22 January 2021

SBI Cards and Payment Services

Rating: **HOLD**
Target Price: Rs1,091
Share Price: Rs 979

Q3: Asset quality markedly improves; recoveries rise, more clarity from management; spends high; 'Hold'

Taking concrete steps to improve asset quality, SBI Cards and Payment Services has written off loans and improved recoveries. Though higher operational costs and lower yield have cut into profitability that is expected to be relevant only for this quarter. Credit-card spends rose due to the festival season and even had comparatively a better market share.

Asset quality improves markedly. Proforma GNPA slid ~300bps in Q3 (4.5% vs. 7.5%) on loans of Rs6.5bn written off and recoveries of ~Rs4bn. The move to write off bad loans in Q3 FY21 and the intention to further do so (in future) is viewed as 'positive'.

The RBI RE book totalled Rs23.4bn in Q3 FY21 vs. Rs21bn the quarter prior. About 33% of the RE book (Rs7.8bn) was over 30 days due and less than 90 days. 65.5% provisions are for these although they are not classified as NPA. The standstill book was ~Rs7.5bn. Thus, there could be stress over the next couple of quarters as the Supreme Court order comes in this regard.

Operating costs, credit costs high. Operating costs rose 7% y/y on account of the festival season's cash-backs and more outlay on collection efforts. However, since the company has written off loans, collection costs would return to normal from the next quarter.

Credit costs were a high 11.4% although less than the 15.7% negative surprise in Q2 FY21. We have factored in credit-cost estimates of 9%/8.5% for FY22/23. NII fell 3% y/y owing to yield contraction as the RBI RE book has lower interest rates. However, ahead, yields are expected to rise. Fee income rose 2% y/y on an increase in credit-card spends (Rs378bn vs. Rs353bn).

Higher TP, 'Hold'. As there is more clarity on the business front, we raise our target to Rs1,091 (earlier Rs985), with a Hold rating. We roll over the valuation to FY23e, to 40x (50x FY22e). **Key risks:** Cap on interest rates, more-than-anticipated delinquencies, altered association with the promoter.

Key financials (YE Mar)	FY19	FY20	FY21e	FY22e	FY23e
Net interest income (m)	25,664	35,404	39,922	45,656	56,693
Pre-provisioning profit (Rs m)	24,828	36,699	42,393	50,640	61,679
Provisions (Rs m)	11,477	19,402	27,996	23,222	27,112
PAT (Rs m)	8,650	12,448	10,769	20,509	25,856
EPS (Rs)	9.5	13.2	11.4	21.6	27.3
NIM (%)	15.2	16.6	16.4	16.5	16.6
Cost-Income (%)	60.4	56.6	51.7	52.4	53.7
RoE (%)	29.1	27.9	18.5	28.3	27.5
RoA (%)	4.8	5.5	4.1	6.9	7.0
GNPA (%)	2.4	2.0	5.5	4.7	3.9

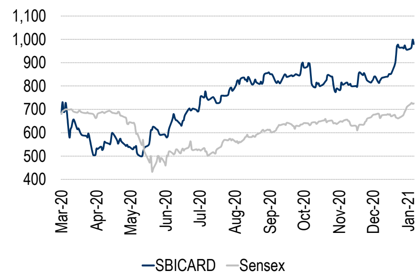
Source: Company, Anand Rathi Research

Key data	SBICARD IN
52-week high / low	Rs1019 / 495
Sensex / Nifty	49625 / 14590
3-m average volume	$21.7m
Market cap	Rs921bn / $12622.2m
Shares outstanding	941m

Shareholding pattern (%)	Dec'20	Sep'20	June'20
Promoters	69.4	69.5	69.5
- of which, Pledged	-	-	-
Free Float	30.6	30.5	30.5
- Foreign Institutions	5.8	5.9	4.2
- Domestic Institutions	3.9	3.2	3.3
- Public	20.9	21.4	23.0

Estimates revision (%)	FY21	FY22	FY23
NII	-0.9	4.9	5.0
Net Profit	1.9	9.9	12.1
EPS	1.9	9.9	12.1

Relative price performance



Source: Bloomberg

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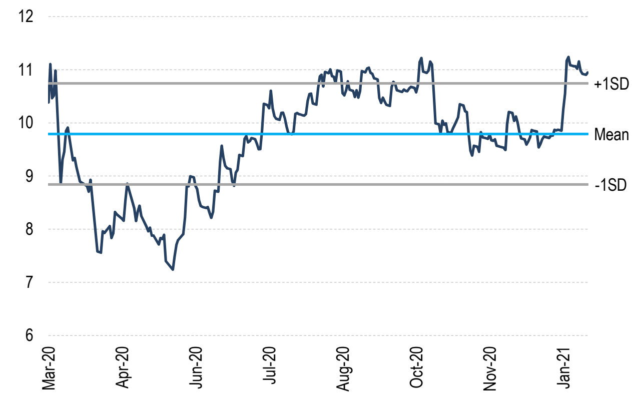
Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Interest income	35,757	48,413	50,920	58,058	72,046
Interest expenses	10,094	13,009	10,999	12,401	15,352
NII	**25,664**	**35,404**	**39,922**	**45,656**	**56,693**
y/y growth		*38%*	*13%*	*14%*	*24%*
Non -interest income	37,111	49,110	47,902	60,696	76,392
Fee income	*30,720*	*39,787*	*39,559*	*51,006*	*64,643*
Net Operating income	**62,775**	**84,514**	**87,824**	**106,352**	**133,085**
Operating expenses	37,947	47,815	45,431	55,712	71,406
PPOP	**24,828**	**36,699**	**42,393**	**50,640**	**61,679**
Provisions and contingencies	11,477	19,402	27,996	23,222	27,112
y/y growth		*69%*	*44%*	*-17%*	*17%*
PBT	13,351	17,296	14,396	27,418	34,567
Tax	4,701	4,848	3,628	6,909	8,711
Tax rate	35%	28%	25%	25%	25%
PAT	8,650	12,448	10,769	20,509	25,856

Source: Company, Anand Rathi Research

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



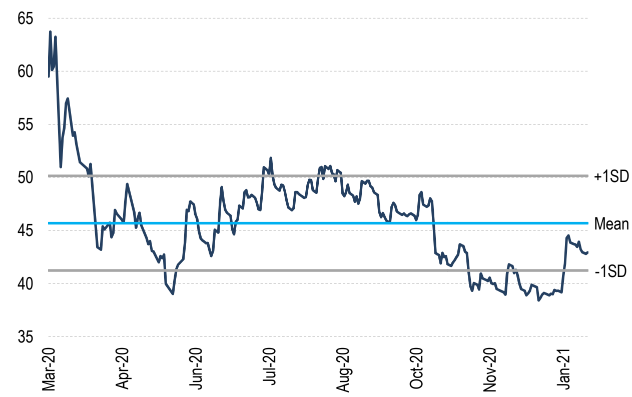
Source: Bloomberg, Anand Rathi Research

Fig 2 – Balance sheet (Rsm)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Cash and bank balances	7,768	6,760	12,062	16,554	17,400
Loans	**179,087**	**228,116**	**232,701**	**283,366**	**354,207**
Property plant and equip.	1,316	639	791	1,056	1,474
Capital work in progress	43	112	290	474	682
Intangible assets	804	903	881	1,314	2,054
Right-of-use Assets	0	1,693	1,386	1,474	1,746
Total Assets	**201,461**	**253,028**	**267,656**	**329,507**	**410,790**
Payables	6,651	7,288	7,662	9,610	12,129
Debt Securities	**40,793**	**56,854**	**58,378**	**71,552**	**89,297**
Borrowings	**82,733**	**104,328**	**107,124**	**131,299**	**163,861**
Subordinated Liabilities	**11,968**	**12,467**	**12,801**	**15,690**	**19,581**
Provisions	6,284	6,026	6,328	6,644	6,976
Total Liabilities	**165,584**	**199,616**	**204,723**	**247,473**	**304,777**
Equity	**35,878**	**53,412**	**62,933**	**82,034**	**106,012**
Total Liab. and Equity	**201,462**	**253,028**	**267,656**	**329,507**	**410,790**

Source: Company, Anand Rathi Research

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



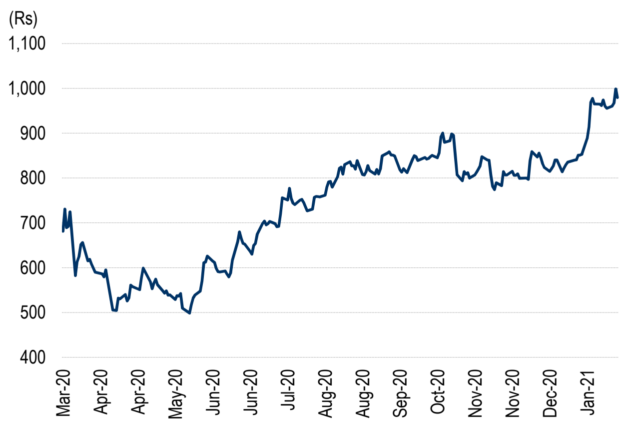
Source: Bloomberg, Anand Rathi Research

Fig 3 – Ratio analysis %

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
NII / total inc.	40.9	41.9	45.5	42.9	42.6
Other inc. / total inc.	59.1	58.1	54.5	57.1	57.4
Cost-income	60.4	56.6	51.7	52.4	53.7
Provision coverage	66.5	67.2	66.6	68.6	73.5
Dividend payout	10.6	7.6	8.8	6.9	7.3
Credit-borrowing	132.2	131.4	130.5	129.7	129.9
Investment-borrowing	0.01	0.01	0.01	0.01	0.01
Gross NPA	2.4	2.0	5.5	4.7	3.9
Net NPA	0.8	0.7	2.0	1.5	1.1
BV (Rs)	39.2	56.7	66.4	86.6	111.9
Adj. BV (Rs)	37.6	55.0	61.6	82.0	107.8
CAR	20.0	22.4	22.9	24.2	21.0
- Tier 1	14.7	17.7	19.4	21.3	18.5
RoE	29.1	27.9	18.5	28.3	27.5
RoA	4.8	5.5	4.1	6.9	7.0

Source: Company, Anand Rathi Research

Fig 6 – Price movement



Source: Bloomberg

Key arguments

Positives

- **Asset quality improvement.** The proforma GNPA was 4.5% vs 7.5% the previous quarter, a 300bp improvement q/q. The company had higher write offs (Rs6.5bn loans) than in other quarters. Moreover, recoveries also were high, a reflection of the collection effort. Our FY22e/FY23e GNPA are 4.7%/3.9%.
- **RBI RE – more clarity.** The RBI RE book totalled Rs23.4bn in Q3 FY21 vs. Rs21bn the quarter prior. About 33% of the RE book (Rs7.8bn) was more than 30 days due and less than 90 days, and on this 65.5% provisions have been made although they are not classified as NPA.
- **Spends and partnerships.** Q3 FY21 credit-card spends grew 8% y/y, 28% q/q, on account of the festival season and associated discounts on e-commerce portals. We remain positive on card spends, which have recovered well after the Q1 FY21 Covid-triggered stress. The focus on co-branding partnerships (Google-Pay, Amex, etc.) and new products in YTD FY21 are expected to further strengthen the company's proposition to its customers. The focus is on retail customers with new categories (e.g., utilities, e-commerce sales) being registered in the Covid era as travel and leisure are still under stress owing to lower sectoral activity. Online spends accounted for 53% at end-9M FY21 vs. 44% at end-FY20.
- **Market share increase.** The company has consistently increased its market share over the years and specifically in YTD FY21 (20.1% market share in spends over Apr-Nov'20).
- **Banca channel sourcing.** Of the new accounts sourced, SBI (bank) accounted for over 50% at end Q3 FY21; overall this is 43% vs. 41.6% a year ago. Also, the acquisition cost of the Banca channel is lower.
- **Lower cost of funds.** The company leveraged the low interest rate environment as the cost of funds fell further from 6.6% in Q2 FY21 to 6.1%.
- **Digital payment infra funds (PIDF).** The government introduced PIDF in order to boost digital payments. This will benefit the company as its focus is on Tier-3 and -4 cities.

Negatives

- **Credit costs:** Credit costs inched up to 11.4% in Q3 FY21 vs. 15.7% the previous quarter. Total management overlay provision was increased to Rs11bn in Dec'20 vs. Rs7.6bn in Sep'20. We have factored in credit costs of 9%/8.5% for FY22e/FY23e, which were 225bps/175bps above the mean for FY17-20 (excl. Rs5bn of extra Covid costs). However, the macro environment is uncertain and the pain could persist.
- **Stage 2 assets:** Although the company doesn't specify Stage 2 on a quarterly basis, the number was 19% in FY20 vs 7% the previous year. In this context (RBI RE and higher stressed assets) in FY21, on a conservative basis, this figure could inch up further in FY21.

Result highlights

Q3 FY21 Results at a Glance

Fig 7 – Income statement

(Rs m)	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21
Interest income	10,492	11,623	12,815	13,482	14,121	12,754	11,681
Interest expenses	3,019	3,194	3,452	3,344	2,746	2,642	2,609
Net interest income (NII)	**7,473**	**8,429**	**9,363**	**10,138**	**11,375**	**10,112**	**9,071**
Non-interest income	12,550	12,106	12,817	11,622	7,835	12,373	13,717
Fee income	9,155	10,223	10,814	9,594	6,677	10,193	11,068
Net operating income	**20,023**	**20,536**	**22,180**	**21,760**	**19,210**	**22,486**	**22,788**
Operating expenses	10,729	12,226	12,585	12,257	9,074	11,086	13,477
PPOP	**9,294**	**8,310**	**9,595**	**9,503**	**10,136**	**11,399**	**9,311**
Provisions and contingencies	**3,969**	**3,289**	**3,763**	**8,382**	**4,853**	**8,617**	**6,483**
PBT	5,325	5,020	5,832	1,121	5,283	2,782	2,829
Tax	1,869	1,218	1,485	285	1,350	720	732
As a % of PBT	*35.1*	*24.3*	*25.5*	*25.5*	*25.6*	*25.9*	*25.9*
PAT	3,456	3,803	4,347	835	3,933	2,061	2,097

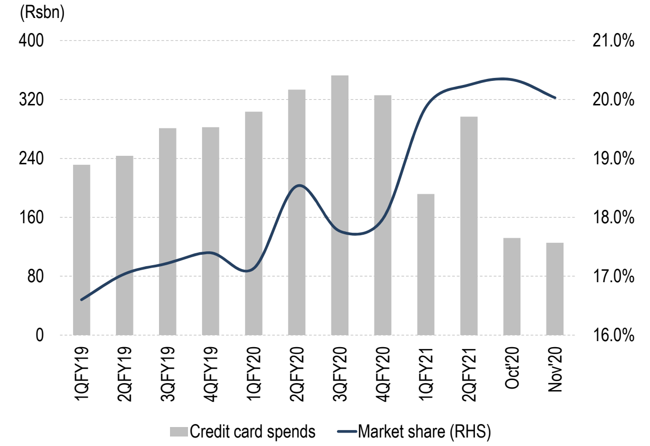
Source: Company, Anand Rathi Research

Fig 8 – Balance sheet

(Rs m)	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21
Financial assets	**213,310**	**230,854**	**246,492**	**237,641**	**228,270**	**228,778**	**257,200**
Cash and bank balances	5,780	4,927	5,078	6,760	5,930	6,797	9,210
Loans	204,570	222,795	239,332	228,116	219,210	219,254	236,960
Other financial assets	2,960	3,132	2,082	2,764	3,130	2,726	11,030
Non- financial assets	**13,280**	**13,738**	**13,443**	**15,387**	**14,320**	**14,351**	**15,570**
Deferred tax assets	1,620	1,286	1,374	2,847	2,790	3,064	4,200
PP&E, other fixed and intangible	3,800	3,267	3,350	3,346	3,150	3,190	3,040
Other non-financial assets	7,860	9,185	8,719	9,195	8,380	8,097	8,330
Total Assets	**226,580**	**244,591**	**259,934**	**253,028**	**242,590**	**243,128**	**272,770**
Financial liabilities	**172,180**	**185,878**	**195,059**	**187,655**	**170,250**	**165,730**	**191,980**
Borrowings including lease liabilities	160,950	174,273	185,777	173,649	160,760	156,966	181,480
Other financial liabilities	11,230	11,604	9,282	14,005	9,490	8,763	10,500
Non- financial liabilities	**15,100**	**15,615**	**17,362**	**11,961**	**15,830**	**16,990**	**19,640**
Provisions	10,120	10,663	12,484	6,026	10,370	11,883	13,980
Other non financial liabilities	4,980	4,952	4,878	5,935	5,460	5,108	5,660
Total liabilities	**187,280**	**201,492**	**212,421**	**199,616**	**186,080**	**184,356**	**211,620**
Equity							
Equity share capital	8,370	9,323	9,323	9,390	9,390	9,397	9,410
Other equity	30,930	33,776	38,190	44,023	47,120	49,375	51,740
Total Liabilities and Equity	**226,580**	**244,591**	**259,934**	**253,028**	**242,590**	**243,128**	**272,770**

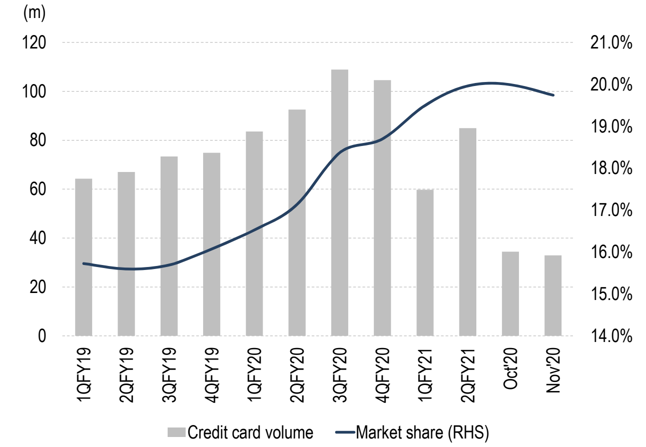
Source: Company, Anand Rathi Research

Fig 9 – Increasing market share (in spends)



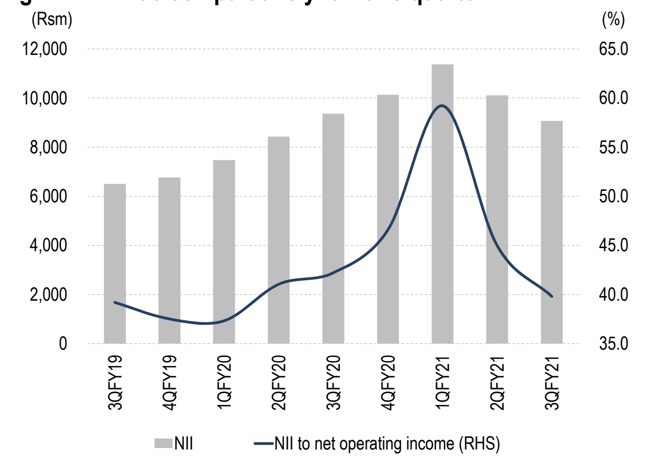
Source: Company, RBI, Anand Rathi Research

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



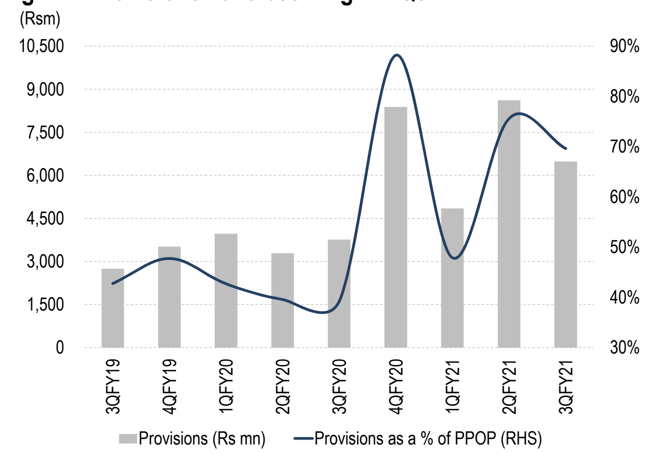
Source: Company, RBI, Anand Rathi Research

Fig 11 – NII was comparatively low this quarter



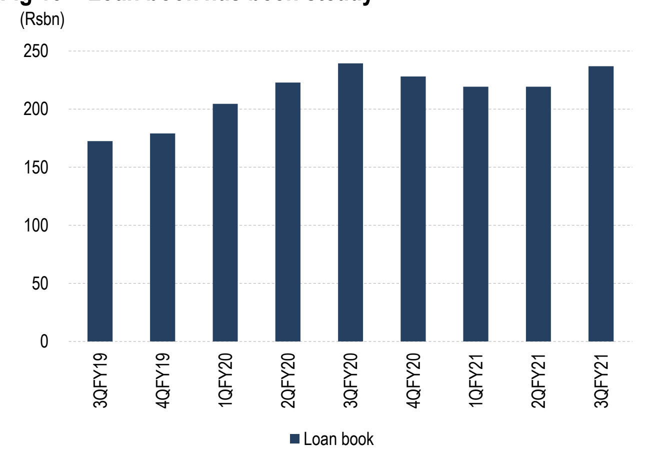
Source: Company, Anand Rathi Research

Fig 12 – Provisions have been high in Q3 FY21



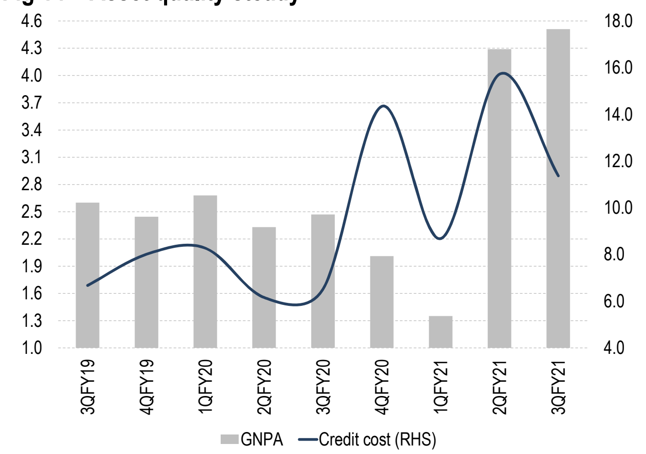
Source: Company, Anand Rathi Research

Fig 13 – Loan book has been steady



Source: Company, Anand Rathi Research

Fig 14 – Asset quality steady



Source: Company, Anand Rathi Research

Conference-call highlights

Q3 FY21 Major highlights

- Retail spends in Q3 FY21 rose ~25% from the prior quarter. Total retail spends were Rs311bn compared to Rs248bn the previous quarter, and Rs264bn in Q4 FY20. Corporate spends continued to grow: Rs67bn, compared to Rs47bn the quarter prior, Rs61bn in Q4 FY20. Several categories have seen a huge positive shift (e.g., apparel).
- SBI Cards continued to increase its market share (credit-card spending) from 17.8% at end-FY20 to 20.1% at end-8M FY21 (Nov'20).
- 918,000 accounts were added during Q3 FY21. In Dec, 340,000 accounts were added, the highest run rate.
- New-to-credit customers (new acquisitions) rose from 18.7% a year ago to 26% in Q3 FY21. The new-to-credit cards declined from 26.5% to 23.8%.
- The 30+ delinquency is lower in Tier-3 than other cities (~0.7% vs 1.1%).
- During the quarter, the company increased its partnerships, collaborating with Paytm and BPCL.

Q3: What grew / shrank

- Net profit at end-Q3 FY21 was Rs2.1bn. Receivables rose 4% y/y to Rs257bn.
- Operating expenses grew 7% y/y for two reasons. All cash-back expenses were in Q3 FY21, compared to last year's spread across Q2 and Q3 FY20. The enhanced focus on collections increased the cash outlay during the quarter. For the next quarter and in future, collection costs are expected to come down to normal.
- The credit-cost situation continues to be hit by the macro-economic situation. Management overlay provision was Rs11bn in Dec'20 vs Rs7.6bn in Sep'20. Thus, during the quarter, the company made an extra provision of Rs3.6bn.
- The sharp decline in yield was due to the proportion of revolvers being high in Q2 FY21. Now, 9% of the revolvers book has been converted to the RE book, which is at a lower interest rate. Ahead, as the EMI book goes up (typically an 18-20% interest rate) and revolver behaviour returns to normal, yields would rise. Currently, transactors are in a higher, 33%, range, compared to the normal 27-28%. Due to the festival season, there has been many EMI transactions and the effect would be seen in Q4 FY21. Also, the company has partnered with Amazon for the Republic Day sale this month.
- On Google Pay, the company is seeing ~50,000 transactions a month. This will rise once more merchants adopt credit-card payments than only UPI currently.
- The share of the self-employed in new sourcing has risen from 21% to 24% in the last 2-3 quarters. Of this 24%, 4% is sourced only from the open-market channel, whereas 20% is from the Banca channel. The open-market channel provides more profitable customers as they "revolve" more often.

RBI RE details

- The RBI-re-structured (RBI RE) loans comprised 9% of receivables, totalling Rs23.4bn. New bookings were Rs6.1bn, whereas Rs3.8bn was paid/closed. About 33% of the RE book (Rs7.8bn) was more than 30 days due and less than 90 days (some evidence of payment either of one or two instalments). The company has made 65.5% provisions (Stage 3 ECL provisions) on this, although they are not classified as NPA. A significant number of RBI RE customers have paid the instalments and are in the 1-30 day bucket (excl. Rs7.8bn book). In the normal course of business, the standstill book (Rs7.5bn) would have been written off but the company is awaiting a Supreme Court decision for further clarity.
- The company made significant efforts toward sourcing of the RBI RE scheme, which was mostly in Sep and Oct as customers were told that the interest rate was fixed at 14% and 16%. These customers earlier thought that they would be provided with a huge waiver by the government but that did not happen. Also, many obtained sufficient time to resolve cash-flow issues.
- The 9% RBI RE book weighted average would be between 12 and 24 months. The behaviour would become clearer in Q4 FY21.
- The EPP (Easy-Payment Plan) was Rs5bn in Q3 FY21. The company provides standard asset provisioning, which is about 1%. No concerns, as payments are regular.
- Fresh NPA (slippage) is ~Rs4bn.
- ECL of 8% is on overall outstandings, which is about Rs20bn.
- Gross NPAs at end-Q3 FY21 were 1.61%. However, they would have been 4.51% absent the Supreme Court order. The sharp reduction of about 300bps over the last quarter was due to a mix of write offs and recoveries. The company has written off loans of Rs6.5bn and recovered ~Rs4bn of loans. Recoveries were higher as there were greater collection efforts and write offs in Q1 FY21. Since the pool of write offs is large, we can expect recoveries ahead to be higher.

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 NPA 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.

Q1 FY21- 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 45x/36x FY22e/FY23e EPS. We roll over our valuation to FY23e earnings and arrive at a higher target price of Rs1,091, at 40x times (50x FY22e), with 11% potential from the current price of Rs979, implying a 'Hold rating'. We are positive on the long-term structural story of credit cards.

Change in estimates

Fig 15 – Change in estimates

	Old			New			Change %		
(Rs m)	FY21e	FY22e	FY23e	FY21e	FY22e	FY23e	FY21e	FY22e	FY23e
NII	40,304	43,542	54,000	39,922	45,656	56,693	*-0.9*	*4.9*	*5.0*
NoI	85,950	100,966	125,291	87,824	106,352	133,085	*2.2*	*5.3*	*6.2*
Net Profit	10,568	18,670	23,072	10,769	20,509	25,856	*1.9*	*9.9*	*12.1*
EPS (Rs)	11.2	19.7	24.3	11.4	21.6	27.3	*1.9*	*9.9*	*12.1*
RoE* %	*18.2*	*26.2*	*25.5*	*18.5*	*28.3*	*27.5*	*31*	*213*	*203*
RoA* %	*4.1*	*6.4*	*6.4*	*4.1*	*6.9*	*7.0*	*(0)*	*45*	*61*

*Source: Anand Rathi Research Note. The changes for fields marked in * is shown in bps*

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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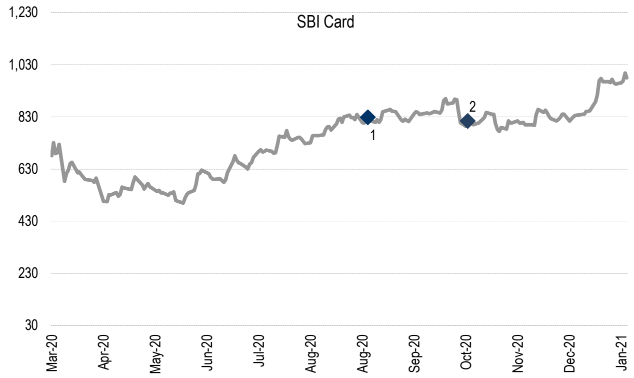

	Date	Rating	TP (Rs)	Share Price (Rs)
1	03-Sep-20	**Buy**	1,021	828
2	22-Oct-20	**Buy**	985	853

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