February 23, 2023

Five-Star Business Finance Limited: Ratings upgraded

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debenture programme – Market linked debenture	45.00	45.00	PP-MLD[ICRA]AA- (Stable); Upgraded from PP-MLD[ICRA]A+ (Stable)
	20.00	0.00	PP-MLD[ICRA]AA- (Stable); Upgraded from PP-MLD[ICRA]A+ (Stable) and withdrawn
Non-convertible debenture programme	375.00	375.00	[ICRA]AA- (Stable); Upgraded from [ICRA]A+ (Stable)
	25.00	0.00	[ICRA]AA- (Stable); Upgraded from [ICRA]A+ (Stable) and withdrawn
Long-term fund-based term loan	865.48	1,200.00	[ICRA]AA- (Stable); Upgraded from [ICRA]A+ (Stable)
Long term – Unallocated	334.52	0.00	-
Non-convertible debenture programme – Market linked debenture	150.00	150.00	PP-MLD[ICRA]AAA(CE) (Stable); outstanding
Total	**1,815.00**	**1,770.00**	

**Instrument details are provided in Annexure I; 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 assigned rating 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 upgrade takes into consideration Five-Star Business Finance Limited's (FSBFL) demonstrated ability to maintain healthy asset quality, while scaling up its portfolio and maintaining a strong earnings profile (RoMA[1] of 8.4% in 9M FY2023). The ratings also factor in the company's strong capital structure, which would support its medium-term growth plans (FSBFL's assets under management (AUM) is expected to increase at a compound annual growth rate (CAGR) of 25-30% during FY2024-FY2026). ICRA notes that the company has received regular capital infusions in the past (~Rs. 2,273 crore raised during FY2016-FY2022), strengthening its capital profile. FSBFL's managed gearing was minimal at 0.8 times as of December 2022. The ratings continue to factor in the company's adequate internal controls and experienced board and senior management team.

FSBFL's asset quality is characterised by gross stage 3 (GS-3) of 1.5% as of December 2022 (1.2% without considering the impact of the Reserve Bank of India's (RBI) circular dated November 12, 2021[2]) compared to 1.3% as of December 2021. The company lends in small ticket sizes. Further, the secured nature of lending (more than 95% of the loans were against self-occupied properties with a loan-to-value (LTV) of about 30-50% as of December 2022) 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 during the scaling-up stage is a monitorable, FSBFL's healthy internal accruals 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 growth plan, which is expected to keep portfolio seasoning at a low level. Geographically, the company is expected to focus on deeper penetration

[1] *Return on managed assets*

[2] *On Prudential Norms on Income Recognition and Asset Classification*

in the existing geographies and the portfolio is expected to remain regionally concentrated in southern India over the medium term. As of December 2022, Tamil Nadu (TN), Karnataka, Andhra Pradesh (AP) and Telangana accounted for 94% of the overall portfolio (100% as of March 2018).

ICRA has upgraded and withdrawn the ratings on the Rs. 25.00-crore non-convertible debentures (NCDs) and Rs. 20.00-crore principal protected - market linked debentures as the same were fully redeemed and there is no amount outstanding against the rated instruments. The ratings have been withdrawn as per ICRA's policy on the withdrawal of credit ratings.

Key rating drivers and their description

Credit strengths

Strong capital structure to support medium-term portfolio growth – FSBFL's capital profile is characterised by a net worth of Rs. 4,165 crore and a capital adequacy ratio of 68.0% as of December 31, 2022. The company received regular equity infusions in the past (~Rs. 2,273 crore raised during FY2016-FY2022), which supported its overall risk profile even as it registered a sharp AUM growth. Its equity shares were listed on National Stock Exchange of India Limited (NSE) and BSE Limited in November 2022. ICRA notes that while FSBFL is expected to increase its portfolio at a CAGR of ~25-30% during April 2023-March 2026, its managed gearing[3] is expected to remain below 4.0 times during this period.

Strong earnings profile – FSBFL's net profitability improved with profit after tax/average managed assets (PAT/AMA) at 8.4% in 9M FY2023 vis-à-vis 7.5% in FY2022. The net interest margin improved to 17.3% in 9M FY2023 from 15.4% in FY2022 largely due to the moderation in the average cost of funds (8.8% in 9M FY2023 vis-à-vis 10.0% in FY2022). Accordingly, the pre-provision operating profitability (PPOP) stood at 11.3% in 9M FY2023 vis-à-vis 10.3% in FY2022. Also, the credit costs declined and stood at 0.2% in 9M FY2023 compared to 0.7% in FY2022 as the overall delinquency levels had improved in 9M FY2023 and write-offs remained modest at 0.2% of the opening AUM.

FSBFL's ability to keep the credit costs under control and maintain optimal operating efficiency over the medium term, as it augments its branch network and geographically diversifies its portfolio, would be key from an earnings perspective. ICRA expects the net profitability to moderate from the current level as the leverage increases, though the same is expected to stabilise at 5.5-6.0% in the medium to long term.

Adequate internal control and risk management systems – FSBFL has a well-experienced board, consisting of eight 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, and one non-executive director. 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.

FSBFL has maintained prudent underwriting policies with the LTV and the fixed obligations to income ratio (FOIR) typically capped at around 40-50%. As of December 2022, 57% of the portfolio had an LTV of less than 40%. AUM with LTV of more than 50% accounted for less than 3% of the portfolio as of December 2022 (1% as of March 2021). Considering the target segment, the tenors are relatively longer with 77% of the loans having a tenor of 7 years. This is expected to keep the instalment at manageable levels for the target customer segment. The loans are largely given for a ticket size of less than Rs. 10 lakh with 89% being below Rs. 5 lakh as of December 31, 2022. The company disbursed loans with an average ticket size of ~Rs. 3 lakh in Q3 FY2023. All loans are sourced in-house – the company has a widely used loan origination system (LOS) and a dedicated collections team at the branch level, which also monitors collections, post 24 months of loan disbursement, apart from the business team. FSBFL relies on its internal assessment of cash flows to arrive at the borrower level eligibility though it verifies the credit bureau report for all cases.

[3] *(Total debt + Off-b/s managed portfolio) / Net worth*

FSBFL's track record of maintaining low loan write-offs over the years provides comfort regarding the risk policies and control systems. However, considering its growth plans and the loan tenor, it would be crucial to maintain commensurate underwriting processes and internal controls and augment its post-disbursement controls and monitoring of loans.

Credit challenges

Modest credit profile of target customer segment; asset quality has, however, remained under control – FSBFL mainly serves borrowers who are small business owners and self-employed individuals with a focus on the services industry and income levels in the range of Rs. 25,000-40,000 per month largely without traditional income proof. Reflecting this moderate credit profile, the softer bucket delinquencies, though improving in recent times, stood high with the 30+ days past due (dpd) at 12.1% as of December 2022 vis-à-vis 19.4% as of December 2021. The GS-3 was modest at 1.5% as of December 2022 vis-à-vis 1.3% as of December 2021 on account of the improving monthly collection efficiency with the company collecting at least one instalment from 97.0% of its loan accounts every month in Q3 FY2023. The company carried overall expected credit loss (ECL) provisions of 1.7% of the AUM and the restructured book stood at Rs. 62.4 crore as of December 2022 (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.

Low portfolio seasoning – FSBFL's consolidated portfolio expanded at a CAGR of 72% during FY2016-FY2022 while it grew at a high pace of 31% (annualised) in 9M FY2023 with disbursements at Rs. 2,282 crore vis-à-vis Rs. 1,756 crore in FY2022. The AUM stood at Rs. 6,242 crore as of December 31, 2022 (Rs. 5,067 crore as of March 31, 2022). The AUM is expected to increase at a CAGR of 25-30% during FY2024-FY2026. 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 (about 5-7 years). As FSBFL is expected to add more branches over the next few years, it would be crucial to keep the quality of loan origination and underwriting under control. The four southern states, i.e. TN, Karnataka, AP and Telangana, continue to account for about 94% (100% as on March 31, 2018) of the overall portfolio. FSBFL is expected to remain a regional player with the southern states accounting for a sizeable share of the portfolio in the medium term.

Environmental and social risks

Given the service-oriented business of FSBFL, its direct exposure to environmental risks/ material physical climate risks is not significant. While, in general, lending institutions can be exposed to environmental risks indirectly through their portfolio of assets, such risks are not material for FSBFL as the incremental lending operations encompass a well-diversified customer base.

With regard to social risks, data security and customer privacy are among the key sources of vulnerabilities for NBFCs as any material lapses could be detrimental to the reputation and invite regulatory censure. FSBFL hasn't faced such lapses over the years which highlights its sensitivity to such risks. Also, the disclosures made by the company outline the key policies, processes, and investments that it has made to mitigate the occurrence of such instances. Customer preferences are increasingly shifting towards digital banking, a phenomenon that provides an opportunity to reduce operating costs. In this regard, FSBFL has been making investments to enhance its digital interface with its customers while continuing to maintain the personal touch point with them. While FSFBL contributes to promoting financial inclusion by lending to the under-served segments, its lending practices remain prudent as reflected in healthy asset quality numbers in this segment compared with its peers.

Liquidity position: Strong

FSBFL's liquidity position remains strong, with the company maintaining free cash and liquid investments of Rs. 1,013 crore and unutilised bank lines of Rs. 320 crore as of December 31, 2022 against repayment and other obligations of Rs. 472 crore during January-March 2023. Its funding mix comprises term loans from banks and financial institutions (62% of the total borrowings as of December 31, 2022), debentures (16%), securitisation (19%) and external commercial borrowings (3%). FSBFL continues to maintain positive cash flow mismatches across all tenors, given its strong capitalisation.

Rating sensitivities

Positive factors – ICRA could revise the outlook to Positive or upgrade the ratings if the company is able to scale up the loan portfolio significantly while maintaining good asset quality and a strong earnings profile on a sustained basis.

Negative factors – Pressure on the ratings could arise in case of an increase in the leverage beyond 4.0 times or a deterioration in the asset quality indicators, leading to 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, primarily 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 a typical loan ticket size of Rs. 2-10 lakh and an average ticket size of Rs. 3-3.5 lakh. Its loans are predominantly backed by self-occupied residential properties. As of December 31, 2022, the company had 369 branches in 156 districts across 8 states/Union Territories.

The six institutional investors (Matrix Partners India Investment Holdings, Norwest Venture Partners, Sequoia Capital, TPG Asia, KKR and TVS Shriram Growth) held a stake of ~58% in the company as of December 2022, with the promoter group (Mr. Lakshmipathy Deenadayalan and his family) being the single largest shareholder at 18.5%.

Key financial indicators (Ind-AS; audited)

Five-Star Business Finance Limited	FY2021	FY2022	9M FY2023*
Total income	1,051.3	1,256.2	1,089.6
Profit after tax	359.0	453.5	434.6
Net worth	2,318.2	3,710.4	4,165.2
Total managed portfolio	4,445.4	5,067.1	6,242.2
Total managed assets	5,793.6	6,343.1	7,431.9
Return on managed assets	7.1%	7.5%	8.4%
Return on net worth	16.8%	15.0%	14.7%
Gearing (reported; times)	1.5	0.7	0.8
Gearing (managed; times)	1.5	0.7	0.8
Gross NPA	1.0%	1.1%	1.5%
Net NPA	0.8%	0.7%	0.8%
CRAR	58.9%	75.2%	68.0%

*Source: Company, ICRA Research; All ratios as per ICRA's calculations; *Provisional; Amount in Rs. crore*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Current Rating (FY2023)						Rating History for the Past 3 Years						
S. No.	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Current Rating	Date & Rating in FY2022		Date & Rating in FY2021			Date & Rating in FY2020	
					Feb-23-2023	Mar-11-2022	Jun-29-2021	Dec-15-2020	Sep-25-2020	Sep-07-2020	Mar-16-2020	Apr-01-2019
1	Market linked debentures	Long term	45.00	45.00	PP-MLD[ICRA]AA- (Stable)	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)	-	-
2	Market linked debentures	Long term	20.00	0.00	PP-MLD[ICRA]AA- (Stable); withdrawn	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	1,200.00	1,127.17	[ICRA]AA- (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	-	-
4	Long term – Unallocated	Long term	0.00	0.00	-	[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	375.00	270.00	[ICRA]AA- (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	25.00	0.00	[ICRA]AA- (Stable); 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: Click Here

Annexure I: 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]AA- (Stable)
INE128S07424	NCD	May-13-20	12.75%	May-13-26	15.00	[ICRA]AA- (Stable)
INE128S07432	NCD	May-28-20	10.50%	May-26-23	15.00	[ICRA]AA- (Stable)
INE128S07440	NCD	Jun-12-20	11.00%	Jun-12-23	25.00	[ICRA]AA- (Stable)
INE128S07457	NCD	Jun-24-20	11.00%	Apr-21-23	115.00	[ICRA]AA- (Stable)
INE128S07507	NCD	Sep-30-20	NA	Sep-30-29	70.00	[ICRA]AA- (Stable)
INE128S07515	NCD	Nov-19-20	9.50%	May-19-22	25.00	[ICRA]AA- (Stable); withdrawn
Unallocated	NCD	-	-	-	105.00	[ICRA]AA- (Stable)
INE128S07499	NCD-MLD	Sep-03-20	10.60%	Feb-22-23	25.00	PP-MLD[ICRA]AA- (Stable)
INE128S07523	NCD-MLD	Dec-15-20	10-yr G-Sec	Jun-15-23	20.00	PP-MLD[ICRA]AA- (Stable)
INE128S07531	NCD-MLD	Dec-15-20	10-yr G-Sec	Mar-15-22	20.00	PP-MLD[ICRA]AA- (Stable); withdrawn
NA	Term loan - 1		NA		23.37	[ICRA]AA- (Stable)
NA	Term loan - 2		NA		33.32	[ICRA]AA- (Stable)
NA	Term loan - 3		NA		39.44	[ICRA]AA- (Stable)
NA	Term loan - 4		NA		12.44	[ICRA]AA- (Stable)
NA	Term loan - 5		NA		22.17	[ICRA]AA- (Stable)
NA	Term loan - 6		NA		100.00	[ICRA]AA- (Stable)
NA	Term loan - 7		NA		9.73	[ICRA]AA- (Stable)
NA	Term loan - 8		NA		13.13	[ICRA]AA- (Stable)
NA	Term loan - 9		NA		54.17	[ICRA]AA- (Stable)
NA	Term loan - 10		NA		40.83	[ICRA]AA- (Stable)
NA	Term loan - 11		NA		18.00	[ICRA]AA- (Stable)
NA	Term loan - 12	Jan-2019 to Dec-2022	NA	Feb-2023 to Sep-2029	63.75	[ICRA]AA- (Stable)
NA	Term loan - 13		NA		175.75	[ICRA]AA- (Stable)
NA	Term loan - 14		NA		11.68	[ICRA]AA- (Stable)
NA	Term loan - 15		NA		7.64	[ICRA]AA- (Stable)
NA	Term loan - 16		NA		47.27	[ICRA]AA- (Stable)
NA	Term loan - 17		NA		12.00	[ICRA]AA- (Stable)
NA	Term loan - 18		NA		70.44	[ICRA]AA- (Stable)
NA	Term loan - 19		NA		1.58	[ICRA]AA- (Stable)
NA	Term loan - 20		NA		223.02	[ICRA]AA- (Stable)
NA	Term loan - 21		NA		86.57	[ICRA]AA- (Stable)
NA	Term loan - 22		NA		50.00	[ICRA]AA- (Stable)
NA	Term loan - 23		NA		10.87	[ICRA]AA- (Stable)
NA	Term loan – Unallocated		NA		72.83	[ICRA]AA- (Stable)

Source: FSBFL

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

Annexure II: List of entities considered for consolidated analysis: Not applicable

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