

Issue details

Issue opens	28-Jul-10
Issue closes*	2-Aug-10
Price band (Rs)**	850-985
Face value (Rs)	10
Lot size	7
Total Issue size (mn)	16.79
- Offer for sale (mn)	9.34
Issue size (Rs m)	16,540
Issue type	100% Book building
IPO rating	CARE IPO Grade 4
Industry	Finance

*Closure date for institutional investors is 31st July, 2010

**Rs50 discount has been offered to retail investors

Shareholding pattern (%)

	Pre IPO	Post IPO
Promoters & promoters group	55.8	37.1
Non Promoters	44.2	39.6
Public	-	23.3

Share reservation (%)

QIB	60
Non institutional	10
Retail	30

Company management

Dr. Vikram Akula	Chairman Managing Director
Mr. Suresh Gurumani	Director

Issue manager

Lead manager	Kotak Investment Banking, Citi, Credit Suisse
Registrar	Karvy
Listing	NSE, BSE

Objective of issues (Rs m)

To augment capital base to meet future capital requirements

To achieve the benefits of listing on the Stock Exchanges

Source: RHP

SKS Microfinance (SKSMF) is the largest microfinance company in India with loan portfolio of ~US\$1bn, 2,000+ branches spread across 19 states and 6.8mn members. Its strengths include pan-India presence, scalable operating model, diversified product revenues and access to various sources of capital. Lending primarily to poor women, the business model involves village centered group lending, thereby ensuring a check on asset quality. The huge demand-supply credit gap and inability of banks to penetrate into unbanked areas have driven the growth of microfinance industry. While valuations appear expensive, the scalable business model, market leadership position and high earnings growth provide comfort. Recommend Subscribe.

Rural centric business model

The success of SKSMF has evolved around five key elements: a) village selection, b) focus towards women, c) member training, d) group lending and e) village level lending and collection. With lending primarily to poor women, the company has expanded its reach to 2,029 branches spread across 19 states and over 6.8mn members. The pan-India presence has further helped mitigate the risk towards local economic slowdowns and disruption. Through systems and solutions in place, it has developed a scalable 3C's model – Capital, capacity and cost reduction, which in turn has helped reach rural masses in large.

Diversified sources of revenue and capital

In addition to core business towards providing traditional loan products, the company has started offering productivity loans directly linked to business. This involves strategic alliances with Nokia, Airtel, Bajaj Allianz, HDFC, METRO and FAL. Despite being a NBFC-ND, the company has benefited from benign interest rate regime and enhanced sovereign ratings. Historically, it has raised funds via alternate channels including – equity and debt issuance, loans with various maturities raised from domestic and international banks, and the securitization of components of loan portfolio.

Limited concerns over asset quality

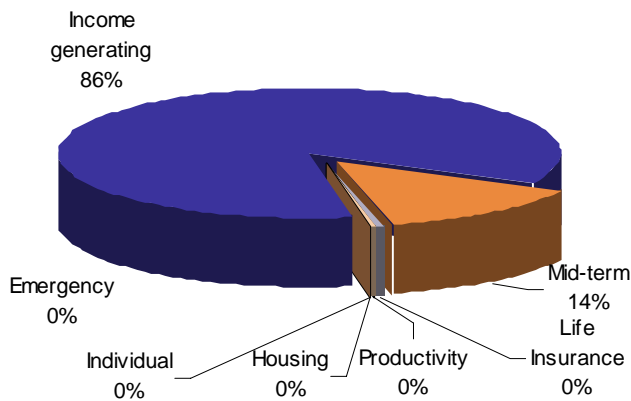
The village centered, group lending model has ensured SKSMF an adequate check on asset quality. Innovative product structuring, focus on income generating loans and primary focus at women have enabled the company to maintain its GNPA and NNPA at low 0.33% and 0.16% respectively. In case of default by an existing member, the group is required to typically make the payment on behalf of a defaulting member. Any negligence towards payment bars the group from further borrowing.

Financial highlights

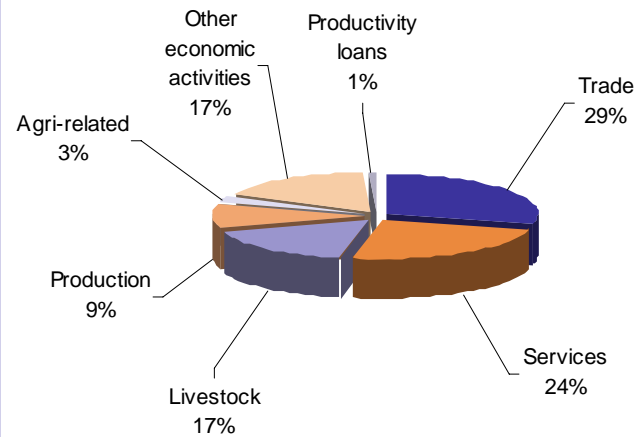
(Rs mn)	FY07	FY08	FY09	FY10
Revenues	445	1,625	5,060	8,736
yoy growth (%)	-	265.1	211.5	72.6
Operating profit	457	1,700	5,540	9,589
PAT	22	166	797	1,748
yoy growth (%)	-	651.3	380.6	119.5
EPS (Rs)	0.8	3.7	14.0	27.1
BV per share (Rs)	26.8	47.8	116.0	146.6
RONW (%)	3.1	7.8	12.2	18.4

Source: RHP, India Infoline Research

Loan mix (end FY10)

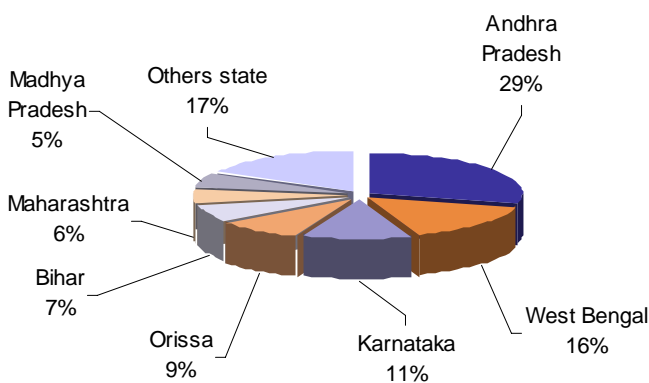


Lending across all segments of credit

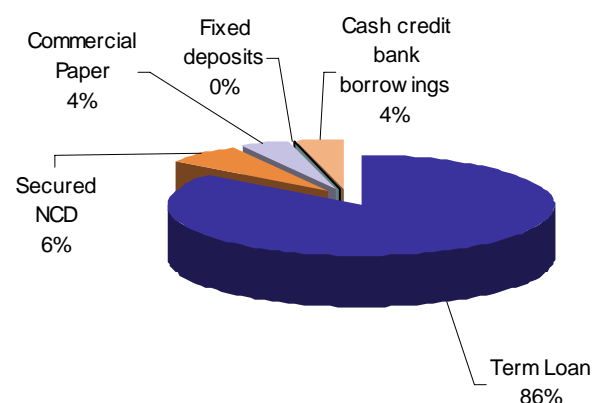


Source: RHP, India Infoline Research

State-wise lending profile (end FY10)



Borrowing mix (end FY10)



Source: RHP, India Infoline Research

Industry positives

- ✦ The recent survey had pegged the total micro-credit demand in India at US\$51.4bn. With two microfinance models in place – Self help group (SHG) and microfinance industry (MFI), the cumulative disbursement, however stood at US\$4.3bn. This huge demand-supply mismatch has urged the need for increasing impetus towards such financial models. Over the years, MFI has outpaced the SHG’s model due to its viable business model which catered directly to the needs of the borrowers. MFI has witnessed strong outreach of 22.6mn clients (50.3% CAGR during FY07-09) and healthy 84.3% CAGR in loans.
- ✦ Microfinance business has evolved with a view to fill the void left between mainstream commercial banks and private money lenders. The models involves offering poor people access with basic financial services such as loans, savings, money transfer services and micro insurance via tailored-made model, easy financing and favorable policies.
- ✦ Rural India had exhibited strong resilience during the recent downturn. This was on back of increasing demand for agriculture and related activities coupled with easy availability of finance. Microfinance companies have exhibited a remarkable performance by increasing their exposure to unbanked, illiterate poor of India. Further, in 2007, RBI enacted rules to include lending to microfinance under priority sector loans. Banks in India are required to maintain 40% of their adjusted net bank credit to priority sector advances. Key government institutions – SIDBI, NABARD too have extended support to microcredit and microfinance companies in India.

Valuations

The company is valued at a FY10 P/B of 3.6x at the lower price band and 4.2x on the upper price band post dilution. This is significantly higher as compared to average P/B for NBFCs at 2-2.5x, PSU banks (1-2x) and private banks (2.5-4x). International MFI companies have however traded at higher multiples due to their longer operating history and higher returns ratio. RoE for SKSMF at 21.7% (end FY10) is largely in line with domestic NBFCs and banks.

Issue details

The issue comprises of a total issue of 16,791,579 equity shares comprising a fresh issue of 7,445,323 equity shares and an offer for sale of 9,346,256 equity shares. The equity dilution would be the tune of 21.6% of total equity base. The issue proceedings are targeted towards increasing business volumes and improving penetration by establishing branches in new geographies and enhancing their existing branches. The company also plans to develop and introduce newer loan products which would help increase the productivity of the members.

Concerns

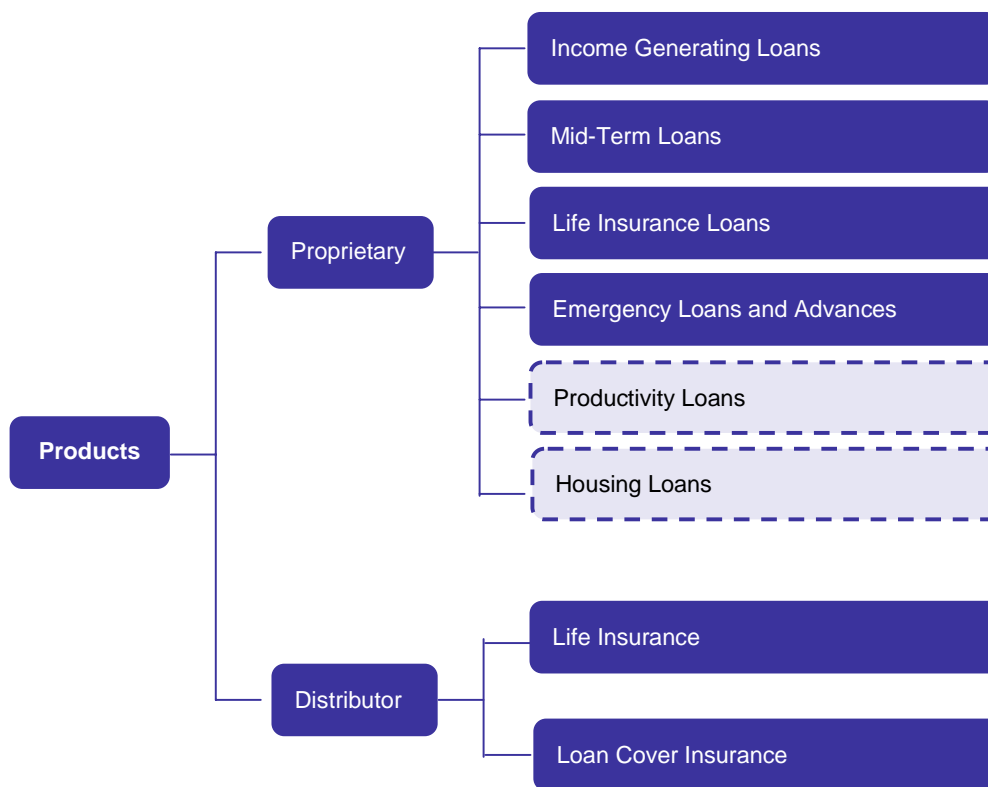
- ✦ SKSMF operates on a labour intensive business model. This in turn calls for elevated levels of employee cost and higher attrition. Employee and interest cost in combine have constituted ~55-60% of total income.
- ✦ With a view to avoid money laundering, several states in India have enacted laws pertaining to regulation towards money lending transactions. These state laws establish maximum rates of interest that can be charged by a person lending money. RBI, however, has not established a ceiling on the rate of interest that can be charged by a NBFC in the microfinance sector. Currently, the RBI requires that the board of all NBFCs adopt an interest rate model taking into account relevant factors such as the cost of funds, margin and risk premium. It is unclear whether NBFCs are required to comply with the provisions of state money lending laws that establish ceilings on interest rates.
- ✦ MFI faces risks such as limited ability to leverage, regulatory clampdowns and unusual credit risks that could lead to collective defaults by a large number of borrowers.

Company Background

SKSMF was established in 1997 as a public society in the form of an NGO in Andhra Pradesh. In 2003 the company issued an aggregate of 99.5% of their fully diluted share capital with the objective of promoting and enhancing the social and economic welfare of groups of poor women, reaching 5.7mn poor women or some 20% of all MFI clients in India. In order to develop a model that could scale rapidly, the company has consistently focused on outreaching as a key measure of its success. The business model involves village centered, group lending to ensure credit discipline.

Some of the premier investors include - Sequoia Capital, Vinod Khosla, SIDBI, Bajaj Allianz, Yatish Trading, Kismet Capital, Sandstone Capital, Silicon Valley Bank and Unitus. SKS borrowers represented by Mutual Benefit Trusts are also one of the largest shareholder groups in the Company.

Product Portfolio



Source: RHP, India Infoline Research

Loan categories

Type of loan	Loan range	Effective Interest rate	Interest pre-payment	Tenure	Payment mode
Income generating	Rs2,000- Rs12,000	26.7-31.4%	1% of the loan amount	50weeks	Equated Weekly Installment
Mid-term	Rs2,000- Rs15,000	26.7-31.4%	1% of the loan amount	After completion of 20weeks of IGL	Equated Weekly Installment
Life-insurance	Rs500 - fixed principal amount	Interest free	NA	25 weeks	NA
Emergency	Rs500 - Rs2,000	Interest free	NA	20 weeks	Repayment due at the end of term
Productivity		30.6-36.2%, with entire interest payable in advance		25 weeks	Equated Weekly Installment
Housing	Rs50,000- Rs150,000	21% + 2% loan processing fee		3-5years	Equated monthly Installment
Individual	Rs50,000 max	NA	NA	12-18months	NA

Source: Company, India Infoline

Key paramteres	Mar-07	Mar-08	Mar-09	Mar-10
Branches	276	770	1353	2029
Districts	103	219	307	354
Staff	2,381	6,818	12,814	21,154
Members (in millions)	0.6	1.88	3.95	6.78
Amount disbursed (Rs bn)	4.5	16.8	44.9	76.2
Portfolio outstanding (Rs bn)	2.8	10.5	24.6	43.2

Source: Company, India Infoline

Financials

Income statement

(Rs mn)	FY07	FY08	FY09	FY10
INCOME				
Income from operations	445	1,625	5,060	8,736
Other Income	12	75	479	854
	457	1,700	5,540	9,589
EXPENDITURE				
Financial Expenses	139	565	1,944	2,884
Personnel Expenses	130	478	1,377	2,164
Operating & other expenses	99	275	735	1,221
Depreciation	24	51	108	126
Provisions & w/ offs	20	42	135	517
PBPT	45	289	1,240	2,677
Prior period items	(19)	-	-	-
Profit before Tax	27	289	1,240	2,677
Adjustments	19	-	-	-
Profit before Tax	45	289	1,240	2,677
Tax Expenses	(23)	(124)	(444)	(929)
Profit after Tax	22	166	797	1,748

Balance sheet

(Rs mn)	FY07	FY08	FY09	FY10
Sources				
Share capital	266	443	571	645
Reserves	448	1,677	6,050	8,816
Networth	714	2,120	6,620	9,461
Loan Funds	2,490	7,898	21,366	26,947
Stock option o/s.	-	3	19	42
Total	3,204	10,021	28,005	36,450
Application				
Gross block	84	223	372	541
Less: Accd dep.	33	84	192	315
Net block	52	139	180	226
Capital WIP	1	7	10	18
Total fixed assets	52	146	190	244
Investments	-	-	-	2
Total current assets	3,289	10,733	30,157	40,135
Total current liabilities	146	867	2,384	4,025
Net working capital	3,143	9,866	27,773	36,110
Deferred Tax Assets	9	9	42	95
Total	3,204	10,021	28,005	36,450

Key ratios

(Rs mn)	FY07	FY08	FY09	FY10
Per share ratio (Rs)				
EPS	0.83	3.74	13.96	27.10
Book value per share	26.80	47.82	116.03	146.63
Leverage ratios (x)				
Debt/Total equity	3.5	3.7	3.2	2.8
Component ratios (%)				
Staff exp	28.4	28.1	24.9	22.6
Interest exp	30.3	33.2	35.1	30.1
Depreciation exp	5.2	3.0	2.0	1.3
Yield Analysis				
Gross Yield	13.6	31.6	25.6	24.7
Portfolio Yield	11.8	28.4	23.9	23.4
Financial Cost Ratio	4.5	11.1	8.5	7.5
Operating cost Ratio	5.2	12.7	12.1	13.6
Loan Loss Ratio	0.9	0.8	0.6	1.1
Taxes	1.1	2.5	1.9	1.3
Total Expense Ratio	11.6	27.0	23.1	23.5

P&L and Balance Sheet Ratios

Non Funds Based Income	8.5	15.4	15.6	18.3
Cost to Income	79.3	70.8	61.8	52.4
Return on Average Equity	5.1	11.7	18.2	21.7
Basic EPS	1.6	5.5	17.8	33.0
Diluted EPS	1.6	5.4	16.1	27.5
Gross NPA	0.1	0.2	0.3	0.3
Net NPA	0.2	0.2	0.2	0.2
Debt to Equity	3.4	3.7	3.2	2.8
Capital risk to asset ratio	24.7	24.7	39.0	28.3

Recommendation parameters for fundamental reports:

Buy – Absolute return of over +10%

Market Performer – Absolute return between -10% to +10%

Sell – Absolute return below -10%

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