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Initiating Coverage

AAVAS Financiers Ltd.

03-May-2021

RETAIL RESEARCH

AAVAS Financiers Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
HFC	Rs.2280	Buy on dips at Rs.2163 and add more at Rs.1965	Rs.2361	Rs.2555	2 quarters

HDFC Scrip Code	AAVFINEQNR
BSE Code	541988
NSE Code	AAVAS
Bloomberg	AAVAS IN
CMP May 03, 2021	2280
Equity Capital (RsCr)	78.3
Face Value (Rs)	10
Equity Share O/S (Cr)	7.83
Market Cap (Rs Cr)	17,983
Adj. Book Value (Rs)	291
Avg. 52 Wk Volumes	5953718
52 Week High	2,672.05
52 Week Low	936.10

Share holding Pattern % (Mar, 2021)	
Promoters	50.08
Institutions	40.35
Non Institutions	9.57
Total	100.0

Fundamental Research Analyst
Nisha Sankhala
Nishaben.shankhala@hdfcsec.com

Our take

Aavas Financiers Ltd (formerly known as Au Housing Finance Ltd) is a retail, affordable housing finance company. It primarily serves the highly underpenetrated and niche segments of low- and middle-income self-employed customers (65% of the book) in semi-urban and rural areas in India where there is a big vacuum of any large HFCs or banks. It has total AUM of Rs 9,454cr as on March 31, 2021 and 280 branches (of which 95 are in Rajasthan). We believe that India's low-cost housing segment provides a huge opportunity and it is at a decadal structural upswing. It has a strong first-mover advantage and is in a good place for delivering future growth. Aavas' robust risk management framework, focus on creating superior technology, and hiring philosophy represent a strong DNA. The management team is led by qualified and experienced professionals, with support from a capable and motivated pool of managers and employees. Aavas is one of the fastest growing HFCs; it has maintained a strong track record of financial performance and operating efficiency over the years. Over FY14-20, it delivered a robust AUM CAGR of 64%. Disbursements during the same period grew by 48% with loan accounts growing 57%. The HFC has best-in-class capital adequacy to fund future growth. Its ability to manage credit quality across business cycles is one of the key differentiators vis-à-vis peers.

Valuation and recommendation:

We have envisaged 23% CAGR for Consolidated Net Interest Income and 19% CAGR for net profit over FY20-FY23E. Further, we have estimated that the loan book would grow at 20% CAGR (home loans at 20% and mortgage loans at 21% CAGR). The initial asset quality picture, post moratorium, looks positive and collection efficiencies have also reached the pre-COVID level. We believe that the NPAs will start to reduce from FY22. We expect Net Interest Margin to remain stable around 8% while RoAA is expected to reach 3.6% in FY23 vs 3.5% in FY21E. The stock is currently trading at a premium valuation, which is mainly driven by granular retail book, industry leading growth, best in-class asset quality, and superior return ratios. We believe that investors can buy Aavas Financiers Ltd on dips at Rs.2163 (5.5xFY23E ABV) and add more at Rs.1965 (5xFY23E ABV) for the base case fair value of Rs.2361 (6xFY23E ABV) and for the bull case fair value of Rs.2555 (6.5xFY23E ABV) over the next two quarters.

Financial Summary

Particulars (RsCr)	Q4FY21	Q4FY20	YoY-%	Q3FY21	QoQ-%	FY19	FY20	FY21E	FY22E	FY23E
NII	132	117	*12*	141	*-6*	338	431	518	677	802
PPOP	102	72	*41*	126	*-19*	267	317	390	538	649
PAT	88	60	*47*	85	*3*	176	249	289	356	423
EPS (Rs)						22.6	31.8	36.8	45.4	53.9
ABV (Rs)						233.8	265.7	299.0	341.3	392.9
P/E (x)						101.2	71.7	62.0	50.2	42.3
P/ABV (x)						9.8	8.6	7.6	6.7	5.8
RoAA (%)						3.6	3.8	3.5	3.6	3.6

(Source: Company, HDFC sec)

Q4FY21 Result Update

In Q4FY21, Aavas reported strong earnings with PAT growing 47%/ 2.7% YoY/QoQ to Rs 87.6 cr on the back of strong AUM growth and margin improvement. The company disbursed Rs 1,012.7cr during the quarter, registering 17% YoY growth and 32% QoQ growth. AUM growth was robust at 21% YoY to Rs. 9,454cr.

As on 31 March 2021, the total number of live accounts stood at 125,591, i.e. 20% YoY growth. The total number of branches stood at 280. The company opened up 17 branches in the quarter, seven of which are in Rajasthan.

The collection efficiency during the quarter was more than 100%. On the asset quality front, 1+ DPD and Gross Stage 3 is around 6.4% and 1% respectively as of Mar-21. Segment wise GNPA ratios stood at 1% for Home Loans, 0.9% for LAP, 0.44% in salaried category, and 1.3% in Self-Employed category. The company took no write-offs in the quarter.

Management has guided that the company plans to enter 3-4 new states every five years and 20-25% AUM growth is expected over the next five years.

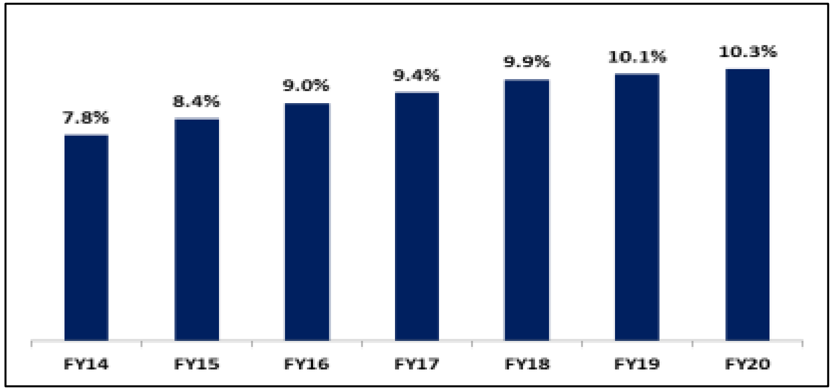
Long-term triggers

Vast opportunity in India's low-cost housing segment

The Indian Housing Finance market size is Rs.21.2 Lakh cr., Mortgage penetration in India is just 10.3% (as of Mar-20), which is substantially lower than developed and other developing nations, leaving huge scope for growth in demand for housing loans. Aavas' overall market share in housing loans in FY20 stood at 0.5% while, in the affordable housing segment, its market share for the same period stood at ~2%. We believe that the Affordable segment could grow at a faster pace than overall industry due to: (a) interest subsidy by Government for affordable housing; (b) favorable demographics; (c) increasing affordability; (d) rapid urbanisation. Moreover, the current urban housing shortage is estimated at 10 mn houses, which is slated to rise in future. As per a CRISIL study, the combined housing finance demand for 2022 stands at Rs.5 trillion for the economically weaker sections (EWS) category and Rs. 30 trillion for the low-income group (LIG) category, both of which are the key target markets for players like Aavas. All these factors show that the housing industry is in a decadal structural upswing and in a good place for delivering future growth.

Since the past five years, the residential real estate sales have been almost stagnant. COVID-19 pandemic has further created a sharp price cut. Early economic indicators are encouraging. The government's constant aids to the sector along with lowest interest rates are key triggers for us to believe that the real estate and housing finance sectors have bottomed out.

Mortgage Penetration (%)



(Source: Company, HDFC sec)

Niche business model

In the mortgage lending business, Aavas has created a niche business model to serve the underpenetrated and under-served segments. Aavas focuses on customers who are from low and middle income groups, self-employed and living in rural or semi-urban areas. Overall, 60.4% of the company's borrowers are self-employed and the remaining 39.6% are salaried borrowers with majority of them in tier 2 to tier 6 cities. Most of the company's offices are in Tier 2, 3 and 4 cities where residents are largely outside the ambit of the formal banking system. The banks and other HFCs have less presence in the segment, which is paving the easy way for the company as it has to face less competition. Its presence is spread across 10 states through 280 branches. Going forward, its future growth is likely to be driven by expansion of its successful credit delivery model into new markets and deeper penetration in the existing ones.

The company has almost zero exposure to developer's financing book (the highest category of risky asset), unlike most of the peers. This says a lot about the way in which the company wants to grow. It has never taken any short-cut routes to growth. It has stuck to its core philosophy.

Under the home loan category, the company provides loan for purchase of home, construction loan and repairs & renovation. The average ticket size is less than Rs.10 Lakh here and the average tenure of outstanding borrowing is less than 11 years. Around 73.5% of AUMs are from this category, while the other mortgage loans contribute the remaining 26.5% (as of March 2021). Other mortgage loans consist of LAPs and top-up loans, which have 200-300bps higher margins than simple home loans.

Strong DNA

The company has put in place strong pillars for growth. Its robust foundation represents the quality of DNA it possesses. In the long run, the company has focused on initiatives and planning through its robust risk management framework, creation of superior technology, and hiring philosophy.

Robust risk management framework

Aavas operates in a segment where majority of its customers are from the informal sector, who lack proper documentation about their sources of income. This makes it hard to determine their loan eligibility. The company, however, has created a robust underwriting team comprising credit managers and disbursement officers, who evaluate the customers' business and financing needs as well as their ability to repay. The company has also been constantly investing in data analystics for better market intelligence, which helps it track the clients credibility and worthiness.

The company has invested in a bounce prediction model, which provides data of cases that can potentially default in three months, resulting in pre-emptive action and decline in bounce incidence. The company created time and work efficiencies through the implementation of analytics, strengthening customer retention.

It successfully maintained its loan-to-value at 50%, which indicates that the prospective loan seeker generally matches the company's contribution, indicating his or her skin in the game and a vested interest in not doing anything that could result in asset repossession (resulting in a loss of savings aggregated over the years). The company has chosen to provide mortgage to individuals building their own homes, where an attractive proportion of the individual's funds has been already invested in the home and its financing is for a property under construction, which the individual would occupy in about a year. Additionally, it holds collateral to mitigate credit risk associated with financial assets.

Hiring philosophy

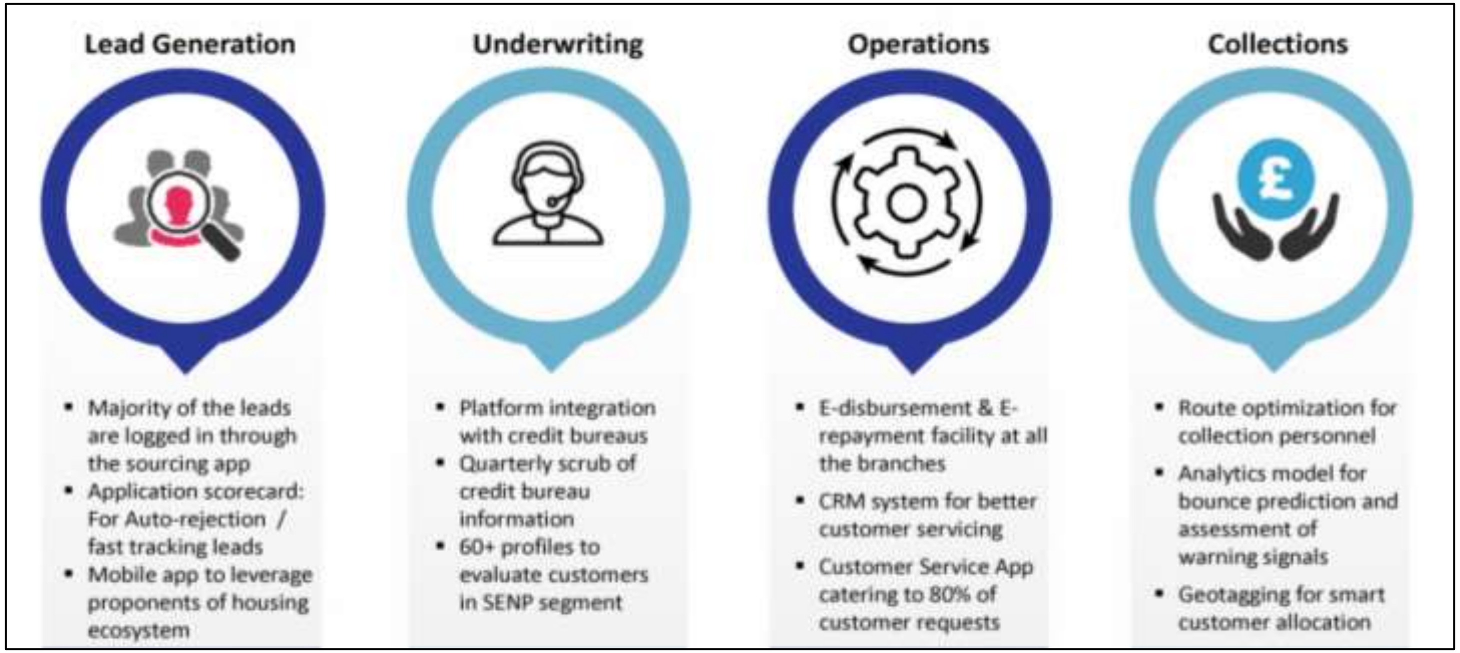
Aavas has created a hiring philosophy of 'hire young, hire fresh, hire local'. Recruitment from local areas helps in better understanding the customers in those regions. They are well-versed with ground realities including language and dialect, customs, social norms, etc. Young employees are lower costs to company and they can be trained and honed to suit the job requirements. They carry no biases from previous mortgage company experience.

Professional leadership

The management team is led by a qualified and experienced professionals, which is supported by a capable and motivated pool of managers and other employees. Aavas is chaired by Mr. Sandeep Tandon, Independent Director, an industry veteran with more than 20 years of experience in technology industry while Mr. Sushil Kumar Agarwal is the Managing Director and CEO possessing more than 19 years of versatile experience in the areas of retail finance, business development, financial management, administration and manpower management.

Superior technology

Aavas has increased focus on machine learning and automation. It has invested in latest technologies like robotics, developing chatbots to reduce manual intervention, and enhancing accurate service process workflow. Superior technology has improved the turnaround time, led to economies of scale, created a distinctive understanding of customer profile, enhanced underwriting skills and, ultimately, led to an improved bottomline.



Robust financials

Aavas has maintained a strong track record of financial performance and operating efficiency over the years. It is one of the fastest growing HFCs. Over FY14-20, it has delivered a robust AUM CAGR of 64%. Disbursement grew by 48% with loan accounts growing 57%.

Despite having a 100% in-house sourcing model, Aavas has moderate operating costs. The cost-to-income ratio declined from 57% in FY14 to 42% in FY21.

The company has been able to deliver superior return ratios. Its RoA stands at 3.5% and RoE stands at 12.91% as of FY21.

It has a well-diversified funding mix. As of March-21, term loans contribute 34.1%, assignment contributes 24.2%, NHB refinancing contributes 22.6%, and NCDs contribute 19%.

Its net interest margin is at 7.7% compared to the industry average of less than 5%.

Best-in-class capital adequacy to fund future growth: The company has never had to worry about liquidity. Even at the time of liquidity crisis, it had more than enough capital. Healthy internal accruals and regular equity infusions in the past have helped it manage surplus liquidity. The capital adequacy ratio remains strong with Tier 1 and overall CAR of 53.33% and 54.54% respectively (as of Q4FY21), which is well above the regulatory requirement at 10% and 13% respectively. This is the best in class and we believe that Aavas should be able to meet its growth target without any external capital infusion in the foreseeable future. Also, it gives the company a competitive advantage over peers as strong capital buffer could provide cushion for absorbing any asset-side shocks. Aavas has also always taken a conservative approach on ALM management and has a surplus across all its lending buckets. In Q4FY21, Rs. 3,361cr of surplus funds were available to the business.

Asset quality: The ability to manage credit quality across business cycles is a key differentiator from the peers. Given the comprehensive credit assessment model, deep understanding of clientele, and collection framework, Aavas is able to manage the best-in-class asset quality. In Q4FY21, its gross NPLs were at 1% of total loans and net NPLs at 0.7%.

Risks and concerns

Inherently risky business profile

Aavas focuses on providing retail home loans to lower income groups, mainly the self-employed groups in semi-urban and rural regions, which makes its business profile inherently risky. As of FY21, 60.4% of its total borrowers are self-employed and the remaining 39.6% are salaried, with majority of them residing in tier 2 to tier 6 cities. The company caters to economically vulnerable borrowers, who have low and undocumented incomes.

However, the company has created an effective risk management system with advance technology and analytics, which helps it, analyse borrower's profile and monitor collection trends, thereby allowing it to manage its asset quality well.

High geographical concentration

The branches are highly concentrated in top-4 states. Out of 280 branches, 95 are in Rajasthan, 44 in Maharashtra, 39 in Gujarat, and 40 in Madhya Pradesh. Any natural calamities, policy change or adverse conditions in these regions could affect the business significantly. To tackle this problem, management has started diversifying away from these four states; new branches are opening in other geographies. However, looking at Aavas's distribution strategy, we believe that diversification would be slow.

Competition

The housing finance industry is highly competitive. It has always faced competition from small finance banks, banks and other HFCs. Banks with wider branch and distribution network and cheaper cost of funds have greater competitive advantage. The stiff competition from banks may pose increasing challenges by way of lower-than-expected loan growth and lower NIM. Moreover, Aavas has signed non-compete agreements with AUSFB for its home loan business segment.

Also, any adverse change of norms for housing finance companies can impact the growth prospects, especially so since the change of the regulatory body from NHB to RBI, as mentioned in Budget FY20.

Macro situation

Over the past 2-3 years, inventory for the real estate sector has been piling up in India, while launch of new projects has come down in the past one and half year, as the COVID-induced economic slowdown has made matters worse.

Slower-than-expected pick-up in the economy could impact the growth of the company's Assets Under Management. The key risks to our thesis are lower-than-expected loan growth and more-than-expected asset quality deterioration.

Ownership Structure

The company is owned by private equity players. Therefore, it is exposed to the risk of change of ownership, which, if it happens, could change business functioning drastically while also impact its stock price significantly. Lack of long term strategic promoters is a weakness. Less than 10% of the equity is in the hands of shareholders other than promoters / institutions. Given the low float the valuations of the stock have been at high levels. Any sustained offloading by the institutions could result in higher float and derating of the stock.

Return ratio of Aavas may not rise majorly beyond 15-17% due to its overcapitalised structure.

Company background

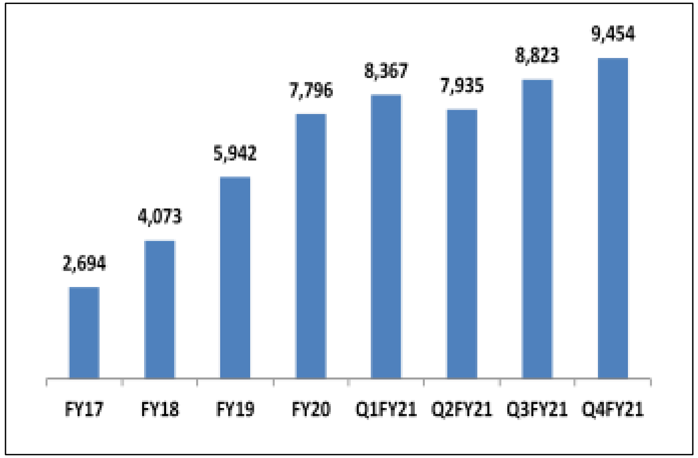
Aavas Financiers Ltd (formerly known as Au Housing Finance Ltd) was incorporated in February 2011 in Jaipur. It got the NHB License in August 2011 and commenced operations from March 2012. AU Small Finance Bank divested majority of its shareholding to two private equity investors – Kedaara Group and Partners Group in June 2016 to comply with the RBI guidelines (criteria for conversion to a small finance bank). Thereafter, Aavas came out with an initial public offering (IPO) in FY19. Currently, it is being managed by a professional management team and is backed by marquee private equity players. As of March 2021, the shareholding of the company includes: Kedaara Capital (29.5%) and Partners Group (20.6%) in the Promoter & Promoter Group category. 40.35% is held by Foreign Portfolio Investors and Domestic Portfolio Investors while rest is held by the public.

Aavas is retail, affordable housing finance company, primarily serving low- and middle-income self-employed customers in semi-urban and rural areas in India. Its product offerings include home loans for the purchase or construction of residential properties, and for the extension and repair of existing housing units. The company has an in-house execution model leading to superior business outcomes. It had total AUMs of Rs 9,454.3cr as on 31 March 2021 and 280 branches (of which 95 are in Rajasthan).

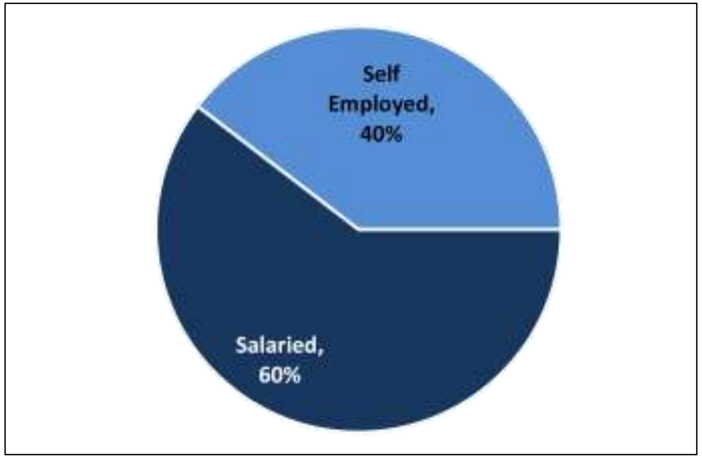
In the overall housing loans market, Aavas is an extremely small payer with only 0.4% share; even in the affordable space, it has a miniscule 2% market share.

AAVAS Financiers Ltd.

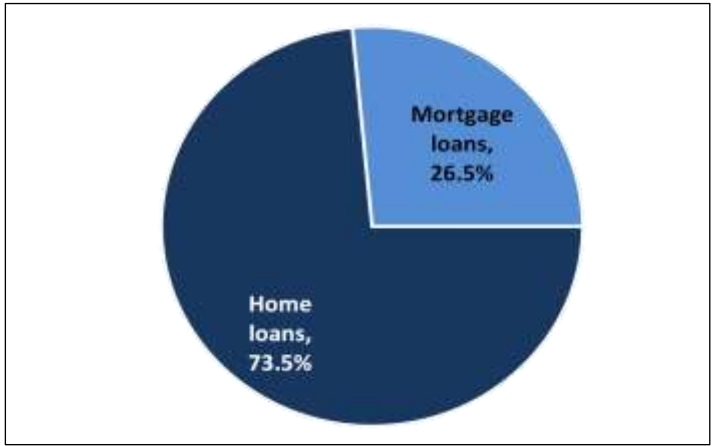
AUM (Rs Cr)



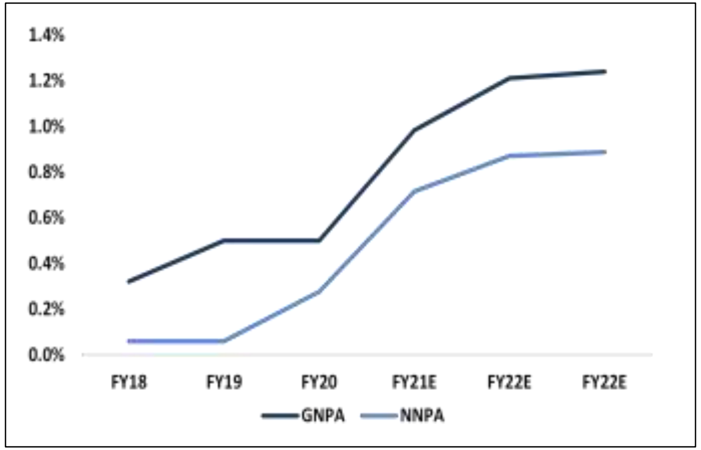
Salaried class dominates AUM



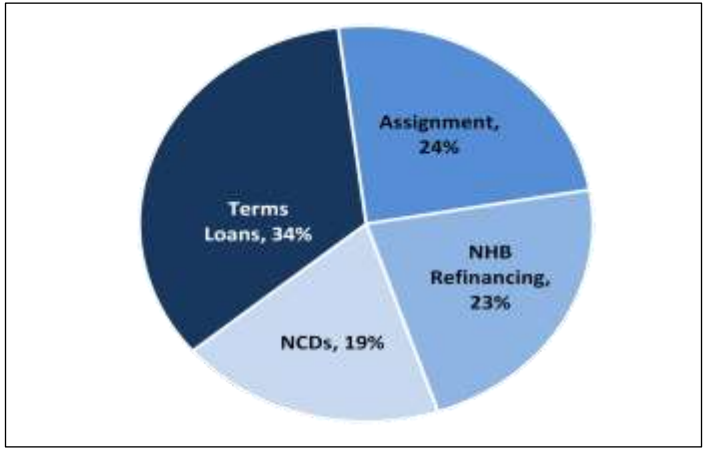
AUM Mix Product Category wise



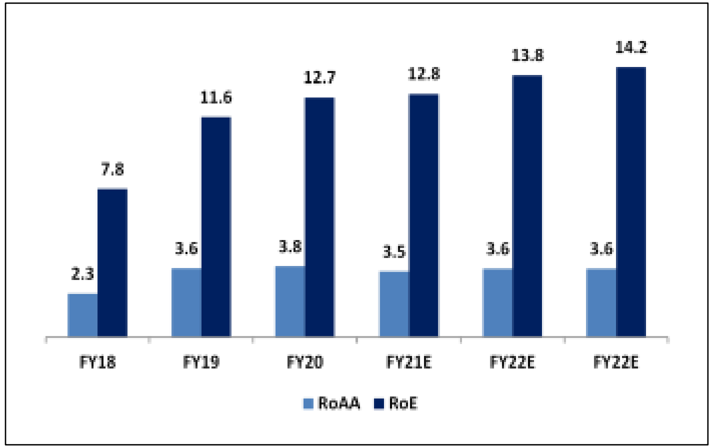
NPAs on the Rising Trend



Well diversified liability profile



Return Ratios



RETAIL RESEARCH

AAVAS Financiers Ltd.

Financials (Consolidated)

Income Statement

(Rs Cr)	FY19	FY20	FY21E	FY22E	FY23E
Interest Income	594	787	976	1198	1436
Interest Expenses	255	356	458	521	634
Net Interest Income	**338**	**431**	**518**	**677**	**802**
Non interest income	117	117	129	140	158
Operating Income	**456**	**547**	**647**	**817**	**960**
Operating Expenses	189	230	257	280	312
PPP	267	317	390	538	649
Prov & Cont	9	15	37	50	69
Profit Before Tax	258	302	353	488	579
Tax	82	53	64	132	156
PAT	**176**	**249**	**289**	**356**	**423**

Balance Sheet

(Rs Cr)	FY19	FY20	FY21E	FY22E	FY23E
Share Capital	78	78	79	79	79
Reserves & Surplus	1759	2020	2322	2679	3102
Shareholder funds	**1837**	**2098**	**2401**	**2757**	**3180**
Borrowings	3663	5369	6348	7729	9173
Other Liab & Prov.	127	191	210	250	276
SOURCES OF FUNDS	**5627**	**7659**	**8959**	**10736**	**12630**
Fixed and Other Intangible Asset	23	61	59	59	64
Investments	10	18	10	10	10
Cash & Bank Balance	684	1196	1125	1309	1340
Advances	4724	6181	7523	8998	10805
Other Assets	186	202	242	360	411
TOTAL ASSETS	**5627**	**7659**	**8959**	**10736**	**12630**

(Source: Company, HDFC sec Research)

AAVAS Financiers Ltd.

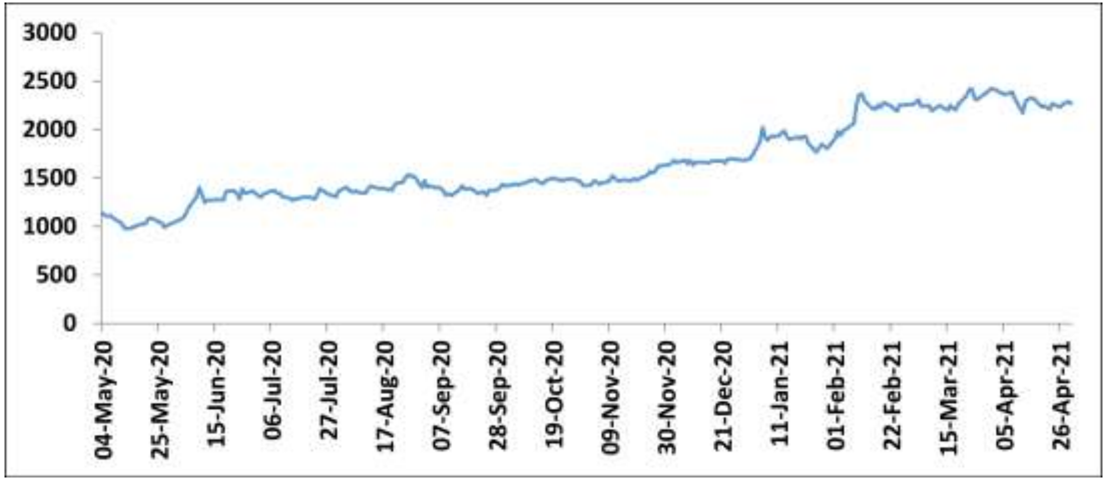
Key Ratios (%)

(Rs Cr)	FY19	FY20	FY21E	FY22E	FY23E
Return Ratios					
Calc. Yield on adv	14.7%	14.4%	14.2%	14.5%	14.5%
Calc. Cost of borr	7.0%	6.6%	7.2%	6.7%	6.9%
NIM	8.4%	7.9%	7.6%	8.2%	8.1%
RoAE	11.6%	12.7%	12.8%	13.8%	14.2%
RoAA	3.6%	3.8%	3.5%	3.6%	3.6%
Asset Quality Ratios					
GNPA	0.5%	0.5%	1.0%	1.2%	1.2%
NNPA	0.1%	0.3%	0.7%	0.9%	0.9%
PCR	29.4%	18.4%	27.2%	28.1%	28.5%
Growth Ratios					
Advances	41.7%	30.8%	21.7%	19.6%	20.1%
Borrowings	33.4%	46.6%	18.2%	21.8%	18.7%
NII	69.6%	27.3%	20.3%	30.7%	18.5%
PPP	94.9%	19.0%	22.8%	38.0%	20.6%
PAT	89.1%	41.5%	15.9%	23.4%	18.7%

Key Ratios (%)

(Rs Cr)	FY19	FY20	FY21E	FY22E	FY23E
Valuation Ratios					
EPS	22.5	31.8	36.8	45.4	53.9
P/E	101.2	71.7	62.0	50.2	42.3
Adj. BVPS	233.8	265.7	299.0	341.3	392.9
P/ABV	9.7	8.5	7.5	6.5	5.6
Dividend per share	0.0	0.0	0.0	0.0	0.0
Other Ratios					
Cost-Income	41.5	42.0	39.8	34.2	32.5
Avg. Net worth/ Avg. Total Assets	3.4	3.1	3.7	3.7	3.9

One Year Price Chart



Disclosure:

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