June 29, 2022 (Revised)

Aavas Financiers Limited: Long-term ratings upgraded to [ICRA]AA (Stable); short- term rating reaffirmed; outlook revised to 'Stable' from 'Positive'

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
NCD Programme	380	380	[ICRA]AA; upgraded from [ICRA]AA-; outlook revised to 'Stable' from 'Positive'
Commercial Paper	50	50	[ICRA]A1+; reaffirmed
Long-term Bank Lines - Cash Credit	210	210	[ICRA]AA; upgraded from [ICRA]AA-; outlook revised to 'Stable' from 'Positive'
Long-term Bank Lines - Term Loan	1,030	1,030	[ICRA]AA; upgraded from [ICRA]AA-; outlook revised to 'Stable' from 'Positive'

**Instrument details are provided in Annexure-1*

Rationale

The revision in the long-term rating considers Aavas Financiers Limited's (Aavas') demonstrated track record of resilient performance during the past few years. The company has continued to grow at a healthy pace while maintaining its key metrics, 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. While the managed gearing is expected to increase from the current level of 3.7x (as on March 31, 2022) with the incremental business being funded out of fresh borrowings, ICRA expects the company to maintain a prudent capitalisation profile over the medium term. Also, ICRA draws comfort from Aavas' good underwriting systems and collection infrastructure which is also reflected in the relatively low 1+ days past due (dpd) of 4.5% as on March 31, 2022, 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 in up to 90+ DPD category came down to 0.3% as on March 31, 2022 from 0.9% on December 31, 2021[1]. The rating also factors in the satisfactory profitability trajectory of the company supported by healthy net interest margins and controlled credit costs.

The long-term rating is, however, constrained by the company's portfolio vulnerability given its target borrower profile. The company's operations remain focused on low-and-middle income self-employed borrowers (60% of the portfolio as on March 31, 2022), who are relatively 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 assets being largely self-occupied residential properties along with the low-ticket size. The rating also factors in limited portfolio seasoning, 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 39% share in the portfolio as on March 31, 2022. Nevertheless, the share of Rajasthan has declined and was lower than 48% in March 2017, with portfolio diversified across sub-districts/towns.

The stable 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. The ability of the company to significantly increase the scale of operations while maintaining 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 while reducing the geographical concentration, would be key monitorable.

[1] Less than 90 DPD portfolio classified as Gross stage 3 following the IRACP norms clarification published by Reserve Bank of India on November 12, 2021.

Key rating drivers and their description

Credit strengths

Healthy capitalisation – Aavas is well capitalised with managed gearing of 3.7 x and capital to risk weighted assets ratio (CRAR) of 52% as on March 31, 2022 as against 3.4x and 54% respectively as on March 31, 2021. 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 managed gearing of 5-6 times 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 the need for external capital infusion for Aavas to meet its growth target. Also, the comfortable capitalisation level provides capital 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 March 31, 2022, gross stage 3 stood comfortable at 1.0% and net stage 3 stood at 0.7%. Moreover, gross stage 3 on a 1-year lagged basis stood at 1.2% as on March 31, 2022, marginally higher than five-year average of about 0.9%. ICRA however notes that the company's portfolio vulnerability given its target borrower profile. Thus, delinquencies in the softer buckets could remain volatile. Though, the company has demonstrated good underwriting systems and collection infrastructure to bring down the 1+ dpd % to 4.5% on March 31, 2022 from the elevated level of (6.4% as on March 31, 2021 and 12.7% as on June 30, 2021). Similarly, the gross stage 3 assets in up to 90+ dpd category came down 0.3% as on March 31, 2022 from 0.89% on December 31, 2021[2]. ICRA takes note of the additional provision made for potential impact of COVID-19 pandemic, whereby overall provision cover against the loan book stands at 0.7% as on March 31, 2022. Moreover, collection efficiency had recovered to 100%+ in Q2FY2022 and only 1.3% of the loan book standing restructured as on March 31, 2022. 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.

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 (NHB). 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 as a share of average managed assets (AMA) of ~6%. This coupled with improving cost structure and controlled credit cost has supported the profitability trajectory. With the increased collection efforts and digital upscaling, the operating cost to AMA ratio for Aavas moderated to 2.9% in FY2022 compared to 2.5% (nonetheless, lower than 5 year average of 3.1%). however, lower credit costs of 0.2% in FY2022 as compared to 0.4% in FY2021 and higher securitisation related income of 1.0% as compared to 0.9% in FY2021 resulted in improvement in overall profitability to Return on managed assets (ROMA) of 2.9% with Return on average net worth (ROE) of 13.7% in FY2022 compared to 2.9% and 12.9% respectively in FY2021. Going forward, NIMs likely to be under some pressure on account of expectation of increase in cost of funding in FY2023 due to higher interest rate environment. The company's ability to profitably grow the loan book while maintaining 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 cash & liquid investments of about Rs. 1,569 crore (as on March 31, 2022), equivalent to ~20% of its on-balance sheet borrowings. This is sufficient compared to total debt servicing (principal and interest) burden of about Rs. 1,534 crore over next 1 year. The company is also maintaining off-balance sheet liquidity in the form of undrawn cash credit limits of Rs. 115 crore documented and un-availed sanctions of Rs. 406 crore from NHB and Rs. 1,115 crore from other banks. As on March 31, 2022, Aavas' ALM reflected scheduled inflows from loan assets of Rs. 2,468 crore during next twelve months

[2] Less than 90 DPD portfolio classified as Gross stage 3 following the IRACP norms clarification published by Reserve Bank of India on November 12, 2021.

against which borrowings aggregating Rs. 1,534 crore were maturing during this period. 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 the leading banks of the country. It also has received funding support from various multilateral agencies like International Finance Corporation (IFC), CDC UK (formerly known as Commonwealth Development Corporation and now British International Investment) 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 Rs. 4,388 crore raised in FY2022 with average weighted maturity of ~8.5 years at 6.0%. Aavas' funding profile is also diversified and includes bank borrowings (37% as on March 31, 2022), 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 – Despite the challenging operating environment Aavas has demonstrated healthy portfolio growth while retaining the key operational and financial metrics, albeit limited portfolio seasoning. The growth has been driven by the increase in the customer base (number of live accounts stood at 1.51 lakh as on March 31,2022 against ~35,000 in March 2017), supported by foray into new regions and deeper penetration in the existing geographies (314 branches as on March 31, 2022 compared to 94 in March 2017) over the past five years, thereby leading to a portfolio CAGR of 33% during FY2017-2022. The AUM expanded by 20% YoY to Rs. 11,350 crore as on March 31, 2022. As far as portfolio mix is concerned, share of individual home loans remains high at about 72% with balance being other mortgage loans as at March 31, 2022. Share of salaried customer segment stood at 40% as of March 31, 2022.

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 39% in the portfolio as on March 31, 2022. 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 314 branches as on March 31, 2022 spread across Rajasthan, Gujarat, Maharashtra, Madhya Pradesh, Delhi, Haryana, Uttar Pradesh, Chhattisgarh, Uttarakhand, Himachal Pradesh, Odisha, and Karnataka.

Exposure to relatively vulnerable borrower profile – Aavas' operations remain focussed on low-and-middle income self-employed and salaried borrowers, 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, prudent loan-to-value (average 53% as on March 31, 2022) 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 and collection infrastructure.

Liquidity position: Strong

Aavas' liquidity profile stands strong with sizeable on-balance sheet liquidity in the form cash & liquid investments of about Rs. 1,569 crore (as on March 31, 2022), equivalent to ~20% of its on-balance sheet borrowings. This is sufficient compared to total debt servicing (principal and interest) burden of about Rs. 1,534 crore over next 1 year. The company is also maintaining off-balance sheet liquidity in the form of undrawn cash credit limits of Rs. 115 crore documented and un-availed sanctions of Rs. 406 crore from NHB and Rs. 1,115 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, 2022, Aavas' ALM reflected scheduled inflows from loan assets of Rs. 2,468 crore during next twelve months against which borrowings aggregating Rs. 1,534 crore were maturing during this period.

Rating sensitivities

Positive factors – Significant increase in 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 earnings profile (RoMA<2.5% on sustained basis) or a sustained weakening of the asset quality (90 dpd above 2.0%). Also, deterioration in the capitalisation 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 Non-Banking Finance Companies[3]
Parent/Group Support	-
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. As of March 31, 2022, the company was operating with 314 branches in 13 states viz. Rajasthan, Maharashtra, Gujarat, Madhya Pradesh, Delhi, Haryana, Chhattisgarh, Uttar Pradesh, Uttarakhand, Himachal Pradesh, Orissa and Karnataka. Assets under its management stood at Rs. 11,350 crore as on March 31, 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 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 5%) as on March 31, 2022.

[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.

Aavas 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 NPAs stood at 1.0% and 0.8%, respectively, as on March 31, 2022, against 1.0% and 0.7%, respectively, as on March 31, 2021.

Key financial indicators

	FY2019	FY2020	FY2021	FY2022
	Audited	Audited	Audited	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 manged 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: 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

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)*	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+
2	Fund-based Term Loan	LT	1,030	267.94	[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- (Positive)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)
4	NCD	LT	380	100	[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 June 1, 2022; 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 June 1, 2022

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 (Stable)
INE216P07183*	NCD	22-Jun-20	6.60%	22-Dec-21	150.00	[ICRA]AA (Stable)
INE216P07134*	NCD	18-Jul-17	8.43%	18-May-22	130.00	[ICRA]AA (Stable)
NA^	Commercial Paper	-	-	7-365 days	50.00	[ICRA]A1+
NA	Cash Credit 1	12-Jan-15	NA	NA	10.00	[ICRA]AA (Stable)
NA	Cash Credit 2	12-Jan-15	NA	NA	30.00	[ICRA]AA (Stable)
NA	Cash Credit 3	5-Sep-14	NA	NA	5.00	[ICRA]AA (Stable)
NA	Cash Credit 4	25-Nov-16	NA	NA	4.00	[ICRA]AA (Stable)
NA	Cash Credit 5	4-Aug-14	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	8.40	[ICRA]AA (Stable)
NA	Term Loan 2	Nov-15	NA	Jan-26	19.82	[ICRA]AA (Stable)
NA	Term Loan 3	Sep-18	NA	Nov-28	37.83	[ICRA]AA (Stable)
NA	Term Loan 4	Nov-16	NA	May-22	3.00	[ICRA]AA (Stable)
NA	Term Loan 5	Apr-19	NA	May-24	20.00	[ICRA]AA (Stable)
NA	Term Loan 6	Sep-16	NA	Mar-23	1.14	[ICRA]AA (Stable)
NA	Term Loan 7	Jul-18	NA	Jun-28	8.23	[ICRA]AA (Stable)
NA	Term Loan 8	Sep-15	NA	Jul-25	7.24	[ICRA]AA (Stable)
NA	Term Loan 9	Jul-17	NA	Jun-27	22.57	[ICRA]AA (Stable)
NA	Term Loan 10	Jul-18	NA	Jun-28	51.35	[ICRA]AA (Stable)
NA	Term Loan 11	Feb-16	NA	Dec-25	19.28	[ICRA]AA (Stable)
NA	Term Loan 12	Aug-17	NA	Sep-27	17.72	[ICRA]AA (Stable)
NA	Term Loan 13	Sep-15	NA	Feb-26	0.33	[ICRA]AA (Stable)
NA	Term Loan 14	Sep-17	NA	Mar-28	54.02	[ICRA]AA (Stable)
NA	Term Loan^	NA	NA	NA	759.06	[ICRA]AA (Stable)

Source: *Aavas, ICRA Research; ^Proposed/unallocated; Note: Rate of Interest not available for term loans; *Redeemed-to be withdrawn later*

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

Source: Aavas

Corrigendum

Following rectification made in the key financial indicators section on page 5 on the document dated June 29, 2022:

“For FY2022, 'return on average assets (%)' updated to 3.6% instead of 3.3%, 'gearing (times)' updated to 2.9 instead of 2.7.”

“For FY2022, 'return on average net worth (%)' updated to 13.7% instead of 12.3%”

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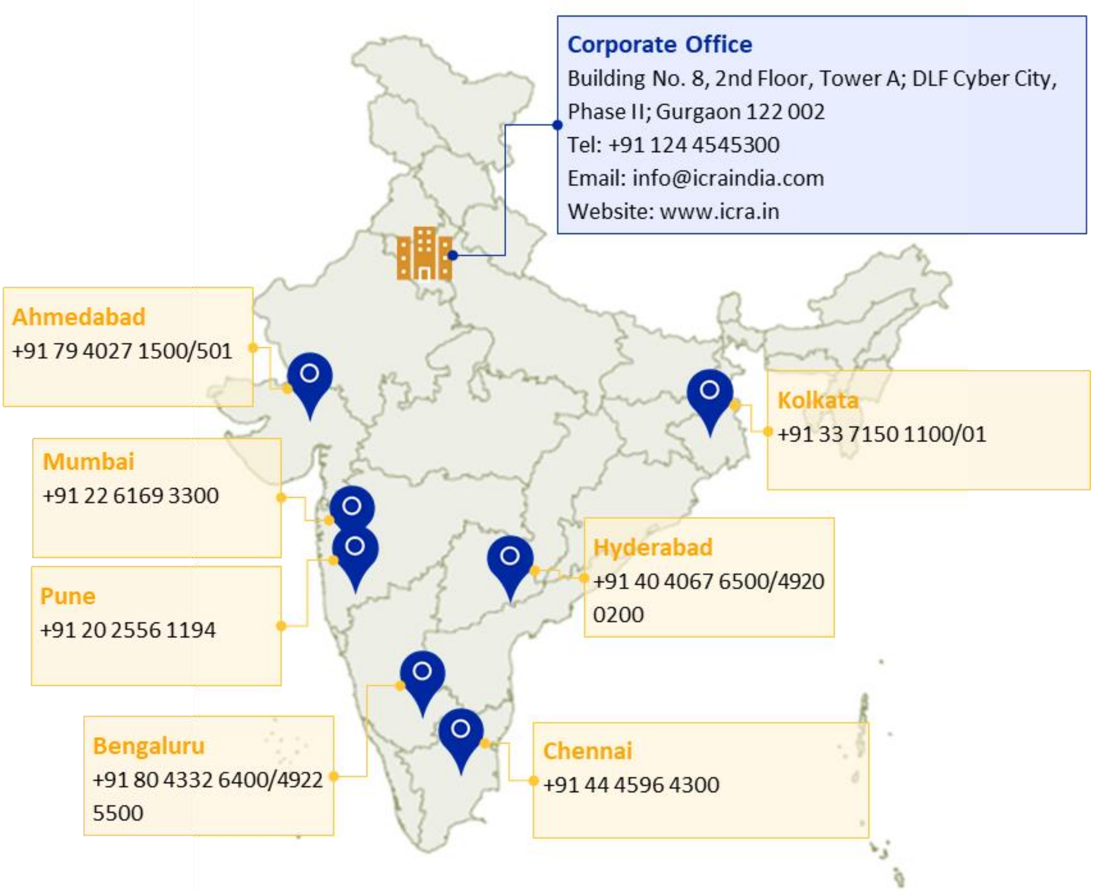

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