FIVE STAR
Business Finance Limited

Date: August 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 June 30, 2023

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 Saturday, July 29, 2023

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

Kindly take the above on record.

For Five-Star Business Finance Limited

BASKARAN SHALINI
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Shalini Baskaran
Company Secretary & Compliance Officer

“Five Star Business Finance Limited

Q1 FY ‘24 Earnings Conference Call”

July 29, 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: **MR. RENISH BHUVA – ICICI SECURITIES**

Moderator: Ladies and gentlemen, good day and welcome to the Q1 FY24 Earnings Conference Call of Five Star Business Finance Limited hosted by ICICI Securities. As a reminder, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing star, then zero on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Renish Bhuva from ICICI Securities. Thank you, and over to you, Mr. Bhuva.

Renish Bhuva: Thank you, Michelle. Hi, good evening everyone and welcome to Five Star Business Finance Q1 FY24 Earnings Call. On behalf of ICICI Securities, I would like to thank Five Star Management Team for giving us the opportunity to host this call. Today we have with us the entire top management team of Five Star represented by Mr. Lakshmipathy, Chairman and Managing Director, Mr. Rangarajan, CEO and Mr. Shrikanth, CFO. I will now hand over the call to Mr. Lakshmipathy for opening remarks and then we'll open the floor for Q&A. Over to you, sir.

L. Deenadayalan: Yes, thank you, Renish. Good afternoon, everyone. I invite you to this Q1 earning call. This is the fourth earning call that Five Star is taking up with the participants. I think we have come across one full year. So four performance of Five Star that you people have seen. So it's a clear understanding that what we say and what we do correlates a lot. With this note, let me open up the outlook what happened in Q1. Generally for lenders, June quarter is a bit muted comparing to the March. I think for Five Star, the June quarter is a trend setter to see how this financial year will be looking like.

Starting from our AUM growth, we have moved our AUM from 5,296 crores last year to 7,583 crores, registering a growth of 43% year on year. And most importantly, quarter on quarter, we moved from 6,915 crores to 7,583 crores, registering a double digit growth of 10%, close to 10%. That has come from, we have opened a good amount of branch. Last full year, we have opened 75 branches. And for the first quarter, April to June, we have opened 13 branches. As we always say, one of the growth levers is starting new branches at existing and the new locations, new states.

This has improved our disbursement and our disbursements have moved from 568 crores to 1,132 crores, nearly 99% growth from year on year. And from quarter on quarter, we have moved 2% higher than the March disbursement. This has happened after COVID. This is the first time that June disbursement, June quarter disbursement has crossed March quarter disbursement. And moving to the collection part, I think collections part also 5 Star has done very well in Q1 of this financial year.

Our collection efficiency as given in our presentation, we have done one of the best collection efficiency. And what we call D1C1, that is collecting an EMI from all live customers, has also been very good, comparing to March, equal to March. What this has resulted is, we have made one of the best current customers.

Our current bucket has moved to all time high of 85%. Pre-COVID, our all time high was 82% of current and 18% of arrear customers. That has now moved to 85% of current. And for the first time ever, our 30 plus metric has dropped down to single digit. It has dropped down to 9.68%.This is the first of its kind in Five Star. So, this shows the strong momentum what Five Star has demonstrated even in collections. If you see across every bucket, be the current or stage 1 or stage 2, we have improved in all buckets. What this has resulted is one of the best asset quality, our 90 plus has moved a bit from 1.04% last quarter to 1.08%. This is just a blip of this being the June quarter. And the technical NPA, what I said in last call also, the new RBI circular which kicked on, that NPA number has moved on from 1.36% to 1.41%, increase of five bps.

So the 90 plus and NPA, technical NPA, mostly remains the same compared with March quarter. The difference between 90 plus and NPA, which is 0.33%, which comes out to INR25 crores of assets, which is lesser than 90 DPD, is being declared as a NPA due to the new circular which got kicked in. This business and collection has resulted in one of the best profits for Five Star. Our PAT, Profit after tax for this quarter has moved from INR139 crores in last year to INR184 crores this year, registering a 32%.

And from last quarter, it moved from INR169 crores to INR184 crores, registering a Q-on-Q of 9%. And from a borrowing cost also, I'm happy to say that our cost on book keeps reducing. Even this quarter, it has reduced from 9.87% to 9.80%. And our incremental borrowing cost remains at 9.18%, which is one of the attractive borrowing costs for the size of the company. And finally, on the provision, we have maintained or increased a bit of provision of ECL, which has moved from 1.61% last quarter to 1.64% this quarter.

So all in all, all the cylinders of business, collections and profitability and quality has been as good for this first quarter of this financial year. We are very optimistic and a very strong hope that this will continue for the next three quarters. Keeping this in mind, we are revising our growth guidance from 30% to 35%. With this, let me conclude my opening remarks and hand it over to my team. I think I'll start with Srikanth to take you through more on the numbers.

Srikanth Gopalakrishnan: Thank you. So, good evening to all of you. A lot of the numbers have already been stated, so I'll just briefly touch upon financial metrics and then maybe open up for queries and questions from your side. Our yields continue to be stable around 24.4%. You'll always see a 10-15 basis points drop this way, that way on a quarter-on-quarter basis. Like Mr. Pathy said, our cost came in at 9.8%, so that's a very healthy spread of 14.6% as compared to a 13.6% spread for Q1 of last financial year.

The NIMs was at about 17.74% primarily you know coming on account of the lower funding costs as compared to closer to 17% for Q1 of FY23. All this is actually resulted in a healthy ROA of about 8.41% for the current quarter and an ROE of 16.62%. The ROE has actually gone up by about 184 basis points year on year and about 50 basis points quarter on quarter. We continue to keep a very well diversified borrowing profile. We have about 50 lenders who have lent to us.

Even during the first quarter, which typically tends to be muted from a borrowing perspective as well. We got sanctions of about INR890 crores out of which we availed INR730 crores of fresh borrowing. This has come in at an interest rate of 9.18%, even assuming the all-in cost including the other fees and other ancillary charges, the number is 9.5%. This compares against

9.53% of last in Q4 that we raised. So the interest rates increase in the market has not impacted us yet.

There is a possibility that there will be some small revisions in the MCLR that will come through because most of our sanctions are based on one year or six-month MCLR. So we may see some uptick coming on the book cost, but we are confident that the incremental cost will be at around 9.5 or maybe lower, which will sort of offset the increase that may come in on account of the MCLR increases.

We have a very good liquidity on the balance sheet. We have about INR1,400 crores, inclusive of the INR160 crores of undrawn sanctions that we have taken. During this quarter, CARE also has upgraded our rating to AA-. So today we have AA- from all three agencies. The profitability continues to be robust. So we had a 32% year-on-year increase in the profitability and a 9% on a sequential basis. So we ended the first quarter with about INR184 crores of profitability.

On the PCR side, again both on the overall AUM, we are maintaining a 1.64%, which is one of the highest for a secured lender. And on the Stage 3 assets, we are maintaining a PCR of 44%. This has come down slightly, but then last quarter itself we had sort of guided you that it was a slight increase in the last quarter. We would like to maintain this around the 40% levels. We are at 44%. Our restructured book is performing well. As a percentage of the overall book, it has actually come down to 0.76%. And even on that, we are maintaining a PCR of about 50%.

And again, about 90% of this restructured book is in the standard category. This is after repayment behavior of seven quarters. So on the whole, I think we have had our growth momentum back. Collections have stacked up extremely well. This is reflecting in the profitability. So with all of these three metrics, the growth, profitability, and quality remaining robust, we are poised to take advantage of the large opportunity available in this segment. On that note, happy to take any questions that any of you may have. Thank you.

Moderator: Thank you very much. We will now begin the question-and-answer session. We have the first question from the line of Ajit Kumar from Nomura. Please go ahead.

Ajit Kumar: So my first question is on the yield side. You were planning to reduce the yield from current 24 to 23 or 22 as the cost of funds goes down. Just wanted to check a status on that. That is my first question.

Management: See, I think we have not yet finalized that because you all know that we all think strongly that rate hike cycle is stopped. But we just wanted to see the first symptom from Reserve Bank, how the stance is been taken. Then we will take up a call appropriately. Yes, what we said holds good.

Ajit Kumar: So I was asking, investment on your balance sheet is up sharply from INR144 crores in last quarter to INR355 crores in this quarter. So again, just wanted to check what has happened there?

Management: So, I think there is nothing here. The way to look at this is, you will have to add the cash and cash equivalents, bank balances and the investments, that has actually gone down to about INR1,600 crores as of last quarter to about INR1,400 crores. So it's a strategy that we use if we are able to get a good rate on the fixed deposits, we would prefer placing it there and typically March quarter is when banks also are interested in you know more of fixed deposits. So there was good returns on that. With the yields going down, the markets are also good now, so mutual funds are earning closer to FD returns. So that is where we have put some money's in the investment. So the way to look at it is the combination of cash, bank balances, and investments, rather than looking at a standalone number. Ajit, does this answer your question?

Moderator: Yes sir, the participants have left the queue, we'll move on to the next question which is from the line of Mahruk Adajania from Nuvama, please go ahead.

Mahruk Adajania: Yes, hello, congratulations on a very good set of numbers. I just had a few questions. Firstly, if you could explain what happened to opex, why that was down and what is the outlook ahead on opex?

Management: So, Mahruk, if you're looking at sequential quarters, this is something that we had highlighted even in the last quarter. In terms of the opex, the last quarter had a one-timer in terms of the corporate social responsibility expenses of about INR9 crores, INR10 crores, which is not coming in the current quarter. So that is where you are seeing a slight reduction in the opex of the current quarter and typically there were other costs that we had taken in the last quarter in terms of provisions for certain conference related expenses and all which are not there in the in the first quarter.

So there were one or two one-timers that were there in Q4, other than that, it's business as usual. Our guidance that we typically try and give you is from a cost to income perspective. While last quarter was at about 38%, it's dropped to about 36.6% in the current quarter. We expect this number to be around 35% to 37% even in a stable state scenario.

Mahruk Adajania: Got it. And my other question is that if rates were to fall and then you're going to pass on, you're going to pass it on to borrowers when rates are cut. So if rates were to fall, how would your margins behave? When will your margins, I mean, they've remained pretty stable, they've expanded. So do you see a drop or it'll stay above the guided range for a very long time?

Management: We will stay above the guided range for a foreseeable future. I won't say very long time because even if you have to drop the rates, it will only happen on the incremental book and the existing book, continues to, the existing book will continue to keep yielding at 24%. So it's not going to have a very quick impact in terms of the spreads coming down.

But over a medium to long term, I think currently the spreads are more like about 14.6%. We would like this number to normalize maybe by about 100, 125 basis points, but that's going to take a medium term at least. It's not going to happen in the short term. And consequently, you will also see shrinkage in the margins, which is currently at about 17.5%.

Our guidance has always been that with leverage kicking in, this number will automatically go down. And with us getting the spreads down, you should probably see again over a medium to long term this number compressing by about 200 to 225 basis points.

Mahruk Adajania: Got it. And just in terms of cost of funds, average versus marginal, would you say, I know there is a gap, but would you still say that average costs have bottomed now or I mean, there can still be further decline?

Management: Nothing major, you can see some decline. Like I said, the book cost is 9.80 while we are onboarding incremental borrowings at around 9.50. So there is a gap there. So you can see some benefit, but it will also be offset to some extent by the MCLR increases that may happen, whatever MCLRs have gone up like I said given that we are on the six months to one year MCLR these have not still impacted us so those may come down. So I don't think you will see any significant benefit coming through in the next few quarters.

Moderator: We'll take the next question from the line of Sameer Bhise from JM Financial. Please go ahead.

Sameer Bhise: Yes, hi. Thanks for the opportunity and congrats on a great set of numbers. So you mentioned that the current book is probably at an all time high, even compared to obviously pre-COVID numbers. What would you attribute this to and how do you expect these numbers to move? Obviously one would want them to improve further, but some changes that you would have implemented and hence the outcome. Some insights would be helpful?

Management: I understood the question. Let me repeat my answer. See I think our current level of 85% of current has moved from a substantial number from COVID-2, because we all know COVID-2 got a hit from a retail customer's perspective. The strategy what we have put in place has really worked out and that has moved the numbers from earlier lesser numbers to 85% of customers in current today. This will continue and I foresee this 85% will move closer to 88% to 89% by March 2024, this financial year March.

And ideally I want it to be around 90% of customers in current and 10% of customers can be in delinquent. I was just saying that please remember that the type of customers whom we lend, these are customers who have a little vulnerable cash flows and seasonal incomes. So definitely there will be some delinquencies. If we are able to maintain at 90 is to 10, I think it's a great number to have for.

Sameer Bhise: Yes, absolutely. Secondly, on the ticket sizes, obviously the Y-o-Y number kind of looks more than a 10% growth, but how does one look at from a three to five year perspective?

Management: Sameer, as we have been guided in last calls, pre-COVID our ticket size was 3.5 lakhs, which dropped down to 2.5 lakhs in COVID-19 due to our conservative approach. That is getting bounced back. Now we have come to around 3.35 lakh per customer and taking in next three years, this will have the inflation number added to it.

So we don't intend to move our ticket size significantly from 3 lakhs to 2x or 3x from here, but definitely the inflation number will be added to it. Maybe in around 3 years down the line, we'll be close to 4.5 lakhs to 5 lakhs. That will be the average ticket size. Without moving our profile of customers, we'll be dealing with the same profile of customers adding the inflation number to the average ticket size.

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

Aditya Padhi: Yes, hi, sir, great set of numbers. I just had one question on the provisions front. You wanted to know that the current provisions are what we should look for going forward like the credit cost or do we expect it to go down or was there a one time thing for the Q1?

Management: See, I think the last year in total if you look at credit cost, and I'm not talking about the provisions on any specific early DPD loans or the delinquent loans, the credit cost is starting to come in because like we updated even in the last call, there was a significant amount of provisions that we had taken, especially during the first and second waves of COVID. And last year was the first year when we -- when given our lower PDs and lower LGDs, the ECL was coming in lower. But having said that, we are also consciously trying to take that number to something that can sort of stay.

So the guidance that we generally give you on the credit cost at around 75, 100 or a little over about that 100 basis points is something that you should keep in. From a staging perspective, we are also trying to see if we can get the Stage 1 provisions around the RBI stipulated levels of about 40 basis points. But that number is probably, you will see a 5 basis points movement quarterly, depending on how the PDs and LGD stack up.

On Stage 2, I think 8% to 9% is our provision coverage that we are envisaging, and Stage 3, like we said, about 40% to 45%. So that's broadly the number that you should build in. There will also be some technical write-offs that we will take on a quarterly basis. I think all of these things should give you, closer to about 75 basis points to 100 basis points of credit cost on a quarterly basis going forward.

Aditya Padhi: Got it, sir. Okay, thank you. Thank you so much.

Moderator: Thank you. We'll take the next question from the line of Arvind Das from Sundaram Alternates. Please go ahead.

Arvind Das: Hello. Thank you so much for the opportunity and congratulations on the great set of numbers. I just had one question. So NIMs had contracted quarter-on-quarter, I would sound, 77 bps, even though like a portfolio yield has been stable and cost of borrowings on the book has come down. I'm just trying to understand why is that?

Management: See, it is purely because of the leverage. You know, earlier, a lot of the funding came through from equity, but today, we are levering the balance sheet. And when you lever the balance sheet, you will see the NIMs going down, you will see ROA is going down but that will have a positive impact on the ROEs. So like we said, NIMs will certainly go down as the leverage in the book increases but I would say, we're still in a very-very attractive territory as far as NIM is concerned but you will definitely see NIM compressions coming through in the future quarters as well.

Arvind Das: Okay sir, I ask this question also because we also had consumed liquidity when compared to the last quarter. So, I thought like even though that hasn't had a cushioning impact on NIM. So that's why I asked that question.

Management: The liquidity comes from debt right? So which has a cost and that will pull down the NIM.

Arvind Das: Yes, okay. Yes, thank you so much.

Moderator: Thank you. The next question is from the line of Ashok Kumar, an individual investor, please go ahead.

Ashok Kumar: Yes, hi, congratulations on a great set of numbers. The current quarter numbers are exactly in line with the revised guidance of 35% CAGR growth for the next two years to three years. So really happy to see this kind of numbers. Sir, my first question is on our branch expansion into northern states. So basically we are a secured lender so the same kind of business model will be continued in the northern states where we are going to open a new branch rapidly in the next two years to three years? That's my first question, sir.

Management: Yes there is no change in the business model as we are moving from South to rest of India. It is a very similar business model with the same means and similar set of customers. We still believe there is a large opportunity for the category of customers that we are serving. So we are not diluting on anything, whether it is sourcing, underwriting or collections. It's the exact same business model that we would like to replicate there.

Ashok Kumar: Okay, so even in terms of the securitization as well, I mean the self-occupied residence as well.

Management: Yes, absolutely, self-occupied residential, ticket size, nature of customers, tenure, everything is going to be very similar.

Ashok Kumar: Okay, thanks, that's helpful. And my second question is basically, of course, if you see the evolution of the Five Star, right now we have reached a stage where our policies, procedures, and the process, and all the fundamentals of the business are exactly in line with the matured business or something. So bearing this in mind, do we have any future plans catering into the new business lines of the products? Maybe just as an example, like microfinance lending or maybe any kind of unsecured lending or something like that?

Management: Ashok, let me be very clear. As I've been saying in last few calls, Five Star is lending to the small shopkeepers and self-employeds who have been in millions in our country. So our first work is to go and capture that market, which has been predominantly captured by the moneylenders market. I think, we have a lot to do in the existing business and we are extremely doing very well.

As answered in the last question also, today we are a predominant South-based player having close to 90%-plus of our disbursement and AUMs come from South. I think, we want to slowly do it in the rest of the country. That is the intent. So you will see a lot of activities happening in the other states apart from South. So we have a lot to do in the same business model and we are doing extremely very well, both from a growth perspective, quality perspective.

I think we have revised our guidance from 30% to 35%, keeping this business model in mind, not getting into any different product at this point of time. So, let's be very clear. So, we want to be a very specialist, one of the leading lenders to the un-lent segment of this country. That's where Five Star wants to be.

Ashok Kumar: Excellent. This is really helpful. So just a clarification. So the revised guidance will be 35% CAGR growth from the next three years in terms of the AUM and the profitability or did I misunderstood it?

Management: So what I said is for next three years AUM, I think profitability will also be in line.

Ashok Kumar: Okay so that's a 35% CAGR, that's what we are aiming for.

Management: Yes.

Ashok Kumar: Okay, thank you very much.

Moderator: Thank you. The next question is from the line of Nischint Chawathe from Kodak Securities. Please go ahead.

Nischint Chawathe: Hi. Thanks for taking my question. So just clarifying, we have seen around 9% quarter-on-quarter loan growth, 10% quarter-on-quarter loan growth, and that has translated into a 100 basis points sort of a reduction in margins. Is that the only reason or is there anything else? I understand the, I mean, obviously in the sense that -- within what they are.

Management: Nischint, I'm not able to get. What, a 100% you're talking about? A 100, which?

Nischint Chawathe: Yes, sorry, your margins are down by almost a 100 basis points. So my point was that, is this purely because of leverage? Because, your loan book is up 9.5% quarter-on-quarter.

Management: Nischint, it's purely because of leverage, nothing else.

Nischint Chawathe: And with that, taking this forward and your new growth guidance, would you have any views when do you probably need to raise capital?

Management: I think, Nischint, we are very long, long way away from raising our capital. I think, as we said in last call, our goal is now to increase the return on equity to the shareholders. As you see from the numbers from last quarter, we have moved from 16.10 to 16.62. And from last year, we moved from 14.78 to 16.62. I think the trajectory is very clear, our logic is very clear and I think way forward, we have to increase the return on equity that can come as we increase our leverage.

And the capital adequacy in which Five Star enjoys today, it means for next five years to seven years, we may not think of raising any capital.

Nischint Chawathe: No, sorry, what I wanted to actually check was, would you want to call out a target peak leverage ratio?

Management: Nischint, this is again something that we have been, sort of guiding. We would like to operate at a peak leverage ratio, and I'm talking about leverage, which is total assets to equity, at around 4.5x to 5x levels, which means debt equity of about 3.5 to 4. But again, given the internal accruals that we'll continue to keep doing, this is a number that's quite far off is our belief. Definitely not going to happen in the next three years to four years, but thereafter, depending on the growth and the profitability, but we would like to operate at this level because even lenders rating agencies are comfortable at this level rather than going all the way up to 6, 7, 8.

Nischint Chawathe: Perfect, that's helpful. Just one question a little qualitative is, are you seeing more competition at the ground, either in terms of, with your customers or for your employees?

Management: Yes, Nischint, yes, competition is always there. There is no lending product without competition, but comparing to other products, I will say, the competition is lesser because people find it very difficult to crack what Five Star has cracked for the last 20 years because this is a customer where you don't have the credit history or a credit document to underwrite. We have to do it in a touch and feel model and over a period of time, you will only master it.

So I don't see there is much competition getting into secured loans. I don't know about unsecured loans because that is the talk of the town. Maybe the unsecured loans part may be a little heated up. From a secured perspective, around that INR3 lakh to INR5 lakh ticket size where Five Star is sweetly positioned, there are only a handful of players and within that, Five Star scores well, both from growth perspective, quality and profitability perspective. So I don't see any big threat coming from competition.

Nischint Chawathe: Perfect. Thank you. That answers my question.

Management: Thank you.

Moderator: Thank you. The next question is from the line of Jaiprakash Toshniwal from LIC Mutual Fund. Please go ahead.

Jaiprakash Toshniwal: Thank you, sir. Good afternoon. Thank you for the results. Sir, a few questions. Just going back on the provisioning cost question, we had a 500 basis fund reduction in ECL provision for Stage 3. Does it relate to any change in policy or is it a normal cost of business?

Management: So there is no change Jaiprakash. The policy remains the same. It is just on the Stage 3 assets if you look at, we create higher provisions on deep delinquent accounts, and also certain overlays. So some of the deep delinquent accounts have come off, have settled. So we create 100% provision on let us say, on a loan which is more than a certain DPD.

Now if that loan settles, then automatically the numbers will come down, right? So you will always, while 5% looks high when you say the number, on a overall book of about 1.5% or 1.4% if you are talking about that number is fairly small and because the book is also small even few settlements could have a mismatch, could have a -- could make us skew this way or that way. That is why, we typically guide around 40% to 45% because we cannot exactly say that the number will go around wherever but I think we will try and maintain 40% definitely for the foreseeable future.

Jaiprakash Toshniwal: Okay. And sir, while in the presentation you mentioned about your IT progress policy I remember earlier you're talking about by Q2 you would be there on the LOS and all. So what is the timeline right now for reaching the milestone of LOS and other IT infrastructure build-up which you are doing?

Management: So Mr. Jaiprakash, we have gone live with the new LOS which is Salesforce. We are doing a gradual roll-up plan. So as we speak at the end of Q1, we have 103 branches which have gone live with the Salesforce. The idea is that this will be at least up by, close to 200 branches by Q2, and we'll be fully live with Salesforce by the end of Q3. So that's the current rollout plan. In addition to that, we have also gone live with our new HRMS, which is Darwin Box platform. We have gone live with that and we have completely moved over to cloud, which is an AWS migration from our existing private servers that we were holding.

The other key initiative from an IT perspective is also that we have moved to Oracle Fusion GL completely, which is obviously much more scalable and robust platform as far as GL is concerned. So these are the big initiatives that have happened in IT specifically during Q1.

Jaiprakash Toshniwal: Okay. And the last question on the cluster strategy illustration which were mentioned in the presentation. Does it mean that our branch peak account handling capacity somewhere around 1,800 accounts to 2,000 accounts and AUM of somewhere around INR30 crores to INR50 crores?

Management: Yes, so I wouldn't call it as the peak capacity, but I think from a prudence perspective and from a risk management perspective, we will always want to make sure that when a branch crosses that level, we are sort of diversifying, because when a branch reaches about close to 2,000 accounts, it very clearly indicates that there is strong potential in the market. So why do you need to concentrate everything in a single branch? So our idea has always been that open a cluster of branches around that, and we will distribute accounts accordingly. So that's the strategy that we have explained through two live examples, one in AP and one in TN.

Jaiprakash Toshniwal: Okay. Perfect. And sir last question on the collection infrastructure, while I remember we were building up a team in TN and one other one of the geography, if you can speak about that point, that's it. So that's a question. Thank you.

Management: So on the collections infrastructure, I think we had gone out with the vertical structure both in Tamil Nadu and Telangana. So it's an evolving model because as the company's current bucket is improving, we are constantly evaluating the fact that we probably don't need the same level of collection infrastructure and a little bit of people can always move back from collections back to the business because that helps us achieve incremental growth without additional headcount. So, this is something that we are constantly evaluating and wherever possible in whichever regions this is something that we will keep moving. So, you can see that the buckets have improved and this is something that we have done in a few regions already in Telangana as far as Q1 is concerned.

Jaiprakash Toshniwal: Okay. Great sir. Thanks I will call back in the queue. Thank you.

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

Pallavi Deshpande: Yes. Just two questions here. One, was on write-offs, what would be the technical write-offs for this quarter versus same quarter last year? And second one would be on this, what would be the share of top five, since we have spread across 50 borrowing partners, what would be the share of the top five?

Management: So, Pallavi, I think the write-off this quarter was at about INR1.85 crores. Just give me a second, I'll give you the number for last quarter as well. So, this is the write-off that we did for this June quarter. Last quarter, we had actually a written off about INR4.6 crores. So, it's lesser, but don't do this comparison. It also -- what we will typically say is about 25 basis points of our book gets written-off in a particular financial year, 25 to 30 basis points.

The quarterly dispersion of that could be a little different depending on how some of the numbers stack up because these are more technical write-offs and not permanent write-offs. But Yes, the number is INR2 crores as compared to INR4.5 crores, INR2 crores this quarter year-on-year, INR4.5 crores for the same quarter last year.

In terms of the borrowing mix, I think that is again that we had given in the presentation itself. We have about 66% of our borrowings in the form of bank term loans, about 21% through securitization transactions. These are the two major structures that we have borrowed in.

On the capital market side, we have done about 6% which are NCDs, and we have done about 5% term loans from other institutions, could be NBFCs and all and 2% is ECBs. Given that, there is a good amount of interest from the bank side, and for institutions to do securitization transactions, those will be the focus areas for this financial year. We will continue to keep tapping the capital markets for NCDs. The only problem in raising money for us through NCDs is typically NCDs, especially from MFs, come with a shorter tenure of about 24 months to 30 months, while we typically prefer at least 36 months to 48 months.

So, there could be some bit of a tenure mismatch, which is where we keep ourselves low, but we will continue to keep evaluating this. If you look at our top five lenders, I think we have some of the largest names on that. We have State Bank of India as our largest lender. We have Kotak, which has a very significant exposure. We have Bank of Maharashtra, who have lent big monies to us. And we have IndusInd Bank, who will be one among the top five and probably Axis Bank will be the other -- Axis and HDFC Bank will be the other lenders will be in the top 5 lenders to 10 lenders to the company.

Pallavi Deshpande: Right, and my question was in the term loans from the banks only, what would be the share of the top five banks in that?

Management: Out of this 66% you will probably see about 40% coming in from the top five, maybe not 40% I would say about 35%.

Pallavi Deshpande: Okay and so what would be the tenure for the term loans from the banks?

Management: These are long tenure. So, especially on the PSU side, we have even started getting loans which are 7 year tenures. But in private sector give us for 4 years to 5 years. So, on an average, the origination tenure on term loans from banks will be anywhere around 5.5 years to 6 years.

Pallavi Deshpande: And sir one last just curious -- we do not have a rating from CRISIL, a long-term rating, any particular reason for that?

Management: Nothing particular these are the -- these are the rating agencies who have been associated with the company for I would say, for at least about 6 years, 7 years. So, CARE and ICRA have been rating the company at least since 2015, 2016, so we have gone ahead with them. Recently, we have done with India ratings. I think CRISIL will definitely come at some point of time.

Pallavi Deshpande: Thank you so much.

Moderator: Thank you. We'll take the next question from the line of Franklin Moraes from Equentis Wealth Advisory. Please go ahead.

Franklin Moraes: Yes, thanks for the opportunity and congratulations on a good set of numbers. So, I wanted to understand in the newer regions that you are entering, who would be your competition and what would be the break-even period?

Management: So, Franklin, I think we expect the break-even period to be a little longer. In South, we typically break-even in about 6 months. But I think given that for the first two years, generally we don't go with a very specific target for a branch and in the rest of India we will want to be definitely be more careful than what we are doing in South. So, the break-even period will be a little longer. We expect it to be close to probably 9 months, 10 months.

On the competition front, it is small finance banks to an extent, regional players who are there in particular states. Actually, majority regional players who are there in particular states. There are very few Pan India players who are also having a very similar focus like us.

Franklin Moraes: And on your AUM growth upgrade from 30% to 35% in this quarter. So, what would be a specific maybe a couple of reasons that would have led us to this upgrade?

Management: We are saying that since COVID-2 including COVID-1 and 2, our growth was around 15%. COVID-1 we grew at 14%, 15% and COVID-2 also we grew at 14%. So, we started to move our growth once we saw the COVID's all got settled and collections are back in full action because we give more importance to collections rather than growth. So, we saw from December 2021 onwards, the collections coming in pre-COVID level. So, then the growth started to focus. So, that is how we gave a guidance of 30% from 15% growth what we saw. And last year we grew at 36%, which was very encouraging from our guidance. But what we saw in September, December, and March of last financial year, that business momentum is continuing same in June, as well as in July month too.

So, that is where the revised guidance was being put in place. So, growing at 10% Q-o-Q and seeing the momentum for next three quarters very strongly in the existing and the newer geographies. So, we think we can easily grow at 35%. So, the execution back on Five Star and the strong momentum that what we are seeing in disbursement and the opportunity that it is a long, long runway that we have, all put together has made our guidance to move from 30% to 35%.

Franklin Moraes: Okay, great, great. Thanks a lot and all the best.

Management: Thank you.

Moderator: Thank you. The next question is from the line of Pooja Ahuja from Monarch Networth. Please go ahead.

Pooja Ahuja: Yes, hi. Thanks for the opportunity and congratulations on the quarter. Firstly, wanted to understand what has led to a sharp drop in our capital adequacy Q-o-Q?

Management: So, two things Pooja. One, is obviously the growth in the book. The second is like I said, the mutual fund investments that we have -- that we kept as of June, that is risk weighted at 100%, the fixed deposits are not risk weighted at 100% so it's a -- that is what has caused the drop, but given our very high capital adequacy we are happy keeping it in an asset that gives us a little better yields as compared to the FDs.

Pooja Ahuja: Sure, sure understood and secondly on the growth I wanted to understand while you've guided for 35%, we've given a 40%-plus growth, what are the levels that we would be comfortable with and what would be our early warning signal in terms of this is where we would cap even though we would find opportunities of growth higher than 35%?

Management: Yes, 35% we don't see any warning signal to emerge from because pre-COVID we were growing at 90% year-on-year. So, that growth already, we have seen it, but the growth got dropped in COVID-1 and 2 on a conscious reason. The growth is back in Five Star. So, we are moving from 30% to 35% guidance. This guidance can even be revised as we see continuous momentum and strong disbursement across the geographies where we are strongly present and entering into the new geographies that those confidence we may also revise.

See, as long as, I keep saying, as long as your collections and quality remains robust with lesser competition in this product, we will not see any warning signal apart from this. So, our collections always on top priority, the quality of asset will be the first warning signal. I think we have been maintaining this quality of asset for the last 20 years and the competition as I said in earlier question is far and few comparing to the other lending products. So, I don't see any hurdle in growing at 35% year-on-year growth for next three years. That's our positive outlook.

Pooja Ahuja: So, my question was more from the point of view of while we can be comfortably growing at 35%, if there are levers to grow further, what is the kind of cap that we would put, let's say at maybe 40% or is this 35% level that we would be comfortable with on a more sustainable basis?

Management: Yes, 35% is the guidance but you know I think a little bit this side, that side is okay. But I don't think we will go with a particular number in mind that this is something that we have to achieve. So depending on market opportunities, we can be a little more agile. But like Mr. Pathy put it, the signal for us is on the asset quality.

Pooja Ahuja: Okay, understood. Yes, that's it from my side. Thank you

Moderator: Thank you. The next question is from the line of Agam from Raj Trading. Please go ahead.

Agam: Yes, Sir, congrats on a good set of numbers. So I have a quick question. In the commentary you mentioned that for this quarter I think you have provided around more than 1.5 bps of credit cost. You have guided for around 1% credit cost. So is this for this quarter and maybe for next, remaining three quarters, will you come down to on a year-on-year basis, the credit cost will be in the guided range?

Management: No, Agam, for this quarter, the credit cost came in at 70 basis points, not 1.5%. The gross NPA was at 1.41%.

Agam: Okay. And typically in your presentation, the 40th slide, we have shown the 30-plus DPD, which has consistently moving every quarter-on-quarter and monthly, so it is around currently it is a 9% so where do you see this number settling in or what is a healthy number to look at this?

Management: Yes, sorry, Agam, we missed your question. Can you repeat it?

Agam: Yes, in your presentation on the slide number 40, you have given a data point on 30-plus DPD in percentage, which has been declining every quarterly. So where can this number settle at or any number which you aspire to be in? This is a 9.68 current this quarter.

Management: No, like we mentioned, obviously, the impact of the second wave of COVID did push up this number and we have been consciously taking efforts to bring this number down, which is why you are seeing it coming down all the way from about 15.7% to 9.7% as we speak. When the current bucket moves up to 90%, and you are looking at 30-plus numbers, you will also see something in the one day to 30 day bucket. So when we get to a current of 89% to 90% and a number, we will probably have a 30-plus number which will be more like 5%, 6% levels. That is where it will stabilize.

But from here onwards, the drop also will be more gradual as what you saw in the last, between June and December. So June and December you would have probably seen about 3.5% drop. I don't think, but you know, even compared to last quarter, it's only a 70 basis points drop. So you will start seeing the drop becoming a lot more gradual, and hopefully over the next four quarters to six quarters, this number should settle around 5%, 6% or thereabouts.

Agam: Correct. And one more last question. On the concentration side, how deeply penetrated in terms of your top states we are, so the incremental growth will be from the other states, or yet there is enough district level penetration to go in your core states itself?

Management: So clearly, Agam, the core states is what is going to be the primary growth driver for the next three years to five years. We have guided that for all the new branch openings totally almost 80% of the new branches will come in from the core states of South states itself because that is our stronghold, that is the areas where we have very significant experience and we have built a very good team. So this is the guidance that we had given. The core states will continue to grow.

The newer states like we had guided earlier, it's more for us to understand these markets, but it's not for immediate AUM growth. But the fact that we will be wetting our feet in the new states and gaining practical exposure there will help us for growth beyond the three years to five years from now. So if you look at from short to medium term, the primary growth regions will be from the south.

Agam: So you don't see any market topping out in any of the core states? There is yet huge opportunity in the core states itself?

Management: Yes. We still believe we are very early stage and multiple opportunities to penetrate far deeper.

Moderator: Thank you. The next question is from the line of Sumit Rathi from Centrum PMS. Please go ahead.

Sumit Rathi: Thank you for this opportunity. Sir, the first question on the growth, raise of the growth guidance from 30% to 35 percentage, I wanted to understand what would be driving this growth. Will it be more in the increase in the ticket size or would it be driven by addition of our new branches or would it be driven by our normal branches getting converted into a super branch? So or would we be increasing the target for our existing employees? What would be the drivers for it, if you can give some Colour?

Management: Yes, definitely, Sumit. I think, as I was saying in earlier questions, the growth momentum has been very strong for the last four quarters. So that's the primary factor where we are increasing our growth guidance from 30%, 35%. The growth comes from three levers, that's what we have been always saying. The first lever is the increase in branches. Last year we opened close to 70 branches, 75 branches. This year we wanted to do a little bit more, so it may be around 80 branches, 85 branches. First quarter we opened close to 13 branches and more branches will be there in the Q2 and Q3. So the first lever of growth will come from a number of branches that we intend to open for this financial year.

Second will be at the branch level, average of officers per branch is somewhere around eight officers per branch. That will move from 8 to 8.5 to 8.5 to 9. So that will bring in more number of people to do more business and collection. So that's the second lever of growth that we intend to see.

Third, of course, there will be increase in ticket size. As we said, we are bouncing back to the pre-COVID ticket size of INR3.5 lakhs. And inflationary around 6%, 7% will get added to the ticket size of what we are currently into it. So all these three levers put together and the strong momentum that what we see at the ground level for last four quarters made us to move from 30% guidance to 35%.

So it is not that we are putting pressure on all the existing officers, our existing productivity itself is one of the best in this lending space. So we don't intend to put any more pressure from our sourcing officers. So the levers of growth will confidently bring 35% or even more as we move forward.

Sumit Rathi: Wonderful. Sir, on the increase in the borrowing side and your intent of adding more value to investors by increasing the ROE, what kind of leverage can we envisage over the next two to three years? Right now we are at around 2x leverage in our ROE tree. Going forward, if you can give some Colour?

Management: Yes, definitely. It's a good question. As we have been saying in the calls, our plan is moving from ROA to ROE. If you see in the last four quarters, the ROE is keeping on increasing. So the plan and strategy is really working around. Yes, we have to increase our leverage. That's where we are increasing our focus to. So as we speak, we are at 2x of leverage, that will move towards 3x to 4x in the next three years. At a growth of 35%, you get a mathematical answer to it. And you see that 16.62% will be closer to 18% in the next three years. So that's the game plan. And over a long term, from three years to five years, we see that touching 20% and even crossing 20% ROE to our customers, to our shareholders.

Sumit Rathi: Great. Sir thank you and all the best for the coming quarters and a year. Thanks a lot.

Moderator: Thank you. The next question is from the line of Parth Desai from Motilal Oswal. Please go ahead.

Parth Desai: Congratulations on a good set of numbers. My main question was on the AUM growth and I think you provided good clarity on where the three diversities should come from. Sir, my another question that you mentioned that number of people per branches will increase and from my -- what I understand about how the cluster branches work, once a specific number of accounts exceed a branch you open a new branch. So with the people in a certain number of branches increasing from let's say 8 to 9 as you mentioned, would this number of accounts also increase per branch? The threshold would increase. And how that would affect your plans to expand the branches going ahead?

And considering that you are going to be investing in technology, branches and manpower altogether, when can we see the operating leverage to flow in and the economic efficiencies to drive moderation in the opex to AUM ratios? Thank you.

Management: So, Parth, you are right in your observation because from a cluster approach as we keep opening new branches by transferring accounts, we don't need to put more number of officers in those branches. So, it's a balance call that we'll have to take whether we intend to put more officers and graduate that to a super branch or whether we want to split it because we see more opportunities in the cluster and then open up a new branch.

So its going to be combination of this two, depending on whatever region in which we are operating. But that is only one of the levers that Mr. Pathy had mentioned. So if later say, we are not able to find opportunities to put more officers in the same branch, that will more than adequately get compensated by the more number of branches that we are able to open in the cluster. So that's what on the first question.

On your second question, see we are still in a very heavy investment phase. And we have been guiding in the past also that our cost to income ratio is one of the best in the industry at this point of time. So we will not want you to assume too much of efficiencies coming in through operational cost savings at this point of time. We are very profitable. We will continue to invest at this point of time as we see good market opportunities. You know, these technology initiatives will at least take 18 months to 24 months for us to go deeper and start seeing some operational efficiencies and cost savings coming through.

Parth Desai: Okay, thank you sir. That's it. Thank you.

Moderator: Thank you. Ladies and gentlemen, that was the last question for today. I would now like to hand the conference over to Mr. Srikanth Gopalakrishnan for closing comments. Over to you.

Srikanth Gopalakrishnan: So, thank you all. I think as a company we are continuing to hold the investor interest as well as the confidence that each of you have placed on us. We are confident of delivering the results that we have sort of guided you on. And for now, we would like to sign off and look forward to connecting with you post the September results. Thank you.

Moderator: Thank you very much sir and thank you to the members of the management. Ladies and gentlemen on behalf of ICICI Securities that concludes this conference. We thank you for joining us and you may now disconnect your lines. Thank you.