

June 16, 2010

CARE ASSIGNS IN-PRINCIPLE 'CARE AA-(SO)' RATING TO THE UNSECURED NON CONVERTIBLE BONDS OF KARNATAKA STATE FINANCIAL CORPORATION**Rating**

Instruments	Amount (Rs. crore)	Ratings ¹	Remarks
Non-Convertible Bonds	123	In-principle 'CARE AA-(SO)' [Double A minus (Structured Obligation)]	Assigned

Rating Rationale

The rating is based on the credit enhancement in the form of unconditional and irrevocable guarantee of Government of Karnataka (GoK) for payment of interest and repayment of principal in respect of such bonds. The credit profile of KSFC draws comfort from being a state entity operating under the administrative control of the Finance Department of GoK, its strong parentage (Government of Karnataka holds 92.41% stake, long operational record of over 5 decades, its diversified borrower profile and track record of timely servicing its debt obligations.

The tenure of the bond is 10 years with a bullet repayment at the end of the 10th year, bi-annual interest payment and a call option at the end of the 7th year. A tripartite agreement among GoK, KSFC and Trustees to the bondholders will assure committed and adequate budgetary support from GoK apart from timely servicing for the repayment of principal and payment of interest on the Bonds till they are finally redeemed.

Company Profile

Karnataka State Financial Corporation (KSFC) was incorporated in 1959, under a central statute, the State Finance Corporations Act, 1951, with a mandate for assisting small and medium enterprises in the state with special focus to the industrially backward areas. The basic regulatory framework and policies followed by KSFC are specified by SIDBI (Small Industries Development Bank of India). KSFC, based in Bangalore, has a network of offices all over Karnataka with 7 zonal offices and 29 branch offices. A tri-partite MoU was entered into by KSFC with SIDBI and the state government, in 2003-04, marking a process of change in the financials of the entity. Subsequently the state government has been infusing equity in the corporation thereby upping its stake in the entity.

¹ "Complete definitions of the ratings assigned are available at www.careratings.com and in other CARE publications"

Industry-wise lending pattern of KSFC shows that engineering, food and services sectors are most crucial. KSFC has an individual unit-wise exposure limit of Rs. 5 crore and a minimum exposure limit of Rs. 5 lakhs except for medical and veterinary doctors where minimum limit is Rs 2 lakh. Profitability has deteriorated mainly due to below average earnings profile, rising interest expenses and higher NPA provisioning. The accounting system was changed from cash system to accrual system, in accordance with RBI and SIDBI guidelines. Net NPAs to Net Loan Assets have reduced substantially in the recent past from 9.7% in 2009 to 2.5% as on 31st March, 2010. The negative net-worth and high NPAs continue to be a concern the company has been generating operating profits in recent years and there has been considerable improvement since 2009.

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CARE 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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