September 04, 2024

Five-Star Business Finance Limited: Rating reaffirmed and rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debenture programme	220.00	220.00	[ICRA]AA- (Stable); reaffirmed
	30.00	0.00	[ICRA]AA- (Stable); reaffirmed and withdrawn
Long-term fund-based bank facilities	5,500.00	6,500.00	[ICRA]AA- (Stable); reaffirmed/assigned for enhanced amount
Total	**5,750.00**	**6,720.00**	

**Instrument details are provided in Annexure I*

Rationale

The rating factors in Five-Star Business Finance Limited's (FSBFL) track record of maintaining a strong capitalisation and earnings profile over the years. Sizeable capital infusions in the past (~Rs. 2,273 crore raised during FY2016-FY2022) have supported FSBFL's capitalisation profile while it reported a return on managed assets (RoMA) in the range of 7.4-8.2% during FY2022-Q1 FY2025. These factors helped the company keep the managed gearing at a modest level (1.2 times as of June 2024) while it registered high portfolio growth at a compound annual growth rate (CAGR) of 63% during FY2017-FY2024 with the portfolio increasing further by 29% (annualised) in Q1 FY2025. While FSBFL's assets under management (AUM) is expected to expand at a CAGR of 30% over the near term (1-3 years), its existing capital structure and expected strong internal accruals should support the AUM growth over the longer term.

FSBFL's asset quality remained under control as the gross stage 3 remained stable at 1.4% as of June 2024, March 2024 and March 2023 (1.2%, 1.1% and 1.0% respectively, without considering the impact of the Reserve Bank of India's (RBI) circular dated November 12, 2021[1]). The small ticket size and secured nature of lending (more than 95% of the loans were against self-occupied residential properties) with a loan-to-value (LTV) of less than 40% for 47% of the AUM as of June 2024, 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 and maintaining a healthy business yield would be crucial over the medium term, in view of its growth plan and target borrower segment. 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 June 2024, Andhra Pradesh (AP), Tamil Nadu (TN), Karnataka and Telangana accounted for 94% of the overall portfolio (100% as of March 2018).

The Stable outlook takes into consideration ICRA's expectation that the company will maintain strong earnings as well as a comfortable asset quality profile over the near to medium term as it scales up its operations.

ICRA has reaffirmed and withdrawn the rating on the Rs. 30.00-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.

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

Key rating drivers and their description

Credit strengths

Strong capital structure to support medium-term portfolio growth – FSBFL's capitalisation profile is characterised by a net worth of Rs. 5,450 crore and a capital adequacy ratio (CAR) of 48.4% as of June 2024. The RBI's circular on higher risk weights for consumer credit extended by non-banking financial companies (NBFCs) impacted the company's reported CAR by about 5% as ~40% of its loans were classified as having been given for consumption purposes, though these were secured in nature. FSBFL had secured 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. ICRA notes that FSBFL is expected to grow its portfolio at a CAGR of ~30% during FY2025-FY2027, its managed gearing is expected to remain comfortably below 4 times during this period.

Strong earnings profile – FSBFL's net profitability improved with profit after tax/average managed assets (PAT/AMA) at 8.2% and 8.1%, respectively, in Q1 FY2025 and FY2024 vis-à-vis 7.9% in FY2023. The net interest margin remained comfortable at 16.0% and 16.2% in Q1 FY2025 and FY2024, respectively, vis-à-vis 16.3% in FY2023, supported by the robust yield on the loan portfolio. Accordingly, the pre-provision operating profitability (PPOP) stood at 11.0% and 10.8% in Q1 FY2025 and FY2024, respectively, vis-à-vis 10.6% in FY2023. Also, FSBFL's operating expenses improved to 5.1% and 5.4% of AMA in Q1 FY2025 and FY2024, respectively, from 5.7% in FY2023, as the operational efficiency improved with the growth in the scale of operations while credit costs stayed low with the asset quality indicators remaining under control.

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, though it has not significantly impacted FSBFL's cost of incremental borrowings so far. Moreover, entities usually have adequate pricing ability to pass on the same, thereby moderating the impact on their earnings performance. FSBFL's ability to maintain a healthy business yield and keep the credit costs under control, as it geographically diversifies its portfolio, would be key from an earnings perspective. 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 an experienced board, consisting of eight members. Apart from the Chairman and Managing Director (promoter) and two joint managing directors (Chief executive officer and Chief financial officer), the board consists of four independent directors 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.

FSBFL has maintained prudent underwriting policies with the LTV and the fixed obligations to income ratio (FOIR) capped at 40-50%. As of June 2024, 47% of the portfolio had an LTV of less than 40% (68% as of March 2021) while AUM with LTV of more than 50% accounted for only 3% (1% as of March 2021). Considering the target segment, the tenors are relatively longer with 77% of the loans having a tenor of seven 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, constituting 87% of the AUM as of June 2024. A minor portion of the customers had more than one loan outstanding as of March 2024. All loans are sourced in-house; the business team, which sources loans, is also primarily responsible for the collections with dedicated collections support and legal teams providing assistance for loans in harder buckets. 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 household 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 8.1% in June 2024 vis-à-vis 10.5% in March 2023. However, the 90+ dpd continued to be modest at 1.2% in June 2024 (without considering the impact of the RBI's circular dated November 12, 2021[2]) 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 98.5% and 99.5% in Q1 FY2025 and Q4 FY2024, respectively, while the company had collected at least one instalment every month from 97.2 % and 97.8% of the portfolio during the respective periods. The restructured book stood at 0.5% of the AUM with provision coverage of 58.2% as of June 2024.

Low portfolio seasoning and geographically concentrated operations – FSBFL's consolidated portfolio expanded at a CAGR of 63% during FY2017-FY2024 while it grew at a pace of 29% (annualised) and 39% in Q1 FY2025 and FY2024, respectively. The AUM stood at Rs. 10,344 crore as of June 2024 (Rs. 6,915 crore as of March 31, 2023) and is expected to increase at a CAGR of ~30% during FY2025-FY2027. Loans with a vintage of less than 1 year stood at 45% of the AUM as of June 2024 compared to 46% as of March 2023. ICRA notes that the steep growth in the past and the expected growth 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. The four southern states, i.e. AP, TN, Karnataka and Telangana, accounted for about 94% (100% as on March 31, 2018) of the overall portfolio as of June 2024. 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. 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 means of payment, which 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 the company 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. 1,891 crore as of June 30, 2024 and sanctioned but unutilised bank lines of Rs. 400 crore against debt-servicing obligations of ~Rs. 1,562 crore during July 2024-June 2025. The funding mix comprises bank term loans (62% of the total borrowings as of June 2024), securitisation (14%), NCDs (12%), term loans from financial institutions and NBFCs (11%) and external commercial borrowings (ECBs; 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.

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

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 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. 3-5 lakh. Its loans are predominantly backed by self-occupied residential properties. As of June 30, 2024, the company had 547 branches across 10 states/Union Territories.

FSBFL was listed on the NSE and BSE in November 2022. As of June 2024, the individual promoters & promoter group (Mr. Lakshmipathy Deenadayalan and his family) held 18.3% in the company, being the single largest shareholder.

Key financial indicators (Ind-AS; audited)

Five-Star Business Finance Limited	FY2023	FY2024	Q1 FY2025*
Total income	1,528.9	2,195.1	669.4
Profit after tax	603.5	835.9	251.6
Total managed assets	8,813.9	11,847.4	12,564.1
Return on managed assets	7.9%	8.1%	8.2%
Gearing (managed; times)	1.0	1.2	1.2
Gross stage 3	1.4%	1.4%	1.4%
CRAR	67.2%	50.5%	48.4%

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

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Current rating (FY2025)			Chronology of rating history for the past 3 years					
	Type	Amount rated (Rs. crore)	Sep-04-2024	FY2024		FY2023		FY2022	
				Date	Rating	Date	Rating	Date	Rating
Long-term fund-based bank facilities	Long term	6,500.00	[ICRA]AA-(Stable)	Jun-09-2023	[ICRA]AA-(Stable)	Feb-23-2023	[ICRA]AA-(Stable)	Jun-29-2021	[ICRA]A+(Stable)
				Jul-24-2023	[ICRA]AA-(Stable)	Mar-01-2023	[ICRA]AA-(Stable)	Mar-11-2022	[ICRA]A+(Stable)
				Jan-05-2024	[ICRA]AA-(Stable)	-	-	-	-
NCD	Long term	220.00	[ICRA]AA-(Stable)	Jun-09-2023	[ICRA]AA-(Stable)	Feb-23-2023	[ICRA]AA-(Stable)	Jun-29-2021	[ICRA]A+(Stable)
				Jul-24-2023	[ICRA]AA-(Stable)	Mar-01-2023	[ICRA]AA-(Stable)	Mar-11-2022	[ICRA]A+(Stable)
				Jan-05-2024	[ICRA]AA-(Stable)	-	-	-	-
Market linked debentures	Long term	-	-	Jun-09-2023	PP-MLD[ICRA]AA-(Stable)	Feb-23-2023	PP-MLD[ICRA]AA-(Stable)	Jun-29-2021	PP-MLD[ICRA]A+(Stable)
		-	-	Jul-24-2023	PP-MLD[ICRA]AA-(Stable)	Mar-01-2023	PP-MLD[ICRA]AA-(Stable)	Mar-11-2022	PP-MLD[ICRA]A+(Stable)
Long term – Unallocated	Long term	-	-	-	-	-	-	Jun-29-2021	[ICRA]A+(Stable)
		-	-	-	-	-	-	Mar-11-2022	[ICRA]A+(Stable)

Complexity level of the rated instrument

Instrument	Complexity Indicator
Non-convertible debentures	Simple
Long-term fund-based bank facilities	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 (Rs. crore)	Current Rating and Outlook
INE128S07366	**NCD**	Apr-11-19	11.40%	Apr-11-24	30.00	[ICRA]AA- (Stable); withdrawn
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)
NA	**Long-term fund-based bank facilities – Term loan**	Oct-23-2019 to Jun-20-2024	NA	Dec-30-2024 to Oct-31-2030	4,740.71	[ICRA]AA- (Stable)
NA	**Long-term fund-based bank facilities – Cash credit**	Nov-15-2012 To Dec-28-2023	NA	NA	54.50	[ICRA]AA- (Stable)
NA	**Long-term fund-based bank facilities – Unallocated**	NA	NA	NA	1704.79	[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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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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