

March 16, 2020

Five-Star Business Finance Limited: [ICRA]A(Stable) assigned to fresh NCD programme; existing rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible Debenture Programme	0.00	500.00	[ICRA]A(Stable); assigned
Non-convertible Debenture Programme	679.00	679.00	[ICRA]A(Stable); reaffirmed
Long-term Fund-based Bank Facilities	100.00	100.00	[ICRA]A(Stable); reaffirmed
Total	779.00	1,279.00	

*Instrument details are provided in Annexure-1

Rationale

The assigned rating considers Five-Star Business Finance Limited's (FSBFL) experienced senior management team, adequate internal controls and its good profitability indicators, aided by the high yield on advances and low leverage. ICRA notes that the net profitability (PAT/AMA) would moderate from the current levels (8.1% in 9M FY2020; provisional) as the leverage increases and the portfolio seasons. However, it is expected to remain at healthy levels of 5-6% over the near to medium term if the credit losses are kept under control. The rating also factors in the company's comfortable capitalisation profile (provisional gearing and CRAR of 1.1 times and 57.0%, respectively, as of December 31, 2019), which is expected to support its envisaged portfolio growth (compound annual growth rate (CAGR) of 50-60%) till FY2023 while keeping its gearing at about 3 times.

The rating, however, considers FSBFL's moderate scale of operations, concentration of its portfolio in the southern states and the risk associated with the target customer segments, which is reflected in the higher overdues in the softer buckets (30+ dpd stood at 10.2% as on December 31, 2019). The risks are partly mitigated by the company's prudent lending norms and the backing of the loan portfolio primarily by self-occupied residential properties. ICRA also takes note of the company's measures to geographically diversify by expanding its non-Tamil Nadu (TN) portfolio. FSBFL ventured into Uttar Pradesh (UP) and Chhattisgarh in the current fiscal and is gradually scaling up its operations in Maharashtra and Madhya Pradesh (MP) where it ventured into in Q4 FY2018. Considering the steep business growth plan including network expansion in new geographies, it would be critical for the company to improve its funding diversity, contain its operating expenses and keep the asset quality indicators under control, going forward.

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), there are four independent directors, five representatives of the private equity 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, which it has 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 resource and risk management, are headed by personnel with adequate experience in these fields.

Adequate internal controls and risk management systems, considering target borrower segment – The company has prudent underwriting policies with the loan-to-value (LTV) and FOIR¹ capped at about 50%. As on December 31, 2019, 66% and 52% of the portfolio had LTV and FOIR of less than 40%, respectively. The loans are largely for a ticket size of less than Rs. 10 lakh with 83% being below Rs. 5 lakh as on December 31, 2019. Considering the target segment, the tenors are relatively longer with 72% of the loans having a tenor of 6-7 years, which is expected to keep the instalment at manageable levels for the borrowers. However, FSBFL would be exposed to the tenor risk and it would be crucial to augment its post-disbursement control and monitoring of loans going forward. The company has set up a dedicated collections team at the branch level, which would take care of collections after 24 months of loan disbursement as 65% of the collections still happen in cash.

The loan sanction 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, residence, personal discussion for income/expense estimation, secondary enquiries about the borrower/borrower's business, etc. Independent reports from both these teams along with the legal opinion on the property (performed by some 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 package for its loan management system. The 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 audits FSBFL on financial, regulatory and risk-related compliances.

Comfortable capital structure – FSBFL's gearing was comfortable at 1.1 times as on December 31, 2019. The equity infusion of Rs. 315 crore in H1 FY2020 by TPG Asia VII SF Pte. Ltd. (TPG) further improved the capital profile. This, along with good internal generation, improved the net worth to Rs. 1,872 crore as on December 31, 2019 from Rs. 1,365 crore as on March 31, 2019. Following the equity infusion, the shareholding of the promoter stood at 21.8%, on a fully diluted basis, with the private equity investors holding a combined 68.6% as on December 31, 2019. ICRA takes note of the steep growth plans of the company over the next few years. However, the capital profile is expected to remain under control with a managed gearing of around 3 times over the next 2-3 years.

Good profitability indicators – On a consolidated basis, FSBFL's profitability (PAT/AMA) stood at 8.9% and 8.1% (provisional) in FY2019 and 9M FY2020, respectively. The profitability is supported by healthy business yields, low leverage and controlled credit costs. With an improvement in the scale of operations, the operating expense ratio improved to 4.9% in 9M FY2020 from 6.1% in FY2018, while the credit cost (includes loan provision) was in the range of 0.4-1.0% during this period. ICRA expects FSBFL's incremental net profitability to be in the range of 5-6% over the medium term. Going forward, the ability to keep the credit costs under control as the portfolio seasons further and maintain good operating efficiencies, considering the steep portfolio expansion plan, 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. Further, around 25-30% of the active borrowers, as on December 31, 2019, were new to the formal credit system. Considering the borrowers' business and income profiles, their credit profiles are 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

¹ FOIR – Fixed obligation to income ratio

documents. The above is reflected in the high softer bucket delinquencies with the 30+dpd at 10.2% as on December 31, 2019, notwithstanding an improvement in the recent past (12.5% as on December 31, 2018). The 90+dpd (1-year lagged) stood at 1.4% as on December 31, 2019 compared to 2.9% as on December 31, 2018. The write-offs (as a percentage of the opening portfolio) stood at 0.2% in FY2019 and 0.0% in 9M FY2020. ICRA notes the high portfolio growth, which exposes the company to higher credit risk. However, these risks are mitigated to an extent by the company's prudent underwriting norms.

Moderate scale and steep envisaged portfolio growth; low portfolio seasoning – FSBFL's standalone portfolio expanded at a CAGR of 89% during April 2017 to March 2019 and by ~86% in 9M FY2020 to Rs. 3,263 crore as on December 31, 2019. Notwithstanding the moderate scale at present, FSBFL's portfolio growth is envisaged at a CAGR of 50-60% till FY2023 while keeping its gearing at about 3 times. The steep growth in the past has resulted 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 improvement in recent past – TN's concentration in the total portfolio reduced to 44% as on December 31, 2019 from 69% as on March 31, 2017. However, the four southern states – TN, Karnataka, Andhra Pradesh (AP) and Telangana – continue to account for about 97% (100% as on March 31, 2017) 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 in Q4 FY2018; currently accounts for 3%). 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 cash and liquid investments of ~Rs. 600 crore as on December 31, 2019 and as on March 5, 2019. The company's asset liability maturity (ALM) profile, as of December 31, 2019, reflects no negative cumulative mismatches in any of the <1-year buckets. As of December 31, 2019, the company had free cash and liquid investments of about Rs. 600 crore, which, along with the principal inflows from loan collection (about Rs. 467 crore for the period) would be more than sufficient to meet the repayment obligations of about Rs. 429 crore over the next 12 months (January-December 2020).

FSBFL's borrowing profile includes loans from banks (36% of the total borrowings as of December 31, 2019), NCDs (56%) and financial institutions (6%). It also had borrowings of Rs. 165 crore through securitisation as on December 31, 2019. Going forward, it would be crucial for the company to diversify its funding profile and secure long-term funding at competitive rates to achieve the envisaged business growth.

Rating sensitivities

Positive triggers – ICRA could revise the outlook to Positive or upgrade the rating 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.

Negative triggers – Pressure on the rating could arise in case of a deterioration in the asset quality indicators (90+dpd of more than 4%), resulting in 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 rating is based on the consolidated financial statements of FSBFL and its subsidiary – Five-Star Housing Finance Private Limited

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 December 31, 2019, secured business loans backed predominantly by self-occupied residential properties constituted 75% of the total portfolio, followed by mortgage loans to micro and small enterprise customers (20%) and small ticket housing loans (5%). As of December 2019, the company had 237 branches.

The five institutional investors (Matrix Partners, Morgan Stanley, TPG Asia, Norwest Venture Partners and Sequoia Capital) held a stake of 68.6% in the company as of December 31, 2019, with the promoter, Mr. Lakshmi pathy, and his relatives holding 21.8% (fully diluted). The company has a wholly-owned housing finance subsidiary, Five-Star Housing Finance Private Limited, with minimal assets under management (AUM) of Rs. 34 crore and gross NPA of Rs. 60 lakh as on December 31, 2019.

Key financial indicators (consolidated; audited)

	FY2018 (Ind-AS)	FY2019 (Ind-AS)	9M FY2020 (Ind-AS; unaudited)
Total Income	200.7	408.9	544.9
Profit after Tax	53.5	156.7	191.0
Net Worth	591.9	1,365.1	1,871.9
Total Managed Portfolio ^	996.2	2,095.9	3,227.9
Total Managed Assets	1,151.1	2,349.8	3,914.0
Return on Managed Assets	5.8%	8.9%	8.1%
Return on Net Worth	13.1%	16.0%	15.7%
Gearing	0.9	0.7	1.1
Gross NPA (%)	1.5%	0.9%	0.7%
Net NPA (%)	1.0%	0.7%	0.6%
Net NPA / Net Worth	1.6%	1.0%	1.0%
CRAR (%)	59.1%	64.8%	57.0%

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

Instrument	Type	Current Rating (FY2020)		Chronology of Rating History for the Past 3 Years								
		Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	FY2020	FY2019			FY2018			FY2017	
				16 March 2020	01 Apr 2019	24 Oct 2018	05 Feb 2018	17 Jul 2017	12 Apr 2017	06 Mar 2017	03 Oct 2016	
1	NCD	Long Term	500.00	-	[ICRA]A (Stable)	-	-	-	-	-	-	-
2	NCD	Long Term	630.00	630.00	[ICRA]A (Stable)	[ICRA]A (Stable)	-	-	-	-	-	-
3	Bank Loans	Long Term	100.00	100.00	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A- (Stable)	[ICRA] BBB+ (Stable)	[ICRA] BBB+ (Stable)	[ICRA] BBB+ (Stable)	[ICRA] BBB+ (Stable)
4	NCD	Long Term	24.00	24.00	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A- (Stable)	[ICRA] BBB+ (Stable)	[ICRA] BBB+ (Stable)	[ICRA] BBB+ (Stable)	-
5	NCD	Long Term	25.00	25.00	[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)
NA	NCD [#]	-	-	-	500.00	[ICRA]A(Stable)
NA	Bank Limits [^]	-	-	-	100.00	[ICRA]A(Stable)

Source: FSBFL; [#]Unallocated #-not yet placed

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Five-Star Housing Finance Private Limited	100.00%	Full consolidation

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