CareEdge RATINGS

Aavas Financiers Limited

September 13, 2022

Ratings

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long-term bank facilities	4,512.00	CARE AA; Stable (Double A; Outlook: Stable)	Revised from CARE AA-; Positive (Double A Minus; Outlook: Positive)
Total bank facilities	**4,512.00 (₹ Four thousand five hundred twelve crore only)**		
Long-term – Long-term instruments	50.00	CARE AA; Stable (Double A; Outlook: Stable)	Revised from CARE AA-; Positive (Double A Minus; Outlook: Positive)
Long-term – Long-term instruments	50.00	CARE AA; Stable (Double A; Outlook: Stable)	Revised from CARE AA-; Positive (Double A Minus; Outlook: Positive)
Non-convertible debentures	375.00	CARE AA; Stable (Double A; Outlook: Stable)	Revised from CARE AA-; Positive (Double A Minus; Outlook: Positive)
Non-convertible debentures	420.00	CARE AA; Stable (Double A; Outlook: Stable)	Revised from CARE AA-; Positive (Double A Minus; Outlook: Positive)
Non-convertible debentures	200.00	CARE AA; Stable (Double A; Outlook: Stable)	Revised from CARE AA-; Positive (Double A Minus; Outlook: Positive)
Total long-term instruments	**1,095.00 (₹ One thousand ninety-five crore only)**		
Commercial paper	100.00	CARE A1+ (A One Plus)	Reaffirmed
Total short-term instruments	**100.00 (₹ One hundred crore only)**		

Details of instruments/facilities in Annexure-1.

Detailed rationale and key rating drivers

The upgrade of the ratings assigned to the various instruments of Aavas Financiers Limited (AFL) derives strength from its experienced management team, established track record of maintaining good asset quality along with portfolio growth, strong capitalisation and comfortable liquidity profile of the company with no negative cumulative mismatches across time buckets as per the asset liability maturity (ALM) statement dated March 31, 2022. CARE Ratings also considered the company's entire debt profile and company's ability to raise funds from various sources at competitive rates.

The ratings also factor in the healthy profitability metrics, high portfolio granularity and adequate risk management and control systems put in place by the company as well as good growth opportunities in the affordable housing segment.

These rating strengths are, however, offset by relatively vulnerable target borrower profile of AFL with majority of customers being new to credit with having modest credit profile (self-employed borrowers comprising 60% of asset under management [AUM] as on March 31, 2022), which makes AFL susceptible to the inherent asset quality risks especially in the current challenging operating environment. However, owing to granularity of loan book with low loan to value ratio (average LTV-54%), strong credit appraisal mechanisms, prudent and proactive risk management and control system coupled with enhanced use of technology and analytics, AFL has been able to keep its asset quality under control.

Also, AFL continues to have geographically concentrated portfolio, with Rajasthan accounting for about 39% of AUM as on June 30, 2022, though reduced from 47% as on June 30, 2018.

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

Rating sensitivities

Positive factors – Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Significant scale up of operations in a sustainable and profitable manner.
- Significant improvement in geographical diversification.
- Comfortable asset quality with credit cost below 0.5% on a sustained basis.

Negative factors – Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Weakness in profitability of AFL with return on total assets (RoTA) below 2.5% on continuous basis.
- Any sharp variation in the portfolio mix.
- Weakness in capitalisation profile with gearing rising above 7x.
- Decline in the asset quality with credit cost rising above 2% on a sustained basis.

Outlook: Stable

Detailed description of the key rating drivers

Key rating strengths

Experienced board of directors and management team: AFL is majority owned by two private equity (PE) investors, Kedaara Capital and Partners Group, who cumulatively held 39.8% shareholding as on March 31, 2022. The board of AFL comprises qualified and experienced personnel possessing strong knowledge in the housing finance domain and includes representatives from both the PE investors and three independent directors. The management team is headed by Sushil Kumar Agarwal, Founder and Managing Director, and Ghanshyam Rawat, Co-founder and CFO, who are supported by an experienced second line of management with vast experience in the finance and housing finance industry.

Robust capitalisation: The capitalisation profile of AFL is strong supported by healthy internal accruals and regular equity infusions in the past. The tangible net worth (TNW) of AFL stood at ₹2,803 crore as on March 31, 2022, up from ₹2,398 crore as on March 31, 2021, on account of positive internal accruals. The company's gearing also stood comfortable at 2.8x as on March 31, 2022. While the gearing is expected to increase with incremental business being funded with fresh borrowings, CARE Ratings Limited (CARE Ratings) expects gearing to remain below 6x in the medium to long term.

The capital adequacy ratio (CAR) of AFL also remains strong with Tier-1 and overall CAR of 51.25% and 51.93%, respectively, as on March 31, 2022, which is well above the regulatory requirement. The capitalisation profile is also supported by lower risk weights assigned on smaller ticket home loans and secured nature of portfolio. CARE Ratings expects that comfortable capitalisation profile of AFL will provide buffer against any asset quality-related shocks, if any.

Diversified resource profile: AFL funding profile remains diversified over the past few years with funding from banks/financial institutions (FIs) (through term loans amounting to 47.85% of the total borrowings as on March 31, 2022), refinance from National Housing Bank (NHB; 27.68%) and through non-convertible debentures (NCDs) and Rupee Dominated Masala Bonds (22.69%). Furthermore, AFL's funding position remains adequate due to strong relationship with all the leading banks of the country and funding support from various international agencies, such as Asian Development Bank (ADB), International Finance Corporation (IFC), and British International Investment (Erstwhile known as CDC).
During FY22 (refers to the period April 1 to March 31), the company has raised fresh borrowing of ₹4,388 crore at a competitive rate of 6.0% with average weighted maturity of 8.5 years. The average borrowing cost of AFL (reported) stood at 6.67% as on March 31, 2022, reduced from 7.83% as on March 31, 2021. Furthermore, AFL has no dependency on short-term commercial paper funding.

Healthy financial risk profile: Engaged in providing affordable housing finance, AFL has registered strong growth with AUM growing at a five-year compounded annual growth rate (CAGR) of 33% from fiscal 2017 till fiscal 2022 primarily driven by denominator effect amid lower base. The housing loan portfolio comprises 72% of the total AUM and the remaining 28% belongs to non-housing portfolio as on March 2022. Furthermore, the non-housing loan portfolio increased to 29% ending quarter June 2022, which is in compliance with the Reserve Bank of India (RBI) guidelines for maintaining the proportion between housing and non-housing loan to 60:40. The non-housing loan comprises loans backed by mortgages with average ticket size of about ₹6.7 lakh. The management aims to keep non-housing loans at around one-fourth of the total loan book in the medium term.

The profitability remains healthy with the net interest margins (NIMs) of 6.5% in FY22. However, a marginal increase can be witnessed in the operating cost due to digital upscaling and initiatives to further improve collection efficiency. This, coupled with improved credit cost of 0.2% in FY22, the company has reported a RoTA of 3.57% in FY22. Going forward, CARE Ratings expects NIMs to be moderated on account of expectation of increase in the cost of borrowing due to higher rate of interest environment and increase in gearing.

For the quarter ended June 30, 2022, the company reported profit after tax (PAT) of ₹89 crore on a total income of ₹353 crore. The annualised NIM and RoTA stood at 6.4% and 3.2%, respectively, as on June 30, 2022.

Track record of good asset quality: AFL has continued to report healthy asset quality metrics with gross non-performing asset (GNPA) ratio of 0.99% and net non-performing asset (NNPA) ratio of 0.76% as on March 31, 2022. However, Asset quality has marginally deteriorated in Q1FY23, with GNPA rising to 1.1% as on June 30, 2022. The rise in NPA numbers is majorly due to RBI notification dated November 12, 2021, on IRAC norms, which has elevated the GNPA ratio by 0.31% and 0.26% as on March 2022 and June 2022, respectively.

Furthermore, with improved collection and underwriting system, delinquency level of AFL in softer buckets (1+dpd) has improved with 1+dpd of 4.46% end-March 31, 2022, down from the elevated level of 6.4% as on March 31, 2021; further, it remains at 4.67% as on June 30, 2022. The provision coverage ratio (PCR) on GNPA stood at 23% end-March 31, 2022.

The asset quality profile of the company is, however, supported by strong control systems and low loan to value (LTV) ratios, with average LTV at about 54% end-March 31, 2022. Also, given the secured nature of the lending with 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.

Key rating weaknesses

Moderate seasoning of loan portfolio; albeit improving and exposure to relatively vulnerable borrower segment: Since its inception in 2012, AFL has registered strong portfolio growth and the seasoning of loan portfolio, though low, has been on an improving trend. AFL's portfolio size remains moderate compared to large, rated players in the housing finance industry. As an affordable housing finance company, AFL is focused on providing secured retail home loans to low and middle income borrowers in semiurban and rural regions, with majority of them having lack of formal income documents. The customers of AFL are a mix of self-employed (60% of AUM as on June 30, 2022) and remaining 40% as salaried borrowers with majority of them in Tier-2 to Tier-6 cities, thereby exposing the company to the relatively economically vulnerable borrower segment. Since this segment is highly susceptible to the impact of economic downturn, maintaining good asset quality while increasing the scale of operations is a key sensitivity. The company has put in place adequate credit appraisal mechanisms and integrated MIS systems. The company has enhanced its risk management system with the use of technology and analytics, which has resulted in better operating efficiencies, effective monitoring of collections, asset quality under control and is further expected to lead to improvement in the asset quality metrics going forward.

Geographical concentration: While the company has presence in 13 states, the state-wise geographic concentration remains high with Rajasthan alone accounting for 39% of the AUM as on June 30, 2022, and top three states (Rajasthan, Maharashtra and Gujarat) together accounting for 71% of AUM as on June 30, 2022, reduced from 47% concentration in Rajasthan and 83% concentration in top three states as of June 30, 2018. However, the company has been deepening its presence in the existing states with opening of new branches at district/tehsil level. The geographic concentration is expected to further come down, as the company plans to expand its operations in other geographies. As on June 30, 2022, the company has presence in 13 states with 318 branches.

Liquidity: Strong

AFL has well matched the tenure of its housing loan book and that of its borrowings, rendering liquidity profile of the company very comfortable with no negative cumulative mismatches across the time buckets as on March 31, 2022. Over the next one year till March 31, 2023, the company expects repayment from loan book (excluding interest) of ₹1,493 crore while its debt repayment will be around ₹1,189 crore.

Analytical approach: Standalone

Applicable criteria

Policy on Default Recognition
Financial Ratios – Financial Sector
Criteria on Assigning 'Outlook' or 'Credit Watch' to Credit Ratings
Criteria for Short Term Instruments
Rating Methodology - Housing Finance Companies (HFCs)

About the company

Aavas Financiers Ltd, a housing finance company, was incorporated in February 2011 as a subsidiary of AU Small Finance Bank (rated 'CARE AA; Stable'). It received the NHB License – Certificate of Registration on August 04, 2011 and commenced operations from March 2012. In June 2016, to comply with the RBI guidelines, AU SFB divested majority of its shareholding to two private equity players – Kedaara Group and Partners Group. As on June 30, 2022, the Kedaara group holds 23.65% stake in AFL, the Partners Group holds 16.16% stake, and remaining 60.19% is held by the public, including management team of AFL and marquee investors. AFL is engaged in providing retail home loans with focus on affordable housing segment to customers in semi-urban and rural regions. As on June 30, 2022, the company operates through a network of 318 branches in 13 states – Rajasthan, Maharashtra, Gujarat, Madhya Pradesh, Delhi, Haryana, Punjab, Chhattisgarh, Uttar Pradesh, Uttarakhand, Himachal Pradesh, Odisha and Karnataka.

Brief Financials (₹ crore)	March 31, 2020 (A)	March 31, 2021 (A)	March 31, 2022 (A)	Q1 FY 2023 (UA)
Total operating income	903.10	1,105.33	1,305.56	352.88
PAT	249.13	289.50	356.80	89.22
Interest coverage (times)	1.8	1.8	1.9	1.8
Total assets	7,653.49	8,956.19	11,014.59	11,594.01
Net NPA (%)	0.34	0.71	0.76	0.84
ROTA (%)	3.75	3.49	3.57	3.16

A: Audited; NA: Not available

Status of non-cooperation with previous CRA: NA

Any other information: NA

Rating history for the last three years: Please refer Annexure-2

Covenants of the rated instruments/facilities: Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3

Complexity level of various instruments rated for this company: Annexure-4

Annexure-1: Details of instruments/facilities

Name of the instrument	ISIN	Date of issuance	Coupon rate	Maturity date	Size of the issue (₹ crore)	Rating assigned along with rating outlook
Fund-based - LT-Term loan		-	-	Sep-30, 2031	4,402.00	CARE AA; Stable
Fund-based - LT-Cash credit		-	-	-	110.00	CARE AA; Stable
Long-term subordinate debt	INE216P08017	Dec-22-2017	9.49%	22-Dec-23	100.00	CARE AA; Stable
Non-convertible debentures	INE216P07167	Sep-16-2019	8.39%	15-Sep-24	345.00	CARE AA; Stable
Non-convertible debentures	INE216P07175	Mar-30-2020	8.65%	30-Mar-28	444.40	CARE AA; Stable
Non-convertible debentures	INE216P07225	Mar-25-2022	Repo rate linked	25-Mar-27	100.00	CARE AA; Stable
Non-convertible debentures	INE216P07217	Nov-26-2021	Repo rate linked	26-Nov-26	99.00	CARE AA; Stable
Non-convertible debentures	Proposed				6.60	CARE AA; Stable
Commercial paper (Standalone)	Proposed				100.00	CARE A1+

Annexure-2: Rating history for the last three years:

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021	Date(s) and Rating(s) assigned in 2019-2020
1	Commercial paper-Commercial paper (Standalone)	ST	100.00	CARE A1+	1)CARE A1+ (05-Apr-22)	1)CARE A1+ (05-Oct-21)	1)CARE A1+ (05-Jan-21)	1)CARE A1+ (06-Jan-20)
2	Fund-based - LT-Term loan	LT	4402.00	CARE AA; Stable	1)CARE AA-; Positive (05-Apr-22)	1)CARE AA-; Positive (05-Oct-21)	1)CARE AA-; Stable (05-Jan-21)	1)CARE AA-; Stable (27-Mar-20) 2)CARE AA-; Stable (06-Jan-20) 3)CARE AA-; Stable (30-Jul-19) 4)CARE AA-; Stable (15-Jul-19)
3	Debt-Subordinate debt	LT	50.00	CARE AA; Stable	1)CARE AA-; Positive (05-Apr-22)	1)CARE AA-; Positive (05-Oct-21)	1)CARE AA-; Stable (05-Jan-21)	1)CARE AA-; Stable (06-Jan-20)
4	Debt-Subordinate debt	LT	50.00	CARE AA; Stable	1)CARE AA-; Positive (05-Apr-22)	1)CARE AA-; Positive (05-Oct-21)	1)CARE AA-; Stable (05-Jan-21)	1)CARE AA-; Stable (06-Jan-20)
5	Debentures-Non-convertible debentures	LT	375.00	CARE AA; Stable	1)CARE AA-; Positive (05-Apr-22)	1)CARE AA-; Positive (05-Oct-21)	1)CARE AA-; Stable (05-Jan-21)	1)CARE AA-; Stable (06-Jan-20) 2)CARE AA-; Stable (31-May-19)
6	Fund-based - LT-Cash credit	LT	110.00	CARE AA; Stable	1)CARE AA-; Positive (05-Apr-22)	-	-	-
7	Debentures-Non-convertible debentures	LT	420.00	CARE AA; Stable	1)CARE AA-; Positive (05-Apr-22)	1)CARE AA-; Positive (05-Oct-21)	1)CARE AA-; Stable (05-Jan-21)	1)CARE AA-; Stable (06-Jan-20) 2)CARE AA-; Stable (13-Dec-19)
8	Debentures-Non-convertible debentures	LT	200.00	CARE AA; Stable	1)CARE AA-; Positive (05-Apr-22)	1)CARE AA-; Positive (18-Nov-21)	-	-

*Long term/Short term.

Annexure-3: Detailed explanation of the covenants of the rated instruments/facilities: Not Available

Annexure-4: Complexity level of various instruments rated for this company

Sr. No.	Name of Instrument	Complexity Level
1	Commercial paper-Commercial paper (Standalone)	Simple
2	Debentures-Non-convertible debentures	Simple
3	Debentures-Non-convertible debentures	Simple
4	Debt-Subordinate debt	Complex
5	Fund-based - LT-Cash credit	Simple
6	Fund-based - LT-Term loan	Simple

Annexure-5: Bank lender details for this company

To view the lender wise details of bank facilities please click here

Note on complexity levels of the rated instruments: CARE Ratings has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

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About us:

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