

January 05, 2024

Five-Star Business Finance Limited: Rating reaffirmed; Rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debenture programme	250.00	250.00	[ICRA]AA- (Stable); reaffirmed
	70.00	0.00	[ICRA]AA- (Stable); reaffirmed and withdrawn
Long-term fund-based term loan	3,940.00	5,440.00	[ICRA]AA- (Stable); reaffirmed/assigned for enhanced portion
Long-term fund-based cash credit	60.00	60.00	[ICRA]AA- (Stable); reaffirmed
Total	4,320.00	5,750.00	

*Instrument details are provided in Annexure I

Rationale

The rating action factors in Five-Star Business Finance Limited's (FSBFL) strong capital and earnings profile. Sizeable capital infusions in the past (~Rs. 2,273 crore raised during FY2016-FY2022) have supported FSBFL's capital profile while it registered a high portfolio growth (compound annual growth rate (CAGR) of 66% during FY2017-FY2023), albeit on a smaller base. The managed gearing was modest at 1.0 times as of September 2023. The company reported a return on managed assets (RoMA) of 8.3% in H1 FY2024 (8.0% in FY2023) while the return on average net worth stood at 16.9% (15.0% in FY2023). Its existing capital structure and expected strong internal accruals would support the growth in its assets under management (AUM), which is expected to increase at a CAGR of 30-35% during FY2024-FY2026.

FSBFL's asset quality is characterised by gross stage 3 of 1.4% as of September 2023 and March 2023 (1.0% and 1.1% respectively without considering the impact of the Reserve Bank of India's (RBI) circular dated November 12, 2021¹). The small ticket size and secured nature of lending (more than 95% of the loans were against self-occupied properties with a loan-to-value (LTV) of less than 50% for 97% of the AUM as of September 2023) along with the high-yielding nature of its exposures provide comfort against the modest risk profile of the target borrower segment. While the asset quality performance during the scaling-up stages is a monitorable, FSBFL's healthy internal accruals and current capital structure support its overall risk profile. Control over the underwriting process would be crucial over the medium term, in view of its growth plan, which is expected to keep the portfolio seasoning at a low level. The company is expected to focus on deeper penetration in the existing geographies and the portfolio is expected to remain regionally concentrated in southern India over the medium term. As of September 2023, Tamil Nadu (TN), Karnataka, Andhra Pradesh (AP) and Telangana accounted for 94% of the overall portfolio (100% as of March 2018).

ICRA has reaffirmed and withdrawn the rating on the Rs. 70.00-crore non-convertible debentures (NCDs) as these have been fully redeemed with no amount outstanding against the same. The rating was 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. 4,736 crore and a capital adequacy ratio of 59.4% as of September 30, 2023. The company had secured regular equity

¹ On Prudential Norms on Income Recognition, Asset Classification and Provisioning

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. The recent RBI circular on higher risk weights for consumption credit extended by non-banking financial companies (NBFCs) shall impact FSBFL's capital adequacy ratio marginally. However, the low leverage shall support its capital structure. ICRA notes that while FSBFL is expected to increase its portfolio at a CAGR of ~30-35% during April 2023-March 2026, its leverage is not expected to exceed 4 times during this period.

Strong earnings profile – FSBFL's net profitability improved with profit after tax/average managed assets (PAT/AMA) at 8.3% in H1 FY2024 vis-à-vis 8.0% in FY2023. The net interest margins have remained comfortable at 16.9% in H1 FY2024 and 16.6% in FY2023, supported by the healthy yield on its loan portfolio. Accordingly, the pre-provision operating profitability (PPOP) stood at 11.1% in H1 FY2024 and 10.8% in FY2023. Also, the company moderated its overall provisions, as a proportion of AUM, to 1.6% as of September 2023 as well as March 2023 from 2.0% in March 2022 though it has increased its stage 3 provision coverage ratio to 50.2% as of September 2023 from 34.9% in March 2022.

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 takes note of the recent RBI circular on higher risk weights for bank credit to NBFCs, which is expected to push up the cost of funds for the sector. However, entities usually have adequate pricing ability to pass on the same, thereby moderating the impact on their earnings performance. ICRA expects the net profitability 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) capped at 40-50%. As of September 2023, 52% 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 September 2023 (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 loan instalments at manageable levels for the target customer segment. The loans are largely given for a ticket size below Rs. 5 lakh, which was 88% of the AUM as of September 30, 2023. 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.

Credit challenges

Modest credit profile of target customer segment; asset quality has, however, remained under control – FSBFL's borrowers are mainly small business owners and self-employed individuals with a focus on the services industry and with gross income levels in the range of Rs. 25,000-40,000 per month, largely without traditional income evidence. Reflecting this moderate credit profile, the softer bucket delinquencies, though improving in recent times, stood high with the 30+ days past due (dpd) at 8.6% as of September 2023 vis-à-vis 10.5% as of March 2023. However, the 90+ dpd was modest at 1.1% as of September 2023 (without considering the impact of the RBI's circular dated November 12, 2021²) vis-à-vis 1.0% as of March 2023 on account of the healthy monthly collection efficiency (collections including arrears but excluding prepayments/total demand for the month). This stood at 100.3% in Q2 FY2024 while the company had collected at least one instalment every month from 98.0%

² On Prudential Norms on Income Recognition, Asset Classification and Provisioning

of the portfolio during this period. The restructured book stood at 0.7% of the AUM as of September 2023. Nevertheless, ICRA notes that the high envisaged portfolio growth exposes FSBFL to incremental credit risk though this is likely to be partially mitigated by its prudent credit norms and policies.

Low portfolio seasoning and geographically concentrated operations – FSBFL’s consolidated portfolio expanded at a CAGR of 66% during FY2017-FY2023 while it grew at a high pace of 39% (annualised) in H1 FY2024 with disbursements at Rs. 2,336 crore vis-à-vis Rs. 3,391 crore in FY2023. The AUM stood at Rs. 8,264 crore as of September 30, 2023 (Rs. 6,915 crore as of March 31, 2023) and is expected to increase at a CAGR of ~30-35% during FY2024-FY2026. The steep growth in the past and the expected growth would result in low portfolio seasoning, considering the average tenor of the loans (about 5-7 years). Loans with a vintage of less than 1 year stood at 49% of the AUM as of September 2023 compared to 39% as of September 2022. 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. The four southern states, i.e. TN, Karnataka, AP and Telangana, accounted for about 94% (100% as on March 31, 2018) of the overall portfolio as of September 2023. 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 lending institutions can be exposed to environmental risks indirectly through their portfolio of assets, such risks are not material for FSBFL as its 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 vulnerability for NBFCs as material lapses could be detrimental to their reputation and invite regulatory censure. FSBFL has not 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 made by it to mitigate the occurrence of such instances. Customer preference is increasingly shifting towards digital banking, a phenomenon that provides an opportunity to reduce the operating costs. In this regard, FSBFL has been making investments to enhance its digital interface with its customers while continuing to maintain a personal touch point with them. While FSBFL contributes to promoting financial inclusion by lending to underserved segments, its lending practices remain prudent as reflected by the healthy asset quality numbers in this segment compared with its peers.

Liquidity position: Strong

The liquidity position is strong with free cash and liquid investments of ~Rs. 1,267 crore as of September 30, 2023 and sanctioned but unutilised bank lines of Rs. 452 crore against debt-servicing obligations of ~Rs. 1,250 crore during October 2023-September 2024. The funding mix comprises bank term loans (69% of the total borrowings as of September 2023), securitisation (21%), NCDs (4%), term loans from financial institutions (4%) and external commercial borrowings (ECB; 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 – The company’s rating could be positively impacted if it is able to scale up its loan portfolio significantly while maintaining good asset quality and a strong earnings profile on a sustained basis.

Negative factors – Pressure on the rating 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 ratings
Parent/Group support	Not applicable
Consolidation/Standalone	The rating is based on the standalone financials of the company

About the company

Five-Star Business Finance Limited (FSBFL) is a Chennai-headquartered 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 September 30, 2023, the company had 456 branches across 10 states/Union Territories.

FSBFL was listed on the NSE and BSE in November 2022. As of September 2023, the single largest shareholder comprised the individual promoters & promoter group (Mr. Lakshminath Deenadayalan and his family), with an 18.3% stake in the company, on a fully diluted basis.

Key financial indicators (Ind-AS; audited)

Five-Star Business Finance Limited	FY2022	FY2023	H1 FY2024
Total income	1,256.2	1,528.9	973.6
Profit after tax	453.5	603.5	383.1
Net worth	3,710.4	4,339.5	4,736.3
Total managed portfolio	5,067.1	6,914.8	8,264.4
Total managed assets	6,343.1	8,702.8	9,679.7
Return on managed assets	7.5%	8.0%	8.3%
Return on net worth	15.0%	15.0%	16.9%
Gearing (reported; times)	0.7	1.0	1.0
Gearing (managed; times)	0.7	1.0	1.0
Gross stage 3	1.1%	1.4%	1.4%
Net stage 3	0.7%	0.7%	0.7%
CRAR	75.2%	67.2%	59.4%

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

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

S. No.	Instrument	Type	Current Rating (FY2024)		Chronology of Rating History for the Past 3 Years									
			Amount Rated	Amount Outstanding	Date & Rating in FY2024			Date & Rating in FY2023		Date & Rating in FY2022		Date & Rating in FY2021		
			(Rs. crore)	(Rs. crore)	Jan-05-2024	Jul-24-2023	Jun-09-2023	Mar-01-2023	Feb-23-2023	Mar-11-2022	Jun-29-2021	Dec-15-2020	Sep-25-2020	Sep-07-2020
1	Market linked debentures	Long term	0.00	0.00	-	PP-MLD[ICRA]AA-(Stable)	PP-MLD[ICRA]AA-(Stable)	PP-MLD[ICRA]AA-(Stable)	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	Long-term fund-based term loan	Long term	5,440.00	4,445.64	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]A+(Stable)	[ICRA]A+(Stable)	[ICRA]A(Stable)	[ICRA]A(Stable)	[ICRA]A(Stable)
3	Long-term fund-based cash credit	Long term	60.00	49.50	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(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)
5	NCD	Long term	250.00	145.00	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]A+(Stable)	[ICRA]A+(Stable)	[ICRA]A(Stable)	[ICRA]A(Stable)	[ICRA]A(Stable)
6	NCD	Long term	70.00	0.00	[ICRA]AA-(Stable); withdrawn	[ICRA]AA-(Stable);	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]A+(Stable)	[ICRA]A+(Stable)	[ICRA]A(Stable)	[ICRA]A(Stable)	[ICRA]A(Stable)

Complexity level of the rated instrument

Instrument	Complexity Indicator
Non-convertible debenture	Simple
Long-term fund-based term loan	Simple
Long-term fund-based cash credit	Simple

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	Current Rating and Outlook
					(Rs. crore)	
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)
INE128S07598	NCD	Jun-15-23	9.10%	Dec-15-26	100.00	[ICRA]AA- (Stable)
Unallocated	NCD	-	-	-	105.00	[ICRA]AA- (Stable)
INE128S07507	NCD	Jun-15-23	NA	Sep-30-29	70.00	[ICRA]AA- (Stable); withdrawn
NA	Term loan - 1		NA		13.17	[ICRA]AA- (Stable)
NA	Term loan - 2		NA		229.41	[ICRA]AA- (Stable)
NA	Term loan - 3		NA		193.75	[ICRA]AA- (Stable)
NA	Term loan - 4		NA		94.94	[ICRA]AA- (Stable)
NA	Term loan - 5		NA		15.51	[ICRA]AA- (Stable)
NA	Term loan - 6		NA		388.38	[ICRA]AA- (Stable)
NA	Term loan - 7		NA		100.00	[ICRA]AA- (Stable)
NA	Term loan - 8		NA		100.00	[ICRA]AA- (Stable)
NA	Term loan - 9		NA		96.97	[ICRA]AA- (Stable)
NA	Term loan - 10		NA		2.92	[ICRA]AA- (Stable)
NA	Term loan - 11		NA		7.64	[ICRA]AA- (Stable)
NA	Term loan - 12		NA		134.74	[ICRA]AA- (Stable)
NA	Term loan - 13		NA		31.46	[ICRA]AA- (Stable)
NA	Term loan - 14		NA		41.00	[ICRA]AA- (Stable)
NA	Term loan - 15		NA		232.50	[ICRA]AA- (Stable)
NA	Term loan - 16		NA		69.53	[ICRA]AA- (Stable)
NA	Term loan - 17		NA		323.03	[ICRA]AA- (Stable)
NA	Term loan - 18	Jan-2019 to Dec-2023	NA	Oct-2023 to Oct-2030	154.30	[ICRA]AA- (Stable)
NA	Term loan - 19		NA		170.13	[ICRA]AA- (Stable)
NA	Term loan - 20		NA		108.93	[ICRA]AA- (Stable)
NA	Term loan - 21		NA		7.48	[ICRA]AA- (Stable)
NA	Term loan - 22		NA		38.50	[ICRA]AA- (Stable)
NA	Term loan - 23		NA		35.74	[ICRA]AA- (Stable)
NA	Term loan - 24		NA		42.11	[ICRA]AA- (Stable)
NA	Term loan - 25		NA		415.42	[ICRA]AA- (Stable)
NA	Term loan - 26		NA		52.50	[ICRA]AA- (Stable)
NA	Term loan - 27		NA		117.72	[ICRA]AA- (Stable)
NA	Term loan - 28		NA		5.98	[ICRA]AA- (Stable)
NA	Term loan - 29		NA		121.88	[ICRA]AA- (Stable)
NA	Term loan - 30		NA		50.00	[ICRA]AA- (Stable)
NA	Term loan - 31		NA		50.00	[ICRA]AA- (Stable)
NA	Term loan - 32		NA		500.00	[ICRA]AA- (Stable)
NA	Term loan - 33		NA		200.00	[ICRA]AA- (Stable)
NA	Term loan - 34		NA		300.00	[ICRA]AA- (Stable)
NA	Term loan - Unallocated		NA		994.36	[ICRA]AA- (Stable)
NA	Cash credit - 1	Nov-15-12	NA	NA	5.00	[ICRA]AA- (Stable)
NA	Cash credit - 2	Aug-06-13	NA	NA	5.00	[ICRA]AA- (Stable)
NA	Cash credit - 3	Jul-04-16	NA	NA	5.00	[ICRA]AA- (Stable)
NA	Cash credit - 4	Mar-19-19	NA	NA	10.00	[ICRA]AA- (Stable)
NA	Cash credit - 5	Oct-20-20	NA	NA	2.00	[ICRA]AA- (Stable)
NA	Cash credit - 6	Nov-17-21	NA	NA	2.00	[ICRA]AA- (Stable)
NA	Cash credit - 7	Nov-23-22	NA	NA	5.00	[ICRA]AA- (Stable)
NA	Cash credit - 8	Dec-08-21	NA	NA	5.00	[ICRA]AA- (Stable)
NA	Cash credit - 9	Feb-22-22	NA	NA	1.00	[ICRA]AA- (Stable)

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated	Current Rating and Outlook
					(Rs. crore)	
NA	Cash credit - 10	Feb-04-22	NA	NA	0.50	[ICRA]AA- (Stable)
NA	Cash credit - 11	Nov-08-21	NA	NA	9.00	[ICRA]AA- (Stable)
NA	Cash credit – Unallocated	NA	NA	NA	10.50	[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

ANALYST CONTACTS

Karthik Srinivasan

+91-22-6114 3444

karthiks@icraindia.com

A M Karthik

+91-44-4596 4308

a.karthik@icraindia.com

R Srinivasan

+91-44-4596 4315

r.srinivasan@icraindia.com

Richardson Xavier J

+91 90 9487 7278

richardson.xavier@icraindia.com

RELATIONSHIP CONTACT

Mr. L Shivakumar

+91 098 2108 6490

shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani

Tel: +91 124 4545 860

communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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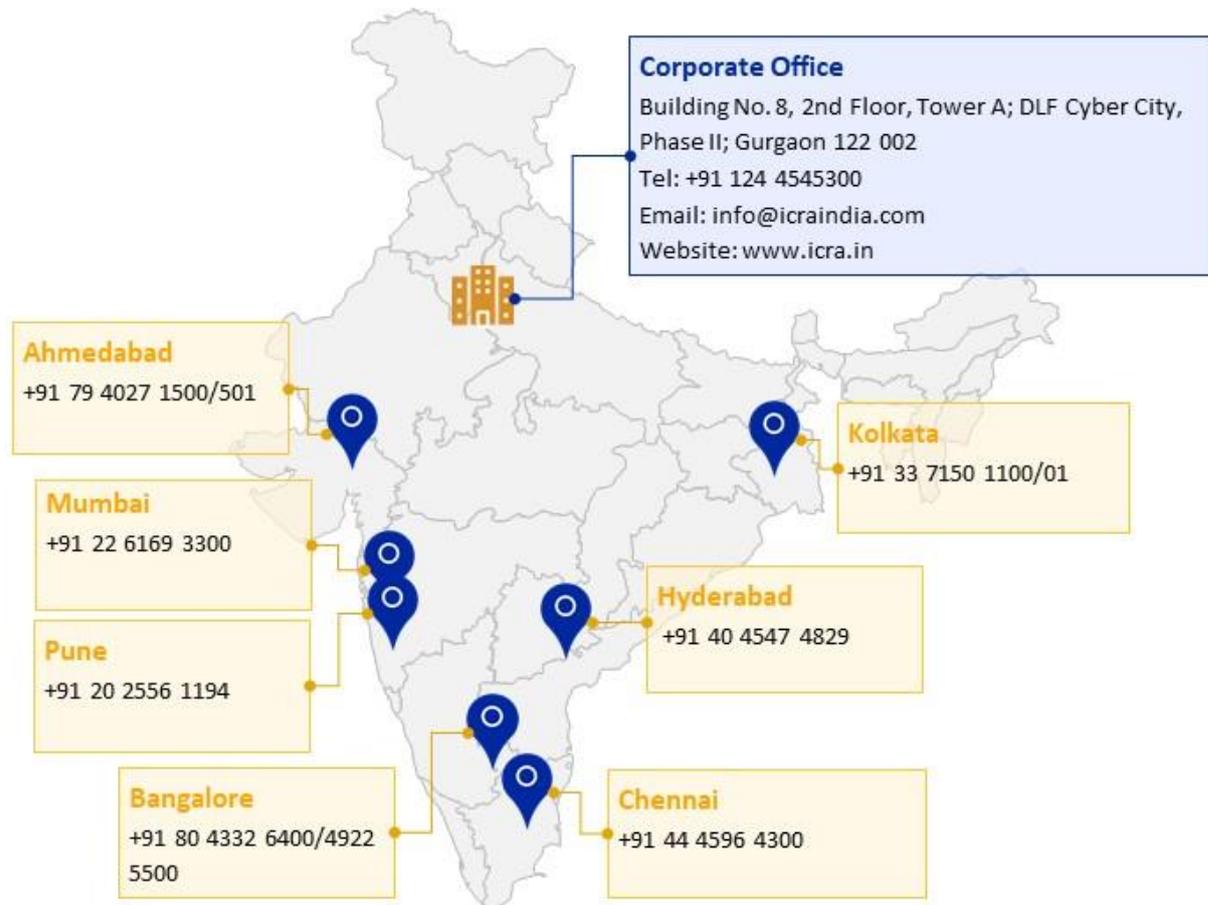
Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001

Tel: +91 11 23357940-45



Branches



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