Karnataka State Financial Corporation

November 30, 2017

Ratings

<table>
<thead>
<tr>
<th>Facilities</th>
<th>Amount (Rs. crore)</th>
<th>Rating(^1)</th>
<th>Rating Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unsecured Bonds Series I @</td>
<td>123 (123)</td>
<td>CARE AA-(SO); Stable [Double A Minus (Structured Obligation); Outlook: Stable]</td>
<td>Reaffirmed</td>
</tr>
<tr>
<td>Unsecured Bonds Series II @</td>
<td>100(100)</td>
<td>CARE AA-(SO); Stable [Double A Minus (Structured Obligation); Outlook: Stable]</td>
<td>Reaffirmed</td>
</tr>
<tr>
<td>Unsecured Bonds Series III @</td>
<td>200(200)</td>
<td>CARE AA-(SO); Stable [Double A Minus (Structured Obligation); Outlook: Stable]</td>
<td>Reaffirmed</td>
</tr>
<tr>
<td>Unsecured Bonds Series IV @</td>
<td>200(200)</td>
<td>CARE AA-(SO); Stable [Double A Minus (Structured Obligation); Outlook: Stable]</td>
<td>Reaffirmed</td>
</tr>
<tr>
<td>Unsecured Bonds Series V @</td>
<td>250(250)</td>
<td>CARE AA-(SO); Stable [Double A Minus (Structured Obligation); Outlook: Stable]</td>
<td>Reaffirmed</td>
</tr>
<tr>
<td>Unsecured Bonds Series VI @</td>
<td>235(235)</td>
<td>CARE AA-(SO); Stable [Double A Minus (Structured Obligation); Outlook: Stable]</td>
<td>Reaffirmed</td>
</tr>
<tr>
<td>Total Facilities</td>
<td>1108</td>
<td>(Rs. One Thousand One Hundred and Eight crore)</td>
<td></td>
</tr>
</tbody>
</table>

Details of instruments/facilities in Annexure-1
@ backed by unconditional and irrevocable guarantee from Government of Karnataka (GoK)

Detailed Rationale & Key Rating Drivers

The rating assigned to the bonds of Karnataka State Financial Corporation (KSFC) is primarily based on credit enhancement in the form of an unconditional and irrevocable guarantee from Government of Karnataka for the payment of interest and repayment of principal. The timely debt servicing is also facilitated by a structured payment mechanism (SPM).

The rating is reflective of the underlying strength of the financial position of the Government of Karnataka including strong adherence to fiscal targets, sustaining revenue surplus position and prudent liquidity management practices.

Karnataka state has been one of the financially and economically strongest states of the country. The state ranks high in ease of doing business and continues to enjoy a revenue surplus position. The state’s economy witnessed moderation during FY17 however the growth has been in line with the national growth rate. The state continued to maintain its fiscal strength while adhering to the fiscal management guidelines prescribed by the Finance Commission and FRBM.

Detailed description of the key rating drivers

Key Rating Strengths

Leading state economy, recording favorable economic growth

The state’s economy grew by 6.9% in FY17 over the 7.3% growth of the previous year. The state’s GSDP growth has been fairly in line with the national growth rate of 7.1% in FY17. All the key sectors recorded positive growth rates in FY17. Karnataka ranked 13th in the states in the country in ease of doing business.

\(^1\) Complete definition of the ratings assigned are available at www.careratings.com and other CARE publications
Press Release

Sustained Revenue surplus utilized majorly for capital creation
Karnataka has been sustaining a revenue surplus over the last 12 years. In FY17 (RE), the revenue surplus was at Rs. 1,063 crores. The state utilizes its revenue surplus towards capital creation, crucial for the future growth potential of the economy.

Fiscally strength and adherence to fiscal discipline
The state continues to be fiscally strong and has been found to be adopting prudent fiscal management practices. The state has been in adherence to the fiscal management guidelines prescribed by the Finance Commission and FRBM i.e. having a zero revenue deficit, maintaining its fiscal deficit below 3% of GSDP, interest to revenue receipts at 9.3% (FY17) is below the 10% norm and the debt to GSDP ratio at 17.8% (FY17) is below the target of 25%.

Eligible for fiscal flexibility under 14th Finance commission
Karnataka is eligible for the fiscal flexibility under the 14th Finance Commission i.e. to have an additional 0.5% of fiscal deficit to GSDP ratio as it has a revenue surplus and its interest to revenue receipts ratio has been less than 10% and debt to GSDP below 25%

Self-reliant
The state is largely self-reliant with its own revenue (tax and non-tax) making up for the major share in its revenue receipts (around 70% of its revenues comes from its own sources).

Increased share in Central taxes
Karnataka’s share in central taxes has increased under the 14th Finance Commission to 4.71% from 4.33% during the 13th Finance Commission. Tax allocations from the Centre have registered a notable increase since FY16. It grew by 63.7% in FY16 and 19.9% in FY17.

Focus on capacity building
The state is incurring higher expenditure towards capital creation. Capital outlay grew by 19.6% in FY17 (RE) following the 5.6% growth in FY16. Irrigation, transport, agriculture and social services such as welfare of SC, ST and OBCs are the focus areas of capital outlay.

Prudent liquidity management and maintenance of CSF to meet contingencies
The state has not availed of Ways and Means Advances (WMA) from the RBI in the last 8 years, reflecting its prudent liquidity management and has established a Consolidated Sinking Fund (CSF) which has a corpus of Rs. 2,340.33 Cr as on March 31, 2016.

Key Rating Weaknesses
High levels of debt
The state’s outstanding debt stands at over Rs. 2 lakh crores year ended March’17. There was a 14.5% growth (y-o-y) in the outstanding debt of the state in FY17 (RE).

Likely pressure on state finances
Farm loan waiver amounting to Rs. 8,167 crores has been announced by the government. Further the State PSU losses have risen in recent years; it grew by 54.6% during FY13-16 which is likely to pressure the state finances. However, the farm loan waiver has not been included in the FY18 budget and is likely to be a part of the supplementary budget and the expenditure towards the same is likely to be spread over the next 2 years.

Analytical approach:
Credit enhancement in the form of unconditional and irrevocable guarantee from Government of Karnataka (GoK).

Applicable Criteria
CARE’s Policy on Default Recognition
CARE’s Criteria on assigning Outlook to Credit Ratings
State Governments
Factoring Linkages in Ratings
About the Company

Karnataka State Financial Corporation (KSFC) was incorporated in 1959, under the State Finance Corporations Act, 1951 by Government of Karnataka (GoK), with a mandate for assisting small and medium enterprises in the state with special focus to the industrially backward areas. GoK is the majority shareholder (96.48%) in the Corporation whereas SIDBI holds 3.49%.

<table>
<thead>
<tr>
<th>Brief Financials (Rs. crore)</th>
<th>FY16 (A)</th>
<th>FY17 (A)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total operating income</td>
<td>311.2</td>
<td>299.4</td>
</tr>
<tr>
<td>PAT</td>
<td>32.1</td>
<td>29.9</td>
</tr>
<tr>
<td>Interest coverage (times)</td>
<td>1.2</td>
<td>1.2</td>
</tr>
<tr>
<td>Total Assets</td>
<td>2608.7</td>
<td>2613.0</td>
</tr>
<tr>
<td>Net NPA (%)</td>
<td>8.8</td>
<td>5.8</td>
</tr>
<tr>
<td>ROTA (%)</td>
<td>1.2</td>
<td>1.1</td>
</tr>
</tbody>
</table>

A: Audited

Status of non-cooperation with previous CRA: Not Applicable
Any other information: Not Applicable
Rating History for last three years: Please refer Annexure-2
Note on complexity levels of the rated instrument: CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.

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**For detailed Rationale Report and subscription information, please contact us at www.careratings.com

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Disclaimer

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In case of partnership/proprietary concerns, the rating/outlook assigned by CARE is based on the capital deployed by the partners/proprietor and the financial strength of the firm at present. The rating/outlook may undergo change in case of withdrawal of capital or the unsecured loans brought in by the partners/proprietor in addition to the financial performance and other relevant factors.
Annexure-1: Details of Instruments/Facilities

<table>
<thead>
<tr>
<th>Name of the Instrument</th>
<th>Date of Issuance</th>
<th>Coupon Rate</th>
<th>Maturity Date</th>
<th>Size of the Issue (Rs. crore)</th>
<th>Rating assigned along with Rating Outlook</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonds-Redeemable Non-Convertible Unsecured Taxable Bonds</td>
<td>June 24, 2017</td>
<td>8.39%</td>
<td>June 24, 2020</td>
<td>123.00</td>
<td>CARE AA- (SO); Stable</td>
</tr>
<tr>
<td>Bonds-Redeemable Non-Convertible Unsecured Taxable Bonds</td>
<td>January 25, 2011</td>
<td>8.60%</td>
<td>January 25, 2022</td>
<td>100.00</td>
<td>CARE AA- (SO); Stable</td>
</tr>
<tr>
<td>Bonds-Redeemable Non-Convertible Unsecured Taxable Bonds</td>
<td>October 18, 2012</td>
<td>9.24%</td>
<td>October 18, 2024</td>
<td>200.00</td>
<td>CARE AA- (SO); Stable</td>
</tr>
<tr>
<td>Bonds-Redeemable Non-Convertible Unsecured Taxable Bonds</td>
<td>February 04, 2017</td>
<td>9.08%</td>
<td>February 04, 2025</td>
<td>200.00</td>
<td>CARE AA- (SO); Stable</td>
</tr>
<tr>
<td>Bonds-Redeemable Non-Convertible Unsecured Taxable Bonds</td>
<td>September 01, 2014</td>
<td>9.19%</td>
<td>September 01, 2024</td>
<td>250.00</td>
<td>CARE AA- (SO); Stable</td>
</tr>
<tr>
<td>Bonds-Redeemable Non-Convertible Unsecured Taxable Bonds</td>
<td>December 26, 2014</td>
<td>8.58%</td>
<td>December 26, 2020</td>
<td>235.00</td>
<td>CARE AA- (SO); Stable</td>
</tr>
</tbody>
</table>

Annexure-2: Rating History of last three years

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Name of the Instrument/Bank Facilities</th>
<th>Type</th>
<th>Amount Outstanding (Rs. crore)</th>
<th>Current Ratings</th>
<th>Rating</th>
<th>Date(s) &amp; Rating(s) assigned in 2017-2018</th>
<th>Date(s) &amp; Rating(s) assigned in 2016-2017</th>
<th>Date(s) &amp; Rating(s) assigned in 2015-2016</th>
<th>Date(s) &amp; Rating(s) assigned in 2014-2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Bonds</td>
<td>LT</td>
<td>123.00</td>
<td>CARE AA- (SO); Stable</td>
<td>-</td>
<td>1)CARE AA- (SO) (07-Oct-16)</td>
<td>1)CARE AA- (SO) (05-Jan-16)</td>
<td>1)CARE AA- (SO) (27-Nov-14)</td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td>Bonds</td>
<td>LT</td>
<td>100.00</td>
<td>CARE AA- (SO); Stable</td>
<td>-</td>
<td>1)CARE AA- (SO) (07-Oct-16)</td>
<td>1)CARE AA- (SO) (05-Jan-16)</td>
<td>1)CARE AA- (SO) (27-Nov-14)</td>
<td></td>
</tr>
<tr>
<td>3.</td>
<td>Bonds-Redeemable Non-Convertible Unsecured Taxable Bonds</td>
<td>LT</td>
<td>200.00</td>
<td>CARE AA- (SO); Stable</td>
<td>-</td>
<td>1)CARE AA- (SO) (07-Oct-16)</td>
<td>1)CARE AA- (SO) (05-Jan-16)</td>
<td>1)CARE AA- (SO) (27-Nov-14)</td>
<td></td>
</tr>
<tr>
<td>4.</td>
<td>Bonds-Redeemable Non-Convertible Unsecured Taxable Bonds</td>
<td>LT</td>
<td>200.00</td>
<td>CARE AA- (SO); Stable</td>
<td>-</td>
<td>1)CARE AA- (SO) (07-Oct-16)</td>
<td>1)CARE AA- (SO) (05-Jan-16)</td>
<td>1)CARE AA- (SO) (27-Nov-14)</td>
<td></td>
</tr>
<tr>
<td>7.</td>
<td>Issuer Rating-Issuer Ratings</td>
<td>Issuer Rating</td>
<td>0.00</td>
<td>CARE BBB- (Is); Stable</td>
<td>-</td>
<td>1)CARE BBB- (Is); Stable (28-Feb-17)</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>
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