

India

HOLD (no change)

Consensus ratings*:	Buy 10	Hold 7	Sell 4
Current price:	Rs1,484		
Target price:	Rs1,600		
Previous target:	Rs1,650		
Up/downside:	7.8%		
InCred Research / Consensus:	-7.5%		
Reuters:	AAVAS IN		
Bloomberg:	AAVAS IN		
Market cap:	US\$1,416m		
	Rs117,442m		
Average daily turnover:	US\$5.0m		
	Rs418.0m		
Current shares o/s:	79.0m		
Free float:	55.0%		
*Source: Bloomberg			

Key changes in this note

► We believe Aavas Financiers' struggle for growth, margins and controlling operating costs will remain till its new management settles down.



Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	(5.8)	1.6	(20.3)
Relative (%)	(5.9)	(9.2)	(32.7)

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

Research Analyst(s)



Jignesh SHIAL
 T (91) 22 4161 1547
 E jignesh.shial@incredresearch.com

Mayank AGARWAL
 T (91) 22 4161 0000
 E mayank.agarwal@incredresearch.com

Rishabh JOGANI
 T (91) 22 4161 0000
 E rishabh.jogani@incredresearch.com

Aavas Financiers Ltd

Growth & earnings dilemma is here to stay

- The weak profitability trend continued, with 3QFY24 PAT at ~Rs1.2bn (+8.8% yoy/-4.2%qoq) as the compression in spreads (-17bp qoq to 5.1%) remains.
- Disbursements grew by ~14% yoy/ 9% qoq to Rs13.7bn, weaker than expected amid the confusion created due to the changes in top management.
- We feel the struggle for growth, margins & controlling operating costs will stay till the new management settles down. Retain HOLD rating with a Rs1,600 TP.

Disbursement dilemma amid low incentives, technology upgrade

Aavas Financiers reported disbursements amounting to Rs13.7bn (+14% yoy/9% qoq) in 3QFY24, lower than the historical trend of ~20-25% yoy growth, due to the change in its top management at the start of the current financial year as well as implementation of a tech-enabled platform, which will be a new growth driver. Management has given guidance of two more quarters for implementation of its full tech-enabled sales platform & normalized loan growth from FY25F. The company has indicated lower incentive & bonuses, which is reflected in lower employee costs. Thus, the typical incentive-led disbursement growth, which used to be the core strength earlier (unlike using third-party distributors/direct sales agents or DSAs), will be missing. Thus, the loan growth dilemma is here to stay.

Margin pressure to continue

Aavas Financiers witnessed ~30bp (calculated) qoq NIM compression due to an 8bp qoq reduction in yields, despite a 10bp qoq rise in the cost of funds. We feel that due to rising competition in affordable housing space, Aavas Financiers is unable to pass on the rising cost of funds. We expect margin pressure to remain for at least a couple of quarters.

Employee incentives dilemma amid delayed technology upgrade

Aavas Financiers reported a low 3.5% yoy/1.3% qoq rise in employee costs, which neutralized the impact of low margins in 3QFY24. While the employee count was stable, management has attributed the muted growth to the absence of incentives & bonuses at the level they were offered earlier. The original plan of the new management was to implement and utilize the tech-enabled platform to source loans and, accordingly, the revised incentive structure was kept low. However, this may keep the attrition level elevated, which may negatively impact the operating leverage of the company.

Outlook & valuation

As highlighted by us earlier, after the change in top management in 4QFY23, Aavas Financiers has been struggling with growth, margins & employee attrition issues, which is reflected in its performance. Our preference for Home First Finance Company over Aavas Financiers in the affordable housing loan space remains intact. We retain HOLD rating on the stock with a lower target price of Rs1,600 (Rs1,650 earlier) at a valuation of ~2.9x FY25F P/BV. Upside risks: Better AUM & RoE guidance. Downside risks: Attrition at the top management level and a slowdown in growth.

Financial Summary

	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Net Interest Income (Rsm)	6,487	7,971	9,072	10,260	12,182
Total Non-Interest Income (Rsm)	1,768	2,220	2,672	2,964	3,749
Operating Revenue (Rsm)	8,255	10,191	11,745	13,224	15,931
Total Provision Charges (Rsm)	(226)	(124)	(313)	(448)	(900)
Net Profit (Rsm)	3,542	4,301	4,672	5,165	6,294
Core EPS (Rs)	45.12	54.78	59.51	65.79	80.18
Core EPS Growth	22%	21%	9%	11%	22%
FD Core P/E (x)	32.89	27.09	24.94	22.56	18.51
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	482.4	548.0	626.5
P/BV (x)	4.15	3.56	3.08	2.71	2.37
ROE	13.6%	14.2%	13.2%	12.8%	13.7%
% Change In Core EPS Estimates					
InCred Research/Consensus EPS (x)					

SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 1: Quarterly summary

Particulars (Rs m)	3QFY23	4QFY23	1QFY24	2QFY24	3QFY24	YoY (%)	QoQ (%)
Net interest income	2,082	2,213	2,262	2,223	2,208	6.1%	-0.7%
<i>NIM (% of AUM)</i>	8.2%	8.3%	8.0%	8.0%	7.9%		
Other income	149	155	174	201	206	38.5%	2.4%
Operating expenses	1,201	1,204	1,339	1,308	1,349	12.3%	3.2%
Operating profit	1,415	1,650	1,464	1,631	1,577	11.5%	-3.3%
Provisions	35	64	57	65	80	126.7%	22.1%
Exceptional items							
PBT	1,380	1,587	1,407	1,565	1,497	8.5%	-4.3%
Tax	307	318	310	348	331	7.8%	-5.0%
<i>Tax rate (%)</i>							
PAT	1,073	1,268	1,097	1,217	1,167	8.8%	-4.2%
AUM (Rs bn)	130.9	141.7	146.5	153.2	160.8	22.9%	5.0%
Disbursements (Rs bn)	12.0	15.8	10.7	12.6	13.7	14.0%	9.0%
GNPAs (%)	1.1%	0.9%	1.0%	1.0%	1.0%		

SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 2: Our revised earnings estimates

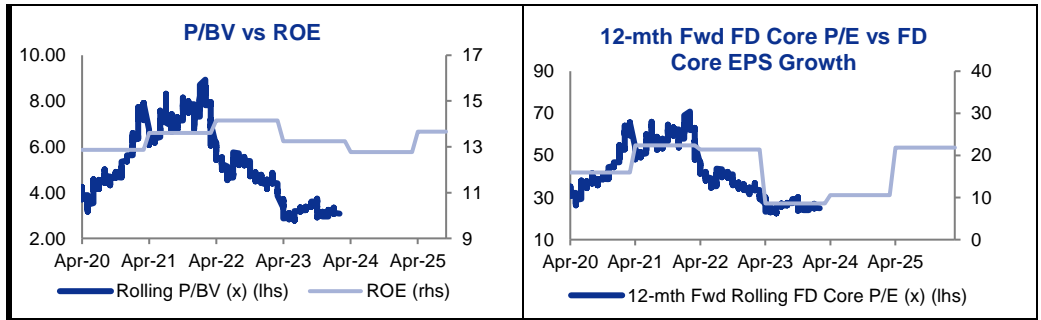
Y/E Mar (Rs m)	FY24F			FY25F			FY26F		
	Earlier	Revised	% change	Earlier	Revised	% change	Earlier	Revised	% change
Net interest income	9,867	9,072	-8.0%	12,438	10,260	-17.5%	14,806	12,182	-17.7%
PPOP	7,222	6,303	-12.7%	8,767	7,156	-18.4%	10,824	9,128	-15.7%
PAT	4,804	4,672	-2.8%	5,826	5,165	-11.3%	7,202	6,294	-12.6%
EPS (Rs)	61	60	-2.8%	74	66	-11.3%	92	80	-12.6%
BV (Rs)	484	482	-0.3%	557	548	-1.7%	646	626	-3.0%
AUM (Rs bn)	176	170	-3.7%	217	203	-6.3%	264	247	-6.8%
GNPAs (%)	1%	1%	1.7%	1%	1%	2.1%	1%	1%	1.3%

SOURCE: INCRED RESEARCH

Conference-call highlights

- Aavas Financiers will continue to focus on branch expansion and open 15-20 branches this year. Management's focus will be more on making it an opex-light model with more touch points, rather than building the physical infrastructure.
- Aavas Financiers has earlier rolled out its Salesforce platform in Phase-1 and processed 0.1m applications through it. Now, it has rolled out Phase-2 by implementing Account Aggregator. In the coming months, Aavas Financiers will roll out lead management, customer service integration and App score.
- States like Karnataka, Uttar Pradesh and Maharashtra have witnessed robust growth.
- The incremental cost of borrowing for Aavas Financiers stood at slightly above 8% which, management believes, is indicative of the cost of funds peaking.
- The company's capital adequacy was impacted by 277bp qoq due to the implementation of higher risk weight on loans against property. The capital adequacy ratio is at 44.8%, which is sufficient to fuel loan growth in the medium-term.
- In Dec 2023, Aavas Financiers generated 13,500 leads worth Rs21bn in loans while in Jan 2024 it generated 14,600 leads worth Rs22bn in loans, which gives its management the confidence of regaining the growth momentum.
- Aavas Financiers is now again reinforcing & re-energizing its Rs0.75m ticket size product, which is a better-yield product for the company.

BY THE NUMBERS



Profit & Loss

(Rsm)	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Net Interest Income	6,487	7,971	9,072	10,260	12,182
Total Non-Interest Income	1,768	2,220	2,672	2,964	3,749
Operating Revenue	8,255	10,191	11,745	13,224	15,931
Total Non-Interest Expenses	(3,506)	(4,577)	(5,442)	(6,069)	(6,803)
Pre-provision Operating Profit	4,749	5,614	6,303	7,156	9,128
Total Provision Charges	(226)	(124)	(313)	(448)	(900)
Operating Profit After Provisions	4,523	5,490	5,989	6,708	8,228
Pretax Income/(Loss) from Assoc.					
Operating EBIT (incl Associates)	4,523	5,490	5,989	6,708	8,228
Non-Operating Income/(Expense)					
Profit Before Tax (pre-EI)	4,523	5,490	5,989	6,708	8,228
Exceptional Items					
Pre-tax Profit	4,523	5,490	5,989	6,708	8,228
Taxation	(981)	(1,189)	(1,318)	(1,543)	(1,934)
Consolidation Adjustments & Others					
Exceptional Income - post-tax					
Profit After Tax	3,542	4,301	4,672	5,165	6,294
Minority Interests					
Pref. & Special Div					
FX And Other Adj.					
Net Profit	3,542	4,301	4,672	5,165	6,294
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%	96.2%	96.6%	96.8%
Avg Liquid Assets/Avg IEAs	116.2%	114.4%	117.8%	124.1%	124.1%
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	135,930	162,615	197,275
Liquid Assets & Invst. (Current)					
Other Int. Earning Assets					
Total Gross Int. Earning Assets	90,534	114,763	135,930	162,615	197,275
Total Provisions/Loan Loss Reserve					
Total Net Interest Earning Assets	90,534	114,763	135,930	162,615	197,275
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	30,720	41,241	45,434
Long-term Investments	675	1,231	1,477	1,772	2,127
Total Assets	110,570	134,105	172,721	210,750	250,550
Customer Interest-Bearing Liabilities					
Bank Deposits					
Interest Bearing Liabilities: Others	80,120	98,873	131,626	163,316	195,569
Total Interest-Bearing Liabilities	80,120	98,873	131,626	163,316	195,569
Banks Liabilities Under Acceptances					
Total Non-Interest Bearing Liabilities	2,360	2,536	3,227	4,417	5,799
Total Liabilities	82,480	101,408	134,853	167,733	201,368
Shareholders Equity	28,086	32,697	37,868	43,017	49,182
Minority Interests					
Total Equity	28,086	32,697	37,868	43,017	49,182

Key Ratios					
	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Total Income Growth	25.2%	22.9%	13.8%	13.1%	18.7%
Operating Profit Growth	21.6%	18.2%	12.3%	13.5%	27.6%
Pretax Profit Growth	28%	21%	9%	12%	23%
Net Interest To Total Income	78.6%	78.2%	77.2%	77.6%	76.5%
Cost Of Funds	6.64%	6.60%	7.20%	6.70%	6.30%
Return On Interest Earning Assets	13.6%	13.5%	13.9%	13.5%	13.1%
Net Interest Spread	6.95%	6.92%	6.66%	6.79%	6.75%
Net Interest Margin (Avg Deposits)					
Net Interest Margin (Avg RWA)					
Provisions to Pre Prov. Operating Profit	5%	2%	5%	6%	10%
Interest Return On Average Assets	6.48%	6.52%	5.91%	5.35%	5.28%
Effective Tax Rate	21.7%	21.7%	22.0%	23.0%	23.5%
Net Dividend Payout Ratio					
Return On Average Assets	3.54%	3.52%	3.05%	2.69%	2.73%

SOURCE: INCRED RESEARCH, COMPANY REPORTS

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