

Press Release

Kerala Financial Corporation

November 04, 2019



Rating Assigned and Reaffirmed

Total Facilities Rated*	Rs. 1000.00 Cr.
Instruments Rated*	Rs. 250.00 Cr.
Long Term Rating	ACUITE Provisional** AA/Stable (Assigned)
Instruments Rated*	Rs. 250.00 Cr.
Long Term Rating	ACUITE AA/Stable (Assigned – converted from Provisional to Final rating)
Instruments Rated*	Rs. 250.00
Long Term Rating	ACUITE AA/Stable (Reaffirmed)
Instruments Rated*	Rs. 250.00
Long Term Rating	ACUITE AA/Stable (Reaffirmed)

* Refer Annexure for details

**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 the rating of '**Acuite Provisional AA**' (**read as ACUITE Provisional double A**) on the Rs. 250 Cr. Proposed Secured Non-Convertible Debentures of Kerala Finance Corporation (KFC). The outlook is '**Stable**'.

Acuité has converted the provisional rating on the Rs. 250.00 Cr. proposed NCDs of KFC to final rating of '**ACUITE AA**' (**read as ACUITE double A**). 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 January 31, 2019.

Further, Acuité has reaffirmed the rating of '**ACUITE AA**' (**read as ACUITE double A**) on the Rs. 500.00 Cr. Secured Redeemable Non-Convertible Debenture Issue of KFC. The outlook is '**Stable**'.

About KFC:

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 as on June 30, 2019 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 as on June 30, 2019.

Analytical Approach

Acuité has considered standalone approach while assessing the business and financial risk profile of KFC and has factored in the financial, operational and managerial support it receives from Kerala Government by virtue of being a State financial Corporation. The rating factors in the high degree of Government holding in KFC along with the systemically important role played by the corporation in implementing the

key financial and developmental objectives of the state. Further, the rating also takes support of the presence of internal credit enhancement put in place by the corporation on the NCDs rated by Acuité in the form of Debt Service Reserve Account and the Structured Payment mechanism.

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 as on June 30, 2019 and is expected to support the corporation given its systemic importance to the state. KFC's capitalisation levels remained adequate at 19.6 percent as June 30, 2019 as against 19.2 percent as on March 31, 2019. KFC's funding mix comprises equity contribution from its shareholders, primarily, GoK, NCDs and borrowings from banks. Of the overall outstanding borrowings Rs. 2263.9 Cr. as on March 31, 2019, NCDs comprise 35.3 percent and remaining 64.7 percent comprise borrowings from banks and institutions. 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 state's 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. 2759.2 Cr. as on June 30, 2019 as against Rs. 2684.0 Cr. as on March 31, 2019 (~Rs. 2452 Cr. as on March 31, 2018). The growth in loan portfolio of KFC in FY2019 has been low at ~9 percent due to natural calamities which had hit the state in FY2019 along with major write offs of Rs. 167 Cr.

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 3.1 per cent of the GSDP for FY2018-19 (RE) (3.9 per cent during the previous year). The outstanding debt of Kerala state as a percentage of GSDP remained over 30 percent for 2018-19 and 2017-18. The state's revenue deficit for 2018-19 (RE) stood at 1.7 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.

Acuité 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 Hospitality segment along with construction and real estate 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 6.2 percent as on June 30, 2019 when compared with 5.8 percent as on March 31, 2019 (previous year 6.4 percent). 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. The company has written off loan worth of Rs. 167.7 Cr. in FY2019 as against 124.8 Cr. in FY2018.

The spike in writeoffs has continued to have a bearing on KFC's profitability metrics. The Return on Average Assets is as low as 0.6 percent in FY2019 as against 0.3 percent in FY2018. The marginal improvement in ROAA is primarily on account of an all-time high write backs of Rs. 112 Cr. in FY2019 as against Rs. 46 Cr. in FY2018. This is primarily on account of one time settlement effort undertaken by the corporation.

Further, the corporation reported Net Interest margin of 4.5 percent in FY2019 as against 5.4 percent in FY2018. The overall profitability continues to be supported by lower operating expenses to earning assets of 1.6 percent in FY2019 (previous year: 1.7 percent) along with low average cost of borrowing of 8.4 percent in FY2019 (previous year: 9.1 percent).

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

Rating Sensitivities

- Credit profile of Kerala Government and timely support to KFC
- Adherence to Structured Payment Mechanism
- Significant deterioration in asset quality

Material Covenants: None

Liquidity Position: Adequate

KFC had adequately matched asset liability profile as on June 30, 2019 with cumulative surplus in all maturity buckets. The corporation's liquidity position is supported by healthy gap between the tenure of loans extended by KFC and the borrowings of the corporation. Further the company's liquidity profile is supported by healthy pipeline of sanctioned but un-availed bank lines of ~Rs. 295 Cr. as on October 30, 2019. The support from GoK should help KFC for any refinancing, if needed.

Outlook: Stable

Acuité 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

Parameters	Unit	FY19(Actual)	FY18 (Actual)	FY17 (Actual)
Total Assets	Rs. Cr.	2949.94	2814.93	2732.17
Total Income*	Rs. Cr.	129.76	140.36	117.18
PAT	Rs. Cr.	17.69	8.30	5.69
Net Worth	Rs. Cr.	457.41	441.08	435.45
Return on Average Assets (RoAA)	(%)	0.61	0.30	0.21
Return on Average Net Worth(RoNW)	(%)	3.94	1.90	1.32
Total Debt/Tangible Net Worth (Gearing)	Times	4.95	4.91	4.68
Gross NPA	(%)	5.8	6.4	8.5
Net NPA	(%)	1.8	2.0	4.2

* Total income equals to Net interest income plus other income

Status of non-cooperation with previous CRA (if applicable)

None

Any other information

None

Applicable Criteria

- Rating of Non-Banking Financing Entities - <https://www.acuite.in/view-rating-criteria-44.htm>
- Default Recognition - <https://www.acuite.in/view-rating-criteria-17.htm>
- Financial Ratios And Adjustments - <https://www.acuite.in/view-rating-criteria-20.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 Instrument / Facilities	Term	Amount (Rs. Cr)	Ratings/Outlook
January 31, 2019	Proposed Secured Non-convertible debentures	Long term	250.00	ACUITE Provisional AA(SO)/Stable (Assigned)
	Secured Nonconvertible debentures	Long term	250.00	ACUITE AA(SO)/Stable (Reaffirmed)
	Secured Nonconvertible debentures	Long term	62.50	ACUITE AA(SO)/Stable (Assigned)
	Secured Nonconvertible debentures	Long term	62.50	ACUITE AA(SO)/Stable (Assigned)

	Secured Nonconvertible debentures	Long term	62.50	ACUITE AA(SO)/Stable (Assigned)
	Secured Nonconvertible debentures	Long term	62.50	ACUITE AA(SO)/Stable (Assigned)
15- Feb-2018	Non-Convertible Debentures	Long term	250.00	ACUITE AA(SO)/Stable (Reaffirmed)
	Proposed Nonconvertible 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 Nonconvertible Debentures	Long term	250.00	ACUITE Provisional AA(SO)/Stable (Assigned)

***Annexure – Details of instruments rated**

ISIN	Name of the Facilities	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. Cr.)	Ratings/Outlook
Rs. 250.00 Cr.						
NA	Proposed Secured Non-convertible Debentures	NA	NA	NA	250.00	ACUITE Provisional AA/Stable (Assigned)
Rs. 250.00 Cr.						
INE818FO7096	Secured Non-convertible Debentures	09.07.2019	8.99	09-07-2023	250.00	ACUITE AA/Stable (Reaffirmed)
INE818FO7070	Secured Non-convertible Debentures	09.07.2019	8.99	09-07-2024		ACUITE AA/Stable (Reaffirmed)
INE818FO7062	Secured Non-convertible Debentures	09.07.2019	8.99	09-07-2025		ACUITE AA/Stable (Reaffirmed)
INE818FO7088	Secured Non-convertible Debentures	09.07.2019	8.99	09-07-2026		ACUITE AA/Stable (Reaffirmed)
Rs. 250.00 Cr.						
INE818FO7021	Secured Non-convertible Debentures	04.04.2018	8.69%	04.04.2022	250.00	ACUITE AA/Stable (Reaffirmed)
INE818FO7039	Secured Non-convertible Debentures	04.04.2018	8.69%	04.04.2023		ACUITE AA/Stable (Reaffirmed)
INE818FO7047	Secured Non-convertible Debentures	04.04.2018	8.69%	04.04.2024		ACUITE AA/Stable (Reaffirmed)
INE818FO7054	Secured Non-convertible Debentures	04.04.2018	8.69%	04.04.2025		ACUITE AA/Stable (Reaffirmed)
Rs. 250.00 Cr.						
INE818FO7013	Secured Non-convertible Debentures	09.05.2016	8.9 %	09.05.2020	250.00	ACUITE AA/Stable (Reaffirmed)
	Secured Non-convertible Debentures	09.05.2016	8.9 %	09.05.2021		ACUITE AA/Stable (Reaffirmed)
	Secured Non-convertible Debentures	09.05.2016	8.9 %	09.05.2022		ACUITE AA/Stable (Reaffirmed)
	Secured Non-convertible Debentures	09.05.2016	8.9 %	09.05.2023		ACUITE AA/Stable (Reaffirmed)

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About Acuité Ratings & Research:

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