

August 22, 2022^(Revised)

Aavas Financiers Limited: Ratings reaffirmed; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term bank lines – Term loan	1,030	2,530	[ICRA]AA (Stable); assigned and reaffirmed
Long-term bank lines – Cash credit	210	210	[ICRA]AA (Stable); reaffirmed
NCD programme	100	100	[ICRA]AA (Stable); reaffirmed
NCD programme [^]	280	0	[ICRA]AA (Stable); reaffirmed and withdrawn
Commercial paper	50	50	[ICRA]A1+; reaffirmed
Total	1,670	2,890	

*Instrument details are provided in Annexure I

[^]The withdrawal is at the request of the company since the rated instruments have matured and fully repaid

Rationale

The ratings factor in Aavas Financiers Limited's (Aavas') demonstrated track record of resilient performance during the past few years despite the challenging operating environment. The company has continued to grow at a healthy pace while maintaining its key metrics, notwithstanding intermittent pressures during the Covid-19 pandemic. ICRA favourably notes that Aavas' capitalisation level remains healthy, while the liquidity position is strong, and the funding mix remains diversified. Although the managed gearing is expected to increase from the current level of 3.6x (as on June 30, 2022) with incremental business being funded out of fresh borrowings, ICRA expects the company to maintain a prudent capitalisation profile over the medium term.

ICRA also draws comfort from Aavas' good underwriting systems and collection infrastructure, which is also reflected in the relatively low 1+ days past due (dpd) of 4.7% as on June 30, 2022 (4.5% as on March 31, 2022), which has improved from the elevated level of 12.7% as on June 30, 2021 (6.4% as on March 31, 2021). Similarly, the gross stage 3 assets declined to 1.08% as on June 30, 2022 (0.99% as on March 31, 2022) from 1.72% as on December 31, 2021, with gross stage assets in the up to 90+ dpd category improving to 0.3% as on June 30, 2022 (0.3% as on March 31, 2022) from 0.9% on December 31, 2021¹. The ratings also factor in Aavas' satisfactory profitability trajectory, supported by healthy net interest margins (NIMs) and controlled credit costs.

The long-term rating is, however, constrained by the company's portfolio vulnerability given its target borrower profile. Aavas' operations remain focussed on low-and-middle income self-employed borrowers (60% of the portfolio as on June 30, 2022), who are relatively more vulnerable to economic cycles and have limited income buffers to absorb income shocks. Thus, delinquencies in the softer buckets could remain volatile. Nevertheless, losses on default are expected to be limited, considering the secured nature of the portfolio with moderate loan-to-value (LTV) ratios and the low ticket size. Moreover, the assets are largely self-occupied residential properties.

The rating also factors in the limited portfolio seasoning, given the high portfolio growth and the geographical concentration of Aavas' portfolio, though the same is improving. While the company has expanded its geographical footprint, dependence

¹ Less-than-90 dpd portfolio classified as gross stage 3, following the Income Recognition, Asset Classification and Provisioning (IRACP) norms clarification published by the Reserve Bank of India (RBI) on November 12, 2021

on its home state of Rajasthan remains high as reflected by its 39% share in the portfolio as on June 30, 2022. Nevertheless, the share of Rajasthan has declined and was lower than 48% in March 2017, with the portfolio diversified across sub-districts/towns.

The Stable outlook on the long-term rating reflects ICRA's expectation that the company will continue to grow its retail business volumes while retaining the healthy operational and financial metrics trajectory. Aavas' ability to increase the scale of operations significantly, while maintaining a healthy financial performance, retaining the diversified funding profile with minimal asset-liability mismatches in the near-term buckets and good asset quality over the medium to long term, and reducing the geographical concentration, would be a key monitorable.

Key rating drivers and their description

Credit strengths

Healthy capitalisation – Aavas is well capitalised with a managed gearing of 3.6x and a capital to risk weighted assets ratio (CRAR) of 50% as on June 30, 2022 against 3.7x and 52%, respectively, as on March 31, 2022 (3.4x and 54%, respectively, as on March 31, 2021). While the leverage is expected to increase from the current level with incremental business being funded out of fresh borrowings, ICRA expects the company to maintain a prudent capitalisation profile with a peak managed gearing of 5-6x over the medium term. In ICRA's opinion, a prudent capitalisation level, the secured nature of the portfolio backed largely by self-occupied residential properties, 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 calibrated growth plans, low leverage, and good internal capital generation, ICRA does not expect Aavas to need external capital infusions to meet its growth target. Also, the comfortable capitalisation level provides a buffer for absorbing unforeseen asset-side shocks, if any.

Track record of good asset quality, notwithstanding intermittent 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 June 30, 2022, the gross stage 3 was comfortable at 1.1% and the net stage 3 stood at 0.8%. Moreover, the gross stage 3 on a 1-year lagged basis stood at 1.3% as on June 30, 2022 (1.2% as on March 31, 2022), marginally above than five-year average of 0.9%. ICRA, however, notes that the company's portfolio remains vulnerable given its target borrower profile. Thus, delinquencies in the softer buckets could remain volatile. Nevertheless, Aavas has demonstrated good underwriting systems and collection infrastructure, which helped bring down the 1+ dpd to 4.7% on June 30, 2022 (4.5% as on March 31, 2022) from the elevated level of 12.7% as on June 30, 2021 (6.4% as on March 31, 2021). Similarly, the gross stage 3 assets declined to 1.08% as on June 30, 2022 (0.99% as on March 31, 2022) from 1.72% as on December 31, 2021, with the gross stage 3 assets up to the 90+ dpd category improving to 0.3% as on June 30, 2022 (0.3% as on March 31, 2022) from 0.9% on December 31, 2021².

ICRA takes note of the additional provision made for any further impact of the pandemic, whereby the overall provision cover against the loan book stood at 0.7% as on June 30, 2022 (0.7% as on March 31, 2022) and only 1.2% of the loan book was restructured as on June 30, 2022 (1.3% as on March 31, 2022). Also, given the secured nature of the lending with the comfortable LTV 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.

Satisfactory profitability trajectory – While Aavas' blended lending yields have continued to moderate over the 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 (NHB) and through loan sell-downs. This is because National Housing Bank (NHB) and loan sell-downs account for a sizeable proportion of the borrowings. The lending spreads have remained range-bound at a healthy level, which is commensurate with the underlying portfolio risk. Also, while the NIMs remain sensitive to the gearing, Aavas has continued to report NIMs at ~6% of the average managed assets (AMA). This,

² Less-than-90 dpd portfolio classified as gross stage 3, following the IRACP norms clarification published by the RBI on November 12, 2021

coupled with the improving cost structure and controlled credit costs, has supported the profitability trajectory in FY2022. With the increased collection efforts and digital upscaling, Aavas' operating cost increased marginally to 3.0% of AMA in Q1 FY2023 from 2.8% in FY2022 (nonetheless, marginally lower than 5-year average of 3.1%).

Though the company had reported a lower credit cost of 0.03% in Q1 FY2023 compared to 0.2% in FY2022, lower securitisation-related income of 0.6% compared to 1.0% in FY2022 resulted in a slight moderation in the overall profitability. Aavas reported a return on managed assets (RoMA) of 2.6% and a return on average net worth (RoE) of 12.5% in Q1 FY2023 compared to 2.9% and 13.7%, respectively, in FY2022. Going forward, the NIMs are likely to be under some pressure on account of the expectation of an increase in the cost of funding in FY2023 due to the higher interest rate environment. The company's ability to grow the loan book profitably while maintaining the credit quality will be a key monitorable.

Strong liquidity profile with diversified funding mix – Aavas' liquidity profile stands strong with sizeable on-balance sheet liquidity in the form of cash and liquid investments of ~Rs. 1,460 crore (as on June 30, 2022), equivalent to ~18% of its on-balance sheet borrowings. This is sufficient compared to the total debt servicing (principal and interest) and operating expense burden of ~Rs. 1,764 crore over the next 1 year. The company is also maintaining off-balance sheet liquidity in the form of undrawn cash credit limits of Rs. 110 crore and documented and unavailed sanctions of Rs. 721 crore from other banks. Furthermore, while Aavas is likely to carry relatively lower on-balance sheet liquidity as the operating environment is easing, it is noted that its Asset and Liability Management (ALM) remains well matched during the normal course of business, aided by the 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 resilient 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 the raising of Rs. 4,388 crore in FY2022 with average weighted maturity of 8.5 years at 6.0% (Rs. 898 crore in Q1 FY2023 with average weighted maturity of ~10 years at 5.65%). Aavas' diversified funding profile includes bank borrowings (38.8% as on June 30, 2022), non-convertible debentures (NCDs; 15.8%) and NHB refinance (22.5%). 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 – Despite the challenging operating environment, Aavas has demonstrated healthy portfolio growth while retaining the key operational and financial metrics. The growth was driven by the increase in the customer base (number of live accounts stood at 1.59 lakh as on June 30, 2022 against ~35,000 in March 2017), supported by its foray into new regions and deeper penetration in the existing geographies (318 branches as on June 30, 2022 compared to 94 in March 2017) over the past five years, thereby leading to a portfolio compound annual growth rate (CAGR) of 33% during FY 2017-2022. The assets under management (AUM) expanded by 24% YoY to Rs. 11,894 crore as on June 30, 2022. As far as the portfolio mix is concerned, the share of individual home loans remained high at about 71% with other mortgage loans accounting for the balance as of June 30, 2022. The share of the salaried customer segment stood at 40% as of June 30, 2022.

Credit challenges

Relatively high, albeit improving, geographical concentration – Aavas commenced lending operations in March 2012 with primary focus on the home state of Rajasthan. While it subsequently expanded its geographical footprint to 13 states/Union Territories (UTs), its dependence on Rajasthan remains high as reflected by its 39% share in the portfolio as on June 30, 2022. Nevertheless, ICRA notes that Rajasthan's share has declined and is lower than 48% as on March 31, 2017. ICRA also notes 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. Aavas had 318 branches as on June 30, 2022 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 June 30, 2022), 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, the prudent LTV (average 53% as on March 31, 2022) and the low ticket size. Moreover, the assets are largely self-occupied residential properties. Also, ICRA draws comfort from Aavas’ demonstrated ability to control the asset quality and credit cost, despite the challenging operating environment during the past few years. This reflects positively on the company’s underwriting norms and collection infrastructure.

Liquidity position: Strong

Aavas’ liquidity profile stands strong with sizeable on-balance sheet liquidity in the form of cash and liquid investments of ~Rs. 1,460 crore (as on June 30, 2022), equivalent to ~18% of its on-balance sheet borrowings. This is sufficient compared to the total debt servicing (principal and interest) and operating expense burden of ~Rs. 1,764 crore over the next 1 year. The company is also maintaining off-balance sheet liquidity in the form of undrawn cash credit limits of Rs. 110 crore and documented and unavailed sanctions of Rs. 721 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 ALM remains well matched during the normal course of business, aided by the long-tenor liabilities raised by it. As on June 30, 2022, Aavas’ ALM reflected scheduled inflows from loan assets of Rs. 2,577 crore during the next 12 months with borrowings of Rs. 1,764 crore maturing during this period.

Rating sensitivities

Positive factors – A significant increase in the scale, while maintaining a healthy financial profile and good asset quality over the medium to long term, while reducing the geographical concentration, would be a credit positive. 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 maintaining the credit profile.

Negative factors – Pressure on the ratings could arise in case of a significant deterioration in the earnings profile (RoMA <2.5% on sustained basis) or a sustained weakening of the asset quality (90 dpd above 2.0%). Also, a deterioration in the capitalisation profile on a sustained basis or an adverse change in the asset-liability maturity profile will be a credit negative.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	ICRA’s Credit Rating Methodology for Non-banking Finance Companies³ Policy on withdrawal of Credit Ratings
Parent/Group support	-
Consolidation/Standalone	Standalone

³ For rating an NBFC, ICRA evaluates its business risk, ownership, management risk and financial risk, and uses this to assess the level and stability of the NBFC’s future financial performance in likely scenarios, as required. The ratings are determined on a going concern basis rather than on a mere assessment of the assets and debt levels on a particular date

About the company

Aavas is a Jaipur (Rajasthan) headquartered housing finance company, which primarily provides housing loans in rural and semi-urban areas. It is present in 12 states and 1 UT, with a network of 318 branches and AUM of Rs. 11,894 crore as on June 30, 2022.

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 launched 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 is: Kedaara Capital (24%), Partners Group (16%), and the management team (7%) with the rest being held by domestic institutional investors (DIIs; 10%), foreign institutional investor (FIIs; 39%) and others (around 5%) as on June 30, 2022.

Aavas reported a profit after tax of Rs. 89 crore in Q1 FY2023 on an asset base of Rs. 11,500 crore as on June 30, 2022 against Rs. 60 crore in Q1 FY2022 on an asset base of Rs. 9,182 crore as on June 30, 2021. Further, the company had reported a profit after tax of Rs. 357 crore in FY2022 on an asset base of Rs. 11,020 crore as on March 31, 2022 against Rs. 289 crore in FY2021 on an asset base of Rs. 8,960 crore as on March 31, 2021. Aavas’ gross and net non-performing advances (NPAs) stood at 1.08% and 0.84%, respectively, as on June 30, 2022, against 0.99% and 0.77%, respectively, as on March 31, 2022.

Key financial indicators

Particulars	FY2019 Audited	FY2020 Audited	FY2021 Audited	FY2022 Audited
PAT	176	249	289	357
Net worth	1,837	2,098	2,401	2,809
Assets under management (AUM)	5,942	7,796	9,454	11,350
Return on average assets	3.6%	3.7%	3.5%	3.6%
Return on managed assets	3.0%	3.1%	2.9%	2.9%
Return on average net worth	11.6%	12.7%	12.9%	13.7%
Gearing (times)	2.0	2.6	2.7	2.9
Managed gearing (times)	2.7	3.3	3.4	3.7
CRAR	67.8%	55.9%	54.4%	51.9%
Gross stage 3	0.5%	0.5%	1.0%	1.0%
Net stage 3	0.4%	0.3%	0.7%	0.8%
Net stage 3/Net worth	0.9%	1.0%	2.2%	2.5%

Source: Aavas’ financial results, ICRA Research; Note: Amount 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 (FY2023)					Chronology of Rating History for the Past 3 Years				
	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)^	Aug 22, 2022	Jun 29, 2022	Date & Rating in FY2022			Date & Rating in FY2021	Date & Rating in FY2020
						Dec 08, 2021	Dec 24, 2020	Oct 30, 2020	Aug 19, 2020	Jul 25, 2019
1 CP	ST	50	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
2 Fund-based term loan	LT	2,530	265.40	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA- (Positive)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)
3 Fund-based cash credit	LT	210	59	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA- (Positive)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)
4 NCD	LT	100	100	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA- (Positive)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)
5 NCD	LT	280	0	[ICRA]AA (Stable); withdrawn	[ICRA]AA (Stable)	[ICRA]AA- (Positive)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)

Source: ICRA Research; Note: LT: Long term, ST: Short term; ^As of July 31, 2022

Complexity level of the rated instruments

Instrument	Complexity Indicator
NCD programme	Simple
Commercial paper	Very Simple
Fund-based term loan	Simple
Fund-based cash credit	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: [Click Here](#)

Annexure I: Instrument details

ISIN / Bank Name	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE216P07209	NCD	Dec-31-2020	6.63%	Dec-31-2025	100.00	[ICRA]AA (Stable)
INE216P07183	NCD	Jun-22-2020	6.60%	Dec-22-2021	150.00	[ICRA]AA (Stable); withdrawn
INE216P07134	NCD	Jul-18-2017	8.43%	May-18-2022	130.00	[ICRA]AA (Stable); withdrawn
NA^	Commercial Paper	-	-	7-365 days	50.00	[ICRA]A1+
NA	Cash Credit 1	Jan-12-2015	NA	NA	10.00	[ICRA]AA (Stable)
NA	Cash Credit 2	Jan-12-2015	NA	NA	30.00	[ICRA]AA (Stable)
NA	Cash Credit 3	Sep-05-2014	NA	NA	5.00	[ICRA]AA (Stable)
NA	Cash Credit 4	Nov-25-2016	NA	NA	4.00	[ICRA]AA (Stable)
NA	Cash Credit 5	Aug-04-2014	NA	NA	10.00	[ICRA]AA (Stable)
NA	Cash Credit^	NA	NA	NA	151.00	[ICRA]AA (Stable)
NA	Term Loan 1	Dec-16	NA	Jan-25	7.62	[ICRA]AA (Stable)
NA	Term Loan 2	Nov-15	NA	Jan-26	18.07	[ICRA]AA (Stable)
NA	Term Loan 3	Sep-18	NA	Nov-28	37.83	[ICRA]AA (Stable)
NA	Term Loan 4	Apr-19	NA	May-24	20.00	[ICRA]AA (Stable)
NA	Term Loan 5	Sep-16	NA	Mar-23	1.14	[ICRA]AA (Stable)
NA	Term Loan 6	Jul-18	NA	Jun-28	8.23	[ICRA]AA (Stable)
NA	Term Loan 7	Sep-15	NA	Jul-25	7.24	[ICRA]AA (Stable)
NA	Term Loan 8	Jul-17	NA	Jun-27	22.57	[ICRA]AA (Stable)
NA	Term Loan 9	Jul-18	NA	Jun-28	51.35	[ICRA]AA (Stable)
NA	Term Loan 10	Feb-16	NA	Dec-25	19.28	[ICRA]AA (Stable)
NA	Term Loan 11	Aug-17	NA	Sep-27	17.72	[ICRA]AA (Stable)
NA	Term Loan 12	Sep-15	NA	Feb-26	0.33	[ICRA]AA (Stable)
NA	Term Loan 13	Sep-17	NA	Mar-28	54.02	[ICRA]AA (Stable)
NA	Term Loan^	NA	NA	NA	2,264.60	[ICRA]AA (Stable)

Source: Aavas, ICRA Research; ^Proposed/unallocated; Note: Rate of interest not available for term loans

[Please click here to view details of lender-wise facilities rated by ICRA](#)

Annexure II: List of entities considered for consolidated analysis: Not Applicable

Corrigendum

Document dated August 22, 2022 has been corrected with revisions as detailed below:

Page No.	Location on Page	Previous data	Revised data
4	Analytical approach	Consolidation approach mentioned	Standalone approach mentioned
4	Analytical approach	Link incorrect for withdrawal policy	Updated the link for withdrawal policy
7	Annexure II: List of entities considered for consolidated analysis	List of subsidiaries mentioned	Not applicable

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