

Karnataka State Financial Corporation

August 08, 2024

Facilities/Instruments	Amount (₹ crore)	Rating ¹	Rating Action
Issuer rating	-	CARE BBB; Stable	Reaffirmed
Redeemable non-convertible unsecured taxable bonds@	100.00 (Reduced from 200.00)	CARE AA- (CE); Negative	Reaffirmed
Redeemable non-convertible unsecured taxable bonds@	50.00 (Reduced from 100.00)	CARE AA- (CE); Negative	Reaffirmed
Redeemable non-convertible unsecured taxable bonds@	100.00 (Reduced from 175.00)	CARE AA- (CE); Negative	Reaffirmed

Details of instruments/facilities in Annexure-1.

@ Credit enhancement in the form of an unconditional and irrevocable guarantee from Government of Karnataka.

Unsupported rating	CARE BBB [Reaffirmed]
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Note: Unsupported rating does not factor in the explicit credit enhancement.

Rationale and key rating drivers for credit enhanced debt

Ratings assigned to bonds of Karnataka State Financial Corporation (KSFC) is primarily based on the credit enhancement (CE) in the form of an unconditional and irrevocable guarantee from Government of Karnataka (GoK) for the payment of interest and repayment of principal.

Rationale and key rating drivers of GoK

Ratings derive comfort from the state recording favourable economic growth in FY24 driven by sizeable tax potential of its service-driven economy with satisfactory growth rate and its high ranking in ease of doing business. Ratings take cognisance of the state's healthy demographic profile, aided by consistently above-average per capita income and growth, high share of the urban population, relatively better social indicators and satisfactory education infrastructure. Ratings also derive comfort from availability of other infrastructure, marked by high per capita power consumption, moderate rail and road density, moderate availability of natural resources, and significantly improved irrigation potential over the years.

Despite slippage into revenue deficit position, the state has been exhibiting reasonable fiscal strength and resilience. The state has been adhering to most of the fiscal consolidation norms prescribed by the Finance Commission in FY24 (RE) and FY25 (BE) in terms of controlling its fiscal deficit and sustainability of its debt obligations. The state is self-reliant with over 75% of its revenues comprising own revenue sources. Karnataka has also been following prudent liquidity management practices and maintaining a consolidated sinking fund (CSF) and guarantee redemption fund (GRF).

Rating strengths are tempered due to a significant increase in expenditure without commensurate revenue receipts resulting in increased borrowings. The increase in committed expenditure due to the implementation of 7th pay commission and payments under the guarantee scheme are expected to weigh down the state's finances in coming years. Ratings are also constrained due to increase in the outstanding debt and guarantee levels and a declining trend in capital outlay.

Rating sensitivities: Factors likely to lead to rating actions

Positive factors

- Attainment of revenue surplus on a sustained basis.
- Sustained adherence to the fiscal consolidation norms prescribed by the Finance Commission.
- Significantly reducing (debt + guarantees) to gross state domestic product (GSDP) to below 18%.

Negative factors

- Widening of revenue deficit.
- Sustained non-adherence to fiscal consolidation targets prescribed by the Finance Commission for fiscal deficit and debt parameters.
- Sustained worsening of (debt + guarantees) to GSDP.
- Loan waivers /higher subsidy outlay among others that could pressurise state finances.

¹Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

Analytical approach:

Credit enhanced debt: Based on CEt in the form of an unconditional and irrevocable guarantee from GoK- Guarantor's assessment.

Issuer rating and unsupported rating: Standalone, and systemic importance to GoK.

Outlook: Negative

Anticipated rise in revenue deficit levels, leading to moderation in fiscal ratios due to increased borrowings is the reason for maintaining the negative outlook. However, if the state manages to enhance fiscal ratios, the outlook may be revised to stable.

Detailed description of key rating drivers-GoK**Key strengths****Service sector-driven economy with high economic potential**

Karnataka, being one of the fastest expanding economies in India, holds significant economic potential. Despite representing ~5% of India's population, the state contributes to 8.7% of the national GDP. As one of the country's most developed and reform-oriented states, Karnataka's economic profile and finances are robust. The services sector remains a major contributor, accounting for over 66.7% of the state's Gross State Value Added (GSVA) in FY24, an increase of 1.3% from the previous year's share of 65.4%.

Adherence to most fiscal consolidation norms

In FY24 (RE), the state demonstrated prudent financial management by adhering to most of the fiscal consolidation norms set by the Finance Commission. Fiscal deficit was effectively managed, remaining well within the 3.00% of GSDP norm at 2.67% in FY24 (RE), and is projected to be 2.95% in FY25 (BE). Ratio of interest/revenue receipts stayed within the 15% limit in FY24 (RE) and is anticipated to maintain this trend in FY25 (BE). Debt to GSDP declined to 22.64% in FY24 (RE), below the 25% norm and is expected to remain below 25% per FY25 (BE).

Self-reliance

The state continues to exhibit considerable self-reliance, with over 75% of its revenues originating from its own sources, including tax and non-tax sources for FY24.

Maintenance of contingency funds

Since FY13, the state has maintained a consolidated sinking fund (CSF) with the Reserve Bank of India (RBI) for the amortisation of its debt obligations. As on May 31, 2024, the fund held a corpus of ₹17,346 crore. Additionally, the state has maintained a guarantee redemption fund (GRF) of ₹527 crore as on May 31, 2024, which is equivalent to over 1% of its total guarantees.

Key weaknesses**Revenue deficit budgeted to be sizable**

State's finances recovered in FY23, after being adversely impacted by COVID-19, and recorded revenue surplus of ₹13,496 crore due to receipt of sizeable goods and services tax (GST) compensation grant from central government. However, with discontinuation of this GST grant from FY24 onwards and the anticipated increase in committed revenue expenditure due to introduction of the five populist guarantee schemes and implementation of 7th pay commission, the state is budgeted to record a revenue deficit of ₹13,951 crore and ₹27,354 crore in FY24 (RE) and FY25 (BE), , 0.54% and 0.97% of the GSDP, respectively. Expenditure under guarantee schemes in FY24 (RE) and FY25 (BE) is estimated to be ₹33,468 crore and ₹52,009 crore, respectively. State's ability to improve fiscal ratios and control the revenue deficit, considering increasing expenditures shall be a key rating monitorable.

Increase in debt and guarantees

The state has elevated debt levels. State's outstanding debt per FY24 (RE) is estimated to be at ₹5.67 lakh crore, an increase of 12.3% over the previous year. Also, its debt to GSDP ratio stood at 22.11%, per FY24 (RE). Debt is budgeted to increase by 15.8% to ₹6.57 lakh crore and debt to GSDP is budgeted to be at 23.41% per FY25 (BE). Increase in the state's indebtedness state is mainly to fund the capital outlay and increasing revenue deficit. However, the state is seen to be taking measures to increase tax and non-tax revenues to improve its fiscal ratios.

There has also been an increase in guarantees extended by the state government to state entities. The state's outstanding guarantees rose to ₹38,356 crore as on March 2023, 16% over the previous year. Guarantees were mainly extended to irrigation (38%), power (47%), housing and urban development (5%). Off-budget borrowings in FY25 are budgeted to be ₹7,507 crore, 44% lower than outstanding off-budget borrowings in FY24.

Declining focus on asset creation

State government has been historically incurring sizable expenditures towards asset creation. However, capital outlay which accounted for nearly 75% of the state's total capital expenditure in FY23 is estimated to decline to 66% and 65% in FY24 (RE) and FY25 (BE), respectively. The state's capital outlay is mainly concentrated towards irrigation and flood control, transport, agriculture and related works and urban development.

Liquidity: Adequate

The state has not availed ways and means advances (WMA) facility from RBI in FY24, reflective of its prudent liquidity management practices.

Rationale and key rating drivers of Karnataka State Financial Corporation (KSFC)

KSFC's issuer rating continues to derive strength from strong parentage of GoK holding 96.14% stake (bonds guaranteed by GoK are rated 'CARE AA-(CE); Negative'), consistent support from GoK by equity infusion leading to comfortable capital adequacy levels, and gearing levels of the corporation, which witnessed consistent improvement over the years. Additionally, KSFC's long operational track record of over six decades, adequate liquidity position and consistent profitability achieved are the positive factors contributing to ratings. Ratings also favourably factors in the structured payment mechanism in place for repayment of bonds. These rating strengths are partially offset by weak asset quality of the corporation despite decrease in gross stressed asset position in FY24 and inherent risk associated with its customer segment.

Rating sensitivities: Factors likely to lead to rating actions-KSFC**Positive factors**

- Improving scale, profits, and asset quality on a sustained basis.

Negative factors

- Higher slippages impacting asset quality and profitability with return on total assets (ROTA) less than 1% on a sustained basis.
- Overall gearing exceeding 3x.
- Moderating support from GoK.

Outlook: Stable

CARE Ratings Limited (CARE Ratings) believes that the entity will sustain its business and financial risk profiles with credit cost under control over the medium term.

Detailed description of key rating drivers-KSFC**Key strengths****Strong parentage and support from GoK**

KSFC is backed by a strong promoter with GoK as the major shareholder with a 96.14% stake as on March 31, 2024. Owing to healthy capital adequacy levels maintained by the corporation, there were no equity infusions in FY24. GoK consistently infused funds in the past to support KSFC's operations. The corporation also receives support from GoK in the form of interest subsidy. In FY24, KSFC received ₹159.67 crore of interest subsidy (FY23: ₹173.62 crore) towards schemes for SC/ST, women entrepreneur and Ministry of Micro, Small & Medium Enterprises (MSME) borrowers.

Comfortable capital adequacy levels

Capital adequacy ratio (CAR) and Tier-1 CAR stood comfortable at 60.15% and 56.59%, respectively, as on March 31, 2024, as against 55.95% and 51.59% as on March 31, 2023. Improvement in CAR is considering accretion of healthy profit in FY24. This provides KSFC with sufficient cushion to absorb elevated provisioning costs, especially considering the relatively high share of stressed assets in the portfolio.

Comfortable gearing levels and structured payment mechanism for repayment of bonds

Aided by profit accretion, and scheduled repayments made, KSFC's gearing levels continued to remain comfortable and witnessed improvement from 0.67x as on March 31, 2023, to 0.54x as on March 31, 2024. Total debt outstanding as on March 31, 2024, stood at ₹684 crore. KSFC's borrowing profile consists of bond issues, which are entirely guaranteed by GoK. KSFC follows structured payment mechanism for repayment of bonds (structure explained in Annexure-3). KSFC also has bank borrowings and it may be noted that KSFC started borrowing without state government guarantee in FY24.

Steady profitability

In FY24, net interest margin witnessed improvement to 9.96% as compared to 8.94% in FY23 with decline in overall reliance on borrowings. KSFC's operational efficiency remained stable with operating expense to total assets at 3.86% in FY24 as compared to 3.62% in FY23 and cost to income ratio stood at 34.11% in FY23 (32.31% in FY23). However, considering lower other income owing to lower recoveries of ₹18.88 crore in FY24 as against ₹40.60 crore in FY24, pre-provision operating profit (PPOP) witnessed decline of 3.6% in FY24 to ₹170 crore (FY23: ₹177 crore). Credit costs witnessed decline to 1.53% in FY24 as against 1.62% in FY23 with improvement in asset quality. Consequently, ROTA improved from 4.60% in FY23 to 5.05% in FY24.

Long operational track record and continuing growth in business despite geographical concentrated operations

KSFC has a long operational track record of over six decades in Karnataka. KSFC has a branch network of 32 branches spread across 30 districts in Karnataka. Loan portfolio witnessed marginal increase to ₹2,063 crore as on March 31, 2024 (March 31, 2023: ₹2,033 crore).

Key weaknesses**Weak asset quality metrics despite significant decline in stressed assets position in FY24**

KSFC's asset quality parameters continued to remain weak with gross non-performing assets (GNPA) and net non-performing assets (NNPA) at 7.09% and 3.43%, respectively, as on March 31, 2024 (March 31, 2023: 6.37% and 3.51%). However, corporation's stressed asset position witnessed significant improvement with reduction in outstanding standard restructured accounts. Standard restructured accounts stood at ₹34.72 crore as on March 31, 2024, which constitutes 1.68% of overall loan portfolio as on March 31, 2024 (March 31, 2023: 7.31%). Consequently, gross stressed assets stood at 8.77% of gross advances as on March 31, 2024, as against 13.68% as on March 31, 2023. Furthermore, net stressed assets (net NPA+90% of standard restructured assets) as a percentage of net worth improved from 17.63% as on March 31, 2023, to 7.58% as on March 31, 2024. KSFC's loss absorption capacity is adequate with improving pre-provisioning operating profit and comfortable Tier-I capital.

Inherent risk associated with its customer segment

Customer segments served by KSFC are MSME, first-generation entrepreneurs in semi-urban and rural areas with minimal or no access to bank financing, which exposes the corporation to inherent risks associated with the industry. With inherently average credit risk profile for borrowers, satisfactory performance of the portfolio is critical for protecting KSFC's earnings profile and asset quality parameters.

Liquidity: Adequate

Per the asset liability management (ALM) statement submitted by the corporation as on March 31, 2024, KSFC's liquidity profile is characterised by positive cumulative mismatches till up to one year bucket. Positive cumulative mismatches were considering the short tenure of advances as against longer borrowings from banks and through bond borrowings. Liquidity is also supported by lower reliance on borrowings with overall gearing at 0.54x as on March 31, 2024. As on March 31, 2024, the corporation had cash and bank balance of ₹107.4 crore.

Applicable criteria

- [Definition of Default](#)
- [Factoring Linkages Government Support](#)
- [Issuer Rating](#)
- [Rating Credit Enhanced Debt](#)
- [Rating Outlook and Rating Watch](#)
- [Financial Ratios - Financial Sector](#)
- [State Governments](#)
- [Non Banking Financial Companies](#)

Adequacy of credit enhancement structure

The guarantee extended by GoK is unconditional and irrevocable, legally enforceable for the entirety of the instrument and entire tenor of bonds with payment structure in place and is in compliance with RBI's norms for credit enhancement ratings. The executed corporate guarantee deeds met all required stipulations of the RBI guidance note.

About the credit enhancement provider-GoK

With its capital city as Bengaluru, GoK is the government for Karnataka. Thawar Chand Gehlot is the Hon'ble Governor of Karnataka and Siddaramaiah is the Honourable Chief Minister of Karnataka.

About the company and industry

Industry classification

Macro-economic indicator	Sector	Industry	Basic industry
Financial services	Financial services	Finance	Financial institution

KSFC was incorporated in 1959, under the State Finance Corporations Act, 1951, by the GoK, with a mandate for assisting small and medium enterprises (SME) in the state with special focus to the industrially backward areas. GoK is the majority shareholder (96.14%) in the corporation, whereas SIDBI holds 3.84% as on March 31, 2024.

Brief Financials (₹ crore)	March 31, 2023 (A)	March 31, 2024 (A)
Total operating income	355	335
PAT	107	116
Total Assets	2281	2296
Net NPA (%)	3.51	3.43
ROTA (%)	4.60	5.05

A: Audited UA: Unaudited; Note: these are latest available financial results

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years: Annexure-2

Covenants of rated instrument/facility: Annexure-3

Complexity level of instruments rated: Annexure-4

Lender details: Annexure-5

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Bonds-Redeemable Non Convertible Unsecured Taxable Bonds	INE549F08509	18-Oct-2012	9.24%	18-Oct-2024	100.00	CARE AA-(CE); Negative
Bonds-Redeemable Non Convertible Unsecured Taxable Bonds	INE549F08517	04-Feb-2013	9.08%	04-Feb-2025	50.00	CARE AA-(CE); Negative
Bonds-Redeemable Non Convertible Unsecured Taxable Bonds	INE549F08525	01-Sep-2014	9.19%	01-Sep-2024	100.00	CARE AA-(CE); Negative
Issuer Rating-Issuer Ratings	-	-	-	-	0.00	CARE BBB; Stable
Un Supported Rating	-	-	-	-	0.00	CARE BBB

Annexure-2: Rating history for last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2024-2025	Date(s) and Rating(s) assigned in 2023-2024	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022
1	Bonds	LT	-	-	-	-	1)Withdrawn (11-Aug-22)	1)CARE AA-(CE); Negative (12-Aug-21)
2	Bonds-Redeemable Non Convertible Unsecured Taxable Bonds	LT	100.00	CARE AA-(CE); Negative	-	1)CARE AA-(CE); Negative (10-Aug-23)	1)CARE AA-(CE); Negative (11-Aug-22)	1)CARE AA-(CE); Negative (12-Aug-21)
3	Bonds-Redeemable Non Convertible Unsecured Taxable Bonds	LT	50.00	CARE AA-(CE); Negative	-	1)CARE AA-(CE); Negative (10-Aug-23)	1)CARE AA-(CE); Negative (11-Aug-22)	1)CARE AA-(CE); Negative (12-Aug-21)
4	Bonds-Redeemable Non Convertible Unsecured Taxable Bonds	LT	100.00	CARE AA-(CE); Negative	-	1)CARE AA-(CE); Negative (10-Aug-23)	1)CARE AA-(CE); Negative (11-Aug-22)	1)CARE AA-(CE); Negative (12-Aug-21)
5	Bonds-Redeemable Non Convertible	LT	-	-	-	-	-	1)Withdrawn (12-Aug-21)

	Unsecured Taxable Bonds							
6	Issuer Rating-Issuer Ratings	LT	0.00	CARE BBB; Stable	-	1)CARE BBB; Stable (10-Aug-23)	1)CARE BBB; Stable (26-Dec-22) 2)CARE BBB (Is); Stable (11-Aug-22)	1)CARE BBB (Is); Stable (12-Aug-21)
7	Un Supported Rating	LT	0.00	CARE BBB	-	1)CARE BBB (10-Aug-23)	1)CARE BBB (11-Aug-22)	-

LT: Long term

Annexure-3: Detailed explanation of covenants of rated instruments/facilities

Name of the Instrument	Detailed explanation
Redeemable non-convertible unsecured taxable bonds	
A. Financial covenants	Not stipulated
B. Non-financial covenants	<p>Structured payment mechanism for repayment of bonds:</p> <ol style="list-style-type: none"> i. At least 30 calendar days prior to the forthcoming due date for payment of interest and / or principal (T-30), KSFC shall credit requisite funds to the Trust and Retention Account (TRA) for servicing bonds on the forthcoming due date and communicate it to trustee. ii. Funds credited to TRA may be put as short-term fixed deposit, only with banks having rating equivalent to AA from SEBI approved credit rating agency, with a lien on the fixed deposit in favour of the trustee. At least five days prior to the due date, the amount invested in fixed deposit shall be transferred to TRA and the interest earned will be credited to the current account of KSFC. After making payment to bond holders, amount lying in TRA's credit may be withdrawn by KSFC. iii. In case KSFC does not deposit funds in TRA at least 30 days prior to the due date, it shall communicate this matter in writing to the finance department, GoK, with a request to provide adequate funds to TRA, indicating the forthcoming due date and amount payable to bondholders with a copy marked to the trustee and the credit rating agency. iv. In case KSFC fails to intimate GoK as required in point (iii) above, the trustee shall intimate GoK at least 25 calendar days prior to forthcoming due date (T25). v. If GoK fails to ensure funds in TRA at least seven business days prior to the due date (T-7), the Trustee shall invoke the guarantee issued by the GoK on (T-7) and inform the credit rating agency about this. vi. On invocation of the guarantee, GoK will deposit the necessary funds to TRA at least three days prior to the due date (T-3). vii. KSFC will ensure the payment to investors on the due date by RTGS/NEFT/funds transfer. Wherever such facilities are not available, cheques/demand drafts (DDs) will be despatched to investors at least five days prior to the due date.

Annexure-4: Complexity level of instruments rated

Sr. No.	Name of the Instrument	Complexity Level
1	Bonds-Redeemable Non Convertible Unsecured Taxable Bonds	Highly Complex
2	Issuer Rating-Issuer Ratings	Simple
3	Un Supported Rating	Simple

Annexure-5: Lender details: Not applicable

Note on complexity levels of rated instruments: CARE Ratings has classified instruments rated by it based on complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for clarifications.

Contact us

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About us:

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