SBI Cards And Payment Services Limited

26 February 2020

IPO Note

Rich valuation for the market leader in a high growth industry

SBI Cards (SBIC), a JV between SBI (74% pre-IPO) and CA Rover Holdings/Carlyle Group (26% pre-IPO), offers an opportunity to play a pure credit cards business in India. Favorable macro tailwinds, which are structural in nature, combined with industry-leading position augur well for SBIC to deliver sustainable growth and profitability. The company commands a strong returns profile with RoA of ~5% in FY19 on the back of strong margins and an improving cost structure. At the upper price band of Rs755/share, the IPO is richly valued at 13.5x BV/46x EPS (trailing). Key risks include (1) slowdown in economy resulting in growth and asset quality challenges (2) regulations on MDR charges.

Favorable macros will support growth: Credit card penetration in India is 3% compared to 42% for China, 89% for Australia and 320% for the US, thus leaving ample room for growth. As India undergoes a change in consumption and spending patterns, credit card usage is expected to increase further from current levels, which should augur well for the overall industry. Development of digital payments infrastructure, rising e-commerce transactions, increased payments convenience, among others, are some of the second order drivers, which are likely to give tailwind to credit card penetration in India. Going forward, credit cards are expected to witness a growth of 23% annually over the next five years. As a result, credit card spends are expected to more than double by FY24E to Rs15.2trn.

Market leader with sound profitability and asset quality: SBIC is one of the largest credit card companies in India with a market share of 18%, which has only improved in recent years. The company enjoys strong profitability profile with RoA/RoE of ~5%/29% as of FY19, driven by strong margins as well as improving cost structure. Though credit costs were higher during FY19, we think that asset quality is manageable with GNPAs/NNPAs of 2.4%/0.8%. Since partnering with SBI a couple of years ago, there is a huge potential to tap the bank's customers, which would help on the growth front. Structurally, we think the company has potential to clock high growth rates given the macro opportunity as well as SBIC's industry positioning. Unfavorable macros could pose growth risk as well as asset quality risk.

Valuation is rich given the growth and profitability: At the upper price band of Rs755/share, the company is being valued at Rs709bn, higher than market expectations/estimates. The issue size is Rs104bn, which is primarily OFS (fresh issue Rs5bn). SBI and Carlyle would be selling 37.2mn shares and 93.2mn shares, respectively. At 13.5x BV/46x EPS (trailing), the IPO is valued richly. At these levels, we think the valuation factors in a very optimistic scenario of sustainable high growth and profitability ratios. Given the anticipation built around the IPO, the stock may deliver listing gains. Key risks include (1) slowdown in economy resulting in growth and asset quality challenges (2) regulations on MDR charges.

Key financials (Rsmn)	FY17	FY18	FY19	9MFY20
NII	13,597	20,485	25,585	25,267
PPoP	11,036	17,194	24,793	27,207
PAT	3,729	6,011	8,627	11,612
EPS (Rs)	4.7	7.7	10.3	12.5
BVPS (Rs)	18.5	30.0	42.8	51.0
RoA (%)	*4.0*	*4.5*	*4.8*	*6.7*
RoE (%)	*28.6*	*31.6*	*29.1*	*37.2*
GNPA (%)	*2.3*	*2.8*	*2.4*	*2.5*
NNPA (%)	*0.8*	*0.9*	*0.8*	*0.8*

Source: DRHP, Company, Nirmal Bang Institutional Equities

NOT RATED

Sector: NBFC

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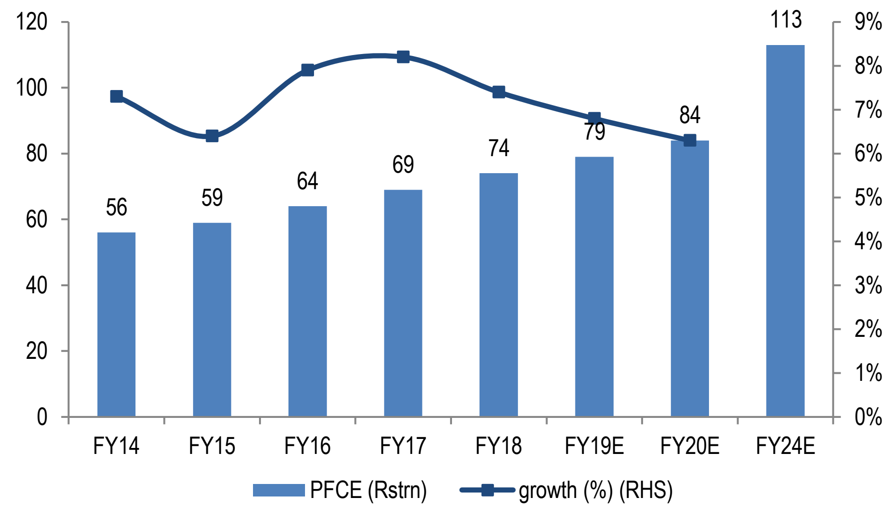
Issue details:

Sector: NBFC
Price band: Rs750-755
Face Value: Rs10
Issue size (mn shares): 137.1-137.2
Issue proceeds (Rsbn): 103-104

Key Growth Drivers

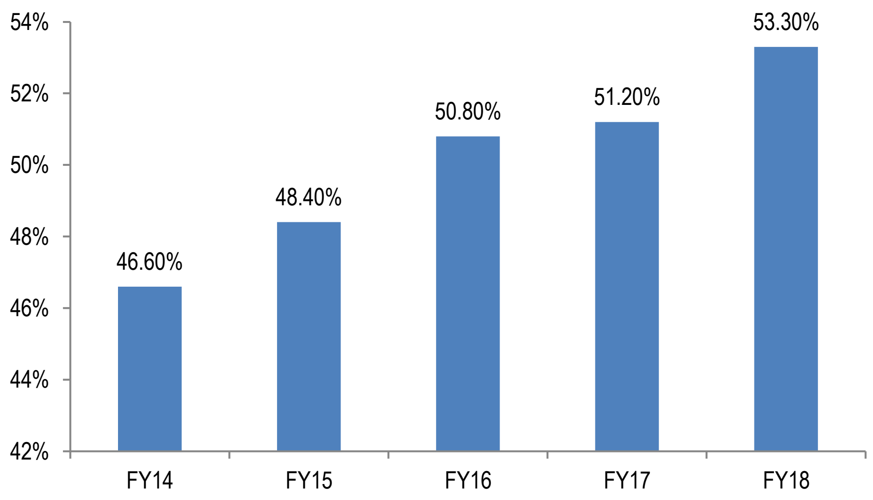
Favorable spending patterns and demographics augur well for the industry: Private final consumption expenditure (PFCE) has grown at 7.3% over FY14-19 and is expected to grow at 7.5% CAGR till FY24. In addition, Indians have been increasingly spending more on discretionary items such as dining, entertainment, vacations and luxury goods. As per CRISIL data, share of discretionary spending has been on the rise, forming 53.3% in FY18 compared to 46.6% in FY14. Going forward, increasing per capita GDP should help increase share of discretionary spending.

Exhibit 1: PFCE is expected to remain on upward trajectory



Source: DRHP, Company, Nirmal Bang Institutional Equities

Exhibit 2: Share of discretionary spending is on the rise



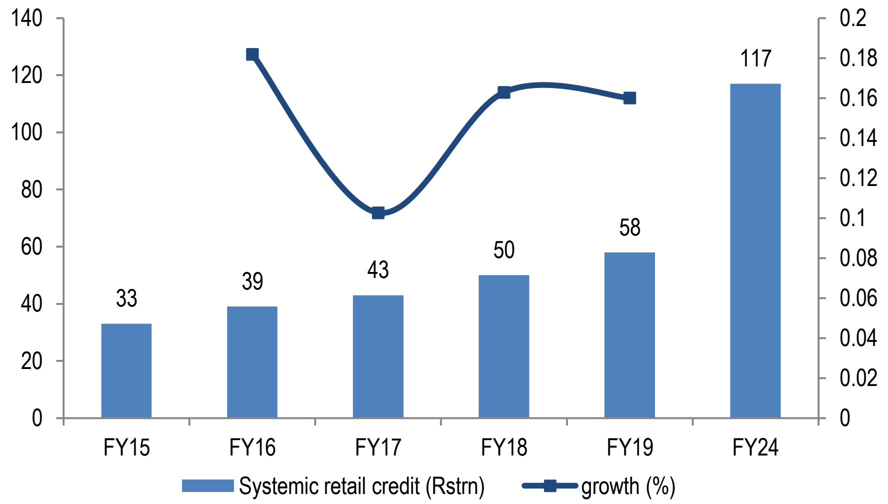
Source: DRHP, Company, Nirmal Bang Institutional Equities

Further, a low median age compared to other countries places India favorably from a growth perspective. A higher share of working population, which is aspiring in nature, is expected to contribute to PFCE. India's working age population is expected to grow from 0.31bn in CY10 to 0.37bn in CY20.

Additional drivers would be urbanization leading to job creation and development of modern services, which in turn should translate into higher urban consumption. Urbanization in India is lower at 34% compared with 56% for Indonesia, 60% for China and 82% for the US.

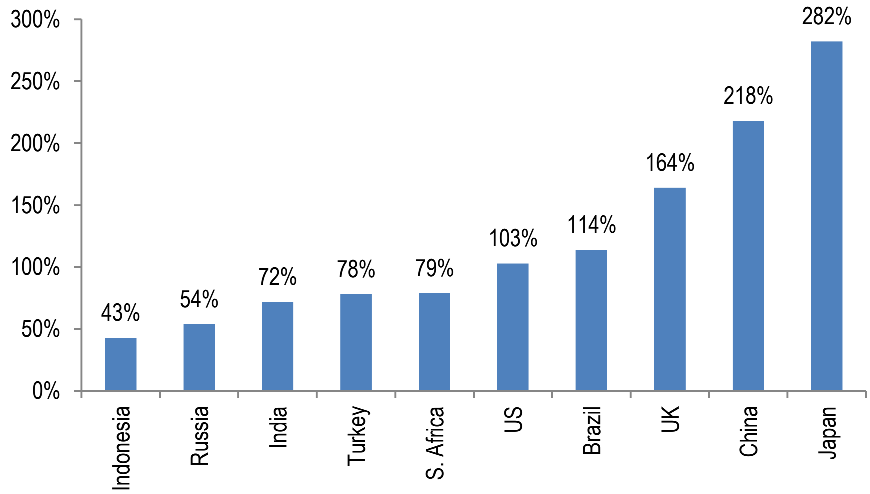
Low credit penetration will propel retail credit growth: Retail credit in India is expected to double to Rs117trn by FY24, which translates into a CAGR of 15%. Growth is expected to be propelled by increase in PCFE with a steady rise in disposable income, shift in consumer-spending pattern and lower averseness to taking debt. As of 2017, India's credit penetration stood at 72% compared to 103% for the US and 164% for the UK. Though, credit penetration has been increasing due to the rapid pace of formalization, the under-penetration still offers room for continued momentum in the medium term.

Exhibit 3: Retail credit is expected to grow at 15% CAGR over FY19-24E



Source: DRHP, Company, Nirmal Bang Institutional Equities

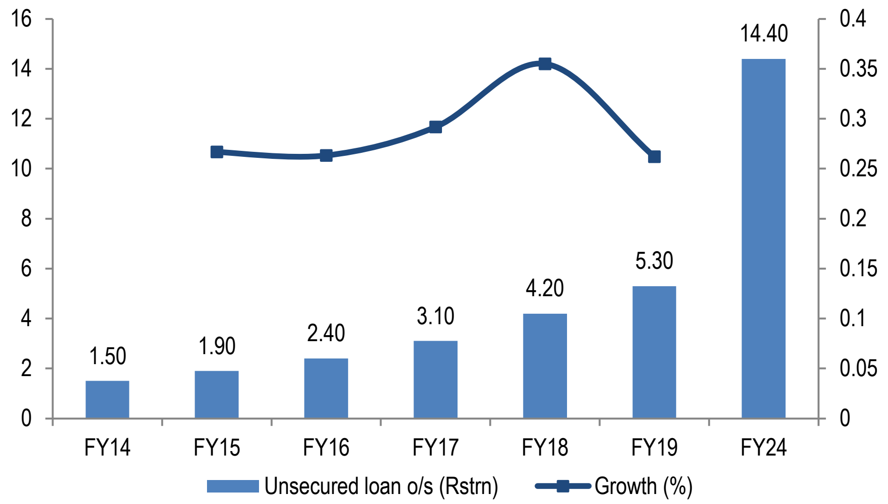
Exhibit 4: Credit penetration (domestic credit as proportion of GDP) in India is on the lower side, despite rapid growth in recent years



Source: DRHP, Company, Nirmal Bang Institutional Equities

Unsecured credit to outpace retail credit growth: Compared to retail credit, unsecured loans have grown at a faster pace in India at a CAGR of 28% to reach approximately 5trn unsecured loans as of FY19. As per Crisil, approximately 25% of new card additions in FY19 were to new-to-credit (NTC) customers. Growth in unsecured lending has been aided by high usage of technology which has helped service/product providers improve their offering through digital initiatives. For low-ticket size offerings, such as credit cards and personal loans, the preference is clearly higher for accessing the digital route. The unsecured loan market in India is expected to reach approximately Rs14.4trn by FY24, which translates into a CAGR of 22%. Over the last 5 years, unsecured credit has grown at a CAGR of 28% and stands at Rs5.3trn as of FY19.

Exhibit 5: Unsecured credit has outpaced overall retail credit growth; likely to grow at 22% over the next 5 years



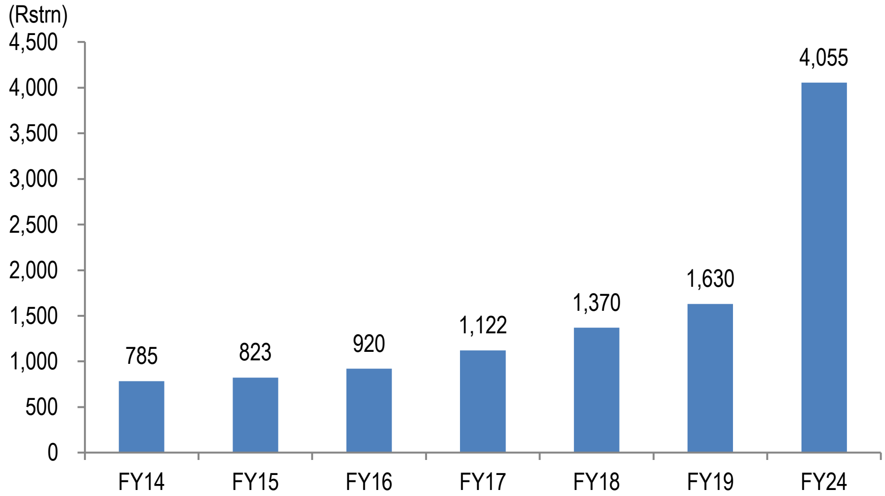
Source: DRHP, Company, Nirmal Bang Institutional Equities

Apart from the aforementioned reasons, steady rise in organized retail penetration and strong growth of e-commerce industry have also resulted in higher growth in the unsecured loan market. CRISIL estimates that credit cards account for 30-35% of overall e-commerce payment value. The e-commerce industry in India is expected to grow from Rs2905bn in FY19 to Rs9025bn in FY24 (23-28% CAGR).

Credit cards to witness highest growth: Within the unsecured basket, credit cards are expected to witness a growth of 23% over the next five years, driven by rising issuance of cards in smaller cities, increasing organized retail penetration and growth in payments infrastructure. Personal loans and consumer durables are also expected to grow at 20-22% and 19-21% over the next five years, respectively. Further, credit card penetration (credit cards per 100 persons) in India stands at 3 compared to 42 for China, 89 for Australia and 320 for the US.

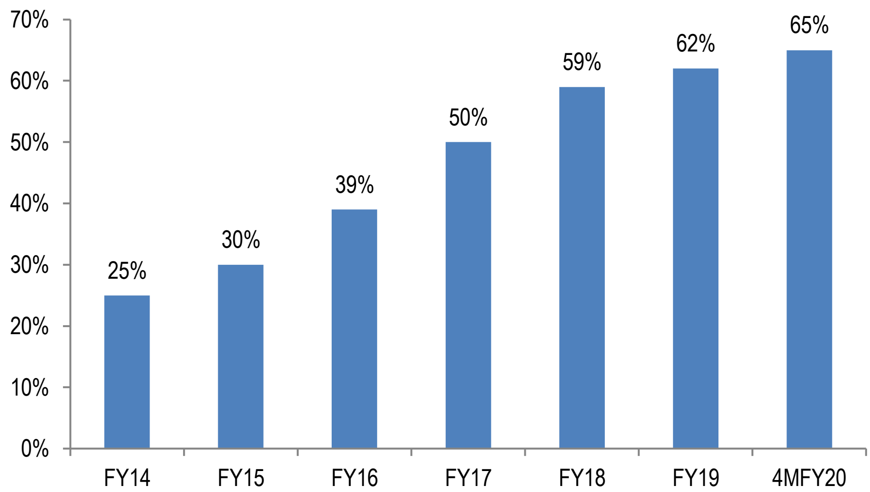
Digital payments will be a catalyst: Digital transactions have grown at 44% CAGR over FY14-19 on the back of increase in mobile internet users, increasing convenience of transacting digitally and a booming e-commerce sector. The payments space has seen rapid innovation in the past few years, led by government and regulatory initiatives as well as changing consumer preferences. The digital payments value in India is expected to more than double to Rs4055trn in FY24, which translates into a CAGR of 20%. This thesis is also supported by increasing share of digital transactions. As of 4MFY20, share of digital transactions strands at 65% compared to 25% in FY14.

Exhibit 6: Digital payments market size



Source: DRHP, Company, Nirmal Bang Institutional Equities

Exhibit 7: Share of digital transactions (%)



Source: DRHP, Company, Nirmal Bang Institutional Equities

Industry overview

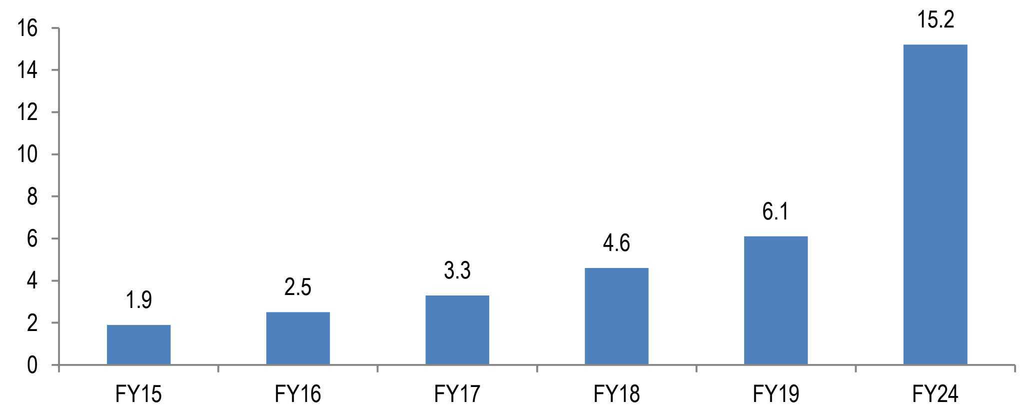
Credit card spends have registered a growth 32% over FY15-19 to reach Rs6.1trn and are expected to grow at a CAGR of 20% to reach Rs15.2trn by FY24. Such growth has been volume-led, while average annual spending has grown at a moderate rate. Number of credit cards issued stood at 47mn as of FY19, growing at 20% over the last five years.

Key reasons for high growth in the credit card industry:

- Increasing acceptance of digital payments by Indian consumers;
- Rise of e-commerce businesses, such as Flipkart/Amazon, providing promotional-offers and EMI financing;
- Banks' focus on cross-sell;
- Ease of payment (convenience) related to travel, shopping, lifestyle purchases, entertainment, healthcare, utility payments.

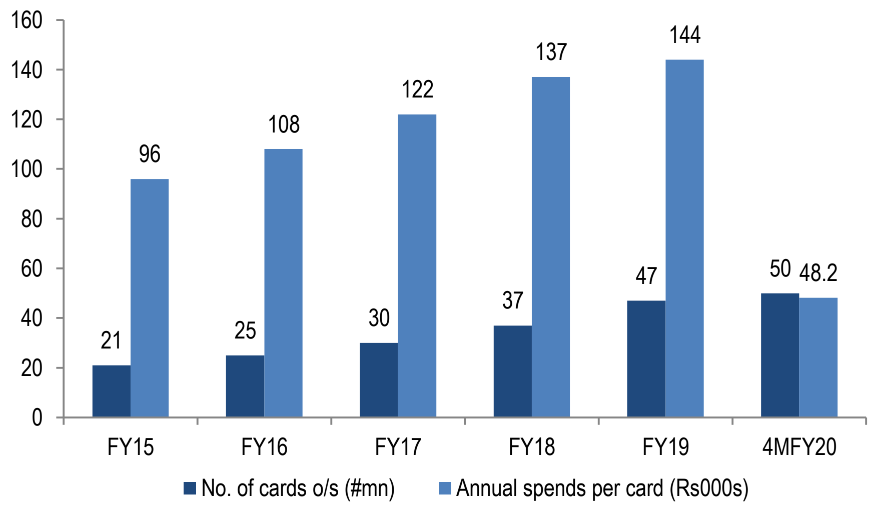
Credit card dues are expected to grow to Rs3313bn by FY24 (CAGR of 23%), supported by spends growth and increasing EMI-based payments.

Exhibit 8: Credit card spends (Rstrn)



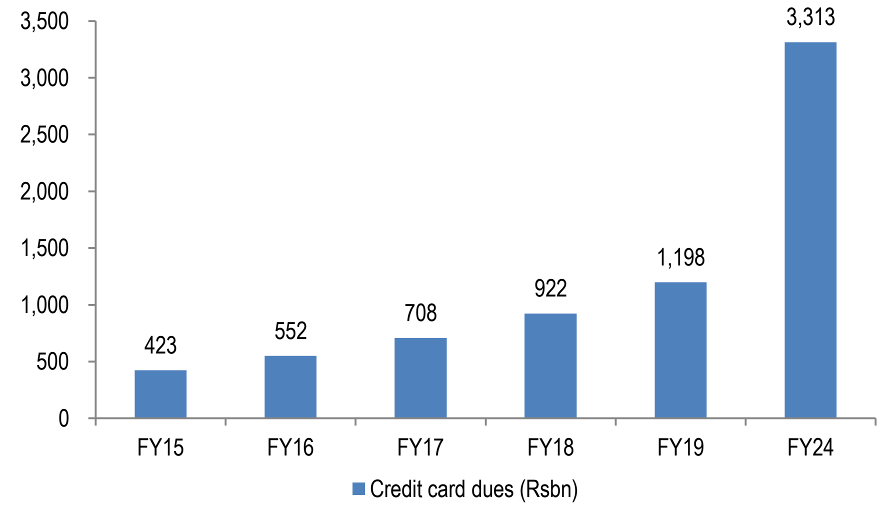
Source: DRHP, Company, Nirmal Bang Institutional Equities

Exhibit 9: No. of cards outstanding and annual spends per card witnessing positive traction



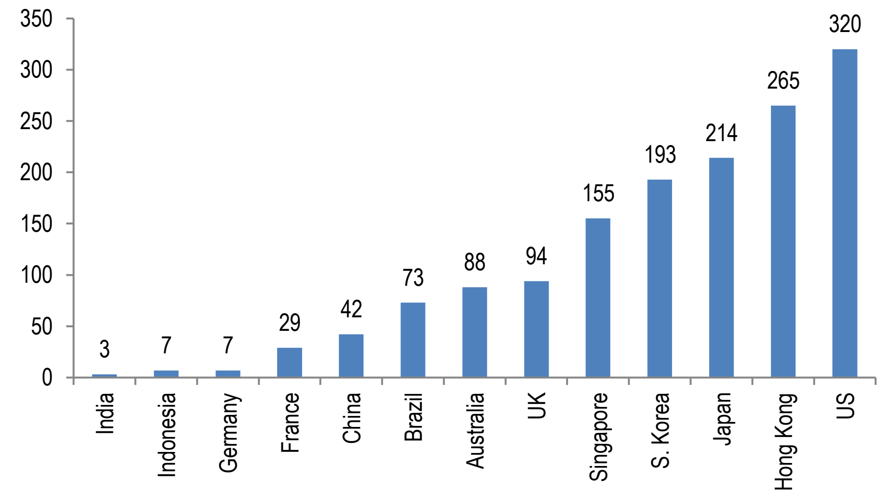
Source: DRHP, Company, Nirmal Bang Institutional Equities

Exhibit 10: Credit card due to witness upward trajectory



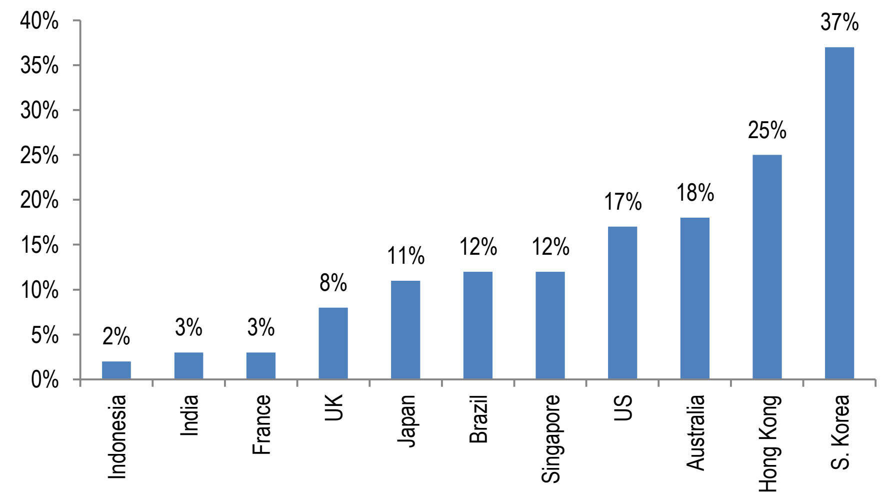
Source: DRHP, Company, Nirmal Bang Institutional Equities

Exhibit 11: Credit card penetration is still low in India at just 3 card per 100 people



Source: DRHP, Company, Nirmal Bang Institutional Equities

Exhibit 12: Credit card spends as % of GDP (CY17)



Source: DRHP, Company, Nirmal Bang Institutional Equities

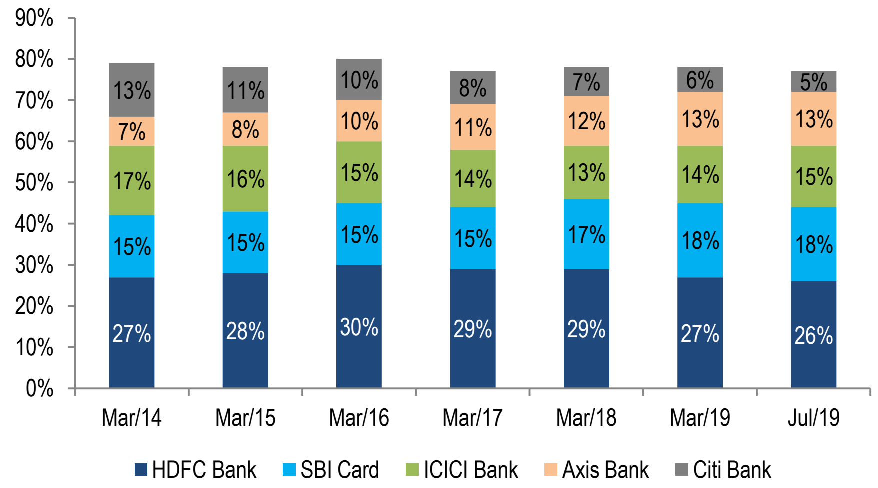
Competitive Scenario – Market is highly concentrated with the top 4

Though there are 74 companies offering credit cards in India, HDFC Bank, Axis Bank, ICICI Bank and SBI Cards (SBIC) dominate the market with approximately 72% market share in terms of number of cards outstanding as of FY19. Market share of these four by credit cards spends stands at 66%.

HDFC Bank is the market leader and has maintained its market share (by no. of cards) at 27%, followed by SBI Cards at 18%, ICICI Bank at 14% and Axis Bank at 13%. New players such as RBL Bank have been emerging strongly on the back of co-branded cards while foreign players like Citi Bank has been losing market share to private banks.

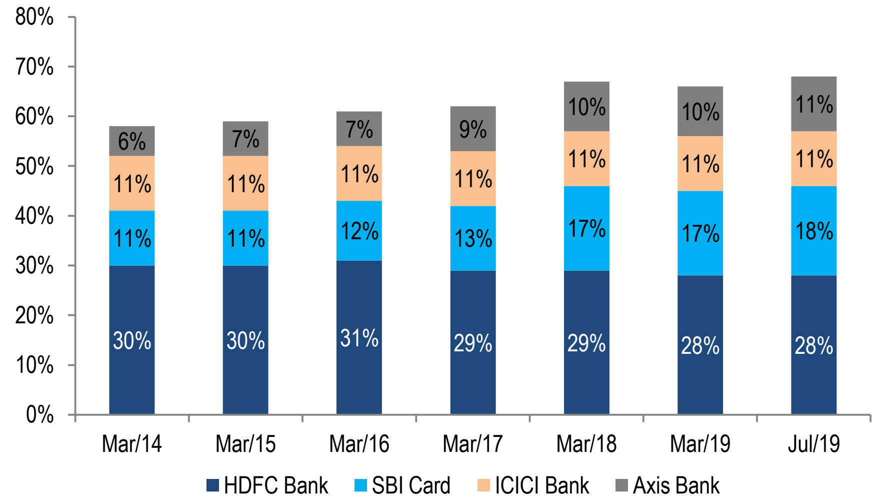
Top players such as HDFC Bank, SBI Cards, ICICI Bank and Axis Bank are expected to continue to account for ~70% market share of the overall credit card outstanding.

Exhibit 13: Market share in terms of total outstanding credit cards



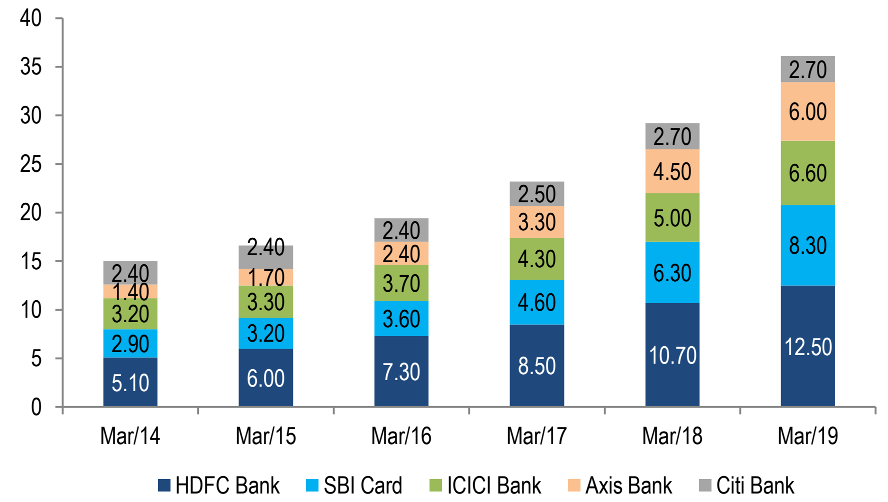
Source: DRHP, Company, Nirmal Bang Institutional Equities

Exhibit 14: Market share in terms of total credit cards spends (%)



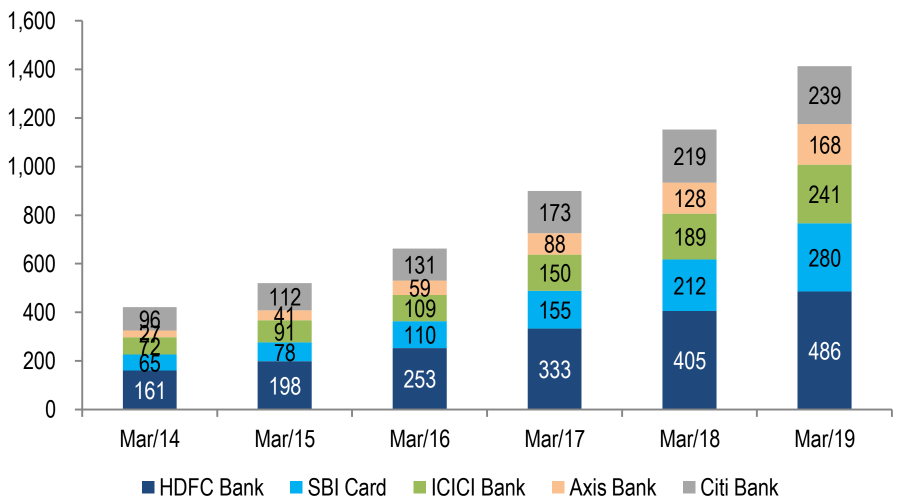
Source: DRHP, Company, Nirmal Bang Institutional Equities

Exhibit 15: No. of cards in force (CIF) (mn)



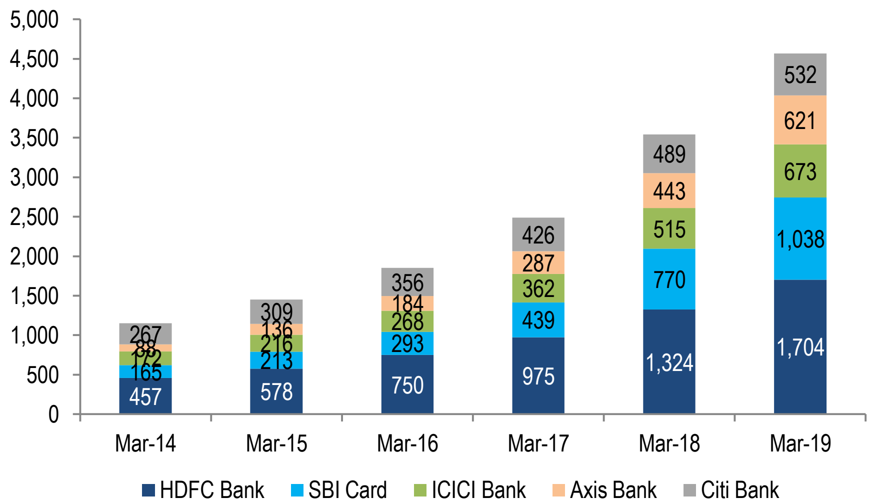
Source: DRHP, Company, Nirmal Bang Institutional Equities

Exhibit 16: No. of transactions (mn)



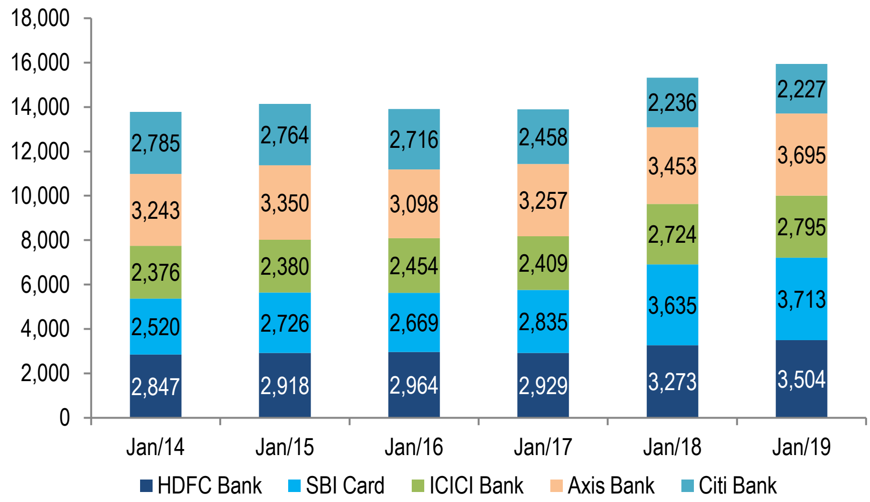
Source: DRHP, Company, Nirmal Bang Institutional Equities

Exhibit 17: Total spend (Rsbn)



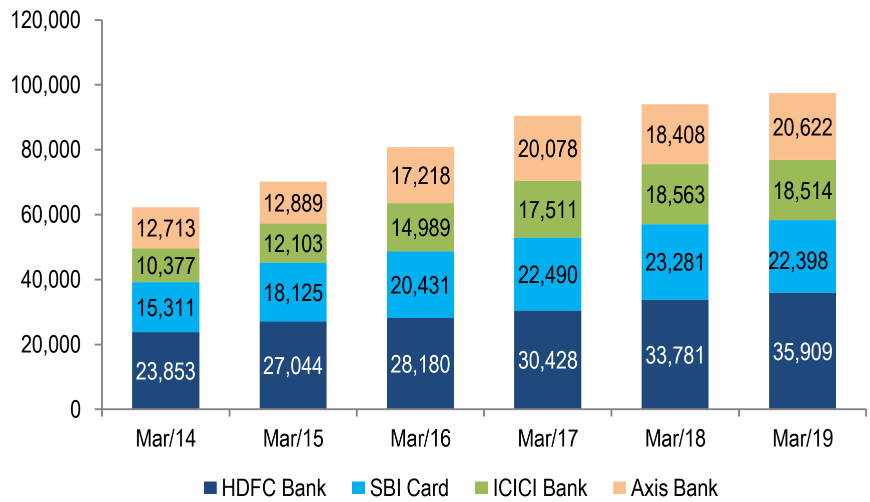
Source: DRHP, Company, Nirmal Bang Institutional Equities

Exhibit 18: Average spend per transaction (Rs)



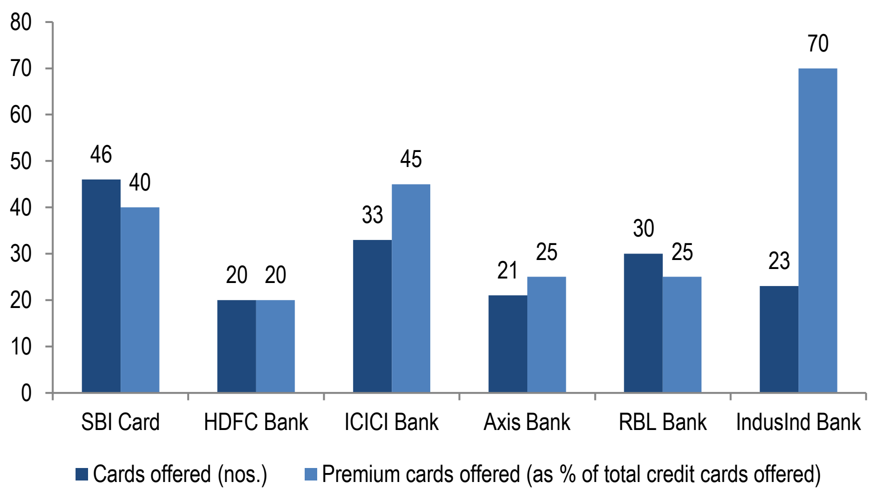
Source: DRHP, Company, Nirmal Bang Institutional Equities

Exhibit 19: Average outstanding per CIF (Rs)



Source: DRHP, Company, Nirmal Bang Institutional Equities

Exhibit 20: Proportion of premium cards offered – Premium cards usually entail offers from airlines, hotel credits, VIP lounge access, premium gifts and a wide range of lifestyle and other benefits



Source: DRHP, Company, Nirmal Bang Institutional Equities

About the Company

SBIC is the second-largest credit card issuer in India with a market share of 18% in terms of number of cards outstanding as of FY19. The company has grown its business faster than the Indian credit card market over the past three years, both in terms of number of credit cards outstanding and amount of credit cards spends by leveraging its strengths and capitalizing on favorable demographics. SBIC is the largest co-brand credit card issuers in India with partnerships including Air India, Apollo Hospitals, BPCL, Etihad, IRCTC, OLA Money and Yatra, among others.

The company has a diversified/multi-channel customer acquisition network, including 33,086 outsourced sales personnel. Being a leading player in the open market customer acquisition, the company has presence in 3,009 open market PoS across India. Additionally, partnership with SBI provides the company with access to SBI's extensive network of 22,007 branches and a base of 436mn customers. Physical customer acquisition network is further complemented by a broad offering of digital channels, including website and mobile application. The company has also integrated its digital customer acquisition platform with SBI's YONO interface which helps market products to SBI's customers.

Over FY17-19, SBIC credit card spends have grown at a CAGR of 54.2% compared to 35.6% for the industry and the number of credit cards outstanding have grown at 34.5% compared to 25.6% for the industry (over the same period).

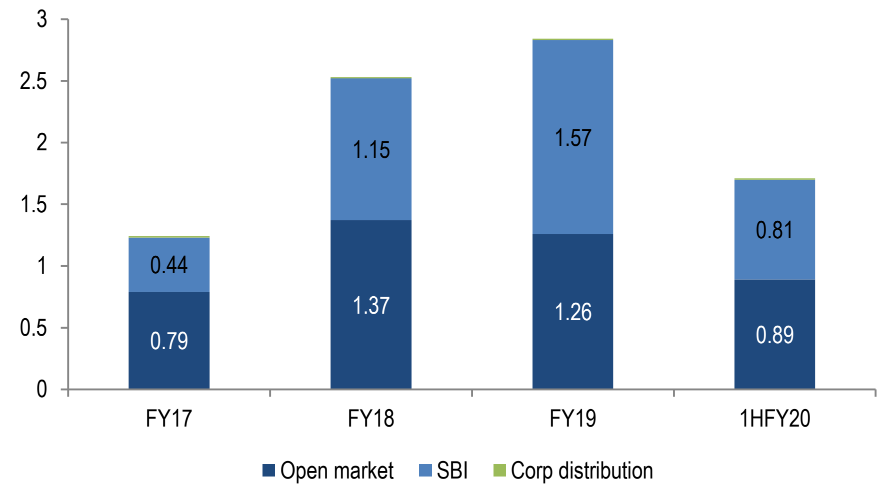
The company enjoys strong profitability profile with RoA/RoE of ~5%/29% as of FY19, driven by strong margins as well as improving cost structure. Within the total gross revenue, 48% is accounted for by interest income and 43% by fee and service charges, thus providing for a diversified revenue profile. Though credit costs were higher during FY19, we think that asset quality is manageable with GNPAs/NNPAs of 2.4%/0.8% as of FY19. Over the years, the company has invested substantially in its collection mechanism which is an integral part of the overall business operations.

Exhibit 21: Profitability comparison

Profitability	Industry	SBIC
NII	11.8%	14.2%
Fee income	17.4%	20.7%
Opex	19.5%	21.1%
Credit costs	4.5%	6.4%
Tax	1.7%	2.6%
RoA	3.5%	4.8%

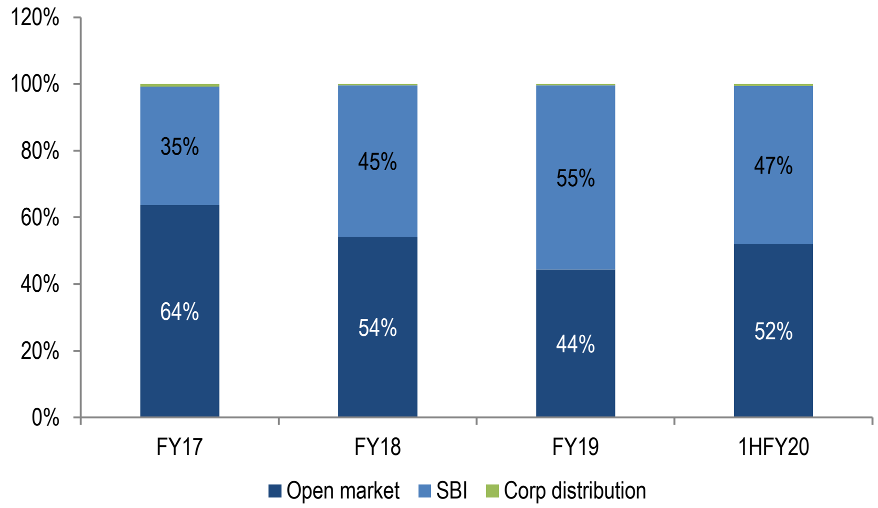
Source: DRHP, Company, Nirmal Bang Institutional Equities

Exhibit 22: Customer acquisition by channel (mn)



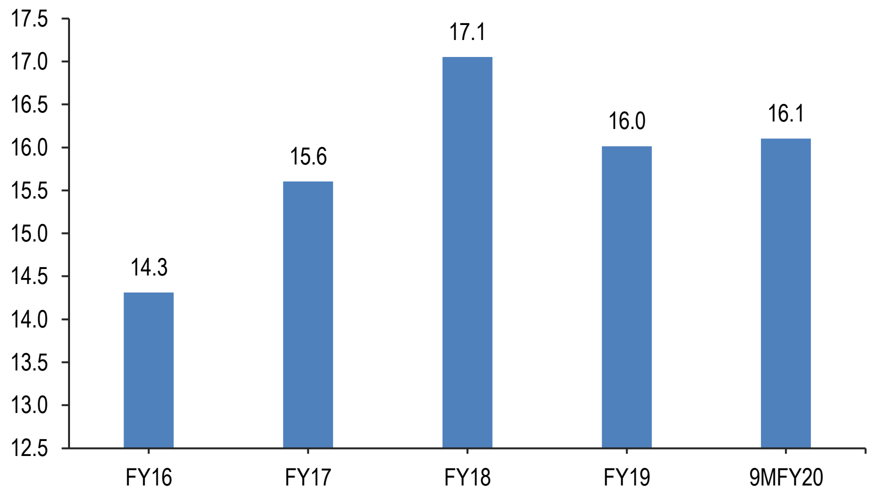
Source: DRHP, Company, Nirmal Bang Institutional Equities

Exhibit 23: Share of customer acquisition by channel (%)



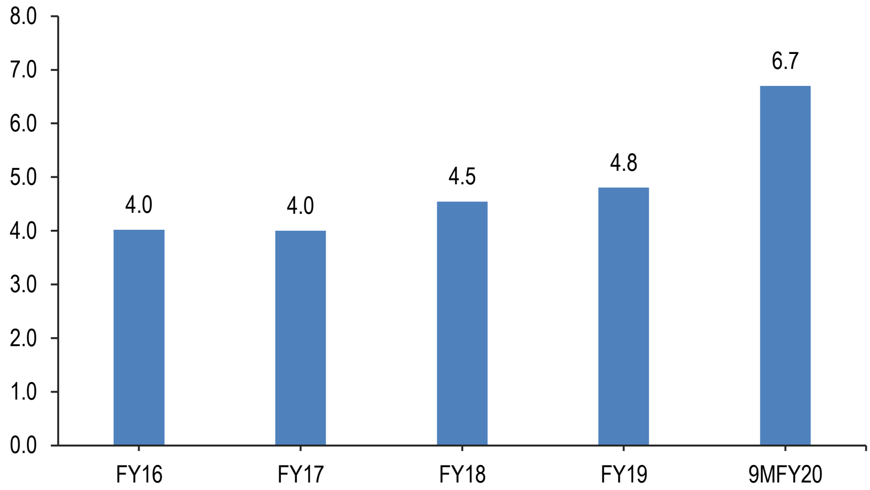
Source: DRHP, Company, Nirmal Bang Institutional Equities

Exhibit 24: NIM (%)



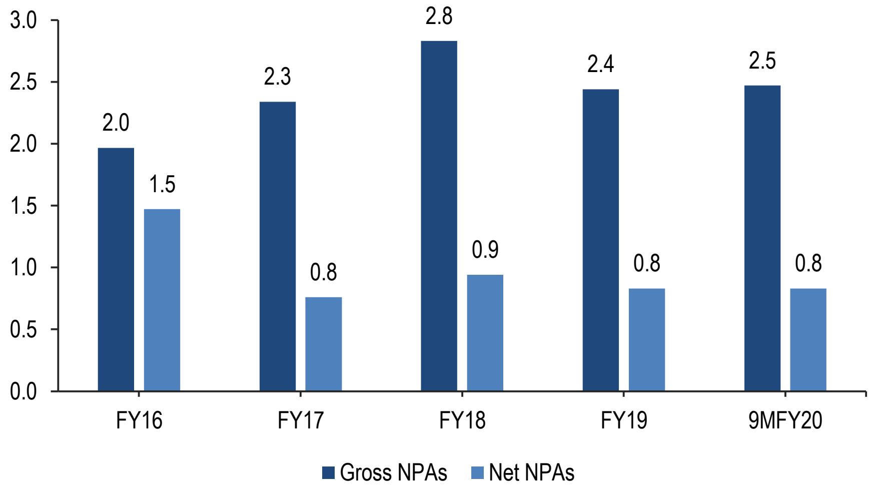
Source: DRHP, Company, Nirmal Bang Institutional Equities

Exhibit 25: RoA (%)



Source: DRHP, Company, Nirmal Bang Institutional Equities

Exhibit 26: Asset quality (%)



Source: DRHP, Company, Nirmal Bang Institutional Equities

Financials

Exhibit 27: Balance sheet

Y/E March (Rsmn)	FY16	FY17	FY18	FY19	9MFY20
Share capital	7,850	7,850	7,850	8,372	9,323
Reserves & surplus	3,700	6,638	15,681	27,445	38,190
Shareholders' funds	**11,550**	**14,488**	**23,531**	**35,817**	**47,513**
Borrowings	59,281	85,567	1,20,577	1,46,082	1,94,064
Other liabilities & provisions	7,972	7,594	12,753	20,497	18,357
Total liabilities	**78,803**	**1,07,650**	**1,56,860**	**2,02,396**	**2,59,935**
Fixed assets	21	239	2,768	3,066	3,350
Investments	-	-	-	15	15
Loans	74,460	99,829	1,40,455	1,79,087	2,39,332
Cash	2,745	2,829	4,727	7,768	5,078
Other assets	1,579	4,753	8,910	12,461	12,160
Total assets	**78,803**	**1,07,650**	**1,56,860**	**2,02,396**	**2,59,935**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 28: Income statement

Y/E March (Rsmn)	FY16	FY17	FY18	FY19	9MFY20
Interest income	13,803	18,882	27,600	35,757	34,931
Interest expenses	4,303	5,284	7,115	10,172	9,664
Net interest income	**13,803**	**18,882**	**27,600**	**35,757**	**34,931**
Non-interest income	11,118	15,829	26,102	37,111	37,471
Net revenues	**20,619**	**29,426**	**46,587**	**62,696**	**62,738**
Operating expenses	13,558	18,390	29,393	37,903	35,531
Operating profit	**7,061**	**11,036**	**17,194**	**24,793**	**27,207**
Provisions	2,679	5,320	8,001	11,477	11,021
PBT	4,382	5,716	9,193	13,316	16,187
Tax	1,543	1,988	3,182	4,689	4,575
PAT	**2,839**	**3,729**	**6,011**	**8,627**	**11,612**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 29: Key ratios

Y/E March (Rsmn)	FY16	FY17	FY18	FY19	9MFY20
Growth (%)					
Net interest income	33.9	43.1	50.7	24.9	34.1
Operating profit	40.2	56.3	55.8	44.2	56.0
Profit after tax	6.5	31.3	61.2	43.5	89.0
Business (%)					
Advances growth	27.7	34.1	40.7	27.5	38.8
Spread (%)					
Yield on loans	20.8	21.7	23.0	22.4	22.3
Cost of borrowings	8.1	7.3	6.9	7.6	7.6
Spread	12.7	14.4	16.1	14.8	14.7
NIM	14.3	15.6	17.1	16.0	16.1
Operational efficiency (%)					
Cost- to-income	65.8	62.5	63.1	60.5	56.6
Cost-to-Assets	19.2	19.7	22.2	21.1	20.5
CRAR (%)					
Tier I	14.3	11.3	12.4	14.7	15.4
Tier II	3.9	4.4	5.9	5.3	3.8
Total	18.1	15.7	18.3	20.0	19.2
Asset quality (%)					
Gross NPAs	2.0	2.3	2.8	2.4	2.5
Net NPAs	1.5	0.8	0.9	0.8	0.8
PCR	25.2	67.5	66.8	66.0	66.4
Credit cost	4.0	6.1	6.7	7.2	7.0
Return ratios (%)					
RoE	26.8	28.6	31.6	29.1	37.2
RoA	4.0	4.0	4.5	4.8	6.7
Per share (Rs)					
EPS	3.6	4.7	7.7	10.3	12.5
BV	14.7	18.5	30.0	42.8	51.0
ABV	13.3	17.5	28.3	41.0	48.8

Source: Company, Nirmal Bang Institutional Equities Research

DISCLOSURES

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