

Change in Rating Symbol

September 16, 2019

Kerala Finance Corporation

Total Instruments Rated	Rs. 750.00 Cr
Long Term Rating	ACUITE AA / Stable
Long Term Rating	ACUITE Provisional AA / Stable

Pursuant to SEBI Circular SEBI/ HO/ MIRSD/ DOS3/ CIR/ P/ 2019/ 70 dated June 13, 2019 there is a revision in the rating symbol. The change to 'CE' suffix / removal of 'SO' suffix for the rated instrument(s) is not to be construed as any change in the rating or Acuite's credit opinion on the said instrument(s). The previous rating rationale is appended herewith for reference.

For the background note, please visit: [https://www.acuite.in/pdf/General%20Communication%20For%20Website%20\(1\).pdf](https://www.acuite.in/pdf/General%20Communication%20For%20Website%20(1).pdf)

Criteria for assigning ratings with 'SO' suffix: <https://www.acuite.in/view-rating-criteria-48.htm>

Criteria for assigning ratings with 'CE' suffix: <https://www.acuite.in/view-rating-criteria-49.htm>

Press Release

Kerala Finance Corporation

January 31, 2019

Rating Reaffirmed and Assigned



Total Facilities Rated*	Rs. 750.00 Cr.
Instruments Rated*	Rs. 250. 00 Cr.
Long Term Rating	ACUITE Provisional^ AA(SO#)/ Stable (Assigned)
Instruments Rated*	Rs. 250.00 Cr.
Long Term Rating	ACUITE AA(SO#)/ Stable (Converted from Provisional Rating to Final Rating)
Instruments Rated*	Rs. 250.00 Cr.
Long Term Rating	ACUITE AA(SO#)/Stable (Reaffirmed)

* Refer Annexure for details

The suffix 'SO' after the rating indicates 'Structured Obligation' on account of the presence of a Structured Payment mechanism and availability of Cash collateral/DSRA.

^The rating will be converted to a final rating after the:

- Appointment of a SEBI Registered Trustee
- Execution of the Trust Deed with the proposed Structured Payment Mechanism (SPM) duly incorporated

Rating Rationale

Acuité has assigned its '**ACUITE Provisional AA (SO)**' (read as **ACUITE Provisional double A; structured obligation**) rating to the Rs. 250.00 Cr Proposed Secured Non-Convertible Debentures of Kerala Finance Corporation (KFC). The outlook is '**Stable**'.

Acuité has converted its provisional rating on the outstanding NCD issue of Rs. 250.00 Cr. of KFC to final rating of **ACUITE AA (SO)** (read as **ACUITE double A (Structured Obligation)**). The outlook is '**Stable**'. The conversion from provisional rating to the final rating reflects the fulfilment of the conditions laid out in the press release dated February 15, 2018.

Further, Acuité has reaffirmed its **ACUITE AA (SO)** (read as **ACUITE double A (Structured Obligation)**) rating on the Rs. 250.00 Cr. Secured Redeemable Non-Convertible Debenture Issue of KFC. The outlook is '**Stable**'. The final rating on this NCD was assigned vide press release dated November 16, 2016.

The provisional rating is valid for 90 days, Acuité reserves the right to alter/modify/extend/withdraw the rating any time prior to 90 days, if such an action is deemed appropriate.

Analytical approach:

Acuité has taken a standalone approach while assessing the business and financial risk profile of KFC, factored in the support from the Government of Kerala and also taken into account the robustness of the structured payment mechanism while arriving at the final rating.

About the Corporation:

Kerala Finance Corporation was incorporated in 1953, under the State Finance Corporations Act, 1951 by Government of Kerala, with an objective of rapid industrialisation of the state by extending financial assistance to Micro, Small and Medium Enterprises in manufacturing and service sector.

The corporation was originally established as the Travancore Cochin Financial Corporation in 1953 and consequent to reorganisation of states on linguistic basis in November 1956, Kerala State was formed and the Travancore Cochin Financial Corporation was renamed as Kerala Financial Corporation.

Government of Kerala is the majority stakeholder with 97.25 percent holding and the balance is headed by domestic banks and other institutions. The corporation operates in 14 districts of Kerala with a network of 16 branches.

Key Rating Drivers:

Strengths:

Ownership and Support from Government of Kerala (GoK):

KFC is a state finance corporation established under the SFC Act, 1951. The board of KFC includes representation from Government of Kerala. The Board of Directors comprise 3 bureaucrats appointed by the Government of Kerala and the others representing SIDBI, LIC of India, Bank of India and State Bank of India (erstwhile State bank of Travancore). This indicates a strong level of managerial support from both prominent public sector enterprises and the Government of Kerala.

KFC's funding profile is supported by the State Government's moral obligation to support the capitalisation levels both on an ongoing basis and in the event of distress. The Government of Kerala is a 97.25 percent stakeholder in the corporation and is expected to support the corporation given its systemic importance to the state. KFC's capitalisation levels remained adequate at 19.46 percent as on September 30, 2018 as against 17.26 percent as on March 31, 2018. KFC's funding mix comprises equity contribution from its shareholders, primarily, GoK, NCDs and borrowings from banks. Of the overall outstanding borrowings Rs. 2166.26 Cr. as on March 31, 2018, NCDs comprise 32.31 percent and remaining 67.69 percent is bank borrowings. The ownership by the GoK enables KFC to borrow at fine pricing from various banks and institutions.

KFC is a Nodal Agency for several policy initiatives by the State Government of Kerala and is responsible to implement the states policy initiatives announced in the annual state budget. The corporation in the past has operationalised various policy initiatives by GoK such as Kerala State Entrepreneur Development Mission and Interest Subvention for Innovative Projects. The corporation is presently promoting schemes such as Startup Support Scheme, receivable financing scheme to support various businesses while extending working capital loans and term loans as its own products. KFC reported loan portfolio of ~Rs. 2497 Cr as on September 30, 2018 as against ~Rs. 2452 Cr. as on March 31, 2018 (FY2017- ~Rs. 2474 Cr.). While the growth in loan portfolio in the current fiscal has been impacted due natural calamities which had hit the state, in FY2018 the growth in loan portfolio had remained flattish mainly on account of major write offs of delinquent assets.

Since the support from GoK is critical to the rating, the credit profile of Kerala state is of key importance. Kerala's fiscal deficit stood at 3.4 per cent of the GSDP for 2017-18 (RE) (4.3 per cent during the previous year). The outstanding debt of Kerala state as a percentage of GSDP remained over 31 percent for 2017-18 and 2016-17. The state's revenue deficit for 2017-18 (RE) stood at 1.9 percent of GSDP (previous year 2.5 percent). The state's fiscal headroom has been

further impacted by the recent natural calamities in FY2019, due to which the state had to seek approval for additional borrowing. While this is expected to put some pressure on Kerala's fiscal metrics over the near term, the overall fiscal health of the state over the medium term is expected to stay satisfactory. Movement in the state's key fiscal metrics i.e. fiscal deficit to GSDP and Debt to GSDP will remain key monitorable.

Acuite believes that the corporation will continue to benefit from strong financial and managerial support from the State Government on an ongoing basis over the medium term.

• **Maintenance of principal cash collateral, DSRA along with presence of Structured Payment Mechanism (SPM):**

The rating factors in the Structured Payment Mechanism (SPM) put in place by KFC to ensure timely availability of funds for servicing of debt obligations. The rating on the NCDs is secured by presence of Structured Payment Mechanism, wherein amount equivalent to principal repayment of respective year shall be brought in by T-7 days (T is the due date) and the said amount will be invested in permitted investments. The maturity proceeds of the said investment will be credited directly to the designated escrow account and will be utilised for principal redemption process.

In case the principal amount is not invested and made sufficient, the principal servicing is additionally secured by way of cash collateral of 20 percent of outstanding principal being maintained at any point of time.

The SPM is also in place for semi-annual servicing of interest obligations, wherein semi-annual interest will be divided into two portions and each interest portion at the beginning of the third and fifth month will be invested in permitted investments and both will mature on the T-1 day of the coupon payment date and the proceeds will be credited directly to the designated escrow account from where the coupon amount will be paid.

In case the interest amount is not invested and made sufficient, the interest servicing is additionally secured by way of DSRA, wherein amount equivalent to one semi-annual interest obligation of the outstanding bonds will be maintained by the issuer on rolling basis.

The cash collateral and DSRA will be lien marked to the debenture trustee and in the event of principal or interest not invested and made sufficient, the trustee will mandatorily liquidate the principal cash collateral and DSRA in order to make the proceeds available for the principal payment and interest payment respectively.

The cash collateral, DSRA, investment as per structured payment mechanism, and funds in the escrow account till such time being utilised would be permitted to remain invested in Fixed deposits with Scheduled commercial banks having preferably AAA rating or AA rating, Central or State Government securities (G Sec/T- Bills /SDL) or AAA/AA paper rated by two SEBI/RBI approved rating agency. These investments will be pledged in favour of debenture trustee.

The rating centrally assumes complete adherence to the SPM by the debenture trustee and KFC on an ongoing basis.

Weaknesses:

Subdued asset quality and modest profitability metrics:

KFC's loan portfolio is concentrated towards construction and real estate segment along with Hospitality segment which exposes KFC's performance to systemic risks associated with the said sectors. The corporation's asset quality continues to remain moderate with gross non-performing assets (GNPAs) at 8.10 percent as on September 30, 2018 when compared with 6.37 percent as on March 31, 2018, and 8.51 percent as on March 31, 2017. This is mainly due to tepid performance in these segments which has impacted the cashflows of the borrowers on account of recent natural calamities in FY19. Further, KFC, as part of flood relief package schemes had restructured nearly Rs.58 Cr. of its loan portfolio.

The subdued asset quality has impacted KFC's profitability metrics. The corporation has written off loans to the extent of Rs. 304.09 Cr in the period FY2016 to FY2018 resulting in lower return on average asset of 0.30 percent in FY2018 as against 0.21 percent in FY2017 and 0.41 percent in FY2016. Further, the corporation reported Net Interest margin of 5.37 percent in FY2018 as against 4.43 percent in FY2017. The overall profitability continues to be supported by lower operating expenses to earning assets of 1.67 percent in FY2018 (previous year: 1.42 percent) along with low average cost of borrowing of 9.06 percent in FY2018 (previous year: 10.16 percent).

Acuite believes that the company's ability to maintain asset quality while expanding its loan portfolio would remain a key rating sensitivity factor.

Liquidity Position

KFC had adequately matched asset liability profile as on September 30, 2018 with cumulative surplus in all maturity buckets. The corporation's liquidity position is supported by cash and bank balance of Rs. 9.64 Cr as on September 30, 2018 and working capital facility of Rs. 200.00 Cr. which remained largely unutilised in the period May 2018 to October 2018, indicating the financial flexibility of KFC. The support from GoK should help KFC for any refinancing, if needed.

Outlook: Stable

Acuite believes that KFC will maintain a 'Stable' outlook over the medium term mainly supported by presence of SPM along with continued support from the GoK. The outlook may be revised to positive in case of significant improvement in the operating performance of KFC backed by improved asset quality. The outlook may be revised to negative in case of non-adherence to the SPM or in case of events which may impinge on GoK's ability to provide financial and operational support to KFC.

About the Rated Entity - Key Financials (Standalone)

	Unit	FY18 (Actual)	FY17 (Actual)	FY16 (Actual)
Total Assets	Rs. Cr.	2814.93	2732.17	2588.44
Total Income*	Rs. Cr.	140.36	117.18	139.46
PAT	Rs. Cr.	8.30	5.69	5.33
Net Worth	Rs. Cr.	441.08	435.45	429.17
Return on Average Assets (RoAA)	(%)	0.30	0.21	0.41
Return on Average Net Worth (RoNW)	(%)	1.90	1.32	2.48
Total Debt/Tangible Net Worth (Gearing)	Times	4.91	4.68	4.46
Gross NPA	(%)	6.37	8.51	10.57
Net NPA	(%)	2.03	4.25	5.93

*Total income equals to Total Income net off interest expense

Applicable Criteria

- Non-Banking Financing Entities: <https://www.acuite.in/view-rating-criteria-10.htm>
- State Government Support - <http://www.acuite.in/view-rating-criteria-26.htm>
- Financial Ratios and Adjustments: <https://www.acuite.in/view-rating-criteria-20.htm>
- Default Recognition: <https://www.acuite.in/view-rating-criteria-17.htm>

Note on complexity levels of the rated instrument
<https://www.acuite.in/criteria-complexity-levels.htm>
Rating History (Upto last three years)

Date	Name of the instrument	Term	Amount (Rs. Cr.)	Ratings/Outlook
15- Feb-2018	Non-Convertible Debentures	Long Term	250.00	ACUITE AA(SO)/Stable (Reaffirmed)
	Proposed Non-convertible Debentures	Long Term	250.00	ACUITE Provisional AA(SO)/Stable (Assigned)
16- Nov-2016	Non-Convertible Debentures	Long Term	250.00	ACUITE AA(SO)/Stable (Assigned)
05-May-2016	Proposed Non-convertible Debentures	Long term	250.00	ACUITE Provisional AA(SO)/Stable (Assigned)

***Annexure – Details of instruments rated**

Name of the Facilities	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. Cr.)	Ratings/Outlook
Proposed Secured Non-convertible debentures	-	-	-	250.00	ACUITE Provisional AA(SO)/Stable (Assigned)
Secured Non-convertible debentures	09.05.2016	8.90%	09.05.2023	250.00	ACUITE AA(SO)/Stable (Reaffirmed)
Secured Non-convertible debentures	04.04.2018	8.69	04.04.2022	62.50	ACUITE AA(SO)/Stable (Assigned)
Secured Non-convertible debentures	04.04.2018	8.69	04.04.2023	62.50	ACUITE AA(SO)/Stable (Assigned)
Secured Non-convertible debentures	04.04.2018	8.69	04.04.2024	62.50	ACUITE AA(SO)/Stable (Assigned)
Secured Non-convertible debentures	04.04.2018	8.69	04.04.2025	62.50	ACUITE AA(SO)/Stable (Assigned)

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About Acuité Ratings & Research:

Acuité Ratings & Research Limited (Erstwhile SMERA Ratings Limited) is a full-service Credit Rating Agency registered with the Securities and Exchange Board of India (SEBI). The company received RBI Accreditation as an External Credit Assessment Institution (ECAI), for Bank Loan Ratings under BASEL-II norms in the year 2012. Since then, it has assigned more than 6,000 credit ratings to various securities, debt instruments and bank facilities of entities spread across the country and across a wide cross section of industries. It has its Registered and Head Office in Mumbai.

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