

India

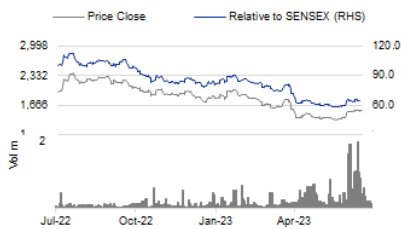
HOLD (no change)

Consensus ratings*: Buy 9 Hold 7 Sell 4

Current price:	Rs1,559
Target price:	Rs1,650
Previous target:	Rs1,650
Up/downside:	5.8%
InCred Research / Consensus:	3.2%

Reuters:	
Bloomberg:	AAVAS IN
Market cap:	US\$1,500m Rs123,267m
Average daily turnover:	US\$5.8m Rs477.2m
Current shares o/s:	79.0m
Free float:	55.0%

*Source: Bloomberg



Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	16.3	(13.0)	(21.8)
Relative (%)	11.6	(21.1)	(36.3)

Major shareholders	% held
Lake Districts	23.0
Partners Group	15.0
Small cap World Fund	8.0



Aavas Financiers Ltd

FY23 AR Analysis: Execution is key

- FY23 AR clearly articulates the company's struggle in tackling high employee attrition rate of ~46.8% vs. ~30% in FY19-21 along with elevated wage hike.
- The new management is focused on scalability (Rs1tr AUM in the next decade), but we prefer to keep a close eye on its execution capabilities.
- Aavas trades at an attractive valuation versus the past. However, we prefer to remain on the sidelines till we regain our confidence on its seamless delivery.

Intense competition leading to increased employee churn

Aavas Financiers (Aavas) reported a 46.8% employee churn rate in FY23, for the second straight year, against an average 30% (FY19-21) along with a rise in median salary hike to 20.5%. We believe the affordable housing space is witnessing a sharp increase in competition from small regional players and small finance banks, which is exerting pressure on established players like Aavas, thereby leading to a higher churn rate and increased employee costs.

Targeting new geographies to achieve aspirational Rs1tr AUM

To improve scalability and achieve diversified growth, Aavas' new management is continuing with the company's diversification strategy. Aavas has set up maximum new branches in Karnataka followed by Madhya Pradesh (MP) and Uttar Pradesh (UP). Aavas is focusing on those states which are witnessing strong loan demand in their Tier-III and Tier-IV cities. We believe the branches set up in new geographies, once they stabilize, would become significant contributors to the incremental growth of Aavas.

Focus on process-driven approach provides growth visibility

Under Aavas 3.0, the company is investing in technology, people and processes which will make it future-ready to handle its aspirational AUM target of Rs1tr in the next decade. Its new management seems to be recognizing the scalability issue faced by non-banking financiers in scaling their AUM beyond Rs150bn-Rs200bn and hence, to support the upcoming scale, it has already started investing in creating a bank-like systems and processes. Though we continue to believe that there is enough steam left in the affordable housing finance business in India amid low penetration and rising standard of living, addressing structural issues like a process-driven approach is the biggest hurdle, which the new management is rightly addressing at this juncture.

Outlook and valuation

We appreciate Aavas's stringent sourcing, underwriting and collection mechanism in rural and semi-urban regions. However, after a change in management, we await seamless execution from the new management to regain confidence in asset quality which, in turn, will drive future profitability. This will be a key trigger to justify the valuation premium. We have valued Aavas at ~3x FY25F P/BV, retaining our HOLD rating on it with a target price of Rs1,650. Downside risk: Asset quality stress. Upside risk: Consistent earnings growth.

Financial Summary	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Net Interest Income (Rsm)	6,487	7,971	9,867	12,438	14,806
Total Non-Interest Income (Rsm)	1,768	2,220	2,873	2,979	3,650
Operating Revenue (Rsm)	8,255	10,191	12,740	15,416	18,455
Total Provision Charges (Rsm)	(226)	(124)	(765)	(937)	(1,144)
Net Profit (Rsm)	3,542	4,301	4,903	5,936	7,325
Core EPS (Rs)	45.12	54.78	62.45	75.61	93.30
Core EPS Growth	22%	21%	14%	21%	23%
FD Core P/E (x)	34.54	28.45	24.96	20.62	16.70
DPS (Rs)	0.00	0.00	0.00	0.00	0.00
Dividend Yield	0.00%	0.00%	0.00%	0.00%	0.00%
BVPS (Rs)	357.8	416.5	485.3	559.7	650.1
P/BV (x)	4.36	3.74	3.21	2.78	2.40
ROE	13.6%	14.2%	13.9%	14.5%	15.4%
% Change In Core EPS Estimates					
InCred Research/Consensus EPS (x)					

SOURCE: INCRED RESEARCH, COMPANY REPORTS

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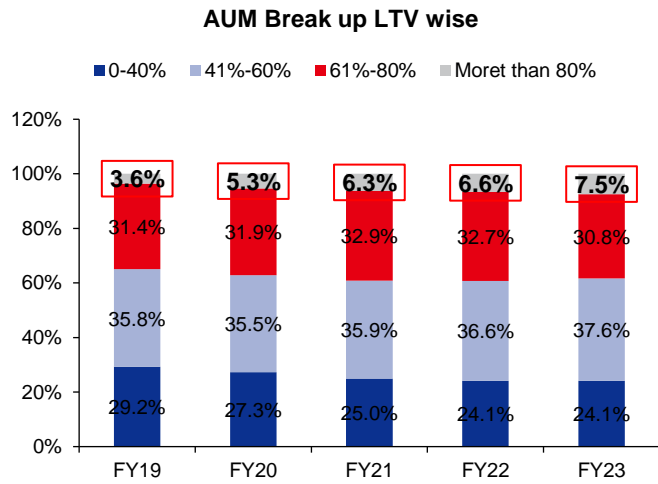
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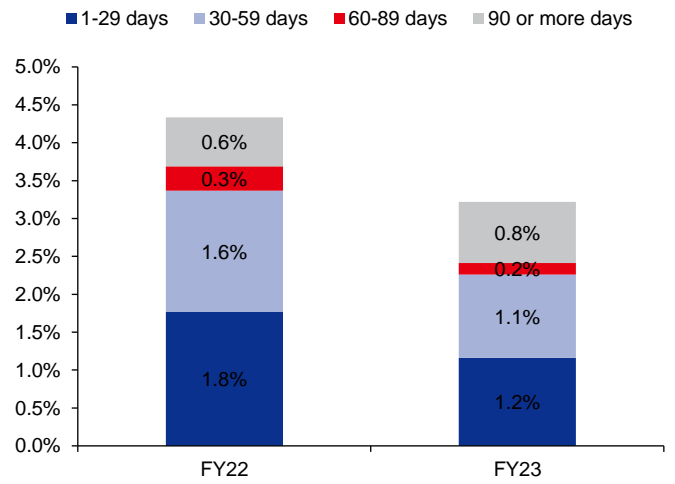
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Figure 1: Rising share of high LTV loans



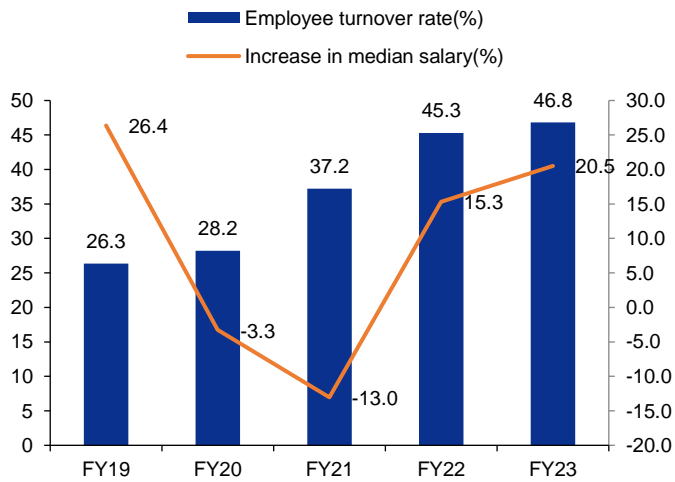
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 2: 1+ days past due (DPD) has improved, but the 90+ bucket remains elevated



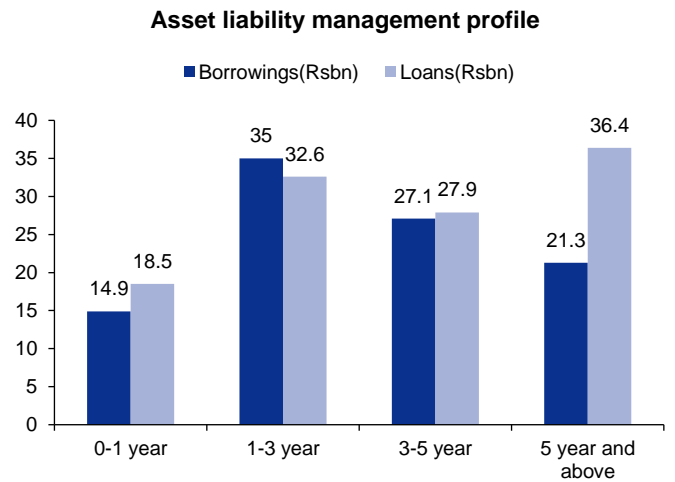
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 3: Increased turnover rate



SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 4: Favourable asset-liability management profile



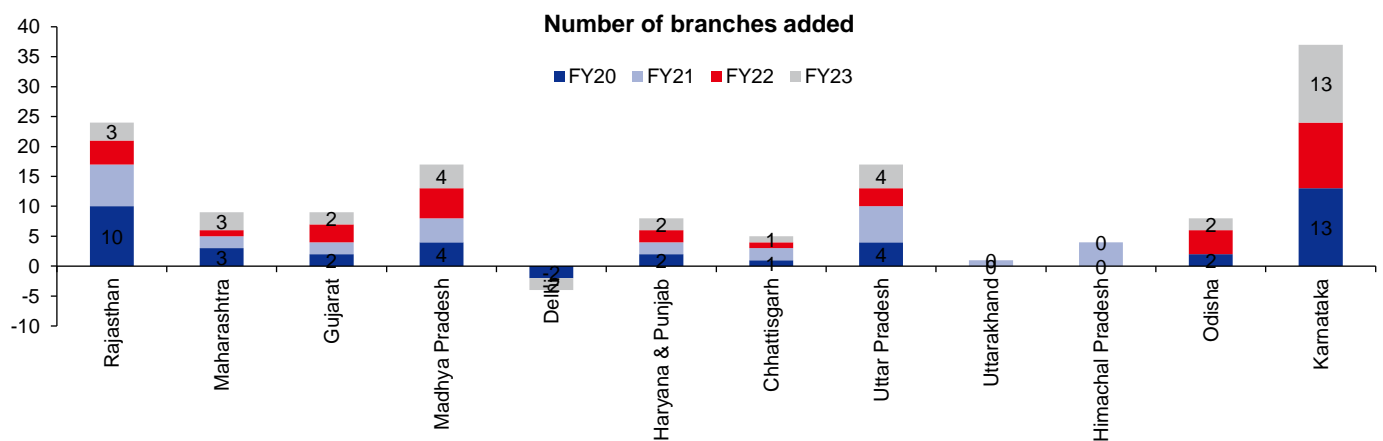
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Highlights from FY23 Annual Report

Targeting new geographies to achieve aspirational Rs1tr AUM

To improve scalability and achieve diversified growth, the new management is continuing with the company's diversification strategy. Aavas has set up maximum branches in Karnataka in FY22 & FY23 followed by Madhya Pradesh and Uttar Pradesh. Aavas is focusing on those states which are witnessing strong demand in their Tier-III and Tier-IV cities. It takes 30-36 months for Aavas to understand a new geography after which it starts getting deeper into these geographies. We believe the branches set up in new geographies, once they stabilize, would be significant contributors to incremental growth of Aavas.

Figure 5: Aavas has set up most branches in Karnataka followed by Uttar Pradesh and Rajasthan

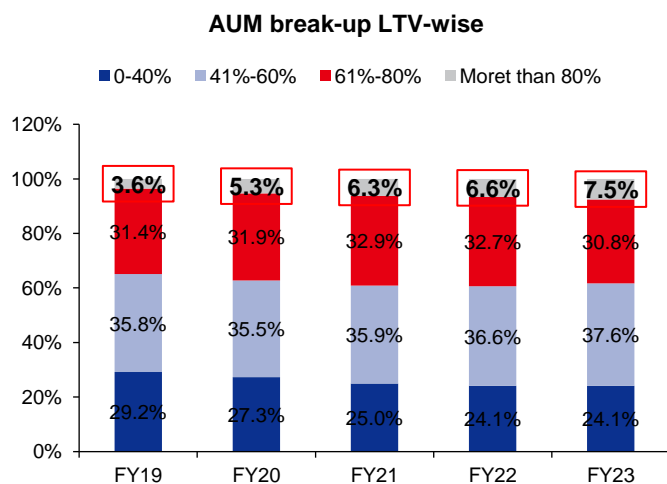


SOURCE: INCRED RESEARCH, COMPANY REPORTS

Rising share of higher LTV loans

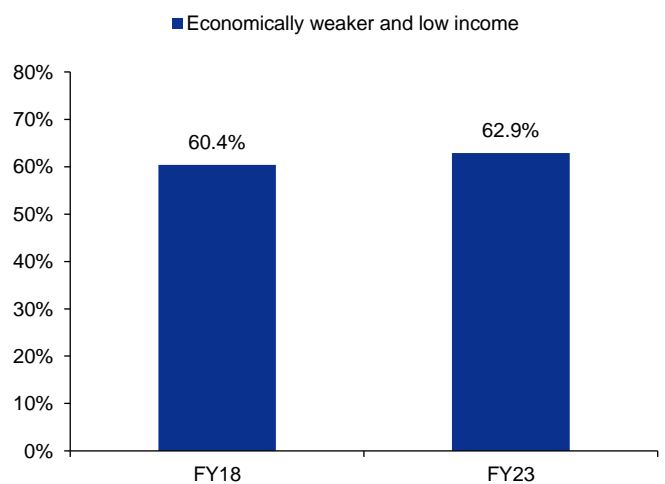
Aavas' loan-to-value or LTV has increased to 7.5% of the assets under management or AUM, up from 3.6% of AUM in FY19. The higher LTV increases the risk of actual loss in case of loans turning into non-performing assets. Also, with a rising LTV, we expect the credit cost, as per ECL methodology, to also increase. Given the rising share of the economically weaker section (EWS) and the low-income section (LIS) profile customers, along with a rising LTV, it makes the company's portfolio slightly riskier. Given the rising penetration of Aavas into deeper geographies, we expect the share of EWS and LIS to increase, but we believe the company should remain cautious in increasing the share of high-LTV loans.

Figure 6: Rising share of higher LTV loans...



SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 7: ...despite the rising share of EWS and low-income customer segments

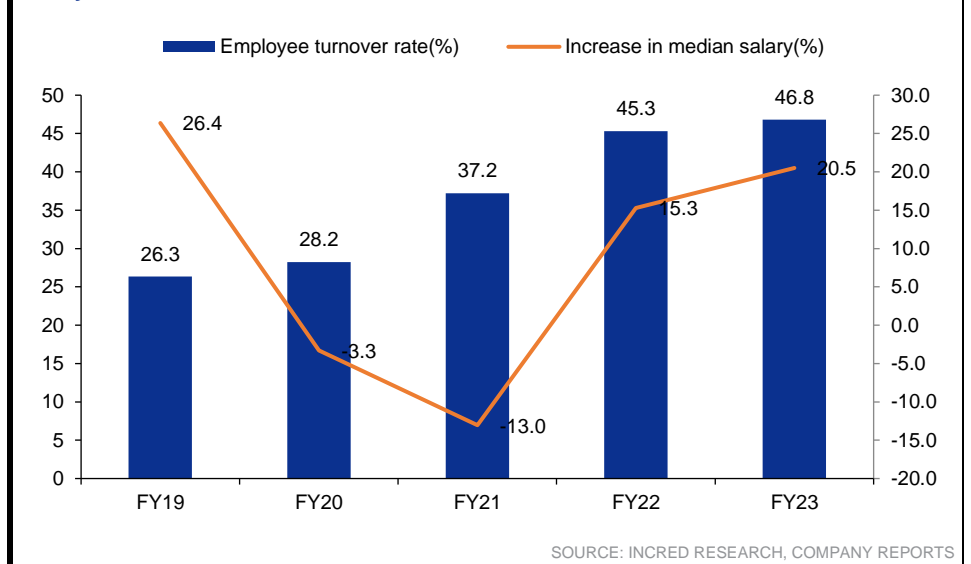


SOURCE: INCRED RESEARCH, COMPANY REPORTS

Employee retention remains a challenge

Aavas generally has a higher attrition rate in case of entry-level employees due to a different business model and higher travelling expenses which, we believe, is normal. However, given the rising competition from small regional players, Aavas is facing a higher attrition rate across levels. We believe Aavas' business model is dependent on its processes and people, and the increased attrition rate due to elevated competition is monitorable.

Figure 8: Employee turnover rate remains elevated, despite a steep increase in median salary



Top management's stability to be under watch

Aavas has increased the number of chief experience officers (CXOs) from 4 in FY17 to 10 in FY23 to support scale. However, out of 10 key management personnel reported in the Annual Report, only three CXOs have been with Aavas for more than two years. Given the differentiated business model of Aavas, we believe the stability of these CXOs is a must for Aavas.

Interestingly, Aavas has increased the salaries of its chief risk officer and chief collection officer by 51% and 36%, respectively. These two CXOs have a higher vintage with Aavas and post exit of the founder MD & CEO Mr. Sushil Agarwal, they have now become important for business stability.

28% of ESOP 2022 scheme lapsed/expired in FY23

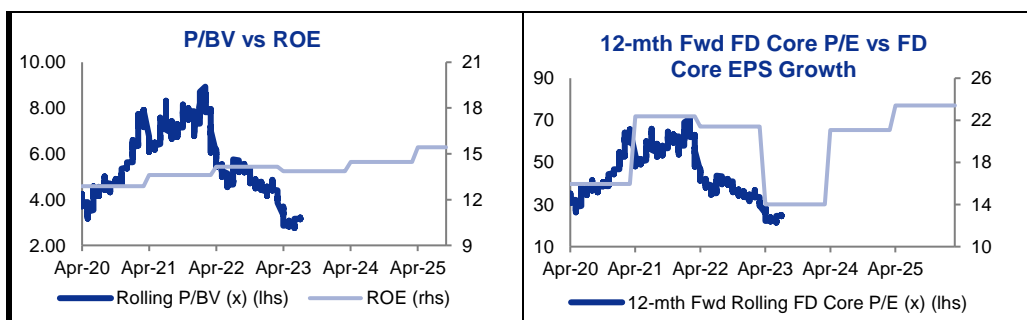
Since 2016, Aavas has come out with employee stock option plans or ESOPs to retain employees, especially the top management. Employees also strongly participated in these schemes and as a result, out of ESOP 2016 (a) only 30% of the ESOPs granted lapsed. However, due to the sharp price correction post ESOP 2022 and the exit of MD & CEO Mr. Sushil Agarwal, 28% of the ESOPs under the ESOP 2022 scheme expired in FY23 itself. We believe that due to the higher exercise price of these schemes than the current share price, ESOP 2020, ESOP 2021 and ESOP 2022 schemes will continue to expire/lapse.

Figure 9: ESOPs expired (scheme-wise) till FY23

ESOP scheme	ESOP 2016(a)	ESOP 2016(b)	ESOP 2016III	ESOP 2019	ESOP 2020	ESOP 2021	ESOP 2022
Options Approved (number of shares)	980,118	3,445,610	719,084	300,000	300,000	300,000	850,000
Lapsed-Till 2023	308,271	48,010		85,758	58,806	44,313	236,300
Expired/Lapsed % of total approved shares	31%	1%		29%	20%	15%	28%
Exercise Price (Rs)	215.2	328	215.2	1,580	2,887	2,477	2,241

SOURCE: INCRED RESEARCH, COMPANY REPORTS

BY THE NUMBERS



Profit & Loss

(Rsm)	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Net Interest Income	6,487	7,971	9,867	12,438	14,806
Total Non-Interest Income	1,768	2,220	2,873	2,979	3,650
Operating Revenue	8,255	10,191	12,740	15,416	18,455
Total Non-Interest Expenses	(3,506)	(4,577)	(5,385)	(6,502)	(7,466)
Pre-provision Operating Profit	4,749	5,614	7,355	8,915	10,989
Total Provision Charges	(226)	(124)	(765)	(937)	(1,144)
Operating Profit After Provisions	4,523	5,490	6,590	7,978	9,845
Pretax Income/(Loss) from Assoc.					
Operating EBIT (incl Associates)	4,523	5,490	6,590	7,978	9,845
Non-Operating Income/(Expense)					
Profit Before Tax (pre-EI)	4,523	5,490	6,590	7,978	9,845
Exceptional Items					
Pre-tax Profit	4,523	5,490	6,590	7,978	9,845
Taxation	(981)	(1,189)	(1,687)	(2,042)	(2,520)
Consolidation Adjustments & Others					
Exceptional Income - post-tax					
Profit After Tax	3,542	4,301	4,903	5,936	7,325
Minority Interests					
Pref. & Special Div					
FX And Other Adj.					
Net Profit	3,542	4,301	4,903	5,936	7,325
Recurring Net Profit					

Balance Sheet Employment

(Rsm)	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Gross Loans/Cust Deposits					
Avg Loans/Avg Deposits					
Avg Liquid Assets/Avg Assets	96.2%	96.0%	96.1%	96.4%	96.6%
Avg Liquid Assets/Avg IEAs	116.2%	114.4%	111.6%	110.4%	109.4%
Net Cust Loans/Assets					
Net Cust Loans/Broad Deposits					
Equity & Provns/Gross Cust Loans					
Asset Risk Weighting					
Provision Charge/Avg Cust Loans					
Provision Charge/Avg Assets					
Total Write Offs/Average Assets					

SOURCE: INCRED RESEARCH, COMPANY REPORTS

BY THE NUMBERS...cont'd

Balance Sheet					
(Rsm)	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Total Gross Loans	90,534	114,763	140,248	172,030	209,310
Liquid Assets & Invst. (Current)					
Other Int. Earning Assets					
Total Gross Int. Earning Assets	90,534	114,763	140,248	172,030	209,310
Total Provisions/Loan Loss Reserve					
Total Net Interest Earning Assets	90,534	114,763	140,248	172,030	209,310
Intangible Assets					
Other Non-Interest Earning Assets	3,365	3,734	3,921	4,313	4,744
Total Non-Interest Earning Assets	3,692	4,295	4,594	5,121	5,714
Cash And Marketable Securities	15,669	13,816	15,656	16,670	19,346
Long-term Investments	675	1,231	1,477	1,772	2,127
Total Assets	110,570	134,105	161,976	195,593	236,497
Customer Interest-Bearing Liabilities					
Bank Deposits					
Interest Bearing Liabilities: Others	80,120	98,873	120,625	147,162	179,538
Total Interest-Bearing Liabilities	80,120	98,873	120,625	147,162	179,538
Banks Liabilities Under Acceptances					
Total Non-Interest Bearing Liabilities	2,360	2,536	3,252	4,489	5,926
Total Liabilities	82,480	101,408	123,876	151,652	185,464
Shareholders Equity	28,086	32,697	38,099	43,941	51,034
Minority Interests					
Total Equity	28,086	32,697	38,099	43,941	51,034

Key Ratios					
	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Total Income Growth	25.2%	22.9%	23.8%	26.1%	19.0%
Operating Profit Growth	21.6%	18.2%	31.0%	21.2%	23.3%
Pretax Profit Growth	28%	21%	20%	21%	23%
Net Interest To Total Income	78.6%	78.2%	77.4%	80.7%	80.2%
Cost Of Funds	6.64%	6.60%	7.50%	7.00%	7.00%
Return On Interest Earning Assets	13.6%	13.5%	14.2%	14.0%	13.8%
Net Interest Spread	6.95%	6.92%	6.69%	6.97%	6.76%
Net Interest Margin (Avg Deposits)					
Net Interest Margin (Avg RWA)					
Provisions to Pre Prov. Operating Profit	5%	2%	10%	11%	10%
Interest Return On Average Assets	6.48%	6.52%	6.66%	6.96%	6.85%
Effective Tax Rate	21.7%	21.7%	25.6%	25.6%	25.6%
Net Dividend Payout Ratio					
Return On Average Assets	3.54%	3.52%	3.31%	3.32%	3.39%

SOURCE: INCRED RESEARCH, COMPANY REPORTS

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