

January 20, 2020

Karnataka Housing Board: [ICRA]A (Stable) reaffirmed and removed from Issuer Not Co-operating category

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long Term – Unallocated Limits	1000.0	1000.0	[ICRA]A (Stable); reaffirmed and removed from Issuer Not Co-operating category
Total	1000.0	1000.0	

Rationale

The rating reaffirmation factors in the strategic importance of KHB to the Government of Karnataka (GoK), with the board playing an important role in providing affordable housing to the weaker sections and the low-income group of the state. The rating continues to derive comfort from the modest financial profile of KHB, characterised by a conservative capital structure with a debt-free status at present and a healthy liquidity position as reflected by a large bank balance. As a result, the KHB is able to fund a major portion of its working capital requirements from its surplus funds, which is reflected by the non-utilisation of overdraft facilities for the last several quarters. ICRA also notes that KHB, in the last two years, started focusing more on contractual works received from several GoK departments, which are backed by advance payments and fixed service charges ranging between 8% to 12%, which have kept their profit margins high, despite a significant decline in their revenues. The profit margins are highly supported by the substantial interest income, which KHB generates through these large advances received for carrying out contractual work. The rating also derives comfort from several completed projects, which are available for sale at present. Additionally, fresh projects in the pipeline along with a strong inflow of contractual work received from the Government departments, are likely to provide revenue visibility to the board over the long term. The rating positively factors in the high credit quality of the state government and KHB's access to external borrowings at competitive rates by virtue of its strong linkages with the GoK.

However, the rating remains constrained by the significant volatility in the KHB's revenues over the years due to its dependence on the real estate demand in the state and timely realisation from the sale of completed projects. The rating also factors in the high inventory levels of unsold housing stocks and work-in-progress projects leading to high working capital requirements. ICRA, however, notes that high working capital requirements are partially offset by the advances received for contractual works received from the various departments of the GoK and gradual realisation from the sale of finished inventory. The rating continues to consider the increasing number of pending litigations, especially in land-acquisition cases, leading to delays in meeting the project timelines and the risks arising out of contingent liabilities for the KHB. ICRA takes note of the Board's inability to finalise its accounts in a timely manner, which limits the scope of analysis. Going forward, the board's ability to improve its revenue and profitability with timely execution of projects and realisation from sale of completed projects, thereby improving the overall financial profile, would remain the key rating sensitivities.

Key rating drivers and their description

Credit strengths

Strategic importance to the state government – A wholly-owned entity of the Government of Karnataka (GoK), the KHB is the nodal agency responsible for development and construction of houses in Karnataka, important for the state government. It carries out acquisition of land across various districts, keeping in line with the vision of equitable

residential development, especially for the weaker sections of the society. It is also responsible for the development of the acquired land parcels to make them adequate for carrying out commercial activities.

Conservative capital structure and adequate liquidity position – Adequate liquidity position at present with healthy cash/bank balances have led to complete pre-closure of bank loans during FY2018. The Board does not have any outstanding loans from any banks as on date. This also resulted in minimal financial support from the GoK over the years.

Contractual work from Government departments supports revenue and profitability - The Board receives contractual work to complete important structures of various state government departments, residential colonies etc., for which it earns a service charge of around 8-12% of the total project cost. Advance payment received against such contractual work from the Government departments has been earmarked specifically for fixed deposits, which would be utilised only for completion of these projects. The interest earned on these deposits is income for the KHB.

Significant improvement in net profit margins supported by high interest income – Large advances received from Government departments against contractual work are deposited in bank accounts as fixed deposits, resulting in high interest income. The non-operating income during FY2019 (provisional) is ~Rs. 41 crore as against Rs. 25.15 crore in FY2018. A similar trend is likely to continue in the medium term as the KHB continues to receive an increasing number of contractual work from the GoK departments as compared to the launch of new housing projects.

Credit challenges

Volatility in revenues and profitability – The KHB's revenue primarily depends on real estate demand, which is highly dependent on macro-economic factors and neither consistent nor uniform across the state, resulting in slower cash flow generation and volatility in the revenues over the years. Additionally, the profit margins remain susceptible to fluctuations in raw material costs.

Significantly high inventory holdings – High inventory levels of unsold housing stocks and work in progress projects lead to high working capital requirements. However, regular advance from customers for ongoing fresh projects and a significant increase in proportion of contractual work (fixed margin and advance payment) from Government departments of the GoK, is likely to reduce its overall inventory levels and subsequent working capital requirements in the medium term.

High risk of contingent liabilities – A large number of pending litigations, especially in land-acquisition cases, leads to delays in meeting the project timelines and increase the risks of contingent liabilities. The instances of fresh litigations, however, are likely to decrease going forward, as large fresh projects are being taken up under the 50:50 land-sharing formula approved by the GoK cabinet in August 2019. Since the landowners are likely to get a significant portion of the developed area, the chances of litigations and delays is likely to reduce gradually over the period of time.

Liquidity position: Adequate

The company has a substantial cash balance amounting to Rs. 618.29 crore, out of which around Rs. 550 crore has been earmarked (fixed deposit) for completion of depository contribution works received from various GoK departments. The interest earned on these deposits would remain in the books of the KHB. The board's liquidity position remains adequate as reflected by substantial own reserves and large advances received from its customers.

The Stable outlook assigned to the rating reflects ICRA's expectation that the KHB would continue to benefit from the regular execution of projects and comfortable liquidity position. The outlook may be revised to Positive if the KHB is able to demonstrate substantial and sustainable growth in revenues and profitability resulting in strong cash accruals and strengthening of the overall financial risk profile. Conversely, the outlook may be revised to a Negative if any slowdown in the revenue weakens liquidity.

Rating Sensitivities

Positive triggers – If the KHB demonstrates substantial and sustainable growth in revenues and healthy cash accruals, strengthening its overall financial profile.

Negative triggers – Significant decline in revenues from its core operations, resulting in lower-than-expected cash accruals and large debt-funded capex, which may adversely impact its liquidity profile.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for State Governments
Parent/Group Support	Not Applicable
Consolidation / Standalone	Standalone

About the entity

The Karnataka Housing Board (KHB) was established under the Karnataka Housing Board Act, 1962 as a successor to the Mysore Housing Board, which was constituted in 1956. The primary objective of the KHB is to provide housing to various sections of people in Karnataka at an affordable price, with special emphasis on the economically weaker sections and the low-income group. The entity is administered by the Housing Department of the GoK and is the nodal agency for delivering housing in the state. The KHB is governed by a Board of Directors (BoD), headed by a Chairman (appointed by the GoK). Other members of the BoD are also appointed by the GoK (mainly representatives of various stakeholder departments). The Housing Commissioner, who is also a member of the BoD, is the executive officer and is responsible for regular operations of the board. The Housing Commissioner is supported by the head of various functions. The KHB headquarter is at Bengaluru. Additionally, there are coordinating/project offices across the state. At present, the KHB has about 600 employees across all its offices, out of which 150 are contractual.

In FY2018, the KHB reported a net profit of Rs. 39.1 crore on an operating income of Rs. 777.2 crore compared to a net profit of Rs. 31.5 crore on an operating income of Rs. 417.7 crore in the previous year. During FY2019, KHB has achieved an operating income of Rs. 335.9 crore (Provisional). However, the detailed financials for the FY2019 have not been finalised as on January 10, 2020.

Key financial indicators (audited)

	FY 2016	FY 2017	FY 2018
Operating Income (Rs. crore)	401.7	417.7	777.2
PAT (Rs. crore)	18.0	31.5	39.1
OPBDIT/ OI (%)	4.9%	6.6%	4.3%
RoCE (%)	3.1%	6.2%	9.1%
Total Debt/ TNW (times)	0.6	0.2	0.0
Total Debt/ OPBDIT (times)	15.7	4.5	0.0
Interest coverage (times)	2,514.5	24.5	62.8

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2020)					Rating History for the Past 3 Years			
		Type	Amount Rated	Amount Outstanding	Rating	Rating	FY2019		FY2018	FY2017
					20-Jan-2020	28-Nov-2019	16-Jul-2018	08-May-2018	-	-
1	Unallocated Limits	Long Term	1000.0	Nil	[ICRA]A (Stable); Reaffirmed and removed from 'Issuer Not Cooperating' category	[ICRA]A (Stable) ISSUER NOT COOPERATING	[ICRA]A (Stable) NDS Non-Cooperation	[ICRA]A (Stable)	-	-

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 Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Long Term – Unallocated Limits	NA	NA	NA	1000.0	[ICRA]A (Stable)

Source: KHB

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