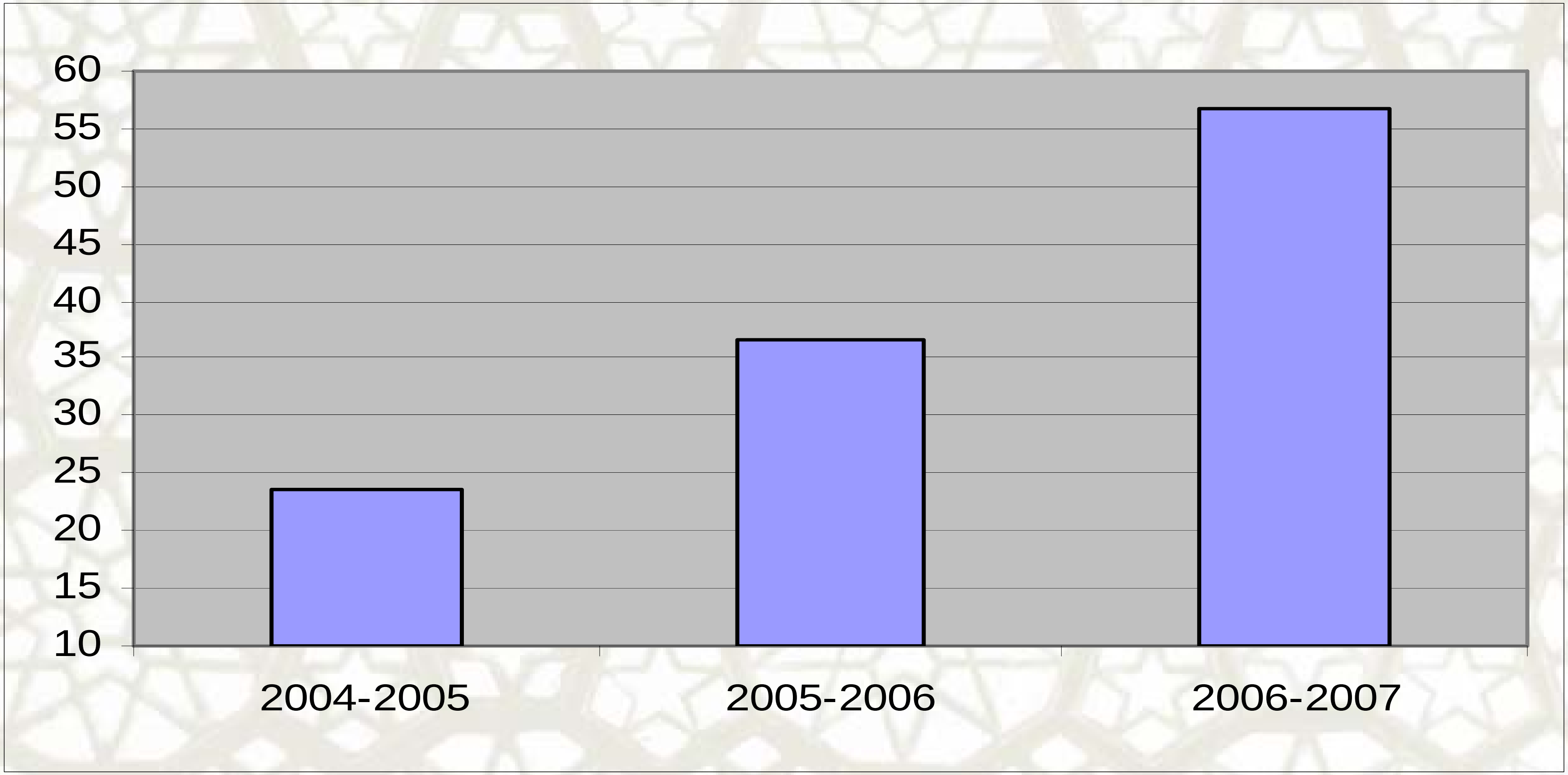
Return on assets



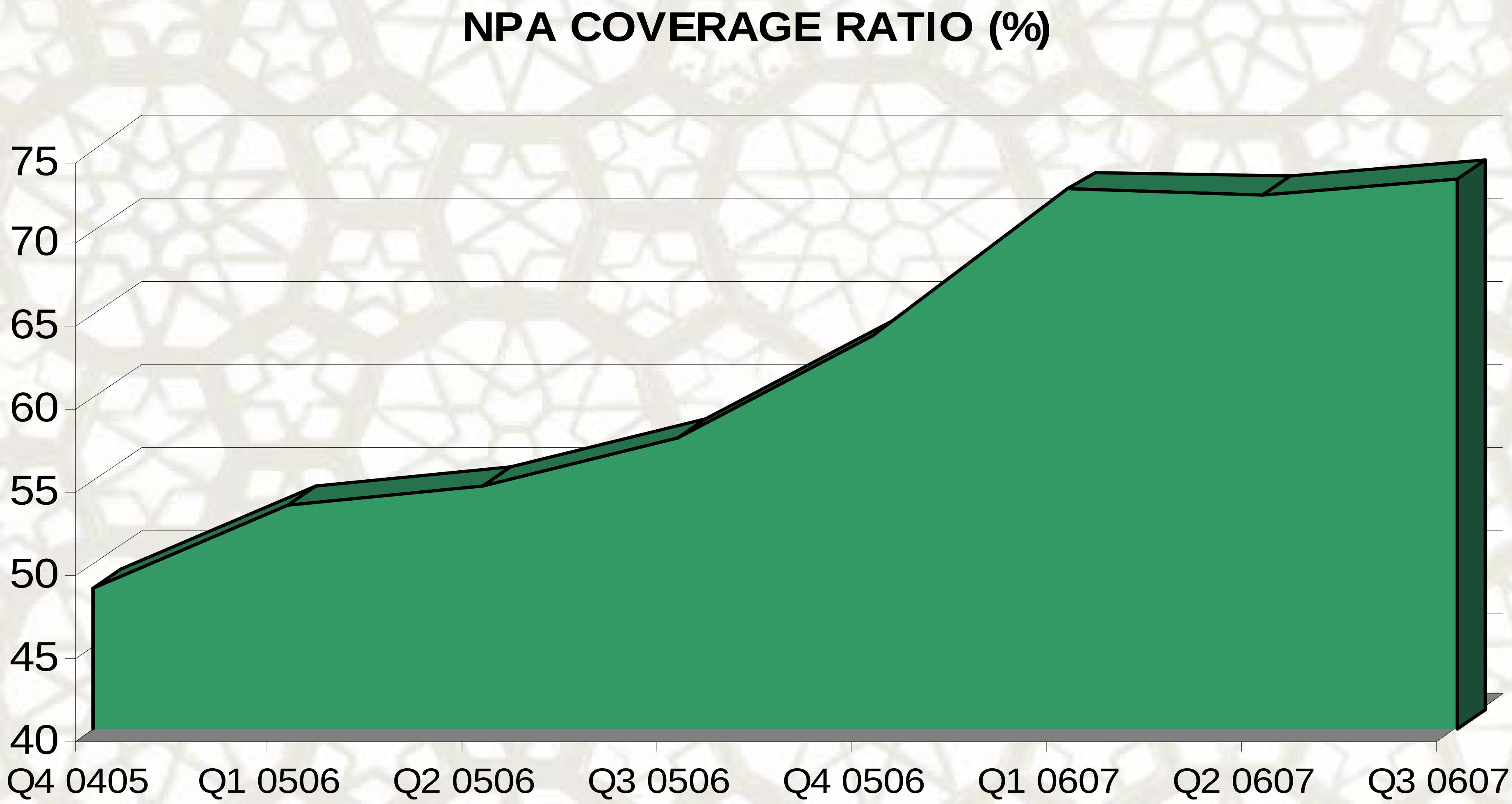
Return on equity



Earning per share



NPA coverage



Financial : Valuations ratios

S.No.	Ratios	2005-2006	2006-2007
1	Earning per Share (annualized)	36.48	56.62
2	Net Asset Value	371.2	414.36
3	Adjusted Book Value	343.43	374.43
4	Price to book value ratio	1.23 *	1.73 @
5	Price to adjusted book value ratio	1.33 *	1.91 @
6	Price Earning Ratio (On Annualised EPS)	12.50 *	12.63 @
7	Market Cap. To Deposits (%)	9.41 % *	13.77% @
8	Market price as on date (Rs.)	456.05 *	714.85 @
9	No. of Shares	48477702	48477702

Profitability Ratios

10 Net Interest Margins (%)	2.68%	2.97%
11 Interest Spreads (%)	2.61 %	2.79%
12 Yield on Advances (Av) (%)(annualized)	8.48%	8.58%
13 Yield on Investments (Av) (%)(Annualized)	6.22%	6.20%
Monthly average	6.74%	6.65%
14 Cost of Deposits (Av) (%) (annualized)	4.55%	4.50%
Monthly average	5.25%	5.28%
15 Return on Assets (%) (annualized)	0.67%	0.96%
(Monthly average)	0.79%	1.14%
16 Return on equity (%) (annualized)	10.21 %	14.67%
17 Gross Profit to AWF (%) (annualized)	1.69%	2.02%
18 Net Profit to AWF (%) (annualized)	0.70%	1.00%

Asset Quality:

27 Gross NPAs (Rs. in Mns)	3702	5018
28 Net NPAs (Rs. in Mns)	1339	1936
29 Gross NPA Ratio (%)	2.52%	2.89%
30 Net NPA Ratio (%)	0.92%	1.13%
31 NPA Coverage Ratio (%)	63.64%	61.43%
32 Gross NPA to Net Worth Ratio (%)	20.57%	24.98%
33 Net NPA to Net Worth Ratio (%)	7.44%	9.64%

Operating ratios:

		2005-2006	2006-2007
34	Operating Expenses to AWF (%) (annualized)	1.36% #	1.35% #
35	Operating Expenses to Total Income (%)	19.00% #	18.08% #
36	Operating expenses to other income (%)	311% #	232.48% #
37	Staff Cost to Total Income (%)	10.59% #	10.69% #
38	Interest Earned to AWF (%)	6.71% #	6.89% #
39	Non Interest Income to AWF (%)	0.44% #	0.58% #
40	Capital Adequacy Ratio (%)	12.14%	13.24%
	Tier I	11.76% #	12.60% #
	Tier II	0.38% #	0.64% #

Efficiency Ratios:

		2005-2006	2006-2007
20	Cost to Income Ratio (%)	44.57%	40.13%
21	CD Ratio (%)	61.67%	67.79%
22	CASA Ratio (%)	34.17%	37.02%
23	Business per Employee (Rs. In Mns)	55.57	61.74
24	Net Profit per Employee (Rs. In Mns)	0.26	0.4
25	Business Per Branch (Rs. In Mns)	845.61	937.34
26	Net Profit per Branch (Rs. in Mns) (Annualized)	3.94	6.09

Perspective

Triad of potential

A. Restoration of Peace

B. Low base

   A. Normal Growth effect

   B. Gap Filling

C. Reconstruction

Civil society normalisation

- **Domestic changes**:
  - Democratically elected sub-national government
  - Local body election after 32 years
  - Same party in power at the Centre and the State after
  - First time a coalition government at the state level
- **International peace process:**
  - Srinagar-Muzaffarabad road opened after 52 years
  - Visa requirement within the greater Jammu and Kashmir a abolished Full diplomatic relations between India and Pakistan restored

Economics of Peace:

A. Pure growth effect

- Increased level of economic activity due to improved socio-political situation
- As a result, bank's business opportunity set widens

For example:

- Tourist inflow in 2006 has already crossed 1989 levels:
  - Income multiplier of tourism sector is 1.66
  - Private sector investments in tourist infrastructure
  - Credit to tourism industry has picked up

J&K Economy : Basic Indicators

Total Population	1.01 crore
Area	1,01,387 sq kms
Density	100 per sq km (325)
Per capita Income	Rs 16,190 (Rs 23,222)
Population BPL	3.48% (26.10%)
Literacy	55.52% (64.84%)
Unemployment rate :	4.21 (3.09)

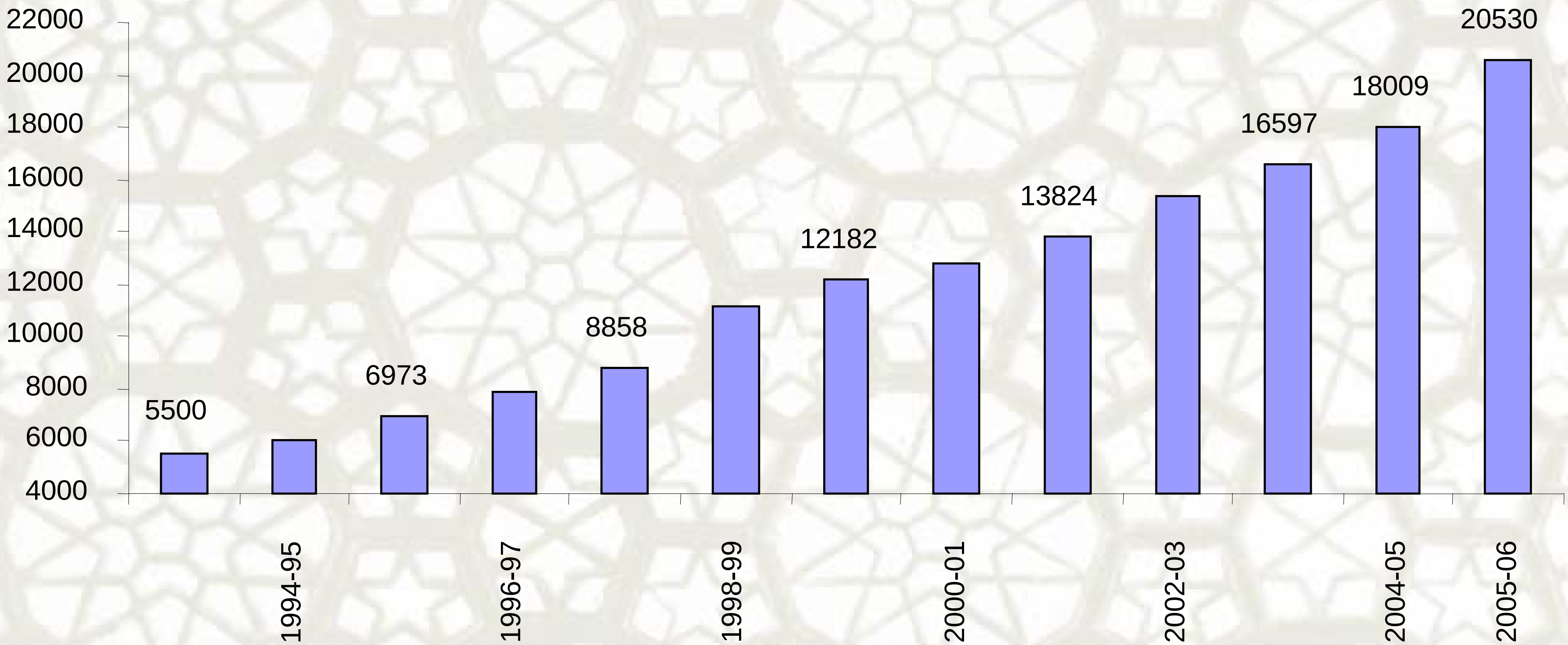
Economic Infrastructure

Road Length (Kms/100SqKm)	35.71 (104.64)
Telephones/100 of population	7.76 (13.57)
Post offices/Lakh of Population	15 (14)
Bank offices per 100 SqKm	0.85 (2.18)
Average population per bank office	13000 (16000)
Hospital Beds per lakh	111
Doctors per lakh	48

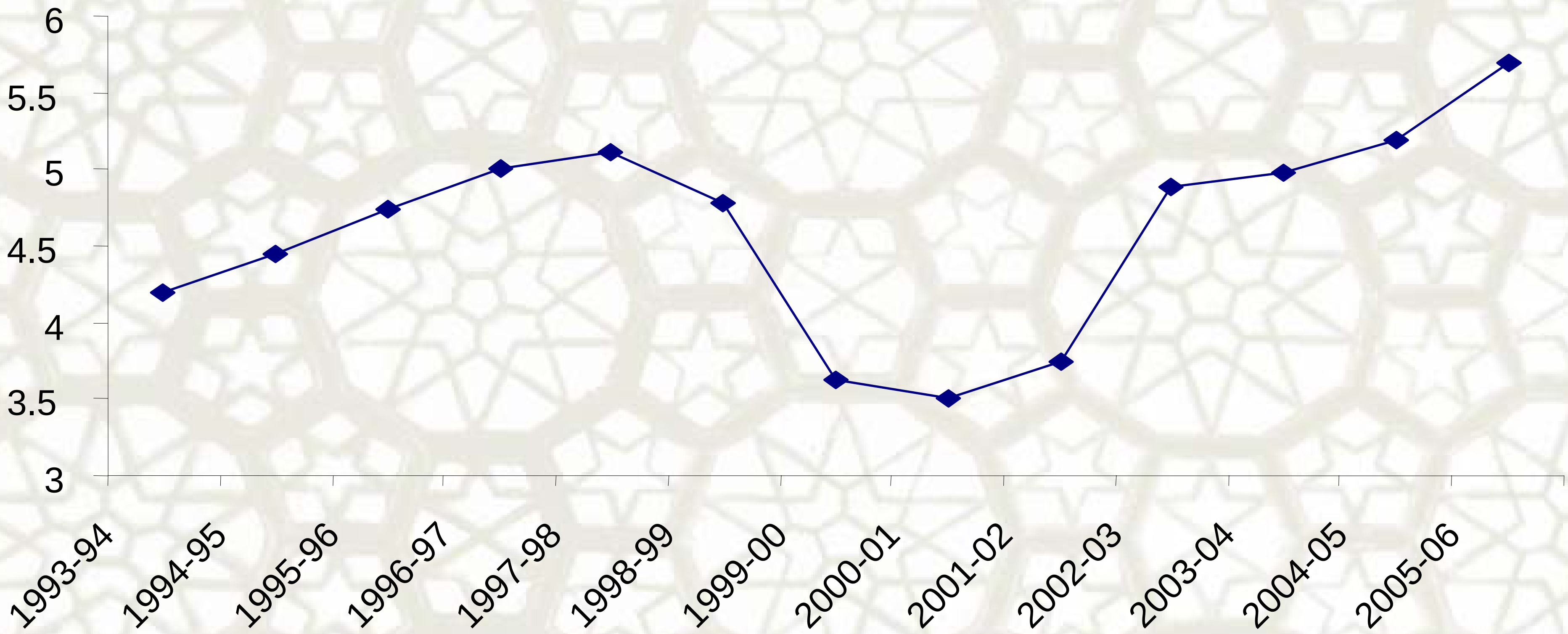
Inter regional variations

- Bank Branches/Area
  - Leh : 1 branch per 3000 sq km
  - Jammu : 1 branch per 15 kms
- Bank branches /Population
  - Kupwara : 20,000 people per branch
  - Leh : 1000 people per branch
- CD Ratio
  - Kargil : 11.41%
  - Srinagar : 81.99%
- Per Capita Income
  - Srinagar : Rs 17896
  - Kupwara : Rs 9999

State Income:



Economic Growth: Trends



Credit gap

- J&K accounts for 0.70 per cent of national GDP
  - Yet, it absorbs only 0.30 per cent of total national credit
- Productive sectors of the economy account for less than 5 per cent of the credit disbursed in J&K
  - Comparable national average is 30 per cent
- J&K accounts for 1 per cent of India's population
  - Yet it accounts for only less than 0.2 per cent of personal credit disbursed in India

Reconstruction Impact

B. Normalcy plus economic reconstruction

- Economic growth accelerates due to reconstruction of economy through :
  * autonomous investments in physical infrastructure
  * Induced investment in production activity

Example:

Acceleration of Economic growth:

- State SDP growth : 13.5 per cent
- Commercial Agricultural growth : 9.7 per cent
- SMEs projected at : 16.3 per cent

Peace through Economic Reconstruction

- **Prime Minister's Reconstruction Plan:**
  - Timeframe : 2005-06 to 2008-09
  - Size : Rs 240 bn
  - Focus areas: Power, Roads, Hospitals and Tourist Infrastructure
- **Asian Development Bank's Multi-sectoral Investment Plan:**
  - Timeframe : 2005-06 to 2009-10
  - Size : Rs 20 bn
  - Focus areas : Rural connectivity, Urban Infrastructure
- **Japanese Bank of Industrial Cooperation:**
  - Timeframe : 2007-08 to 2010-11
  - Size : Rs 35 bn
  - Focus areas : Water supply and Urban sanitation

Staggering Numbers

- Prime Minister's Reconstruction Plan: Rs 240 bn
- Asian Development Bank's Multi-sectoral Investment: Rs 20 bn
- Japanese Bank of Industrial Cooperation: Rs 37 bn
    - In addition to this,
- Normal spending plans: Rs 45 bn p.a
- Three year autonomous expenditure of: Rs 340 bn+
- All this money will be managed by and will pass through the banking channels of the Jammu and Kashmir Bank
- And this is not all.....

Private Investment :Picking Up

- Quantity:
  - Investment in the SME sector till July 2005 : Rs 35 bn
  - Proposals in the pipeline: Rs 120 bn
  - The flow of funds is in the range of : Rs 500 bn
- Quality:
  - Top notch Indian corporates:
    - Bharti
    - Reliance (ADA) Infocom
    - Mahindra and Mahindra
    - Lupin Laboratories
    - Essar telecom

Catching Up

From current levels to “Catch up” with national average:

- Of personal finance, credit has to triple
- Of credit intensity, credit in J&K has to increase five-fold

But by then,

- National average would have risen….
- Game of catching up will drive and sustain volumes and asset growth of the Bank

Bottom line impact

Per capita Income levels rise:

- savings rate increases;
- financial savings increase proportionally

Capacity for servicing personal loans will increase

With such a massive investment dose:

- inflation likely to increase ....
- real rate of interest will decline...
- making mortgages more attractive

Retail lending increases

Trickle down impact

Crowding in of investment:

- public investment in infrastructure will induces private investment with backward and forward linkages
- Credit demand for financing SME's and ancillaries associated with infrastructural projects picks up
- Credit demand for induced demand : financing private sector projects

SME lending will increase

To sum up

- New strategy has started paying off
- Consolidation Phase will now give way to margin enhancing growth phase, led by
  - High growth of J&K
  - Reconstruction
  - Specialised lending
- Better financial intermediation through innovation
- Raising J&K level of credit absorption to national levels

Contra cyclical in 2007-08

- Expansion
- Aggressive credit growth
- Improved liability management
- Productivity enhancements
  - Labour
  - Capital

Macroeconomic Context

- Stage set for a moderate pace of loan growth in 2007-2008
- Expected range of growth is 20–22 per cent.
- Monetary policy will be contractionary
- Liquidity scenario will be be biased towards tightness.

Macroeconomic Outlook

- Positive:

- Signs of overheating
- Rising inflation
- Correction will not be sharp despite an adverse monetary policy,
- momentum should ensure a soft landing
- Economy should expand by 8 percent,
- Inflation will rise to around 5.5 – 6 percent

Global Growth

- Asia expected to grow at 7.5 percent in fiscal 2007-08,
- Expansion of 8.3 percent in 2006,
- India will continue be an out-performer
- This will impact FII and FDI inflows

Global Growth: monetary impact

- Higher relative growth prospect will continue to bring high capital inflow
- Currency appreciation pressure.
- Most important macroeconomic variable for management and tracking in 2007-2008 is exchange rate

Monetary Policy

- Entire monetary policy and liquidity management will be hinged on how RBI chooses to handle exchange rate.
- To hold the exchange rate at currently levels it will have to push money into the system.
- So aggressive use of CRR and other levers of liquidity control is likely.

Monetary Policy

- Interest rates will rise by another 50 bps through the last quarter.
- Some levers of liquidity control will be tightened
- Credit slowdown will happen
- Cost of deposits will rise

Fiscal Policy

- Lower fiscal deficit should support lower bond yields.
- Increased income limit for TDS on interest on bank deposits may lead to higher deposit mobilization
- Dividend distribution tax of 25% makes money market funds less attractive and can lead to higher deposit growth
- SARFAESI Act now available to RRBs to recover bad loans; RRBs to accept NRE deposits

Banking Sector Outlook

- Increase in risk weightage:
  - RBI may further tightened norms due to continued high asset prices.
  - risk weightage for loans to the commercial real estate sector from 100% to 125%.
  - investment in mortgage-backed-securities (MBS) will attract risk weightage of 125%.
  - Risk weightage on home loans from 50% to 75%.
  - Provisioning liability for banks.

Recap

- J&K Bank will grow its business much faster
- At rising margins and lower costs, even as
- Economic growth in India declines marginally and
- Banking sector slows downs with cautious outlook on performance

Thank you!

J&K Bank