FIVE STAR
Business Finance Limited

Date: December 02, 2022

The National Stock Exchange of India Limited,
Exchange Plaza,
Bandra-Kurla Complex,
Bandra (E), Mumbai 400 051
Symbol: FIVESTAR

BSE Limited
Listing department,
First floor, PJ Towers,
Dalal Street, Fort Mumbai 400 001
Scrip code: 543663

Sub: : Transcript of the Earnings Conference Call for the quarter ended September 30, 2022

Dear Sir/ Madam

Pursuant to Regulation 30 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, Please find enclosed the transcript of the Earnings Conference Call held on Wednesday, November 30, 2022.

The same is available on the website of the Company at https://fivestargroup.in/investors/

Kindly take the above on record.

For Five-Star Business Finance Limited

Shalini Baskaran
Company Secretary & Compliance Officer

"Five-Star Business Finance Limited Q2 FY '23 Earnings Conference Call"

November 30, 2022

MANAGEMENT: **MR LAKSHMIPATHY DEENADAYALAN – CHAIRMAN AND MANAGING DIRECTOR – FIVE-STAR BUSINESS FINANCE LIMITED**
MR RANGARAJAN KRISHNAN – CHIEF EXECUTIVE OFFICER – FIVE-STAR BUSINESS FINANCE LIMITED
MR SRIKANTH GOPALAKRISHNAN – CHIEF FINANCIAL OFFICER – FIVE-STAR BUSINESS FINANCE LIMITED

MODERATOR: **MS MAHRUKH ADAJANIA – NUVAMA INSTITUTIONAL EQUITY**

Moderator: Good morning, ladies and gentlemen, and welcome to the Q2 FY '23 Earnings Conference Call of Five Star Business Finance Limited. 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 Ms. Mahrukh Adajania from Nuvama Institutional Equity. Thank you. And over to you, ma'am.

Mahrukh Adajania: Hi. Good morning, everyone, and welcome to the earnings call of Five Star Business Finance. We have with us the top management team of Five Star represented by; CMD, Mr. Lakshmipathy Deenadayalan; the CEO, Mr. Rangarajan Krishnan; and the CFO, Mr. Srikanth Gopalakrishnan. With this brief introduction, I hand over the call to the management team of Five Star business. Over to you.

Lakshmipathy D.: Thank you, Mahrukh. Good morning, all. First of all, a warm welcome, and thank you for joining the first conference call of Five Star Business Finance. Before getting into the Q2 performance of Five Star, let me talk a bit about myself and my journey in Five Star. As introduced, people call me as Pathy. I joined Five Star in 2002. This is a 38-year-old NBFC started in 1984 lending to two-wheelers and consumer durables.

When I joined Five Star, we wanted to move away from vehicle business to something new of its kind, niche of its kind. So that is where we found out lending to nano or small businesses, single-shop owners and self-employed, today, we are truly, fully present with them for last 20 years, very successfully in the last 20 years. These profile of customers were not been seen positively by other former lenders, whereas we saw them very positively, especially the service segment in which we cater to essential service shops. So those are the predominant customers of Five Star.

For last 20 years, first 10 years, we learned them a lot. How does we underwrite them, how does we set our collection model, which perfectly suits them. So that was a learning curve for Five Star, and from 2015 onwards, our growth started. So we were growing close to 90% CAGR before COVID has hit us in 2020. During COVID, it was a conscious call to grow slower. So we were growing at 15% in COVID-1 and COVID-2, but we put our collections in front, and we did one of the best collections, in one among the best collections among the lenders of this profile of customers.

Now the COVIDs all settled, we are back to the growth plan. That takes us to the performance what we did in Q2 of this financial year. I will read this as one of the best quarters ever we have seen after COVID. Just to take you on the numbers, our AUM has grown from INR 4,639 crores in last September to INR 5,732 crores in this September. And from June, it has grown 8% from INR 5,297 crores to INR 5,732 crores. So we have grown 8% in the quarter and supporting the growth, the disbursement also has gone up from INR 568 crores in June quarter to INR 803 crores in this September with a growth of close to 40% and from INR 353 crores in last

September to INR 803 crores in this September. One of the good disbursement that ever we have seen in this quarter.

Taking you directly to the asset quality, we have also moved our asset quality from 1.44% in September '21 to 1.15% in the September '22 with a sharp drop of close to 30%, 35%. And comparing to last quarter, we were almost flat in the asset quality. And finally, to the branches, which led the growth of disbursement and AUM, we have opened close to 80 branches in last one year. And specifically within last three months, from June to September, we have opened close to 41 branches, which is one of the best addition of branches ever we have seen in Five Star.

Finally on the borrowing side, I think Five Star is sweetly positioned. The cost of funds keep dropping for Five Star. We were borrowing close to 9% last year. Now we are borrowing at 8.6% all-in cost. And the cost of funds from the book has dropped down to 10.7% last year to 10.5% this year. So even going forward, we think our borrowing cost is going to be in the same range. So there is no need of transferring any increase of lending cost to the borrowers for coming quarters. So with these numbers, let me hand over to Srikant to run through in more details.

Srikanth G.: Thank you, sir. Very good morning to all of you. As Mr. Pathy said, I think this has been one of the very good quarters for us, especially coming after two years of pandemic. I will take you through some of the numbers and then open out for questions. So as of September 2022, our total active loans had grown to about INR 2.5 lakhs from about INR 1.9 lakhs in September 2021, representing a growth of about 32% on a year-on-year basis. Branch count increased from 268 to 352, which is like we added almost 75 to 80 branches in the last one year, one of the most robust growth that we have seen in the branch additions, about 84 branches during the year. In the first half of this year, we added 52 branches, which is again one of the highest for Five Star in the last many years. Disbursements increased by about 127% year-on-year to INR 803 crores in the second quarter and about INR 1,371 crores in the first half of this year.

AUM grew by 24% year-on-year to INR 5,732 crores. The ratios remained stable. As of September, our average yield on the portfolio was about 24.19% for the quarter with a cost of funds of 10.48%, resulting in a spread of 13.71%. Comparing this number against the quarter of September 2021, we were at about 13.5% spread. So despite a significant increase in the rates by RBI, our spreads have increased, and this has come purely on the back of lower funding costs.

NIMs very healthy at 18.2% for the quarter, and at about 17.6% for the first half of the year as compared to 15.94% for the half year ended September 2021. We have also been increasing our efficiencies. Our cost to income for the first half of this year was at 34.11% as compared to 35.34% for the half year ended September 2021. This has resulted in a healthy return on assets. And whenever we are talking any of these ratios, I would just like to remind you that this is on the basis of average total assets and not on the portfolio. So we had a healthy return on assets of 8.68% for the first half of this year with a return on equity of about 14.66%.

Coming to the borrowing side, we have a well-diversified borrowing profile with 51 lenders having lent to us. About 60% of our borrowings on the book today is fixed rate, so which is not going to have any impact in an interest rate rising scenario. Bank lending contribute about 50% of our debt. We pretty much have all the public sector and private sector banks on our debt table. We have also diversified our borrowings not just in term loans, but into nonconvertible debentures, market-linked debentures. We have done securitization transactions. We have also done an external commercial borrowing. So it's a well-diversified borrowing profile, both from a lender perspective as well as from a structure perspective.

The on-balance sheet liquidity is sufficient at INR 795 crores as of September 2022 without assuming any of the incremental sanctions, which will help us to meet our growth targets for the next two quarters. As of now, we enjoy a rating upgrade of A+ from both ICRA and CARE, and we'll be taking up with the rating agencies for the possible rating upgrade to come.

Over the last five quarters, the collection efficiencies have been showing consistent improvement. For the quarter of September '22, we clocked a collection efficiency of 100.1%. In fact, three out of five quarters from September 2022, we have been clocking over 100% collection efficiency. The other two quarters have seen north of 98%. So the pandemic clouds have receded, and we are back to our normalcy in terms of both growth and collections.

While there was an increase in the 30-plus number consequent to the second wave of COVID, but we have been able to bring that down significantly to 13.62% as of September 2022. This will drop a little more gradually as we go forward. The gross Stage 3 assets, 90-plus stood at 1.15% in September '22 as compared to 1.44% in September '21. And we maintained a very robust provision coverage, both on the Stage 3 assets and on an overall AUM. On Stage 3 assets, our provision coverage stood at a little over 44%. On our overall AUM, it was at 1.77%.

Our restructured book as on September 22, we overall restructured a book of 1.83%. But as of September, '22, it stood only at 1.18%. And even on this portfolio, we maintain a provision coverage of over 50%. So, the restructured assets have seen post restructuring payment behaviour of more than 1 year and north of 91% of the restructured book remains in the standard category.

For the first half of the year, we clocked a PAT of INR 284 crores, representing a growth of 30% year-on-year. For the quarter ended September 22, our PAT was at INR 144 crores, representing a growth of 22% year-on-year. We had a net worth of over INR 4,000 crores as of 30th September. So, we have delivered robust growth, profitability, and quality for the quarter and the first half of the year and are confident of this trajectory to continue for the remaining 2 quarters as well. With these brief remarks, we open the floor out to questions. Thank you.

Moderator: We have the first question from the line of Shailesh Kanani from Centrum Broking.

Shailesh Kanani: Good morning, sir, and thanks for the opportunity. Also, congratulations on a good set of numbers. Sir, first question on our 30-plus DPD book. It seems to be a little on the higher side. Can you shed some light on that? And also, what can be the long-term average for 30% for us.

Management: So Shailesh, given the profile that we are operating, it is important to note that these are people who are graduating from the unorganized institutions. So, while they definitely get benefits in the form of better interest rates, more prudent lending practices. There is always an expectation of a little bit of flexibility that these customers would expect from institutions like Five Star. So that is why you would typically see a 30-plus number being a little higher. And historically, if you look at our numbers, these were always around the 10% to 12% levels even pre COVID.

But what is important to note is that these 30-plus numbers are coming on a vintage portfolio. So, it's not like people who are becoming delinquent early in their life cycle of the loan. Or these are not customers who are going to continuously roll forward into higher buckets. So, there are going to be some events in their families that could happen, which may make them miss one instalment and the ability to come back to a current bucket by paying 2 instalments is not that high.

So, while they continue to service the subsequent instalments, they may sort of stay on in the 30-plus bucket or a 31 to 60 bucket; rather than paying up the loan in, let's say, a door-to-door tenure of 60 months or 84 months, they may end up paying in 62 or, 86 months. So, we don't really see a big risk as far as where we see a 10% to 12% kind of a 30-plus number. So, like we said, this would sort of hover around the 10% to 12% even in a steady-state scenario.

Shailesh Kanani: So, we are quite comfortable and confident that it will not get flowed down to 90+ -- that is a normal long-term average 10 to 12% double-digit number?

Management: Very clearly are pre-Covid number. One of the best 30 plus what we have seen was around 10%, 11%. If you see from our presentation, it is moving from 17.6% in last September to 13.62%. And from last June, it has moved down to from 15.7% to 13.6 million -- so next 2 quarters, by the March end, we'll be comfortably reaching the pre-COVID level, which will be maintained in the steady state because as Srikanth said, if you want to really lend to these profile of customers, single shop and self-employed, they have some kind of cash flow issues for a longer because our loans are not shorter. Our loans are 5 years and 7 years loans. During the 5-year cycle and 7-year cycle, we can't expect those customers to pay the dues in the month as normally you and me will do it.

So, you have to have some flexibility. That is where Five Star differentiates from others. We give the flexibility to those customers -- but at the end of 90 plus, we ensure that flexibility is not given. So hence that 90-plus is one of the lowest in the market.

Shailesh Kanani: Okay. Sir, one more question. One is on the yield front, seems to be pretty interesting at 24% to 26%. Again, if you can shed some light or give some long-term guidance. What -- how is the competitive landscape? And can we sustain on this kind of attractive yield on our book -- can you give your view on this?

Management: Shailesh, I think if you again trace back in the presentation, we have given you our numbers from FY '15, the yields have broadly ranged anywhere from around 24% to 25% See, the first thing to note is these are people who are graduating from unorganized institutions. So, the price

sensitivity is not that high. And given that we are lending for 5 to 7 years, a percentage increase in the yield or a percentage decrease in the yield leads them to about INR 80 to INR 100 of difference in EMI.

So, it's not a very highly price-sensitive segment, number one. The second point is, having said that, we would always like to be a responsible lender. So, our focus is not so much on the yields, but it is more on the spreads that we want. So even in the past, if you look at, we have been operating at a spread of about 12% to 13%, while it is a little higher at this point of time, given our drop in cost of funds. But -- in an ideal scenario, we would have passed on some of these things to the customers. But today, the interest rate cycle is still a little bit uncertain out there.

So, we would like that to sort of stabilize before we take a call on passing on some of these benefits to the borrowers. So, we can clearly say that our focus will be on the spreads, and we would like to maintain our spreads at about 12% to 13% in the quarters to come. We are confident of maintaining that.

Shailesh Kanani: So basically, I wanted to see if there is any change in competitive landscape? And are we facing on any pressures on -- from the client side in respect to interest rates per se, it -- there is nothing like that, right?

Management: Yes. Shailesh, there is absolutely nothing that we are seeing at this point of time from a competitive landscape, most players who are exclusively focused on this segment are around similar levels. So, there is nothing specific from a competitive landscape. It's more an internal call, like Srikanth put it, we will be a responsible lender. So, as we see benefits that is accruing to us because of lowering borrowing costs, we will pass that to the customer, but it's not because of a competitive pressure.

Management: Let me also add to what Ranga said. There's a perception in the market that Five Star has been lending to an overcrowded market. Let me be very clear. As I said, this is a very niche segment where we don't compete taking the files from other NBFCs and other small finance banks, we take the file from unorganized lender, which is money lenders and borrowing from friends and families.

So that is our niche. And in fact, we are operating in a very less competitive market. That's the truth. So why I'm saying this is, let's not put SME lending or MSME lending or a small business lending in one basket. It ranges from close to INR 1 lakh to INR 10 crores is being called as small-small business loans. What is special on Five Star, -- we are operating at 3 lakhs to 5 lakh ticket size, and we are operating at 5 years to 7-year tenure, which most of the people are not willing to operate because of the operating cost increase and they don't have that kind of underwriting experience what we have -- so we are participating in a less crowded market. Even within the less crowded market, Five Star stand tall, both in quality and profitability, if you compare with our competitors. So, I don't see any big competitive intensity is going to grow up, and we are welcome for that because we don't want to be the watchman for this sector. People

will come. We want them to come, but they have to lend and see that our asset quality and profitability stack up that time

Moderator: We have the next question from the line of Pranav Gupta from ASK Investment Managers.

Pranav Gupta: Hi sir. Good morning. Just a couple of questions, probably a continuation from the previous one. So you said that most of your customers you are taking files from the unorganized lenders and these customers are not rate sensitive and our tenures are typically five to seven years. So just wanted to understand that the natural progression for the customer taking a loan from Five Star eventually is to move on to NBFC or larger ticket size or a bank. What is a repeat rate once the customer repays and what is the natural progression for our customer? That is the first question.

Management: So Pranav, I will take it. So essentially when a customer walks into Five star and then he has a loan track record, it's not just that he is building a track record with Five star and it automatically can be taken over by a larger institution. Because while he will have a track record, he will still not have documentary proofs of income for somebody to easily assess the customer. 60% of our repayment comes back in cash. How many institutions will have the muscle and the ability to collect cash collections in a operationally robust manner is still questionable.

That is second, 3rd. These are customers like we have pointed out, they are not going to exactly pay on the due date. There will be some delays. These are earn and pay customers. We have seen them operating over the last 20 years. So there is a very clear track record for us and an experience for us as to how these people will behave. Which means we are okay with some operational delays as long as it's not translating into credit default. But if you were to look at the credit bureau scores of these customers, it's not going to be one of the best track record that they are going to have, where they are going to have an automatic debit from their bank accounts exactly on the due date.

So it is not a very easily tappable customer segment for a larger player. And most importantly, what we also seen from the market, this is what Mr. Pathy was pointing out a little while earlier is that majority of the large players, be it NBFCs or banks, we have seen them having some kind of resistance for coming down on the ticket size to this level. So they believe that probably it's operationally too intensive or maybe economically doesn't make sense given their cost structure for them to come down to this level.

So given all that, it's not an automatic ladder in which customer comes to Five Star and then five years later he is being taken over by somebody else. There are a lot of nuances in this segment. But that said, I think if we were to give you a guidance overall in terms of the way that it moves out of every 100 customers that we pick up from the unorganized lending to organized segment where they are coming in with Five Star for the first time, we have always seen about 10% of the customers graduating upwards.

So they are extremely good paying exactly on the due dates, have operating bank accounts, there are no delays, have a good track record, their business improves, they have a larger appetite for higher ticket loan and then they graduate up and move towards a larger NBFC or a bank. We've

also seen the reverse. We have seen about 10% of the customers going back to money lenders because they are not used to the rigor or discipline of exactly paying for the due date.

But if you had to take the rest of the 75%, 80%, they stay with Five Star because we understand them, they understand us. There is a comfort level, there is an extremely good service that we provide to them. So these are customers who will take a loan from us, who will part prepay when they have access to good chunkier cash flows. They will take a loan again from Five Star whenever there is a need.

Pranav Gupta: Okay, so essentially you're saying that barely 10% of our customers are eventually graduating even after five, seven years. They are unable or unwilling either of the two to move to a larger ticket size or lower rate. Because it's slightly surprising to see that even after a five or seven years loan a customer is still coming to about INR 3 lakhs to INR 5 lakhs again from Five Star at a 24% yield?

Management: I agree. I understand where you're coming in from. But the issue is not about the rates. The issue is about how do you assess those customers. So how many people have developed the capabilities today to go deeper and actually assess the cash flows and the collateral values of these people at the Tier-6 town where you are not going to depend on any intermediaries to do this and probably spend about four to five days on the field just gathering primary data points. So the issue is not about the rates. I think anybody can lend at lower rates but the issue is are you willing to put this operational intensive efforts to go down to that point?

Pranav Gupta: So could you quantify a possible, whatever balance transfer out that would sort of help to understand?

Management: The balance transfer outs are very low. We should be seeing balance transfer out of anything between 3% to 5%. But I think this needs to be correlated with the balance transfer in as well. Because there are people who are coming from other institutions to Five Star also where we see the numbers are more like about 6% to 8%. So from that perspective there is a positive balance transfer in. So most of the prepayments, most of the closures that we see on the portfolio are actually closures happening out of the own sources of borrowers rather than balance transfers. So today the balance transfers are much lower and Five Star has a positive edge from a balance transfer perspective.

Pranav Gupta: What are the type of customers that transfer into Five Star? Where are these customers coming from?

Management: They will come from other NBFC's mostly. But generally the balance transfer is not just a transfer of outstanding loan, they will also expect a top up on top of that loan. So maybe they had originally taken a loan of about INR 5 lakhs. Today the current outstanding could be three lakhs. They may have a track record of whatever one or two years with an existing NBFC. So they may look to top up back to INR 5 lakhs or maybe INR 5.5 lakhs depending on what their requirement is at this point of time. So if you are able to assist those customers and they come

within your risk bracket it's a balance transfer plus a top up. So that's the attraction for customers to walk into Five Star.

Pranav Gupta: Just a last follow up on this before I join back in the queue. So, I mean, if I look at this example that you gave that a customer has borrowed from another NBFC and eventually wants to top up and has come to Five Star two issues here A there is another NBFC or multiple other NBFC's who actually assess that customer are willing to lend or willing to collect from the customer in whatever way or form required. And B if they have already assessed the customer why are they not willing to talk his loan up, if he's a good customer and if he's not a good customer, then why is Five Star taking him. That's the sort of point I'm trying to understand?

Management: Yes, fair point Pranav. I don't think we ever sort of have this idea that we are the only player in the segment but if you look at what Shrikant has answered, the balance transfers are hardly about 1% to 2%. So this is not a large people who are just graduating from other NBFCs to us but all we are trying to say is that it does exist and there could be various reasons why existing NBFC is not willing to give more to them. Maybe this is not a focus segment, maybe the relationship manager has not reached out to them, whatever it could be but it's a very small trickling segment which will come out and we are not going to have an automatic program.

Pranav Gupta: I just wanted to reconfirm if I got the number wrong because I had heard 7% to 8%. Did I hear that wrong? You said 1% to 2%.

Management: Yes, the net Ranga is talking about 6% to 8% minus 3% to 5%.

Pranav Gupta: Sure, go on. Sorry to interrupt you.

Management: It will come, but it's not a very significant focus segment and just to clarify, we don't have a programmatic automatic kind of a top up loan program wherein anybody who is coming in from other NBFCs we are giving them 50% higher or anything only if it fits within our risk profile bucket, area of operations, we might want to do that. This is not a key segment but that said I think people will come down and depending on operational efficiencies that we can track there will always be people who will walk in.

Management: Just to end this question, as I said in the opening remarks that our business model is not to get files from other NBFC's and other small finance bank but we want to disturb the money lending market and bring the customer from informal to formal. That is our core, that is where our focus concentration all will be there incrementally. If a customer is walking from other NBFCs to us, we don't stop that.

Moderator: We have the next question from the line of Umang Shah from Kotak Mutual Fund.

Umang Shah: Yes good morning, thanks for taking my question and congratulations to the team for quarter, just a couple of them that I have, one is on restructured loans. I just wanted to confirm the current outstanding book is at about 1.2%. And in the opening remarks, Srikanth mention, it has improved from 1.8% of that was in the previous quarter, is it, or?

Management: No. So when we restructured the book in the first quarters and second quarters of last financial year, we had done a consolidated restructuring of 1.86% of the book at that point of time. So the overall number was about INR 83 crores, INR 84 crores. The outstanding on that is about 1.18% of the current portfolio, which is about INR 65 crores.

Umang Shah: Any particular reason why you are holding a 50% provisions on these loans given the fact that our Stage 3 provision cover itself is about 44%. And also if you could help me where exactly are these the structure loans classified? I mean are they in Stage 2, or they are considered as a standard loan?

Management: Yes. I think, Umang, that's a good question. Before Srikanth answering that, please understand the color of Five Star. For the last 20 years, I've been in Five Star, we have not done a single restructuring. We have not given any ECLG or any kind of what a regulator wanted to give it, we were not giving to our customers because customers are not willing for that, so keeping that in mind, this is the first restructuring Five Star has done in history, which is 1.86% of the overall numbers when the COVID-2 hit us in strongly both in health and wealth of our customers. So being the first of its kind. We always want to be very conservative. We are very conservative in provision and we also want to be very conservative with this restructured book.

Srikanth G: So Umang, just to give you some data points around this, why we are holding a provision. Yes, the restructured book is not performing similar to a normal book. The Stage 2 is higher in the restructured book a little over 60%. But let me also clarify to you, these were given as moratorium for six months between April and September of last year. So that means the customer has actually been paying up from October.

Now, from October to September of this year, out of 12 installments, there are people who have paid nine installments, but yes, there is a stress in the book. There are people who have probably missed two to three installments in this period, and which is why we also decided that we should probably hold a slightly higher provision as compared to the normal book on this portfolio. And we will continue to monitor this portfolio and keep a buffer provision on this so that it does not come and hit the P&L at a later point of time.

Umang Shah: So just wanted to confirm on borrowings. You mentioned that 60% are fixed rate in nature, given that 50% of our borrowings are bank borrowings, just wanted to understand, is there any portion of the bank loans which are fixed rate in nature and if fixed rate for how long?

Management: So Umang, banks have lent money in the form of term loans. Banks have also participated in our securitization transactions. And they have also subscribed to the NCDs as part of the TLTRO during the first wave of COVID. So while the term loans obviously are linked to either MCLR, most of them to MCLRs and very few to external benchmarks. The securitization and the NCD transactions are fixed in nature. And when I mean fixed, these are fixed for life. So there is not a fixed and a floating rate structure for a portion of tenure. The loans are fixed for life. The term loans are variable, but for the term loans, out of the balance 50%, which are NCDs and

securitization are fully fixed for the life of the borrowing. And some portion of the bank borrowings, which are in the form of NCDs and securitization are also fixed.

Umang Shah: So the way to look at it is you mentioned that your marginal cost of borrowing is closer to about 8.5%, and also, we have done an equity raise. So at least in the foreseeable future, our cost of funds are unlikely to move up or probably the overall cost of funds should only improve from here on before it starts stabilizing or starts moving up? I think we still have maybe a few more quarters for this trend to continue, is that a fair assumption?

Management: Yes, Umang. That's a fair assumption. Because today, our incremental cost of borrowings. So see, from two places, you can get an impact on the cost of funds. One is re-pricing on the existing book, which is going to happen for 40% of the portfolio, depending on how the rates move in the market. The second is on the incremental borrowings. Given that the incremental borrowings will be a larger proportion as compared to the book that will get re-priced. And today, while we are borrowing at 8.5% to 8.75%, even if these rates are going to go up, and I'm sure they're going to go up. They're not going to stay at 8.75% forever.

Given that our book cost of funds is at about 10.5%. Mathematically, we will only be seeing some benefit that will come through. So for the foreseeable future, we don't envisage the book cost of funds significantly going up. There may be some low-cost borrowings, especially those that were availed during the first wave of COVID through the PCG and the TLTRO route, which may come up for maturity, which may push the cost by a few basis points, but we are not expecting, but most likely, those are going to be compensated by the low-cost incremental borrowing that we'll do. So we don't envisage at least for the next few quarters, the borrowing on the cost of funds and the book to go up.

Umang Shah: Just last question from my end is, given that COVID related uncertainties behind asset quality and collections have stabilized, what sort of growth are we envisaging, over the next two to three years?

Lakshmipathy D.: See, I think, as I said in opening remarks, we were growing at 15% in COVID-1 and COVID-2, pre-COVID very healthy growth was been demonstrated from 2015 to 2020. We are very strong feeling is the growth will be in a very healthy portion from now onwards. You will be seeing in quarter-on-quarter performance, if you see June versus September, we grew our AUM by 8% and disbursement close to 40%. So that's a clear indication that growth for this financial year and next two financial year will be very healthy. It will be very strong growth comparing to what we did in COVID periods.

Umang Shah: Just one data point, if you can provide. Post IPO, what would be your net worth if that number is what you can help me with?

Management: So as of September, I think we were at about INR 4,006 crores.

Moderator: We have the next question from the line of Shweta Daptardar from Elara Capital.

Shweta Daptardar: Congratulations for a good set of earnings. So I have a couple of questions. The first one being, I'm just taking cue from the previous question. So while you mentioned the growth should remain healthy, but now that we have crossed the INR 6,000-odd crores are close to INR 6,000-odd crores AUMs. So now is the time where we'll see a lot of vintage and seasoning of portfolio happening, what challenges do you perceive going forward? That's my first question.

Srikanth G.: So Shweta, the last two years, we have seen a lot of challenges. So it's not that the book is only growing. There was quite a bit of seeing with a smaller set of growth numbers for the last two years in to COVID. Incrementally, we don't see any further challenges, which is envisaged in the foreseeable future. We are adequately investing both in people and some in terms of branch network. You will see that from our performance that for the first half of this year, we've already opened 52 branches.

Generally, we tend to open up about 50 to 60 branches in a year. This year, we have opened already 52 branches in the first half of the year because we wanted to upfront opening of the branches in the first half. So does these branches start contributing towards the second half of the year. So you will not see the same set of branch opening in the second half, but at least for the first half, if you are opening, we are able to spread out these assets by the time we are moving towards the year-end. So there is a lot of optimism on the ground. We are seeing green shoots. We are seeing demand clearly picking up over the period this year. This quarter, more than 600 people have joined Five Star. So with these kind of investments, I think we are confident of seeing a healthy rate of growth that Mr. Pathy mentioned. We are not currently looking at any significant impact that we are going to see from the market.

And just to add one point, for last 12 months, our collection efficiency is around 100%. So that clearly demonstrates the underwriting what Five Star has done is clearly stacking up very well even during COVID-1and COVID-2. So we don't see any risk from us for next few quarters and next few years. The growth will be healthy, stronger growth we'll be demonstrating the stronger growth with the kind of profitability what we do and the kind of quality what we deliver.

Shweta Daptardar: Sir, my follow-up question to that is, so if I look at our headcount number, around 6,700 stands one of the highest. So also if I compare that with the AUM books closer to INR 6,000-odd crores, this number looks pretty much on the higher side. So would you like to comment on productivity ratio? And also you could give a breakup of this headcount in terms of sales field force and underwriting?

Management: Yes. So largely, Shweta, this number is a little elevated for this quarter, but kindly keep in mind that we have opened 41 branches during this quarter alone. So this is more an investment that we have done in this quarter, but like-to-like, you will not see this kind of an elevated number. Normal branch openings in the quarter will be about 8 to 10 branches. So -- or maybe about 10 to 12 branches.

But this quarter being a little bit different, you are seeing a little elevated numbers in terms of number of people who have joined. But like I said, this time, the strategy was consciously to

upfront the opening of our branches so that we are able to get the productivity out before the end of the year, and that is what we have done. So in terms of overall manpower, we have given some breakup in the presentation that we have circulated there. Overall, if you look at the number of officers...

Management: So Shweta, just giving you some numbers. I think between the business and collections officers, which is the feet on street, we almost have about 4,680 people as of September 2022, like both Mr. Pathy and Ranga said, this is the biggest number given the coming on the back of an increased branch network. We have about 100 people on the supervisory side. These could be area managers, regional managers, state heads and all those people. So put together, the branch managers, the field officers and supervisors are about 4,800 people out of the 6,700.

Additionally, we have about 550 people on the credit side. These are the people who do the field inspections and the approval. As you would know, we don't have any businessperson who have an approval power in Five Star, entire approval power rests with credit. So put together out of the 6,700 people, you have about 5,300 which are on the business in the credit side. The rest of it purely will come from the other support functions, primarily from operations and the cash management, the cashiers at the branches, you have about 700 people on the operations side.

These are the people who do the data entry, the entire -- the documentation at the branches and all that. And from a cashier perspective, people who collect the cash, make the receipts in the branch, that's another 450 people. So these are the primary drivers of the 6,700. In terms of the other support start, we'll have about 200 people.

Shweta Daptardar: Sure. Sir, do you also share a few productivity ratios? What has been your AUM per branch and profit per employee?

Management: See, AUM per branch pre-Covid has sort of hovered around INR 17 crores or so. You should also just keep in mind that over the last five to seven years, Five Star has been growing significantly, both in terms of the portfolio and in terms of the number of branches. The number of branches will obviously be a little ahead of time as compared to the portfolio. So if you look at in the past, I think we had hovered around the INR 17 crores portfolio at an overall level.

Currently, it's about INR 16.3 crores or so. But let me just break that up a little bit for you. You will also have to see the vintage of the branches and the productivity at a vintage level any branch, for example, I think this is something that we have given in the slide as well, Slide #10. Any branch which has actually crossed three years or over five years, clearly gets into a complete productivity. So the branches which have a 3- to 5-year vintage, as of September contributed INR 17.3 crores per branch and branches, which are over five years old, was almost at about INR 29 crores. So it is -- 84 branches are less than 1 year.

And these are the branches which have got opened between September '21 and September 22. Those are contributing lesser. The average AUM for these branches is only about INR 1.5 crores because a lot of 40-odd branches got opened only in 1 quarter, so they would not have become productivity. But our steady-state metrics will be anywhere around the INR 17 crores to INR 18

crores kind of average per branch in a steady-state scenario. But when we are in a growth phase, this number will look a little bit muted, but it should come to about INR 17 crores, INR 18 crores once we reach the steady state growth.

Shweta Daptardar: One last question from my side. So we are today present or concentrated in the further build and we are expanding and moving out of home to regions. So when you say contiguous expansion strategy, do you elucidate more into what is your strategy like? And what are the challenges you are seeing while going into newer markets, given the fact that you slightly late in terms of penetration?

Management: Yes. By contiguous expansion strategy, what we mean essentially is that we will never put up a branch which is more than 100 kilometers from an existing branch. So while we have presence in Central India and geographies today, but we have expanded contiguously right from Tamil Nadu. So Tamil Nadu is our home state. We started in Tamil Nadu. And from there, we gradually expanded both to Karnataka and Andhra Pradesh. From there, we reached out to Telangana.

And through Karnataka, we reached out to Maharashtra and from there to MP. So that's how I think we have traveled our journey so far. Our philosophy has always been that whenever we enter a new state, we maximum put up only 4 branches, and we will wait out for about 24 months to see how these 4 branches perform. In the first 24 months, these branches will not carry a business target. But in the -- we will want to rate these branches across a wide variety of parameters, including customer behavior, employee loyalty, the leadership team that we're able to form in a particular state, what happens if there is a loan default.

Is there any political influence that we're able to see on the ground? Is there any fraudulent document which is sort of coming our way? And what are the legal nuances and operational challenges that we are able to see in the branches in the first 24 months. Only when we get the confidence that things are stacking up, right, for the first 24 months, then we take a call to rapidly expand beyond that. So the journey from 4 branches to 40 branches will be rapid. We will sort of do that in the next 18 to 24 months, if we decide and if we are able to get confidence from the particular state, -- we have had the mixed experiences.

So we have had the states where we – the first 24 months were extremely good, like the state of Andhra Pradesh and Telangana where we have rapidly expanded. We have also had states where the first 24 months was not so good, like the case of Karnataka and Maharashtra. And in these states, unless we are able to pinpoint in terms of what went wrong, whether it is people, whether it is location, whether it is customer selection or leadership team that we are able to form in a particular state, unless we get that right, we will not press the pedal of acceleration in a particular state. So a case in point is between Maharashtra and Madhya Pradesh, both this state started out in 2018.

The experience has been mixed between these two states. We have 40 branches, close to 40 branches in Madhya Pradesh today, and we just have about 5 branches in Maharashtra. So the strategy clearly is going to be that we will expand in areas that is strong for us where we are

having really good leadership team across the business and collection verticals. So for the foreseeable future, that is about three to five years from now, we will continue to penetrate and grow stronger in the southern geographies because this is the place where we have more than 15 years of track record.

Really good teams have seen at least five cycles of giving loans and collecting it back profitably on time. So you will see the significant growth of Five Star in the next at least three to five years coming in from South -- but that said, of course, the proportion will drop. Today, South contributes about 93%. A few years back, this was 100%. Today, it is 93%. So the proportion may drop about 85% to 80% over the next three to five years. But the newer states are not for the next five years of growth, but it takes time for us to stabilize and understand each state. So we will be putting up seed branches in each of those states, understanding the nuances and these states are extremely important for the growth beyond five years.

Moderator: We have the next question from the line of Nidhesh Jain from Investec.

Nidhesh Jain: Firstly, data keeping question on the gross NPA as per the revised RBI announced, what would be the gross NPA for us as of September 22?

Management: So Nidhesh, the revised the circular comes into effect from 1st October 2022. So we are not disclosing that number for September. But having said that, we have been -- while as part of our road shows and whenever we have been saying, given that RBI now has given us time in the entire about nine months of this calendar year, where it has helped us fine-tune our internal system as well as set the expectations right in the minds of the borrowers. Our belief is that in a steady-state scenario or once numbers have started coming in from October, we believe that the difference between the draw Stage 3 and the NPAs per revised RBI norm should be around 100 basis points.

Nidhesh Jain: So what I understand that this number was pretty high, let's say, six months or three, four quarters back. So what we have done to reduce this number so drastically, given the customer profile that we have may not be able to bring two EMIs or more than one EMI at one go. So how, on the ground, we have been able to improve this number so drastically in the last three, four quarters?

Lakshmipathy D.: Yes. Nidhesh, this is a very important question. See, as Srikanth said, we got a time of nine months when we represented RBI, RBI took it in a positive way and gave all NBFCs nine months deferring the circular. See, from Five Star perspective, as I said, we take the customer from informal segment. There is no due date concept from informal segment. There is no due date when a guy is taking a loan from money lender. So when you move from money lender to Five Star, his mind still says it's a due month rather than due date. And we were also comfortable in the earlier regime that if a customer pays within the month, we are very happy on it.

But when the circular came as all suddenly on November 12th, so it needed some time for us to go back to the customer and explain the importance of the due date rather than due month. So for last nine months, we are able to see a very-very good traction that customer is able to appreciate the logic of paying on due date rather than paying the, during the month. So that has

moved from, if I say in September, almost close to 90%, 93% of the customers are paying on the due date, because the culture has changed at the ground level, not only from Five Star, all the NBFCs have moved the culture from due month to due date. So that also has helped the sector very well.

October month onwards, it is stacking up very well. In fact, we have crossed touching 95% of the customers paying on the due date. So as we see the first quarter, that is a December quarter onwards, the difference between the growth Stage 3 and the circular NPA will not be more than 100 bps is what Srikanth just said.

Nidhesh Jain: Secondly, if you could give some details about the customer segment in terms of how many of the customers that we are originating will be new to credit. What could be the distribution of CIBIL score, let's say, customers more than the 750 CIBIL score of customers between 350 to 750 or some data around that, that would be helpful?

Rangarajan K.: So 25% of our customers will be absolutely new to credit, having not taken any loans from the formal segment, but 75% of our customers will have a credit bureau footprint. But typically, we see them having footprint in one of the following three products. It could be a micro finance loan. It could be a two-wheeler loan or it could be a gold loan. So these are the three primary products that the customers have taken. But most of these customers would not have taken a loan of a similar ticket size from another lender or for a similar product that we have.

So for at least three-fourth of the customers that we finance, we will be the first lender to give them a ticket size between INR 3 lakhs to INR 5 lakhs for a business loan purpose, which is secured. The other products that they would have taken is mostly not based on underwriting, but it's based on a product-based lending, be it gold or be it vehicles or be it a micro finance loan.

So I think that's it, we rely more on high mark scores rather than CIBIL scores. I think just given the nature of the customers and the loans that they could have taken, scores are a little bit misguiding in this segment in the sense that somebody could have just taken a micro finance loan of INR 20,000 and could have a CIBIL score of 750 plus. It may mean nothing when we are taking a call for a seven-year tenure on this customer for loan ticket size, which is much higher than a micro finance loan. So we don't look at spread of scores.

For us, what is more important is the character assessment that we do on the ground and the cash flows that we're able to get it. So while the scores are important, but I think the way we look at the scores is if there is a default, what is the product in which he has defaulted. If it's a secured product, at least if it's a loan ticket where at least he has taken INR 1 lakh to INR 2 lakhs and then there is a default, we take those more seriously than any kind of a score which is emanating from an ordinary product.

Nidhesh Jain: And then thirdly, sir, on the profitability. So sir, how do we really think about the profitability from the customers that we are generating 7%, 8% ROA in your mind is reasonable. And I'm coming on a context that in some other segments, we have seen vendors making super number profit of 7%, 8% ROA for two to three years, then competition came in and then the ROAs and

growth, both have completely gone away from those segments. So shouldn't it be a good strategy to operate at 18%, 20% yield and make the segment extremely unattractive for the new incumbency. We are getting to know that a lot of new NBFCs are trying to enter in the segment. Your point is valid it's a difficult segment to crack a lot of these companies will not be successful, but by even make this segment so attractive that new companies will enter this segment to operate?

Management: Yes. It's a very good point, Nidhesh. See, as we speak today, our ROAs are at north of 8% because we are well capitalized and our debt to the capital is low. So hence, you get a lot of profits from capital because there is no interest servicing part on it. But at a steady state, we don't think that 8% is doable here.

We can guide you a steady-state ROA of around 6% to 6.5%, when a leverage hitting is around 3x to 4x. So that is the steady-state guidance that we are giving. And we don't say that 8% ROA will stay here. But not because of the competition that the ROA will get reduced, but I think from a reasonable lender, we wanted to also bring down the lending rate wherever we get the benefit both from borrowing cost and operational efficiency going up, we wanted to pass on that benefit to the customer. That's the stand what Five Star has taken.

Yes, as Ranga also said, most people wanted to get into the segment, but people find out after getting into segment, it is not so easy to operate and easy to understand the customers' cash flow character and the collateral what they are willing to give it to us assessing that as it's a big challenge. So not on competitive intensity, but on being a very responsible lender, we wanted to bring down our lending rate. And as the leverage picks up, as you pay more interest, the ROA also starts to drop down from 8% to around 6% to 6.5%. That's our guidance we wanted to give.

Nidhesh Jain: And sir, do we charge prepayment penalty to our customers, if they do BT out?

Management: No, we don't charge any prepayment penalty for anything beyond 12 months. So only if the prepayment happens within 12 months, there is a penalty of 1%. But beyond that, there is no charge.

Nidhesh Jain: So what is the thought process behind that? Because I see that all other lenders charge pretty hefty prepayment penalty on the fixed rate loan, there is no prepayment panties allowed. So what is the thought process behind that?

Management: Yes, I think the thought process really is that what we are serving is a business customer. So they will always have access to chunkier and good cash flows after a good cycle or a good season. You can't prevent the customer from coming back and prepaying to you either partly or fully, we have always seen that the customer appreciates this. We give them a max tenure of seven years. So most of our loans, while we can give a loan for two years, but we actually extend the loan for seven years because it eases the EMI pressure on the customer.

Most customers will be more optimistic about their cash flows, and they may want to take a loan for two or three years, but that's detrimental to them because if, let's say, one season goes bad,

they may not be in a position to pay that higher EMI. So our strategy is always give the loan for a max tenure of seven years but allow them to prepay whenever they have access to cash flows, good cash flows.

And that's why we have also kept our seven-year rates are lower than two-year rates. The seven-year rates is at 24%- and two-year rates is 26%. So we naturally nudge the customers to take tenure longer tenure loan. Having nudge the customers to take a longer tenure loan, you can't stop them from prepaying because that's not fair to the customers. So they will prepay and they deeply appreciate this aspect about Five Star, which is why they will prepay and we have seen multiple customers, when they have good access to cash flows, they'll prepay the loan fully and they will come back probably in two months and then take a loan again from Five Star when there is a need. So we have not kept any resistance here for a prepayment charge beyond 12 months.

Nidhesh Jain: And lastly, one more data point question on the attrition rate, how is the attrition rate at the ground level that we are seeing?

Management: Yes. The attrition rate that we measure and which is most important for us is from the branch managers and above, that's a touch point on the ground because the branch managers are the knowledge centers in a branch, and they hold the culture and they hold the customers right from start to finish. At that level, our attrition rates are between 8% to 9%, probably one of the lowest in the industry. We give extremely good career path to our employees of Five Star. So they tend to stay with us for the long term from that point. But if you were to go below the branch manager level, just at an officer level, there the attrition rate is in line with the market, somewhere between 25% to 30% at the officer level, but anybody about the branch manager, we'll be at one of the lowest in the market at somewhere between 8% to 9%.

Moderator: We have the next question from the line of Piran Engineer from CLSA.

Piran Engineer: Some of these might be basic, because I'm new to the company. Just wanted to understand one thing as to how you all ensure Stage 2 does not slip into Stage 3? Because if I look at your 30 to 60 buckets or 60 to 90 buckets, they're reasonably elevated, like more of the NBFCs are what you can expect. But then the 90-plus bucket is 1%. So if you could just talk a bit about what steps you all take to ensure that the 60 DPD loan does not become 90 DPD? That will be really helpful.

Management: So thank you, Piran. I think this is a very important question. And we will continue to explain this as long as it takes. The first point for us that we measure is when does a customer move from Stage 1 to stage 2. That is important. I think we are very clear that if it's an early movement, if it's a quick mortality in our parlance, which is any account which is turning into arrear or it is turning into an NPA. A quick mortality for us is defined as any account turning into an NPA in the first year. And quick arrear is defined as any account turning into an arrear in the first six months.

These are taken extremely seriously by us, and we go right in the point of doing a full-fledged staff accountability analysis, right from the person who source the file, the person who underwrote the file and the final approval, is there anything that we have slipped. Things can go, if it's beyond our control, it's fine, like customer has met with an accident or there is a natural calamity in that particular area, that's different. But if it's anything related to customer-related aspects, those are seen extremely carefully.

So I think if you were to look at this part, most of the Stage 1 and Stage 2 part of Five Star is not customers who are going to be in the early part of their lifetime within Five Star. So now you have to just understand and put yourself in the shoes of the customer, most of our customers are earn-and-pay customers, 65% of our customers are single shop owners. So these are people who have to open their shop every day, earn and pay the EMI. They don't have access to significant savings.

So given that, there will always be something which is happening around his life. It could be something good or bad, which is happening in his life, maybe a marriage in his family, maybe a death in his family, some health emergency. So we will see that beyond the 24-month period when something happens to his family and he has been extremely prompt on paying his EMI still that point of time, when he has a genuine reason and then he's explaining that to the branch, you can't turn a blind eye towards that. You can't say, I don't know what happens in your family, you will have to pay the EMI.

So in such circumstances, we actually allow the customer and give a formal permission for him not to pay an EMI. It could happen in the 25th month or the 28 months. So a customer slips from Stage 1 to Stage 2 at that point of time. What we measure for such customers is that in the subsequent month or in the subsequent month from that point, we will make sure that he is at least servicing one EMI and staying in the same bucket. He may not have the wherewithal to repay two EMIs and come back to current, but that's perfectly fine with us.

The way we think about it is that somebody has delayed one EMI in like 24-months, it's fine. The one EMI will be paid along with the delayed interest or the two EMIs will be paid along with the delayed interest when he's settling the loan; when we are sitting on a collateral, which is self-occupied residential property, there is neither going to be interest loss income here or a credit loss situation. So we are fine with that situation.

But for us, what is most important is, is he servicing a subsequent EMI. So most of the customers whom you are seeing in the Stage 2 bucket, the stabilization levels in that bucket is extremely important, and that's what it depends. But when a customer moves from 31 days to 60 days and actually moves to the 61 days to 90 days bucket, we cut off this flexibility to the customer because we have already given him two excuses.

And so the culture within the customers and they have been explained well is that, yes, if there is a genuine reason why you are delaying, that's fine. But I think if you have already taken two excuses, we will not permit you to go beyond the 61 days to 90 days. So there, we will make

sure that through our concerted collection efforts and educating the customer, we are arresting any further flows from 61 days to 90 days and beyond. So that's one reason why you will see something in Stage 2, but consistently across years, across cycles, we have not seen this slipping and moving forward to a 90-plus bucket.

Piran Engineer: Just a couple of numbers-related questions, pre-COVID we used to operate at about 17%, 18% provision coverage ratio, which has now been buffered up to about 45%. How should we think about modeling this over a steady state period? 17%, 18%, honestly, also seems to be a bit low for the category of customers you all cater to?

Management: No. I understood your question. See, when we all transitioned from IGAAP to Ind AS, there was a methodology that was built, and we were following that methodology without building any kind of an overlay on any of these assets. So it was purely derived from a probability of default and loss given default. Our belief was that there was not much of flexibility to build overlays and incremental provisions, pre-COVID.

So that is why if you see, given that our probability of default is one of the lowest and our loss give in default is also very low because we managed to collect almost close to the contracted IRR even on a Stage 3 asset. The provision coverage at that point of time was 20% or a little lower than 20% on Stage 3 assets. But when COVID hit and we started creating the overlays across the various buckets, more so on Stage 2 and Stage 3, we also found ways to build more provisions on Stage 3 assets because if you just go back a year before the adoption of Ind AS, our provision coverage was, we had actually taken it up to 34%, 35% on the 90-plus assets.

But it naturally dropped down because of the methodology of ECL. But post-COVID, we have also found ways to build some overlays on these assets. While in the last couple of quarters, it has moved a little bit to 39% and 44%. Our guidance to you is that this number will be at around 35% in a steady-state scenario, which is what you should probably model for.

Piran Engineer: Just lastly, out of your 2.5 lakhs all your customers, and I think I'm just asking a previous question in a different way, how many of these would be first time to Five Star and how many of them would be repeat customers have taken their second loan or third loan from Five Star?

Management: So we measure that in two ways, Piran. The first is a number of customers who have taken a top-up loan from us, and the top-up loan is defined as customers who are running two loans parallelly with Five Star. We have a pretty strict top up policy. We don't extend the top-up loans in the first 24 months. Somebody has to have a good track record in the first 24 months. More importantly, they have to be a 0 DPD customer for them to be eligible for a top-up loan at that point of time.

So, we will do a fresh assessment of the customer at that stage. If there is room both in LTV and in the DBR ratios and the track record is good, we will extend a top-up loan to that customer. So that's about 10%. 10% of our portfolio of customers will be running two loans together. That's the top-up loan. But if you were to look at repeats, it will be about 15%. But just mind you that the average tenure is about 5 years. So, if you were to look at 5 years back, Five Star in 2017

was just about INR 500 crores AUM. So, repeats will come over a period of time. But you have to see that in the context of what we were 5 years back and those are the customers who will be coming for repeats at this point of time. It is a healthy number.

Piran Engineer: So you're basically saying about 35,000, 40,000 customers are repeat customers.

Management: Yes. So, we are just breaking that up. Either people who are repeat customers running multiple points would be about, say, 20,000 or 25,000. There will be another 20,000 or so who have closed their old loan, given a little bit of time and then come back to the company for another loan. They have closed it out of their own sources. But having had the need to -- for funds again, they have come back to the company. So put together, you are right, about 40,000 to 50,000 customers would be some form of repeat customers.

Piran Engineer: So that's actually quite a high number because 5 years back, that wouldn't be your total customers, right? The way I'm trying to think is that most of the customers who would have taken a loan from you are retaking another loan at the end of the 5-year time period. Is that the right way to think about it?

Management: Piran, that's why I gave you this breakup. The breakup of repeats is different from the breakup of top-ups. Somebody becomes eligible for a top-up at the end of 2 years and not 5 years. So, you can't look at a 5-year back number and then compare put both together and then see -- so 2 years back, we were still INR 4,000 crores in 2020. So, they are all eligible for a top up potentially. So that's a good mix. And if you split that and then see only repeat, it's about 15%, which comes overall.

Management: So Piran, even there, this principle will hold good because the customer who's actually prepaying, let us say, in 2 years, 2.5 years or 3 years comes back after a six-month period. And so, it is not like every customer prepays only after 5 years. What we are saying is because of the prepayment, the average tenure of the portfolio drops to 4.5, 5 years. But people are going to be prepaying at points of time, right? So, anybody who was there, let's say, 2, 2.5 years back, could have prepaid the loan by March could have come and taken a loan in September. Nothing stops them from doing that.

Piran Engineer: I'm a bit confused. I'll take it offline, but if I can just ask this question, this 15% repeat customers includes the 10% top-up customers or it's over and above that?

Management: It's over and above.

Moderator: We have the next question from the line of Gaurav Kochar from Mirae Asset Managers.

Gaurav Kochar: Firstly, if I split the number of branches that you've, roughly 50 would be in the newer geographies and 300 would be in the older geographies. In FY '22, you had given the breakup of super branches and the normal branches. So roughly around 140 branches were super branches. My question is, how long does it take for a branch to turn into a super branch? And I wanted some cost ratios. So, the cost to AUM at a company aggregate level is around 6%. I just

wanted some sense on what is the initial cost to asset for a branch before it turns into a super branch?

Management: So, the super branch eligibility comes to a branch after 24 months of good performance. So, we will not make super branch within 24 months. So, at the end of 24 months, firstly, we will see what the team that has formed in the branch. And we will assess it for all parameters in terms of ability to good business, good collections, loyalty factor, no frauds in the first 24 months, no bad documents, no bad selection of customers. So, with all that, a branch becomes eligible for a super branch.

Once it becomes a super branch, we double the teams essentially. So, till then, we could have operated with about 5 officers. It becomes a super branch; we will give 10 officers to that branch. Till then, our branch can source files only from a 25, 30-kilometer radius. The moment it becomes a super branch, they can go up to 50-kilometer radius from a branch. A branch would have definitely broken even somewhere between the 6- to 9-month time frame for us from the time of putting up the branch. So, all those branches which are becoming a super branch would have definitely broken even within the first year itself, but they become eligible for a super branch only after the second year.

Gaurav Kochar: And sir, my question was with regards to the cost to AUM. At an aggregate level, it's around 6%. Can you give some colour around how does that -- for a branch, how does it transition initially? And once it becomes a super branch, there would be some benefits of operating leverage and scale. So how should we look at this number, let's say, 2 years out depending on the branch rollout strategy? And in your view, what kind of branches?

Management: So, Gaurav, I think the first point to be kept in mind is that any branch turns breakeven at the end of 6 months. So, from there onwards, it starts contributing to the profitability. Obviously, in the initial stages of the branch, this OPEX to AUM is going to be higher because the operating leverage is still not kicked in. So, our belief is that -- and if you look at the branch vintage that we've given to you in the distribution strategy slide, which is Slide number 10 of the presentation.

We have about 222 branches, which are actually greater than 3 years old. So, our belief is the operating leverage reaches the optimal level at a company, about 6% or so or maybe slightly lower than that at around a 3-year mark. So, a branch which is at about 3 years and with a portfolio of something like INR 15 crores to INR 18 crores at an average sort of reaches the optimal mark at 6% level. Anything which is less than 3 years is going to be slightly higher and would reach a 6% level when it comes to a INR 15-16 crores kind of an AUM.

Gaurav Kochar: Okay. Okay. And to just summarize all of this, let's say, in 2 to 3 years' time frame, where do you see the total number of branches? And if the mix is more skewed towards more than 3-year branches, if the branch rollout strategy kind of slows down over the next couple of years, given that we've already upfronted the investments. In that context, where do you see a steady state cost to assets or cost to AUM?

Management: So, Gaurav, our idea is to put up at least 50 to 60 branches per year. This year is a little higher given the fact that the last 2 years were muted with COVID. So, this year, we -- maybe we'll go to about 70 branches. We've already opened 52 in the first half of the year. But steady state, I think, 50 to 60 branches is a good number, which we can digest without any compromises on the culture or the quality of people that we are able to take in each of those branches.

Like I said, the majority of these branches will come in South, so which is the existing areas of strength that we have, maybe about 20% of these branches will come in the non-South region. So given all this, yes, the proportion of new branches vis-a-vis the total set of branches will definitely drop. So, from a cost-to-income perspective, Srikanth will just cover that.

Srikanth G. So, Gaurav today, about 65% of our branches are greater than 3 years. And obviously, as we keep adding, this proportion will definitely go up. This should reach to something like 70%, 75% over the next few years. And each of these branches are going to be operating at about 5.5% to 6%. So, there is some bit of operating efficiency possible. But if we are looking at a very significant operational efficiency, I don't think that is going to come through because Five Star is already operating at one of the best productivities. So, we believe that from 6%, this number can bring anywhere around 5% to 5.5% in a steady-state scenario.

Gaurav Kochar: Cost to income?

Management: Cost to income will range at around 35%, where we are already at. So OPEX to AUM of about 5% to 5.5% because the AUM will keep growing. And the cost to income of about 35% is what we would guide you for in a steady-state scenario.

Gaurav Kochar: And just last question, data keeping question. You mentioned the total restructured book outstanding is 1.18. Is that a gross number or a net number?

Management: Gross number. INR 65 crores, about INR 65 crores, INR 66 crores is the gross number, on which we hold a provision of about INR 28-odd crores, INR 28 crores, INR 30 crores, which is a 50% provision.

Gaurav Kochar: Sure. And this provision is already part of your Stage 2 ECL. Is that correct?

Management: It is part of Stage 1, Stage 2, Stage 3 ECL, whichever place the assets are lying.

Gaurav Kochar: And any other provision that you're carrying outside of ECL any COVID or any contingent...

Management: For us, everything is built through the ECL methodology, Gaurav. So, we don't create any incremental provisions like the contingency buffer and all that. Our overall provision as of September '22 was at about INR 101.6 crores, representing 1.77% of our overall AUM.

Moderator: We have the next question from the line of Franklin Moraes from Equentis Wealth Advisory.

Franklin Moraes: So, in terms of your shift to the new RBI regulation, you mentioned there could be an increase in gross NPAs. So just wanted to understand, will there be a corresponding provisioning impact as well?

Management: So, Franklin, we are not envisaging any significant provision impact coming through because some of these cases, which potentially could become an RBI NPA, but not a gross Stage 3, we have already provided for at more than or equal to 10%. So, from an RBI perspective, we are not envisaging any provision increase coming on account of the additional 100 basis points of NPAs that will come through.

Franklin Moraes: And in terms of your restructuring book, what is the collection efficiency?

Management: We are today seeing collection efficiencies on that book of about 70% to 75%. There are slippages, like I said, Stage 1 assets are at about 30%. Stage 2 assets are at about 60%, about 8%, 9% is Stage 3. So there is definitely a lower collection efficiency on that book as compared to the normal book. But more from a collection efficiency perspective, we are giving you a bucket-wise data between Stage 1, Stage 2 and Stage 3.

Franklin Moraes: Okay. And what is the moratorium percentage in this book?

Management: So our restructuring was only -- was only in the form of moratorium, which we gave between for the installments falling between April 2021 and September 2021 -- so from October 2021, people have already started paying and moving DPDs if they are not paying. So you have a post restructuring repayment behavior of one year.

Franklin Moraes: Okay. So basically, nothing is in the moratorium as of now. So whatever collection inefficiencies are there from probably the coming quarters will be fully paid?

Management: It was already in the last four quarters and coming quarters, again, will be based on actual demand on all these loans.

Franklin Moraes: So just to clarify, we just gave six months moratorium for all the restructuring, what we have done in June of last year. It's very short moratorium.

Management: The overall restructuring book is only 1.18%.

Franklin Moraes: Sure, sure. In terms of your CAR, there has been a reduction of about 7% on a 6-month basis. So just wanted to understand like maybe on an annualized basis, can we see maybe 10% to 15% of car reduction it depending on your AUM growth?

Management: Yes. I think you can -- so see, CAR is a function of two things, Franklin. One is the kind of investments that we maintain at points of time. So in the -- especially you just go back six months before, pretty much FDs or mutual funds were yielding similar rates. So we were pretty putting in FDs because they don't carry a risk base, whereas investment carry a risk base. But as you see, currently, we are probably putting a little more on the investment in the mutual funds side.

So it is a function of one, the growth in the portfolio and the growth in the balance sheet. It is also a question of how your liquidity is sort of kept either in the form of mutual funds or FDs. But I think about 10% to 15% reduction in car on a year-on-year basis is something that could be looked at. But having said that, this is a ratio that is at a very high level for us. So we'll have to see how it sort of pans out as the portfolio starts growing.

Management: And just to clarify, I don't keep a CAR as your point of reference for justifying the growth. As Srikanth said, investments then can also bring down the CAR. So as I said in other question, you will see very healthy growth from Five Star in the quarters to come.

Franklin Moraes: Okay. Sir, and my last question is, recently, we have seen that the FTX issue blowing up wherein Sequoia has been impacted and they had to write down the investment and Sequoia is a major investor in our company as well. So have we got any confirmation from them like whether they would continue to hold their investments? Or is there any threat of them exiting?

Management: So Franklin, that is absolutely beyond the scope of discussion. This is what got impacted the Sequoia US, I think the way these funds are structured are very different. We will have no impact from this event.

Management: And Franklin, and just to give you a perspective, Sequoia is also one of the institutional promoters as part of this IPO. So that also sort of signals their intent to stay with the company for a longer period of time.

Moderator: Thank you as that was the last question for today. I would now like to hand the conference over to Mr. Lakshmipathy Deenadayalan for closing comments. Over to you, Chairman, sir.

Lakshmipathy D.: Yes. Thank you for all the participants who participated in the first conference call of Five Star. As we have been speaking with many, many people from the road shows and calls. I think we will take more time to explain our business model because, as I said in the opening comments, this is a very niche segment, both in quantum of the loan and the tenure of the loan that we give to our customers is very unique. So we keep explaining this in more calls to come. Just to closing comment, please expect a good growth, good quality and good profitability to continue in Five Star. Thanking you and meeting you in the next conference call, which is Q3 of December. Thank you.

Moderator: Thank you very much, sir. On behalf of Five Star Business Finance Limited, that concludes this conference. Thank you for joining us, and you may now disconnect your lines. Thank you very much, sir. Have a great day.