October 30, 2020

Aavas Financiers Limited: [ICRA]AA-(Stable) rating assigned

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
NCD Programme	-	40	[ICRA]AA- (Stable); assigned
NCD Programme	350	350	[ICRA]AA- (Stable); outstanding
Commercial Paper	50	50	[ICRA]A1+; outstanding
Long-term Bank Lines	1,240	1,240	[ICRA]AA- (Stable); outstanding
Total	**1,640**	**1,680**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings take into account Aavas' sustained and resilient performance during the past few years despite the challenging operating environment. The company has continued to grow at a healthy calibrated pace while maintaining its key metrics. As the scale has doubled during the past two years, the company has demonstrated a significant improvement in its cost structure. Also, Aavas continued to report a better-than-industry average asset quality (gross stage 3 of 0.46% as on June 30, 2020), capitalisation (gearing of 2.6x and capital adequacy of 56% as on June 30, 2020) and solvency metrics with an improving profitability trajectory. While the ongoing challenging operating environment amid the Covid-19 pandemic is likely to lead to some weakening in the asset quality and profitability, ICRA notes that Aavas has sufficient capital buffer to absorb asset-side shocks without significantly impairing its financial profile from the current strong level. Also, ICRA draws comfort from Aavas' demonstrated ability to bring down the portfolio under moratorium to one of the lowest levels (17.8% in June 2020) in the housing finance industry. This reflects positively on the company's underwriting norms, collection infrastructure and analytical systems. ICRA expects the company to continue with its trajectory going forward as well.

With the incremental business being funded out of fresh borrowings, the leverage is expected to increase from the current level. However, ICRA expects the company to maintain a prudent capitalisation profile over the medium term with a gearing of upto 4-5x. Aavas' liquidity profile is also strong with sizeable on-balance sheet liquidity in the form of cash & liquid investments of about Rs. 1,575 crore (as on September 30, 2020), equivalent to ~26% of its borrowings.

The long-term rating is, however, constrained by the geographical concentration of Aavas' portfolio despite a steady improvement. While Aavas has expanded its geographical footprint to 11 states, dependence on its home state of Rajasthan remains high as reflected by its 42% share in the portfolio as on March 31, 2020. 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 (65% of the portfolio as on March 31, 2020), who are relatively more vulnerable to economic cycles and have limited income buffers to absorb income shocks. In this context, given the ongoing economic slowdown and the relatively less seasoning of the portfolio, delinquencies in the softer buckets could remain volatile, though the company has reported a consistent improvement in the 1+ DPD figures so far. 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 assets being largely self-occupied residential properties along with the low-ticket size.

Key rating drivers and their description

Credit strengths

Track record of healthy capitalisation despite strong growth in loan book – Aavas is comfortably capitalised with a gearing of 2.6x and a capital to risk weighted assets ratio (CRAR) of 56% as on June 30, 2020. Despite the strong growth pursued during the past four years with a portfolio CAGR of 47%, the capitalisation level remained healthy aided by modest profitability and regular equity infusions leading upto an initial public offering (IPO) in FY2019. The company's regulatory capital adequacy is also supported by the relatively lower risk weights on small-ticket housing loans, which form a major proportion of its portfolio. With the incremental business being funded out of fresh borrowings, the leverage is expected to increase from the current level. However, ICRA expects the company to maintain a prudent capitalisation profile over the medium term with a peak gearing of 4-5x. In ICRA's opinion, a prudent capitalisation level, the secured nature of the portfolio backed largely by self-occupied residential properties, moderate LTV ratios, 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 sufficient capital buffer for absorbing any unforeseen asset-side shocks in the current operating environment.

Sustained superior asset quality vis-à-vis peers, though some weakening in current environment cannot be ruled out – While ICRA believes that the asset quality is likely to come under pressure, especially for select segments, due to the ongoing pandemic and the resulting slowdown, it is noted that Aavas has continued to demonstrate good control on its asset quality. While the 1+ DPD stood at 2.43% as on March 31, 2020, the gross stage 3 stood at 0.46% and the net stage 3 at 0.34%. This compares favourably with the eight-quarter peak level of 4.9% and 0.64% for the 1+ DPD and the gross stage 3, respectively. Moreover, the gross stage 3 on a 1-year lagged basis stood at 0.6% as on March 31, 2020, comparing favourably with 0.7% during the last two years. It is also noted that the company reported a further improvement in the 1+ DPD in Q1 FY2021 (1.5% as on June 30, 2020) and it continues to report superior indicators vis-à-vis peers, albeit on a high growth book. This reflects positively on Aavas' underwriting norms, collection infrastructure and analytical systems. While delinquencies in the softer buckets could remain volatile, losses in case of defaults are expected to be limited. This is on account of the secured nature of Aavas' lending with moderate LTV ratios at origination (less than 55% as on March 31, 2020) and with most of the properties being self-occupied. Moreover, the company is covered under the SARFAESI Act.

Strong liquidity profile with diversified funding mix – Aavas' liquidity profile is strong with sizeable on-balance sheet liquidity in the form of cash & liquid investments of about Rs. 1,575 crore (as on September 30, 2020), equivalent to ~26% of its borrowings. This is sufficient compared to the total debt servicing (principal and interest) and operating expense burden of about Rs. 550 crore during H2 FY2021. The company is also maintaining off-balance sheet liquidity in the form of undrawn cash credit limits of Rs. 142 crore, documented and unavailed sanctions of Rs. 206 crore from National Housing Bank (NHB) and documented and unavailed sanctions of Rs. 664 crore from other banks. Aavas' liquidity profile is supported by the availability of 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 two years. The company continues to borrow at competitive rates and raised Rs. 1,179 crore in Q4 FY2020 at a weighted average rate of 8.12% for a tenor of 120 months and Rs. 716 crore in Q1 FY2021 at a weighted average rate of 6.02% for a tenor of 43 months. Aavas' funding profile is also diversified and includes bank borrowings (36% as on June 30, 2020), non-convertible debentures (NCDs; 19%) and NHB refinance (21%). Securitisation and assignments account for the balance (24%), 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 strong 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 1.04 lakh as on March 31, 2020 against ~53,000 in March 2018 and ~35,000 in March 2017), supported by deeper penetration in the existing geographies (259 branches as on September 30, 2020 compared to 165 in March 2018 and 94 in March 2017) over the past four years, thereby leading to a portfolio CAGR of 47% during 2016-2020.

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 11 states, its dependence on Rajasthan remains high as reflected by its share of 42% in the portfolio as on March 31, 2020. 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 about 1,000 tehsils across these geographies. The company had 259 branches as on September 30, 2020 (165 as on March 31, 2018), spread across Rajasthan, Gujarat, Maharashtra, Madhya Pradesh, Delhi, Haryana, Uttar Pradesh, Chhattisgarh, Uttarakhand, Punjab and Himachal Pradesh.

Exposure to relatively vulnerable borrower profile – Aavas' operations remain focussed on low-and-middle income self-employed borrowers (65% of the portfolio as on March 31, 2020), who are relatively more vulnerable to economic cycles and have limited income buffers to absorb income shocks. In this context, given the ongoing economic slowdown and the relatively less seasoning of the portfolio, delinquencies in the softer buckets could remain volatile, though the company has reported a consistent improvement in the 1+ DPD figures so far. Nevertheless, the losses on default are expected to be limited considering the secured nature of the portfolio with moderate LTV ratios and the assets being largely self-occupied residential properties along with the low-ticket size. Also, ICRA draws comfort from Aavas' demonstrated ability to bring down the portfolio under moratorium to one of the lowest levels (17.8% in June 2020) in the housing finance industry. This reflects positively on the company's underwriting norms, collection infrastructure and analytical systems.

Liquidity position: Strong

Notwithstanding the curtailed cash inflows due to the moratorium extended to a portion of the loan book (24% in April and 17.8% in June), Aavas' liquidity profile is strong with sizeable on-balance sheet liquidity in the form cash & liquid investments of about Rs. 1,575 crore (as on September 30, 2020), equivalent to ~26% of its borrowings. This is sufficient compared to the total debt servicing (principal and interest) and operating expense burden of about Rs. 500 crore in H2FY2021. The company is also maintaining off-balance sheet liquidity in the form of undrawn cash credit limits of Rs. 142 crore (Rs. 118 crore in March 2020), documented and unavailed sanctions of Rs. 206 crore from NHB and documented and unavailed sanctions of Rs. 664 crore from other banks. Furthermore, while Aavas is likely to carry relatively lower on-balance sheet liquidity once the operating environment eases, it is noted that its asset liability maturity (ALM) profile remains well matched during the normal course of business, aided by the long-tenor liabilities raised by the company. As on March 31, 2020, Aavas' ALM reflected scheduled inflows from loan assets of Rs. 822 crore (14% of on-book loan assets, including prepayments basis past trend) during the next 12 months against which borrowings of Rs. 651 crore (12% of borrowings) are maturing.

Rating sensitivities

Positive triggers – ICRA could revise the outlook to Positive or upgrade the long-term rating if the company is able to sustain a healthy financial performance and good asset quality over the next three to five years 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 a Positive outlook or an upward rating revision.

Negative triggers – Pressure on the ratings could arise in case of a significant increase in the gearing beyond 4.5x over the next three years or a sustained weakening of the asset quality (stage 3 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
Parent/Group Support	Not applicable
Consolidation/Standalone	Consolidation

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. It is present in 11 states in north, west and central India with a network of 259 branches (as on September 30, 2020) and assets under management of Rs. 7,935 crore (on book portfolio of Rs. 6,356 crore) as on June 30, 2020.

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 shareholding as on June 30, 2020 stood as: Kedaara Capital (30%), Partners Group (24%), AuSFB (6%) and the management team (7%) with the rest being held by domestic institutional investors (DIIs; 7%), foreign institutional investor (FIIs; 25%) and others (around 2%).

Aavas reported a profit after tax of Rs. 249 crore in FY2020 on an asset base of Rs. 7,679 crore as on March 31, 2020 against Rs. 176 crore in FY2019 on an asset base of Rs. 5,640 crore as on March 31, 2019. Aavas' gross and net NPAs stood at 0.46% (on book) and 0.34% (on book), respectively, as on March 31, 2020, against 0.47% (on book) and 0.37% (on book), respectively, as on March 31, 2019.

Key financial indicators

	FY2018	FY2019	FY2020	Q1 FY2021
	Audited	Audited	Audited	Unaudited
PAT	93	176	249	50
Net worth	1,190	1,837	2,098	2,151
Gross Loan book	3,342	4,737	6,202	6,383
Assets under management (AUM)	4,073	5,942	7,796	7,935
Return on average assets (%)	2.8%	3.6%	3.7%	2.5%
Return on average net worth (%)	10.3%	11.6%	12.7%	9.4%
Gearing (times)	2.3	2.0	2.6	2.6
CRAR (%)	61.6%	67.8%	55.9%	56.0%
Gross stage 3 (%)	0.5%	0.5%	0.5%	0.5%
Net stage 3 (%)	0.4%	0.4%	0.3%	0.3%
Net stage 3/Net worth (%)	1.1%	0.9%	1.0%	1.0%

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 last three years

	Instrument	Current Rating (FY2021)					Rating History for the Past 3 Years			
		Type	Amount Rated	Amount Outstanding	Rating		FY2020	FY2019	FY2018	
					Oct 30, 2020	Aug 19, 2020	Jul 25, 2019	Jun 22, 2018	Dec 11, 2017	Sep 08, 2017
1	CP Programme	ST	50	-*	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-
2	Fund-based Bank Loans	LT	1,240	902.65^	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
3	NCD Programme	LT	40	-*	[ICRA]AA- (Stable)	-	-	-	-	-
4	NCD Programme	LT	350	290*	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)

*Source: ICRA research; Note: LT: Long term, ST: Short term; ^As of July 2020; * As of October 22, 2020; Amount in Rs. Crore*

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE216P07134	NCD	18-Jul-17	8.43%	18-May-22	130.00	[ICRA]AA-(Stable)
INE216P07159	NCD	17-Apr-18	8.90%	17-Apr-23	10.00	[ICRA]AA-(Stable)
INE216P07183	NCD	22-Jun-20	6.60%	22-Dec-21	150.00	[ICRA]AA-(Stable)
Yet to be placed	NCD	-	-	-	100.00	[ICRA]AA-(Stable)
NA	Commercial Paper	-	-	7-365 days	50.00	[ICRA]A1+
NA	Cash Credit 1	12-Jan-15	NA	NA	40.00	[ICRA]AA-(Stable)
NA	Cash Credit 2	10-Apr-14	NA	NA	10.00	[ICRA]AA-(Stable)
NA	Cash Credit 3	5-Sep-14	NA	NA	18.00	[ICRA]AA-(Stable)
NA	Cash Credit 4	25-Nov-16	NA	NA	4.00	[ICRA]AA-(Stable)
NA	Cash Credit 5	26-Dec-18	NA	NA	25.00	[ICRA]AA-(Stable)
NA	Cash Credit^	NA	NA	NA	113.00	[ICRA]AA-(Stable)
NA	Term Loan 1	19-Sep-17	NA	NA	22.89	[ICRA]AA-(Stable)
NA	Term Loan 2	5-Jun-13	NA	NA	0.01	[ICRA]AA-(Stable)
NA	Term Loan 3	24-Sep-15	NA	NA	13.89	[ICRA]AA-(Stable)
NA	Term Loan 4	25-Sep-17	NA	NA	77.74	[ICRA]AA-(Stable)
NA	Term Loan 5	12-Apr-14	NA	NA	3.17	[ICRA]AA-(Stable)
NA	Term Loan 6	29-Feb-20	NA	NA	100.00	[ICRA]AA-(Stable)
NA	Term Loan 7	17-Feb-16	NA	NA	50.29	[ICRA]AA-(Stable)
NA	Term Loan 8	13-Dec-16	NA	NA	13.93	[ICRA]AA-(Stable)
NA	Term Loan 9	23-Nov-13	NA	NA	1.60	[ICRA]AA-(Stable)
NA	Term Loan 10	3-Nov-15	NA	NA	57.89	[ICRA]AA-(Stable)
NA	Term Loan 11	27-Sep-18	NA	NA	78.36	[ICRA]AA-(Stable)
NA	Term Loan 12	29-Sep-15	NA	NA	13.19	[ICRA]AA-(Stable)
NA	Term Loan 13	18-Mar-17	NA	NA	16.66	[ICRA]AA-(Stable)
NA	Term Loan 14	25-Nov-16	NA	NA	8.00	[ICRA]AA-(Stable)
NA	Term Loan 15	12-Apr-19	NA	NA	80.00	[ICRA]AA-(Stable)
NA	Term Loan 16	17-Sep-15	NA	NA	24.95	[ICRA]AA-(Stable)
NA	Term Loan 17	4-Jul-17	NA	NA	34.72	[ICRA]AA-(Stable)
NA	Term Loan 18	31-Jul-18	NA	NA	12.08	[ICRA]AA-(Stable)
NA	Term Loan 19	31-Jul-18	NA	NA	70.83	[ICRA]AA-(Stable)
NA	Term Loan 20	19-Jan-16	NA	NA	26.45	[ICRA]AA-(Stable)
NA	Term Loan 21	23-Feb-16	NA	NA	26.35	[ICRA]AA-(Stable)
NA	Term Loan 22	13-Nov-14	NA	NA	0.01	[ICRA]AA-(Stable)
NA	Term Loan 23	3-Aug-17	NA	NA	36.10	[ICRA]AA-(Stable)
NA	Term Loan 24	23-Mar-17	NA	NA	36.54	[ICRA]AA-(Stable)
NA	Term Loan^	NA	NA	NA	224.35	[ICRA]AA-(Stable)

Source: Aavas; ^proposed/unallocated

Annexure-2: List of entities considered for consolidation: Not applicable

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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