ICRA Credit Perspective

UTKARSH MICRO FINANCE PRIVATE LIMITED

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GRADING

ICRA has reaffirmed the MFI grading of Utkarsh Micro Finance at M2 (pronounced M two). The grading is valid till June 2014. M2 Indicates that in ICRA's current opinion, the Graded MFI's ability to manage its microfinance activities in a sustainable manner is high. ICRAs MFI Grading is not a comment on any specific debt servicing capability of the MFI. The grading is valid till June-2014.

Website:
www.icra.in

June 2013

Grading Rationale

The grading factors in Utkarsh's experienced management team, strong investor profile, its ability to raise equity at regular intervals from existing investors to meet its growth plans and improvement in financial flexibility with increase in the number and quality of lenders from 13 as on March 31, 2012 to 24 as on March 31, 2013. The grading also factors in Utkarsh's relatively prudent credit policies, good loan monitoring and collection mechanisms supported by strong Management Information Systems (MIS), Risk Management and Internal Audit Processes which have enabled it to maintain good asset quality indicators and collection efficiencies(100.00%% for FY2013).

There have been some improvements in Operational procedures of the company with Utkarsh bringing a formal Risk policy and branch risk rating model in place. The company has also formalised training procedures and manuals at all levels. Further, Utkarsh has initiated a pilot for Mobile Based Transactions operations through which field staff would be able to enter client collection and attendance data on mobile phone and this could replace the manual entry in the Collection and Disbursement Sheet . Utkarsh has also put in a formal grievance redressal mechanism in place.

The grading is however constrained by moderate scale of operations (managed portfolio size of Rs 178 crore as on March 31, 2013), relatively high pace of growth, and large expansion plans in relation to current size of operations (company plans to grow at a CAGR of 60% over the next four years). Though Utkarsh's portfolio concentration in the state of Uttar Pradesh reduced from 79% as on March 31, 2012 to 68% as on March 31, 2013, it continues to remain high. ICRA has noted management's intention to geographically diversify the portfolio further with opening of branches in states of Bihar, Uttarakhand, Madhya Pradesh and NCR.
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 and replacing existing employees especially at field level for the existing attrition rates of 24-25%. Utkarsh's geographical concentration in the state of Uttar Pradesh though declining continues to remain high at 68.5% as on March 31, 2013.

In 2012-13, there was some decline in net interest margins earned by the company, due to reduction in rate of interest charged by the company. Nevertheless, with the improvement in operating efficiencies as the company grew its managed portfolio from Rs 75 crore as on March 31, 2012 to Rs. 178 crore as on March 31, 2013, the active borrowers per loan officer increased from 492 to 580, operating expenses (in relation to average managed advances declined from 13.08% in FY2012 to 9.38% in FY2013) profitability indicators of the company reported an improvement from 1.65% in 2011-12 to 1.81% in 2012-13. Going forward, ICRA expects profitability of Utkarsh to improve further with some further moderation in operating expenses, and fee based income initiatives such as opening of NPS accounts and insurance distribution started by 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) , International Finance Corporation (IFC) and Norwegian Microfinance Initiatives (NMI) have made equity investment in the company. It is currently operating in UP, Bihar, Madhya Pradesh, Uttarakhand, Delhi and plans to cater to entire Northern and Central India. The company had 104 branches with a managed portfolio of Rs 178 crore as on Mar-13, with 68% of its portfolio in Uttar Pradesh and 24% 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 vis Profit After Tax(PAT) of Rs 3.89 crore on a managed asset base of Rs 298 crore as on Mar-13 vis-a- PAT of 1.41 crore on a managed asset base[1] of Rs 130.84 crore in FY2012.

Table 1: Shareholding Pattern

	Mar-13	Mar-12	Mar-11
	% share	% share	% share
Aavishkaar Goodwell India Microfinance	31.32%	31.03%	31.04%
Norwegian Microfinance Initiative	27.38%		
International Finance corporation	15.58%	16.69%	16.69%
Individual shareholders	14.2%	33.38%	33.38%
Promoters	6.4%	14.79%	15.09%
Intellicash Microfinance Network	0.19%	0.44%	0.44%
ESOP	4.85%	3.36%	3.36%
Total	**100.00%**	**100.00%**	**100.00%**

Mr Govind Singh (promoter) has 17.5 lacs preference rights exercisable at par. There is a plan to exercise these post permission from RBI. Thereafter, Promoter's share would increase to 10.8%.

[1] Total Assets +assigned portfolio

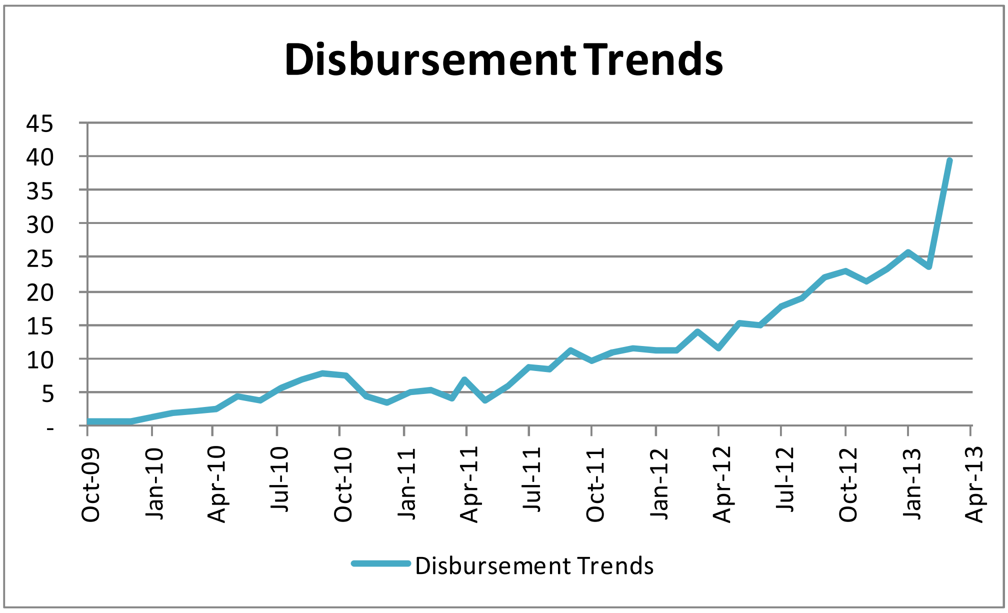
Table 2: Highlights of Operations

	Mar-13	Mar-12	Mar-11	Mar-10	Sep-09
No of States	5	2	2	1	1
Total Branches*	102	75	52	13	4
Total Centers*	14,369	7,826	3,902	499	25
Total Members*	200,066	110,886	58,623	8,719	388
Total Active Borrowers	197,874	106,369	55,506	8,208	130
Total Groups*	49,087	25,816	12,456	1753	78
Credit Portfolio (Managed) (Rs. cr)	178	75.3	31.86	6.34	0.12
Growth (%)	137%	136%	402%	5106%	
No. of Employees (FDO) [1]	623	408	325	114	31
Credit Officers	341	216	195	73	20
Active Borrowers per branch	1,940	1,418	1,067	631	32.5
Active Borrowers per Credit Officer	580	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 primarily women from rural and semi-urban regions, with weak income backgrounds, and 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 processing fees of 1%.
Recently the company has ventured into the Microenterprise loans (higher ticket size loans from Rs 30,000 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).

The company would contribute 2% of its PBT to Samutkarsh Welfare Services for credit plus activities.



Summary Grading Rationale

	Parameters	Overall Comments
A	**Business Risk**	
1	Operating Environment	MFIs face considerable regulatory risks. The RBI guidelines for MFI's restrict the operational flexibility by fixing margin ceilings. The expected pressure on financial returns to lenders and investors could impact availability of capital to the sector. Therefore, it would be critical for MFIs to control their operating costs. Post the Andhra Pradesh crisis in October 2010, the availability of funds to the microfinance sector was restricted. While availability of funds from the banking system has improved in the past 2 years, the improvement has been slower than expected. Further, while the Microfinance Bill, which could provide clarity on several operational and regulatory issues, has been cleared by the cabinet, it is pending enactment. Once the MFI Bill is cleared, it is expected to further boost the lenders' and investors' confidence in the sector. The current penetration of MFIs is still low in India, which provides adequate potential for growth. Establishment of credit bureaus is likely to ensure good credit culture among borrowers and also curtail multiple lending. However, political risks apart from regulatory risks continue to remain high especially for regionally concentrated MFIs. Moreover, the regionally concentrated MFIs continue to the face the geographical concentration risks.
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 March 31, 2013 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 and third line of management and the company has identified employees to be nurtured to develop the fourth line further to manage the geographical expansion. There have been some improvements in Operational procedures of the company with Utkarsh bringing a formal Risk policy and branch risk rating model in place. The company has also formalised training procedures and manuals at all levels. Utkarsh is presenting using a web based module (implemented by Craft Silicon) which can handle large 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 To improvise on this, Utkarsh has started Mobile Based Transactions operations which would enter client collection and attendance data on mobile phone to replace the Collection and Disbursement Sheet on a pilot basis.Utkarsh has also put in a formal grievance redressal mechanism in place.

	Parameters	Overall Comments
3	Scalability (in relation to business plans)	Utkarsh plans to grow at a CAGR of 60% over the next 4 years, and would require regular capital infusion as internal capital generation may not be sufficient. The company has received regular equity infusions in the past and is planning a larger round of equity infusion in FY2015 to manage the growth. Further, though the company has increased the quality and number of lenders in its resource profile, it would require larger lines from banks to reach the requisite scale of operations. The company would also need to tap other debt market funding sources to diversify its resource profile. It would also be important for the company to recruit and train personnel going forward, in line with the planned branch expansion and replacing existing employees especially at field level for the existing attrition rates of 24-25%. 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 has scaled up its training facilities and also formalised training modules in place. The recruitment process has also been decentralised.
4	Asset Quality	Though Utkarsh is in growth phase and its track record is moderate, it has been able to maintain sound asset quality with over 99.99% repayment rates till March 2013. Further, Utkarsh's good origination processes, all incremental sanctions taking place post credit bureau checks and rigorous supervision by operations team & regular 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. Utkarsh's geographical concentration in the state of Uttar Pradesh though declining continues to remain high at 68.5% as on March 31, 2013. Though the company is diversifying into new geographies of Uttarakhand, Madhya Pradesh and National Capital Region (NCR) and has recently diversified in micro-enterprise loan segment, ability of the company to maintain the same level of asset quality while growing and diversifying the portfolio at a higher asset base would be the key grading sensitivity going forward as well.
B	**Financial Risk**	
1	Liquidity and Funding Profile	Utkarsh diversified its resource profile in FY2013 and added 11 new lenders taking the overall lender list of 24 lenders and raised Rs 278 crore during the year albeit at a relatively higher cost of funds. The lender base consists of seven Public sector banks, ten private sector banks and seven NBFCs,. The company has also received funds from banks backed by 50% guarantee by ADB. The company has also received a line from IndusInd Bank, where it is acting as a sourcing agent and servicer for the bank's microfinance portfolio with a first loss default guarantee provided by Utkarsh, Further, though the company has increased the quality and number of lenders in its resource profile, it would require larger lines from banks at competitive rates (specially post the recent change in RBI regulation where the margin cap for all MFIs has been maintained at 12%) to reach the requisite scale of operations. The company would also need to tap other debt market funding sources to diversify its resource profile. 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.

2	Capitalisation	Despite 178% growth in portfolio and relatively low internal capital generation, the company has been able to maintain good capitalisation indicators (Gearing assuming assigned book as debt was 3.45 times as on March 31, 2013) supported by regular capital infusions from existing investors.(Rs. 20 crore received in 2012-13). The company is planning a larger round of equity infusion in FY2015 to manage the growth. The company has IFC, Aavishkaar Goodwell and Norweigian Microfinance Initiative as investors. Of these, IFC and Aavishkaar Goodwell were the initial investors and have invested in regular rounds of equity infusions and NMI frontier Fund has invested in two rounds of equity. The promoter stake in the company as on March 31, 2013 was 6.04%. In order to protect dilution in stake, the promoter would be exercising preferential rights convertible into common equity shares at par. Post the exercise of these rights, the promoter’s shareholding is expected to increase to 10.8%.
3	Profitability	In 2012-13, there was some decline in net interest margins earned by the company. Nevertheless, with the improvement in operating efficiencies as the company grew its managed portfolio from Rs 75 crore as on March 31, 2012 to Rs. 178 crore as on March 31, 2013, the active borrowers per loan officer increased from 492 to 580, operating expenses (in relation to average managed advances declined from 13.08% in FY2012 to 9.38% in FY2013) profitability indicators of the company reported an improvement from 1.65% in 2011-12 to 1.81% in 2012-13. Going forward, ICRA expects profitability of Utkarsh to improve further with some further moderation in operating expenses, higher yield earned on the microenterprise loan segment and fee based income initiatives such as opening of NPS accounts and insurance distribution started by 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.

Strengths

- Company continues to focus on areas of moderate penetration in rural areas, – UP, MP, Bihar and Uttarakhand. Management is well aware of negative areas within the target geographies, geographical diversification likely to improve going forward.
- 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 , credit bureau checks mandatory
- Experienced and professional management team, good second and third line of management team as well
- Comfortable capitalisation profile with capital infusion of Rs 20 crore in FY2013 (net worth increased from 38.60 crore as on Mar-12 to Rs 64.30 crore as on Mar-13
- Strong investor profile, with IFC , Norwegian Microfinance Initiative(NMI) and Aavishkaar Goodwell as the investors
- Good MIS, Risk Management and Internal Audit, systems
- 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 100.00% so far

Challenges

- Ability to maintain the same level of asset quality while growing and diversifying the portfolio at a higher portfolio
- Maintaining asset quality in the future
- Ability to improve geographical diversification of operations further
- Ability to further diversify the funding profile at competitive cost of funds
- Ability to improve profitability indicators by reducing operating expenses and maintaining the low credit costs.
- Ability to recruit and train personnel to me the expansion plans and attrition rates especially at field level

Business Risk Profile

Operating Environment

Post the AP Crisis, RBI brought in several prudential regulations for NBFCs in the microfinance business and also created NBFC-MFIs as a separate category of NBFCs for focused prudential regulation. The RBI vide its Master Circular for Lending to Priority Sector also established that loans extended by banks to MFIs would continue to have priority sector status. This is expected to be a major positive for the MFIs in the medium term, as it may lead to continued of bank funding to the sector owing to the priority sector lending targets that the banks need to meet. The regulatory changes brought about by RBI for NBFCs engaged in microfinance in the past couple of years including introduction of mandatory use of credit bureaus and debt ceilings for borrowers is a positive for the sector in the long term, but could strain short-to-medium term growth. MFIs business and financial performance is expected to be impacted in the near term at least because of ceiling on interest margins, restriction on processing fees, prohibition of security deposits and stricter provisioning requirements.

Over a longer term, however, this would help in improving the operational efficiencies by pruning the cost structures and also bringing credit discipline by introduction of credit bureaus. In the two years since these regulatory changes were introduced, most of the leading NBFC-MFIs have started contributing data. This has helped in checking the number of loans, quantum of loans and credit track record of a borrower. These checks have helped in reducing incidence of overleveraging as well as filtering of delinquent borrowers- these measures are likely to have a good long term impact on credit quality of MFIs.

Other challenges for microfinance lending are as follows:

- The political risk continues to remain high for players especially with significant regional concentration. 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.
- The ticket sizes have increased for many MFIs, given the cap of Rs 50,000 and given that borrower can avail loans from at most 2 MFIs. The higher ticket sizes have led to longer loan tenures thus increasing the risk.
- 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.
- The potential impact of politically motivated actions / events (for instance, debt waivers announced by government, competing programmes at subsidised rates, or other regulatory actions), could also impact the credit culture among borrowers adversely. Also extreme weather conditions like flood or draught, natural calamities, epidemics, etc. can severely impact the earning capability of such members, thus impacting their loan repayment ability.
- While in the past, the intense competition amongst MFIs, especially in the Southern India, lend to over-leveraging of the borrowers, the restriction that borrowers can avail loans from at most two MFIs with overall borrowing not exceeding Rs 50,000 has helped to curb the same. Moreover, with more MFIs actively participating in the development of a Credit Bureaus and having commenced sharing of data with the Bureau, the issues pertaining to overleveraging may get addressed in future. However, competition from informal sources of funding like moneylenders continues to remain a threat, as borrowers maybe initially skeptical of coming to MFIs.

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.

Despite these positives, return on equity for MFIs is likely to register only a moderate improvement because of the margin ceiling. While the relief on margins provided for large MFIs[2] is expected to provide temporary relief on profitability, ICRA does not expect MFIs to alter lending rates in view of the operational difficulties involved in implementing the same across their vast borrower base. MFIs can, however, take advantage of the higher margins in FY2014 if they are able to tap funding at lower costs. Although RBI introduced a separate category of NBFC-MFIs in December 2011, licenses are yet to be issued.

[2] RBI allowed 12% interest margin for large MFIs upto March 31, 2014 after which the margin is reduced to 10%

Further, the sector would continue to need fresh equity for growth as ICRA expects the pace of growth to be higher than the pace of internal capital generation in the medium term. While sector-focused and social investors could continue to invest in MFIs that demonstrate strong performance, ability of the sector to attract financial investors needs to be watched. As the operating environment improves, MFIs are also expected to venture into individual loans and other secured and unsecured loan products, Maintaining control over asset quality by building strong systems without compromise on internal audit and controls and building adequate cushions to absorb event risks would be important for expansion. Further some MFIs have also started initiatives to improve profitability through fee based income to clients and non clients and portfolio origination and servicing for banks through partnered products, which are likely to be the ROE drivers in a regulated environment scenario.

Governance Structure, Management and Systems

Ownership Structure

Post the recent equity infusion of Rs 20 crore in Utkarsh, the share of promoter Mr. Govind Singh has reduced to 6.40% and Aavishkaar Goodwell India Microfinance has emerged as the largest shareholder in the company. The promoter Mr Govind Singh plans to increase his stake in the company to 10.8% through exercise of 17.5 lacs preference rights which can be exercised at par. The company plans to grow at a fast pace in the medium term and would start preparing for a large round of equity infusion in the second half of the current financial year.

Board Structure and Processes

Table 3 : Board of Directors as of March 31, 2013:

Name	Designation	Brief Profile
Govind Singh	MD & CEO	
Trilok Nath Shukla	COO	
Ajai Raj Sharma	Independent Director	Retired IPS officer
Ajay Maniar	Aavishkaar Goodwell Representative	Principal at Aavishkaar Goodwell
Ulf Linders	Investment Director NMI Frontier Fund	He is the Managing Director of the NMI Frontier Fund He has earlier worked with ABB and European Bank/EBRD.
Ramni Nirula	Independent Director	Retired as Senior General Manager in ICICI Bank
Vijayalakshmi Das	Independent Director	MD of Ananya Finance for inclusive Growth & CEO of FWWB

Utkarsh had a seven member board as on Mar-13 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 . The other functional heads have also been associated with the Microfinance sector . The company has a good second and third line of management and has identified employees at zonal levels for mentoring and taking up higher positions in the organisation to manage the growth.

Systems and Processes

IT Systems

Utkarsh is using a web based module implemented by 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.
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 sheetfor 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

The company has made further improvements in its MIS systems.

- Mobile Based Transactions pilot
Utkarsh plans to replace the Collection and Disbursement Sheet with mobile based software where attendance and collections related data of the borrower can be tracked. As of now, pilot runs are going on in 2 branches . With the implementation of mobile based technology, data can be generated on real time basis, besides brining operational efficiencies.

- **Credit Bureau Checks**
All sanctions take place post processing by credit bureau. The company has put in a system in place wherein in post the Group Recognition Test the credit bureau checks are done at Head office. Earlier the head office used to inform the Branch Managers on the phone. However the company has now put in a programme in place wherein the negative credit bureau reports are sent to the respective branch managers through SMS before the disbursement date.

- **Toll Free Number**
The company has introduced a toll free number, where in all calls received are recorded automatically and resolved within a period of 48 hours

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

Apart from the regular branch audit , the company has also put in a Branch Risk Rating model in place, wherein apart from the feedback from the branch audit report, the status of credit risk and operational risk in the branches and is assessed based on Portfolio concentration, audit score, turnover of field staff, client acquisition and Portfolio at Risk. Scores are assigned in the category of critical, High, Moderate and low. Utkarsh was assisted by M2i Consulting in the same

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 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's Provisioning policy is also more conservative than the RBI norms. As for the income recognition on assigned/securitised portfolio, , the company amortises the profit on sale of loan portfolio over the tenure of the loan portfolio assigned /sold.

Scalability

Table 4 : Quarterly Trends:

	Mar-13	Dec-12	Sep-12	Jun-12	Mar-12	Dec-11	Sep-11	Jun-11	Mar-11
No. of states + Union Territory (UT)	5	5	4	2		2	2	2	2
No. of districts	24	24	21	19	19	17	14	13	12
No. of branches	102	92	85	77	75	67	57	52	52
No. of groups	49,087	42,156	36,735	30,739	25,816	19,423	16,007	13,703	12,456
No. of active members	198,181	168,691	149,196	125,516	106,369	76,770	60,344	54,449	55,506
No. of active borrowers per branch	1,943	1,834	1,755	1,630	1,418	1,146	1,059	1,047	1,067
Portfolio Size (Rs. cr.)	178.25	137.41	111.65	87.76	75.3	59.97	44.88	32.24	31.86
Disbursements	88.68	67.57	58.44	41.57	36.31	32.26	28.51	16.8	14.34
No. of loan officers	341	312	274	229	216	192	197	173	195
Active Borrowers per loan officer	581.18	540.68	544.51	548.1	492.45	399.84	306.31	314.73	285
Repayment Rate		100.00%	99.99%	99.99%	99.97%	99.96%	99.96%	100%	100%
New Members Added	40916	30801	32988	25954	24976	21482	14854	7423	10,846
Drop-out Members	12126	11213	8280	1921	7252	3836	9377	3227	2,925.00
No. of new members as % of existing members	30.30%	19.29%	18.39%	12.97%	32.53%	35.60%	27.28%	13.37%	22.25%
No. of drop out members as % of existing members	8.98%	7.02%	4.62%	0.96%	9.45%	6.36%	17.22%	5.81%	6.00%

Utkarsh reported a 178% growth in portfolio in FY2013, The no of active borrowers per branch and credit officer also improved with improvement in borrower penetration per branch and shifting towards fortnightly mode of repayment (from weekly) to enable more no of borrowers to be covered per credit officer. In FY13 the company expanded its presence from 19 districts to 24 districts (with incremental growth in state of 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 and further to 68% in Mar-13.The company plans to expand to the states of Bihar,MP and Uttarakhand in the current financial year. Within UP as well, the company is planning to expand to areas of western UP. Nevertheless, UP is likely to continue to have a majority share of the portfolio in the medium term being an area of moderate penetration and good potential . 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. . 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

Table 5 : Capitalisation Trends

Rs crore	Mar-13	Mar-12	Mar-11	Mar-10
Tier 1 Capital	64.30	38.6	12.63	6.88
Tier 2 Capital	0.93			
Total Capital	65.23			
FLDG for assigned book	8.44	5.7	1.58	-
Total Capital	56.79	32.88	11.05	
Risk Weighted Assets	145.34	41.57	25.83	6.63
CRAR (Reported)	43.61%	79.11%	42.78%	103.77%
Capital adjusted for FLDG In Relation to RWA	39%	79.11%	42.78%	103.77%
Gearing assuming assigned book as debt	3.45	2.33	2.13	0.51

Despite 137% growth in portfolio and relatively low internal capital generation, the company has been able to maintain good capitalisation indicators supported by regular capital infusions from existing investors. (Rs. 20 crore received in 2012-13). The company is planning a larger round of equity infusion in FY2015 to manage the growth.

As for calculation of CRAR , the company has started adding the contingent liabilities (first Loss Default Guarantee) to the risk weighted assets as against deducting the First Loss Default Guarantee being deducted from the networth earlier.

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 12th Standard , with knowledge of the local language and good communication skills. However attrition rates at the loan officer levels are in line with industry rates of 24-25% given the tough nature of job at field level and adverse climatic conditions in the main area of operations. Therefore continuous training sessions are required for planning the growth as well as replacing the departed employees. The company has scaled up its training facilities and also formalised training modules in place. The recruitment process has also been decentralised.

The staff is trained at the company's training centres and the training procedures are standardised. Company has decentralised its training procedures and has 5 training centred at Varanasi, Arrah, Gorakhpur, Satna and Haridwar. 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 in another district. The officers are 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. 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. With the help of an external consultant formalised training modules in place across various levels and for various roles.

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 COO. The company has issued ESOPs to senior and middle management. With the growth in portfolio, the company would require qualified and experienced executives for monitoring the operations and other functions.

The auditors of the company – M/s B S R and Co (KPMG) are reputed auditors.

Tie-up of funding sources

Table 6 : Access to debt

Rs crore	Mar-13		Mar-12		Mar-11	
Net worth	64.37		38.6		12.61	
Term Loan from Banks and Fis	180.3	82%	52.91	59%	18.56	69%
Off balance sheet	40.93	18%	36.96	41%	8.29	31%
Total Borrowings	221.20	100%	89.87	100%	26.84	100%
Gearing (assuming assigned book as debt)	3.45		2.33		2.13	
Cost of funds (From Spreads)	10.56%		15.59%		14.65%	
Weighted Average Cost of Borrowings	14.08%					

Utkarsh diversified its resource profile in FY2013 and added 11 new lenders taking the overall lender list of 24 lenders and raised Rs 278 crore during the year albeit at a relatively higher cost of funds. The lender base consists of seven Public sector banks, ten private sector banks and seven NBFCs. The company has also received funds backed by partial guarantee from Asian Dev Bank The company has also received a line from IndusInd Bank, where it is acting as a sourcing agent and servicer for the bank's microfinance portfolio with a first loss default guarantee provided by Utkarsh, Further, though the company has increased the quality and number of lenders in its resource profile, it would require larger lines from banks at competitive rates (specially post the recent change in RBI regulation where the margin cap for all MFIs has been maintained at 12%) to reach the requisite scale of operations. The company would also need to tap other debt market funding sources to diversify its resource profile. Utkarsh is planning to further diversify its borrowing profile in FY2014, and is in the process of tying up funds through NCDs and ECBs apart from adding more lenders through bank loans. The company has a comfortable liquidity profile given 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.

Liquidity

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

Financial Performance

Table 7 : Profitability Indicators

Rs crore	FY2013		FY2012		FY2011	
Net Interest Income (including income from assignment)	17.71	115%	8.24	57%	5.26	1322%
Non Interest Income / Fee Income	1.68	36%	1.23	-25%	1.65	2257%
Operating Income	18.43	95%	9.47	37%	6.91	1470%
Operating expense	11.89	73%	6.89	40%	4.92	259%
Operating Profit	6.54	154%	2.58	30%	1.99	-314%
Provisions-credit	0.55	151%	0.22	69%	0.13	333%
PBT	5.99	179%	2.15	109%	1.03	-208%
PAT	3.89	178%	1.4	54%	0.91	-196%

- Despite 137% growth in portfolio Utkarsh reported lower (115%) growth in Net Interest Income because of decline in interest spreads. However, lower growth in operating expenses and maintenance of low credit provisions helped the company report 178% growth in Profit after Tax from Rs 1.4 crore to Rs. 3.89 crore in 2012-13.

- Decline in net interest margins was offset with the improvement in operating efficiencies as the company grew its managed portfolio from Rs 75 crore as on March 31, 2012 to Rs. 178 crore as on March 31, 2013, the active borrowers per loan officer increased from 492 to 580, operating expenses (in relation to average managed advances declined from 14.8% in FY2012 to 10.4% in FY2013) profitability indicators of the company reported an improvement from 1.65% in 2011-12 to 1.81% in 2012-13. Further and maintenance of low credit provisions led to an improvement profitability indicators of the company.

- Going forward, ICRA expects profitability of Utkarsh to improve further with some more moderation in operating expenses, higher yield earned on the microenterprise loan segment and fee based income initiatives such as opening of NPS accounts and insurance distribution started by 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.

Table 8 : Key Ratios

	FY13	FY12	FY11	FY10
Yield on Average Loans	26.42%	27.09%	31.83%	28.57%
Yield on Average Investments	3.29%	7.34%	6.69%	4.62%
Yield on Average Earning Assets	15.45%	22.07%	31.15%	15.81%
Cost of Average Interest Bearing Funds	10.86%	15.59%	14.65%	0.96%
Lending Spreads	15.56%	11.50%	17.18%	27.61%
Gross Interest Spread	4.59%	6.48%	16.50%	14.84%
Key Ratios (Managed Portfolio)				
Net Interest Margin /AMA	7.81%	10.46%	17.11%	8.75%
Non Interest Income/AMA	0.78%	1.56%	5.37%	5.13%
Operating expenses AMA	5.54%	8.75%	16.01%	87.82%
Operating Expenses/ Managed advances	10.4%	14.80%	21.96%	87.82%
Operating Profit / AMA	2.79%	3.28%	6.47%	-68.13%
Credit Prov. & Write-offs / AMA	0.26%	0.28%	0.42%	2.20%
PBT/ AMA	2.79%	2.73%	3.35%	-69.60%

	FY13	FY12	FY11	FY10
PAT/ AMA	1.81%	1.78%	2.96%	-69.60%
PAT (excl. Minority Interest) / Average Net worth	8.03%	6.22%	9.34%	-51.81%
Cost Income Ratio	64.50%	74.67%	81.33%	308.59%

AMA- Average Managed Assets

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-2013)	Rs. 64.33 crore
Number of Branches (Mar-13)	102
Number of active borrowers (Mar-13)	198,181
Number of field officers (Mar-13)	341
Balance Sheet size (Mar-13)(including managed book)	Rs 302.5 crore

Managing Director	Mr Govind Singh	
Auditors	BSR and CO (KPMG)	
Shareholding Pattern (Mar-13)		**Mar-13**
		% share
	Promoters	6.41%
	Individual shareholders	14.26%
	International Finance	15.58%
	Aavishkaar Goodwell India	31.33%
	Norwegean Microfinance	27.38%
	Intellecash Microfinance	0.19%
	ESOP	4.85%
	Total	100.00%

Board of Directors	Name	Designation
	Govind Singh	MD & CEO
	Trilok Nath Shukla	Executive Director
	Ajai Raj Sharma	Independent Director
	Ajay Maniar	Aavishkaar Goodwell Representative
	Ulf Linders	NMI Frontier Fund Representative
	Ramni Nirula	Independent Director
	Vijayalakshmi Das	Independent Director

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