

September 24, 2018

IPO Note

IPO Fact Sheet

Opening Date	September 25, 2018
Closing Date	September 27, 2018
BRLMs	HDFC Bank, ICICI Securities, Citi, Edelweiss, Spark Capital
Issue Size	Rs17.28 – 17.34bn
Fresh Issue (mn share)	4.87-4.89
Offer for Sale (mn share)	16.25

Issue Details

Pre-issue equity (m shares)	73.7
Post-issue equity (m shares)	78.60-78.61
Post-issue Market Cap (Rs bn)	64.30-64.53

Shareholding Pattern

(%)	Pre-Issue	Post-Issue
Promoters	81.3%	80.2%

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Valuations leave little room for negative surprise

Aavas Financiers Ltd (Aavas) is a play on affordable housing finance with loan portfolio of Rs 43,591 mn. Aavas was promoted by AU Small Finance Bank (SFB) but is now controlled by private equity (PE) companies, namely; Kedaara Capital and Partners Group. Aavas operates 165 branches across 8 western/northern states with focus on small towns. It has ATS of ~ Rs 0.86 mn for housing loans with 85% being individual loans.

Aavas has strong business momentum (65% disbursements/78% loan growth in FY14-FY18) with greater thrust on operational efficiency, strong credit quality marked by in-house business sourcing, wider usage of analytics, risk management and collection framework with resultant GNPA at mere 0.5% (Q1FY19). Such superior metrics have led to ratings upgrade from BBB+(FY14) to A+(FY18) resulting into cost of funds (CoF) decline from 12.3% (FY14) to 8.6% (Q1FY19). However, at trailing book and upper price band (Rs 821), P/E of 52x, P/B of 5.0x and post infusion at 4.1x P/B (FY19), valuations stand at a significant premium vis-à-vis peer set (quality HFCs trading at ~3x) pricing in all the positives. Further, elevated CAR at 61%, challenging market conditions, coupled with higher valuations entail greater risk to sustenance of high growth and improved RoE's. Although long term prospects look positive, valuations are stretched and leave scope for negative surprise. AVOID.

- **Niche positioning and strong operational framework – key strengths:** Unique positioning between nationalized banks and money lenders, Aavas engages in serving self-employed customers (64% of loans) having limited access to formal credit (36% of loans to new to credit customers) with majority of credit being extended towards single unit properties (end-user is occupant). Without compromising on asset quality (GNPA:0.5%) and maintaining superior asset-liability management underpinned by cost effective long term funding, Aavas has succeeded in maintaining robust business momentum (65% disbursements/78% loan growth) over past 4 years.
- **Geographic concentration – a key concern:** With close to 50% loan mix concentrated in Rajasthan region and continued deeper penetration plans would retain this high mix. Going by the peer-set experiences (Tamil Nadu, Karnataka regions) and challenging market environment, Aavas' business is prone to geographic concentration risks in near to medium term.
- **High capitalization; expensive valuations deterrent:** High capital adequacy (61%) will not only depress RoE in near term (current RoE at 11%) but elevated valuations would require high growth to improve ratios and justify valuations. Market conditions are challenging with high interest rates, bond yields volatility and anemic property market. Although technological driven processes (data analytics for onboarding customers, risk management, collection framework), regional expansion and stepping-up leverage signal bettering operational efficiencies in long term, valuations leave little scope for a negative surprise. AVOID.

Aavas Financiers Ltd– valuations leave little room for negative surprise

Incorporated as a subsidiary of Au SFB in Feb'11 for providing housing finance in rural and semi-urban areas, Aavas Financiers (erstwhile Au Housing Finance Ltd) started its operations in Mar'12 and is headquartered in Jaipur, Rajasthan. Erstwhile promoted by AU Small Finance Bank (SFB) (today holds 7.2%), now promoted by private equity (PE) companies, namely; Kedaara Capital (51.8% holding) and Partners Group (35.2%), Aavas Financiers is a retail, affordable housing finance company with loan book of Rs 43.6bn.

With thrust on providing housing loans (85%: individual housing loans and 22.4% mortgage loans including LAP) predominantly in smaller towns, Aavas operates off 165 branches across 8 western/northern states (Rajasthan, Maharashtra, Madhya Pradesh, Gujarat, Chhattisgarh, Haryana, Delhi and Uttar Pradesh) with ATS of ~ Rs 0.86 mn. Company follows the contiguous expansion of geographic footprint and network of branches.

Unique positioning between nationalized banks and money lenders, Aavas engages in serving self-employed customers (64% of loans) having limited access to formal credit (36% of loans to new to credit customers) with majority of credit being extended towards single unit properties (end-user is occupant). Being a customer-centric organization, the active customer retention rate of 57%. With 68% of the business happening in first 3 weeks as against 30% industry average, the company endeavors in providing effective customer experience matching HDFC standards in Tier II/III towns. Almost 60% of the loan portfolio stands extended to customers with earnings below Rs 50,000 per month with customer acquisition run-rate per months standing at 2500 with 10,000 files being sourced each month.

Core Business Strategy:

- Foray in new states – no growth targets in first 18 months
- Creation of risk structure before creating business structure in a new geography
- Low ticket lending, low LTV, no change in current business mix

Robust collections framework and huge dependency on data analytics (60 people tech team, 10 member analytics team) in turn has enabled to build prediction loss model and also aided reduction in TAT (54% of loan cases today have TAT lesser than 10 days). The company has also engaged with rating agencies to develop rating score card model. Aavas lays greater focus on soft bucket than 90 dpd+ bucket since inception.

Effective ALM management holds the key as the company expects to maintain positive ALM over next 5 years supported by robust liability management (cost effective long term funding). With ratings upgrade in place, the average cost of borrowings stood at 8.6% (FY18) as against higher levels of 12.3% (FY14). This coupled with superior asset quality and growth have led to 2.5% RoA sustenance with spread maintenance at ~5% since past 7 years.

Key risks to business:

With Rajasthan accounting for 46% of overall loans (Mar'18) (48% as on March 31, 2017), reflects **geographical concentration risks** and with further penetration plan in place, the mix should remain higher. Said that, Aavas aims to diversify and move off the home turf post capital infusion.

With 64% of the portfolio comprising of low to middle income self-employed group (earning <₹50,000/month), it stands **vulnerable to credit cycles**. However, low LTV (45-50%) with secured lending (self-occupied residential properties), low ticket size (₹8.6 lakhs), in-house sourcing model with adequate risk management tools, portfolio monitoring systems/ SARFAESI and improved analytical systems should be able to limit credit losses. Still, soft bucket movement need to be closely watched.

Higher capitalization (61.8% post infusion of Rs. 4.41 bn by PE/management in FY18) and **low gearing** (2.4x) have **depressed RoEs** to 11.2% (FY18) from higher levels of 21.5% (FY16) and 15% (FY17). The company aims to step-up gearing to 5x-6x, improve customer profile, diversify across geographies which can further boost ratings (3 rating approvals in last 2 years).

Exhibit 1: Issue Details

Launch Date	25th September 2018		
Issue Period	Opening Date: 25 th September, 2018; Closing Date: 27 th September, 2018		
Issuer	Aavas Financiers Ltd.		
Net Offer	Rs 17.28-17.34 bn		
Price Band	Rs 818 –821		
Offer Structure	@ Upper Band	@Lower Band	
(No. of shares in mn)	21.14	21.12	
Fresh Issue	4.89	4.87	
Offer for Sale (Rs mn)	16.25		

Source: RHP, PL

AU SFB sold its stake in Aavas Financiers to Kedaara Capital and Partners Group in June'16 on conversion into small finance bank.

Exhibit 2: Change in Shareholding Pattern

	Pre-Offer	Post-Offer
Lake District (Promoter)	47.8%	33.6%
ESCL (Promoter)	23.2%	16.3%
Master Fund (Promoter Group)	10.2%	7.2%
Kedaara AIF-1	1.3%	0.9%
Sushil Kumar Agarwal	5.6%	4.1%
Vivek Vig	1.0%	0.8%

Source: RHP, PL



Key Management Personnel

Exhibit 3: Management Details

Member	Designation	Details
Sushil Kumar Agarwal	Whole time Director/CEO	Associated with Aavas since its incorporation in 2011, Sushil Kumar Agarwal, a qualified chartered accountant, company secretary was previously associated with Au SFB as its Business Head – SME & Mortgages. Mr. Agarwal has previously worked with ICICI Bank Ltd, Kotak Mahindra Primus Limited and has over 17 years of experience in the retail financial services space
Ghanshyam Rawat	CFO	Mr. Rawat was appointed as the Chief Financial Officer with effect from June 1, 2014 and he presently heads finance and treasury; accounts; internal audit; compliance; budget and analytics departments. A bachelor in commerce from the Rajasthan University, Mr Rawat is a fellow member of the Institute of Chartered Accountants of India. He has been previously associated with First Blue Home Finance Ltd, Accenture India Private Ltd and Deutsche Postbank Home Finance Ltd.

Source: Company, PL

AAVAS Financiers in Charts

Exhibit 4: Geographic concentration risks persist

Geography	% of overall branch n/w	% of overall loans
Rajasthan	43.4	46.6
Gujarat	16.3	16.7
Maharashtra	20.5	19.3
MP	14.5	9.9
Delhi	1.2	4.4
Haryana	1.8	1.1
UP	0.6	1.8
Chhattisgarh	1.8	0.2

Source: Company, PL

Exhibit 6: Stronger margin profile

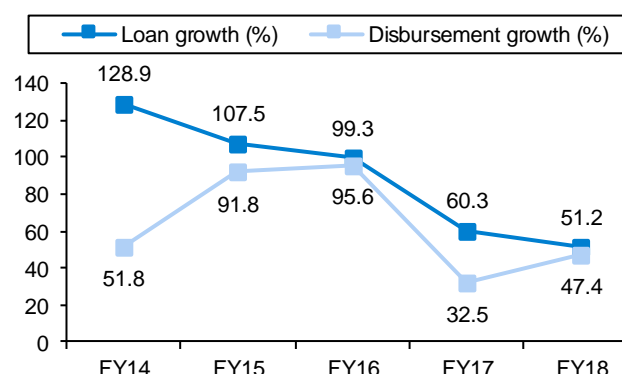
	FY14	FY15	FY16	FY17	FY18
Yield on loans (%)	18.1	16.5	15.1	14.7	14.0
Cost of funds (%)	12.3	11.4	10.5	9.6	8.7
NIM (%)	6.7	6.8	6.1	6.6	7.3
Spreads (%)	5.9	5.1	4.6	5.1	5.3

Source: Company, PL

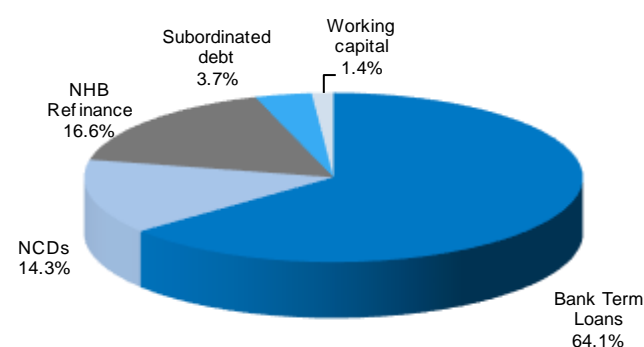
Exhibit 8: Pristine asset quality, credit costs to be watched

	FY14	FY15	FY16	FY17	FY18	Q1FY19
GNPA (%)	0.22	0.52	0.55	0.79	0.34	0.50
NNPA (%)	0.19	0.43	0.42	0.60	0.26	0.38
PCR (%)	15.6	18.4	23.3	24.0		22.8
Credit costs (% of AUM)	0.2	0.4	0.3	0.4	0.1	0.2

Source: Company, PL

Exhibit 5: Healthy business traction record


Source: Company, PL

Exhibit 7: Liability mix supportive of effective ALM


Source: Company, PL

Exhibit 9: Higher CAR and low leverage depress RoE

	CAR (%)			Leverage (x)			RoE (%)		
	FY16	FY17	FY18	FY16	FY17	FY18	FY16	FY17	FY18
Aavas	27.5	46.8	61.5	8.4	5.4	3.8	21.5	14.8	11.2
Gruh	17.8	18.4	18.8	13.7	12.2	11.7	31.0	30.0	29.0
Repco	20.6	20.9	23.0	8.0	8.0	7.6	17.6	18.1	17.5
Can Fin	20.7	18.5	19.1	12.4	12.5	11.7	17.8	21.9	22.3
PNB HFC	12.7	21.6	16.6	10.7	8.7	7.6	17.0	15.0	14.0

Source: Company, PL

Financials

Exhibit 10: Income Statement (Rs mn)

Y/e March	FY14	FY15	FY16	FY17	FY18
Net Interest Income	203	429	756	1,275	2,044
Other Income	39	81	184	352	638
Net Income	242	510	940	1,627	2,682
Growth %		110.7	84.3	73.1	64.8
Operating expenses	138	197	405	673	1,245
Growth %		42.8	105.6	66.2	85.0
Pre Provision Profit	104	313	535	954	1,437
Provisions	10	23	36	78	19
Profit Before Tax	94	290	499	876	1,418
Tax Expense:	31	99	172	304	488
Tax Rate (%)	33.0	34.1	34.5	34.7	34.4
PAT	63	191	327	572	930
Growth (%)		203.2	71.2	74.9	62.6

Source: Company, PL

Exhibit 11: Balance Sheet (Rs mn)

Y/e March	FY14	FY15	FY16	FY17	FY18
Equity	299	329	384	582	692
Reserves	255	685	1,654	5,082	10,293
Net worth	554	1,014	2,038	5,664	10,985
Deposits	-	1	2	3	4
Borrowings	3,544	7,042	14,468	17,934	25,958
Total Liabilities	4,098	8,057	16,508	23,598	36,944
Cash & Bank	23	111	2,349	2,758	5,650
Investments	-	-	-	8	141
Loans	4,062	8,283	14,545	21,328	31,724
Others	13	-337	-388	-496	-571
Total Assets	4,098	8,057	16,508	23,598	36,944

Source: Company, PL

Exhibit 12: Key Ratios & Valuation

Y/e March	FY14	FY15	FY16	FY17	FY18
Key Ratios (%)					
NIM	6.7	6.8	6.1	6.6	7.3
GNPA	0.22	0.52	0.55	0.79	0.34
NNPA	0.19	0.43	0.42	0.6	0.26
RoA	1.5	3.0	2.6	2.7	3.0
RoE	11.4	24.3	21.5	14.8	11.2
Other Key data					
EPS	2.0	5.5	8.2	11.1	15.9
BVPS	17.8	29.4	51.2	110.1	187.5
DPS	0.0	0.0	0.0	0.0	0.0
Valuations (@ upper band Rs 821)					
PER	402.6	148.1	99.5	74.0	51.8
P/BV	46.0	27.9	16.1	7.5	4.5

Source: Company, PL



PL's Recommendation Nomenclature

Buy	: Over 10% Outperformance to Sensex over 12-months
Hold	: -5% to 10% Outperformance to Sensex over 12-months
Sell	: > -5% Underperformance to Sensex over 12-months
Not Rated (NR)	: No specific call on the stock
Under Review (UR)	: Rating likely to change shortly



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