22 October 2020

SBI Cards and Payment Services

Rating: **BUY**

Target Price: ₹985

Share Price: ₹853

Q2 FY21: Exponential rise in provisions; more clarity on re-structuring; spends increase; Buy

On an 86% rise in provisions, SBI Cards' H1 FY21 net profit slid 17% y/y. Its asset quality deteriorated; GNPA was 4.3% but it offered customers the RBI's and its own restructuring scheme. Spends in Q2 FY21 averaged Rs99bn/month (Rs111bn/month a year ago, Rs64bn the quarter prior) and inching toward pre-Covid levels.

Further provisions dent profitability; credit costs rise. H1 FY21 net profit slid 17% y/y on an 86% rise in provisions, incl. an additional provision of Rs2.7bn. Together with Rs4.9bn in Q4 FY20, additional provisions totalled Rs7.6bn. Credit costs were 12.2% at end-H1 FY21. We maintain 12.4% credit costs for FY21 but increase to 9%/8.5% for FY22/23.

NII strong, fee income fell. NII grew 35% y/y in H1 FY21 owing to a 22% rise in interest income and a 13% drop in interest costs. Net operating income grew a meagre 3% y/y primarily on an 18% slide in non-interest income (a 13% drop in fee income). The fee income decline stemmed chiefly from an 11% y/y contraction in credit-card spends (Rs296bn vs Rs333bn) due to Covid-19. Operating expenses slipped 12% y/y with the focus on lowering employee and other operating expenses.

Clarity on restructuring scheme; NPAs to inch up: The RBI restructuring book totalled Rs21bn and the in-house EPP plan was Rs1.6bn in Q2 FY21. The company is seeing traction in repayments under the RBI restructuring scheme (RBI RE). Moreover, it has made provisions for both, the RBI RE and standstill accounts. GNPAs were 4.3% (7.5% proforma) vs 2.3% a year ago. We have raised our GNPA estimates to 5.5%/4.8%/3.6% for FY21/22/23.

Lowering profit estimates, maintaining a 'Buy'. We lower our target to Rs985 (earlier Rs1,021), and retain our Buy rating, valuing the stock at 50x FY22e earnings. Key risks: Cap on interest rates, higher-than-anticipated delinquencies and any alteration in the association with the promoter.

Key financials (YE Mar)	FY19	FY20	FY21e	FY22e	FY23e
Net interest income (m)	25,664	35,404	40,304	43,542	54,000
Pre-provisioning profit (Rsm)	24,828	36,699	41,957	47,459	57,331
Provisions (Rsm)	11,477	19,402	27,829	22,499	26,486
PAT (Rsm)	8,650	12,448	10,568	18,670	23,072
EPS (Rs)	9.5	13.2	11.2	19.7	24.3
NIM (%)	15.2	16.6	16.9	16.1	16.1
Cost-Income (%)	60.4	56.6	51.2	53.0	54.2
RoE (%)	29.1	27.9	18.2	26.2	25.5
RoA (%)	4.8	5.5	4.1	6.4	6.4
GNPA (%)	2.4	2.0	5.5	4.8	3.6

Source: Company, Anand Rathi Research

Key data	SBICARD IN
52-week high / low	Rs919 / 495
Sensex / Nifty	40558 / 11896
3-m average volume	$22.5m
Market cap	Rs801bn / $10888.3m
Shares outstanding	940m

Shareholding pattern (%)	Sep'20	June'20	Mar'20
Promoters	69.5	69.5	69.6
- of which, Pledged	-	-	-
Free Float	30.5	30.5	30.4
- Foreign Institutions	5.9	4.2	4.2
- Domestic Institutions	3.2	3.3	3.3
- Public	21.4	23.0	22.9

Estimates revision (%)	FY21	FY12	FY13
NII	6.2	4.3	4.1
Net Profit	0.8	-3.5	-3.7
EPS	0.8	-3.5	-3.7

Relative price performance

Source: Bloomberg

Mohit Mangal
Research Analyst
+9122 6626 6732
mohitmangal@rathi.com

Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rsm)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Interest income	35,757	48,413	52,727	57,474	71,368
Interest expenses	10,094	13,009	12,423	13,932	17,367
NII	**25,664**	**35,404**	**40,304**	**43,542**	**54,000**
y/y growth	*25%*	*38%*	*14%*	*8%*	*24%*
Non -interest income	37,111	49,110	45,646	57,424	71,291
Fee income	*30,720*	*39,787*	*36,403*	*47,455*	*59,366*
Net Operating income	**62,775**	**84,514**	**85,950**	**100,966**	**125,291**
Operating expenses	37,947	47,815	43,993	53,507	67,960
PPOP	**24,828**	**36,699**	**41,957**	**47,459**	**57,331**
y/y growth	*44%*	*48%*	*14%*	*13%*	*21%*
Prov. and conting.	11,477	19,402	27,829	22,499	26,486
PBT	13,351	17,296	14,128	24,959	30,845
Tax	4,701	4,848	3,560	6,290	7,773
Tax rate	35%	28%	25%	25%	25%
PAT	8,650	12,448	10,568	18,670	23,072

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (Rsm)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Cash and bank balances	7,768	6,760	14,764	15,677	17,625
Loans	**179,087**	**228,116**	**220,622**	**279,150**	**344,151**
Property plant and equip.	1,316	639	788	1,035	1,422
Capital work in progress	43	112	289	466	664
Intangible assets	804	903	879	1,289	1,984
Right-of-use Assets	0	1,693	1,386	1,464	1,715
Total Assets	**201,461**	**253,028**	**257,802**	**324,073**	**400,118**
Payables	6,651	7,288	7,264	9,467	11,880
Debt Securities	**40,793**	**56,854**	**55,348**	**70,488**	**87,464**
Borrowings	**82,733**	**104,328**	**101,563**	**129,345**	**160,497**
Subordinated Liabilities	**11,968**	**12,467**	**12,136**	**15,456**	**19,179**
Provisions	6,284	6,026	6,328	6,644	6,976
Total Liabilities	**165,584**	**199,616**	**195,070**	**244,079**	**298,930**
Equity	**35,878**	**53,412**	**62,732**	**79,994**	**101,189**
Total Liab. and Equity	**201,462**	**253,028**	**257,802**	**324,073**	**400,118**

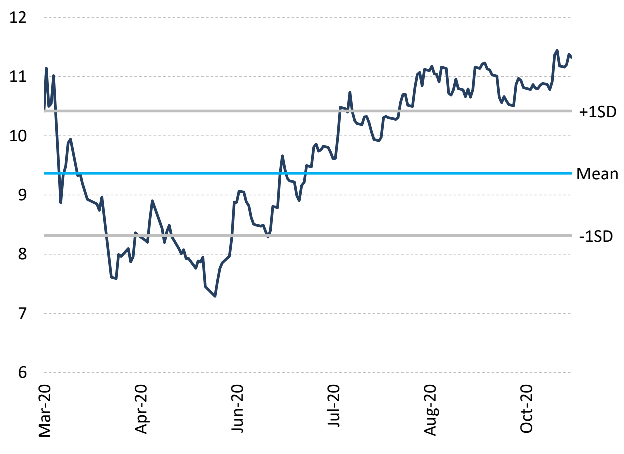
Source: Company, Anand Rathi Research

Fig 3 – Ratio analysis %

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
NII/ total inc.	40.9	41.9	46.9	43.1	43.1
Other inc. / total inc.	59.1	58.1	53.1	56.9	56.9
Cost-income	60.4	56.6	51.2	53.0	54.2
Provision coverage	66.5	67.2	65.9	68.1	70.6
Dividend payout	10.6	7.6	9.0	7.6	8.2
Credit-borrowing	132.2	131.4	130.5	129.7	128.8
Investment-borrowing	0.01	0.01	0.01	0.01	0.01
Gross NPA	2.4	2.0	5.5	4.8	3.6
Net NPA	0.8	0.7	2.0	1.6	1.1
BV (`)	39.2	56.7	66.2	84.4	106.8
Adj. BV (`)	37.6	55.0	61.6	79.7	102.8
CAR	20.0	22.4	23.6	23.3	20.8
- Tier 1	14.7	17.7	20.0	20.5	18.3
RoE	29.1	27.9	18.2	26.2	25.5
RoA	4.8	5.5	4.1	6.4	6.4

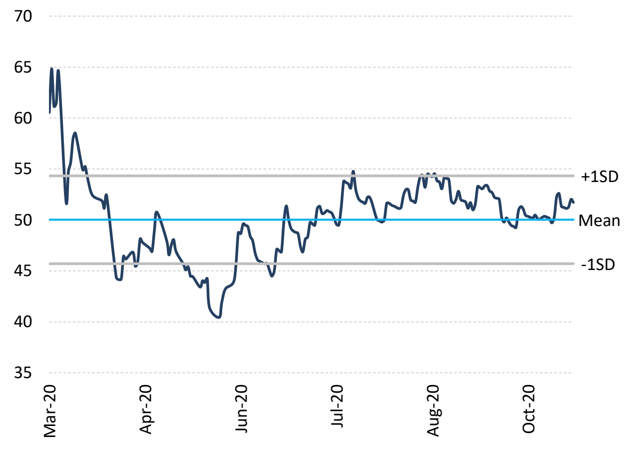
Source: Company, Anand Rathi Research

Fig 4 – One-year-forward price-to-book



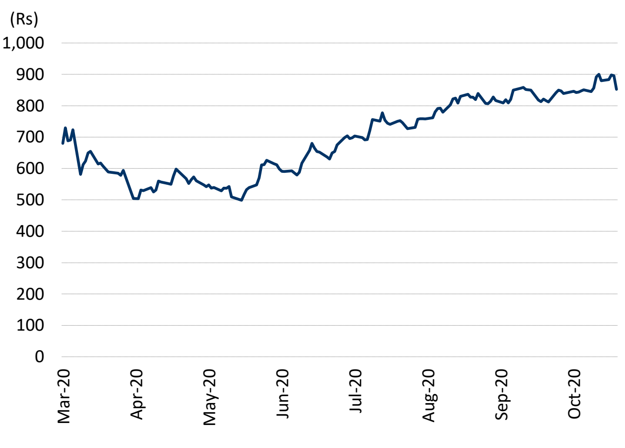
Source: Bloomberg, Anand Rathi Research

Fig 5 – One-year-forward price-to-earnings



Source: Bloomberg, Anand Rathi Research

Fig 6 – Price movement



Source: Bloomberg

Result highlights

Q2 FY21 Results at a Glance

Fig 7 – Income statement

(Rsm)	4QFY19	1QFY20	2QFY20	3QFY20	4QFY20	1QFY21	2QFY21
Interest income	9,494	10,492	11,623	12,815	13,482	14,121	12,754
Interest expenses	2,728	3,019	3,194	3,452	3,344	2,746	2,642
Net interest income (NII)	**6,766**	**7,473**	**8,429**	**9,363**	**10,138**	**11,375**	**10,112**
Non -interest income	11,269	12,550	12,106	12,817	11,622	7,835	12,373
Fee income	9,134	9,155	10,223	10,814	9,594	6,677	10,193
Net operating income	**18,035**	**20,023**	**20,536**	**22,180**	**21,760**	**19,210**	**22,486**
Operating expenses	10,669	10,729	12,226	12,585	12,257	9,074	11,086
PPOP	**7,366**	**9,294**	**8,310**	**9,595**	**9,503**	**10,136**	**11,399**
Provisions and contingencies	**3,517**	**3,969**	**3,289**	**3,763**	**8,382**	**4,853**	**8,617**
PBT	3,849	5,325	5,020	5,832	1,121	5,283	2,782
Tax	1,362	1,869	1,218	1,485	285	1,350	720
As a % of PBT	*35.4*	*35.1*	*24.3*	*25.5*	*25.5*	*25.6*	*25.9*
PAT	2,487	3,456	3,803	4,347	835	3,933	2,061

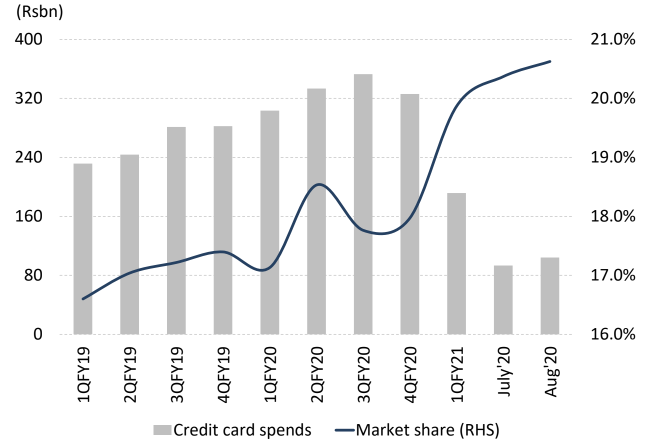
Source: Company, Anand Rathi Research

Fig 8 – Balance sheet

(Rsm)	4QFY19	1QFY20	2QFY20	3QFY20	4QFY20	1QFY21	2QFY21
Financial assets	**190,124**	**213,310**	**230,854**	**246,492**	**237,641**	**228,270**	**228,778**
Cash and bank balances	7,768	5,780	4,927	5,078	6,760	5,930	6,797
Loans	179,087	204,570	222,795	239,332	228,116	219,210	219,254
Other financial assets	3,269	2,960	3,132	2,082	2,764	3,130	2,726
Non- financial assets	**11,338**	**13,280**	**13,738**	**13,443**	**15,387**	**14,320**	**14,351**
Deferred tax assets	1,633	1,620	1,286	1,374	2,847	2,790	3,064
PP&E, other fixed and intangible	2,164	3,800	3,267	3,350	3,346	3,150	3,190
Other non-financial assets	7,541	7,860	9,185	8,719	9,195	8,380	8,097
Total Assets	**201,462**	**226,580**	**244,591**	**259,934**	**253,028**	**242,590**	**243,128**
Financial liabilities	**152,817**	**172,180**	**185,878**	**195,059**	**187,655**	**170,250**	**165,730**
Borrowings including lease liabilities	135,494	160,950	174,273	185,777	173,649	160,760	156,966
Other financial liabilities	17,323	11,230	11,604	9,282	14,005	9,490	8,763
Non- financial liabilities	**12,767**	**15,100**	**15,615**	**17,362**	**11,961**	**15,830**	**16,990**
Provisions	6,284	10,120	10,663	12,484	6,026	10,370	11,883
Other non financial liabilities	6,483	4,980	4,952	4,878	5,935	5,460	5,108
Total liabilities	**165,584**	**187,280**	**201,492**	**212,421**	**199,616**	**186,080**	**184,356**
Equity							
Equity share capital	8,372	8,370	9,323	9,323	9,390	9,390	9,397
Other equity	27,506	30,930	33,776	38,190	44,023	47,120	49,375
Total Liabilities and Equity	**201,462**	**226,580**	**244,591**	**259,934**	**253,028**	**242,590**	**243,128**

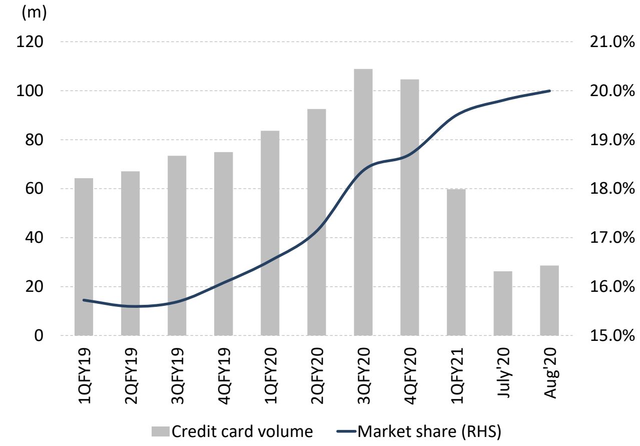
Source: Company, Anand Rathi Research

Fig 9 – Increasing market share (in spends)



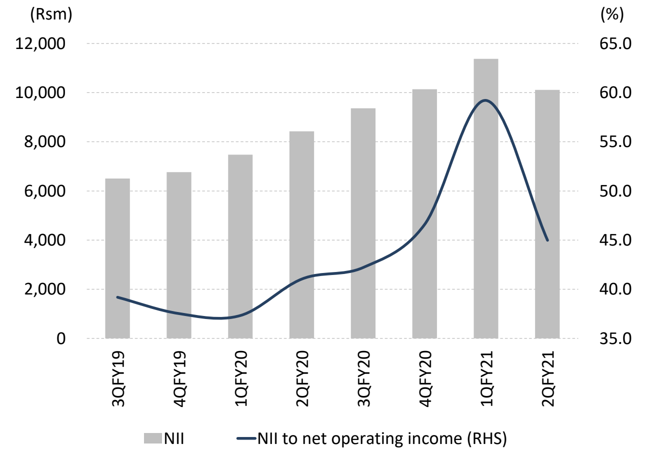
Source: Company, RBI, Anand Rathi Research

Fig 10 – ...the same trend seen in volume



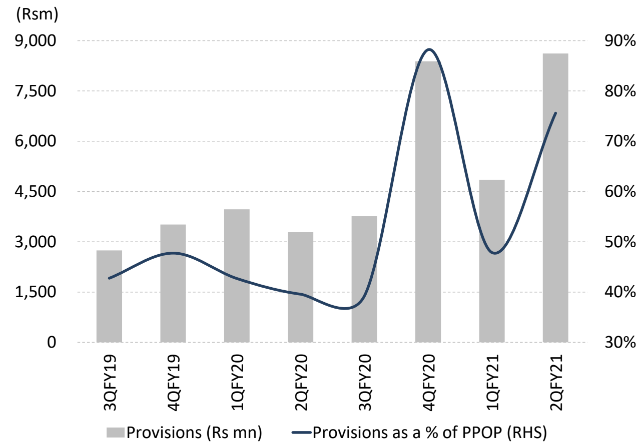
Source: Company, RBI, Anand Rathi Research

Fig 11 – NII has seen strong momentum



Source: Company, Anand Rathi Research

Fig 12 – Provisions has increased exponentially in Q2FY21

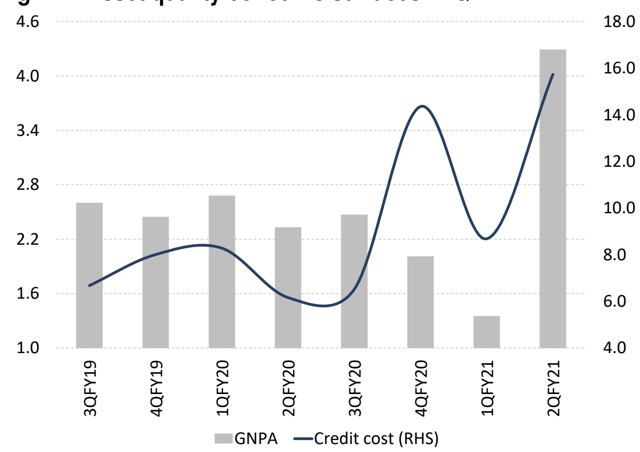


Source: Company, Anand Rathi Research

Fig 13 – Loan book has remained steady

Source: Company, Anand Rathi Research

Fig 14 – Asset quality concerns surfaces in Q2FY21



Source: Company, Anand Rathi Research

Conference-call highlights

Q2 FY21 Major highlights

- Retail spends in Q2 FY21 have rise ~50% compared to the prior quarter. Total retail spends were Rs248bn compared to Rs166bn the previous quarter, and Rs264bn in Q4 FY20. Corporate spends continued to grow: Rs47bn, compared to Rs25bn the quarter prior, Rs61bn in Q4 FY20.
- SBI Cards' continued to increase its market share (credit-card spending) from 17.8% at end-FY20 to 20.2% at end 5M FY21 (Aug'20). Volume-wise, it rose from 17.7% at end-FY20 to 19.7% at end 5M FY21.
- New-to-credit customers (new acquisitions) rose from 18.6% a year ago to 23.4% in Q2 FY21. The new-to-credit cards rose from 25.6% to 27.9%.
- The sourcing of new accounts from the Banca channel rose from 55% in Q1 FY21 to 58%.
- The new sourcing from tier-3 and others accounted for 27% of the total. Moreover, the 30+ delinquency is lower than tier-1 cities (~0.7% vs 1.14%).
- The company has collaborated with Google Pay, which has been a very important step in the digital push. Also, it has been the number one for UPI (nearly 50%). Regular MDR charges apply even in this partnership. The company is optimistic about the partnership.
- Fee income is on regular business and there is no extraordinary factor to it.
- Corporate spends gained traction in Q2 FY21. Once corporate travel begins, the numbers will aid to credit-card spends.

New dimension – re-structured book details

- Gross NPA at end-Q2 FY21 was 4.29%. However, it would have been 7.46% absent the Supreme Court order. The Court told financial institutions not to classify accounts that were not NPA on 31st Aug'20 as NPAs till further orders. There is no overlap.
- The RBI re-structured (RBI RE) loans comprised 9% of receivables, totalling Rs21bn. This doesn't include the EPP (Easy-Payment Plan) figures. The total under EPP was Rs1.6bn in Q2 FY20. More customers can join later in the year
- The NPL figure in absolute terms was Rs10.3bn (4.3% of GNPA), Rs7.62bn (standstill), totalling Rs17.9bn (7.46%). Stage 2 includes (i) RBI RE and (ii) standstill.
- Most customers that default are self-employed and strict filters are applied to them. It is generally sourced from the open-market channel. The asset quality of customers originating from the Banca channel is much better than the open-marketing channel.
- The company's moratorium book in the second phase was lower than in the first phase.
- At end-Q2 FY21, net NPAs (incl. standstill) were 2.7%.

Resolution framework

- The problem of high NPAs is primarily due to the moratorium stock. Second, the first month of the RBI RE book started in October and a large proportion of it has been paid up although not entirely 100%. Suppose they pay the first three instalments it should be normal.
- People prefer the RBI RE to EPP as in the latter much has to be paid upfront that in the former. The RBI RE would be converted into an EMI program and would be paid in a year or two. According to management, under the RBI RE program, payment by customers has been satisfactory. In the next two months, there will be more clarity regarding this book depending on customer payments.
- The company has made a provision of 10% for the RBI RE and this has already taken a hit. On standstill, the company has made provisions similar to stage-3 assets, about 65.5%. For standstill, the company is pulling customers toward the RBI RE scheme. This scheme is applicable till Dec.
- The company is open to settlements and looking at customers who are willing to pay at one go, on which the company might take a hit.
- Resolution can take time but the situation is in control. The RBI RE was formed only on 6th Aug.
- The benefit of the RBI RE is that a customer gets more time to repay and the interest rate reduces. For the RBI RE, the interest rate is 14-15% and for a maximum two years. The interest rate in EPP is 12-20% and for a maximum 3-18 months. Also, the EPP is not reported to the Bureau as the minimum amount is paid. However, the RBI RE is reported to the Bureau as restructured book. About 200,000 customers are unable to transact currently as they are in either of the schemes.
- Since the RBI RE has turned delinquent, cards are blocked. If a customer pays three months' EMI, a card would be unblocked (to the extent of the payment). This also applies to the EPP.

Ecommerce tie-up

- Partnership with e-commerce players is a huge fillip to spends and has been ongoing for the last seven years. The cashback is capped and there is also a minimum amount to be spent. There is a contractual arrangement with e-commerce players. A large proportion of sales are seen in high-ticket consumer durables, etc. This is generally converted into EMIs; thus, interest income is earned.
- A fixed amount is paid by the company to e-commerce players. Generally, sales are much higher in comparison. 50% of sales come from tier-2 cities and beyond, in which the company has a good grip. Also, many inactive customers take part. For example, in the latest Big Billion Sale (2020), nearly 100,000 customers who were inactive in the last six months took part.

Q1FY21- Major highlights

Spends. By end-Jun, credit card spends are back to ~75% of pre-Covid average daily levels. Q1 FY21 spends were Rs191bn vs. Rs302bn a year ago.

- Online retail spends in Q1 FY21 were 56%, compared to 44% in FY20. Digital spends are expected to increase significantly and can be considered a positive in the pandemic.
- Retail spending is bifurcated into three categories: Category-1 (department stores, fuel, health, utilities, etc.) grew 23% in Jun compared to pre-Covid levels (average of Dec'19 to Feb'20). Category-2 (consumer durables, apparel, etc.) grew 21%, whereas Category-3 (travel agents, hotels, etc.) plunged 78%.
- This is a huge opportunity for corporate spending as B2B transactions are quite large. Currently, corporate bodies realise that utility payments can be digitised. Businesses are opening up, with resultant vendor payments. The company has a good relationship with SBI, multinationals and other vendors, regarding which it is optimistic.
- Overall, the entertainment industry is down; and hotels will take long to recover. However, consumer durables (eg, laptops) are seeing traction. Huge pent-up demand was seen as soon as the lockdown was imposed (end-Mar) as people were saving. Even when the country was opening up, huge demand was seen initially. Then, spending was even higher than pre-Covid levels. Today, spends are stable and gradually increasing; hence, no pent-up demand can be seen now.

Cards in force: Card-in-force grew 20% y/y to 10.6m vs. 8.8m a year ago.

Acquisitions. Here there has been a strong rebound. New accounts acquired rose from ~80,000 in May'20 to ~181,000 in Jun'20, 57.6% of pre-Covid average daily acquisitions (pre-Covid refers to average of Dec'19-Feb'20). The company has introduced Video KYC to acquire customers, especially helpful during the pandemic.

- **Average duration of EMI loan book**: Most of the EMI loan book would be for 9-10 months. However, here could be a short-term requirement too, for a 3–5 month timeframe. The company recently ran promotional schemes with online players like Amazon and Flipkart. It was noted that 80% of consumer durable sales were on an EMI basis.

Rise in market share. Market-share for cards in force was 18.3% at end-1M FY21 from 14.8% at end-FY16. For spends, it grew from 12% to 19.6%.

Profit margins. The return on average assets (RoAA) was 6.3% for Q1 FY21 vs. 6.5% a year ago. The return on average equity (RoAE) was 28.3% in Q1 FY21 vs. 36.1% a year back.

Moratorium: The number of customers under the moratorium declined significantly. Moratorium accounts slid from 1.25m in May to 0.15m in Jun. In value, the decline was from Rs70bn to Rs15bn. Any customer who wanted the moratorium had to inform the company and there is an opt-in clause. If the option is not chosen a customer is out of the moratorium. This is nothing related to payment or prepayment.

Change in customer proposition: Revolvers accounted for 45% of customers in Jun'20, compared to 38% pre-Covid. This is about an Rs8bn increase in revolvers. Transactors have come down from 30% to 25% as spending levels have reduced. However, management opines that it is not the correct picture and will change once the situation returns to complete normalcy.

MDR: The merchant discount rate (MDR) differs across categories. Eg, online health and travel will have the same weights but there could be different rates across other categories. It is around 2% overall.

Asset quality: Although GNPAs have improved from 2.68% in Q1 FY20 to 1.35%, this may not present the true picture due to the moratorium.

Cost of funds: The cost of funds declined to 6.6% in Q1 FY21. Major reasons were (i) prepayment of higher-cost borrowings, to be replaced with lower-cost funds for the benefit of lower MCLR rates; (ii) lower utilisation of limits. However, there is no guarantee that this will continue as utilisation levels can increase and so too the MCLR.

Capital adequacy: The company's capital adequacy inched up to 24.4% in Q1 FY21 vs. 18.9% a year ago.

Provisions: It did not make separate Covid provisions although it may do so in future on the basis of requirement.

Operating expenses decline. There are three types of opex:

- Variable: Level of activity was down, and hence declined
- Semi-variable (eg, reward points): less used by customers and the company deferred some expenses.
- Fixed expenses: low as the company saved some money (rent waivers) on some properties not being used and some savings on travel.

Collections and Infrastructure: The company has created a strategy collection group and efforts are being made to scale up the collection infrastructure. The field force rose from 4,200 to 8,000 whereas tele rose from 1,100 to 2,000. Besides, a large number of employees has moved to he collections department to bolster the company's effort. Further, the company on-boarded two digital partners to educate people on higher credit scores. Also, there is a robot to manage ALMs, daily inflow and outflows.

Change of MD and CEO: Mr Ashwini Tiwari, currently managing the SBI's (the bank) US operations, will take over the company as Mr Hardayal decided to voluntarily retire

Valuation

We have valued the company on a P/E multiple. The stock trades at 43x FY22e earnings and we value it at 50x FY22 earnings. We cut our price target to Rs985 from Rs1,021 on concerns of asset quality and higher credit costs. However, we retain our 'BUY' rating with a 15% upside from current levels. We remain positive on the long term structural story and the spends inching toward pre-Covid levels.

Change in estimates

We have increased our loan book by 2% for FY21 and also our NII estimates owing to better-than-expected interest income and lower interest costs. However, we lower our net profit estimates 3.5% and 3.7% for FY22 and FY23 respectively. This decline is primarily due to the rise in credit costs.

Fig 15 – Change in estimates

	Old			New			Change %		
(Rsmn)	FY21e	FY22e	FY23e	FY21e	FY22e	FY23e	FY21e	FY22e	FY23e
NII	37,955	41,759	51,881	40,304	43,542	54,000	6.2%	4.3%	4.1%
NOI	86,177	101,440	125,805	85,950	100,966	125,291	-0.3%	-0.5%	-0.4%
Net Profit	10,479	19,354	23,949	10,568	18,670	23,072	0.8%	-3.5%	-3.7%
EPS (Rs)	11.1	20.4	25.3	11.2	19.7	24.3	0.8%	-3.5%	-3.7%
ROE	18.1%	27.0%	26.1%	18.2%	26.2%	25.5%	0.8%	-3.2%	-2.6%
ROA	4.1%	6.7%	6.7%	4.1%	6.4%	6.4%	0.3%	-4.5%	-4.5%

Source: Anand Rathi Research

Risks

- **Cap on interest rates:** We believe this is the major risk facing the company and even others in the industry. Indian regulations do not impose any limit on interest rate charged to cardholders. However, regulations could change, and there could be a cap on (i) interest rates or (ii) MDR charges in future. This would result in lower income for the company.
- **Continued deterioration in macro-economic conditions:** Poor economic conditions (GDP growth rate, consumer confidence, unemployment, etc.) reduce the use of credit cards as customers tend to save more than spend. This invariably reduces the sources of income of card companies. Besides, such conditions hurt cardholders' ability to pay, increasing delinquencies, charge-offs and provisions for credit losses; even decreasing recoveries.
- **Keener competition could result in a shrinking customer base:** The credit-card market is highly saturated. Thus, competitors may offer higher value propositions or may use better advertising or cross-selling strategies to acquire and retain more cardholders, capturing more market-share.

Appendix

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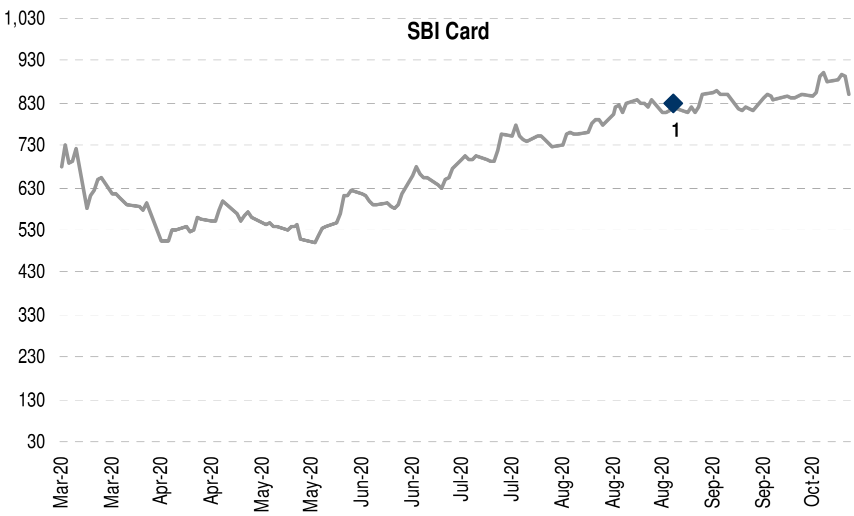
Rating and Target Price History (as of 22 October 2020)



	Date	Rating	TP (₹)	Share Price (₹)
1	03-Sep-20	Buy	1,021	828

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ARSSBL registered address: Express Zone, A Wing, 9th Floor, Western Express Highway, Diagonally Opposite Oberoi Mall, Malad (E), Mumbai – 400097.
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