

Karnataka State Financial Corporation

January 31, 2019

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Bond Programme	77.00	77.00	[ICRA]AA- (SO) (Stable) / Reaffirmed
Total	77.00	77.00	

Rating Rationale

The rating reaffirmation for Karnataka State Financial Corporation's (KSFC) bond programme is solely based on the strength of the guarantee provided by the Government of Karnataka (GoK).

Outlook: Stable

The stable outlook factors in the unconditional and irrevocable guarantee by Government of Karnataka. The outlook may be revised to 'Positive' or 'Negative' depending on the change in the credit profile of Government of Karnataka.

Key Rating Drivers

Credit strengths

- **State ownership and support** – KSFC is primarily held by Government of Karnataka (GoK) with a shareholding of 95.87% as on March 31, 2018. The rating derives strength from the unconditional and irrevocable guarantee extended by the GoK towards repayment of principal and interest due thereon over the tenure of the rated bonds, and a structured payment mechanism, which includes an escrow account to be monitored by a Trustee. Thus, the rating assigned to the bond programme primarily reflects the credit strength of the GoK and the integrity and expected adherence to the structured payment mechanism.

Credit challenges

- **Moderate risk profile of KSFC** – KSFC is a state financial corporation incorporated with the objective of promoting industrial activity in Karnataka by providing financial assistance to small and medium sized industries. Accordingly, KSFC lends to marginal borrower segment which in turn results in high non-performing assets (NPA). As on March 31, 2018, KSFC's gross NPA increased and stood at 14.7% compared to 12.0% as on March 31, 2017 because of tight operating environment. KSFC's portfolio remained largely flat at Rs.1,825.2 crore as on March 31, 2018 against Rs.1,808.8 crore as on March 31, 2017. Portfolio growth has however witnessed some revival during 9M FY2019 driven by improved offtake in advances under interest subsidy schemes offered by GoK; portfolio stood at Rs.1,903.9 crore as on December 31, 2018. During FY2018, KSFC's yields declined marginally owing to higher slippages resulting in interest reversals. This, together with higher credit costs during the year resulted in lower net profit of Rs.25.6 crore (0.95% PAT / ATA) in FY2018 compared to Rs.29.9 crore (1.1% PAT / ATA) in FY2017.

KSFC is largely funded through government guaranteed bonds, which comprised about 98% of its total debt outstanding as on March 31, 2018. The corporation's gearing was comfortable at 1.5x as on March 31, 2018; however, with the

transfer of pass through equity¹ to GoK during FY2019, the gearing is expected to increase to about 2.3 - 2.5x by March 31, 2019. During Q4 FY2019, KSFC is expected to receive equity capital of Rs.68 crore. ICRA expects GoK to continue to extend timely liquidity and equity support going forward.

Liquidity Position

KSFC's liquidity position remains comfortable with cash and liquid investment balances of Rs.220.4 crore as on December 31, 2018 against repayment obligations of Rs.110 crore in Q4 FY2019. Additionally, expected equity infusion of Rs.68 crore during Q4 FY2019 would support its liquidity profile.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA's Credit Rating Methodology for Non-Banking Finance Companies Approach for rating debt instruments backed by third-party explicit support
Parent/Group Support	The assigned ratings are based on unconditional, irrevocable guarantee extended by Government of Karnataka.
Consolidation / Standalone	Rating is based on standalone financial statements of the company.

About the company:

Karnataka State Financial Corporation was formed under Section 3 of the State Financial Corporation Act, 1951 (SFC Act) on March 31, 1959. The objective of the corporation is to promote industrial activity in the State of Karnataka by providing financial assistance to industries, particularly to the small and the medium sized units. The assistance is usually in the form of term loans up to a maximum limit of Rs. 20 crore, mainly to first-generation entrepreneurs. KSFC also provides fee-based financial services such as distribution of insurance and mutual fund products and advisory services. The corporation has 32 branch offices in all the district head-quarters of Karnataka.

The corporation is primarily held by Government of Karnataka with a shareholding of 95.87% as on March 31, 2018 with the other shareholder being Small Industries Development Bank of India (SIDBI) with a stake of 4.10% and the balance 0.03% being held by insurance companies and financial institutions.

¹ KSFC had received equity from GoK amounting to a total of Rs.610 crore, which was for specific investments into Cauvery Neeravari Nigam Limited, Karnataka Neeravari Nigam Limited and Krishna Bhagya Jala Nigam Limited, in the past. However, during FY2018 and 9M FY2019 the corporation has transferred the aforementioned investments (Rs.150 crore in FY2018 and Rs.460 crore in 9M FY2019) along with the corresponding equity to GoK.

Key financial indicators

	FY 2017 (audited)	FY2018 (audited)
Total Income	287.9	287.0
Profit after Tax	29.9	25.6
Net worth	1,001.4	952.0
Total Managed Portfolio	1,808.8	1,825.2
Total Managed Assets	2,732.3	2,630.0
Return on Average Managed Assets (%)	1.1%	1.0%
Return on Average Net worth (%)	3.2%	2.6%
Gross NPA (%)	12.0%	14.7%
Net NPA (%)	5.8%	6.6%
Net NPA / Net worth	9.7%	11.5%
Managed Gearing (times)	1.5	1.5
CRAR (%)	35.8%	37.8%

Note: Amounts in Rs. Crore; Source: KSFC, ICRA research

Government of Karnataka's Finances

The GoK has recorded sustained revenue surpluses since FY2005, aided by a high own tax effort and modest revenue spending. Moreover, the GoK's fiscal deficit remained below the target of 3% of gross state domestic product (GSDP) recommended by the successive Finance Commissions (FCs) during FY2011 to FY2017. The Medium-Term Fiscal Plan (MTFP) 2018-22 published along with the FY2019 budget, projects the fiscal deficit of the GoK to remain below 3% of GSDP in FY2018 Revised Estimates (RE) and FY2019 Budget Estimates (BE) as well. In addition, reflecting the healthy fiscal balances, Karnataka remains one of the least indebted states in the country. Its debt stock in FY2017 remained well below the implicit target of 25% of GSDP suggested by the Fourteenth Finance Commission (FFC). Moreover, the GoK's interest payments are forecast to account for 9.7% of its revenue receipts each in FY2018 RE and FY2019 BE, remaining below the norm of 10% of revenue receipts suggested by the FFC.

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

Instrument	Type	Current Rating (FY2019)			Chronology of Rating History for the past 3 years		
		Amount Rated (Rs. crore)	Amount Outstanding (Rs Crore)	FY2019 Jan 2019	FY2018 Dec 2017	FY2017 Dec 2016	FY2016 Oct 2015
1 Bonds Programme	LT	77.00	77.00	[ICRA]AA- (SO) (Stable)	[ICRA]AA- (SO) (Stable)	[ICRA]AA- (SO)	[ICRA]A+ (SO)

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE549F08459	Bonds Programme	27-01-10	8.23%	27-01-20	77.00	[ICRA]AA- (SO) (Stable)

Source: KSFC

Annexure - 2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
NA	NA	NA

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