

India

HOLD (no change)

Consensus ratings*: Buy 11 Hold 7 Sell 3

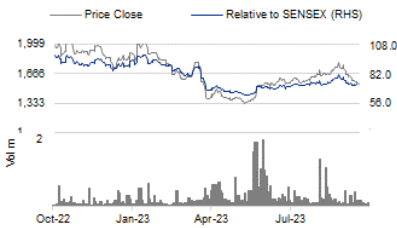
Current price:	Rs1,547
Target price:	Rs1,650
Previous target:	Rs1,650
Up/downside:	6.7%
InCred Research / Consensus:	-5.1%

Reuters:	
Bloomberg:	AAVAS IN
Market cap:	US\$1,686m Rs122,433m
Average daily turnover:	US\$7.3m Rs533.5m
Current shares o/s:	79.0m
Free float:	55.0%

*Source: Bloomberg

Key changes in this note

➤ As the decline in staff costs come amid lower incentives, it's leading to weak disbursements, which may continue to remain subdued going ahead.



Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	(9.2)	(2.6)	(22.2)
Relative (%)	(6.3)	1.1	(26.9)

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

Analyst(s)

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Aavas Financiers Ltd

Growth & earnings dilemmas are here to stay

- Aavas Financiers posted a strong 2Q PAT of ~Rs1.2bn (+11% qoq), despite weak AUM growth/margin fall, as lower staff costs aided operating leverage.
- As the decline in staff costs comes amid lower incentives, it's resulting in a weak disbursement trend, which may continue to remain subdued.
- We believe Aavas Financiers' struggle in respect of growth, margins and operating costs may continue for some time. Retain HOLD with a Rs1,650 TP.

Disbursement dilemma amid low incentives, technology upgrade

Aavas Financiers reported 2QFY24 disbursements at Rs12.5bn (+9.7% yoy/+17.8% qoq), below our/street expectations, even as management's guidance pegged the implementation of the tech-enabled Salesforce platform would lead to superior growth from 2QFY24F. However, the disappointment continues. Management gave guidance of two more quarters for the full implementation of the tech-enabled platform & normalized disbursement growth from FY25F. The company stated that there were lower incentives & bonuses, which is reflected in lower staff costs. Thus, the typical incentive-led disbursement growth, which used to be the core strength of Aavas Financiers (unlike using third-party distributors/direct sales agents or DSAs), will also be missing in the coming quarters. Thus, the disbursement growth dilemma is here to stay.

Employee incentive dilemma amid delayed technology upgrade

Aavas Financiers reported a ~13.6% sequential decline in employee costs, which neutralized the impact of lower margins in 2Q. While the employee count sequentially was stable, management attributed the decline to the absence of previous-level incentives, bonuses, as well as one-off adjustment of salary of the outgoing CEO last quarter. The original plan of the new management was to implement and utilize the tech-enabled platform to source loans and, accordingly, revised the incentive structure low. We believe the delay in implementation of the tech-platform, coupled with low incentives, will weigh on growth for Aavas Financiers. Also, lower incentives can trigger another round of employee attrition, which may force the company to revise its incentive structure again. Thus, the staff costs dilemma is also here to stay.

Outlook & valuation; we still prefer HFFS over Aavas Financiers

As highlighted by us previously, after the change in top management in 4QFY23, Aavas Financiers has been struggling with growth, margin, and employee attrition problems, which is reflected in its performance as well. We have been preferring Home First Finance Company or HFFC over Aavas Financiers since the past few quarters, despite a steep correction in the stock price of the latter, as we believe the dilemmas over growth and earnings are here to stay for at least a couple of quarters. We retain our HOLD rating on Aavas Financiers with a target price of Rs1,650, or 3x FY25F P/BV. Upside risks: Better AUM & RoE guidance. Downside risks: Attrition at top management level, and growth slowdown..

Financial Summary	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Net Interest Income (Rsm)	6,487	7,971	9,497	12,167	14,737
Total Non-Interest Income (Rsm)	1,768	2,220	2,873	2,979	3,650
Operating Revenue (Rsm)	8,255	10,191	12,370	15,146	18,387
Total Provision Charges (Rsm)	(226)	(124)	(383)	(781)	(1,144)
Net Profit (Rsm)	3,542	4,301	4,800	5,766	7,067
Core EPS (Rs)	45.12	54.78	61.15	73.45	90.02
Core EPS Growth	22%	21%	12%	20%	23%
FD Core P/E (x)	34.29	28.25	25.30	21.07	17.19
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	484.0	556.5	643.9
P/BV (x)	4.33	3.72	3.20	2.78	2.40
ROE	13.6%	14.2%	13.6%	14.1%	15.0%
% Change In Core EPS Estimates					
InCred Research/Consensus EPS (x)					

SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 1: Quarterly results

Particulars (Rs m)	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	YoY (%)	QoQ (%)
Net interest income	1,802	1,877	2,082	2,213	2,262	2,223	18.4%	-1.7%
<i>NIM (% of AUM)</i>	7.7%	8.2%	8.2%	8.3%	8.0%	8.0%		
Other income	143	140	149	155	174	201	44.2%	15.5%
Operating expenses	1,026	1,147	1,201	1,204	1,339	1,308	14.1%	-2.3%
Operating profit	1,156	1,394	1,415	1,650	1,464	1,631	17.0%	11.4%
Provisions	9	16	35	64	57	65	304.1%	14.8%
Exceptional items								
PBT	1,147	1,378	1,380	1,587	1,407	1,565	13.6%	11.3%
Tax	254	310	307	318	310	348	12.4%	12.4%
<i>Tax rate (%)</i>								
PAT	892	1,068	1,073	1,268	1,097	1,217	14.0%	11.0%
AUM (Rs bn)	118.9	125.4	130.9	141.7	146.5	153.2	22.1%	4.6%
Disbursements (Rs bn)	10.9	11.5	12.0	15.8	10.7	12.6	9.7%	17.8%
GNPAs (%)	1.08%	1.10%	1.13%	0.92%	1.00%	1.04%		

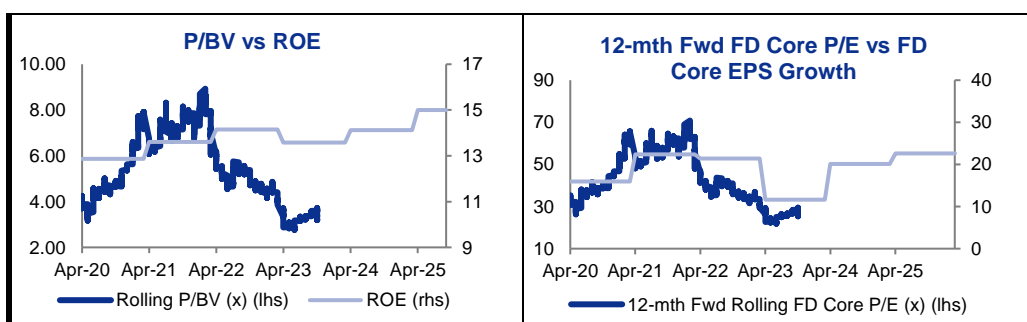
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 2: Our revised earnings estimates

Y/e Mar (Rs m)	FY24F			FY25F			FY25F		
	Earlier	Revised	% change	Earlier	Revised	% change	Earlier	Revised	% change
Net interest income	9,867	9,497	-3.7%	12,438	12,167	-2.2%	14,806	14,737	-0.5%
PPOP	7,222	6,800	-5.8%	8,767	8,489	-3.2%	10,824	10,592	-2.1%
PAT	4,804	4,800	-0.1%	5,826	5,766	-1.0%	7,202	7,067	-1.9%
EPS (Rs)	61	61	-0.1%	74	73	-1.0%	92	90	-1.9%
BV (Rs)	484	484	0.0%	557	556	-0.1%	646	644	-0.4%
AUM (Rsbn)	176	176	0.0%	217	217	0.0%	264	264	0.0%
GNPAs (%)	1%	1%	0.0%	1%	1%	0.0%	1%	1%	0.0%

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	9,497	12,167	14,737
Total Non-Interest Income	1,768	2,220	2,873	2,979	3,650
Operating Revenue	8,255	10,191	12,370	15,146	18,387
Total Non-Interest Expenses	(3,506)	(4,577)	(5,569)	(6,657)	(7,795)
Pre-provision Operating Profit	4,749	5,614	6,800	8,489	10,592
Total Provision Charges	(226)	(124)	(383)	(781)	(1,144)
Operating Profit After Provisions	4,523	5,490	6,418	7,708	9,448
Pretax Income/(Loss) from Assoc.					
Operating EBIT (incl Associates)	4,523	5,490	6,418	7,708	9,448
Non-Operating Income/(Expense)					
Profit Before Tax (pre-EI)	4,523	5,490	6,418	7,708	9,448
Exceptional Items					
Pre-tax Profit	4,523	5,490	6,418	7,708	9,448
Taxation	(981)	(1,189)	(1,617)	(1,943)	(2,381)
Consolidation Adjustments & Others					
Exceptional Income - post-tax					
Profit After Tax	3,542	4,301	4,800	5,766	7,067
Minority Interests					
Pref. & Special Div					
FX And Other Adj.					
Net Profit	3,542	4,301	4,800	5,766	7,067
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%	111.5%	110.2%	109.3%
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	15,554	16,415	18,859
Long-term Investments	675	1,231	1,477	1,772	2,127
Total Assets	110,570	134,105	161,873	195,338	236,010
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	37,997	43,686	50,547
Minority Interests					
Total Equity	28,086	32,697	37,997	43,686	50,547

Key Ratios					
	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Total Income Growth	25.2%	22.9%	19.1%	28.1%	21.1%
Operating Profit Growth	21.6%	18.2%	21.1%	24.8%	24.8%
Pretax Profit Growth	28%	21%	17%	20%	23%
Net Interest To Total Income	78.6%	78.2%	76.8%	80.3%	80.2%
Cost Of Funds	6.64%	6.60%	7.50%	7.00%	7.00%
Return On Interest Earning Assets	13.6%	13.5%	13.9%	13.8%	13.7%
Net Interest Spread	6.95%	6.92%	6.40%	6.80%	6.73%
Net Interest Margin (Avg Deposits)					
Net Interest Margin (Avg RWA)					
Provisions to Pre Prov. Operating Profit	5%	2%	6%	9%	11%
Interest Return On Average Assets	6.48%	6.52%	6.42%	6.81%	6.83%
Effective Tax Rate	21.7%	21.7%	25.2%	25.2%	25.2%
Net Dividend Payout Ratio					
Return On Average Assets	3.54%	3.52%	3.24%	3.23%	3.28%

SOURCE: INCRED RESEARCH, COMPANY REPORTS

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