Thematic Report

25th March, 2022

DALAL & BROACHA
STOCK BROKING PVT. LTD.

Opportunity for all

Nothing is more expensive than a missed opportunity.
- H. Jackson Brown

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Opportunity for all

Overview of affordable housing finance market

Housing finance companies saw a sharp revival in their overall business growth in H2 CY21, supported by robust end-user interest aided by government impetus, better affordability, and lower interest rates. Within housing, affordable housing saw a faster bounce back as relative demand increased in tier 3 and 4 towns. India's mortgage market can broadly be divided into two segments by ticket size of the housing loan at the time of disbursement- 1) loans with a ticket size of more than Rs 15 lakhs, and 2) loans with a ticket size of Rs 15 lakhs & below. The former can be called the normal mortgage market, which is prominent in the metro/urban areas, and the latter which generally includes houses in the outskirts of these areas and semi-urban and rural areas. **Given the high under penetration in EWS/LIG segment, we remain positive on this space and are showing comparatives in 3 new age-listed affordable HFCs i.e. Home First, Aavas Financiers and Aptus Value Housing Finance.**

Most of the housing shortage lies in EWS-LIG segment: The mortgage penetration in India from formal lending sources is only 10%, while the remaining 90% of the mortgage needs are satisfied using own funds and informal borrowing sources, widening the room for HFCs. The housing shortage in India is estimated to increase to 100 million units by 2022, of which 95% will be from the "bottom of the pyramid" including the EWS/LIG (for more details refer Exhibit 1). These customers are primarily new to credit customers, without formal income proofs, and are unserved or underserved by formal financial institutions. Catering to this segment requires a special skill set, which is based on an assessment of their income through various methods, and the income of all the earning members in a family. Over the years, these new-age lenders (such as Home First, Aavas, and Aptus) studied and developed credit assessment models specifically customized to service these types of customers.

Aavas Financiers (Consistently above industry loan growth with adequately seasoned book): It has grown it' AUM and PAT by 41% and 55% CAGR, respectively over FY16-21, supported by a unique expansion strategy, which focuses on steady scale-up in three to four states at a particular time. The Company significantly diversified its customer base, making it possible for them to access diverse funding avenues through unique and customized products at progressively better terms and risk-adjusted rates at the locations where formal funding is limited. The Company maintained a lower delinquency percentage, which validates underwriting skills, customer selectivity (majorly single unit self-occupied homes), low construction tenure (often less than a year) & in-house teams (underwriting/collection/valuation/ mortgage risk).

Home First Finance (well-balanced loan book, with a tilt towards home loans and salaried class): It is a technology-driven, affordable housing finance company, which focuses on niche customer segments and had reported robust AUM growth of 50% CAGR over FY16-21. The company does a more holistic assessment of the customer's family income & provides the right loan amount. So, the customers are willing to pay that little extra (average yield stood at 13% vs 9-11% of large peers). Its technology-led operating model helps it to deliver industry-leading productivity ratios & the turnaround time of 48 hr vs an industry average of 8 to 10 working days. The company has crossed Rs 5,000 Cr AUM in the month of January'2022.

Aptus Value Housing Finance (industry leading return ratio with stable asset quality): It has a strong business model, with best-in-class return ratios (RoA over 6%) among its peers, robust operating efficiency (Opex to assets ~2.8% levels), and well managed asset quality (GNPAs ~1.5% in Q3FY22). In the last few years, the company has demonstrated its ability to grow the loan book without compromising asset quality or profitability. Its loan book clocked 42% CAGR over FY18-FY21, while revenue & PAT grew at a CAGR of 48% and 59% respectively. Aptus' business also stands out in terms of margins, with NIM at ~9% supported by the higher yields (~17% which is 3-4% higher than peers).

Big opportunity in affordable housing finance segment

More thrust towards affordable housing: Real estate industry had been battling weak demand for the past couple of years, and one of the key reasons was unaffordability, as developers focussed on the middle and premium income-category projects. However, Government initiatives have prompted developers to explore affordable housing as a new area. Going ahead, most of the incremental supply being added in urban stock is expected to be via affordable housing. Besides, the formalization of the industry is likely to bring in more transparency, leading to an increase in consumer demand.

Housing shortage of ~100 mn units, while credit opportunity of Rs 50-60tn India's housing shortage is estimated to increase to 100 Mn units by 2022, of which 95% will be from the "bottom of the pyramid" including the lower income group (LIG) and economic weaker section (EWS). Total incremental housing loans demand, if this entire shortage is to be addressed, is estimated to be in the region of Rs. 50 trillion to Rs. 60 trillion of which Rs 9 trillion to 10 trillion would be towards the affordable housing segment. Within the affordable segment, loans under ticket size of Rs 15 lakh comprised 70% by volume and 38% by value. Considering the same, we continue to like housing finance companies (HFCs), which are focused on the affordable housing finance segment.

Exhibit 1: Shortage of Housing Units in India

Particular	2007	2012	2022E
Shortage and requirement (mn)			
EWS	21.8	10.6	45
LIG	2.9	7.4	50
MIG and above	0	0.8	5
Total	**24.7**	**18.8**	**100**
Value of units, LTV to be financed by HFCs, SCBs (Rs Lakh Cr)			
EWS	10.9	5.3	33.8
LIG	2.9	7.4	100
MIG and above	0.2	4.1	40
Total	**14**	**16.8**	**173.8**
Construction costs (Rs Lakh Cr)			
EWS	10.9	5.3	36
LIG	2.2	5.6	62.5
MIG and above	0.1	1.6	15
Total	**13.2**	**12.5**	**113.5**

Source: RBI, Dalal & Broacha research

Exhibit 2: The usual characteristics of the affordable housing finance niche are captured in the following realities

Low average ticket size	Nearly 70% of the niche is accounted for by loans of Rs10 lakh or lower.
Self-employed	Nearly 85% affordable HFCs cater to the growing needs of the self-employed where yields are typically higher than the salaried segment
Low loan to value	More than 60% of the loans made in the affordable housing finance niche have a Loan To Value (LTV) of less than 70%, indicating a higher skin in the game for the borrower and correspondingly lower risk for the lender.
Undocu-mented income	This segment is marked by a distinctive reality where most of the borrowers are without documented formal income; they are sought by customers who are new to credit and the entire process warrants a cash flow-based assessment.
Format	Much of the financing is for single units and self-occupied houses, indicating that they are for active use and not investmrnt

Source: AAVAS Financiers, Dalal & Broacha research

Exhibit 3: Housing finance sector catalysts

Mortgage penetration

- The mortgage penetration in India from formal lending sources is only 9%, while the remaining 91% of the houses are built using own funds and informal borrowing sources, widening the room for HFCs (Source: Assocham)

Demographics

- Close to 65% of India's population is under 35 years, a class of the population considered economically productive. The number of nuclear families is rising

Urbanization

- By 2030, 40% of the country's population, are expected to reside in cities. The country requires 700 to 900 Mn square meters of residential and commercial space to be built annually till 2030. This migration means that nearly 90% of the demand is likely to be generated from the bottom of the economic pyramid.

Affordability

- The cost of housing finance in India is among the lowest across developing economies. Besides, lower fixed deposit /saving accounts returns are incentivizing investments in home ownership. The cost of real estate has remained steady for one of the longest periods in recent times, enhancing home ownership affordability

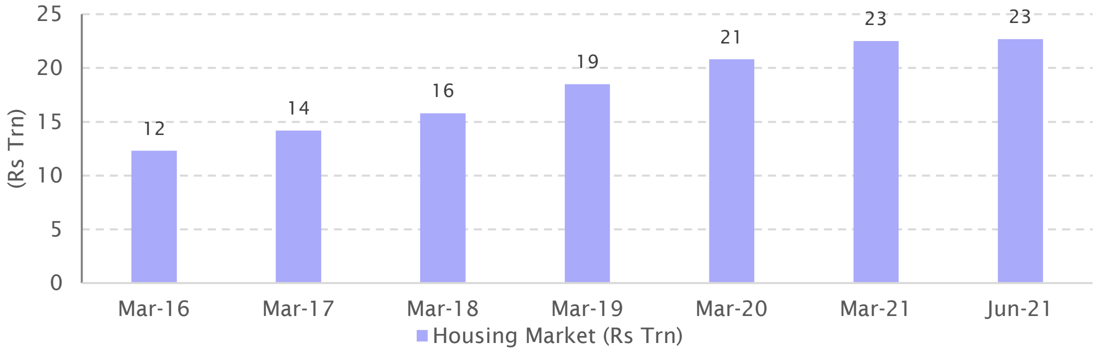
Source: AAVAS Financiers, Dalal & Broacha research

Exhibit 4: **Country-wise mortgage to GDP ratio (%)**

Sweden	UK	US	Singapore	Germany	Malaysia	Korea	Thailand	China	India	India FY23E
82%	69%	63%	50%	36%	34%	31%	20%	18%	10%	13%

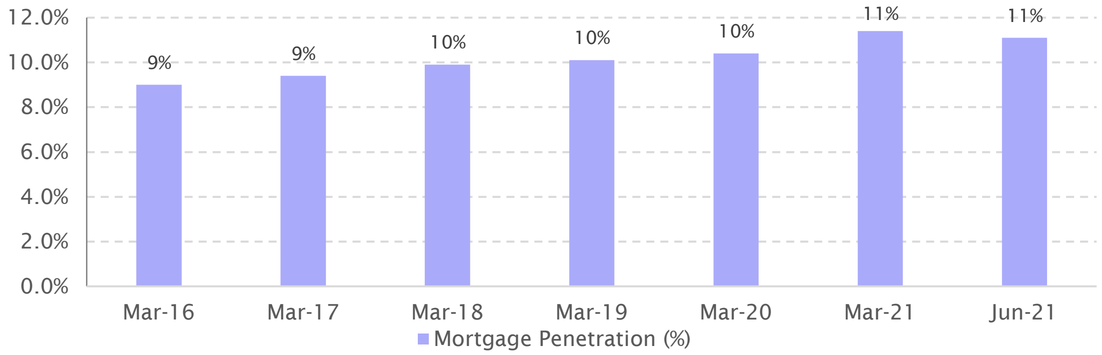
Source: Aavas Financiers, Dalal & Broacha Research

Exhibit 5: Growing Indian Housing Finance Market



Source: Aavas Financiers, Dalal & Broacha Research

Exhibit 6: **Opportunity Size**



Source: Aavas Financiers, Dalal & Broacha Research

Ample Liquidity in Market: most of the HFCs are maintaining strong balance sheet liquidity for the last few quarters and steadily reduced their dependence on short-term funding sources like CPs, which helped in enhancing asset liability mismatches in the near-term buckets. Meanwhile, the current on-balance sheet liquidity would also help in maintaining funding costs for certain quarters as the industry positioned for the rising interest rate cycle, making the cost of incremental borrowings is likely to rise across capital market instruments.

Exhibit 7: Basic Business Metrics

Rs Bn	Home First Finance					Aptus Value Housing					Aavas Financier				
	FY18	**FY19**	**FY20**	**FY21**	**9MFY22**	**FY18**	**FY19**	**FY20**	**FY21**	**9MFY22**	**FY18**	**FY19**	**FY20**	**FY21**	**9MFY22**
Profit and Loss Statement															
Net Interest Income	0.64	1.27	1.98	2.47	1.98	1.40	1.99	3.04	4.18	4.15	2.81	4.29	5.13	6.08	4.71
CAGR				*56.9*	*33.4*				*43.9*	*37.4*				*29.3*	*21.9*
Net Income	0.68	1.44	2.26	2.69	2.75	1.49	2.21	3.39	4.49	4.47	3.01	4.56	5.47	6.47	5.86
CAGR				*57.9*	*46.5*				*44.4*	*38.7*				*29.0*	*24.5*
Operating expense	0.41	0.72	1.02	1.03	0.89	0.47	0.67	0.88	0.98	0.87	1.65	1.89	2.30	2.57	2.45
CAGR				*35.7*	*33.6*				*27.7*	*20.6*				*16.0*	*34.1*
PPOP	0.27	0.73	1.24	1.66	1.85	1.02	1.54	2.51	3.51	3.60	1.37	2.67	3.17	3.91	3.42
CAGR				*83.0*	*53.6*				*51.1*	*43.9*				*41.8*	*18.5*
Credit cost	0.03	0.07	0.17	0.32	0.22	0.01	0.01	0.03	0.06	0.24	0.03	0.09	0.15	0.37	0.33
CAGR				*123.1*	*-6.2*				*93.5*	*766.3*				*142.5*	*9.5*
PBT	0.24	0.65	1.07	1.34	1.63	1.01	1.53	2.48	3.45	3.36	1.34	2.58	3.02	3.53	3.09
CAGR				*76.7*	*78.2*				*50.6*	*35.8*				*38.0*	*19.5*
PAT	0.16	0.45	0.80	1.00	1.26	0.67	1.12	2.11	2.67	2.60	0.93	1.76	2.49	2.90	2.41
CAGR				*84.3*	*82.9*				*58.8*	*36.0*				*46.0*	*19.4*
Balance sheet															
AUM	13.56	24.44	36.18	41.41	49.94	14.17	22.47	31.79	40.68	48.05	40.73	59.42	77.96	94.54	106.13
CAGR				*45.1*	*26.7*				*42.1*	*26.7*				*32.4*	*20.3*
Borrowings	13.09	21.35	30.14	33.27	30.24	8.42	16.00	20.15	25.08	21.49	27.38	36.53	53.52	63.45	72.29
CAGR				*36.5*	*6.5*				*43.9*	*-0.7*				*32.3*	*11.5*
Total Assets	13.65	24.82	34.80	45.10	46.31	14.45	23.28	37.47	45.20	49.93	40.40	56.27	76.58	89.60	101.59
CAGR				*48.9*	*15.5*				*46.2*	*21.8*				*30.4*	*11.9*
Disbursements	7.46	15.73	16.18	10.97	13.89	7.41	10.89	12.71	12.98	11.22	20.51	26.72	29.30	26.57	23.15
CAGR				*13.7*	*115.5*				*20.6*	*25.4*				*9.0*	*40.8*
Return ratios															
RoA (%)	1.4	2.4	2.7	2.5	3.6	6.2	6.1	7.0	7.3	7.8	2.9	3.6	3.7	3.5	3.4
RoE (%)	5.1	10.7	10.9	8.7	11.5	11.4	17.4	17.5	14.5	14.1	10.6	11.6	12.7	12.9	12.7
Operating ratio															
Opex to AUM (%)	3.7	3.8	3.4	2.6	2.7	4.1	3.8	3.4	2.7	2.6	4.9	3.8	3.3	3.0	3.3
Yield on assets (%)	12.6	12.3	12.9	13.0	12.8	17.4	17.3	17.2	17.0	16.9	14.0	13.8	13.6	13.2	12.8
Cost of funds (%)	8.8	8.4	8.8	8.0	7.2	9.5	9.8	9.8	8.4	8.0	8.6	8.7	8.4	7.4	7.0
NIM (%)	5.3	5.4	5.1	4.8	5.6	7.9	7.5	7.4	8.6	8.9	9.0	9.3	8.2	7.7	8.1
Asset quality															
GNPAs (%)	0.6	0.8	1.0	1.8	2.6	0.5	0.4	0.7	0.7	1.5	0.5	0.5	0.5	1.0	1.7
Coverage ratio (%)	20.0	25.0	26.0	36.0	22.7	19.0	25.0	23.0	27.0	25.2	16.0	22.0	26.0	27.0	23.4
Customer and performance profile															
AUM mix (%)															
Salaried (%)					73					28					40
Non-salaried (%)					27					72					60
Housing (%)					91					55					72
Non-Housing (%)					9					45					28

Source: Company, Dalal & Broacha Research

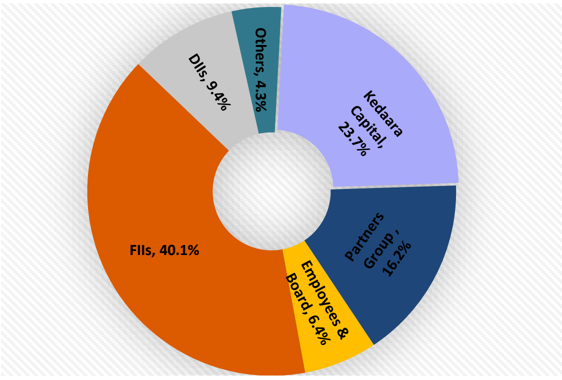
CAGR* (FY18-FY21)/YoY (%)

AAVAS FINANCIERS
Report card

Business Profile

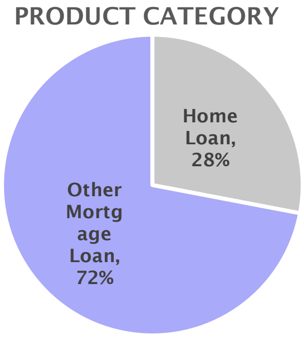
Aavas is primarily engaged in the business of providing housing loan to customers belonging to low and middle income segment in semi-urban and rural areas. The company's AUM and disbursements grew by ~50% CAGR and 31% CAGR respectively over FY15-FY21. Net income increased by ~57% CAGR, while operating profit and PAT grew by ~50% CAGR & 31% CAGR respectively over FY15-FY21.

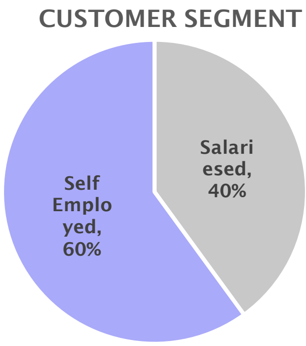
SHAREHOLDING PATTERN

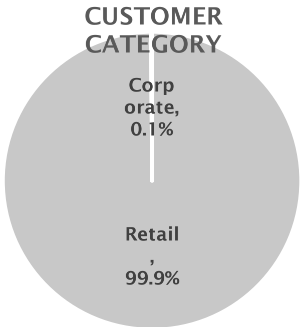


Investor Details	Holding
Capital Group	8.36%
GIC	5.90%
Wasatch Global Investor	5.49%
Nomura AMC	3.86%
Kotak Mahindra AMC	2.94%
SBI Life Insurance	1.88%
Vanguard Group	1.28%
Abu Dhabi Investment	1.19%
William Blair	1.19%
Buena Vista Fund	1.14%
C Worldwide AMC	1.11%
Stewart Investors	1.07%
Tata AIA Life Insurance	1.03%

AUM Break-up







LIABILITY MIX

The company's strong asset profile has been supported by a conservative liability side including Terms Loans (38.4%), Assignment (23.6%), NHB (22.8%) and NCDs (15.2%), zero CPs despite strong short term rating of A1+. Capital Adequacy stands at 51.6% of which Tier 1 is 50.9% as on Q3FY22.

PRESENCE

Aavas has total 298 branches mainly in Tier 2, 3 and 4 cities and Rajasthan (96 branches) remains the major market for the company with significant presence in Maharashtra (44), Gujarat (40%) and MP (40%). The company is expanding its operations in UP, Haryana, Uttarakand and Himanchal Pradesh.

MANAGEMENT DEPTH

Sandeep Tandon (Chairperson)

He has completed the Harvard Business School YPO President Program. He previously served as the MD of Tandon Advance Device and as a Director on the Board of Accelyst Solutions.

Sushil Agarwal (MD & CEO)

He is a qualified CA and has been associated with Aavas since its incorporation in 2011. He has previously worked with ICICI Bank as its Chief Manager and with Kotak Mahindra Primus as an Assistant Manager. He has more than 19 years of experience in the field of retail financial services

AUDITORS

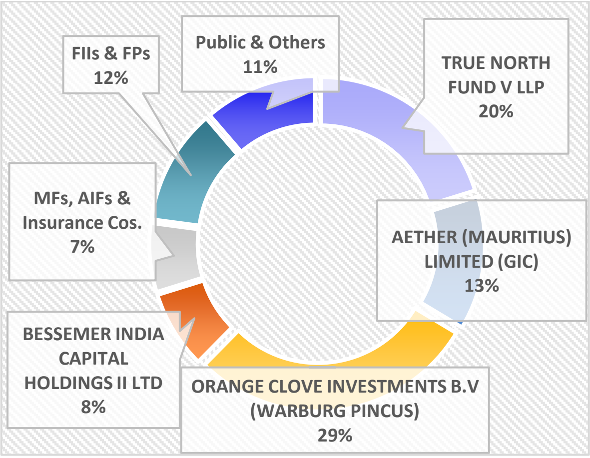
S. R Batliboi & Associates

HOME FIRST FINANCE COMPANY INDIA
Report card

Business Profile

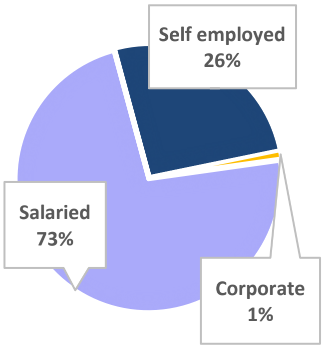
Home First Finance Company India Limited (HomeFirst) is a technology driven affordable housing finance company that targets first time home buyers in low and middle-income groups. In its eleven-year journey, the company has provided housing loans to more than 60,000 customers across 13 States/UT in the country. HomeFirst has crossed Rs 5,000 Cr AUM in the month of January'2022

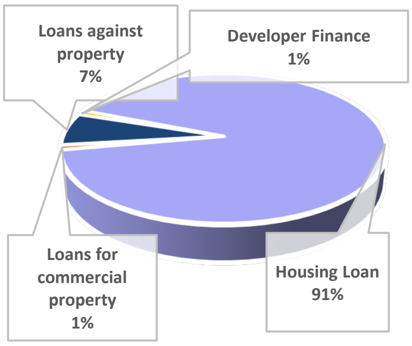
SHAREHOLDING PATTERN

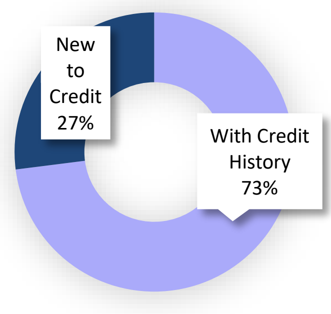


KEY INVESTORS	% HOLDING*
SUNDARAM MF	2.1
MOTILAL OSWAL AIF	1.5
ICICI PRU MF	0.9
ADITYA BIRLA SUNLIFE	0.6
KUWAIT INVESTMENT AUTHORITY FUND	1.7
BUENA VISTA	1.7
GOLDMAN SACHS ASSET MGMT	1.3
MORGAN STANLEY	0.9
AL MEHWAR COMMERCIAL INVESTMENTS	0.7
NOMURA AM	0.7
CRESTWOOD	0.7
GRANDEUR PEAK	0.6
FIDELITY INTERNATIONAL	0.5

AUM Break-up







LIABILITY MIX

The company's strong asset profile has been supported by a conservative liability side including Banks (45%), Assignment (25%), NHB (23%), NCDs (5%), and NBFC (2%) zero CPs despite strong short term rating of A1+. Capital Adequacy stands at 59% of which Tier 1 is 57.8% as on Q3FY22.

PRESENCE

HomeFirst has total 76 branches mainly in Tier 2, 3 and 4 cities and Gujarat (20 branches) remains the major market for the company with significant presence in Maharashtra (17) and Tamil Nadu (11%). The company is expanding its operations in Rajasthan, Karnataka, Telangana, MP and UP.

MANAGEMENT DEPTH

Deepak Satwalekar (Chairman)

He was associated with HDFC Limited as MD and HDFC Standard Life Insurance Company as MD & CEO Currently he is associated with Asian Paints Limited and Wipro as an Independent Director.

Manoj Viswanathan (MD & CEO)

He has 24+ years in Consumer Lending. At Citi, he was heading the branch-based consumer lending business spanning 450 branches with a customer base of more than 1 Mn customers.

AUDITORS

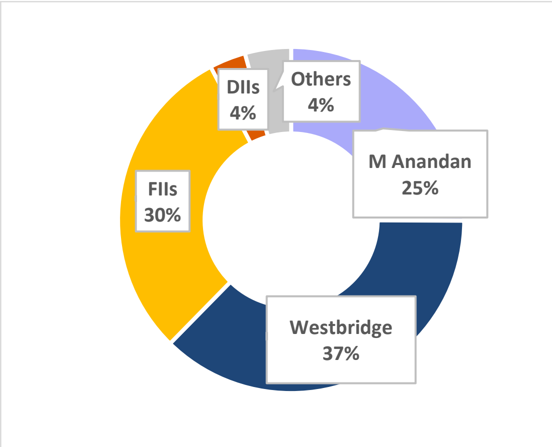
Deloitte Haskins & Sells

APTUS VALUE HOUSING FINANCE INDIA
Report card

Business Profile

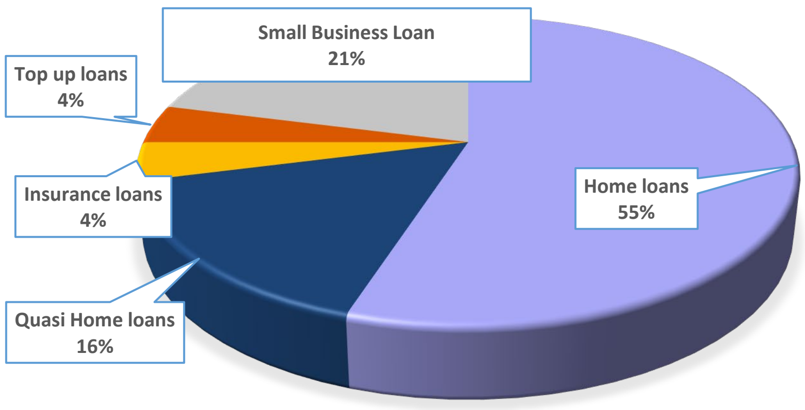
Aptus is an entirely retail focussed housing finance company primarily serving low and middle income self-employed customers in the rural and semi-urban markets of India for the purchase and self-construction of residential property, home improvement and extension loans; LAP; and business loans. The company do not provide any loans with a ticket size above Rs 2.50 million.

SHAREHOLDING PATTERN



Investor Details	Holding
Malabar Group	8.51%
Steadview Capital	3.47%
Sequoia	3.21%
Ward Ferry	2.87%
Madison	2.79%
Genesis	1.44%
Aberdeen	1.29%
Capital Research	1.27%
Neuberger Berman	1.22%
DSP Mutal Funds	0.67%
Axis Mutual Fund	0.27%
Edelweiss Mutual Fund	0.24%

AUM Break-up



LIABILITY MIX

The company's strong asset profile has been supported by a conservative liability side including Banks (51%), NHB (27%), IFC,MF (17%) and Others (5%), zero CPs despite strong short term rating of A+.

PRESENCE

Aptus has total 298 branches mainly in Tier 2, 3 and 4 cities and Tamil Nadu (79 branches) remains the major market for the company with significant presence in Andhra Prades (71), Telangana (31%) and Karnataka (21%). The company is expanding its operations in Maharashtra, Odisha and Chhattisgarh.

MANAGEMENT DEPTH

M. Anandan (Chairman & MD)

He has over 40 years of experience in the financial services sector and has previously served as t h e MD of Cholamandalam Investment and Finance Company Limited.

P. Balaji (Executive Director & CFO)

He has various years of experience in the textiles, telecom and finance sectors. He was previously associated with the Bombay Dyeing and Manufacturing, Hutchison Max Telecom and Cholamandalam MS General Insurance.

AUDITORS

S. R Batliboi & Associates

Aavas Financiers

Initiating Coverage | BFSI

DALAL & BROACHA
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Equity Research Desk

25 March 2022

Strong Business with Numerous Growth Drivers

Aavas Financiers is one of the consistent performers in housing finance companies not just in terms of loan growth (FY18-FY21 CAGR of 32%) and operating performance (FY18-FY21 PPOP CAGR of 42%), but also in terms of asset quality (GNPAs restricting below 2%) and return ratios (ROA above 2.5%). Aavas' loan book is more seasoned then other two HFCs which we are covering in our current report. Despite the seasoning, it has managed to deliver best-in-class asset quality and controlled credit cost. Over the next few years (FY21-24), we expect the company's AUM to grow at 23% CAGR, PAT to grow at 19% CAGR and return ratio such as ROA to remain stable above 3%, supported by improvement in productivity from past investments (in people/branches) and risk-based pricing Strategy

Rating	TP (Rs)	Up/Dn (%)
BUY ON DIPS	2,632	18

Market data		
Current price	Rs	2,226
Market Cap (Rs.Bn)	(Rs Bn)	176
Market Cap (US$ Mn)	(US$ Mn)	2,300
Face Value	Rs	10
52 Weeks High/Low	Rs	3,340 / 2,124
Average Daily Volume	('000)	188
BSE Code		541988
Bloomberg		AAVAS.IN

Source: Bloomberg

Ability to grow AUM faster than the industry average over a prolonged period

Considering high under-penetrated in India's low-cost housing finance market, we believe the company can consistently deliver above industry AUM for the next several years, supported by niche positioning (~61% self-employed), entrenched presence (most branches are >50km away from the main city), and technology-backed processes (Using Application scorecard for Auto-rejection / fast tracking leads). Besides, better productivity in existing branches along with adding new branches in new states will also drive AUM growth. In the last five years, the company has added 204 branches and stood at 298 branches in 9MFY22, higher than peers such as Repco Home and Can Fin Homes. With a well-capitalized balance sheet, sturdy internal accruals, and the low Risk-weighted asset on low ticket housing loans, the company can grow its loan book by 20-25% CAGR over the next 4-5 years without any additional capital requirements.

Focus on risk-based pricing to bring balance between asset quality and profitability/ Focus on risk-based pricing to ensure strong and consistent profitability

Aavas use a risk-based pricing approach to price risk correctly by offering finer interest rates to deserving customers, where higher interest rates are charged on people with a low credit score. It has built a proprietary under-writing team for income assessment and risk-based pricing of customers. With demand being less sensitive to interest rates, the company's approach has played out well for margins and profitability. The company's average yield stood at 13.5% (~300-400 bps higher than large HFCs), given the high share of self-employed customers (60% of AUM) and LAP segment (72% of AUM). On the liability side, Aavas has no CPs outstanding and prefers long-term borrowings from banks, NHB and multi-lateral institutions. A diversified borrowing mix has enabled the company to bring down its cost of funds by 165 bps over the past five years to ~7% and helped the company to maintain its spreads in the range of 5-6%.

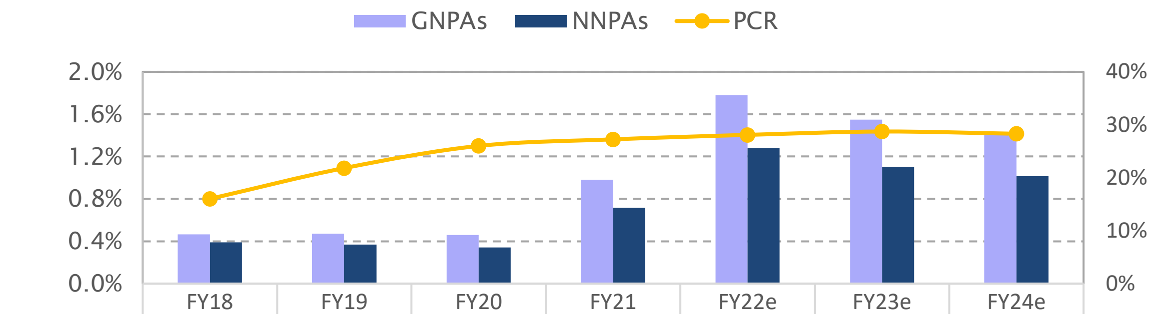
Valuation and Outlook

We believe Aavas Financiers has all the right ingredients, which include conservative management, well-capitalized balance sheet, best-in-class asset quality, and superior return ratios. Besides, focusing on low ticket housing loans, on less competitive areas (semi-urban and rural) and serving underserved new-to-credit self-employed customers made it stand out vs large HFCs, justifying premium valuation. At CMP, the stock trades at 5.7x its FY23E ABV and 4.9x its FY24E ABV. We assign a 'Buy on Dips' rating on Aavas Financiers with a price target of Rs 2632, valuing the stock at 5.8x FY24E standalone P/ABV.

Asset Quality

Despite COVID-19 linked disruptions, Aavas Financiers has been able to maintain superior asset quality, with GNPAs restricting below 2% and credit costs below 0.6% (annualized in 9MFY22). This was driven by cautious lending practices and in-house risk management practices such as verification of credit history from credit information bureaus, personal verification of customer's business place or residence, in-house technical and legal verification, and conservative LTV parameters and property insurance cover. With COVID-related stress behind, we expect credit costs to settle ~0.4% levels over FY22-24E.

Exhibit 1: AUM Break-up Robust asset quality



	FY18	FY19	FY20	FY21	FY22e	FY23e	FY24e
GNPAs	0.46%	0.47%	0.46%	0.98%	1.78%	1.55%	1.42%
NNPAs	0.39%	0.37%	0.34%	0.71%	1.28%	1.10%	1.02%
PCR	16.0%	21.8%	26.0%	27.2%	28.1%	28.7%	28.3%

Source: Company, Dalal & Broacha Research

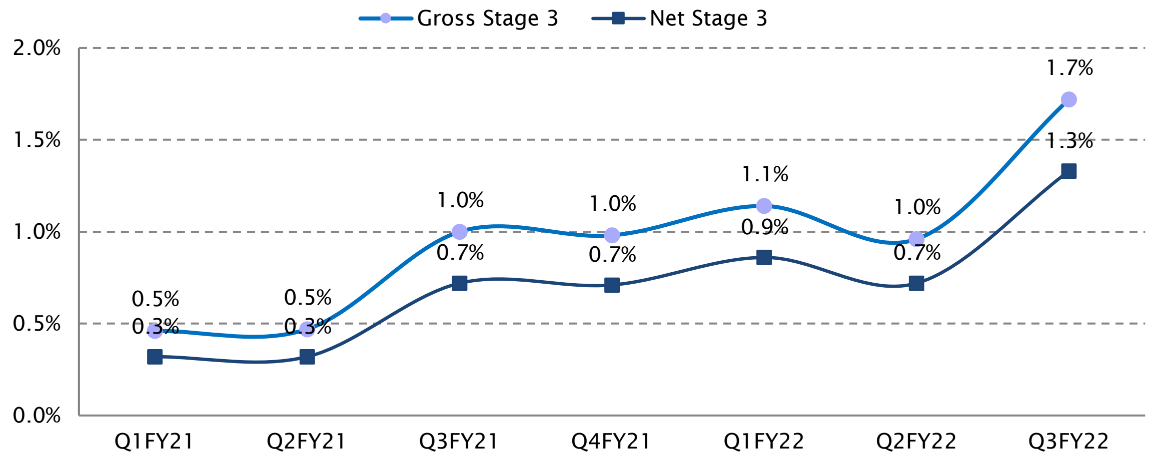
Some of the key initiatives that support better asset quality

- The company created a proprietary under-writing team for income assessment and risk-based pricing of customers. Besides, the company applies a scorecard to evaluate risk profiles and streamline the approval process, which reduces the incidence of error.
- The company also conducts a macro-analysis of the property, neighbourhood, title and land laws; the micro-analysis is also conducted by a focused team which is usually done when the customer least expects it.
- The company validates property valuations from the buy-side and sell-side to arrive at a precise understanding. The company's Risk Officer makes dozens of visits to customer sites for a familiar understanding
- In order to minimize error impact, the company generated two valuation reports beyond a specific ticket size.
- Meanwhile, the company has built a four-tier collections architecture (including tele-calling, field collection, legal recovery, and settlement team), focusing on the management of early delinquencies. Over the years during different challenges such as Demonetization, implementation of GST and RERA, Aavas has demonstrated better asset quality compared to most peers.
- We also expect lower LGD from NPLs, given the secured nature of its lending with conservative loan to value ratio at origination (~ 50-60% as of Dec 31, 2022), most of the properties being self-occupied. The company has separate teams to handle hard bucket NPLs and the resolution of cases under SARFAESI.

Stage 3 number adversely impacted by new asset classification norms, though underlying credit quality unchanged

As of Q3 FY22, Aavas' stage-3 assets stood at 1.72% (up by 76 bps QoQ), which includes 89 bps with DPD up to 90 but categorized as GNPA on account of RBI notification. However, 1 day past due stood at 6.45%, declined considerably from 12.67% in Q1FY22, indicating normalization in asset quality stress. Management is confident to bring down this ratio to ~5% in the next two or three quarters.

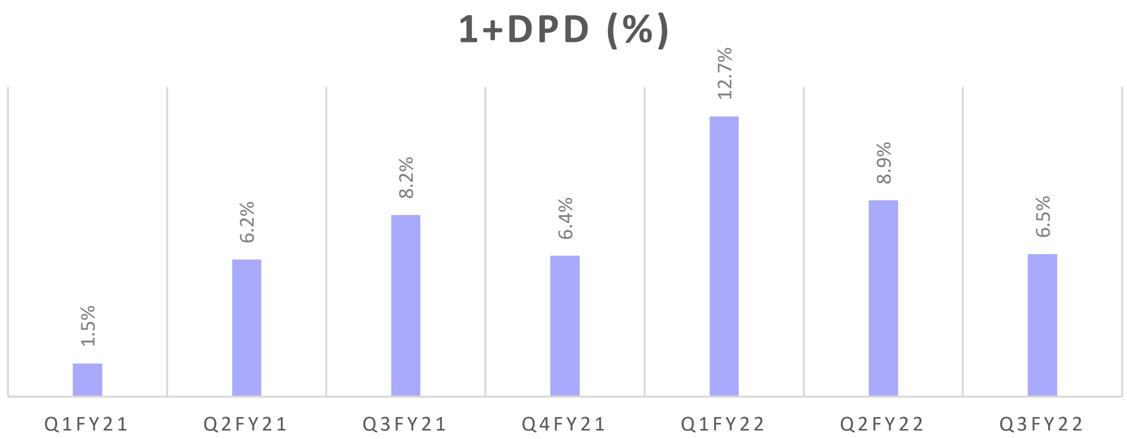
Exhibit 2: Headline asset quality number adversely impacted by RBI's revised norms



Source: Company, Dalal & Broacha Research

Restructured assets stood at Rs 1.50 Bn (marginally up from Rs 1.48 Bn QoQ), which classified as stage 2 assets and a provision of Rs 0.20 Bn has been created on such accounts. Total provision for COVID-19 impact (including that for Resolution Framework 2.0) stands at Rs 305.8 Mn as of 31-Dec-21. Overall ECL provisions surged by 13% QoQ to ~Rs0.79 Bn, covering 93 bps of gross loan assets (85bps QoQ).

Exhibit 3: Asset Quality Trend

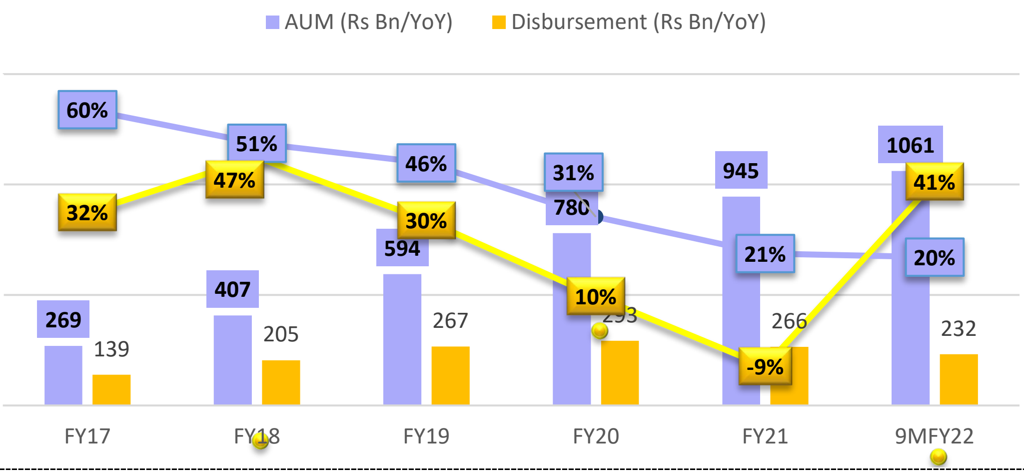


Source: Company, Dalal & Broacha Research

Loan growth to pick up in upcoming quarters

Over the years, Aavas has shown consistent growth in its business, with AUM grew by ~50% CAGR and disbursements clocked ~31% CAGR over FY15-FY21, supported by sturdy investment into geographic expansion (added 204 branches in last five years), increased use of data analytics (designed scorecard to make appropriate loan offers) and favorable funding costs (helped by improved credit rating). With lower credit penetration in LIG/MIG segment and improve productivity from existing branches, we believe the company can consistently deliver growth above industry average for the next several years.

Exhibit 4: AUM growth trends



Source: Company, Dalal & Broacha Research

The company mainly focuses on low/middle-income self-employed borrowers (~61%) in semi-urban/rural areas, who have limited access to formal credit and looking to purchase, construct, extension, and repair existing units.

In order to serve this kind of customers, the company has developed its own credit appraisal process, which includes income assessment, (even in absence of requisite income proofs), personal verification of customer's business place or residence, in-house technical & legal verification and conservative LTV parameters.

Aavas has an end-to-end in-house operating model, which covers mostly all processes from sourcing to collection activities and avoids employing DSAs. However, the company has recently started DSA model on a pilot basis, contributing ~1% or less.

With FY21 being an aberration due to higher thrust on asset quality, disbursement momentum was strong 41% YoY in 9MFY22, which aided Aavas to 20% YoY rise in AUM to Rs106 Bn; we expect the company to deliver AUM growth of 23% CAGR over FY21-FY24. This growth will be fueled by better productivity in existing branches along with contiguous geographic expansion in existing states.

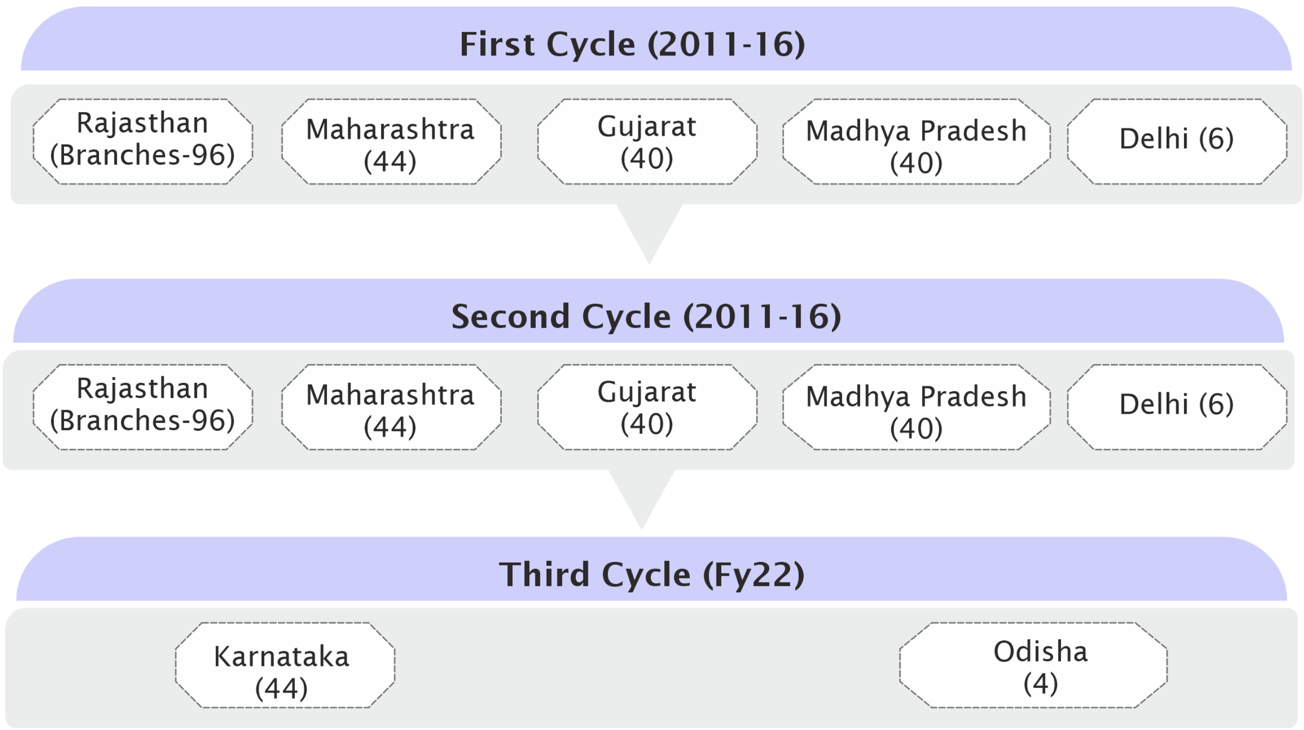
The company believes in a concentrated expansion, which means deeper penetration in few states instead of spreading rapidly across multiple states. This approach gives a better understanding of local characteristics, greater control over asset quality, and solid customer relationships.

The company largely deals with a self-employed segment or borrowers who have limited income proofs, therefore requiring a greater understanding of local economics. The company has even formulated 60+ profiles to facilitate customer valuation (SENP segment).

Contiguous Branch Expansion

- Aavas focuses on contiguous branch expansion with a view to supporting its growth, deeper penetration in the states, and enhancing customer reach. The Company created a systems-dependent distribution plan for each branch resulting in an effective hub and spoke business plan.
- Whenever the company enters into a new state, it opens new branches in district headquarters and then expands deeper by deploying personnel to tehsils adjacent to source new customers. The company currently served over 1100 tehsils through 298 branches and intends to achieve a tehsil level penetration of ~ 85% in all the states in which it operates.
- The company also goes slow in the first three years in new markets, with no sales target, and focuses on understanding market behavior.
- With a 100% in-house sourcing model, the company has a higher employee base of 5679 employees as of Mar'21, with an average age of ~30.64 years. The company follows the "hire young, hire local" philosophy, where proper training and understanding of local mathematics allows employees to become more productive and perform better.

Exhibit 5: Geographical Expansion; focuses on 4-5 states at a time



Source: Company, Dalal & Broacha research

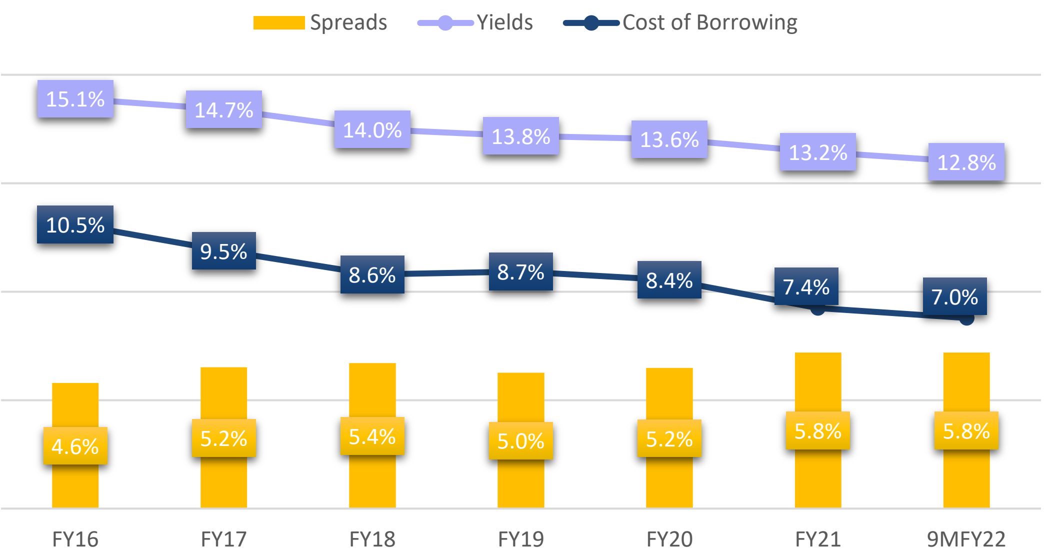
Lower attrition in top-level management:

- The Company has three levels of employees, one is senior management team, second is supervisory level and third is branch level field team.
- So, at managerial level, the company has a very negligible attrition level, supervisory level it is also very less (less than 5%) over a period and at the ground level since the company hire very fresh guys; it is a little bit high attrition rate.

Operating performance remained strong

Over the years, Aavas has reported a strong operating performance not just in terms of NII (FY18-FY21 CAGR of 37%) and PPOP (FY18-FY21 CAGR of 42%) terms, but also in terms of bottom-line performance (FY18-FY21 PAT CAGR of 46%). The company uses a risk-based pricing approach to price risk correctly by offering finer interest rates to deserving customers, where higher interest rates are charged on people with low credit scores. Its average yield stood at 13.5% (~300-400 bps higher than large HFCs), given the high share of self-employed customers (60% of AUM) & LAP segment (72% of AUM). On the liability side, a diversified borrowing mix has enabled it to bring down the cost of funds by 165 bps over the past 5 years to ~7% and, helped the company to maintain its spreads in the range of 5-6%.

Exhibit 6: Risk-based pricing power manifesting into better Spreads



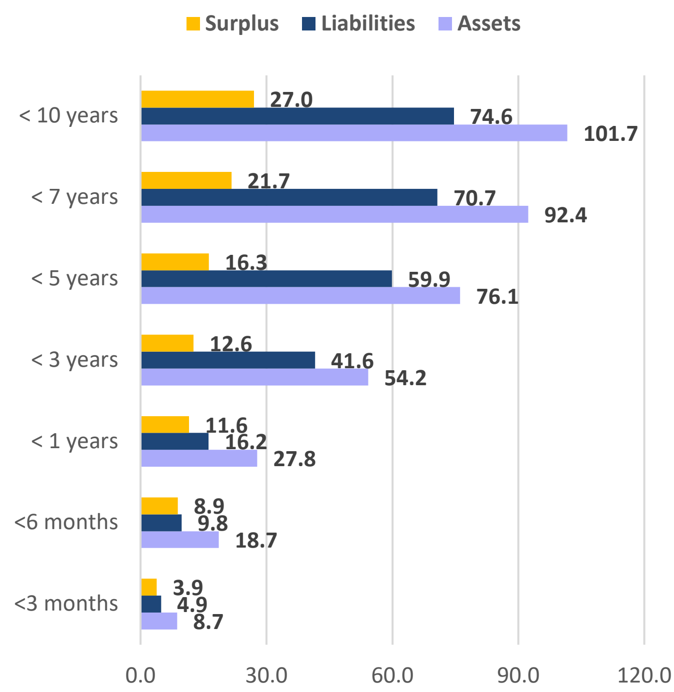
Source: Company, Dalal & Broacha research

Well diversified borrowing mix with no CPs exposure

- Aavas has no CPs outstanding and prefers long-term borrowings from banks, NHB and multi-lateral institutions. As of Dec'21, the company's average cost of borrowings stood at 7.03% on an outstanding amount of Rs 72.3 bn with an average maturity of 127 months.
- The company manages its borrowing structure through prudent asset-liability management and takes various measures, which include diversification of the funding sources, tenure optimization, structured interest rates and prudent timing of borrowing to maintain its borrowing cost at optimum level.
- The company has also actively tapped Securitization/Direct Assignment market, which has enabled it to create liquidity, reduce the cost of funds and minimize asset liability mismatches.
- The company's overall borrowing includes Terms Loans (38.4%), Assignment (23.6%), NHB (22.8%) and NCDs (15.2%), zero CPs despite a strong short-term rating of A1+.
- Many borrowers from semi-urban and rural areas want low volatility in their EMIs and prefer to opt for fixed rates. In order to manage the same, the company built a conservative policy where it lends fixed-rate loans with fixed-rate liabilities and the same for floating rates.

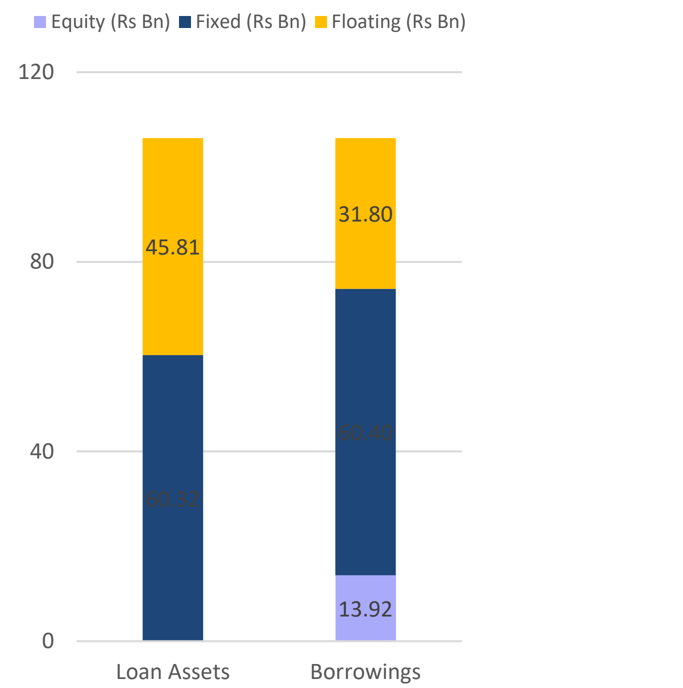
Robust Liability Management

Exhibit 7: ALM Surplus (Rs Bn)



Source: Company, Dalal & Broacha research

Exhibit 8: Loan Assets & Borrowings (Rs Bn)

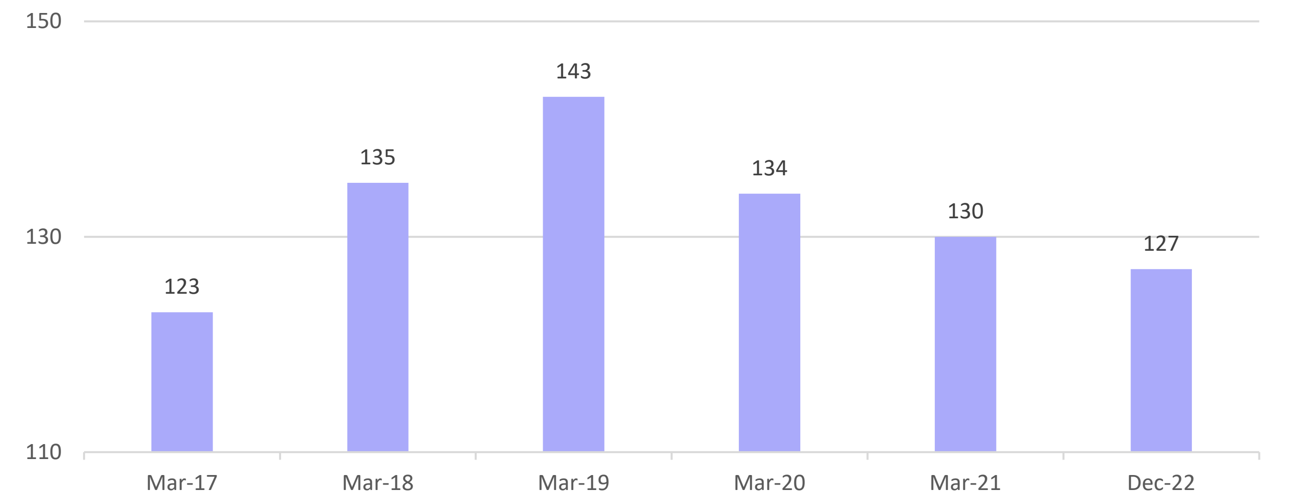


Source: Company, SSL

Comfortable Liquidity Position

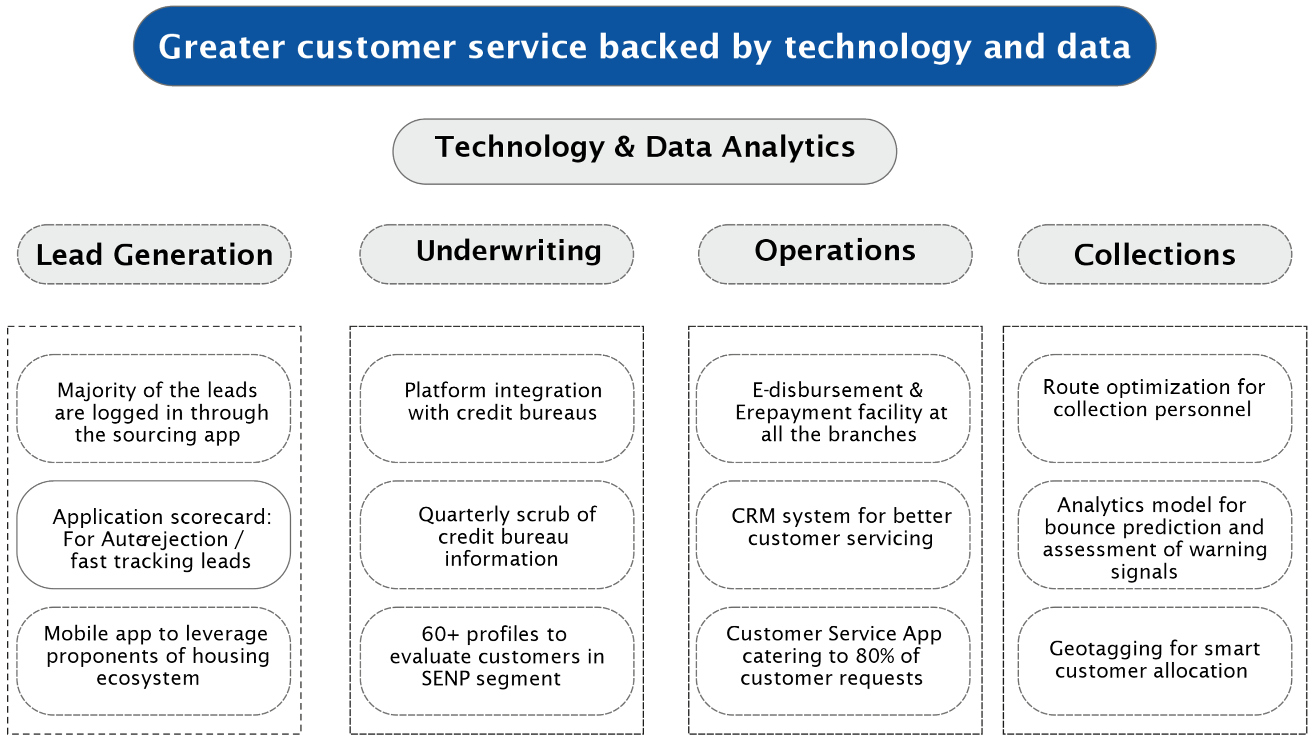
PARTICULARS (RS BN)	Q4 FY22	Q1FY23	Q2FY23	Q3FY23
OPENING LIQUIDITY	25.43	26.71	25.98	27.74
ADD: PRINCIPAL COLLECTIONS & SURPLUS FROM OPERATIONS	4.29	4.05	4.40	4.33
LESS: DEBT REPAYMENTS	3.01	4.78	2.63	3.73
CLOSING LIQUIDITY	26.71	25.98	27.74	28.34

Exhibit 9: Average tenor of outstanding borrowing (months)



Source: Company, Dalal & Broacha research

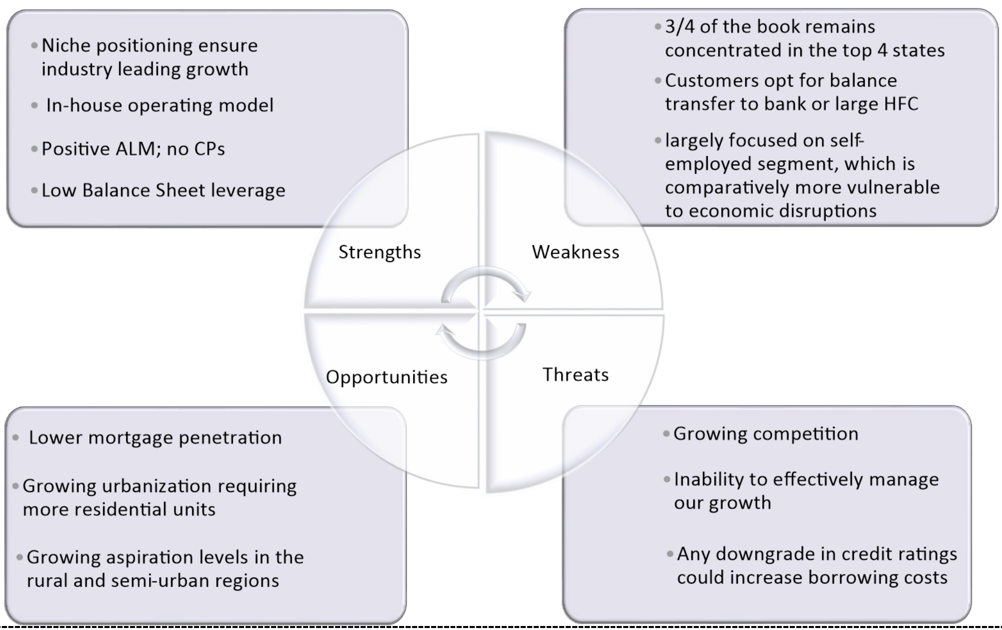
Exhibit 10: Greater customer service backed by technology and data



Source: Company, Dalal & Broacha research

The company's application scorecard, use of a mobile application for recording and monitoring leads and geotagging of properties, and the use of data analytics enable it to mitigate risks and improve its operational efficiencies. The use of technology also allows the company to provide streamlined approval and documentation procedures and reduce turnaround times (average TAT reduced from 21 days in FY14 to 13 days in FY21) and incidence of error

Exhibit 11: SWOT analysis of Aavas



Source: Company, Dalal & Broacha research

BULL CASE SCENARIO

Rs Mn	FY20	FY21	FY22e	FY23e	FY24e
AuM	77961	94543	115025	145894	187629
Growth (%)	31.2	21.3	21.7	26.8	28.6
Profit and Loss Statement					
NII	4304	5182	6237	7618	9545
Opex	2296	2566	3201	3778	4518
PPOP	3174	3905	4614	5798	7470
Provisions	153	371	407	409	444
PAT	2491	2895	3147	4031	5255
Financial ratios					
NIM (%)	6.7	6.5	6.6	6.8	6.9
RoA (%)	3.8	3.5	3.2	3.5	3.7
RoE (%)	12.7	12.9	12.3	13.8	15.5
GNPA (%)	0.5	1.0	1.8	1.5	1.3
NNPA (%)	0.3	0.7	1.3	1.1	0.9
Per Share					
EPS	31.9	37.0	40.1	51.1	66.6
Adj BV	268.3	305.9	344.5	393.6	460.1
P/E	69.8	60.2	55.5	43.6	33.4
P/Adj BVPS	8.3	7.3	6.5	5.7	4.8
Target multiple			7		
Target price (INR)			3220		
Upside (%)			45		

- In our bull case, we assume an AUM CAGR of 26% over FY21to FY24, supported by contiguous branch expansion (deeper penetration) and proactive investments in people, process, and technology.
- We expect significant cost control, with the cost-to-income ratio declining to 38% by FY24 as compared to 40% in FY21. Besides, Margins would increase 44 bps over FY21-24 to 6.9%, supported by higher loan growth, better yields and stable cost of funds.
- Asset quality would be slightly better, with GNPA of 1.3% and NNPA of 0.9% by FY24
- This results in PAT CAGR of 22% over FY21-24, with RoA/RoE of 3.7%/15.5% in FY24.

BEAR CASE SCENARIO

Rs Mn	FY20	FY21	FY22e	FY23e	FY24e
AuM	**77961**	**94543**	**113242**	**134318**	**157539**
Growth (%)	31.2	21.3	19.8	18.6	17.3
Profit and Loss Statement					
NII	4304	5182	6101	6816	7644
Opex	2296	2566	3200	3767	4444
PPOP	3174	3905	4441	4805	5161
Provisions	153	371	404	654	945
PAT	2491	2895	3019	3105	3153
Financial ratios					
NIM (%)	6.7	6.5	6.5	6.3	6.2
RoA (%)	3.8	3.5	3.1	2.8	2.5
RoE (%)	12.7	12.9	11.8	10.9	9.9
GNPA (%)	0.5	1.0	1.8	2.5	2.8
NNPA (%)	0.3	0.7	1.3	1.9	2.1
Per Share					
EPS	32	37	38	39	40
Adj BV	268	306	343	379	419
P/E	70	60	58	57	56
P/Adj BVPS	8.3	7.3	6.5	5.9	5.3
Target multiple			3.5		
Target price (INR)			**1465**		
Upside (%)			**-34**		

- In our bear case, we assume an AUM CAGR of 19% over FY21 to FY24, adversely impacted by lower branch productivity and higher BT out.
- We expect the C/I ratio to increase to 46% by FY24 as compared to 40% in FY21, adversely impacted by lower loan growth & declining NIM.
- Asset quality would be under pressure, with GNPA of 2.8% and NNPA of 2.1% by FY24, adversely impacted by higher delinquency. This results in PAT CAGR of 3% over FY21-24, with RoA/RoE of 2.5%/9.9% in FY24.

Financials

P&L (Rs Mn)	FY21	FY22	FY23	FY24
Interest income	9,764	11,352	13,742	16,934
Interest expense	4,582	4,999	6,170	7,791
NII	**5,182**	**6,352**	**7,571**	**9,142**
Non-interest income	1,289	1,558	1,900	2,317
Net revenues	**6,471**	**7,910**	**9,471**	**11,459**
Operating expense	2,566	3,200	3,769	4,453
PPOP	**3,905**	**4,710**	**5,702**	**7,005**
Provisions	371	405	478	564
PBT	**3,533**	**4,305**	**5,224**	**6,441**
Tax	638	1,085	1,316	1,623
PAT	**2,895**	**3,220**	**3,907**	**4,818**

Balance sheet	FY21	FY22	FY23	FY24
Share capital	175	175	175	175
Reserves & surplus	13,631	15,199	17,329	19,984
Net worth	**13,805**	**15,374**	**17,504**	**20,159**
Borrowings	30,537	36,034	44,390	54,919
Other liability	**759**	**903**	**1,122**	**1,393**
Total liabilities	45,101	52,311	63,015	76,471
Fixed assets	167	203	254	304
Investments	**3,750**	**4,106**	**3,757**	**3,489**
Loans	33,265	42,604	54,849	70,020
Cash	**6,799**	**4,321**	**3,053**	**1,532**
Other assets	1,121	1,076	1,103	1,126
Total assets	45,101	52,311	63,015	76,471

Ratios	FY21	FY22	FY23	FY24
Growth (%)				
NII	20	23	19	21
PPOP	23	21	21	23
PAT	16	11	21	23
Advances	22	20	23	24
Spread (%)				
Yield on Funds	13.1	12.9	13.2	13.3
Cost of Funds	8.0	7.3	7.4	7.7
Spread	5.2	5.7	5.7	5.5
NIM	6.5	6.8	6.8	6.9
Asset quality (%)				
Gross NPAs	1.0	1.8	1.5	1.4
Net NPAs	0.7	1.3	1.1	1.0
Provisions	27	28	29	28
Return ratios (%)				
RoE	12.9	12.6	13.4	14.4
RoA	3.5	3.3	3.4	3.5
Per share (Rs)				
EPS	37.0	41.0	49.5	61.0
BV	307	347	395	456
ABV	306	345	393	454

Valuation (x)				
P/E	60.2	54.3	45.0	36.5
P/BV	7.3	6.4	5.6	4.9
P/ABV	7.3	6.4	5.7	4.9

Source: Dalal & Broacha Research, Company

Home First

Initiating Coverage | BFSI

Best is yet to come!

Equity Research Desk

25 March 2022

Home First Finance Company (Home First) is a technology driven, affordable housing finance company, which can double its AUM in the next three years, supported by deep distribution in relevant markets, data Science backed underwriting and diversified financing profile. Besides, stable-to-improving margins, increasing efficiency in cost structure, and a well-provided balance sheet will enhance the core return ratio (RoA 2.5% in FY21 to 3.8% in FY24) over the medium term.

Rating	TP (Rs)	Up/Dn (%)
BUY	**889**	**25**
Market data		
Current price	**Rs**	**714**
Market Cap (Rs.Bn)	(Rs Bn)	63
Market Cap (US$ Mn)	(US$ Mn)	819
Face Value	Rs	2
52 Weeks High/Low	Rs	921/ 440
Average Daily Volume	('000)	47
BSE Code		543259
Bloomberg		HOMEFIRS.IN

Source: Bloomberg

What do we like about Home First?

- As Net Income growth (FY21-FY24 CAGR of 31%) is expected to be higher than cost growth (FY21-FY24 CAGR of 27%), the company's cost to income ratio (C/I ratio) will continue to trend down in our view providing significant operating leverage. Many HFCs have shown a similar trend. For example, Can Fin Homes' C/I ratio has improved from 28% (loan book at ~ Rs 58 Bn) in FY14 to 15.3% (loan book at ~ Rs 221 Bn) in FY21.
- The company's asset quality performance in 9MFY22 has displayed a solid resilience with 1+ DPD improved from 7.6% to 6.5% on QoQ basis, while 30+ DPD improved from 5.2% to 4.7% on QoQ basis. Collection efficiency (CE) mostly reached to pre-Covid levels at 99% in Dec-21 vs 98% in Sep-21 and 94% in May-21. However, GNPAs up by 82 bps QoQ to 2.6% and NNPAs up by 76 bps QoQ to 2%, adversely impacted by the RBI's new IRACP clarification.
- With capital adequacy ratio of 59% (Tier 1- 57.8%), Home First is well positioned to grow without the need to raise capital over the medium term.
- Strong ownership (True North, Aether & Warburg Pincus) provides the required comfort in Company's ability to achieve its mid-to-long-term goals

What Does Home First Bring to the Table?

- Home First does a more holistic assessment of the customer's family income & provides the right loan amount. So, the customers are willing to pay that little extra (Home First's average yield stood at 13% vs 9-11% of large peers).
- The company's technology led operating model helps it to deliver industry-leading productivity ratios & the turnaround time of 48 hr vs. industry average of 8 to 10 working days.
- Home First's branch productivity is one of the highest among its small size peers (AuM per branch stood at Rs 575 Mn).

Valuation and outlook

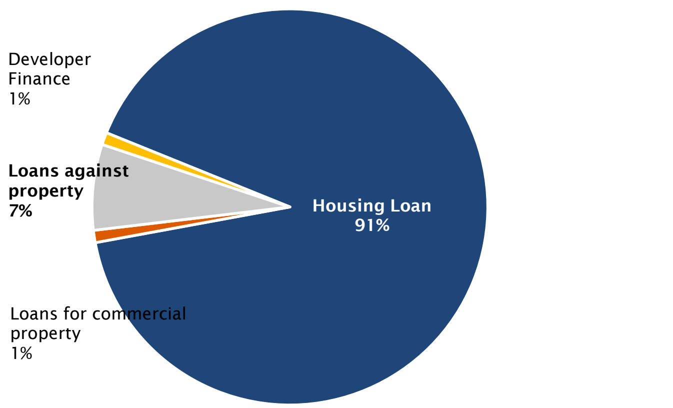
We like Home First because of its Niche positioning, solid profitability and sustainable growth trajectory. Besides, its ability to leverage technology for better service delivery, funding availability with competitive cost of funds and investment by marque private equity players (like True North, Warburg Pincus, Aether Mauritius and Bessemer India) adds to positivity. We believe that it offers an 'early stage' investment opportunity given strong growth momentum, focused strategy and high capitalization. We have already seen similar instances wherein such companies have delivered strong returns, the classic example being GRUH Finance – was trading at >10.7x FY19 P/BV for RoA of ~2.7% levels. Thus, we have assigned a 'Buy' rating on Home First with a price target of Rs 889, valuing the stock at 4x FY24E P/Adj BV.

Business Profile

- Home First focuses on a niche customer segment, which might not be exactly creditworthy for most of the larger banks and HFCs. Most of Home First's customers are first time home buyers and may not have credit histories supported by tax returns and other documents.
- The company does a more holistic assessment of the customer's family income, spends time the customer to understand what other sources of income they have, how many family members are working and so on. This holistic assessment and providing the right loan amount are very critical for the customers.
- These are the people who are either salaried (employed by small firms or work in junior positions in larger companies), or self-employed, (running small businesses like providing transportation facilities in auto rickshaw or other vehicles, running grocery shops, and other businesses).
- In terms of product features as well the risk-reward metrics concerns, the company has a granular portfolio with high customer equity, typically for self-occupied house (92% of loans), Salaried customers (74% of loans) with very small exposure to Developer financing (2% of loans).
- The company try to fill the home financing gap for this segment that large NBFCs /HFC/banks normally do not cater to because of operational costs and lack of proven credit history.

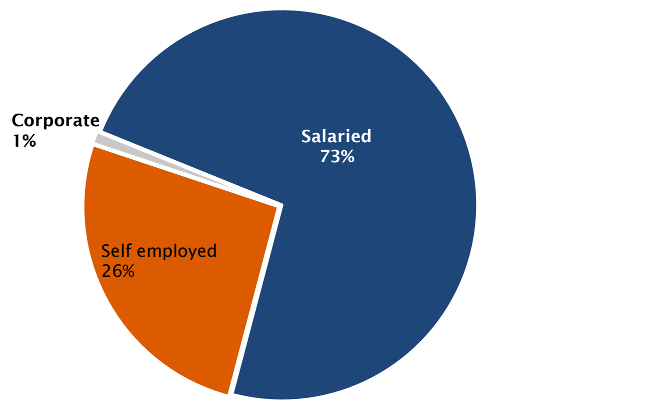
Profit Mix

Exhibit 1: Sharp focus on Housing Loans



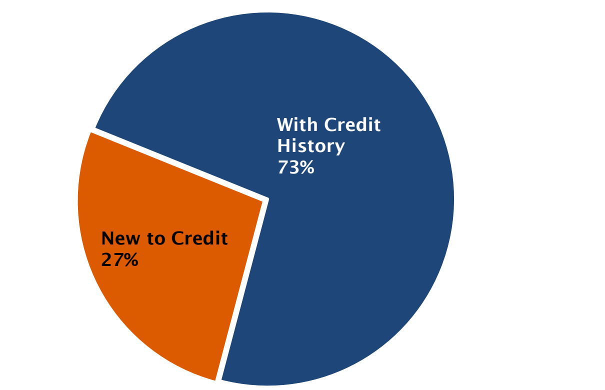
Source: Company, Dalal & Broacha research

Exhibit 2: Higher proportion of salaried customers



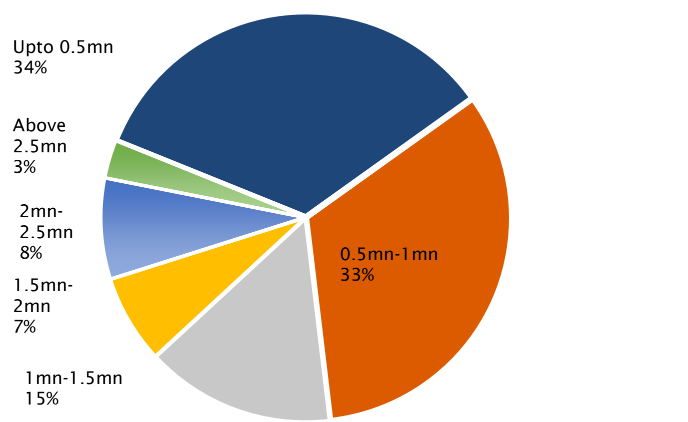
Source: Company, Dalal & Broacha research

Exhibit 3: Optimal balance of credit tested



Source: Company, Dalal & Broacha research

Exhibit 4: Granular portfolio



Source: Company, Dalal & Broacha research

Robust Credit Approval Process

Initial Screening and Pre-Sanction Check:

Fresh customer leads are logged into the system by its relationship managers (RM). Thereafter, RM conducts home & workplace visits and submit the completed digital loan application along with its commentary on visits and personal discussion with the customer. This is cross checked by its underwriting and operations team for several factors including completeness of application form, KYC, eligibility, fraud check, credit bureau, income assessment, LTV, value of collateral, bank statements, debt burden and third party databases for income and asset ownership.

Customer Credit Underwriting:

The Company has centralized underwriting team assisted by data science backed customer-scoring model to evaluate a customer's ability to repay the loan and maintain consistency in underwriting procedures across branches and regions. The company utilize proprietary machine learning credit scoring models for credit assessment process and bifurcates customers into different categories based on the level of risk, to make a final decision.

Loan Collection and Monitoring:

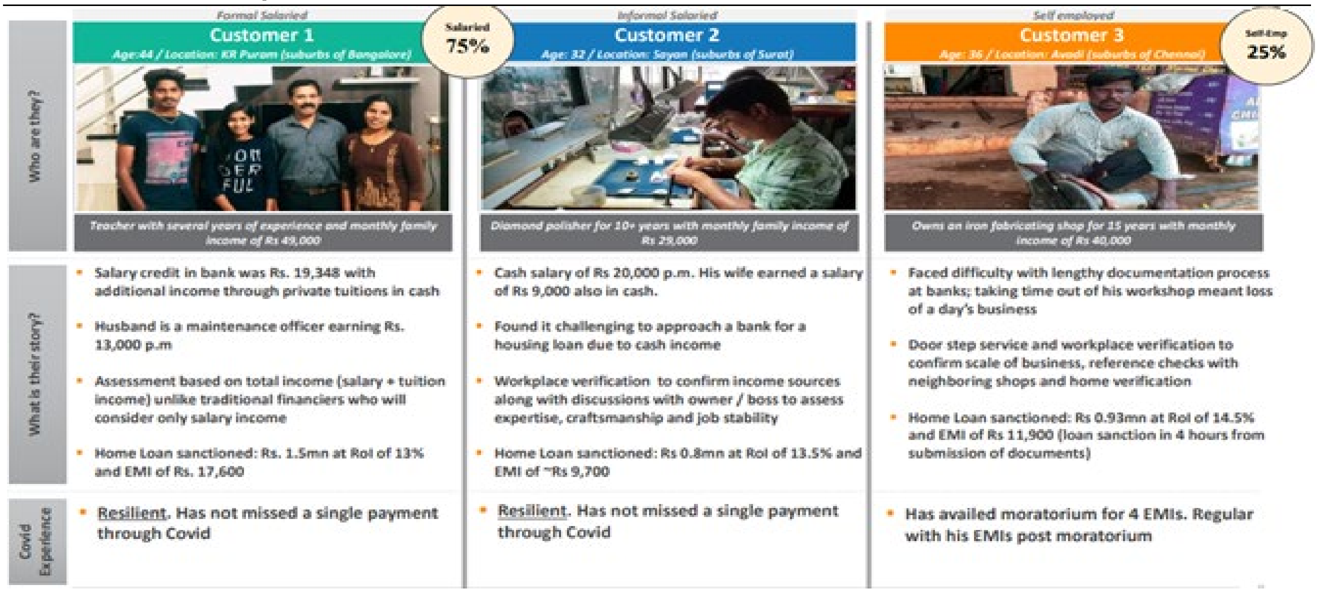
The Company has set up a robust and tiered, collections management system with prescribed collection action at each stage of severity of default. All its borrowers register for an automated debit facility, which reduces its cash management risk, and tracks the status of instalments collected on a real time basis through a collections module. Approximately 93% of its collections for the financial year 2020 were non-cash based.

Exhibit 5: **Value Proposition**

ACCESS	SPEED	TRANSPARENCY	SERVICE
▪ Understanding customer's needs via well educated & trained RMs ▪ Right-size the loan through a holistic evaluation of all formal/informal sources of income ▪ Alternative documents (Life insurance policies, property deeds etc.) used for evaluation	▪ 48 Hr Turn Around Time for Approval ▪ Centralised & consistent underwriting ▪ Mobility solutions for customers, employees and sales channels for quick and efficient processes and service	▪ Mandatory counselling sessions for customers on loan and insurance terms ▪ Digital access to loan documents for the customer ▪ No prepayment charges and easy prepayment options	▪ Home visits coupled with paperless process to ensure minimal disruption to daily customer routine ▪ Dedicated Service Manager for every customer ▪ Customer app for easy access to loan statements, prepayments and raising service requests

Source: Dalal & Broacha Research, Company

Exhibit 6: **Few examples of Customer**

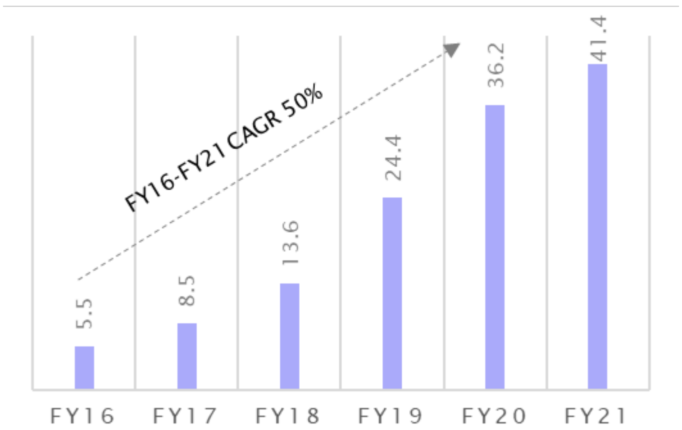


New bright kid on the block!

- Given the under-penetration in the niche customer segment that Home First caters to, we feel that it will be able to maintain its strong loan book growth in the foreseeable future.
- Despite the liquidity crunch, the company has posted a FY15-FY20 AUM CAGR of 52%. Currently, the company's loan book stood at ~Rs 49.94 Bn, which will likely double in the next three years, supported by diversified sourcing channels and expanding distribution network (stood at 76 branches vs. 42 four years back).
- There are many examples where well managed companies are able to double their loan book in two to three years. For e.g. Can Fin Homes has almost doubled its loan book from Rs 58 Bn in FY 14 to Rs 106 B n in FY16, while GRUH Finance has doubled its loan book from Rs 54 Bn in FY13 to Rs 111 Bn in FY16.
- We believe Home First is in early growth phase and there is a lot of scope to expand the business.

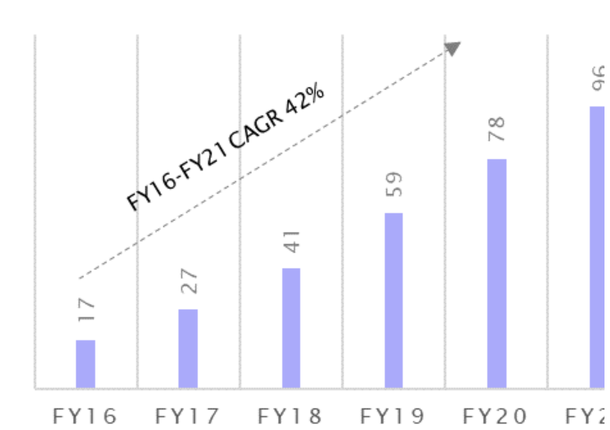
Significant headroom for growth

Exhibit 7: Home First



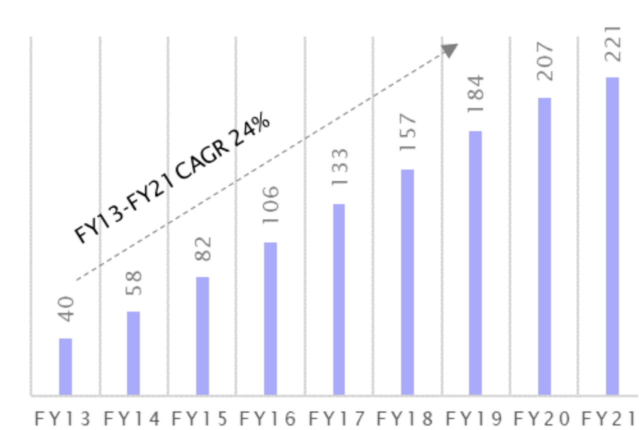
Source: Dalal & Broacha Research, Company

Exhibit 8: Aavas Financiers



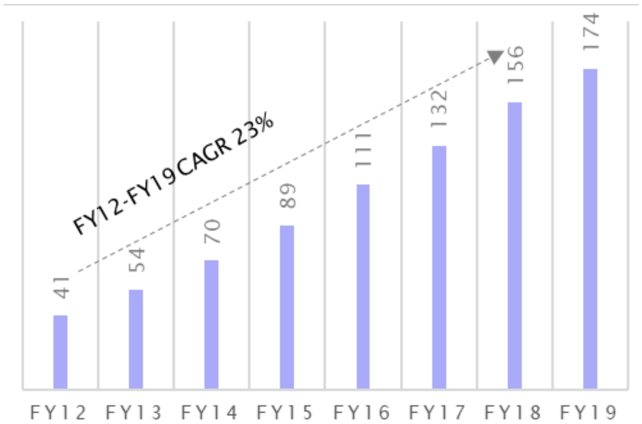
Source: Dalal & Broacha Research, Company

Exhibit 9: Canfin Homes



Source: Dalal & Broacha Research, Company

Exhibit 10: GRUH Finanance

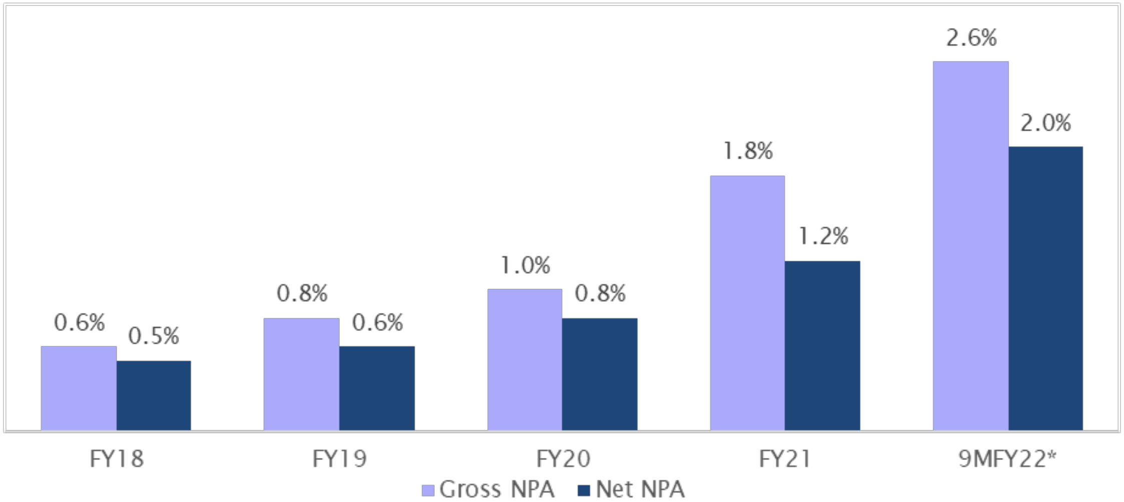


Source: Dalal & Broacha Research, Company

Superior asset quality aided by data and technology analytics

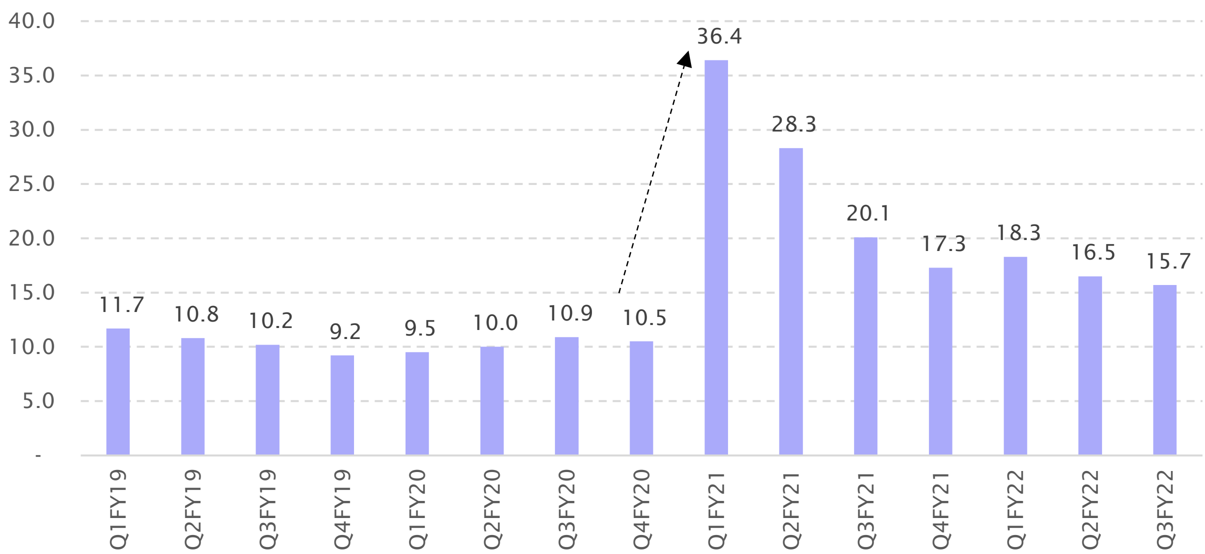
- Home First's asset quality was adversely impacted by the RBI's IRACP clarification, with GNPAs up by 82 bps QoQ to 2.6% and NNPAs up by 76 bps QoQ to 2% in Q3FY22. However, the changes in IRACP norms does not have a material impact on the financials. The company's Bounce rates improved in Jan'22 to 15.2% (Q3 FY22 – 15.7%, Q2 FY22 – 16.5%).
- During Q3FY22, 1+ DPD improved from 7.6% to 6.5% on QoQ basis. 30+ DPD improved from 5.2% to 4.7% on QoQ basis. Collection efficiency (CE) mostly reached to pre-Covid levels at 99% in Dec-21 vs 98% in Sep-21 and 94% in May-21
- On provisions, ECL provision as on Dec'21 is Rs 473 Mn; resulting in total provision to loans outstanding ratio at 1.2% vs 1.3% QoQ; and the Stage 3 provision coverage ratio is at 46.2% vs 77.4% QoQ. Total restructuring was just at 0.76% of AUM as of Sep'21.
- The company has also imposed more stringent credit guidelines and further strengthening the underwriting process keeping in mind the COVID-19 environment for new customers as well as existing customers for already approved loans

Exhibit 11: Chart 11: Asset Quality have a relatively lower impact of the pandemic



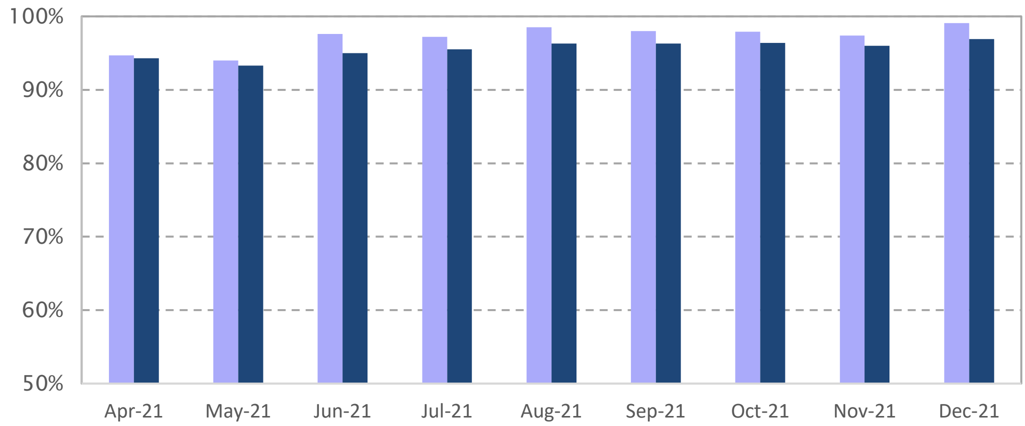
Source: Dalal & Broacha Research, Company / *0.9% GNPA & 0.7% of NNPA impacted by RBI's Re-classification circular

Exhibit 12: Chart 12: Movement of Bounce Rate



Source: Dalal & Broacha Research, Company

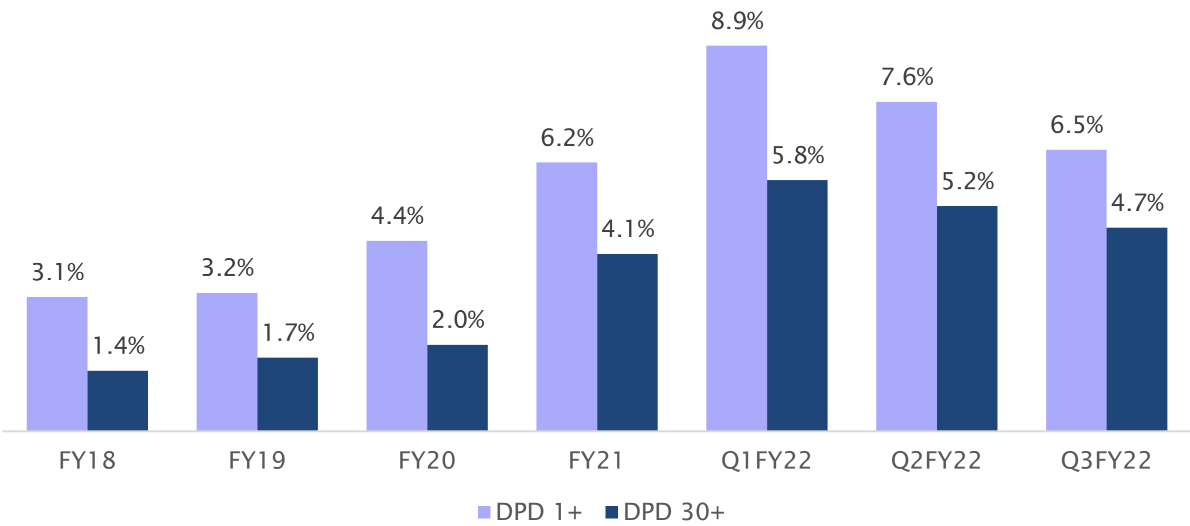
Exhibit 13: Chart 13: Strong recovery in collection efficiency



	Apr-21	May-21	Jun-21	Jul-21	Aug-21	Sep-21	Oct-21	Nov-21	Dec-21
Collection efficiency	94.7%	94.0%	97.6%	97.2%	98.5%	98.0%	97.9%	97.4%	99.1%
Unique customers	94.3%	93.3%	95.0%	95.5%	96.3%	96.3%	96.4%	96.0%	96.9%

Source: Dalal & Broacha Research, Company

Exhibit 14: Chart 14: Movement of DPD 1+ & DPD 30+

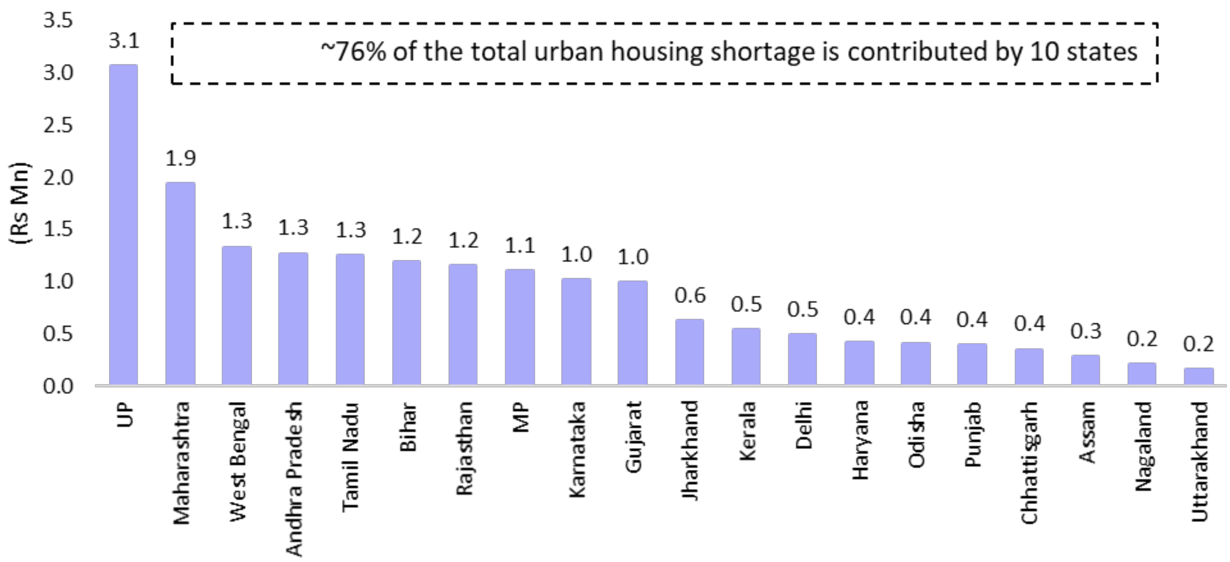


Source: Dalal & Broacha Research, Company

Strategic Market Selection & Contiguous Expansion

- While increasing the scale of its operations, Home First has strategically expanded to geographies where there is substantial demand for affordable housing finance along with industry portfolio-at-risk levels.
- According to the CRISIL Report, the 60 districts in which the company is present accounted for ~ 48% of the affordable housing finance market in India during FY19 and have a high per capita income with rising levels of urbanization.
- As per the estimates of the Twelfth Five Year Plan, 10 states accounted for approximately 76% of the urban housing shortage. These ten states account for ~98% of its portfolio.

Exhibit 15: Chart 15: State-wise urban housing shortage



Source: Dalal & Broacha Research, Company

- Home First focuses on a few geographies where it has a good understanding and scales up gradually to manage costs and asset quality better.
- In the last three years, the company has demonstrated its ability to successfully identify new regions to set up branches and grow its market share in such regions. For e.g. the company has identified Jaipur, Ahmedabad, Surat, Indore, Nagpur, Raipur, Hyderabad, Bengaluru and Chennai to set up its branches.
- The following table reflects the improvement in its market share, in terms of origination of home loans in the bucket size of Rs 500,000 to Rs 2500,000, for the periods indicated;

Branch Location	Home First's market share during Q1 FY18	Home First's market share during Q4 FY20
Jaipur	0.10%	2.30%
Ahmedabad	1.70%	2.70%
Surat	1.70%	2.50%
Indore	0.20%	2.30%
Nagpur	0.90%	2.20%
Raipur	0.30%	0.80%
Hyderabad	0.20%	1.10%
Bengaluru	0.20%	1.90%
Chennai	1.00%	2.00%

Source: Dalal & Broacha Research, Company

Branch opening strategy:

- Whilst demand for credit in its target segment remains abundant, execution remains key given the largely informal credit assessment requires extensive understanding of local geography.
- Therefore, before setting up new branches, the company conduct in-depth studies and market research to assess the potential demand for its products and engage with local property valuers and legal advisors.
- The company has outreach program where a person works in the location for about six months, builds up a small portfolio and then put the branch. This way the company can identify all the issues and problems at an earlier stage.

Better efficiency

HFCs (FY21/ Rs Mn)	Average AUM per branch	Disbursements per branch
Gruh Finance*	895	254
Motilal Oswal Home Finance	338	26
Aadhar Housing Finance	418	111
Aavas Financiers	338	95
Aptus Value Housing Finance	214	68
Home First	**575**	**152**

Source: Dalal & Broacha Research, Company (*-FY19)

Diversified Sourcing Channels

- Home First has a diverse range of lead sourcing channels, which includes connectors, architects, affordable housing developers, in addition to conducting loan camps and micro marketing activities, and utilizing employee and customer referrals and branch walk-in customers.
- During FY21, 62.2% of its leads come from connectors, followed by 14.6% from builder ecosystem, 7.4% from branches, 6.1% from construction community, 4% from marketing, 2.5% from micro connectors, 2.2% from digital and 0.9% from strategic alliance.
- Connectors are third-parties who provide the company with customer leads on a commission basis paid only when a loan is disbursed and they do not assist in the loan application process.
- The company's connectors are generally individuals such as insurance agents, tax practitioners and local shopkeepers. As of September 30, 2020, the company has over 800 active connectors, which has increased from over 470 active connectors in March 31, 2018.
- The company has also entered into arrangements with certain digital lead aggregators and other digital players within the housing and real estate ecosystem, which helps the company to source leads with embedded customer data.

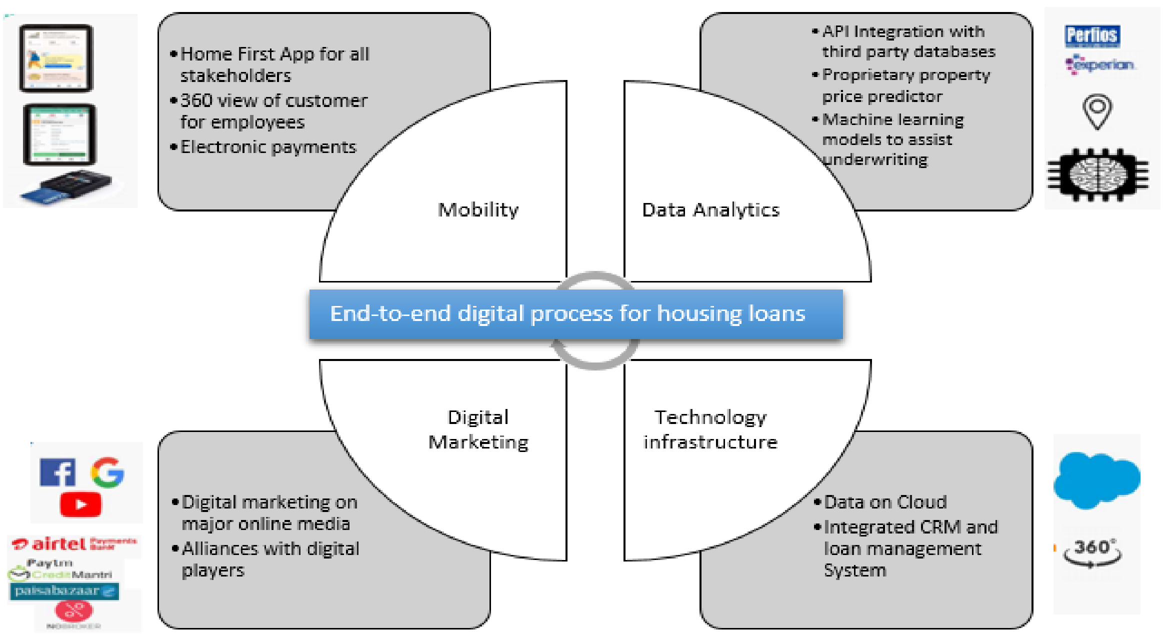
Increasing strategic tie-ups

- Home First has established a tie-up with one of the leading payment banks in the country, Airtel Payments Bank, for providing housing loans in affordable category to their customers.
- It has also entered into arrangements with a range of new fintech partners including No Broker Technologies Solutions, Lendingkart Technologies and One97 Communications (Paytm) for advertising and promotional activity of its affordable housing loans.
- VNC Group, a manufacturer and distributor of building materials used in construction was on-boarded as an alliance partner in south India to jointly address the needs of an individual house builder.
- The company has also initiated its campaign on Paytm using the banner advertisement channel.

Leveraging Technology to increase scale & better productivity

- What we most like about Home First is that they are not just riding on the latest buzzwords – 'Tech' and 'Analytics'. Instead, the company is using them as a platform to differentiate itself from the peers. Home First is using technology across the value chain right from origination to disbursements to collections.
- Because of this, the company can deliver industry-leading productivity ratios and has a turnaround time of 48 hours against the industry average of 8 to 10 working days.
- It uses data analytics, application scorecard, mobile application for recording & monitoring leads and geo-tagging of properties to mitigate risks and improve efficiency. This also provides streamlined approval and documentation procedures and reduce incidence of error.
- In short, Home First uses its technology prowess to right-price the risk, improve customer retention, maintain healthy asset quality, and provide better risk-adjusted returns to its investors.
- The company's integrated customer relationship management and loan management system provides a holistic view of its customers and ensures connectivity and uniformity across its branches.

Exhibit 16: **Scalable operating model built on holistic technology use**

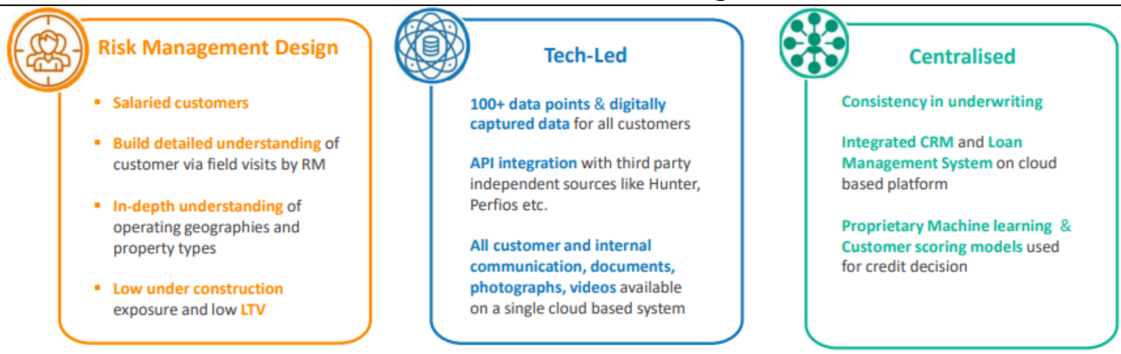


Source: Dalal & Broacha Research, Company

How technology helps to meet strategic objectives

- Business growth: The Company has entered into arrangements with several digital lead aggregators and other digital companies in the housing and real estate ecosystem such as Homelane, Paisa Bazaar, Quikr India, Credit Mantri and Aapka Painter, which helps the company to source leads embedded with customer data.
- Improve underwriting: To improve underwriting accuracy and to identify areas of concern, the company has entered into arrangements with numerous third party service providers to obtain additional information such as fraud related data, banking, investment and taxation related data, and vehicle ownership of customers.
- Technology Driven Collections System: Home First has built a robust collections management system wherein approximately 93% of its collections for FY2020 were non-cash based, which eases stress on monitoring financial transactions and reduces its cash management risk. Furthermore, the company perform predictive analytics to predict the probability of default, which helps them in obtaining early signals of potential defaults and initiate appropriate action to mitigate risks.
- Overall, Home First is focused on creating an end-to-end digital process for housing loans encompassing digital marketing, exhaustive customer data capture through API integrations with third-party databases such as Hunter and Perfios, automated underwriting via machine learning algorithms and instant approvals through mobility solutions.

Exhibit 17: Data Science backed centralized underwriting

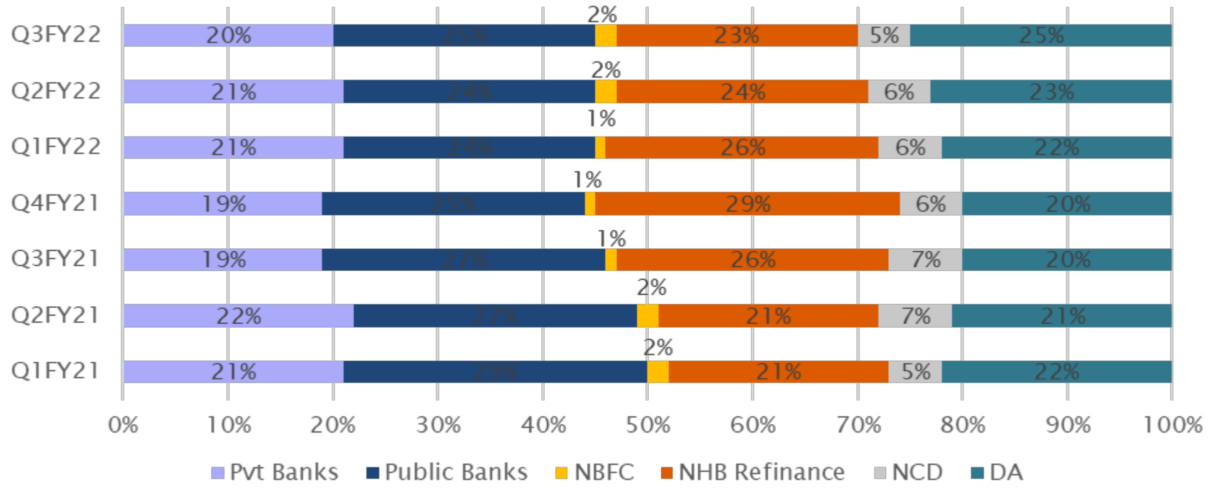


Source: Dalal & Broacha Research, Company

Multiple sources of funding help to maintain healthy liquidity

- Home First has built a diversified funding mix which includes: 1) Banks (45% of total borrowing); 2) NBFC (2% of total borrowing); 3) proceeds from the issuance of NCDs (5% of total borrowing); 4) refinancing from the NHB (23% of total borrowing); and 5) Direct Assignment (25% of total borrowing).
- Availability of funds from a wide range of sources has reduced the company's dependency on any one segment. The company has zero borrowings through commercial paper and its cost of borrowing has been trending downwards.
- Its liquidity buffer as of Dec 2021 stood at 14.05 Bn. Because of the company's sturdy track record number of its lender relationship increased from 10 in FY18 to 19 in Q3FY22.
- In the last few years, the company has improved its credit ratings from 'CARE A-' in FY17 to 'CARE A+' Q3FY22 and also currently have an A+ (Positive) rating from ICRA.

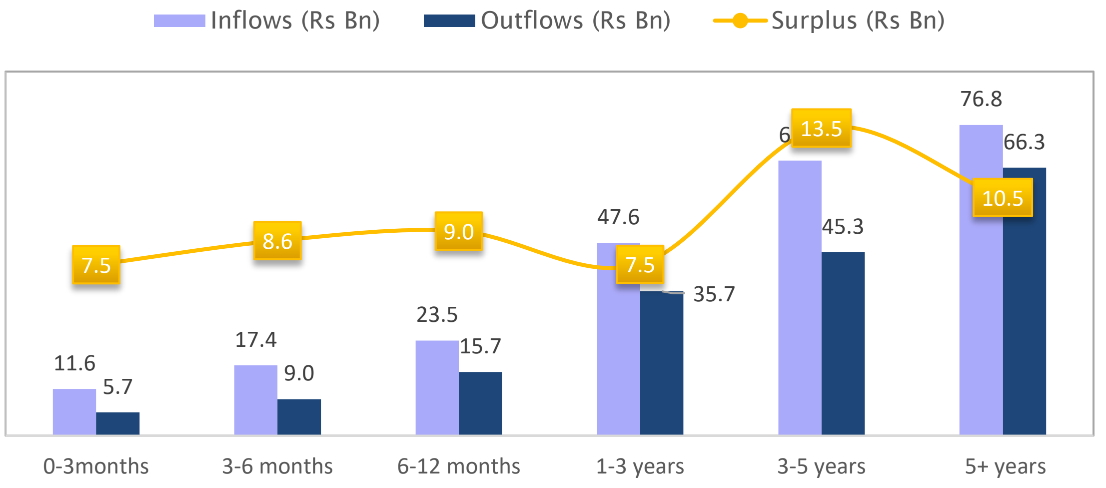
Exhibit 18: Borrowing Break-up



Source : Dalal & Broacha Research, Company

- With access to various sources of funds and a focus on long-term borrowings, Home First has a favourable asset-liability position across all categories.
- Home First regularly explore assignment transactions, which helps the company to optimize its capital usage, bring down leverage, and improve cost of funds as well as balance the existing liquidity position.
- Securitization per se works very well from an ALM point of view also because it is linked directly to the asset. It helps build credibility with banks and lending institutions as they review the company's book and form an opinion on its book on a more detailed basis because securitization goes through a fairly detailed level of audit.
- Prepayment of the loans, which is the key risk to asset and liability mismatch. While the contractual tenure of the home loans is around 17 to 20 years, the effective tenure is in the region of around 6 to 7 years.
- Consistent demand for affordable housing loans and diversified sourcing channels are helping the company to award new loans to continuously maintain the higher assets than liabilities.

Exhibit 19: ALM Position as of December 31, 2021

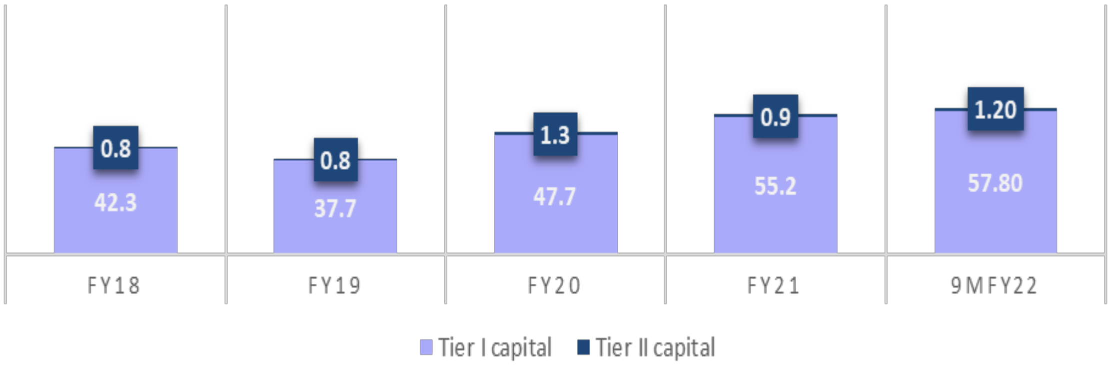


Source: Dalal & Broacha Research, Company

Very Well Capitalised

- With capital adequacy ratio (post completion of IPO) of 63% compared to 15% regulatory threshold, Home First is well positioned to grow without the need to raise capital over the medium-term.
- It has sufficient headroom for debt capital to fund its planned growth and will likely to tie up additional funds at competitive rates accordingly. Promoters and PE investors have regularly infused equity capital in the company to support business growth of the company.
- Because of which, the company has been maintaining healthy capitalization levels over the past few years. Due to periodic capital infusion, the gearing level reduced from 4.7x in FY19 to 3.3x in FY21.

Exhibit 20: Chart 18: Healthy capital adequacy

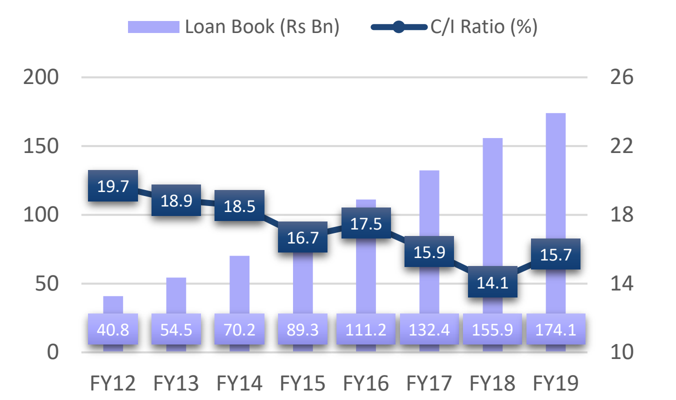


Source: Dalal & Broacha Research, Company

Profitability to be driven by improving operating efficiency

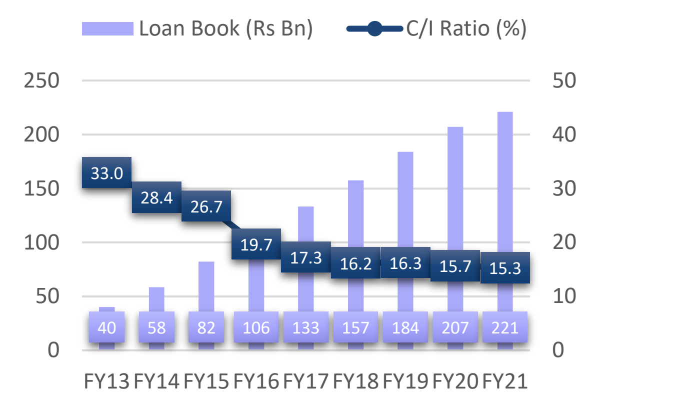
- Home First has built a technology driven operating model, which can increase its operations and drive growth in revenue with lower incremental costs.
- As revenue growth is expected to be higher than cost growth, the company's cost to income ratio (C/I ratio) will continue to trend down in our view providing significant operating leverage.
- Many HFCs have shown a smiler trend. For example Can Fin Homes' C/I ratio improved from 28% (loan book at ~ Rs 58 Bn) in FY14 to 15.3% (loan book at ~ Rs 221 Bn) in FY20, while GRUH Finance & PNB Housing saw C/I ratio drop from 19.7% & 23% (loan book at ~ Rs 40 Bn) in FY12 to 15.7% (loan book at ~ Rs 174 Bn) & 19.6% (loan book at ~ Rs 847 Bn) in FY19.
- Given the nature of the process, operating costs are typically very high in the initial years; therefore, players who are, over a period of time, able to achieve a fair degree of standardization in the process by building models revolving around specific customer profiles and geographies are usually able to manage operating costs efficiently. Significant headroom for growth

Exhibit 21: PNB Housing



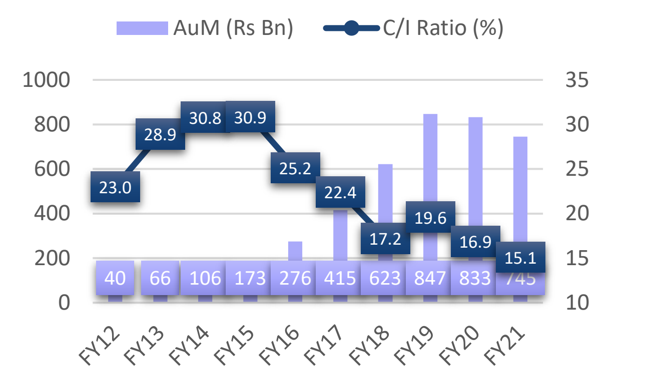
Source: Company, Dalal & Broacha Research

Exhibit 22: Home First



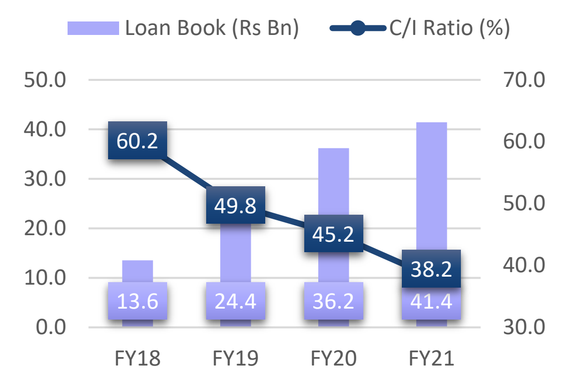
Source: Company, Dalal & Broacha Research

Exhibit 23: PNB Housing



Source: Company, Dalal & Broacha Research

Exhibit 24: Home First



Source: Company, Dalal & Broacha Research

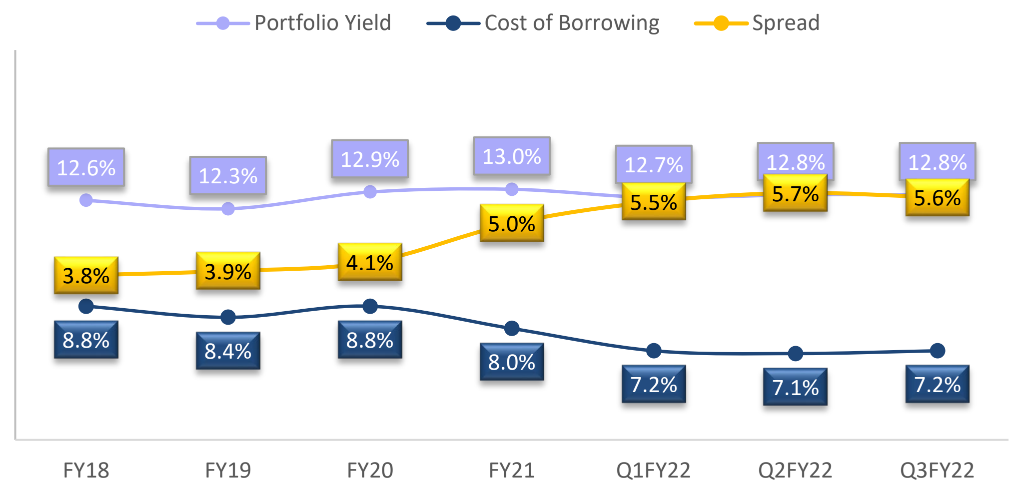
What will make the company more efficient?

- The company has invested a lot of money in people, process and technology over the past few years. With the completion of large part of franchise investments, leverage benefits will flow as it gains scale.
- Furthermore, the company is looking to increase the productivity in its existing branches. We believe operating leverage will improve as efficiency across branches will enhance over the medium term. Most large branches are operating at C/I ratio of 22-25% vs overall C/I ratio of 38% in FY21.
- Home First is not solely dependent on volume to bring efficiency. It is also using technology to leverage economies of scale to enhance productivity and reduce turnaround times and transaction costs.
- Its digital service delivery mechanisms and operating model brings uniformity in its operations, increases customer satisfaction and expand business in geographies that offer growth opportunities. Going forward, we believe the company will further leverage its technology and strong internal processes to support growth and improve operating efficiencies.

Margins remain Strong

- Home First has been operating at healthy spreads of ~ 4-6% for the past few quarters. During Q3FY22, the company's spread has improved to 5.6% on account of decline in cost of fresh borrowing, which can be attributed to rate reset of MCLR of various banks and competitive marginal costs of fresh borrowing.
- The company does a more holistic assessment of its family income and providing the right loan amount are very critical for the customers, so they are willing to pay that little extra to get that additional service (Home First's average yield stood at 13% vs 9-11% of large peers).
- With healthy pricing power resulting in relatively sticky yields along with a diversified borrowing profile resulting in moderated CoF, we expect healthy margins to continue over the next few years.

Exhibit 25: Stable on-book spreads

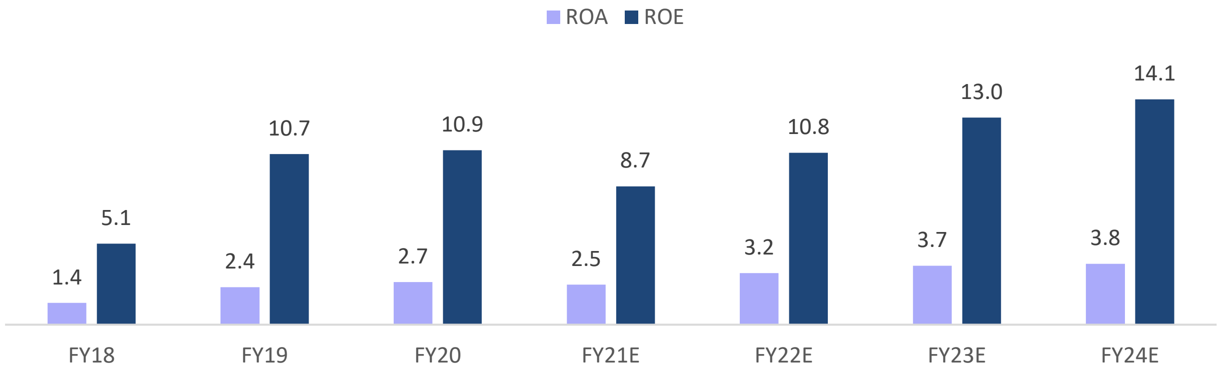


Source: Dalal & Broacha Research, Company

Healthy return ratios

- With stable other income and healthy improvement in operating leverage, we see a healthy PPOP profile in the medium to long term. With a stellar credit quality, we expect the best in class credit cost to continue.
- Thus, we expect a healthy RoA profile and with increasing leverage resulting a strong RoE improvement over the medium term.
- We remain structurally positive on the housing landscape in the wake of high affordability, favorable demographics and support from the government in terms of PMAY.
- With a CAR of ~59% and leverage of 3.1x, we believe Home First has adequate capital to grow at a rate of ~25-30% per annum for the next 3-4 years

Exhibit 26: return ratios are in rising trend



Source: Dalal & Broacha Research, Company

ROA Tree

ROA PROGNOSIS	FY19	FY20	FY21E	FY22E	FY23E	FY24E
NII / ASSETS	5.5	5.4	5.1	5.4	5.8	6.1
OTHER INCOME / ASSETS	2.0	2.2	1.6	2.2	2.5	2.5
NET INCOME / ASSETS	**7.5**	**7.6**	**6.7**	**7.7**	**8.3**	**8.6**
OPEX / ASSETS	3.7	3.4	2.6	2.8	3.0	3.0
PROVISIONS / ASSETS	0.4	0.6	0.8	0.6	0.4	0.5
PBT / ASSETS	**3.4**	**3.6**	**3.4**	**4.3**	**4.9**	**5.1**
TAX / ASSETS	1.0	0.9	0.8	1.1	1.2	1.3
ROA	**2.4**	**2.7**	**2.5**	**3.2**	**3.7**	**3.8**
LEVERAGE (X)	4.5	4.1	3.5	3.3	3.5	3.7
ROE	**10.7**	**10.9**	**8.7**	**10.8**	**13.0**	**14.1**

Source: Dalal & Broacha Research, Company

BULL CASE SCENARIO

Rs Mn	FY20	FY21	FY22e	FY23e	FY24e
AuM	36,184	41,411	53,202	70,305	93,503
Growth (%)	48.1	14.4	28.5	32.1	33.0
Profit and Loss Statement					
NII	1,609	2,035	2,652	3,408	4,330
Opex	1,020	1,028	1,341	1,717	2,171
PPOP	1,238	1,662	2,390	3,162	3,963
Provisions	165	322	293	251	352
PAT	795	1,001	1,569	2,177	2,701
Financial ratios					
NIM (%)	5.0	4.7	5.0	5.2	5.2
RoA (%)	2.7	2.5	3.2	3.7	3.7
RoE (%)	10.9	8.7	10.8	13.2	14.3
GNPA (%)	1.0	1.9	1.4	1.2	1.1
NNPA (%)	0.8	1.2	0.9	0.7	0.7
Per Share					
EPS	10.2	11.5	17.9	24.9	30.9
Adj BV	116.2	153.4	171.7	196.3	226.1
P/E	70.3	62.3	39.8	28.7	23.1
P/Adj BVPS	6.1	4.7	4.2	3.6	3.2
Target multiple	4.5				
Target price (INR)	1018				
Upside (%)	43%				

BEAR CASE SCENARIO

Rs Mn	FY20	FY21	FY22e	FY23e	FY24e
AuM	36,184	41,411	52,374	61,878	71,962
Growth (%)	48.1	14.4	26.5	18.1	16.3
Profit and Loss Statement					
NII	1,609	2,035	2,576	2,920	3,251
Opex	1,020	1,028	1,314	1,587	1,878
PPOP	1,238	1,662	2,329	2,611	2,835
Provisions	165	322	289	410	546
PAT	795	1,001	1,526	1,647	1,712
Financial Ratios					
NIM (%)	5.0	4.7	4.9	4.7	4.4
RoA (%)	2.7	2.5	3.1	2.9	2.7
RoE (%)	10.9	8.7	10.5	10.2	9.6
GNPA (%)	1.0	1.9	2.6	2.8	2.7
NNPA (%)	0.8	1.2	2.1	2.2	2.1
Per Share					
EPS	10.2	11.5	17.5	18.8	19.6
Adj BV	116.2	153.4	165.3	182.0	200.1
P/E	70.3	62.3	40.9	37.9	36.4
P/Adj BVPS	6.1	4.7	4.3	3.9	3.6
Target multiple	2.5				
Target price (INR)	500				
Upside (%)	-30%				

Financials

P&L (Rs Mn)	FY21	FY22	FY23	FY24
Interest income	4,237	5,058	6,425	8,231
Interest expense	2,202	2,407	3,061	3,986
NII	**2,035**	**2,652**	**3,364**	**4,245**
Non-interest income	655	1,079	1,435	1,736
Net revenues	**2,690**	**3,731**	**4,799**	**5,981**
Operating expense	1,028	1,341	1,705	2,104
PPOP	**1,662**	**2,390**	**3,093**	**3,877**
Provisions	322	293	245	328
PBT	**1,340**	**2,097**	**2,848**	**3,550**
Tax	339	528	718	895
PAT	**1,001**	**1,569**	**2,130**	**2,655**

Balance sheet	FY21	FY22	FY23	FY24
Share capital	175	175	175	175
Reserves & surplus	13,631	15,199	17,329	19,984
Net worth	**13,805**	**15,374**	**17,504**	**20,159**
Borrowings	30,537	36,034	44,390	54,919
Other liability	**759**	**903**	**1,122**	**1,393**
Total liabilities	45,101	52,311	63,015	76,471
Fixed assets	167	203	254	304
Investments	**3,750**	**4,106**	**3,757**	**3,489**
Loans	33,265	42,604	54,849	70,020
Cash	**6,799**	**4,321**	**3,053**	**1,532**
Other assets	**1120.8**	**1076**	**1102.7**	**1126**
Total assets	45,101	52,311	63,015	76,471

Ratios	FY21	FY22	FY23	FY24
Growth (%)				
NII	26	30	27	26
PPOP	**34**	**44**	**29**	**25**
PAT	26	57	36	25
Advances	**10**	**28**	**29**	**28**
Spread (%)				
Yield on Funds	12.7	12.6	12.8	13.0
Cost of Funds	7.9	7.2	7.6	8.0
Spread	4.8	5.4	5.2	4.9
NIM	4.7	5.0	5.2	5.3
Asset quality (%)				
Gross NPAs	1.8	2.5	1.8	1.5
Net NPAs	1.2	1.8	1.3	1.1
Provisions	36	27	28	30
Return ratios (%)				
RoE	8.7	10.8	13.0	14.1
RoA	2.5	3.2	3.7	3.8
Per share (Rs)				
EPS	11.5	17.9	24.4	30.4
BV	158	176	200	231
ABV	153	167	192	222

Valuation (x)	FY21	FY22	FY23	FY24
P/E	62.3	39.8	29.3	23.5
P/BV	4.5	4.1	3.6	3.1
P/ABV	4.7	4.3	3.7	3.2

Source: Dalal & Broacha Research, Company

Aptus Value Housing Finance

Initiating Coverage | BFSI

DALAL & BROACHA
STOCK BROKING PVT. LTD.

Equity Research Desk

25 March 2022

Strong loan growth with better returns

Aptus Value Housing Finance (Aptus) has a strong business model, with best-in-class return ratios (RoA ~7%) among its peers, robust operating efficiency (Opex to assets stand below 2.6% levels in FY21), and well-managed asset quality (GNPA stood at 1.53% in Q3 FY22). In the last few years, the company has demonstrated its ability to grow the loan book without compromising asset quality or profitability. The company's loan book clocked 42% CAGR over FY18-FY21, while revenue & PAT grew at a CAGR of 48% and 59% respectively. The company is confident of posting a loan growth of 25-30% for the foreseeable future. Aptus' business also stands out in terms of margins, with NIM at 9.1% mainly supported by the higher yield on loans (~17% which is 3-4% higher than peers).

Rating	TP (Rs)	Up/Dn (%)
BUY ON DIPS	371	16

Market data		
Current price	**Rs**	**320**
Market Cap (Rs.Bn)	(Rs Bn)	158
Market Cap (US$ Mn)	(US$ Mn)	2,073
Face Value	Rs	2
52 Weeks High/Low	Rs	395 / 278
Average Daily Volume	('000)	282
BSE Code		543335
Bloomberg		APTUS.IN

Source: Bloomberg

How does the business operates?

- All aspects of the company's lending operations are in-house including sourcing, underwriting, valuation, and legal assessment of collateral and collections, which allow the company to get a holistic view of a borrower's financial profile, including creditworthiness and associated risks.
- The company operates its business in a centralized manner, where each vertical from sales, legal, technical, and collection functions report independently to head office.
- People from the branch are only responsible for sales, customer service, field verification & collection functions, while credit assessment & disbursement are undertaken at central office.

How do they manage risks ?

- After disbursement, the company monitors loan accounts for the first 15 to 24 months to check for early signals of potential defaults and conduct post disbursement audits. Also, conduct site visits after three months of disbursing a loan and periodically thereafter.
- The company has entered into arrangements with insurance companies to offer credit shield insurance to its customers which covers the outstanding loan liability in the event of the death of the borrower. ~100% of the company's customers are covered in the credit shield policy.
- Aptus has a granular portfolio with high customer equity, which can be seen in average loan-to-value of ~40% and average ticket size of Rs0.8-0.9mn.
- The company also has asset creation criteria, where they consider recently added tangible assets, including new land, investment in FDs, MFs and Chit funds etc., based on past income.

Valuation & outlook

We like Aptus for its strong business architecture, which is reflected in its best-in-class return ratios (RoA ~7%), customized underwriting process (mainly for low-income customer segments), and better combination of technology and human touch (100% in-house operations). Outlook for affordable housing space remained optimistic, given increasing urbanization, government push through interest subsidy schemes, and improved affordability of borrowers. With a healthy liability franchise and robust capital buffer, the company is an excellent growth play in underpenetrated low-cost housing finance space in rural & semi-urban markets. We expect growth to recover to ~28% CAGR over FY21-24E. Meanwhile, the behavioral maturity of housing loans is 7-8 years, whereas >60% of the company's book is built over the past four years. Hence portfolio seasoning is yet to be seen. At CMP the stock trades at 5x its FY23E ABV and 4.3x its FY24E ABV. We assign a 'Buy' rating on Aptus with a price target of Rs 371, valuing the stock at 5x FY24E standalone P/ABV.

Asset Quality

- Despite having higher exposure towards non-housing portfolio, Aptus has been able to maintain strong asset quality across economic cycles including events such as demonetization, liquidity crisis that was triggered by defaults by large financial services companies, etc.
- Moreover, COVID-19 pandemic was a litmus paper test for its asset quality, which the company passed with flying colors. This was mainly due to the company's strict discipline such as low LTV (~40%), exposure to self-occupied residential properties, monitoring end use of funds, and not providing any loans to builders or for commercial real estate.
- The company also conducts all aspects of its lending operations in-house including sourcing, underwriting, valuation, and legal assessment of collateral and collections, which enables it to maintain direct contact with its customers, reduce turn-around-times and the risk of fraud.
- The company has also entered into arrangements with insurance companies to offer credit shield insurance and property insurance to its customers.

Exhibit 1: **Robust Underwriting, Monitoring and Collections Process**

100% In-House Sourcing	Leveraging Technology	Stringent Credit Underwriting	Robust Collection Management System
• 202 branches • +1217 personnel for sales • 0% Sourcing from DSA /Builders	• Referral Mobile App to create strong sourcing network and generate leads • Digital Onboarding and KYC	• Cash flow assessment Pre & Post Disbursement • Centralized Underwriting	• 15-24 months Monitoring early default signs • 90 DPD Legal action / SARFAESI

Source: Company, Dalal & Broacha Research

Exhibit 2: Resilient Model Across Economic Cycles

Particulars	GST Implementation	NBFC Liquidity Crisis	Covid-19 (1ST Wave)	Covid-19 (2nd Wave)
	FY18	FY20	FY21	9MFY22
AUM growth (YoY)	66%	42%	28%	24%
Yield	17%	18%	17%	17%
GNPA	0.50%	0.70%	0.70%	1.53%*
ROA	6.00%	7.80%	7.4	7.8%^

Source: Company, Dalal & Broacha Research (^ Annualised, * as per RBI circular 12 Nov 2021)

Exhibit 3: COLLECTION PHASES

OVER 90 DAYS PAST DUE
The company initiate legal action through SARFAESI and conduct arbitration proceedings

30 TO 89 DAYS PAST DUE
The company conduct field visits to a customer's place of business or residence and issue legal notices

1 TO 29 DAYS PAST DUE
The company send customers letters and call them to remind them of their overdue payments

Source: Company, Dalal & Broacha

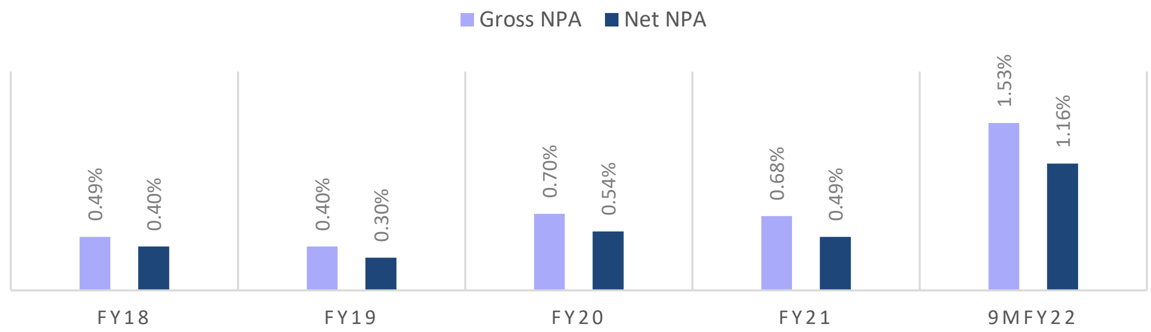
What Makes Aptus' Asset Quality Better ?

- **Centralised loan sanctioning:**
  - The company operates its business in a centralized manner and has set up separate internal verticals for its sales, legal, technical and collection functions who report independently to its head office.
  - Branch offices are responsible for sales, customer service, field verification and collection functions, while credit assessment and disbursement of loans are undertaken at the company's central office.
  - The company has a credit officer at its branches who is responsible for collating & verifying relevant documentation, conducting reference checks, and responding to basic queries. Credit officers use several methods to evaluate a customer's earning capacity and prepare a video of a customer's place of work and residence to enable the underwriting team to make well-informed decisions.
  - The company's credit assessment team at its central office comprised 212 personnel, as of Dec 31, 2021. For legal and technical functions, the company has teams of in-house qualified personnel (+211 personnel) who are placed in hubs that cater to several branches each.
- **Post Disbursement Audits; Built > 60 types of customer profiles**
  - After the disbursement of a loan, the company closely monitors loan accounts for the first 15 to 24 months to check for early signals of potential defaults and conduct post disbursement audits. It also conducts site visits after three months of disbursing a loan and periodically thereafter.
  - The company utilizes its analytics platform to maintain different templates of customer profiles and increase business while managing risks. Over years, the company has studied and developed credit assessment models specific to over 60 types of customer profiles, which are customized to regions and specific types of employment.
  - The company regularly update these profiles depending upon regional and local market-specific developments and macro disruptions such as the COVID-19 pandemic.
  - This has helped the company reduce subjectivity in forecasting the future income of potential customers, thus enabling robust credit underwriting.
- **Robust Risk Management Architecture**
  - The company has established a risk management and audit framework to identify, assess, monitor and manage various types of internal and external risks.
  - The company also conducts stress testing of its portfolio, a portfolio-wise analysis, pin-code wide analysis and sourcing-wise analysis to check for probability of defaults.
  - Furthermore, the company monitors profile-wise concentration risk at the portfolio level as well as for individual profiles at each of its branches.
  - The company also performs analysis on lagged delinquency and executive wise delinquencies. It has also entered into arrangements with insurance companies to offer credit shield insurance and property insurance to our customers.
- **Strong Technology framework and data analytics:**
  - The company has leveraged technology in various facets of its operations and has robust systems and processes to assist in its underwriting and collections functions and to monitor asset quality.
  - These systems and processes are also technology enabled with a view to ultimately digitize the entire life cycle of a loan from origination to closure. The company has also implemented digitized collection models, which has led to an increase in its collection efficiencies.

➢ LIMITED IMPACT OF COVID-19 PANDEMIC ON THE PORTFOLIO QUALITY

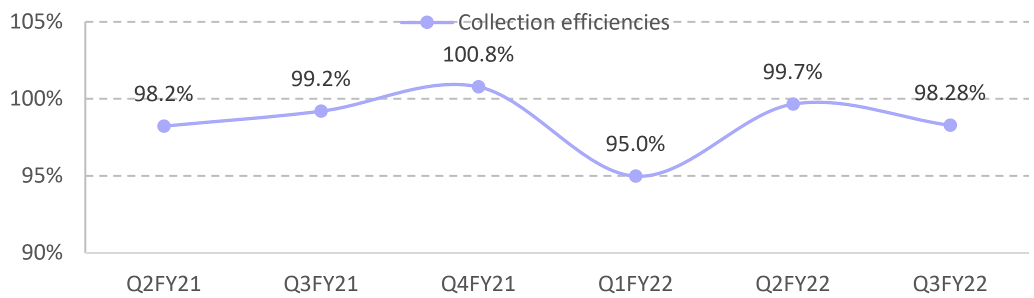
- Despite having higher exposure towards non-housing portfolio, Aptus has been able to maintain strong asset quality, with gross NPA at 1.53% and net NPA at 1.16%. GNPA without considering the impact of RBI circular was at ~ 1.1% only, better compared to most of its peers.
- Collection efficiencies stood at 98.3% in Dec 2021, marginally dropping from 99.7% due to due to abnormal rains in the month of Oct-21 and Nov-21, but improved vis-a-vis 95% in June 2021. This has led to a marginal increase in 30+ DPD (12.27% vs 10.08%), as the backlog has got created, which is most likely being collected in a phased manner in the next few months.
- With superior credit underwriting, better collection infrastructure, we strongly believe that the company's asset quality will gradually reach pre-covid levels in the next few quarters.

Exhibit 4: Asset Quality Trends



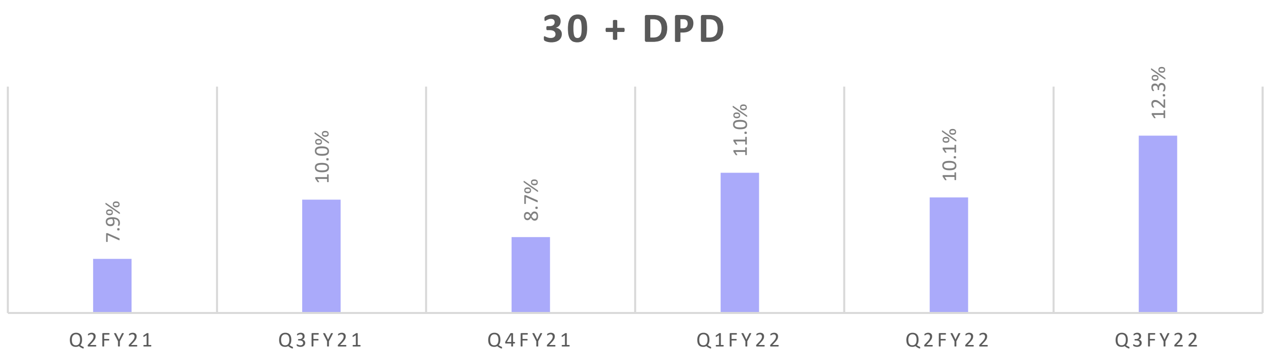
Source: Company, Dalal & Broacha Research

Exhibit 5: Collection efficiency trend



Source: Company, Dalal & Broacha Research

Exhibit 6: Early stress indicator (30+ DPD)

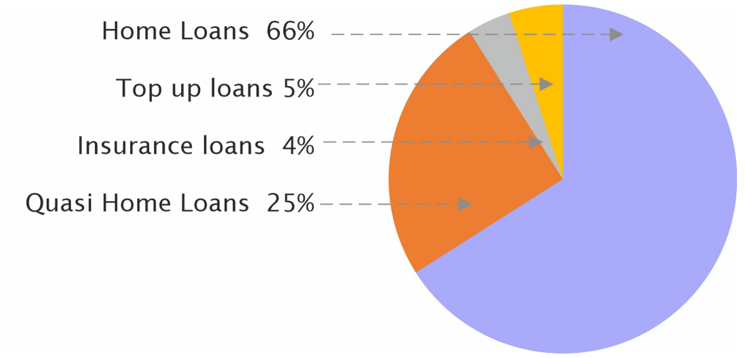


Source: Company, Dalal & Broacha Research

Diversified Loan Portfolio with niche customer focus

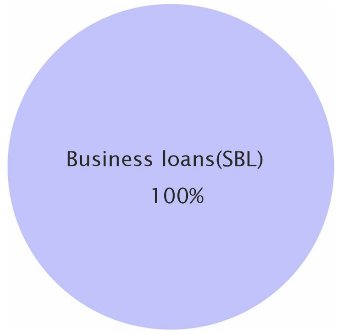
Aptus has four products which include 1) direct home loan which is given for the purpose of either construction, purchase, repairs, or renovation of the house. These loans are charged an interest rate of ~13-14%. Then there is 2) quasi home loans, given to self-employed customers post construction of house. This kind of customer used surplus business cash flows for building their house and take loans whenever they face cash shortage for running the business. These loans are charged an interest rate of ~17-17.5%. 3) The company also provides Insurance loans to its customers to pay a premium for credit shield insurance ranging between four to five percent of the total home loan. Under credit shield insurance, the entire loan outstanding is repaid by the insurance company in the event of the death of a customer. ~100% of the company's customers are covered in credit shield policy, which helps a lot during Covid 19 pandemic. 4) The company through its NBFC gives secure business loans to SMEs for meeting their business requirements. The company doesn't give these loans for consumption purposes like marriage, education, etc. These loans for a period of seven years and charge an interest rate of ~20-21%.Secured Portfolio – Home Loans (HL)/Small Business Loans (SBL)

Exhibit 7: HFC AUM Rs. 41.38 bn



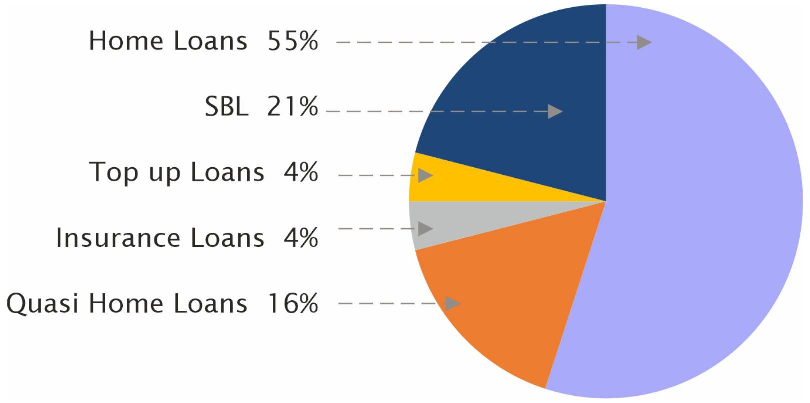
Source: Company

NBFC AUM Rs. 6.67 bn



Source: Company,

Exhibit 8: Consolidated Aum Rs.48.05 bn



Source: Dalal & Broacha Research, Company

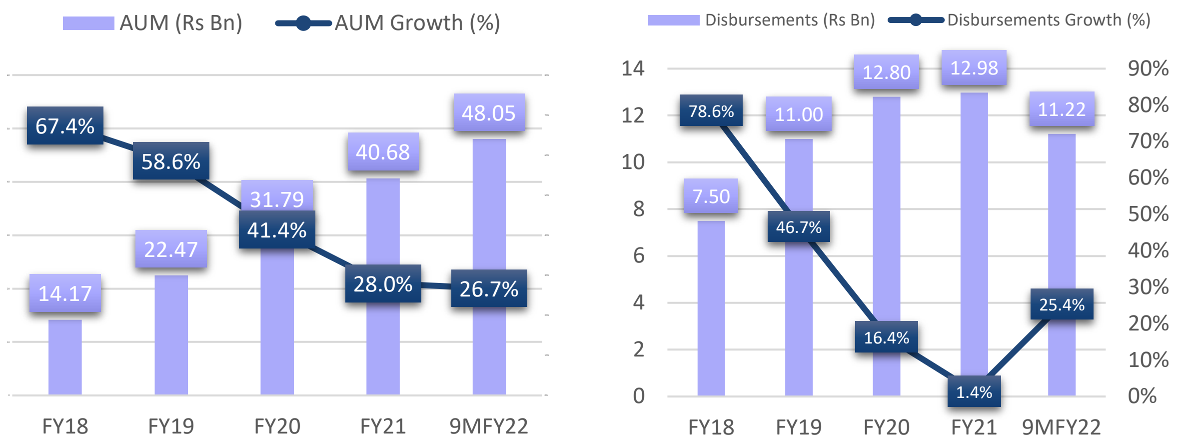
LIG Customers-73%/ Self Employed Borrowers-72%

Rural Focus-66%/ Average Ticket Size < Rs 10 lakh

Loan growth to pick up the coming quarters

We strongly believe that Aptus has all the right ingredients to maintain a strong and resilient AUM growth over the medium term, supported by deeper penetration in existing states, expanding into new states (Maharashtra, Odisha, and Chhattisgarh), and investment in technological initiatives driving improvement in customer profiling. Besides, the company's focus on under-penetrated and underserved segments (mainly the EWS and LIG categor4y) and government initiatives like fiscal incentives and Credit Linked Subsidy Scheme, should also bode well from AUM growth perspective.

Exhibit 9: Robust AUM growth



Source: Dalal & Broacha Research, Company

The company conducts all aspects of its lending operations in-house, which allows it to maintain direct contact with customers and establish strong relationships with them, leading to customer referrals, high levels of customer satisfaction, and increased loyalty. It has also helped mitigate underwriting and default risks by enabling it to have a customer base with a better credit profile. The company sources customers directly through its sales team, which comprised over 1,217 personnel as of December 31, 2021. Its in-house sourcing model helps it make a better credit evaluation of customers on a wide range of parameters after collating all customer information in its database. In order to give better and faster services, the company has also developed in-house teams for property evaluation, property valuation, conducting legal assessments and collections.

Exhibit 10: Information & Technology: Key Enabler of Growth

Customer Onboarding	Lending Software	Collections App	Customer Relationship & Service	Business Intelligence & Analytics	Human Resources
• Sales app, referral app, credit verfn. app and property app E-KYC, E-Nach	• End-to-end software solution	• Payments automation via Bharat Bill Pay, Google Pay, Paytm etc	• Automated CRM and customer service requests	• "Power" analytics platform	• Human resources anagement system application

Source: Dalal & Broacha Research, Company

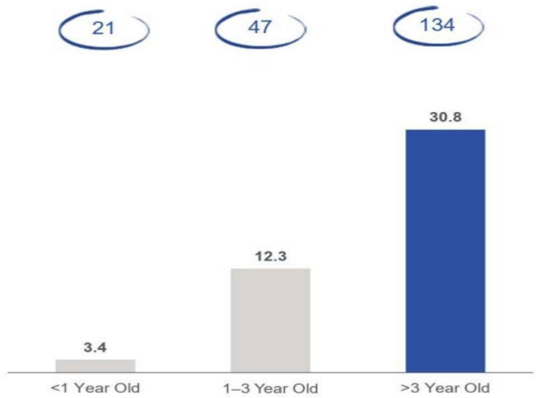
Branch operation

- Over the years, Aptus has reported a strong branch expansion mainly in semi urban and rural areas, to serve customer segment which primarily new to credit customers, without formal income proofs and are unserved or underserved by formal financial institutions.
- The company has added 12 branches so far in FY22, taking its branch network to 202. The company focuses on deeper penetration rather than spread out across the country and not able to manage risk. Employee count increased from 1913 in FY21 to over 2100 so far in FY22.
- Being headquartered in Chennai, Tamil Nadu, the company has progressively expanded its presence to three more states namely Andhra Pradesh, Telangana and Karnataka. With better per-capita income and higher financial literacy the company has enough space for growth in these four states. It is also expanding its network in other states such as Maharashtra, Odisha and Chhattisgarh at a slower rate to understand the regions in a better manner. These new states might have different economies in terms of competition, customer requirements, regulatory regimes and even business practices, therefore going slow is the better choice.
- On average one branch costs ~3-4 lakh in tier III & tier IV cities, which typically breakeven in 6 to 7 months. Hub location branches take more time to break even ~8-9 months, given the amount invested is more. Typically, the company has 5-6 employees in each branch, which includes 4-5 sales officers, one credit officer and one branch manager. Credit officer is responsible for collating and verifying relevant documentation, conducting reference checks and responding to basic queries. If the number of accounts goes beyond 100 in a particular branch, a collection agent is also stationed there. Usually, each branch covers a 50 Kms radius.

Exhibit 11: Scalability

	Tamil Nadu	Andhra Pradesh	Telangana	Karnataka
Per Capita GDP *Compared to national average of INR 157k*	1.8x	1.1x	1.5x	1.5x
GDP Growth *India average: 4%*	13%	9%	8%	7%

State	No of branches	% of AUM as on				
		Q3 FY 22	Q2 FY 22	FY 21	FY 20	FY 19
TamilNadu	79	49%	50%	52%	56%	60%
AndhraPradesh	71	30%	29%	28%	25%	21%
Telangana	31	12%	11%	10%	10%	9%
Karnataka	21	9%	10%	10%	10%	11%
Total	**202**	100%	**100%**	**100%**	**100%**	**100%**



Source: Dalal & Broacha Research, Company

- The large part of near-term growth will come from these existing branches as productivity of low vintage branches will improve over the period of time. This means the 21 branches with Rs 34 Mn average loan book will move towards Rs. 123 Mn and 47 branches with an average loan book of Rs 123 Mn will move towards Rs 308 Mn, while 134 branches with an average loan book Rs 308 Mn will show a higher loan book size (few branches have loan book size of over Rs 500 Mn).
- With continued investment in the budding franchise, we expect that the company will open 20-25 branch annually and take the total tally to >250 branches by FY24E.

Exhibit 12: Key Growth Strategies

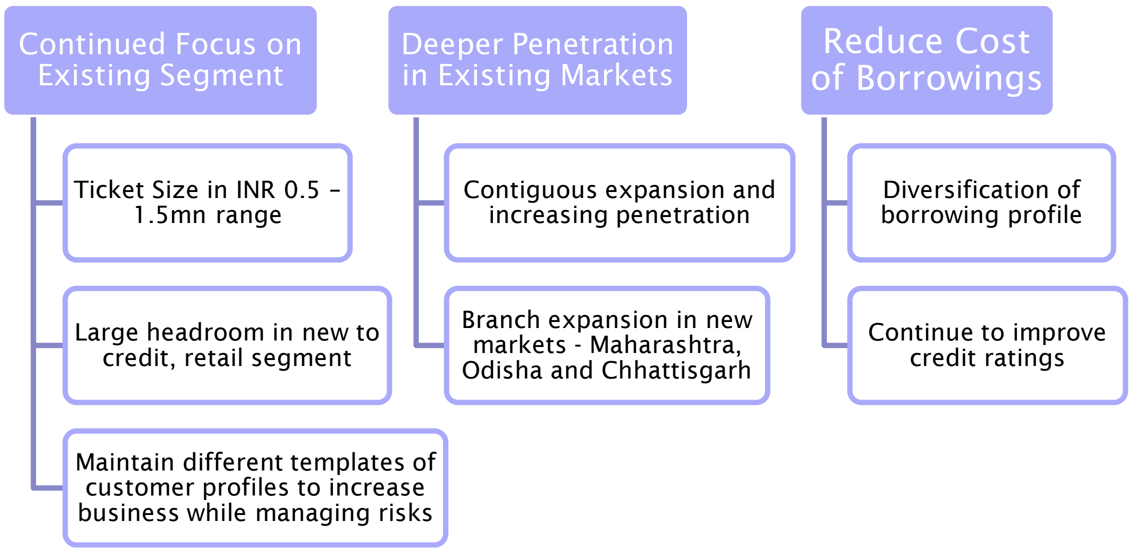


Exhibit 13: Basic inside of portfolio

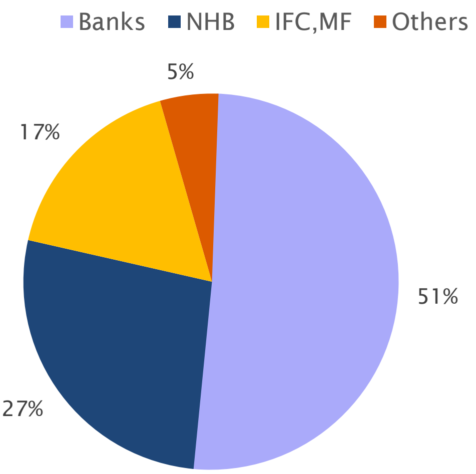
FY21	*Home loans*	*LAP*	*Business loan*	*Consolidated*
AUM (Rs Bn)	21.03	8.90	10.47	40.68
ATS (in lakh)	7.2	7.1	6.2	7
Average yield	15.38%	17.00%	20.45%	16.88%
GNPA	0.58%	0.21%	1.25%	0.68%
Tenure (in Months)	147	133	101	NA
LTV	38.89%	38.27%	39.21%	NA
BT out	1.99%	1.18%	1.53%	1.70%
Collection Efficiency	99.75%	99.97%	99.65%	99.76%

Source: Dalal & Broacha Research, Company

Robust Funding Management

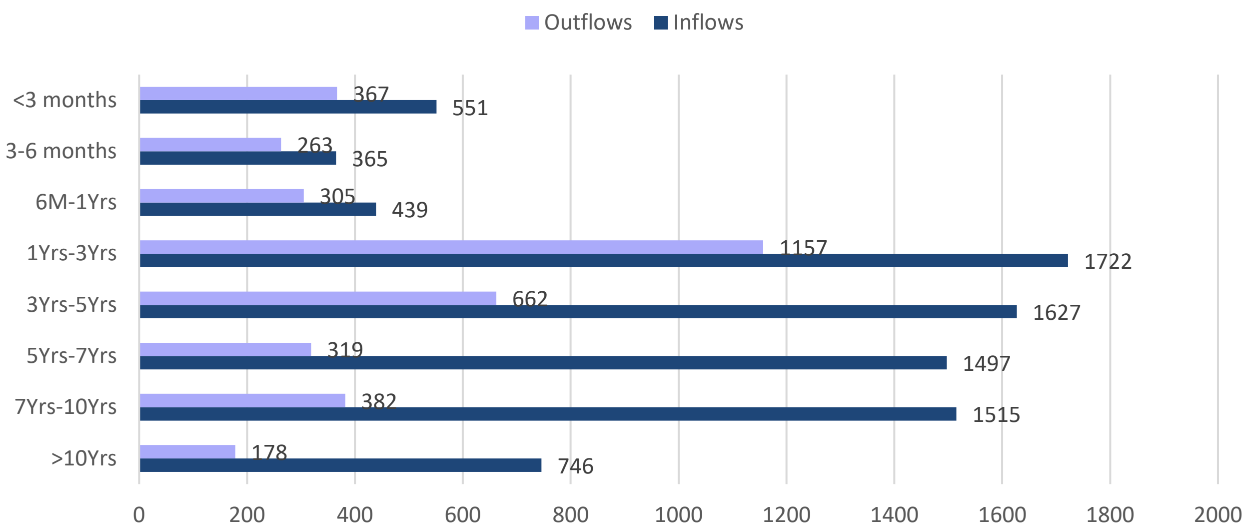
- Aptus has well diversified borrowings, with 49% coming from NHB and DFIs like IFC and large financial institutions, while balance 51% came from banks (linked to the MCLR).
- ~49% borrowings are fixed rate, including NHB borrowings (up to 10-15 years) and IFC funding (7 years). 51% of the bank borrowings are linked to the MCLR and most of them are linked to 6-months or 1-year MCLR basis.
- Recently, ICRA has upgraded the company's long-term rating to AA- (Stable)' from A+ (Stable)', while CARE upgraded outlook to 'A+ (positive)' from 'A+ (stable)'. This rating upgradation will help the company to raise funds at more competitive rates.
- As on Dec 2021, the company has sufficient on balance sheet liquidity of Rs 2.70 Bn, while including the undrawn sanctions from NHB and other banks, the same will be Rs 8.33 Bn. Moreover, there is also operational cash surplus that is accruing on a month-on-month basis.

Exhibit 14: Diversified and Balanced Funding Mix



Source: Dalal & Broacha Research, Company

Exhibit 15: ALM Surplus as on December 31, 2022

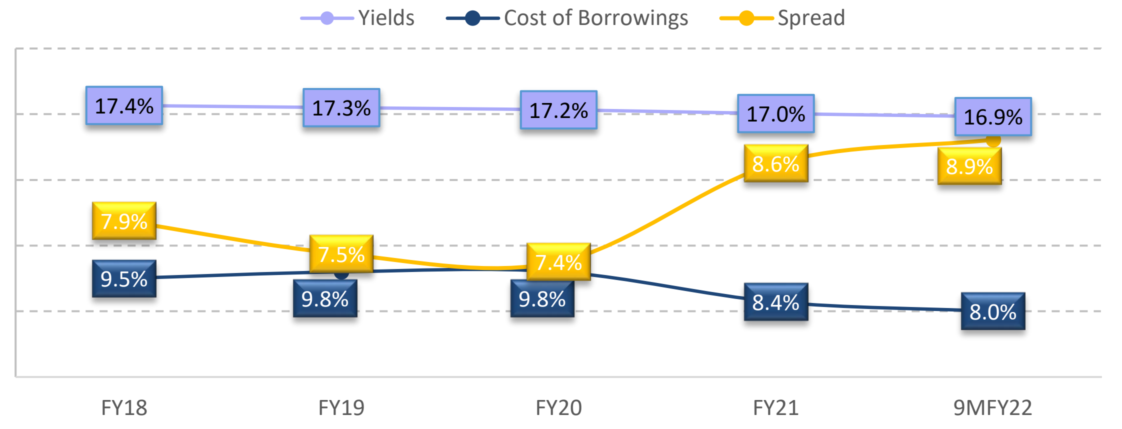


Source: Dalal & Broacha Research, Company

Industry leading return ratios

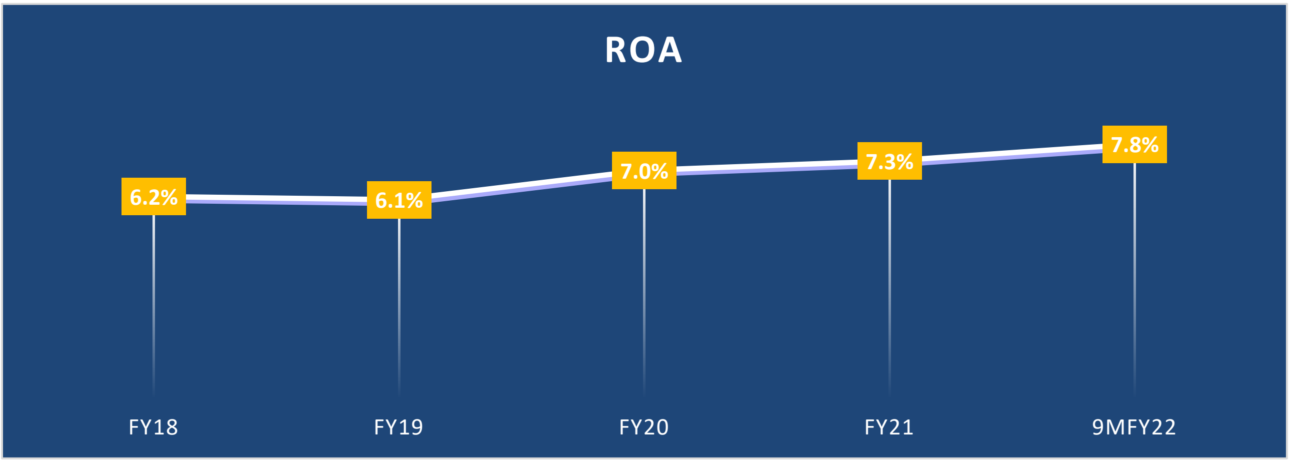
Aptus has one of the best return ratios among peers, which was supported by a superior lending model, well-defined customer segment from semi urban & rural areas, and no major asset quality concerns. The company's focus on serving niche customer segments, which are primarily new to credit customers, without formal income proofs and are unserved or underserved by formal financial institutions, allow it to charge higher interest rate than peers. As of March 31, 2021, the company's average yield on disbursements was 16.9% (which is 3-4% higher than peers), while home loan, LAP and business loans command yields of 15.4%, 17 % and 20.5%, respectively. The company's business also stands out in terms of margins, with NIM at 9.1% mainly supported by stable yields and declining cost of funds. Diversified borrowing mix along with credit rating upgrades have allowed the company to bring down its cost of funds. We expect credit costs to remain under control in the near to medium term, supported by limited asset quality risk, due to superior credit underwriting, clientele profile, and better controls. In the last few years, the company has demonstrated its ability to grow the loan book without compromising asset quality or profitability. The company's loan book clocked 33% CAGR over FY19-FY21, while revenue & PAT grew at a CAGR of 40% and 55% respectively.

Exhibit 16: Yields remain sticky despite lower borrowing cost



Source: Dalal & Broacha Research, Company

Exhibit 17: Best-in-class RoA



Source: Dalal & Broacha Research, **Company**

BULL CASE SCENARIO

Rs Mn	FY20	FY21	FY22e	FY23e	FY24e
AuM	31,787	40,678	51,805	69,066	93,061
Growth (%)	41.4%	28.0%	27.4%	33.3%	34.7%
Profit and Loss Statement					
NII	3,007	4,174	5,156	6,569	8,465
Opex	884	978	1,164	1,445	1,812
PPOP	2,507	3,509	4,298	5,598	7,324
Provisions	34	58	97	103	149
PAT	2,110	2,669	3,142	4,110	5,367
Financial ratios					
NIM (%)	10.0%	10.2%	9.9%	9.8%	9.9%
RoA (%)	6.9%	6.5%	6.0%	6.1%	6.2%
RoE (%)	17.5%	14.5%	13.2%	13.7%	15.4%
GNPA (%)	0.7%	0.7%	1.6%	1.4%	1.2%
NNPA (%)	0.5%	0.5%	1.2%	1.1%	0.9%
Per Share					
EPS	4.5	5.6	6.3	8.3	10.8
Adj BV	36.1	41.5	56.0	64.3	75.0
P/E	71.7	56.9	50.5	38.6	29.6
P/Adj BVPS	8.9	7.7	5.7	5.0	4.3
Target multiple					6
Target price (INR)					450
Upside (%)					41%

BEAR CASE SCENARIO

Rs Mn	FY20	FY21	FY22e	FY23e	FY24e
AuM	31,787	40,678	51,546	62,538	74,658
Growth (%)	41.4%	28.0%	26.7%	21.3%	19.4%
Profit and Loss Statement					
NII	3,007	4,174	5,142	6,105	6,974
Opex	884	978	1,164	1,414	1,703
PPOP	2,507	3,509	4,283	5,137	5,863
Provisions	34	58	97	143	199
PAT	2,110	2,669	3,131	3,736	4,236
Financial ratios					
NIM (%)	10.0%	10.2%	9.9%	9.5%	9.2%
RoA (%)	6.9%	6.5%	6.0%	5.8%	5.6%
RoE (%)	17.5%	14.5%	13.1%	12.5%	12.5%
GNPA (%)	0.7%	0.7%	1.7%	1.9%	2.1%
NNPA (%)	0.5%	0.5%	1.3%	1.5%	1.6%
Per Share					
EPS	4.5	5.6	6.3	7.5	8.5
Adj BV	36.1	41.5	56.0	63.4	71.8
P/E	71.7	56.9	50.6	42.5	37.5
P/Adj BVPS	8.9	7.7	5.7	5.0	4.5
Target multiple					3
Target price (INR)					215
Upside (%)					-33%

Source: Dalal & Broacha Research, Company

Financials

P&L (Rs Mn)	FY21	FY22e	FY23e	FY24e
Interest income	6,239	7,771	9,776	12,486
Interest expense	2,065	2,308	2,945	4,016
NII	**4,174**	**5,463**	**6,831**	**8,469**
Non-interest income	314	349	481	650
Net revenues	**4,487**	**5,813**	**7,312**	**9,120**
Operating expenses	978	1,144	1,467	1,846
PPOP	**3,509**	**4,668**	**5,846**	**7,273**
Provisions	58	321	172	184
PBT	**3,451**	**4,347**	**5,674**	**7,089**
Tax	781	1,096	1,430	1,787
PAT	**2,669**	**3,252**	**4,244**	**5,303**

Balance sheet	FY21	FY22e	FY23e	FY24e
Share capital	949	991	991	991
Reserves & surplus	18,845	27,097	31,341	36,644
Net worth	**19,795**	**28,088**	**32,332**	**37,635**
Borrowings	25,151	27,364	36,428	49,479
Other liability	**256**	**272**	**283**	**294**
Total liabilities	45,202	55,725	69,044	87,407
Fixed assets	96	103	109	115
Investments	**528**	**665**	**579**	**492**
Loans	39,898	50,807	65,214	84,343
Cash	**4,378**	**3,829**	**2,802**	**2,100**
Other assets	**302.57**	**321.194**	**339.408**	**357.345**
Total assets	45,202	55,725	69,044	87,407

Ratios	FY21	FY22e	FY23e	FY24e
Growth (%)				
NII	39	31	25	24
PPOP	**40**	**33**	**25**	**24**
PAT	27	22	31	25
AuM	**28**	**27**	**28**	**29**
Spread (%)				
Yield on Funds	17.1	16.9	16.7	16.6
Cost of Funds	9.1	8.8	9.2	9.3
Spread	8.0	8.2	7.5	7.3
NIM	10.2	10.9	11.0	10.9
Asset quality (%)				
Gross NPAs	0.7	1.7	1.5	1.4
Net NPAs	0.5	1.3	1.1	1.0
Provisions	27	23	25	24
Return ratios (%)				
RoE	14.5	13.6	14.0	15.2
RoA	6.5	6.4	6.8	6.8
Per share (Rs)				
EPS	5.6	6.6	8.6	10.7
BV	42	57	65	76
ABV	41	55	64	74
Valuation (x)				
P/E	56.9	48.8	37.4	29.9
P/BV	7.7	5.6	4.9	4.2
P/ABV	7.8	5.8	5.0	4.3

Source: Dalal & Broacha Research, Company

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