

## Press Release

### Kerala Financial Corporation

October 06, 2021

### Rating Reaffirmed



<b>Total Facilities Rated*</b>	Rs. 1000.00 Cr.
<b>Long Term Rating</b>	ACUITE AA/ Stable (Reaffirmed)

\*Refer Annexure for details

### Rating Rationale

Acuité has reaffirmed the long term rating of '**ACUITE AA**' (read as **ACUITE double A**) on the Rs. 1000.00 Cr Secured Non-convertible Debentures of Kerala Financial Corporation (KFC). The outlook is '**Stable**'.

The rating factors in the majority ownership of the Government of Kerala (98.54 percent) and KFC's strategic importance as financial institution for assistance of Micro, Small and Medium Enterprises (MSME) sector in the state. The rating takes into account the regular support from Government of Kerala as reflected in the recent equity infusion of Rs 200.00 Cr during FY2021 and its experienced management. KFC's capitalization levels remained adequate at 22.85 percent as on March 31, 2021. The rating also takes into account KFC's portfolio growth (Rs 4621.12 Cr. as on March 31, 2021 as against Rs 3351.90 Cr. as on March 31, 2020) driven by higher disbursements of Rs 3710 Cr during FY2021 as against Rs 1447 Cr during FY2020. By virtue of state government ownership and support, the corporation enjoys strong resource raising ability at lower cost of funds thereby maintaining comfortable liquidity buffers to meet its funding requirements. Also, the rating 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.

The rating is however constrained on account of concentration in MSME Sector comprising of 92.30 percent as on March 31, 2021, weakening of asset quality parameters and resultant impact on profitability. While on-time portfolio has declined to 68.70 percent as on June 2021 as against 81.57 percent as on March 2020, KFC reported GNPA (90+DPD) at 6.46 percent as on June 2021 as against 4.74 percent as on March 2020. Going forward, credit profile of Kerala state and KFC's systematic importance, KFC's ability to maintain asset quality and profitability would remain key monitorable.

### About the company

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 98.54 percent holding and the balance is headed by domestic banks and other institutions. As on March 31, 2021, the corporation operates in 14 districts of Kerala with a network of 16 branches. 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 systematically 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. 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).

The Government of Kerala is the 98.54 percent stakeholder in the corporation and is expected to support the corporation given its systemic importance to the state. KFC's capitalization levels remained adequate at 22.85 percent as on March 31, 2021 as against 22.40 percent as on March 31, 2020.

By virtue of state government ownership and support, the corporation enjoys strong resourcing raising ability at lower cost of funds thereby maintaining comfortable liquidity buffers to meet its funding requirements. KFC's funding profile is supported by the State Government's moral obligation to support the capitalization levels both on an ongoing basis and in the event of distress. KFC's funding mix comprises equity contribution from its shareholders primarily GoK, NCDs and borrowings from banks. Of the overall outstanding borrowings of Rs 4269.19 Cr. as on March 31, 2021, NCDs comprise ~22 percent and remaining ~77 percent is bank borrowings.

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 operationalized 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 business while extending working capital loans and term loans as its own products. KFC reported loan portfolio of Rs. 4141.90 Cr as on June 30, 2021 as against Rs. 3351.90 Cr. as on March 31, 2020.

Since the support from GoK is critical to the rating, the credit profile of Kerala state is of key importance. The state's fiscal headroom has been further impacted by the recent COVID outbreak. 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 utilized 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 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 with 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:**

- **Asset Quality and moderate profitability.**

The outbreak of COVID-19 and the intermittent lockdowns have significantly impacted the cash flows of the borrowers thereby impacting the collection efficiency and asset quality. Given the challenges, the delinquencies have increased and the company reported a 90+DPD at 6.46 percent as on June 30, 2021 (3.58 percent as on March 31, 2021) as against 4.74 percent as on March 31, 2020. This in turn, has led to higher provisioning and decline in the profitability in FY2021 (Rs 6.58 Cr for FY2021 as against Rs 18.37 Cr for FY2020). The corporation reported Net Interest margin of 3.01 percent in FY2021 as against 3.24 percent in FY2019. The profitability continues to be supported by lower operating expenses to earning assets of 0.82 percent for FY2021 as against 1.15 percent in FY2020 along with low average cost of borrowing of 8.15 percent in FY2021. The corporation's return on average assets stands at 0.14 percent as on March 31, 2021 (0.54 percent for FY 2020).

Acuité believes, given the challenges, the company's ability to manage the additional slippages while maintaining the profitability will be crucial.

#### **Liquidity Position-Adequate**

KFC's overall liquidity profile remains well matched with no negative cumulative mis-matches in near to medium term as per ALM dated March 31, 2021. The company is in talks with various lenders to raise long term debt. The company's liquidity position is supported by unencumbered Cash and Bank Balance of Rs 100.77 Cr as on March 31, 2021. The support from GoK should help KFC for any refinancing, if needed.

#### **Rating Sensitivity**

- Credit Profile of Kerala Government and timely support to KFC.
- Movement in Asset Quality and Profitability metrics.

#### **Material Covenants**

KFC is subject to covenants stipulated by its lenders/investors in respect of various parameters.

#### **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**

Particulars	Unit	FY21 (Actual)	FY20 (Actual)
Total Assets	Rs. Cr.	5340.88	3860.40

Total Income*	Rs. Cr.	137.75	114.92
PAT	Rs. Cr.	6.58	18.38
Net Worth	Rs. Cr.	678.35	584.75
Return on Average Assets (RoAA)	(%)	0.14	0.54
Return on Average Net Worth (RoNW)	(%)	1.04	3.53
Debt/Equity	Times	6.29	5.18
Gross NPA	(%)	3.58	4.74
Net NPA	(%)	1.48	1.45

\*Total income equals to Net Interest Income plus other income.

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

Not Applicable.

**Any other information**

None

**Applicable Criteria**

- Default Recognition - <https://www.acuite.in/view-rating-criteria-52.htm>
- Non- Banking Financing Entities - <https://www.acuite.in/view-rating-criteria-44.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 (Up to last three years)**

Date	Name of the Facilities	Term	Amount ( Rs Cr)	Ratings/Outlook
1-Oct-2020	Non-Convertible Debentures	Long Term	250.00	ACUITE AA/Stable (Assigned)
	Non-Convertible Debentures	Long Term	250.00	ACUITE AA/Stable (Reaffirmed)
	Non-Convertible Debentures	Long Term	250.00	ACUITE AA/Stable (Reaffirmed)
	Non-Convertible Debentures	Long Term	250.00	ACUITE AA/Stable (Reaffirmed)
18-Aug-2020	Proposed Non-Convertible Debentures	Long Term	250.00	ACUITE Provisional AA/Stable (Reaffirmed)
	Non-Convertible Debentures	Long Term	250.00	ACUITE AA/Stable (Reaffirmed)
	Non-Convertible Debentures	Long Term	250.00	ACUITE AA/Stable (Reaffirmed)
	Non-Convertible Debentures	Long Term	250.00	ACUITE AA/Stable (Reaffirmed)

4-Nov-2019	Proposed Non-Convertible Debentures	Long Term	250.00	ACUITE Provisional AA/Stable (Assigned)
	Non-Convertible Debentures	Long Term	250.00	ACUITE AA/Stable (Reaffirmed)
	Non-Convertible Debentures	Long Term	250.00	ACUITE AA/Stable (Reaffirmed)
	Non-Convertible Debentures	Long Term	250.00	ACUITE AA/Stable (Reaffirmed)
31-Jan-2019	Proposed Non-Convertible Debentures	Long Term	250.00	ACUITE Provisional AA (SO) /Stable (Assigned)
	Non-Convertible Debentures	Long Term	250.00	ACUITE AA (SO) /Stable (Reaffirmed)
	Non-Convertible Debentures	Long Term	62.50	ACUITE AA (SO) /Stable (Assigned)
	Non-Convertible Debentures	Long Term	62.50	ACUITE AA (SO) /Stable (Assigned)
	Non-Convertible Debentures	Long Term	62.50	ACUITE AA (SO) /Stable (Assigned)
	Non-Convertible 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 Non-Convertible Debentures	Long Term	250.00	ACUITE Provisional AA (SO) /Stable (Assigned)

**\*Annexure – Details of instruments rated**

Lender Name	Name of the Facilities	Date of Issuance	Coupon Rate	Date of Maturity	Size of the Issue (Rs. Cr.)	Rating/Outlook
Not Applicable	Secured Non-Convertible Debentures (Series 1/2020)	Not Applicable	Not Applicable	Not Applicable	250.00	ACUITE AA /Stable (Reaffirmed)
Not Applicable	Secured Non-Convertible Debentures (Series 1/2019)	Not Applicable	Not Applicable	Not Applicable	250.00	ACUITE AA /Stable (Reaffirmed)
Not Applicable	Secured Non-Convertible Debentures (Series 1/2018)	Not Applicable	Not Applicable	Not Applicable	250.00	ACUITE AA /Stable (Reaffirmed)
Not Applicable	Secured Non-Convertible Debentures (Series 1/2016)	Not Applicable	Not Applicable	Not Applicable	250.00	ACUITE AA /Stable (Reaffirmed)

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### About Acuite Ratings & Research:

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