INTEGRATED REPORT 2020-21

Aavas FINANCIERS LTD

SAPNE AAPKE, SAATH HAMAARA

How we are enhancing value for all our stakeholders

Our priorities

Growing need to enhance value for all stakeholders	Concurrent priority in explaining how this value was enhanced	Transparent disclosure in the Annual Report	Invest in business to achieve long-term outperformance

Overview

There is a growing recognition that the value created by companies cannot be measured uni-dimensionally by market valuation or Profit after Tax, which explains the growing importance of the Integrated Value-Creation Report as a communication discipline.

This Integrated Value-Creation Report overcomes the shortcomings of the conventional communication approach through a comprehensive reporting framework that reconciles 'hard' and 'soft' initiatives into an integrated format.

The measurement of value creation needs to be holistic, covering every major organizational constituent. This preference has been directed by a premium on long-term business sustainability over one-off profitability (which can often be derived from limited factors across a short period). The result is a commitment to enhance value for all stakeholders (employees, customers, vendors, shareholders, lenders, society and the government).

The primary purpose of Integrated Reporting is to explain to financial capital providers how an organization enhances value. The impact of the integrated report extends beyond financial stakeholders; it enhances understanding across all stakeholders - including employees, customers, suppliers, business partners, local communities, legislators, regulators and policy-makers.

Interestingly, no Capital exists in isolation; each constituent (Capital) is inter-connected with the other and one cannot have a sustainable value-creation movement without all Capitals being adequately serviced.

- *Financial Capital comprises surpluses driving the financial engine.*
- *Manufactured Capital comprises ongoing investments in efficient processes and technologies,*
- *Intellectual Capital comprises knowledge and experiences that take the business ahead.*
- *Human Capital comprises people skills, experiences and capabilities.*
- *Social & Relationship Capital comprises value derived from vendors, customers and societal uplift.*
- *Natural Capital comprises a responsible consumption of natural resources and efficient production with a declining carbon footprint.*

As a forward-looking organization, we have published an Integrated Report as a part of our reporting discipline.

Compounded growth

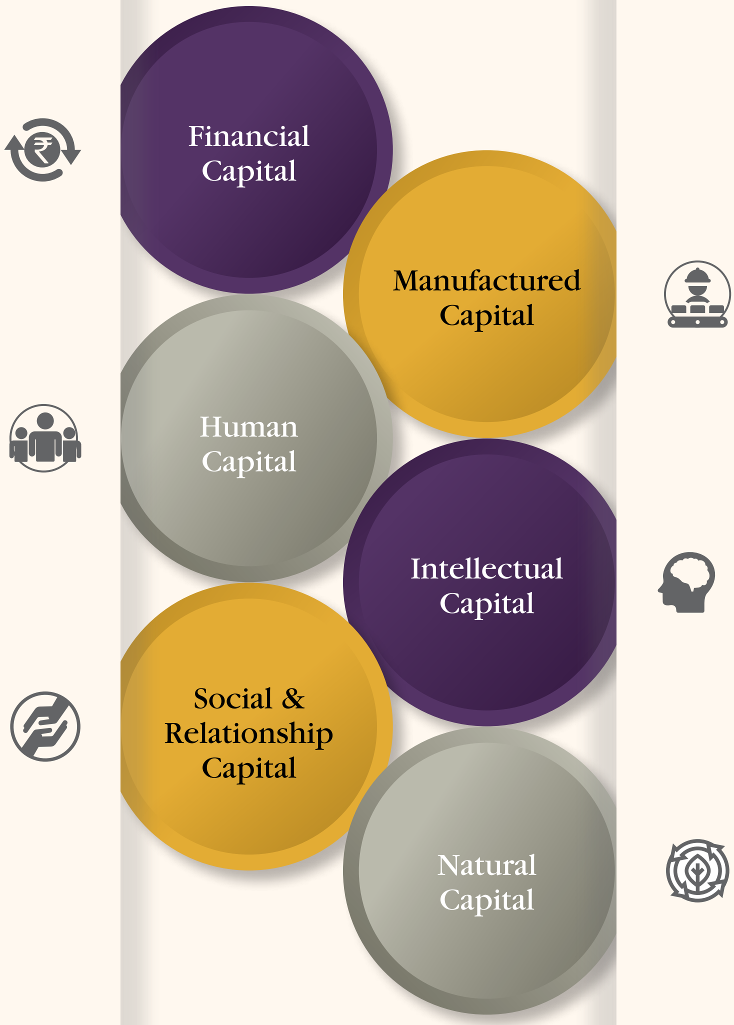
41.2
Five years % CAGR in revenues

55.4
Five years % CAGR in PAT

Assets under management

1,679.87
₹ crore, assets under management, FY 2015-16

9,454.29
₹ crore, assets under management, FY 2020-21


Financial Capital
Manufactured Capital
Human Capital
Intellectual Capital
Social & Relationship Capital
Natural Capital

HOW WE ENHANCED VALUE ACROSS OUR CAPITALS IN 2020-21

Drivers of value at Aavas

At Aavas, the interplay of value for our stakeholders has translated into our business sustainability.

Our employees represent the aggregate knowledge of how to grow the business across a range of functions (funds procurement, process management, marketing, branding, treasury management etc.). Our focus is to provide an exciting workplace, generate stable employment and enhance productivity.

Our shareholders provided capital when we went into business. Our focus is to generate sufficient projects, growing RoE (Return on Equity) and in doing so enhance value of their holdings.

Our vendors provide credible and a continuously supply of goods and services. Our focus is to maximize quality procurement at declining average costs with the objective to widen our markets strengthening sustainability.

Our customers keep us in business by seeking housing finance and other loan products, generating the financial resources to sustain operations. Our focus is servicing a larger number of customers around our preferred rate points, retain them and facilitate them with a larger number of our customized products as per their requirements.

Our communities provide the social capital (education, culture education, health, environment etc.). Our focus is to support and grow communities through consistent engagement. The governments in the areas of our presence provide us with a stable structural framework that ensures law, order, policies etc. Our focus is to play the role of a responsible citizen, serving as a role model

At Aavas, we believe that the prudent interplay of the value generated by each stakeholder and our consistent payback ensures business sustainability and the ability to enhance organizational value.

Financial Capital

Financial Capital (shareholders' equity and debt) represents a critical driver of business and in helping leverage the full value of other Capitals. At Aavas, the strength of our Financial Capital helped catalyze business expansion and sectorial leadership.

Outcomes in FY 2020-21

1,105.34
₹ crore, Revenue

289.50
₹ crore, Profit After Tax

2,401.40
₹ crore, Net worth

Manufactured Capital

Manufactured Capital is the Company's infrastructure (tangible and intangible) leveraged for value creation. We are prudently managing our capital investments to create a portfolio of assets that helps create value for our clients.

Outcomes as on March 31, 2021

280
Branches

11
States of presence

Human Capital

Human Capital indicates an aggregate statement of employees' competencies, knowledge and experience.

Outcomes as on March 31, 2021

5,679
Employees

30.64
Average employee age (years)

Intellectual Capital

Intellectual Capital refers to the collective knowledge, research, thought leadership, brand management and intellectual property used to support business activities. Our Intellectual Capital consists of our strong brand, experienced professionals, cutting-edge technology and robust processes.

Outcomes as on March 31, 2021

Effective Operations and business continuity during the COVID-19 scenario

EY Entrepreneur of the Year in the Financial Services Category bestowed on Mr. Sushil Kumar Agarwal, Managing Director and CEO

Automation of various compliance processes and meetings

Social and Relationship Capital

Social and Relationship Capital refers to the value derived from relationships with clients, investors, regulators, suppliers and community.

Outcomes as on March 31, 2021 (Through Aavas Foundation)

1,00,000+
Children provided with education and holistic development

50+
Women from 50 villages provided with employability and entrepreneurship

500+
Safety kits distributed for the welfare of construction workers

Natural Capital

Natural Capital refers to the natural resources the Company uses to create value for its stakeholders, as well as its efforts to promote natural resource preservation and environmental mitigation.

Outcomes as on March 31, 2021 (Through Aavas Foundation)

6,300
Number of tress planted

>10
Acres of land covered by our tree plantations

INTEGRATED VALUE-CREATION AT AAVAS

Building an anti-fragile business model

THE PRIORITIES

- Demonstrating sustainability across business cycles
- Enhancing value for each stakeholder, strengthening traction and business visibility

THE CHALLENGES

- There were several companies engaged in the business of housing finance before Aavas Financiers entered the business.
- The company had the option to do exactly what the others had done; in the sameness lay reasonable security; in the sameness also lay the prospect of playing the game like everyone else had played it and no better.

THE RESPONSE

- Aavas selected to not just play a different game; it selected to create a different game and then establish competence
- The result: a distinctively outperforming business model

THE UPSIDES

- Willingness to build for the long-term
- Clarity to lend to only those likely to service the loan on time and in full, staying engaged with the customer during the loan life cycle
- Freedom to engage in patient business-building without being distracted by short-term considerations

1 Broadening presence in a market niche

Overview

When Aavas entered the business, it had two alternatives: follow an established trend or walk the road less travelled.

The company could have selected to fund the needs of urban house builders or real estate companies needing working capital loans during construction phase. The advantage of this approach would have been that most (if not all) of these customers possessed a credit history that could be examined or accessed. Aavas could take safe financing calls; it could engage in high-ticket lending that would have shown up visibly in revenues. Besides, this business model would not warrant the opening of offices in remote rural locations.

Even as Aavas had options, the company selected the more difficult; when it had an option that was tried and tested, it experimented with the unusual; it selected to address the housing finance needs of the under-banked and limited income document seekers of housing finance. The Company resisted the temptation to invest in properties, finance real estate builders, engage in corporate loans or finance large properties under construction.

When Aavas could have opted to service a customer set that would have entailed lower costs, it invested in one that required it to spend additionally upfront; when it could have shown to its lenders that it was reaching out to customers with an established credit sheet, it exercised the contrarian option by reaching out to those with virtually no income-proof documents.

The result is that the Aavas customer communication protocol is marked by simplicity and onboarding assistance for unlettered customers. The company's call centre communicates in two languages; the website enables customers to engage with the service desk; the use of information technology makes it possible for customers to exercise the self-help option.

Over the years, Aavas strengthened its customer engagement through the credit-linked subsidy scheme, which links eligible loanees with the concerned government scheme (Pradhan Mantri Awas Yojana) to access available subsidies. This coordination with the government has helped moderate the customer's monthly installments during loan tenure.

Besides, Aavas insures customers so that in the event of an unforeseen expiry, the insurance protects family members through property retention and payment of the outstanding loan amount on their behalf.

Snapshot

- Aavas resisted the usual, predictable and simple approach
- The company addressed the housing finance needs through simple documentation procedure
- The company was driven by the vision to transform lives and lifestyles of those at the lower-end of India's social pyramid

The company's strategic journey and direction

- Addressed the needs through simple documentation procedure
- Invested in the business upfront
- Focused on transparency
- Focused on transforming customer lives
- Focused on communication simplicity
- Strengthened customer engagement through technology

2 Strengthening customer engagement

Overview

At Aavas, customer engagement does not end with disbursement of the loan; its work-in-progress approach catalyzes the customer relationship with the objective of retention.

Snapshot, FY 2020-21

- Service hours extended from 7:30 a.m. to 8 p.m.
- Increased customer service team to address growth in volumes
- Invested in robotics and in development and upgradation of chatbots
- Customer queries resolved in 24 to 48 hours

Active number of loan accounts

77,400+	104,700+	1,25,500+
As on March 31, 2019	As on March 31, 2020	As on March 31, 2021

The company's strategic journey and direction

1. It enhanced responsiveness for customers, personalization and distinctive values
2. It invested in understatedness, IT infrastructure and loan life-cycle focus
3. It enhanced responsiveness for customers, personalization and distinctive values
4. It serviced small amounts, focusing on retail-focused mortgage financing

3 Building a proprietary value-chain

Overview

At Aavas, we recognized that to build a quality business, it was imperative to control every aspect.

The company's focus on in-house sourcing was spread across three levels – Lead generation and sourcing, Risk management and Collections. The company customized the design of each of these functions from its rich experience; this design was integrated into the digital architecture for seamless control across locations; the company periodically strengthened operating benchmarks.

Lead generation and sourcing

- The company selected to source leads directly from the marketplace
- It leveraged technology and data analytics to generate leads through alternative channels (digital and social media for instance)
- The company introduced Application Scorecard to evaluate risk profiles; its streamlined approval process minimized errors

Risk management

- The company created a proprietary under-writing team for income assessment and risk-based pricing of customers
- The company's in-house legal team managed the external legal verification
- The company generated two valuation reports beyond a specific ticket size to minimize error impact
- The company risk-tested files by its resident risk containment unit

Collections

- The company created a four-tier collections architecture, focusing on the management of early delinquencies
- It sustained call centres in two languages that helped initiate timely collections
- It tracked collections in real-time

The result of these initiatives, managed from within, helped moderate the turnaround time in the processing of new loan application, strengthened the company's ability to price risks, strengthened control on loan take-over by other institutions, enhanced collections efficiency and moderated Gross Net Performing Assets.

Snapshot, FY 2020-21

- The company finished the year with a turnaround time of 13.1 days despite market disruption due to lockdowns (10.6 days in the previous financial year)
- The AUM of the Company grew to ₹9,454.29 crore (₹7,796.09 crore in previous financial year)
- Total Income grew by 22% to ₹1,105.34 crore for the financial year 2020-21 (₹903.09 crore in previous financial year)

Average loan ticket size

8.59

₹ lakh, Fy 2018-19

8.40

₹ lakh, FY 2019-20

8.49

₹ lakh, FY 2020-21

4 Presence in some of the attractive Indian housing finance markets

Overview

At Aavas, we believe that sustainable success is derived from the ability to be present in the right markets within India.

The 'right markets' need to be marked by the following priorities: largeness of the rural/semi-urban market, low housing finance penetration, uniformity in the demographic pattern, growing incomes, high customer integrity, repayment hygiene and willingness to invest in a higher life quality.

Based on this reality, the company selected to be present in 11 States across North, Central and West India. Besides, a number of these states were contiguous, making it possible to generate economies of brand and goodwill.

Within these states, the Company created offices in Tier 2, 3 and 4 pockets where residents were largely untouched by the formal banking system.

The Company commenced operations through a presence in Rajasthan, Gujarat and Maharashtra in 2012. Thereafter, the Company consolidated its presence in these States before extending to new markets. The company expects to widen its footprint through an intensive approach where it extends to contiguous regions after a large potential of its existing catchment areas has been addressed.

Snapshot, 2020-21

- Added 30 new branches during the year under review
- Expanded the operations to 11 States
- E-disbursement and e-repayment facility at all branches

Number of branches

165
Number of branches, FY 2017-18

210
Number of branches, FY 2018-19

250
Number of branches, FY 2019-20

280
Number of branches, FY 2020-21

Principal markets, March 31, 2021

95
Rajasthan

39
Gujarat

40
Madhya Pradesh

44
Maharashtra

62
Rest*

**National Capital Region, Haryana, Punjab, Chattisgarh, Uttar Pradesh, Uttarakhand and Himachal Pradesh*

The company's strategic journey and direction

Grew presence in pockets untouched by housing finance for the undocumented

Focused on market marked by growing incomes and aspirations

Established branches at Tier 2, 3 and 4 pockets

Gradually increased our presence in 11 States and penetrate more

5 Controlling our yields, borrowing costs and spreads with discipline

Overview

At Aavas, we are driven by the need to generate a superior spread to swing through all business circles, making it possible for us to reinvest, widen our footprint deeper and service a larger number of customers.

During the last seven years, the company created a virtuous cycle: providing customers housing finance loans at an attractive cost, protecting its asset quality through high collection efficiency, generating a superior credit-rating, mobilizing fresh debt at a lower cost, passing a part of that benefit to customers and reaching out to a larger number of customers.

The result is evident in the numbers: the company's yield declined every year in line with cost of borrowing and opex efficiency ending 2020-21: from a high of 18.13% in 2013-14 to 13.16% in 2020-21. This indicates that the company contributed attractively to the traction for affordable housing finance loans across the markets of its presence.

This decline in yields (benefiting customers) was prompted by a strengthening Balance Sheet and corresponding credibility that made it possible for the company to mobilize larger debt quantities at progressively declining year-on-year costs (except for one year during an unprecedented liquidity crisis): from a weighted average debt cost of 12.28% in 2013-14 to 7.40% in 2020-21.

The outcome of a competent treasury function was consistency in spread management: 5.85% in 2013-14 to 5.76% in 2020-21 (declining only one year to below 5%).

This overarching reality indicates the willingness of the management to pass borrowing cost declines (12.28% in 2013-14 to 7.40% in 2020-21) to lower yields benefiting customers (18.13% in 2013-14 to 13.16% in 2020-21) while using the difference to build scale, moderate overheads and strengthened profitability.

Snapshot, 2020-21

- Yields declined from 13.63% as on March 31, 2020 to 13.16% as on March 31, 2021
- Cost of borrowings declined from 8.44% as on March 31, 2020 to 7.40% as on March 31, 2021
- Spread was 5.76% as on March 31, 2021
- Spreads strengthened 57 bps from March 31, 2020 to March 31, 2021
- Long-term credit rating upgradation

Yields

18.13
Percentage, 2013-14

13.99
Percentage, 2017-18

13.16
Percentage, 2020-21

Cost of borrowings

12.28
Percentage, 2013-14

8.63
Percentage, 2017-18

7.40
Percentage, 2020-21

The company's strategic journey and direction

Focus on generating a yield higher than market average

Generated a superior credit-rating

Yield declined, cost of borrowing moderated, spreads were protected

Mobilized larger debt without comprising book quality

6 Strengthening our long-term liquidity

Overview

As Aavas, we are convinced that in the business of affordable housing finance, it is not adequate to manage liquidity for the day or year; it is imperative to create a platform for multi-year liquidity.

This conviction has been born out of an experience that a number of successful non-banking finance companies suddenly experience a liquidity crisis that threatens all that they may have achieved over the years. Drawn from this learning, the Aavas management decided that it would create a comfortable multi-year asset-liability platform that would enhance the confidence of lenders (existing and prospective), broad-basing the lender family on the one hand and moderating borrowing costs on the other. We also do believe that a comfortable asset-liability profile strengthens shareholder value, opening up alternative financing possibilities should they ever need to be exercised.

The company strengthened its asset-liability profile through various strategies: diversified the funding mix (term loans, assignment, NHB refinancing and non-convertible debentures), broad-based the lender mix to 30 as on March 31, 2021 and consciously resisted the mobilization of commercial paper.

As a matter of prudence, the company did not select to nurse a negative asset-liability mismatch as it would have increased the pressure on the company to mobilize additional borrowings at a later date, threatening prospective spreads. The existence of a positive asset-liability mismatch sent out a strong message of structural long-term financing stability, attracting additional stakeholders and enhancing sectorial respect. Besides, the company consistently maintained the positive asset-liability mismatch starting from less than three months to less than six months to every single year across the coming decade. The result is that the company intends to stay comfortably liquid every single year across the next ten years, its liquidity rising sharply around the third year onwards.

Besides, the Company was adequately capitalized at 54.38% capital adequacy ratio (as on March 31, 2021), far above the minimum required level of 14% stipulated by the RBI.

The company ended the financial year under review with a total liquidity position of ₹2,836 crore (cash, cash equivalents, unavailed CC limits, documented and unavailed sections from other banks) compared with ₹2,532 crore as on March 31, 2020.

We believe that this long-term surplus provides the company with adequate funds to grow the business in a sustainable manner.

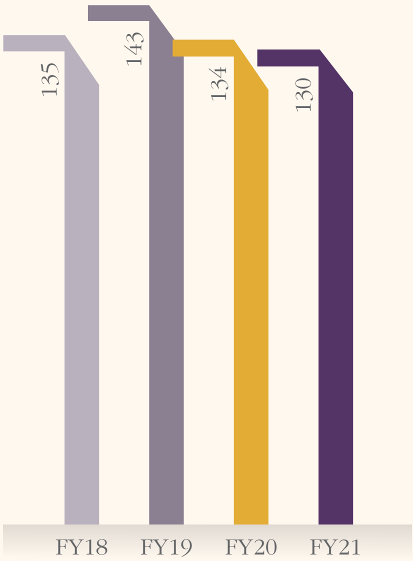
Snapshot, 2020-21

- Additional borrowing of ₹2,901 crore for 117 months at 6.6%
- Total number of lenders was 30 on March 31, 2021
- The company generated a surplus of ₹950.4 crore (difference between assets and liabilities as at year-end)
- Total liquidity position was ₹2,836 crore at the year-end

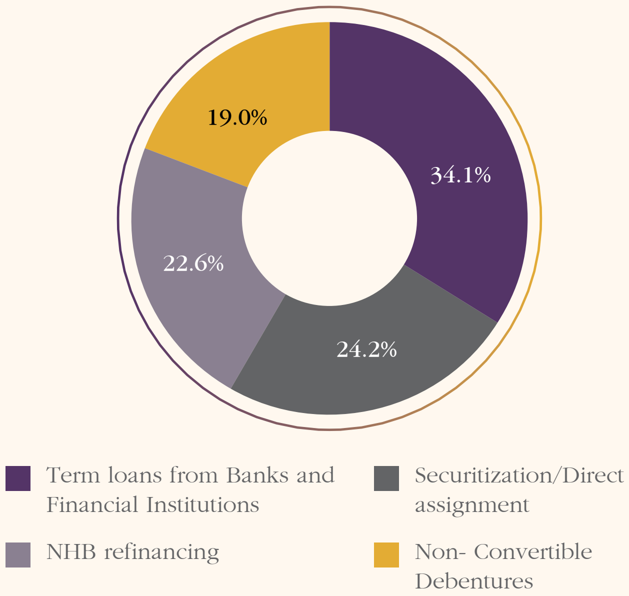
The company's strategic journey and direction

- Strengthened multi-year liquidity
- Diversified the funding mix
- Broad-based the lender mix
- Maintained a fixed-floating rate consistency
- Achieved positive asset-liability mismatch
- Enhancing sectorial respect

Average tenure of outstanding borrowings (months)



Our diversified funding mix, March 31, 2021



7 Controlling overheads, net interest margins and maximizing capital returns

Overview

At Aavas, we believe that for a business that is people-intensive and spread across locations, there is a priority in cost management with the objective to protect profitability and amortize costs more effectively when the company grows.

During the building phase of its existence, Aavas was required to invest upfront in infrastructure and technologies. Since returns from these investments could not be immediately monetized, the company's focused cost structure was relatively high in the first few years when compared with its larger competitors.

During the last few years, the company began to leverage superior value from its technology investments, generating a larger quantum and proportion of customers from the digital medium. The result is that as customer acquisition costs declined, the overall operating expenditure moderated.

Snapshot, FY 2020-21

- Opex to average total assets stood at 3.01% for FY 2020-21
- Return on assets (RoA) stood at 3.49% for FY 2020-21
- Return on equity (RoE) stood at 12.91% for FY 2020-21