Re-initiating Coverage

SBI Cards and Payment Services Ltd.

March 21, 2022

SBI Cards and Payment Services Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
NBFC-Financial	Rs.854.2	Buy between Rs.850-860 & add more on dips of Rs.745	Rs.931	Rs.993	2 quarters

HDFC Scrip Code	SBICARD
BSE Code	543066
NSE Code	SBICARD
Bloomberg	SBICARD
CMP Mar 17, 2022	854.2
Equity Capital (Rs mn)	9,405
Face Value (Rs)	10
Equity Share O/S (mn)	943
Market Cap (Rs bn)	805.6
Book Value (Rs)	78
Avg. 52 Wk Volumes (mn)	2764961
52 Week High	1,164.7
52 Week Low	712.4

Share holding Pattern % (Dec, 2021)	
Promoters	69.5
Institutions	22.2
Non Institutions	8.3
Total	100.0

HDFCsec Retail research stock rating meter

for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings

Fundamental Research Analyst
Nisha Sankhala
Nishaben.shankhala@hdfcsec.com

Our Take:

SBI Cards and Payment Services Ltd. (SBIC) is the second largest and only listed credit card issuer company in India. SBIC is a unique franchise of generating high return ratios as it has developed smart customer acquisition strategy, balanced revenue mix and stringent risk management practices. Even during the times of Covid led slowdown, the performance of the company did not deteriorate that much despite being in the business of unsecured lending. SBIC derives significant financial, managerial and branding support from SBI – its parent company. Recent improvement in overall business momentum gives us the confidence that the recovery in the economy and credit demand has started. Spends should improve from hereon as the travel and entertainment related high margin segments could get back on track. The increasing share of revolve in the loan mix with improving spends traction is likely to drive the per card profitability for SBIC.

Improvement in payment, changing consumer behavior and favorable Indian demographics provides huge opportunity for growth of highly underpenetrated credit card market. However credit card players like SBIC are prone to some of the longer-term category disruption risks from UPI, BNPL, and potential regulations on Merchant Discounting Rate (MDR) cap.

We had issued Initiating Coverage report on SBI Cards and Payment Services Ltd. on 23rd September, 2020 and recommended Buy on dips to Rs.683-687 band and add further on dips to Rs.637-641 band, for base case target of Rs.721 and bull case target of Rs.797 over the next two quarters.

Link for the Initiating Coverage:
https://www.hdfcsec.com/hsl.docs/SBI%20Cards-%20Initiating%20Coverage-23092020-202009231023023648711.pdf

Valuation & Recommendation:

Recent quarterly numbers of the company shows sign of business momentum returning back. We have envisaged 25% CAGR for total revenue and 45% CAGR for Adjusted Net Profit over FY21-24E. NII is estimated to grow at 24% CAGR over same time fame. The company has delivered superior returns over past few years. The average of RoAA and RoAE in past seven years stood at 4.4% and 28% respectively. We expect SBIC to deliver ~6.2%/28% RoAA/RoAE by FY24E led by strong growth in CIF (Cards In force) / spends and steady unit economics. Recent price correction offers excellent opportunity to enter quality high growth stocks like SBIC. Currently, the company is trading at 26.6x FY24E EPS and 6.9x FY24E ABV (vs average 7.2x since listing). The consumer finance segment should be among the fastest to return to growth and profitability as the economy improves and operating conditions normalise. **We feel that investors can BUY SBIC between Rs.850-860 band (26.6xFY24E EPS, 6.9xFY24E ABV) and add further on dips to Rs.745 band (23.2xFY24E EPS, 6.0xFY24E ABV) for the Base case target of Rs.931 (29xFY24E EPS, 7.5xFY24E ABV) and Bull Case target of Rs.993 (30.9xFY24E EPS, 8.0xFY24E ABV) over period of six months.**

Financial Summary (Rs.bn)

	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	FY21	FY22E	FY23E	FY24E
NII	10.0	9.1	9.9	9.2	8.4	38.8	39.9	55.3	73.7
Total income	28.6	22.8	25.4	24.4	17.2	86. 7	104.3	133.4	168.0
PPOP	11.4	9.3	22.9	10.6	8.1	39.6	43.9	54.8	70.3
PAT	3.9	2.1	84.0	3.4	11.9	9.8	15.0	22.8	30.2
EPS (Rs.)	4.1	2.2	84.2	3.6	12.1	10.5	16.0	24.2	32.1
ROAE (%)						16.9%	21.7%	26.6%	28.0%
ROAA (%)						4.0%	4.9%	5.9%	6.2%
ABVPS						64.2	78.0	97.7	124.1
P/ABV(x)						13.3	11.0	8.7	6.9
P/E (x)						81.5	53.4	35.3	26.6

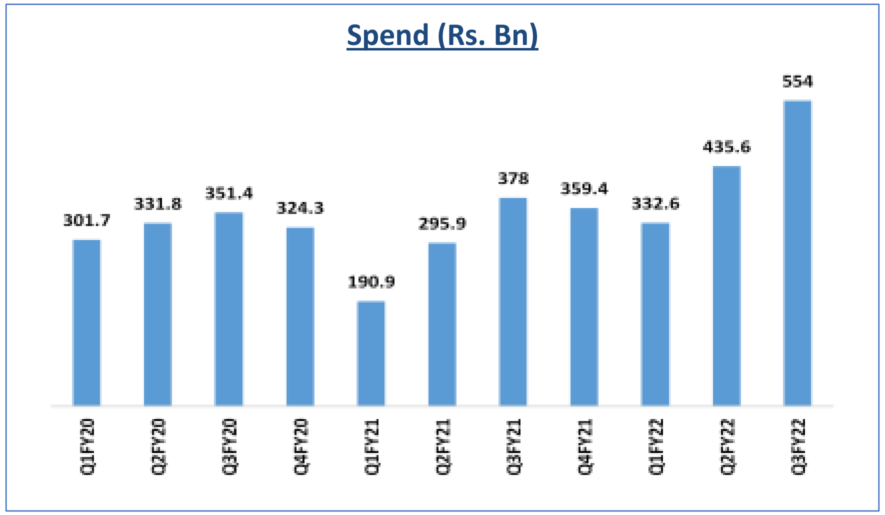
(Source: Company, HDFC sec)

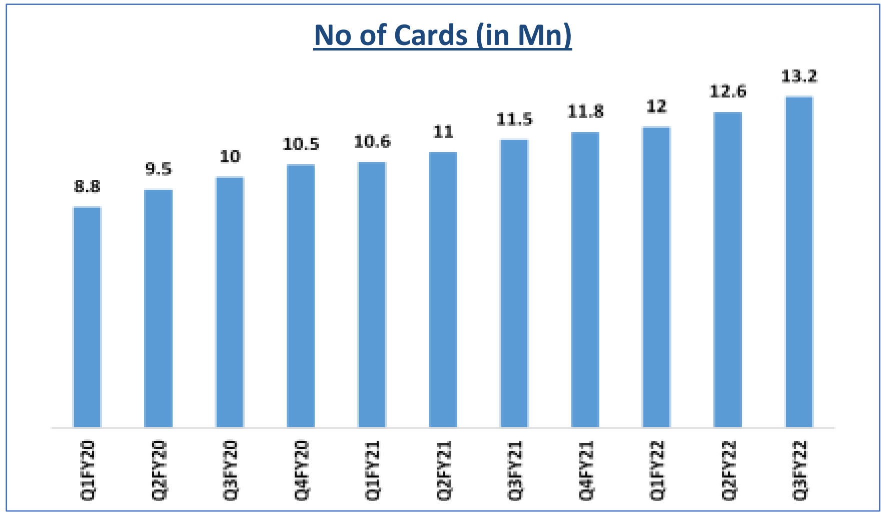
Q3FY22 Result Update

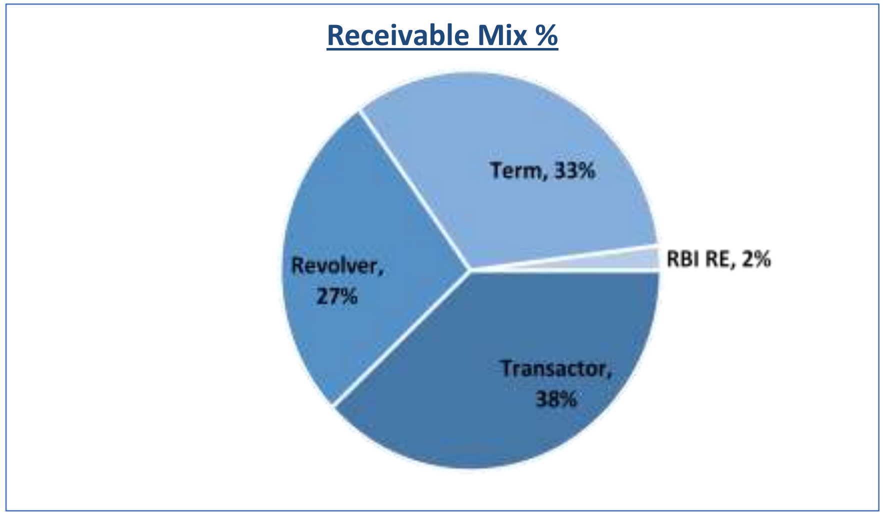
The company has reported further recovery in the overall business in Q3FY22. NII growth during the quarter came at 10% YoY and 8.4% QoQ while total revenue of the company grew by 25% YoY. SBIC reported healthy PPOP growth of 23% YoY on the back of strong other income (+36% YoY). High opex (+28% YoY) was driven by higher account additions, marketing campaigns, and tech investments to scale up and further digitise the customer acquisition engine. Cost to income ratio came at 60%, up 90bps. The company has reported net earnings growth of 84% YoY and 12% QoQ. Net Interest Margin for the quarter remained slightly under pressure at 14%, down 49 bps YoY.

Business gains momentum

There has been a strong improvement in spends both in retail and corporate category. During the quarter, total spend grew by 47% YoY. Retail category reported growth of 36%, while corporate category was resilient at 93% YoY growth. Online spends contributed ~54% of the total retail spend. This solid recovery in spend has room for further improvement as the high margin category like travel & entertainment have still not reached normalized levels. Overseas travel is way below the normal level. Card-in-force grew by 15% YoY to 13.2 mn. New accounts volume stood at 1,008k for Q3FY22 up by 10% as compared to 918k for Q3FY21. Receivables grew by 13% and revolve book stood at 27% of receivables. This is much lower than pre-Covid levels of ~40%. The increasing share of revolve in the loan mix with improving spends traction is likely to drive the per card profitability for SBI Cards. During the quarter SBIC partnered with Paytm for tokenisation.







Asset Quality

GNPA declined by ~50 bps QoQ to 3.4% and NNPA remained stable at 0.9% QoQ. Net credit costs clocked in at 7.1%, led by accelerated write-offs and prudent management overlay (110bps); they are likely to subside further with a receding stress pool. RBI RE book at 2% is down from 4% in Q2FY22. Provision coverage declined ~400 bps QoQ at 74% due to write-offs. No impact of the recent RBI circular on daily NPL recognition and upgrade was felt as SBI cards was already following this. GNPA ratio has been gradually moderating, and the management expects this trend to continue in coming quarters.

Healthy capitalization

The company has a healthy capital adequacy ratio at 24.2% with Tier 1 at 21.3% against the regulatory requirement of 15%. The company has been assigned highest ratings by the rating agencies, which helps it borrow money at lower cost (CoF at 5.45% in Q3FY22). Raising capital is less of an issue for the company as it could get financial support from the parent company if need be. Asset-liability management (ALM) profile had cumulative positive mismatch in all the buckets of up to one year because of the short tenure of assets. The company has Rs.64.6 bn of sanctioned bank lines unutilized and available for draw down as at Dec-21.

Long-term triggers

Un-paralleled support from parent company

SBIC hosts the credit card business of the parent. Credit card being one of the important product in the bank’s product offering, SBIC gets strategically important status from SBI. SBI is itself engaged in cross selling credit cards as one of the value products. Having one of the largest bank of the country as a parent company is the biggest advantage for SBIC. The company benefits from its parentage on both sides of the balance sheet. As mentioned in above point, the company has get liquidity support as well as high credit rating (mostly due to its SBI parentage) gives access to low cost borrowing. On the assets side, SBI’s massive retail assets pool serves as a potential customer base for SBI Cards. The sourcing fee paid to SBI is substantially lower than the sourcing costs from Open Market channels. Besides this, the company also has other numerous advantages like managerial advice, branding etc.

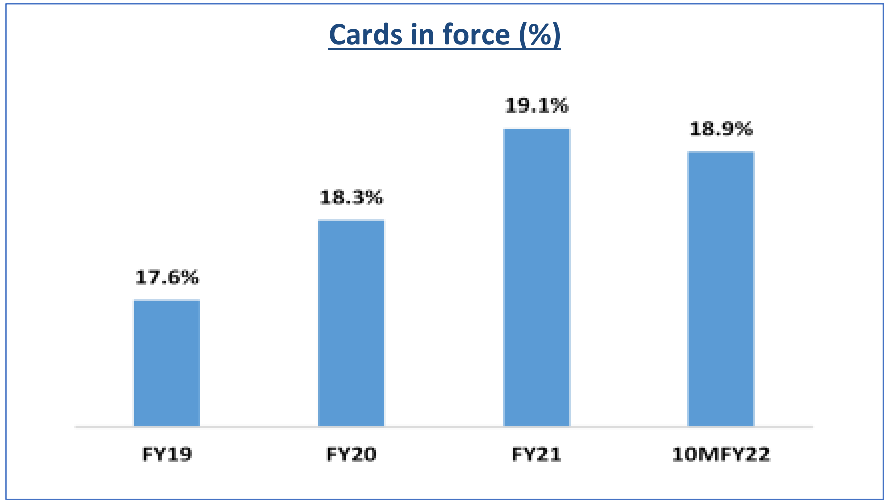
India’s under penetrated market provides huge opportunity of growth

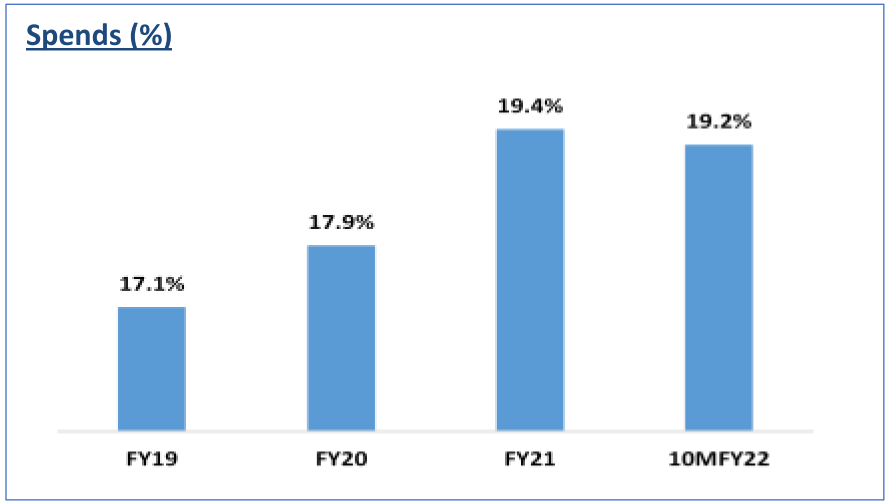
There has been a healthy growth in Indian credit card industry in past few years still India is a highly under penetrated market, with average card ownership per 100 people being 4, compared to 105 in Brazil, 26 in Russia, 53 in China, 79 in Australia, 92 in UK and 331 in USA (Source: BIS Data). This represents a huge potential to increase credit card penetration in India. Improvement in payment infrastructure (POS and BQR terminals has seen over 2.5X growth in last 3 years) and change in consumer behavior like preference for digitization in payments, credit acceptance, shopping via e-commerce mode etc. are the key structural changes that should help the credit card industry grow at a robust pace. India has favorable demographics with huge young population, rising per capita income, rapid urbanization etc. that could also support the growth. Moreover, Indian credit card industry is highly concentrated. Top four issuers have almost 75% of market share in terms of cards in force and spends. SBIC being a pure credit card issuer company and 2nd largest player is in a sweet spot to garner opportunities lying ahead. The credit card sector also has major entry barriers including high upfront investments, high customer acquisition cost, and a large customer base to achieve economies of scale, apart from regulatory restrictions for non-banks from issuing credit cards.

SBI Cards: a unique franchise

SBIC is the second largest and only listed credit card issuer company in India. The company has emerged as a formidable, superior-quality, high-growth franchise with deep moats around customer acquisition and risk management, as well as tailwinds from credit card ecosystem's expansion. The company has delivered superior returns over past few years. The average of RoAA and RoAE in past seven years stood at 4.4% and 28% respectively. Investment in SBIC is a pure play on India's low penetrated fast growing credit card business.

Market Share:





Customer acquisition strategy

The company has built customer acquisition strategy in such a way that it brings superior profitability while maintaining credit risk. There are two main source of customer acquisition: 1) Open Market and 2) Banca customers.

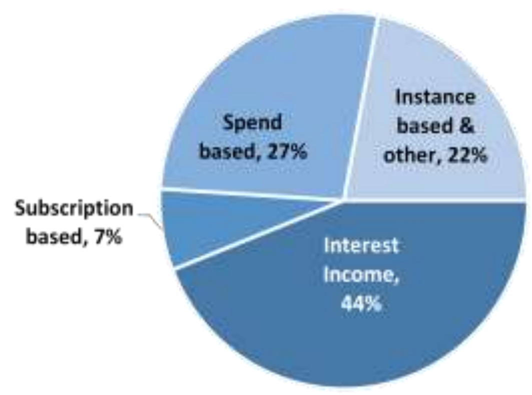
Customers acquired through the Open Market channel have higher acquisition costs (and higher attrition rate as well) when compared to those acquired through the Banca route. In comparison to Banca clients, they are typically carded customers with higher per card spends, higher revolve rates, and thus higher credit costs. While Open Market customers have higher per card profitability due to higher spends and balances, Banca customers have a superior RoA due to a higher proportion of fee income and lesser contribution of interest income (due to lower balances).

Open market channel contribute 49% to the total sourcing in the quarter (~57% on an outstanding basis).

Balanced revenue mix

SBIC's revenue mix is almost equally divided between fee based income and interest income. There are multiple streams of fee income such as spends-based fees, subscription fees, instance-based fees, service charges and business development incentive income. This brings stability in the company's revenue as fee based income is less susceptible to market fluctuations, such as interest rate volatility etc.

Revenue composition as of Q3FY22 (%)



Digital infrastructure

Technology is the core competency for the company. It has been constantly investing in upgrading and on boarding new technologies. This has helped in creating create a state-of-the art technology infrastructure, both at the back end and front end. SBIC has introduced a round-the clock self-service facility, accessible through websites, mobile apps, chatbot, messaging platforms such as WhatsApp, among others. Recently, it has also launched Video KYC to ensure zero contact, hassle-free customer onboarding. The core technology systems enabled the company build scalable peripheral applications for online customer acquisition, servicing, customer relationship management, fraud management and credit risk applications. SBI Card Private Cloud is a private cloud service facilitating secure remote operations across verticals. Integration with YONO Mobile app has increased digital sourcing.

Risks & Concerns:

- Any adverse change of regulation might impact the business growth of the company.
- The company's operations significantly depend on IT systems. So any disruptive new development in the field or system failure could impact the business. Also any data leakage or security breach of data of customers might damage the reputation and be costly for the company.
- Longer than expected slowdown in economy can hit consumer spending levels and asset quality for the company.
- The company has strong dependence on the parent company. The arrangement with its promoter is not exclusive. So if SBI enters into any similar or competing relationships with third parties, it can significantly impact the business growth.
- Rising competition from not only other credit cards issuers (i.e. other banks) but also other payment solution providers (such as UPI, e-wallets, etc.) cab ne a concern. UPI's market share in digital payments has risen sharply and turned out to be a challenge to the credit-card business.
- Any cap on interest rates or merchant discounting rates proposed by the regulator in future could impact earnings severely. Indian regulations do not impose any limit on interest rates charged to cardholders. The discussion paper from the RBI is still awaited on MDR. However, regulations could change and a cap could be placed on interest rates or MDR (Merchant Discount Rate) charges in future.
- The largest issuer of credit cards in India is now allowed by the RBI to issue new cards. The embargo was enforced in December 2020 and was lifted in August 2021. It is now going aggressive to recapture the lost market share.
- Rising competition from existing and new Banks/Fintech players is another concern.

Company Background:

SBI Cards and Payment Services Limited (SBIC) is a non-banking financial company that offers extensive credit card portfolio to individual cardholders and corporate clients which includes lifestyle, rewards, travel & fuel and banking partnerships cards along with corporate cards covering all major cardholders' segments in terms of income profile and lifestyle. The brand has a wide base of over 13 mn cards in force as of Q3FY22. It has diversified customer acquisition network that enables to engage prospective customers across multiple channels. As of Dec-21, SBIC's Market share on the basis of Cards in force is at 19.2% and on the basis of Spends is at 19%. SBIC's income arises primarily from charging interest (on carried forward loans and EMIs) and related fees on using credit-based solutions.

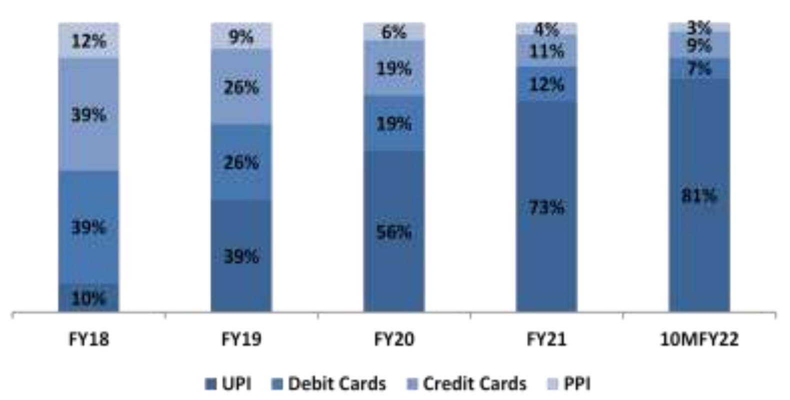
SBIC started its operations in 1998 as a JV between SBI and GE Capital. GE Capital's ownership stake in SBIC was acquired by SBI and the Carlyle Group in 2017. Effective from April 1, 2018, SBI Business Process and Management Services Pvt. Ltd (SBIBPMSL), an entity that provided back-end payment and processing services to SBIC, was merged into SBIC. On March-20 the company got itself listed on exchanges. Currently, SBI owns 69.2% stake in the company.

Industry Overview (10MFY22):

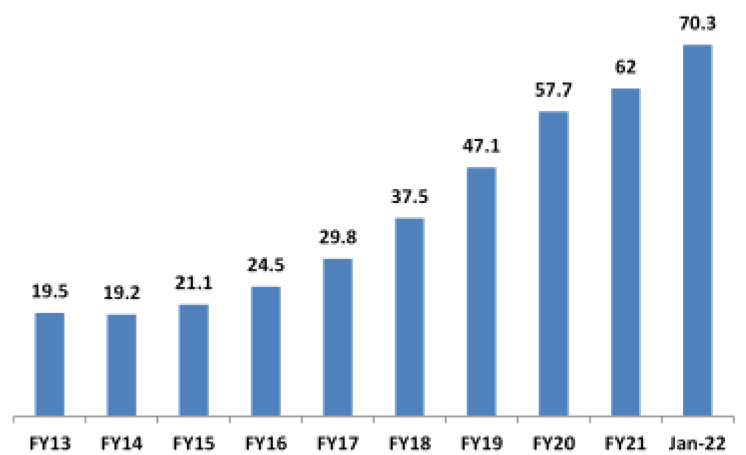
	Cards-in-Force (mn)	Spends (Rs bn)	Net Card Additions ('000s)	Market share (CIF)	Market share (Spends)
HDFC Bank	16.0	2062	1060	22.8%	26.3%
SBI Cards	13.3	1500	1491	18.9%	19.2%
ICICI Bank	12.6	1570	2011	17.9%	20.1%
Axis Bank	8.4	664	1208	11.9%	8.5%
Credit Card Industry	**70.3**	**7839**	**8203**		

(Source: RBI, HDFC sec)

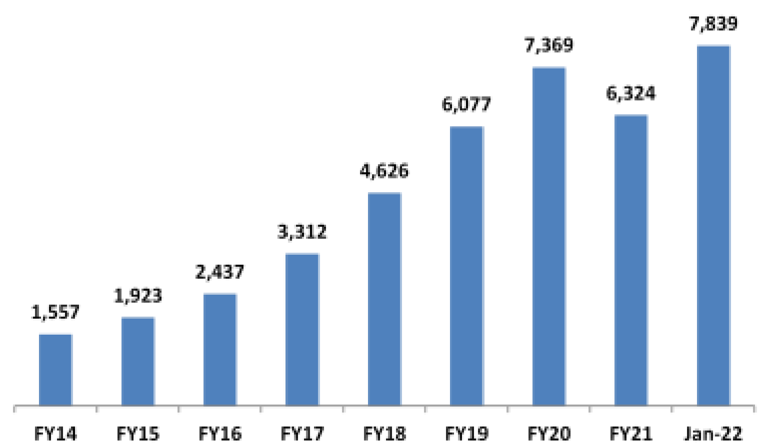
Digital payments market share



Credit Cards o/s (Nos in mn)



Credit Cards Spends (Rs.bn)



Outstanding credit cards

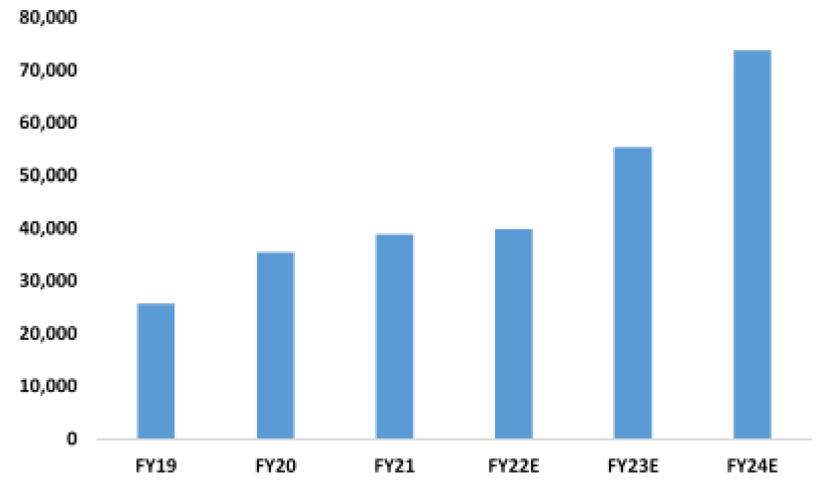
O/s Cards (in mn)	FY20	FY21	FY22YTD	Jul-21	Aug-21	Sep-21	Oct-21	Nov-21	Dec-21	Jan-22
HDFCB	14.5	15	16	14.8	14.7	15	15.2	15.5	15.8	16
SBICARD	10.5	11.8	13.3	12.2	12.4	12.6	12.8	13	13.2	13.3
ICICIBC	9.1	10.6	12.6	11.2	11.5	11.7	12	12.1	12.4	12.6
AXSB	7	7.1	8.4	7.2	7.3	7.5	7.7	7.9	8.1	8.4
CITI	2.8	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6
RBK	2.7	3	3.6	3.1	3	3.1	3.2	3.4	3.5	3.6
KMB	2.3	2.4	2.9	2.4	2.4	2.4	2.5	2.6	2.7	2.9
AMEX	1.7	1.5	1.4	1.5	1.5	1.4	1.4	1.4	1.4	1.4
SCB	1.5	1.5	1.3	1.4	1.4	1.4	1.4	1.4	1.4	1.3
IIB	1.4	1.5	1.8	1.6	1.6	1.7	1.7	1.7	1.8	1.8
Total industry	**57.7**	**62**	**70.3**	**63.4**	**63.9**	**65**	**66.4**	**67.6**	**68.9**	**70.3**

Credit Card spends

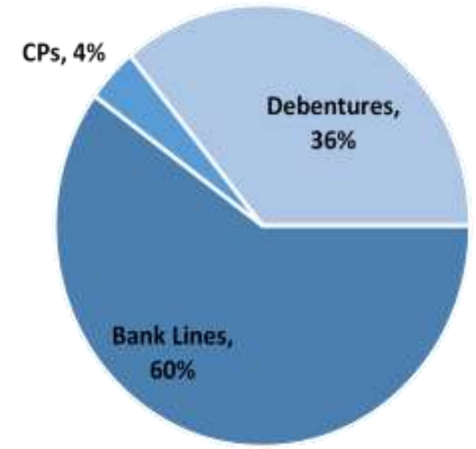
(in Rs bn)	FY20	FY21	FY22YTD	Jul-21	Aug-21	Sep-21	Oct-21	Nov-21	Dec-21	Jan-22
HDFCB	2122.8	1956.3	2062.4	208.9	206.5	202.2	265.9	230.6	236.9	218.1
SBICARD	1314.5	1227.9	1500.7	143.7	145.8	147	190.9	177.5	186.5	175.9
ICICIBC	900.6	923.3	1570.7	143.6	152.7	172.7	216.4	178.7	198.9	188.7
AXSB	768.3	530	664.1	61.7	68.5	67.8	92.2	73.2	76	76.8
CITI	525.6	368.2	360.3	36.3	38.5	37	43.4	41.1	40.8	36.3
RBK	295.4	296	352.4	34.6	34.8	34.5	41.8	38.6	41.6	40.5
KMB	198.9	160.7	202.7	18.5	20.5	26.1	25.7	23	23.4	23.5
AMEX	534.7	233	235	22.4	25.1	25.4	29.9	27.4	28.2	22.3
SCB	107.1	95.9	102.8	10.6	10.7	10.5	11.4	11.4	11.5	10.4
IIB	301.6	260.5	360.6	33.3	36.6	41.5	48.1	47.5	47	37.8
Total	**7369.5**	**6324.4**	**7839**	**751.2**	**779.8**	**804.8**	**1012.3**	**894.9**	**942**	**880.4**

(Source: RBI, HDFC sec)

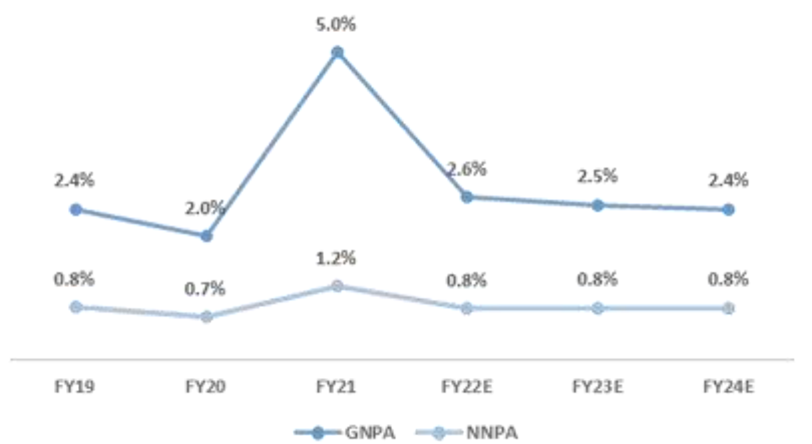
Estimated ~24% CAGR in NII (Rs. mn) between FY21-24E



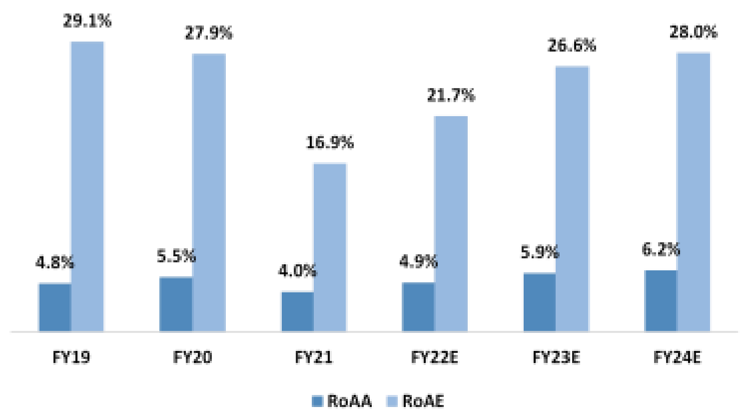
Borrowing Mix (%)



Asset Quality Trend (%)



Return Ratios (%)



Financials

Income Statement

(Rs mn)	FY20	FY21	FY22E	FY23E	FY24E
Interest earned	48,413	49,277	52,018	72,054	95,022
Interest expended	13,009	10,434	12,153	16,726	21,334
Net interest income	**35,404**	**38,843**	**39,864**	**55,328**	**73,688**
Other income	49,110	47,854	64,463	78,027	94,358
Total income	84,514	86,697	1,04,328	1,33,355	1,68,046
Operating expenditure	47,815	47,079	60,379	78,583	97,770
Pre-provisioning operating profit	**36,699**	**39,618**	**43,949**	**54,772**	**70,276**
Non-tax provisions	19,402	26,386	23,836	24,356	29,876
Profit before tax	17,296	13,232	20,112	30,416	40,399
Tax expenditure	4,848	3,392	5,068	7,665	10,181
Profit after tax	**12,448**	**9,840**	**15,044**	**22,751**	**30,219**

Balance Sheet

(Rs mn)	FY20	FY21	FY22E	FY23E	FY24E
Share capital	9,390	9,405	9,405	9,405	9,405
Reserves and surplus	44,023	53,615	66,402	85,741	1,11,427
Net worth	53,412	63,020	75,808	95,146	1,20,832
Borrowings	1,73,649	1,80,680	2,32,996	3,00,763	3,75,790
Other liabilities and provisions	25,966	26,428	31,274	39,669	49,971
Total equity and liabilities	**2,53,028**	**2,70,129**	**3,40,078**	**4,35,578**	**5,46,594**
Cash and cash equivalents	6,760	7,181	4,725	8,558	14,245
Investments	15	9,576	9,959	10,457	11,084
Advances	2,28,116	2,34,591	3,01,222	3,86,557	4,86,637
Fixed assets	3,346	3,182	3,659	4,208	4,839
Other assets	14,791	15,599	20,513	25,799	29,789
Total assets	**2,53,028**	**2,70,129**	**3,40,078**	**4,35,578**	**5,46,594**

(Source: Company, HDFC sec)

Key Ratio

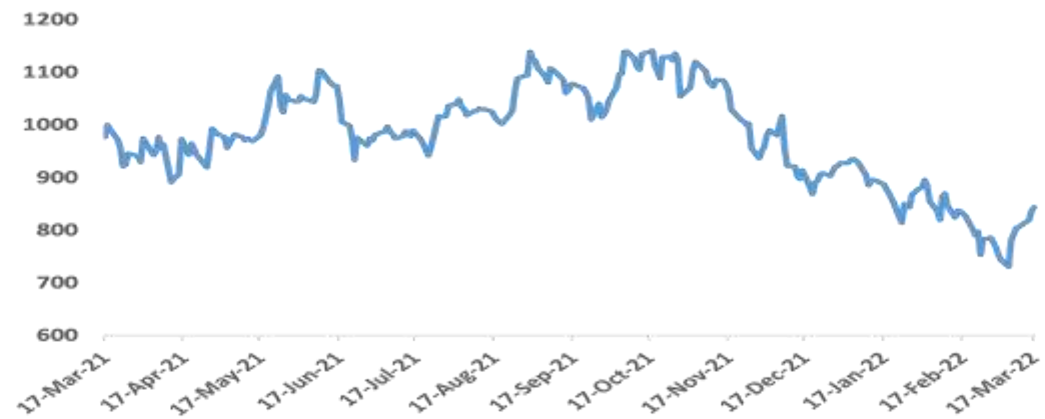
	FY20	FY21	FY22E	FY23E	FY24E
Valuation metrics					
EPS	14.9	10.5	16.0	24.2	32.1
BVPS	64	67	81	101.2	128.5
ABVPS	62	64	78	97.7	124.1
RoAA	5.5%	4.0%	4.9%	5.9%	6.2%
RoAE	27.9%	16.9%	21.7%	26.62%	27.98%
P/E	57.4	81.5	53.4	35.3	26.6
P/ABV	13.8	13.3	11.0	8.74	6.88
Profitability ratios					
Yield on advances	22.7%	20.0%	18.4%	20.1%	20.9%
Cost of funds	8.4%	5.9%	5.9%	6.3%	6.3%
Core spread	14.3%	14.1%	12.5%	13.8%	14.6%
Net interest margin	16.9%	16.1%	14.1%	15.3%	16.1%
Operating efficiency ratios					
Cost-average assets	21.0%	18.0%	19.8%	20.3%	19.9%
Cost-income	56.6%	54.3%	57.9%	58.9%	58.2%

(Source: Company, HDFC sec)

Key Ratio

	FY20	FY21	FY22E	FY23E	FY24E
Balance sheet structure ratios					
Loan growth	27.4%	2.8%	28.4%	28.3%	25.9%
AUM growth	27.4%	2.8%	28.4%	28.3%	25.9%
Borrowing growth	28.2%	4.0%	29.0%	29.1%	24.9%
Debt/Equity (x)	3.3	2.9	3.1	3.2	3.1
CRAR	22.4%	24.8%	22.8%	21.6%	21.1%
Tier 1	17.7%	20.9%	19.8%	19.3%	19.4%
Asset quality metrics					
Gross NPAs	4,844	12,543	8,298	10,091	12,361
Net NPAs	1,588	2,776	2,489	3,229	4,079
GNPA %	2.0%	5.0%	2.6%	2.5%	2.4%
NNPA %	0.7%	1.2%	0.8%	0.8%	0.8%
PCR	67.2%	77.9%	70.0%	68.0%	67.0%
Provisioning as % of AUM	9.5%	11.4%	8.9%	7.1%	6.8%

One Year Price Chart



HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

HDFC securities Limited, I Think Techno Campus, Building - B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Phone: (022) 3075 3400 Fax: (022) 2496 5066

Compliance Officer: Binkle R. Oza Email: complianceofficer@hdfcsec.com Phone: (022) 3045 3600

HDFC Securities Limited, SEBI Reg. No.: NSE, BSE, MSEI, MCX: INZ000186937; AMFI Reg. No. ARN: 13549; PFRDA Reg. No. POP: 11092018; IRDA Corporate Agent License No.: CA0062; SEBI Research Analyst Reg. No.: INH000002475; SEBI Investment Adviser Reg. No.: INA000011538; CIN - U67120MH2000PLC152193