Fedbank Financial Services Limited

21-November-23

Subscribe – Long Term

Shivam Gupta
shivamgupta@rathi.com

Issue Details

Issue Details	
Issue Size (Value in ₹ million, Upper Band)	10,930.3
Fresh Issue (No. of Shares in Lakhs)	429.1
Offer for Sale (No. of Shares in Lakhs)	351.6
Bid/Issue opens on	22-Nov-23
Bid/Issue closes on	24-Nov-23
Face Value	Rs. 10
Price Band	133-140
Minimum Lot	107

Objects of the Issue

- **Fresh issue: ₹ 6,008 million**

1. To meet the company's future capital requirements.
2. Meeting offer expenses.

- **Offer For Sale: ₹ 4,923 million**

Book Running Lead Managers
ICICI Securities Limited
BNP Paribas
Registrar to the Offer
Link Intime India Private Limited

Capital Structure (₹ million)	Aggregate Value
Authorized share capital	9900.00
Subscribed paid up capital (Pre-Offer)	3260.76
Paid up capital (post-Offer)	3689.88

Share Holding Pattern %	Pre-Issue	Post Issue
Promoters & Promoter group	72.3%	62.4%
Public	27.7%	37.6%
Total	100.0%	100.00%

Financials

Particulars (₹ In million)	FY23	FY22	FY21
Revenue from operations	**11,788**	**8,693**	**6,918**
Operating expenses	4,423	3,601	2,802
EBITDA	**7,365**	**5,092**	**4,116**
Other Income	359	143	57
Depreciation	419	367	273
EBIT	**7,305**	**4,869**	**3,901**
Interest	4,722	3,477	3,132
PBT	**2,430**	**1,392**	**769**
Tax	629	358	152
Consolidated PAT	**1,801**	**1,035**	**617**
EPS	**4.88**	**2.80**	**1.67**
Ratios	**FY23**	**FY22**	**FY21**
EBITDAM	62.48%	58.58%	59.50%
PATM	15.28%	11.90%	8.92%
Sales growth	35.60%	25.66%	

Company Description

Fedbank Financial Services Ltd. is a retail focused non-banking finance company ("NBFC") promoted by The Federal Bank Limited. They have the second and third lowest cost of borrowing among the micro, small and medium enterprises ("MSMEs"), gold loan and MSME & gold loan peer set in India in Fiscal 2023 and three-months period ended June 30, 2023, respectively. As on March 31, 2023, they had the third fastest AUM growth among NBFCs in the peer set in India with a three-year CAGR of 33% between Fiscals 2020 and 2023, and the fourth fastest year-on-year AUM growth of 42% for three-months period ended June 30, 2023. They are one among five private banks promoted NBFCs in India. They are the fastest growing gold loan NBFC in India among the peer set as of March 31, 2023, and had the fastest year-on-year growth among gold loan NBFCs in India as of June 30, 2023. As on June 30, 2023, 86.24% of their total Loan Assets are secured against tangible assets, namely gold or customer's property.

They are focused on catering to the MSMEs and the emerging self-employed individuals ("ESEIs") sector. the ESEI and MSME segment is largely unaddressed by lending institutions in India. The company believes that this segment provides them with a sizeable opportunity to rapidly grow and expand further. They have a well-tailored suite of products targeted to match their customers' needs, which includes mortgage loans such as housing loans; small ticket loan against property ("LAP"); and medium ticket LAP, unsecured business loans, and gold loans. They had the third highest growth in disbursement among the peer set with a three-year CAGR of 35% between Fiscals 2020 and 2023. Their mortgage loans, gold loans and the unsecured business loans had an AUM of ₹ 47,024.46 million, ₹ 31,241.72 million, and ₹ 14,872.49 million, respectively as on June 30, 2023.

They have been rated "AA" by CARE for its non-convertible debentures ("NCDs") since 2022, and "AA-"– by India Ratings and Research Private Limited for their NCDs and bank loans since 2018. They are promoted by Federal Bank, which, they believe, adds a degree of trust among their stakeholders. Federal Bank will continue to own more than 51% of their outstanding share capital post the completion of the Offer. They believe that their long operating history, track record, management expertise and the "Federal Bank" brand have enabled them to establish a competitive position in the markets they serve and create trust among their customers, lenders, regulators, and investors.

The company offers a comprehensive suite of financial products and services including various fund-based and non-fund-based products. Some of their key fund-based products for RE developers are long-term, medium-term, and short-term loans (for projects, manufacturing, and equipment financing), top-up loans, bridge loans, takeover financing, and loans against securitization of future cashflows. The company also provide line of credit to other NBFCs for on-lending to RE and EEC projects.

They also have a "Phygital" doorstep model, a combination of digital and physical initiatives, for providing customized services to their customers across all their products. This also helps them to constantly remain in touch with their customers.

Valuation

At the upper price band company is valued at P/BV of 2.5X with a market cap of ₹ 51,651 million post issue of equity shares.

We believe that issue is fairly priced and recommend "**Subscribe – Long Term**" rating to the IPO.

The company is headquartered in Mumbai, Maharashtra. As of June 30, 2023, they are present in 17 states and union territories across India with a strong presence in Southern and Western regions of India. These states contribute more than 75% of India's GDP in Fiscal 2023. As of June 30, 2023, they covered 190 districts in 17 states and union territories in India through 584 branches. Their branches are in states, such as Andhra Pradesh (including Telangana) and Rajasthan, which have better asset quality than other states as of Fiscal 2023. Additionally, they have dedicated micro-sites on their website for each of the branches, which focus solely on customer engagement for its branch customers.

They have entered into an agreement in Fiscal 2020 with a service provider for records management, preservation of documents and related services, valid for a period of five years. When they underwrite a loan, they collect various data points from the customer, including subjective and objective information. These are collected in digital and physical format. Subsequently, they spend time validating the data and analyzing the customers' creditworthiness. Thereafter, the information is validated through various application programming interfaces ("APIs"), which are integrated in their loan origination system. Lastly, for their gold loan portfolio, the information is passed through the decision engine for final determination of sanctions of the loan amount. Their underwriting process has allowed us to manage defaults and NPAs across all its products in Fiscals 2023, 2022 and 2021, and the three-months period ended June 30, 2023. Their Gross NPA was 2.26%, 2.05%, 2.03%, 2.23% and 1.01% for the three-months period ended June 30, 2023 and June 30, 2022, and Fiscals 2023, 2022 and 2021, respectively, and Net NPA was 1.76%, 1.57%, 1.59%, 1.75% and 0.71% for the three-months period ended June 30, 2023 and June 30, 2022, and Fiscals 2023, 2022 and 2021, respectively.

Competitive Strengths

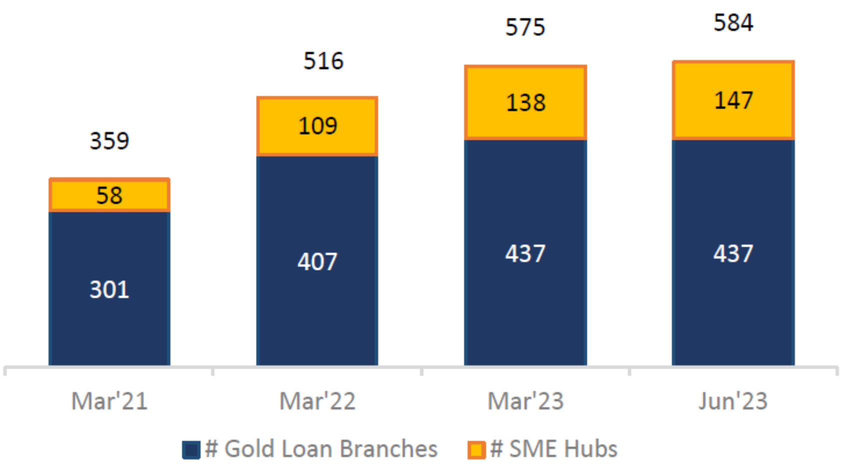
The following strengths give them a competitive advantage in the Indian retail credit industry:

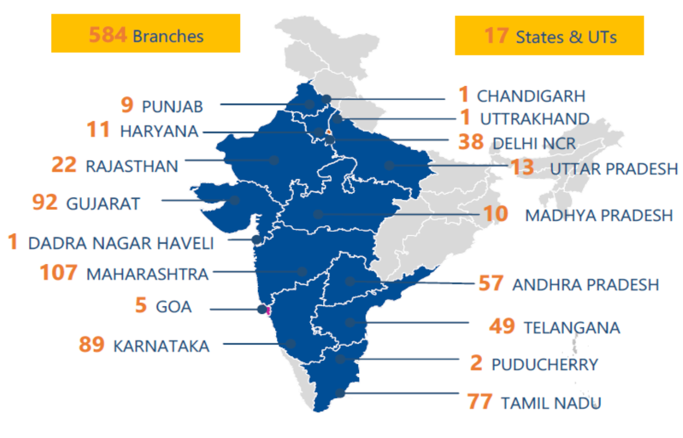
- They are present in large, underpenetrated markets with strong growth potential.
- They are focused on retail loan products with a collateralized lending model targeting individuals and the emerging MSME sector.
- Strong underwriting capability and presence in select customer segment combined with robust risk management capabilities focused on effective underwriting and collections.
- Experienced, cycle tested management team - Well diversified funding profile with an advantage of lower cost of funds.
- Technology driven company with scalable operating model - They are present in large, underpenetrated markets with strong growth potential.

The Indian retail credit market grew at a strong pace over the last few years from ₹ 30 trillion in Fiscal 2018 to ₹ 60 trillion in Fiscal 2023, and it constituted 32% of total systemic credit in India. Retail credit is expected to further grow at a CAGR of 14-15% between Fiscals 2023 and 2025. The credit gap is much larger in the case of ESEIs, and they are focused on catering to the financial needs of such ESEIs.

Given that the market is large, has good growth prospects, is under penetrated and profitable, retail credit is expected to continue to remain a key focus area for banks and NBFCs. In terms of credit to households as a proportion of GDP, India lags other markets, with retail credit hovering at around 26% of GDP as of Fiscal 2023. They believe this presents them with an opportunity for growth. Due to increasing awareness about benefits of availing gold loans from the organized segment, the share of organized gold loan financiers has increased from 56-58% in Fiscal 2017 to approximately 61-63% (in terms of value) in Fiscal 2023. Further, as of March 2023, the gold pledged with financiers constituted around 7% of the 28,000 tons of gold holdings in Indian households. They believe that they are well positioned to take advantage of the opportunity this presents for growing their gold loan business.

As on June 30, 2023, the company's AUM across various products was 33.12% for gold loans, 25.33% for medium ticket LAP, 24.52% for small ticket LAP and housing loans and 15.76% for unsecured business loans. According to the CRISIL Report, housing finance and gold loans cover 46% and 12% of the retail loans industry, respectively, in India in Fiscal 2023. The retail nature of their business reduces any industry concentration risk to their total AUM. The following chart and map set forth their branch network as on June 30, 2023, and branch footprint evolution during the last three Fiscals and the three-months period ended June 30, 2023.





As of June 30, 2023

In the three-months period ended June 30, 2023, and Fiscals 2023, 2022 and 2021, their top five states in terms of AUM constituted 78.01%, 78.72%, 80.30% and 85.07% of their total AUM, respectively, while the top three states in terms of AUM contributed towards 53.63%, 54.59%, 58.54% and 63.66% of their total AUM, respectively. Further, as on June 30, 2023, 305 of the total branches have been in operation for more than three years while the remaining 279 have been in operation for less than three years.

They are focused on retail loan products with a collateralized lending model targeting individuals and the emerging MSME sector.

The company is largely focused on a collateralized lending model for their retail finance segment, targeting ESEI consumers and the emerging MSME sector. As on June 30, 2023, 86.24% of their total Loan Assets are secured against tangible assets, namely the customer's gold or property. The company's average ticket size was ₹ 0.13 million in the three-months period ended June 30, 2023. Out of the collateral for their medium ticket LAP and small ticket LAP, 77.37% of the collateral is self-occupied residential or commercial property as of June 30, 2023. As on June 30, 2023, the average LTV on their total Loan Assets with property collateral at the time of sanctioning the loan was 51.37%. In their experience, the value of collateral property generally appreciates over time. In addition, their LTV at the time of sanction further reduces over the term of the loan as the loan is serviced. The following table provides the split of their AUM by product category as at June 30, 2023 and June 30, 2022, and March 31, 2023, 2022 and 2021, year on year growth, split of total AUM as at June 30, 2023, ATS for disbursal in the three-months period ended June 30, 2023, yield as at June 30, 2023, NPA percentage as on June 30, 2023, underwriting methodology and average LTV as at June 30, 2023:

Product	AUM as at June 30,2023 (₹in million)	AUM as at June 30,2022 (₹in million)	AUM as at March 31,2023 (₹in million)	AUM as at March 31,2022 (₹ in million)	AUM as at March 31,2021 (₹in million)	Growth from June 30,2022 to June 30,2023	YoY Growth from Fiscal 2022 to Fiscal 2023	YoY Growth from Fiscal 2021 to Fiscal 2022	Split of AUM (as at June 30,2023)	ATS (₹ in million) for disbursal in the three months period ended June 30,2023	Yield on disbursement as of June 30,2023	NPA % (as at June 30,2023)	Underwriting	Average LTV (As at June 30,2023)
Mortgage loan														
Small Ticket LAP	17,219.25	11,940.28	16,661.56	10,864.10	6,768.62	44.21%	53.36%	60.51%	18.25%	1.18	17.68%	2.36%	Assessed Income	46.81%
Medium Ticket LAP	23,892.28	15,925.68	22,884.02	15,258.50	13,324.13	50.02%	49.98%	14.52%	25.33%	4.79	12.51%	3.23%	Income Based	51.94%
Housing Loan	5,912.92	3,684.10	5,518.20	3,201.90	1,413.37	60.51%	28.84%	126.52%	6.27%	1.36	13.95%	2.45%	Assessed Income	62.37%
Gold Loan	**31,241.72**	**24,247.85**	**29,860.34**	**22,475.30**	**19,177.87**	**28.84%**	**32.86%**	**17.19%**	**33.12%**	**0.10**	**16.23%**	**0.88%**	**In-house Valuation**	**71.75%**
Unsecured Business Loan	**14,872.49**	**9,892.28**	**14,542.80**	**9,010.18**	**4,978.89**	**50.34%**	**61.40%**	**80.97%**	**15.76%**	**2.31**	**17.37%**	0.38%	Income Based	NA
Others	1,203.42	954.03	1,229.12	1,062.06	2,961.43	26.14%	15.72%	-64.14%	1.28%	Nil	NA	37.51%	-	NA
Total	**94,342.08**	**66,644.22**	**90,696.04**	**61,872.04**	**48,624.31**	**41.56%**	**46.59%**	**27.25%**	**100.00%**	**0.13**	**16.07%**	**2.26%**	**-**	**59.51%**

Strong underwriting capability and presence in select customer segment combined with robust risk management capabilities focused on effective underwriting and collections.

They have an effective underwriting capability, built on their experienced underwriting team and established processes, which assess the quality of their potential customers' business and collaterals, and then reasonably estimate the possibility of defaults, prior to disbursal of loans. The percentage of their retail installment loans which are underwritten is represented by the sanction to login ratio, which was 40.05%, 44.01%, 45.30%, 45.83% and 43.51% for the three-months periods ended June 30, 2023, and June 30, 2022, and Fiscals 2023, 2022 and 2021, respectively. They recognize risk management as an integral part of their business. They have formulated their risk management policy considering, among others, the practices and principles governing risk management prescribed by the RBI. Their Board, supported by their senior management team, takes the lead in establishing a strong risk management culture. Their risk management framework is driven by the Board and its subcommittees including the Audit Committee, the Risk Management Committee, and the asset liability committee of their Company.

While they focused on the underserved category of the Indian retail loan market, they follow prudent customer selection policies with 86.71% of their customers having an established credit history, and 77.94% of their credit rated borrowers rated with a CIBIL score greater than 650 or CMR score less than or equal to 6 as on June 30, 2023. Their effective credit risk management is reflected in their portfolio quality indicators such as collection efficiency backed by adequate provisioning cover. The company believes that their risk management policies have resulted in healthy asset quality and low credit costs. The following tables sets out the break-up of the loans across stages as per Ind AS:

Particulars	For three months period ended June 30,		For Fiscal		
	2023	2022	2023	2022	2021
	(₹ in million, except percentages)				
Gross Carrying Amount					
Stage 1	78,571.16	56688.47	75689.67	51311.37	44514.09
Stage 2	3,594.21	4156.94	3766.77	5012.22	1288.18
Stage 3	1,897.71	1272.78	1645.03	1285.82	468.08
Total Gross Carrying Amount - Loans	84,063.12	62118.19	81101.47	57609.41	46270.35
Expected Credit Loss Allowance - Loans					
Stage 1	328.49	282.09	317.09	252.52	453.56
Stage 2	344.67	453.07	422.24	625.07	155.52
Stage 3	423.86	301.83	365.18	283.73	139.86
Total ECL Allowance Loans	1,097.02	1036.99	1104.51	1161.32	748.94
Net Carrying Amount - Loans					
Stage 1 (9=1-5)	78,242.67	56406.38	75372.58	51058.85	44060.53
Stage 2 (10=2-6)	3,249.58	3703.87	3344.53	4387.15	1132.66
Stage 3 (11=3-7)	1,473.85	970.95	1279.85	1002.09	328.22
Total Net Carrying Amount - Loans (12=4-8)	82,966.06	61081.2	79996.96	56448.09	45521.41
Ratio of Total ECL Allowance Loans to Total Gross Carrying Amount (13=8/4*100)	1.30%	1.67%	1.36%	2.02%	1.62%

Experienced, cycle tested management team

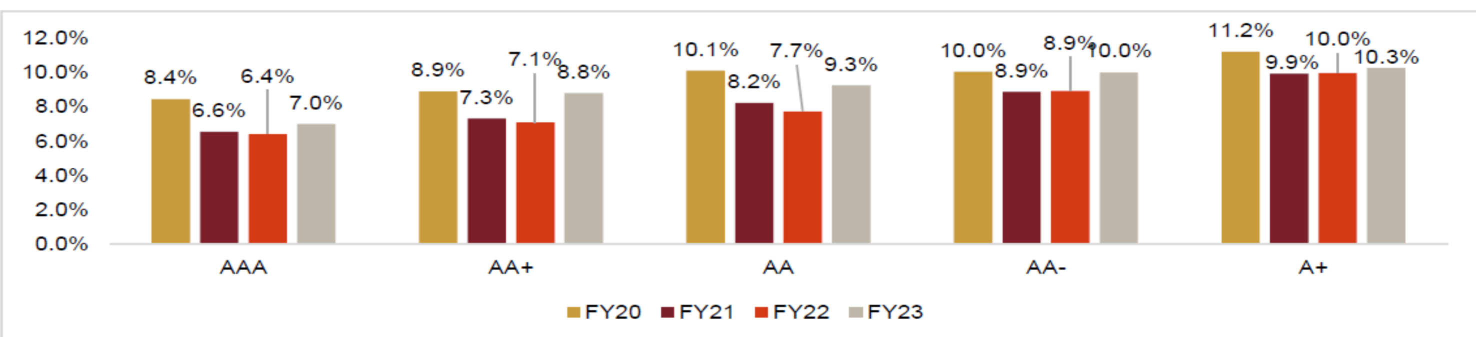
The company's senior management team has significant experience in the financial services industry and the team members are instrumental in developing and implementing their business strategy and commitment to fair and transparent business practices. Their senior management team has consolidated experience of over 200 years with a diversified track record in the banking and financial services industry. The track record and experience of their senior management across various events in Indian economic history provides us with the ability to react to changes and adapt and implement innovative solutions to deal with economic challenges.

Well diversified funding profile with an advantage of lower cost of funds

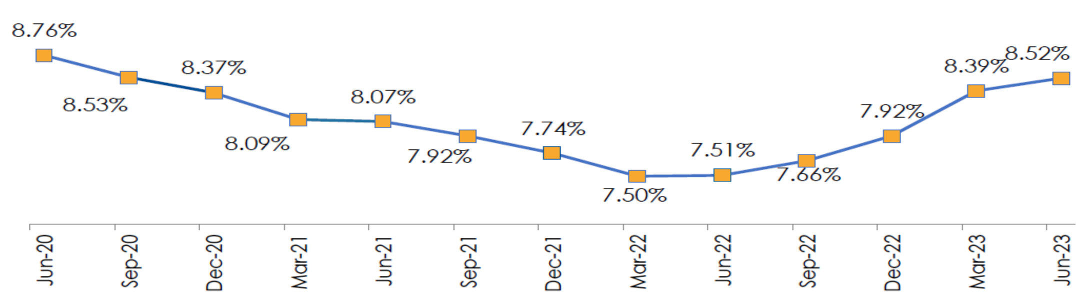
The company's ability to access diversified sources of funding is a key contributor to their growth. They intend to continue to diversify their funding sources, identify new sources and pools of capital and implement robust asset liability management policies with the aim of further optimizing their borrowing costs and helping expand its net interest margin. Their average cost of borrowing was 2.22%, 1.86%, 7.77%, 7.44% and 8.30% for the three-months periods ended June 30, 2023, and June 30, 2022, and Fiscals 2023, 2022 and 2021, respectively. They can access borrowings at a competitive cost due to their stable credit history, credit ratings, conservative risk management policies and strong brand equity.

In addition, their cost of incremental borrowings, being new loans sanctioned in the relevant period, reduced from 8.36% in Fiscal 2021 to 7.02% in Fiscal 2022. It increased to 8.02% in Fiscal 2023 due to an increase in interest rates. The cost of incremental borrowings during the three-months period ended June 30, 2023, was 8.57%. Further, while they have been rated "AA-" by CARE for their NCDs since 2022, and "AA-" by India Ratings and Research Private Limited for the NCDs and bank loans since 2018. They are one of only two long term AA rated players among the peer set which have cost of borrowings less than 8.5% between Fiscals 2019 and 2023. Their rating of AA and AA-indicates, resilient liability origination despite challenges faced by the Indian economy for varied factors and the failure of other NBFC companies in India. The following charts set forth the average cost of borrowing trend in the industry by ratings category:

Average Cost of Borrowing Trend by Ratings Category



The company's Average Monthly Cost of Borrowing



Technology driven company with scalable operating model.

The following chart reflects the technology framework as of June 30, 2023:

Strategies

The company's aim is to implement the following key strategies in the business:

• Continue to deliver consistently and one of the industry leading return matrices building on past performance.
• Focus on performance of the large branch network and extracting operating leverage.
• Continue to invest in technology and digitization initiatives.
• Continue to invest in talent and employee training to achieve industry leading productivity parameters.
• Capitalize on the understanding of their customer as a foundation for customer retention and customer acquisition.
• Continue to deliver consistently and one of the industry leading return matrices building on past performance.

The company has delivered consistent and one of the industry leading performances across various benchmarks, such as AUM Growth and cost of funds. For example, As on March 31, 2023, they had the third fastest AUM growth among NBFCs in the peer set in India with a three-year CAGR of 33% between Fiscals 2020 and 2023. According to the CRISIL Report, they are one of only two long term AA rated players among the peer set which have cost of borrowings less than 8.5% between Fiscals 2019 and 2023. The company has the second and third lowest cost of borrowing among the MSME, gold loan and MSME & gold loan peer set in India in Fiscal 2023 and three-months period ended June 30, 2023, respectively.

Their performance is a result of their business model and the implementation of different initiatives across their business. Further, because of these various initiatives, they believe they will be able to reduce their GNPA and NNPA levels, improve their credit ratings for new fund raising, further reduce the cost of the borrowing and deliver better return ratios.

Focus on performance of large branch network and extracting operating leverage.

As of June 30, 2023, they are present in 17 states and union territories across India with a strong presence in Southern and Western regions of India. As of June 30, 2023, the company covered 190 districts in the 17 states and union territories in India through 584 branches. There is a huge demand-supply gap in the MSME loan segment, especially in lower ticket size segments. The MSME loans segment has been growing strongly with a four-year CAGR of 18% between Fiscals 2019 and 2023 and the overall MSME portfolio is expected to grow at 12-14% CAGR between Fiscals 2023 and 2025. As on March 31, 2023, the top 15 states accounted for 92% of the overall MSME loans portfolio, based on the value of the overall MSME loans outstanding.

The company's presence across these states gives them the ability to meet the demand from these underpenetrated markets and customer categories. They intend to continue to focus on their branch level AUMs to increase the total number of customers and total AUM. Further, they have adopted a contiguous strategy wherein they aim to expand across regions in India where they have a presence and expand to adjacent geographies by evaluating areas with established credit culture.

Continue to invest in the technology and digitization initiatives.

The company have invested ₹ 4.75 million, ₹ 9.80 million, ₹ 82.68 million, ₹ 128.40 million and ₹ 40.10 million in their information technology and digital systems, in the three-months periods ended June 30, 2023, and June 30, 2022, and Fiscals 2023, 2022 and 2021, respectively, constituting 0.13%, 0.40%, 0.70%, 1.48% and 0.58% of their revenue from operations during the same periods. They have implemented automated, digitized technology-enabled services to increase their customer offerings. The company plans to continue investing in technology and digitization and to ensure their information technology systems continue to help us with several functions, including loan origination, credit underwriting, risk management, collections, customer service and retention. They believe that such investments will help improve recoveries and reduce their operating expenses, their cost of customer acquisition and credit costs over time.

Continue to invest in talent and employee training to achieve industry leading productivity parameters.

The business model requires them to hire many sales employees and as on June 30, 2023, they have 2,878 sales employees. They undertake comprehensive onboarding training as well as ongoing training initiatives so that their employees are equipped to deal with business and regulatory requirements. As a result, their employees are trained to assess and appraise the creditworthiness of their customers with limited documented income. Further, their employees are trained to handle and engage customers and these trainings have helped their dealings with their customers, with an emphasis on marketing and sales knowledge for their products. In addition, the company's employees periodically receive training on their products, processes, incentives. Further, they also receive regular training related to their core systems to enable them to operate their systems with minimum intervention. The company's employees are trained to exercise operational risk controls including effective segregation of duties, access, authorization, and reconciliation procedures.

Capitalize on their understanding of their customer segment as a foundation for customer retention and customer acquisition.

The company has a customer-centric model and accordingly, their products and services are designed and customized to meet the requirements of their customers and their target markets. They are focused on catering to the ESEI and the MSME segments. The company has a "Phygital" doorstep model, a combination of digital and physical initiatives, and has been using technology, people and all the other resources to improve customer experience. Over the years, they have gained a deep understanding of the Indian retail loan industry, including ESEI and MSME customers, which has enabled them to meet the financing requirements of potential customers.

The MSME credit demand is estimated to be around ₹ 117 trillion, of which 21% of demand was met through formal financing. Historically, there has been a perception of high risk and prohibitive costs for delivering services physically and that has constrained the ability of traditional institutions to provide credit to underserved or unserved MSMEs and self-employed individuals.

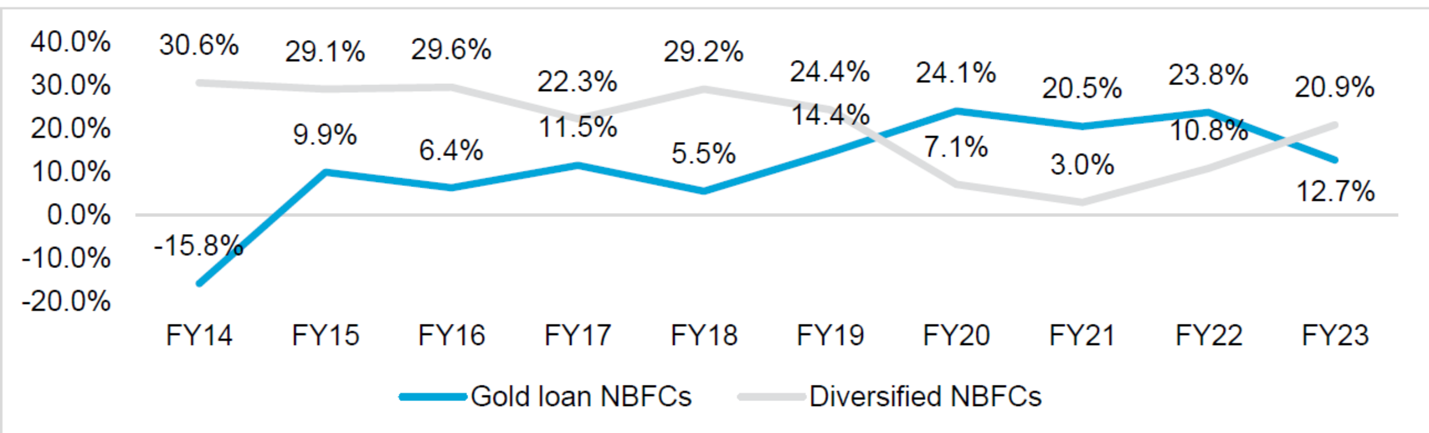
Description of business and operations.

They are registered with the RBI as a NBFC-ND-SI. The Company was initially engaged in the distribution of, among other things, personal cars and housing loans for the Promoter, the Federal Bank. In 2018, True North Fund VI LLP, their financial investor, invested in them and has since, together with their Promoter, supported them with capital to fuel their growth. As a result, the company's net worth has grown to ₹ 14,149.03 million during the three-months period ended June 30, 2023, from ₹ 13,556.82 million during Fiscal 2023, ₹ 11,535.18 million during Fiscal 2022 and ₹ 8,347.34 million during Fiscal 2021. They have categorized their business into three business segments, namely the distribution segment, the retail finance segment, and the wholesale finance segment. The distribution segment comprises of distributing housing loans, personal car loans, personal loans, home equity mortgage loans and retail asset products for their Promoter, Federal Bank. The retail finance segment comprises gold loans, medium ticket LAP, small ticket LAP, unsecured business loans, personal loans, and housing loans. The wholesale finance segment comprises construction finance to developers and loans to other NBFCs.

Retail Finance Segment

Under the company's retail finance segment, they offer a wide range of financial solutions that help ESEI consumers and MSMEs meet their growing credit needs. Their retail finance operations are divided into three categories: gold loans which are loans against gold as a collateral, mortgage loans to MSMEs and ESEIs which include loans against property as collateral such as small ticket LAP, medium ticket LAP and housing loans and unsecured business loans. They operate a "small business lending model" with gold loans as an important element of this model to provide them a countercyclical hedge for disruptions in the Indian economy and the retail loans industry. The credit demand from the ESEI and the MSME segment drives the business growth when there is an upturn in the economy. On the other hand, the demand for gold loans drives their business growth when there is a downturn in the economy. Their gold loan portfolio acts as an active hedge against the cyclicality in the Indian retail lending industry that may arise due to economic or other factors. Over the years, gold prices have shown a consistent increase, and have, in most part, increased at a pace higher than the annual rate of inflation.

Y-o-Y growth trend of gold loans NBFCs vs diversified NBFCs



Gold Loans

The company target individual customers for their gold loan products, which start from ₹ 3,000 with an average ticket size of ₹ 0.10 million. They believe their key proposition to such customers includes their quick processing times and accessibility during the pledge and release, transparency and friendliness, trust and security, privacy, and confidentiality, as well as a respect for their hard-earned or sentimental asset. The company's gold loan offerings come with tailor made schemes with flexibility of tenor, interest payment choices and digital and branch-based repayment options. As of June 30, 2023, they had approximately 0.32 million gold loan accounts, representing an AUM of ₹ 31,241.72 million, accounting for 33.12% of their total Loan Assets, while as of June 30, 2022, they had approximately 0.25 million gold loan accounts, representing an AUM of ₹ 24,247.85 million, accounting for 36.38% of their total Loan Assets. As of March 31, 2023, they had approximately 0.32 million gold loan accounts, representing an AUM of ₹ 29,860.34 million, accounting for 32.92% of their total Loan Assets. As of March 31, 2022, the company had approximately 0.23 million gold loan accounts, representing an AUM of ₹ 22,475.30 million, accounting for 36.33% of the total Loan Assets. As of March 31, 2021, their gold loans AUM stood at ₹ 19,177.87 million, accounting for 39.44% of their total Loan Assets.

The company offers doorstep gold loans, whereby their employees carry out the appraisal and instant disbursal at the customers' premises, before transferring the pledged gold to a nearby branch with in-transit security which includes an electronic safe with GPS for tracking. They introduced a maker-checker model, end-to-end monitoring device 'Prototype Sec Box' in Fiscal 2023, which has a digital locking system, which is automated and can only be operated by the company's central team. It has multiple features such as audio video recorder, heat sensor and vibration sensor.

Mortgage Loans

The company's mortgage loans target the emerging MSME sector. Each product has multiple programs, and they can provide customized credit solutions to the target segment depending on the customer's needs and available documentation. Mortgage loans are sanctioned based on cash flows assessed using multiple income evaluation methods. The company typically provides mortgage loans for working capital purposes. As of June 30, 2023, 98.30% of their mortgage loans qualify for priority sector lending.

The company typically provide small ticket LAPs for business expansion or for the acquisition of a new property. They fulfil loan requirements for various business needs, and loans typically range from ₹ 1.00 million to ₹ 2.00 million. They typically provide housing loans for construction or acquisition of a new property. They fulfil loan requirements for housing needs, and the loans typically range from ₹1.00 million to ₹2.00 million.

As of June 30, 2023, their medium ticket LAPs were secured with an average LTV ratio of approximately 51.16%. Loans were provided on a fixed and floating interest rate basis and typically range from ₹ 2.50 million to ₹ 10.00 million. As of June 30, 2023, their medium ticket LAPs have an ATS of ₹ 4.79 million and an average disbursement yield of 12.51%. The company provides multiple income evaluation methods to arrive at income eligibility, carry out in-depth personal discussions to understand the business and cash flows of the customer, and leverage technology to achieve faster end-to-end turnaround times.

- **Industry Snapshot:**

NBFC OVERVIEW

Constituents of NBFC industry in India

The Indian financial system includes banks and NBFCs. Though the banking system dominates financial services, NBFCs have grown in importance by carving a niche for themselves by catering to customers in underbanked regions or those who would not be catered to by traditional financial institutions, due to absence of credit history or lack of proper collateral records.

Classification of NBFCs

NBFCs are classified on the basis of liabilities into two broad categories – deposit-taking and non-deposit-taking. Deposit-taking NBFCs ("NBFC-D") are subject to requirements of capital adequacy, liquid assets maintenance, exposure norms, etc. In addition, in 2015, non-deposit-taking NBFCs with an asset size of ₹ 500 crore and above were labelled as "systemically important non-deposit taking NBFCs" ("NBFC–ND–SI") and separate prudential regulations were made applicable to them.

Scale based approach proposed for NBFCs

RBI in January 2021 had proposed a tighter regulatory framework for NBFCs by creating a four-tier structure with a progressive increase in intensity of regulation in a discussion paper titled "Revised Regulatory Framework for NBFCs – A Scale-based Approach". Based on the inputs received, in October 2021, RBI put in place a revised regulatory framework for NBFCs which is slated to be effective from October 2022. In Framework for Scale Based Regulation for NBFCs, RBI has said the regulatory and supervisory framework of NBFCs should be based on a four-layered structure based on their size, activity, and perceived riskiness: Base Layer, Middle Layer, Upper Layer and Top Layer. NBFCs in lower layer are expected to be known as NBFC-Base Layer ("NBFC-BL"). NBFCs in middle layer are expected to be known as NBFC-Middle Layer ("NBFC-ML"). An NBFC in the Upper Layer is expected to be known as NBFC-Upper Layer ("NBFC-UL") and is expected to invite a new regulatory superstructure. There is also a Top Layer, ideally supposed to be empty.

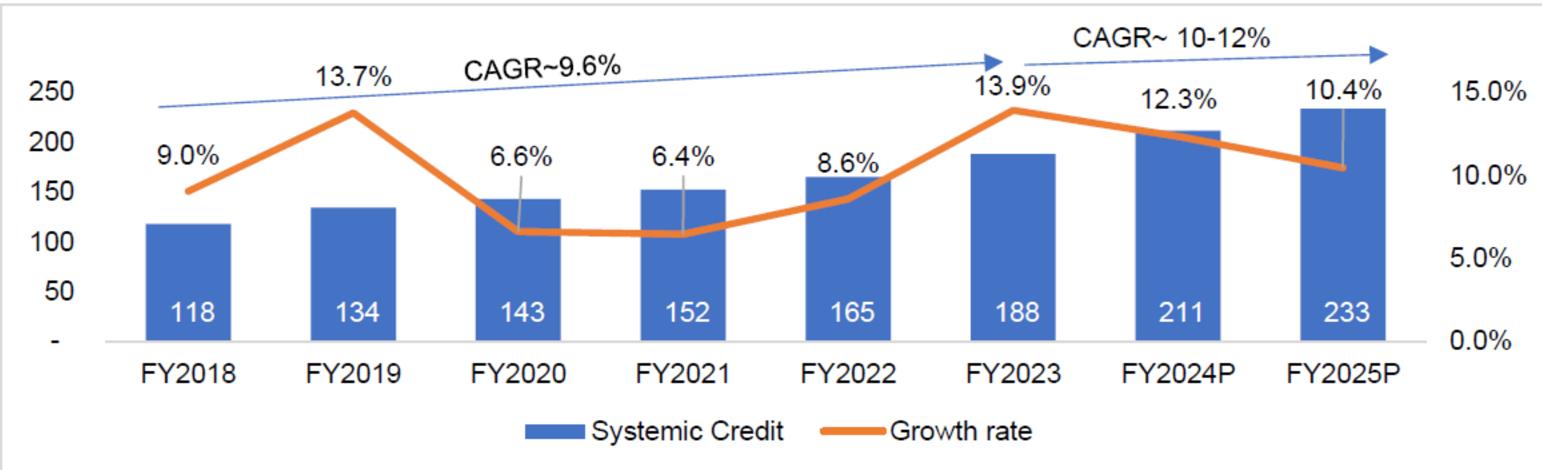
RBI has taken a balanced view, and instead of going for a one size fits all, it has opted for differential regulation based on size and the systemic importance of an NBFC. In addition, the importance of NBFCs in providing credit to underserved customers has been recognised. RBI has not proposed imposition of CRR and SLR on NBFCs, which would come as a relief to NBFCs.

Systemic credit to grow at 10-12% CAGR between fiscal 2023-2025

Overall systemic credit growth took a hit in the first half of fiscal 2021 on account of a significant slowdown in retail credit and intensifying COVID-19 pandemic which triggered a national lockdown. The COVID-19 pandemic came as a jolt for an already slowing economy with a decadal low growth in GDP, low private consumption, cautious lending by financial institutions, poor capex, and in turn, weakening credit growth. However, with a slew of the Government of India and regulatory measures announced, Indian economy started to revive in the second half of the fiscal. In Fiscal 2021, credit grew by approximately 6.4% supported by disbursements to MSMEs under the ECLGS and an uptick in economic activity post the COVID-19 lockdown. In Fiscal 2022, the systemic credit growth picked up steam despite the second wave of COVID-19 hurting economic growth in the first quarter of the fiscal. The systemic credit grew at 8.6% from the previous year to reach approximately ₹ 165 trillion. The growth was mainly driven by the budgetary push towards investments, pick-up in private investment, and business activity also slowly humming back to pre-COVID levels. In Fiscal 2023, Systemic credit showed strong growth on back of pent-up retail demand from sectors like housing and auto. Credit demand also grew due to strong credit demand from NBFCs and trade segment. CRISIL MI&A projects systemic credit to grow at 10-12% CAGR between Fiscals 2023 and 2025.

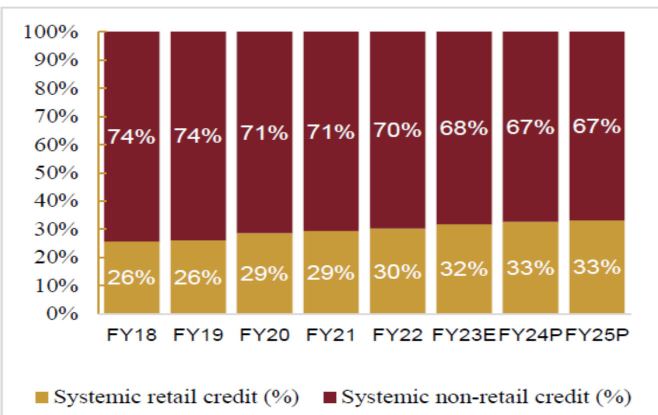
<u>Installed Capacity Trend</u>

Systemic growth to grow by 10-12% over Fiscals 2023-2025

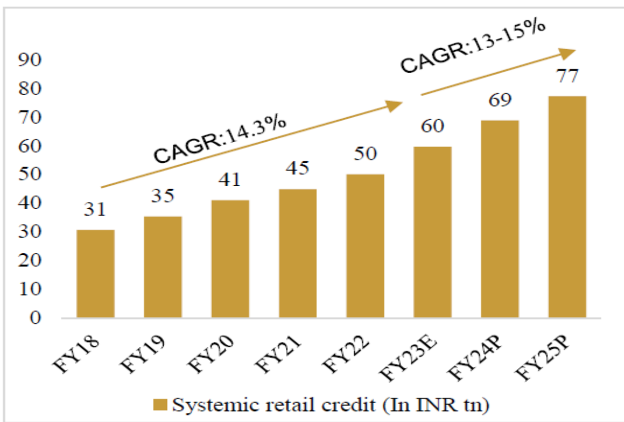


While systemic credit in India grew at a tepid rate of 9.6% CAGR annually between Fiscal 2018 and Fiscal 2023, systemic retail credit grew at a much faster rate of 14.3% CAGR during the same period. Retail credit growth in Fiscal 2020 was around approximately 16.3% which came down to approximately 9.5% in Fiscal 2021. However, post- COVID-19 pandemic, retail credit growth revived back to reach approximately 11.3% in Fiscal 2022. CRISIL MI&A estimates retail credit to have grown at approximately 19-20% year on year in Fiscal 2023. CRISIL MI&A thus expects retail credit growth to continue in the long term with banks and NBFCs' continued focus on the segment.

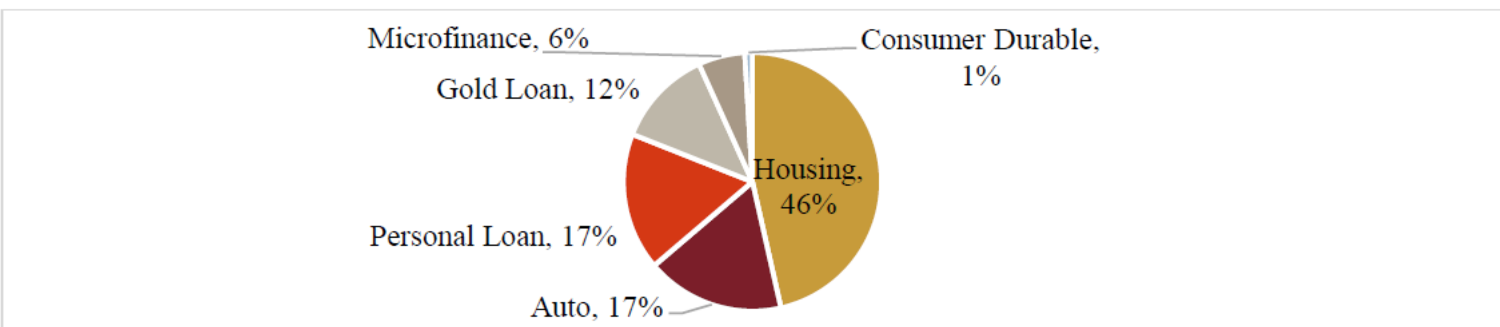
Retail segment accounts for 32% of overall systemic credit as of Fiscal 2023



Retail credit growth to continue on a strong footing in Fiscal 2024



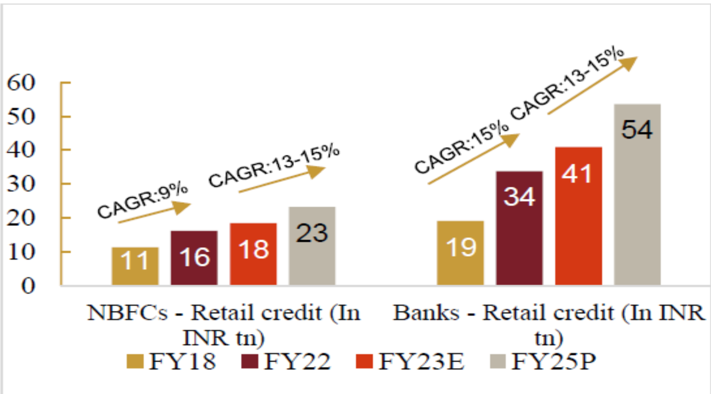
<u>Retail credit mix as of Fiscal 2023</u>



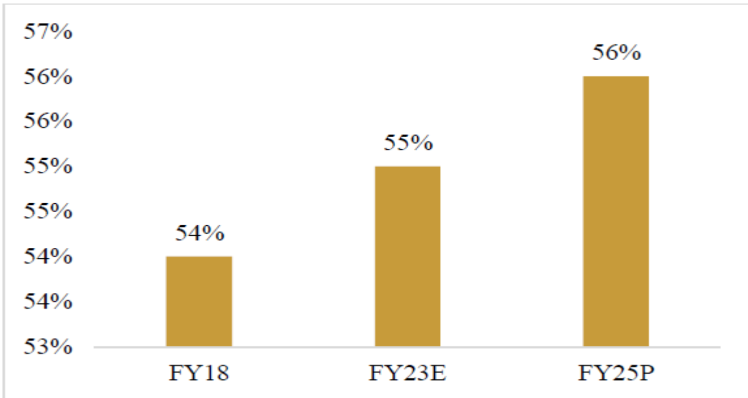
Retail segment to support NBFCs overall credit growth.

The NBFC sector has, over the years, evolved considerably in terms of size, operations, technological sophistication and entry into newer areas of financial services and products. The number of NBFCs as well as the size of the sector have grown significantly, with a number of players with heterogeneous business models starting operations. Over the last few years, CRISIL MI&A has seen a transformation in the Indian financial services landscape. The increasing penetration of neo-banking, digital authentication, and mobile phone usage as well as mobile internet has resulted in the modularization of financial services, particularly credit. The sector has also seen the emergence of a number of finTechs that leverage technology, data, and business insights to provide various financial products and services to identified customer segments. FinTech players in India started lending in Fiscal 2015 but they started gaining traction from Fiscal 2017 onwards. The business model of finTech firms differ widely but in almost all cases they use technology to change or support existing way of doing business, and hold the promise of enhancing customer convenience, facilitating access to credit for unserved or underserved customer segments and/or improving operating efficiency. Many times, fintech's enter tie-ups with financing partners (banks and NBFCs) to take the loans originated by them on the balance sheet of the partner.

NBFCs retail credit is expected to grow at 13-15% CAGR in next 3 years



Share of retail credit in total NBFC credit to continue to grow

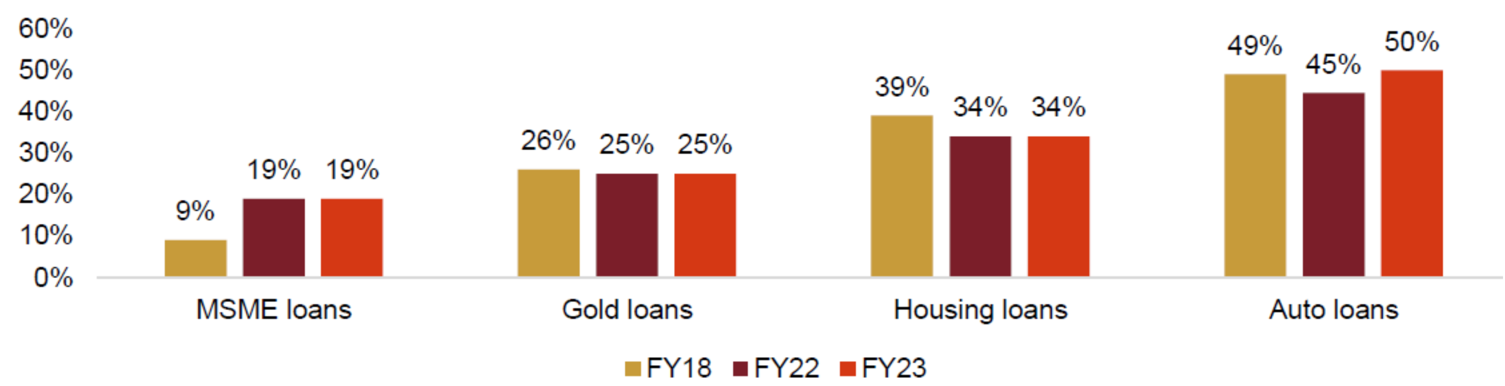


NBFCs have a reasonable market share across segments.

NBFCs have consistently gained or maintained market share across most asset classes over the last few years. Though, in certain segments such as housing finance to prime customers, they have lost market share to banks due to the decline in market interest rates. In the gold loans market, NBFCs slightly lost market share in Fiscal 2022 due to increasing focus of banks (both public and private) towards gold loans as well as RBI permitting banks to offer gold loans at a higher loan-to-value amidst the COVID-19 pandemic. However, in Fiscal 2023 and first quarter of Fiscal 2024, LTV in gold loans have shrunk owing to rise in prices of gold and a conservative approach taken by banks. Nevertheless, NBFCs continue to have a healthy market share across other segments.

NBFCs have been able to compete with banks mainly on account of their strong origination skills, extensive reach, better customer service, faster processing, fewer documentation requirements, digitalization of customer on-boarding process, customized product offerings, local knowledge, and differentiated credit appraisal methodology.

Market share of NBFCs in overall credit across select asset classes



In Fiscal 2023, NBFCs' borrowings from banks witnessed high growth resulting in an increase in share to 36% of total funding up from 29% at the end of Fiscal 2022. The share of bank's lending to NBFCs have almost doubled during last 10 years. During Fiscal 2023, with interest rate tightening and repo increasing by 250 bps to 6.50%, the cost of debt market borrowing increased leading to high-risk premium for lower rates NBFCs, leading to banks term loans becoming the preferred source of borrowing. - 15.8% 9.9% 6.4% 11.5% 5.5% 14.4% 24.1% 20.5% 23.8% 12.7% 30.6% 29.1% 29.6% 22.3% 29.2% 24.4% 7.1% 3.0% 10.8% 20.9% -20.0% 0.0% 20.0% 40.0% FY14 FY15 FY16 FY17 FY18 FY19 FY20 FY21 FY22 FY23 Gold loan NBFCs Diversified NBFCs 9% 26% 39% 49% 19% 25% 34% 45% 19% 25% 34% 50% 0% 10% 20% 30% 40% 50% 60% MSME loans Gold loans Housing loans Auto loans FY18 FY22 FY23 155 This was also supported by improved credit growth during Fiscal 2023 across all segments leading to higher demand of bank credit from NBFC. Going forward, CRISIL MI&A believes that funding access would gradually improve for NBFCs who are able to demonstrate strong performance and strong parentage. However, reliance on bank funding and funding from other NBFCs and small finance banks is expected to remain high in Fiscal 2024.

Key Risk:

- The company may face asset-liability mismatches, which could affect their liquidity and consequently may adversely affect their operations and profitability.
- The company have had negative cash flows in the past and may continue to have negative cash flows in the future.
- As on June 30, 2023, 93.65% of their gross AUM was in Gujarat, Maharashtra, Telangana, Andhra Pradesh, Tamil Nadu, Karnataka, Puducherry and Delhi. Accordingly, the company's operations are concentrated in six states and two union territories and any adverse developments in these regions could have an adverse effect on their business and results of operations.
- As the company handles high volumes of cash and gold jewellery in a dispersed network of branches, they are exposed to operational risks, including employee negligence, fraud, petty theft, burglary, and embezzlement, which could harm their results of operations and financial position.
- The company's inability to maintain their capital adequacy ratio could adversely affect their business, results of operations and financial performance.
- The company's inability to meet their obligations, including financial and other covenants under their debt financing arrangements could adversely affect their business, results of operations and financial condition.
- The company's business depends on a well-regarded and widely known brand, as well as the brand and reputation of their Promoter, Federal Bank, and the Federal Bank group entities, and any failure to maintain, protect and enhance their brand would harm the company's business.
- Any deterioration in the performance of any pool of receivables securitized and assigned to banks and other institutions may adversely impact their financial performance.
- There are pending litigations against the Company and their Promoter. Any adverse decision in such proceedings may render them liable to liabilities/penalties and may adversely affect their business, cash flows and reputation.

Comparison with Listed Peers:

Name of the Company	Total Revenue (₹ in million)	Face Value (₹)	P/E	P/B	EPS (Basic) (₹)	Return on Net Worth (%)	NAV per share (₹)
Fedbank Financial Services Limited	12146.8	10	28.68	2.5	4.9	13.3%	42.11
Aptus Value Housing (Consolidated)	11289.99	2	28.58	4.0	10.1	15.1%	67.05
IIFL Finance (Consolidated)	84471.1	2	15.53	2.2	39.5	17.9%	236.37
Five Star Business Finance (Consolidated)	15289.28	1	37.54	4.9	20.7	13.9%	148.94
Manappuram Finance Limited (Consolidated)	67499.47	2	8.06	1.2	17.07	15.6%	113.95
Muthoot Finance Limited (Consolidated)	119750.05	10	15.39	2.4	86.5	16.9%	539.69
SBFC Finance Limited	7403.61	10	48.33	3.7	1.7	8.7%	19.42

Valuation:

At the upper price band company is valued at P/BV of 2.5X with a market cap of ₹ 51,651 million post issue of equity shares.

We believe that issue is fairly priced and recommend "**Subscribe – Long Term**" rating to the IPO.

DISCLAIMER:

Analyst Certification

- The views expressed in this Research Report accurately reflect the personal views of the analyst(s) about the subject securities or issuers and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report. The research analysts are bound by stringent internal regulations and also legal and statutory requirements of the Securities and Exchange Board of India (hereinafter "SEBI") and the analysts' compensation are completely delinked from all the other companies and/or entities of Anand Rathi, and have no bearing whatsoever on any recommendation that they have given in the Research Report

Anand Rathi Ratings Definitions

- Analysts' ratings and the corresponding expected returns take into account our definitions of Large Caps, Mid-Caps & Small Caps as described in the Ratings Table below:

	Buy	Hold	Sell
Large Caps (Top 100 companies)	**>15%**	**0%-15%**	**Below 0%**
Mid-Caps (101st-250th company)	>20%	0%-20%	Below 0%
Small Caps (251st company onwards)	>25%	0%-25%	Below 0%

Research Disclaimer and Disclosure inter-alia as required under Securities and Exchange Board of India (Research Analysts) Regulations, 2014

Anand Rathi Share and Stockbrokers Ltd. (hereinafter refer as ARSSBL) (Research Entity, SEBI Regn No. INH000000834, Date of Regn. 29/06/2015) is a subsidiary of the Anand Rathi Financial Services Ltd. ARSSBL is a corporate trading and clearing member of Bombay Stock Exchange Ltd (BSE), National Stock Exchange of India Ltd. (NSEIL), Metropolitan Stock Exchange of India Ltd. (MSE), and depository participant with National Securities Depository Ltd (NSDL) and Central Depository Services Ltd. (CDSL), ARSSBL is engaged into the business of Stock Broking, Depository Participant, Mutual Fund distributor.

The research analysts, strategists, or research associates principally responsible for the preparation of Anand Rathi research have received compensation based upon various factors, including quality of research, investor client feedback, stock picking, competitive factors, and firm revenues.

General Disclaimer: - This Research Report (hereinafter called "Report") is meant solely for use by the recipient and is not for circulation. This Report does not constitute a personal recommendation or consider the particular investment objectives, financial situations, or needs of individual clients. The recommendations, if any, made herein are expression of views and/or opinions and should not be deemed or construed to be neither advice for the purpose of purchase or sale of any security, derivatives, or any other security through ARSSBL nor any solicitation or offering of any investment /trading opportunity on behalf of the issuer(s) of the respective security (ies) referred to herein. These information / opinions / views are not meant to serve as a professional investment guide for the readers. No action is solicited based upon the information provided herein. Recipients of this Report should rely on information/data arising out of their own investigations. Readers are advised to seek independent professional advice and arrive at an informed trading/investment decision before executing any trades or making any investments. This Report has been prepared on the basis of publicly available information, internally developed data and other sources believed by ARSSBL to be reliable.

ARSSBL or its directors, employees, affiliates, or representatives do not assume any responsibility for, or warrant the accuracy, completeness, adequacy and reliability of such information / opinions / views. While due care has been taken to ensure that the disclosures and opinions given are fair and reasonable, none of the directors, employees, affiliates, or representatives of ARSSBL shall be liable for any direct, indirect, special, incidental, consequential, punitive or exemplary damages, including lost profits arising in any way whatsoever from the information / opinions / views contained in this Report. The price and value of the investments referred to in this Report and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance. ARSSBL does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding taxation aspects of any potential investment.

Opinions expressed are our current opinions as of the date appearing on this Research only. We do not undertake to advise you as to any change of our views expressed in this Report. Research Report may differ between ARSSBL's RAs and/ or ARSSBL's associate companies on account of differences in research methodology, personal judgment and difference in time horizons for which recommendations are made. User should keep this risk in mind and not hold ARSSBL, its employees and associates responsible for any losses, damages of any type whatsoever.

ARSSBL and its associates or employees may; (a) from time to time, have long or short positions in, and buy or sell the investments in/ security of company (ies) mentioned herein or (b) be engaged in any other transaction involving such investments/ securities of company (ies) discussed herein or act as advisor or lender / borrower to such company (ies) these and other activities of ARSSBL and its associates or employees may not be construed as potential conflict of interest with respect to any recommendation and related information and opinions. Without limiting any of the foregoing, in no event shall ARSSBL and its associates or employees or any third party involved in or related to computing or compiling the information have any liability for any damages of any kind.

Details of Associates of ARSSBL and Brief History of Disciplinary action by regulatory authorities & its associates are available on our website i.e. www.rathionline.com

Disclaimers in respect of jurisdiction: This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would subject ARSSBL to any registration or licensing requirement within such jurisdiction(s). No action has been or will be taken by ARSSBL in any jurisdiction (other than India), where any action for such purpose(s) is required. Accordingly, this Report shall not be possessed, circulated and/or distributed in any such country or jurisdiction unless such action follows all applicable laws and regulations of such country or jurisdiction. ARSSBL requires such recipient to inform himself about and to observe any restrictions at his own expense, without any liability to ARSSBL. Any dispute arising out of this Report shall be subject to the exclusive jurisdiction of the Courts in India.

logos used in this report are trademarks or service marks or registered trademarks or service marks of ARSSBL or its affiliates, unless specifically mentioned otherwise.

- **Statements on ownership and material conflicts of interest, compensation - ARSSBL and Associates**
- **Answers to the Best of the knowledge and belief of ARSSBL/ its Associates/ Research Analyst who is preparing this report.**

Sr. No.	Statement	Answers to the Best of the knowledge and belief of the ARSSBL/ its Associates/ Research Analyst who is preparing this report
1	ARSSBL/its Associates/ Research Analyst/ his Relative have any financial interest in the subject company? Nature of Interest (if applicable), is given against the company's name?.	NO
2	ARSSBL/its Associates/ Research Analyst/ his Relative have actual/beneficial ownership of one per cent or more securities of the subject company, at the end of the month immediately preceding the date of publication of the research report or date of the public appearance?.	NO
3	ARSSBL/its Associates/ Research Analyst/ his Relative have any other material conflict of interest at the time of publication of the research report or at the time of public appearance?.	NO
4	ARSSBL/its Associates/ Research Analyst/ his Relative have received any compensation from the subject company in the past twelve months.	NO
5	ARSSBL/its Associates/ Research Analyst/ his Relative have managed or co-managed public offering of securities for the subject company in the past twelve months.	NO
6	ARSSBL/its Associates/ Research Analyst/ his Relative have received any compensation for investment banking or merchant banking or brokerage services from the subject company in the past twelve months.	NO
7	ARSSBL/its Associates/ Research Analyst/ his Relative have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past twelve months.	NO
8	ARSSBL/its Associates/ Research Analyst/ his Relative have received any compensation or other benefits from the subject company or third party in connection with the research report.	NO
9	ARSSBL/its Associates/ Research Analyst/ his Relative have served as an officer, director or employee of the subject company.	NO
10	ARSSBL/its Associates/ Research Analyst/ his Relative has been engaged in market making activity for the subject company.	NO

Other Disclosures pertaining to distribution of research in the United States of America

The research report is a product of Anand Rathi Share and Stock Brokers Ltd. (hereinafter refer as ARSSBL) under Marco Polo Securities 15a6 chaperone service which is the employer of the research analyst(s) who has prepared the research report. The research analyst(s) preparing the research report is/are resident outside the United States (U.S.) and are not associated persons of any U.S. regulated broker-dealer and therefore the analyst(s) is/are not subject to supervision by a U.S. broker-dealer, and is/are not required to satisfy the regulatory licensing requirements of FINRA or required to otherwise comply with U.S. rules or regulations regarding, among other things, communications with a subject company, public appearances and trading securities held by a research analyst account.

Research reports are intended for distribution by only to "Major Institutional Investors" as defined by Rule 15a-6(b)(4) of the U.S. Securities and Exchange Act, 1934 (the Exchange Act) and interpretations thereof by U.S. Securities and Exchange Commission (SEC) in reliance on Rule 15a 6(a)(2). If the recipient of this report is not a Major Institutional Investor as specified above, then it should not act upon this report and return the same to the sender. Further, this report may not be copied, duplicated and/or transmitted onward to any U.S. person, which is not the Major Institutional Investor. In reliance on the exemption from registration provided by Rule 15a-6 of the Exchange Act and interpretations thereof by the SEC in order to conduct certain business with Major Institutional Investors, ARSSBL has entered into a chaperoning agreement with a U.S. registered broker dealer, Marco Polo Securities Inc. ("Marco Polo").

1. ARSSBL or its Affiliates may or may not have been beneficial owners of the securities mentioned in this report.
2. ARSSBL or its affiliates may have or not managed or co-managed a public offering of the securities mentioned in the report in the past 12 months.
3. ARSSBL or its affiliates may have or not received compensation for investment banking services from the issuer of these securities in the past 12 months and do not expect to receive compensation for investment banking services from the issuer of these securities within the next three months.
4. However, one or more of ARSSBL or its Affiliates may, from time to time, have a long or short position in any of the securities mentioned herein and may buy or sell those securities or options thereon, either on their own account or on behalf of their clients.
5. As of the publication of this report, ARSSBL does not make a market in the subject securities.
6. ARSSBL or its Affiliates may or may not, to the extent permitted by law, act upon or use the above material or the conclusions stated above, or the research or analysis on which they are based before the material is published to recipients and from time to time, provide investment banking, investment management or other services for or solicit to seek to obtain investment banking, or other securities business from, any entity referred to in this report.

- As of the publication of this report, ARSSBL does not make a market in the subject securities.
- Additional information on recommended securities/instruments is available on request.
- Compliance officer-Deepak Kedia, email id - deepakkedia@rathi.com, Contact no. +91 22 6281 7000.
- Grievance officer-Madhu Jain-email id- grievance@rathi.com, Contact no. +91 22 6281 7191
- ARSSBL registered address: Express Zone, A Wing, 9th Floor, Western Express Highway, Diagonally Opposite Oberoi Mall, Malad (E), Mumbai – 400097. Tel No: +91 22 6281 7000 | Fax No: +91 22 4001 3770 | CIN: U67120MH1991PLC064106.