

December 08, 2021

Aavas Financiers Limited: [ICRA]AA- (Stable)/[ICRA]A1+ reaffirmed; Outlook on long-term rating revised to 'Positive'

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
NCD Programme	380	380	[ICRA]AA-; reaffirmed and outlook revised to 'Positive' from 'Stable'
Commercial Paper	50	50	[ICRA]A1+; reaffirmed
Long-term Bank Lines	1,240	1,240	[ICRA]AA-; reaffirmed and outlook revised to 'Positive' from 'Stable'
NCD Programme	110	-	[ICRA]AA-; reaffirmed and outlook revised to 'Positive' from 'Stable', and withdrawn [#]
Total	1,780	1,670	

*Instrument details are provided in Annexure-1; ^ Withdrawn as instruments have been redeemed and fully repaid basis confirmation by the company

Rationale

The ratings factor in Aavas' track record of good asset quality and profitability trajectory, notwithstanding intermittent pressures during the pandemic. ICRA favourably notes that Aavas' capitalisation level remains healthy, while liquidity position is strong and funding mix continues to be diversified. In this regard, the 'Positive' outlook on the long-term rating reflects ICRA's expectation that the company will continue to demonstrate its ability to grow retail business volumes while retaining healthy operational and financial metrics trajectory. While the leverage is expected to increase from the current level of 2.7x (as on September 30, 2021) with the incremental business being funded out of fresh borrowings, ICRA expects the company to maintain a prudent capitalisation profile over the medium term with a gearing of upto 4-5x.

ICRA however notes that the company's portfolio vulnerability has increased given its target borrower profile and challenging operating environment. Thus, delinquencies in the softer buckets could remain volatile, though, so far the company has demonstrated good control. As expected, the 1+DPD % stood relatively elevated at 12.7% as on June 30, 2021 before recovering partially to 8.9% as on September 30, 2021. Similarly, while 90+ DPD stood comfortable, it was elevated at 1.14% as on June 30, 2021 and 0.96% as on September 30, 2021 compared to 15-quarter average of 0.66%. Nevertheless, it is noted that that additional provision has been made for potential impact of COVID-19 pandemic, whereby overall provision cover against the loan book stands increased at 0.8% as on September 30, 2021 compared to 0.3% in December 2019. Moreover, collection efficiency recovered to 100%+ in Q2FY2022 with only 0.7% customers not paying an instalment in September 2021 and only 1.8% of the loan book standing restructured. Nevertheless, in light of the recent RBI clarification on IRAC norms, the reported gross NPA% for the company could increase over the next couple of quarters and subsequently stabilise at comfortable level. The long-term also factors in the geographical concentration of Aavas' portfolio despite a steady improvement. While Aavas has expanded its geographical footprint, dependence on its home state of Rajasthan remains high as reflected by its 40% share in the portfolio as on September 30, 2021. Nevertheless, the share of Rajasthan has declined and was lower than 48% in March 2017, with portfolio diversified across sub-districts/towns. Also, the company's operations remain focussed on low-and-middle income self-employed borrowers (60% of the portfolio as on March 31, 2021), who are relatively more vulnerable to economic cycles and have limited income buffers to absorb income shocks.

The rating for Rs. 110 crore NCD programme has been withdrawn on request of the company and in accordance with ICRA's policy on withdrawal of ratings. The instruments have been redeemed and fully repaid basis confirmation by the company.

Key rating drivers and their description

Credit strengths

Healthy capitalisation – Aavas is well capitalised with gearing of 2.7x and capital to risk weighted assets ratio (CRAR) of 52% as on September 30, 2021 as against 2.6x and 56% respectively as on March 31, 2020. While the leverage is expected to increase from current levels with incremental business being funded with fresh borrowings, ICRA expects the company to maintain prudent capitalisation profile with peak gearing of 4-5x over the next two to three years. In ICRA's opinion, a prudent capitalisation level, the secured nature of the portfolio backed largely by self-occupied residential properties, average LTV of around 53%, and low-ticket sizes would be the key mitigants against the inherent risks associated with the company's portfolio given the target borrower profile. Considering the low gearing and good internal capital generation, Aavas should be able to meet its growth target without needing any external capital infusion. Also, the comfortable capitalisation level provides capital buffer for absorbing unforeseen asset-side shocks, if any, in the current operating environment.

Track record of good asset quality, notwithstanding some weakening during the pandemic – While the asset quality came under pressure during the pandemic, Aavas has continued to report healthy asset quality indicators. As on September 30, 2021, gross stage 3 stood comfortable at 0.96% and net stage 3 stood at 0.72%. Moreover, gross stage 3 on a 1-year lagged basis stood at 1.1% as on September 30, 2021, marginally higher than five-year average of about 0.9%. ICRA however notes that the company's portfolio vulnerability has increased given its target borrower profile and challenging operating environment. Thus, delinquencies in the softer buckets could remain volatile, though, so far the company has demonstrated good control. As expected, the 1+DPD % stood relatively elevated at 12.7% as on June 30, 2021 before recovering partially to 8.9% as on September 30, 2021. Similarly, while gross stage 3 % stood comfortable, it was elevated at 1.14% as on June 30, 2021 and 0.96% as on September 30, 2021 compared to 15-quarter average of 0.66%. Nevertheless, it is noted that that additional provision has been made for potential impact of COVID-19 pandemic, whereby overall provision cover against the loan book stands increased at 0.8% as on September 30, 2021 compared to 0.6% in March 2021 and 0.3% in December 2019. Moreover, collection efficiency recovered to 100%+ in Q2FY2022 with only 0.7% customers not paying an installment in September 2021 and only 1.8% of the loan book standing restructured. Also, given the secured nature of the lending with comfortable loan to value ratio at origination, most of the properties being self-occupied, and the company being covered under the SARFAESI Act., losses, in case of defaults, are expected to be limited. Nevertheless, in light of the recent RBI clarification on IRAC norms, the reported gross NPA% for the company could increase over the next couple of quarters and subsequently stabilise at comfortable level.

Satisfactory profitability trajectory - While Aavas' blended lending yields have continued to moderate over past few years, the same has been accompanied by declining borrowing costs, given the company's ability to raise funds at competitive rates with sizeable proportion of borrowings from National Housing Bank and through loan sell downs. As a result, the lending spreads have remained range-bound at healthy level, which is commensurate with the underlying portfolio risk. Also, while the net interest margins (NIM) remain sensitive to the gearing, Aavas has continued to report NIMs of 6%-7%. This coupled with improving cost structure (notwithstanding the increase in H1FY2022) and controlled credit cost has supported the profitability trajectory, barring intermittent pressure during the pandemic. With the improving scale and resulting economies of scale, the operating cost to averaged managed assets ratio for Aavas improved to 2.6% in FY2021 compared to average of 3.4% over last three years. Overall, the company reported ROA of 3.5% with ROE of 12.9% in FY2021 compared to 3.7% and 12.7% respectively in FY2020. Subsequently, while the company witnessed a dip in profitability in Q1FY2022 amid the second wave of the pandemic; a healthy recovery was seen in Q2FY2022 as reflected by RoE of 14.5%, though partially supported by sizeable securitisation related income. Overall, Aavas achieved a comfortable RoA of 3.3% and RoE of 12.3% in H1FY2022.

Strong liquidity profile with diversified funding mix – Aavas' liquidity profile stands strong with sizeable on-balance sheet liquidity in the form of cash & liquid investments, equivalent to ~18% (Rs. 1,205 crore as on September 30, 2021) of its on-balance sheet borrowings as of September 30, 2021. This is sufficient compared to total debt servicing (principal and interest) and operating expense burden during H2FY2022. The company is also maintaining liquidity in the form of undrawn cash credit limits of Rs 124 Crore, and documented and un-availed sanctions of Rs 1,065 Crore from NHB and other banks. Furthermore, while the company is likely to carry relatively lower on-balance sheet liquidity as the operating environment is easing, it is noted that the company's ALM remains well matched during normal course of business, aided by long-tenure funding lines from banks and other financial institutions with no dependence on short-term commercial paper funding since inception.

Further, the company's financial flexibility is good, given its relationships with all the leading banks of the country. It also has funding support from various multilateral agencies like International Finance Corporation (IFC), CDC UK (formerly known as Commonwealth Development Corporation) and Asian Development Bank (ADB).

Aavas' funding profile remains diversified and unchallenged despite the risk averseness witnessed by the broader non-banking financial company (NBFC)/housing finance company (HFC) sector during the past few years. The company continues to borrow at competitive rates as reflected by Rs. 2,900 crore raised in FY2021 with average maturity of around 10 years at 6.6% and Rs.890 crore raised in Q2FY2022 with average maturity of around 8.5 years at 6.5%. Aavas' funding profile is also diversified and includes bank borrowings (37% as on September 30, 2021), non-convertible debentures (NCDs; 18%) and NHB refinance (23%). Securitisation and assignments account for the balance (23%), given that a significant proportion of the portfolio qualifies for priority sector lending, thereby providing an additional funding source.

Demonstrated ability to grow retail business volumes without affecting key metrics despite challenges in the operating environment – Aavas has demonstrated healthy portfolio growth while retaining the key operational and financial metrics, despite the challenging operating environment. The growth has been driven by the increase in the customer base (number of live accounts stood at 1.35 lakh as on September 30, 2021 against ~35,000 in March 2017), supported by foray into new regions and deeper penetration in the existing geographies (297 branches as on September 30, 2021 compared to 94 in March 2017) over the past five years, thereby leading to a portfolio CAGR of 37% during 2017-2021. The AUM expanded by 21% YoY to Rs. 9,454 crore in March 2021, before growing further to Rs. 10,148 crore in September 2021. As far as portfolio mix is concerned, share of individual home loans remains high at about 72% (as of September 30, 2021). Share of salaried customer segment stood at 40% as of September 30, 2021.

Credit challenges

Relatively high, albeit improving, geographical concentration – Aavas commenced lending operations in March 2012 with a primary focus on the home state of Rajasthan. While it has subsequently expanded its geographical footprint to 13 states, its dependence on Rajasthan remains high as reflected by its share of 40% in the portfolio as on September 30, 2021. Nevertheless, ICRA notes that the share of Rajasthan has declined and is lower than 48% as on March 2017. Also, it is noted that Aavas has a presence in the deeper pockets of the state and its portfolio is diversified across the sub-districts/towns in the state. While the share of Rajasthan in the portfolio is not expected to reduce significantly in the medium term, the overall geographical diversity is likely to improve with the company gradually expanding into other states and already having a presence in over 1,200 tehsils across these geographies. The company had 297 branches as on September 30, 2021 spread across Rajasthan, Gujarat, Maharashtra, Madhya Pradesh, Delhi, Haryana, Uttar Pradesh, Chhattisgarh, Uttarakhand, Punjab, Himachal Pradesh, Odisha, and Karnataka.

Exposure to relatively vulnerable borrower profile – Aavas' operations remain focussed on low-and-middle income self-employed borrowers (60% of the portfolio as on September 30, 2021), who are relatively more vulnerable to economic cycles and have limited income buffers to absorb income shocks. In this context, given the challenging operating environment, delinquencies in the softer buckets could remain volatile. Nevertheless, the losses on default are expected to be limited considering the secured nature of the portfolio with LTV of around 53% and the assets being largely self-occupied residential properties along with the low-ticket size. Also, ICRA draws comfort from Aavas' demonstrated ability to control the asset quality and credit cost, despite the challenging operating environment during past few years. This reflects positively on the company's underwriting norms, collection infrastructure and analytical systems.

Liquidity position: Strong

Aavas' liquidity profile stands strong with sizeable on-balance sheet liquidity in the form cash & liquid investments (Rs. 1,205 crore as on September 30, 2021), equivalent to ~18% of its on-balance sheet borrowings. This is sufficient compared to total debt servicing (principal and interest) and operating expense burden of about Rs. 1,000 crore during H2FY2022. The company is also maintaining off-balance sheet liquidity in the form of undrawn cash credit limits of Rs. 119 crore, documented and un-availed sanctions of Rs. 255 crore from NHB, and documented and un-availed sanctions of Rs. 810 crore from other banks.

Furthermore, while the company is likely to carry relatively lower on-balance sheet liquidity as the operating environment is easing, it is noted that the company's ALM remains well matched during normal course of business, aided by long tenor liabilities raised by the company. As on March 31, 2021, Aavas' ALM reflected scheduled inflows from loan assets of Rs. 1,277 crore during next twelve months against which borrowings aggregating Rs. 1,015 crore were maturing during this period.

Rating sensitivities

Positive factors – ICRA may upgrade the long-term rating if the company is able to sustain a healthy financial performance and good asset quality over the near to medium term while reducing the geographical concentration. Retaining the diversified funding profile with minimal asset liability mismatches in the near-term buckets, as the company expands its portfolio, would also be crucial for an upward rating revision.

Negative factors – Pressure on the ratings could arise in case of a significant increase in the gearing beyond 4.5x over the medium term or a sustained weakening of the asset quality (PAR-90 above 2.0%). Also, deterioration in the earnings profile on a sustained basis or an adverse change in the asset liability maturity profile will be credit negative.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA's Credit Rating Methodology for Housing Finance Companies Policy on Withdrawal of Credit Ratings
Parent/Group Support	-
Consolidation/Standalone	Consolidated financials

About the company

Aavas Financiers Limited (Aavas) is a Jaipur (Rajasthan) headquartered housing finance company, which primarily provides housing loans in rural and semi-urban areas. As of September 30, 2021, the company was operating with 297 branches in 13 states viz. Rajasthan, Maharashtra, Gujarat, Madhya Pradesh, Delhi, Haryana, Chhattisgarh, Uttar Pradesh, Uttarakhand, Punjab, Himachal Pradesh, Orissa and Karnataka. Assets under its management stood at Rs. 10,148 crore (on book portfolio of Rs. 8,277 crore) as on September 30, 2021.

Aavas was incorporated as a subsidiary of Au Financiers (India) Limited (now Au Small Finance Bank Limited (AuSFB)) in February 2011, and it formally began its operations in March 2012. Later, in June 2016, AuSFB sold its stake in Aavas to private equity (PE) investors – Kedaara Capital and Partners Group – to meet the Reserve Bank of India's (RBI) criteria for conversion to a small finance bank. Thereafter, Aavas came out with an initial public offering (IPO) in FY2019 and its equity shares got listed on the stock exchanges on October 8, 2018. The total issue size was Rs. 1,734 crore, of which ~Rs. 360 crore was raised for business operations while the rest was utilised to pay off the existing shareholders. The company's current shareholding stands as: Kedaara Capital (24%), Partners Group (16%), and the management team (7%) with the rest being held by domestic institutional investors (DIIs; 9%), foreign institutional investor (FIIs; 40%) and others (around 4%) as on September 30, 2021.

Aavas reported a profit after tax of Rs. 289 crore in FY2021 on an asset base of Rs. 9,008 crore as on March 31, 2021 against Rs. 249 crore in FY2020 on an asset base of Rs. 7,679 crore as on March 31, 2020. Subsequently, in H1 FY2022, the company achieved a PAT of Rs. 152 crore. Aavas' gross and net NPAs stood at 0.96% (on book) and 0.72% (on book), respectively, as on September 30, 2021, against 0.47% (on book) and 0.32% (on book), respectively, as on March 31, 2020.

Key financial indicators

	FY2019	FY2020	FY2021	H1 FY2022
	Audited	Audited	Audited	Unaudited
PAT	176	249	289	151
Net worth	1,837	2,098	2,401	2,570
Gross Loan book	4,737	6,202	7,573	8,277
Assets under management (AUM)	5,942	7,796	9,454	10,148
Return on average assets (%)	3.6%	3.7%	3.5%	3.3%
Return on average net worth (%)	11.6%	12.7%	12.8%	12.3%
Gearing (times)	2.0	2.6	2.7	2.7
CRAR (%)	67.8%	55.9%	54.4%	52.1%
Gross stage 3 (%)	0.5%	0.5%	1.0%	1.0%
Net stage 3 (%)	0.4%	0.3%	0.7%	0.7%
Net stage 3/Net worth (%)	0.9%	1.0%	2.2%	2.3%

Source: Aavas' financial results, ICRA research; Note: Amounts in Rs. crore; All figures and ratios are as per ICRA's calculations/adjustments

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the Past 3 Years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)*	Dec 08, 2021	Date & Rating in FY2021			Date & Rating in FY2020	Date & Rating in FY2019
						Dec 24, 2020	Oct 30, 2020	Aug 19, 2020	Jul 25, 2019	Jun 22, 2018
1	CP	ST	50	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
2	Fund-based Term Loan	LT	1,030	353	[ICRA]AA- (Positive)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)
3	Fund-based Cash Credit	LT	210	59	[ICRA]AA- (Positive)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)
4	NCD	LT	380	380	[ICRA]AA- (Positive)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)
5	NCD	LT	110	-	[ICRA]AA- (Positive) Withdrawn	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)

Source: ICRA Research; **Note:** LT: Long term, ST: Short term; ^As of October 31, 2021; Amount in Rs. Crore

Complexity level of the rated instruments

Instrument	Complexity Indicator
NCD Programme	Simple
Commercial Paper	Very Simple
Long-term Bank Lines	Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: www.icra.in

Annexure-1: Instrument details as on October 31, 2021

ISIN / Bank Name	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE216P07209	NCD	31-Dec-20	6.63%	31-Dec-25	100.00	[ICRA]AA- (Positive)
INE216P07183	NCD	22-Jun-20	6.60%	22-Dec-21	150.00	[ICRA]AA- (Positive)
INE216P07134	NCD	18-Jul-17	8.43%	18-May-22	130.00	[ICRA]AA- (Positive)
Not placed	Commercial Paper	-	-	7-365 days	50.00	[ICRA]A1+
NA	Cash Credit 1	12-Jan-15	NA	NA	40.00	[ICRA]AA- (Positive)
NA	Cash Credit 2	10-Apr-14	NA	NA	10.00	[ICRA]AA- (Positive)
NA	Cash Credit 3	5-Sep-14	NA	NA	5.00	[ICRA]AA- (Positive)
NA	Cash Credit 4	25-Nov-16	NA	NA	4.00	[ICRA]AA- (Positive)
NA	Cash Credit^	NA	NA	NA	151.00	[ICRA]AA- (Positive)
NA	Term Loan 1	19-Sep-17	NA	NA	13.54	[ICRA]AA- (Positive)
NA	Term Loan 2	24-Sep-15	NA	NA	0.33	[ICRA]AA- (Positive)
NA	Term Loan 3	25-Sep-17	NA	NA	65.14	[ICRA]AA- (Positive)
NA	Term Loan 4	17-Feb-16	NA	NA	3.13	[ICRA]AA- (Positive)
NA	Term Loan 5	13-Dec-16	NA	NA	9.98	[ICRA]AA- (Positive)
NA	Term Loan 6	3-Nov-15	NA	NA	25.96	[ICRA]AA- (Positive)
NA	Term Loan 7	27-Sep-18	NA	NA	46.14	[ICRA]AA- (Positive)
NA	Term Loan 8	25-Nov-16	NA	NA	3.00	[ICRA]AA- (Positive)
NA	Term Loan 9	12-Apr-19	NA	NA	27.50	[ICRA]AA- (Positive)
NA	Term Loan 10	17-Sep-15	NA	NA	12.80	[ICRA]AA- (Positive)
NA	Term Loan 11	4-Jul-17	NA	NA	28.13	[ICRA]AA- (Positive)
NA	Term Loan 12	31-Jul-18	NA	NA	9.90	[ICRA]AA- (Positive)
NA	Term Loan 13	31-Jul-18	NA	NA	60.81	[ICRA]AA- (Positive)
NA	Term Loan 14	23-Feb-16	NA	NA	20.67	[ICRA]AA- (Positive)
NA	Term Loan 15	3-Aug-17	NA	NA	26.05	[ICRA]AA- (Positive)
NA	Term Loan^	NA	NA	NA	676.92	[ICRA]AA- (Positive)
INE216P07159	NCD	17-Apr-18	8.90%	17-Apr-23	10.00	[ICRA]AA- (Positive) Withdrawn
INE216P07191	NCD	4-Nov-20	6.70%	NA	100.00	[ICRA]AA- (Positive) Withdrawn

Source: Aavas, ICRA Research; ^Proposed/unallocated; Note: Maturity dates not available for term loans

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Aavas Financiers Limited	Rated Entity	Full Consolidation
Aavas Finserv Limited	Subsidiary	Full Consolidation

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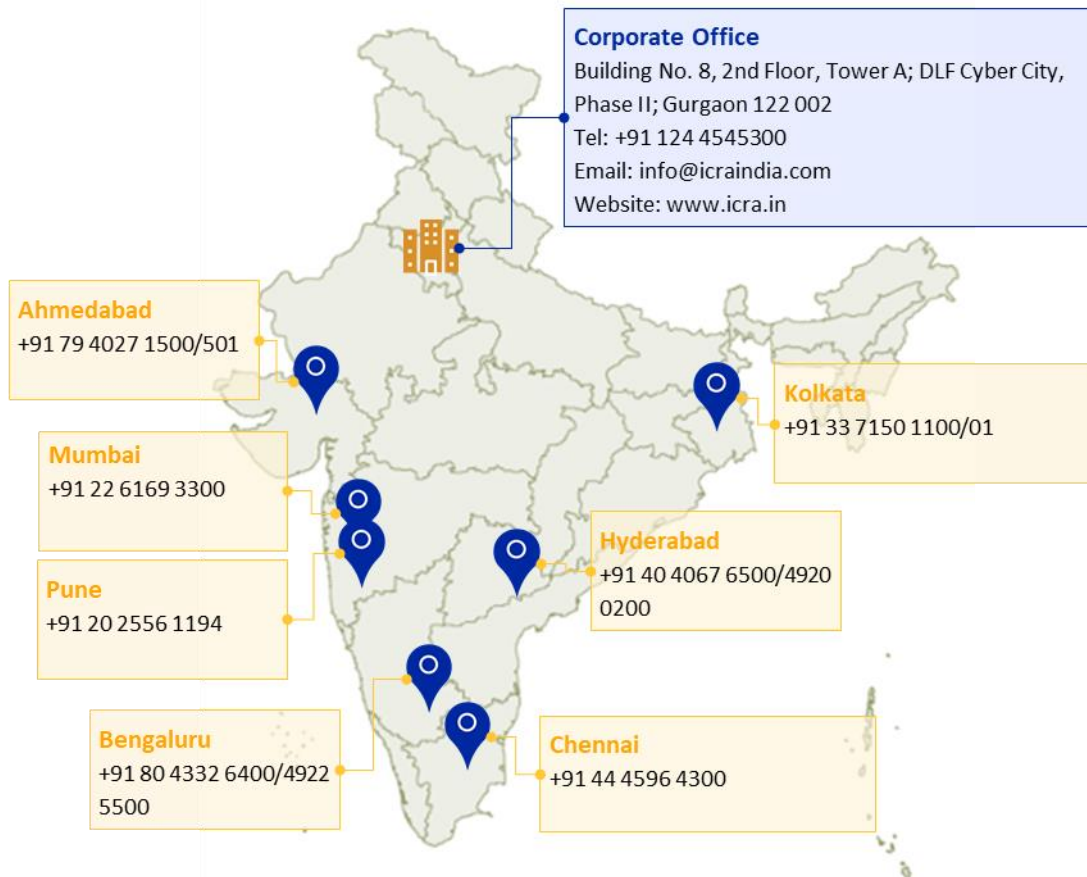
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