

Press Release

Kerala Financial Corporation

August 18, 2020

Rating Reaffirmed



Total Facilities Rated*	Rs. 1000.00 Cr.
Instruments Rated*	Rs. 250.00 Cr.
Long Term Rating	ACUITE Provisional** AA/Stable (Reaffirmed)
Instruments Rated*	Rs. 250.00 Cr.
Long Term Rating	ACUITE AA/Stable (Reaffirmed)
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 reaffirmed the long term rating of '**ACUITE Provisional AA' (read as ACUITE provisional double A)** on the Rs. 250.00 Cr. Proposed Secured Non-Convertible Debentures of Kerala Financial Corporation (KFC). The outlook is '**Stable**'.

Acuité has reaffirmed the long term rating of '**ACUITE AA' (read as ACUITE double A)** on the Rs. 750.00 Cr. Secured Non-convertible debentures of KFC. The outlook is '**Stable**'.

About KFC:

Kerala Financial Corporation was incorporated in 1953, under the State Finance Corporations Act, 1951 by Government of Kerala, with an objective of rapid industrialization 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 reorganization 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 98.15 percent holding and the balance is held by banks and other financial institutions. As on March 31, 2020, the corporation operates in 14 districts of Kerala with a network of 16 branches and with headquarters at Thiruvananthapuram. Shri. Sanjay Kaul IAS is the current Chairman and Managing Director of KFC.

Analytical approach:

Acuité has considered the 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 the support of the presence of internal credit enhancement proposed in the form of Debt Service Reserve Account (DSRA) 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. Around 98.2 percent shareholding is held by Government of Kerala and balance is held by banks and financial institutions, as on March 31, 2020. The primary objective of KFC is to ensure rapid industrialization of the state of Kerala by extending financial assistance to MSMEs in the manufacturing and services sector in the state. KFC is a Nodal Agency for several policy initiatives by the State Government of Kerala and is responsible for implementing the state's policy initiatives announced in the annual state budget. Besides long term financial assistance, KFC has also started offering short term products such as bill discounting scheme for government contractors backed by promissory notes from GoK. It also has various entrepreneurial schemes to support various start-ups. The board of KFC primarily comprises representation from Government of Kerala. The Board of Directors comprises of 3 bureaucrats appointed by the Government of Kerala and the others representing SIDBI, LIC of India and State Bank of India (erstwhile State bank of Travancore). The primary focus of the Corporation during FY 2020-21 will be to launch new loan schemes to help MSMEs, start-up entrepreneurs and existing units to overcome the challenges faced due to the COVID-19 outbreak. KFC's loan portfolio stood at ~Rs. 3352 Cr as on March 31, 2020 as against ~Rs. 2684 Cr. as on March 31, 2019.

KFC's funding profile is supported by the State Government's moral obligation to provide on-going support for growth and development of the state and also in times of distress. As a part of the annual budget, KFC received approval of Rs.200 Cr. of capital infusion from GoK, wherein Rs.110 Cr. was infused in March 2020 and balance to be infused in current fiscal. KFC's capitalization levels remained adequate at 22.40 percent as on March 31, 2020 (19.24 percent as on March 31, 2019). KFC's funding mix comprises equity contribution from its shareholders primarily GoK, Non-Convertible Debentures(NCDs) and bank borrowings. Of the overall outstanding borrowings ~Rs.3028 Cr. as on March 31, 2020, bank borrowings comprise ~65 percent (~Rs.1979 Cr.) and balance ~35 percent (~Rs.1049 Cr.) comprise NCDs. Of the total NCDs of Rs.~1049 Cr.,~298 Cr. comprise NCDs guaranteed by GoK. The ownership by the GoK enables KFC to borrow at fine pricing from various banks and institutions.

The support from GoK is critical to the rating and thus, the credit profile of Kerala state is a key rating sensitivity. Kerala's fiscal deficit stood at 3.0 per cent of the GSDP for FY2019-20 (RE) (3.45 per cent for 2018-19(A)). The outstanding debt of Kerala state as a percentage of GSDP remained over 30 percent for 2019- 20 (RE) and 2018-19. The state's revenue deficit for 2019-20(RE) stood at 2.01 percent of GSDP (2.23 percent for 2018-19(A)). The state's fiscal headroom is expected to be impacted by the recent COVID-19 outbreak. While this has been a secular trend impacting almost all the states, the near to medium outlook on the fiscal profile will depend on the speed of recovery of economic activity over the next one year. Acuite believes, while there could be some impact on fiscal metrics in the current year that is FY 2021 due to the pandemic and the resultant increased spending required, the policy responses of the state to the current situation will be key determinants of its near to medium-term fiscal profile.

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

- **Maintenance of principal cash collateral, DSRA along with the 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 the presence of Structured Payment Mechanism wherein amount equivalent to principal repayment

of the 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 the 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 a rolling basis.

The cash collateral and DSRA will be lien marked to the debenture trustee and in the event of principal or interest is 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 utilized would be permitted to remain invested in fixed deposits with scheduled commercial banks having a rating of A1+ or higher for short term deposits and AA rating or higher for long term deposits, Central or State Government securities (G Sec/T- Bills /SDL) or corporate bonds/debentures issued by PSUs, Financial institutions, Insurance Companies, scheduled commercial banks, government-owned NBFCs, having a rating of AA or higher by at least two SEBI 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 on-going basis.

Weaknesses:

- **Moderate asset quality and profitability; leveraged capital structure impacting further debt raising ability**

The pandemic and resultant lockdowns have impacted the movement of men and goods across the country. Several businesses have been impacted and the impact has been more severe on the MSME segment. The disruption in business activities is more pronounced in sectors like hospitality and real estate. KFC's loan portfolio is mostly skewed towards services segment. The hospitality and Construction Real Estate (CRE) segment comprised around ~38 percent of the total loan book of ~Rs.3352 Cr. as on March 31, 2020. The current operating environment is likely to result in considerable disruption in both these segments over the near to medium term, thereby impacting the credit profiles of the borrowers. This, in turn, is likely to cause asset quality pressures and high incidence of credit costs for players like KFC. KFC has also faced significant asset quality pressures and credit costs in the past. The corporation's gross non-performing assets (GNPAs) stood at ~4.7 percent as on March 31, 2020 as compared to ~5.8 percent as on March 31, 2019. The corporation has incurred significant write-offs of ~Rs.107 Cr. in FY 2020 and ~Rs.168 Cr. in FY 2019.

The profitability of KFC has been impacted because of the high credit cost and the ROAA has always been below ~1 percent over the past three years. The corporation's return on average assets (ROAA) stood at ~0.5 percent for FY 2020 (~0.6 percent for FY 2019). KFC has traditionally relied on a high level of debt to sustain its business growth. The corporation is presently geared at ~5.2 times as on March 31, 2020 compared to ~4.9 times as on March 31, 2019. Most of its debt is by way of bank borrowings and long term NCDs. KFC is also attempting to gradually optimize

its cost of borrowings so as to improve its profitability. Acuite believes that KFC could face challenges in raising additional debt due to its leveraged capital structure.

Acuite believes that KFC could face elevated challenges in maintaining asset quality pressures over FY 2021. The ability to maintain healthy growth in loan book while maintaining asset quality in a subdued operating environment will be a key monitorable.

Acuite believes that even in the event of high credit costs impacting KFC's operating performance and its profitability, the continued support from GoK will help in maintaining capitalization buffers. Acuite believes that KFC will play a pivotal role in Kerala state's development over the near to medium term.

Rating Sensitivities

- Credit profile of Kerala Government and timely support to KFC
- Ownership of GoK
- Adherence to Structured Payment Mechanism
- Significant changes in asset quality, profitability and liquidity.

Material Covenants:

KFC is subject to covenants stipulated by its lenders/investors in respect of various parameters like capital structure, asset quality, among others. The company is adhering to all terms and conditions stipulated as covenants by all its lenders/investors.

Liquidity Position: Adequate

KFC has adequately matched asset-liability profile as per the ALM statement as on March 31, 2020. Around ~28 % of advances mature within one year vis. a vis. ~22 % of borrowings that mature within one-year. During FY 2020, GoK infused ~Rs.110 Cr of equity capital in KFC as a part of the ~Rs.200 Cr. of capital infusion received during the annual budget in February 2020. The corporation is expected to receive continuous support from GoK as result of being strategically important to the state's development.

KFC's liquidity profile is supported by unencumbered cash and bank balance of ~Rs. 174 Cr. as on March 31, 2020 and unavailed bank lines (term loans) of ~Rs.435 Cr. as on March 31, 2020. The support from GoK should help KFC for any refinancing if needed. Further, while KFC's ~44 percent portfolio is currently under a moratorium from March 2020 till August 2020, the corporation, in turn, has not availed moratorium from any of their lenders both under phase 1 (May 2020) and phase 2 (till August 2020). Further, as per confirmation from the client, Acuite understands that KFC has paid most of the dues ahead of the regular schedule to most of its lenders.

Outlook: Stable

Acuite believes that KFC will maintain a 'Stable' outlook over the medium term mainly supported by the presence of DSRA and SPM along with continued support from the GoK. The outlook may be revised to positive in case of a 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 significant deterioration in asset quality 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	FY20(Actual)	FY19(Actual)
Total Assets	Rs. Cr.	3860.40	2949.94
Total Income*	Rs. Cr.	114.92	129.76
PAT	Rs. Cr.	18.38	17.69
Net Worth	Rs. Cr.	584.75	457.41
Return on Average Assets (RoAA)	(%)	0.54	0.61
Return on Average Net Worth (RoNW)	(%)	3.53	3.94
Total Debt/Tangible Net Worth (Gearing)	Times	5.18	4.95

Gross NPA	(%)	4.74	5.77
Net NPA	(%)	1.45	1.82

* 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-52.htm>
- Financial Ratios And Adjustments - <https://www.acuite.in/view-rating-criteria-53.htm>

Note on complexity levels of the rated instrument

<https://www.acuite.in/view-rating-criteria-55.htm>

Rating History (Upto last three years)

Date	Name of Instrument / Facilities	Term	Amount (Rs. Cr)	Ratings/Outlook
November 04, 2019	Proposed Secured Non-convertible debentures	Long term	250.00	ACUITE Provisional AA/Stable (Assigned)
	Secured Nonconvertible debentures	Long term	250.00	ACUITE AA/Stable (Reaffirmed)
	Secured Nonconvertible debentures	Long term	250.00	ACUITE AA/Stable (Reaffirmed)
	Secured Nonconvertible debentures	Long term	250.00	ACUITE AA/Stable (Reaffirmed)
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)

***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 (Reaffirmed)
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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