

Press Release

Karnataka State Finance Corporation

September 30, 2020



Rating Assigned

| | |
|-------------------------------------|--|
| Total Bank Facilities Rated* | Rs. 700.00 Cr. |
| Long Term Rating | ACUITE AA(CE)/ Outlook: Stable (Assigned) |

* Refer Annexure for details

Rating Rationale

Acuité has assigned the long term rating of '**ACUITE AA (CE)**' (**read as ACUITE double A Credit Enhancement**) on the Rs. 700 crore of bank facilities of Karnataka State Finance Corporation. The outlook is '**Stable**'

About the company

Karnataka State Finance Corporation (KSFC) was established in 1959 under the SFCs' Act, 1951 to provide long term loans to Micro, Small and Medium Enterprises (MSMEs) in the State of Karnataka. The loans are provided for the establishment of new industries and expansion, modernization, diversification of existing industries. The corporation was established to play a pivotal role in the industrial and economic development of the state of Karnataka.

Government of Karnataka (GoK) is the majority stakeholder with 91.9 percent holding. Out of the balance, 8.1 percent is held by SIDBI and banks and other financial institutions hold the balance. As on March 31, 2020, the corporation operates in 30 districts of Karnataka with a network of 32 branches.

Analytical Approach

Acuité has considered the standalone approach while assessing the business and financial risk profile of KSFC and has factored in the financial and managerial support it receives from the Government of Karnataka. The rating also factors in the guarantee from the Government of Karnataka for the rated bank facilities.

Standalone Rating

ACUITE BBB/Stable (Assigned)

Key Rating Drivers

Strengths

• Ownership and Support from Government of Karnataka:

KSFC is a state finance corporation established under the SFC Act, 1951. Around 91.9 percent shareholding is held by Government of Karnataka. The corporation is headquartered at Bengaluru and has a network of 32 branches across 30 districts. The primary objective of KSFC is to provide loans for the establishment of new industries and expansion, modernization, diversification of existing industries in the state of Karnataka. KSFC's loan portfolio at ~Rs. 2,208.25 Cr as on March 31, 2020 as against ~Rs. 1,948.87 Cr. as on March 31, 2019.

KSFC'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 in times of distress. As a part of the annual budget, KSFC received approval of Rs.100 Cr. of capital infusion from Government of Karnataka, out of which Rs.50 Cr. was infused in August 2020 and balance to be infused in current fiscal. The corporation's capitalization levels remained adequate at 31.8 percent as on March 31, 2020 (28.7 percent as on March 31, 2019). The corporation's funding mix comprises equity contribution from its shareholders primarily GoK, Bonds and bank borrowings. Of the overall outstanding borrowings, ~Rs.1565 Cr. as on March 31, 2020, Bonds comprise ~68 percent (~Rs.1,067 Cr.) and balance ~32 percent (~Rs.495 Cr.) comprise of bank borrowings. All of the above borrowings are guaranteed by GoK the ownership by the GoK enables KSFC 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 Karnataka state is a key rating sensitivity.

Karnataka's fiscal deficit stood at 2.28 per cent of the GSDP for FY2019-20(RE) (2.73 per cent for 2018-19(A)).

The outstanding debt of Karnataka state as a percentage of GSDP stood at 18.2 percent for 2019- 20 (RE) (19.2 percent in 2018-19(A)). The state's revenue surplus for 2019-20(RE) stood at 0.02 percent of GSDP (0.05 percent for 2018-19(A)). The state's primary deficit stood at 1.18 percent for FY2019-20 (RE) (1.63 percent for 2018-29(A)). In 2019-20, agriculture, manufacturing and services contributed 10 percent, 26 percent and 64 percent respectively. The state's fiscal headroom is expected to be impacted by the overall challenging economic environment triggered by the 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. Acuité 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.

Besides the financial support, the board of KSFC primarily comprises representation from Government of Karnataka the Board of Directors comprises of 4 bureaucrats appointed by the Government of Karnataka and the others representing SIDBI, LIC of India, Apex Bank and a Chartered Accountant. Dr. Ekoop Caur, IAS is the current managing director.

Acuité 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.

Weaknesses

• Moderate Asset Quality

The corporation's gross non-performing assets (GNPAs) stood at ~9.6 percent as on March 31, 2020 as compared to ~12.0 percent as on March 31, 2019. KSFC has been incurring significant credit costs over the past 2-3 year. The write-offs were Rs. 27.62 Cr in FY2020 and Rs.72.25 Cr in FY2019. As on March 31, 2020, the top 20 NPAs comprise of 24.8% of overall NPAs. Most of the NPAs was in the Hospitality and Construction Sector. 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, Hospitality and Real Estate segment. The current operating environment is likely to result in a considerable disruption in 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. KSFC could face challenges in containing elevated pressures in containing asset quality.

Acuité believes that KSFC ability to grow a healthy loan portfolio while effectively containing asset quality stress will be a key rating sensitivity.

Liquidity Position: Adequate

KSFC has unencumbered cash and bank balance of ~Rs.82 Cr. as on August 31, 2020. The corporation is expected to receive continuous support from GoK as result of being strategically important to the state's development. During FY 2020, GoK infused ~Rs.100 Cr of equity capital in KSFC and Rs. 50 Cr in FY2021; they are expected to infuse additional Rs. 50 Cr by the end of the current fiscal. The corporation has monthly obligations (debt servicing obligation and operating expenses) of ~Rs. 20 Cr and its collections have improved to Rs. 10.73 Cr. which is estimated to be around 37% of the scheduled collection.

The corporation had granted blanket moratorium to all of its borrowers till the month of August 2020, KSFC however, has not availed moratorium from any of their lenders/investors till August 2020. The corporation is also in the process of receiving additional term loans from the bank in Q3FY2021.

Rating Sensitivity

- Credit profile of the Government of Karnataka
- Ownership of GoK
- Significant changes in asset quality
- Changes in Regulatory Environment

Material Covenants

As per confirmation received from client vide mail dated September 19, 2020. 'KSFC is adhering to all terms and conditions stipulated'

Assessment of Adequacy of Credit Enhancement

Not Applicable

Outlook: Stable

Acuite believes that KSFC will maintain a 'Stable' credit profile over the medium term mainly driven by the financial and managerial support from the GoK. The outlook may be revised to positive in case of a significant improvement in the credit profile of the guarantor coupled with an improvement in the standalone operational performance of KSFC. The outlook may be revised to negative in case of a sharp decline in the credit profile of GoK.

About the Rated Entity - Key Financials

| | Unit | FY20 (Actual) | FY19 (Actual) |
|------------------------------------|---------|---------------|---------------|
| Total Assets | Rs. Cr. | 2,487.14 | 2,045.78 |
| Total Income | Rs. Cr. | 185.20 | 154.66 |
| PAT | Rs. Cr. | 31.37 | 9.55 |
| Net Worth | Rs. Cr. | 744.92 | 606.31 |
| Return on Average Assets (RoAA) | (%) | 1.38 | 0.42 |
| Return on Average Net Worth (RoNW) | (%) | 4.90 | 1.26 |
| Debt/Equity | Times | 2.05 | 2.07 |
| Gross NPA | (%) | 9.60 | 12.00 |
| Net NPA | (%) | 4.88 | 5.71 |

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>
- Explicit Credit Enhancements - <https://www.acuite.in/view-rating-criteria-49.htm>
- State Government Support - <https://www.acuite.in/view-rating-criteria-26.htm>

Note on complexity levels of the rated instrument

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

Rating History (Upto last three years)

None

*Annexure – Details of instruments rated

| Name of the Facilities | Date of Issuance | Coupon Rate | Maturity Date | Size of the Issue | Ratings/Outlook |
|------------------------|------------------|-------------|---------------|-------------------|---------------------------------|
| Term Loan | 29.06.2019 | 7.20% | 30.06.2026 | 50.00 | ACUITE AA(CE)/Stable (Assigned) |
| Term Loan | 24.03.2020 | 7.95% | 31.03.2027 | 250.00 | ACUITE AA(CE)/Stable (Assigned) |

| | | | | | |
|------------------------|----------------|----------------|----------------|--------|---------------------------------|
| Term Loan | 22.11.2019 | 8.60% | 30.11.2025 | 100.00 | ACUITE AA(CE)/Stable (Assigned) |
| Term Loan | 16.12.2019 | 8.50% | 31.12.2026 | 150.00 | ACUITE AA(CE)/Stable (Assigned) |
| Proposed Bank Facility | Not Applicable | Not Applicable | Not Applicable | 150.00 | ACUITE AA(CE)/Stable (Assigned) |

Contacts

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About Acuité Ratings & Research:

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