

India

ADD (no change)

Consensus ratings*: Buy 18 Hold 3 Sell 2	
Current price:	Rs1,706
Target price:	Rs2,000
Previous target:	Rs2,000
Up/downside:	17.2%
InCred Research / Consensus:	3.6%
Reuters:	AVAS.NS
Bloomberg:	AAVAS IN
Market cap:	US\$1,859m Rs135,008m
Average daily turnover:	US\$7.2m Rs526.0m
Current shares o/s:	79.0m
Free float:	73.5%
*Source: Bloomberg	

Key changes in this note

- The disbursement trend remained weak amid tech implementation as well as extended monsoons in northern India, however an improvement is likely in 2HFY25F.



Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	(1.2)	4.5	16.8
Relative (%)	0.6	4.4	(4.6)

Major shareholders	% held
Lake Districts	15.6
Partners Group	10.9
First Sentier Investors	4.9

Research Analyst(s)



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

Meghna LUTHRA
T (91) 22 4161 1500
E meghna.luthra@incredresearch.com

Rishabh JOGANI
T (91) 22 4161 1569
E rishabh.jogani@incredresearch.com

Aavas Financiers Ltd

Gearing up for growth with focus on spreads

- Aavas Financiers posted a better-than-expected 2Q PAT of Rs1.48bn (InCred estimate: Rs1.26bn) led by a lower provision & improving operating efficiency.
- Disbursement trend remained weak amid tech implementation & extended monsoons in northern India, however an improvement is likely in 2HFY25F.
- Aavas remains a safe bet in the current volatility, however its growth and spreads need to improve. We maintain our ADD rating with a TP of Rs2,000.

Weak disbursement; improving geographic presence is encouraging

Aavas Financiers (Aavas) reported 2QFY25 disbursements amounting to Rs13bn (flat qoq) as a one-time shutdown, coupled with an extended monsoon season in several parts of India had affected the construction activity, resulted in lower fresh disbursement. However, the demand environment and new customer acquisition for Aavas is expected to remain healthy in 2HFY25F. Aavas is improving its presence in new geographies as well as deepening it in existing strongholds. We are building in ~15% CAGR in disbursements over FY24-27F, which will translate into ~20.4% CAGR in assets under management or AUM.

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

Aavas witnessed ~11bp decline in its spreads sequentially to ~489bp amid a consistent rise in the cost of funds as well as stagnant yield on advances. However, its margin witnessed a sequential improvement of ~47bp to ~778bp amid superior AUM yields compared to disbursement yields. Though margins may remain volatile in the near term, the recent hike of ~25bp in the prime lending rate (PLR) will support yields for ~68% of the variable loan book. Management has highlighted that during the expansion into new geographies, Aavas 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 yield.

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 a higher attrition rate followed by elevated tech-driven expenses to improve overall efficiency. We believe such tech investments will improve the overall efficiency at branch as well as employee level. We expect the cost-to-average assets ratio for Aavas to improve to ~3% by FY26F vs. ~3.6% in FY24.

Outlook & valuation

Aavas remains a safe bet on the asset quality front in the current volatile environment, however growth and spreads need to improve. We like Aavas as it is returning to a profitable growth trajectory with improving return ratios. The 2Q performance has been a mixed bag, however we expect an improvement in coming quarters. We retain our ADD rating on Aavas with a target price of Rs2,000, or ~3x FY26F BV. Downside risks: Attrition in top management and growth slowdown.

Financial Summary

	Mar-23A	Mar-24A	Mar-25F	Mar-26F	Mar-27F
Net Interest Income (Rsm)	7,971	9,063	10,132	11,952	14,396
Total Non-Interest Income (Rsm)	2,220	2,856	3,483	3,811	4,382
Operating Revenue (Rsm)	10,191	11,919	13,615	15,763	18,778
Total Provision Charges (Rsm)	(124)	(245)	(305)	(363)	(435)
Net Profit (Rsm)	4,301	4,907	5,899	7,040	8,509
Core EPS (Rs)	54.78	62.51	75.14	89.68	108.39
Core EPS Growth	21%	14%	20%	19%	21%
FD Core P/E (x)	31.14	27.29	22.70	19.02	15.74
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)	416.5	480.6	555.8	645.5	753.8
P/BV (x)	4.10	3.55	3.07	2.64	2.26
ROE	14.2%	13.9%	14.5%	14.9%	15.5%
% Change In Core EPS Estimates					
InCred Research/Consensus EPS (x)					

SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 1: Quarterly earnings performance

Particulars (Rs m)	1QFY24	2QFY24	3QFY24	4QFY24	1QFY25	2QFY25	YoY (%)	QoQ (%)
Net Interest Income	2,262	2,223	2,208	2,371	2,446	2,418	8.8%	-1.1%
<i>NIM (% of AUM)</i>	8.0%	8.0%	7.9%	7.9%	7.3%	7.8%		
Other Income	174	201	206	285	261	242	20.4%	-7.2%
Operating Expenses	1,339	1,308	1,349	1,434	1,379	1,368	4.6%	-0.8%
Operating Profit	1,464	1,631	1,577	1,818	1,695	1,948	19.5%	14.9%
Provisions	57	65	80	43	86	48	-25.9%	-43.8%
Exceptional Items								
PBT	1,407	1,565	1,497	1,775	1,609	1,900	21.4%	18.1%
Tax	310	348	331	349	348	421	21.0%	20.9%
PAT	1,097	1,217	1,167	1,426	1,261	1,479	21.5%	17.3%
AUM (Rsbn)	146.5	153.2	160.8	173.1	178.4	184.0	20.1%	3.1%
Disbursements (Rsbn)	10.7	12.6	13.7	18.8	12.1	12.9	2.8%	6.8%

SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 2: Our revised earnings estimates

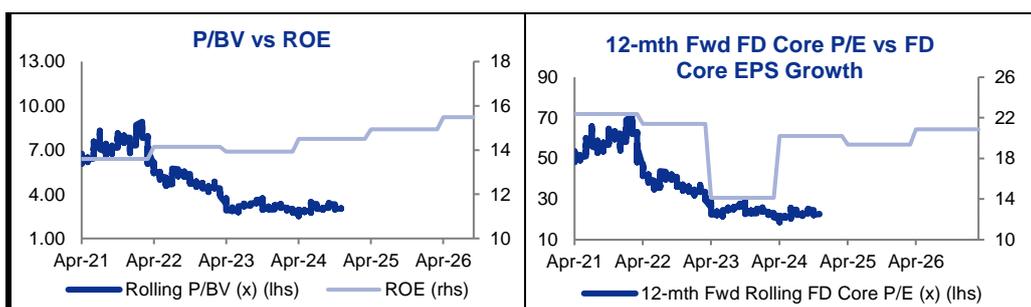
Y/E Mar (Rs m)	FY25F			FY26F			FY27F		
	Earlier	Revised	% change	Earlier	Revised	% change	Earlier	Revised	% change
Net interest income	10,946	10,132	-7.4%	13,530	11,952	-11.7%	16,679	14,396	-13.7%
PPOP	7,916	7,868	-0.6%	9,640	9,389	-2.6%	12,193	11,344	-7.0%
PAT	5,774	5,899	2.2%	7,028	7,040	0.2%	8,900	8,509	-4.4%
EPS (Rs)	74	75	2.2%	90	90	0.2%	113	108	-4.4%
BV (Rs)	561	556	-0.9%	656	645	-1.7%	776	754	-2.9%
AUM(Rsbn)	213	207	-3.0%	264	247	-6.1%	327	296	-9.4%

SOURCE: INCRED RESEARCH, COMPANY REPORTS

2QFY25 earnings conference-call highlights

- Spreads compressed by ~11bp qoq due to an ~7bp qoq rise in the cost of funds and ~4bp decline in yields.
- The spread compression was on account of compressed yield on disbursements in the last around two years.
- Current yield on AUM is ~13.04% while the yield on disbursements was ~12.74% in 1HFY25, which was ~12.54% yoy.
- The company raised its lending rate by ~25bp in Oct 2024, which will impact the overall AUM yield with a lag.
- Disbursements at ~Rs13bn (up ~2.5 yoy and ~6.8% qoq) were impacted by IT upgradation and an extended monsoon season.
- The company implemented TAP upgradation with the loan management system, Oracle, which resulted in a one-time LMS shutdown.
- Total IT capitalization guidance stands at ~Rs600m, which will be amortized over a period of seven years.
- The extended monsoon season affected building and construction activity in some parts of the country.
- Disbursements grew by ~22% yoy in Sep and Oct 2024 cumulatively.
- AUM growth guidance stands at 20%+ yoy for FY25F.
- Management indicated 1+dpd at <5%, GNPA ratio <1.25% and credit costs <25bp for FY25F.
- The balance transfer was 5.2% on an annualized basis in 2QFY25, which was flat qoq.
- Balance transfer and customer payout was ~16%, which is guided to be 17-18% for FY25F.

BY THE NUMBERS



Profit & Loss

(Rsm)	Mar-23A	Mar-24A	Mar-25F	Mar-26F	Mar-27F
Net Interest Income	7,971	9,063	10,132	11,952	14,396
Total Non-Interest Income	2,220	2,856	3,483	3,811	4,382
Operating Revenue	10,191	11,919	13,615	15,763	18,778
Total Non-Interest Expenses	(4,577)	(5,430)	(5,747)	(6,374)	(7,434)
Pre-provision Operating Profit	5,614	6,489	7,868	9,389	11,344
Total Provision Charges	(124)	(245)	(305)	(363)	(435)
Operating Profit After Provisions	5,490	6,245	7,563	9,026	10,909
Pretax Income/(Loss) from Assoc.					
Operating EBIT (incl Associates)	5,490	6,245	7,563	9,026	10,909
Non-Operating Income/(Expense)					
Profit Before Tax (pre-EI)	5,490	6,245	7,563	9,026	10,909
Exceptional Items					
Pre-tax Profit	5,490	6,245	7,563	9,026	10,909
Taxation	(1,189)	(1,337)	(1,664)	(1,986)	(2,400)
Consolidation Adjustments & Others					
Exceptional Income - post-tax					
Profit After Tax	4,301	4,907	5,899	7,040	8,509
Minority Interests					
Prof. & Special Div					
FX And Other Adj.					
Net Profit	4,301	4,907	5,899	7,040	8,509
Recurring Net Profit					

Balance Sheet Employment

(Rsm)	Mar-23A	Mar-24A	Mar-25F	Mar-26F	Mar-27F
Gross Loans/Cust Deposits					
Avg Loans/Avg Deposits					
Avg Liquid Assets/Avg Assets	96.0%	95.8%	95.6%	95.6%	95.7%
Avg Liquid Assets/Avg IEAs	114.4%	112.5%	112.7%	111.8%	110.4%
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-23A	Mar-24A	Mar-25F	Mar-26F	Mar-27F
Total Gross Loans	114,763	140,044	165,325	197,931	237,164
Liquid Assets & Invst. (Current)					
Other Int. Earning Assets					
Total Gross Int. Earning Assets	114,763	140,044	165,325	197,931	237,164
Total Provisions/Loan Loss Reserve					
Total Net Interest Earning Assets	114,763	140,044	165,325	197,931	237,164
Intangible Assets					
Other Non-Interest Earning Assets	3,734	4,191	4,610	5,071	5,578
Total Non-Interest Earning Assets	4,295	5,351	6,002	6,742	7,583
Cash And Marketable Securities	13,816	17,978	20,787	21,947	23,381
Long-term Investments	1,231	1,822	2,550	3,315	4,144
Total Assets	134,105	165,195	194,664	229,934	272,272
Customer Interest-Bearing Liabilities					
Bank Deposits					
Interest Bearing Liabilities: Others	98,873	123,365	145,933	172,909	205,169
Total Interest-Bearing Liabilities	98,873	123,365	145,933	172,909	205,169
Banks Liabilities Under Acceptances					
Total Non-Interest Bearing Liabilities	2,536	4,097	5,101	6,355	7,922
Total Liabilities	101,408	127,462	151,033	179,263	213,092
Shareholders Equity	32,697	37,732	43,631	50,671	59,180
Minority Interests					
Total Equity	32,697	37,732	43,631	50,671	59,180

Key Ratios					
	Mar-23A	Mar-24A	Mar-25F	Mar-26F	Mar-27F
Total Income Growth	22.9%	13.7%	11.8%	18.0%	20.4%
Operating Profit Growth	18.2%	15.6%	21.2%	19.3%	20.8%
Pretax Profit Growth	21%	14%	21%	19%	21%
Net Interest To Total Income	78.2%	76.0%	74.4%	75.8%	76.7%
Cost Of Funds	6.60%	7.45%	7.50%	7.20%	7.00%
Return On Interest Earning Assets	13.5%	13.6%	13.2%	12.9%	12.7%
Net Interest Spread	6.92%	6.16%	5.75%	5.70%	5.70%
Net Interest Margin (Avg Deposits)					
Net Interest Margin (Avg RWA)					
Provisions to Pre Prov. Operating Profit	2%	4%	4%	4%	4%
Interest Return On Average Assets	6.52%	6.06%	5.63%	5.63%	5.73%
Effective Tax Rate	21.7%	21.4%	22.0%	22.0%	22.0%
Net Dividend Payout Ratio					
Return On Average Assets	3.52%	3.28%	3.28%	3.32%	3.39%

SOURCE: INCRED RESEARCH, COMPANY REPORTS

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- Add** The stock's total return is expected to exceed 10% over the next 12 months.
- Hold** The stock's total return is expected to be between 0% and positive 10% over the next 12 months.
- Reduce** The stock's total return is expected to fall below 0% or more over the next 12 months.

The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

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Definition:

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- Neutral** A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
- Underweight** An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

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Definition:

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- Neutral** A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
- Underweight** An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.