

IPO NOTE
IPO Details

| | |
|--------------------|---|
| Face Value | Rs. 10 |
| Price Band (Rs.) | Rs. 850 - 985 |
| Issue Opens | 28-Jul-10 |
| Issue Closes | 02-Aug-10 |
| BRLM | Kotak Mahindra Capital Citigroup Global Markets India Credit Suisse Securities |
| Registrar to issue | Karvy Computer share |
| Issue Size | 16,791,579 |

Pre issue shareholding pattern

| Shareholders | % Stake |
|-----------------------------|---------|
| Promoter and Promoter Group | 55.8% |
| Non-Promoter Group | 44.2% |

Post issue shareholding pattern

| Shareholders | % Stake |
|-----------------------------|---------|
| Promoter and Promoter Group | 37.1% |
| Non-Promoter Group | 39.6% |
| Public | 23.3% |

| Allocation (not less than) | No. of shares |
|----------------------------|---------------|
| QIBs | 10,074,948 |
| Non-Institutional | 1,679,157 |
| Retail | 5,037,474 |

| IPO Details | Lower End | Upper End |
|-----------------------------------|--------------|--------------|
| Price Band | Rs. 850 | Rs. 985 |
| Equity Shares prior to issue (mn) | 64.5 | 64.5 |
| Fresh Issue of shares (mn) | 7.4 | 7.4 |
| Total Equity Shares (mn) | 72.0 | 72.0 |
| Share Capital (mn) | Rs. 720 | Rs. 720 |
| Implied market cap (mn) | Rs. 61,176.7 | Rs. 70,893.0 |

SKS Microfinance Ltd
Subscribe

SKS Microfinance Limited (SKS), a microfinance institution, was incorporated on September 22, 2003 under the Companies Act, 1956 and was registered as a non banking financial company (NBFC-ND) with the RBI in 2005. SKS is one of the largest players in the Indian microfinance 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. SKS is coming out with an initial public offer (IPO) of 16,791,579 equity shares of Rs. 10 each at a price band of Rs. 850-985 per share. SKS intends to utilise the net proceeds from the issue to augment the capital base to meet its future capital requirements arising out of growth in the business and to achieve the benefits of listing on the Stock Exchanges.

SKS's issue appears an excellent investment opportunity as:

- The total portfolio loans outstanding increased at a CAGR of 147.7% from Rs. 780.50 mn as of March 31, 2006 to Rs. 29.4 bn as of March 31, 2010, and we expect this trend to continue due to huge untapped potential in the rural markets.
- The Company has maintained higher NIM (Net Interest Margin) in the range of 11.5%-14% in the past few years on account of high yield on advances which provides a competitive advantage over its peers.
- SKS offers a proven and strong business proposition with good governance, experienced management team, expertise in the industry and various strategic alliances.
- Pan India geographical presence places it in the likes of some of the established NBFCs in terms of scale of operations. The Company's branches have increased from 276 in FY07 to 2,029 in FY10.
- Maintains superior asset quality with non performing assets being Rs. 48.03 mn or 0.16% of the loans outstanding at the end of FY10.

Valuation and Recommendation

According to our valuation, at a price band of Rs. 850 – Rs. 985, the Company proposes a P/B multiple of 3.5x and 4.1x for FY11E at lower and upper end of the price band, respectively, which is at par to its closest listed peer, S.E. Investments Ltd.

| Year to March | FY08 | FY09 | FY10 | FY11E | FY12E | CAGR(%) |
|---|-------|-------|-------|--------|--------|---------|
| <i>(Figures in mn, except per share data)</i> | | | | | | |
| Net Interest Income | 766 | 2,474 | 4,681 | 7,731 | 12,015 | 60% |
| Total Operating Income | 1,700 | 5,540 | 9,589 | 12,169 | 19,023 | 41% |
| Net Profit | 166 | 797 | 1,748 | 2,091 | 3,656 | 45% |
| Per Share Data | | | | | | |
| Adjusted EPS | 5.4 | 16.1 | 27.5 | 30.2 | 51.4 | 37% |
| PER (x) @ Rs. 850 | nm | 52.9x | 30.9x | 28.1x | 16.5x | |
| PER (x) @ Rs. 985 | nm | 61.3x | 35.9x | 32.6x | 19.1x | |
| P/B (x) @ Rs. 850 | nm | 6.3x | 5.7x | 3.5x | 2.7x | |
| P/B (x) @ Rs. 985 | nm | 7.4x | 6.6x | 4.1x | 3.2x | |

Moreover, with a comparable ROA and higher NIM of 4.93% and 13.76%, respectively, against its peer's (SE Investment) ROA and NIM of ~5% and 10.7%, respectively, we believe SKS's issue is attractively priced. Besides the Company maintains high assets quality with a Net NPA of 0.16% for FY10, thus we recommend investors to Subscribe to the issue.

IPO

Issue details

SKS will enter the capital markets on July 28, 2010 with its initial public offer (IPO) of 16,791,579 equity shares of Rs 10 each at a price band of Rs. 850- Rs. 985 per share, with a minimum bid lot of 7 shares. The IPO will close on August 02, 2010. Of the IPO, a total of 7,445,323 are freshly issued equity shares by the Company whereas 9,346,256 equity shares are offered for sale by the selling shareholders. The retail investors are offered a discount of Rs. 50 on the issue price.

Issue objectives

SKS intends to utilise the Net Proceeds from the issue to

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

Promoters

The Company's promoters are Dr. Vikram Akula, SKS Mutual Benefit Trusts, MUC, Kismet Microfinance, SCI II and Sequoia Capital India Growth Investments - I. Its promoter currently holds 55.8% of the pre-offer paid-up equity share capital of the company, which will be reduced to 37.1% after the IPO.

Investment Rationale

Emerging player in the growing industry

As per 'Inverting The Pyramid' study by 'Intelicap', the micro-credit demand in India is expected to be ~ USD 51.4 bn, which is currently being catered by Microfinance Institutions (MFIs) and Self Help Groups (SHGs). Majority of the loan disbursements are being captured by for-profit MFIs in terms of clients (62%) and loan portfolio (75%). Going forward, the MF (Micro Finance) industry is expected to continue to grow at a sturdy pace as the MFIs qualify for mandatory priority sector lending that Indian Banks are subject to. In addition, the larger MFIs accessing the capital markets and selling their loans to banks after securitizing their assets also brings in good news for the sector growth prospects. In the current MF environment, SKS stands out as a distinguished new player which is well established, offers unique advantages to its clients, holds a strong management team and has strong growth credentials. Accordingly, we believe that SKS would benefit a lot in the current conducive environment for MF growth.

Offering strong business proposition

The Company's management comprises of professionals with relevant industry experience. The senior management team's professionals have a minimum of 17 years of experience, particularly in retail and commercial banking and experience in specific retail asset class of MF loans for the past 4-5 years. Secondly, the Company follows good corporate governance practises. In fact SKS has various committees to monitor issues vital to the Company. Thirdly, the Company has garnered substantial experience in the MF industry through understanding of the needs and behaviours of the individuals and issues specific to the MF industry in India in order to develop skills in training its members and designing specialized financial products. Fourthly, SKS not only plans to leverage its distribution network to diversify its revenue inflows but also has strategic alliances with players such as Nokia, Bajaj Allianz to provide various product offerings. Lastly, the Company has also achieved diversification in terms of sources of borrowing with borrowings from 48 banks and financial institutions, thereby reducing its dependence on one source only (as of March 31, 2010, no single creditor represented more than 22.5% of the total Indebtedness).

Strong financials add to the merry

SKS has grown leaps and bounds in the past few years. The total portfolio loans outstanding increased at a CAGR of 147.7% from Rs. 780.50 mn as of March 31, 2006 to Rs. 29.4 bn as of March 31, 2010. Over the four year period from fiscal 2006 to fiscal 2010, the profit after tax & extraordinary item increased at a CAGR of 221.0%, from Rs. 16.47 million to Rs. 1.7 bn. NIM has been maintained at ~11.5%-14% in the past few years on account of high yield on advances. In addition, SKS also benefits from the strong balance sheet liquidity due to the structural nature of its loan portfolio with maturity of less than a year and active liquidity management by the Company. The Company also manages liquidity actively and keeps buffer for contingency to disburse new loans.

Pan-India coverage

The Company has extended and consolidated its geographical presence across India in the past few years which place it in the likes of some of the established NBFCs in terms of scale of operations. Unlike the industry concentration in the southern states, SKS has established presence in the western as well as southern states also. The Company's branches have increased from 276 in FY07 to 2,029 in FY10. The Company now touches 19 states as compared to 11 in FY07. We believe the Company would benefit from such coverage as the geographical coverage remains vital for the MF industry.

Superior Asset quality

The Company maintains a unique model which ensures timely repayment of loans with a low rate of default, given the high rates of portfolio growth. As of March 31, 2010 the net non performing assets, or NPAs, was Rs. 48.03 mn or 0.16% of the loans outstanding. The Company has been able to maintain superior asset quality due to its product structure in which peer

ensures timely repayment. Besides, the loans are focussed on women borrowers and are income generating loans for poor households. The seasoning of loan portfolio is also less than the conventional retail loans as these loans have shorter maturity cycle (less than a year).

Risks and concerns

Limited operating history and fast growing business make it difficult to evaluate business

SKS was incorporated in 2003 as a private limited company in India and in 2005 it was registered with the RBI as a NBFC-ND. As a result of such limited operating history, there is limited historical financial and operating information available to help prospective investors evaluate the Company's past performance with respect to making an investment in the Equity Shares.

Certain loans obtained by SKS may be recalled by the lenders at any time

SKS certain indebtedness can be recalled at any time. As of March 31, 2010, its total secured and unsecured indebtedness was Rs. 26.9 bn, of which 55.8% can be recalled by its lenders at any time. If the lenders exercise their right to recall a loan, it could have a material adverse affect on the business and financial position of the Company.

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