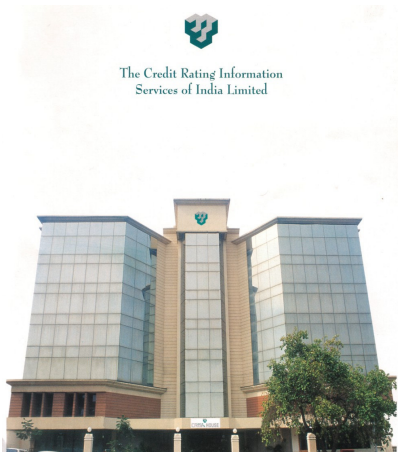


MFI Grading: Bhartiya Samruddhi Finance Limited (BSFL), India

MAY 2003

ABOUT CRISIL



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MFI GRADING

Bhartiya Samruddhi Finance Limited, India
Grade: *mfR2* (First Update)

A **Microfinance (*mfR*) grade** is CRISIL’s current opinion on the ability of the micro finance institution to conduct operations in a scalable and sustainable manner.

CredibilityFirst assigns the grade on an eight-point scale from ***mfR1* (highest grade)** to ***mfR8* (lowest grade)**.

The **microfinance grade** is a measure of the overall weighted average performance of the MFI on a broad range of parameters under the **MICROS[®] methodology**. It includes the traditional creditworthiness analysis using the CRAMEL approach, modified as applicable to the MFI sector. MICROS stands for **M**anagement, **I**nstitutional arrangement, **C**apital adequacy & asset quality, **R**esources, **O**perational effectiveness and **S**calability & sustainability.

Based on the scores assigned for each of the sub-parameters of MICROS, the composite grades (grade 1 to grade 8, with 1 being the highest and 8 being the lowest) are shown in the table below. The scores are assigned on the basis of CRISIL’s defined benchmarks.

<u>Parameter</u>	<u>Grade</u>
➤ Management	2
➤ Institutional Arrangement	1
➤ Capital Adequacy & Asset Quality	3
➤ Resources	2
➤ Operational Effectiveness	2
➤ Scalability & Sustainability	2

Based on the total weighted average score, the grade for BSFL is *mfR2*

Validity: This grading is valid for the current capital structure of the company. If this capital structure were to change or there were to be any other significant change in the company or the external environment, CRISIL would recommend a review whenever such changes take place or at the end of one year, **whichever is earlier**.

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FACTS SHEET (as of December 31, 2002)	
Legal structure	Public Limited company, Registered as an NBFC
Contact person	Mr. S Viswanatha Prasad Chief Operating Officer Bhartiya Samruddhi Finance Limited 501-502, Nirmal Towers, Dwarkapuri Colony Punjagutta, Hyderabad 500 082, India. Tel: (91)40 – 2335 0171 Fax: (91)40 – 2335 8846
Year of incorporation	1996
Geographical presence	20 branches (units) spread across Andhra Pradesh, Maharashtra, Orissa and Karnataka
Business approach	Engaged in microcredit and follows different lending strategies: <ul style="list-style-type: none"> ➤ Direct loans to individuals ➤ Loans to joint liability groups (JLGs) ➤ Loans to self help groups (SHGs) / Federation of SHGs ➤ On-lending through intermediaries to individuals and groups
Active borrowers	37,540
Total staff	263
Credit officer productivity (no. of loan accounts)	187
Women borrowers	25.68%
Loans outstanding (Rs. in million)	308.56
Avg. loan size disbursed (Rs.)	10,852
Portfolio at risk (> 30 days)	9.98%
Operational self-sufficiency	116.30%
Financial self-sufficiency	81.33%
Return on funds deployed*	2.39%
Return on equity*	4.77%

* annualized basis

SUMMARY

The reaffirmation of **mFR2** grade reflects the company's experienced management, comfortable capital position, good financial flexibility and strong risk management systems. These positive factors strengthen CRISIL's view on the scalability and sustainability of BSFL's microfinance programme. However, though there has been a marginal improvement in the asset quality, there is still scope for further improvement. Going forward, BSFL's ability to improve its operational and financial self-sufficiency parameters and sustain growth in volumes without impacting asset quality are key grading sensitivities.

BSFL is one of the leading microfinance institutions (MFIs) in India and its loan portfolio is spread across 3,463 villages in four states of India. It is amongst the few MFIs in the world to adopt multiple distribution channels and lending methodologies. The company currently offers 14 loan products covering individuals, self help groups (SHGs)/federations and MFIs/NGO-MFIs. During FY 2002-03, the company has intensified the distribution of insurance products to its clients.

The company has an eminent board drawn from the fields of finance, microcredit, academics and the NGO sector besides representation by overseas equity investors. The governance practices at the MFI are in line with those of professionally managed mainstream financial institutions. There is a high level of participation by the independent directors on the company's performance and its operational strategy. BSFL has been able to attract qualified professionals to manage the day-to-day operations.

BSFL has an established credit approval, disbursal, collection and monitoring systems in place. The decentralization of small loan sanction process to the unit level has ensured quicker credit delivery than other formal financial intermediaries in the rural regions. Similarly, the linkage of customer service agents (CSAs) commission to collection efficiency has ensured proper appraisal of new borrowers. The company has during FY 2002-03 introduced independent loan audit exercise to ensure greater compliance of its credit approval and loan monitoring policies at the unit level. The increase in adherence to documented policies is expected to have a positive impact on BSFL's asset quality and in turn on its profitability. The portfolio at risk greater than 30 days (PAR > 30 days) has trended downward, leading to corresponding reduction in loan loss provision during FY 2002-03. However, PAR>90 days has remained stagnant while the PAR> 180 days has deteriorated from FY 1999-00 levels. During the past one year, the management has followed cautious lending approach by curtailing the origination of loans to SHGs/MACS, following aggressive SHG-bank linkage programme in Andhra Pradesh.

BSFL enjoys diversified funding mix with access to long-term loans. Further, the financial flexibility is high on account of access to relatively lower cost funds from both banks and multilateral agencies. The equity infusion of Rs. 165.50 million in November 2001, resulted in an improvement in capital adequacy ratio to 58.57% as of December 2002 compared with 26.10% as of March 2001. The current capital position is comfortable to meet the projected growth plans.

A substantial portion of the capital received has been invested in marketable securities and bank deposits. While this has offered high degree of liquidity; it has impacted the profitability of the company. The company's efficiency levels are amongst the best in the Indian MFI industry, which is reflected in a low operating expense ratio of 9.15% as of December 2002. The good operational efficiency ratio is due to its average loan disbursement of Rs. 10,852 per client as against the first time disbursement of Rs. 3,000-Rs. 5,000 in case of most other Indian MFIs. The operating efficiency is expected to improve further with the increase in number of loan accounts per village and increase in repeat borrowers. Fee based income is expected to increase in the coming years with the distribution of insurance products.

The operational self-sufficiency (OSS) ratio of 116.30% as of December 2002 indicates that BSFL is able to meet all its expenses out of its earnings and is not dependent on grants for meeting its operational expenses. BSFL's return on equity (RoE) increased to 4.77% as of December 2002 from 2.48% as of March 2000, which is the highest among CRISIL evaluated MFIs. This increase is on account of the decline in cost of borrowings and the improvement in operating efficiency. Similarly, the return on funds deployed (RoA) improved to 2.39% as of December 2002 from 1.03% as of March 2000.

Tables

Table 1: Key performance parameters

	Rs. in million			
	31/12/2002* (9 months)	31/03/2002	31/03/2001	31/03/2000
Loans outstanding	308.56	225.33	154.80	111.31
Equity	206.00	206.00	40.50	40.50
Reported net worth	219.10	211.36	43.48	42.41
Total funds deployed	454.04	404.82	195.21	128.84
Total income	54.97	49.72	32.57	22.39
Profit after tax (reported)	7.70	2.11	1.28	1.04
Total loan loss	1.64%	2.93%	2.28%	1.50%
Operational self-sufficiency	116.30%	105.77%	107.16%	112.23%
Financial self-sufficiency	81.33%	85.01%	84.69%	97.48%
Personnel efficiency*	5.35%	4.87%	4.70%	6.51%
Administrative efficiency*	3.80%	3.61%	4.87%	5.35%
Operational efficiency*	9.15%	8.48%	9.57%	11.87%
Portfolio-at-risk (>30 days)	9.98%	15.34%	17.38%	24.25%
Portfolio-at-risk (>90 days)	8.12%	7.52%	9.25%	8.82%
Return on funds deployed*	2.39%	0.77%	0.79%	1.03%
Return on net worth*	4.77%	1.82%	2.97%	2.48%
Total debt/net worth (times)	0.90	0.80	3.28	1.75
Capital adequacy	58.57%	73.38%	26.10%	34.99%

* annualized basis

Table 2: Board of directors

Name	Position	Profile/Other directorships
Ms. Bharti Gupta Ramola	Chairperson	Senior Director, PricewaterhouseCoopers, India
Prof. Malcolm Harper	Director	Emeritus Professor, Cranfield School of Management (UK), Director, Micro-Credit Ratings International Ltd (M-CRIL).
Mr. Deep Joshi	Director	Programme Director, PRADAN, India
Mr. S. Loganathan	Director	Executive Director, Association for Sarva Seva Farms (ASSEFA), India
Mr. Joe Madiath	Director	ED, Gram Vikas, Orissa, India
Mr. Anoop Seth	Director	Chief Financial Officer, Infrastructure Development Finance Company Limited (IDFC)
Mr. Paul Di Leo	Director	Senior Managing Director, Shorebank Corporation, USA
Mr. Bastiaan Jaap Rekveld	Director	Investment Officer, Stichting Hivos Triodos Fonds, Netherlands
Ms. Nandini Adya	Director	Investment Officer, International Finance Corporation, New Delhi, India
Mr. Vijay Mahajan	Managing Director	Co-Chairman, Sa-dhan (Association of Indian MFIs)

Table 3: Senior management

Name	Designation
Mr. S. Viswanatha Prasad	Chief Operating Officer
Mr. Shubhankar Sengupta	Manager- Operations & HR
Ms. Kanchan Pandhre	Manager - Accounts
Mr. D. Sattaiah	Manager - Special Projects

Table 4: Shareholding (as on February 28, 2003)

Investors	%
Indian	
BASICS Limited	47.04
ICICI Limited	04.85
HDFC Limited	02.43
Others	00.04
Total Indian Equity	54.36
Foreign	
International Finance Corporation, USA	22.82
Stichting Hivos Triodos Fonds, Netherlands	11.41
Shorebank Corporation, USA	11.41
Total Foreign Equity	45.64
Total Equity	100.00

Table 5: Outreach summary

	31/12/2002	31/03/2002	31/03/2001	31/03/2000
No. of loans disbursed	26,816	25,345	13,367	8,437
Disbursements (Rs. in million)	291.01	285.53	188.25	139.00
No. of loans outstanding	37,540	26,630	13,889	7,958
Loan outstanding (Rs. in million)	308.56	225.33	154.80	111.31
No. of units*	19	15	11	5
No. of villages covered	3,463	3,111	1,607	956
Loan accounts/unit	1,976	1,775	1,263	1,592
Average loan disbursement (in Rs.)	10,852	11,265	14,083	16,475
Average loan balance (in Rs.)	8,219	8,462	11,145	13,987
Women borrowers [#]	25.68%	26.15%	33.96%	46.16%

* branches; # the decline is due to reduction in exposure to SHGs/Federations and MACS, which are largely women based

Table 6: Funding profile of BSFL

As on	Rs. in million							
	31/12/2002	%	31/03/2002	%	31/03/2001	%	31/03/2000	%
Net worth	219.10	47.64	211.36	51.54	43.48	21.85	42.41	32.17
Bank loans	39.68	8.63	3.43	0.83	19.01	9.55	3.50	2.65
Loan from holding company	0.00	0.00	45.97	11.21	42.75	21.48	30.70	23.29
Term loans from financial institutions	157.75	34.30	120.39	29.36	81.08	40.74	40.00	30.34
Cash security from borrowers	35.11	7.64	23.02	5.61	9.57	4.81	10.27	7.79
Current liabilities	8.26	1.79	5.93	1.45	3.12	1.57	4.94	3.76
Total	459.90	100.00	410.10	100.00	199.01	100.00	131.82	100.00

Table 7: Borrowings outstanding (as of February 28, 2003)

Lending Institution	Disbursement details		Interest	Loan outstanding
	Rs. million	Date disbursed	%	Rs. million
Small Industries Development Bank of India – I	20.00	30-Sep-99	11.00	8.04
CORDAID, Netherlands*	20.00	21-Mar-00	9.50	18.75
ICICI Bank Limited, India	40.00	13-Jun-00	13.50	38.98
Small Industries Development Bank of India - II	30.00	01-Jun-01	11.00	24.00
Overdraft with Canara Bank, Andhra Pradesh	0.75	18-Feb-02	9.75	0.69
Small Industries Development Bank of India - III	15.00	22-Oct-02	11.00	15.00
CORDAID, Netherlands	20.00	23-Dec-02	9.50	20.00
Housing Development Finance Corporation Limited, India	10.00	31-May-00	12.00	6.53
Developpment International Desjardins, Canada	12.33	03-Jan-01	6.00	12.33
Shorebank Corporation, USA	23.92	10-Oct-01	8.33	23.92
Developpment International Desjardins, Canada	13.74	05-Feb-02	6.00	13.74
Developpment International Desjardins, Canada	15.45	14-Dec-02	6.00	15.45
HDFC Bank Limited, India	10.00	04-Feb-03	12.10	10.00
Total	231.19			207.43

* Interest rate reduced from 10% to 9.50% in September 2002

BSFL prepaid Rs. 45.97 million loan from BASICS Limited in December 2002.

Table 8: Human resources summary

	31/12/2002	31/03/2002	31/03/2001	31/03/2000
Total employees (excluding CSAs)	126	85	75	56
Total employees (including CSAs)	263	172	115	65
Employee turnover	1.90%	10.00%	15.27%	28.78%
Number of credit officers (Field executive +CSAs)	201	127	108	57
Loan outstanding/Credit officer (Rs. in million)	1.54	1.77	1.43	1.95
Credit officer productivity (no. of loan accounts)	187	210	129	140

Table 9: Portfolio quality

	31/12/2002		31/03/2002		31/03/2001		31/03/2000	
	PAR (Rs. in million)	%	PAR (Rs. in million)	%	PAR (Rs. in million)	%	PAR (Rs. in million)	%
Total outstanding balance associated with loans that are								
On time	267.25	86.61	181.12	80.38	120.31	77.72	74.12	66.58
Late (at least one payment)								
1-30 days	10.5	3.41	9.66	4.28	7.58	4.90	10.21	9.17
31-60 days	3.03	0.98	10.03	4.45	9.41	6.08	10.00	8.99
61-90 days	2.72	0.88	7.59	3.37	3.18	2.05	7.16	6.44
91-180 days	4.92	1.59	4.69	2.08	3.58	2.31	4.39	3.94
181-360 days	9.38	3.04	6.48	2.88	6.87	4.44	4.02	3.61
361 & above	10.76	3.49	5.76	2.56	3.87	2.50	1.41	1.27
Total	308.56	100.00	225.33	100.00	154.80	100.00	111.31	100.00
PAR (> 30 days)	9.98%		15.34%		17.38%		24.25%	
PAR (> 90 days)	8.12%		7.52%		9.25%		8.82%	
PAR (> 180 days)	6.53%		5.44%		6.94%		4.48%	

Table 10: Disbursement breakup based on loan value

	Rs. in million							
	31/12/2002		31/03/2002		31/03/2001		31/03/2000	
Loan value (in Rs.)	Amount	%	Amount	%	Amount	%	Amount	%
<Rs.10, 000	145.57	50.02	144.14	50.49	66.45	35.30	37.45	26.95
Rs. 10, 001-25,000	117.25	40.29	105.86	37.08	68.13	36.19	44.94	32.33
Rs. 25,001-50,000	19.56	6.72	27.71	9.70	26.01	13.82	20.27	14.58
Rs. 50,001 – 200,000	3.77	1.30	2.73	0.95	5.63	2.99	13.96	10.04
> Rs. 200,000	4.86	1.67	5.09	1.78	22.03	11.70	22.38	16.10
Total	291.01	100.00	285.53	100.00	188.25	100.00	139.00	100.00

Table 11: Purpose-wise and channel-wise classification portfolio distribution (in %)

	31/12/2002	31/03/2002	31/03/2001	31/03/2000
1. Purpose-wise classification[#]				
Agriculture and allied loans*				
Crop Joint Liability Groups (JLGs)	23.92	20.95	20.49	20.22
Crop loans to individuals	0.36	0.54	2.11	9.41
Agri long term loan to individuals	2.93	3.47	4.20	6.05
Agri allied loans (dairy, poultry, etc) to individuals	20.18	21.94	19.00	16.46
Sub-total	47.39	46.90	45.80	52.14
Non-farm loans				
Micro enterprises (< Rs. 50,000)	44.13	45.73	37.53	28.80
Growth micro enterprises (Rs. 50,000-Rs. 200,000)	0.28	0.24	1.17	3.97
Sub-total	44.41	45.98	38.70	32.77
Loans to groups (does not include Agri JLGs)				
General purpose SHG	1.08	1.24	4.20	14.67
SHG without cash security	0.91	0.93	3.03	0.00
Federations of SHG/MACS	2.32	2.37	6.40	0.00
General purpose-ROSCAS	0.77	0.63	0.24	0.00
Sub-total	5.09	5.17	13.87	14.67
Loans to individuals				
General purpose - individual	0.21	0.15	0.14	0.42
House repair & expansion loans	1.98	0.44	0.40	0.00
Vehicle loans- employees/CSAs	0.92	1.36	1.09	0.00
Sub-total	3.11	1.95	1.63	0.42
Total	100.00	100.00	100.00	100.00
2. Channel-wise classification				
Loans to individuals	70.99	73.88	65.64	65.11
Loans to JLGs	23.92	20.95	20.49	20.22
SHGs	5.09	5.17	13.87	14.67
Total	100.00	100.00	100.00	100.00

[#] See table 12 for loan classification definitions; ^{*}End use of loans to SHGs/MACS could also be for agricultural and allied activities and hence exposure to agriculture could be higher.

Table 12: Loan guidelines

Loan classification	Definition	Interest rate & payment*	Loan processing fee and cash security	Principal repayment
Farm loans - up to Rs. 50,000 only				
Crop loans	Short term loans for cultivation of multiple crops. Only through JLGs.	24%	10% cash security + 2% loan processing fee	In minimum 2 installments in less than 11 months period.
Crop loans and agri long term loans to individuals	Loan for land development, irrigation or agri equipment etc.	24%	10% cash security + 2% loan processing fee	Cash flow based repayments. Term upto 3 years; at least 3 installments each year.
Agri allied loans to individuals	Loans for allied activities like milch animals, poultry, piggery, fishery or sheep/goat rearing	24%	10% cash security + 2% loan processing fee	Cash flow based monthly repayments. Quarterly repayments for goat & sheep rearing. Term upto 2 years
Non-farm loans				
Micro enterprises	Enterprises including manufacturing, trade & services for loans up to Rs. 50000 only	24% payable monthly	10% cash security + 2% loan processing fee	Cash flow based monthly repayments. Preferably of 24 installments and maximum of 36 with proper justification
Growth micro enterprises	Enterprises including manufacturing, trade & services which generates significant wage employment-restricted to repeat borrowers up to Rs. 0.2 million	21% payable monthly	10% cash security + 2% loan processing fee	Cash flow based monthly repayments. Preferably of 24 installments and maximum of 36 with proper justification
General purpose loans				
SHG with cash security	Loans through SHG with no end-use restriction	15% payable monthly / bi-monthly	10% cash security + 2% loan processing fee	With at least monthly / bi-monthly payment of interest. Term upto 2 years.
SHG without cash security	Loans through SHG with no end-use restriction	18% payable monthly / bi-monthly	2% loan processing fee	With at least monthly / bi-monthly payment of interest. Term upto 2 years.
Federation of SHG or MACS	Loans through federation of SHG/MACS with no end-use restriction	15% payable monthly / bi-monthly	2% loan processing fee	With at least monthly / bi-monthly payment of interest. Term upto 2 years.
Revolving Savings and Credit Groups (ROSCAS)	Loans to women who have been involved in running a ROSCAS for at least 3 years.	21% payable monthly	10% cash security + 2% loan processing fee	Cash flow based monthly repayments. Term up to 2 years
General purpose individual	Loans up to Rs. 10,000 to two-time repeat borrowers	24% payable monthly	2% loan processing fee	12 equal monthly installments
House repair and expansion loan	Up to Rs. 50,000 only	18% payable monthly	2% loan processing fee	Term upto 3years; monthly repayments
Vehicle loan to employees / CSAs	Up to a maximum of Rs. 40,000 for field executives and up to Rs. 30,000 for CSAs	15% payable monthly		Term upto 5 years cash flow based monthly repayments

*Interest rate are on a declining basis

Terms:

- Loans for growth micro-enterprises have to be fully securitized.
- No collateral security is essential for loans up to Rs. 50,000. Taking collateral security of assets for loans upto Rs. 20,000 is prohibited
- Agri term loans and housing loans will be given only in villages with more than ten live monthly recovery accounts and an on-time repayment rate $\geq 95\%$
- All loans with moratorium more than 2 months, will have to be approved by head office loan committee except crop, goat and sheep rearing and agri-investment loans
- It is strongly recommended that repayment installments be scheduled between 1st and 10th of every month.
- No borrower should be given concurrently more than one loan at any point of time except for house repair and expansion and general-purpose individual loans (for 3rd time borrower). Agri-term loans may be given to existing crop loan borrowers.
- A timely closure incentive may be paid at the time of closing the account, if the last installment is paid in time @ Rs. 20 (maximum) per thousand of total principal disbursed.

Table 13: Abbreviations

Abbreviations	
ALM	Asset Liability Management
AP	Andhra Pradesh
APMAS	Andhra Pradesh Mahila Abhivrudhi Society
BASICS	Bhartiya Samruddhi Investments Consulting Services Limited
BASIX Group	BASICS and its companies in which it has equity stake
BSFL	Bhartiya Samruddhi Finance Limited
COO	Chief Operating Officer
CORDAID	Catholic Organization for Relief and Development, Netherlands
CRISIL	The Credit Rating Information Services of India Limited
CSAs	Customer Service Agents
FWWB	Friends of Women's World Banking, India
FX	Field Executive
FY	Financial year. The financial year for BSFL, like most Indian companies, is April to March
GoI	Government of India
HDFC	Housing Development Finance Corporation Limited, India
HO	Head Office
HR	Human Resources
ICICI Bank	ICICI Bank Limited, India
IFC	International Finance Corporation, USA
IGS	Indian Grameen Services
IIM	Indian Institute of Management
IIT	Indian Institute of Technology
ILA	Independent Loan Audit
IMRB	Indian Market Research Bureau
IRMA	Institute of Rural Management, Anand, Gujarat
JLG	Joint Liability Group
KBSLAB	Krishna Bhima Samruddhi Local Area Bank
LAB	Local Area Bank
MACS	Mutually Aided Co-operative Societies
MFI	Microfinance Institution
MIS	Management Information System
MPLAEP	Madhya Pradesh Livelihoods Enhancement Action Programme
NBFC	Non-Banking Finance Company
NGO	Non Government Organization
OD	Overdraft
PAR	Portfolio at Risk

Table 13: Abbreviations (Contd.)

Abbreviations	
PCO	Public Call Office
PLR	Prime Lending Rate
PRADAN	Professional Assistance for Development Action. A well-known NGO for rural livelihood promotion
RBI	Reserve Bank of India, which is India's central bank
RoA	Return on Assets
RoE	Return on Equity
ROSCAS	Rotating Savings and Credit Associations
SDC	Swiss Agency for Development and Cooperation
SFR	Swiss Franc
SHG	Self Help Group
UH	Unit Head
UK	United Kingdom
ULC	Unit Loan Committee
USA	United States of America

Table 14: Indicators and terms

Indicators and terms	Definitions
<u>Institutional & Outreach</u>	
Disbursements	Loans disbursed during the period
Women borrowers	Total number of active women borrowers / Total number of active borrowers
Average funds deployed	Total assets - Fixed assets - Intangibles
Gross spread	Total fund based income - Total interest paid on liabilities
Portfolio at risk (PAR)	Unpaid principal balance of all loans with atleast 1, 30, or more days past due / loan outstanding
Repayment rate	Total amount recovered in the last one year / (Total amount recoverable in the last one year + over dues)
Employee turnover	Number of employees left during the year / Average total number of employees
Credit officer productivity	Number of loan outstanding / Number of credit officers
Adjusted total expenses	Total expenses + Inflation adjustment + Subsidy adjustment
Inflation adjustment	(Average net worth - average fixed assets) * Inflation
Subsidy adjustment	Commercial cost of borrowings - subsidized cost
<u>Yield</u>	
Fund based yield	Total fund based income / Average funds deployed
Portfolio yield	Total interest income from loans / Average loan outstanding
<u>Overheads</u>	
Operational efficiency	Operating expenses / Average funds deployed
Personnel efficiency	Personnel expenses + incentives & commissions to CSA / average funds deployed
Administrative efficiency	Administrative expenses / Average funds deployed
<u>Profitability</u>	
Return on equity	Profit after tax (adjusted) / Average net worth
Return on funds deployed	Profit after tax (adjusted) / Average funds deployed
Operational self sufficiency	Total income / Total expenses
Financial self sufficiency	Total income / Total expenses adjusted for inflation and subsidy
Total loan loss rate	Loan loss provision & write-offs / Average loan outstanding
<u>Capitalization</u>	
Debt / Net worth	Total borrowings (short term + long term) / Net worth
Capital adequacy	Net worth / Risk weighted assets

Assessment of BSFL using MICROS methodology

1. MANAGEMENT ANALYSIS

1.1 *History & track record*

Bhartiya Samruddhi Finance Limited (BSFL), which is the first NBFC-MFI in India, commenced its microfinance programme in 1996. It is one of the few MFIs in the world to adopt multiple distribution channels & lending methodologies for offering loan products to individuals, SHGs and federation of SHGs/MFIs. The company currently offers 14 loan products.

BSFL is promoted by Bhartiya Samruddhi Investments Consulting Services Ltd (BASICS), which has 47.04% stake in the company. Apart from BSFL, BASICS has also promoted Indian Grameen Services (IGS) and Krishna Bhima Samruddhi Local Area Bank (KBSLAB). BASICS through these companies offers financial services and techno-managerial support services focused at rural poor. BASICS is primarily funded by two long-term loans from Ford Foundation (USD 2 million; 1% interest rate, tenor of 15 years) and Swiss Agency for Development and Cooperation (SFR 2.5 million; 1% interest rate, tenor of 11 years) amounting to Rs.193.38 million (as of March 2002). For meeting the repayment obligations commencing in FY 2005-06, BASICS had earlier sought to create a sinking fund to which BSFL and KBSLAB were expected to contribute in the form of dividends. However, as both these companies are not currently in a position to contribute to the sinking fund in the form of dividend, BASICS is renegotiating the restructuring of its repayment obligation terms with both these multilateral agencies. While these negotiations are going on, BASICS has repaid USD 1 million out of the above USD 2million to Ford Foundation in January 2003.

KBSLAB, which started operations in February 2001, is one of the first RBI approved local area banks (LABs) to commence operations. This LAB had a slow start and a lower than anticipated growth in advances and deposits during FY 2001-02. It had disbursed Rs. 36.99 million, and had loan outstanding of Rs. 25.29 million and net worth of Rs. 51.55 million as of year ending March 31,2002. IGS the other group company of BSFL provides technical assistance and support services to customers of the BASIX group and to others on an assignment basis. IGS has in the past been able to obtain grants from Sir Ratan Tata Trust and SDC for its support services.

As of December 2002, BSFL had 37,540 active borrowers, and had a loan outstanding of Rs. 308.56 million. Its loan portfolio is spread across 3,463 villages in 20 districts in four Indian states - Andhra Pradesh (AP), Karnataka, Maharashtra and Orissa. The loan portfolio has witnessed a gradual shift to micro loans (less than Rs. 50,000) from loans to small enterprises, SHGs and SHG federations (Rs. 50,000 and above). The following factors had an impact on the disbursement growth during the past three years – (a) two of BSFL's old units - Raichur (Karnataka) and Mahabubnagar (AP) ceased fresh disbursements in 2001 after KBSLAB started operations in these two districts; (b) Severe drought condition during FY 2002-2003 and (c) Marginal increase in loans to SHGs/MACS owing to competition from banks.

1.2 *Alliances and network*

The BASIX group of which BSFL is a part, enjoys good relationships with several state governments/ Government of India (GoI), financial and multilateral institutions. The group in recent times has been involved with two well known state government livelihood initiatives –

Madhya Pradesh Livelihoods Enhancement Action Programme (MPLEAP) and Andhra Pradesh Mahila Abhivrudhi Society (APMAS). The group in the past has also created market linkages with few corporates and a dairy cooperative. Mr. Vijay Mahajan, the Managing Director of BSFL and co-promoter of BASICS, is the Chairperson of Sa-dhan, the association of Indian MFIs and has been an advisor in the field of rural livelihood to the Planning Commission, GoI. BSFL has been able to attract equity from several domestic and international institutions.

1.3 Documentation levels

BSFL has a detailed operational manual in place. The manual documents the company's loan products and operational procedures such as loan appraisal, disbursal, collection and monitoring process. The adherence to the documented policies is satisfactory. However, the periodic independent loan audit (ILA) by external auditors introduced during FY 2002-03 has helped the management in understanding the degree of adherence to the policies & procedures at the units (more details in sub-parameter: *Processes controls & audit*). With rapid increase in units and staff during the past two years, the ILA is an useful exercise to sensitize the unit staff on the need for adherence. BSFL has now linked the feedback of ILA as one of the performance pay criteria for its employees.

1.4 Management information systems

1.4.1 Credit approval mechanism

The loan approval mechanism at BSFL is decentralized and only large loans (Rs. 50,000 and above) are referred to the head office (HO). All loans below Rs. 50,000 are approved and sanctioned by the unit loan committee (ULC) comprising of the Unit Head (UH) and at least two field executives (FXs). Loan applications above Rs. 50,000 are forwarded to the HO loan committee after approval by the ULC. BSFL employs customer service agents (CSAs) for generating business and collection of repayments. The pay of CSAs is entirely variable and is linked to the quality of loan portfolio originated by them.

1.4.2 Loan and overdue monitoring systems

Repayments are on a monthly / quarterly basis and are collected by CSAs at the clients place. The MIS systems at the unit level provide day-wise overdue statements (village-wise and product-wise) and upcoming repayments (CSA-wise and FX-wise).

The team during the last year's review raised concerns on delayed loan follow up by the HO. During the FY 2002-03, the management has addressed this issue by

- creating an additional layer of Area Managers for increased monitoring of units.
- conducting random client survey as part of the ILA to determine the frequency of client visits by FX.

1.4.3 Cash flow management system & fraud control

Few of the ILA reports studied by the team have highlighted the need for improving cash management at the unit level. To address this, BSFL at one of its unit has obtained a bank overdraft (OD) facility. Whenever the unit requires funds for disbursement, it uses the OD facility

instead of requesting the HO to transfer funds to the local bank on a periodic basis and incurring demand draft charges. BSFL is currently holding most of the unutilized funds from equity infusion in the form of liquid assets (investments and cash & banks balances). During the first nine months of FY 2002-03, it had earned an annualized return of 6.67% on these liquid investments.

The large area covered by CSAs for cash collections (20 km radius) and significant proportion of individual loans (71% as of December 2002) in the total portfolio, do pose a challenge to BSFL in preventing occasional frauds by CSAs. With a grant support from IFC, the company is currently testing hand held devices that allow CSAs to issue receipts to the clients for the payments collected and upload the data into the existing MIS at the unit office. This mechanism would help to monitor the financial handling by the CSA. Similarly, the ILA feedback could help BSFL in strengthening its systems thereby improving cash flow management and fraud control.

1.5 Use of IT in operations

The current *FoxPro* based application software used at BSFL units is functionally complete to a large extent and achieves integration of portfolio tracking and accounting functions besides allowing users to generate various standardized reports. This software application is capable of handling multiple loan products. In order to overcome the limited processing capacity of the *FoxPro* based application, the company is developing this software on an *Oracle* platform. All units send monthly reports to the HO, which are consolidated and analyzed using an *Oracle Discoverer* tool.

A separate division has been created within BASICS to offer software tools to other MFIs based on in-house expertise besides developing technology solutions to deliver financial services through new channels. One such product currently in pilot phase is the provision of credit through *smart cards*. Under this channel, the servicing agent usually located at the public call office (PCO) and equipped with a computer connected with a *smart card* reader and modem, disburses loans (Rs. 500-1,000) to the clients. Using a *smart card reader*, the transaction data is captured and transferred to the unit office instantaneously.

1.6 Human resource management

BSFL recruits graduates and postgraduates in agricultural sciences, commerce, management and engineering from local universities/colleges. The group in recent times has been able to recruit managers from reputed companies at the senior management level. CSAs are local youth with rural backgrounds and selected at the unit level through an entrance test. Fresh recruits are provided on-field training. Managers are encouraged to attend programs on MFI and related subjects conducted by IIMs and IRMA.

Roles are clearly defined and followed both at the HO and the units. Salaries of branch employees (FX and UH) are the best in the Indian microfinance sector and are in line with those paid by large agro-chemical companies locally. As a result the attrition rates at BSFL have ranged between moderate to low during the past three years (*see Table 8: Human resources summary*). While employees receive part of their pay as performance bonus, the pay of CSAs is entirely variable. The company is not only in the forefront in payment of best salaries in the sector but also in implementation of human resource policies and systems. It conducts annual professional / personal learning and review process which allows employees to set professional and personal objectives for themselves with inputs from their colleagues and mentors. Similarly, it has recently

appointed a retired IIM Professor to conduct human resources and institutional development process review.

1.7 Processes controls & audit

As the company's units are spread across a wide geographical area, it has appointed local audit firms for unit audit. The team in its earlier report highlighted that having a single auditor across units could ensure consistency in audit quality. Towards this end, the company has during FY 2002-03 made its statutory auditor conduct workshop for its unit auditors. In addition, it had introduced independent loan audit (ILA) to ensure compliance by the units. Under ILA, the appointed local audit firm audits books of accounts, verifies loan documentation and transactions and conducts a field visit for CSA audit trail on a monthly basis. The compliance reports sent by the local audit firms are reviewed at the HO regularly and feedback is provided to the audit firms and the Unit Heads. This apart, the statutory auditor of the company visits each unit and does rating of all units on two parameters - internal controls and loan portfolio on an annual basis.

By linking CSA commissions and performance pay of the employees to portfolio quality, the HO is able to have reasonable degree of control on the operations of the unit. The HO provides operational flexibility at unit level in identifying villages and customers; but ensures that it has a control on the branches by way of sectoral exposure limits and adherence to the defined credit appraisal process.

1.8 Social impact on environment/local impact

To assess the impact of BSFL's credit operations on employment, income and asset ownership, awareness and self-esteem of the borrowers besides understanding the awareness, knowledge and significance of savings and insurance services, the company had appointed Indian Market Research Bureau (IMRB) to carry out a study. The study was conducted in two modules – one targeted at individual borrowers and the other at SHGs. The following are the major findings of the study:

Individuals

- Favorable interest rates, fast processing of loans and familiarity with BSFL employees were the key considerations for taking loans from BSFL.
- Average monthly household income was marginally higher amongst BSFL borrowers largely due to increase in gains from agriculture & allied activities and business/trade (non-agri & agri allied clients). Similarly, while BSFL borrowers stated increased level of cultivation as the key reason for increase in employment, non-BSFL sample stated increase in magnitude of business as the key reason for increase in employment.
- The shift from traditional sources of fuel to gas and electricity was higher amongst BSFL borrowers.
- BSFL's borrowers reported lower level of indebtedness than non-BSFL sample.

SHGs

- Marginally better education levels amongst BSFL borrowers than the non-BSFL SHG sample.
- Average monthly household incomes were higher amongst BSFL borrowers compared to non-BSFL SHG sample. Similarly, average assets and amenities were higher amongst BSFL borrowers. On the other hand, the value of modern household assets was higher in non-BSFL SHG sample.
- A relatively greater proportion of BSFL borrowers used high investment (capital intensive) farm assets.
- No change in income was reported amongst BSFL borrowers while non-BSFL sample reported decrease in income.
- The average area under cultivation, the average area owned and the net returns were higher amongst BSFL borrowers. Similarly, ownership of animals was higher amongst BSFL borrowers.
- Conducive repayment schedule and ease of obtaining the loans were considered the strengths of BSFL. However, there were varied customer views on the interest rates charged by the company.

2 INSTITUTIONAL ARRANGEMENT

2.1 Management ownership & governing board

BASICS, which holds 47.04% stake in BSFL, is promoted by well-experienced and well-recognized promoters namely, Mr. Vijay Mahajan (73% stake), Ms. Bharti Gupta Ramola (23% stake) and Mr. Deep Joshi (4% stake). Mr. Mahajan is an alumnus of IIT Delhi and IIM, Ahmedabad and promoted PRADAN (an NGO) in 1982. He is a well-known expert on the unorganized sector and has been on various committees on rural development, poverty alleviation and microfinance set up by different ministries of state and central government. Mr. Deep Joshi is a graduate from MIT's Sloan School of Management and worked with Ford Foundation prior to joining PRADAN. Ms. Ramola (alumnus of IIM Ahmedabad), BSFL's Chairperson and currently Executive Director, PricewaterhouseCoopers India Ltd., had earlier worked with ICICI Group and Nehru Foundation for Development. BSFL has an eminent board drawn from the fields of finance, micro credit, academics and NGO sectors. During FY 2002-03, three new directors representing the three overseas institutional equity investors were inducted into the board.

Both the company and the Basix group have been able to attract qualified professionals to manage the day-to-day operations. The involvement of the Managing Director, who is also the promoter of the holding company, in the day-to-day operations, is limited. At BSFL, the Chief Operating Officer (COO) takes most of the operational decisions and is supported by a team of able senior managers. The management also actively involves unit heads in annual planning and budgeting process.

2.2 MFI governance practices

The board meets once a quarter to discuss the financial and operational performance and ratify the programme strategy to be adopted by the management. The study of some of the minutes of past board meetings reveals that the independent directors actively participate in discussion of the company's performance and its operational strategy. These independent directors sought the management's views on matters relating to the company's performance on financial and non-financial targets. The company has two sub-committees comprising the Managing Director and three other directors to overlook audit and finance functions.

2.3 Goals & strategies

The mission statement talks about providing sustainable livelihoods to rural poor and women through provision of financial and technical assistance. The mission statement also mentions the group's goal of striving to yield a competitive rate of return to its investors so as to access mainstream capital markets and human resources on a continuous basis.

The company has added some financial goals during FY 2001-02, as requested by equity participants. These are:

- Operating expenses as % of loan outstanding $\leq 12\%$
- ROA $\geq 1.25\%$
- PAR (>90 days on non-crop loans) $< 5\%$
- Loans outstanding to women should be one-third of the loans outstanding
- Loans outstanding to direct borrowers (≤ 400 USD) should be one-third of the loan outstanding (43.82% as of December 2002)

The company has to meet any three of the five goals at the end of FY 2005.

The goals are translated into a strategic plan and then into a budget at the beginning of the year. The performance of the first nine months of FY 2002-03 indicates that the company has not anticipated severe drought conditions in Andhra Pradesh and Karnataka and the competition from banks in extending credit to SHGs¹. Banks are able to do SHG lending at interest rates lower than BSFL as their cost of funds are comparatively lower. Thus, while BSFL had a positive growth in disbursement for the first nine months of FY 2002-03 (Rs. 291.01 million), it is unlikely to meet the disbursement target of Rs. 434 million for the whole year and therefore the profitability for FY 2002-03 is likely to be impacted. With multilaterals willing to support microfinance programmes in states like Maharashtra, Chattisgarh and Jharkhand with low cost funds, BSFL is gearing to expand in these states and achieve its performance targets.

¹ Banks have disbursed Rs. 2670.92 million to SHGs in Andhra Pradesh during FY 2001-02. The cumulative disbursement by banks to SHGs in Andhra Pradesh as of March 2002 is Rs. 5212.57 million (Source: NABARD).

3 CAPITAL ADEQUACY AND ASSET QUALITY

3.1 Ability to raise equity and capital adequacy

The access to equity is a major positive feature of BSFL's funding profile. As a result of the equity infusion of Rs. 165.50 million in November 2001, the capital adequacy improved to 58.57% as of December 2002 from 26.10% in March 2001.

3.2 Portfolio at risk

The score of BSFL on this sub-parameter has been increased, factoring in the decisions of the both the board and management to change the portfolio mix as the conditions warranted. The company with significant funds in hand could have achieved its loan disbursement targets for the current year, had it increased its exposure to SHGs/MACS. However, BSFL has been cautious in not lending to this sub-sector keeping in mind the sharp increase in SHG-bank lending in Andhra Pradesh, where 13 out of BSFL's 19 units are located.

The quality of BSFL's loan portfolio has improved over the past few years. PAR greater than 30 days has come down to 9.98% as of December 2002 from 24.25% as of March 2000. However, the PAR greater than 90 days has remained stagnant during the above period while the PAR greater than 180 days has increased to 6.53% from 4.48% during this period as the company found it difficult to recover loans in units where it has ceased fresh disbursements, following KBSLAB's commencement of operations in these regions. To ensure overall improvement in asset quality, BSFL has adopted certain policies such as change in portfolio mix, stabilization of MIS process, standardization of CSA commission settlement and the part linkage of performance pay to portfolio quality.

The company has reduced its exposure to individual crop and agri investment loans while at the same time increasing the exposure to agri-allied loans and JLG crop loans (*see Table 11*). Similarly, exposure to SHGs/MACS has come down, while non-farm micro enterprise loans have increased to 44.13% from 28.80%. It has ensured that the sectoral exposure limits are applicable even at the unit level thereby minimizing the concentration risk at all levels.

3.3 Write-off levels

BSFL's provisioning norms are conservative in comparison to RBI's prudential norms for NBFCs. From FY 2001-02, the company has increased the portfolio risk reserve to 40% for PAR greater than 400 days from the earlier policy of 10% for PAR greater than 90 days. As a result, the portfolio risk reserve along with the RBI mandated requirement would take the total provisioning to 50% for PAR greater than 400 days. During FY 2001-02, BSFL has also adopted the write-offs on a case-to-case basis based on various underlying factors affecting the recoverability of the loan.

4 RESOURCES

4.1 *Ability to raise resources*

BSFL has demonstrated significant financial flexibility by tying up with domestic and international financial institutions for infusion of both debt and equity. The access to long-term funds is a positive feature of the funding profile of the company.

4.2 *Cost of funds*

BSFL has used part of the equity funds to retire its high cost borrowings, resulting in a drop in the cost of funds to 9.60% (December 2002) from 13.10% (March 2000). All the borrowings as of December 2002 were at the prime lending rate (PLR) or at sub-PLR rates.

4.3 *Liquidity & asset liability management*

The liquidity position of the company is comfortable. The company has parked excess funds from equity infusion in mutual fund investments and bank deposits. As a result, the loan outstanding as a percentage of total assets declined to 67.09% as of December 2002 from 84.44% as of March 2000. BSFL's borrowings are of long tenure (four years and above), while the assets are of short and medium term tenure (one to three years, except employee loans which are for five year term). As a result, there is no asset liability mismatch. The limited investment in fixed assets is another positive feature of BSFL's resource management.

5 OPERATIONAL EFFECTIVENESS

5.1 Office outreach and quality of infrastructure

BSFL's operations are geographically diversified across twenty districts in four states covering 3,463 villages. The company has historically operated in inter-state border districts, which made its entry into a new state relatively easier. Using this strategy BSFL now plans to make further inroads into Maharashtra, besides entering Chattisgarh. It also has plans to start operations in Madhya Pradesh and Jharkhand, where IGS and MPLEAP have an operational presence.

5.2 Efficiency

BSFL has a 1:1 ratio of staff to CSAs (who are not on the company's rolls and are only paid commissions) and about 76% of the total workforce of the company (including CSAs) are credit officers. As a result of high proportion of field level workforce, the company has been able to attain reasonable increase in loan outstanding even with shift towards small loan accounts. The number of loan accounts per credit officer increased to 210 in March 2002 from 140 loan accounts in March 2000 but marginally dropped to 187 accounts in December 2002 due to recruitment of significant number of credit officers. Improved productivity more than compensated for the shift to small loan accounts.

BSFL's operational efficiency ratio (operating expenses to average funds deployed), which is amongst the best in the Indian MFI industry improved further to 9.15% as of December 2002 from 11.87% as of March 2000. By increasing the CSA workforce at the field level, BSFL has been able to improve personnel efficiency ratio to 5.35% as of December 2002 from 6.51% as of March 2000. BSFL's efficiency ratios are better than most other MFIs in India as it has a average loan disbursement of Rs. 10,852 in comparison to Rs. 3,000-Rs.5,000 for other MFIs.

5.3 Profitability

The operational self-sufficiency (OSS) ratio of 116.30% indicates that BSFL is able to meet all its expenses out of its earnings and is not dependent on grants for meeting its operational expenses. The fee based income comprising loan-processing fees and consulting assignment fees played an important role in the company registering surplus in the past. The financial self-sufficiency (FSS) ratio of 81.33% (*see Annexure 3 for calculation*) indicates that the company is still dependent on subsidized borrowings².

BSFL's return on equity (RoE) increased to 4.77% as of December 2002 from 2.48% as of March 2000), which is the highest among CRISIL evaluated MFIs. This increase is on account of the decline in cost of borrowings and the improvement in operating efficiency. Similarly, the return on assets (RoA) improved to 2.39% as of December 2002 from 1.03% as of March 2000.

² Total expenses are adjusted for inflation and interest expense at commercial rates (assumed as State Bank of India's PLR +3.5%). The objective of these adjustments is to understand how well the MFI would cover all the costs if its operations were not subsidized and if it were to fund its operations with commercial-cost liabilities.

6 SCALABILITY AND SUSTAINABILITY

6.1 Resource base sustainability

The company in the past has been successful in raising both debt and equity from financial institutions and institutional investors. The low debt to equity levels would allow BSFL to raise additional borrowings as and when required. Multilateral agencies are expected to provide low cost funds to BSFL for expanding its operations. The company can achieve further improvement in operating efficiencies in the current operational areas. The current average loan accounts per village of 11 indicates that there is considerable scope for expanding number of loan accounts. About one-third of BSFL's existing clients are repeat borrowers and as their number increases, appraisal costs for loan sanction are expected to come down. The tie-up with various insurance companies for insurance product distribution is not only expected to have a positive impact on the asset quality of its unsecured loan portfolio but also result in increased fee based income.

6.2 Organizational sustainability - ability to develop into a mainstream financial institution

BSFL has been conceived as a mainstream financial institution with a focus on microfinance. The company has been successful in achieving various objectives - undertaking development objectives, raise institutional equity from a combination of investors (commercial banks and multilaterals) and remain a regulated financial institution. Similarly, from the beginning the company has been able to attract qualified professionals, implement risk management systems, offer multiple credit products and operate in multiple states.

6.3 Programme sustainability - ability to sustain operations on a larger scale

The company has significant expertise in microfinance and rural livelihood creation and in CRISIL's opinion, the access to capital, long term funds, multiple lending channels, products, diversified geographical presence and proactive board and management are likely to allow BSFL adapt its operational strategy quickly to the changing environment and sustain its operations on a much larger scale.

6.4 Comments on projections

BSFL has projected an increase in total income from Rs. 49.72 million in March 2002 to Rs. 237.57 million in March 2005. The net profit is expected to increase from Rs. 2.11 million (adjusted) to Rs. 27.23 million during the above period. The fund based yields are likely to improve from the current levels due to increased deployment of funds by way of loans. Loans, which constituted 68% of the funds deployed as of December 2002 is projected to increase to 88% as of March 2005. The increase in operating expenses is due branch expansion and this will have an impact on efficiency ratios. Overall, the projections of the company seem to be optimistic considering the intense competition from the SHG-bank linkage programme last year, which is expected to continue in future as well. However, the experience of the management is expected to help the company in facing the competition by optimally pricing the loans and achieving growth without compromising on asset quality.

Annexures

Annexure 1: Significant accounting policies followed by the company**a) Basis of preparation of financial statements:**

The financial statements are prepared under historical cost convention, on accrual basis of accounting and in accordance with the provision of Companies Act, 1956 and comply with the Accounting Standards issued by the Institute of Chartered Accountants of India to the extent applicable, except otherwise stated and the directions issued by Reserve Bank of India for Non- Banking Financial Companies from time to time, wherever applicable.

b) Revenue recognition:

- i. Interest on loans is recognized on accrual basis.
- ii. Income on non-performing assets is recognized only when realized and no interest, which has remained past due for more than six months at the end of the accounting year, is treated as income.
- iii. In respect of service contracts, income is recognized on the basis of proportionate Completion of the Contract with reference to the stage of performance and corresponding income.

c) Fixed assets:

- i. These are stated at cost.
- ii. Depreciation is provided on the straight-line method at the rates specified in Schedule XIV of The Companies Act, 1956.
- iii. In respect of additions the depreciation is provided prorata from the date the assets are put into use.

d) Loans and advances:

These are classified as standard assets, sub-standard assets, doubtful assets and loss assets in terms of the Non Banking Financial Companies Prudential Norms (Reserve Bank) Directions 1998.

e) Provision for loan losses:

- i. Provisions for doubtful loans and advances have been made as per the norms stated in the Non Banking Financial Companies Norms (Reserve Bank) Directions, 1998.
- ii. In addition the company also sets aside an amount equal to 40% of the principal outstanding of loans overdue by 400 days to a portfolio risk reserve.
- iii. Portfolio risk reserve: An amount of Rs. 3.4 million being 50% of the loan outstanding pertaining to non-performing loans in Raichur and Mahabubnagar, is being transferred during the period ended December 31, 2002 (Previous Year: Rs. 1.29 million). This is being done as the company has ceased normal business operation at these locations.

- iv. Based on NBFC norms and the company's additional provisions, the total provisioning for loans overdue is as follows:

Days overdue	Provision
180 days and above	10%
400 days and above	50%
730 days and above	100%

f) Write-off policy:

Loans are written off if the management is satisfied that it has exhausted all options for recovery of principal and interest on the loan.

g) Details of bad debts written off (as of December 31, 2002)

Rs. in million

Loans overdue	Amount
Below 730 days	1.14
730 days and above	1.52
Other overdues	0.20
Total	2.87

h) Employee benefits:

- i. Provident fund contribution is accounted on actual liability basis and paid into government.
- ii. Gratuity is being computed as per statutory norms on actuarial valuation basis and paid into a trust created with and for this purpose, through the group schemes of Life Insurance Corporation of India.

i) Miscellaneous expenditure:

Written off over five year period in equal installments.

j) Foreign exchange transactions:

Foreign currency current assets and current liabilities outstanding at the balance sheet date are translated at the exchange rates prevailing on the date and the net gain or loss is recognized in the Income and expenditure account. All other currency gains and losses are recognized in income and expenditure account.

k) Contingent liabilities: Nil

Annexure 2: Financial statements

Income and expenditure statement

Rs. in million

For the year ended	31/12/2002	31/03/2002	31/03/2001	31/03/2000
Period	9 months	12 months	12 months	12 months
Results type	Un audited	Audited	Audited	Audited
<u>Fund based income</u>				
Interest income from loans [#]	39.22	40.61	26.64	17.16
Income from investments	7.29	3.52	0.63	0.58
Other income	0.63	0.44	0.00	0.00
Total fund based income	47.13	44.57	27.27	17.75
Interest paid	13.22	15.62	11.57	6.56
Gross spread	33.91	28.95	15.71	11.18
<u>Fee based income</u>				
Loan processing fees	6.09	4.56	2.98	1.23
Consultancy fees	1.58	0.38	2.08	1.18
Service charge from group companies	0.00	0.00	0.00	2.22
Other fee based income	0.17	0.21	0.24	0.03
Total fee based income	7.84	5.15	5.29	4.65
Total income	54.97	49.72	32.57	22.39
Gross profit	41.74	34.10	21.00	15.83
<u>Expenses</u>				
Personnel expenses	12.68	9.49	5.92	5.63
Commission to CSAs	4.56	5.12	1.69	0.92
Administrative expenses	12.23	10.83	7.89	5.39
Total expenses	29.47	25.45	15.51	11.94
<u>Write-offs and provisions</u>				
Write-off of bad debts	2.87	4.60	2.20	0.42
Provision for loan loss	0.42	0.97	0.82	0.85
Total	3.29	5.57	3.03	1.27
Depreciation on owned assets	1.28	0.37	0.29	0.18
Profit before tax	7.70	2.71	2.18	2.44
Tax	0.00	0.60	0.90	1.40
Profit after tax (reported)	7.70	2.11	1.28	1.04
Add: non-recurring income	0.00	0.22	0.00	0.00
Profit after tax (adjusted)	7.70	2.33	1.28	1.04
Accretion to reserves (reported)	7.70	2.11	1.28	1.04
Accretion to reserves (adjusted)	7.70	2.33	1.28	1.04

is net of 2% rebate for on-time repayment

Balance sheet

Rs. in million

As at	31/12/2002*	31/03/2002	31/03/2001	31/03/2000
Liabilities	Un audited	Audited	Audited	Audited
Share capital	206.00	206.00	40.50	40.50
Portfolio risk reserve	5.54	2.14	0.85	0.37
Other reserves	7.68	3.38	2.34	1.55
Less: Miscellaneous expenditure not written off	-0.11	-0.15	-0.20	0.00
Net worth	219.10	211.36	43.48	42.41
Term loans from financial institutions	157.75	120.39	81.08	40.00
Bank loans	39.68	3.43	19.01	3.50
Loans from holding companies	0.00	45.97	42.75	30.70
Total long term borrowings	197.43	169.78	142.83	74.20
Total short term borrowings	0.00	0.00	0.00	0.00
Sundry creditors	1.23	0.53	0.32	1.01
Interest accrued but not due	2.31	0.96	0.76	0.47
Cash security from borrowers	35.11	23.02	9.57	10.27
Other liabilities	0.25	0.40	0.05	0.26
Provision for taxation	1.50	1.50	0.42	2.47
Provision for loan loss	2.97	2.55	1.58	0.75
Total current liabilities	43.37	28.95	12.70	15.22
Total Liabilities	459.90	410.10	199.01	131.82
Assets				
Loans and advances	308.56	225.33	154.80	111.31
Investments in mutual funds	39.85	43.50	0.00	0.00
13.5% Government Securities (2007)	0.09	0.09	0.09	0.09
Total investments	39.94	43.59	0.09	0.09
Cash & bank balances	85.74	121.95	32.33	7.95
Advance payment of tax	0.00	0.00	0.00	2.58
Interest accrued	9.35	7.31	5.21	4.87
Other current assets	10.46	6.64	2.78	2.03
Total current assets	105.55	135.90	40.32	17.44
Total funds deployed	454.04	404.82	195.21	128.84
Net fixed assets	5.85	5.28	3.80	2.98
Total Assets	459.90	410.10	199.01	131.82

Key financial ratios

Year ended	31/12/2002*	31/03/2002	31/03/2001	31/03/2000
	Un audited	Audited	Audited	Audited
Yield*				
Fund based yield (A)	14.63%	14.85%	16.83%	17.63%
Portfolio yield	19.59%	21.36%	20.02%	20.19%
Fee based income /Avg. funds deployed	2.43%	1.72%	3.27%	4.62%
Cost of funds*				
Interest paid/Average funds deployed (B)	4.11%	5.20%	7.14%	6.52%
Interest paid/Average borrowings (C)	9.60%	9.99%	10.66%	13.10%
Interest spread*				
Gross spread/Average funds deployed (A) - (B)	10.53%	9.65%	9.69%	11.11%
Spreads on lending (A) - (C)	5.03%	4.86%	6.17%	4.54%
Overheads				
Operational efficiency	9.15%	8.48%	9.57%	11.87%
Personnel efficiency	5.35%	4.87%	4.70%	6.51%
Administrative efficiency	3.80%	3.61%	4.87%	5.35%
Profitability*				
Return on equity	4.77%	1.82%	2.97%	2.48%
Return on funds deployed	2.39%	0.77%	0.79%	1.03%
Operational self sufficiency	116.30%	105.77%	107.16%	112.23%
Financial self sufficiency	81.33%	85.01%	84.69%	97.48%
Asset quality*				
Net write-offs / average loan outstanding	1.43%	2.42%	1.66%	0.50%
Loan loss provisions / average loan outstanding	0.21%	0.51%	0.62%	1.00%
Total loan loss rate	1.64%	2.93%	2.28%	1.50%
Capitalization				
Total debt/Net worth (times)	0.90	0.80	3.28	1.75
Capital adequacy	58.57%	73.38%	26.10%	34.99%

* annualized basis

Annexure 3: Calculation of self-sufficiency ratios

Rs. in million

	31/12/2002	31/03/2002	31/03/2001	31/03/2000
Total income (i)	54.97	49.72	32.57	22.39
Total expenses (ii)	47.27	47.01	30.39	19.95
Operational self sufficiency (adjusted) - (i)/(ii)	116.30%	105.77%	107.16%	112.23%
Assumptions				
Inflation (Wholesale Price Index) -annual growth [#]	3.30%	3.60%	7.10%	3.30%
Commercial rates (State Bank of India's PLR + max. spread of 3.5%)	14.50%	14.50%	15.50%	16.50%
Adjustments				
a) Inflation adjustment				
Average net worth (1)	215.23	127.42	42.94	41.89
Average fixed assets (2)	5.57	4.54	3.39	2.12
Inflation adjustment = (1-2)*inflation	6.92	4.42	2.81	1.31
b) Subsidy adjustment				
Average borrowings	183.60	156.31	108.52	50.10
Commercial cost of borrowings = average borrowings * commercial rates (3)	26.62	22.66	16.82	8.27
Actual cost of borrowing (4)	13.22	15.62	11.57	6.56
Subsidy adjustment (3-4)	13.40	7.05	5.25	1.71
Adjusted total expenses (iii) = Total expenses + inflation adjustment + subsidy adjustment				
	67.58	58.48	38.45	22.97
Financial self sufficiency (adjusted) - (i)/ (iii)	81.33%	85.01%	84.69%	97.48%

Index numbers of wholesale prices (base year 1993-94) for all commodities have been considered. Inflation figures for year ending March are percentage variation of average weekly index numbers. The inflation for year ending December 2002 is the percentage variation of index number as of December 28, 2002. Source: CRISIL Centre for Economic Research; RBI Weekly Statistical Supplement dated January 18, 2003.

Annexure 4: Projected financial statements

Projected income and expenditure statement provided by the company

Rs. in million

For the year ended	31/03/2004	31/03/2005
	Projected	Projected
<u>Fund based income</u>		
Interest income from loans	118.55	194.44
Income from investments	4.66	7.36
<u>Total fund based income</u>	123.20	201.80
<u>Interest paid</u>	34.95	66.21
<u>Gross spread</u>	88.26	135.60
<u>Fee based income</u>		
Loan processing fees	13.75	20.30
Consultancy fees	1.00	1.50
Registration fee from new borrowers	4.07	4.74
Income from insurance distribution	3.53	9.23
<u>Total fee based income</u>	22.36	35.76
<u>Total income</u>	145.56	237.57
<u>Gross profit</u>	110.61	171.36
<u>Expenses</u>		
Personnel expenses	26.06	31.19
Commission to CSAs	15.89	20.50
Administrative expenses	30.98	50.73
<u>Total expenses</u>	72.93	102.42
<u>Write-offs and provisions</u>		
Write-off of bad debts	0.00	0.00
Provision for loan loss	20.08	22.10
<u>Total</u>	20.08	22.10
Depreciation on owned assets	6.50	7.94
<u>Profit before tax</u>	11.10	38.90
Tax	3.33	11.67
<u>Profit after tax (reported)</u>	7.77	27.23
Add: Grants and donations	0.00	0.00
<u>Profit after tax (adjusted)</u>	7.77	27.23

Projected balance sheet provided by the company

	Rs. in million	
	31/03/2004	31/03/2005
	Projected	Projected
Liabilities		
Share capital	206.00	206.00
Other reserves	2.17	0.32
Portfolio risk reserve	20.23	50.68
Less: Miscellaneous expenditure not written off	0.00	0.00
Net worth	228.40	257.00
Term loans from financial institutions	454.88	773.57
Total long term borrowings	454.88	773.57
Total short term borrowings	0.00	0.00
Sundry creditors	0.00	0.00
Cash security from borrowers	71.54	97.61
Savings mobilized	0.00	50.00
Other liabilities	7.90	7.90
Provision for loan loss	32.61	54.71
Provision for dividend	0.00	10.30
Total current liabilities	112.05	220.52
Total liabilities	795.33	1251.09
Assets		
Loans & advances	694.66	1090.69
Investments		
- Government Securities	0.00	0.00
Total investments	0.00	0.00
Cash & bank balances	26.71	19.94
Deposits with banks	50.59	115.59
Interest accrued but not due	5.32	11.17
Other current assets	2.11	2.11
Total current assets	84.73	148.81
Total funds deployed	779.39	1239.50
Net fixed assets	15.94	11.59
Total assets	795.33	1251.09

Key financial ratios based on projected financial statements

Year ended	31/03/2004	31/03/2005
Yield		
Fund based yield (A)	20.18%	19.99%
Portfolio yield	22.70%	21.78%
Fee based income /Avg. funds deployed	3.66%	3.54%
Cost of funds		
Interest paid/Average funds deployed (B)	5.72%	6.56%
Interest paid/Average borrowings (C)	11.08%	10.78%
Interest spread		
Gross spread/Average funds deployed (A) - (B)	14.46%	13.43%
Spreads on lending (A) - (C)	9.10%	9.21%
Overheads		
Operational efficiency	11.95%	10.15%
Personnel efficiency	6.87%	5.12%
Administrative efficiency	5.07%	5.03%
Profitability		
Return on equity	3.49%	11.22%
Return on funds deployed	1.27%	2.70%
Total loan loss rate	3.85%	2.48%
Capitalization		
Total debt/Net worth (times)	1.99	3.01
Capital adequacy	31.81%	23.04%

Key assumptions made by the company for financial projections

Indicator	2002-03	2003-04	2004-05
Disbursement (Rs. in million)	433.88	650.00	1015.00
Loan outstanding at the end of the year (Rs. in million)	349.61	507.46	980.48
Average loan balance (Rs.)	8,753	10,328	10,500
No. of new clients added during the period	16,300	20,400	23,700
No. of active clients	39,943	63,325	93,793
No. of credit officers (FX+CSAs)	297	325	400
Credit officer productivity (no. of loan accounts)	174	194	234
No. of life insurance policies sold	4,300	60,581	58,000
No. of non-life insurance policies sold	500	6,883	13,000

- It has been assumed that the company would be mobilizing fixed deposits of Rs. 50 million from its clients during FY 2004-05. It would be paying an interest of 10% per annum on the fixed deposits.

- Interest on investments, deposits and bank balance has been assumed at 8% per annum.
- Loan processing fee of 2% and registration fee of Rs. 200 has been assumed.
- Average commission fee for life insurance policy has been assumed at Rs. 8.16 / Rs. 1000 sum assured. Similarly, the average commission fee for non-life insurance policy has been assumed at Rs.18/ 1000 sum insured.
- The projections assume a cash security of 10% on average loan disbursement.

Annexure 5: Profile of group companies

- BASICS Limited is the holding company
- The Krishna Bhima Samruddhi Local Area Bank (KBSLAB) received the license from RBI in November 2000 and commenced banking operations in February 2001.
- Indian Grameen Services (IGS) undertakes research, training and institutional development

Rs. in million

Particulars	BASICS Ltd.		KBSLAB		IGS	
	31/03/2002	31/03/2001	31/03/2002	31/03/2001	31/03/2002	31/03/2001
Total Income	10.58	9.78	6.61	2.09	11.02	7.12
Profit after tax	0.66	0.78	1.51	0.05	0.69	0.45
Share capital	1.10	1.10	50.00	50.00	0.08	0.08
Net worth	6.42	5.74	51.55	50.05	40.15	18.67
Total deposits & borrowings	193.38	145.51	3.95	4.70	0.05	0.00
Total assets	204.73	153.96	58.60	58.10	40.67	19.01

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