FIVE STAR
Business Finance Limited

Date: February 03, 2023

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 December 31, 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 Monday, January 30, 2023.

The recording can also be accessed from the link : https://fivestargroup.in/investors/

Kindly take the above on record.

For Five-Star Business Finance Limited

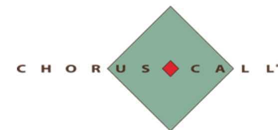
Shalini Baskaran
Company Secretary & Compliance Officer

Five-Star Business Finance Limited
Registered Office : New No. 27, Old No. 4, Taylor's Road, Kilpauk, Chennai - 600 010.
Phone : 044 - 4610 6200, e-mail : info@fivestargroup.in, Website : www.fivestargroup.in
CIN : U65991TN1984PLC010844

"Five-Star Business Finance Limited

Q3 FY '23 Earnings Conference Call"

January 30, 2023



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: Ladies and gentlemen, good day and welcome to the Q3 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. Thank you and over to you ma'am.

Mahrukh Adajania: Hi. Good morning everyone. I welcome you all to the earnings call of Five-Star Business Finance Limited. We have with us our top management team of Five Star represented by; CMD, Mr Lakshmipathy Deenadayalan, CEO Mr Rangarajan Krishnan and CFO Mr Srikanth Gopalakrishnan.

With this brief introduction, I hand over the floor to the management team of Five Star, they'll start with their brief overview on results after which we'll move on to Q&A. Over to you.

Lakshmipathy Deenadayalan: Thank you, Mahrukh. Good morning all. This is the second conference call for Five Star. Thank you for people joining in. To start with a very positive note, last time I said the Q2 was one of the best quarters for Five Star, so this quarter I may rate it is better than the best. We will take you through on that logic.

Before that, I just wanted to spend a minute for the new participants in this conference call, a few points on Five Star. As we all know, Five Star is playing into a niche segment which is less crowded. We are lending to single or small shopkeepers, self-employed and cash salaried segments for last 20 years.

And why we are saying it as being less crowded, these people don't have a formal documentary proof to show their credit history. So, you have to build your own assessment capability on assessing their cash flows, integrities and put your collection model which can suit their earn and pay cycle. So, we have been doing it very successfully. That's been evidenced by our quality of asset and profitability for the last many-many years.

Now taking you through the performance of Q3, first let me take you through on the loan portfolio which has seen a strong growth. We have moved from INR 4,767 crores to INR 6,242 crores year-on-year, registering a growth of 31% and on Q-on-Q, we have moved from INR 5,732 crores to INR 6,242 crores with one of the best Q-on-Q growth of 9%.

Moving to the disbursement, we have moved from INR 426 crores to INR 910 crores comparing year-on-year with 114% growth and comparing with Q-on-Q, we have moved from INR 802 crores to INR 910 crores with a healthy disbursement growth of 13%, which has been led by increase in number of branches; as I said last time, we are adding good number of branches. Comparing last December to now, we have added close to 89 branches and comparing to last quarter, we have added 17 branches. So as of now, the total branches stands at 369 branches for Five Star.

Now taking you to the very important point, which is the asset quality of Five Star. Let me start with 90-plus and come to the NPA. So, 90-plus has been flat, comparing to last quarter, at 1.16%. But the terminology NPA has bit been changed which is in line with RBI circular dated 12, November 2021 which got implemented from 1, October, 2022, and that stands at 1.45%. The difference between

1.16% of 90-plus and NPA of 1.45% is 0.29% which is INR 18.10 crores of loans, which have been categorized as NPA even though it is less than 90 DPD, as per the new circular which got kicked in from 1, October 2022.

Then moving to the liability, I am happy to register we have raised more than INR 1,000 crores in a single quarter which is the first of its kind in Five Star. So we are building our strength not only on assets we are also building our strength in liabilities. Few more data, our incremental cost of borrowing has moved from 8.5% last year to 8.7% this year with the increase of 20 bps even though repo rate has moved from 4% to 6.25% with an increase of 225 bps. So that shows the comfort lenders have on Five Star, being a good capitalized company, and quality, and profitability standing by.

And cost of borrowing on the book has come down from 10.50% in last year to 10.35% now. So as I said in last quarter also, there is no need of increase of lending rates to our borrowers; that will not occur in quarters to come. Finally, on the profitability, we have moved from INR 118 crores of PAT to INR 151 crores of PAT, registering a 28% growth in year-on-year. And from INR 144 crores to INR 151 crores, Q-on-Q, with registering a growth of 5%.

Finally, on rating, I am happy to announce our rating has moved from A+ to AA-. India rating has assigned the AA- rating to Five Star. So with this, let me hand over the session to Srikanth, our CFO, to take you through more.

Srikanth Gopalakrishnan: Very good morning to all of you. I will just quickly touch upon a few aspects and then hand over for any Q&A. See from a numbers perspective, as in the previous quarters, I think our growth has been both branch-led as well as customer-led, with a very minimal increase in ticket sizes. So we have had a total active loan base moving from INR 2.5 lakhs in September to about INR 2.7 lakhs today. And on a year-on-year basis, this represented a growth of 24% from about INR 2.15 lakhs.

Branch count continues to be robust. We have added 89 branches during the last one year and about 17 branches during the quarter. And the branch count stands at 369 branches as of December. The growth in AUM has been at about 31% year-on-year and 9% quarter-on-quarter. We ended December quarter with INR 6,242 crores of loan book for nine months ended December 31, 2022. Our average yield on the portfolio was at about 24.11% and average cost of funds at around 10.35%. This has resulted in a spread of 13.76% as against spread of 13.49% during the nine months of financial year 2022.

NIM again is at a very healthy number of about 18.55% for the quarter, primarily due to lower leverage but a large part of it is also being on the back of lower funding costs. Year-to-date, the NIM has improved to 17.91%. Our cost to income stands at a very healthy number of about 35.56% for the first nine months as compared to 35.62% for the nine months ended December 2021. This has resulted in a return of assets of 8.64% year-to-date and a return on equity of 14.66%. So that's it from the numbers perspective.

From a borrowings perspective, I think we have a very healthy borrowing profile with about 50 lenders lending to us. The bank lending proportion has been going up. That tends to be very sticky proportion of the overall borrowings for us. So banks contribute about 56% of our debt and we have diversified our borrowings, across non-convertible debentures, market linked debentures. We have

done securitization transactions and also issued ECBs. As Mr. Pathy said, during the quarter, we raised over INR 1,050 crores of incremental debt at an all-in cost of about 9.1%.

What you see on the presentation of 8.7% for the nine months is only the coupon. Last quarter if you look at it, it was 8.7% of all-in cost. So that did go up by 40 basis points. But what is important to note is that while the cost of funds has gone up by about 40 basis points as compared to the previous quarter, we are still borrowing a very good quantum of debt at optimal cost.

And as compared to the Q4 of last year, our borrowing cost has actually gone up by about 42 basis points despite the fact that RBI has raised their repo rate by about 225 basis points. So clearly, Five Star is seen as an attractive lending institution by the lenders. As Mr. Pathy said India ratings has given us a rating of AA- during this quarter, which is very clearly something that stands testimony to the strength of the company. We are hoping that the other rating agencies will also follow during this period.

On balance sheet liquidity remains robust at over INR 1,000 crores without taking any of the pipeline sanctions, so we are expecting that this will tide us in a very good manner over the next two quarters. What all this has actually done is bring down our overall borrowing cost on the book as well from about 10.56% last year to about 10.35% for the nine months ended December. And for the quarter, it's at 10.26%. So very counterintuitively, Five Star has seen a reduction in borrowing costs despite the adverse interest environment over there.

On the collections, again, we have spoken about the business momentum. The collections have also been very robust, not just during this quarter, but over the last about six quarters or so. We have been clocking a collection efficiency of over 98% in the last six quarters with four quarters showing over 100% in collection efficiency. Even the 30-plus number which you are seeing about 13.5%, 13.7% last quarter, it's actually dropped down to closer to 12.1% as we speak as of December 2022.

One important development, I think Mr. Pathy touched upon this is the upgradation norms that got implemented from 1, October Just to refresh everyone's memory, RBI came out with the circular on November 12, 2021, and then followed up with another circular on February 15, 2022, where these upgradation norms were deferred to 1st October. So basically, what this means is any loan that crosses 90 DPD at any day during the quarter can only be brought back to standard asset only if they clear all the over dues. So given our profile of earn and pay customers, there are always going to be some customers who may not be able to pay on the due date, but they will clear before the month end.

So our Stage 3 assets or NPA that we have aligned to the revised norms stands at 1.45%. But out of this 1.45%, 1.16% represents assets that are over 90 days past due as on December 31, 2022. 0.29% predominantly is sitting in the bucket of 61 to 90 and 31 to 60. However, since these customers crossed 90 DPD at some point of time during the quarter and they have not regularized their account to zero DPD, which is why they will also have to be classified as NPA. But if you would recall, we had guided even last quarter that this number, the dichotomy between Stage 3 assets and NPA would be around 75 to 100 basis points. For this quarter, it's only at about 29 basis points.

We continue to hold a very robust provision both on the overall book as well as on the Stage 3 assets. On the Stage 3 assets, our provision has been almost flat compared to previous quarter. Currently, we hold about 44.78% provision on the Stage 3 assets and 1.66% provision on overall AUM. With

the effects of COVID having almost receded completely, and we are seeing very good traction across the various portfolio buckets, the overall provision coverage on the AUM will gradually start normalizing in the coming quarters, and that's something that you will keep seeing.

On the restructured book, we restructured 1.83% of our assets during the second wave of COVID. Currently, the restructured book as a proportion of overall AUM stands at 1% at INR 62 crores. And even on this book, we maintained a very healthy provision coverage of about 48.61%. It's also good to note that there is a good performance that we are seeing on the restructured book. About 91% of the restructured book continues to be in the standard category. If you recall, it's been five quarters since the restructuring ended. So even after five quarters, we have about 91% of the book who's staying in the less than 90-day bucket.

Profit for the quarter, as Mr Pathy had outlined, is about INR 150 crores, representing a 28% year-on-year growth. For the nine months, we had clocked a profit after tax of INR 435 crores, representing an increase of 29% year-on-year. We had a net worth of INR 4,165 crores as of December 2022. So this quarter, the company has continued to show a very robust growth, profitability and quality. And we are very confident and remain well poised to continue the momentum in Q4 as well. Typically, Q4 tends to be the best quarter for us as for any other NBFC. So we are very confident of showing good results for that quarter as well.

So with this note, we will take a pause here, and we'll open out for any questions that any of you may have. Thank you very much.

Moderator: The first question is from the line of Pranav from Rare Enterprises.

Pranav: Sir, have you shared anywhere SMA 1, SMA 2 data in the presentation?

Srikanth Gopalakrishnan: So Pranav, we have given you the numbers of 30-plus and 90-plus. So 30-plus consists of both SMA 2 and SMA 3. So 30-plus stands at 12.1%. And if you remove 1.45% out of that, which will be about 10.55% or 10.6%, so that's one data that we have. We also have on the slide, the subsequent slide the bucket-wise portfolio breakup. So SMA 1, which is one to 30 stands at about a little over 7%, 31 to 60, which is SMA2, stands at 5.42%, 61 to 90 stands at 5.23%, and NPA stands at 1.45%. So this is on Slide 26.

Pranav: So this data, if you track it for, say, before COVID and during COVID, how has this data improved? Any trend that you can give -- for any one of these data points, for example, say, 30 to 60 DPD? Any trend that you can draw and highlight?

Lakshmipathy Deenadayalan: Yes. Pranav, let me take it up. Srikanth will come up with the numbers. See, Pranav, I think pre-COVID, our numbers have to be compared with pre-COVID with now, because these customers are earn-and-pay customers, you can't expect them to be in the current stage till the tenure gets closed. So we have to track them, when is that their first arrears hits the customers and the subsequent months how the customers pays the arrears is the trend what we will have to see it.

So if you just compare this with other lenders or lending to prime customers, this may be a little higher. But we know that because that is why I said this is a less crowded market. When you want to

lend to these customers, you have to be very clear about their earning pattern and their paying pattern for a long-long time. We have a pattern for the last 20 years.

If you see our pre-COVID, the current bucket was around 82%. Now it stays at 80.87%, which is 81%. It has moved substantially from last December from 67%. So I think very confidently, next quarter, we will break our best ever current at Five Star. That's what the trend has been showing at Five Star. So I think Srikanth, has numbers. I think I'll leave it to Srikanth.

Srikanth Gopalakrishnan: Yes. So Pranav, I think we are broadly in line with our best numbers that we have seen pre-COVID. Like Mr. Pathy said, current is about, we were at 82%. We are at 81% currently. In fact, on the one- to 30-day bucket, we are actually better off, as compared to 8% 1 to 30, we are at about 7% today

31 day to 60 day broadly in line, we were at about close to 4.5% then we are at about 5.4% now. And 61 day to 90 day we were at about 4% because there will be something that the NPA also will be showing a little higher number. So we were at 4%, and we are currently at about 5%.

So there is a 1% difference in the 31 to 60 and 61 to 90 day bucket as compared to the best numbers that we clocked pre-COVID, but things are definitely coming down. As you will see, even in the presentation between December '21, September '22 and December '22, not just in terms of percentages, across the various buckets, you will see the absolute quantum also dropping. So we are very confident that this number will show better improvement in the March and the subsequent quarters to come.

Pranav: Last question from my side. I'll come back in the queue. So the 369 branches that we have, what is per year typically we will increase?

Rangarajan Krishnan: So Pranav, the normal opening rate of opening of branches is about 50 to 60 branches per year. That has been our pre-COVID track record in terms of number of new branches that we get to open per year. This year has been a little higher. In the last one year, as Mr. Pathy had put it, we had opened about 89 branches. The rate is higher because the last two years because of COVID were muted in terms of branch openings. So there is some pent-up demand that is getting absorbed this year. But I think we'll get back to normalcy of about 50 to 60 branches per year going forward.

Moderator: The next question is from the line of Rahul Bhangadia from Lucky Investment Managers.

Rahul Bhangadia: Two questions. One, if you could give us an indication or guidance on your credit cost going ahead because this quarter is a really low number. What should we expect going ahead on a medium term?

Srikanth Gopalakrishnan: Yes. So see, if you look at during the quarter of December '21, we had a credit cost of about a little over close to 100 basis points, about 94 basis points because that was also the time post first wave, second wave, we were consciously building more of provisions, that has started normalizing. So our belief, while this quarter looks at about 27 basis points or so, our belief is that this number will be anywhere around the 1% level once we have a steady-state scenario. So what it used to be pre-COVID around 1% or so is where we think the credit cost should start stabilizing in a steady-state scenario.

Lakshmipathy Deenadayalan: Rahul, just to add a point, from a guidance perspective, I think we are extremely performing very well. Let me take the inputs from the earlier question where COVID hit most of the sectors in our country, but we were able to manage one of the best asset quality, even though the DPD performance

was a little down. That DPD performance is now picking up. That's what last question we clarified. We'll be beating all the numbers of previous best DPDs at Five Star in next quarter. But having said that, as a guidance of credit cost, I think we'll be happy to give you at 1% to 1.5% at a longer go, having the performance is really good, but I want to be more cautious, so to give a guidance of 1% to 1.5% in the long run.

Rahul Bhangadia: Second question was, what is the general repayment period that happens here 2.5 years to three years? And has that number changed over the last four, five years?

Srikanth Gopalakrishnan: Sorry, it's not 2.5 to three years, Rahul. It's more like four, 4.5 years. See, our origination tenure is up to seven years. In fact, almost 85% of our loans get sanctioned for a seven-year tenure. Adjusted for prepayments, what we see is that this number is around four to 4.5 years. It has sort of largely stayed around that level in the last few years. So we are not seeing it significantly increasing or significantly constricting.

Rahul Bhangadia: So the reason that I asked this question was if you look at the, in your presentation from, you have given data from FY '15 to FY '22, if you look at the loan disbursements and then the growth in the AUM, broadly, the 2.5 to three year number that comes out. So that's why I asked this.

Srikanth Gopalakrishnan: So a lot of loans, whatever gets booked in the initial part of the year, you'll see the repayments, rest of it you may not see. So typically, what we see is about 2.5% of runoff every month, so 2% to 2.5%. So 2% at 24% for the year works about a little over four, 4.5 years.

Moderator: The next question is from the line of Jeetu Punjabi from EM Capital Adviser.

Jeetu Punjabi: Just one bigger question is, what are the trends you're seeing on the ground, which would translate into growth? Are you seeing an opportunity to expand much faster and grow the book faster? Are you in the mode where you need to be a little more cautious? And would you -- and I also saw on media, there was a comment which talked about 20%, 25% growth. Does that look doable in the next four to six quarters as well?

Lakshmipathy Deenadayalan: Ravi, let me start. I'll ask Ranga to even add. See, we will always be very cautious. We will not be dynamic when we handle these customers. As I said, single shop owners, self-employed and cash salary customers, which is very hard to break. So we'll be always cautious. That's our philosophy.

At the ground level, we see tremendous opportunity, as I've been saying to everyone and everyone knows that this is a segment of customers who have not been -- that credit was not being met by former lenders years and decades for now. But Five Star took a call in 2002 and went behind them and successfully have done in the last 20 years.

We are very optimistic from this opportunity perspective. These are the things that will drive our growth. See first, we were at INR 3.5 lakh average ticket size which has come down to INR 2.5 lakhs during COVID consciously, and now we are slowly picking back. So we are at INR 3 lakhs average ticket size as of December. That will move towards INR 3.5 lakh. That's the first point that we wanted to reach. Because we were lending at INR 3.5 lakh average ticket size pre-COVID.

Second, growth, as Ranga said, we'll be opening close to 50, 60 branches, which used to be 40, 50 branches pre-COVID. So we'll be doing it at 50 to 60 branches here on. So that will give us a next leg of growth.

And we are happy to say we keep adding number of officers even at the existing branches, which is performing phenomenally well. So with these three levers of growth and the tremendous opportunity at the ground, but our mind always puts us in very conscious mode, definitely, we can deliver the growth what you refer to our interview, which I gave a few days back.

Jeetu Punjabi: So, I hear you talking both about the structural opportunity that you've seen in the long term, which has been played out. And second, also the three levers that you're seeing being used to expand the book. But are you seeing just the underlying economic environment enough to step up a gear? Or are you still going to stay in the same gear you were earlier? Sorry for belaboring the point, but I just thought, I wanted a little bit of color on the underlying environment.

Rangarajan Krishnan: So Jeetu, the underlying environment has clearly sort of picked up from the COVID lows. We used to take about on an average, six months to breakeven when we open a new branch. We are getting back to that norm. Like Mr. Pathy put it, a large part of our growth even historically has been driven by how much we want to grow rather than mindlessly sort of opening a set of branches that we are not able to digest well and keep up the culture, both in terms of repayment and in terms of the culture of credit that we have built painstakingly over the last about 20 years.

So while technically, what you say is right, which is the opportunity is quite large and we may be an opportunity to open even 100 branches per year, but I think we are still in a mode where we want to make sure that what has been built over the years cannot get compromised for any reason. So, which means, we will continue to build slowly and steadily about 50 to 60 branches per year.

The other nuance that sort of works well in this segment is that every state is very different. Every state has a culture. Every customer has a culture. Every state has a culture, so it's not easy to randomly go into new states and start opening up branches.

If you look at throughout this year, bulk of the branches that we opened in the last 12 months, 89 branches we have opened, bulk of the branches are in states where we already have a very-very significant and a strong presence. So, we are consolidating our positions in the core states of South.

While at the same time sort of opening seed branches, experimental branches in the Central Indian states. This cautiousness is something that we always carry forward as a culture of Five Star. But I think the growth numbers that you have mentioned and that we have guided in the past are imminently sort of meetable even with this cautiousness as upwards from our side.

Moderator: The next question is from the line of Sagar from Anand Rathi.

Sagar: I just wanted a little bit color on the client base you have in comparison to the South based banks, like Karur Vysya, South Indian Bank, etcetera. And also if they are rated -- overview on the rating?

Srikanth Gopalakrishnan: With the client base, how they are different as compared to, let's say, the banks of Karur Vysya South Indian bank.

Rangarajan Krishnan: Yes. Sagar, our clients are largely, I would segment them into three categories. The first segment are people who are single shop owners. This forms the bulk of whom we serve. So these are people either by themselves or through their family members, they provide some kind of a service. It could be anything that a common man needs for every day.

So it could be a kirana shop, provisions, flower vendors, food vendors, eateries, pharmacies, repair shops, salons. So the classic service segment is what we target. This forms about 60% of our customer base. 25% of our customers are self-employed individuals. These are category B and category C, self-employed individuals, not doctors and engineers, but more in the category of plumbers, painters, masons. That's the category that we significantly serve.

And the last 15% are employed. So these are -- they are largely cash salaried who are employed in the informal segment. So people who work in shops, factories, such casual laborers. People who are wage earner. So that forms about 15% of the people.

So across these categories, in general, the common trends are while they have income, but they don't have documentary proof to prove their income significantly. It's more of Kacha bill and what papers that they maintain for running their business. So the idea and the challenge here is how do you assess cash flows in the absence of documentary proofs of income, and that is where we specialize in.

If you were to take a look at the bank, I think the segment is at least 2%, 3%, not just above this, while they also could be doing businesses, small businesses, but it could be something far higher than a single shop owner that you will see on an average when you walk down the street on a market lane. So these people are bank targets. Maybe doing a single shop, but it could be a supermarket. So there could be people who are doing a much higher skilled job.

So while everything is MSME, while everything is small ticket loans, but I think the color and segment of what different people target is very different in the market.

Lakshmipathy Deenadayalan: And to add what Ranga said on few notches, its clearly, you can differentiate between the average ticket size, what Five Star specialized, where is the banks that you mentioned, which are doing predominant business in lending to MSME in South India, our average ticket price is INR 3 lakhs, right? I think I don't know any bank lends to an individual client for a INR 3 lakh loan for a seven-year tenure. So their ticket size may be in the north of INR 10 Lakhs or INR 15 lakhs. So lending to a shopkeeper can be a common terminology. But within the shop keeper, the average ticket size where Five Star specialized is between INR 3 lakh to INR 5 lakhs.

Moderator: The next question is from the line of Janish Shah, an Individual Investor.

Janish Shah: Yes. Sir, just a few things I just wanted to understand about the business attributes. One is -- so a few of the observations which I have is that you have a 100% collection doing in-house. That's one part. Second is the leverage on the balance sheet has been low. And the third important aspect is the technology, the use of technology?

How these three things are differentiating company from the rest of the players in the market? And if you can just understand where -- how this differentiation is more secure to us as compared to the

other players? And going ahead, like what kind of trend do you see within the resulting out of these three unique things which we have, if you can just throw some light on this aspect?

Rangarajan Krishnan: So thank you, Janish. So I'll just take up all the three aspects one-by-one. The first is 100% in-house collections. This has been the core of what we have always put up within Five Star and not only 100% in-house collections, we also have the norm that the person who originates the business is responsible for collections. So, this is a key differentiation between us versus many other players in the market. We fundamentally believe that if a person understands the pain of collections, he's going to be a lot more responsible when you're sourcing your business.

So even while we have set up a collection vertical within Five Star over the last about 1.5 years or so, but it's a conscious decision for the collection verticals only to handle customers which are above 24 months bucket. So, 24 months of tenure, not bucket, 24 months of tenure. So which means for the first 24 months since origination, whatever bucket the customer is going to be, whether it is the current bucket or arrear bucket or even an NPA bucket, the account does not get transferred into collections vertical. So the person who has originated has to handle that loan. This is something that is core to what we have built and we don't have any intention of changing this even over the medium to long term. So, we will continue to have 100% full-time employees who are handling collections.

The other early call that we have taken at Five Star as at, there are three core verticals. The first is sourcing. The second is underwriting and the third is collections. These three define who a lender is and across the three verticals, we will not have anything which is outsourced. So we will not have DSA agents who are sourcing loan, we will not have some third-party agencies who are helping us underwrite the loans or get it to a particular format or we will not have anybody else who is collecting our loans. Across all the three verticals, which is fundamental to a lender, we will continue to manage 100% with full-time employees or Five Star.

On the second part, which is on leverage, you must understand that we are a stand-alone NBFC. We are not backed by large parental houses. It was started by an individual. We have painstakingly come to this point over about 38 years so far. And as you will see that this sector is not smooth. The sector will have its ups and downs. So, unless we are really well capitalized, you cannot press the pedal of acceleration and growth over the medium to long-term period.

So one of the early calls that we have taken is that we will -- when we started inviting private capital which is the marquee names, who have backed us from 2014 to 2020, we will ensure that good quality capital coming in from the investors who will stay with us for the long term because unless you have the capital comfort, you're not going to be in a position to improve your rating, you're not going to be in a position to get high-quality professionals to join your firm.

You can't get bankers to take comfort on a stand-alone NBFC and sort of extend their lending lines. It is going to be very difficult when suddenly banks are going to start being very cautious because of sectoral impact. You can't just be on and off into the market. So I think capital comfort was absolutely required during our high-growth phase, and that's the reason we built significant buffers of capital over the 2014 to 2020 period.

But as we see, you will obviously recall that when we came out with an IPO, it was complete OFS. We didn't want to raise a single rupee of capital from public because we believe we have reached the

point where we are significantly and adequately capital sufficient at this point of time. And we have the comfort of very high accruals. So for the first nine months of this financial year, there already are about INR 434 crores of PAT, and we have not paid any dividends. So the entire thing is going to be sort of reaped into the business.

So this is going to continue for the foreseeable future where we are going to have strong accruals. It's a profitable model, and we have significant capital comfort. So any investor with us at this point of time, is going to enjoy the upside in terms of profitable growth without dilution, and that has been -- we will increase leverage, but it will be organically increased over a period of time. Just to increase leverage, we are not going to accelerate the pace beyond the rate of comfort that we are good with.

The last part is on tech. Obviously, every business has to have tech angle at this point of time, and we continue to significantly invest into tech. But you must sort of understand the customer segment that we are targeting is not the usual customer segment that comes in the mainstream media or news when you sort of compare other fin techs or NBFCs what other in the segment. Bulk of our branches are between Tier 3 and Tier 6.

Well over 90% of our brands are between Tier three and Tier six. And obviously, I had explained the customer profile of people that we target. So these people are not or category one adopters of technology. So their ability to understand, adopt technology is very different from the average sort of mind share that you get when you speak of tech in a business.

So we are cautious about what works for this segment, how that has to be implemented within the Five Star, without sort of diluting our focus or making people uncomfortable with sort of thrusting technology where it is not needed, we will tread a fine line here. But that said, I think we are making sort of fairly significant investments, especially over the last two, three years into technology, and that will continue to provide guidance over the next few years to come.

Janish Shah: Yes. Just a follow-up on these two. One is, you mentioned about the leverage, maybe turning a little better, but is there a threshold which you have defined for that? And second, when we are talking about the cost to income -- the reason why I'm asking about the use of technology more from a cost perspective, how much it pushed down the cost? And what would be the -- when you lever it -- I can see, we have built the building blocks. You have added the branches. You have added the people. You are investing in technology, but the cost-to-income ratio remaining at a much sustainable level more close to between 30, 35.

But where do we see going ahead when you see the scale -- as you said, like, when the business starts scaling up over next two, three years, where do you see the cost-to-income ratio also moving towards, is there going to be a more reinvestment, which has not happened over the next two, three years for this business, which will be in linear to the growth and the business. That's what I wanted to understand.

Srikanth Gopalakrishnan: From a leverage perspective, historically, I think we have been comfortable around 3 to 4x of leverage, which means 3x of debt equity, which is something people even the debt providers, the credit agencies are all comfortable with, and you don't have too much of pressure to start building up the capital.

So our belief is that over the next about three years or so, our leverage should be at about 2 to 3x, which will push up the ROE. See, you should also look at today, the net interest margins are inflated to some extent because of lower leverage. So while the spreads are at a very healthy level and we will continue to remain at the 12 to 13% kind of spread, you will definitely see some kind of a drop in the net interest margins because of leverage going up.

So what is currently at about 17.5-18% will probably drop to about 14-15% in a steady-state scenario. So there will be a compression in the return on assets on account of this. But then given the leverage kicking in and the return on assets at a steady-state being around 6% or so, about 3 to 4x of leverage, we should be looking at 20 to 22% of return on equity in a steady-state scenario. So you will definitely see these numbers panning out over the next three plus years.

From a cost-to-income perspective, we are probably -- given the segment that we're operating in, where it is a little bit more intensive on the manual side, while we will definitely leverage technology, we have built a very strong senior management team, so you don't need to invest a lot more on the management side.

But then you will also need to keep putting feet on street. There are always going to be efforts both on underwriting and collections that we'll have to expand. So we don't see too much of ability on the cost to income to drop. But where we have the abilities as the assets keep increasing, what currently you're seeing in opex to AUM of about 6-6.25% for the year should definitely in a steady-state scenario come to about 5.5% or so. 5.5- 6% is what we think is a steady-state scenario opex to AUM.

But cost of income could broadly range around 34-35% even in a steady-state scenario. But with the incomes going up, that pushes up the ROA. And with leverage and debt equity going up, that pushes up ROE.

Lakshmipathy Deenadayalan: Janish, being an important question, let me also reiterate. See, I think our cost-to-income ratio is one of the best in this industry to the price that what we lend to the market. Even at this quarter, we are at 38%. If you knock down onetime expense that we shared with our employees due to our successful IPO, it will be around 35-36%. So that will be one of the best cost-to-income ratio to the segment or to the IRRs what we lend. That's point number one.

So the game plan will be shifting our ROA towards ROE. Today, if you see ROA is around the north of 8% because of low leverage. As Srikanth said, the leverage is going to kick in. That's the focus at what we have planned for.

As a data point, we have raised more than INR 1,050 crores in a single quarter. That shows the ability of leveraging ourselves. So even at the leverage of one to two currently, our return on equity is at around 14.67%, close to 15%. That will move towards 20-22% as the leverage kicks in.

So don't expect a big drop in cost-to-income ratio. As I said, we are one of the best in the market if you compare with the IRRs what we lend for, and yes we are fully loaded on management, fully loaded on technology, and there will be some slight drop in opex as a percentage of AUM, what Shrikant said, but the focus will be moving towards a healthy return on equity to the shareholders.

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

Chandra: I had a few questions. One, can you just share the stage two assets, which is maybe two or three year vintage at this point in time? Reason being just trying to understand some of your customer segments obviously can't roll back two payments at one point in time and would have been originated during somewhere on the lockdown period. Just trying to understand just by vintage the Stage two.

Srikanth Gopalakrishnan: Chandra, just give us a few minutes. I think you can proceed with your questions. We will get you the data shortly.

Chandra: Sure. Second is just what is the number of collection officers, which we have right now? And how should we fundamentally think of the pure collection officers over a period of time on a per branch level. My understanding was that you have maybe about 1,200 with about 20,000 bucks a month, which is about INR 30 crores odd annualized. So just how should we think of just pure collection officers on a per branch level on a steady-state basis? That's one.

Second is just the target spreads, how do you think over a period of time. You did say it was just 12-13%. Your incremental cost of borrowing is still lower than the average cost of borrowing, one, and the customers are not as sensitive to yield as you said in the past. So given that the average cost of borrowing, the incremental is still lower than the average, how should we just think over the medium and over the longer term?

Then the other question is that, we have about 270,000-odd live cases, 360 branches, maybe about 730 odd per branch. How do we think from a risk management perspective this concentration in certain regions like do we -- for example, if you work by a pin code, for example, we don't do more than 20 cases or 30 cases in a pin code. How do we think of risk management? And the very last question is, what is your attrition at the branch officer level? And how many of them have you shared stock with? Thank you.

Rangarajan Krishnan: Chandra, I'll just take a few questions while Srikanth is gathering the data. Firstly, we have about a little over 1,000 officers, collection officers as we have at this point of time. There are two points that I would like to clarify here. We have -- within collection officers at this point of time, we have two types of collection officers.

One is what we call is the collection vertical itself, which means they don't do anything apart from collections. They are just doing collections, and it's a separate vertical, where they have a manager, they have a supervisor. They even have a state head who is only looking at collection. At this point of time, there are two states which have a connection vertical, which is Tamil Nadu and Telangana.

For the rest of the states at this point of time we have a collection support, which means they are collection officers only, but they don't have a vertical, which means they don't have a separate supervisor who is dedicated to collections. They are officers who will support the branch in collections. They will do only collection but they are officers who are supporting the branch in collection. But across this two, let me not confuse you with more nuances between the two. But at this point of time, across this two, we have about 1,000 officers.

And the way to think about it is that each officer on an average, can handle about 125 accounts. So that's the metric that we have. So, whatever is the number of accounts that we have over the 24

months vintage, that divided by 125 is the metric that we will adopt in terms of number of collections officers that we will have. So, it's linear.

But when we first moved a set of accounts to collections, you will see the spurt. But if you look at over the steady state, every quarter, whatever is a new set of accounts, which is moving towards the collection vertical, we will have those many number of officers at the collection level.

Second, on the risk management framework. So we are very clear that we have two types of branches. We have a normal branch, and we have a super branch. At this point of time, we have a normal branch of a little over 210 branches and super branches of about 160 branches. Super branch is a branch which has a vintage of more than two years. They are very good in collections. They are good in business. They have created a presence for themselves in the locations in which they operate. We then graduate the branch to become a super branch.

Once they become the super branch, that's the first touch point in terms of how we start managing this. We address risk at multiple levels - once the branch starts becoming super branch, which means we don't want to be dependent on a single branch manager because that's where the first risk starts.

So what we do is that the super branch is, in essence, it will have two branch managers, and it will also have one senior branch manager who is handling the two branch managers. So we'll have about 10 officers. It will have two branch managers and one senior branch manager.

So at the officer level, there are redundancies which are built that somebody resigns, it's not going to suffer either from a collection's perspective because there are 10 officers. At a branch manager and SBM level, there are redundancies. Even if one of the branch managers were to go, between the three of them, which is one SBM and two assistant branch managers, we'll easily be able to support whatever happens at the branch level. So this is from a people perspective how we manage your risk.

Second, if, let's say, the branch becomes a super branch and the number of accounts which are handled by the branch increases, we will keep adding officers to that branch. We will not put enormous pressure on the existing set of officers only to handle all the accounts from a collection perspective and also generate incremental business. The thumb rule that we have is that if an officer is doing business and collection on an average, he can handle about 100 accounts.

So the moment it crosses per officer level of 100 accounts, we will start adding more and more officers as per the need in the branch. So we have branches which have more than 12-13 officers at this point of time. We also have branches where we have lesser number of officers given the accounts.

The third way we manage risk is that if a branch becomes too big because they have done extremely good business. Let’s say they have 2,000 accounts. We don't want to just keep building on the same branch for any reason. So what we will do is that we will open nearby branches because we believe that there is a lot of good potential in that area. So we'll open a branch which is 20 kilometers, 25 kilometers away. Not just open a branch, but we will transfer a set of accounts from this existing branch to the new branch.

So as the branch gets opened, on day one, they will have about let's say, 500, 600 accounts, which are getting transferred to them, which reduces the risk at the single branch location level. So there are multiple – touch points that we do from a risk management perspective right at the branch level.

And of course, there are layers much above the branch. The number of supervisors that we have. Three years back, we used to have about 20 supervisors. At this point of time, we have 87 supervisors. So on an average, each supervisor doesn't handle more than five branches. So they are there for the first need of a branch, whether it be collections, be it the business, be it recruitment. So we will continue to promote people internally. Most of the supervisors are people who are groomed internally, and they take on responsibilities because they're very good.

Most of the supervisors will have a vintage of more than five years with Five Star. So we will continue to add supervisors as necessary in each of these metrics. So across business collections, supervisory layers and credit, the risk management is sort of embedded into the ways the business scales up and overall taken up to the next level.

At the attrition level, I just add that point. If you take attrition at officer level in a branch is about 29%, 28-29% overall, largely in line with the industry. If you had to split it, most of this 28-29% will be for people who are with Five Star for less than a year. Somebody who is about more than a year generally tends to stay with Five Star for a longer period. The reason could be that when people join from other NBFCs, they have to set right with the culture, the thought of doing business and collections together. So for various reasons, the attrition at that level maybe a little higher but in line with the industry.

But if you have to go one level higher which is the people who really matter in the branch and who are controlling the branch, which is what is the BM and above level will be roughly at about 9-10%.

Srikanth Gopalakrishnan: Chandra, getting back to the two questions that you asked one is the vintage-wise Stage two and the target spread that we are looking at. See vintage wise Stage two, about 98% of the accounts which are in stage two are two years and more. So we have only 2% of Stage two customers, which are 30 plus, 30 to 90 who are in Stage two who have been in the company for less than two years vintage. So typically, Stage two comes in only after 24 months or so. So 98% are over 24 months.

In terms of the target spreads, yes, today spreads are higher, and we are sort of guiding you for a 12 to 13% kind of spread. This is something we updated even on the last call. In a normalized scenario, I think some of the benefits that we have obtained on the reduced cost of funds we would have passed on to the customers. Because at the end of the day, we also want to be a responsible lender despite the fact that this segment may not be extremely price sensitive, but any benefit that we get, at least a good portion of that, we want to pass on to our borrowers.

So in a normal scenario, we would have passed on some of these benefits, but today, we don't know exactly where this entire interest rate cycle is going to sort of peak out or end. So we are being on a little bit of a wait-and-watch kind of scenario.

Once we realize that the interest rate scenario has peaked, I think we will definitely pass on some of the benefits to the incremental loans, which will gradually bring down the spreads to about 12 to

13%. So while it's about 13.7 today, we should expect to see about 75 to 100 basis points dropping. And that would be gradual because it is fixed rate portfolio, we can't reprice the existing book.

But on incremental loans, the borrowing rate will be lower. So to that extent, it will start slowly, gradually pulling the spread down to 12 to 13 levels.

Chandra: Sure. So your Stage two, for example, right now is actually where it was in say 2019 approximately there. So is it, obviously during this period, you have added customers who have fallen back on their payments, one or two payments and not been able to repay both those payments at the same time, which is why some of them may be residing in Stage two. Is it fair to assume that once they get flushed out eventually from the system and complete their dues that your actual stage two may be lower than where it was in 2019 levels? Is that possible?

Srikanth Gopalakrishnan: Chandra, I think the guidance that we would probably try and give you is our Stage two should be more like about, while it is about roughly maybe about 10.5 to 10.6% as we speak. Even in a steady state, I think this number will be more like 8 to 9%. If we are expecting people to significantly roll back or significantly not fall into buckets or fall into buckets and then come back to Stage one and all that, it's not going to be the case.

Our belief is that our one plus number will be more like 15%, 16% in a steady-state scenario. Currently, it's almost at about 19%. Maybe we will see another 2, 3 percentage point bettering here. And if you trickle down from there, we should see a stage two, which is a 30 plus including the 90 plus numbers of about 10%. And if you assume a 1.5 to 2% kind of NPA number, 1.5% more like 90 plus, we should be seeing a stage two number of anywhere around 8% to 8.5%. So while there will be some improvement that we'll keep coming through. But I think even in a steady state, the number is expected to be at around 8% or so.

Chandra: And I didn't get the answer, just how many of the branch managers have stock in the company?

Rangarajan Krishnan: So we have given stock options to all the senior branch managers and above. So, it's not a branch manager level. So every senior branch manager, supervisor and anybody above that, totally about 350 employees of Five Star have stock options.

Moderator: The next question is from the line of Arjun Bagga from Baroda BNP Paribas.

Arjun Bagga: Sir, just wanted to get one, some colour on the restructured book. I understand it is at 1% currently. So if I would just understand how this has moved over the last two, three quarters? What have been the kind of slippages there and what has been the repayment?

Srikanth Gopalakrishnan: So Arjun, I think, number one, in the history of Five Star, I think we have done only one restructuring, which is during COVID-2, where we restructured about INR 83 crores of assets. And even this restructuring, we gave them a moratorium for six months between April 2021 and September 2021.

So what you are seeing today, which is 1%, which is INR 62 crores. So, there is a rundown of INR 21 crores that has already happened. INR 62 crores is the book, which is live as on date. And like I said, 91% of these customers are in standard category. About 9% our customers, who are in the 90-plus category.

See, the difference in collection efficiency between this as well as a normal account, yes, there is a difference. In fact, if you look at the 61-day DPD of this portfolio, it will be on the higher side, not even comparable to what we are seeing on the normal book. But what is also heartening to note that it is not that a large portion of this is actually slipping to 90-plus. We are only seeing about 8%, 10%, which is slipping to 90-plus and staying at 8%, 10% on a quarter-on-quarter basis.

If you recall, even last quarter when we gave you the numbers, while it was 1.16% of the overall book, restructured portfolio, even then, we had 91% standard. So we are seeing about 9%, 10% who is in the 90-plus category. And like how we guided you even in the past, we expect that about 20% or so of this book is going to 20%, 25% of this book is going to be at 90-plus. Eventually, there will be some level of credit cost that we have to observe on this book. But to add this, what they've also been consciously doing is building a very robust provision coverage.

As I highlighted, we are at about close to 50% provision coverage on the restructured book. So even if there is an eventual credit cost of about 20%, 25% that we'll have to absorb on this book, we are more than adequately covered, and there will be -- we don't expect any incremental impact on to the P&L.

Arjun Bagga: Another question on the asset quality. So I understand during this quarter, we took the regulatory change of classifying less than 90 DPD assets also as the GNPAs, which I understand most of the peers like or close competitors like Aavas or Aptus had done like last year itself when the circular came out for the first time. So any specific reasons that this was not done in the last quarter, Q2, when we first reported the results. And second is, did I understand it correctly that the number, which stood at around 29 bps during this quarter, maybe -- that maybe as between 75 to 100 bps, if my understanding is correct?

Srikanth Gopalakrishnan: Arjun, so two things. First, why did we not implement earlier. The answer is the RBI came out with a circular on November 20, 2021. And the deferral of upgradation norm was given on February 15, 2022, post the declaration of results of most of -- all the equity participants. We had taken a very conscious call. At that point of time, we were not required to disclose the December results being only a debt listed entity. And we had also said, given the way that this circular was floated out, there was no time given for institutions to prepare and given our borrower profile people who have been paying with a few days delay here and there, but regularizing the account before the month end. We needed that time to educate our internal system, educate our staff. Thankfully, RBI gave that on February 15. So we had the time to educate them, and that's where you are seeing the results of 1.45%, which is only 29 basis points difference.

So why did we not come in September quarter? There was no need for us to come in September quarter, because the upgradation norms are kicking in only from 1st October. So any customer who slips into 90-plus from 1st October, but does not come back to 0 DPD is what is needed to be reported as NPA, which is why we are doing it in this quarter. So one is there was no need for us to report in the September quarter. The circular is effective 1st October, and we have disclosed from this quarter.

Your second point is correct, your assumption. What you are seeing as 29 basis points currently, that's the impact of one quarter, there will be some buildup that you will keep seeing in every quarter. But we believe that, that number over a steady-state should not be more than about 75 to 100 basis points of difference between actual 90-plus and what is being reported as NPA.

Arjun Bagga: Just one last question from my side. So I understand that the incremental cost of funds for us during the quarter has, I think, gone up by some 60, 70 bps, still, the portfolio cost of funds continues to go down. I think that is down some 15, 20 bps on a quarter-on-quarter basis. Just to understand there, sir, is there some changes or renegotiations from our side on the existing lines as well? Or is it just that the repayments are coming at -- sorry, the newer borrowing that we're doing that is coming at lower compared to portfolio-level borrowing's costs?

Srikanth Gopalakrishnan: So it is a second part, Arjun. The replacement cost is coming lower than the original cost of the debt, which is getting replaced, which is why mathematically, you're seeing the numbers going down. So it's technically, our book was running at 10.5%. Now firstly, I would like to correct you, during this quarter, this number went up by about 50 basis points as compared to the previous quarter. So we are borrowing at an all-in cost, and when I mean all-in, I'm including all ancillary costs like processing fees and other borrowing costs. So that is at about 9.12%. But given that the book was running at 10.5% and the replacement happening is 9.1%, mathematically, the 10.5% is coming down to 10.35% for the nine months and 10.26% for the quarter.

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

Shubhranshu Mishra: Couple of questions. The first one is, given the fact that we lend out to the guys who are in the unorganized segment are slightly below prime, are there any development financial institution subscribing to our bonds? If yes, what would be the quantum whether domestic or any foreign development institutions who subscribe to our bond or have given us any line of credit. That's the first one.

Second is any kind of negative covenants we have on the bonds, that's the second. And if we can split the AUM into ticket size as per proportion. So what proportion of the AUM would be less than INR 1 lakh, INR 1 lakh to 3 lakhs would be what proportion? INR 3 lakh to INR 5 lakh and INR 5 lakh plus?

Srikanth Gopalakrishnan: So Shubhranshu, I think the first question on the DFI lending, yes, we have taken -- borrowed money from DFIs, both domestic as well as international. Domestic institutions like SIDBI have lent to us in the past, while currently, we don't have a line, but we are in talks with SIDBI to get a fresh line. On the international side, we have had monies that we have raised from institutions like Responsibility in the past.

The ECB that we are currently carrying on book is given by the Swedish development, sovereign fund, Swedfund. So developmental institutions are lending monies to us, but unfortunately, given hedging cost and given the withholding tax, there is some level of increase in terms of borrowing monies from foreign institutions, foreign developmental institutions, which is why you don't see a big proportion of money that we have borrowed from them. But we will continue to evaluate to see what best we can do in terms of borrowings from the DFIs.

Shubhranshu Mishra: The second question was on negative covenants on bonds. If we are -- any kind of bond market making exercise, do the market makers ask for any kind of negative covenants, whether verbal or written, either?

Srikanth Gopalakrishnan: So nothing specific, Shubhranshu, in terms of the negative covenants. These are typical covenants where we are expected to maintain certain financial ratios. We are expected to inform them about changes in board, changes in management and all that. So you don't really see any major negative covenants that we have agreed to as part of any of the lending agreements, not just on the DFI side, but across the various borrowings that we have done.

Rangarajan Krishnan: Shubhranshu, on the ticket size, up to INR 3 lakh, or up to INR 5 lakh is the core bucket, 88% of our loans are up to INR 5 lakh. If you had a further split it, up to INR 3 lakh will be about 48% and INR 3 lakh to INR 5 lakh will be about 40%. Within the INR 5 lakh to INR 10 lakh...

Shubhranshu Mishra: Up to INR 3 lakh above number, sir?

Srikanth Gopalakrishnan: 46% of our book is up to INR 3 lakhs. 43% is between INR 3 lakh and INR 5 lakh. So that's 89%. About 10% of the book is between INR 5 lakh and INR 10 lakhs, and we just have 1% of the book, which is more than INR 10 lakhs.

Moderator: The next question is from the line of Chintan Shah from ICICI Securities.

Chintan Shah: Congratulations on strong set of number. Just one question on the coverage ratio. So on the Stage 3 coverage -- on Stage 1 loan, our coverage has come down to roughly 27 bps, which was like 32 bps a quarter or one to two quarters around 30s within the past quarter. And similarly, coverage on Stage 2 has also come down a little. And also as management has guided for credit cost in the range of 100 to 150 bps for the next year. So what could be the -- any ballpark numbers? Any targets on the coverage ratio of Stage 1 and Stage 2?

Srikanth Gopalakrishnan: So Chintan, I think historically, even in last quarter, we did have a little bit of overlays even on Stage 1 assets, more on potential IRAC, those customers who could have become IRAC DPDs. Historically, we have seen Stage 1 being at about 30 basis points or so, 25 to 30 basis points even pre-COVID. So I think the guidance that we'll give you is Stage 1, we'll continue to be at about 25 to 30 basis points.

On the Stage 2, again, it was a little higher, especially in December quarter or the quarters earlier than that, primarily because a lot of the 61 to 90 DPD loans, which had the potential of becoming NPA under the revised RBI regime were given higher provisions, that's why December '21, you are seeing an 8.3% of Stage 2 coverage.

But that's been gradually coming down. September, it was at about 7.5%. We are at 7.25% as we speak. Again, this is broadly at a steady-state right now. We should operate anywhere around 6.5% to 7% of Stage 2 provision coverage. Stage 3 is at 45% currently. We will -- again, over here, there is a little bit of overlays that we have built in, but we would probably think this number will be anywhere around 35% to 40%, 42% in a steady-state scenario.

Lakshmipathy Deenadayalan: Chintan, just to reiterate what we said on the credit cost guidance. So we have said overall credit cost guidance of 1% to 1.5%. And so on behalf of that, we have an overall provision at the ECL as 1.66%. Well, we are well over than our guidance. As the guidance comes down, I think overall provisions as a part of ECL may also come down.

Chintan Shah: So sir, you mean that 1% to 1.5% is provisions or to total ECL provisions as a percentage of assets. That would be around 1.5%. Is that understanding correct?

Srikanth Gopalakrishnan: Sorry, Chintan, can you repeat it?

Chintan Shah: Yes. I think for Q3, we have 1.66%, which is ECL provision as a percentage of total assets at 1.66%. So that number would be around 1.5%. Is that correct?

Srikanth Gopalakrishnan: No. Chintan. See, this 1.66%, like I said, it will start normalizing. Just to give you a sense pre-COVID, this number used to be about 80 to 90 basis points.

Chintan Shah: Yes. That I understand, yes.

Srikanth Gopalakrishnan: So what we are saying is 1% to 1.5% is the credit cost hit that will come on to the P&L, both in the form of write-offs and as incremental provisions that we will build, what comes on as the ECL as a percentage of AUM will, I think, gradually start dropping. At this point of time, we don't want to give a long-term guidance, we just want to see how things pan out, but it will start normalizing from 1.66%, which is a little bit on the higher side, especially with COVID effects receding and our bucket showing a much better performance as compared to what we saw in the last couple of years.

Chintan Shah: And just one last one on the lending rate hike, I suppose we would have not taken any lending rate hikes since RBI reported hike from May. And do we also see any need for it in the coming quarters, even if there is a for example, 25 or 50 basis points hike from current levels?

Srikanth Gopalakrishnan: No. At this point of time, like we said, our spread very ironically has only been going up. So there is clearly no intent on the side of the company to increase the lending rates to the borrowers. Once we see the peak of the interest rate cycle, and our spreads continuing to remain robust as they are today, we will probably look at passing on some of the benefits that we have derived on the borrowing cost to the borrower. So you'll actually see an incremental lending rate coming down by whatever proportion that's available in the form of benefit that we can pass to the borrowers. So nothing on the anvil for lending rate increase.

Chintan Shah: Just one follow-up on this. So in terms of our competitors, their lending rate would be relatively similar to our lending rate, or on the high end or on the lower end?

Rangarajan Krishnan: For this product, Chintan, it will be similar.

Chintan Shah: So in case if we pass on the lending rates to the borrowers, then we will be at a relatively lower rate than our peers in case they don't pass on?

Rangarajan Krishnan: Yes.

Moderator: The next question is from the line of Piran Engineer from CLSA.

Piran Engineer: Congrats on the quarter. I just have a follow-up question to one of the earlier participant's question. What is the difference between collection vertical and collection support?

Rangarajan Krishnan: Collection vertical is when, right from the officer level till the state head level, we have a separate person who is responsible only for collections. So you have an officer collection, manager

collections, senior manager collections, supervisor collections, state head collections. So this is what we define as a collection vertical. In a collection support, the support ends at the branch level. So you have an officer collection, but you have a branch manager who does both business and collections. And from there above, it's a joint responsibility. So you have a supervisor who does both business and collections. You have a state head who is doing both business and collections.

Historically, Five-Star always had that approach. And now when we decided to move towards the collection vertical, we don't want to disrupt this arrangement across all the states because it takes time to set up the collection vertical and you have to do it carefully. So we are doing it in phases. We have done it for the first two states, big states, and we will be doing it in phases over the next three to four quarters across the other state.

Piran Engineer: So a collection branch manager in the collection support function, he reports to the senior branch manager. Is that right? And not to like an area collection manager?

Rangarajan Krishnan: Correct. You're right. Yes.

Moderator: The next question is from the line of Saptarshee Chatterjee from Centrum PMS.

Saptarshee Chatterjee My question is on the collection interventions that we do preferably more on the 30-day DPD-plus buckets like what all the interventions that we do that helps us to bring down the GNPA to close to around 12% level?

Rangarajan Krishnan: So Saptarshee, usually the first 30 days, it rests with the branch. So the branch teams, along with the branch managers, they'll assess if at all, there is a delay from the customer as to why there is a delay. They will want to assess if the reason is genuine, because most of our customers are earn and pay customers. It could be for the genuine reason that the customer has not paid in a particular month, maybe on the due date. But if he regularizes this before the end of month, it is okay. And the branch manager and the officers responsible for that role, they will take a call on what necessary steps needs to be taken.

But I think the moment it crosses 30 days, the supervisors, I mentioned earlier in the call that we have about 87 supervisors at this point of time. The supervisors also get into an active role into this. So anything which is above 30 days, especially within the 31 to 60 days, the supervisors will ensure that -- they are more senior people. So they will want to take a call on whether the branch manager is assessing the situation rightly. Is it a problematic customer? Is it a willful defaulter or if it's a genuine case where you can give a little more time and the customer will come back to regularization. So that part happens within the 31 to 60 days where the supervisor, if necessary, he will even go and personally visit these customers or maybe he'll follow-up with -- on phone with these customers. He'll go for calls along with the branch managers, all these interventions happens within the 31 to 60-day number. So given that a senior person is involved, we will see significant fall right at this bucket.

But anything that crosses the 60-day bucket and moves into the bucket 3, which is 61 to 90 days, not just the supervisor, even the head office is involved, the legal teams are involved, we will be sending centralized notices to the customers, asking him to explain the reason, maybe a loan recall notice will be sent.

We will send some advisory or cautionary notices to the customer in terms of what happens at the time of a default. This, alongside the head office supervisors, we also have senior people at the head office, which includes the chief business officer, the chief operating officer, deputy chief business officer. I think all the people, we will also be involved in terms of following up directly with the supervisors and the branch managers alongside taking the call on where necessary legal action is required.

All that put together gives us the good results in terms of arresting any further flows beyond the 90 days and that's why we are able to get very good numbers at the -- even if somebody has slipped to the bucket 3 doesn't automatically go into our NPA. We will be able to arrest significant proportion, 95%, 96% of the proportion, the same bucket and not allow for forward flow.

Saptarshee Chatterjee And on the like number of employees you have around 6,000 close to 7,000 employees. Can you please give some breakup of, like, you have already told about 1,000 collection offices, but what kind of number of business officers, number of branch managers, number of underwriting people, legal people, like if you can give some breakup of this employee base?

Rangarajan Krishnan: Yes. So roughly, within the business and collections, we add all of them together, we have about 4,850 people, and this forms about 70% of our overall employee base. We have almost 600 people in credit. This is about 8.5%. We have about 700 people in operations. That's about 10% of our overall workforce. We also have people in, who act as cashiers in branches. That's about close to 500.

That's about another 7%. We have legal teams internally. This includes both people who give opinions and who cross-check opinions and also people who are involved in recovery efforts. We have 80 people full-time lawyers within Five-Star. So that's about under 1% roughly. The rest is head office and management. So totally put together, we have 6,933 employees as of December.

Saptarshee Chatterjee And last question is in terms of your branch structure, can you give some breakup of your branch opex? Yes, just for a branch of more than five years of vintage what kind of opex in terms of intensities that go into?

Srikanth Gopalakrishnan: Today, when we set up a branch, we have, we booked five officers, one branch manager, one cashier, one field credit person and one operations officer. So that's a total of nine people. Typically, what we see as a salary for -- salary, both fixed and variable for a field officer is about INR 20,000, INR 25,000. So that's like 1 lakh to 1.25 lakh. You have branch manager who will be getting anywhere around INR 40,000 to INR 50,000. So that's 1.75 lakh.

Each of the other people on a broad basis, the credit operations support and cashier, the average salary will be about INR 20,000. So if you're talking about 1.75 lakh for the business and collections and another about INR 75,000 for the other staff, so this INR 2.5 lakh on the personnel cost. Plus, these are all very low-frill branches there.

So you will probably have about another INR 10,000 of electricity cost and various other opex expenses. So it should not cross more than INR 3 lakh for a normal branch when we start. Depending on the increase in the number of officers, the assistant branch managers, the multiple branch managers and the senior branch manager for the super branches, the 3 lakh may go anywhere all the way up to INR 6 lakh to INR 7 lakhs.

Saptarshee Chatterjee Sir, can I squeeze in just one last question. In terms of number of loan accounts, I think you have close to around 2.7 lakh loan accounts. Do you have any number in mind in terms of target addressable market? Like what kind of numbers you can reach in your existing states? After which you have to break into other states?

Rangarajan Krishnan: Yes. We roughly today, just about 7% of our portfolio comes from non-south. 93% of the portfolio is within south. I had explained the philosophy that we consistently followed. It's difficult or we want to be cautious when it comes to expansion in newer geographies and states, while we will put branches, but it's going to be at a very measured pace as compared to penetration within the existing states that we have. So the bulk of expansion that we envisage in the next two to three years, at least 80% to 85% of the expansion will happen within the southern states. That said, we will anyway be putting up branches in Central India and we also have intent to enter into one or two neighborhood states from where we are already present in Central India. But these will be more measured. But in terms of AUM impact, it will take another 24 to 36 months for these states to really matter and come to a reasonable level. The first two to three years, we'll be cautiously expanding in new geographies. Bulk will come in from the existing regions.

Srikanth Gopalakrishnan: So, Saptarshee, just to add, I think while we don't have a state-wise breakup of the target addressable market, one of the studies that we had put in our prospectus, which was done by CRISIL was the target addressable market across the country. And this is exactly the profile of borrowers that we are catering to, where people have a property, they are in the service-oriented businesses, they don't have lending from formal institutions.

It's INR 22 trillion. That's INR 22 lakh crores and institutions like us all put together have not even scratched the surface a bit. So I think in terms of the market opportunity, it is very high. And a lot of this market opportunity is also concentrated in states like South India like Tamil Nadu, Andhra, Telangana, Rajasthan, Madhya Pradesh, Maharashtra and all that. So it is a very huge market out there in terms of opportunity.

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

Chandra: Sir, just a follow-up, obviously, the last couple of years as you're adding this collection vertical has seen the employee expense number going up pretty significantly. I would think that some of this will be basically just filling up this entire function. And here on, it's a function of case growth. So is it just reasonable to assume that once you get to -- I was looking at like your case numbers like a couple of years back, and it seems that you need to -- I think once you hit 1,200 or 1,300 is where you sort of beyond which you sort of grow with the increase in the number of cases. So just trying to understand just directionally, how should we start thinking of employ opex after you get your target?

Lakshmipathy Deenadayalan: Yes, Chandra, I think because one of your follow-up earlier question, what is the guidance going forward. See for last first 20 years from 2002 to 2022, we didn't have any collection vertical neither collection support. As Ranga said, officer who sources the file has to be the in-charge person for collection too. That worked very well. But during COVID 1 and COVID 2, if you see or recall the presentation, our DPDs were a little lower because of the customers got impacted on the cash flows, not in a big way from 90-plus. But if you see our current and 30-plus, it has bit spiked up.

To give an immediate effect to it, we thought we will incorporate two things. One is the collection support and a collection vertical. So having said that, we don't want to give at the day one of file getting disbursed, we wanted after 24 months of tenure getting completed.

As Ranga said, putting a vertical in a state is not an easy joke. It's not a cake walk. You have to be very-very careful in selecting the people, giving those accounts to their hands and see how it works. So that is why Tamil Nadu got implemented and Telangana subsequently got implemented, whereas the rest of the states, we started with the collection support. Collection support is much easier to put in a branch. Suppose if a branch has 1,000 accounts, we can give one branch manager and two officers to start with. And as the number of accounts goes up, the number of officers can be increased. So this is the thought process.

But having seen this in last four, five quarters, if you see, recollect, our numbers are bettering quarter-on-quarter. In fact, next quarter, our numbers will be further better than what we see. But now, we are thinking that, yes, on a guidance basis, per branch, if it matures beyond 24 months, we will give a collection support or a vertical will be three to four people in that branch. So it will not be as big number as you see now because it's time of correcting your DPDs, putting things back in order. We have invested a lot in that. But this team, I'm very confident, we can handle more-and-more accounts that flows into 24-months tenure. So going forward, I think a number of people handling collection will be moderated going forward.

Moderator: The next question is from the line of Pranav from Rare Enterprises. As there is no response, we'll move the next question which is from the line of Varship Shah from Envision Capital.

Varship Shah: So our loan has fully collateralized. So could you give some color on the kind of collateral that we collect and LTV on the same?

Rangarajan Krishnan: So Varship, bulk of the collateral that we take is a self-occupied residential property, and we don't take Kacha houses. So these are all Pakka houses backed by a clear document. So we will take two legal opinions on this document, one external, one internal. And we'll also go and register our mortgage with the state government registration authority. So you can very clearly see Five-Star ownership of mortgage on each of these properties that we do. So 95% is SORP. The balance 5% may be about commercial properties, which are shops owned by the borrowers, which gets mortgaged to us.

The origination LTVs will be about largely between 40% and 50% is the origination LTV. The portfolio LTV as of Q3 will be about 37%.

Varship Shah: And who would be our primary competitors? Will it be fintechs or unorganized money lenders? And if you could just throw some details on that -- some information?

Rangarajan Krishnan: The primary competitors are money lenders across each of the markets that we serve. Like I covered earlier, we are largely between Tier 3 and Tier 6 now. So primary focus across this segment is disrupting the money lending segment. That is where most of these people have been financed so far. When they see an organized lender, especially a company with track record of more than 35 years registered with RBI and then having a good brand name, coming there, we see a lot of people

naturally preferring us over an unorganized money lender for better practices, for easier loan process and for the safety of the documents that they give it to us as part of the mortgage.

This apart, of course, there are several other people who are also targeting this segment. A few other NBFCs, a few other small finance banks. But I would say that as compared with most other players, we are very significantly focused only on this segment, which is a small business growth segment, and we have no other product and no other diversions beyond this.

Moderator: The next question is from the line of Khushboo Rai from Money Control.

Khushboo Rai: Congratulations on the good sets of number. Just one question. Sir, what do you think regarding the sustainability of the margins? The margins has been in the range of around 15% to 18% for the last couple of years. So what are the reasons and how sustainable is this level?

Srikanth Gopalakrishnan: So Khushboo, I think we already gave you a guidance. See, our margins are a little higher because of lower leverage that we have. So the more portfolio gets funded by debt, there will be compression in the margins. What we look at more closely is the spread because that reflects the ability of the company to raise debt at the optimal cost.

So the margins is actually a function of leverage thereafter, our belief is that in a steady-state scenario, we should be operating at a spread of 12% to 13% and a margin of 14% to 15% as we go forward. So there will be a constriction of about 2% to 2.5% in the margins over the next few years. But then given that the leverage will increase, you will also see this translating into higher return on equity to the shareholders.

Moderator: I would now like to hand the conference over to the management for any closing comments.

Lakshmipathy Deenadayalan: So thank you all. Thank you for listening us very patiently about our new business model, niche business model that we have created and a follow-up on results. Thank you. As I said, March quarter will be also better than this quarter. I'm hoping in very optimism way and see you soon on the Q4 conference call. Thank you.

Moderator: Thank you. On behalf of Five-Star Business Finance, that concludes this conference. Thanks for joining us, and you may now disconnect your lines.