FIVE-STAR BUSINESS FINANCE

nuvama institutional equities

RESULT UPDATE

KEY DATA

Rating	BUY
Sector relative	Outperformer
Price (INR)	766
12 month price target (INR)	950
52 Week High/Low	877/600
Market cap (INR bn/USD bn)	224/2.7
Free float (%)	42.0
Avg. daily value traded (INR mn)	451.0

SHAREHOLDING PATTERN

	Jun-24	Mar-24	Dec-23
Promoter	26.5%	26.5%	26.5%
FII	57.5%	56.1%	54.3%
DII	6.1%	7.0%	7.8%
Pledge	0%	0%	0%

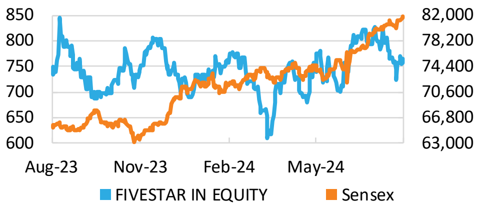
FINANCIALS (INR mn)

Year to March	FY23A	FY24E	FY25E	FY26E
Revenue	12627	17266	22281	28128
PPoP	8249	11713	15251	19513
Adjusted profit	6035	8359	10890	13983
Diluted EPS (INR)	20.7	28.6	37.2	47.8
EPS growth (%)	33.1	38.0	30.3	28.4
RoAE (%)	15.0	17.5	19.2	20.8
P/E (x)	37.0	26.8	20.6	16.0
P/BV (x)	5.1	4.3	3.7	3.1

CHANGE IN ESTIMATES

	Revised estimates		% Revision	
Year to March	FY25E	FY26E	FY25E	FY26E
Revenue	22,281	28,128	0.0%	0.0%
PPOP	15,251	19,513	0.0%	0.0%
Adjusted profit	10,890	13,983	0.0%	0.0%
Diluted EPS (INR)	37.24	47.81	0.0%	0.0%

PRICE PERFORMANCE



Strong earnings in tough quarter

Five-Star posted strong numbers in Q1FY25 yet again with PAT growing 37% YoY/7% QoQ, on an already strong base in Q4FY24. The 30+DPD inched up 22bp QoQ compared with higher deterioration at peers as it took special collection initiatives and also because Five-Star's loans are secured against SORP. Strong AUM growth, stable spread driven by lower CoF, and lower QoQ credit cost were key drivers of growth.

Reiterate 'BUY' given strong growth along with stable asset quality. The company shall pass on 50–75bp of savings on CoF to borrowers starting Q2FY25. We retain TP of INR950/3.6x BV FY26E. Strong movement from unorganised to organised lending and Five-Star's strong collections are key positives.

Robust AUM growth and NIM with stable NPLs; digital collections up

AUM rose strongly by 36% YoY/7% QoQ. Marginal CoF fell QoQ as the company got new borrowings (including INR5bn) from IFC at favourable rates. Marginal CoF declined to 9.5% from 9.6%; average CoF stayed flat at 9.65% while loan yield also stayed stable leading to stable spread QoQ. Five-Star's liquidity buffer was 18% of AUM, 2–3% higher than normalised range as it wants to add bigger lenders and cannot fully time sanctions from them. NII grew 31% YoY/5% QoQ. CI was 30.7% from 32.71% YoY. Credit cost fell 5% QoQ with improving PD and LGD. PAT grew 7% QoQ/37% YoY. Cash collections fell to 35% from 47% with initiatives to improve digital collections. From May-24, it has made it mandatory for borrowers to agree to UPI Autopay at the pre-disbursement stage that shall further improve digital thrust. Five-Star added 27 branches and 31 employees QoQ. A large proportion of new branches are from splitting big branches to control risks and have better supervision. Due to this, AUM and disbursal per branch are distorted, but overall AUM growth remains intact. Proportion of AUM in one–three years has moved up 3% to 40% QoQ. According to the CEO, there is no change in origination tenor and pre-payment rates are stable. It has guided for AUM growth of above 30%, healthy asset quality and some moderation in spreads as incremental lending rates rise by 50–75bp.

Rise in 30+ DPD lower than peers

Due to seasonality, elections and heatwave, 30+DPD rose 22bp QoQ to 8.1% while CE fell 100bp QoQ/YoY to 98.5%. However, the deterioration was much lower than peers mainly due to most of Five-Star's loans being secured by SORP. ECL cover on GS2+GS3 was lower QoQ with better PD, LGD and higher provisions in earlier quarters. GS3 was steady at 1.4% with ECL cover of 52%. Five-Star did not encounter any major asset quality deterioration in its key state of Tamil Nadu unlike other lenders; only, AUM growth in Tamil Nadu was slower than AP/Telangana.

Financials

Year to March	Q1FY25	Q1FY24	% Change	Q4FY24	% Change
Net Revenue	5,112	3,874	32%	4,814	6%
Pre-provisioning Profits	3,547	2,611	36%	3,326	7%
Reported Profits	2,516	1,837	37%	2,361	7%
EPS	8.6	6.3	37%	8.1	7%

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Financial Statements

Income Statement (INR mn)

Year to March	FY23A	FY24E	FY25E	FY26E
Net interest income	12,325	16,481	21,360	27,032
Non interest income	301	785	921	1,095
Fee and forex income	138	219	296	399
Misc. income	81	123	159	207
Investment profits	83	443	466	489
Net revenues	**12,627**	**17,266**	**22,281**	**28,128**
Operating expense	4,378	5,553	7,029	8,615
Employee exp	3,464	4,286	5,229	6,275
Other opex	914	1,267	1,801	2,341
Pre provision profit	**8,249**	**11,713**	**15,251**	**19,513**
Provisions	201	554	692	818
PBT	**8,047**	**11,159**	**14,559**	**18,694**
Taxes	2,012	2,800	3,669	4,711
PAT	**6,035**	**8,359**	**10,890**	**13,983**
Extraordinaries	0	0	0	0
Reported PAT	**6,035**	**8,359**	**10,890**	**13,983**
Diluted EPS (INR)	20.7	28.6	37.2	47.8
DPS (INR)	0	0	5.6	7.2

Important Ratios (%)

Year to March	FY23A	FY24E	FY25E	FY26E
Net interest margins	20.6	19.9	19.1	18.4
Cost-income	34.7	32.2	31.5	30.6
Tax rate	(25.0)	(25.1)	(25.2)	(25.2)

Valuation Metrics

Year to March	FY23A	FY24E	FY25E	FY26E
Diluted PE (x)	37.0	26.8	20.6	16.0
Price/BV (x)	5.1	4.3	3.7	3.1

Source: Company and Nuvama estimates

Balance Sheet (INR mn)

Year to March	FY23A	FY24E	FY25E	FY26E
Equity capital	291	292	292	292
Reserves	43,104	51,669	60,926	72,811
Net worth	43,395	51,962	61,218	73,104
Deposits	0	0	0	0
Borrowings	42,473	63,158	85,895	1,16,818
Other liabilities	1,160	1,768	2,075	2,659
Total	**87,028**	**1,16,888**	**1,49,189**	**1,92,581**
Assets				
Loans	68,222	96,851	1,25,906	1,63,678
Investments	1,446	1,077	2,743	7,943
Cash & equi	15,809	16,717	18,000	18,000
Fixed assets	449	643	804	1,005
Other assets	1,102	1,599	1,735	1,954
Total	**87,028**	**1,16,888**	**1,49,189**	**1,92,581**
BV/share (INR)	148.9	177.7	209.3	250.0

Balance Sheet Ratios (%)

Year to March	FY23A	FY24E	FY25E	FY26E
Credit growth	33.7	42.0	30.0	30.0
Gross NPA ratio	1.4	1.4	1.4	1.4
Net NPA ratio	0.7	0.6	0.8	0.8

ROA Decomposition (%)

Year to March	FY23A	FY24E	FY25E	FY26E
NII/Assets	16.4	16.2	16.1	15.8
Fees/Assets	0.2	0.2	0.2	0.2
Inv profits/Assets	0.1	0.4	0.3	0.3
Net revenues/assets	16.7	16.5	16.4	16.2
Opex/Assets	(5.8)	(5.4)	(5.3)	(5.0)
Provisions/Assets	(0.3)	(0.5)	(0.5)	(0.5)
Taxes/Assets	(2.7)	(2.7)	(2.8)	(2.8)
Total costs/Assets	(8.8)	(8.7)	(8.6)	(8.3)
RoA	8.0	8.2	8.2	8.2
Equity/Assets	53.5	46.8	42.5	39.3
RoAE	15.0	17.5	19.2	20.8

Valuation Drivers

Year to March March	FY23A	FY24E	FY25E	FY26E
EPS growth (%)	33.1	38.0	30.3	28.4
RoAE (%)	15.0	17.5	19.2	20.8

Q1FY25 earnings call: Key takeaways

Guidance

- AUM growth is likely to be above 30% while disbursement growth would come in at 25–27%. Number of loans would grow in the range of 18–20%.
- RoE for FY25 is expected to cross the 19% mark. In Q1FY25, RoE stood at an all-time high of 18.95%.
- Marginal CoF could go up to 9.65% in the coming quarters as the company starts raising funds through capital markets.
- In the next two–three years, the focus would be on bringing leverage close to 3.75x–4x while the debt to equity ratio would be at 2.75x–3x. The increase would lead to RoA at ~7% and RoE above 20% in the next three–four years.
- In FY25, management envisages opening 200 new branches, out of which 80–90 would be new while the rest would be from splitting of existing branches.

Loans and disbursements

- AUM in the quarter crossed a milestone of INR100bn, growing 36% YoY, driven by disbursement growth at 16% YoY.
- Active loans have gone up to 0.41mn, clocking 29% growth indicating growth is driven by an increase in the borrower base rather than an increase in ticket size.
- Ticket size for Five-Star Business Finance has remained stable at INR0.35mn, which could go up to INR0.4mn by end-FY25.
- The repayment rate has been stable at 22–25% in the quarter. Management stated the origination tenure for the company is about six to six-and-a-half years while behavioural tenure stands at four to four-and-a -half years.
- Furthermore, there has been no change in origination tenure in the last few quarters. Yet AUM proportion in one–three years has risen due to the behaviour of paying back loans in 4–4.5 years.
- Top-up loans are ~8–10% of the total loan book. For top-up loans, the whole underwriting process is repeated, and customers need to have two years of seasoning before becoming eligible for a top-up loan.

Borrowings

- Management guided that bank borrowings will fall to 50% of total borrowings in the next two–three years.
- The company has received incremental sanctions to the tune of INR8.5bn out of which management has availed INR8.25bn at an all-inclusive cost of 9.47% in Q1.
- Management is focusing on diversifying the borrowings mix going ahead with more non-banks, capital market transactions, and DFI getting added in the coming quarters.
- Five-Star Business Finance would continue to maintain a conservative stance on liquidity buffer at 15–17% of total AUM.

- In terms of borrowing, ~65% of the book is linked to the floating rate while the rest is linked to fixed rate. The share of the floating rate increased due to the issuance of NCDs. On the floating book, ~70% is linked to MCLR while the rest is linked to EBLR while 75% of EBLR-linked facilities are repo rate linked.
- In terms of rate cuts, 30% of the book would be impacted positively on an immediate basis while the rest would see a positive impact in the course of the next 12 months.

Yields, costs and margins

- NIMs declined 47bp sequentially due to increased debt and leverage.
- CoF in the quarter remained stable sequentially at 9.6%; however, the incremental cost of borrowing declined to 9.47% versus 9.58% in Mar-24.
- Starting Aug-24, Five-Star would pass on the benefit of lower CoF to borrowers by cutting lending rates on incremental loans to the tune of 50–75bp. Hence, the impact on average NIM would be around 20–25bp.
- Cost to income ratio is likely to remain stable at 35–36% for FY25.

Branch expansion

- The company added 27 branches in the quarter. The total branch count now stands at 547. Out of the total branch additions, 14 were opened in Maharashtra, Madhya Pradesh and other central Indian geographies.
- Approach of split branch/cluster approach continues wherein one big branch gets split into two branches due to which officers get transferred from a bigger branch to new smaller branches. Out of the 27 new branches, 50% were a result of the split branch approach.

Asset quality

- In Q1FY25, credit cost stood at 61bp while credit cost for FY25 would be at 70–80bp driven by incremental provisions to the tune of INR90mn and technical write-offs.
- PCR for stage 3 assets stood at 52% while overall PCR stood at 1.3%. As part of regulatory guidelines, management would maintain PCR at above 50% on stage 3 assets.
- On an annual basis, technical write-offs are ~25-30bps while credit loss would be ~15-20bps.

Collections efficiency

- CE was a bit lower at 98.5% versus 99.5% in March 2024 largely due to elections, heat waves, and seasonality while CE for unique customers remained stable. CE in July 2024 has already improved.
- Management stated, C.E. for the company was better compared with peers because of the good strategy put in place and strong on-ground collection infrastructure. The secured nature of lending also helps.
- Digital penetration in terms of collections witnessed a sharp jump towards digital payments. The proportion of non-cash to cash payments stood at 65%: 35%. The aim is to bring the ratio to 70%:30% by the end of FY25.

- Improvement in digital penetration was driven by payments app, tie-up with Razorpay, and DBPS apps like Google Pay. The company also started printing QR codes on passbooks, wherein the customer can scan the QR code and make a very specific payment. Starting May 2024, all the fresh disbursements have a mandatory UPI auto pay sign-up.

Other highlights

- Share of portfolio in Tamil Nadu has declined in the last few years, as states like Andhra and Telangana were growing at a much faster rate. Management stated TN and Karnataka would witness higher growth in the coming quarters.

Exhibit 1: Asset quality indicators

INR Mn	Q1FY25	Q4FY24	Q3FY24	Q2FY24	Q1FY24
Loan Outstanding (Gross)					
Stage 1	95,047	88,802	81,849	75,542	68,491
Stage 2	6,938	6,276	6,208	5,984	6,270
Stage 3	1,454	1,328	1,251	1,118	1,072
Total	**1,03,439**	**96,406**	**89,308**	**82,644**	**75,833**
ECL Provision					
Stage 1	380	350	293	299	278
Stage 2	552	507	476	490	493
Stage 3	757	721	679	561	474
Total	**1,689**	**1,578**	**1,448**	**1,350**	**1,245**
Loan Outstanding (Net)					
Stage 1	94,667	88,452	81,556	75,243	68,214
Stage 2	6,386	5,769	5,732	5,494	5,777
Stage 3	697	607	572	557	598
Total	**1,01,750**	**94,828**	**87,860**	**81,294**	**74,589**
ECL Provision (%)					
Stage 1	0.4%	0.4%	0.4%	0.4%	0.4%
Stage 2	8.0%	8.1%	7.7%	8.2%	7.9%
Stage 3	52.1%	54.3%	54.3%	50.2%	44.2%
Total	**1.6%**	**1.6%**	**1.6%**	**1.6%**	**1.6%**

Source: Company, Nuvama Research

Exhibit 2: Yields, costs and margins movement

%	Q1FY25	Q4FY24	Q3FY24	Q2FY24	Q1FY24
Yield on loans	24.2%	24.2%	24.3%	24.2%	24.4%
Average CoF - cumulative	9.6%	9.6%	9.7%	9.8%	9.8%
Spread	14.6%	14.6%	14.6%	14.5%	14.6%
NIM	16.7%	17.2%	16.8%	17.7%	17.7%

Source: Company, Nuvama Research

Exhibit 3: Borrowing mix

%	Q1FY25	Q4FY24	Q3FY24	Q2FY24	Q1FY24
Bank term loans	62%	65%	66%	69%	66%
NCD	12%	5%	5%	4%	6%
Securitisation	14%	17%	21%	21%	21%
ECB	1%	1%	1%	2%	2%
Other term loans	11%	12%	6%	4%	5%
Total borrowings	**100%**	**100%**	**100%**	**100%**	**100%**

Source: Company, Nuvama Research

Exhibit 4: Income statement summary

INR mn	Q1FY25	Q4FY24	Q1FY24	YoY %	QoQ %
Interest Income	6,411	5,992	4,637	38%	7%
Less: Interest expense	1,582	1,377	962	64%	15%
Net Interest Income	**4,829**	**4,615**	**3,676**	**31%**	**5%**
Fee Income	65	84	54	20%	-23%
Net gain	185	86	112	65%	115%
Non - Interest Income	**251**	**170**	**166**	**51%**	**47%**
Other Income	32	29	32	1%	14%
Total Income	**5,112**	**4,814**	**3,874**	**32%**	**6%**
Employee Expenses	1,228	1,143	987	24%	7%
Depreciation	64	74	48	31%	-14%
Other Expenses	273	271	228	20%	1%
Total Operating expenses	**1,565**	**1,488**	**1,263**	**24%**	**5%**
Operating profit (PPOP)	**3,547**	**3,326**	**2,611**	**36%**	**7%**
Less: Impairment on financial instrument	185	194	152	22%	-5%
Profit before tax	**3,362**	**3,132**	**2,459**	**37%**	**7%**
Less: Current tax	919	838	694	32%	10%
Less: Deferred tax	-73	-66	-72	0%	9%
Total Tax expense	846	771	622	36%	10%
Profit After tax	**2,516**	**2,361**	**1,837**	**37%**	**7%**

Source: Company, Nuvama Research

Company Description

Five-Star extends, secured, small ticket loans, to the unorganised small and medium entrepreneurs who are at the bottom of the pyramid (sub-prime) and do not have access to formal sources of finance. Given that Five-Star's target segment is the bottom of the pyramid with very low-ticket size, it faces less competition. The company describes its own business model as "lending to the unlent". A large portion of Five-Star's loans and branches are in the Southern states.

Investment Theme

Five-Star's market opportunity in lending secured, small ticket loans to the unbanked, small entrepreneurs is huge against its low market share. We believe focussed branch expansion, deep understanding of customer behaviour, strong underwriting and collections are its key strengths that will drive a best-in-class earnings growth. We reiterate BUY with TP of INR 950.

Key Risks

- Limited ability of its low-income, borrowers to absorb economic shocks.
- Risk of increasing competition from banks who may lend at lower yields.
- Lower seasoning of the portfolio.

Additional Data

Management

Chairman & MD	Lakshmipathy Deenadayalan
CEO	Rangarajan Krishnan
COO	Vishnuram Jagannathan
CFO	Srikanth Gopalakrishnan
Auditor	M/s S R Batliboi & Associates LLP

Holdings – Top 10*

	% Holding		% Holding
TPG Asia	9.28	HDFC MF	2.79
Sirius II PTE	6.02	Smallcap World	2.63
Norwest Venture	5.16	Fidelity Funds	2.06
Peak XV Partner	3.77	Atma Ram Builder	1.60
Sequoia Capital	3.47	Saudi central bank	1.11

**Latest public data*

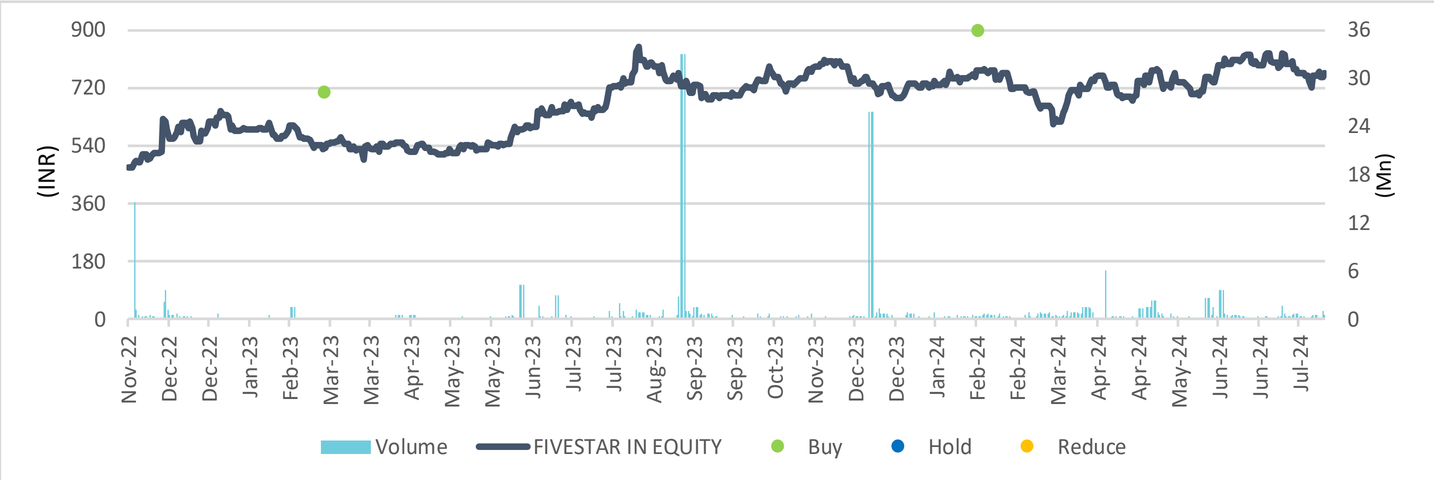
Recent Company Research

Date	Title	Price	Reco
01-May-24	Strength in every parameter; *Result Update*	758	Buy
02-Feb-24	Strong earnings; RoE progressing well; *Result Update*	775	Buy
01-Nov-23	Q2FY24: A strong quarter again; *Result Update*	741	Buy

Recent Sector Research

Date	Name of Co./Sector	Title
26-Jul-24	Banking & Finance	Tighter LCR will call for 4% more deposi; *Sector Update*
01-Jul-24	Banking & Finance	Loan growth holds; deposit growth soft; *Sector Update*
01-Jul-24	Banking & Finance	Sops likely for HFCs in Union Budget; *Sector Update*

Rating and Daily Volume Interpretation



Source: Bloomberg, Nuvama research

Rating Rationale & Distribution: Nuvama Research

Rating	Expected absolute returns over 12 months	Rating Distribution
Buy	15%	216
Hold	<15% and >-5%	61
Reduce	<-5%	26

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