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Aavas Financiers ltd

Sector: HFC /Mid -Cap | Note on IPO

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19 September 2018

Background: Aavas Financiers (AFL) is a Jaipur based company, incorporated in 2011. The company is engaged in the business of providing retail, affordable housing finance to low and middle income self-employed customers in rural and semi urban areas in India, for the purchase or construction of residential properties, and for the extension and repair of existing housing units. The company operates through 165 branches spread across 92 districts in eight states of which, they have a significant presence in the four states of Rajasthan, Gujarat, Maharashtra and Madhya Pradesh. Almost all loans are sourced by the in house sales team, and the company has 52,788 active loan accounts as of March 2018. The company was initially incorporated as a subsidiary of AU Small finance Bank and later sold off to private firms- Lake District Holdings, Kedaara Capital AIF and Partners Group ESCL Ltd (who are now the promoters).

Issue Opening Date	25th Sept 2018
Issue Closing Date	27th Sept 2018
Face Value (INR)	10
Price Band (INR)	818-821
Fresh Issue (mn, shares)	4.87-4.89
Offer for Sale (mn. shares)	16.25
Issue Size (INR bn)	17.29-17.34

Shareholding Pattern Pre-Issue	As a % of total shares
Promoters	84.67
Public	5.52
Directors & KMP	9.81

P&L Summary (INR bn)

Y/E March	2016	2017	2018
Net interest Income	0.94	1.62	2.67
Other income	0.00	0.00	0.01
Total revenue	0.94	1.63	2.68
Operating profit	0.54	0.95	1.44
Provisions	0.04	0.08	0.02
PBT	0.50	0.88	1.42
Tax	0.17	0.30	0.49
PAT	0.33	0.57	0.93
EPS	8.24	11.10	15.87
EPS growth (%)	48.74	34.71	42.97
P/E (X)	99.64	73.96	51.73

Balance Sheet Summary (INR bn)

Y/E March	2016	2017	2018
Share Capital	0.38	0.58	0.69*
Reserves	1.65	5.08	10.29
Net worth	2.04	5.66	10.98
Liabilities			
Borrowings	13.09	15.89	22.65
Other liabilities	1.98	2.96	4.54
Total	17.11	24.51	38.17
Assets			
Fixed assets	0.06	0.10	0.18
Investments	-	0.01	0.14
Cash & bank	2.35	2.76	5.65
Advances	0.53	0.73	1.04
Others	14.18	20.90	31.16
Total	17.11	24.51	38.17
RoA (%)	1.92	2.33	2.43
ROE (%)	16.08	10.09	8.46
P/BV (X)	15.46	8.43	5.23
GNPA (%)	0.55	0.79	0.34
CAR (%)	27.46	46.85	61.55
Tier 1 (%)	27.00	46.15	55.94

*In June 2018, share warrants were converted into equity shares, hence the Pre issue share capital increased to INR 0.71bn as of June 2018.

Objects of the Offer

- The offer comprises of a fresh issue of INR 4bn and offer for sale INR 13.34bn from promoter holding.
- The objects of the issue are to augment its capital base to meet future capital requirements arising out of growth in the business and to enhance visibility and brand image through listing of shares.

Key Positives

- Aavas Financiers's loan book grew by 78% CAGR over FY14-18 to INR 40bn. Given, the industry tailwinds like Government's push for affordable housing (through tax incentives, budgetary allocation and CLSS scheme), the estimated shortage in housing in both rural & urban areas (43.67mn and 10mn respectively), increasing urbanization and higher disposable income, the strong loan growth momentum is expected to continue in the coming years also.
- The management of the company has conservatively built their existing portfolio with Zero exposure to developer finance, under construction properties and plots, to keep the book granular.
- In FY18, 60.40% of the Gross Loan Assets came from customers who belonged to the economically weaker section and the low income group and 34.76% from customers who were new to credit. Self employed segment accounts for ~63.81% of the Gross Loan Book. As of FY18, LAP accounts for ~23% of their loan book.
- The average ticket size of home loans and mortgage loans were at INR 0.88mn and INR 0.8mn respectively. The average loan to value stood at 51.7% and 45.8% respectively for home loans and other mortgage loans, at the time of sanction.
- Since the company concentrates on segments that have less or no access to formal credit, it enjoys better bargaining power and hence the yields have been higher (vs. peers in affordable housing). However, due to increasing competitive intensity the yields dropped from 18% in FY14 to 14% in FY18. But, the company has strong ALM in place and hence, the cost of borrowings have also come down to 8.65% in FY18 from 12.28% in FY14. Consequently NIMs have increased from 6.71% in FY14 to 7.25% in FY18, despite dip in yields.
- AFL relies on internal sourcing only. Sourcing all loans internally, helps the company mitigate underwriting and default risks. Also, personal contact with customers in rural and semi-urban markets encourages repeat business and leads to referrals.
- Their effective credit risk management is reflected in the portfolio quality indicators such as high repayment rates and low rates of delinquencies across business and economic cycles. In FY18, GNPAs stood at 0.34% and NNPA at 0.26%. End-to-end control of the collections process has helped them reduce 1dpd loans as a % of Gross Advances from 14.51% in FY14 to 4.82% in FY18. Also, GNPAs as a % of gross loan assets fell from 0.79% in FY17 to 0.34% in FY18, which is the lowest amongst its peers.

Risks

- Supreme court in its recent ruling, halted all construction projects in Maharashtra, Madhya Pradesh, Uttarakhand and Chandigarh after they failed to comply with its order to come up with a policy on solid waste management, till next hearing (October 9th). Projects worth INR 4.64tn, for a total of 575,900 units are already behind schedule in the country and this could further add on to the number. The company has significant operations in these states, though their exposure to under construction projects in these states is not known exactly. Though the company has no exposure towards construction finance (and hence there is no impact on recoveries), this could delay disbursement growth for the company from these regions in individual loan segments.
- The company has ~70% of its borrowings at floating rates and 55.43% of loan assets at floating rates.

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Rising bond yields could exert pressure on NIMs, as the company may find it difficult to pass on the increase in costs to the customers, due to increasing competition in the affordable housing space.

- As share of riskier segments increases, asset quality could be deteriorated.

Following is a comparison of Aavas financiers with its peers in affordable housing and housing finance space:

Particulars	Aavas Financiers	Gruh Finance	Indiabulls HF	Dewan Housing	LIC HF	Reliance HF
Loan Book (In INR bn)	40.73	158.57	1,259.63	1,209.40	1,686.52	163.79
Yields (%)	13.99	11.10	NA	11.20	10.19	11.30
NIMs (%)	7.25	4.34	5.00	3.44	2.34	3.20
GNPA (%)	0.34	0.45	0.78	0.93	1.20	0.80
Div Yield (%)	-	0.50	3.54	0.50	1.50	0.63
RoA (%)	2.43	2.45	3.18	1.10	1.30	1.30
RoE (%)	8.46	29.08	28.81	13.30	17.00	13.90
P/Bv# (X)	4.16	17.36	3.85	2.18	1.85	1.98
P/E#	66.81	66.09	14.02	16.50	11.71	17.11

Source: Bloomberg, Company RHP (FY18), CSEC Research
#upper limit of INR 821 is considered on diluted EPS/BPS post issue

The table below highlights the dilution in equity post issue:

Particulars	Pre issue	Post issue
PAT (INR mn)	929.33	929.33
EPS (INR per share)	13.13	12.29
Net worth (INR mn)	10,984.71	14,935.99
No of shares (in mn)	70.76	75.62
Book Value (INR per share)	155.24	197.51
CMP (upper limit)	821	821
Market cap (INR mn)	58,093.14	62,086.48
P/BV (X)	5.29	4.16
P/E (X)	62.51	66.81
RoE (%)	8.46	6.22
Promoter holding (%)	84.67	57.73

Valuation: AFL has a healthy capital base, to fund growth objectives in the long term, (pre issue CRAR is at 61.55%). Tailwinds in affordable housing segment would augur well for the loan book growth going ahead. Its target customers being self employed individuals, will aid in keeping the yields higher than peers and result in elevated NIMs. This coupled with stringent credit practices will keep the GNPAs lower and hence aid in scripting the earnings growth going ahead.

The company will raise funds to the tune of INR 4bn through this issue, which will boost the capital adequacy further (CRAR will be 81%, considering RWA as at FY18). We believe the valuation of 4.16X FY18's BV (on the upper limit of INR 821) is justified, given its loan growth potential, superior yields on assets and best in class asset quality. Hence we recommend a SUBSCRIBE to the issue.

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