Five Star Business Finance Ltd

ICICI direct Research

Price Band ₹ 450 - 474

NOT RATED

November 8, 2022

Bet on fast growing small business finance market…

About the Company: Five Star Business Finance Ltd (FSBF) provides secured business loans to micro-entrepreneurs and self-employed individuals in urban, semi urban and rural markets.

- As of June 30, 2022, total AUM was at ₹ 5296.5 crore, with strong growth at 49.73% CAGR in FY18-22
- As of June 30, 2022, gross NPA ratio was at 1.12% while net NPA was at 0.68%

Key triggers/Highlights:

- As per Crisil Research estimate MSME credit gap still persist at ~₹ 85 lakh crore as of FY22, while total size of MSME lending market to be at ~₹ 21 lakh crore as of March 2022
- Industry's small business loans grew at a fast pace with portfolio registering a CAGR of 22% over FY18-22. The small business loans portfolio is expected to grow at 16-18% CAGR over FY22-25
- FSBF is headquartered in Chennai with a strong presence in South India and all loans are secured by borrower's property. Total ~95% of loan portfolio comprises loans from ₹ 1 lakh to ₹ 10 lakh in principal amount, with an average ticket size of ₹ 2.9 lakh as of Q1FY23
- FSBF primarily offer small loans for business purposes, which accounted for ₹ 3290.3 crore (62.12% of total loans) as of Q1FY23. Growth was primarily volume led through increasing customer base while keeping the ATS stable
- In FY22, the proportion of NTC customers in small business loans segment is estimated to be ~27% for NBFCs
- Stage 3 assets as percentage of gross loans were at 1.12% in Q1FY23 and 1.05% in FY22. NIMs stood at 19.17% in Q1FY23 and 17.68% in FY22

What should investors do? FSBF is a player with healthy fundamental performance and robust growth in fast growing small business finance market. At the upper end of the price band, the company is valued at ~3.7x FY22 BV (post issue).

- We assign **UNRATED** rating to the IPO

Key risk & concerns

- Geographic concentration could impact operations
- Substantial portion of customers are first time borrowers
- High competitive intensity in small business finance industry
- >60% of collections are in cash which may impact operations

FIVE STAR Business Finance Limited

Particulars

Issue details	
Issue opens	9th November 2022
Issue Closes	11th November 2022
Issue Size	₹1960 crore
OFS	₹1960 crore
Price Band	₹450 - 474
No.of Shares on offer (in cr)	4.13 - 4.35
QIB (%)	50
NIB (%)	15
Retail (%)	35
Min Lot Size	31

Shareholding Pattern (%)

Shareholding pattern	Pre-issue	Post issue
Promoter group	40.07	33.65
Public	59.93	66.35

Objects of issue

Object of the issue
To carry out offer for sale and achieve the benefits of listing the equity shares on the stock exchanges.

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IPO Review

ICICI Securities – Retail Equity Research

Key Financial Summary

₹ crore	FY20	FY21	FY22	CAGR FY20-22
NII	529.9	689.7	903.2	30.6%
PAT	262.0	359.0	453.5	31.6%
EPS	10.1	14.0	16.1	26.4%
BVPS	76.0	90.4	127.4	29.4%
ROA %	7.3	7.0	7.2	
ROE %	15.4	16.9	13.9	
P/E	47.1	33.8	29.5	
P/BV	6.2	5.2	3.7	

Source: RHP, ICICI Direct Research

Company Background

Five Star Business Finance (FSBF) is a NBFC (ND-SI) providing secured business loans to micro-entrepreneurs and self-employed individuals, each of them largely excluded by traditional financing institutions. The company is headquartered in Chennai, Tamil Nadu, with a strong presence in south India. All loans are secured by their borrowers' property, predominantly being self-occupied residential property (SORP). Over 95% of its loan portfolio comprises loans from between ₹ 1 lakh and ₹ 10 lakh in principal amount, with an average ticket size of ₹ 2.9 lakh, ₹ 2.7 lakh, ₹ 2.8 lakh, ₹ 2.6 lakh and ₹ 3.1 lakh in Q1FY23, Q1FY22, FY22, FY21 and FY20, respectively.

During Q1FY23, Q1FY22, FY22, FY21 and FY20, the company provided loans to more than 205,000 customers. They had an active loan base of 230,175 and 217,745 as of June 30, 2022 and March 31, 2022, respectively. Gross term loans have grown to ₹ 5296.5 crore as of Q1FY23 (₹ 5067 crore as of FY22), from ₹ 1008.2 crore as of FY18 at a CAGR of 49.73% in FY18-22.

FSBF primarily offer their customers small loans for business purposes, which accounted for ₹ 3290.3 crore (62.12% of gross term loans), ₹ 2876.9 crore (62.85% of gross term loans), ₹ 3163.4 crore (62.43% of gross term loans), ₹ 2793.4 crore (62.84% of gross term loans) and ₹ 2447.7 crore (62.89% of gross term loans), as of Q1FY23, Q1FY22, FY22, FY21 and FY20 as well as loans for asset creation such as home renovation or improvement, or for meeting expenses for significant economic events such as marriage, healthcare and education, which accounted for ₹ 2006.2 crore (37.88% of gross term loans), ₹ 1700.5 crore (37.15% of gross term loans), ₹ 1903.5 crore (37.57% of gross term loans), ₹ 1651.9 crore (37.16% of gross term loans) and ₹ 1444.4 crore (37.11% of gross term loans), as of the same dates.

FSBF's growth is primarily volume led through increasing its customer base while keeping the ATS (Average Ticket Size) stable. The interest rates on loans depend on the underlying tenor (which ranges from two to seven years), with is ~95% of loans sanctioned being between the interest rate range of 24% and 26% and between the tenure range of five and seven years. Total 100% of its leads for customers are sourced in-house without any use of direct selling agents. Further, all of its loans are fully secured with more than 95% of the collateral being SORP at the time the loan application is approved.

The target customers are mainly –

- in urban and semi-urban locations, as well as in the rural markets.
- who typically derive income from "everyday" cash and carry businesses with a focus on services;
- with household net cash-flows of ~₹ 25,000 to ₹ 40,000 per month;
- who can provide collateral (typically land and building of ~₹ 10 lakh in value; and
- whose family will act as co-applicants on the loan

FSBF had an extensive network of 311 branches, as of Q1FY23 spread across ~ 150 districts, eight states and one union territory, with Tamil Nadu, Andhra Pradesh, Telangana and Karnataka being key states. Such key states collectively accounted for ~85% of its branch network by number, as of Q1FY23. As of June 30, 2022, ~95% of its branches were located in cities and towns with populations up to 10 lakh.

Exhibit 1: Key operating metrics

Key Operational Metrics	FY20	FY21	FY22	Q1FY23
Live Accounts	1,43,079	1,76,467	2,17,745	2,30,175
Branches	252	262	300	311
Number of Loans Disbursed	76,634	48,111	63,633	19,793
Disbursements (₹ in crore)	2,409	1,245	1,756	568
Gross Term Loans(₹ in crore)	3,892	4,445	5,067	5,297
Gross Term Loans Growth (%)	84	14	14	5
Stage 3 Gross Term Loans to Gross Term Loans	1.4	1.0	1.1	1.1
Stage 3 Gross Term Loans (net) to Gross Term Loans	1.1	0.8	0.7	0.7
Total number of employees	3,734	3,938	5,675	6,077
Average Ticket Size	3.1	2.6	2.8	2.9
Average Yield on Gross Term Loans (%)	24.2	24.2	24.1	24.2
Average Cost of Borrowing (%)	12.1	11.5	10.5	10.5
Net Interest Margin (%)	16.7	16.0	17.7	19.2
Operating Expenses to Average Total Assets(%)	4.9	4.2	4.9	5.5
Impairment loss allowance to Average Total Assets	1.4	0.7	0.7	-0.0
Cost to Income Ratio (%)	39.0	34.3	36.9	32.3

Source: RHP, ICICI Direct Research

Exhibit 2: DPD to gross term loans data

Metrics	FY20	FY21	FY22	Q1FY23
30+ DPD to Gross Term Loans (%)	11.8%	12.4%	16.8%	15.7%
60+ DPD to Gross Term Loans (%)	6.7%	6.5%	6.6%	8.0%
Stage 3 Gross Term Loans to Gross Term Loans (%)	1.4%	1.0%	1.1%	1.1%
Impairment loss allowance on Stage 3 Gross Term Loans (₹ crore)	9.4	8.1	18.5	23.2
Stage 3 Gross Term Loans (net) to Gross Term Loans (%)	1.1%	0.8%	0.7%	0.7%
Incremental restructured portfolio (₹ in crore)	0.0	0.0	0.0	0.0
Total restructured portfolio (₹ in crore)	0.0	0.0	73.1	71.2
Total restructured portfolio as a % of Gross Term Loans (%)	0.0%	0.0%	1.4%	1.3%

Source: RHP, ICICI Direct Research

Exhibit 3: Branch network

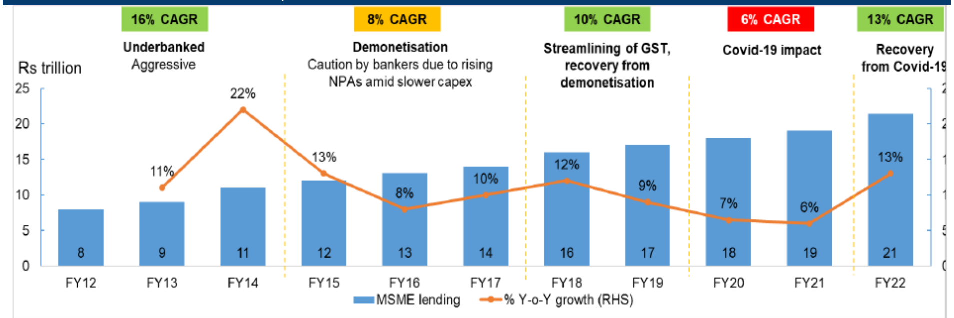
State	Year of Entry	Districts	Nos of branches	% of Total Branches	% of Total Gross Term Loans
Tamil Nadu	1985	39	100	32.2%	38.1%
Andhra Pradesh	2014	20	84	27.0%	29.8%
Telangana	2016	31	48	15.4%	19.5%
Karnataka	2014	20	33	10.6%	7.2%
Madhya Pradesh	2018	33	37	11.9%	4.6%
Maharashtra	2018	3	5	1.6%	0.6%
Chhattisgarh	2019	3	3	1.0%	0.1%
Uttar Pradesh	2019	1	1	0.3%	0.1%
Total		**150**	**311**	**100.0%**	**100.0%**

Source: RHP, ICICI Direct Research

Industry Overview

As per Crisil Research, the total size of MSME lending market across ticket sizes and various player groups (banks, NBFCs, small finance banks, and other formal lenders) was ~₹ 21 lakh crore as of March 2022. This market size includes loans taken by MSMEs across various constitution types (sole proprietorships, partnership firms, private, public limited companies and cooperatives) 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. Loans to MSMEs have grown at 10% CAGR in FY12-22, which is similar to the nominal GDP growth in this period.

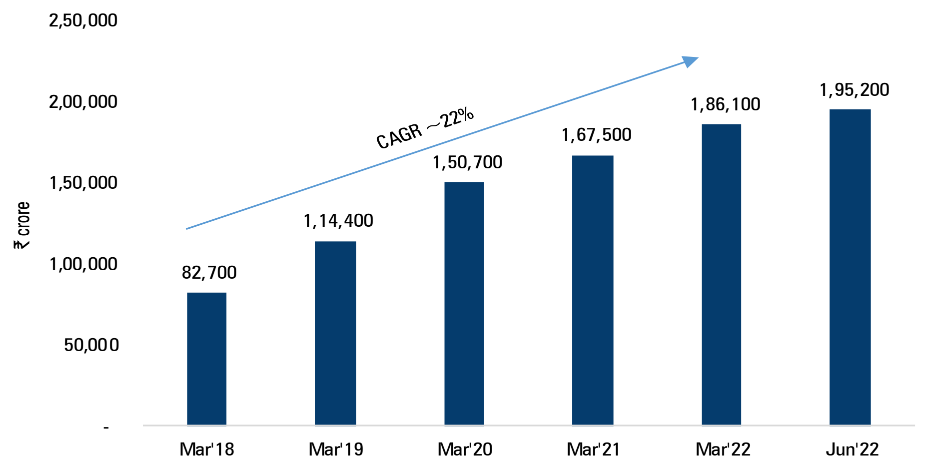
Exhibit 4: MSME credit o/s estimated at ₹ 21 lakh crore as of March 2022



Source: RHP, ICICI Direct Research

The overall portfolio outstanding of small business loans (ticket size less than ₹10 lakh) given out by banks and NBFCs was estimated to be ~₹ 1.86 lakh crore as of March 2022 and ₹1.95 lakh crore as of June 2022. Small business loans grew at a fast pace with portfolio registering a CAGR of 22% in FY18-22. Over the last few years, expansion in branch network, more data availability and government initiatives like GST, UDYAM, and increasing thrust to adoption of digital payments has led to increasing focus of lenders, especially NBFCs, on the underserved segment of MSME customers including individuals and micro-entrepreneurs. Loan portfolio of Five Star Business Finance grew at 50% CAGR in the same period to ₹ 5100 crore in FY22.

Exhibit 5: Small business loans (< ₹ 10 lakh)



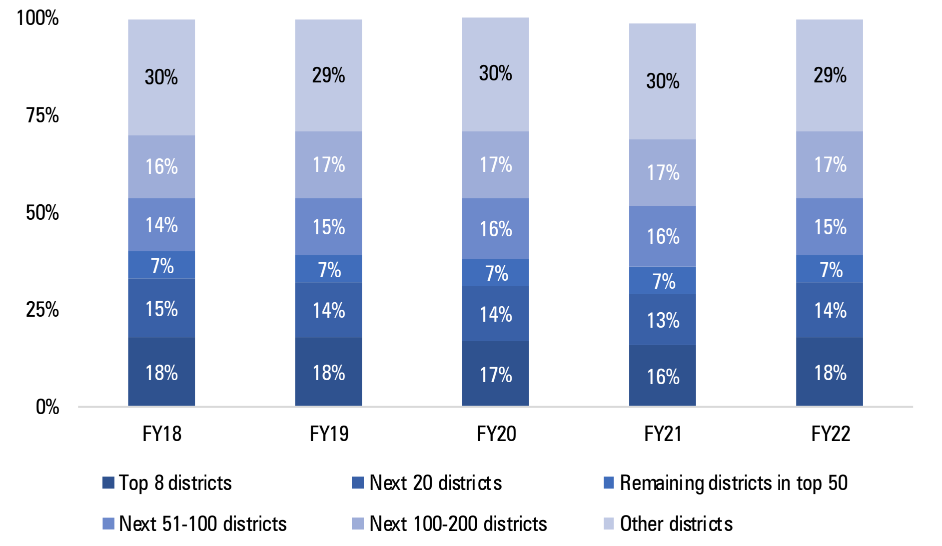
Source: RHP, ICICI Direct Research

Penetration on small business loans increasing in smaller cities

Over the years, share of smaller cities has increased in the small business loans segment owing to increasing penetration of financial services and players focusing on the underserved customer segment. Share of loans outside top 50 cities has increased from 60% in FY18 to 61% in FY22. Small business loans portfolio in smaller cities has grown at relative higher CAGR compared to that in top 50 cities.

Share of new to credit (NTC) customers has increased over the years, indicating increasing penetration of small business loans. Overall, share of new to credit customers in small business loan segment with ticket size less than ₹ 10 lakh has increased from 9% in FY17 to 25% in FY20. Among player groups, public sector banks have highest share of NTC customers followed by NBFCs. Growth of new to credit customers is much higher in small business loans of ticket size less than ₹ 10 lakh compared to that of ticket size more than ₹ 10 lakh across players. In FY22, the proportion of NTC customers in small business loans segment is estimated to have further increased to around 27% for NBFCs.

Exhibit 6: Small business loans (< ₹ 10 lakh)



Source: RHP, ICICI Direct Research

The small business loans segment has been growing strongly with a four-year CAGR of 22% between FY18 and FY22. However, there are wide variations across states and within various districts in the same state as well, which indicates latent opportunity for offering loans to unserved or underserved customers. Based on the value of small business loans lower than ₹10 lakh ticket size outstanding, the top 16 states accounted for 95% of the market size in this segment as of June 2022. Tamil Nadu tops the list with the highest share of 15%, followed by Maharashtra (13%), Karnataka (9%), Rajasthan (8%) and Gujarat (7%).

There is a huge demand supply gap in the small business loan segment. With increasing presence of small business loans in smaller cities and rising focus of lenders on underserved target customer segment, loan portfolio is expected to see a strong growth in future. According to RBI, size-wise credit to large industry grew 5.2% in July 2022 vs. contraction of 3.8% a year ago. Medium enterprises posted credit growth of 36.8% in July 2022 compared to 59% last year, while credit growth to micro and small enterprises accelerated to 28.9% in July 2022, from 10.5% during the same period in the last year. In the short term, rise in economic activity, higher working capital requirement due to rising input costs is likely to cause an uptick in the credit demand. The small business loans portfolio is expected to grow at 16-18% CAGR in FY22-25 aided by increasing lender focus and penetration of such loans, enhanced availability of data, increasing lender comfort while underwriting such loans, enhanced use of technology, newer players entering the segment and continued government support.

High credit gap in target customer segment

Less than 15% of ~7 crore odd MSMEs have access to formal credit in any manner as of March 2022. High risk perception and the prohibitive cost of delivering services physically have constrained traditional institutions' ability to provide credit to underserved or unserved MSMEs and self-employed individuals historically. As a result, they resort to credit from informal sources. This untapped market offers huge growth potential for financial institutions. As stated earlier, the credit gap was estimated at ~₹ 58.4 lakh crore as of 2017 and is estimated to have widened further to ~₹ 85 lakh crore as of FY22.

More players in consumer-facing businesses with a repository of data (like e-commerce companies and payment service providers) are expected to enter the lending business, intensifying competition. For example, in June 2018, Amazon India launched a platform for lenders and sellers, wherein sellers can choose loan offers from various lenders at competitive rates. In August 2021, Meta (earlier known as Facebook) partnered with Indifi Technologies to provide loans to small businesses that advertise on its platform. Incumbent traditional lenders will increasingly leverage the network of their partners and/or digital ecosystem to cross-sell products to existing customers, tap customers of other lenders, and also cater to new-to-credit customers. This will expand the market for MSME loans.

Exhibit 7: Comparison of key segments

Segments	Market Size – Portfolio outstanding March 2022 (₹ lakh crore)	Ticket size	Yields	Typical tenure	Collateral Quality	Tendency to default
Secured property-backed small Business Loans	1.8	Small to Medium	High	Medium	Good	Low
Secured non-LAP loans	13.6	Small to Medium	High	Low	Good	Low
Microfinance loans	3.9	Small	Medium	Low	No collateral	Relatively High
Housing loan	25.4	Large	Medium	High	Very good	Low
Auto Loans	10.1	Small to Medium	Low to Medium	Low to medium	Moderate	Medium
Personal Loans	1.3	Small	High	Low	No collateral	Medium to High

Source: RHP, ICICI Direct Research

Peer Comparison

Exhibit 8: Comparison of key players

FY22	AUM (₹ crore)	Disbursements (₹ crore)	AUM per branch (₹ crore)	Disbursement per branch (₹ crore)	CI ratio	YoA	NIMs	RoA	RoE	Branches	Employees
AUSFB	16500	4800	18	5	57%	12%	5%	2%	16%	919	27817
Shriram City Union	14700	7000	15	7	41%	21%	10%	3%	13%	986	27997
Aavas Financiers	11300	3600	36	11	31%	13%	7%	4%	14%	314	5222
Five Star Business	**5100**	**1800**	**17**	**6**	**32%**	**25%**	**15%**	**8%**	**15%**	**300**	**5675**
Home First Finance	5400	2000	68	25	34%	13%	6%	4%	13%	80	851
Aptus Value Housing	5200	1600	25	8	19%	17%	11%	7%	15%	208	2271
LendingKart	3300	2700	NM	NA	43%	30%	15%	6%	-21%	NA	NA
Vistaar Finance	2400	NA	13	NA	51%	19%	10%	3%	10%	192	1966
Veritas Finance	2200	1200	10	5	49%	22%	12%	3%	7%	229	2727
Aye Finance	1500	NA	5	NA	80%	25%	12%	2%	-6%	312	NA
Digikredit Finance	500	NA	28	NA	129%	32%	12%	18%	-65%	18	NA

Source: RHP, ICICI Direct Research

Investment Rationale

Experienced leadership with professional management team

FSBF is led by qualified and experienced management personnel, who are supported by a capable and motivated team of managers and other employees. The management team has knowledge and understanding of the small business finance landscape in India and the expertise and vision to organically grow the business. They also have diverse experience in a range of financial products and functions related to business and operations and are supported by qualified personnel who have an in-depth understanding of the geographic regions in which they operate, their loan products and customer segment as a result of focus on hiring local staff with strong local personal and professional networks. The founder, Promoter, Chairman and Managing Director, Lakshmipathy Deenadayalan, has been associated with the company for the past 20 years. He has a deep understanding of customer behaviour, business and operations and has been critical to developing and enhancing business model and driving total income and profitability.

Exhibit 9: Details of Management team

Name of the employee	Designation	Total yrs of experience	Associated with FSBF	Past associations
Rangarajan Krishnan	CEO	~18	7.0	Spark Financial Holdings Private Limited, IFC (South Asia Department), Standard Chartered Bank, HDFC Bank Limited
Srikanth Gopalakrishnan	CFO	~20	7.0	Citibank N.A., Asirvad Microfinance Private Limited
Vishnuram Jagannathan	COO	19.0	5.0	HDFC Bank, Deutsche Bank AG, HSBC
Parthasarathy Srinivasan	Chief Credit Officer	18.0	4.0	DBS Bank Limited, ICICI Bank, Standard Chartered Bank
Sathya Ganesh Thirumalaidoss	Chief Business Officer	17.0	5.2	ICICI Bank Limited, Cholamandalam Investment and Finance Company Limited, Shriram Housing Finance Limited
Vanamali Sridharan	Chief Technology Officer	28.0	1.0	Equitas Small Finance Bank, Suryoday Small Finance Bank Limited, Accenture Services Private Limited, Standard Chartered Bank (Dubai)
Jayaraman Sankaran	Chief Risk Officer	~22	2.0	Redington (India) Limited, Arabian Automobile Alliance LLC
Ramesh Kannah	Chief Legal Officer	~18	0.5	HDFC Limited, ICICI Bank Limited, Cholamandalam Investment and Finance Company Limited, Piramal Capital and Housing Finance Limited
Naveen Raj	Chief Audit Officer	~15	0.5	Deloitte, Haskins & Sells, BSR & Co LLP

Source: RHP, ICICI Direct Research

Fastest growth in AUM among its peers

According to Crisil, the potential market for residential property-backed secured MSME lending in India is ~₹ 22 lakh crore, with Uttar Pradesh, West Bengal, Maharashtra, Rajasthan and Tamil Nadu collectively accounting for over half of such potential market. Crisil also notes that while this potential market opportunity is significant, it observes that there are few formal financiers of scale who cater to this segment. Crisil attributes this to the relatively high cost of serving such market, the time required to build expertise, the requirement of having strong knowledge of the local market and regional dynamics and the challenges associated with building a credit underwriting model for non-income proof customers and collections infrastructure.

FSBF has the fastest gross term loans growth among its compared peers (being NBFCs in India) with more than ₹ 3000 crore in gross term loans, with a CAGR of 65% (FY17 to six months ended September 30, 2021), catering to the small business finance needs of unserved and underserved customers. While their gross term loans have grown to ₹ 5067 crore as of March 31, 2022 from ₹ 1008 crore as of March 31, 2018, at a CAGR of 49.73% (between FY18 and FY22) the growth has primarily been volume led with consistent ATS and steady yields.

Strong collections infrastructure leading to robust asset quality

While FSBF's underwriting model contributes to suitable customers being on-boarded, they have also created a strong on-ground collections infrastructure to ensure that they maintain a high asset quality. Many of the customers have previously borrowed from money lenders or other such unorganised lenders and although they have observed minor delays in servicing of regular monthly instalments, which they view as a typical part of the repayment culture, such delays do not 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.

FSBF's collections process involves high-touch engagement between business officers and customers and to optimise this interaction it ensures that each relationship officer is responsible for no more than 120 customers on an average. It adds business officers as the business grows. The number of business officers increased from 1,834 as of March 31, 2020 to 2,008 as of March 31, 2021, and further to 2,467 as of March 31, 2022 and 2,550 as of June 30, 2022. The number of loans per relationship officer was 90, 88, 88 and 78, as of June 30, 2022 and March 31, 2022, 2021 and 2020, respectively. These figures have been consistently below their average 120-loan limit and as such, has provided each relationship officer with sufficient capacity to attend to each loan effectively, leading to maintaining robust asset quality. The company also has a strong monitoring mechanism that ensures involvement and intervention from various individuals across business, all of which also ensures a robust asset quality.

Ability to expand to new underpenetrated geographies

As of March 31, 2022, less than 15% of ~7 crore MSMEs in India have access to formal credit in any form. Historically, there is a perception of high risk and prohibitive costs of delivering services physically that have constrained traditional institutions ability to provide credit to underserved or unserved MSMEs and self-employed individuals. As a result, such borrowers resort to credit from informal sources and as such, this relatively untapped market offers huge growth potential for financial institutions such as FSBF.

Since starting as a Chennai based NBFC, FSBF has demonstrated its ability to grow beyond its local market. Its first growth phase was between FY10 and FY15, where it increased from six branches in Chennai to 39 branches across Tamil Nadu. Between FY15 and FY18, it started to expand in Andhra Pradesh, Telangana and Karnataka, growing from three branches to 72 branches during this period. Since then, FSBF has further expanded to 165 branches across Andhra Pradesh, Telangana and Karnataka, as of June 30, 2022. Such state-based gross term loans growth demonstrates that the company can successfully grow its footprint and gross term loans in new states while consolidating presence in home state of Tamil Nadu and other states. Recently, FSBF has expanded into Madhya Pradesh, Chhattisgarh, Maharashtra and Uttar Pradesh. Collectively, these four states accounted for 5.48% of total gross term loans with 46 branches, as of June 30, 2022.

Total 100% in-house sourcing, comprehensive credit assessment, robust risk management

FSBF's 100% in-house sourcing, comprehensive credit assessment and robust risk management and collections framework allows to identify, monitor and manage risks inherent in operations. Catering primarily to small business owners and self-employed customers while maintaining asset quality requires a special skillset in absence of traditional income evidence, such that lending to these borrowers is based on an assessment of their income and cash-flows through various methods. First, it ensures all of its loans are sourced in-house, either through its branch-led local marketing efforts (i.e. door-to-door or specific referral marketing), repeat customers or through walk-ins. In-house sourcing allows for complete control over the quality of customer and processes involved to disbursement, which leads to better asset quality, compared to other methods of customer acquisition. Further, as its customers are on-boarded by own officers and not by third party selling agents who may or may not be working with multiple financial institutions, FSBF experiences a lower churn rate of customers throughout its portfolio.

In addition, self-employed customers are prone to variable cash flows and lending to them requires robust underwriting systems to appropriately price the risk. As a result of experience, expertise and underwriting model, the company have been able to effectively serve such customers, while maintaining asset quality, and expanding into newer geographies. As of June 30, 2022, an estimated 95% of the loans that the company disbursed were for single-unit and SORPs. It has a high SORP focus. The company also aims to have conservative average loan-to-value ratios and instalment to income ratios on outstanding loan accounts, which can mitigate adverse events and cyclical effects.

The FSBF credit team is independent of business and collections teams. Only the file credit team has the authority to approve and sanction loans while the field credit team only has recommendation powers. There is complete independence between the credit team and business & collection team. All incentives for the credit team are linked to file processing not file approval.

Access to diversified and cost-effective long-term financing

FSBF have secured financing from diversified sources of capital, including term loans; proceeds from loans securitised; 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 capital requirements. Average cost of borrowings on 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. Cost of incremental borrowings decreased from 11.37% in FY20 to 9.68% in FY21 and to 8.51% in FY22, and was nil and 8.42% in three months ended June 30, 2021 and 2022. FSBF believe that the company is able to access borrowings at a competitive cost due to its stable credit history, strong credit ratings, equity capital position and low leverage, and risk management policies. As of June 30, 2022, FSBF borrowed from 17 private sector banks, seven public sector banks, 13 NBFCs, one mutual fund, and 14 other entities; and outstanding borrowings were ₹ 730 crore from private sector banks, ₹ 585 crore from public sector banks, ₹ 365 crore from NBFCs, ₹ 150 crore from mutual funds and ₹ 689 crore from other entities.

Key risks and concerns

Geographic concentration may impact operations

FSBF's operations are primarily focused on Tamil Nadu, Andhra Pradesh, Telangana and Karnataka. Such key states collectively account for ~85% of branch network as of June 30, 2022. As of June 30, 2022, ₹ 2017.2 crore, or 38.09% of gross term loans, ₹ 1577 crore, or 29.77% of gross term loans, ₹ 1032.5 crore, or 19.50% of gross term loans, and ₹ 379.3 crore, or 7.16% of gross term loans were attributable to Tamil Nadu, Andhra Pradesh, Telangana and Karnataka, respectively. Any significant social, political or economic disruption, or natural calamities or civil disruptions in these regions, or changes in the policies of the state or local governments of these regions or the Government of India, could disrupt business operations. The occurrence of, or inability to, effectively respond to any such event, could have an adverse effect on business, cash flows and results of operations.

Substantial portion of customers are first time borrowers

FSBF has customers who are first-time borrowers from formal secured lending ecosystem. As of June 30, 2022, 30.42% of customers were new to lending ecosystem. Such customers generally may have higher risk of non-payment or default due to a number of reasons such as business failure, insolvency etc. Of such first-time borrowers, during Q1FY23 and FY22, ₹ 12.3 crore, or 0.23% of total gross term loans and ₹ 10.99 crore, or 0.22% of total gross term loans experienced default (i.e. 90+ DPD category), respectively. To the extent FSBF is unable to successfully manage the risks associated with lending to customers new to credit, it may become difficult to recover outstanding loan amount.

Interest rate volatility impacts lending & treasury operation

FSBF's results of operations depend substantially on level of net interest income. Any change in interest rates would affect interest expense on floating interest-bearing liabilities as well as NII and NIM. Any increase in cost of funds may lead to a reduction in NIM, or require it to increase interest rates on loans disbursed to customers in the future to maintain its NIM. Moreover, if there is an increase in interest rates they pay on their borrowings and the company are unable to pass to their customers, it may find it difficult to compete with its competitors, who may have access to low-cost funds.

Competing in highly competitive small business finance industry

The small business finance industry in India is highly competitive and FSBF compete with unorganised money lenders, friends and family members, certain larger NBFCs and HFCs, NBFCs that also offer loans for business purposes but backed for property, as well as certain microfinance entities and small finance banks. Competition in the industry also depends on, among other things, the evolution of government policies relating to the industry, the entry of new participants, and the extent to which there is a consolidation among banks and financial institutions in India. FSBF expects competition to intensify in future. Its ability to compete effectively will depend, in part, on ability to maintain or increase margins. Inability to react effectively to these or other market developments or compete effectively with new and existing players in the increasingly competitive small business finance industry may affect business and results of operations may be adversely affected.

Significant portion of collections are in cash

Certain customers are from the semi-urban and rural markets, which carry additional risks due to limitations on infrastructure and technology. For instance, their target customers primarily deal in cash only and their income levels can vary significantly on a monthly basis, particularly around local events and festivals, and as such they have tailored their systems to accept high cash collections. For Q1FY23, FY22, FY21 and FY20, 61.9%, 62.6%, 64.9% and 69.6% of total collections, respectively, were in cash of which 100% were cash collections at branches.

Financial Summary

Exhibit 10: Profit & Loss Statement (₹ crore)

₹ crore	FY20	FY21	FY22	Q1FY23
Interest Earned	746.8	1014.9	1203.8	335.2
Interest Expense	216.9	325.2	300.6	64.8
NII	**529.9**	**689.7**	**903.2**	**270.4**
Other Income	40.5	36.4	52.4	3.8
Total Income	570.4	726.1	955.6	274.3
Operating expense	171.8	214.4	305.8	88.5
Operating Profit	**398.6**	**511.6**	**649.7**	**185.8**
Provisions	49.3	35.2	45.5	-0.4
Tax	87.4	117.4	150.7	46.7
Net Profit	**262.0**	**359.0**	**453.5**	**139.4**

Source: RHP, ICICI Direct Research

Exhibit 11: Balance Sheet (₹ crore)

₹ crore	FY20	FY21	FY22	Q1FY23
Assets				
Cash balances	451.1	1355.7	879.9	713.2
Investments	0.0	0.0	248.2	189.2
Advances	3830.8	4358.7	5102.4	5454.4
Fixed Assets	11.1	8.5	12.1	13.0
Other Assets	60.2	70.7	100.4	101.8
Total	**4353.2**	**5793.6**	**6343.1**	**6471.5**
Equity & Liabilities				
Capital	25.6	25.6	29.1	29.1
Reserves & Surplus	1919.0	2292.5	3681.2	3827.8
Networth	**1944.6**	**2318.2**	**3710.4**	**3857.0**
Deposits	0.0	0.0	0.0	0.0
Borrowings	2363.7	3425.2	2558.8	2520.3
Other Liabilities and Provisions	44.9	50.2	73.9	94.3
Total	**4353.2**	**5793.6**	**6343.1**	**6471.5**

Source: RHP, ICICI Direct Research

Exhibit 12: Key ratios (₹ crore)

	FY20	FY21	FY22
No. of shares (crore)	25.6	25.6	29.1
BV (₹)	76.0	90.4	127.4
EPS (₹)	10.1	14.0	16.1
P/E (x)	47.1	33.8	29.5
P/BV	6.2	5.2	3.7
RoA (%)	7.3	7.0	7.2
RoE (%)	15.4	16.9	13.9

Source: RHP, ICICI Direct Research

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