

SKS Microfinance Ltd

 28th July 2010

SUBSCRIBE
PRICE BAND: Rs 850-985
Analyst: Krinal Shah
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BACKGROUND & BUSINESS

Analyst: Punit Chande
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SKS is the largest MFI in terms of total value of loans outstanding, number of borrowers and number of branches, according to the October, 2009 CRISIL report. It is categorized as NBFC-ND and regulated by RBI.

Issue Details	
Issue Size to public	Rs.1427-1654cr
Face Value (Rs)	Rs.10
Bid opens	28-July-2010
Bid closes (for Retail & Non Institution)	2-Aug-2010
Bid Closes (for QIB)	30-July-2010
Issue band (Rs)	Rs. 850-985
Issue Type	100% Book Building

Its Core Business is to provide financial services exclusively to poor women predominately located in rural areas in India and to help them become financially self-reliant. Loans are given only for small businesses or for other income generating activities and not for personal consumption. As of March 31, 2010, SKS had 6.78 million women borrowers and total disbursements worth more than Rs.14, 000 crore (\$3 billion).

Lead Managers
Kotak Mahindra Capital Citigroup Credit Suisse

Registrar
Karvy

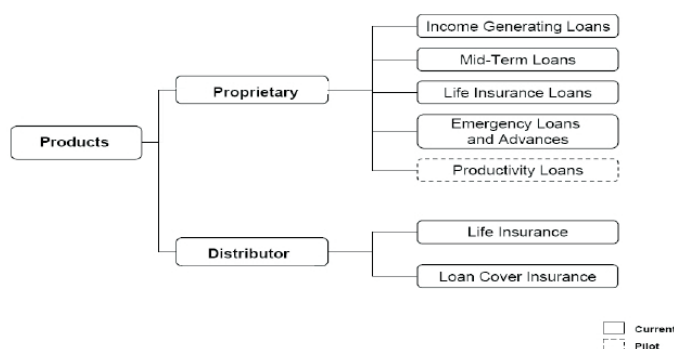
Issue Structure	
	Equity Shares
Net Shares offered to Public	1,67,91,579
QIB Portion	1,00,74,948
Non Institutional Portion	16,79,157
Retail Portion	50,37,474

No of Issued, subscribed and paid up shares before the issue	6,54,27,219
No of Issued, subscribed and paid up shares after the issue	7,19,72,542

Fresh Issue	74,45,323
Offer for Sale	93,46,256

IPO Grade

CARE: CARE IPO GRADE 4 (Above average fundamentals)

SKS MICROFINANCE PRODUCT FAMILY


OBJECT OF THE ISSUE

- To augment capital base to meet future capital requirements arising out of growth in the business
- To achieve the benefits of listing.

VALUATION

From the valuation perspective it is quite expensive as pre issue it is trading at 31x of its EPS of FY10 on lower band of price while at 36x on the higher band. Post issue it will trade at 35x on the lower band and 41x on the higher side. In view of the P/BV, it is trading at 5.7 times of its FY10 BV on the lower band and 6.7x on the higher band. Post issue, it will trade at 3.7 times of its book value on the lower band and 4.3 times of its higher band. Considering the unique business model along with strong fundamentals and growth potentials of the company, the attached premium is justifiable. Hence we recommend **SUBSCRIBE** rating on the stock at the **lower price band**.

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INVESTMENT RATIONALE:

Unique Business Model

Joint liability model enabled to maintain repayments rates at more than 99% on collateral free loans

With a disciplined methodology and group lending model adopted by the company, it enabled to maintain repayment rates at more than 99% on collateral free loans. The company utilizes a village centered, group lending model to provide unsecured loans to the members who ensure credit discipline through mutual support and peer pressure within the group. Failure by an individual member to make timely loan payments will prevent other group members from being able to borrow 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.

Competitive Advantage over Banks

Market leadership and expertise in providing customised services in unbanked areas, offers the company a competitive advantage over banks

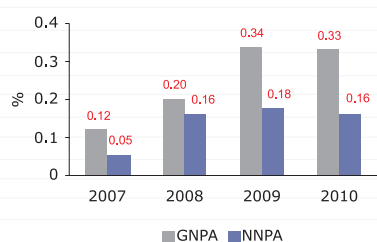
The company's focused lending to poor women of India since inception has made the company experienced enough to understand the needs and behaviours of such segments and the complexities with such lending. Its regular contact with members for product sales, collections, product training, and group decision making provides the capability to offer a variety of financial products nationally in areas that most companies cannot. According to the knowledge, culture and need of such women, the company develops the customised products that gives it the competitive advantage over commercial banks. The company also provides product awareness training programmes for its members thus it translates into better loan book performance and sustained business growth.

Widening the Sources of Revenue

Entered into strategic partnership with Nokia and Airtel for mobile services while a project with Metro for working capital need of Kirana stores

Along with providing the traditional loans to the women, the company is also concentrating on other means of sources that can give them better access towards diversifying of its sources of revenues. The company has started to offer productivity loans that are designed for purchase of goods that enhance the productivity of its members. A move towards it, the company entered into strategic partnership with Nokia and Airtel for mobile services while a project is going on with Metro to fulfil the working capital need for operating kirana stores. It also offers access to insurance products and loans to finance them. Such other products have different pricing structures and payment terms which allow diversifying and increasing its revenue streams and revenue base.

Asset Quality

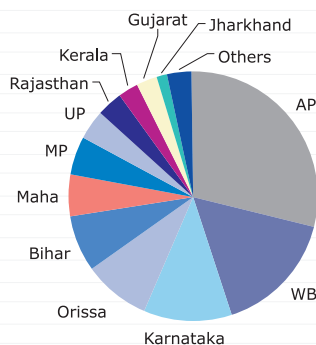


Well-Managed Asset Quality

SKS' loans are disbursed only to women, primarily for income-generating activities due to which the credit risk is low. SKS adopts a Joint Liability Group approach to lending, with each group consisting of five members giving mutual guarantee to each other. Each centre has around 5-7 JLGs, which again guarantees the combined loans mutually, thus minimizing the default risk. GNPA of the company as on Mar 10 stood at 0.33% while NNPA was just 0.16% of its credit book.

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Loan Exposure



Pan India Presence

The company enjoys the market leader position in the industry with an approximately 6.8 million members, 2029 branches, a presence in 19 states and loans outstanding of Rs. 43210 million. With pan-India presence in the low income segment gives it a well developed distribution network in rural India. This distribution channel allows it to facilitate the sale of these alternative products at a lower cost to its members.

The national presence and large volumes give it the leverage to negotiate favorable terms with institutions that want to distribute their products through its network and result in lower pricing for the products that are distributed to its members.

Experienced Team Running the Business

All of senior managers have over 17 years of experience with well reputed national and multinational companies, particularly in the retail and commercial banking industries.

Experienced and highly qualified board members are behind the picture in developing such unique and effective products that accelerates the profit making business model of the company with repayment rate over 99%. The management team has significant experience in the microfinance and financial services industry and has developed the knowledge to identify and offer products and services that meet the needs of its members, while maintaining effective risk management and competitive margins.

In addition to the founder and Chairman, Dr. Vikram Akula, its senior management team is comprised of Chief Executive Officer and Managing Director, Chief Operating Officer and Chief Financial Officer. Substantially all of senior managers have over 17 years of experience with well reputed national and multinational companies, particularly in the retail and commercial banking industries.

BUSINESS STRATEGIES

To expand range of income generating and productivity loan products

- To expand membership through increased geographic coverage and penetration in existing markets
- To expand range of income generating and productivity loan products
- To leverage distribution channels into new revenue streams
- To continue to develop information technology platform and risk management systems
- To pursue strategic business alliances

RISK CONCERNS

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- In addition, many potential members in the lower income segments do not have access to any form of organized institutional lending, and rely on loans from informal sources, especially money lenders, landlords, local shopkeepers and traders at much higher rates
- Majority of SKS's loan book is provides at a fixed rate, with increases in cost of funds if not passed on.
- Over-leveraging by the borrowers is a key risk, as there have been instances where borrowers accessed funds from multiple lenders.
- Another concern is the seasonality of the earnings, which are back-ended to the second half of the year.
- Given that the MFI loans are to low income groups, during natural calamities, the loan portfolios may result in NPAs due to the inability of the borrower to pay.

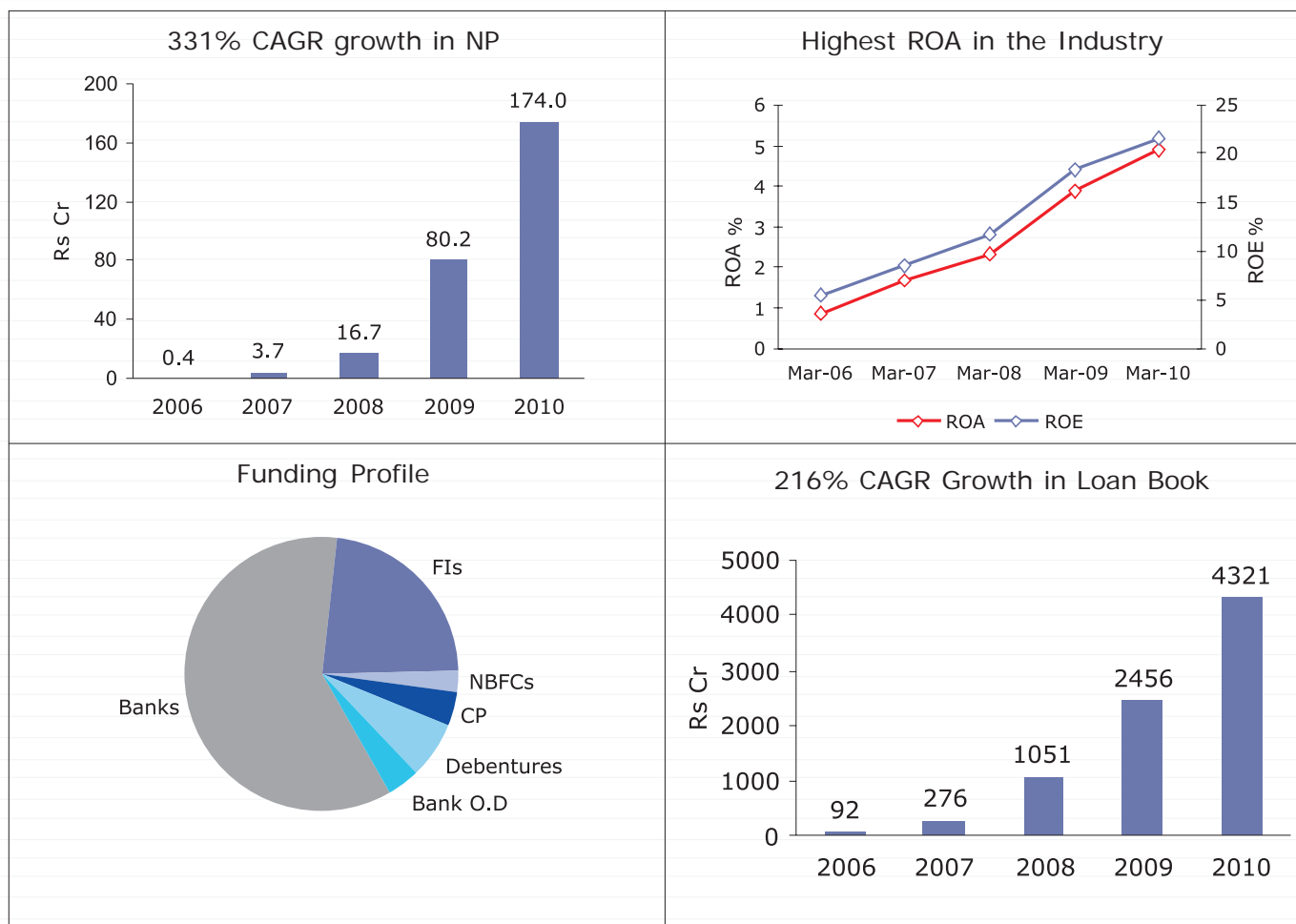
FINANCIALS & VALUATION:

Running on a growth model, it widened its network and customer base by more than 25 times and 33 times respectively over the last 5 years.

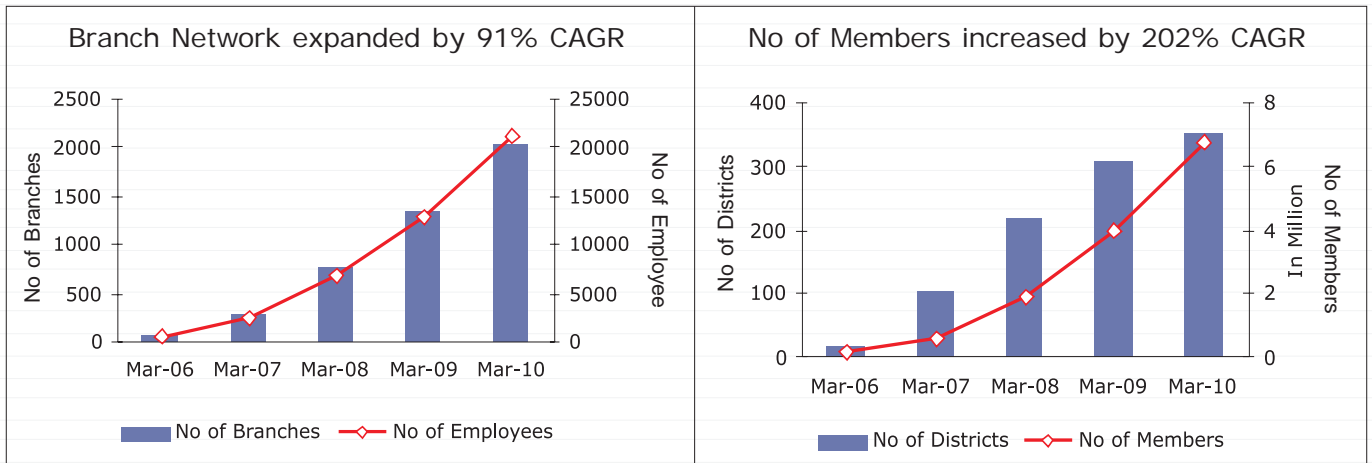
With a broad network base in southern region, the company is serving on the grass root level, still managed to expand its credit book by 216% CAGR over FY2006-10 with a repayment rate at more than 99% on unsecured loans. Running on a growth model, it widened its network and customer base by more than 25 times and 33 times respectively over the last 5 years. With a capital base of more than 28%, it aimed at maintaining the same growth momentum in the years to come. Furthermore it started to concentrate on diversifying its revenue model that will offer immense growth potentials in future.

*Hence we recommend **SUBSCRIBE** rating on the stock lower price band.*

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Source : Company / Anagram Research



Profit and Loss Statement

(Amt in Rs Cr)	2006	2007	2008	2009	2010
INCOME :					
Operating Income	9.3	45.2	169.1	552.6	873.6
Other Income	0.7	2.3	0.9	1.4	85.4
Total Income	9.9	47.5	170.0	554.0	958.9
EXPENDITURE :					
Operating & Admin Expenses	1.9	9.3	27.9	72.5	111.2
Miscellaneous Expenses	1.2	3.5	5.6	17.8	62.6
Interest	2.7	13.5	56.5	194.4	288.4
Employee Expense	2.5	12.5	46.1	134.4	216.4
Total Expenditure	8.2	38.7	136.0	419.1	678.6
Gross Profit	1.7	8.8	34.1	134.9	280.3
Depreciation	0.8	2.4	5.1	10.9	12.6
Profit Before Tax	1.0	6.4	28.9	124.1	267.7
Tax	0.2	3.7	11.4	45.6	98.1
Fringe Benefit tax	0.1	0.3	0.9	1.5	0.0
Deferred Tax	0.3	-1.2	-0.1	-3.3	-5.2
Reported Net Profit	0.4	3.7	16.7	80.2	174.8
Earnings Per Share-Unit Curr	0.3	1.4	3.8	16.8	27.1
Book Value-Unit Curr	10.3	26.9	47.9	136.5	147.8

Source : Company / Anagram Research

Balance Sheet

(Amt in Rs Cr)	2006	2007	2008	2009	2010
SOURCES OF FUNDS :					
Share Capital	13.9	26.6	44.3	57.1	64.5
Reserves Total	0.5	45.0	168.0	605.9	889.3
Total Shareholders Funds	14.4	71.7	212.3	662.9	958.0
Secured Loans	69.2	249.0	789.8	1947.4	2579.6
Unsecured Loans	0.0	0.0	0.0	39.4	115.1
Total Loan Funds	69.2	249.0	789.8	1986.8	2694.7
Total Liabilities	83.6	320.7	1002.1	2649.7	3652.7
APPLICATION OF FUNDS :					
Loan / Non-Current Assets	0.0	0.0	0.0	0.0	0.0
Net Block	5.1	5.2	13.9	18.0	22.6
Capital Work in Progress	0.0	0.1	0.6	1.0	1.8
Investments	0.0	0.0	0.0	0.0	0.2
Current Assets, Loans & Adv.					
Cash and Bank Balance	17.6	56.5	275.2	1547.0	973.5
Loans and Advances	77.2	272.4	798.1	1468.7	3037.0
Total Current Assets	94.8	328.8	1073.3	3015.7	4013.5
Less: Current Liab. & Prov.					
Current Liabilities	14.1	8.2	77.2	374.1	368.4
Provisions	2.0	6.1	9.4	15.1	34.1
Net Current Assets	78.7	314.6	986.7	2626.5	3611.0
Misc Exp not written off	0.0	0.0	0.0	0.0	7.7
Net Deferred Tax	-0.3	0.9	0.9	4.2	9.5
Total Assets	83.6	320.7	1002.1	2649.7	3652.7

Source : Company / Anagram Research

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