“Five-Star Business Finance Limited

Q3 FY ‘24 Earnings Conference Call”

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MODERATOR: **MR SAMEER BHISE – JM FINANCIAL**

Moderator: Ladies and gentlemen, good day, and welcome to Five-Star Business Finance Limited Q3 FY '24 Earnings Conference Call hosted by JM Financial. 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 an operator by pressing star then zero on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr Sameer Bhise from JM Financial. Thank you, and over to you, sir.

Sameer Bhise: Thank you, Muskaan. Good morning, everyone, and welcome to the Five Star Business Finance 3Q FY '24 Earnings Conference Call. First of all, I would like to thank the management of Five Star Business Finance for giving us this opportunity to host the conference call.

From the management side, we have Mr Lakshmipathy Deenadayalan, Chairman and MD; Mr Rangarajan Krishnan, CEO; and Mr Srikanth Gopalakrishnan, CFO of the company. We will have opening remarks from Mr Lakshmipathy Deenadayalan to give a brief update on the business, post which we will open the floor for Q&A. Over to you, sir. Thank you.

Lakshmipathy Deenadayalan: Yes. Thank you, Sameer, for a quick intro. I welcome every participant for the third earnings call for this financial year and sixth earnings call since listed. Let me start with a very optimistic note to congratulate my operating and finance team for their excellent work, what they have done during this challenging quarter.

From the operational side, two of our big states, Tamil Nadu and Andhra had the brunt of weather, we all know the floods in Tamil Nadu. Despite that, we are able to put our business and collections on the best foot. And the ERP implementation is completely done. And last quarter, Andhra, Telangana, which is a significant big state for Five Star, our ERP implementation was done. With this, the entire Five Star's ERP has moved from FinnOne to Salesforce.

And the November circular, issued by the regulator, which brought in a lot of constraints, banks lending on NBFC and Five Star has demonstrated well. So, we will look into the numbers.

With this, let me get into the numbers, as usual, we'll start with the business side, then we'll go to the collection side. In the business side, we'll start with the branches. We have opened close to 24 branches in Q3. With this, the total count of branches opened in first 9 months is 111 branches. It has moved to 480 branches as we stand today. As we said in last call, we intend to open close to 120 branches for this full year, and you will see a few more branches in Q4.

With very good number of branches getting opened, our distribution was also good, but it was flat comparing with last quarter with INR1,210 crores. But if you compare with year-on-year, we have given a 33% growth in our disbursement. This is in spite of the flooding, what we said in Tamil Nadu and Coastal Andhra. We were able to manage the good disbursement which has resulted in a very good AUM growth from INR 8,264 crores to INR 8,931 crores with an 8% Q-on-Q growth and 43% year-on-year.

That has resulted in a good revenue. Our income has moved from INR 522 crores to INR 570 crores, which is a 9% growth on Q-on-Q and 47% growth in year-on-year, and also resulted in good profitability, moved from INR 199 crores in Q2 quarter to INR 217 crores in Q3 with a growth of 9% and 44% year-on-year.

So, with this, let me take you to the collection side, which is a very important metric for a lender. Our collection efficiency has been maintained at one of the best numbers. We are at 99.1%. Comparing to a slight tad low, in last quarter it was 100%. And unique customer, which is a very important metric, that how much we collect from each customer. That has also moved a little tad down from 98% to 97.5%.

Both the collection efficiency and unique customer has seen a very small blip in spite of being a challenging weather conditions in last quarter. But our 30 plus which has shown a healthy move, it was at 8.59% in September quarter, that has come down to 8.35% in December quarter.

Another metric, which is current to arrear as a percentage, was at 86.5% to 13.5%, has also improved to 86.7% versus 13.30%. So, we are reaching closer to the number, what we said 90% current in the next financial year, maybe the first quarter of next financial year.

And finally, on the IRAC NPA, which is the technical NPA what we call, and Stage 3 assets, have moved from 1.35% to 1.40%. Comparing to last year, it has dropped from 1.45% to 1.40%. So, it will be in the ranges in the same way.

And finally, on cost of funds, the book cost of fund has dropped down from 9.71% to 9.64%. And incremental cost of fund, which is very important metric after the November circular of RBI, has moved from 9.5% to 9.57%, which is just 7 bps. Since the circular, our treasury team was able to get close to INR 1,500 crores, taking even January into account with just 7 bps of cost going up.

So, with this, we conclude that the confidence from lenders, especially banks to NBFCs like Five Star significantly has stood well. With this, let me hand over the call to Srikanth to take us through on all metrics further deeper. Thank you.

Srikanth Gopalakrishnan: A very good morning to all of you. As Mr Pathy has outlined, Q3 was a robust quarter for us. We fared well across the various financial and the operational metrics. On the branch count, it was a good quarter for us. So, we added 24 branches for the quarter. And for the full year, the last 12 months, we have added about 111 branches. So, we are at 480 branches as of December 31. This has translated into a good disbursal quantum despite some impact because of the floods in Tamil Nadu and Andhra and an AUM impact.

So, our AUM grew by 8% quarter-on-quarter and 43% year-on-year. We ended slightly short of INR 9,000 crores for December 31st. From a financial metrics perspective, our yields continue to remain stable at around 24 to 24-quarter despite our average cost of funds dropping marginally. Our incremental cost did go up a bit, inch up a little bit, but very marginally. We had a spread of 14.6% for the quarter as against a spread of 13.8% for Q3 FY '23. Obviously, with increasing leverage, the NIMs will continue to drop. So, the NIMs dropped to 16.8% compared to 17.68% as of the previous quarter, like I said, primarily on account of higher debt and increased leverage.

We have also been a little conservative during this quarter because of the risk weight circulars coming through and the regulatory overtures that are being given. So, we maintained a slightly higher liquidity during this quarter, which resulted in increased leverage and lower NIM. If we do a quick back-of-the-envelope calculation and reduce our debt by about INR 300 crores / INR 400 crores, our NIMs would have looked much better. Our NIMs would have been at about 17.4%, which should have been a drop only of about 30 basis points rather than 80 basis points as we're seeing now.

Cost to income remain range-bound. It's actually shown an improvement during this quarter to about 34.5% as compared to 38% for Q3 FY '23. We have done one of the industry best ROA. Again, ROA will show a contraction with increased leverage. But we still did an 8.25% ROA for the quarter and an ROE of closer to 18%. The ROE has increased by over 300 bps year-on-year and by about 65 basis points quarter-on-quarter. Obviously, you will not see such sharp increases as we go forward, but there will be increases with increased leverage in the ROE.

Our borrowing profile continues to be well diversified. While we still have a little bit of a higher proportion in terms of bank term loans, but we are very conscious to diversify our borrowings. In fact, during this quarter, we also did 1 capital market transaction. We issued NCDs for about INR 105 crores. During the quarter, we received an incremental sanction of close to INR 1,400 crores and availed about INR 1,000 crores out of that. All-inclusive costs being 9.57% for the quarter, which is 7 basis points higher than the previous quarter number of 9.5%.

For the full year, the 9 months ended December, we have gotten sanctions of about INR 3,500 crores and availed about INR 3,000 crores at an all-inclusive cost of 9.52%, so which is extremely attractive as compared to what has been happening around us in the last 12 to 18 months. We have a liquidity buffer of about INR- 1,800 crores and an unavailed sanction lines of another INR 475 crores.

Mr Pathy has touched up on the collection efficiency, so I don't want to repeat them. But what is important is across the various stages of assets, we are showing improvement. Our Stage 1 is getting better. Our Stage 2 assets actually came down to about 6.95% from 7.24%. There's a marginal blip in the Stage 3 assets, primarily on account of the floods.

But we also continue to maintain a very robust provision coverage ratio both on Stage 3 and on the overall AUM. Our PCR on Stage 3 is at 54.26%. And PCR on overall AUM is at 1.62%. As we have always been guiding you, we would continue to remain optimistically cautious, neither aggressive nor conservative, but we'll ensure that the right amount of provisions are being created on our balance sheet.

On the restructured book, the book has dropped to about 0.59% of our overall AUM. And even on this portfolio, we maintain a PCR of over 50% so we don't see any risks coming on this portfolio at all. So, all this has resulted in a very strong profitability for the quarter at INR 217 crores, which is a 44% year-on-year growth.

And on a sequential basis, our PAT has gone up by 8% from INR 199 crores to INR 217 crores. Net worth almost at INR 5,000 crores. And with the last quarter typically being the best for us and for any other NBFC, we are very hopeful to carry forward this momentum and deliver a strong set of numbers in Q4 as well.

On that note, we would like to open up for any questions that any of you may have. Thank you.

Moderator: Thank you very much. We will now begin the question-and-answer session. And the first question is from the line of Maharukh Adajania from Nuvama.

Marukh Adajania: Congratulations. My first question is just on the cost of funds. So, you've managed your cost of funds very well this quarter even in terms of incremental cost of funds. How do they move from here on? And what is the portion of the book that gets affected by higher risk rates?

Srikanth Gopalakrishnan: So Maharukh, on the cost of funds, like we said, we are continuing to be very sharp in focusing on getting the right cost of funds for us. As you would have seen, the incremental cost came in at 9.57%. But again, you will probably see some uptick -- when I mean uptick, there are some increases coming on this, both on account of risk weights and on account of the fact that we definitely want to diversify our borrowings.

Today, about 66% of our loans are from bank term loans. But when we move to capital markets, the cost tends to be slightly higher. So, we will probably guide you for maybe another 25 basis points increase from here on over the next few -- next couple of quarters. So that is the impact on the cost of funds that we see on the incremental cost.

On the book, again, there is still a delta between what we are borrowing today and where the book cost is at. So, at some point of time, these will converge and you won't see any further benefits coming through. But with our spreads, I think even an additional 10, 15 basis points increase in our book cost is not going to cause any concern for us.

In terms of the risk weights, we have gone -- on a conservative basis, we have only bifurcated our portfolio into 3 parts. One is loans given for business purposes, which clearly do not attract a higher risk weight. Loans given for housing, again, do not attract a higher risk weight. Any other loans, which are given for any other purposes, which could be marriage, education, medical emergencies and all that. So that roughly constitutes about 20% to 30% of our portfolio has attracted a higher risk weight.

So, we have seen about roughly 3.5 to 4 percentage points impact in our capital adequacy. We are at about 53-odd percent. If not for the risk weight, we would probably be close to about 57%.

Lakshmipathy Deenadayalan: So just to finish this point, Maharukhh, as we stand today, banks are very vibrant, and they are very positive lending to Five Star. But having said that, Board and we have taken a call to move slowly away from bank borrowings to the market borrowings. That will be the plan of action for next 3 to 4 quarters. So that -- that's where Srikanth has given a 25 bps increase in cost of funds when we move from bank funding to market funding.

Marukh Adajania: Got it. But just on risk weight, basically 25% of your book is affected, but your entire portfolio of bank loans would be impacted in terms of higher cost if at all banks have passed higher costs? Or how does it work?

Srikanth Gopalakrishnan: Yes. We don't -- see, we have always been very conservative as far as our PSL classification is concerned. So, we have not taken any PSL benefit from any of the banks. So technically, I would say, if not all, Maharukhh, so obviously, this does not impact the NCD, this does impact the securitization. It will only be impacting the bank term loans, which is, like I said, about 65%, 66%. But having said that, we have not really seen any of the banks come back to us, except for maybe 1 or 2 banks who have asked us for any increase on our existing facilities.

Even post the circular that was given by RBI, we have managed to raise monies at 9.5% or even sub-9.5% from some of the marquee names, be it the State Bank of India, be it Indian Bank. So, each of these people have -- and some private sector banks as well. They have all given us sanctions at 9.5% or sub-9.5% even after the risk weight circular coming into effect. So, we really don't see too much of impact coming on our cost of funds on the book because of the risk weight increase.

Moderator: The next question is from the line of Renish from ICICI.

Renish: Congrats on a good set of numbers. Sir, just one clarification on our Page #46, wherein we have mentioned that there is intercorporate deposit with Bajaj Finance of around INR100 crores. So, what is that? I mean, what's the feature of that? And why sort of we have put this deposit with Bajaj Finance?

Srikanth Gopalakrishnan: So, Renish, this is a -- what you are seeing here is a typical investment. Our investment policy provides for three avenues of investments. One is fixed deposits of banks. The second is or rather I would say four, fixed deposits of banks, we put some money in government securities. We also invest in liquid mutual funds. And very, very selectively, we have taken some names, AAA, NBFCs, really large NBFCs where we can put monies in their deposits. So that is the intercorporate deposit that you're seeing.

This also includes a portion of deposits on a securitization transaction that we have done with Bajaj Finance. So, it's a pure investment. But from an accounting standard, we will probably have to classify it as -- under the loans because these are with NBFCs and not with the banks.

Renish: Got it. And just on the balance sheet side, again. So, our cash and bank balances have gone up by almost INR500 crores. So, is there any specific reason to keep such a high liquidity or this is just in the -- let's say, presumption of very high growth in Q4, and hence, we want to maintain that liquid balance sheet?

Srikanth Gopalakrishnan: So, Renish, like we said, when the circular came in sometime in November, I think there was a little bit of concern on -- in terms of how this is going to impact supply from the bank side. So, we actually went a little bit conservative and put monies ahead of time that we would have wanted. So, it's not like -- if it was a normal quarter, probably we would have been INR300 crores, INR400 crores lesser. But given whatever is happening out at the macro level, we just were a little conservative in terms of taking a little higher funds.

So ideally, we would like to maintain about 15% of our AUM in the form of liquid cash and other liquid investments, but we are slightly higher. We are almost at about 20% at this point primarily because of being a little more conservative and not because assuming the Q4 will be good. Q4, obviously, we are going to get more monies as well. Like I said, we are sitting on almost INR500 crores of unavailed sanctions. But some monies we took because we also wanted to lock in the rate. Little bit of apprehension was there in the initial period whether banks will hold on to the rates that they have sanctioned to us. So probably we took a little more money than we would have wanted.

Renish: Lastly, on this -- our geographical diversification. So if you look at the Andhra Pradesh contribution which has been increasing over the past 1 year, it is slightly, I would say, is not opposite, but when we talked, we've always been mentioning that we'll be growing in other non-Southern state. But at least in past 1 year, that is not happening. So can you please throw some light on what is happening on the diversification front?

Rangarajan Krishnan: So, Renish, we have been consistent in our commentary where we have said that for the next 3 years the bulk of the growth is always going to go from South. This is a regional business and South is our strongest hold. So South will contribute bulk of the growth. In fact, we have been guiding that, of the incremental branches which are getting opened, 80% of the branches will get opened in South and 20% will get opened in the rest of country which is what has happened. So of all the branches which have got opened in the first 9 months, 80% is in the South, predominantly in Andhra, Telangana, a little bit in Tamil Nadu. And 20% has come in non-South.

So as far as the rest of the country is concerned, we've opened new branches in Rajasthan, we opened new ranges in Uttar Pradesh. We've expanded in Maharashtra, we've expanded in Pradesh. But like we have always guided whenever we enter a new state, and this includes Rajasthan and UP for this year. This is the first year that we've entered these 2 states, we will always take at least a period of 18 to 24 months to see how this first few branches behave before accelerating the pace in the use case. So yes, the diversification is on but it's not going to happen in a rush.

Lakshmipathy Deenadayalan: So just to add to it, if you see our presentation, the rest of the country was around 4% of our AUM. That has moved to 6% now. So that's a significant growth even the base was lower. But as Ranga said, we are not in a hurry in rest of the country. We have to learn a lot there. And we have learnt a lot in South. So our growth will come from South predominantly for next 2 years, 3 years down the line.

Renish: Got it. Got it. And just last one from my side on the spread. So given the way a regulator is saying over the last couple of months, be it on risk weight or some commentary on the MFI lending rate, etcetera, do you foresee any regulatory risk on our spread?

Srikanth Gopalakrishnan: So, Renish, nothing as yet -- we have been talking to the regulators at various forums. They've also been in our office for a regular routine inspection and all that. So I don't think we're getting any concerns from them on the spreads. But like we always have maintained, forget external stimulus or influences, we would like to be a responsible lender.

And at some point of time in the future, we are going to be reducing our rates. So hopefully, that will sort of -- if at all there is anything in the mind of the regulator, which we are not aware of at this point of time, even that will get addressed indirectly.

Moderator: The next question is from the line of Chandrasekhar from Fidelity.

Chandrasekhar: Maybe just a question on opex, up 18% only Y-o-Y. Just may be help us understand what's happening. Are we done -- is the move from people who are collections to business that's largely done, and that's why? That's question one.

Second is just where are we just in terms of our book assets or maybe the onward, the fresh sourcing, the ability to get the Udyam certificate and, I mean, as a result would be eligible for the PSL. Some -- any update around that?

And then lastly, I remember, I think the whole idea of not borrowing on NCDs from now right now because there wasn't enough of a market in itself from the supply side, given where our rating is. So what's the pressure right now itself to look at NCDs? Why not after you actually get a rating increase?

Lakshmipathy Deenadayalan: I'll take up that collection people first. Then I'll ask Srikanth to talk about the opex cost, priority sector and the NCDs, the question what you asked.

See, from the collections point, as we have been saying that this is the work in progress. There is no time line that we wanted to fix intentionally. Because collections are very important, we don't want to take a call on collection and move them slowly towards productive side, which is the business side. That is work in progress happening. Quite a good number of people have moved from collections to business because our numbers are getting settled well.

So it will take its time, but I don't want to say any time line that entire collection team. Obviously, there will not be entire collection team moving towards business because we always want some support to be given to the harder buckets to the business team through collection specialist team. So that will be there. But the excess what we have today, which we built up after the whole New Year that will slowly go and get mingled with the business, but it will take its own time. There is no time limit constraint for us or no guidance that we have given to the market. It will take its own time. But we will ensure that our collection efficiency and the business productivity is maintained at the best level.

Chandrasekhar: Is that why -- I mean, right now, while that shift is happening, which is why the opex growth sort of slowed down eventually should pick up...

Srikanth Gopalakrishnan: No Chandra. No, no, no. So that's the point I wanted to say. See opex has gone up let's say year-on-year by 18%.

Rangarajan Krishnan: Is coming down...

Chandrasekhar: It's coming down. I mean, the opex is actually -- I mean, your AUM is running at 43% and upwards of 40% and opex come down.

Srikanth Gopalakrishnan: So Chandra, I think, we have also made investments in the past, ahead of time, right? So those productivities are actually coming through as we speak. So it's not just because of collections people. So it's not just personnel cost, which is actually coming down. Some bit on the operational expenses that you are seeing on the technology, all those things are actually contributing.

More than looking at the absolute quantum of increase between quarters or between years, I would actually tell you, if you look at the numbers in terms of the cost to income, that will give you a better perspective. Obviously, the cost to income was slightly higher than what we would have liked in Q3 of FY '23, which was at 38%.

That's come down to about 34.5% as we speak. But the steady-state number will be anywhere around 35% to 37% is the guidance that we are giving. So it's -- I'd say it's more productivity increases and assets getting built out rather than any of the collection verticals flowing back to the business side.

Yes. Secondly, on your PSL question, so we are -- we have done some initial samples, Chandra. Again, not very representative samples because the numbers are extremely small. We had tried doing about 100-odd cases into the Udyam registration. What we've also seen is about 80-odd cases have come in where we have gotten the Udyam registration. So the good part that we are seeing is of the business loans that we're actually putting into the registration portal, which is the - Udyam Assist or whatever, we are getting a good conversion out of that.

But like I said, the sample is too small. So I don't think we'll be able to give you any representative guidance at this point of time. Maybe give us a quarter or 2 more, and we'll be able to come back and say that what is the proportion of incremental book that we'll build, which would qualify for PSL. The initial results are quite encouraging is all the results that we have at this point of time.

Thirdly, on the NCD part. See, one of the things that we've always been saying -- or which markets have also been sort of questioning us is on the diversification of our borrowings and especially with the regulator also giving certain statements in terms of wanting the NBFCs to reduce the reliance on bank funding. And this was also discussed at our Board at various meetings. So very consciously, we are taking the call that we would want to start seeing the diversification of our borrowings, which is why the first transaction that we did after quite a while of INR100 crores.

Again, this came in at good cost. This came in at a tenure of 36 months. So we have not compromised on the tenure or compromised on the cost. So we are not going to compromise; we may compromise a little bit on the cost if good tenures and good quantums come through, but we are definitely not going to compromise much on the tenures.

But I think we will give a lot more importance to the diversification at this point of time. If it has to -- like I said, push the cost by maybe 25 basis points, I think we have -- our P&L has the ability to absorb that. So we are not going to be unduly worried by that. I think the focus has slightly shifted to diversification of borrowings from market -- capital market in the form of NCDs. We are also targeting DFIs. Hopefully, over the next couple of quarters, we will see one conversion at least.

So focus is clearly on diversification. Cost is definitely going to be an important parameter that we'll keep tracking, but a marginal increase in cost is something that we are prepared for.

Moderator: The next question is from the line of Dinesh Kulkarni from RDST.

Dinesh Kulkarni: Can you hear me?

Lakshmipathy Deenadayalan: You're clear. Please go ahead.

Dinesh Kulkarni: First of all, congratulations on a good set of numbers. I have a couple of questions here. First is on the branch additions. Like are we expecting a lower branch addition in this quarter compared to the previous one? I mean, like maybe around 30 is what I'm getting because we are seeing 120 for the whole year, right? If you could clarify on that?

Lakshmipathy Deenadayalan: Yes, it will be around 120 for the full year. So we have already opened 107 branches. So mathematically, it's only 9 pending. But I cannot precisely say that we'll be around 10, 12 branches which will be opened in this quarter. Generally, at Five Star, the last quarter, the branch opening will be lower. And first 2 quarters of the financial year, you will see lot of branches getting opened.

Dinesh Kulkarni: Okay. That's great. So then how should we look at the numbers going forward, maybe not on a quarterly basis, but year-on-year? Is that number of 70, 80 branches per year will that remain in that range or will it increase -- can we expect more -- additional branches?

Rangarajan Krishnan: This year is a little bit atypical. Usual branch openings will be about 70, 80. But this year, we have put the branch openings a little more. We had definitely guided for 120 branches, but we are expecting to open a little more than 120 branches for this year. So you will also see us opening few more branches for this quarter. It will be at least equal to or slightly more than what we've opened in Q3.

As far as next year is concerned, we will definitely open at least close to 80 to 100 branches every year. The base is growing, and we are also expanding beyond south. So we are confident of opening and maintaining this pace of close to 100 branches per year for the ensuing 2 to 3 years.

Dinesh Kulkarni: No, that's great. That's great. And can you just give some clarification -- or how do we see the employees growing? Because I mean I see you're adding like more than 1,000 employees every year or like year-to-date for this year. So do we see a similar pace in the growth? Or now we are -- we've matured there in terms of addition?

Rangarajan Krishnan: Dinesh, at some level, this is fairly linear, and it's a brick-and-mortar model. We are -- we rely largely on physical branches existence on the ground. That's what gives us control on both business and collections at the local level. So as the branches are growing, you will see this incrementally increasing because this comes with a number of business officers, sales officers and the supporting services that we have to put at each branch.

So the pace will be similar. This year, it's a little bit more, like I said, because of more number of branches. But if you're assuming, let's say, we open about 100 branches every year, the incremental number of people will at least be close to similar number, 1,500 to 1,800 per year.

Dinesh Kulkarni: Okay. That sounds great. That's awesome. And then last question, do we have any AUM guidance there, reference, like, If I remember, you said something like INR20,000 crores a few years back. Do we see a long-term AUM guidance here?

Lakshmipathy Deenadayalan: So the guidance, what we were giving was 35% growth. We are very confident that we will deliver that kind of growth in this financial year. Next financial year also, taking market opportunity --

considering market opportunities, the growth may not be -- it is doable next financial year, but we should consider how the regulatory regime is getting changed. So the concern of exuberance in lending what is there in the minds of RBI has to be also looked into.

From a market opportunity perspective, yes, we are very positive, and we'll be taking up all strides to grow higher. But having said that, we have to keep in mind that how does RBI look into the credit growth of this country. So we should also align ourselves, but we are very confident that we'll be closing this financial year at 35%. Of course, next financial year also is going to be in this similar range.

Moderator: The next question is from the line of Nischint Chawathe from Kotak Institutional Equities.

Nischint Chawathe: I just wanted to get a sense if you would want to guide anything on normalized Stage 2 levels in terms of where do you think is a more optimum level that you are comfortable with? I know there has been a steady improvement over time, but what do you think is a more normal as well for you?

Srikanth Gopalakrishnan: So, Nischint, broadly, we are seeing we want our current portfolio to be at 90%, and maybe a 1 to 30 portfolio of another 2%, 2.5%, if you add. And let's say in a steady state, we are at about 1.5% to 1.75% of Stage 3, that leaves you with roughly about 5.5% to 6% of Stage 2 is what we think mathematically is possible. We are still a little away from that is our view, but broadly I think you will see -- you could see some more benefits coming through in the next few quarters, and then it will sort of stabilize.

Nischint Chawathe: Sure. And on ECL coverage on balance sheet, do you think that -- I mean, I know you kind of run down some of the excess coverage that you have. But just as a mark of maybe caution or prudence you've given the fact that we're doing very well on the operational side, do you think that you would want to kind of create a little bit of buffer at this point of time.

Srikanth Gopalakrishnan: See, we are already -- our belief is that we are already sitting with some buffer on this. I don't want to go pre-COVID, but just to give you a sense of the numbers, pre-COVID, if you see it was sub-1%, it went up to 2% to 2.1% during the peak of COVID, both wave 1 and wave 2. And then it has sort of normalized at 1.6%. The last few quarters has been broadly steady, 1.6% to 1.65% is what we have been maintaining.

Like I said, I think we will neither be aggressive nor be too conservative. I think we will be a lot more realistic. Our belief is these numbers will keep going down maybe in the next few quarters. But I think we will probably maintain a Stage 3 at 50% or over 50% and the balance coming through. So maybe at around 1.5%, 1.4%, 1.5% would probably be a steady state number that we think is appropriate for the portfolio that we are building.

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

Pallavi Deshpande: Sir, just 2, 3 here. First would be on this NCD INR105 crores, the private placement. I just wanted to know at what rate and what was the tenure of that?

And second question would be the Tamil Nadu floods. We didn't see much impact of that, whether it's the peer small finance bank did see that impact. I just wanted to understand how were we able to avoid any significant impact there?

And lastly, on the tech spend, how much would it be? The Salesforce, how is the accounting for it done?

Srikanth Gopalakrishnan: Yes. So, Pallavi, let me take the first and the third one, and then I'll request Mr. Pathy and Ranga to answer the second one. On the NCD, like I said, this is -- we have not compromised on the tenure at all. This is a 3-year NCD that we have issued. And the rate -- the all-in cost is at around 9 -- 9.40-ish levels, I may be off 5 basis points this way that way, but it's around 9.40-ish level, which is better than what we are borrowing from some of the banks also.

So the quantum is not what we would have -- we would have preferred bigger quantum, but I think the interest is there. People are willing to put longer tenure monies and given the safety that they are seeing in the company, which means a lower risk premium, the pricing is also attractive. So that's from the NCD perspective. It's INR105 crores that we have done.

See, in terms of the tech spend, first of all, we have given the numbers. We have actually spent about INR28 crores for this financial year. This does not include the head count spend. This is purely the tech spend ex-head count, both the capex and opex. Comparative number for FY '23 was about INR19.3 million -- sorry, INR19.3 crores and for the 9 months is about INR28 crores. So clearly, there is a good amount of spend that is going through.

See, in terms of the accounting part of it, most of our tech spends are on the SaaS models, which are based on licenses. So there is an implementation cost and there is a licensing cost. The implementation cost is amortized over the life, which is typically 5 years. The licensing cost is taken on a month-on-month basis. And the licensing cost, obviously, is a step-up model. So as the business grows, there will be the licensing costs going up.

So you will see typical this INR28 crores going up a little bit in the coming years as well. This is not just for Salesforce. This is across all the technology spends that we are doing. Amortization of the implementation costs, which is treated as a sort of a right-to-use asset and the license cost is taken on a month-on-month basis. TN flood?

Rangarajan Krishnan: No, on TN floods, see given the nature of the customers that we serve, most of these customers are earn-and-pay customers. So when there is a flood situation and they are unable to carry on their regular businesses, be it opening a kirana shop or be rendering some essential services, it naturally impacts the revenues for those few days. And the floods were fairly intense in many parts of South Tamil Nadu and in and around Chennai. Also in large parts of Coastal Area. So we have quite a -- large cluster of branches in these regions.

So these are -- obviously, there will be some delays from collections on people who have not been able to open their shops during these times. But we don't see any long-term impact of this. They will quickly be able to bounce back. But for those -- 1 week or 10 days, inability to open their shops, there will be some impact in collections, and that's what we have seen.

Pallavi Deshpande: Right, sir. And sir, just one last one. So in terms of what is the target like you mentioned, you will bring down the bank funding, which is 66%. So over the next 1 year, where do we see that going?

And I believe the rest of it is securitization, who are the clients from there?

Srikanth Gopalakrishnan: So, Pallavi, I think at this point of time, we would not want to venture to give you a number per se on this. But clearly, there is a very strong intent to diversify the funding sources. So we are talking with AMCs, we are talking with DFIs to do NCD issuances or ECB issuances. We will also deepen the securitization market. So our belief is the 66% will progressively keep coming down. And like I said, we don't want to give you a number at this point of time, but you will see gradual drops coming in this so that we are able to diversify the funding sources and have a much larger base of sources that we could tap into at any point of time.

Moderator: The next question is from the line of Ajeet Kumar from Nomura Capital.

Ajeet Kumar: Congrats for great set of numbers. So 2 to 3 questions from my side. Circling back to the number of employees, last 2 quarters, we have seen a higher number of employee additions with number being approximately 1,200. So in which area and at what seniority level are we adding these employees?

And also a few quarters back, you had highlighted that attrition level at officer level is high at around 25% to 30%. So has that come down? And what would be the current attrition level at various levels now? So that is my first question.

Rangarajan Krishnan: Ajit, on this, the employee additions is fairly directly proportional to the number of branch openings, and the anticipated number of branches that we intend to open. So if you look at the last 2 quarters, last 2 quarters alone we have opened almost close to 90 branches odd. So that's a significant number. So the employee additions are in line with that. Most of these employee additions are happening at the field level. So this will be the officers, branch managers and the support staff who are manning the branches.

On the attrition part, it is at similar levels. It has not gone up or it has not gone down. Of course, the issue continues to remain that if at all, the attrition is a little bit elevated, it's more at entry level for us and people who have spent less than a year in Five Star.

Ajeet Kumar: Okay. Okay. Okay. And second question is your average ticket size on disbursement has remained broadly at around INR0.34 million in the last few quarters. I remember earlier you used to highlight that ATS will grow at least in line with inflation. So can we expect this ATS to go up from here on? Or will it remain at the similar level of INR0.33 million, INR0.34 million?

Rangarajan Krishnan: So ATS has been going up. It has -- we are very clear that we are not changing the customer segment whom we are serving. So it is the same set of customers. And the first priority is for us to get the ATS back to pre-COVID levels. So if you look at very specifically last quarter, the ATS has indeed gone up, I think, if you go decimal wise, it has gone up from about INR3.39 lakhs to about INR3.44 lakhs. And that's a steady progress that we have been seeing for the last few quarters. The first intent is it will come to about the 3.5 lakhs, which is the pre-COVID level. And from here on, we are expecting the growth based on the inflation.

Ajeet Kumar: Okay. Okay. Okay. And lastly, one data keeping question. You had earlier provided data on super branch, which effectively is 2 branches in an area where there is a good business potential. So can you please provide the updated number on super branches that is there out of total of 480 branches?

Rangarajan Krishnan: So Ajit, the super branch strategy, we are evaluating whether it is good for a company to have more super branches or it is good for the company to have more number of smaller branches in an area, and that is something that we are still experimenting. So number of branches that we opened in the last 2 to 3 quarters, it's a mix of small branches getting opened in the vicinity rather than making a number of super branches.

Because I think the advantage you get with smaller branches is, it can be more spread out. You will have a lesser number of officers in each of the branch. So, from an OpEx perspective, it's far more easier. You will have an ability to reach out to customers much more easier and nearer. And of course, from a risk diversification perspective, it's far better.

The current focus is -- it's not necessary for us to grow only by opening super branches or only by graduating a branch to a super branch. As opposed to that, we can also open cluster branches, which is what the current focus is on. So we are experimenting with both. I think we will get more clarity on the way forward on this over the next 2 to 3 quarters.

Ajeet Kumar: Sure. So is it fair to say, I mean, proportion of super branch in the total branches would have gone down since you have opened so many branches in the last couple of quarters?

Rangarajan Krishnan: Yes, yes. Absolutely. Because all the new branches would have opened and that's a significant number, they were all normal branches. So the proportion of super branches would have definitely come down.

Moderator: The next question is from the line of Shubhranshu Mishra from Phillip Capital.

Shubhranshu Mishra: Three questions. The first one is on the Stage 3 provisions at around 50% to 54%. For a secured book like us, it sounds out of that because this should be pretty much the LGD. That's the first question. Second is on what is the net curing rate from bucket 1 to bucket 2 this quarter versus, say, a year ago, what was the number?

Third would be, what kind of premium does the bank charge to us above MCLR and EBLR? A blended rate would be okay.

Srikanth Gopalakrishnan: So Shubhranshu, on the Stage 3 provisions, like we said, we are -- we agree with your point, we are probably carrying higher, but then there has also been some soft communication from the regulator also that it is better for us to maintain these provisions at north of 50%. So we have taken that. And -- not just for us, for all NBFCs. So we have taken that suggestion and we are also building this provision.

See don't -- please understand that this is not LGD because for us, the way that we define is that any loan that turns NPA, and if it is not getting cured within a short period of time, and now it has to come all the way to 0 for it to be treated as a standard asset, that would take a long period of time. So during this point of time, it is going to remain as a PD, and the LGD is only taken on loans which have either matured or which are closed.

So there will be a lot of cases which have probably matured, but where the loans are not closed, but where we are holding the property. So you'll never see that loss actually happening, but there is a timing difference between when the loan matures and when we are probably able to settle some of these loans, which could show a little artificially inflated LGD.

So if you look at one of the other data points that we have actually given in the presentation, even on about 5,000 loans, which were NPAs at the time of settlement, on the majority of loans, we have not lost more than 2% IRR, forget the question of any principal loss. So there is no way that we will have an LGD of 55% or 54% or anything more than 50% on the Stage 3. But we will continue to keep creating these provisions because these provisions are those which will help us in rainy days.

So be clear that it's more an accounting thing that we do. The eventual loss, even if you look at from a credit loss perspective that we are probably doing this guidance in the past, would probably be anywhere around 25 basis points to 50 basis points, but nothing beyond that. So there's no question of 50% LGD on any of these NPAs. So that is number one.

But we will continue to keep creating provisions, the P&L affords it. And even after creating these provisions, our credit cost is up 40 basis points. So in a good days it's prudent for any lender to create more provisions. So we will continue on that path.

Yes. See, net curing rate, Shubhranshu, will probably have to come back to you. We don't have an answer right at this point of time, but we will probably come back to you.

On the third question in terms of spreads to MCLRs and EBR, See, today, it is extremely varied, like for example, the MCLRs of PSUs are very low. For example, if you take a State Bank of India, they will probably be giving us anywhere the spread of 1.5% to 1.75% or so. But if you look at a private sector bank, there are cases where they may be lending at 25 basis points over MCLR.

So I think the spread over MCLR or EBR is not a very relevant data point to look at. What is the relevant data point is the overall cost of funds. So this would mean -- there are some banks which charge a slightly higher fee because banks are still on the IGAAP and not IndAS and some of them upfront their fee.

So there are some banks that are a little more hungry for fees than the others. So you will -- rather than looking at the spread over MCLR or EBR, we have still not reached that stage where we are going to be fighting for that last 5 basis points. But what is important to look at is the overall cost of funds, which is the number that we are giving in our presentation as well.

Shubhranshu Mishra: Just one observation that -- well, you did explain the Stage 3 provisions, but it still looks out of whack for a secured book that we run. And the second part is that we do speak about our strong collection mechanism. It seems out of whack, 50% is too high for a secured book. It seems like it's an unsecured book that we are running, which is not the case. So that's my only observation here?

Lakshmipathy Deenadayalan: Yes. Yes. We again reinstate that Five Star is a fully secured book. And not that alone, 95% of our security is coming from self-occupied residential property and 5% comes from the commercial shops and the vacant lands.

So having said that, I think, Srikanth has explained the regulatory environment around the lenders today. And our profitability is also on the good side. So the Board has taken a clear call that to have a good provision at the time when we can afford to do it. So that will help us as we move forward towards the challenging times. So keeping that advice in mind, we have gone up our provisions from around 50% to 55%. That's the background on it.

Nothing to do on collection, nothing to do on security. We've continued to -- we'll continue to show the robust collections and continue to show robust recovery from NPA accounts that will not change.

Srikanth Gopalakrishnan: So, Shubhranshu, just on your question on curing, what we treat it as rollbacks from 31 to 60 to 1 to 30 or 1 to 30 to current, these numbers used to be higher in the past because the flows were also a little higher. Today, given the fact that we have contained the flows largely, so the curing is also lesser. So what we're typically seeing is whatever a loan gets into a 31- to 60-day bucket, you will generally see about 90% of that loan stabilizing in that bucket.

So they don't roll forward also. You will see about 5% of those loans rolling forward, and 5% of those loans getting back to lower buckets. So this has been the last, I would probably say, 3, 4 quarters' averages. If you go before that, the numbers used to be -- the stabilization used to be more like 85%, the rollback used to be 10%. The flow forward was about 7%, 8%. And these numbers were a little higher earlier, but last 4 quarters, we are largely about 5% of roll forward, 5% of rollback and about 90% of stabilization.

Shubhranshu Mishra: So we are almost curing everything that's getting rolled forward? Close to that?

Srikanth Gopalakrishnan: Close to that, yes.

Moderator: The last question is from the line of Aravind R from Sundaram Alternates.

Aravind R: Congratulations on the great set of numbers. Just a like a few questions. So can you give me a better information about EBLR, MCLR and fixed rate borrowing in terms of – percentage of borrowings, can you give some color on that?

Srikanth Gopalakrishnan: So Aravind, is your question about fixed versus variable rate borrowings?

Aravind R: Yes, sir. Yes, sir. Fixed rate and EBLR and MCLR, if you can give that too, yes.

Srikanth Gopalakrishnan: See fixed number, we have given, I think, we're at -- about 29% borrowings is fixed. So I'll say 70-30, 70% variable and about 30% fixed. In -- on the universe of EBR versus MCLR, I think EBR will probably be 10%, 15%.

Most of it is MCLR. It is only those banks who have very high MCLRs, their MCLRs are more than our overall borrowing cost, which is where we have gone ahead with EBR. I would probably put that number at about 10%, 15% or maybe 15%, 20%. 80% of our loans will be on MCLR. And most of these MCLR loans are also 6 months or 1 year MCLR. So we don't go with the 3-month MCLR and all that.

Aravind R: Sure. And this income from securitization, like is it booked in interest income itself or is it part of the other fee income or whatever it is?

Srikanth Gopalakrishnan: No, no. It is part of the interest on loan portfolio. That's typically treated as a loan portfolio and treated as borrowing. So you'll see that on the interest line, both on the income and interest expenses.

Aravind R: Even the differential that we get?

Srikanth Gopalakrishnan: Yes. So there is no upfronting of incomes at all, Aravind, in the securitization transaction. It is for all practical purposes under IndAS treated as part of your loan book, treated as part of the borrowing. So it will come -- the 24% that we charge to the customer will come as interest on the loan portfolio. The 9%, 9.5% that we pay to institution will come as a borrowing cost and the differential flows into PBT.

Aravind R: Sure. Directly goes to the PBT. Okay. Okay. And just one last question. So AUM growth has been phenomenal, like in Andhra Pradesh and Telangana whereas it has been a little slightly lower in Karnataka and Tamil Nadu. Is it because of the branch additions that's happening in Andhra Pradesh and Telangana happening in the existing cluster whereas in like other markets it's happening in the newer clusters or any other reason for it?

Lakshmipathy Deenadayalan: The reason is simple. The team formed and the collection pattern what we see in Andhra and Telangana makes us more optimistic to open more branches and recruit more people at the geographies. But Tamil Nadu is not lacking. You would have seen Tamil Nadu branches also going up. And this -- next financial year, you will see lot of investments in Tamil Nadu.

Karnataka is stabilizing. During COVID, we had an impact in Karnataka slightly comparing to the other 3 states of South. So we -- that's a prudent practice of Five Star. If we see any kind of slip, we will take our good time to rectify that and move forward. So we are not in a hurry. But good news is, I have been saying in last few calls that Karnataka stabilization is there to stay.

So now it's a time that we will be investing more branches in Karnataka, too, because the geographies are quite bigger. It's a bigger state. So that's the background. No other background on split of our branches in South.

Moderator: Thank you. As that was the last question, I would now hand the conference over to Ms. Gayathri Shivaram for closing comments.

Gayathri Shivaram: Thank you. Thank you, everyone, for joining the call, and thank you to the management of Five Star for giving us this opportunity to host the call.

Lakshmipathy Deenadayalan: Yes. Thank you all from Five Star team at -- from Chennai. So hope to meet you all in Q4 earnings call with more vibrant numbers. Thank you all.

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