

28 October 2023

India | Equity Research | Q2FY24 result review

## Aavas Financiers

NBFCs

### Credit growth gaining traction; IT transformation happening as planned

The top management of Aavas Financiers (Aavas) changed in May'23, yet, its H1FY24 and Q2FY24 financial performances have been encouraging and reinforce our view that the new management team would be able to maintain its industry-leading position in AHFC space and deliver 2.5-3% RoA and 15-20% RoE on a steady basis. Notably, disbursements grew 18% QoQ after falling >30% QoQ in Q1FY24 owing to seasonality (Q1 generally being a weak quarter) and IT transformation. It has successfully rolled out and stabilised phase I of Salesforce and Oracle Fusion (ERP-GL) went live in Sep'23. The new Loan Management System on Flexcube is currently under testing and migrations. With improved visibility on management stability, its focus on tech-driven processes and operating leverage, we maintain **BUY** with an unchanged target price of INR 1,800, valuing the stock at 3.5x on Sep'24E BVPS.

### Q2FY24 financial performance

PAT during Q2FY24 grew 11% QoQ driven by 4% QoQ NII growth and 14% QoQ decline in staff cost, owing to one-off ESOP expenses incurred in Q1FY24. AUM grew 5% QoQ while NIM remained stable QoQ at 8%. Disbursements gathered pace as reflected in strong 18% QoQ growth. Credit cost remained well within control at 21bps vs 16bps QoQ. Underlying asset quality trend continued to be strong as reflected in 1+ dpd bucket falling to 3.58% in Sep'23 from 3.68% in Jun'23.

### New management will continue Aavas 3.0 journey as envisaged earlier

Aavas will continue to invest towards building infrastructure (people and technology) to deliver 20-25% long-term AUM growth. Under its digital transformation programme, it has gone live with its Salesforce application and expects its ERP system to go live by Q4FY24. This should reduce TAT from the current level of 10-12 days to 6-7 days. Aavas is also investing in building analytics capabilities to enhance customer experience. The upgraded tech-driven process is likely to improve productivity; hence, the company expects 20-25bps reduction in the opex ratio every year FY25 onwards vs current level of 3.9%. AUM mix is likely to remain ~65-70% for home loans and 30-35% for non-home loans. **Key risks:** 1) Elevated opex weighing on RoA improvement, 2) competitive pressure on yields.

### Financial Summary

Y/E March (INR mn)	FY22A	FY23A	FY24E	FY25E
Net Interest Income (INR mn)	6,513	7,971	9,477	11,498
PAT (INR mn)	3,568	4,301	4,811	5,941
EPS (INR)	44.9	54.1	60.5	74.8
% Chg YoY	22.6	20.4	11.9	23.5
P/E (x)	34.4	28.6	25.6	20.7
P/BV (x)	4.4	3.8	3.3	2.8
Gross Stage - 3 (%)	1.0	0.9	0.8	0.9
RoAA (%)	3.6	3.5	3.3	3.3
RoAE (%)	13.7	14.2	13.7	14.7

#### Renish Bhuva

renish.bhuva@icicisecurities.com  
+91 22 6807 7465

#### Vaibhav Arora

vaibhav.arora@icicisecurities.com

#### Market Data

Market Cap (INR)	122bn
Market Cap (USD)	1,471mn
Bloomberg Code	AAVAS IN
Reuters Code	AVAS BO
52-week Range (INR)	2,078 / 1,335
Free Float (%)	61.0
ADTV-3M (mn) (USD)	4.7

Price Performance (%)	3m	6m	12m
Absolute	(2.6)	10.5	(22.2)
Relative to Sensex	0.9	4.2	(30.3)

ESG Disclosure	2021	2022	Change
ESG score	-	-	-
Environment	-	-	-
Social	-	-	-
Governance	-	-	-

**Note** - Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures.

Source: Bloomberg, I-sec research

#### Previous Reports

07-08-2023: [Q1FY24 results review](#)

26-05-2023: [Company update](#)

### **Disbursement gathering pace; AUM growth remained >20% YoY**

New process stabilisation and enhanced digital capabilities led to a sharp recovery in volumes as reflected in strong 18% QoQ growth disbursement during Q2FY24. Under revamped Salesforce based LOS in Q1FY24, it already sanctioned 27,000+ cases worth INR 30bn and processed 67,000 log-ins since Q1FY24. Disbursements growth during Q2FY24 was equally divided between HL (up 18% QoQ) and LAP (17% QoQ). Disbursements mix continued to be steady with HL contributing 67% and LAP at 33% as on Sep'23. Notably, average ticket size on disbursements increased to INR 1.3mn in Q2FY24 vs INR 1.1mn in Q2FY23 while ATS in LAP remained steady at ~INR 0.8mn.

Strong recovery in disbursements and steady repayment rate (~4% non-annualised) led to 5% QoQ growth in AUM during Q2FY24. AUM growth during FY24YTD stands at 8% as on Sep'23. Home loan growth stood at 4% QoQ while LAP portfolio grew 5% QoQ.

### **IT transformation moving as per plan; business volumes picking up with visible early sign of operating leverage**

Considering its scale (AUM of >INR 100bn), increasing competition and to improve productivity, it initiated IT transformation drive 3-4 quarters back. As on Sep'23, it has successfully rolled out and stabilised phase I of Salesforce and Oracle Fusion (ERP-GL) went live in Sep'23. The new Loan Management System on Flexcube is currently under testing and migrations. Revamped digital platform is showing initial signs of productivity improvement as reflected in 18% QoQ disbursement growth but 2% QoQ decline in total operating expense. As a result, opex to assets fell 30bps QoQ to 3.6% in Q2FY24 from 3.9% in Q1FY24. Overall, Aavas expects opex to assets to settle at 3.3% in the near term.

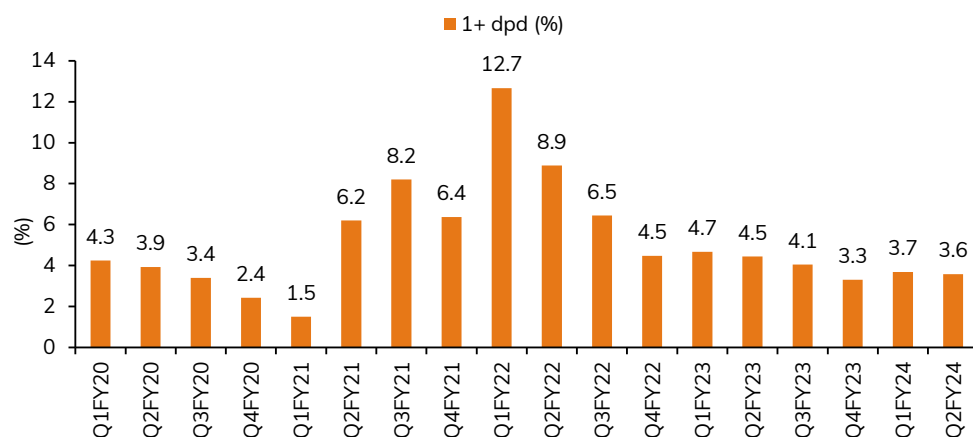
### **Spreads fell 30bps QoQ to 5.3%; NIM remained stable at 8%**

Competitive pressure on yields (down 11bps QoQ) and rising borrowing cost (up 20bps QoQ) led to a sharp decline in spreads to 5.3% during Q2FY24. However, the same remained above the guided range of 5%. Despite spread compression, NIM remained stable at 8% driven by higher DA income at INR 466mn vs INR 330mn QoQ. The management highlighted that bulk of rate pass-on to customers is behind and further rate pass-on would be challenging due to stiff competition. Overall, it expects spread to settle down at around 5% over the next 1-2 quarters. However, NHB borrowing in H2FY24, development financial institution loans (low rates) and PTC would restrict spreads slipping below the guided range of 5% in FY24E.

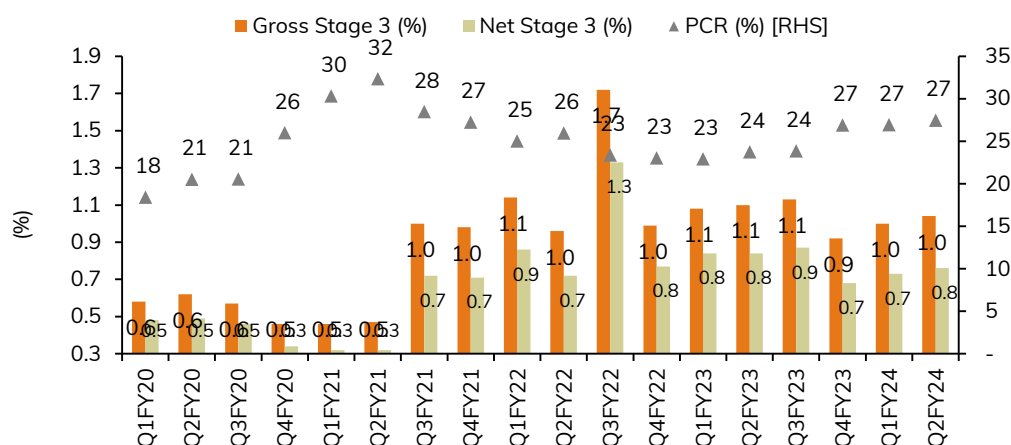
**Exhibit 1: Q2FY24 result review**

	Q2FY23	Q1FY24	Q2FY24	% YoY	% QoQ
<b>Income statement (INR mn)</b>					
Interest income	3,808	4,494	4,765	25.1	6.0
Interest expenses	1,410	1,866	2,036	44.4	9.1
<b>Net interest income</b>	<b>2,398</b>	<b>2,627</b>	<b>2,729</b>	<b>13.8</b>	<b>3.9</b>
Non-interest Income	143	175	209	46.3	19.7
<b>Total Income (net of interest expenses)</b>	<b>2,541</b>	<b>2,802</b>	<b>2,938</b>	<b>15.7</b>	<b>4.9</b>
Employee expenses	772	949	820	6.2	(13.6)
Depreciation and amortization	69	73	76	10.3	4.9
Fees and Commission expenses	23	22	31	35.5	43.2
Other operating expenses	282	295	380	34.7	28.8
<b>Total Operating Expense</b>	<b>1,147</b>	<b>1,339</b>	<b>1,308</b>	<b>14.1</b>	<b>(2.3)</b>
<b>Pre-provisioning profit (PPoP)</b>	<b>1,394</b>	<b>1,464</b>	<b>1,631</b>	<b>17.0</b>	<b>11.4</b>
Provisions and write offs	16	57	65	304.1	14.8
<b>PBT</b>	<b>1,378</b>	<b>1,407</b>	<b>1,565</b>	<b>13.6</b>	<b>11.3</b>
Tax expenses	310	310	348	12.4	12.4
<b>PAT</b>	<b>1,068</b>	<b>1,097</b>	<b>1,217</b>	<b>13.9</b>	<b>10.9</b>
<b>EPS (INR)</b>	<b>13.5</b>	<b>13.9</b>	<b>15.4</b>	<b>13.8</b>	<b>10.9</b>
<b>Balance Sheet (INR mn)</b>					
Share capital	790	791	791	0.1	0.1
Reserves & surplus	29,524	33,096	34,344	16.3	3.8
<b>Shareholders' funds</b>	<b>30,314</b>	<b>33,887</b>	<b>35,136</b>	<b>15.9</b>	<b>3.7</b>
<b>Borrowings</b>	<b>85,712</b>	<b>1,06,772</b>	<b>1,11,444</b>	<b>30.0</b>	<b>4.4</b>
Deferred tax liabilities (net)	427	506	540	26.6	6.8
Other Liabilities and provisions	2,427	2,827	3,256	34.2	15.2
<b>Total Liabilities and SHE</b>	<b>1,18,880</b>	<b>1,43,992</b>	<b>1,50,376</b>	<b>26.5</b>	<b>4.4</b>
Fixed assets	410	631	647	58.0	2.5
<b>Loans</b>	<b>1,00,818</b>	<b>1,19,144</b>	<b>1,24,026</b>	<b>23.0</b>	<b>4.1</b>
Cash & bank balances	13,391	18,937	20,016	49.5	5.7
Investments	668	1,523	1,527	128.5	0.3
Other Assets	3,593	3,757	4,159	15.8	10.7
<b>Total Assets</b>	<b>1,18,880</b>	<b>1,43,992</b>	<b>1,50,376</b>	<b>26.5</b>	<b>4.4</b>
<b>Key ratios</b>					
<b>AUM (INR mn)</b>	<b>1,25,437</b>	<b>1,46,500</b>	<b>1,53,195</b>	<b>22.1</b>	<b>4.6</b>
-Home Loans (INR mn)	88,935	1,02,257	1,06,777	20.1	4.4
-Other mortgage loans (INR mn)	36,502	44,243	46,418	27.2	4.9
<b>Disbursements (INR mn)</b>	<b>11,467</b>	<b>10,682</b>	<b>12,585</b>	<b>9.7</b>	<b>17.8</b>
-Home Loans (INR mn)	7,783	7,136	8,419	8.2	18.0
-Other mortgage loans (INR mn)	3,684	3,546	4,166	13.1	17.5
AUM/branch (INR mn)	391	421	438	12.0	4.0
Yield on average AUM (%) [Reported-YTD]	12.9	13.3	13.2	30 bps	-11 bps
Borrowing costs (%) [Reported-YTD]	7.0	7.7	7.9	87 bps	20 bps
Spreads (%)	5.9	5.6	5.3	-57 bps	-31 bps
<b>NIM (%) [Reported-YTD]</b>	<b>8.2</b>	<b>8.0</b>	<b>8.0</b>	<b>-17 bps</b>	<b>0 bps</b>
<b>Op cost as % of avg assets</b>	<b>3.9</b>	<b>3.9</b>	<b>3.6</b>	<b>-37 bps</b>	<b>-30 bps</b>
Cost to income (%)	45.1	47.8	44.5	-63 bps	-327 bps
1+ dpd (%)	4.45	3.68	3.58	-87 bps	-10 bps
<b>Gross Stage 3</b>	<b>1.10</b>	<b>1.00</b>	<b>1.04</b>	<b>-7 bps</b>	<b>4 bps</b>
<b>Net Stage 3</b>	<b>0.84</b>	<b>0.73</b>	<b>0.76</b>	<b>-8 bps</b>	<b>3 bps</b>
<b>Provision coverage ratio (%)</b>	<b>23.8</b>	<b>26.9</b>	<b>27.5</b>	<b>372 bps</b>	<b>54 bps</b>
Credit cost as a % of avg AUM [annualized]	0.05	0.16	0.17	12 bps	1 bps

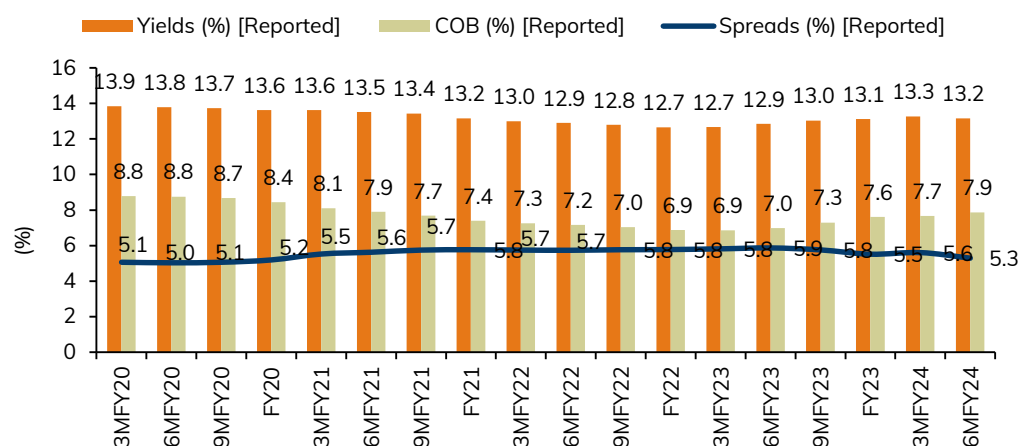
Source: Company data, I-Sec research

**Exhibit 2: Underlying asset quality strong with 1+ dpd of 3.6%**


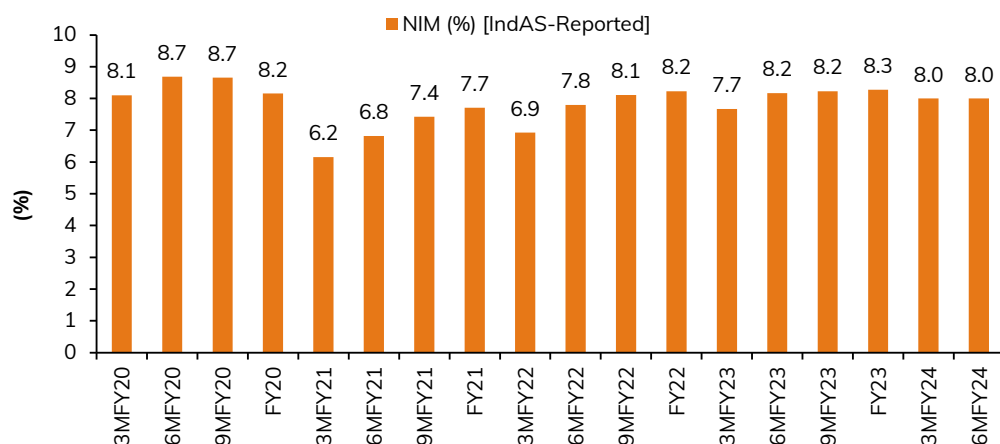
Source: Company data, I-Sec research

**Exhibit 3: Steady GNPA levels at ~1% with PCR maintained at 27%**


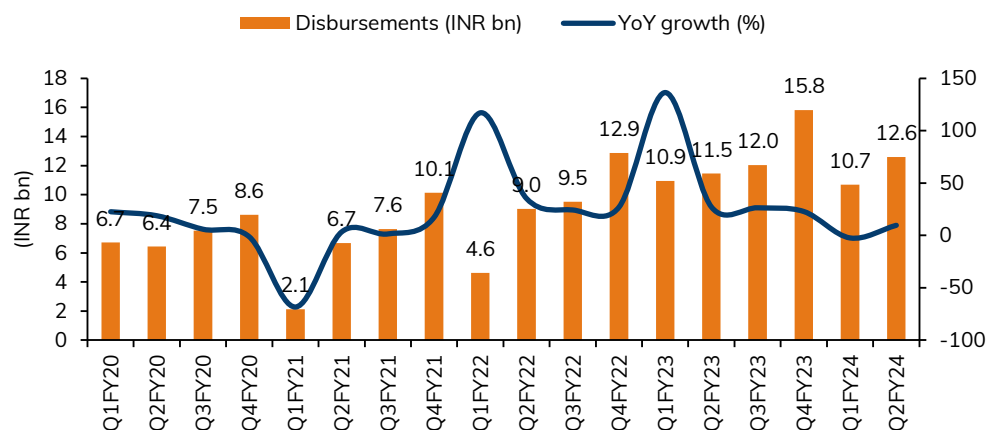
Source: Company data, I-Sec research

**Exhibit 4: Spreads compressed by 30 bps; however, remained above the guidance of >5%**


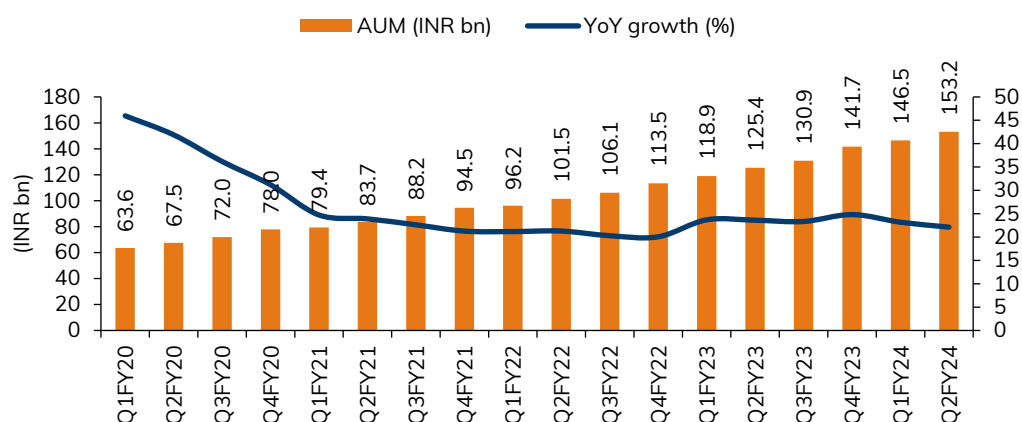
Source: Company data, I-Sec research

**Exhibit 5: NIM maintained at 8% driven by DA income**


Source: Company data, I-Sec research

**Exhibit 6: Growth in disbursements bounced back 10% YoY, after falling 2% in Q1FY24...**


Source: Company data, I-Sec research

**Exhibit 7: ...while AUM growth sustained at 22% YoY**


Source: Company data, I-Sec research

### Exhibit 8: Shareholding pattern

%	Mar'23	Jun'23	Sep'23
Promoters	39.1	39.1	39.1
Institutional investors	51.3	49.4	49.7
MFs and others	7.2	11.0	10.7
FIs/Banks	0.0	0.0	0.0
Insurance	3.8	2.0	2.1
FIIIs	40.3	36.4	36.9
Others	9.6	11.5	11.2

Source: Bloomberg

### Exhibit 9: Price chart



Source: Bloomberg

## Financial Summary

### Exhibit 10: Profit & Loss

(INR mn, year ending March)

	FY22A	FY23A	FY24E	FY25E
Interest Income	11,288	13,882	16,876	20,998
Net gain on fair value changes	53	96	119	129
Interest Expenses	(4,775)	(5,910)	(7,398)	(9,500)
<b>Net Interest Income (NII)</b>	<b>6,513</b>	<b>7,971</b>	<b>9,477</b>	<b>11,498</b>
Other Income	1,768	2,220	2,640	3,453
<b>Total Income (net of interest expenses)</b>	<b>8,281</b>	<b>10,191</b>	<b>12,117</b>	<b>14,951</b>
Employee benefit expenses	(2,322)	(3,006)	(3,843)	(4,764)
Depreciation and amortization	(238)	(287)	(316)	(348)
Fee and commission expenses	(57)	(76)	(91)	(109)
Other operating expenses	(889)	(1,208)	(1,437)	(1,702)
<b>Total Operating Expense</b>	<b>(3,506)</b>	<b>(4,577)</b>	<b>(5,687)</b>	<b>(6,922)</b>
<b>Pre Provisioning Profits (PPoP)</b>	<b>4,775</b>	<b>5,614</b>	<b>6,430</b>	<b>8,028</b>
Provisions and write offs	(226)	(124)	(263)	(412)
<b>Profit before tax (PBT)</b>	<b>4,549</b>	<b>5,490</b>	<b>6,168</b>	<b>7,616</b>
Total tax expenses	(981)	(1,189)	(1,357)	(1,676)
<b>Profit after tax (PAT)</b>	<b>3,568</b>	<b>4,301</b>	<b>4,811</b>	<b>5,941</b>

Source Company data, I-Sec research

### Exhibit 11: Balance sheet

(INR mn, year ending March)

	FY22A	FY23A	FY24E	FY25E
Share capital	789	791	795	795
Reserves & surplus	27,297	31,906	36,717	42,657
<b>Shareholders' funds</b>	<b>28,086</b>	<b>32,697</b>	<b>37,511</b>	<b>43,452</b>
Borrowings	79,725	98,407	1,18,042	1,52,004
Provisions & Other Liabilities	2,039	2,500	3,060	3,864
Deferred tax liabilities (net)	354	502	507	512
<b>Total Liabilities and Stakeholder's Equity</b>	<b>1,10,204</b>	<b>1,34,105</b>	<b>1,59,121</b>	<b>1,99,832</b>
Fixed assets	327	561	673	808
<b>Loans</b>	<b>90,534</b>	<b>1,14,763</b>	<b>1,40,566</b>	<b>1,77,689</b>
Investments	675	1,231	1,231	1,231
Other Assets	3,365	3,734	3,921	4,117
<b>Total Assets</b>	<b>1,10,204</b>	<b>1,34,105</b>	<b>1,59,121</b>	<b>1,99,832</b>

Source Company data, I-Sec research

**Exhibit 12: Key ratios**

(Year ending March)

	FY22A	FY23A	FY24E	FY25E
<b>AUM and Disbursements (INR mn)</b>				
AUM	1,13,502	1,41,667	1,80,212	2,27,807
Disbursements	36,022	50,245	64,472	80,590
Repayments	17,063	22,080	25,926	32,995
<b>Growth (%):</b>				
Total AUM (%)	20.1	24.8	27.2	26.4
Disbursements (%)	35.6	39.5	28.3	25.0
Repayments (%)	70.9	29.4	17.4	27.3
Loan book (on balance sheet) (%)	20.3	26.8	22.5	26.4
Total Assets (%)	23.0	21.7	18.7	25.6
Net Interest Income (NII) (%)	25.7	22.4	18.9	21.3
Non-interest income (%)	37.1	23.8	18.7	31.8
Total Income (net of interest expenses) (%)	28.0	23.1	18.9	23.4
Operating Expenses (%)	36.6	30.5	24.3	21.7
Employee Cost (%)	34.9	29.4	27.8	24.0
Non-Employee Cost (%)	54.1	35.9	19.0	18.4
Pre provisioning operating profits (PPoP) (%)	22.3	17.6	14.5	24.8
Provisions (%)	(39.1)	(45.0)	111.6	56.7
PBT (%)	28.7	20.7	12.3	23.5
PAT (%)	23.2	20.5	11.9	23.5
EPS (%)	22.6	20.4	11.9	23.5
<b>Yields, interest costs and spreads (%)</b>				
NIM on loan assets (%)	7.2	6.9	6.7	6.5
NIM on IEA (%)	5.6	5.6	5.4	5.3
NIM on AUM (%)	6.3	6.2	5.9	5.6
Yield on loan assets (%)	12.5	12.1	12.0	11.8
Yield on IEA (%)	9.6	9.8	9.7	9.6
Yield on AUM (%)	10.9	10.9	10.5	10.3
Cost of borrowings (%)	6.7	6.6	6.8	7.0
Interest Spreads (%)	5.8	5.5	5.2	4.8
<b>Operating efficiencies</b>				
Non interest income as % of total income	0.5	0.5	0.5	0.5
Cost to income ratio	42.3	44.9	46.9	46.3
Op.costs/avg assets (%)	3.5	3.7	3.9	3.9
Op.costs/avg AUM (%)	3.4	3.6	3.5	3.4
No of employees (estimate (mn))	5,222	6,034	7,049	7,696
No of branches (x)	314	346	381	416
Salaries as % of non-interest costs (%)	66.2	65.7	67.6	68.8
NII /employee (INR mn)	1.2	1.3	1.3	1.5
AUM/employee(INR mn)	21.7	23.5	25.6	29.6
AUM/ branch (INR mn)	361.5	409.4	473.0	547.6
<b>Capital Structure</b>				
Average gearing ratio (x)	2.8	3.0	3.1	3.5
Leverage (x)	3.9	4.1	4.2	4.6
CAR (%)	48.4	44.2	42.5	39.0
Tier 1 CAR (%)	47.7	43.8	41.1	37.6
Tier 2 CAR (%)	0.7	0.4	1.4	1.4
RWA (estimate) - INR mn	58,847	74,596	91,368	1,15,498
Loan assets	82	86	88	89
RWA as a % of loan assets	65.0	65.0	65.0	65.0

Source Company data, I-Sec research

	FY22A	FY23A	FY24E	FY25E
<b>Asset quality and provisioning</b>				
GNPA (%)	1.0	0.9	0.8	0.9
NNPA (%)	0.8	0.7	0.6	0.6
GNPA (INR mn)	904	1,067	1,125	1,599
NNPA (INR mn)	695	780	810	1,119
Coverage ratio (%)	22.2	26.1	28.0	30.0
Credit Costs as a % of avg AUM (bps)	22	10	16	20
Credit Costs as a % of avg on book loans (bps)	22	10	16	20
<b>Return ratios</b>				
RoAA (%)	3.6	3.5	3.3	3.3
RoAE (%)	13.7	14.2	13.7	14.7
ROAAUM (%)	3.4	3.4	3.0	2.9
<b>Valuation Ratios</b>				
No of shares	79	79	79	79
No of shares (fully diluted)	80	79	79	79
ESOP Outstanding	0	0	0	-
EPS (INR)	44.9	54.1	60.5	74.8
EPS fully diluted (INR)	44.9	54.1	60.5	74.8
Price to Earnings (x)	34.4	28.6	25.6	20.7
Price to Earnings (fully diluted) (x)	34.5	28.6	25.6	20.7
Book Value (fully diluted)	353	411	472	547
Adjusted book value	344	402	462	533
Price to Book	4.4	3.8	3.3	2.8
Price to Adjusted Book	4.5	3.9	3.4	2.9

Source Company data, I-Sec research

**Exhibit 13: Key Metrics**

(Year ending March)

	FY22A	FY23A	FY24E	FY25E
<b>DuPont Analysis</b>				
Average Assets (INR mn)	99,902	1,22,155	1,46,613	1,79,476
Average Loans (INR mn)	82,884	1,02,648	1,27,664	1,59,128
Average Equity (INR mn)	26,050	30,392	35,104	40,482
Interest earned (%)	11.3	11.4	11.5	11.7
Net gain on fair value changes (%)	5.3	7.9	8.1	7.2
Interest expended (%)	4.8	4.8	5.0	5.3
<b>Gross Interest Spread (%)</b>	<b>6.5</b>	<b>6.5</b>	<b>6.5</b>	<b>6.4</b>
Credit cost (%)	0.2	0.1	0.2	0.2
<b>Net Interest Spread (%)</b>	<b>6.3</b>	<b>6.4</b>	<b>6.3</b>	<b>6.2</b>
Operating cost (%)	3.5	3.7	3.8	3.8
<b>Lending spread (%)</b>	<b>2.8</b>	<b>2.7</b>	<b>2.5</b>	<b>2.4</b>
Non interest income (%)	1.7	1.7	1.7	1.9
<b>Operating Spread (%)</b>	<b>4.6</b>	<b>4.5</b>	<b>4.2</b>	<b>4.2</b>
Tax rate (%)	21.6	21.7	22.0	22.0
<b>ROAA (%)</b>	<b>3.6</b>	<b>3.5</b>	<b>3.3</b>	<b>3.3</b>
Effective leverage (AA/ AE)	3.8	4.0	4.2	4.4
<b>RoAE (%)</b>	<b>13.7</b>	<b>14.2</b>	<b>13.7</b>	<b>14.7</b>

Source Company data, I-Sec research



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Name of the Compliance officer (Research Analyst): Mr. Atul Agrawal, Contact number: 022-40701000, **E-mail Address** : [complianceofficer@icicisecurities.com](mailto:complianceofficer@icicisecurities.com)

For any queries or grievances: [Mr. Prabodh Avadhoot](mailto:Mr.Prabodh.Avadhoot) Email address: [headservicequality@icicidirect.com](mailto:headservicequality@icicidirect.com) Contact Number: 18601231122

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