25 May 2023

Company Update | Sector: Financials

AAVAS Financiers

BSE SENSEX	S&P CNX
61,774	18,285

Stock Info

Bloomberg	AAVAS IN
Equity Shares (m)	78
M.Cap.(INRb)/(USDb)	109.7 / 1.3
52-Week Range (INR)	2410 / 1377
1, 6, 12 Rel. Per (%)	-14/-26/-49
12M Avg Val (INR M)	262
Free float (%)	60.9

Financials Snapshot (INR b)

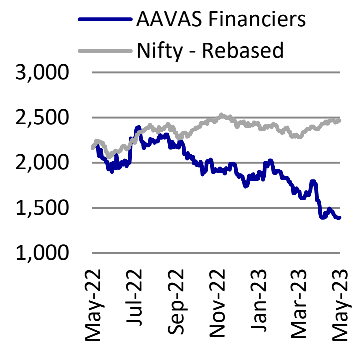
INR b	FY23	FY24E	FY25E
NII	8.0	9.8	12.3
PPP	5.6	7.0	9.0
PAT	4.3	5.3	6.8
EPS (INR)	54.4	66.4	85.9
EPS Gr. (%)	20	22	29
BV/Sh. (INR)	414	480	566
Ratios (%)			
NIM	6.2	6.1	6.0
C/I ratio	44.9	44.0	41.6
Credit cost	0.12	0.23	0.22
RoA	3.5	3.5	3.6
RoE	14.2	14.9	16.4
Valuation			
P/E (x)	25.5	20.9	16.1
P/BV (x)	3.4	2.9	2.5

Shareholding pattern (%)

As On	Mar-23	Dec-22	Mar-22
Promoter	39.1	39.2	39.2
DII	12.5	10.9	9.9
FII	38.8	37.9	39.9
Others	9.5	12.0	11.0

FII Includes depository receipts

Stock Performance (1-year)



CMP: INR1,388 TP: INR1,530 (+10%) Neutral

Poised to capitalize on the significant growth opportunities

We attended AAVAS's analyst meet where the management was represented by the entire senior leadership including the MD & CEO Mr. Sachinder Bhinder and the President & CFO Mr. Ghanshyam Rawat.

We highlight the key takeaways from the meet below:

- Mr. Sachinder Bhinder, the recently appointed MD & CEO of AAVAS, presented the company's strategic vision of capitalizing on the opportunities within the affordable housing sector by leveraging its expansive geographical presence, robust technology infrastructure, and disciplined liability management strategy. AAVAS by: a) maintaining a customer-centric approach, b) continuously improving its underwriting processes, and c) effectively leveraging data analytics, aims to grow its loan book sustainably and deliver superior value to its stakeholders.
- Management highlighted that with the ongoing IT transformation, there will be a significant improvement in the average turnaround time (TAT) for loan sanctioning and disbursals. With the loan files moving to digital, there will be productivity improvements that will translate into operating efficiencies and sustainable decline in operating cost ratios.
- The company stated that it has always been ahead of its peers in managing risk and with the implementation of various ERP solutions (incl. Oracle Fusion) as well as newer and more extensive analytics it will be able to monitor risk much more closely than before. This will help deliver the same pristine asset quality.
- AAVAS has an AUM of ~INR142b as of Mar'23 and has delivered an AUM CAGR of 28% over FY18-FY23 while maintaining GNPAs of <1% all through the 13 years of its operations.
- Despite having a ~60% self-employed customer mix, the superior execution on asset quality and the benign credit costs (across cycles, over the last 13 years) have corroborated that this asset quality is indeed an outcome of its robust underwriting and collections infrastructure.
- We now model a ~28% AUM CAGR over FY23-FY25E. This translates into a 26% consol. PAT CAGR over the same period and an RoA/RoE of 3.6%/16% in FY25.
- Valuations have significantly de-rated over the last one month and the stock now trades at 2.9x FY25E P/BV. Before turning constructive, we would closely monitor the execution on AUM growth and asset quality under the new leadership of Mr. Bhinder. Moreover, we would also keenly observe how the IT transformation accelerates disbursements and improves productivity for AAVAS. **Retain Neutral with a TP of INR1,530 (based on 2.7x Mar'25E BVPS).**

Opening remarks from Mr. Sachinder Bhinder (MD & CEO)

- AAVAS places a strong emphasis on governance, which is further reinforced by the composition of its Board of Directors. The Board consists of seasoned and skilled professionals, underscoring the company's commitment to sound governance practices.
- The company attributes its strong asset quality to its robust quality metrics, which have been rigorously tested and proven effective across various credit cycles and economic downturns.

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- In pursuit of sustainable growth, the company aims to improve profitability and expand its loan portfolio by catering to the underserved segments in tier III-V cities, and leveraging advanced technology.
- AAVAS's growth strategy rests on four core pillars: a) performing prudent risk underwriting, b) managing financial capital efficiently, c) leveraging the potential of human capital, and d) harnessing the power of technology.
- Further, the company prioritizes a customer-centric approach by designing products and services that are tailored to meet the specific needs and preferences of its customers.

Driving growth through wide market reach

- AAVAS has established a strong presence with a wide network of 346 branches operating across 13 states and 2,500 towns in India.
- In line with its growth strategy, the company aims to enhance its market penetration in these existing geographies by leveraging its in-depth understanding of the local dynamics and utilizing its accumulated knowledge to drive loan book expansion.
- Moreover, it harnesses the power of analytics to identify and explore new geographies that present significant growth opportunities.
- By leveraging both its physical branch network and robust technology infrastructure, the company is well-positioned to achieve its growth targets and capitalize on the emerging market prospects.

Navigating crises through prudent liability management

- It is worth noting that AAVAS has consistently maintained a positive asset-liability management (ALM) across all time buckets, with an average asset tenor of eight years and an average liability maturity of 11 years.
- The company's credit rating has steadily improved over the years, positively impacting its CoF. Further, the company has consistently maintained spreads of over 5% across economic cycles.
- AAVAS has maintained a prudent funding strategy by not raising short-term funding through CPs. This approach has proven beneficial, allowing the company to navigate through challenging periods such as the IL&FS crisis and the pandemic without experiencing significant adverse effects on CoF.
- Further, its active participation in promotional funding schemes initiated by the Reserve Bank of India (RBI) and the National Housing Bank (NHB) has helped maintain competitive CoF.
- In terms of capital raising, AAVAS does not have any plans to raise capital in the coming five years.
- The company has undertaken assignment and securitization transactions as part of its strategy to diversify its loan portfolio and improve its CoF and RoA profile. By earning a spread of 7% on these assignment transactions, the company has witnessed an improvement in its RoA.
- Currently, around 7% of its total assets are funded through assignment and securitization transactions.
- Looking ahead, management anticipates that co-lending activities will constitute 10% of its borrowing mix within the next three-to-five years.

Well-positioned to achieve sustainable growth

- Management has expressed confidence in the growth potential of the affordable housing segment in India. It believes that the share of AHFCs in the affordable housing finance market will improve sustainably over the years, indicating significant headroom for growth.
- AAVAS has been actively expanding its presence across the country, with branches reporting a CAGR of 16% over FY18-23. During the same period, the company's AUM recorded a robust CAGR of 28%.
- Management has guided for ~20-25% AUM growth in the subsequent years.
- New branches reach break-even within 12-15 months and ~90% of the new branches have achieved positive RoE within the same timeframe. The company has not closed down any branches in the last 10 years.
- States with a vintage of 5+ years have consistently delivered growth with superior asset quality, highlighting the company's ability to sustain healthy performance in well-established markets.
- While AAVAS primarily focuses on serving Economically Weaker Sections (EWS) and Low-Income Group (LIG) segment customers, the company has developed underwriting capabilities that extend across the entire customer pyramid, from EWS to High-Income Group (HIG) and affluent customers.
- Digital channels have also played a key role in the company's business, contributing ~10% of the overall business as of Mar’23.

Robust underwriting practices to safeguard long-term stability

- AAVAS has established a robust team structure to support its operations and risk management. The company's legal team consists of 97 in-house professionals – including 70 lawyers – complemented by a network of 390 empanelled law firms.
- In terms of technical expertise, AAVAS has built an in-house team of 177 professionals – including 170 civil engineers – supported by 170 valuation firms. This technical team plays a crucial role in assessing the quality and value of properties, and providing valuable insights for the lending process.
- To manage risk effectively, AAVAS has established a dedicated Risk Control Unit (RCU) team with 102 in-house professionals. This team conducts an average of 50 visits per month, ensuring thorough risk assessment and due diligence on the properties financed by the company.
- The company's commitment to leveraging technology is evident in its practice of geo-tagging 100% of the properties.
- AAVAS has invested in developing customized credit assessment templates, combining them with a core touch and feel model. This approach strengthens the underwriting process, enabling the company to take informed lending decisions based on comprehensive credit assessments.
- Having underwritten more than 0.8m customers over the years, AAVAS has built a valuable customer database. It leverages this database to gain insights into customer behavior and patterns, thereby facilitating better customer engagement and risk management.
- AAVAS has maintained a healthy asset quality track record, with year-to-date write-offs amounting to a mere 0.11% of its cumulative disbursements.
- Besides, the average credit costs over FY20-23 stood at 0.23% of the AUM.

Leveraging technology to drive growth and improve processes

- AAVAS is committed to continuously upgrading its IT infrastructure to drive sustainable growth, improve operational efficiency, and deliver superior customer experiences. The company aims to create robust and scalable systems that facilitate seamless business expansion and provide flexibility to introduce new products.
- To enhance operational efficiency, AAVAS is focused on optimizing its cost structure and improving employee efficiency through advanced technology and digital operations.
- Over FY20-23, the company has introduced various technological advancements, including the launch of the tech app, customer app 2.0, chat-bot, and digital collections. Additionally, it has collaborated with Deloitte to develop a comprehensive tech roadmap, referred to as tech 3.0.
- Two key transformation initiatives undertaken by AAVAS are GATI and UNNATI. Under the GATI initiative, the company plans to leverage Sales-force to implement a new digital loan origination platform (LOS). The initial phase of rolling out the customer service system has already been completed.
- As part of the UNNATI initiative, AAVAS intends to adopt Oracle Flex-cube, a modern loan management system (LMS), to facilitate scalability. Moreover, the company plans to implement Oracle ERP Cloud, a next-generation cloud-based ERP system, for back-office process automation and enhanced financial control monitoring.

Developing analytic tools to enhance business operations

- AAVAS has made significant advancements in leveraging analytics to enhance its business operations. It has developed various analytical tools classified under descriptive, prescriptive, and predictive analytics, to gain valuable insights into customer behavior and trends.
- In collaboration with Deloitte, AAVAS has established an end-to-end cloud-based and scalable data architecture system. This robust infrastructure enables efficient data management and analysis, supporting the company's decision-making processes.
- One notable achievement is the development of a churn prediction model. This model identifies customers who are likely to request for balance transfers in future, providing AAVAS with valuable time to proactively engage with these customers and deploy retention strategies. This proactive approach helps improve customer retention and strengthens the company's business performance.
- Additionally, AAVAS has implemented a bounce prediction model that forecasts cases of loan bounces in advance, providing the company with a window of 10-15 days to take appropriate actions. By identifying potential bounce cases early on, AAVAS can tailor its strategies based on factors such as loan tenor, customer profile, loan type, and geographical considerations.
- Through the utilization of analytics and technology, AAVAS has successfully managed its collections while maintaining the same team size over the past three years.

Valuation and View

- AAVAS delivered a healthy RoA/RoE of 3.5%/14.2% in FY23. It has a sustainable business model that it can utilize to scale up profitably across geographies over the long term.
- Its constant endeavor to improve its technological edge and relentless focus on asset quality has made it a standout player among peers. Notably, its 1+DPD remains below the comfortable level of ~4%, driven by its prudent underwriting process and efficient collection efforts.
- The company's focused and customer-centric approach, combined with its penetration in Tier 3 and 4 cities, has enabled it to achieve steady disbursement growth.
- Given the investments being made in sourcing, distribution and technology, AAVAS will embark on a very strong disbursement growth trajectory in FY24. However, it will be vital to closely monitor the execution under the new MD & CEO Mr. Bhinder and how he maintains cohesion in the senior/middle management to achieve the desired outcomes on AUM growth and asset quality.
- The stock trades at 2.9x FY25E P/BV and any re-rating in valuation multiples will depend on consistent delivery of strong asset quality and robust AUM growth, which could potentially be pursued by the new leadership. **Reiterate Neutral with a TP of INR1,530 (based on 2.7x Mar'25E BVPS).**

Story in charts

Exhibit 1: Disbursement CAGR of ~28% over FY23-25E…

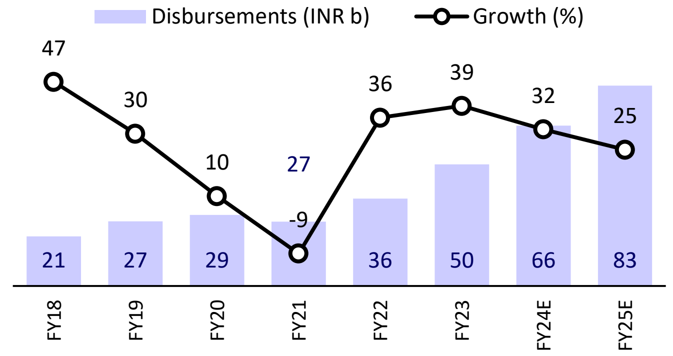


Exhibit 2: …driving AUM CAGR of 28% over the same period

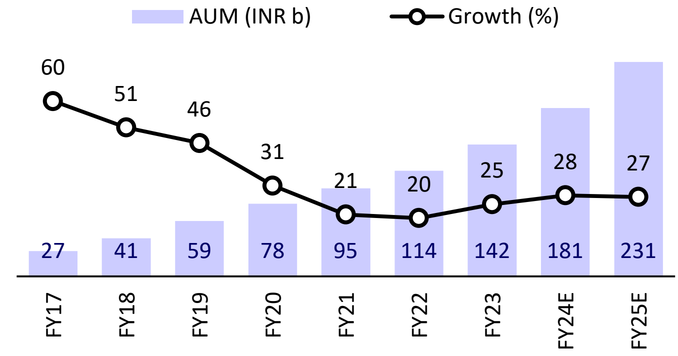


Exhibit 3: Spreads expected to normalize at ~7%…

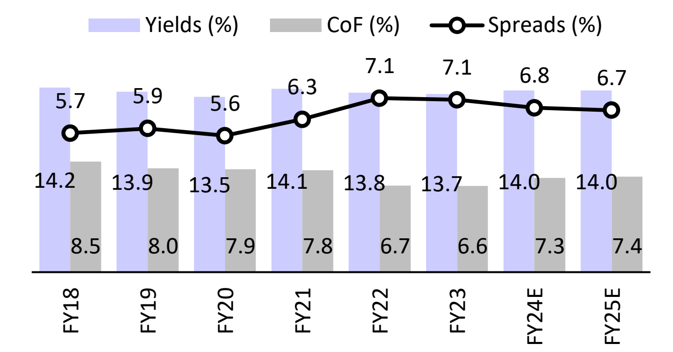


Exhibit 4: …leading to NIM of ~6% over FY25E

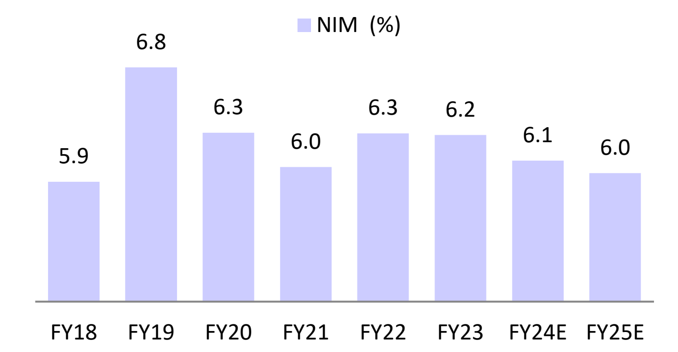


Exhibit 5: CIR to moderate to 42% over FY25E…

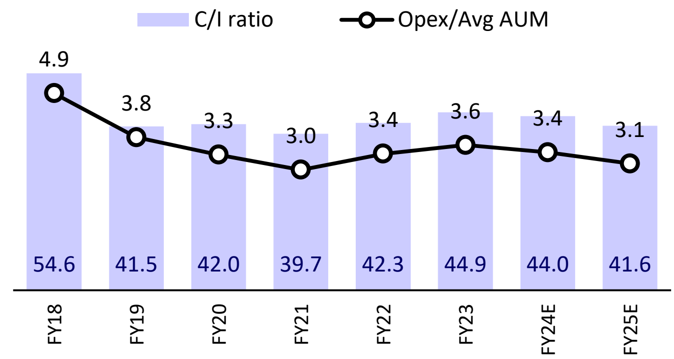


Exhibit 6: …driven by improving productivity metrics

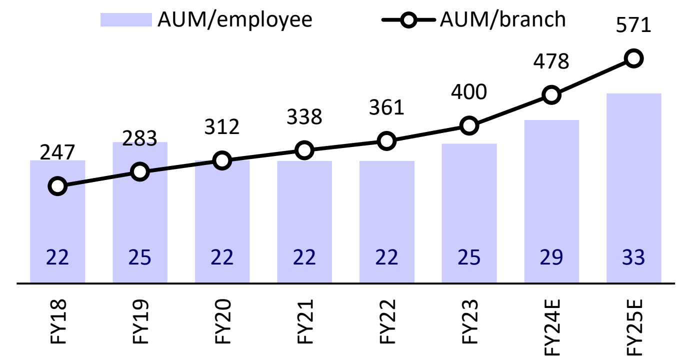
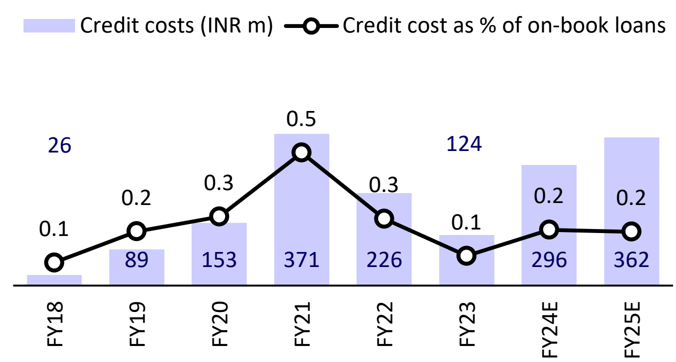
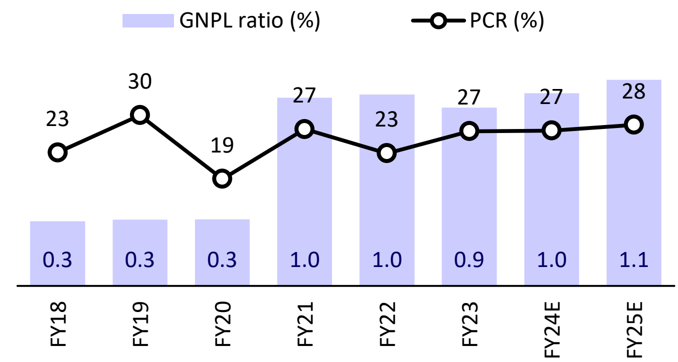


Exhibit 7: Expect credit costs to normalize at 0.2% over FY25



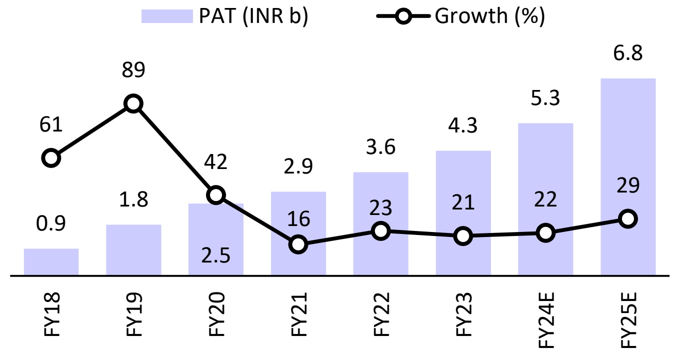
Source: MOFSL, Company

Exhibit 8: Asset quality to remain largely stable



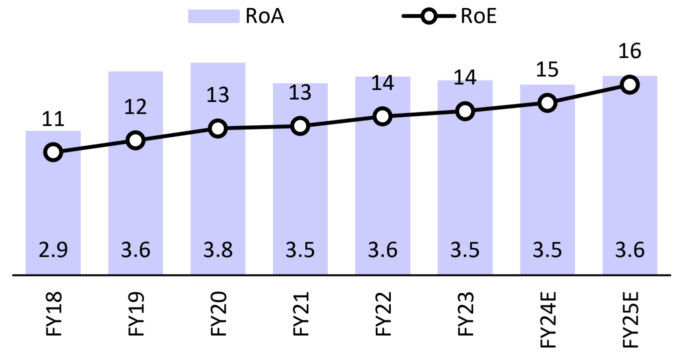
Source: MOFSL, Company

Exhibit 9: Profitability expected to improve gradually…



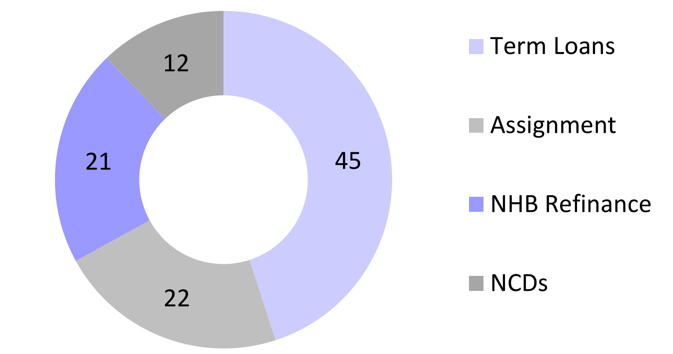
Source: MOFSL, Company

Exhibit 10: …leading to an RoA of ~3.5% in FY24/FY25 each



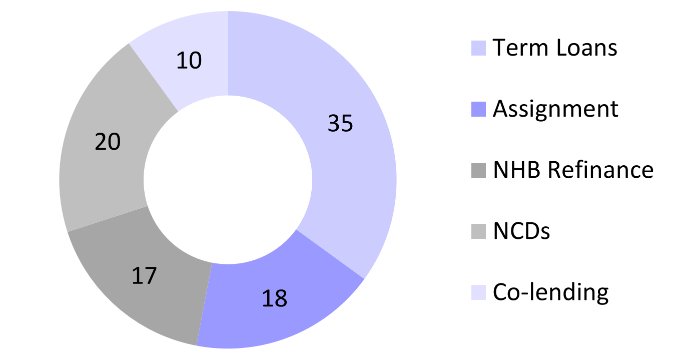
Source: MOFSL, Company

Exhibit 11: Liability mix as of FY23



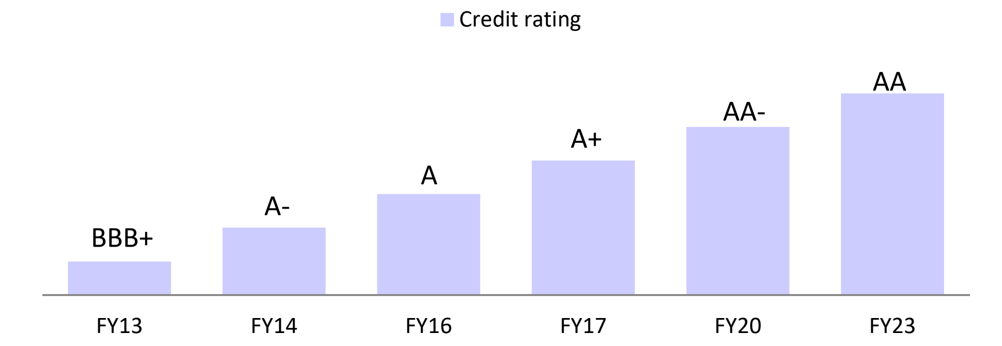
Source: MOFSL, Company

Exhibit 12: Company expects co-lending to form 10% of the liability mix over the subsequent years



Source: MOFSL, Company

Exhibit 13: Progression of credit rating over the years



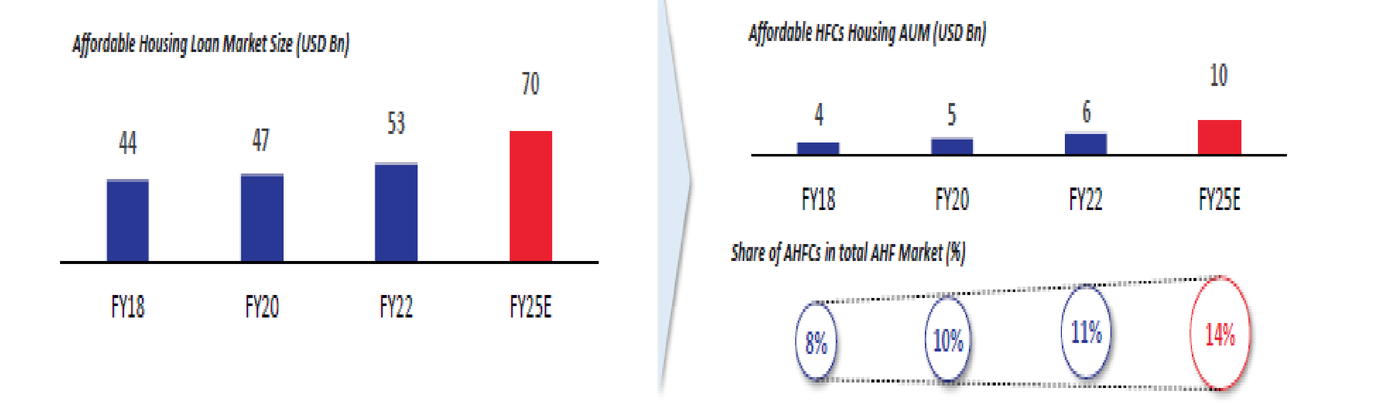
Source: MOFSL, Company

Exhibit 14: Strong track record of self-funding growth…

INR cr.	Period	Up to FY16	Up to FY23	Difference
Total Share Capital	Cumulative	151	1,410	1,258
Retained Earnings and Profit	Cumulative	52	1,860	1,808
AUM	As of	1,680	14,167	12,487
Liabilities	As of	1,463	9,841	8,377

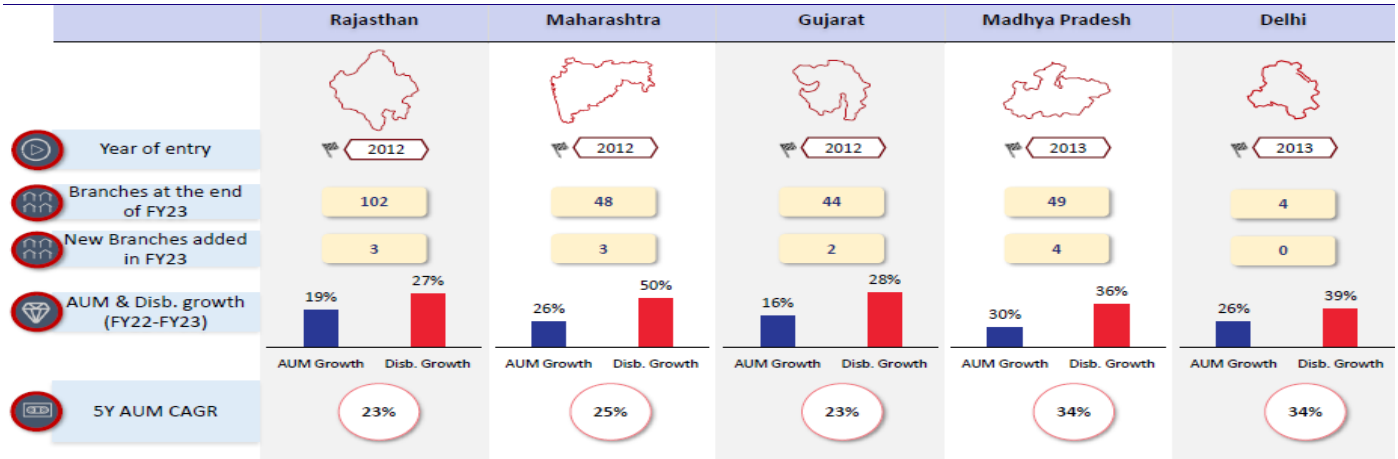
Source: Company, MOFSL

Exhibit 15: …backed by long-term structural tailwinds



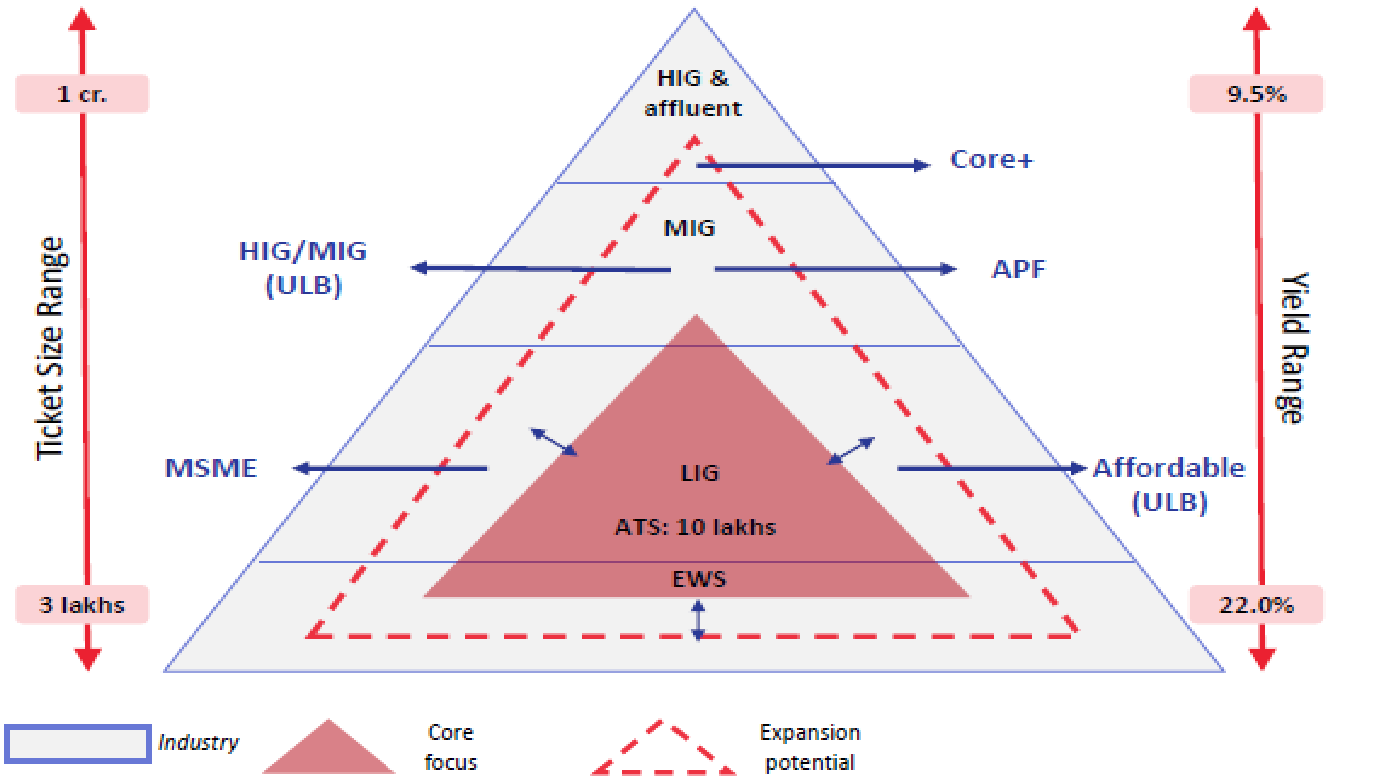
Source: MOFSL, Company

Exhibit 16: Deep penetration model ensures notable headroom for growth in core states



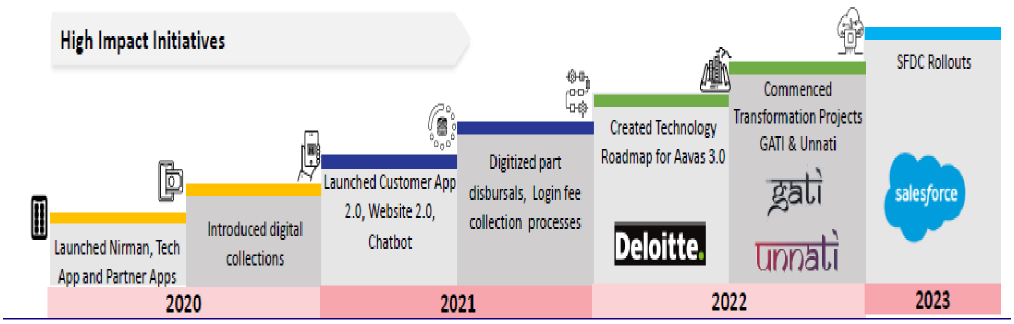
Source: MOFSL, Company

Exhibit 17: Ability to cater across segments with core focus on serving EWS and LIG segments



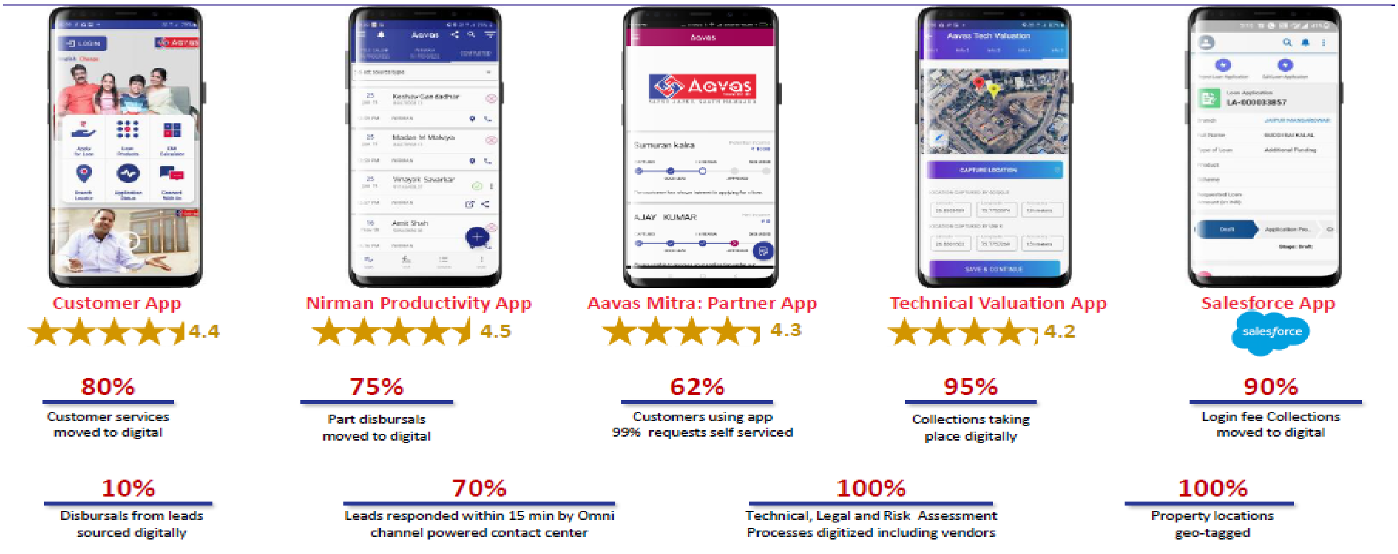
Source: MOFSL, Company

Exhibit 18: Evolution of technological initiatives



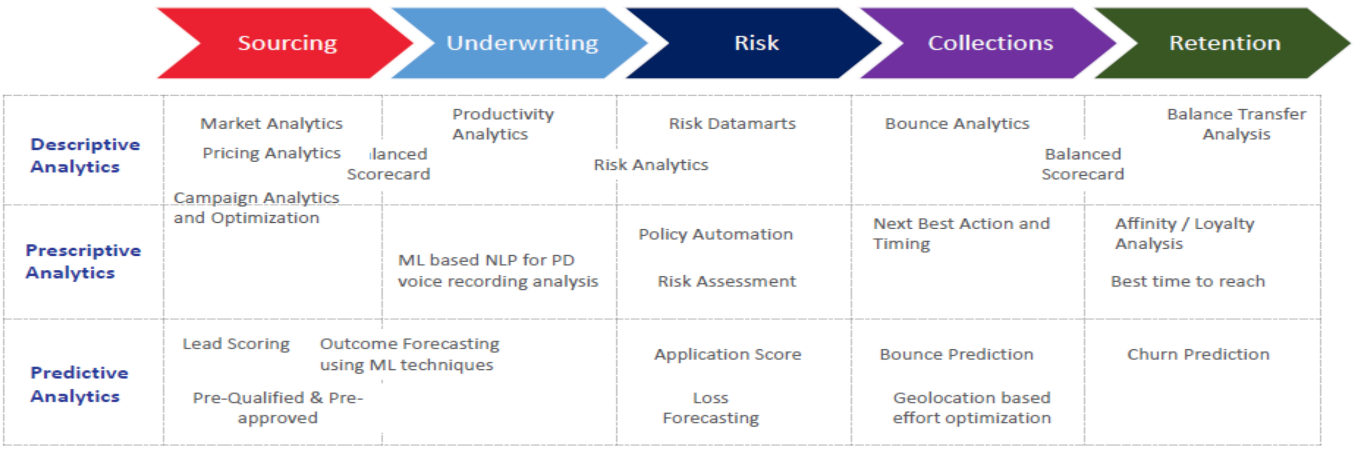
Source: MOFSL, Company

Exhibit 19: Developed user-friendly applications for both clients and employees



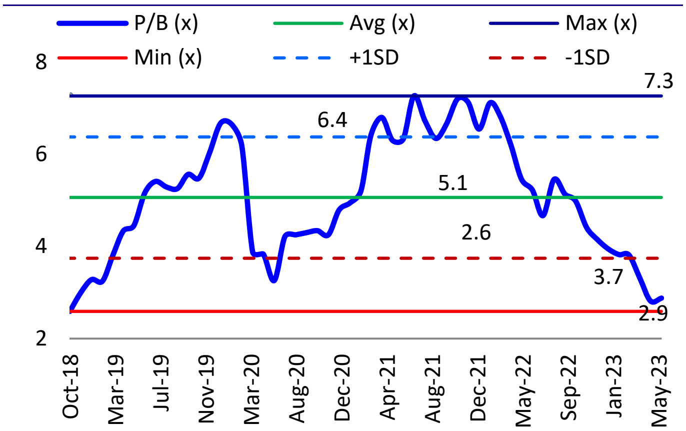
Source: MOFSL, Company

Exhibit 20: Leveraging data analytics across customer life cycle



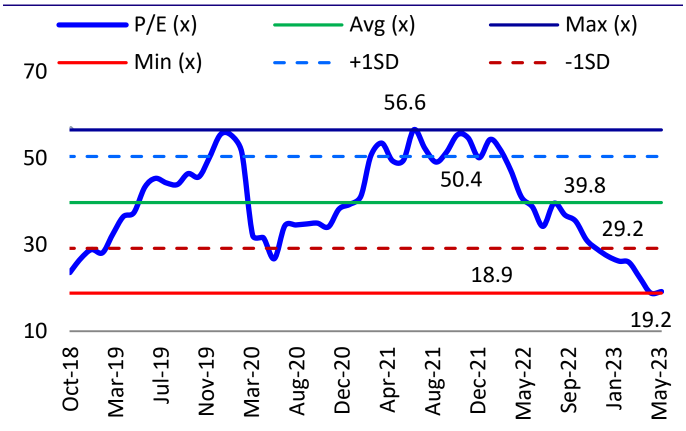
Source: MOFSL, Company

Exhibit 21: One-year forward P/B ratio



Source: MOFSL, Company

Exhibit 22: One-year forward P/E ratio



Source: MOFSL, Company

AAVAS Financiers: Financials and valuations

Income statement

INR m

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Interest Income	2,707	3,926	5,935	7,864	9,764	11,288	13,882	17,965	22,925
Interest Expended	1,428	1,931	2,554	3,561	4,582	4,775	5,910	8,190	10,653
Net Interest Income	**1,279**	**1,995**	**3,382**	**4,304**	**5,182**	**6,513**	**7,971**	**9,775**	**12,273**
Change (%)	69.0	56.0	69.5	27.3	20.4	25.7	22.4	22.6	25.6
Gain on Securitisation	5	602	783	766	864	1,240	1,518	1,822	2,095
Other Operating Income	343	417	391	401	426	528	701	893	1,100
Total Income	**1,627**	**3,014**	**4,556**	**5,470**	**6,471**	**8,281**	**10,191**	**12,490**	**15,468**
Change (%)	62.5	85.3	51.2	20.1	18.3	28.0	23.1	22.6	23.8
Operating Expenses	673	1,645	1,890	2,296	2,566	3,506	4,577	5,495	6,439
Operating Income	**953**	**1,369**	**2,666**	**3,174**	**3,905**	**4,775**	**5,614**	**6,994**	**9,029**
Change (%)	78.1	43.6	94.7	19.1	23.0	22.3	17.6	24.6	29.1
Provisions	67	26	89	153	371	226	124	296	362
PBT	**887**	**1,343**	**2,577**	**3,020**	**3,533**	**4,549**	**5,490**	**6,699**	**8,667**
Tax	308	412	818	529	638	981	1,189	1,447	1,872
Tax Rate (%)	34.7	30.7	31.7	17.5	18.1	21.6	21.7	21.6	21.6
PAT	**579**	**931**	**1,759**	**2,491**	**2,895**	**3,568**	**4,301**	**5,252**	**6,795**
Change (%)	80.4	60.9	89.0	41.6	16.2	23.2	20.5	22.1	29.4
Proposed Dividend	0	0	0	0	0	0	0	0	0

Balance sheet

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Capital	582	692	781	783	785	789	791	791	791
Reserves & Surplus	5,082	11,207	17,589	20,196	23,229	27,297	31,906	37,158	43,953
Net Worth	**5,663**	**11,899**	**18,370**	**20,979**	**24,014**	**28,086**	**32,697**	**37,949**	**44,743**
Borrowings	**17,935**	**27,376**	**36,533**	**53,520**	**63,454**	**79,725**	**98,407**	**1,27,515**	**1,62,352**
Change (%)	23.1	52.6	33.4	46.5	18.6	25.6	23.4	29.6	27.3
Other liabilities	908	1,126	1,366	2,081	2,132	2,392	3,002	3,302	3,797
Total Liabilities	**24,507**	**40,401**	**56,268**	**76,580**	**89,600**	**1,10,204**	**1,34,105**	**1,68,765**	**2,10,893**
Loans	**21,638**	**33,334**	**47,245**	**61,808**	**75,233**	**90,534**	**1,14,763**	**1,44,903**	**1,84,491**
Change (%)	47.2	54.1	41.7	30.8	21.7	20.3	26.8	26.3	27.3
Investments	**8**	**45**	**45**	**45**	**45**	**675**	**1,231**	**1,268**	**1,306**
Change (%)	NM	NM	0.0	0.0	0.0	1,400.4	82.3	3.0	3.0
Other assets	2,861	7,022	8,978	14,727	14,323	18,994	18,112	22,594	25,096
Total Assets	**24,507**	**40,401**	**56,268**	**76,580**	**89,600**	**1,10,204**	**1,34,105**	**1,68,765**	**2,10,893**

E: MOFSL Estimates

AAVAS Financiers: Financials and valuations

Ratios									(%)
Y/E March	**FY17**	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24E**	**FY25E**
Spreads Analysis (%)									
Avg Yield on Loan portfolio	14.8	14.2	13.9	13.5	14.1	13.8	13.7	14.0	14.0
Avg. Cost of borrowings	8.8	8.5	8.0	7.9	7.8	6.7	6.6	7.3	7.4
Interest Spread	6.1	5.7	5.9	5.6	6.3	7.1	7.1	6.8	6.7
Net Interest Margin (AUM)	5.8	5.9	6.8	6.3	6.0	6.3	6.2	6.1	6.0
Profitability Ratios (%)									
RoE	15.0	10.6	11.6	12.7	12.9	13.7	14.2	14.9	16.4
RoA	2.8	2.9	3.6	3.8	3.5	3.6	3.5	3.5	3.6
Loans/Equity (x)	3.8	2.8	2.6	2.9	3.1	3.2	3.5	3.8	4.1
Cost/Income	41.4	54.6	41.5	42.0	39.7	42.3	44.9	44.0	41.6
Asset Quality (%)									
Gross NPAs	169	107	158	210	739	904	1,067	1,466	1,989
Gross NPAs to Adv.	0.8	0.3	0.3	0.3	1.0	1.0	0.9	1.0	1.1
Net NPAs	129	83	112	171	538	695	780	1,070	1,432
Net NPAs to Adv.	0.6	0.2	0.2	0.3	0.7	0.8	0.7	0.7	0.8

VALUATION	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Book Value (INR)	97	172	235	268	306	356	414	480	566
Price-BV (x)					**4.5**	**3.9**	**3.4**	**2.9**	**2.5**
EPS (INR)	9.9	13.5	22.5	31.8	36.9	45.2	54.4	66.4	85.9
EPS Growth YoY	19	35	67	41	16	23	20	22	29.4
Price-Earnings (x)					**37.6**	**30.7**	**25.5**	**20.9**	**16.1**
Dividend per share (INR)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Dividend yield (%)					**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

E: MOFSL Estimates

Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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