FIVE STAR
Business Finance Limited

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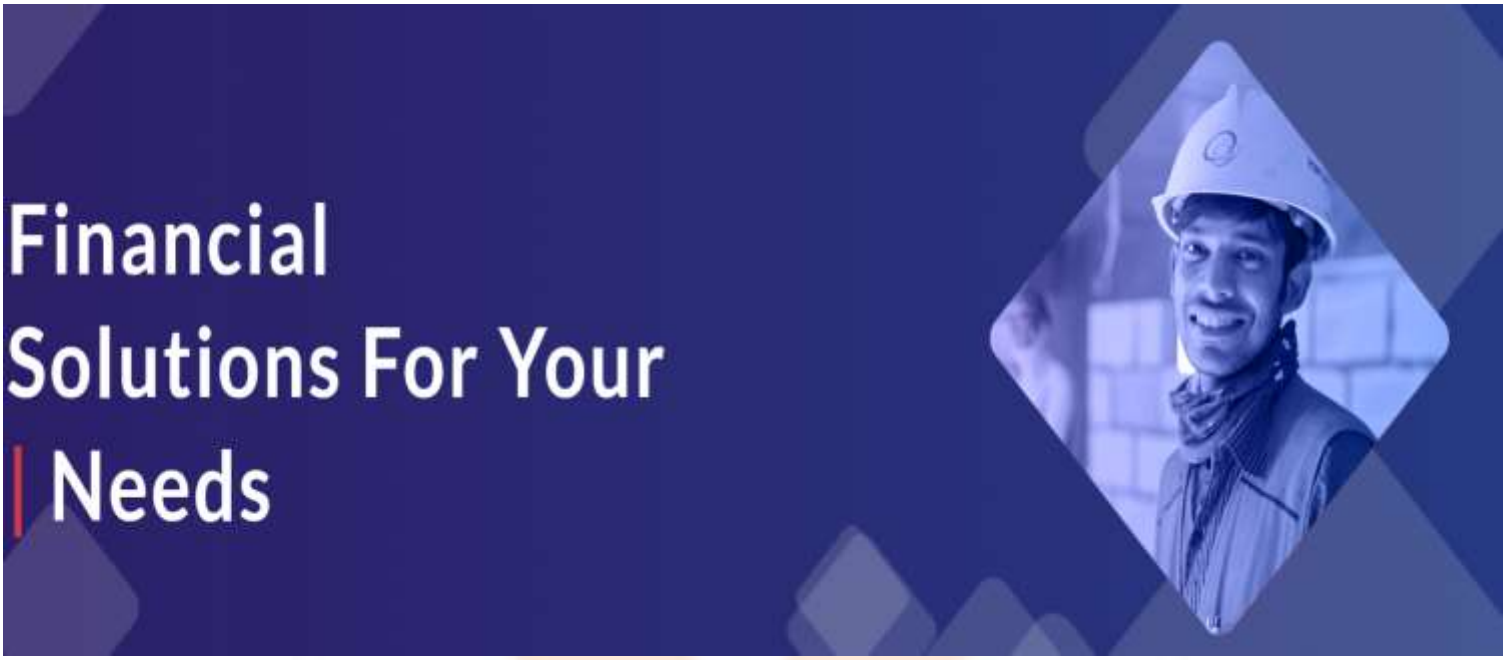
Low gearing capping return ratios?



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Five Star Business Finance Ltd (Five Star or FSBFL) provides secured business loans to micro-entrepreneurs and self-employed individuals who are largely excluded by traditional financing institutions. The company is headquartered in Chennai, Tamil Nadu, with a strong presence in south India. All of its loans are secured by borrowers' property, which is predominantly self-occupied residential property (SOPR).

Among its compared peers (being NBFCs in India):

- Within a subset of large peers (with more than INR 3,000 cr in Gross Term Loans), Five Star has the fastest gross term loans growth, with a CAGR of 65.0% between FY17-21.
- Within a subset of large peers (with more than INR 3,000 cr in Gross Term Loans), it has the highest average return on gross term loans of 7.5%, across the period covering FY20 to FY22.
- Five Star is also among the top three in terms of asset quality.

95% of Five Star's loan portfolio comprises loans between INR 1 lakh to INR 10 lakh in principal amount, with an average ticket size of INR 2.9 lakh, as on June, '22.

The company targets customers:

- in urban, semi-urban, rural markets of India, where faster growth in bank credit activity is expected 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 INR 25,000 to INR 40,000 per month.
- who can provide collateral, typically land and building.
- whose family will act as co-applicants on the loan.

Industry	Financial

Issue Details	
Listing	BSE & NSE
Open Date	9, Nov 2022
Close Date	11, Nov 2022
Price Band	INR 450-474
Face Value	INR 1
Market Lot	31 shares
Minimum Lot	1 Lot

Issue Structure	
Offer for Sale	100%
Fresh Issue	0%
Issue Size (Amt)	INR 1960 cr
QIB Share (%)	≥ 50%
Non-Inst Share (%)	≤ 15%
Retail Share (%)	≤ 35%
Post issue M Cap	INR 13,811 cr

Key Financial Data (INR Cr, unless specified)

	Interest earned	NII	PPOP	Net Profit	EPS (₹)	Ad BVPS (₹)	RoAA (%)	RoAE (%)	P/E (X)	P/BV (X)
FY20	786.7	569.4	398.6	262.0	10.3	70.1	NA	NA	45.9	6.6
FY21	1,049.7	721.9	511.6	359.0	14.0	83.9	7.1	16.8	33.8	5.6
FY22	1,254.1	953.5	649.7	453.5	16.1	126.2	7.5	15.0	29.5	3.7

Key highlights

Unique business model with focus on 3 Cs

Five Star is 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. As per the company, it focusses on 3 Cs while making any lending decision:

- **C**haracter
- **C**ash-flow
- **C**ollateral

The methodology of underwriting ensures that Five Star 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. It has enabled Five Star to mitigate credit risk and successfully underwrite new loans while maintaining asset quality.

The unique elements of the underwriting process of Five Star are as follows:

- Loans are given to households 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 service oriented businesses.

- Multiple physical verification touch points by business and collection teams and field credit teams to assess applicants and collateral.

- All underwriting processes are done in-house, by its employees, which ensures staff accountability.

- Independent field credit verification is undertaken on all proposals.

- Conservative loan-to-value ratios and installments to income ratios on its outstanding loan accounts.

Five Star has strong on-ground collections infrastructure which helps to maintain a robust asset quality

Five Star has created a strong "on-ground" collections infrastructure to ensure that it maintains a high asset quality. Many of the company's customers have previously borrowed from moneylenders or unorganized lenders and hence while the company observes minor delays in the servicing of regular monthly instalments, it is part of the repayment culture and such delays don't necessarily translate into loan defaults as per the company. The collections infrastructure is underpinned by the following:

- Branches adequately staffed with business officers in such a way that the number of loans per relationship officer does not exceed 120, which provides each officer with the capacity to undertake both business and collection activities effectively.

- Older branches are equipped with a collections vertical to which the collections responsibility of accounts is transferred once the accounts cross a certain vintage; this frees up business officers' time, enabling them 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.

- Branch staff incentives are aligned with every business and collection target so that meeting such targets in both areas are required to qualify for incentives.

Five Star has 100% in-house sourcing, credit, risk & collections team leading to good asset quality

Five Star has 100% in-house sourcing, credit assessment and robust risk management, collections framework that allows it to identify, monitor and manage risks inherent in its lending operations. Catering primarily to small business owners and self-employed customers, while maintaining asset quality, requires a special skillset in the 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. For this, the company ensures that all of its loans are sourced in-house, either through branch-led local marketing efforts, repeat customers or through walk-ins. In-house sourcing allows Five Star 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, customers are on boarded by the company's own officers and not by third party selling agents.

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, Five Star has been able to effectively serve such customers while maintaining asset quality and expanding into newer geographies.

As of Q1FY23, ~95% of the loans that were disbursed were for single-unit SORPs. Five Star 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.

Key Managerial Personnel

Key Person	Designation	Details
Lakshmipathy Deenadayalan	MD & CH	He holds a bachelor's degree in engineering in computer science and engineering from the University of Madras. He was a member of the managing committee of Finance Companies' Association (India). He was first appointed as a director on the Board of FSBFL on June 21, 2002.
Anand Raghavan	Independent Director	He is a member of the Institute of Chartered Accountants of India. He was associated as a Partner with Ernst and Young LLP for ten years. He has served as a member of the committee on functioning of asset reconstruction companies formed by the RBI and the committee to formulate schemes for revival of MSMEs constituted by the Government of Tamil Nadu. He has previously served as Vice President – Corporate Affairs of Sundaram Finance Limited. He has been serving as a director on the Board of FSBFL from July 28, 2016.
Srinivasaraghavan Thiruvallur Thattai	Independent Director	He holds a bachelor's degree in commerce from the University of Madras and a master of business administration degree from Gannon College, Commonwealth of Pennsylvania. He has wide range of experience in the financial services industry and has served close to two decades as director of Sundaram Home Finance Limited. He has been serving as an independent director on the Board of FSBFL from August 25, 2021.
Bhama Krishnamurthy	Independent Director	She holds a master of science degree from University of Mumbai. She is on the board of directors of several companies such as Muthoot Microfin Limited, Cholamandalam Investment and Finance Company Limited and Reliance Industrial Infrastructure Limited. In the past, she served as Chief General Manager of Small Industries Development Bank of India. She has experience of over 36 years in the field of financial services. She has been serving as an independent director on the Board of FSBFL from April 12, 2016.
Ramkumar Ramamoorthy	Independent Director	He holds a bachelor's degree in arts from University of Madras, master's degree in arts from University of Madras, master's degree in philosophy from University of Madras and a post graduate diploma in journalism from the Rajendra Prasad Institute of Communication and Management, Bombay. He has over 22 years of experience in the technology industry. Previously, he was associated with Tata Consultancy Services and as Chairman and Managing Director of Cognizant Technology Solutions India Private Limited. Presently, he is associated with Catalincs Partners LLP as a partner.
Ravishankar Ganapathyagraharam Venkataraman	Non-Executive Director	He holds a bachelor's degree in computer science and engineering from Bharathidasan University and a post graduate diploma in management from the Indian Institute of Management, Ahmedabad. He has over 16 years of experience in private equity funds. Previously, he was associated with McKinsey & Company, Inc. Presently, he is associated with Sequoia Capital India LLP, where he acts as the managing partner and with Sequoia Capital India Advisors Private Limited, where he acts as the managing director. He has been serving as a director on the Board of FSBFL from August 18, 2017.

Vikram Vaidyanathan	Non-Executive Director	He holds a bachelor's degree in engineering from Visveswaraiah Technological University, Belgaum and a post graduate diploma in management from India Institute of Management, Bangalore. He is a director on the board of, inter alia, Ver Se Innovation Private Limited and OFB Tech Private Limited. He has been serving as a director on the Board of FABFL from August 21, 2015.
Thirulokchand Vasan	Non-Executive Director	He holds a diploma in hotel management and catering technology from Empee Institute of Hotel Management and Catering Technology, Madras. He was previously associated with Indus Hospitality Careers and Training Private Limited, Cruise Ships Catering and Services International N.V, Carnival Cruise Lines Inc and Oriental Hotels Limited. He has been serving as a director on the Board of FABFL from December 15, 2016.

Source: Company Reports & Ventura Research

Key Risks & Concerns

- The company requires substantial capital for its business and any disruption in the company's sources of capital could have an adverse effect on business, results of operations and financial condition.
- The risk of non-payment or default by its borrowers may adversely affect the business, results of operations and financial conditions.
- The company's inability to meet obligations, including financial and other covenants under its debt financing arrangements, could adversely affect business, the results of operations and financial condition.
- Any deterioration in the performance of any pool of receivables securitized to banks and other institutions may adversely impact results of operations.
- Non-compliance with the RBI's observations made pursuant to its periodic inspections and violations of regulations prescribed by the RBI, could expose the company to certain penalties and restrictions.
- The Coronavirus pandemic (COVID-19) has had certain adverse effects on business, operations, cash flows and financial conditions, and the extent to which it, or the effect of outbreaks of any other severe communicable disease, may continue to do so in the future is uncertain and cannot be predicted.

Issue Structure and Offer Details

The proposed issue size of Five Star Business Finance's IPO is INR 1,960 cr, which comprises of an OFS of 43,555,666 to 41,350,317 shares. The price band for the issue is in the range of INR 450-474 and the bid lot is 31 shares and multiples thereof.

Issue structure

Category	Allocation
QIB	At least 50% of public issue
Non institutional buyers	Not more than 15% of public issue
Retail	Not more than 35% of public issue

Source: Company Reports & Ventura Research

Selling Shareholders

Name of Selling Shareholder	Type	No. of shares
SCI Investments V	Promoter	Up to 3,517,765 Equity Shares
Matrix Partners India Investment Holdings II LLC	Promoter	Up to 15,177,511 Equity Shares
Matrix Partners India Investments II Extension LLC	Investor	Up to 255,000 Equity Shares
Norwest Venture Partners X Mauritius	Investor	Up to 7,625,464 Equity Shares
TPG Asia VII Pte Ltd	Investor	Up to 14,774,578 Equity Shares

The shares are based on a higher price band of INR 474

Source: Company Reports & Ventura Research

Change in shareholding

Category	Pre IPO	Post IPO
Promoter	**40.07%**	**33.65%**
Public (Investor selling shareholder)	**31.95%**	**24.17%**
Public (Others)	**27.98%**	**42.17%**

Source: Company Reports & Ventura Research

Financial Analysis

Y/E March (INR crore)	FY20	FY21	FY22	Y/E March (INR crore)	FY20	FY21	FY22
Income Statement				Ratio Analysis			
Interest Income	786.7	1,049.7	1,254.1	Efficiency Ratio (%)			
Interest Expense	217.4	327.9	300.6	Int Expended / Int Earned	27.6	31.2	24.0
Net Interest Income	569.4	721.9	953.5	Int Income / Total Funds	18.1	18.1	19.8
YoY change (%)		*26.8*	*32.1*	NII / Total Income	72.3	68.7	75.9
Non Interest Income	0.6	1.5	2.1	Other Inc. / Total Income	0.1	0.1	0.2
Total Net Income	570.0	723.4	955.6	Ope. Exp. / Total Income	21.8	20.1	24.3
Total Operating Expenses	171.3	211.8	305.8	Net Profit / Total Funds	6.0	6.2	7.2
Pre Provision profit	398.6	511.6	649.7	Credit / Total borrowings	162.1	127.3	199.4
YoY change (%)		*28.3*	*27.0*	Invt / Total borrowings	0.0	0.0	9.7
Provisions	49.3	35.2	45.5	NIM (calc)		14.4	16.0
Profit Before Tax	349.3	476.4	604.2				
YoY change (%)		*36.4*	*26.8*	Solvency			
Taxes	87.4	117.4	150.7	Gross NPA (Rs. Cr)	53.2	45.2	53.1
Net profit	262.0	359.0	453.5	Net NPA (Rs. Cr)	43.8	37.1	34.5
YoY change (%)		*37.0*	*26.3*	Gross NPA (%)	0.0	0.0	0.0
				Net NPA (%)	1.1	0.8	0.7
Balance Sheet				Capital Adequacy Ratio (%)	52.9	58.9	75.2
Cash	289.8	1,267.2	613.2	Tier I Capital (%)	52.9	58.9	75.2
Balance with RBI	161.3	88.5	266.8	Tier II Capital (%)	0.0	0.0	0.0
Investments	0.0	0.0	248.2				
Loan and Advances	3,830.8	4,358.7	5,102.4	Per Share Data			
Other Assets	71.2	79.1	112.5	EPS	10.3	14.0	16.1
Total Assets	4,353.2	5,793.6	6,343.1	Book Value	71.7	85.3	127.4
Debt	1,078.9	1,303.8	1,008.5	Adj Book Value of Share	70.1	83.9	126.2
Borrowings	1,284.8	2,121.4	1,550.3				
Other Liability	44.9	50.2	73.9	Valuation Ratio			
Equity	25.6	25.6	29.1	Price/Earnings (x)	45.9	33.8	29.5
Reserves	1,919.0	2,292.5	3,681.2	Price/Book Value (x)	6.6	5.6	3.7
Share warrant O/s	0.0	0.0	0.0	Price/Adj.Book Value (x)	6.8	5.6	3.8
Total Liabilities	4,353.2	5,793.6	6,343.1				
				Return Ratio			
Dupont Analysis				RoAA (%)		7.1	7.5
% of Average Assets				RoAE (%)		16.8	15.0
Net Interest Income		14.2	15.7				
Non Interest Income		0.0	0.0	Growth Ratio (%)			
Net Income		14.3	15.7	Interest Income		33.4	19.5
Operating Expenses		4.2	5.0	Interest Expenses		50.8	-8.3
Operating Profit		10.1	10.7	Other Income		139.4	39.1
Provisions & Contingencies		0.7	0.8	Total Income		33.5	19.5
Taxes		2.3	2.5	Net profit		37.0	26.3
ROAA		7.1	7.5	Advances		13.8	17.1

Source: Company Reports & Ventura Research

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