

**CARE assigns 'CARE IPO Grade 4' to the proposed IPO of
SKS Microfinance Ltd.**

Grading

Particulars	No of equity shares (in lakh)	Grading
IPO Grading	167.92* of Rs.10 each	'CARE IPO Grade 4'

*including an offer for sale by selling shareholders of 93.46 lakh

CARE has assigned a 'CARE IPO Grade 4' to the proposed IPO of SKS Microfinance Ltd (SKSML). 'CARE IPO Grade 4' indicates Above Average Fundamentals. CARE assigns IPO grades on a scale of Grade 5 to Grade 1, with Grade 5 indicating strong fundamentals and Grade 1 indicating poor fundamentals. CARE's IPO grading is an opinion on the fundamentals of the issuer. The grade assigned to any individual issue represents a relative assessment of the 'fundamentals' of the issuer.

Grading Rationale

The grading reflects SKSML's position as one of the largest players in the Indian micro finance industry having pan India operations with a well diversified portfolio. The grading takes into account track record of the promoters, experienced board of directors and strong management profile. The grading also takes into account good corporate governance practices adopted by the company including presence of various committees and independence of the board. The grading considers the strong financial position with healthy margins including good asset quality, comfortable capital adequacy ratio, comfortable liquidity position and access to diverse sources of institutional funding. The grading also considers the strong industry growth in recent period with good prospects for future growth on account of large unmet potential demand.

The grading is however moderated by company's sensitivity to operational risk on account of large volume of cash transactions & decentralized operations spread across the country. Further, the grading also factors in the industry risks on account of any adverse change in government policies, low seasoning of the industry portfolio and asset quality risks on account of political/religious interventions. However some of these risks are mitigated due to the high diversification of SKSML's asset portfolio.

Company Profile

SKSML is one of the largest players in the Indian micro finance industry, lending to women borrowers organised as joint liability groups. It was founded by Dr. Vikram Akula, who has more than 10 years of experience in the field of microfinance. SKSML was incorporated on September 22, 2003 under the Companies Act, 1956 and was registered as a non deposit

taking non banking financial company (NBFC-ND) with the Reserve Bank of India (RBI) in 2005. It converted from a Private Limited to a Public Limited Company, with effect from May 20, 2009. As on March 31, 2010, major shareholders of the company include Sequoia Capital India II LLC, Sandstone Investment Partners I, Kismet Microfinance and SKS MBTs (mutual benefit trusts).

Management

SKSML is run by a professional management team with relevant industry experience. 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. Additionally the company management has gained substantial experienced in the specific retail asset class of microfinance loans during the last 4-5 years while running its pan India scale of operations. In addition to founder and Chairman, Dr. Vikram Akula, senior management team comprises of Mr.Suresh Gurumani (Chief Executive Officer and Managing Director) who has 22 years of experience in the banking sector and was with Barclays Bank Plc as Retail Banking head before joining SKSML; Mr.M.R. Rao (Chief Operating Officer) who has 22 years of experience in retail financial services and was with ING Vysya as head Alternate Channels before joining; and Mr.S.Dilli Raj (Chief Financial Officer) who has 18 years of experience in funding, finance, taxation & accounting and was with First Leasing Company of India Limited as the Chief Financial Officer before joining.

Corporate Governance

Along with strong management the grading is supported by the good corporate governance practices adopted by the company including presence of various committees and independence of the board. SKSML has constituted various committees including audit committee, shareholders/investors grievance committee, finance committee, asset liability management, risk management committee, remuneration & compensation committee and nomination committee. It has five independent directors which constitute 50% of board of directors. Board of SKSML comprises of experienced investor, industry and management professionals. SKSML board comprises of experienced professionals including Dr.Vikram Akula, Mr.Suresh Gurumani, Mr.P.H.Ravi Kumar, Dr.Tarun Khanna, Mr.V.Chandrasekaran, Mr.Geoffrey Tanner Wooley, Mr.Pramod Bhasin, Mr.Sumir Chadha, Mr.Ashish Lakhnpal, Mr.Paresh D. Patel.

Operations

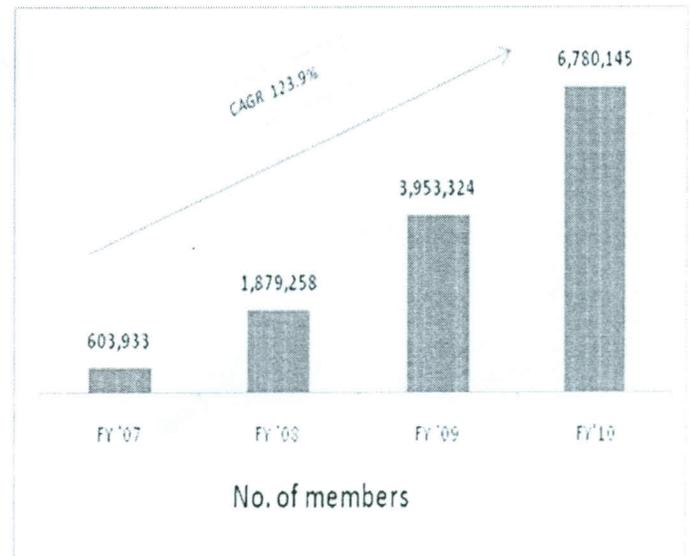
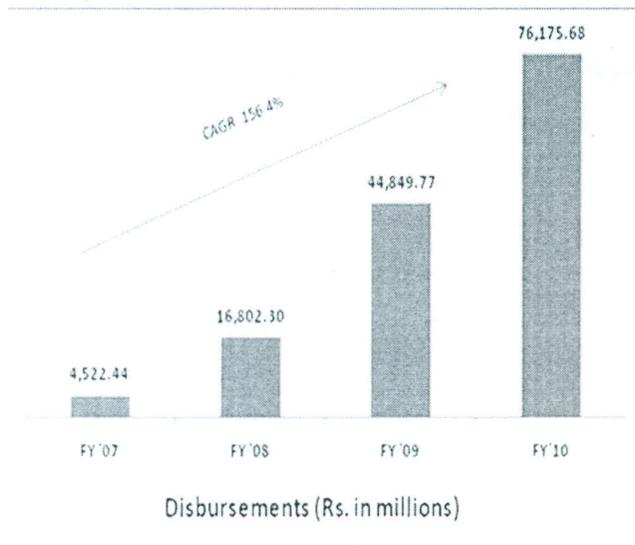
Microfinance lending is the core area of operations for SKSML and the company has grown to a pan India scale with increasing geographical diversification in its portfolio.

Microfinance loans are a unique retail loan asset class whose asset quality, in addition to conventional factors like earning capacity of borrowers & collection model of the lender, is based on peer pressure coming from the joint liability of these loans. SKSML provides loans to individual members (women) in a group (JLG - Joint Liability Group) with each group consisting of five members. The loans provided to individuals are based on the mutual guarantee from members. The JLGs in turn are part of a 'Centre' which comprises around 4-10 JLGs and the staff of SKSML interacts with the group members in centre meetings. There is also a second level of mutual guarantee wherein JLGs mutually guarantee other JLGs in a Centre. While these loans are given without collateral, mutual guarantee and the co-borrower / member pressure act as risk mitigants. The loans are repaid on a weekly basis. SKSML lends to JLGs at interest rates of around 12.5% to 15% [flat - equivalent to 23.6% to 28.1% on Internal Rate of Return (IRR) basis] with around 50 weeks repayment tenure. The ticket size of these loans is very small and ranges from Rs. 2,000 to Rs. 50,000 for SKSML. Collections are cash based.

Lending operations of SKSML are decentralised and its branches are responsible for appraisal, disbursement, collection and delinquency management. The Head Office (HO) keeps track of operations of the branches through regular reporting done by the branch managers and other supervisory staff (area managers and unit managers). SKSML has strengthened its internal controls and systems to reduce operational risks of the company. One of the primary operational risks is managing large volumes of cash movement that is exposed to theft and fraud. SKSMLs operational risk control / mitigation measures include tying up with leading banks for cash management, taking insurance coverage (for fidelity, cash in transit, cash in safe and fixed assets), formation of a crisis management team to handle frauds and strengthening of the internal audit team. The Management Information System (MIS) has been further strengthened for better monitoring of its business and also the portfolio asset quality. Additionally increasing diversification and size also provides comfort as impact of any single operational risk event is becomes smaller for the company on a proportionate basis.

The scale of operations of SKSML has grown rapidly and it has achieved a substantial level of geographical diversification. Its current scale of operations in terms of portfolio size is comparable to some of the established NBFCs which have been in operation for a much longer period of time. While the microfinance industry has large portfolio concentration in southern states of India, SKSMLs has good geographical diversification with a large coverage in eastern and western states along with southern states. 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.

Particulars	FY07	FY08	FY09	FY10
Number of Branches	276	770	1,353	2,029
Number of States	11	16	18	19
Number of District	103	219	307	341
Number of Employees	2,381	6,818	12,814	21,154
Total AUM (Rs cr)	276.16	1,050.60	2,456.41	4,320.69



As on March 31, 2010, the company operated in 19 states with 2,029 branches covering 57 lakh active borrowers with total AUM of Rs.4,321 crore including assigned portfolio of Rs.1,384 crore. As on March 31, 2010 the state-wise contribution of total AUM stood at 29.1% (Andhra Pradesh), 14.6% (West Bengal), 11.2% (Karnataka), 9.7% (Orissa), 6.9% (Bihar) and 6.1% (Maharashtra).

While the core business for SKSML is microfinance lending, it is planning to leverage the large distribution network to diversify its revenue streams in future. It has had strategic alliances with Nokia, Bajaj Allianz, HDFC Ltd, METRO Cash & Carry, Future Agrovet Ltd and others to provide various offerings.