March 11, 2022

Five-Star Business Finance Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debenture programme – Market linked debenture	65.00	65.00	PP-MLD[ICRA]A+ (Stable); reaffirmed
Non-convertible debenture programme	400.00	400.00	[ICRA]A+ (Stable); reaffirmed
	200.00	0.00	[ICRA]A+ (Stable); reaffirmed and withdrawn
Long term-fund based-term loan	960.21	865.48	[ICRA]A+ (Stable); reaffirmed
Long term - Unallocated	239.79	334.52	[ICRA]A+ (Stable); reaffirmed
Non-convertible debenture programme – Market linked debenture	150.00	150.00	PP-MLD[ICRA]AAA(CE) (Stable); outstanding
Non-convertible debenture programme – Market linked debenture	125.00	125.00	PP-MLD[ICRA]AAA(CE) (Stable); outstanding
Total	**2,140.00**	**1,940.00**	

**Instrument details are provided in Annexure-1; For the credit enhanced ratings of the entity, refer to the rationales given under the structured finance section here*

The letters, PP-MLD, prefixed to a rating symbol stand for principal protected market linked debentures. According to the terms of the rated instrument, the amount invested, i.e. the principal, is protected against erosion while the returns on the investment could vary, being linked to movements in one or more variables such as equity indices, commodity prices, and/or foreign exchange rates. The rating assigned expresses ICRA's current opinion on the credit risk associated with the issuer concerned. The rating does not address the risks associated with variability in returns resulting from adverse movements in the variable(s) concerned

Rationale

The rating action considers Five-Star Business Finance Limited's (FSBFL) augmented capital structure, which would support its medium-term growth plans and its healthy earnings profile (RoMA[1] of 7.4% in 9M FY2022). Regular capital infusions in the past (~Rs. 1,366 crore raised during FY2016-FY2020) have supported FSBFL's capital profile while it registered a high portfolio growth (compound annual growth rate (CAGR) of 68% over FY2016-FY2021), albeit on a smaller base. In 9M FY2022, it raised further equity of ~Rs. 900 crore from existing / new investors and individual shareholders including the promoters. Accordingly, its managed gearing stood at 0.8 times as of December 2021. The strengthened capital profile would bolster the growth in FSBFL's assets under management (AUM), which is expected to increase at a CAGR of 45-50% during FY2023-FY2024. The ratings continue to factor in FSBFL's adequate internal controls, its diversified board and senior management team.

FSBFL's asset quality witnessed some deterioration with its 90+ days past due (dpd) portfolio at 1.3% as of December 2021 compared to 1.0% as of March 2021, primarily due to the impact of the second wave of the pandemic in Q1FY22. However, the 90+ dpd portfolio improved between September 2021 and December 2021, going down from 1.4% as of September 2021 to 1.3% as of December 2021. The small-ticket loans, secured nature of lending (more than 95% of the loans are against self-

[1] *Return on managed assets*

occupied properties with a loan-to-value (LTV) of 35-50%) and the high-yielding nature of its exposures provide comfort against the modest risk profile of its target borrower segment. While the asset quality performance continues to be a monitorable given the significant softer bucket delinquencies, FSBFL's healthy internal generation and strengthened capital structure support its overall risk profile.

Control over the underwriting process would be crucial over the medium term, in view of the steep growth plans. Geographically, the company is expected to focus on deeper penetration in the existing geographies and this portfolio is expected to remain regionally concentrated in southern India over the medium term. As of December 2021, Tamil Nadu (TN), Karnataka, Andhra Pradesh (AP) and Telangana accounted for 94.9% of the overall portfolio (100% as of March 2018).

ICRA has reaffirmed and withdrawn the rating on the Rs. 200.00-crore non-convertible debentures (NCDs) as the same were fully redeemed and there is no amount outstanding against the rated instrument. The rating was withdrawn as per ICRA's policy on the withdrawal of credit ratings.

Key rating drivers and their description

Credit strengths

Augmented capital structure to support medium-term portfolio growth – FSBFL's capitalisation profile is characterised by a net worth of Rs. 3,580 crore and a capital adequacy ratio of 79.1% as of December 31, 2021. The company secured regular equity infusions in the past (~Rs. 1,366 crore raised during FY2016-FY2020), which supported its overall risk profile even as it registered a sharp AUM growth. ICRA notes the recent equity infusion of ~Rs. 900 crore from existing investors (Sequoia Capital and Norwest Ventures), new investors (Sirius II Pte. Ltd (KKR), TVS Shriram Growth Fund) and individual shareholders (including the promoter) in FY2022. ICRA notes that while the company is expected to increase its portfolio at a CAGR of ~45-50% during April 2022-March 2024, its leverage is not expected to exceed 4 times during this period.

Healthy earnings profile – FSBFL's net profitability remained healthy with profit after tax/average managed assets (PAT/AMA) at 7.4% in 9M FY2022 vis-à-vis 7.1% in FY2021. The net interest margins improved to 14.7% in 9M FY2022 from 14.0% in FY2021 largely due to the reduction in the cost of funds (10.3% in 9M FY2022 vis-à-vis 11.3% in FY2021). The pre-provision operating profitability (PPOP) stood at 10.1% in 9M FY2022, supported by the improvement in the net interest margin. The credit costs increased to 0.8% in 9M FY2022 from 0.7% in FY2021 as FSBFL increased its overall expected credit loss (ECL) provision (as a proportion of AUM) to 2.2% as of December 2021 from 1.9% as of March 2021. Write-offs remained modest and stood at 0.4% of the AUM.

So far, the profitability has been supported by healthy yields, low leverage and controlled credit costs. The healthy PPOP provides comfort regarding the near-term earnings performance. Over the medium term, the ability to keep the credit costs under control and maintain optimal operating efficiency, as the company augments its branch network and diversifies its portfolio geographically, would be key from an earnings perspective. ICRA expects FSBFL's net profitability to remain at 7-8% during FY2022-FY2024.

Fairly diversified board and experienced senior management team – FSBFL's board is quite diversified, consisting of 8 members. Apart from the Chairman and Managing Director (promoter), the board consists of four independent directors, two non- executive nominee directors of the private equity (PE) investors, one non-executive director and three board observers from PE investors. ICRA takes note of the experience of the promoter and the senior management team in retail lending and banking services. The senior management team has been steadily augmented over the past few years in view of the growth plans. The key business functions, including internal audit, business & collections, technology, credit, risk, treasury and human resources, are headed by personnel who have adequate experience in these fields. The board has 10 committees including the Audit Committee and the Risk Management Committee, which are headed by the independent directors.

Adequate internal control and risk management systems, considering target borrower segment – FSBFL has maintained prudent underwriting policies with the LTV at 35-50%. As of December 2021, 61% of the portfolio had an LTV less than 40%.

Further, only 2.7% of the portfolio had an LTV of more than 50% as of December 2021 (1.0% as of March 2021). Considering the target segment, the tenors are relatively longer with 97% of the loans having a tenor of 5-7 years, which is expected to keep the instalment at manageable levels for the borrowers. FSBFL verifies the credit bureau report for all cases though it largely relies on its internal assessment of cash flows for arriving at the borrower-level eligibility.

Loan sanctioning is a three-layered process involving detailed due diligence by the branch team (part of business sourcing), which is followed by the field-level credit team, which also independently undertakes all the processes followed by the branch team for onboarding the borrowers. The due diligence done by the branch and field credit teams includes visits to the business location and residence, personal discussion for income/expense estimation, secondary enquiries about the borrower/ borrowers' business, etc. Independent reports from both teams along with the legal opinion on the property (performed by external empanelled lawyers and scrutinised by the internal legal team) are submitted to the credit approval team. The credit approval team, based on inputs provided and, if required, post discussion with the borrower, approves/rejects the loan proposals.

The company has an enterprise resource planning (ERP) module for its loan management system. Its internal audit team (currently 20+ members) undertakes the audit of key branch-related transactions on an ongoing basis including a surprise audit of all the branches at least twice a year. In addition, an external chartered accountancy firm has been appointed by FSBFL as the (External) Internal Auditor to check on financial, regulatory and risk-related compliances.

The company has also set up a dedicated collections team at the branch level, which would monitor collections post 24 months of loan disbursement. The low loan write-offs and recoveries from non-performing advances (NPAs; based on the last three-year data), wherein FSBFL was also able to recover a sizeable portion of the accrued interest, provide comfort on the risk policies and control systems. However, considering its growth plans, it would be crucial to maintain commensurate underwriting processes and internal controls and augment its post-disbursement controls and monitoring of loans considering the loan tenor.

Credit challenges

Modest credit profile of target customer segment; asset quality has, however, remained under control – FSBFL predominantly provides small-ticket loans with an average ticket size of Rs. 3.0-3.5 lakh to micro-entrepreneurs and self-employed borrowers belonging to the middle-income and lower-income segments. The loans are largely given for a ticket size of less than Rs. 10 lakh with 88% being below Rs. 5 lakh as of December 31, 2021. In terms of the borrower segment, ~70% of the borrowers belong to the service industry and most of the borrowers do not have documentary proofs of income. Considering the borrower's business and income levels, their credit profiles are expected to be modest. This is reflected in the high softer bucket delinquencies with the 30+dpd at 19.4% as of December 31, 2021 (12.4% as of March 31, 2021). However, the 90+ dpd[2] stood at 1.3% as of December 2021 vis-à-vis 1.0% as of March 2021, primarily due to the impact of the second wave of the pandemic in Q1FY22. However, the 90+ dpd portfolio improved between September 2021 and December 2021, going down from 1.4% as of September 2021 to 1.3% as of December 2021.

The collection efficiency (collections including arrears but excluding prepayments/total demand for the month) had improved to 96-102% in November/December 2021. The company carried overall ECL provisions of 2.2% of the AUM as of December 2021 and the restructured book stood at about Rs. 80 crore as of December 2021. ICRA, however, notes that the high envisaged portfolio growth exposes FSBFL to higher credit risk, though this is likely to be partially mitigated by its prudent credit norms and policies.

Steep envisaged portfolio growth; low portfolio seasoning – FSBFL's consolidated portfolio expanded at a CAGR of 81% during FY2016-FY2020 while it grew at a moderate pace of 7% in 9M FY2022 due to the impact of the Covid-19 pandemic. The AUM

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[2] *Gross NPAs as on December 31, 2021, adhering to the Reserve Bank of India's (RBI) circular dated November 12, 2021 stood higher than the reported 90+ dpd. However, ICRA notes that the implementation of the circular has been postponed to H2 FY2023.*

stood at Rs. 4,768 crore as of December 31, 2021 (Rs. 4,445 crore as of March 31, 2021) and is expected to increase at a CAGR of 45-50% during FY2023-FY2024. The steep growth in the past and the expected growth going forward would result in low portfolio seasoning, considering the average tenor of the loans (5-7 years). Further, as FSBFL is expected to add more branches over the next few years, it would be crucial to keep the asset quality and operating costs under control.

Regionally concentrated exposure, notwithstanding improvement in the recent past – TN's concentration in the total portfolio reduced to 40% as of December 31, 2021 from 69% as of March 31, 2017. However, the four southern states – TN, Karnataka, AP and Telangana continue to account for about 95% (100% as on March 31, 2018) of the overall portfolio. The company has been taking steps to diversify its geographical presence and had operations in 8 states with 280 branches as of December 2021. FSBFL is expected to remain a regional player with the southern states accounting for a sizeable share of the portfolio in the medium term.

Liquidity position: Strong

The liquidity position is strong with free cash and liquid investments of ~Rs. 1,491 crore as of December 31, 2021 against repayment and other obligations of ~Rs. 1,004 crore during January-August 2022. The funding mix comprises debentures (45% of the total borrowings as of December 2021), term loan from banks (26%), securitisation (21%) and term loans from financial institutions (the balance). Going forward, it would be crucial for FSBFL to secure adequate long-term funds at competitive rates, to achieve the envisaged business growth, while maintaining a strong liquidity profile.

Rating sensitivities

Positive factors – ICRA could revise the outlook to positive or upgrade the ratings if the company is able to sustain good quality portfolio growth while maintaining its healthy earnings profile over the medium term.

Negative factors – Pressure on the ratings could arise in case of an increase in the leverage beyond 4.5 times or a deterioration in the asset quality indicators, resulting in a decline in the RoMA to less than 4.0% on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA's credit rating methodology for non-banking finance companies ICRA's policy on withdrawal of credit rating
Parent/Group Support	Not applicable
Consolidation/Standalone	The ratings are based on the standalone financials of the company

About the company

Five-Star Business Finance Limited (FSBFL) is a Chennai-headquartered non-banking financial company (NBFC) extending secured loans to micro entrepreneurs and self-employed individuals, predominantly in semi-urban markets. The company commenced operations in 1984, with a focus on consumer loans and vehicle finance. In 2005, it shifted its focus to small business loans with typical loan tickets of Rs. 2-10 lakh and an average ticket size of Rs. 3.5 lakh. The loans are predominantly backed by self-occupied residential properties and FSBFL had 280 branches as of December 31, 2021.

The seven institutional investors (Matrix Partners, TPG Asia, Norwest Venture Partners, Sequoia Capital, Sirius II Pte. Ltd (KKR), Bay Capital and TVS Shriram Growth Fund) held a stake of 70.6% in the company as of December 31, 2021, with the promoters holding ~20% (fully diluted).

Key financial indicators (Ind-AS; audited)

Five-Star Business Finance Limited	FY2020	FY2021	9M FY2022*
Total Income (Rs. crore)	787.3	1,051.3	928.0
Profit after Tax (Rs. crore)	261.9	359.0	335.7
Net Worth (Rs. crore)	1,944.6	2,318.2	3,580.1
Total Managed Portfolio (Rs. crore)^	3,830.8	4,358.8	4,664.7
Total Managed Assets (Rs. crore)	4,353.2	5,793.6	6,367.4
Return on Managed Assets %	7.8%	7.1%	7.4%
Return on Net Worth %	15.8%	16.8%	15.2%
Gearing (reported; times)	1.2	1.5	0.8
Gearing (managed; times)	1.2	1.5	0.8
Gross NPA%	1.4%	1.0%	1.3%
Net NPA%	1.1%	0.8%	0.8%
CRAR%	52.9%	58.9%	79.1%

Source: *Company, ICRA Research; All ratios as per ICRA's calculations; ^ Net of loan provisions/ECL; *Provisional.*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

				Current Rating (FY2022)			Rating History for the Past 3 Years					
S. No.	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding	Current Rating	Date & Rating in FY2022	Date & Rating in FY2021			Date & Rating in FY2020		Date & Rating in FY2019
				(Rs. crore)	Mar-11-2022	Jun-29-2021	Dec-15-2020	Sep-25-2020	Sep-07-2020	Mar-16-2020	Apr-01-2019	Oct-24-2018
1	Market linked debentures	Long term	40.00	40.00	PP-MLD[ICRA]A+ (Stable)	PP-MLD[ICRA]A+ (Stable)	PP-MLD[ICRA]A (Stable)	-	-	-	-	-
2	Market linked debentures	Long term	25.00	25.00	PP-MLD[ICRA]A+ (Stable)	PP-MLD[ICRA]A+ (Stable)	PP-MLD[ICRA]A (Stable)	PP-MLD[ICRA]A (Stable)	PP-MLD[ICRA]A (Stable)	-	-	-
3	Long-term fund-based term loan	Long term	865.48	865.48	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	-	-	-
4	Long term - Unallocated	Long term	334.52	334.52	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A(Stable)	[ICRA]A(Stable)	[ICRA]A (Stable)
5	NCD	Long term	400.00	400.00	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A(Stable)	[ICRA]A(Stable)	[ICRA]A (Stable)
6	NCD	Long term	200.00	0.00	[ICRA]A+ (Stable); reaffirmed & withdrawn	[ICRA]A+ (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A(Stable)	[ICRA]A(Stable)	[ICRA]A (Stable)

For the credit enhanced ratings of the entity, refer to the rationales given under the structured finance section here

Complexity level of the rated instrument

Instrument	Complexity Indicator
Non-convertible debenture – Market linked debenture	Moderately Complex
Non-convertible debenture	Simple
Long-term fund-based term loan	Simple
Long term – Unallocated	Not Applicable

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: **www.icra.in**

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE128S07366	NCD	Apr-11-19	11.40%	Apr-11-24	30.00	[ICRA]A+ (Stable)
INE128S07424	NCD	May-13-20	12.75%	May-13-26	15.00	[ICRA]A+ (Stable)
INE128S07432	NCD	May-28-20	10.50%	May-26-23	15.00	[ICRA]A+ (Stable)
INE128S07440	NCD	Jun-12-20	11.00%	Jun-12-23	25.00	[ICRA]A+ (Stable)
INE128S07457	NCD	Jun-24-20	11.00%	Apr-21-23	115.00	[ICRA]A+ (Stable)
INE128S07507	NCD	Sep-30-20	NA	Sep-30-29	70.00	[ICRA]A+ (Stable)
INE128S07515	NCD	Nov-19-20	9.50%	May-19-22	25.00	[ICRA]A+ (Stable)
Unallocated	NCD	-	-	-	105.00	[ICRA]A+ (Stable)
INE128S07499	NCD-MLD	Sep-03-20	10.60%	Feb-22-23	25.00	PP-MLD[ICRA]A+ (Stable)
INE128S07523	NCD-MLD	Dec-15-20	10 yr G-Sec	Jun-15-23	20.00	PP-MLD[ICRA]A+ (Stable)
INE128S07531	NCD-MLD	Dec-15-20	10 yr G-Sec	Mar-15-22	20.00	PP-MLD[ICRA]A+ (Stable)
INE128S07465	NCD	Jul-03-20	9.75%	Jan-03-22	50.00	[ICRA]A+ (Stable); reaffirmed & withdrawn
INE128S07473	NCD	Jul-31-20	9.75%	Jan-31-22	50.00	[ICRA]A+ (Stable); reaffirmed & withdrawn
INE128S07473	NCD	Aug-11-20	9.50%	Jan-31-22	50.00	[ICRA]A+ (Stable); reaffirmed & withdrawn
INE128S07481	NCD	Aug-20-20	9.50%	Feb-20-22	50.00	[ICRA]A+ (Stable); reaffirmed & withdrawn
NA	Term loan - 1	Jan-2017 To Dec-2021	NA	Jan-2022 To Feb-2026	0.69	[ICRA]A+ (Stable)
NA	Term loan - 2		NA		16.47	[ICRA]A+ (Stable)
NA	Term loan - 3		NA		3.33	[ICRA]A+ (Stable)
NA	Term loan - 4		NA		22.45	[ICRA]A+ (Stable)
NA	Term loan - 5		NA		4.17	[ICRA]A+ (Stable)
NA	Term loan - 6		NA		5.09	[ICRA]A+ (Stable)
NA	Term loan - 7		NA		5.63	[ICRA]A+ (Stable)
NA	Term loan - 8		NA		6.06	[ICRA]A+ (Stable)
NA	Term loan - 9		NA		4.44	[ICRA]A+ (Stable)
NA	Term loan – 10		NA		122.05	[ICRA]A+ (Stable)
NA	Term loan – 11		NA		18.00	[ICRA]A+ (Stable)
NA	Term loan – 12		NA		10.83	[ICRA]A+ (Stable)
NA	Term loan – 13		NA		8.17	[ICRA]A+ (Stable)
NA	Term loan – 14		NA		7.92	[ICRA]A+ (Stable)
NA	Term loan – 15		NA		29.47	[ICRA]A+ (Stable)
NA	Term loan – 16		NA		17.78	[ICRA]A+ (Stable)
NA	Term loan – 17		NA		23.97	[ICRA]A+ (Stable)
NA	Term loan – 18		NA		17.50	[ICRA]A+ (Stable)
NA	Term loan – 19		NA		21.18	[ICRA]A+ (Stable)
NA	Term loan – 20		NA		17.65	[ICRA]A+ (Stable)
NA	Term loan – 21		NA		3.83	[ICRA]A+ (Stable)
NA	Term loan - 22		NA		31.06	[ICRA]A+ (Stable)
NA	Term loan - 23		NA		28.33	[ICRA]A+ (Stable)
NA	Term loan - 24		NA		17.39	[ICRA]A+ (Stable)
NA	Term loan - 25		NA		15.28	[ICRA]A+ (Stable)
NA	Term loan - 26		NA		15.97	[ICRA]A+ (Stable)
NA	Term loan - 27		NA		17.72	[ICRA]A+ (Stable)
NA	Term loan - 28		NA		6.66	[ICRA]A+ (Stable)
NA	Term loan - 29		NA		18.94	[ICRA]A+ (Stable)
NA	Term loan - 30		NA		16.66	[ICRA]A+ (Stable)
NA	Term loan - 31		NA		3.75	[ICRA]A+ (Stable)
NA	Term loan - 32		NA		50.00	[ICRA]A+ (Stable)

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term loan - 33		NA		56.25	[ICRA]A+ (Stable)
NA	Term loan - 34		NA		20.79	[ICRA]A+ (Stable)
NA	Term loan - 35		NA		100.00	[ICRA]A+ (Stable)
NA	Term loan - 36		NA		50.00	[ICRA]A+ (Stable)
NA	Term loan - 37		NA		50.00	[ICRA]A+ (Stable)
NA	Long term – Unallocated		NA		334.52	[ICRA]A+ (Stable)

Source: *FSBFL*

Please click here to view details of lender-wise facilities rated by ICRA

Annexure-2: List of entities considered for consolidated analysis: Not applicable

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