December 15, 2020

Five-Star Business Finance Limited: PP-MLD[ICRA]A(Stable) assigned to Rs. 40-crore NCD

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible Debenture Programme -Market linked debentures	0.00	40.00	PP-MLD[ICRA]A(Stable); assigned
Non-convertible Debenture Programme-Market linked debentures	25.00	25.00	PP-MLD[ICRA]A(Stable); outstanding
Non-convertible Debenture Programme	1,249.00	1,249.00	[ICRA]A(Stable); outstanding
Long-term Fund-based Bank Facilities	909.96	909.96	[ICRA]A(Stable); outstanding
Long term - Unallocated	290.04	290.04	
Total	**2,474.00**	**2,514.00**	

**Instrument details are provided in Annexure-1*

Rationale

The assigned ratings consider Five-Star Business Finance Limited's (FSBFL) adequate loan appraisal processes, good profitability indicators and comfortable capital structure. The company has a diversified board with representatives from five private equity (PE) investors and has an experienced senior management team. FSBFL's 90+ dpd (1-year lagged) increased marginally on a YoY basis (1.9% as of September 2020 vis-à-vis 1.5% as of September 2019) but is under control at present. Impact of the covid-19 on borrower cashflows and the consequent impact on FSBFL' asset quality would remain a near-term monitorable. However, the currently low leverage, secured nature of lending (more than 95% of the loans are against self-occupied residential properties with a loan-to-value (LTV) at about 40-50%) and the high-yielding nature of its exposures provides some comfort.

ICRA takes note of FSBFL's steep portfolio growth plans during FY2022-FY2023 (CAGR of ~60%) while the growth in the current fiscal is expected to be moderate at about 10-15%. The ability to get commensurate funding and keep control over the underwriting process would be crucial during this period. The steep growth would keep the portfolio seasoning at modest levels. The company ventured into Uttar Pradesh (UP) and Chhattisgarh during FY2020 and is scaling up its operations in Maharashtra and Madhya Pradesh (MP), where it ventured into in FY2019. Notwithstanding this, its exposure would be regionally concentrated in Southern India over the medium term. As of September 2020, Tamil Nadu (TN), Karnataka, Andhra Pradesh (AP) and Telangana accounted for 96% of the overall portfolio (100% as of March 2018)

Key rating drivers and their description

Credit strengths

Fairly diversified board and experienced senior management team – FSBFL's board is quite diversified, consisting of 12 members. Apart from the Chairman and Managing Director (promoter), the board consists of four independent directors, five representatives of the PE investors and two non-executive directors. 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, treasury, human resources and risk management are headed by personnel who have adequate experience in these fields.

Adequate internal controls and risk management systems, considering target borrower segment – The company has prudent underwriting policies with the LTV and FOIR[1] typically capped at 40-50%. As of September 30, 2020, 67% and 60% of the portfolio had an LTV and FOIR less than 40%, respectively. Assets under management (AUM) with more than 50% LTV or FOIR is less than 10% of the overall portfolio, as per the company. The loans are largely for a ticket size of less than Rs. 10 lakh with 86% being below Rs. 5 lakh as of September 30, 2020. Considering the target segment, the tenors are relatively longer with 75% of the loans having a tenor of 6-7 years, which is expected to keep the instalment at manageable levels for the borrowers. Going forward, it would be crucial to augment its post-disbursement controls and monitoring of loans considering the loan tenor. The company has set up a dedicated collections team at the branch level, which would also monitor collections post 24 months of loan disbursement apart from the business team.

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 ERP module for its loan management system. Its internal audit team 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 accountant firm has been appointed by FSBFL as (External) Internal Auditor to check on financial, regulatory and risk-related compliances.

Comfortable capital structure – FSBFL's gearing stood at 1.4x as of September 2020 (1.2x as of March 2020). Regular capital infusions over the last four financial years, totalling to Rs. 1,366 crore (infusion of Rs. 315 crore in FY2020), supported the capital profile while the company registered a sharp portfolio growth. The promoter's shareholding stood at 21.7% on a fully diluted basis with all PE investors currently holding about 68.5%. While ICRA takes note of FSBFL's steep growth plans over FY2022-FY2023, the capital profile is expected to remain under control with a managed gearing around 3.0x during this period.

Good profitability indicators – FSBFL's profitability (profit after tax/average managed assets; PAT/AMA) stood at 7.8% in FY2020 (7.9%(prov) in H1 FY2021) vis-à-vis 8.9% in FY2019 largely because of the decline in the net interest margins and higher provisions (1.5% in FY2020, 0.2% in H1FY2021 vis-à-vis 0.4% in FY2019) in view of the expected Covid-19 impact. The net interest margins declined to 14.3% (prov) (16.7% in FY2020 and 18.6% in FY2019) in H1FY2021 partly due to the higher on balance sheet liquidity (cash and cash equivalents of ~25% of the total assets as of September 2020 vis-à-vis 9.8% as of March 2020 and 9.4% as of March 2019). The operating expense ratio improved to 3.5% (prov) during H1 FY2021 (4.8% in FY2020 and 5.8% in FY2019) supported by an improvement in the scale of operations and as the operational costs were controlled on account of the pandemic. Profitability thus far is supported by healthy business yields, low leverage and controlled credit costs. ICRA expects FSBFL's net profitability going forward to be in the range of 5-6% over the medium term. FSBFL' ability to keep the credit costs under control in view of the pandemic's impact on the cash flows of the target borrowers would be critical over the near term. Also, as the company expects steeper growth in FY2022 and FY2023, controlling the credit costs on account of portfolio seasoning and maintaining the operating efficiencies at optimal levels would be key for incremental profitability.

Credit challenges

Modest credit profile of target customer segment – FSBFL predominantly provides small-ticket loans with an average ticket size of Rs. 3.5-4.0 lakh to self-employed borrowers belonging to the middle-and-lower-income segments. About 86% of the AUM is upto Rs. 5.0 lakh bucket with about 75% having a loan tenure of 6-7 years as of September 2020. Further, around 30% of the active borrowers are new to the formal credit system. Considering the borrowers' business

[1] *FOIR – Fixed obligation to income ratio*

and income profiles, their credit profile is expected to be modest and vulnerable to income shocks. These borrowers usually have limited alternatives for funding from formal channels in the absence of proper income documents. The above is reflected in the high softer bucket delinquencies with the 30+dpd at 11.8% as of March 31, 2020 though the same improved to 3.3% in September 2020 (6.0% in June 2020). The improvement partly resulted from the asset classification standstill in the softer delinquencies buckets because of the moratorium and on account of some collections from these accounts. The 90+dpd (1-year lagged) stood at 1.9% as of September 2020 (1.5% in September 2019). ICRA also notes the improvement in the collections[2] to ~99% as of September 2020 which marginally dipped to ~96% as of October 2020 due to seasonality trend witnessed in the past. The collection efficiency had had dipped to ~51% in April 2020 because of the covid-19 lockdown. About 65-70% of the collections are still made in the cash mode. ICRA, however notes that the high envisaged portfolio growth exposes the company to higher credit risk though this is likely to be somewhat partially mitigated by the company's prudent credit norms.

Steep envisaged portfolio growth; low portfolio seasoning – FSBFL's consolidated[3] portfolio expanded at a CAGR of more than 95% during April 2018 to March 2020. The portfolio expanded by ~84% in FY2020 to Rs. 3,892 crore as on March 31, 2020 and remained at similar levels as of Sept 2020. FSBFL envisages a 10-15% growth in the current fiscal and a CAGR of ~60% over the period April 2021-March 2023. The ability to secure adequate funds and source good quality assets would be crucial to achieve the envisaged growth. 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). Further, as the company 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 the improvement over the recent past – TN's concentration in the total portfolio reduced to 43% as on September 30, 2020 from 69% as on March 31, 2017. However, the four southern states – TN, Karnataka, AP and Telangana continue to account for about 96% (100% as on March 31, 2018) of the overall portfolio. The company ventured into UP and Chhattisgarh in the current fiscal and is scaling up its operations in Maharashtra and MP (ventured into in FY2019; currently accounting for 4%). 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: Adequate

FSBFL's liquidity profile remains adequate with free cash and liquid investments of ~Rs. 860.3 crore as on November 30, 2020 against debt obligations of ~Rs. 667.4 crore during December to May 2021. ICRA notes that the collections were impacted due to the pandemic though the same improved to ~99% as of September 2020 (~96% as of October 2020) from ~89% in July 2020 (51% in April 2020). The company did not avail a moratorium from any of its lenders and raised close to Rs. 1,200 crore during April-November 2020 in the form of various instruments like term loans, securitisation and NCD.

FSBFL's borrowing profile includes debentures (49% of the total borrowings as of September 30, 2020), term loans from banks (27%), loans from non-banking financial companies/financial institutions (NBFCs/Fis; 7%) and securitisation (17%). Going forward, it would be crucial for the company to secure adequate long-term funds at competitive rates, to achieve the envisaged business growth, while maintaining a comfortable liquidity profile.

Rating sensitivities

Positive triggers – ICRA could revise the outlook to positive or upgrade the ratings if the company is able to sustain a good quality portfolio growth and geographical diversification while maintaining a healthy financial performance over the near to medium term.

[2] *Total collections excluding prepayments/monthly demand (not adjusted for moratorium)*
[3] *FSBFL's wholly-owned housing finance subsidiary was amalgamated into this company w.e.f. April 01, 2019*

Negative triggers – Pressure on the ratings could arise in case of a deterioration in the company's asset quality indicators (90+dpd of more than 4%), resulting in the return on managed assets (RoMA) falling below 4.0% on a sustained basis, or any sizeable weakening in its liquidity profile.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA's Credit Rating Methodology for Non-Banking Finance Companies
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 NBFC catering to small businesses and retail customers in the urban and 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 micro, small and medium business loans. As of September 30, 2020, secured business loans and mortgage loans to micro and small enterprise customers comprised 73% and 21% of the total portfolio followed by small-ticket housing loans (6%). These loans are predominantly backed by self-occupied residential properties and the company operated with 266 branches as of September 30, 2020.

The five institutional investors (Matrix Partners, Morgan Stanley, TPG Asia, Norwest Venture Partners and Sequoia Capital) held a stake of 68.5% in the company as of June 30, 2020, with the promoter, Mr. Lakshmipathy, holding 21.7% (fully diluted). FSBFL's wholly-owned housing finance subsidiary was amalgamated into the parent company with effective date April 1, 2019.

Key financial indicators (Ind-AS)

	FY2019 (Audited)	FY2020 (Audited)	H1 FY2021 (Provisional)
Total Income	408.9	787.3	504.5
Profit after Tax	156.7	261.9	189.1
Net Worth	1,365.1	1,944.6	2,134.3
Total Managed Portfolio ^	2,095.9	3,830.8	3863.6
Total Managed Assets	2,349.8	4,353.2	5,257.4
Return on Managed Assets	8.9%	7.8%	7.9%
Return on Net Worth	16.0%	15.8%	18.5%
Gearing	0.7	1.2	1.4
Gross NPA (%)	0.9%	1.4%	1.3%
Net NPA (%)	0.7%	1.1%	1.0%
Net NPA / Net Worth	1.0%	2.3%	2.0%
CRAR (%)	64.8%	52.9%	58.4%

Amount in Rs. crore; ^ Net of loan provisions/ECL

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

				Current Rating (FY2021)				Rating History for the Past 3 Years					
S.No	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	FY2021			FY2020	FY2019		FY2018		
					Dec-15-2020	Sep-25-2020	Sep-07-2020	Mar-16-2020	Apr-01-2019	Oct-24-2018	Feb-05-2018	Jul-17-2017	Apr-12-2017
1	Market linked debentures	Long term	40.00	40.00	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)	-	-	-	-	-	-
3	Bank loans	Long Term	909.96	909.96	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	-	-	-	-	-	-
4	Bank Loans	Long Term	290.04	290.04	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A- (Stable)	[ICRA] BBB+ (Stable)	[ICRA] BBB+ (Stable)
5	NCD	Long Term	1,249.00	1,249.00	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A- (Stable)	[ICRA] BBB+ (Stable)	[ICRA] BBB+ (Stable)

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the 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
INE128S07267	NCD	28-Feb-17	11.25%	26-Feb-21	24.00	[ICRA]A(Stable)
INE128S07309	NCD	12-Apr-17	11.50%	30-Mar-23	25.00	[ICRA]A(Stable)
INE128S07358	NCD	29-Mar-19	12.64%	29-Mar-22	55.00	[ICRA]A(Stable)
INE128S07366	NCD	11-Apr-19	11.40%	11-Apr-24	30.00	[ICRA]A(Stable)
INE128S07374	NCD	16-Apr-19	12.64%	16-Apr-22	180.00	[ICRA]A(Stable)
INE128S07390	NCD	28-May-19	12.64%	28-May-22	180.00	[ICRA]A(Stable)
INE128S07408	NCD	28-Jun-19	12.64%	28-Jun-22	185.00	[ICRA]A(Stable)
INE128S07424	NCD	13-May-20	12.75%	13-May-26	15.00	[ICRA]A(Stable)
INE128S07432	NCD	28-May-20	10.50%	26-May-23	15.00	[ICRA]A(Stable)
INE128S07440	NCD	12-Jun-20	11.00%	12-Jun-23	25.00	[ICRA]A(Stable)
INE128S07457	NCD	24-Jun-20	11.00%	21-Apr-23	115.00	[ICRA]A(Stable)
INE128S07465	NCD	03-Jul-20	9.75%	03-Jan-22	50.00	[ICRA]A(Stable)
INE128S07473	NCD	31-Jul-20	9.75%	31-Jan-22	50.00	[ICRA]A(Stable)
INE128S07473	NCD	11-Aug-20	9.50%	31-Jan-22	50.00	[ICRA]A(Stable)
INE128S07481	NCD	20-Aug-20	9.50%	20-Feb-22	50.00	[ICRA]A(Stable)
INE128S07507	NCD	30-Sep-20	NA	30-Sep-29	70.00	[ICRA]A(Stable)
Unallocated	NCD	-	-	-	130.00	[ICRA]A(Stable)
INE128S07499	NCD	03-Sep-20	10.60%	22-Feb-23	25.00	PP-MLD[ICRA]A(Stable)
Unallocated	NCD	NA	NA	NA	40.00	PP-MLD[ICRA]A(Stable)
NA	Term loan - 1	Mar-16 to June-20	NA	Nov-20 to May-25	1.88	[ICRA]A(Stable)
NA	Term loan - 2		NA		4.31	[ICRA]A(Stable)
NA	Term loan - 3		NA		12.58	[ICRA]A(Stable)
NA	Term loan - 4		NA		0.90	[ICRA]A(Stable)
NA	Term loan - 5		NA		2.22	[ICRA]A(Stable)
NA	Term loan - 6		NA		0.86	[ICRA]A(Stable)
NA	Term loan - 7		NA		4.71	[ICRA]A(Stable)
NA	Term loan - 8		NA		22.50	[ICRA]A(Stable)
NA	Term loan - 9		NA		29.41	[ICRA]A(Stable)
NA	Term loan - 10		NA		3.72	[ICRA]A(Stable)
NA	Term loan - 11		NA		4.18	[ICRA]A(Stable)
NA	Term loan - 12		NA		3.08	[ICRA]A(Stable)
NA	Term loan - 13		NA		5.00	[ICRA]A(Stable)
NA	Term loan - 14		NA		6.94	[ICRA]A(Stable)
NA	Term loan - 15		NA		13.20	[ICRA]A(Stable)
NA	Term loan - 16		NA		27.87	[ICRA]A(Stable)
NA	Term loan - 17		NA		18.33	[ICRA]A(Stable)
NA	Term loan - 18		NA		37.50	[ICRA]A(Stable)
NA	Term loan - 19		NA		27.50	[ICRA]A(Stable)
NA	Term loan - 20		NA		19.17	[ICRA]A(Stable)
NA	Term loan - 21		NA		8.24	[ICRA]A(Stable)
NA	Term loan - 22		NA		11.25	[ICRA]A(Stable)
NA	Term loan - 23		NA		19.70	[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 - 24		NA		14.44	[ICRA]A(Stable)
NA	Term loan - 25		NA		183.11	[ICRA]A(Stable)
NA	Term loan - 26		NA		27.00	[ICRA]A(Stable)
NA	Term loan - 27		NA		26.67	[ICRA]A(Stable)
NA	Term loan - 28		NA		18.67	[ICRA]A(Stable)
NA	Term loan - 29		NA		17.42	[ICRA]A(Stable)
NA	Term loan - 30		NA		50.00	[ICRA]A(Stable)
NA	Term loan - 31		NA		37.78	[ICRA]A(Stable)
NA	Term loan - 32		NA		38.00	[ICRA]A(Stable)
NA	Term loan - 33		NA		100.00	[ICRA]A(Stable)
NA	Term loan - 34		NA		6.83	[ICRA]A(Stable)
NA	Term loan - 35		NA		40.00	[ICRA]A(Stable)
NA	Term loan - 36		NA		50.00	[ICRA]A(Stable)
NA	Term loan - 37		NA		15.00	[ICRA]A(Stable)
NA	Unallocated		NA		290.04	[ICRA]A(Stable)

Source: FSBFL; Amount in Rs. crore

Annexure-2: List of entities considered for consolidated analysis: NA

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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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