



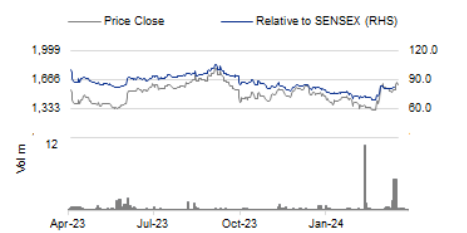
## India

## ADD (previously Hold)

|                              |            |        |        |
|------------------------------|------------|--------|--------|
| Consensus ratings*:          | Buy 14     | Hold 6 | Sell 2 |
| Current price:               | Rs1,605    |        |        |
| Target price:                | Rs2,000 ▲  |        |        |
| Previous target:             | Rs1,650    |        |        |
| Up/downside:                 | 24.6%      |        |        |
| InCred Research / Consensus: | 17.2%      |        |        |
| Reuters:                     |            |        |        |
| Bloomberg:                   | AAVAS IN   |        |        |
| Market cap:                  | US\$1,525m |        |        |
|                              | Rs127,051m |        |        |
| Average daily turnover:      | US\$7.8m   |        |        |
|                              | Rs653.8m   |        |        |
| Current shares o/s:          | 79.0m      |        |        |
| Free float:                  | 55.0%      |        |        |
| *Source: Bloomberg           |            |        |        |

## Key changes in this note

- ▶ With expanding presence in new states (Karnataka/UP) as well as deepening presence in Rajasthan/Gujarat/Maharashtra, growth remains sustainable.



Source: Bloomberg

| Price performance | 1M   | 3M  | 12M   |
|-------------------|------|-----|-------|
| Absolute (%)      | 21.1 | 6.4 | 11.9  |
| Relative (%)      | 18.1 | 1.2 | (9.2) |

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

## Research Analyst(s)



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## Aavas Financiers Ltd

## Efficiencies to drive superior profitability

- We upgrade Aavas Financiers to ADD (HOLD earlier) with a higher target price of Rs2,000, as we believe the company is back to profitable growth trajectory.
- We are building in ~31.6% CAGR in PAT over FY24-27F led by NII CAGR of ~27.4% and operating leverage kicking in amid improved efficiency.
- With expanding presence in new states (Karnataka/UP) as well as deepening presence in Rajasthan/Gujarat/Maharashtra, the growth remains sustainable.

## Momentum in disbursements amid improving geographic presence

Aavas Financiers (Aavas) reported disbursements amounting to Rs18.8bn (+19.1%yoy/+37.4%qoq) amid its improving presence in new geographies like Karnataka and Uttar Pradesh or UP as well as deepening presence in existing strongholds like Rajasthan, Gujarat and Maharashtra. The top four states at present contribute more than 80% to its business, but we expect a gradual diversity in AUM in the coming years. The company has invested in various tech-related initiatives which will enhance overall efficiency and contribute towards AUM growth. We are building ~27.5% CAGR in disbursements over FY24-27F which, in turn, will translate into ~24.7% CAGR in AUM.

## Spreads close to bottom; recent rise in yields to aid margins

Aavas witnessed ~6bp decline in spreads sequentially to ~506bp amid a consistent rise in the cost of funds as well as stagnant yield on advances. This resulted in a ~3bp decline in margins to ~791bp. Though the margins may remain volatile in the near term, the recent hike of ~25bp in the prime lending rate (PLR) will support yields for ~60% of the variable loan book. Management has highlighted that in case of expansion into new geographies, the company prefers low risk/low yield customers. However, gradually with the rise in comfort, the company will increase its dominance in superior-yield products. Thus, the recent expansion in southern and eastern India will eventually generate better yields. Management also intends to increase the share of low-ticket home loans (less than Rs1m) with superior yields, which will aid margins in the coming years.

## Operating leverage to boost profitability further

Post change in management, Aavas witnessed a steep rise in operating expenses, which were initially pertaining to employee costs amid higher attrition followed by elevated tech-driven expenses to improve overall efficiency. We believe such tech investments will improve overall efficiency at branch and employee levels. We expect the cost-to-average assets for the company to improve to ~3.1% by FY27F against ~3.6% in FY24.

## Outlook &amp; valuation

We have upgraded Aavas' rating to ADD (from HOLD earlier) with a higher target price of Rs2,000 (Rs1,650 earlier), corresponding to ~2.9x FY26F, as we expect overall RoA to improve ~3.8% and RoE to improve to ~18% in FY26F led by improving margins & superior operating efficiency. Downside risks: Attrition in top management and growth slowdown.

## Financial Summary

|                                 | Mar-22A | Mar-23A | Mar-24F | Mar-25F | Mar-26F |
|---------------------------------|---------|---------|---------|---------|---------|
| Net Interest Income (Rsm)       | 6,487   | 7,971   | 9,063   | 12,285  | 15,222  |
| Total Non-Interest Income (Rsm) | 1,768   | 2,220   | 2,856   | 3,620   | 4,378   |
| Operating Revenue (Rsm)         | 8,255   | 10,191  | 11,919  | 15,905  | 19,600  |
| Total Provision Charges (Rsm)   | (226)   | (124)   | (245)   | (467)   | (579)   |
| Net Profit (Rsm)                | 3,542   | 4,301   | 4,907   | 7,036   | 8,958   |
| Core EPS (Rs)                   | 45.12   | 54.78   | 62.51   | 89.62   | 114.11  |
| Core EPS Growth                 | 22%     | 21%     | 14%     | 43%     | 27%     |
| FD Core P/E (x)                 | 35.58   | 29.30   | 25.68   | 17.91   | 14.07   |
| 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   | 480.6   | 576.6   | 697.1   |
| P/BV (x)                        | 4.49    | 3.85    | 3.34    | 2.78    | 2.30    |
| ROE                             | 13.6%   | 14.2%   | 13.9%   | 17.0%   | 17.9%   |

% Change In Core EPS Estimates

InCred Research/Consensus EPS (x)

SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 1: Quarterly earnings summary**

| Particulars (Rs m)           | Q4FY22       | 1QFY23       | 2QFY23       | 3QFY23       | 4QFY23       | 1QFY24       | 2QFY24       | 3QFY24       | 4QFY24       | YoY (%)       | QoQ (%)       |
|------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|---------------|---------------|
| Net Interest Income          | 1,804        | 1,802        | 1,877        | 2,082        | 2,213        | 2,262        | 2,223        | 2,208        | 2,371        | 7.1%          | 7.4%          |
| NIM (% of AUM)               | 8.2%         | 7.7%         | 8.2%         | 8.2%         | 8.3%         | 8.0%         | 8.0%         | 7.9%         | 7.9%         |               |               |
| Other Income                 | 143          | 143          | 140          | 149          | 155          | 174          | 201          | 206          | 285          | 83.6%         | 38.1%         |
| Operating Expenses           | 1,059        | 1,026        | 1,147        | 1,201        | 1,204        | 1,339        | 1,308        | 1,349        | 1,434        | 19.2%         | 6.3%          |
| <b>Operating Profit</b>      | <b>1,357</b> | <b>1,156</b> | <b>1,394</b> | <b>1,415</b> | <b>1,650</b> | <b>1,464</b> | <b>1,631</b> | <b>1,577</b> | <b>1,818</b> | <b>10.2%</b>  | <b>15.3%</b>  |
| <b>Provisions</b>            | <b>-104</b>  | <b>9</b>     | <b>16</b>    | <b>35</b>    | <b>64</b>    | <b>57</b>    | <b>65</b>    | <b>80</b>    | <b>43</b>    | <b>-32.4%</b> | <b>-45.8%</b> |
| Exceptional Items            |              |              |              |              |              |              |              |              |              |               |               |
| PBT                          | 1,461        | 1,147        | 1,378        | 1,380        | 1,587        | 1,407        | 1,565        | 1,497        | 1,775        | 11.9%         | 18.5%         |
| Tax                          | 264          | 254          | 310          | 307          | 318          | 310          | 348          | 331          | 349          | 9.6%          | 5.4%          |
| Tax Rate (%)                 |              |              |              |              |              |              |              |              |              |               |               |
| <b>PAT</b>                   | <b>1,197</b> | <b>892</b>   | <b>1,068</b> | <b>1,073</b> | <b>1,268</b> | <b>1,097</b> | <b>1,217</b> | <b>1,167</b> | <b>1,426</b> | <b>12.4%</b>  | <b>22.2%</b>  |
| <b>AUM(Rs bn)</b>            | <b>113.5</b> | <b>118.9</b> | <b>125.4</b> | <b>130.9</b> | <b>141.7</b> | <b>146.5</b> | <b>153.2</b> | <b>160.8</b> | <b>173.1</b> | <b>22.2%</b>  | <b>7.7%</b>   |
| <b>Disbursements (Rs bn)</b> | <b>10.9</b>  | <b>11.5</b>  | <b>12.0</b>  | <b>12.0</b>  | <b>15.8</b>  | <b>10.7</b>  | <b>12.6</b>  | <b>13.7</b>  | <b>18.8</b>  | <b>19.1%</b>  | <b>37.4%</b>  |
| <b>GNPA (%)</b>              | <b>0.99%</b> | <b>1.08%</b> | <b>1.10%</b> | <b>1.1%</b>  | <b>0.9%</b>  | <b>1.0%</b>  | <b>1.0%</b>  | <b>1.0%</b>  | <b>0.9%</b>  | <b>0.0%</b>   | <b>0.0%</b>   |

SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 2: Our revised earnings estimates**

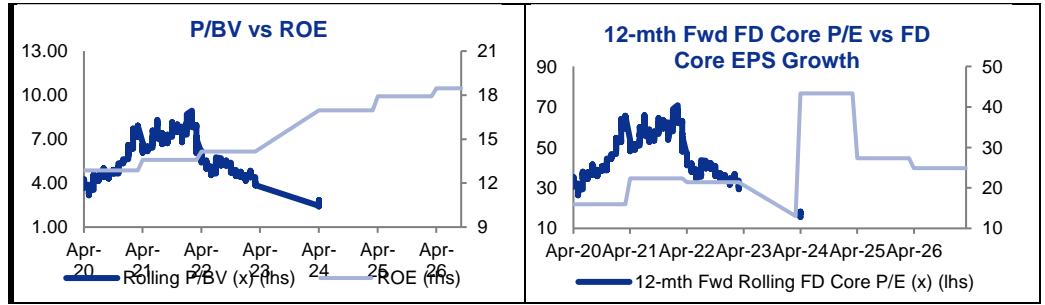
| Y/E Mar (Rs m)      | FY25F      |            |              | FY26F      |            |              | FY27F     |            |           |
|---------------------|------------|------------|--------------|------------|------------|--------------|-----------|------------|-----------|
|                     | Earlier    | Revised    | % change     | Earlier    | Revised    | % change     | Earlier   | Revised    | % change  |
| Net interest income | 10,703     | 12,285     | 14.8%        | 12,827     | 15,222     | 18.7%        | NA        | 18,750     | NA        |
| PPOP                | 7,700      | 9,545      | 24.0%        | 9,799      | 12,137     | 23.9%        | NA        | 15,399     | NA        |
| PAT                 | 5,576      | 7,036      | 26.2%        | 6,788      | 8,958      | 32.0%        | NA        | 11,186     | NA        |
| EPS (Rs)            | 71         | 90         | 26.2%        | 86         | 114        | 32.0%        | NA        | 142        | NA        |
| BV (Rs)             | 553        | 577        | 4.4%         | 637        | 697        | 9.5%         | NA        | 846        | NA        |
| <b>AUM (Rs bn)</b>  | <b>209</b> | <b>214</b> | <b>2.7%</b>  | <b>254</b> | <b>268</b> | <b>5.5%</b>  | <b>NA</b> | <b>335</b> | <b>NA</b> |
| <b>GNPA (%)</b>     | <b>1%</b>  | <b>1%</b>  | <b>-7.5%</b> | <b>1%</b>  | <b>1%</b>  | <b>-4.9%</b> | <b>NA</b> | <b>1%</b>  | <b>NA</b> |

SOURCES: INCRED RESEARCH, COMPANY REPORTS

## 4QFY24 earnings conference-call highlights

- The home loan rate is around 12.5% and for MSME loans it is around 15%.
- During the quarter, there was balance transfer of loans and to retain customers, and the rates were trimmed which had a hit on NIM. The balance transfer rate continues to be at 5bp per month on outstanding loans. In balance transfer cases, the company looks at case-by-case considering whether it is its focus area and whether it is getting overleveraged by taking a call. There is nothing to worry about this aspect as of now.
- Borrowing across multiple sources has aided in keeping the cost of borrowing low. For instance, the company has tied up with large all India financial institutions which provide concessional rates, like the National Housing Bank provides concessional rate to housing finance companies, pass-through certificate transaction, etc.
- The 1+DPD is at 3.12%, which has improved due to the quality of sourcing, quality of underwriting and constant efforts of the company's risk and collection team.
- Credit cost for the quarter is 11bp and for the full year it is 16bp.
- Management gave guidance that the spreads will improve by 25bp from 5.06% next quarter.
- Rajasthan's share in the loan book is at 35%. The company remains focused on building its loan book in Uttar Pradesh and Karnataka.
- The branch expansion is set to be at 10%. Additional branches to go deeper in Karnataka, Uttar Pradesh and other regions.
- The assignment of loans to witness a strong growth of 15-20% as due to quality assets, there is an interest from banks. The loan book comprises 17-18% MSME loans where the company has made 23-27% disbursements, which adds to the interest of banks.
- Employee costs are higher due to ESOPs and long-term incentive cost plans.
- The tax rate was lower due to adjustments made on account of the final assessment order.
- The digital channel had 13% of the disbursements, which was historically at 10%. Rest of the disbursements are hybrid, with digital and physical touch, and an opex-light model.
- The tech transformation is on track, and it will not impact the business going ahead.

BY THE NUMBERS



**Profit & Loss**

| (Rsm)                                   | Mar-22A        | Mar-23A        | Mar-24F        | Mar-25F        | Mar-26F        |
|---|----------------|----------------|----------------|----------------|----------------|
| Net Interest Income                     | 6,487          | 7,971          | 9,063          | 12,285         | 15,222         |
| <b>Total Non-Interest Income</b>        | <b>1,768</b>   | <b>2,220</b>   | <b>2,856</b>   | <b>3,620</b>   | <b>4,378</b>   |
| Operating Revenue                       | 8,255          | 10,191         | 11,919         | 15,905         | 19,600         |
| <b>Total Non-Interest Expenses</b>      | <b>(3,506)</b> | <b>(4,577)</b> | <b>(5,430)</b> | <b>(6,360)</b> | <b>(7,462)</b> |
| Pre-provision Operating Profit          | 4,749          | 5,614          | 6,489          | 9,545          | 12,137         |
| <b>Total Provision Charges</b>          | <b>(226)</b>   | <b>(124)</b>   | <b>(245)</b>   | <b>(467)</b>   | <b>(579)</b>   |
| Operating Profit After Provisions       | 4,523          | 5,490          | 6,245          | 9,078          | 11,559         |
| <b>Pretax Income/(Loss) from Assoc.</b> |                |                |                |                |                |
| Operating EBIT (incl Associates)        | 4,523          | 5,490          | 6,245          | 9,078          | 11,559         |
| <b>Non-Operating Income/(Expense)</b>   |                |                |                |                |                |
| Profit Before Tax (pre-EI)              | 4,523          | 5,490          | 6,245          | 9,078          | 11,559         |
| <b>Exceptional Items</b>                |                |                |                |                |                |
| Pre-tax Profit                          | 4,523          | 5,490          | 6,245          | 9,078          | 11,559         |
| Taxation                                | (981)          | (1,189)        | (1,337)        | (2,043)        | (2,601)        |
| Consolidation Adjustments & Others      |                |                |                |                |                |
| <b>Exceptional Income - post-tax</b>    |                |                |                |                |                |
| Profit After Tax                        | 3,542          | 4,301          | 4,907          | 7,036          | 8,958          |
| Minority Interests                      |                |                |                |                |                |
| Pref. & Special Div                     |                |                |                |                |                |
| <b>FX And Other Adj.</b>                |                |                |                |                |                |
| Net Profit                              | 3,542          | 4,301          | 4,907          | 7,036          | 8,958          |
| 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%         | 95.8%         | 95.8%         | 96.0%         |
| <b>Avg Liquid Assets/Avg IEAs</b>      | <b>116.2%</b> | <b>114.4%</b> | <b>112.5%</b> | <b>114.3%</b> | <b>116.0%</b> |
| Net Cust Loans/Assets                  |               |               |               |               |               |
| <b>Net Cust Loans/Broad Deposits</b>   |               |               |               |               |               |
| Equity & Provsns/Gross Cust Loans      |               |               |               |               |               |
| Asset Risk Weighting                   |               |               |               |               |               |
| <b>Provision Charge/Avg Cust Loans</b> |               |               |               |               |               |
| <b>Provision Charge/Avg Assets</b>     |               |               |               |               |               |
| Total Write Offs/Average Assets        |               |               |               |               |               |

SOURCE: INCRED RESEARCH, COMPANY REPORTS

**BY THE NUMBERS...cont'd**

| <b>Balance Sheet</b>                      |                |                |                |                |                |
|---|----------------|----------------|----------------|----------------|----------------|
| <b>(Rsm)</b>                              | <b>Mar-22A</b> | <b>Mar-23A</b> | <b>Mar-24F</b> | <b>Mar-25F</b> | <b>Mar-26F</b> |
| <b>Total Gross Loans</b>                  | <b>90,534</b>  | <b>114,763</b> | <b>140,044</b> | <b>171,372</b> | <b>214,405</b> |
| Liquid Assets & Invst. (Current)          |                |                |                |                |                |
| Other Int. Earning Assets                 |                |                |                |                |                |
| Total Gross Int. Earning Assets           | 90,534         | 114,763        | 140,044        | 171,372        | 214,405        |
| <b>Total Provisions/Loan Loss Reserve</b> |                |                |                |                |                |
| Total Net Interest Earning Assets         | 90,534         | 114,763        | 140,044        | 171,372        | 214,405        |
| Intangible Assets                         |                |                |                |                |                |
| <b>Other Non-Interest Earning Assets</b>  | <b>3,365</b>   | <b>3,734</b>   | <b>4,191</b>   | <b>4,610</b>   | <b>5,071</b>   |
| <b>Total Non-Interest Earning Assets</b>  | <b>3,692</b>   | <b>4,295</b>   | <b>5,351</b>   | <b>6,002</b>   | <b>6,742</b>   |
| Cash And Marketable Securities            | 15,669         | 13,816         | 17,978         | 26,626         | 35,213         |
| <b>Long-term Investments</b>              | <b>675</b>     | <b>1,231</b>   | <b>1,822</b>   | <b>2,550</b>   | <b>3,443</b>   |
| Total Assets                              | 110,570        | 134,105        | 165,195        | 206,551        | 259,802        |
| Customer Interest-Bearing Liabilities     |                |                |                |                |                |
| Bank Deposits                             |                |                |                |                |                |
| Interest Bearing Liabilities: Others      | 80,120         | 98,873         | 123,365        | 154,722        | 196,541        |
| Total Interest-Bearing Liabilities        | 80,120         | 98,873         | 123,365        | 154,722        | 196,541        |
| Banks Liabilities Under Acceptances       |                |                |                |                |                |
| Total Non-Interest Bearing Liabilities    | 2,360          | 2,536          | 4,097          | 6,561          | 8,535          |
| Total Liabilities                         | 82,480         | 101,408        | 127,462        | 161,283        | 205,076        |
| Shareholders Equity                       | 28,086         | 32,697         | 37,732         | 45,268         | 54,726         |
| <b>Minority Interests</b>                 |                |                |                |                |                |
| Total Equity                              | 28,086         | 32,697         | 37,732         | 45,268         | 54,726         |

| <b>Key Ratios</b>                        |                |                |                |                |                |
|--|----------------|----------------|----------------|----------------|----------------|
|  | <b>Mar-22A</b> | <b>Mar-23A</b> | <b>Mar-24F</b> | <b>Mar-25F</b> | <b>Mar-26F</b> |
| Total Income Growth                      | 25.2%          | 22.9%          | 13.7%          | 35.6%          | 23.9%          |
| Operating Profit Growth                  | 21.6%          | 18.2%          | 15.6%          | 47.1%          | 27.2%          |
| Pretax Profit Growth                     | 28%            | 21%            | 14%            | 45%            | 27%            |
| Net Interest To Total Income             | 78.6%          | 78.2%          | 76.0%          | 77.2%          | 77.7%          |
| Cost Of Funds                            | 6.64%          | 6.60%          | 7.45%          | 6.70%          | 6.30%          |
| Return On Interest Earning Assets        | 13.6%          | 13.5%          | 13.6%          | 13.9%          | 13.6%          |
| Net Interest Spread                      | 6.95%          | 6.92%          | 6.16%          | 7.17%          | 7.33%          |
| Net Interest Margin (Avg Deposits)       |                |                |                |                |                |
| Net Interest Margin (Avg RWA)            |                |                |                |                |                |
| Provisions to Pre Prov. Operating Profit | 5%             | 2%             | 4%             | 5%             | 5%             |
| Interest Return On Average Assets        | 6.48%          | 6.52%          | 6.06%          | 6.61%          | 6.53%          |
| Effective Tax Rate                       | 21.7%          | 21.7%          | 21.4%          | 22.5%          | 22.5%          |
| Net Dividend Payout Ratio                |                |                |                |                |                |
| Return On Average Assets                 | 3.54%          | 3.52%          | 3.28%          | 3.79%          | 3.84%          |

SOURCE: INCRED RESEARCH, COMPANY REPORTS

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