

**FIVE-STAR BUSINESS FINANCE LIMITED**
**November 04, 2022**

**SMC Ranking**  
★ ★ ★ ★ ★ (1.5/5)

**Issue Highlights**

Industry	NBFC-ND-SI
Offer for sale (Shares)	41,350,316
<b>Net Offer to the Public</b>	<b>41,350,316</b>
Issue Size (Rs. Cr.)	1860-1960
Price Band (Rs.)	450-474
Offer Date	9-Nov-22
Close Date	11-Nov-22
Face Value	1
Lot Size	31

Issue Composition	In shares
Total Issue for Sale	41,350,316
QIB	20,675,158
NIB	6,202,547
Retail	14,472,611

Shareholding Pattern (%)	Pre-issue	Post-issue
Promoters & promoters group	40.07%	33.57%
QIB	58.32%	57.73%
NIB	1.61%	3.74%
Retail	0.00%	4.97%
<b>Total</b>	<b>100.00%</b>	<b>100.00%</b>

\*calculated on the upper price band

**Objects of the Issue**

- (i) To carry out the Offer for Sale
- (ii) To achieve the benefits of listing the Equity Shares on the Stock Exchanges

**About the company**

Incorporated in 1984, Five Star Business Finance Limited is an NBFC-ND-SI (Non-Banking Finance Company) providing secured business loans to micro-entrepreneurs and self-employed individuals. It has an extensive network of 311 branches, as of June 30, 2022, spread across eight states and one union territory and approximately 150 districts across India, with Tamil Nadu, Andhra Pradesh, Telangana and Karnataka being the key states. Five Star Business Finance Limited has created a business model based on identifying an appropriate risk framework and the ideal instalment-to-income ratio to make sure that customers have the resources to repay the loan after meeting their regular obligations and other event-based capital requirements. It is headquartered in Chennai, Tamil Nadu with a strong presence in south India. As of September 30, 2021, it had a total of 4,306 employees. It has provided loans to more than 185,000 customers in total. It had an active loan base of 230,175 and 217,745 as of June 30, 2022, and March 31, 2022, respectively. With more than 3000 Crore in AUM, the company has the fastest AUM growth among the compared peers. As of June 30, 2022, and March 31, 2022, the Total Borrowings were Rs 2520. Crore and Rs 2559 Crore, respectively.

**Strength**

**Fastest Gross Term Loans growth among its compared peers:** The company is the fastest Gross Term Loans growth among its compared peers with more than Rs.3000 Crore in Gross Term Loans, with strong return and growth metrics and a significant potential addressable market.

**Strong “on-ground” collections infrastructure leading to its ability to maintain a robust asset quality:** While its underwriting model contributes to suitable customers being onboarded, it has also created a strong “on-ground” collections infrastructure to ensure that it maintains a high asset quality. Many of its customers have previously borrowed from moneylenders or other such unorganized lenders, and although it has observed minor delays in the servicing of regular monthly installments, which it views as a typical part of the repayment culture, such delays don’t necessarily translate into loan defaults. A key mechanism it uses to prevent defaults in such circumstances is maintaining a strong collections infrastructure designed to keep the credit and repayment discipline of the borrower intact. The company has a strong monitoring mechanism that ensures involvement and intervention from various individuals across its business, all of which also ensures a robust asset quality.

**Ability to successfully expand to new underpenetrated geographies through a calibrated expansion strategy:** Since starting as a Chennai based NBFC, it has demonstrated its ability to grow beyond its local market. Its first growth phase was between Financial Year 2010 and Financial Year 2015 where it increased from six branches in Chennai to 39 branches across Tamil Nadu. Between Financial Year 2015 and Financial Year 2018, it started to expand in the states of Andhra Pradesh, Telangana and Karnataka, growing from three branches to 72 branches during this period. Since then, it has further expanded to 165 branches across Andhra Pradesh, Telangana and Karnataka, as of June 30, 2022. Recently, it has expanded into Madhya Pradesh, Chhattisgarh, Maharashtra and

**Book Running Lead Manager**

- ICICI Securities Limited
- Edelweiss Financial Services
- Kotak Mahindra Capital Company
- Nomura Financial Advisory and Securities (India) Private Limited

**Name of the registrar**

- KFin Technologies Limited

Uttar Pradesh. Collectively, these four states accounted for 5.48% of its total Gross Term Loans with 46 branches, as of June 30, 2022.

**100% in-house sourcing, comprehensive credit assessment and robust risk management and collections framework, leading to good asset quality:** Its 100% in-house sourcing, comprehensive credit assessment and robust risk management and collections framework allows it to identify, monitor and manage risks inherent in its operations. As of June 30, 2022, an estimated 95% of the loans that it disbursed were for single-unit, SORPs, that is, it has a high SORP focus. It also aims to have conservative average loan-to-value ratios and installment to income ratios on its outstanding loan accounts, which can mitigate adverse events and cyclical effects. Over the last three Financial Years and the three months ended June 30, 2022, the company has provided loans to more than 205,000 customers.

**Access to diversified and cost-effective long-term financing with a conservative approach to asset liability and liquidity management:** The company has secured financing from diversified sources of capital, including term loans; proceeds from loans securitized; proceeds from the issuance of NCDs; issuances of principal protected market linked debentures; and proceeds from loans assigned; from banks, financial institutions, mutual funds and other domestic and foreign financial and development finance institutions to meet its capital requirements. Its Average Cost of Borrowings on its Average Total Borrowings was 10.53% as of June 30, 2022, 10.68% as of June 30, 2021, 10.51% as of March 31, 2022, 11.48% as of March 31, 2021 and 12.07% as of March 31, 2020. It generally maintains its cash and cash equivalents, investments in government securities and liquid money market mutual funds to at least the gross of (i) next three months of scheduled debt repayments, (ii) next three months of operational costs and (iii) next one month of projected disbursements. As of June 30, 2022 and March 31, 2022, it had cash and bank balances and investment (comprising cash and cash equivalents, other bank balances and investment in mutual funds and government securities (excluding fixed deposits provided as credit enhancement for securitization transactions)) of Rs. 829.50 Crore and Rs. 1055.30 Crore, respectively.

## Strategy

**Increase penetration:** It tends to increase penetration in existing markets through increasing branch staff numbers, increasing its branch network in the existing geographies and diversifying to contiguous markets. It is constantly evaluating additional locations using its criteria and expects to continue to add branches to grow out network in the near term. As of June 30, 2022, it has reached an approximate district level penetration of 93%, 77% and 94% in the states of Tamil Nadu, Andhra Pradesh, Telangana, respectively, and 65%, 63%, 8%, 11% and 1% in the states of Karnataka, Madhya Pradesh, Maharashtra, Chhattisgarh and Uttar Pradesh, respectively.

**Continue to focus on small business owners and self-employed individuals:** It has plans to continue to focus on small business owners and self-employed individuals and increase its market share. For instance in terms of credit availability generally, the CRISIL Report notes that there is a wide variation across states and within various districts in the same state, which indicates latent opportunity for providing banking services to unserved or underserved customers. In many locations, it has customers who are first time borrowers from the formal secured lending ecosystem. As of June 30, 2022, 30.42% of its customers were new to credit, while the remaining customers the bank were sanctioned higher ticket loans with higher tenors than they had availed earlier.

**Optimize its borrowing costs, reduce operating expenses further and continue to expand and diversify its lender base:** Its Average Cost of Borrowings was 10.53% as of June 30, 2022, 10.51% as of March 31, 2022, 11.48% as of March 31, 2021 and 12.07% as of March 31, 2020. This steady decline over the last three financial years is due to several factors, primarily its financial performance

and improving credit ratings. A lower Average Cost of Borrowing enables it to competitively price its loan products and helps it to grow its business and operations and increase its NIMs. It has also diversified its funding sources by using instruments such securitization transactions, non-convertible debentures, and principal protected market linked debentures to ensure that its debt capital requirements are met at optimal costs. Its developed distribution and collections infrastructure is a key factor in its operating leverage and will help reduce its operating expenses.

**Continue to invest in Technology and Data Analytics to build a scalable and efficient operating model / to improve customer experience, increase productivity and decrease costs:** It has made strategic investments in its information technology systems and implemented automated, digitized technology enabled platforms and proprietary tools, to strengthen its offerings and derive greater operational, cost and management efficiencies. From April 1, 2019 through to June 30, 2022, it has invested Rs 24.50 Crore on in its information technology systems, and as of June 30, 2022, its IT and data science teams comprised of 25 personnel.

**Focus on Enhancing its Risk Management Framework:** As the company has increased the scale of its operations and expanded into new geographies, it has intended to continue focusing on enhancing its risk management framework to maintain the credit quality of its loan portfolio. Its risk management initiatives will include obtaining a better understanding of the geographies in which the bank is present and the ones where it has intended to expand to, improving the credit scoring models and algorithms that it has currently deployed, improving its collection techniques and its property underwriting procedures, as well as initiate portfolio analytics activities.

**Enhance its Brand Recall to Attract New Customers:** It has believed that having a strong recognizable brand is a key attribute in its business, which will help it attract and retain customers, increases customer confidence and influences purchase decisions. Having a strong and recognizable brand will also assist the company in recruiting and retaining employees. It has intended to continue to undertake initiatives to increase the strength and recall of its 'Five-Star' brand to attract new customers. It has seek to build its brand by engaging with existing and potential customers' through customer literacy programs, sponsor popular events in the regions, the company has operated and advertised in newspapers, hoardings and in other advertising media.

### Risk factor

- The company requires substantial capital for its business.
- It has had negative cashflows and incurred losses in the past and can continue to incur in future.
- A substantial portion of its customers are first time borrowers which increases risks of non-payment or default for it.
- Its operations are primarily focused in the states of Tamil Nadu, Andhra Pradesh, Telangana and Karnataka.

### Peer comparison

Valuation									
Co_Name	Net Total Income	PAT	EPS	P/E	P/BV	BV	FV	Price	Mcap
AU Small Finance	7969.50	1258.59	18.89	32.54	4.06	151.23	10	614.60	40951.79
Aptus Value Hou.	902.65	415.45	8.34	38.90	5.55	58.47	2	324.40	16154.88
AAVAS Financiers	1456.31	399.92	50.61	36.90	4.87	383.27	10	1867.35	14757.00
Fusion Micro Finance Limited	955.57	453.55	15.57	30.45	3.72	127.34	1	474.00	13810.75



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Considering the P/E valuation, on the upper end of the price band of Rs.368, the stock is priced at pre issue P/E of 142.64x on FY22 EPS of Rs.2.58. Post issue, the stock is priced at a P/E of 170.22x on its EPS of Rs.2.16. Looking at the P/B ratio at Rs.368, pre issue, book value of Rs. 158.66 of P/Bvx 2.32x. Post issue, book value of Rs.192.58of P/Bvx 1.91.

Considering the P/E valuation, on the lower end of the price band of Rs.350, the stock is priced at pre issue P/E of 135.67 on FY22 EPS of Rs.2.58 .Post issue, the stock is priced at a P/E of 161.90x on its EPS of Rs.2.16. Looking at the P/B ratio at Rs.350, pre issue, book value of Rs. 158.66 of P/Bvx 2.21x. Post issue, book value of Rs.192.58of P/Bvx 1.82.

## Industry Outlook

The National Sample Survey (NSS) 73rd round dated June 2016 estimated that there are around 63.5 million MSMEs in India. Since then, the number of MSMEs is estimated to have increased further to around 70 million as of fiscal 2022. MSMEs complement large corporates as suppliers or directly cater to end users. The MSME sector contributes to India's socio-economic development by providing huge employment opportunities in rural and backward areas, reducing regional imbalances, and assuring equitable distribution of national wealth and income. The segment currently contributes to 30% of the GDP, over 40% of exports and creates employment for about 110 million people in the country, thus supporting economic development and growth. To bring in more enterprises under the ambit of MSMEs and widen the definition of MSMEs taking into account inflation over the past few years, in June 2020, the Government revised the MSME investment limit across each category and introduced an alternate and additional criterion of turnover buckets to the definition. It further removed the difference between the definition of manufacturing based and services based MSMEs. CRISIL Research estimates the total size of MSME lending market across ticket sizes and various player groups (banks, NBFCs, small finance banks, and other formal lenders) to be around Rs21 trillion as of March 2022. This market size includes loans taken by MSMEs across various constitution types (sole proprietorships, partnership firms, private and public limited companies, and co-operatives) and the ticket size spectrum, and includes loans extended in the name of the firm/entity/company as well as the individuals in case of micro enterprises or entrepreneurs. CRISIL Research estimates loans to MSMEs to have grown at a CAGR of 10% during fiscal 2012 to fiscal 2022, which is similar to the nominal GDP growth in this period. This can be attributed to various events during this time span that has impacted MSMEs – demonetisation of high-value currency loans in November 2016, the implementation of GST subsequently, the economic slowdown in fiscal 2020 followed by the Covid-19 pandemic. In fiscal 2022, with recovery in economic activity, MSME lending also grew at a 13% on-year.

## Outlook

Five-Star Business Finance Limited ("Five Star") is an NBFC-ND-SI providing secured business loans to microentrepreneurs and self-employed individuals, each of whom are largely excluded by traditional financing institutions. The small business finance industry in India is highly competitive. It faces competition from other NBFCs as well as scheduled commercial banks. Moreover, the issue is fully OFS and the amount raised will not go to the company.

**An Indicative timetable in respect of the Issue is set out below:**

<b>EVENT</b>	<b>INDICATIVE DATE (On or about)</b>
BID/ISSUE OPENS ON	09-November-22
BID/ISSUE CLOSES ON	11-November-22
Finalisation of Basis of Allotment with the Designated Stock Exchange	16-November-22
Initiation of refunds (if any, for Anchor Investors)/unblocking of funds from ASBA Account	17-November-22
Credit of Equity Shares to demat accounts of Allotees	18-November-22
Commencement of trading of the Equity Shares on the Stock Exchanges	21-November-22

## Annexure

### Consolidated Financials

#### Profit & Loss

Rs. in Cr.

Particulars	Period ended 30-Jun-22 (3 Months)	Period ended 31-Mar-22 (12 Months)	Period ended 31-Mar-21 (12 Months)
Interest Earned	335.22	1203.77	1014.88
Interest Expended	64.80	300.60	325.19
<b>Net Interest Income</b>	<b>270.42</b>	<b>903.17</b>	<b>689.69</b>
Other Income	3.84	52.40	36.38
<b>Net Total Income</b>	<b>274.26</b>	<b>955.57</b>	<b>726.06</b>
Operating Expenses	88.10	351.36	249.62
<b>Operating Profits</b>	<b>186.16</b>	<b>604.21</b>	<b>476.44</b>
Provisions & Contingencies			
<b>Profit Before Tax</b>	<b>186.16</b>	<b>604.21</b>	<b>476.44</b>
Provision for Tax	46.73	150.66	117.45
<b>Net Profit for the year</b>	<b>139.43</b>	<b>453.55</b>	<b>358.99</b>
Add : Profit brought forward			
<b>Profit After Tax</b>	<b>139.43</b>	<b>453.55</b>	<b>358.99</b>

**Balance sheet is on next page**



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### Balance Sheet

Rs. in Cr.

Particulars	As on 30-Jun-22	As on 31-Mar-22	As on 31-Mar-21
<b>Assets</b>			
<b>Financial assets</b>			
Cash and cash equivalents	409.57	613.16	1,267.18
Bank balances other than cash and cash equivalents	303.64	266.78	88.54
Loans	5,454.35	5,102.41	4,358.75
Investments equivalents	189.16	248.18	-
Derivative Financial Instruments	0.41	-	-
Other financial assets	18.70	17.98	4.74
<b>Total Financial Assets</b>	<b>6,375.83</b>	<b>6,248.51</b>	<b>5,719.22</b>
<b>Non-financial assets</b>			
Current tax assets (net)	3.16	2.20	7.96
Deferred tax assets (net)	47.13	46.67	36.99
Investment property	0.04	0.04	0.04
Property, plant and equipment	12.99	12.15	8.46
Right of use asset	20.80	19.78	14.53
Other intangible assets	1.00	0.89	1.90
Other non-financial assets	10.60	12.84	4.53
<b>Total Non-Financial Assets</b>	<b>95.72</b>	<b>94.55</b>	<b>74.40</b>
<b>Total Assets</b>	<b>6,471.55</b>	<b>6,343.07</b>	<b>5,793.61</b>
<b>Liabilities</b>			
<b>Financial liabilities</b>			
Derivative financial instruments	-	1.39	-
Trade payables	10.93	13.00	8.67
Debt securities	947.41	1,008.53	1,303.79
Borrowings (other than debt securities)	1,572.91	1,550.30	2,121.41
Other financial liabilities	53.54	41.47	17.17
<b>Total Financial Liabilities</b>	<b>2,584.79</b>	<b>2,614.69</b>	<b>3,451.04</b>
<b>Non-financial liabilities</b>			
Current tax liabilities (net)	10.94	-	-
Provisions	13.49	9.00	7.20
Other non-financial liabilities	5.34	9.02	17.20
<b>Total Non-Financial Liabilities</b>	<b>29.78</b>	<b>18.02</b>	<b>24.40</b>
<b>Total Liabilities</b>	<b>2,614.57</b>	<b>2,632.72</b>	<b>3,475.44</b>
<b>NET Worth</b>	<b>3,856.98</b>	<b>3,710.35</b>	<b>2,318.17</b>
Net worth represented by:			
Share capital	29.14	29.13	25.65
Other equity	3,827.84	3,681.22	2,292.53
<b>Net Worth</b>	<b>3,856.98</b>	<b>3,710.35</b>	<b>2,318.17</b>



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## RANKING METHODOLOGY

<b>WEAK</b>	★
<b>NEUTRAL</b>	★ ★
<b>FAIR</b>	★ ★ ★
<b>GOOD</b>	★ ★ ★ ★
<b>EXCELLENT</b>	★ ★ ★ ★ ★

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