Initial Public Offer

NOVEMBER 07, 2022

IPO Note

(Note: All the information in this note is taken from RHP)

(For private circulation only)

FIVE STAR BUSINESS LTD.

NOT RATED

Offer Details

The offer consists of an offer for sale of Rs. 1,960 cr. (at the upper end of the price band) The price band is in the range of Rs. 450-474/share.

Details of the offer

Particulars	Details
Price band (Rs/share)	450-474
Opening date of the Issue^	9-Nov-22
Closing date of the issue	11-Nov-22
No. of shares pre-issue (nos. lakhs)	**2,914**
Fresh Issue (nos. lakhs)*	-
Offer for sale (nos. lakhs)*	414
No. of shares post-issue (nos. lakhs)*	**2,914**
Fresh Issue size (Rs Cr)*	-
Offer for sale size (Rs Cr)*	1,960
Issue size (Rs Cr)*	1,960
Face Value (Rs/ share)	1
Bid Lot	31 and multiples thereof
Book Building	
QIBs (Including Anchor)	50%
Non-Institutional	15%
Retail	35%
Book Running Lead managers (BRLM)	ICICI Securities Limited/ Edelweiss Financial Services Limited/ Kotak Mahindra Capital Company Limited/ Nomura Financial Advisory and Securities (India) Private Limited.
Registrar to the issue	KFin Technologies Limited

*Source: Company's RHP, * Based on upper price band ^The Anchor Investor Bidding Date shall be one Working Day prior to the Bid/Offer Opening DateObjects of the issues*

Objects of issues

Particulars	Rs. Cr.*
Offer for sale (Not to be received by the company)	1,960
Total	1,960

*Source: Company's RHP, *Based on upper price band*

Shareholding pattern

Particulars	Pre-Issue	Post-Issue*
Promoter & Promoter Group holding (%)	39.9	33.6
Public holding (%)	60.1	66.4
Total (%)	**100.0**	**100.0**

*Source: Company's RHP, *Based on upper price band*

Hemali Dhame
hemali.dhame@kotak.com
+91 22 6218 6433

Selling shareholders

Particulars	Amount to be raised from the offer for sale (Rs. Cr.)	Number of equity shares offered in the offer for sale*	Number of equity shares held pre offer for sale	% of pre offer paid up equity share capital	% of share-holding offered for sale	% of post-offer paid up equity share capital*
Promoter						
M atrix Partners India Investment Holdings II, LLC	719	15,177,511	36,447,465	12.46	41.64	7.30
SC I Investments V	167	3,517,764	25,696,500	8.79	13.69	7.61
Other Selling Shareholders						
Matrix Partners India Investments II Extension, LLC	12	255,000	612,319	0.21	41.64	0.12
Norwest Venture Partners X - Mauritius	361	7,625,464	29,748,060	10.17	25.63	7.59
TPG Asia VII SF Pte. Ltd.	700	14,774,578	62,726,964	21.45	23.55	16.46
	168	3,539,091	3,539,091	1.21	100.00	-

*Source: Company RHP * Based on the upper price band*

Listing schedule

Finalisation of Basis of Allotment with the Designated Stock Exchange	On or about November 16, 2022
Initiation of refunds (if any, for Anchor Investors)/unblocking of funds from ASBA Account	On or about November 17, 2022
Credit of Equity Shares to demat accounts of Allottees	On or about November 18, 2022
Commencement of trading of the Equity Shares on the Stock Exchanges	On or about November 21, 2022

Source: Company RHP

About the Company

The Company is an NBFC-ND-SI providing secured business loans to micro-entrepreneurs and self-employed individuals, each of whom are largely excluded by traditional financing institutions. Headquartered in Chennai, Tamil Nadu with a strong presence in south India and all of its loans are secured by borrowers' property, predominantly being SORP.

Within a subset of large peers (with more than Rs. 3,000 cr in Gross Term Loans),

- it has the fastest Gross Term Loans growth, with a compound annual growth rate ("CAGR") of 65.0%;
- the highest average return on Gross Term Loans of 7.5%, across the period covering Financial Years 2022, 2021 and 2020; and
- across the period covering Financial Years 2022, 2021 and 2020; and for each of those Financial Years, return on Gross Term Loans as calculated by CRISIL was 7.5%, 7.1% and 7.8%, respectively
- the three best for gross non-performing assets (Stage 3 Gross Term Loans as a percentage of Gross Term Loans of 1.05%) as of March 31, 2022, while it has the best asset quality among lenders identified by CRISIL as engaged in extending MSME business loans, with other lenders reporting 90+ DPD more than 2%.

AUM Mix

Rs. Cr	June 30,2022	June 30,2021	FY22	FY21	FY20
Small Business loans	3,290	2,877	3,163	2,793	2,448
Loans for asset creation and others	2,006	1,701	1,904	1,652	1,444

Source: Company RHP

The growth is primarily volume led through increasing customer base while keeping the ATS stable, and it expects this to continue. The interest rates on loans depend on the underlying tenor (which ranges from two to seven years), with approximately 95% of the loans sanctioned being between the interest rate range of 24% to 26% and between the tenure range of five to seven years. 100% of leads for customers are sourced in-house without any use of direct selling agents to source leads for us; further, all of loans are fully secured with more than 95% of the collateral being SORP at the time the loan application is approved.

The Company targets customers:

- in urban and semi-urban locations, as well as in the rural markets of India, where CRISIL expects faster growth in bank credit activity as financial awareness increases;
- who typically derive income from "everyday" cash and carry businesses with a focus on services;
- with household net cash-flows of approximately Rs. 25,000 to Rs. 40,000 per month;
- who can provide collateral (typically land and building of approximately Rs. 10 lacs in value; and
- whose family will act as co-applicants on the loan. These customers have unencumbered title to the collateral, are reasonably resistant to business cycles and macro events, and are typically more motivated to service the loans without defaults primarily as a result of high customer equity in the collateral property.

The Company had an extensive network of 311 branches, as of June 30, 2022, spread across approximately 150 districts, eight states and one union territory, with Tamil Nadu, Andhra Pradesh, Telangana and Karnataka being key states. Such key states collectively accounted for approximately 85% of branch network by number, as of June 30, 2022.

The Company started operations in Chennai, Tamil Nadu and has increased the scale of operations through growth in number of branches by adopting a calibrated strategy of contiguous expansion across geographies where there is substantial demand for its offering. Such contiguous expansion is underpinned by utilizing neighboring branches to evaluate local credit environments combined with focus on hiring local staff with an understanding of the catchment area, strong local personal and professional networks and the market. As of June 30, 2022, approximately 95% of branches were located in cities and towns with populations up to one million.

Table

	Units	FY20	FY21	FY22	June 30 2022
Live Accounts	Nos	143,079	176,467	217,745	230,175
Branches	Nos	252	262	300	311
Number of Loans Disbursed	Nos	76,634	48,111	63,633	19,793
Disbursements	Rs. Cr	2,409	1,245	1,756	568
Gross Term Loans	Rs. Cr	3,892	4,445	5,067	5,297
Gross Term Loans Growth	%	84.2	14.2	14.0	4.5
Stage 3 Gross Term Loans to Gross Term	%	1.4	1.0	1.1	1.1
Stage 3 Gross Term Loans (net) to Gross Term Loans	%	1.1	0.8	0.7	0.7
Total number of employees	Nos	3,734	3,938	5,675	6,077
Number of Business and Collections Officers	Nos	1,834	2,008	2,467	2,550
Gross Term Loans per Business Officer (₹ in millions)	Rs. Cr	2.1	2.2	2.1	2.1
Disbursement per Business Officer(18) (₹ in millions)	Rs. Cr	1.7	0.7	0.8	0.2
Average number of Business Officers per branch	Nos	7.3	7.7	8.2	8.2
Average Ticket Size	Rs. Cr	0.03	0.03	0.03	0.03
Average Yield on Gross Term Loans	%	24.2	24.2	24.1	24.2
Average Cost of Borrowing	%	12.1	11.5	10.5	10.5
Net Interest Margin	%	16.7	16.0	17.7	19.2
Operating Expenses to Average Total Assets	%	4.9	4.2	4.9	5.5
Impairment loss allowance to Average Total Assets	%	1.4	0.7	0.7	0.0
Cost to Income Ratio	%	39.0	34.3	36.9	32.3
Profit for the period / year after tax	Rs Cr	262	359	454	139
Net Profit Margin	%	33.3	34.2	36.1	41.1
Profit per employee	Rs Cr	0.09	0.09	0.10	0.02
Net Worth	Rs Cr	1,945	2,318	3,710	3,857
Total Borrowings	Rs Cr	2,364	3,425	2,559	2,520
Return on Average Net Worth	%	15.4	16.9	13.9	3.69^
PCR (on Stage 2 & 3 assets)	%	9.7	13.4	10.4	10.1
Gross Term Loans on Restructured Accounts (22)	Rs Cr	NA	NA	73.80	71.06

Source: Company RHP

Strengths

Fastest Gross Term Loans growth among compared peers with more than Rs. 3,000 cr in Gross Term Loans, with strong return and growth metrics and a significant potential addressable market (CRISIL Report)

According to CRISIL, the potential market for residential property-backed secured MSME lending in India is approximately Rs. 2,200,000 cr (Rs. 22 trillion), with Uttar Pradesh, West Bengal, Maharashtra, Rajasthan and Tamil Nadu collectively accounting for over half of such potential market. CRISIL also notes that while this potential market opportunity is significant, it observes that there are few formal financiers of scale who cater to this segment. CRISIL attributes this to the relatively high cost of serving such market, the time required to build expertise, the requirement of having strong knowledge of the local market and regional dynamics, and the challenges associated with building a credit underwriting model for non-income proof customers and collections infrastructure.

The Company's business currently operates within this market and has an underwriting model that caters to such customers, and as such it is well positioned for further growth within this market.

Over the last two decades of operations in this particular product, the success and growth are an outcome of a customer centric business model, where through practices and policies, it can address specific issues faced by small business owners and self-employed individuals, and leverage its local presence to develop detailed and relevant local level knowledge. It is able to identify local level opportunities, ensure careful customer selection, timely loan approval disbursals and efficient real time monitoring of collections.

As per the CRISIL Report, it had the highest average return on Gross Term Loans of 7.5% among compared peers with more than Rs. 3,000 Cr in Gross Term Loans. Such returns are as a result of its ability to lend to customers at consistently superior yields and then control costs through initiatives including:

- reduction in cost of borrowings;
- use of technological advancements to drive improvement in productivity and bring down operational costs;
- robust collections infrastructure; and
- effective risk containment and continuous monitoring leading to low credit costs, low branch costs and efficiency in hiring through local talent pools.

Among the select institutions to develop an underwriting model that evaluates the cash-flows of small business owners and self-employed individuals in the absence of traditional documentary proofs of income (CRISIL Report)

The Company has an underwriting model to provide secured financial solutions to small business owners and self-employed individuals and over the last two decades of operation in this particular product, are among the select institutions to have developed such model in India. (CRISIL Report).

The model is customer centric and is underpinned by underwriting practices that triangulate the character, cash-flow, and collateral of potential customers. This methodology of underwriting ensures it is able to evaluate both the willingness and the ability of the customer to repay the loan, despite the absence of traditional documentary proofs of income. This has enabled it to mitigate credit risk and successfully underwrite new loans while maintaining the asset quality. The underwriting practices are characterized by a multi-level evaluation process for each loan, where the sourcing team is responsible for conducting the preliminary assessment of each potential borrower, which is then independently evaluated by Field Credit Team, before File Credit Team reviews and approves the loan proposal.

Fundamental elements of the underwriting model, include:

- loans are given to the household where all household members whose cash-flows are factored in to evaluate the proposal or those who have a current or potential claim on the property being mortgaged, shall be included as co-applicants to the loan proposal;
- deliberately focusing on services oriented businesses with majority of the target market comprising individuals that are typically impacted by macro down-cycles last, while being first to emerge from such cycles;
- multiple physical verification touchpoints by Business and Collection teams and Field Credit Teams to assess applicants and collateral;
- SORP collateral focus;
- all activities carried out as part of underwriting process are undertaken by employees, which it believes ensures staff accountability, independent field credit verification is undertaken on all proposals;
- limit loan approval powers to the File Credit Team only, with loan amount limits based on approver experience; and
- conservative loan-to-value ratios and instalment to income ratios on outstanding loan accounts.

Strong "on-ground" collections infrastructure leading to its ability to maintain a robust asset quality.

Many of the customers have previously borrowed from moneylenders or other such unorganized lenders, and although it has observed minor delays in the servicing of regular monthly instalments, which it views as a typical part of the repayment culture, such delays don't necessarily translate into loan defaults. A key mechanism it uses to prevent defaults in such circumstances is maintaining a strong collections infrastructure designed to keep the credit and repayment discipline of the borrower intact.

The collections infrastructure is underpinned by the following:

- branches adequately staffed with Business Officers, with the number of loans per Relationship Officer on average not exceeding 120, which is expected to provide each officer with the capacity to undertake both business and collections activities effectively;
- older branches with a collections vertical to which the collections responsibility of accounts is transferred once the accounts cross a certain vintage, which effectively frees up the time for Business Officers to focus on new business;
- branches staffed with persons sourced from the local area, with each branch servicing an area with a limited radius, resulting in branch staff being able to quickly attend a customer's location as issues arise;
- keeping the responsibility of sourcing and collections with the same Relationship Officer so that he/she is incentivised to source suitable files and undertake follow-up activities with the customers until closure of the loan; and
- branch staff incentives aligned with each of business and collections targets so that meeting such targets in both areas are required to qualify for incentives.

The collections process involves high-touch engagement between Business Officers and customers and to optimize this interaction, it ensures that each Relationship Officer is responsible for no more than 120 customers on an average.

The number of Business Officers increased from 1,834 as of March 31, 2020 to 2,008 as of March 31, 2021, 2,467 as of March 31, 2022 and to 2,550 as of June 30, 2022. The number of loans per Relationship Officer was 90, 88, 88 and 78, as of June 30, 2022 and March 31, 2022, 2021 and 2020, respectively.

It also has a strong monitoring mechanism that ensures involvement and intervention from various individuals across business, all of which also ensures a robust asset quality. For instance, for accounts within the 1-30 DPD, collections efforts include reminder messages, calls from the branch and visits by the Branch Manager to the customer's business or residence. For loan accounts in the 31-90 DPD category, follow-up activity is undertaken whereby supervisors, and senior management including Deputy Head – Business and Collections, Chief Business Officer, COO, CEO and the Chairman and Managing Director become involved on a need basis with all efforts being made so that the account stabilises in the same category or rolls back into lower categories. For accounts in the 90+ DPD category, there is a coordinated effort between the corporate office and the branch to bring the account to a lower category.

It incentivizes branches to adhere to a certain Stage 3 Gross Term Loans target at the branch level and the incentives for each individual at the branch are linked to the branch adhering to such Stage 3 Gross Term Loans target.

Ability to successfully expand to new underpenetrated geographies through a calibrated expansion strategy

According to the CRISIL Report, as of March 31, 2022, less than 15% of approximately 7 cr MSMEs in India have access to formal credit in any form, and historically, there is a perception of high risk and prohibitive costs of delivering services physically that have constrained traditional institutions' ability to provide credit to underserved or unserved MSMEs and self employed individuals. As a result, such borrowers resort to credit from informal sources and as such, this relatively untapped market offers huge growth potential for financial institutions. (CRISIL Report).

Since starting as a Chennai based NBFC, it has demonstrated an ability to grow beyond local market. The first growth phase was between Financial Year 2010 and Financial Year 2015 where it increased from six branches in Chennai to 39 branches across Tamil Nadu. Between Financial Year 2015 and Financial Year 2018, it started to expand in the states of Andhra Pradesh, Telangana and Karnataka, growing from three branches to 72 branches during this period. Since then, it had 181 further expanded to 165 branches across Andhra Pradesh, Telangana and Karnataka, as of June 30, 2022.

In addition, from March 31, 2017 to June 30, 2022, the Gross Term Loans in Tamil Nadu (including Pondicherry) grew from Rs. 342.98 cr to Rs. 2,017.21 cr, in Andhra Pradesh grew from Rs. 127.17 cr to Rs. 1,577.00 cr, and in Telangana grew from Rs. 11.49 cr to Rs. 1,032.58 cr.

The state-based Gross Term Loans growth demonstrates that it can successfully grow its footprint and Gross Term Loans in new states while consolidating presence in the home state of Tamil Nadu and other states. Recently, it had expanded into Madhya Pradesh, Chhattisgarh, Maharashtra and Uttar Pradesh. Collectively, these four states accounted for 5.48% of total Gross Term Loans with 46 branches, as of June 30, 2022.

According to the CRISIL Report, Andhra Pradesh Karnataka and Uttar Pradesh have significant potential for growth given relatively low credit penetration and recent strong economic growth.

The Company adopts a calibrated strategy of contiguous expansion across geographies where there is substantial demand for its offering and which has allowed for the maintenance of robust asset quality. Such contiguous expansion requires low operational expenditure and is underpinned by utilizing neighboring branches to evaluate local credit environment combined with its focus on hiring local staff with an understanding of the catchment area, strong local personal and professional networks and the market.

Where it starts operations in a new geography or where contiguous expansion is not possible, it typically begins by establishing pilot branches to gain a deeper understanding of the catchment area and customer characteristics. The senior management closely supervises expansion efforts to ensure branch and staff performance meet expectations which is typically based on past experience, as well as periodic review for potential deeper expansion. 100% in-house sourcing, comprehensive credit assessment and robust risk management and collections framework, leading to good asset quality.

The 100% in-house sourcing, comprehensive credit assessment and robust risk management and collections framework allows it to identify, monitor and manage risks inherent in its operations. Catering primarily to small business owners and self employed customers while maintaining asset quality requires a special skillset in absence of traditional income evidence, such that lending to these borrowers is based on an assessment of their income and cash-flows through various methods. First, it ensures all of its loans are sourced in-house, either through its branch-led local marketing efforts (i.e., door-to-door or specific referral marketing), repeat customers or through walk-ins. In-house sourcing allows for complete control over the quality of customer and processes involved to disbursement, which leads to better asset quality, compared to other methods of customer acquisition.

Further, as its customers are onboarded by its own officers and not by third party selling agents who may or may not be working with multiple financial institutions, it will experience a lower churn rate of customers throughout the portfolio. In addition, self-employed customers are prone to variable cash-flows and lending to them requires robust underwriting systems to appropriately price the risk. As a result of its experience, expertise, and underwriting model, it has been able to effectively serve such customers, while maintaining asset quality, and expanding into newer geographies. As of June 30, 2022, an estimated 95% of the loans that it has disbursed were for single-unit, SORPs, that is, it has a high SORP focus.

It also aims to have conservative average loan-to-value ratios and instalment to income ratios on outstanding loan accounts, which can mitigate adverse events and cyclical effects. Over the last three Financial Years and the three months ended June 30, 2022, it has provided loans to more than 205,000 customers.

To assist with credit assessment and risk management functions, it has created a four layered process for customer evaluation – two layers within the business and collections team and two layers within the credit team, in addition to independent legal checks.

It also conduct an in-depth analysis of the potential customer by considering their character, their existing cash-flow to assess their repayment abilities, and their collateral, as well as ensure that families act as co-applicants which underpins applicants' motivation to service the loan without default. The credit team is independent of the business and collections teams and only the File Credit Team has the authority to approve and sanction loans, while the Field Credit Team has recommendation powers only. There is complete independence between the credit team and the business and collection team and all incentives for the credit team are linked to file processing, not file approval.

The organizational structure is such that almost all of business and collections team members are also responsible for collections. It had a 4,381-member business and collections team including 3,424 Business Officers and Collection Officers catering to 230,175 loan accounts, as of June 30, 2022. The business and collections team (which includes Business Officers, Branch Managers and Supervisory and Head Office support layers) focusses on early warning signals and it has localized teams to monitor cases that show signs of delinquency. It also uses credit bureau checks, and has set up a system of case monitoring by the risk team whereby it can review certain information of borrowers, identify areas of concern and initiate prompt action. This includes supervisory interventions by head-office to ensure efficiency in the collections process. The credit underwriting and risk management teams also utilize technology to process loan applications and analyze credit risks, which also improves the customer experience due to better customer service and engagement and faster turnaround time as a result of faster decision making.

It believes that the effective credit risk management is reflected in the portfolio asset quality indicators such as high repayment rates and low rates of Stage 3 Gross Term Loans and Stage 3 Gross Term Loans (net) across business and economic cycles. As of June 30, 2022, the Stage 3 Gross Term Loans accounted for 1.12% of Gross Term Loans, while Stage 3 Gross Term Loans (net) accounted for 0.68% of Gross Term Loans.

Such organizational structure, credit assessment, risk management and collections framework has allowed it to maintain asset quality during macro downcycles. The risk management framework includes a comprehensive audit mechanism of internal audits performed at a corporate level on a quarterly basis, regular branch level audits and management audits, which cover specific risk-based assignments. It has set up a Risk Management Committee to review and identify current and emerging risks, develop risk assessment and measurement systems and establish policies, practices and other control mechanisms to manage risks and develop risk tolerance limits, monitor positions against approved risk tolerance limits and report its findings to senior management. The Risk Management Committee is also kept informed of accounts that have turned into “quick mortality accounts” (i.e., accounts that turn into Stage 3 Gross Term Loans within one year of disbursal) and any gaps in the underwriting process that have led to this, including staff accountability.

Access to diversified and cost-effective long-term financing with a conservative approach to asset liability and liquidity management.

It has secured financing from diversified sources of capital, including term loans; proceeds from loans securitized; proceeds from the issuance of NCDs; issuances of principal protected market linked debentures; and proceeds from loans assigned; from banks, financial institutions, mutual funds and other domestic and foreign financial and development finance institutions to meet capital requirements.

It believes that it is able to access borrowings at a competitive costs due to stable credit history, strong credit ratings, equity capital position and low leverage, and risk management policies.

As of June 30, 2022, it borrowed from 17 private sector banks, seven public sector banks, 13 NBFCs, one mutual fund, and 14 other entities; As of June 30, 2022 and March 31, 2022: the "current borrowings" (i.e., borrowings comprising debt securities and borrowings accounted for 59.25% and 47.21% of the Total Borrowings, and "non-current borrowings" account for 40.75% and 52.79% of the Total Borrowing, respectively; the weighted average residual tenure of the outstanding borrowings, including securitization was 29.78 months and 29.15 months, respectively; and it had Rs. 478.83 cr and Rs. 437.76 cr in undrawn borrowing facilities from 15 and 14 lenders, respectively.

Total Borrowings to Total Equity ratio was 0.65, 0.69, 1.48 and 1.22 for the three months ended June 30, 2022 and the Financial Years 2022, 2021 and 2020, respectively.

The Asset Liability Management Committee maintains the cash and cash equivalents, investments in government securities and liquid money market mutual funds to at least the gross of:

- next three months of scheduled debt repayments,
- next three months of operational costs and
- next one month of projected disbursements.

As of June 30, 2022 and March 31, 2022, it had cash and bank balances and investment (comprising cash and cash equivalents, other bank balances and investment in mutual funds and government securities (excluding fixed deposits provided as credit enhancement for securitisation transactions)) of Rs. 829.499 cr and Rs. 1,055.25 cr, respectively. It further adjusts its liquidity levels based on the prevailing economic conditions. For instance, in order to mitigate certain economic impacts of the COVID-19 pandemic, it increased the liquidity levels such that average liquidity as of the month-end of the 12 months in Financial Year 2021 was ₹11,119.86 million as compared to ₹6,937.46 million for Financial Year 2020. In addition, it also has in place asset liability management strategies, such as avoiding any cumulative ALM. As of June 30, 2022, and March 31, 2022, 2021 and 2020, it had positive ALM across all the maturities, which has allowed it to meet the growing loan demands of rapidly increasing customer base.

Experienced, cycle-tested leadership with a longstanding promoter, professional management team and supported by marquee investors

The Company is led by qualified and experienced management personnel, who is supported by a capable and motivated team of managers and other employees. The management team has knowledge and understanding of the small business finance landscape in India and the expertise and vision to organically grow the business. They also have diverse experience in a range of financial products and functions related to the business and operations and are supported by qualified personnel who have an in-depth understanding of the geographic regions in which it operates, loan products and customer segment as a result of focus on hiring local staff with strong local personal and professional networks.

The founder, Promoter, and Chairman and Managing Director, Lakshmipathy Deenadayalan, has been associated with Five Star for the past 20 years. He has a deep understanding of customer behavior and the business and operations, and has been critical to developing and enhancing the business model and driving the total income and profitability.

Certain of management team members:

Name of the employee	Designation	Total years of experience	Years of experience with the company	Recent past employers include
Rangarajan Krishnan	Chief Executive Officer	~18	7	Spark Financial Holdings Private Limited, IFC (South Asia Department), Standard Chartered Bank, HDFC Bank Limited
Srikanth Gopalakrishnan	Chief Financial Officer	~20	7	Citibank N.A., Asirvad Microfinance Private Limited
Vishnuram Jagannathan	Chief Operating Officer	19	5	HDFC Bank, Deutsche Bank AG, HSBC
Parthasarathy Srinivasan	Chief Credit Officer	18	4	DBS Bank Limited, ICICI Bank, Standard Chartered Bank
Sathya Ganesh Thirumalaidoss	Chief Business Officer	17	5.2	ICICI Bank Limited, Cholamandalam Investment and Finance Company Limited, Shriram Housing Finance Limited
Vanamali Sridharan	Chief Technology Officer	28	1	Equitas Small Finance Bank, Suryoday Small Finance Bank Limited, Accenture Services Private Limited, Standard Chartered Bank (Dubai)
Jayaraman Sankaran	Chief Risk Officer	~22	2	Redington (India) Limited, Arabian Automobile Alliance LLC
Ramesh Kannah	Chief Legal Officer	~18	0.5	HDFC Limited, ICICI Bank Limited, Cholamandalam Investment and Finance Company Limited, Piramal Capital and Housing Finance Limited
Naveen Raj	Chief Audit Officer	~15	0.5	Deloitte, Haskins & Sells, BSR & Co LLP

Source: Company RHP

Further, field teams (business and collections, and credit) and file credit teams have an in-depth understanding of customer segment, loan products, types of collateral and businesses of borrowers.

The Shareholders include marquee investors, including affiliates of TPG Capital, Sequoia Capital, Matrix Partners, Norwest Venture Partners, KKR and TVS Capital Funds Limited and it believes it has benefited significantly from their collective vision and experience. They, along with the senior management, have been instrumental in formulating and executing the core strategies and implementing the corporate governance framework, which has been and will continue to be critical to the growth of the business. It also has a distinguished Board comprising industry professionals. The Independent Directors strengthen the reputation of the Board.

The overall growth, performance of the portfolio, asset quality and continued profitability during challenging periods demonstrates the strengths of the KMP, management team and Board.

Strategies

Increase penetration in existing markets through increasing branch staff numbers, increasing branch network in the existing geographies and diversifying to contiguous markets

While it has grown its operations in relatively newer markets, the operations have historically focused in the south Indian states of Tamil Nadu, Andhra Pradesh, Karnataka and Telangana. Such states contribute significantly to its Gross Term Loans and it intends to continue to expand in these states in a contiguous manner, to drive greater and deeper penetration.

The business model is scalable and by drawing on the experience of its team, it expects to be able to expand its operations efficiently, with low incremental costs. The strategies include deepening its presence in its existing geographies through a combination of increasing the number of Field Officers and setting up new branches.

For states where it has no or very low existing presence, it will continue to review a number of factors including demographics and competitive landscape before establishing a branch. The strategy remains to grow contiguously into such areas by gauging the business potential of a particular state and drill down into specific locations suitable for branch opening. When it enters a new state through contiguous expansion, it opens new branches in district headquarters and then expand deeper by deploying personnel to adjacent areas to source new customers. It is constantly evaluating additional locations using its criteria and expect to continue to add branches to grow out network in the near term.

As of June 30, 2022, it had reached an approximate district level penetration of 93%, 77% and 94% in the states of Tamil Nadu, Andhra Pradesh, Telangana, respectively, and 65%, 63%, 8%, 11% and 1% in the states of Karnataka, Madhya Pradesh, Maharashtra, Chhattisgarh and Uttar Pradesh, respectively. Accordingly, it believes there is scope to continue to grow the business further in these states.

Continue to focus on small business owners and self-employed individuals

The Company plans to continue to focus on small business owners and self-employed individuals and increase its market share. For instance in terms of credit availability generally, the CRISIL Report notes that there is a wide variation across states and within various districts in the same state, which indicates latent opportunity for providing banking services to unserved or underserved customers. In many locations, it has customers who are first time borrowers from the formal secured lending ecosystem. As of June 30, 2022, 30.42% of its customers were new to credit, while the remaining customers were sanctioned higher ticket loans with higher tenors than they had availed earlier.

It believes its underwriting model, which is based on its understanding of income assessment and collateral assessment for this customer segment, with limited reliance on documented income, is a key strength which would make customers prefer it over its competitors and which it intends to reinforce to achieve Gross Term Loans growth.

Optimize the borrowing costs, reduce operating expenses further and continue to expand and diversify the lender base

The Average Cost of Borrowings was 10.53% as of June 30, 2022, 10.51% as of March 31, 2022, 11.48% as of March 31, 2021 185 and 12.07% as of March 31, 2020. This steady decline over the last three financial years is due to several factors, primarily its financial performance and improving credit ratings. A lower Average Cost of Borrowing enables it to competitively price loan products and help grow the business and operations and increase NIMs. It has also diversified its funding sources by using instruments such securitization transactions, non-convertible debentures, and principal protected market linked debentures to ensure that the debt capital requirements are met at optimal costs. It intends to continue to diversify its funding sources, enhance limits from existing sources, identify new sources and pools of capital and implement robust asset liability management policies with the aim of further optimizing its borrowing costs and help increase NIM. Further, it intends to expand and diversify its lender base, and seek to obtain funding from insurance, pension and provident funds, overseas lenders, external commercial borrowings and through the issue of commercial paper. It is focused on improving asset and liability management to ensure that it continues to have a positive asset-liability position. It believes that this will help it improve its credit ratings further and reduce the average cost of borrowings. The developed distribution and collections infrastructure is a key factor in its operating leverage and will help reduce its operating expenses. Further, it expects that strategic investments in technology and digitization across business will further reduce its operating expenses and credit costs over time. It will continue to review and identify means to improving cost to income ratio and improving overall NIM from current levels. As a result of these various initiatives it seeks to continue to maintain the low levels of Stage 3 Gross Term Loans which should assist in minimizing credit costs, as well as improve its credit ratings for new fund raising, reduce the cost of borrowing and hence deliver strong return ratios.

Continue to invest in Technology and Data Analytics to build a scalable and efficient operating model / to improve customer experience, increase productivity and decrease costs

The Company has made strategic investments in its information technology systems and implemented automated, digitized technology enabled platforms and proprietary tools, to strengthen its offerings and derive greater operational, cost and management efficiencies.

The IT and data science teams comprised of 25 personnel. It has also recruited Vanamali Sridharan as Chief Technology Officer, who has over 28 years of experience working with banks and technology strategy consultancies, as well as appointed a dedicated Head of Engineering, Development and Data Sciences to lead the in-house technology development and data analytics. It also has a Head of Technology, who oversees its Customer Acquisition system, Loan Management system and Collections system along with managing the infrastructure and security architecture across the Head Office and Branch offices.

It plans to ensure that the information technology systems continue to help it with several functions, including loan origination, credit underwriting, collections and customer service and retention. In particular, over the short to medium term, it aims to focus its information technology and data capabilities towards the following areas:

- developing an Application Programming Interface ("API") infrastructure to leverage the strength of various third party service providers / fintech companies and aim to partner with them to augment / create more efficient processes;
- improving accuracy and breadth of customer data capture across portfolio for purposes of analytics and insight generation;
- use data, analytics and machine learning to complement the current underwriting processes to ensure it onboards the most suitable borrowers and maintain a robust asset quality;
- developing a robust customer credit scoring model; automation of existing manual activities within its underwriting process to reduce turnaround times for loan sanctions and reduce transaction costs; and
- supplementing its collections infrastructure by leveraging existing payment architecture towards collecting EMI repayments from its borrowers.

It believes that the adoption of such digital service delivery mechanisms has and will continue to enable it to be more efficient, customer friendly and over time improve cost efficiencies through automation, and perform more reliable data analytics for customized products to suit the diverse requirements of its customers and improved customer satisfaction.

Focus on Enhancing Risk Management Framework

As it increases the scale of its operations and expand into new geographies, it intends to continue focusing on enhancing its risk management framework to maintain the credit quality of loan portfolio. The risk management initiatives will include obtaining a better understanding of the geographies in which it is present and the ones where it intends to expand to, improving the credit scoring models and algorithms that it has currently deployed, improving its collection techniques and its property underwriting procedures, as well as initiate portfolio analytics activities. In connection with analytics activities, it intends to carry out a comprehensive analysis of its portfolio, determining behavioral and other trends of its customers and use those to strengthen its credit assessment framework. It has an existing and comprehensive data lake (being a repository of data stored in its natural/raw format) which contains data from all the sub-systems being used to which it plans to add data from external and third party sources with a view to creating an internal single data source to aid in its data analytics and insight generation. Credit assessment is crucial to its operations since many of its customers are new to credit or belong to underserved segments of society with medium to low income levels. The strength in credit assessment is derived from well-trained front-end teams who spend time with its prospective customers and provide a detailed assessment of their income sources, employment stability, savings and repayment capacity. It will continue to invest in hiring and training people to ensure that it maintains its proficiency in credit assessment.

Enhance Brand Recall to Attract New Customers

The Company believes that having a strong recognizable brand is a key attribute in its business, which will help it attract and retain customers, increases customer confidence and influences purchase decisions. Having a strong and recognizable brand will also assist it in recruiting and retaining employees. It intends to continue to undertake initiatives to increase the strength and recall of 'Five-Star' brand to attract new customers. It seeks to build its brand by engaging with existing and potential customers' through customer literacy programs, sponsor popular events in the regions it operates and advertise in newspapers, hoardings and in other advertising media.

Key Risks

- The Company's operations are primarily focused in the states of Tamil Nadu, Andhra Pradesh, Telangana and Karnataka.
- The Company has had negative net cash flows in the past and may continue to have negative cash flows in the future.
- The Company's previous Statutory Auditor has included an emphasis of matter paragraph in their report on financial statements for the Financial Years 2021 and 2020.
- The Company is dependent on a number of Key Managerial Personnel and senior management.
- The Promoter, Lakshmipathy Deenadayalan, has provided personal guarantees for loan facilities obtained by the Company, and any failure or default to repay such loans could trigger repayment obligations on the Promoter, which may impact the Promoter's ability to effectively service his obligations as the Promoter and thereby, adversely impact the business and operations.

Financials

Restated Consolidated Statement of Assets and Liabilities

Y/E March (Rs. In Crores)	As of Mar 2020	As of Mar 2021	As of Mar 2022	As of Jun 2022
Assets				
Financial Assets	-	-	-	-
Cash and cash equivalents	290	1,267	613	410
Bank Balance other than cash and cash equivalents	161	89	267	304
Loans	3,831	4,359	5,102	5,454
Investments	-	-	248	189
Derivative Financial Instruments	-	-	-	0
Other Financial assets	5	5	18	19
Total Financial Assets	4,287	5,719	6,249	6,376
Non-financial Assets	-	-	-	-
Current tax assets (Net)	4	8	2	3
Deferred tax assets (Net)	28	37	47	47
Investment property	0	0	0	0
Property, plant and equipment	11	8	12	13
Right of use assets	15	15	20	21
Other intangible assets	2	2	1	1
Other non-financial assets	5	5	13	11
Total Non-Financial Assets	66	74	95	96
Total Assets	**4,353**	**5,794**	**6,343**	**6,472**
Liabilities and Equity				
Liabilitites				
Financial Liabilities				
Derivative financial instruments	-	-	1	-
Payables	-	-	-	-
Trade Payables	7	9	13	11
Debt Securities	1,079	1,304	1,009	947
Borrowings (Other than Debt Securities)	1,285	2,121	1,550	1,573
Other financial liabilities	16	17	41	54
Total Financial Liabilities	2,386	3,451	2,615	2,585
Non-Financial Liabilities				
Current tax liabilities (Net)	1	-	-	11
Provisions	6	7	9	13
Other non-financial liabilities	16	17	9	5
Total Non-Financial Liabilities	23	24	18	30
Total Liabilities	2,409	3,475	2,633	2,615
Equity	-	-	-	-
Equity Share capital	26	26	29	29
Other Equity	1,919	2,293	3,681	3,828
Total Equity	1,945	2,318	3,710	3,857
Total Liabilities and Equity	**4,353**	**5,794**	**6,343**	**6,472**

*Source: Company's RHP: * Proforma*

Restated Consolidated Statement of Profit and Loss

Y/E March (Rs. In Crores)	As of Mar 2020	As of Mar 2021	As of Mar 2022	As of Jun 2022
Revenue from operations				
Interest Income	747	1,015	1,204	335
Fees income	30	22	29	1
Net gain on fair value changes	10	13	21	2
Total Revenue from operations	787	1,050	1,254	338
Other income	1	2	2	1
Total Income	**787**	**1,051**	**1,256**	**339**
Expenses	-	-	-	-
Finance costs	217	325	301	65
Fees expenses	0	3	-	-
Employee benefits expense	127	164	236	72
Depreciation and amortisation expense	10	11	12	4
Impairment on Financial Instruments	49	35	46	-0
Other expenses	34	37	57	13
Total expenses	**438**	**575**	**652**	**153**
Profit before tax	**349**	**476**	**604**	**186**
Tax expense	-	-	-	-
Current tax	101	126	160	47
Deferred tax (net)	-13	-8	-9	-0
Tax expense	87	117	151	47
Profit for the period / year	**262**	**359**	**454**	**139**
Other Comprehensive Income	-	-	-	-
Items that will not be reclassified to profit or loss	-	-	-	-
Re-measurement of the defined benefit plan	-1	-1	-2	-0
Income tax relating to items that will not be reclassified to profit or loss	0	0	0	0
Net other Comprehensive Income/(deficit) not to be reclassified subsequently to profit or loss	-1	-1	-1	-0
Items that will be reclassified to profit or loss	-	-	-	-
Net movement on effective portion of cash flow hedge	-	-	-1	-1
Income tax relating to items that will be reclassified subsequently to profit or loss	-	-	0	0
Net other Comprehensive Income to be reclassified subsequently to profit or loss	-	-	-1	-0
Other Comprehensive Income/(deficit) for the period/year, net of income tax	-	-	-2	-1

*Source: Company's RHP: * Proforma*

RATING SCALE (PRIVATE CLIENT GROUP)

Definitions of ratings

BUY – We expect the stock to deliver more than 15% returns over the next 12 months

ADD – We expect the stock to deliver 5% - 15% returns over the next 12 months

REDUCE – We expect the stock to deliver -5% - +5% returns over the next 12 months

SELL – We expect the stock to deliver < -5% returns over the next 12 months

NR – **Not Rated.** Kotak Securities is not assigning any rating or price target to the stock. The report has been prepared for information purposes only.

SUBSCRIBE – We advise investor to subscribe to the IPO.

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NA – **Not Available or Not Applicable.** The information is not available for display or is not applicable

NM – **Not Meaningful.** The information is not meaningful and is therefore excluded.

NOTE – Our target prices are with a 12-month perspective. Returns stated in the rating scale are our internal benchmark.

FUNDAMENTAL RESEARCH TEAM (PRIVATE CLIENT GROUP)

Shrikant Chouhan
Head of Research
shrikant.chouhan@kotak.com
+91 22 6218 5408

Arun Agarwal
Auto & Auto Ancillary
arun.agarwal@kotak.com
+91 22 6218 6443

Amit Agarwal, CFA
Transportation, Paints, FMCG
agarwal.amit@kotak.com
+91 22 6218 6439

Hemali Dhame
Banking & Finance
hemali.dhame@kotak.com
+91 22 6218 6433

Jatin Damania
Metals & Mining, Midcap
jatin.damania@kotak.com
+91 22 6218 6440

Purvi Shah
Pharmaceuticals
purvi.shah@kotak.com
+91 22 6218 6432

Rini Mehta
Research Associate
rini.mehta@kotak.com
+91 22 6218 6433

K. Kathirvelu
Support Executive
k.kathirvelu@kotak.com
+91 22 6218 6427

Sumit Pokharna
Oil and Gas, Information Tech
sumit.pokharna@kotak.com
+91 22 6218 6438

Pankaj Kumar
Construction, Capital Goods & Midcaps
pankajr.kumar@kotak.com
+91 22 6218 6434

TECHNICAL RESEARCH TEAM (PRIVATE CLIENT GROUP)

Shrikant Chouhan
shrikant.chouhan@kotak.com
+91 22 6218 5408

Amol Athawale
amol.athawale@kotak.com
+91 20 6620 3350

Sayed Haider
Research Associate
sayed.haider@kotak.com
+91 22 62185498

DERIVATIVES RESEARCH TEAM (PRIVATE CLIENT GROUP)

Sahaj Agrawal
sahaj.agrawal@kotak.com
+91 79 6607 2231

Prashanth Lalu
prashanth.lalu@kotak.com
+91 22 6218 5497

Prasenjit Biswas, CMT, CFTe
prasenjit.biswas@kotak.com
+91 33 6615 6273

Karan Kulkarni
karan.kulkarni@kotak.com
+91 20 6608 3292

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Details of	Contact Person	Address	Contact No.	Email Id
Customer care/ Client Servicing	Mr. Tabrez Anwar	Kotak Securities Ltd., 2nd Floor, Neptune Elements, Road No 22, Wagle Industrial Estate, Kisan Nagar, Thane (West), Thane. Maharashtra, 400604	18002099191/ 18002099393	service.securities@kotak.com ks.escalation@kotak.com
Head of Customer care/ Client Servicing	Mr. Hitesh Sindhwani	Kotak Securities Ltd., 2nd Floor, Neptune Elements, Road No 22, Wagle Industrial Estate, Kisan Nagar, Thane (West), Thane. Maharashtra, 400604	022-42858208	ks.servicehead@kotak.com
Compliance Officer	Mr. Sanjayu Nair	Kotak Towers, 8th Floor, Building No.21, Infinity Park, Off Western Express Highway, Malad (East), Mumbai, Maharashtra - 400097.	022-42858484	ks.compliance@kotak.com
CEO	Mr. Jaideep Hansraj	Kotak Towers, 8th Floor, Building No.21, Infinity Park, Off Western Express Highway, Malad (East), Mumbai, Maharashtra - 400097.	022-42858301	ceo.ks@kotak.com