UTKARSH MICRO FINANCE PRIVATE LIMITED

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GRADING

ICRA has upgraded the MFI grading of Utkarsh Micro Finance Private Limited (Utkarsh) from M3+ (pronounced M three plus) to M2 (pronounce M2). The grading indicates that in ICRA's current opinion, the graded MFIs ability to manage its microfinance activities in a sustainable manner is high. Within the category, the sign of + (plus) is appended to the Grading Symbol to indicate their relative position within the Grading category concerned. The grading is valid till June 2013. ICRAs MFI Grading is not a comment on any specific debt servicing capability of the MFI.

Grading Rationale

The upgrade in grading reflects Utkarsh's experienced management team, ability of the company to raise debt as well as equity to raise funds post the Andhra Pradesh crisis, its strong investor profile, presence in areas of relatively moderate microfinance penetration, relatively prudent credit policies, good loan monitoring and collection mechanisms supported by strong Management Information Systems (MIS) and Internal Audit function. The grading also factors in improvement in profitability indicators of the company supported by reduction in operating expenses and low credit provisions. The grading is however constrained by relatively short track record of the operations (company has been in operations since July 2009), small size of operations (managed portfolio size of Rs 75.30 crore as on Mar-12), relatively high geographical concentration risk as major part of Utkarsh's operations are concentrated in Eastern parts of Uttar Pradesh (UP) (79%) which makes the portfolio more vulnerable to external shocks and large expansion plans in relation to current size of operations (company plans to grow at a CAGR of 85% over the next four years). The company has been able to maintain good asset quality indicators and collection efficiency (99.997% as on Mar-2012) so far; albeit on the relatively lower seasoned book.

Utkarsh is compliant with RBI's directives to NBFC-MFIs and checks for multiple lending and overleveraging of borrowers through cross-checks with credit bureaus. Though the company has a diversified resource profile with presence of 13 lenders, the company would have to increase the share of funding from banks in the form of term loans (funding from assignments accounted for 41% of the total borrowings as on Mar-12) going forward to achieve the projected scale of operations. While the company is currently adequately capitalised, it would need regular equity infusions for growth going forward. Further, Utkarsh is yet to establish a track record of sustainable operations in the newer micro-enterprise loan product being ventured at present. It would also be important for the company to recruit and train personnel going forward, in line with the planned branch expansion. As the company grew its portfolio from Rs 32 crore as on Mar-11 to Rs 75 crore in Mar-12, the active borrowers per loan officer increased from 285 to 492 and the fixed overhead expenses spread over a larger asset base, which led to decline in operating expenses (in relation to average managed advances from 21.96% in FY2011 to 14.80% in FY2012 and led to improvement in profitability indicators of the company though the increase was offset by a higher , decline in yields (from 31.74% to 25.94%) leading to an overall decline in profitability indicators of the company. Going forward operating expenses are expected to decline further with the increase in scale of operations of the company. Nonetheless, it would be important to maintain strict control over credit provisions by maintaining superior collection levels in the group loans and individual loans businesses to support the profitability indicators going forward.

Company Background

Utkarsh Micro Finance Pvt. Ltd is registered with the Reserve Bank of India as an NBFC as Non Banking Finance Company (NBFC) with its registered and Corporate office in Varanasi (Uttar Pradesh). The Company is promoted by Mr. Govind Singh, the former Business Head for Microbanking at ICICI Bank. Besides the promoter and other individual shareholders (promoter's friends and associates), Aavishkaar Goodwell (AG) and International Finance Corporation (IFC) and Norwegian Microfinance Initiatives(NMI) have made equity investment in the company. It is currently operating in UP and Bihar and plans to cater to entire Northern and Central India. The company is operating out of 75 branches with a managed portfolio of Rs 75 crore as on Mar-12, at present with 79% of its portfolio in Uttar Pradesh and 21% in Bihar. Utkarsh utilizes a five-member group lending methodology under Joint Liability Group model, wherein the group members undertake the responsibility of approving the loans, disbursements and repayments. Utkarsh reported PAT of Rs 1.40 crore on a managed asset base of Rs 134 crore as on Mar-12 vis-a-vis Profit After Tax(PAT) of 0.91 crore on a managed asset base[1] of Rs 41crore in FY2011.

[1] Total Assets +assigned portfolio

Shareholding Pattern

	Mar-12	Mar-11	Mar-10
	% share	% share	% share
Promoters	15.13%	15.09%	12.04%
Individual shareholders	33.38%	33.38%	44.71%
International Finance Corporation	16.69%	16.69%	14.90%
Aavishkaar Goodwell	31.03%	31.04%	27.66%
Intellecash Microfinance Network Co Pvt Ltd	0.44%	0.44%	0.69%
ESOP	3.36%	3.36%	
Total	100.0%	100.0%	100.0%

Apart from this, Aavishkaar Goodwell invested Rs 6 crore in the form of Compulsorily Convertible Debentures and NMI Frontier Fund infused Rs 15.8 crore as Compulsorily Convertible Preference Shares(CCPS) and IFC invested Rs 3.2 crore as CCPS in FY2012 which are convertible in November 2012.

	Name of Debenture holders (Compulsorily Convertible)	No. of CCDs
1.	Aavishkaar Goodwell India Microfinance Development Co II Ltd.	6,00,000
	Total	6,00,000

	Name of Preference Shareholders (Compulsorily Convertible)	No. of CCPS
1.	NMI Frontier Fund KS, Norway	49,52,978
2.	International Finance Corporation (IFC)	10,03,134
	Total	59,56,112

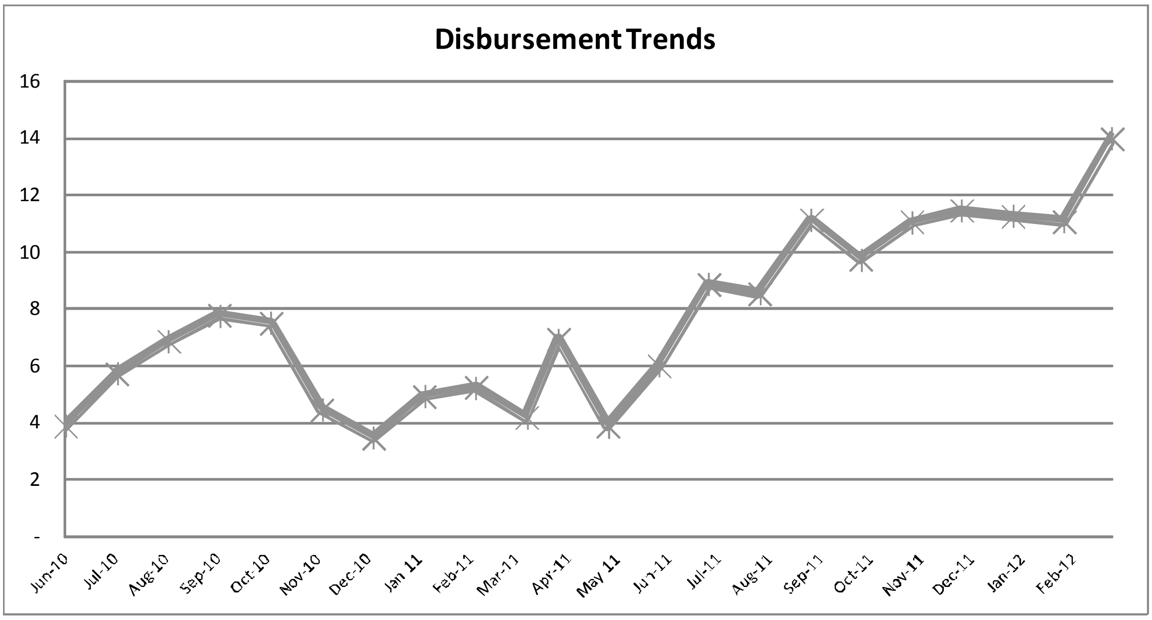
Table 2: Highlights of Operations

	Mar-12	Mar-11	Mar-10	Sep-09
No of States	2	2	1	1
Total Branches*	75	52	13	4
Total Centers*	7,826	3,902	499	25
Total Members*	110,886	58,623	8,719	388
Total Active Borrowers	106,369	55,506	8,208	130
Total Groups*	25,816	12,456	1753	78
Credit Portfolio (Managed) (Rs. cr)	75.30	31.86	6.34	0.12
Growth (%)	136%	402%	5106%	
No. of Employees (FDO) [1]	408	325	114	31
Credit Officers	216	195	73	20
Active Borrowers per branch	1,418	1,067	631	32.50
Active Borrowers per Credit Officer	492	285	112	6.5

** As on Mar-09*

Utkarsh utilizes a five-member group lending methodology under Joint Liability Group model, wherein the group members undertake the responsibility of forming the group, joint liability, and repayments. The borrowers are mainly women mainly in rural and semi-urban regions, come from weak income backgrounds, with no access to organised credit and in most cases do not have a credit history. 2 to 6 groups form a centre. While this makes the lending risky (the loans being unsecured), the group dynamics, which has been historically tested and in varied markets, should be effective in curtailing shortfall in collections from any borrower. The borrowers typically are involved in animal husbandry projects, small trade, cottage industries, agricultural based projects and other textile related projects. For lending in these segments Utkarsh earns yields in the range of 25.94% apart from a processing fees of 1%.
Recently the company has started a pilot for Microenterprise loans (higher ticket size loans from Rs 50,000 onwards). Through the pilot the company would try to assess the demand for the product and the repayment behaviour of the borrowers. The share of this portfolio would remain less than 15% of the total portfolio of Utkarsh (based on the experience from the pilot programme). To assist the company in rolling out the product, the company would employ a resident consultant from MicroSave, supported by IFC..

The company has contributed 3% of its PBT to Samutkarsh Welfare Services in FY 2011-12 and from FY 2012-13 onwards, the company would be contributing 2% of its PBT to Samutkarsh Welfare Services for credit plus activities.



The portfolio of Utkarsh has been growing at a fast pace in 2011-12(except some slowdown seen post the Andhra crisis post which disbursements has gradually picked up). With respect to the guidelines from RBI on 3 May 2011, and Dec-2011, Utkarsh is compliant with the same for incremental disbursements made from May 2011 onwards.

Summary Grading Rationale

	Parameters	Overall Comments
A	**Business Risk**	
1	Operating Environment	The Microfinance sector expanded rapidly till Oct-2010. However, post the crisis in Andhra Pradesh in October 2010, Banks restricted the flow of funds to MFIs. Subsequently, the recommendations of the Malegam Committee were broadly accepted by the RBI and the final guidelines for NBFC-MFIs were published in December 2, 2011. Post Dec-2011 guidelines of RBI, bank funding to MFIs has improved in Q4, FY12 though the availability of funds remains lower than pre-AP crisis levels. Given the nature of the business, regular flow of funds is crucial to maintain as well as grow the business operations. However, given that the current penetration of MFIs is still low in India, the potential for growth appears significant. Further with 2 Credit Bureaus in place, (Hi-Mark and Equifax) and the conditions stipulated by RBI on leverage status of borrowers (total borrowing of Rs 50,000 and funding not to exceed from more than 2 MFIs) is likely to prevent excessive growth and overleveraging of borrowers.. Also the draft MFI Bill was cleared by the Cabinet and introduced in the parliament in May 2012 which would bring a central regulation in place so the risk of state-level regulations (of similar nature as that passed in AP in Oct-10) will be mitigated. With the passage of the bill, political risk will be mitigated to a large extent as MFIs will be regulated by RBI)
2	Governance Structure, Management and Systems	Transparent shareholding pattern; shareholders have a good representation on the Board. Utkarsh had a seven member board as on Mar-12 with all the directors experienced in their respective area of expertise. The board has two investor directors (representatives from Aavishkaar and NMI), three independent directors of which two have finance/Microfinance expertise and two executive directors. The board meets on a quarterly basis and if required it may meet more often. The Utkarsh Board is actively involved in strategy formulation and also approves the company's business plan. The Board is also involved in areas related to HR and Training, Social Performance Initiatives as well as introduction of new products. The company has an experienced and professional second line of management as well which has been strengthened further to manage the geographical expansion. The company has developed good internal audit systems and has good MIS systems in place. Utkarsh migrated to a new web based module (implemented by Craft Silicon) which can handle larger size of operations, with an integrated Accounting module. Though the branches are not connected and do not have a computer, data is available online with a lag of three days at the head office
3	Scalability (in relation to business plans)	Utkarsh plans to grow at a CAGR of 85% over the next 4 years, and would require regular capital infusion as internal capital generation may not be sufficient. The company has factored in Rs. 40 crore equity infusion in FY2014. Further, though the company has a diversified resource profile it would require larger lines from banks to reach the requisite scale of operations. With scaling up of business, Utkarsh would require a larger number of trained employees to support its operations. With the shift in repayment frequency from weekly to fortnightly the company is expecting the loan officers to handle a larger number of clients, therefore the loan officers are expected to increase at a lower level than portfolio growth. The company would also need to scale up their training facilities. For addressing these issues the company has enrolled a resident consultant from MCRIL supported by Norwegian Microfinance Initiatives, who would work with them over a period of one year, study their training modules, appraisal mechanisms, develop training modules and also advise on incentive policies and organisation structure

	Parameters	Overall Comments
4	Asset Quality	Though Utkarsh is in growth phase and has started operations less than 3 years ago, it has been able to maintain sound asset quality with over 99.997% repayment rates till March 2012. Further, rigorous supervision by operations team & rigorous follow up audits by Internal Audit Department have also helped the company to maintain asset quality indicators. So far, Utkarsh has not been affected by any political or external environmental issues. Further the company plans to diversify into new geographies of Uttarakhand and Madhya Pradesh and has recently diversified in micro-enterprise loan segment , ability of the company to maintain the same level of asset quality while diversifying the portfolio geographically and increasing the product mix is yet to be seen

B	**Financial Risk**	
1	Liquidity and Funding Profile	Utkarsh diversified its resource profile in FY2012 and added 6 new lenders taking the overall lender list of 13 lenders (including 2 PSU banks). While these relationships have helped in meeting funding requirements in the past albeit at high interest rates, the company would have to diversify its resource profile to meet its business plan and increase its funding mix from public sector banks. Further the company will have to increase share of direct term loans in its mix and reduce the share of assignments in the overall funding (41% of funds as on Mar-12) as ICRA expects volume of assignment transactions to be affected in short term post the issuance of RBI guidelines on the same. The company has a comfortable liquidity profile however; the tenor of assets being shorter than the liabilities, however regular flow of funds is crucial to maintain as well as grow business operations and would have a key bearing on its liquidity profile. (The company has been able to raise Rs 25 crore equity and Rs 119 crore of debt in FY 11-12.)
2	Capitalisation	The capital adequacy of the company was comfortable as on Mar-12 owing to capital infusion in FY2012. Going forward, the company plans to grow at a CAGR of 85% over the next 4 years and increase its penetration in states of Central India (UP, Bihar, Uttarakhand, MP). To support its growth plans, Utkarsh would require regular capital infusion as internal capital generation may not be sufficient. The company has factored in Rs. 40 cr equity infusion in FY2014 in its business plan. The promoter has 15.13% stake in the company and is willing to dilute it further for scaling up the operations of the company. However to protect dilution in stake, the promoter has preferential rights of the company convertible into common equity shares at par latest by December 2012.With regard to accounting policy of the company for calculating CRAR the company has been prudent in accounting for capital for assigned book (First Loss Default Guarantee is deducted from the net worth for calculating CRAR)
3	Profitability	The company reported PAT of Rs 1.40 crore on a managed asset base of Rs 134 crore in FY2012 vis-a-vis PAT of Rs 0.91 crore on an asset base of Rs 41 crore in FY2011. As the company grew its portfolio from Rs 32 crore to Rs 75 crore in Mar-12, the active borrowers per loan officer increased from 285 to 492 and the fixed overhead expenses spread over a larger asset base, which led to decline in operating expenses(in relation to average managed advances from 22% in FY2011 to 14.8% in FY2012. The company has also ventured into microenterprise loans where the yields are higher and would support overall profitability levels. Nonetheless, it would be important to maintain strict control over credit provisions by maintaining superior collection levels in the group loans and individual loans businesses.

Strengths/Challenges

Strengths

- Company continues to focus on areas of moderate penetration in rural areas, – UP, MP, Bihar and Uttarakhand, relatively low. Management is well aware of negative areas within the target geographies, geographical diversification likely to improve going forward.
- Experienced and professional management team, good second line of management team as well
- Strong investor profile, with IFC , Norwegian Microfinance Initiative(NMI) and Aavishkaar Goodwell as the investors,
- Good Internal Audit, Tracking and MIS systems
- Relatively prudent credit policies, as company does not offer midterm loans, lends to people staying for atleast 3 years at same location, performs borrower wise cash flow analysis
- Incentives to loan officers capped beyond forming 75 members per month thus reducing the risks associated with high growth by compromising portfolio quality
- Good asset quality indicators with repayment rate over 99.997% so far

Challenges

- Small size of operations, growth rate expected to be high over the medium term till the company becomes a medium sized MFI.
- To improve geographical diversification of operations to mitigate political and other risks; though contiguous expansion strategy helps the company in monitoring and controlling costs, but exposes the company to political and other risks
- To increase share of funding from public sector banks to achieve planned scale of operations
- To improve profitability indicators by reducing operating expenses and maintaining the low credit costs.
- Getting good manpower, training and retaining them

Business Risk Profile

Operating Environment

MFI sector in India has been facing a challenging time post the ordinance—which was subsequently adopted as an Act--issued by the Andhra Pradesh (AP) government, which stipulated that the periodicity of loan repayment should be less than a month even under existing loan agreements and centre meetings can happen only in designated places in the villages. This led to significant decline in collections in the State of Andhra Pradesh. While the asset quality in other states has largely remained unaffected, some deterioration in asset quality was also seen in the neighbouring districts of Tamil Nadu. However, given the crisis in Andhra Pradesh, banks restricted the flow of funds to MFIs, particularly those operating out of Andhra Pradesh. While the recommendations of the Malegam Committee — appointed by the RBI to address various allegations on MFIs pertaining to high interest rate charged by MFIs, overleveraging of borrowers and so on – have been largely acknowledged to have several long-term positives for the sector, there are several operational challenges in the short to medium term. The RBI had vide its circular dated 3 May 2011 confirmed the continuity of the priority sector status for MFI loans and also stipulated some lending and pricing norms for MFIs and clearly mentioned which of the assets would be considered as qualifying assets for Priority Sector Benefits. Subsequently, the recommendations of the Malegam Committee were broadly accepted by the RBI and the final guidelines for NBFC-MFIs were published in December 2, 2011. Also the draft MFI Bill was cleared by the Cabinet and introduced in the parliament in May 2012 which would bring a central regulation in place so the risk of state-level regulations (of similar nature as that passed in AP in Oct-10) will be mitigated. Post Dec-11 guidelines of RBI, bank funding to MFIs has improved in Q4FY12 though the availability of funds remains lower than pre-AP crisis levels. Given the nature of the business, regular flow of funds is crucial to maintain as well as grow the business operations.

However, given that the current penetration of MFIs is still low in India, the potential for growth appears significant. Further with 2 Credit Bureaus in place, (Hi-Mark and Equifax) and the conditions stipulated by RBI on leverage status of borrowers (total loan per borrower of Rs 50000 and funding not to exceed from more than 3 MFIs) is likely to prevent excessive growth and overleveraging of borrowers

Other challenges for Microfinance lending are as follows:

- The political risk continues to remain high for these players. Also the risk of contagion in the event of any communal issues or any other local issues is also high.
- Given the low-ticket sizes, the cost of legal recourse becomes unviable for such loans and thus MFIs depend more on joint liability mechanisms to ensure repayments.
- A large proportion of borrowers of MFIs are below poverty line and are wage laborers or marginal entrepreneurs, therefore their resilience of their repayment capacity could be impacted due to economic, social or political reasons.
- Loan waiver schemes introduced by the Government could also impact the credit culture among borrowers adversely. Also extreme weather conditions like flood or draught can severely impact the earning capability of such members.

Nevertheless, in light of the fact that the current penetration of MFIs is still low (in single digits) of the total poor in India, ICRA feels that there is a potential for growth and scaling up operations provided the MFIs are able to design effective control mechanisms. However, this would be subject to availability of adequate funds to MFIs.

Governance Structure, Management and Systems

Ownership Structure

Mr. Govind Singh and his family hold 15.13% stake in the company. Further 33.38% of the stake is held by friends and ex colleagues of Mr Govind Singh (Further Aavishkaar Goodwell holds 31.03% stake in the company and the International Finance Corporation holds 16.69%. The company received Rs 15.8 and Rs 3.2 crore in the form of compulsorily convertible preference shares (CCPS) from NMI Fund and IFC respectively and Rs 6 crore equity infusion in the form of Compulsorily convertible debentures from existing investor Aavishkaar Good well in FY2012. The CCD & CCPS are convertible in November 2012. The company plans to grow at a fast pace in the medium term and would start preparing for another round of equity infusion in the last quarter of the current financial year.

Board Structure and Processes

Board of Directors as of March 31, 2012:

Name	Designation	Brief Profile
Govind Singh	MD & CEO	
Trilok Nath Shukla	Head Operations	
Ajai Raj Sharma	Independent Director	Retired IPS officer
Ajay Maniar	Aavishkaar Goodwell Representative	Currently Principal at Aavishkaar Goodwell. Has 15 years experience across rating agencies and banks.
Henning Haugerudbraten	Investment Director NMI Frontier Fund	He is the Investment Director of the NMI Frontier Fund He has earlier worked with McKinsey & Company & World Bank
Ramni Nirula	Independent Director	Currently with ICICI Foundation, Retired as Senior General Manager in ICICI Bank
Vijayalakshmi Das	Independent Director	MD of Ananya Finance for inclusive Growth

Utkarsh had a seven member board as on Mar-12 with all the directors experienced in their respective area of expertise. The board has two investor directors(representatives from Aavishkaar and NMI) ,three independent directors of which two have finance/Microfinance expertise and two executive directors. The board meets on a quarterly basis and if required it may meet more often. The Utkarsh Board is actively involved in strategy formulation and also approves the company's business plan. The Board is also involved in areas related to HR and Training, Social Performance Initiatives as well as introduction of new products.

Management

Mr. Govind Singh is the promoter of the company and is holding the position of Managing Director and CEO. He started the company in August 2009 with an experienced management team acting as functional heads.

Mr Govind Singh was the former business head for microbanking at ICICI Bank. He was responsible for Building ICICI Bank's microfinance funding portfolio (wholesale funding to MFIs), maintaining relationships with and developing the Business Correspondent Model.

Mr Govind Singh is assisted by functional Heads (Core Team Members) who have been associated with the company since inception. All the functional heads have good experience in their relevant areas. The second line of management has been strengthened further with recruitment of Head Risk externally. The other functional heads have also been associated with the Microfinance sector .

Field officers who are on the rolls of the company handle entire operations. At the field level, the field officers report to the branch managers who in turn report to the Area Managers. Each area manager handles 3 branches and reports to divisional manager who handles 9 branches The Area Manager reports to a Divisional manager, who reports to Regional Manager. The Regional Manager reports to Zonal Manager who in turn reports to the Head of Operations. The auditors of the company – M/s B S R and Co (KPMG) are reputed auditors.

Systems and Processes

IT Systems

Utkarsh migrated to a new web based module which can handle larger size of operations implemented by Craft Silicon, with an integrated Accounting module. The advantages of this software vis-à-vis the software earlier (FIMO provided by Jayam) is that it can handle a larger scale of operations. Further earlier each branch was running a separate module and it had to be integrated manually. With the migration to this system the integration is automatic.

This software is quite comprehensive, capturing all client details, loan purpose, client attendance, loan details and also the track record of the loan repayment and delinquency details, if any is appropriately maintained.
Every branch does not have a computer as there are major power issues in UP, and it is costly for the company to maintain generator/UPS at every branch. Daily collection and disbursement Data is entered in the system at the Divisional Office. Each Divisional office caters to 9 branches and a dedicated data entry operator enters data for the branches..
The loan officers work with a collections and disbursement sheet (CDS) which contain the centre wise collections and disbursements they have to make. The CDS is generated at the divisional office every Wednesday and Saturday for the next 3 days. One of the credit officers from the branch physically takes the hard copy of these CDS sheets on Wednesday to the Divisional Office (for entered collections, disbursement and attendance data for Monday, Tuesday and Wednesday), The divisional office, hands over the CDS sheets for the coming three days (Thursday, Friday, Saturday) to the Credit officer which contains details on upcoming group, meetings, collections and disbursements to be made

Some of the key features of the MIS systems of the company are

- Attendance Tracking at member level
- Portfolio cuts based on purpose, region, product, IRR, cycle of loan, religion
- Tracking Loan Utilisation Check in Collection and Disbursement Sheet

Internal Audit Process

Utkarsh has developed a three tier Internal Audit System where all branches go through atleast one of the following types of audits every month The company has a ten member internal audit team and internal audit plan is prepared in advance and the team of auditors schedule the audits accordingly. All audits are surprise audits

- Snap Audit - lasts for a day
- Short Audit – lasts for 2-3 days every branch with more than 500 clients to be covered monthly
- Comprehensive Audit -lasts for 6-8 days, every branch to be covered atleast quarterly

The company has developed a comprehensive checklist, with weightages for each parameter for the comprehensive audit. The checklist is comprehensive and covers the field operations, record keeping, statutory compliances, accuracy of Management Information Systems (MIS), monitoring mechanism and compliance with code of conduct.

The comprehensive audit process for each branch lasts for 6 days. The audit team stays in the respective branches for six days and verifies all the records and documents corresponding to that particular branch. The audit members also accompany the Loan officers to the centre meetings to verify the collection processes at the field level. Upon completion of audit detailed audit reports are prepared and submitted to the Head Internal Audit who consolidates all the audit reports and submits it to the Managing Director. An Audit report is not complete till the deficiencies observed in the previous audit are complied with.

Risk Management Systems

Utkarsh has mandated M2i consulting for customising IFCs Global Risk tool for the Microfinance sector. Though the company has already developed a risk template and identified all the key risks in their entire operations process, the consultant would help in improving the Risk management tool further.

Client Protection Practices

The company has developed a robust client protection practices in place, which is reflected in its relatively conservative credit policies. Some of the key highlights of the credit policies of Utkarsh are as follows.

- All incremental sanctions are to take place post checking with Credit Bureau
- No Mid Term Loans
- Utkarsh would not be the second lender where a borrowers outstanding is more than Rs 30000 and third lender in any case
- Loan application captures family's outstanding loans
- Borrower wise cash flow analysis is part of the disbursement form

The company has also put in a good grievance redressal mechanism in place with a dedicated phone line for grievances and a grievance redressal committee which meets every month at Head office. Incentive structures for loan officers are also controlled and capped for new client acquisitions beyond 75 clients. Further, the company also contributes a portion of its Profit Before Tax to Samutkarsh Welfare Services a section 25 not for profit company, primarily to undertake credit plus activities for Utkarsh's borrowers

Accounting Policies

Utkarsh books interest income on the industry-accepted Internal Rate of Return (IRR) basis. Utkarsh Provisioning policy is also higher than the minimum prescription by RBI. For Capital adequacy calculations, the company does not differentiate between capital treatment for assignment and securitisation transactions,(credit enhancement deducted from Capital)The Company has changed its accounting policy with respect to recognition of income from asset assignment on sale of loan portfolio. Until FY2011, excess of the sale consideration received over the loan portfolio assigned/sold was recognized upfront. However, starting from the current financial year, the Company has amortised the profit on sale of loan portfolio over the tenure of the loan portfolio assigned /sold.

Scalability

Quarterly Trends:

	Mar-12	Dec-11	Sep-11	Jun-11	Mar-11	Dec-10	Sep-10	Jun-10	Mar-10
No. of states + Union Territory (UT)		2	2	2	2	2	2	1	1
No. of districts	19	17	14	13	13	13	11	9	7
No. of branches	75	67	57	52	52	52	45	30	13
No. of groups	25,816	19,423	16,007	13,703	12,456	10,467	7,983	4,094	1,753
No. of active members	106,369	76,770	60,344	54,449	55,506	48,751	43,199	19,446	8,208
No. of active borrowers per branch	1,418	1,146	1,059	1,047	1,067	938	960	648	631
Portfolio Size (Rs. cr.)	75.30	59.97	44.88	32.24	31.86	30.02	26.99	13.88	6.34
Disbursements	36.31	32.26	28.51	16.80	14.34	15.41	20.35	10.72	6.65
No. of loan officers	216	192	197	173	195	212	270	146	73
Active Borrowers per loan officer	492	400	306	315	285	230	160	133	112
Repayment Rate[1]	99.997%	99.998%	99.999%	100%	100%	100%	100%	100%	100%
New Members Added	24976	21482	14854	7423	10,846	12,804	19,544	11,835	5,840
Drop-out Members	7252	3836	9377	3227	2,925.00	1,467.00	552.00	167.00	54
No. of new members as % of existing members	32.53%	35.60%	27.28%	13.37%	22.25%	29.64%	100.50%	144.19%	
No. of drop out members as % of existing members	9.45%	6.36%	17.22%	5.81%	6.00%	3.40%	2.84%	2.03%	

The company has been scaling up operations at a fast pace as it is still in growth phase However, the company has been following a contiguous expansion strategy (expansion in neighbouring districts) to monitor the portfolio more effectively. In FY12 the company expanded its presence from 13districts to 19 districts (with incremental growth in area in Bihar), which resulted in decline in geographical concentration of its portfolio in UP from 95% as on Mar-11 to 79% as on Mar-12.

The company plans to expand to the states of MP and Uttarakhand in the current financial year. Within UP as well, the company is planning to expand to areas of western UP. The company plans to expand to 100 branches by March 2013.The company has put in place good systems and monitoring mechanisms which provide a good platform to expand operations. Further, extensive surveys are done before entering any village, covering poverty levels, literacy levels, population, various risks in the area, primary occupation of the villagers etc. Extensive community meetings are also conducted before members are admitted.

Access to capital

Rs crore	Mar-12	Mar-11	Mar-10
Total Capital	38.6	12.63	6.88
FLDG for assigned book	5.7	1.58	-
Total Capital	32.	11.05	
Risk Weighted Assets	41.57	25.83	6.63
CRAR	79.11%	42.78%	103.77%
Gearing assuming assigned book as debt	2.33	2.13	0.51

Going forward, the company plans to grow at a CAGR of 85% over the next 4 years and increase its penetration in states of Central India (UP, Bihar, Uttarakhand,MP). To support its growth plans, Utkarsh would require regular capital infusion as internal capital generation may not be sufficient. The company has factored in Rs. 40 cr equity infusion in FY2014 in its business plan. The promoter has 15.13% stake in the company and is willing to dilute it further for scaling up the operations of the company. However to protect dilution in stake, the promoter has preferential rights of the company convertible into common equity shares at par latest by November 2012.

With regard to accounting policy of the company for calculating CRAR the company has been prudent accounting for capital for assigned book (First Loss Default Guarantee is deducted from the networth for calculating CRAR).

Human Resources

With scaling up of business, Utkarsh would require a larger number of trained employees to support its operations. At the field officer level, the basic requirement is that the staff must have passed Class 12, with knowledge of the local language and good communication skills, which are available easily standardised.
The staff is trained at the company's training centres and the training procedures are standardised. Company has two training centres- Varanasi & Allahabad. It is planning to have another training centre in Bihar. Every employee goes through 5 days of classroom training, followed by a test and 5 days of field training. After the field training, the employee is sent for 3 months of on the job training on the field. During this period they remain in 1 branch. In the first 1-1.5 months they work with an existing credit officer, post which they are permitted to form groups if they are found capable of doing so. Utkarsh intends to grow at a fast pace in the medium term. With The shift in repayment frequency from weekly to fortnightly the company is expecting the loan officers to handle a larger number of clients, therefore the loan officers are expected to increase at a lower level than portfolio growth. Also the attrition rates being moderate, particularly at the junior levels, it is important for the company to develop policies to retain the staff.

After confirmation a person is placed at a place which is 40-50 kms away from their home and usually in another district. The officers rotated across branches atleast once in 6 months. Refresher trainings for new products, code of conduct, compliance are held once in three months at divisional offices. Recently the company has stopped disbursements on Saturdays, and alternate Saturdays are kept exclusively for training purposes. With The shift in repayment frequency from weekly to fortnightly and increase in coverage per branch, the active members per loan officers penetration has increased and therefore the loan officers are expected to increase at a lower level than portfolio growth, which would also bring down operating expenses for the company.The company plan to retain the senior level management through ESOPs. With the growth in portfolio, the company would require qualified and experienced executives for monitoring the operations and other functions

New Initiatives

The company has identified M-Cril as a consultant for improving the HR and Training systems and processes. M cril staff would be present at their office over a period of 6 months to 1 year and suggest improvements in HR processes and would include development of new HR and Training modules, appraisal mechanisms, and also advise on incentive policies and organisation structure. The focus of this project would be nurturing the staff at the loan officer level. This initiative is being supported by one of the investors- Norwegian Micro finance initiative.

Tie-up of funding sources

Access to debt

Rs crore	**Mar-12**		**Mar-11**		**Mar-10**	
Networth (including CCDs and CCPS)	38.60		12.61		6.88	
Term Loan from Banks and FIs	52.91	59%	18.56	69%	3.50	100%
Off balance sheet	36.96	41%	8.29	31%	-	0%
Total Borrowings (incl Off B/s)	89.87	100%	26.84	100%	3.50	100%
Gearing (assuming assigned book as debt)	2.33		2.13		0.51	
Cost of funds	15.59%		14.65%			

Utkarsh plans to leverage its net worth to between 3-4 times over the next 4-5 years. Being a non-deposit taking NBFC, it cannot access public deposits and has to rely on secondary sources, mostly banks and FIs for tie-ups of funds.Utkarsh diversified its resource profile in FY2012 and added 6 new lenders taking the overall lender list of 13 lenders (including 2 PSU banks). While these relationships have helped in meeting funding requirements in the past albeit at high interest rates, the company would have to diversify its resource profile to meet the its business plans and increase its funding mix from public sector banks. Further the company will have to increase share of direct term loans in its mix and reduce the share of assignments in the overall funding (41% of funds as on Mar-12) as ICRA expects volume of assignment transactions to be affected in short term post the issuance of RBI guidelines on the same. In the current financial year the company is expected to receive a sanction for ADB guaranteed funding line of Rs 20 crore. The company is also in the process of raising funds through the NCD route.

Financial Performance

Profitability

	FY2012		FY2011		FY2010
Net Interest Income(including income from assignment)	8.24	57%	5.26	1322%	0.39
Non Interest Income / Fee Income	1.23	-25%	1.65	2257%	0.07
Operating Income	9.47	37%	6.91	1470%	0.46
Operating expense	6.89	40%	4.92	259%	1.41
Operating Profit	2.58	30%	1.99	-314%	(0.95)
Provisions-credit	0.22	69%	0.13	333%	0.03
PBT	2.15	109%	1.03	-208%	(0.95)
PAT	1.40	54%	0.91	-196%	(0.95)

Note: Amounts in Rs. Crore

- Utkarsh reported improvement in earnings largely supported by increase in operating efficiency and stable credit provisions.
- In FY2011 the company had received Rs 55 lakh performance based grant from IFC, which enabled the company to report marginal profits. If we were to exclude the same, the company reported a 344% growth in PBT in FY2012 over FY2011.
- Utkarsh was charging an interest 31.74% earlier which has been reduced to 25.94% post the RBI guidelines in May 2011 ,which led to a decline in yields. Further, rise in cost of funds led to an overall decline in lending spreads to 11.50% in FY2012

- As the company grew its portfolio from Rs 32 crore to Rs 75 crore in Mar-12, the active borrowers per loan officer increased from 285 to 492 and the fixed overhead expenses spread over a larger asset base, which led to decline in operating expenses(in relation to average managed advances from 22% in FY2011 to 14.8% in FY2012.
- Despite decline in net interest margins, the company was able to maintain its operating profitability (excluding the grant received from IFC) because of substantial decline in operating expenses and stable credit provisions. Nevertheless the company will have to bring down its operating expenses further and maintain its credit provisions at present levels to improve profitability indicators as it leverages its net worth further. The company has also ventured into microenterprise loans where the yields are higher could support overall profitability levels. Nonetheless, it would be important to maintain strict control over credit provisions by maintaining superior collection levels in the group loans and individual loans businesses.

KEY RATIOS	FY12	FY11	FY10
Yield on Average Loans	27.09%	31.83%	28.57%
Yield on Average Investments	7.34%	6.69%	4.62%
Yield on Average Earning Assets	22.07%	31.15%	15.81%
Cost of Average Interest Bearing Funds	15.59%	14.65%	0.96%
Lending Spreads	11.50%	17.18%	27.61%
Gross Interest Spread	6.48%	16.50%	14.84%
Key Ratios (Managed Portfolio)			
Net Interest Margin /AMA	10.46%	17.11%	8.75%
Non Interest Income/AMA	1.56%	5.37%	5.13%
Operating expenses AMA	8.75%	16.01%	87.82%
Operating Expenses/ Managed advances	14.80%	21.96%	87.82%
Operating Profit / AMA	3.28%	6.47%	-68.13%
Credit Prov. & Write-offs / AMA	0.28%	0.42%	2.20%
PBT/ AMA	2.73%	3.35%	-69.60%
PAT/ AMA	1.78%	2.96%	-69.60%
PAT (excl. Minority Interest) / Average Net worth	6.22%%	9.34%	-51.81%
Cost Income Ratio	74.67%%	81.33%	308.59%%

AMA- Average Managed Assets

Liquidity

The average tenure of Utkarsh's loan portfolio is 29 fortnights while duration of liabilities is higher at 12-24 months. The long tenure of the loans and the portfolio collections would support fresh disbursements to some extent.

COMPANY PROFILE—Utkarsh Micro Finance Private Limited

Date of Incorporation	May 1990	
Constitution	Non-Deposit Taking NBFC	
Registered Office	S-2/639-56, Varuna Vihar colony, J.P Mehta Road, Cantt. Varanasi-221002 (U.P.) India	
Corporate Office	S-2/639-56, Varuna Vihar colony, J.P Mehta Road, Cantt. Varanasi-221002 (U.P.) India	
Net Worth (Mar-2012)	Rs. 38.61 crore (including CCD of Rs 6 crore)	
Number of Branches (Mar-12)	75	
Number of active borrowers (Mar-12)	106,369	
Number of field officers (Mar-12)	216	
Balance Sheet size (Mar-12)(including managed book)	Rs 134 crore	
Managing Director	Mr Govind Singh	
Auditors	BSR and CO	
Shareholding Pattern (Mar-12)		**Mar-12**
		% share
	Promoters	15.13%
	Individual shareholders	33.38%
	International Finance corporation	16.69%
	Aavishkaar Goodwell India	31.03%
	Intellecash Microfinance Network	0.44%
	ESOP	3.36%
	Total	100.0%

	Name	Designation
Board of Directors	Govind Singh	MD & CEO
	Trilok Nath Shukla	Head Operations
	Ajai Raj Sharma	Independent Director
	Ajay Maniar	Aavishkaar Goodwell Representative
	Henning Haugerudbraten	Investment Director NMI Frontier Fund
	Ramni Nirula	Independent Director
	Vijayalakshmi Das	Independent Director

ICRA Limited

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