"Five Star Business Finance Limited Q2 FY'24 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to Five Star Business Finance Q2 FY24 Results Conference Call hosted by ICICI Securities.

As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal the operator by pressing '*' then '0' on your touchtone phone. Please note that the conference is being recorded.

I now hand the conference over to Mr. Lakshmipathy Deenadayalan – Chairman and Managing Director. Thank you and over to you, sir.

Lakshmipathy D: Thank you for transferring the call. And I welcome all the participants to the fifth earning call overall and second earning call for this financial year.

As you all know, we connected you with the last September 2022 results. We are again connecting you back with September '23, almost five quarters and one full financial year has been the connection between you and us.

It was a very exciting journey for us for the last 12 months. Always Five Star, we are proud to say we are a collection first NBFC. Because we feel growth is a lighter side, but collecting back is going to be the difference between any lender.

So, to start with the numbers, I'll start with the collection side. Overall collections came out very well. We'll say this is an excellent quarter from a quality perspective. The collection efficiency comparing with last quarter moved from 99.6% to over 100% and the unique customer which we call collecting an EMI from every customer which we measure by D1C1, the terminology what internally we call, moved from 97.5% to 98%. So, 98% of the customers have paid EMI in each month in last quarter. That's a very encouraging sign. So, the forward flow has been arrested to that extent.

The next important metric in collections is 30-plus, where people ask us. I'm happy to say that 30-plus has also dropped down from 9.68% last quarter to 8.59% this quarter.

Another color of collections what we say the current to the arrears ratio of the customers; 78% of the customers were in current and 22% of the customers were in arrears in last September and it moved to 85% of the customers in current and 15% of the customers in arrears in June, we have bettered that in September. 86.5% of the customers are in current now and with only 13.5% of the customers are in arrears. As guided to the market, we will reach this to 90%... that is 90% of the customers will be in current and 10% alone will be in the arrears going forward maybe in next two quarters… maybe June of 2025.

And taking you to the next important collection metric which is a non-performing asset. 90-plus, we call, it also bettered from 1.08% in June quarter to 1.07% in September quarter.

Coming to the IRAC Stage-3 as per the new circular, even there we have bettered ourselves; we were at 1.41% in June quarter, which has come down to 1.37%. So, all in all, the collections on all metric and all buckets have shown a tremendous improvement that again proves that the Five Star is a collection-first business model.

And now taking you to the business side, which is very important. First, from the branch, we have opened close to 70 branches in last quarter, which is one of the highest in history of Five Star. So, the total branch count is at 456 branches as we stand today. Because of branches getting opened and business officers getting joined in the new branch, our loan disbursement has also seen all time high; it was at 1,132 crores in June, it has gone up to 1,204 crores, registering a 6% increase and registering a 50% increase comparing to last year. And this has resulted in a good growth in AUM; we have moved from Rs.7,583 crores in June to Rs.8,264 crores in September with a growth of 9% sequentially and 44% year-on-year. Both quality and growth has resulted in good profits. Our incomes have gone up from Rs.484 crores last quarter to Rs.522 crores this quarter, registering a growth of 8% sequentially and 44% year-on-year. And profit after tax has moved from Rs.184 crores to close to Rs.200 crores a quarter (which is 199 Crores), registering a 9% growth and 38% growth year-on-year.

Finally, before handing over to Srikanth, the borrowing side has also shown a good amount of stability; our cost of borrowing on the book in this quarter is at 9.7%, move a tad lesser from 9.8% and incremental borrowing is coming at 9.5% all in all.

So, from the collection side business side and the borrowing side, Five Star is able to bring out their best performance again in the September quarter and this will continue as we move forward.

Now, I'll hand it over to Srikanth to go deeper into each subject, then we'll take up the questions.

Srikanth Gopalakrishnan: Thank you, sir, and a very good morning to all of you.

As Mr. Pathy has highlighted some of the numbers around collections business as well as the borrowings, I'll just touch some finer aspects and hand it over to all of you for any questions that you may have.

In terms of the financial metrics, we have grown our AUM at about 9% sequentially to Rs.8,264 crores. Coming on the back of very strong branch expansion, 70 new branches have been added for the quarter, and on the back of borrower expansion. So, again, this has not been a ticket size led growth, but it's a diversified growth that we have managed to achieve. So, our borrower base increased from about 3.2 lakhs in June to 3.4 lakhs as of September.

In terms of the financial metrics, the yields have remained stable at around 24.2%. The cost of funds surprisingly continues to show a decreasing trend, which means Five Star is looked at as a very attractive destination for lenders to lend monies to. So, while we are borrowing incrementally at 9.5%, the book cost dropped from 9.8% to 9.7%. so, which is a spread of close to 14.5%.

The leverage has moved up a little bit, but given our strong accruals, I think we will still see a gradual growth in the leverage in the quarters to come. So, the NIMs are almost at about 17.7% translating to return on assets of about 8.5% and return on equity of a little over 17%.

Despite the branch expansion, we have managed to keep the costs intact. Our cost-to-income is still only at about 36% or so and we have been guiding all of you that even in a steady state December will be anywhere around 35% to 37%.

In terms of the borrowings, we have borrowed almost more than Rs.2,000 crores in the first half of this year, with about Rs.1,150 crores coming in the second quarter. The good part is we have managed to add two new banks and sizable sanctions have come in. In fact, one of the transactions while the executions spilled over to 3rd October because of some change in holidays but including the cost, I think we are at about 9.5% incremental cost. And as we speak, the incremental cost continues to stay around 9.5% to 9.6%. So, we don't envisage any significant negative impact in the cost of funds in the quarters to come.

Collection efficiencies have stacked up really well, like what Mr. Pathy highlighted. Not just 1+, even our 30+ has continued to show a decreasing trend, from about 9.68% last quarter, we have brought that down to about 8.59% for this quarter. So, we will continue to keep demonstrating this number on the lower trajectory, which will ensure that the stress portfolio… for us, 30+ is not a stress, but typically markets perceive 30+ to be a stress portfolio. Even that number will continue to keep going down.

We continue to maintain a good provision coverage ratio on our overall book on the stage-3 assets as well as on our restructured portfolio. On the overall book, we are almost at similar levels of PCR; we were at 1.64% last quarter, just dropped by one basis point to 1.63%. On Stage-3 assets, we have taken the PCR to a little over 50%, we were at about 44% last quarter. This is again coming purely out of the ECL model and the overlays that the company wants to carry on its books on a conservative basis.

Restructured book continues to show a very encouraging trend. Most of the book is in the standard category. In fact, the overall restructured book has actually come down to 0.66% of our overall book and even on this we maintain close to 50% provision coverage. So, we don't really envisage any risk emanating out of this restructured book in the quarters or the years to come.

PAT registered an 8% to 9% growth from about Rs.184 crores last quarter to Rs.199 crores sequentially and year-on-year it went up from Rs.144 crores to Rs.199 crores. Net worth continues to remain robust. Capital adequacy is almost close to 60%.

So, I think all in all, it's been a very encouraging quarter in terms of asset quality, profitability and growth. And given the branch network that we have built in, I think today we have a very solid platform to ensure that we build our growth on this strong edifice in a very safe and secure manner. So, whatever guidance we have given you continues to stand. We are hopeful of coming out with a strong set of results in the quarters to come as well.

On that note, I will hand over to any of you for questions, happy to take the questions.

Moderator: We will now begin the question-and-answer session. The first question is from the line of Mahrukh Adajania from Nuvama. Please go ahead.

Mahrukh Adajania: My first question is on your collection efficiency. You've always delivered well on collection and you seem very confident that the customers in arrears will improve from here on as well. So, what gives you the confidence because your collection infrastructures always been strong, is it that their business environment is improving or that your collection efforts have intensified further?

Lakshmipathy D: The business model what Five Star has built for last 20 years plus or more than that, is from the back of the assessing the collection first and assessing the customer on the cash flow and character, leaving the collateral aside. So, what gives us the confidence is the profile of customers whom we are backing for last two decades, purely the shopkeepers and self-employed's of our country; they are quite busy now and their sales are coming back to the pre-COVID level and their margins are sticking very well. So, this is from one side. Second side, as you know, we are a secured lender, our entire loans are secured, we lend on the residential property where the customers and family members live in. This also gives the emotional attach and seriousness to the family members, even during the downturn cash flow cycle. So, these two things, the service sector whom we are backing, and we are backing them with one of the strong collaterals. And of course, the third one is important. With the collection infrastructure what we have put at the ground level, we are able to reach customers or customers are able to reach us in 30 minutes of time. So, with all three put together, our collections are always on the good side. There was some kind of pressure during COVID times because we didn't restructure a lot. So, we are correcting those things, and we are bouncing back better than all pre-COVID collections metric whatever Five Star has seen. So, the strength of the cash flow and the underwriting strength and the infrastructure collections we put up at the ground level, all three are giving us good results quarter-on-quarter, that gives us strong belief that going forward our collections will be better, better every quarter.

Mahrukh Adajania: So, as the business environment is improving, which is why you're confident of holding credit costs here, is it, or because there has been strong growth post-COVID, so as the portfolio seasons, do we see inching up of credit cost or it's going to stay at these levels?

Lakshmipathy D: So, I think the credit cost will stay in the same sub-1% level; even during demon, COVID-1 and 2, we didn't see this getting spiked up… just spiking it with a very short period of time in COVID and got settled where our eventual credit cost has to be. So, I don't think the credit cost will have any impact even the growth kicks in for Five Star, because the growth what we are getting into, the guidance of 35%-plus year-on-year, it's not going to be a big growth for Five Star because we have already seen big growth pre-COVID. So, we know how to underwrite the customers, keep the collections intact. So, it doesn't have any impact on the credit cost going forward.

Mahrukh Adajania: My last question is on attrition. So, in your segment of business, has the attrition rate increased in the last six months or in the last nine months or is it manageable because attrition lead in the other BFSI space is on the higher side?

Rangarajan Krishnan: Attrition has not specifically increased, it is remaining at the same level, we are expecting that over the next three to four quarters things will gradually come down. But I think we measure attrition very clearly at what level is the attrition happening both from an experience perspective and from the internal level perspective. For us, attrition largely is happening at the people who are less than 12-months old in Five Star. So that's a manageable attrition. And also, it's happening at mostly junior level. If you have to measure attrition at branch managers and above, it's an extremely a low number for us and we continue to be one of the best in the industry as far as that is concerned. So, it's under manageable level.

Moderator: The next question is from the line of Aditya Padhi from Girik Capital. Please go ahead.

Aditya Padhi: Regarding the portfolio yield on your slide #38, we can see the 20 bps drop in the Q2 FY24. Any reason for that?

Srikanth Gopalakrishnan: You just have to look at this a little differently. We will always have about 20, 25 basis points movement in the yields. See, the way that the entire accrual process happens is on an ideal basis. While whatever is the difference that is charged to the customer on an overdue account, it's through the penal interest methodology, which doesn't come into the yield. So, whenever there is a reduction in overdues or whenever there is a little bit of ideal numbers not coming through in terms of the repayment schedule, you will see a slight movement in the yield. So, our submission is that don't give too much of importance to 20, 25 basis points movement in yield this way, that way. You will always see that happening depending on how the DPD numbers stack up, because we assume that the customer has actually made the payment while doing the accrual for the next month and the overdue also gets added to the denominator. So, both these aspects may pull down the yield 15, 20 basis points this way, that way. Unless the yields are going to go above or below by more than 25, 30 basis points is when the concern should be, which we have never seen in the past. So, 15, 20 basis points it is more accounting methodology rather than anything impacting the underlying portfolio.

Moderator: Next question is from the line of Sameer Bhise from JM Financial. Please go ahead.

Sameer Bhise: Pathy sir, just wanted to ask on the competitive intensity in our core products. Given that we've been doing so well, have you seen competitive intensity increase and just some sense on the landscape going ahead?

Lakshmipathy D: Yes, of course, competitive intensity will be there in the minds of many lenders. Whether that is going to actually take part at the ground level, we have to wait and see because everyone wanted to get into the lending to the shopkeepers and lending to the self-employed of this country. That's the buzz word today. But my own view is the competitive intensity is increasing at sub-1 lakh level and above 10 lakhs level. There is a reason for it. Sub-1 lakh level, generally, it's the microfinance or unsecured loans where your underwriting is very little, right? You can underwrite it quickly. Whether it is accurate or not, we have to wait and see. But your underwriting and your turnaround time is very quick. For 10 lakhs loan and above, you spend that much of good time for underwriting that it is worth spending for that. That's what the market thinks. But between 1 lakh and 10 lakhs, we see lesser people getting into it, either they see it is operationally not viable or the underwriting becomes more challenging. I think that's where Five Star kicks in. We have been doing it for last two decades very well. Our sweet spot is between 3 lakhs and 5 lakhs. Here, the turnaround time for each file takes close to five to seven days. We spend almost three days at the ground level to underwrite their character, cash flow and collateral. You know it very well. But people find it very difficult to get into these kinds of loans to spend this much of time. But, for us it makes more sense because we have been doing it year-on-year. So, keeping these things in mind, I'm seeing the competitiveness is increasing, but it is not as heavy in any other products that what we see in vehicles, gold or home loans. Comparing to that, the competitive intensity is lesser here, because a lot of work has to be done by any lender if he wants to be a long-term lender.

Sameer Bhise: What kind of players have you seen incrementally looking at this product, are these SFBs or smaller NBFCs or any of the technology-led companies also are looking at this product?

Lakshmipathy D: Sameer, I'll say all. I don't want to miss anyone because everyone wanted to get in, but let me put an important point. See, everyone wanted to get into their experience and their beliefs. For example, just to take fintech, I have already said in the conference call, fintechs, they wanted to get into this shopkeepers lending. But I don't know how successful they are, only the data you people have to share with us. But their product is little different, and their place of operation is little different. They are operating in Tier-1 and Tier-2, whereas we are operating at Tier-3 to Tier-7 towns, which is even at 25,000 population Five Star branch will be there. But, at that location, the technology penetration or the QR code penetration is not high. So, their place of operations is Tier-1 and Tier-2 and our place of operation is little different. And coming to the product also, they lend to an unsecure short-term cash flow-based algorithm, whereas we lend to bigger ticket size to set up a business or to repay money lenders borrowing for a longer-term, seven years. So, I think you have to see. Lending to a shopkeeper can be the same, but the product is different, the place of operation is different.

Sameer Bhise: Secondly, in terms of the technology piece, are we like fully live on sales force across all branches now?

Rangarajan Krishnan: So, Sameer, we had given a gliding path wherein we wanted to move from the old ERP that we had into sales force. So as of the first quarter end, we had gone live only with one state which is Tamil Nadu. As of Q2 we had gone live with Karnataka and all the central Indian states and we had given a clear path that by end of Q3 will be fully live. So, as we speak in October, we have gone live with four of our biggest states, which is Andhra Pradesh. So, that leaves us only with one state which is yet to go live which is Telangana. And incidentally, we are kicking off the training in Telangana today. So, we are clearly on the path to a complete integration into sales force by end of Q3.

Lakshmipathy D: I just wanted to highlight one point here. Transforming from one ERP to another ERP is a big exercise. Five Star started this exercise from Q1 of this financial year and we are successfully doing it on a quarter-on-quarter basis. If you see our disbursement or our growth, didn't come under any effect at all, right? So, the credit has to be given to our teams for planning which state to go live and when. So, I think we will completely move from an existing ERP to the new ERP without any disturbance in the growth and the disbursements. So, that is the key point. I don't see any disturbance happening because of the ERP transition.

Sameer Bhise: One final question to Srikanth on securitization. How do you see the opportunity going ahead or do you want to keep the share at current level?

Srikanth Gopalakrishnan: We are definitely looking at broad basing our borrowings in terms of various structures, in terms of the type of lenders from whom we borrow. Securitization is definitely an attractive source given that it's a ring-fenced pool of receivables, there is a credit enhancement that we offer to the lender. So, we are looking at securitization as one of the key avenues as a funding resource. But, having said that, at the time of giving these loans, these probably are a little more cherry-picked as compared to the other loans. We would not want to be very high on securitization. Specifically, we'll try and maintain it about 25% to 35% of our overall borrowings. In fact, we onboarded one very strong name. That's the name that I said, which ideally should have gotten signed by 29th September, but because of the change in holidays, it got pushed to 3rd October. So, Deutsche Bank has actually taken a 350 crores exposure through an investment in one of our PTCs. So, we will continue to keep evaluating

that, from the right kind of lenders and for good amount of quantum. Given that it's an on-book treatment today, we don't really distinguish too much between a term loan and a securitized receivable. So, we'll continue to look at it. But we will ensure that we don't probably cross, let's say 1/3 of our borrowings in the form of securitization.

Moderator: The next question is from the line of Nischint Chawathe from Kotak. Please go ahead.

Nischint Chawathe: The first one is on the borrowings mix and the share of NCD has kind of come down to 4%. Any specific reason, I mean, it's come down or it's kind of collapsed from like 35%, 40% in the past?

Srikanth Gopalakrishnan: There's no specific reason as such. A lot of NCDs got onboarded especially during the COVID first wave and the COVID second wave as part of the TLTRO and PCG schemes, all of which got redeemed in the recent past. And today, the markets are a little choppy. While definitely we are exploring raising NCDs from mutual funds, from alternate investment funds, wealth management firms, the interest rates are not that conducive. If you compare the differential between a bank term loan and an NCD interest rate, the difference is almost like 50, 75 basis points. So today, given that we are getting a good traction from banks for the term loans and the fact that these are coming in at more attractive rates and for longer tenure. Today, markets are not willing to take exposures of more than let us say 2, 2.5 years while our product is a seven-year loan. So, keeping in mind the cost considerations, ALM considerations, we have been a little more skewed towards the term loans. But having said that, we are making all our efforts towards penetrating the NCD markets across various categories of institutions and you will see that going up in the next few quarters.

Nischint Chawathe: If I look at it, your cost of funding is 9.5%. If you're saying 50, 75 basis points, we are effectively saying that the NCD demand is coming closer to around 10%, 10.25%, which is somewhere closer to probably what an A-rated company may be borrowing. Were the investors in these NCDs earlier mutual funds or were the banks, is it something that probably a set of kind of lenders are today missing in our borrowing profile?

Srikanth Gopalakrishnan: I would probably say; mutual funds are one set of categories that we have been targeting. But they have been a little choppy to say, like I said, they're not willing to take a longer tenure bet on an NCD. If today we have to do an 18, 24 months kind of an NCD, I think we will get that for let's say 25 basis points over than what we are coming through. Especially in the past, like I said, the TLTRO and PCG NCDs were subscribed by the bank. So, as a category, mutual funds have been a little more nascent in our portfolio. We probably had mutual fund borrowings only from one or two AMCs. But that is something that we are trying to address. But today there is also a good amount of demand for NCDs from AIF, from wealth management firms, there are corporates who want to subscribe to the NCDs as part of their investment strategy. So, I think we will definitely see tractions coming through. We are also making some headway with the mutual funds. But like I said, it's a little time-consuming process given the lack of complete stability in the market, but sooner than later I think we will have NCD traction building up substantially.

Nischint Chawathe: The second question is on growth. The way you're tracking growth in the first half of the year, would you want to increase the guidance for the year?

Lakshmipathy D: If you recollect in the month of May and June, we came to the market and we revised our guidance from 30% to 35%. Having said that, our growth is becoming stronger quarter-on-quarter we're able to give 9% sequentially and that will continue if next quarter also turns up well. We don't want to revise the guidance immediately. We'll wait and watch how this demand at the ground level… it is picking up as we guided to the market, we'll open 70 to 80 branches, already we have opened 83 branches in the first six months. That shows that the demand at the ground level is picking up very well. But I don't want to give too much of guidance changes this way and that way. So, we will wait for next two quarters. Definitely, if the same trend continues, in the March quarter I'll come out with a revised guidance if needed. But, as I speak now, the 35% growth guidance which we changed, now becomes stronger and stronger in our mind. This will be there for a longer period.

Nischint Chawathe: So, the question essentially was that are you able to see anything in the ground because of which you would sort of have a slightly softer guidance for the year?

Lakshmipathy D: I understood that. I don't see anything affecting our guidance growth because we have said 35% growth and we have been growing at 40% year-on-year comparatively. I don't see anything affecting the ground level. The cash flows are good, the demands are good, as I said, we opened more branches, seeing a good demand mostly in the southern states and the new states which we wanted to get in and month-on-month also our disbursements are going up. So, I'm not seeing any significant insights from the ground level that will affect the growth trajectory.

Moderator: The next question is from the line of Ajit Kumar from Nomura. Please go ahead.

Ajit Kumar: So, two to three questions from my side. First one is, if I look at your state wise AUM numbers, growth in AP has been quite strong from past five to six quarters, higher than the overall AUM growth. Any specific reason for this and do you expect this trend to continue?

Lakshmipathy D: See, I think the southern states are the big contribution for our disbursement and our AUM; close to 96% of our growth comes from South. If you bifurcate south, Andhra is now becoming a leading contributor to the disbursement and AUM growth because we see good demand there, the population is very good and you see a lot of towns interconnected very closely especially in the coastal part of Andhra, where most of our branches are being present. So, we also see a very good collection traction in Andhra. Keeping all this in mind, we are investing a lot in Andhra. Even from out of this 80-plus branches which we opened for the first six months; I think more than 50% of the branches would have gone to Andhra. So, we see a good demand there, the collection culture is good there and the team what we have gathered there is also giving us a very great result. All put together, Andhra is improving their AUM on QoQ basis. That doesn't mean Tamil Nadu, Telangana and Karnataka is lacking that, but comparatively, Andhra growth looks pretty good, and we are very happy with the way in which we have taken up Andhra.

Ajit Kumar: Second question is, how should we look at the branch addition going forward? You had guided earlier 60 to 70 branch addition every year, but this quarter itself we have added roughly 70 branches. So, what will be the momentum going forward as well?

Lakshmipathy D: Yes, momentum will be strong is what we hope because one of the key metrics which induces us to open branches is the demand at the ground level. How does you measure that? When a branch is

getting breakeven in six months, that means the branch is garnering close to Rs.2.5 crores of AUM for six months. So, that gives a clear indication that the customers wanted to move from informal to formal side and come to Five Star for their business and housing needs. So, this is the first and foremost indication of what we have to see at the ground level. Till now, it's very encouraging; the branches what we have opened is breaking even at six to nine months as we speak. So, I'm thinking we will revise the guidance of branch opening now moving from 70 to 80 what we said this year, we will be at surprisingly close to 120 branches for this full financial year. If all things go well, we will add another 40 branches in next six months.

Ajit Kumar: Lastly, 30-plus DPD has come down to 8.6%, which is great. So, looking at the current situation on ground, how should this number trend, let's say, in the remaining half of the year?

Rangarajan Krishnan: There has been a clear focus in making sure that the collection efficiency is stacking up extremely well, especially the unique collection efficiency that we track, and we have given you the numbers. So, the unique collection efficiency that Mr. Pathy also mentioned in his opening remarks, we have crossed 98%. So, that's clearly arresting the forward flows to a very, very significant extent. So, you will see this number getting improved even further. When we say that the current portfolio will go closer to 90%, obviously the 30-plus will drop even further to where we expect in the next two to three quarters.

Moderator: The next question is from the line of Jaiprakash Toshniwal from LIC MF. Please go ahead.

J Toshniwal: Sir, taking the question of Nischint on NCD side, is there a discussion with the credit rating agencies to improve our rating and if that yes, what are the KPIs we are looking to increase our ratings?

Srikanth Gopalakrishnan: So, Jai, I think we have gotten the rating upgrade from A+ to AA-minus over the last couple of quarters. Some of the rating agencies came up December, the March quarter and the one rating agency upgraded us in the last quarter. So, I don't think there is any immediate rating upgrade on the anvil. The next rating upgrade will probably depend upon the kind of portfolio growth that we get to and maybe a little bit comfort of the rating agency in terms of the seasoning of the portfolio. But having said all this, I think today the NCD market not coming in is not just because of company-specific factors, there are a lot of macroeconomic factors which are at play, especially there are companies who are willing to offer significantly higher rates to onboard NCDs and especially the gold Loan NBFCs, microfinance companies and even vehicles, they are willing to take monies at shorter tenure which is more attractive given the volatile interest rate environment. People are not willing to commit for a longer period of time, they don't know how the entire interest rate scenario is going to stack up, which is where we are probably not able to raise as much of NCDs as we would have liked. Because we want at least for a three-year or a three year plus kind of a tenure and the rates to stack up closer to what we are borrowing either through the term loans or securitizations, but the numbers are a little wacky. And given that our demand is being met by banks through term loans and securitization transactions, we have not aggressively gone out to issue NCDs for subscription. But having said that, there is a very clear mandate to the treasury internally that we will have to push the NCDs both through the private placement and also public issue of NCDs which may come in during the latter part of this year or early part of next year. So, I think you will start seeing traction coming in the next few quarters and the NCD proportion also going up significantly. Hopefully, the

interest rate environment also will get a lot more benign. And then with that stability, I think we should be attractively looked at even by the NCD players, be it the mutual funds, AIFs or the wealth management funds for them to invest monies into our papers.

J Toshniwal: Second question is on our AUM of state wise. So, if we look into the last two quarters, you have added Rajasthan and it's basically in September '22 presentations, Maharashtra, Chhattisgarh, Uttar Pradesh. The growth is pretty slow out there in terms of not also adding branches, hardly we added two branches in Rajasthan. Anything specific you want to highlight or it's just that you're building up the portfolio and being cautious on these.

Lakshmipathy D: Jai, your point is very clear, and you picked up very well. That is our style. If you have been hearing our conference call since last five times, we are very clear here to say we are not going to rush for the growth in the newer geographies… we don't want to do that. So, the growth is going to come from the southern market where we have been lending and collecting for the last 20 years. That gives us great confidence to whom we are lending, how we are lending and how we are collecting the EMIs back. Having said that, if you see three years, five years down the line, we don't want to be in a southern market alone, we want to be in a pan India market. So, we are starting to lend in the newer markets slowly but steadily. So, whatever the growth guidance I have given, I have only given keeping the south market in mind and I don't want to pressurize my rest of the country team to show the growth and lend into wrong hands. So, we want to be very slow and we want to be very steady. If you see quarter-on-quarter or year-on-year the states what you said will have a steady growth. But please don't compare that with the southern market because that's our growth engine whereas the rest of the country will become a growth engine at the right time. So, now I'll hand it over to Ranga to talk a little bit more on the rest of the country.

Rangarajan Krishnan: Mr. Pathy has rightly summarized it. As far as any new state is concerned, we have always been guiding that we will be extremely conservative in the first 24 months. So, in the first 24 months we'll hardly be opening, maybe four to six branches only, in a newer state. Because the 24-month period is an extremely critical period for us where we get to see a variety of things clearly on the ground, that includes our own people, that includes the first few loans that we have lent. We also told you in the past that for the first probably a year or so, every loan that we give out in the new state is approved either by the M.D. or myself. So, we are that much very, very clearly focused on what are the set of customers that we are building in a new state, who are the teams that we're getting in the first few branches. So, these new states we will pick it up slowly. If you look at Madhya Pradesh, which we opened about five years back today, Madhya Pradesh has more than 50 branches. So, growth is not going to come in a sudden manner in the newer states. The growth is more than adequately compensated for in the southern markets. In the newer markets this year we've identified Rajasthan, UP and Gujarat, apart from expansion in Maharashtra. So, these are the new markets where you will clearly see us putting up branches and putting up investing teams, but the growth will definitely take time to pick up in the newer states.

J Toshniwal: While you mentioned that competitive intensity is there from everywhere, you're not concerned much about it. So, what are the key areas of pointers you are right now focusing on in terms of concerning points or anything you want to highlight?

Lakshmipathy D: We are focusing on what we have been focusing for the last 20-years, nothing special that we are taking from a competitive intensity perspective. As I said, competitive intensity should be there for the right product. So, people are all willing to get into this segment, bigger NBFCs and smaller finance banks. But the experience says, it's not so easy game to play, but the good part to play is sub-1 lakh and more than 10, 15 lakhs area where people find it very comfortable. But nothing specific that we are worried about competitiveness, and we are not growing aggressively or we are not growing slowly or we are tweaking our lending rates, nothing doing from our side, we are doing our business as we've been doing. But one point what I wanted to emphasize here is we don't want to be a southern lender anymore. So, we want to be at Pan India. Competitiveness is maybe one of the reasons where we wanted to get into newer locations also. So, we are very keen, as Ranga said today, we are at nine states, we'll be at 10, 11 states in a year or two. So that also keeps us more safer that we have reached to the more geographies and more people.

Moderator: The next question is from the line of Vivek Ramakrishnan from DSP Mutual Fund. Please go ahead.

V Ramakrishnan: Just as a follow up, when you go into a new state, are you finding any major cultural differences when you compare to the southern states where you are comfortable in? Question #2 is, in terms of attrition, when you lose at the lower management level, which is what you said, where do they usually go, do you have any idea, whether they're going to another bank or an NBFC? Question #3, we buy into your optimism, but if you could tell us what worries you have on the ground, that will be useful also?

Lakshmipathy D: From a newer state I will ask Ranga to answer. On question #2, I can't answer anything with whom we are going towards. I think see, this business model is very unique. I don't think any one does this kind of business model, underwriting, collection setup which I have not seen in any NBFC. Because we have not copied from anyone, everything is being built here from the base of the experience. So, we don't specifically take people from a specific name or a specific entity. Anyone wishes to grow their career can join Five Star because they can grow their careers because the company is good, the growth rates are good, the incentives are good, the business model competitiveness is lower comparing to the other products. So, anyone can join Five Star and earn a good name and career in Five Star. Talking about the third point which you said, nothing specific concerns me at this given point of time. It is good that people all talk about lending to small businesses. We are happy to register ourselves that we are a category creator when no one saw this as an opportunity 20 years back. We saw this as an opportunity, and we never diverted into any other product. We just picked on with the same customers, same profiles for decades. So, we are very happy that more people are looking into it. So, I don't feel any concerns, I feel bit proud that we're able to take this category from informal slowly to the formal side.

Rangarajan Krishnan: On the first question where you're asking about any cultural differences in the newer states, there will be definitely cultural differences. I think in India, taste changes every 50 kilometers. So, you will not find that even restaurants are very similar in 50 kilometers. So, which means when we are entering a new state, there will be cultural differences. There are fundamentally the set of customers that we target that does not differ. We still go behind essential services, we still go behind the self-employed category. But within that there will always be slight nuances in cash flows, in repayment track. I think more importantly, there be a lot of cultural differences between people, which is our own

people. Every state has a unique culture in terms of loyalties, in terms of people sticking to a particular company, people building careers, attrition levels are very different. So, every state is different. I don't think we are saying one state is better than the other. But, it's important for you to understand the nuances of that state to make sure that you're an attractive employer in that new state. Also, what differs significantly between state-to-state is land records are very different, the way you evaluate legal risks, the way you evaluate title deeds and go and get your mortgage registered, it's different. It's not one country still. So, there are multiple nuances especially when it comes to dealing with ancestral properties and the way title deeds have been passed on through generations. It's a very different and nuanced market. So, it takes time for you to learn these things, which is why in the first 24 months of entering a new state, we don't put pressure at all from a growth perspective for the newer state. It's more important for us to understand all the nuances, check the fundamentals right and then set up the state for a growth for a longer period of time.

Lakshmipathy D: Vivek, sorry, I misunderstood your question. If your question is on the attrition, where does our people go? If that is your question, yes, today as this business model is getting more hotter and hotter, people finding right talent from here, they choose Five Star employees to pick and build it. But it's not so easy for people to just to poach our employees and start building the Five Star model. But as rightly said, this is not a model that can be built in overnight, it has to be built with the exercise. So, I can't name where the people are moving in. Yes, there is a good amount of demand from an employee side which is getting poached by other NBCFs and small finance banks.

Moderator: The next question is from the line of Pallavi Deshpande from Sameeksha Capital. Please go ahead.

P Deshpande: Just wanted to know, of these new branches that you'll be adding, what would be the spread of south versus non-south? And second was on the collections in cash. What would be the percentage of that?

Lakshmipathy D: So, what we have been guiding to the market is close to 75:25, that is 75% of the branches will be in south and 20%, 25% of the branches will be in the rest of the country. So that's what we have been guiding. More or less, it's aligning with the same percentage what I said. From a cash collection versus non-cash, close to 55% of our collections comes from cash and 45% comes from non-cash in all types of digital media including the NACH. It used to be around 65% or more, that is slowly coming down to 55% now, and it may also further come down as we move forward. But we are not here to guide market that we will be at so and so percentage of cash because we are very comfortable in cash. As long as the customer is comfortable, we are comfortable. As long as customer feels digital is comfortable, we are comfortable. So, there's nothing hard and fast from our side.

P Deshpande: On the guidance with regard to the branches, right, a year back, we were looking more spreading out to the non-south region. Is there a change in strategy, just wanted to understand that because I mean the opportunity maybe still big in south, is that the reason?

Lakshmipathy D: We have not changed this pattern what I guided earlier; it was 75 to 80 percentage of branches in south and 20% to 25% of the branches will be in non-south, to be more specific. One or two branches can miss this way or that way. But broadly, our thought process is very clear, we want to be a very strong player in north going forward… going forward means for the next few years, not few quarters. But having said that south is a very big market. Just to give a comparison, HDFC has close to 500 branches in Tamil Nadu. I just saw it in public domain… it's a public data. So, we have only 120

branches here. If a bank has 500 branches, why can't we? So, that's from one state. If you multiply that with four big states of south, which is Andhra, Telangana, Karnataka and Tamil Nadu, you have a very huge opportunity in south itself. But, as I said, from a competitive intensity to improve our presence where we are not there, we are very clearly to focus on non-south which is the central, north and western part of our countries. So, there is no change in that thought process. Still, we feel south is the dominant place to operate and non-south is very key from Five Star perspective, so we are investing a lot in non-south too.

P Deshpande: So, two years hence do we see this mix changing because like you said you wait for two years for the branches to mature, you open only three or four, you learn about the state and then you open more branches. So, does this mix change two years hence in terms of 75:25?

Lakshmipathy D: Certainly, it will change. All depends upon the results that what we are getting from the non-south branches, what we have put in Rajasthan, Uttar Pradesh and expanding in Gujarat and Maharashtra. So, we we'll wait and see how the results are. But as I said, we will not push for the results. Let the results comes as it comes. When the results are good, when the green shoots we are able to see there, definitely, we will not shy away by revising the guidance of 75:25.

Moderator: The next question is from the line of Saptarshee Chatterjee from Groww AMC. Please go ahead.

S Chatterjee: My question is more on the environment part… that already you have touched upon it, but like we are seeing commentary from the consumption companies that rural and semi urban consumption demand has been slow. But on that perspective, we are seeing that growth for you as well as some of these NBFCs have been very strong. So, can you please touch upon how you are seeing more of the demands and cash flows of your customers and there do you have to like paddle more towards distribution-driven growth and customer acquisition-driven growth for more customer acquisitions or it is the strong demand any which way?

Rangarajan Krishnan: So, there are two ways to tackle this question. One is what are you seeing primarily from a consumption perspective on the rural, semi-urban. Our growth is purely not dependent only on that aspect. Our growth is also dependent on how much of conversions that we are able to do from people who are moving from unorganized to organized sector. So, as far as that is concerned, we are clearly seeing a trend in markets after markets wherever we are able to open new branches, we're seeing very, very good traction and we're able to convert more and more people from unorganized money lending to more organized lending. So, that is what is giving us a solid growth on the ground. So, the strategy has not changed for us. I think that is what is giving us the confidence from a growth guidance perspective also. Of course, it is going to be a combination of distribution-led growth. So, that's where we have now increased the guidance in terms of the number of branches that we are willing to open in a particular year. We have already opened 83 branches this year and Mr. Pathy has guided just now that we will be at least opening another 40 to 45 branches during this year itself. So, it is going to be a combination of distribution-led strategy and the fact of people moving from unorganized to organized. That is giving us a combination of good growth guidance.

S Chatterjee: Just one part on this is with increased branches, are we going much deeper into the geographics like some Tier-3, Tier-4 to Tier-5, Tier-6 for the branches?

Rangarajan Krishnan: So, we have two branch-led strategies. One is what do we do in the southern markets and second is what do we do on the non-south markets. So as far as the southern markets are concerned, the clear strategy of the company is to penetrate deeper and deeper. We are already going up to Tier-7 cities and we still have huge opportunity for us even within Tier-6, Tier-7 cities in each of the southern markets where we're already present. So as far as south is concerned, the strategy clearly is to penetrate deeper and deeper, open more branches, expand the franchise and attract the customers more and more. But as far as the non-south locations are concerned, we are just putting up the first few branches probably in a particular state. So, in these states we are still not going very, very deep. Most of our branches are still in probably Tier-2 to Tier-3 or Tier-4 cities. We will penetrate these larger cities first, get a hang of the culture and the state and slowly penetrate these states as we move forward from here.

S Chatterjee: You have already touched upon on the competition, but wanted to know what are the yield level that your competition is working on and therefore the differential of your yield versus competition? And overall let's say some 2-3 years down the line, do you see that growth and yields will be a challenge? And if the situations and demands worsen, which one will you prioritize more on, either on yields or on growth?

Srikanth Gopalakrishnan: I think on the yields, if you look at from a competition perspective, we are at least at par if not lower than our competitors. So, it is not very differential and the kind of demand that we are getting. If we are way off from the market, this is not the demand that we will be getting. So, we are at par with the market…in fact, we are actually better than some of the bigger players also in terms of the yield. Like we have been guiding, see, our intent is not to keep the yields at where they are today. Our intent is to ensure that we maintain the spreads. Now, we have had quite some benefit on the cost of funds coming through in the last about four to six quarters. But given the very volatile interest rate environment, we have not passed some of these benefits to our borrowers, which we will start gradually passing on once the interest rate environment becomes a lot more predictable. So, the question is not compromising yield or compromising growth or whatever. I think the question is more towards ensuring that we are a responsible lender, lending at the right interest rates to our borrowers. See, the segment is not very price sensitive. A percentage difference in yield for a seven-year loan will probably translate to about Rs.70 to Rs.80 EMI every month for a lakh of loan. So, it's not a very price-sensitive segment. But at the same time, we want to be a responsible lender and operate at around 12% to 13% kind of a spread in a steady state scenario. So, once the interest rate environment stabilizes, I think we'll start seeing some benefits that we pass on to our borrowers. Not with a view to ensure that we get the growth that we want. But like I said, being a responsible lender and ensuring that the borrowers get the optimal cost for the borrowings.

Moderator: The next question is from the line of Aravind from Sundaram Alternates. Please go ahead.

Aravind: I just have like one question on this gross Stage-3 assets in terms of one year lag. I can see that like from the 1s Quarter of 2023 it's been inching up. Is there any some cause of concern there in those?

Srikanth Gopalakrishnan: The intent is not a concern. The point is also that when you're growing, the lag is slightly higher compared to what we have been seeing in FY21 or FY22, the growth was also much lower, so the buildup was much lesser. But having said that if you look at the last quarter numbers also, typically,

the one-year lag has always been at around the 1.75% to 2% level and this is something that we have shown be it in Q2 FY21 which was the COVID period, Q2 FY22 which was again a COVID period and Q2 FY24. So, I think largely the numbers will be around the 2% level which is where this number has always been even in the past. In fact, it used to be more. If we extrapolated a few quarters earlier when we were in a much faster growth pace, this number would have been higher, but one-year lag will typically settle at around the 1.75% to 2% level. And this also has the new RBI norm built into right, it's 1.35%. So, you should also take that into consideration. when you look at Q2 FY21 or Q2 FY22 that does not have the RBI norm getting built. So technically if you see 1.7% of Q2 FY22 is not an apple-to-apple comparison as against 1.95% of Q2 FY24. Q2 FY22 would have been a 90 plus number of about 1% to 1.1% vis-à-vis what we are looking at the new IRAC norm of 1.35% for Q2 FY24. So, you will also have to factor in for the 20, 30 basis points increase.

Aravind: One is other income, other incomes doesn't look like it is connected to disbursements. Even though the disbursements have grown quarter-on-quarter, other income hasn't grown. Operating expenses, we are investing heavily in IT like either for ERP or other technological like transformation stuff. Will that have an impact on OPEX process ratio or cost-ratio like in a significant way?

Srikanth Gopalakrishnan: So, firstly, Aravind, your observation is right on the other income. The other income is predominantly investment income that we earn on our FDs, that we earn on our mutual funds on the excess liquidity that we carry. So, it does not really have a straight correlation to the disbursals that we do. It depends on the kind of borrowings that we do and the yields that are available out there. So last year the other incomes are actually lower because the yields were much lower in the market. Yields are definitely getting better and which is why you're seeing the other income getting higher. See, in terms of the operating expenses, we are definitely putting a lot more investment into the technology and all that. Rather than looking at either an operational expenses in absolute quantum or whatever, I think the way that you'll also have to see is look at the cost-to-income, so which is where we guided our cost-to-income is expected to be around 35% to 37% range. And this is sort of remained range-bound for the last four to six quarters ever since we have been… even prior to that it was range-bound, but the last five quarters when we've been public, I think it has remained range bound around 36% to 37% level. We are very confident that despite the investments that we make in technology, we are not doing anything that's probably a sunk cost or that will give us benefits over a longer period of time. We are reaping the benefits. So, you will see the cost-to-income stabilized around those levels in the quarters to come as well. So, no adverse impact expected on the P&L because of additional technology spends or the slightly increased operating expenses.

Aravind: I was asking specifically on the core fee income, around like that Rs.42 crores, I thought that was just related to disbursement. I understand the other income is summation of the core fee income based on disbursements and then like investments we make and other –

Srikanth Gopalakrishnan: Today, the core fee income is also part of the interest income. If you look at the interest income, it comprises of interest on loans, it comprises of interest on fixed deposits, it comprises of processing fees and the other legal and operational expenses where the proportion remains unamortized. So, everything is getting clubbed in the interest income in slide 47 that we have given. The other two numbers that you're talking about, which is net gain on fair value changes, is primarily on account of the mutual fund incomes that we do. And fees and other income will be primarily recovery of bad

debt and the other incidental incomes that we get on account of certain storage costs and all that. The numbers are anyway fairly muted; it's about Rs.7, 8 crores per quarter.

Moderator: The next question is from the line of Harshvardhan Agrawal from Bandhan AMC. Please go ahead.

H Agrawal: I just wanted to understand, you mentioned that you have –

Moderator: Sir, can you speak loudly? Your voice is very low.

H Agrawal: You mentioned in the opening remarks you guided for the second half would be 120, earlier guided was around 70,80. So I just wanted your thought process as to how the opex would look like in the second-half because I believe, there are some marketing expenses, etc., So, opex in the second-half where will we see from the first half?

Lakshmipathy D: I think the good part is if you break that 120, 80 branches have been opened in the first six months itself. So, all the cost has been incurred as we have shown in September itself. So, it's only the balance of 40-45 branches which we will be opening in the next six months. But the good part is the 80 branches which opened in the first six months start to react more positively for the next six months. So, that will adequately take care of the income side. I think I'll ask Srikanth to explain it a little more.

Srikanth Gopalakrishnan: See, on the operating expenses side, what we always say is, irrespective of the branches that we put in, our breakeven is one of the strongest; in about six to nine months we are able to break even at a branch level and even covering fixed cost at the head office level, this is like nine to 12 months that we are able to do. So, from that perspective, there is no adverse impact that we are expecting either opex as a percentage of AUM or like I updated in the earlier question in terms of the cost-to-income. So, the broad guidance around the opex to AUM of about 6%, 6.5% and the cost-to-income guidance of about 35% to 37% continues to stand even in a growing scenario.

Moderator: The next question is from the line of Nidhesh from Investec. Please go ahead.

Nidhesh: A couple of questions. First is, how is the vintage 12 months MOB Stage-3 for us? And second is how are the BT out rates we are seeing in our portfolio?

Srikanth Gopalakrishnan: I think the point is, in terms of the Stage-3 one-year vintage, we will not see much at all. Like what we say is what we track as quick mortality account, that is very, very far and few for us. So, you will not see one-year vintage loans which are getting into Stage-3. Typically, the breakup of Stage-3 will be more like three plus years loans. Because our belief is, whatever a little bit of shocks or delays as the customer could do, he may probably delay one in 18 installments or so. So, that means typically for him to get into Stage-3 will be at the end of the third year or so. So, you will not really see too much of one-year vintage in Stage-3. The quick mortality is extremely low. Sorry, what is the second question? I just missed it.

Nidhesh: What are the balance transfer rates?

Srikanth Gopalakrishnan: Today, our balance transfers both in and out are extremely minimal. Like we said, our business model is built to displace the money lenders. So, while we'll be taking a lot of loans away from the

unorganized markets, those don't typically classify as balance transfers in. And similarly, our borrowers are happy with us as long as we provide them what they want in terms of the loan quantums, good service and the flexibility in terms of repayment, they're happy to stay with us. So, I think you will not see either of these numbers crossing about 2%, 3% both BT in and BT out.

Moderator: Ladies and gentlemen, that was the last question for today. I would now like to hand the conference over to Mr. Lakshmipathy Deenadayalan, sir, for closing comments.

Lakshmipathy D: Yes. Thank you, participants. I know there are a few more questions lined up, but we have already crossed one hour 45 minutes and thank you for patiently being with us. We apologize for the pending questions. Definitely, we will take it up in the next earning call or you can reach out to the IR team, where the number has been given in the website where we will take up your questions.

To conclude, as I said, we have been with you for last one full year with five quarters of numbers and what we say and what we deliver now matches very clearly and we are very confident that this category what we have built in the last 20 years is here to stay and here to grow. And Five Star has an edge comparing with other lenders, the experience what we got in the last 20 years will help us to scale through with the right quality and right profitability without missing these two. So, thank you again for reaching out in this conference call and waiting for a long time and we will meet in the next earning call.

Moderator: On behalf of ICICI Securities, that concludes this conference. Thank you for joining us and you may now disconnect your lines.