IPO Note | **Expensive, but could still give listing gains** | **July 27, 2010**

Issue Snapshot:

Issue Open: July 28 – August 02, 2010 (For QIB Bidders issue closes on July 30,2010)

Price Band: Rs. 850– Rs. 985

Issue Size: Rs. 1427.2 cr – 1653.97 cr (going to the company Rs.633.2 cr – Rs.733.8 cr, going to offering shareholders Rs.793.9 – Rs.919.9 cr)

Issue Size: 16,791,579 equity shares (incl fresh issue of 7.45 mn shares and offer for sale of 9.34 mn shares)

QIB	atleast	60%
Retail	not less than	30%
Non-Institutional	not less than	10%

Face Value: Rs 10

Book value: Rs 147.27 (March 31, 2010)

Bid size: - 7 equity shares and in multiples thereof

100% Book built Issue

Capital Structure:

Pre Issue Equity: Rs. 64.52 cr
Post issue Equity: Rs. 71.97 cr

Listing: BSE & NSE

Lead Manager: Kotak Mahindra Capital Company Ltd, Citigroup Global Markets India Pvt Ltd, Credit Suisse Securities (I) Pvt Ltd

Registrar to issue: Karvy Computershare Pvt Ltd

Shareholding Pattern

Shareholding Pattern	Pre issue %	Post issue % *
Promoters & Promoter Group	55.80	50.05
Public (incl institutions & employees)	44.20	49.95
Total	**100.0**	**100.0**

assuming pricing at higher end of band

CARE IPO grading: 4/5 indicating above average fundamentals

Background & Operations:

SKS Microfinance Ltd (SKSML) is the largest Microfinance Institution (MFI) in India in terms of total value of loans outstanding, number of borrowers, and number of branches. It is a non-deposit taking non-banking finance company, or NBFC-ND, registered with and regulated by the Reserve Bank of India (RBI). It is engaged in providing microfinance services to individuals from poor segments of rural India. Its mission is to eradicate poverty by providing financial services to the poor and by using its channel to provide goods and services that the poor need. SKSML's core business is providing small loans exclusively to poor women predominantly located in rural areas in India. These loans are provided to such members essentially for use in their small businesses or other income generating activities and not for personal consumption. These individuals often have no, or very limited, access to loans from other sources other than private moneylenders who charge very high rates of interest. The ultimate goal of microfinance is to enable the poor to build assets, increase incomes, reduce vulnerability to shocks and economic stress and improve quality of life by enabling better access to education and healthcare. The microfinance industry has grown at a rapid pace across the world and has created a positive impact in the lives of millions of poor people.

SKSML utilizes a village centered, group-lending model to provide unsecured loans to its members. This model ensures credit discipline through mutual support and peer pressure within the group to ensure individual members are prudent in conducting their financial affairs and are prompt in repaying their loans. Failure by an individual member to make timely loan payments will prevent other group members from being able to borrow from SKSML in the future; therefore the group will typically make the payment on behalf of a defaulting member or, in the case of willful default, will use peer pressure to encourage the delinquent member to make timely payments, effectively providing an informal joint guarantee on the member's loan. It also uses its distribution channel to help provide other services and goods that it has found that its members need. For instance, it distribute and administer life insurance policy products for its members and have pilot programs to provide loans to its members to purchase select consumer products that increase their productivity.

In addition to its market leadership position and the expertise in microfinance which it has developed, its competitive strengths includes its scalable operating model which leverages technology, diversified product revenues, diversified sources of capital and its pan-India distribution network. Its strategy is to further expand its membership, loans and product offerings by relying on these strengths. It continues to finance its expansion by accessing multiple sources of capital, both debt and equity, including listed debentures, priority sector qualifying loans from banks, and equity investments from venture capital and private equity investors, institutions and others. Additionally, it seeks to sell or assign its portfolio loans to banks to improve its financial position and finance its growth.

For the year ended March 31, 2010, each of it's Sangam Managers managed approximately 571 members on average. As of March 31, 2010, it has 18,344 sales personnel, which comprised 86.7% of its total workforce, and 2,029 branches. It has a high employee attrition rate. For fiscal 2008, 2009 and 2010, its employee attrition rate was 24.6%, 29.7% and 25.7%, respectively.

SKSML also distributes and administers various insurance policy products for insurance companies based in India. These policies are issued and underwritten by third party insurers and it distributes and administers them on their behalf. It receives commissions and earn fees for such arrangements. The table below indicates the relative composition of its Distributor Products portfolio by type and by revenue for the year ended March 31, 2010 and by number of policies outstanding as of March 31, 2010:

Insurance Type	Revenue		Policies Outstanding	
	Rs. (Crs)	%	Number	%
Loan Cover Insurance	32.323	62.7	12759417	81.7
Life Insurance	19.252	37.3	2864567	18.3
Total	51.575	100	15623984	100

Please read important disclosures on the last page

Objects of Issue:

The objects of the Issue are:

- Augment its capital base to meet future capital requirements arising out of growth in its business.
- To achieve the benefits of listing on the Stock Exchanges.

Means of Finance

The entire fund requirement will be met entirely from the proceeds of the Fresh Issue and issue related expenses.

Triggers:

Market Leadership: SKSML is the largest MFI in India in terms of total value of loans outstanding, number of borrowers, and number of branches as of September 30, 2008. As of March 31, 2010, it had approximately 0.68 crores members, 2,029 branches, a presence in 19 states and loans outstanding of Rs. 2936.72 crores. Its market leadership position in the microfinance sector enhances its reputation and credibility with its members and its lenders. This enhanced reputation and credibility has numerous benefits, including the ability to secure capital at lower costs, recruit and retain employees, retain its existing members and expand into new regions and product areas.

Expertise in Microfinance: SKSML has been focused on lending to poor women in India. Its experience has given it a specialized understanding of the needs and behaviours of the individuals in this segment across India, the complexities of lending to these individuals and issues specific to the microfinance industry in India and its processes. This gives SKSML a competitive advantage over commercial banks. As a result of its experience it has developed skills in training its members and designing specialized financial products. It also uses its knowledge of its members, including their culture, habits and education to design customized financial products. It provides basic product awareness training for its members because the poor in India are often illiterate or semi-literate and therefore unaware of loan terms and interest rates. SKSML's standardized training programs serves as a platform for increased trust and discipline within the member group and the larger aggregation of between three and 10 member groups, which it calls a Sangam. This financial literacy training has a concurrent socio-economic benefit enabling women to apply what they have learned in its training program to other aspects of their lives.

Superior Asset Quality: SKSML has developed a unique model to ensure that its loans are repaid on time and with a low rate of default, given its high rates of portfolio growth. As of March 31, 2010 its net non performing assets, or NPAs, was Rs.4.80 crore or 0.16% of its loans outstanding. In addition to traditional tools such as disciplined credit processes, and credit verification, its product structure, sales and collection process and segment specific approach are designed to result in a higher repayment rate for its loan portfolio.

Scalable Operating Model: Establishing and growing a successful rural microfinance business in India involves the significant challenge of addressing the rural poor that live in remote locations across India. To address this problem SKSML has designed a scalable model and has developed systems and solutions for the following three components that is required to effectively scale its business:

- **Capital:** The ability to access large and diverse groups of capital funds required for this market.
- **Capacity:** The capacity to provide its products and services to millions of members.
- **Cost Reduction:** The implementation of technology and process based systems to reduce the cost of conducting numerous complex transactions.

SKSML recognizes that conducting business through millions of transactions across thousands of rural locations involves substantial repeat interactions with its members and its employees, thus increasing operating costs. To reduce operating costs, it has deployed and continually improves a sophisticated technology platform. This allows SKSML to improve field level productivity by simplifying data entry, improving the accuracy and efficiency of collections and improving fraud detection. It also gathers data on items related to its members and loan portfolio, which can be used for management decision making.

Pan-India Rural Distribution Network: SKSML's presence throughout India results in significant competitive advantages, particularly in the following areas:

- **Distribution Platform:** SKSML's pan-India presence in the low-income segment gives it a well-developed distribution network in rural India. Its regular contact with members for product sales, collections, product training, and group decision-making gives it the capability to offer a variety of financial products nationally in areas that most companies cannot. This distribution channel allows it to facilitate the sale of these alternative products at a lower cost to its members.

- **Product Pricing Power:** National presence and large volumes give SKSML the leverage to negotiate favourable terms with institutions that want to distribute their products through its network and result in lower pricing for the products that is distributed to its members. This gives SKSML a competitive advantage over other regional lenders as well as other products distributors as it can provide its members with a larger range of products at lower costs.

Diversified Sources of Revenue: Diversification of SKSML's business and revenue base is a key component of its success, both with respect to its product offerings and the geographies, which it serves. As of March 31, 2010, it had 2,029 branches in 19 states across India with no state accounting for more than 28.8% of its outstanding loan portfolio. Its broad footprint across India allows it to lend in almost all geographies in India, which mitigates its exposure to local economic slowdowns and disruptions resulting from political circumstances or natural disasters. While its core business is providing its members with its traditional loan products, it also offers other loans that are designed for purchase of goods that enhance the productivity of its members. SKSML offers access to insurance products and loans to finance them. Such other products have different pricing structures and payment terms, which allow it to diversify and increase its revenue streams and revenue base. Providing its members with these other products fosters brand loyalty.

Access to Multiple Sources of Capital and Emphasis on Asset and Liquidity Management: SKSML has constantly strived to diversify its sources of capital. As of March 31, 2010, it had outstanding loans of Rs. 2694.67 crore from more than 48 banks and other financial institutions and it had a debt to equity ratio of 2.84. In addition to such funding, it is also able to fund the growth of its operations and loan portfolio through issuances of equity and private and publicly traded debt securities, loans with various maturities raised from domestic and international banks, and the securitization of components of its loan portfolio. It has diversified its lenders among public sector domestic banks, private sector domestic banks, private sector foreign banks, and institutional investors. As of March 31, 2010, no single creditor represented more than 22.5% of its total indebtedness. It has recently obtained credit ratings for its debt securities to improve its access to, and reduce its, cost of capital. In addition to traditional cash flow management techniques, it also manages its cash flow through active asset liability strategies. It has structured its model to primarily borrow on a long-term basis while lending on short-term basis. This allows it to better meet the growing loan demands of its rapidly increasing membership even if external borrowings and funding sources face temporary dislocation. It also manages its liquidity through stringent financial metrics that assess its ability to meet corporate debt and ongoing operational obligations. This allows SKSML to monitor the funding needs of its growth in a disciplined and well-defined manner.

Business Strategy:

To expand its Membership through Increased Geographic Coverage and Penetration in Existing Markets: SKSML is focused on growing its membership base to increase the aggregate number of loans it can make in its loan portfolio. In order to increase its membership, it seeks to:

- Establish branches in new geographies, including areas where the first mover advantage is important to establishing brand recognition and customer loyalty.
- Establish additional branches in areas in which it is already present and where it can leverage its leadership position and brand recognition to increase membership.
- Increase membership through greater penetration in its existing branches.

To expand Range of Income Generating and Productivity Loan Products: SKSML's goal is to provide its members with loan products that yield an increase in income generated as a result of the loan. One of the elements of its strategy is to continue to increase its revenue base from its members. In order to achieve these increases in revenue it is introducing newer and more innovative loan products including loans for the purchase of products such as mobile phones that could increase the productivity of a member. It has entered in to a strategic relationship, with Nokia India Private Limited, or Nokia, where it issues a loan to a member for the purchase of a Nokia mobile phone. In addition, it has recently commenced a pilot program to provide home improvement loans to its members. Wider variety of loan products differentiates SKSML from competitors and increases member retention. It is also increasing the principal amount of its loans on a measured basis to members that demonstrate a strong track record of loan repayment and increased capacity to pay. It has recently obtained the RBI's approval to market and distribute mutual funds as an agent for an initial period of two years.

To leverage Distribution Channels into New Revenue Streams: SKSML has built a large distribution network in rural India. It can leverage this network to distribute financial products of other institutions to its members at a cost lower than other institutions. Its network also allows such distributors to access a segment of the market to which many do not otherwise have access. Currently, it has a distributor relationship with Bajaj Allianz Life Insurance Company Limited, for the sale of their life insurance products, while meeting the protection or savings needs of its members. It receives a fee-based commission on these sales. This type of revenue lowers its revenue risk exposure to longer-term interest income based products. Having distributed over 2.9 million policies as of March 31, 2010. The predominantly longer term and repetitive nature of these products increases member loyalty and retention.

To continue to develop Information Technology Platform and Risk Management Systems: SKSML recognize its ability to compete effectively as an MFI requires it to utilize technology to effectively control the risks, costs and errors associated with the complex transactions that are inherent in its rapidly growing business. It has developed and implemented a proprietary technology system that provides field level data entry, loan tracking and loan portfolio reporting on an aggregated enterprise-wide basis, which has reduced its transaction costs and increased its ability to manage loan applications, disbursements, duration and other member specific data. SKSML intends to further develop this system to enable real-time Internet based reporting from all of its branches as well as integration with other accounting systems that it is currently using. In addition, it intends to purchase and implement an integrated risk management system that could further enhance its ability to manage the risks inherent to its business.

To pursue Strategic Business Alliances: SKSML constantly evaluates and forms new strategic business alliances to strengthen its market share and product offerings. It has entered into strategic alliances with Nokia, BALICL, HDFC, METRO and FAL. In addition, it has unique knowledge, experience and business models that could leverage in other countries. It could enter into joint ventures and strategic relationships to make an entry into these markets. While it has not made any such investments or acquisitions as of the date hereof, it is evaluating the potential for such opportunities, and may proceed, in a measured way, in the future.

Industry:

Microfinance offers poor people access to basic financial services such as loans, savings, money transfer services and micro insurance, according to the Consultative Group to Assist the Poor, or CGAP, an independent policy and research organization. The industry emerged to alleviate poverty on the premise that poor people, like everyone else, need a diverse range of financial services to run their business, build assets and reduce vulnerability to fluctuations in their income. Their needs for financial services have been traditionally met through a variety of financial relationships, mostly informal. In the past two decades, different types of financial services providers for poor people have emerged, including non-government organizations, or NGOs; cooperatives; community-based development institutions like Self Help Groups, or SHGs, and credit unions; commercial and state banks and microfinance institutions, or MFIs, offering new possibilities. The ultimate goal of microfinance is to enable the poor to build assets, increase incomes, reduce vulnerability to shocks and economic stress and improve quality of life by enabling better access to education and healthcare. The microfinance industry has grown at a rapid pace across the world and has created a positive impact in the lives of millions of poor people.

Impact of Microfinance on the Poor

Microfinance provides the poor with long-term economic and social benefits. Sustained access to micro-credit enables the poor to increase household income. These economic improvements are often accompanied by wider ranging social developments that improve the quality of life through improved social standing for women, nutrition, education and healthcare.

Economic and Social Benefits: By utilizing borrowed funds for additional working capital for their business and for investments in additional income generating assets, borrowers are able to increase business activity and generate additional household income. This additional income, if either reinvested by purchasing additional land, animals or facilities or deposited in savings, can further increase household income. The reinvestments will either expand an existing business, add new businesses that diversify sources of income and reduce income exposure from fluctuations in any one business or increase savings that reduce the need to sell family assets during times of crisis. For the household, improved economic conditions can result in secondary economic and social benefits as well. Women are the largest borrowers of microfinance and women generally tend to direct additional income toward better nutrition, education and healthcare for the family. Households are able to send more children to school for longer periods and to make greater investments in their children's education. Increased earnings can lead to better nutrition, living conditions, and a lower incidence of illness. Increased earnings and access to microinsurance also mean that households may seek out and pay for health care services when needed.

For women, money management, greater control over resources, and access to knowledge can lead to more choices and potentially a voice in family and community matters. Economic empowerment is accompanied by increases in self-esteem, self-confidence, and new opportunities. Qualitative and quantitative studies have documented how access to financial services has improved the status of women within the family and the community. Women often become more assertive and confident. In regions where female mobility is strictly regulated, women have often become more visible and are better able to negotiate the public sphere. Women involved in microfinance may also own assets, including land and housing, and play a stronger role in decision-making.

RBI Initiatives

Banks in India are required to lend a certain required percentage, either directly or indirectly, to specified sectors of the population and industry designated as priority sectors. Currently, domestic commercial banks are required to maintain 40.0% of their adjusted net bank credit or credit equivalent amount of assigned or securitized assets, whichever is higher as total priority sector advances. These include loans for agriculture, small enterprises, retail trade, micro-credit, education and housing. Of the 40.0% total requirement, 18.0% of the net bank credit or credit equivalent of assigned or securitized asserts must qualify as agriculture and allied activities sector loans. Additionally, 10.0% must qualify as designated weaker section loans. In 2007, the RBI enacted rules to include microfinance loans within the purview of these mandatory priority sector bank-lending requirements. Qualifying loans could not exceed Rs. 50,000.00 per borrower. These rules thus allowed banks to lend to SHGs and MFIs to satisfy their priority sector lending requirements, reducing their need to satisfy the requirements through direct lending which they often found difficult to meet with the lack of a strong rural banking network. In the same year, the RBI also enacted rules that provided for bank purchases of securitized assets comprised of loans by SHGs and MFIs to priority sector borrowers to qualify for the mandatory priority sector bank lending requirements. While the RBI has enacted rules that subject banks to interest rate ceilings for micro-credit loans, microfinance institutions that are registered as NBFCs are currently not subject to similar interest rate ceilings.

Future outlook and key trends for Indian MFIs

Reaching a critical mass: According to the Bharat Microfinance Report, MFIs member base increased from 14.1 million in 2008 to 22.6 million in 2009. Increased scale and sophistication can lead to greater costs savings. In addition, scale and sophistication can ensure greater access to funds for growth at lower costs, which could result in improved pricing for borrowers.

Increasing role of technology: Larger MFIs are increasingly relying on technology to control costs and enhance scalability. They have implemented computerized management information systems and Internet based technologies in the field to ensure real-time data transfers. Graphical user interfaces have been simplified to standardize data entry, enable the use of vernacular languages and minimize need for specialized training. Finally, some MFIs are exploring the use of mobile phones, global positioning system enabled systems and smart cards to enable real-time data transfer and greater autonomy in the field.

Distribution of products and services other than credit: Microfinance is increasingly seen as being more than micro-credit and the member network and reach of MFIs is viewed as a potential distribution channel to the poor. Various financial products and services such as insurance, housing loans, savings deposits, money transfer services and pension products can be distributed through MFIs.

Concerns:

If SKSML is unable to manage its growth effectively its business and reputation could be adversely affected: Network of SKSML branches and members has expanded rapidly from 1,353 branches serving approximately 0.39 crores members located in 18 states across India as of March 31, 2009 to 2,029 branches, serving approximately 0.67 crores members located in 19 states across India as of March 31, 2010. It expects the expansion of its geographic footprint and network of branches and members to continue which could further constrain its capital resources and make asset quality management increasingly important. It will need to enhance and improve its financial, accounting, information technology, administrative and operational infrastructure and internal capabilities in order to manage the future growth of its business. If it is unable to manage its future expansion successfully, its ability to provide products and services to its members could be adversely affected, and, as a result, its reputation could be damaged and its business and results of operations materially and adversely impacted.

If loan loss reserves are insufficient to cover future loan losses, its financial condition and results of operations could be materially and adversely affected: All of SKSML's loans are unsecured. Non-performing or low credit quality loans can negatively impact its results of operations. Its net NPAs as a percentage of net loans outstanding were 0.16% as of March 31, 2010, 0.18% as of March 31, 2009 and 0.16% as of March 31, 2008. Its total net non-performing loans were Rs. 4.80 crore as of March 31, 2010, Rs. 2.52 crore as of March 31, 2009 and Rs. 1.23 crore as of March 31, 2008. It cannot be assured that it could be able to effectively control and reduce the level of the impaired loans in its total loan portfolio. The amount of its reported non-performing loans could increase in the future as a result of growth in its total loan portfolio. If it is unable to manage its NPAs or adequately recover its loans, its results of operations could be adversely affected. Moreover, there is no precise method for predicting loan and credit losses, and it cannot be assured that its monitoring and risk management procedures could effectively predict such losses or that loan loss reserves could be sufficient to cover actual losses. If it is unable to control or reduce the level of its non-performing or poor credit quality loans, its financial condition and results of its operations could be materially and adversely affected.

Introduction of new products and services may not be successful and, as a result its reputation would be harmed and its market leadership would be at risk: SKSML could incur substantial costs to expand its range of products and services and cannot guarantee that such new products will be successful once they are offered due to its own shortcomings. In addition, it could not correctly anticipate its members' needs or desires, which could change over time, and from time to time it has discontinued unsuccessful or nonstrategic products. It currently distributes endowment or whole life insurance policies issued and underwritten by a third party insurance company to its members. Additionally, it has entered into arrangements with a mobile phone manufacturer, as well as consumer goods wholesaler, to facilitate the distribution of their products to its members. In the event that these products or any new products it introduces in the future do not meet the standards or expectations of its members or in the event of a default by these third parties from whom such products are sourced or disputes originating out of such products or distribution, it could be subject to reputational risk, which could further impact its member base and its ability to grow the member base, consequently further adversely affecting its business, results of operations and financial condition.

Obtained certain loans, which could be recalled by its lenders at any time: Certain of SKSML's indebtedness can be recalled at any time. As of March 31, 2010, its total secured and unsecured indebtedness is Rs. 2694.67 crores, of which 55.8% could be recalled by its lenders at any time.

SKSML handles cash in a high volume of transactions occurring through a dispersed network of branches and Sangam Managers, it is exposed to operational risks which could harm its results of operations and financial position: SKSML handles a large amount of cash through a high volume of small transactions taking place in its network, it is exposed to the risk of fraud or other misconduct by employees or outsiders. These risks are further exaggerated with the high level of delegation of power and responsibilities its business model requires. In addition, its dependence upon automated systems to record and process transactions could further increase the risk that technical system flaws or employee tampering or manipulation of those systems could result in losses that are difficult to detect.

Business could suffer if SKSML is unable to secure additional capital it needs to fund its operations: SKSML's business requires significant capital. It has historically relied on significant debt and equity issuances, as well as cash flow from operations to fund its operations, capital expenditures and expansion. Expanding its geographic footprint and extending new proprietary and distributed product and service offerings to its members could have an impact on its long-term capital requirements, which is expected to increase significantly. Its ability to obtain additional capital is subject to a variety of uncertainties. In addition, adverse developments in the Indian and world credit markets could significantly increase its debt service costs and the overall costs of its borrowings. It may not be able to secure timely additional financing on favourable terms, or at all. The terms of any additional financing may place limits on its financial and operating flexibility. If it is unable to obtain adequate financing if and when it requires, its ability to grow or support its business and to respond to business challenges could be limited and its business prospects, financial condition and results of operations could be materially and adversely affected.

Loans due within one year account for all of SKSML's interest income, and a significant reduction in short term loans could result in a corresponding decrease in its interest income: All of the loans issued by SKSML are due within one year of disbursement. The relatively short-term nature of its loans means that its long-term interest income stream is less certain than if a portion of its loans were for a longer term. In addition, its members may not obtain new loans from it upon maturity of their existing loans, particularly if competition increases. The potential instability of its interest income could materially and adversely affect its results of operations and financial position.

If SKSML is unable to attract, motivate, integrate or retain qualified personnel at levels of experience that is necessary to maintain its quality and reputation, it could be difficult for it to manage its business and growth: SKSML depends on the services of its executive officers, key employees and Sangam Managers for its continued operations and growth. In particular, its senior management has significant experience in the microfinance, banking and financial services industries. The loss of any of its executive officers, key employees or senior managers could negatively affect its ability to execute its business strategy, including its ability to manage its rapid growth. The loss of the services of such personnel or the inability to identify, attract and retain qualified personnel in the future could make it difficult for SKSML to manage its business and growth and to meet key objectives.

A failure of operational systems or infrastructure, or those of third parties, could impair the liquidity, disrupt the businesses, cause damage to the reputation and result in losses: Business of SKSML is highly dependent on its ability to process a large number of transactions. Its financial, accounting, data processing or other operating systems and facilities may fail to operate properly or become disabled as a result of events that are wholly or partially beyond its control, adversely affecting its ability to process these transactions. Additionally, shortcomings or failures in its internal processes or systems could lead to an impairment of its financial condition, financial loss, disruption of its business and reputational damage. Inability to operate and remain competitive could depend in part on SKSML's ability to maintain and upgrade its information technology systems on a timely and cost-effective basis. Its failure to maintain or improve or upgrade its management information systems in a timely manner could materially and adversely affect its competitiveness, financial position and results of operations.

Failure to comply with financial and other restrictions imposed on SKSML under the terms of its borrowings could adversely affect its ability to conduct its business and operations: In connection with SKSML's borrowings from lenders, it has agreed to restrictive covenants that require, among other things, that it maintains certain levels of debt, capital and asset quality or limit the scope of its lending activities to certain specified geographies. Its ability to execute expansion plans, including its ability to obtain additional financing on terms and conditions acceptable to it, could be severely and negatively impacted as a result of these restrictions and limitations. Failure to comply with any of these covenants could result in an event of default, which could accelerate SKSML's need to repay the related borrowings and trigger cross-defaults under other borrowings. An event of default could also affect its ability to raise new funds or renew maturing borrowings as needed to conduct its operations and pursue its growth initiatives.

Microcredit lending poses unique risks not generally associated with other forms of lending in India, and, as a result, it could experience increased levels of non-performing loans and related provisions and write-offs that negatively impact its results of operations: SKSML's core mission is to provide loans to fund the small businesses and other income generating activities of its members. Its members are typically poor and illiterate women living in rural India, who have limited sources of income, savings and credit histories, and who cannot provide its with any collateral or security for their borrowings. It also disburses non-interest bearing loans to its members in the event of emergencies, such as pregnancy, funerals and natural disasters. In addition, it has extended loan repayment moratoriums of two to three weeks to members who have been victims of flood conditions. While it do extend such moratoriums on a case by case basis, extensive flood conditions could adversely affect the ability of its members to make loan payments on time and in turn negatively impact its results of operations. In addition, SKSML relies on non-traditional guarantee mechanisms in connection with its loan products, which is generally secured by informal individual and group guarantees, rather than tangible assets. As a result, its loan products pose a higher degree of risk than loans secured with physical collateral. Due to the precarious circumstances of its members and its non-traditional lending practices it could, in the future, experience increased levels of non-performing loans and related provisions and write-offs that negatively impact its business and results of operations.

Competition from banks and financial institutions, as well as state-sponsored social programs, could adversely affect the profitability and position in the Indian microcredit lending industry: SKSML faces its most significant competition from other MFIs and banks in India. Many of the institutions with which it competes have greater assets and better access to, and lower cost of, funding than it does. It anticipates that it could encounter greater competition as it continue expanding its operations in India, which could result in an adverse effect on its business, results of operations and financial condition. Banks also indirectly participate in microfinance by making loans and providing other sources of funding to other MFIs. In addition, it is aware that some commercial banks are beginning to directly compete with for-profit MFIs for lower income segment customers in certain geographies.

Fluctuations in interest rates and other market risks, could adversely affect the financial condition and results of operations: Business of SKSML substantially depends on interest income from operations. In fiscal 2010, 78.9% of its total income was interest income on portfolio loans. Market risk refers to the probability of variations in its interest income or in the market value of its assets and liabilities due to interest rate volatility. Changes in interest rates affect its interest income and the volume of loans it issues. Increases in short-term interest rates could increase its cost of borrowing adversely affecting its profitability. Interest rate increases could result in adverse changes in its interest income, reducing its growth rate and the value of its financial assets. In addition, it could incur costs (which, in turn, will impact results) as it implements strategies to reduce future interest rate exposure. The market value of an obligation with a floating interest rate could be adversely affected when interest rates increase. Increases in interest rates could reduce gains or require it to record losses on sales of its loans and, as a result, adversely affecting its financial condition.

Governmental and statutory regulations, including the imposition of an interest-rate ceiling, could adversely affect the operating results and financial position: As a non-deposit taking NBFC, SKSML is subject to regulation by Indian governmental authorities, including the Reserve Bank of India, or RBI. These laws and regulations impose numerous requirements on it, including asset classifications and prescribed levels of capital adequacy, cash reserves and liquid assets. There may be future changes in the regulatory system or in the enforcement of the laws and regulations that could adversely affect it. In the event that the government of any state in India requires it to comply with the provisions of their respective state money lending laws, or imposes any penalty against it, its Directors or its officers, including for prior non-compliance, its business, results of operations and financial condition could be adversely affected.

All of the revenue is derived from business in India, and a decrease in economic growth in India could cause the business to suffer: SKSML derives all of its revenue from its operations in India and, consequently, its performance and the quality and growth of its business is dependent on the health of the economy of India. This economy has sustained growth over the five years ended fiscal 2010 with an average real gross domestic product growth rate of approximately 8.5%. However, the Indian economy could be adversely affected by factors such as adverse changes in liberalization policies, social disturbances, terrorist attacks and other acts of violence or war, natural calamities or interest rates changes, which could also affect the microfinance industry. Any such factor may contribute to a decrease in economic growth in India could adversely impact SKSML's business and financial performance.

Financials - P&L:

Particulars	**FY10**	**FY09**	**FY08**	**FY07**	**FY06**
Income From Operations	873.6	506.1	162.5	44.5	9.0
Other Income	85.4	47.9	7.5	1.2	1.0
Total Income	958.9	554.0	170.0	45.7	9.9
Total Expenses	691.2	429.9	141.1	41.1	9.0
Financial Expenses	288.4	194.4	56.5	13.9	2.8
Personnel Exoenses	216.4	136.0	47.5	13.0	2.8
Other expenses	122.1	75.2	27.8	9.9	1.9
Provisions and Write Offs	51.7	13.4	4.2	2.0	0.8
Depreciation	12.6	10.8	5.1	2.4	0.8
PBT before E O Items	267.7	124.1	28.9	4.5	1.0
E O Items	0.0	0.0	0.0	0.0	1.9
PBT	267.7	124.1	28.9	4.5	2.9
Tax	92.9	44.4	12.4	2.3	1.2
PAT	**174.8**	**79.7**	**16.6**	**2.2**	**1.6**
Equity	64.5	47.9	44.3	26.6	13.9
Net Interest Income	**585.2**	**311.6**	**106.0**	**30.6**	**6.2**

Operating Profit	**267.7**	**124.1**	**28.9**	**4.5**	**1.0**
EPS (on pre-issue equity)	**27.1**	**16.6**	**3.7**	**0.8**	**1.2**
EPS (on fully diluted equity)	**24.3**	**11.1**			

Conclusion:

SKSML is one of the largest players in the Indian micro finance industry having pan India operations with a well-diversified portfolio. It has a track record of the promoters, experienced board of directors and strong management profile. The company has the strong financial position with health margins including good asset quality, comfortable capital adequacy ratio, comfortable liquidity position and access to diverse sources of institutional funding. It has the strong industry growth in recent period with good prospects for future growth on account of large unmet potential demand. The company is sensitivity to operational risk on account of large volume of cash transaction & decentralized operations spread across the country. Any adverse change in government policies, low seasoning of the industry portfolio and asset quality risks on account of political/religious intervention is some key risks that it faces. However some of these risks are mitigated due to the high diversification of SKSML's asset portfolio. The salary costs of SKSML are high given its business model. Further dependence on improvement in rural conditions is high as any setback in terms of monsoon failure or floods etc could jack up the NPA rates. Possibility of some sort of regulation on the interest rates charged going into future is another concern.

The microfinance industry has large portfolio concentration in southern states of India. SKSML's has good geographical diversification with a large coverage in eastern and western states along with the southern states (55.8% of its loan portfolio as on Mar 31, 2010 comes from AP, West Bengal and Karnataka. Also the vast, rural level loan distribution and collection network of the company provides an opportunity to diversify into other products by leveraging this network. The core business of the company is microfinance lending. It is planning to leverage the large distribution network to diversify its revenue streams in future. It has strategic alliance with Nokia, Bajaj Allianz, HDFC Ltd, METRO cash & carry, Future Agrovet Ltd and others to provide various offerings, which could increase its revenues going forward.

Peer Analysis	Total Income		PAT		PATM%		BV	EPS	CMP	PE	P/BV
	FY10	FY09	FY10	FY09	FY10	FY09	Latest	FY10			
SE Investment *	88.4	48.9	26.3	13.8	29.8	28.2	14.8	1.3	50.6	38.9	3.4
SKS Microfinance	958.9	554.0	174.8	79.7	18.2	14.4	147.3	27.1	850 - 985	At 850 - 31.37 At 985 - 36.35	At 850 - 5.77 At 985 - 6.69

* = Standalone fig

SKSML has issued shares in the past 15 months to private equity investors @ Rs.300 per share. The current issue is priced a bit on the expensive side (31.4-36.3 times its FY10 EPS and 5.77-6.68 times its BV for FY10). Its smaller peer SE Investments has also risen 200% over the past 4-5 months aided by Bonus and split announcements. On a comparative basis with its peer, SKSML does not seem too expensive. However compared to Banks and Finance companies, it seems expensive based on P/E, dividend yield and P/BV basis. On a post issue basis, however the P/BV could come down, mainly due to the premium collected in the issue. Given its size, the present institutional investors, the recent growth and prospects going forward and the fancy towards the sector, the issue could still give some listing gains.

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