

FIVE-STAR BUSINESS FINANCE

RESULT UPDATE

KEY DATA

Rating	BUY
Sector relative	Outperformer
Price (INR)	877
12 month price target (INR)	1,010
52 Week High/Low	944/600
Market cap (INR bn/USD bn)	257/3.1
Free float (%)	44.0
Avg. daily value traded (INR mn)	1,987.8

SHAREHOLDING PATTERN

	Sep-24	Jun-24	Mar-24
Promoter	21.6%	26.5%	26.5%
FII	56.7%	57.5%	56.1%
DII	9.0%	6.1%	7.0%
Pledge	0.0%	0.0%	0.0%

FINANCIALS

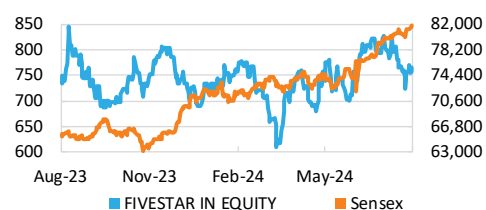
(INR mn)

Year to March	FY23A	FY24E	FY25E	FY26E
Revenue	12627	17266	22366	28273
PPoP	8249	11713	15611	19831
Adjusted profit	6035	8359	11047	14050
Diluted EPS (INR)	20.7	28.6	37.8	48.0
EPS growth (%)	33.1	38.0	32.2	27.2
RoAE (%)	15.0	17.5	19.5	20.9
P/E (x)	42.3	30.7	23.2	18.3
P/BV (x)	5.9	4.9	4.2	3.5

CHANGE IN ESTIMATES

	Revised estimates		% Revision	
Year to March	FY25E	FY26E	FY25E	FY26E
Revenue	22366	28273	0.4	0.5
PPOP	15611	19831	2.4	1.6
Adjusted profit	11047	14050	1.4	0.5
Diluted EPS (INR)	37.8	48.0	1.4	0.5

PRICE PERFORMANCE



Strong earnings and asset quality

Five-Star announced in-line earnings and stable asset quality in Q2FY25. The company has slowed disbursal growth in view of sectoral issues and regulatory nudge. Disbursals grew 4% YoY/fell 5% QoQ. AUM growth stood strong at 32% YoY/6% QoQ. Spread remained stable QoQ with stable CoF. The 30+DPD stood at 8.44% from 8.1% QoQ. CE dipped only marginally by 10bp QoQ to 98.4%.

Reiterate 'BUY' given strong growth and stable asset quality. The company has cut growth guidance to 25% for FY25E from 30% and shall also lower disbursement yield by 200bp next month. Given that lower yield shall take time to flow through total NIM, we expect spread to remain stable. Our new TP is INR1,010/4x BV (earlier TP INR950).

Strong growth and quality in stressed sector

AUM grew strongly by 32% YoY/6% QoQ. In view of rising stress in some segments of the sector and regulatory nudge, the company slowed disbursal growth to 4% YoY, which is a decline of 5% QoQ. Marginal CoF rose 10bp QoQ while average CoF remained stable at 9.65%. Loan yield also remained broadly stable falling 4bp QoQ to 24.18%. As such, portfolio spread remained stable at 14.53%. Five-Star's liquidity buffer stood at INR19.4bn including cash of INR17bn and INR2.4bn of undrawn sanctions. NII grew 30% YoY/7% QoQ. CI stood at 30.2% from 30.7% QoQ. Credit cost rose 17% QoQ from 70bp to 79bp of loans. PAT grew at a strong 7% QoQ/34% YoY. The company added 113 branches QoQ. A large proportion of new branches are from splitting big branches to control risks and have better supervision.

Rise in 30+ DPD lower than peers

The 30+DPD rose 34bp QoQ to 8.44% and CE fell 10bp QoQ/YoY to 98.4%. GS3 loans rose from 1.47% to 1.41%, a small rise. However, the deterioration was much lower than peers mainly because most of Five-Star's loans are secured by SORP. ECL cover on GS2 fell 50bp QoQ while ECL cover on GS3 fell 28bp QoQ but remained healthy at 51.8%. Total 15% of Five-Star's loans, which is 59,000 loans, are overleveraged i.e. the applicant has three or more loans with other financial institutions. Of the loans which are overleveraged, only about 1,600 translating to just 0.4% of the total active loans have exhibited lower collection efficiency in the last six months. The overlap with MFI and gold is 30% while with other segments such as 2W and agri are small.

Reiterate 'BUY'

Despite a cut in growth guidance and lower incremental yield, we believe Five-Star's growth and profitability shall remain superior to peers. When many small lenders are in deep stress, Five-Star's earnings highlight its resilient business model.

Financials

Year to March	Q2FY25	Q2FY24	% Change	Q1FY25	% Change
Net Revenue	5,427	4,165	30%	5,112	6%
Pre-provisioning Profits	3,800	2,775	37%	3,547	7%
Reported Profits	2,679	1,994	34%	2,516	7%
EPS	9.2	6.9	34%	8.6	7%

Financial Statements

Income Statement (INR mn)

Year to March	FY23A	FY24E	FY25E	FY26E
Net interest income	12,325	16,481	21,257	27,047
Non interest income	301	785	1,108	1,226
Fee and forex income	138	219	278	356
Misc. income	81	123	150	170
Investment profits	83	443	680	700
Net revenues	12,627	17,266	22,366	28,273
Operating expense	4,378	5,553	6,754	8,442
Employee exp	3,464	4,286	5,229	6,484
Other opex	914	1,267	1,526	1,959
Preprovision profit	8,249	11,713	15,611	19,831
Provisions	201	554	843	1,048
PBT	8,047	11,159	14,768	18,784
Taxes	2,012	2,800	3,722	4,733
PAT	6,035	8,359	11,047	14,050
Extraordinaries	0	0	0	0
Reported PAT	6,035	8,359	11,047	14,050
Diluted EPS (INR)	20.7	28.6	37.8	48.0

Important Ratios (%)

Year to March	FY23A	FY24E	FY25E	FY26E
Net interest margins	20.6	19.9	19.4	18.9
Cost-income	34.7	32.2	30.2	29.9
Tax rate	(25.0)	(25.1)	(25.2)	(25.2)

Valuation Metrics

Year to March	FY23A	FY24E	FY25E	FY26E
Diluted PE (x)	42.3	30.7	23.2	18.3
Price/BV (x)	5.9	4.9	4.2	3.5

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	61,059	73,002
Net worth	43,395	51,962	61,351	73,294
Borrowings	42,473	63,158	79,580	1,08,228
Other liabilities	1,160	1,768	2,004	2,553
Total	87,028	1,16,888	1,42,936	1,84,075
Assets				
Loans	68,222	96,851	1,23,969	1,61,160
Investments	1,446	1,077	2,427	2,955
Cash & equi	15,809	16,717	14,000	17,000
Fixed assets	449	643	804	1,005
Other assets	1,102	1,599	1,735	1,954
Total	87,028	1,16,888	1,42,936	1,84,075
BV/share (INR)	148.9	177.7	209.8	250.6

Balance Sheet Ratios (%)

Year to March	FY23A	FY24E	FY25E	FY26E
Credit growth	33.7	42.0	28.0	30.0
Gross NPA ratio	1.4	1.4	1.5	1.4
Net NPA ratio	0.7	0.6	0.6	0.6

ROA Decomposition (%)

Year to March	FY23A	FY24E	FY25E	FY26E
NII/Assets	16.4	16.2	16.4	16.5
Fees/Assets	0.2	0.2	0.2	0.2
Inv profits/Assets	0.1	0.4	0.5	0.4
Net revenues/assets	16.7	16.5	16.7	16.9
Opex/Assets	(5.8)	(5.4)	(5.2)	(5.2)
Provisions/Assets	(0.3)	(0.5)	(0.6)	(0.6)
Taxes/Assets	(2.7)	(2.7)	(2.9)	(2.9)
Total costs/Assets	(8.8)	(8.7)	(8.7)	(8.7)
RoA	8.0	8.2	8.5	8.6
Equity/Assets	53.5	46.8	43.6	41.2
RoAE	15.0	17.5	19.5	20.9

Valuation Drivers

Year to March	FY23A	FY24E	FY25E	FY26E
EPS growth (%)	33.1	38.0	32.2	27.2
RoAE (%)	15.0	17.5	19.5	20.9

Q2FY25 conference call: Key takeaways

Guidance

- AUM growth guidance was cut down from 30% to 25% For FY25E considering the current environment and the RBI's commentary. Growth guidance for FY26E would reassessed in the next financial year.
- Cost to income ratio is likely to be maintained at 35% in a steady state scenario.
- Given the cut in growth guidance, RoA is likely to be ~8% for FY25E.
- RoE in Q2FY25 crossed the 19% mark for the first time as it stood at 19.02%.
- Longer term guidance (three–five years) for spreads is 12% while that for RoA is 6% in a steady state scenario.

Drop in lending rates by 200bp

- Management has decided to drop lending interest rate by 200bp to ~22.5% with effect from November 1, 2024. This shall lead to spread compression only on incremental disbursements. Given a high share of fixed loans, the impact on NIM will be gradual.
- The decision has been taken in line with the management's long standing guidance of bringing the spread to 12%-level. Consequent to this cut, the desired spreads level would be achieved in a faster manner.

Bureau scrub on active loans

- Management had reviewed the bureau data on its active loans and found out that, of the total active loans of ~0.43mn, ~13.7% of loans (~58,000) are over-leveraged (3 or more loans with other financial institutions).
- Of these overleverage loans, only ~0.4% (~1,600 loans) are showing signs of lower collection efficiency in last 6 months.
- Furthermore, ~30% total borrowers have an active microfinance loan; however, management said it is not witnessing any deterioration in the asset quality of these borrowers.
- Management believes there could be cases where, post sanction from Five Star, the borrower would have taken another loan from a different lender.
- From the bureau scrub, management found out that the overlap of loans is generally for gold loans, vehicle loans, microfinance, unsecured and agri loans. Overlap is as high as 30% for gold and microfinance each.
- Management believes there is no compression in the borrower's income, but there is over-leverage from the borrowers as can be seen in the bureau data.

Comments on cut in AUM guidance

- Management said that it has consciously slowed down the disbursements growth to moderate the portfolio growth considering the environment and regulator's commentary.
- It emphasised the fact that there was no stress within its portfolio, but it is the external factors because of which the guidance has been cut.
- Slowdown in disbursement would not lead directly to decline in opex because the opex is more skewed towards fixed salaries (65–70% portion)

Borrowings

- In line with earlier stance of management on moving towards non-banks, Five Star has added Kotak MF and Nippon MF for their securitisation transactions.
- The cost of funding would be higher initially, but this is the premium for diversification which management is prepared to bear.
- 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.
- The company has a liquidity buffer of INR17bn and a INR2.5bn of undrawn sanctions from banks and financial institutions.

Costs and margins

- Spreads declined marginally QoQ largely due to increased debt and leverage.
- CoF in the quarter remained stable at 9.65%; however, the incremental borrowing cost was up 5bp QoQ to 9.52% in Q2FY25.

Branch expansion

- The company added 113 branches in the quarter. The total branch count now stands at 660. Out of this, 32 are new branches and 77 are split branches.
- Management would continue with its approach of split branch/cluster approach, wherein one big branch gets split into two branches due to which officers get transferred from a bigger branch to new smaller branches.
- Typically, a branch takes ~seven –nine months to breakeven i.e. to achieve AUM of INR250mn to cover all the branch costs. Furthermore, average employees per branch would be brought down to ~10–11 per branch once the branch stabilises.
- Branch addition in H1 would generally be faster than H2.

Asset quality

- Write-offs for the current quarter were ~INR110mn.
- Collection efficiency declined marginally from 98.5% in Q1FY25 to 98.4% in Q2FY25.

Other highlights

Login to sanction ratio stood at ~75% and sanction to disbursement ratio stood at ~95%.

Exhibit 1: Change in estimates

	FY25E	FY26E	FY25E	FY26E	FY25E	FY26E
	Old		New		% Change	
NII, INR M	21,360	27,032	21,257	27,047	-0.5%	0.1%
PAT, INR M	10,890	13,983	11,047	14,050	1.4%	0.5%
EPS, INR	37.2	47.8	37.8	48.0	1.4%	0.5%
Target price, INR		950		1,010		6.3%

Source: Company, Nuvama Research

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Exhibit 2: Breakdown of stressed assets

INR Mn	Q2FY25	Q1FY25	Q2FY24	YoY %	QoQ %
Bucket					
Current Stage (Stage - 1)	93,974	89,696	71,482	31.5%	4.8%
1-30 (Stage-1)	6,071	5,351	4,060	49.5%	13.5%
31-60 (Stage-2)	4,165	3,815	3,099	34.4%	9.2%
61-90 (Stage-2)	3,458	3,122	2,885	19.9%	10.8%
90+ (Stage-3)	1,604	1,454	1,118	43.5%	10.3%
Total	1,09,272	1,03,438	82,644	32.2%	5.6%
Stage 1 Assets	1,00,045	95,047	75,542	32.4%	5.3%
Stage 2 Assets	7,623	6,938	5,984	27.4%	9.9%
Stage 3 Assets	1,604	1,454	1,118	43.5%	10.3%
Gross Stage 3 %	1.47%	1.41%	1.35%		

Source: Company, Nuvama Research

Exhibit 3: Asset quality indicators

INR Mn	Q2FY25	Q1FY25	Q4FY24	Q3FY24	Q2FY24
Loan Outstanding (Gross)					
Stage 1	1,00,045	95,047	88,802	81,849	75,542
Stage 2	7,623	6,938	6,276	6,208	5,984
Stage 3	1,604	1,454	1,328	1,251	1,118
Total	1,09,272	1,03,439	96,406	89,308	82,644
ECL Provision					
Stage 1	399	380	350	293	299
Stage 2	569	552	507	476	490
Stage 3	831	757	721	679	561
Total	1,799	1,689	1,578	1,448	1,350
Loan Outstanding (Net)					
Stage 1	99,646	94,667	88,452	81,556	75,243
Stage 2	7,054	6,386	5,769	5,732	5,494
Stage 3	773	697	607	572	557
Total	1,07,473	1,01,750	94,828	87,860	81,294
ECL Provision (%)					
Stage 1	0.4%	0.4%	0.4%	0.4%	0.4%
Stage 2	7.5%	8.0%	8.1%	7.7%	8.2%
Stage 3	51.8%	52.1%	54.3%	54.3%	50.2%
Total	1.7%	1.6%	1.6%	1.6%	1.6%

Source: Company, Nuvama Research

Exhibit 4: Movement in yield, cost and margin

%	Q2FY25	Q1FY25	Q4FY24	Q3FY24	Q2FY24
Yield on loans	24.2%	24.2%	24.2%	24.2%	24.2%
Cost of borrowing	9.7%	9.7%	9.6%	9.6%	9.7%
Spread	14.5%	14.6%	14.6%	14.6%	14.5%
NIM	16.9%	16.7%	17.2%	16.8%	17.7%

Source: Company, Nuvama Research

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Exhibit 5: Borrowing mix

%	Q2FY25	Q1FY25	Q4FY24	Q3FY24	Q2FY24
Bank term loans	60%	62%	65%	66%	69%
NCD	12%	12%	5%	5%	4%
Securitisation	18%	14%	17%	21%	21%
ECB	1%	1%	1%	1%	2%
Other term loans	10%	11%	12%	6%	4%
Total borrowings	100%	100%	100%	100%	100%

Source: Company, Nuvama Research

Exhibit 6: Financial snapshot

INR mn	Q2FY25	Q1FY25	Q2FY24	YoY %	QoQ %
Interest Income	6,793	6,411	5,041	35%	6%
Less: Interest expense	1,631	1,582	1,059	54%	3%
Net Interest Income	5,161	4,829	3,982	30%	7%
Fee Income	67	65	41	62%	3%
Net gain	161	185	106	52%	-13%
Non - Interest Income	228	251	147	55%	-9%
Other Income	38	32	35	7%	17%
Total Income	5,427	5,112	4,165	30%	6%
Employee Expenses	1,248	1,228	1,058	18%	2%
Depreciation	67	64	57	17%	5%
Other Expenses	312	273	275	14%	14%
Total Operating expenses	1,627	1,565	1,389	17%	4%
Operating profit (PPOP)	3,800	3,547	2,775	37%	7%
Less: Impairment on financial instrument	218	185	106	106%	17%
Profit before tax	3,582	3,362	2,670	34%	7%
Less: Current tax	987	919	707	40%	7%
Less: Deferred tax	-84	-73	-31	170%	16%
Total Tax expense	903	846	676	34%	7%
Profit After tax	2,679	2,516	1,994	34%	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

Despite cut in growth guidance and lower incremental yield, we believe Five-Star's growth and profitability will remain superior to peers. When many small lenders are in deep stress, Five-Star's earnings highlight its resilient business model. We reiterate 'BUY' given strong growth and stable asset quality. Our new TP is INR1,010/4x BV from INR950 earlier.

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	Lakshmiopathy Deenadayalan
CEO	Rangarajan Krishnan
COO	Vishnuram Jagannathan
CFO	Srikanth Gopalakrishnan

Holdings – Top 10*

	% Holding		% Holding
Sirius II PTE	6.02	Fidelity Funds	2.40
HDFC MF	3.24	Peak XV Partner	1.76
Smallcap World	2.63	Saudi central b	1.63
Nomura India	2.53	Max life	1.50
Norwest Venture	2.41	Govt PF Global	1.40

*Latest public data

Recent Company Research

Date	Title	Price	Reco
01-Aug-24	Strong earnings in tough quarter; <i>Result Update</i>	766	Buy
01-May-24	Strength in every parameter; <i>Result Update</i>	758	Buy
02-Feb-24	Strong earnings; RoE progressing well; <i>Result Update</i>	775	Buy

Recent Sector Research

Date	Name of Co./Sector	Title
19-Sep-24	Banking & Finance	Sensitivity to rise in credit cost; <i>Sector Update</i>
05-Sep-24	Banking & Finance	Revisiting risks of CEO reappointment; <i>Sector Update</i>
28-Aug-24	Banking & Finance	UPS – Negative for state banks; <i>Sector Update</i>

Rating Rationale & Distribution: Nuvama Research

Rating	Expected absolute returns over 12 months	Rating Distribution
Buy	15%	223
Hold	<15% and >-5%	65
Reduce	<-5%	23

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Abneesh Roy

Head of Research Committee

Abneesh.Roy@nuvama.com
