Anvil

Anvil Shares & Stockbroking Pvt Ltd

Financials
July 9, 2020

CMP	**695**
Target Price	**821**
Sensex	**36329**

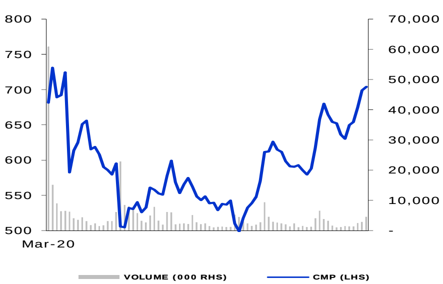
Equity Cap (INR mn)	9390
Face Value (INR)	10.0
Free float (%)	30.5
INR / USD	75.0
Market cap (INR bn)	653.5
Market cap (USD bn)	8.7
52 Wk High/Low (INR)	769 /495
Avg traded vol (shares)*	1006750
Avg trading value (INR mn)*	390

* 6 months BSE average

Shareholding Pattern (%) – Mar'20

Promoter	69.6
Foreign Institutional Investor	4.1
MF / FI / UTI / Banks	3.8
Public & Others	22.0
Bodies Corporate	0.6

2 yr Price and Volume Chart



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SBI Cards & Payments Ltd

Initiating Coverage — BUY — Target Price : Rs 821

SBI Cards & Payments Ltd (SBIC) is a pure play on improving digital payments culture, rise in discretionary consumption and underpenetrated credit card & retail credit industry. The company is the second largest card issuer in India with industry leading growth in volumes (FY 17-20 CAGR of 31.9%, industry at 24.6%) and Spends (FY17-20 CAGR of 44%, industry at 30.6%). We believe SBICs strong parentage, brand image and market leadership will enable the company to capture rising share in India's fast growing credit card industry.

Investment Rationale

Second largest player in underpenetrated market: India is extremely underpenetrated whether it is in terms of carded population (4 in 100 Indians have a credit card) or spends / card when compared to peers and developed economies, creating a long term factor for sustainable growth. While other factors like lower per capita income in India etc are at play, we believe there is reasonable scope for the Cards in Force (CIF) to increase from 57.7mn currently to over ~145mn over the next 5 years, implying strong growth of over 20%+. Further, we expect credit card spends to grow at 25%+ driven largely by card additions and rising spends / card over the medium- long term. SBIC is the 2ndlargest card issuer in the country, in an extremely concentrated market, where the top 4 card issuers control 70% market share. This highlights the complexity of business, infrastructure set-up & technological sophistication required to run this business.

Huge opportunity to cross-sell to SBI customers: SBIs parentage provides SBIC with a huge opportunity to cross-sell, with access to 448mn+ customers and leveraging its vast branch network of over 22100+. The cross selling initiative (Project Shikhar launched in Oct 2017) has been very effective with credit cards sourced through banca channel at 49.5% in FY20 (FY17 – 36%). Despite the increased sourcing from SBI, SBICs penetration of SBI's debit card base (278.1mn cards) is extremely low at ~4% (FY16 - 1.9%) as compared to industry leader HDFC bank at 45.2%. Consequently, we believe SBIC is well placed to capture a rising share of India's growing credit card penetration story with market share gains.

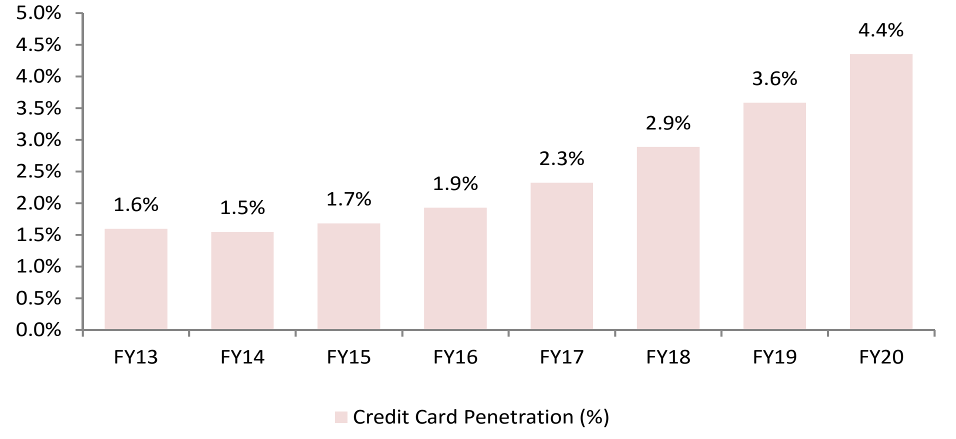
COVID-19 impact in FY21, expect normalization post: We expect that growth & asset quality are likely to be impacted in FY21E, due to COVID-19 related lock down. Anecdotal evidence from the GFC suggests that credit costs rose to 8-10%. Conservatively, we factor in elevated credit costs of 12.8% on the back of already conservative build up in provisions in FY20 of 9.5%. Post which we expect credit costs to revert to long term averages. We draw comfort from ~85% salaried customers in SBICs customer base, increased role of credit bureaus & option to convert customer's revolving credit into EMIs. We expect credit card issuances & spends to rebound post FY21E.

View & Valuation: We Initiate Coverage on SBIC with a BUY rating and a Target Price of Rs 821 using Residual Income Model (P/E – 39.8x & P/BV of 8.7x FY22E). We have assumed a higher cost of equity (12.93%) as compared to 11.5% for private banks, to factor in the relatively untested experience of retail asset quality cycle, risks of regulatory intervention and uncertain impact on growth & profitability from COVID-19. Valuations appear rich when compared to other financials, but given the fact that SBIC is the only unique pure play credit card company with a long growth runway in an under penetrated credit card market, ability to cross sell to SBIs customer base, providing strong visibility of sustainable 25%+ RoE and 30%+ compounding of earnings, premium valuations should sustain, in our view.

Indian credit card industry growth remains strong but penetration levels are still abysmally low

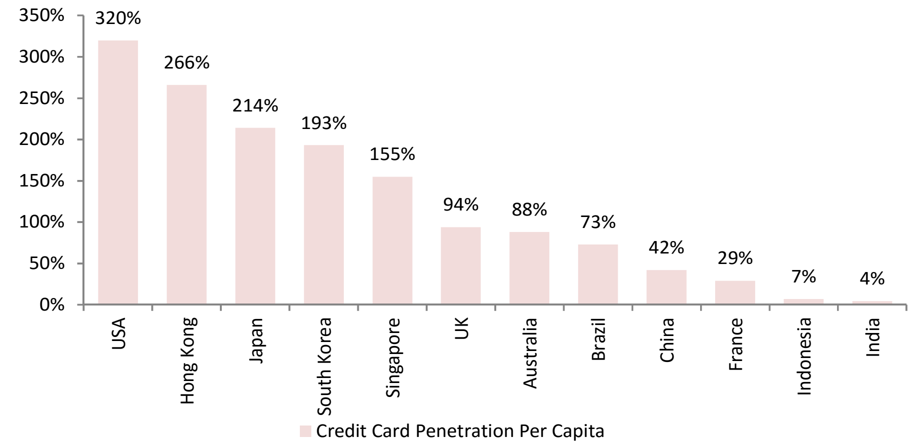
India's credit card industry has grown at a robust pace over the past 5 years with Cards In Force (CIF) growing at CAGR of 22.3%, transactions witnessing a CAGR of 28.8% and spends witnessing a CAGR of 30.8%. Despite this strong growth in the past 5 years, India remains massively underpenetrated as only 4 in 100 people in India own a credit card and CIF to population stands low at 4.4%. Even if we look at card spends as percentage of GDP, India lags most developing and developed countries. We do believe that this is primarily due to India's low per capita income.

Exhibit: Credit card penetration in India is on the rise but remains low at merely 4.4%



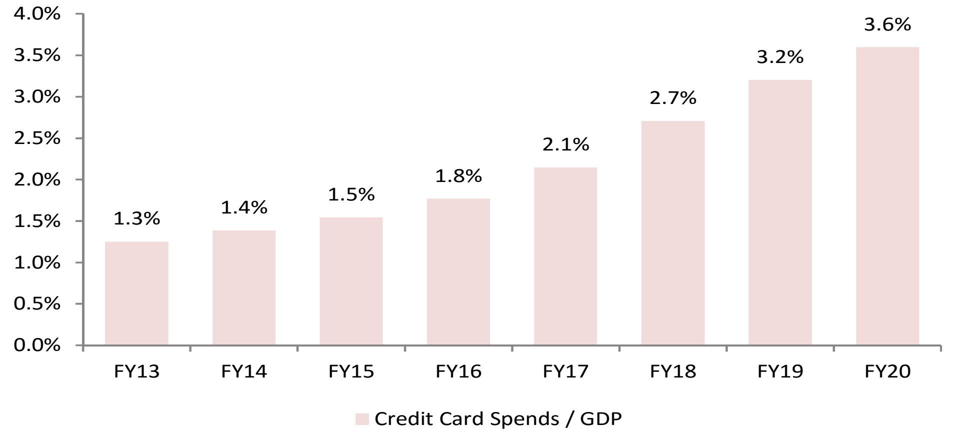
Source: MOSPI, RBI, Anvil Research

Exhibit: India credit card penetration one of the lowest vs global peers



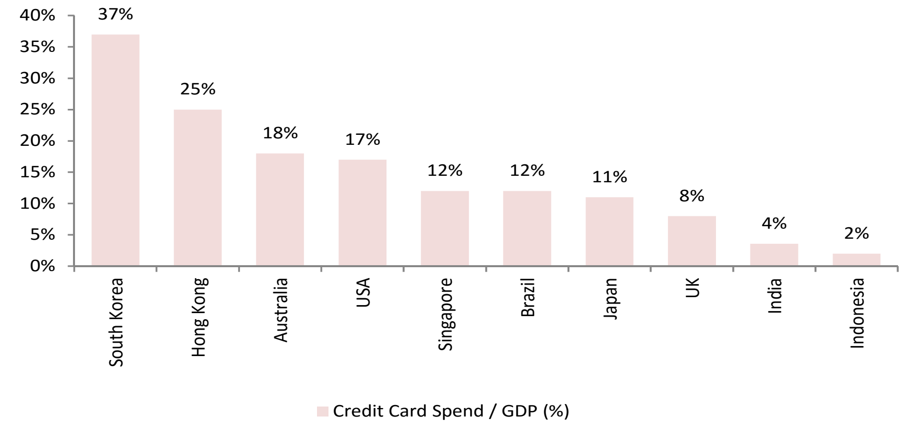
Source: World Bank, Bank for International Settlement (BIS), CRISIL, Anvil Research

Exhibit: Credit card spends as % to GDP have been increasing



Source: MOSPI, RBI, Anvil Research

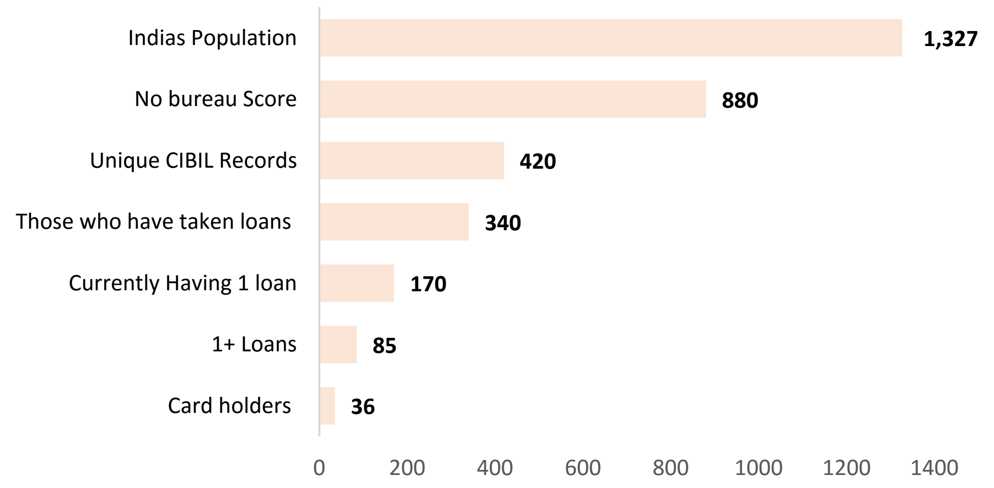
Exhibit: Credit card spends global comparison, India at the bottom



Source: World Bank, Bank for International Settlement (BIS), CRISIL, Anvil Research

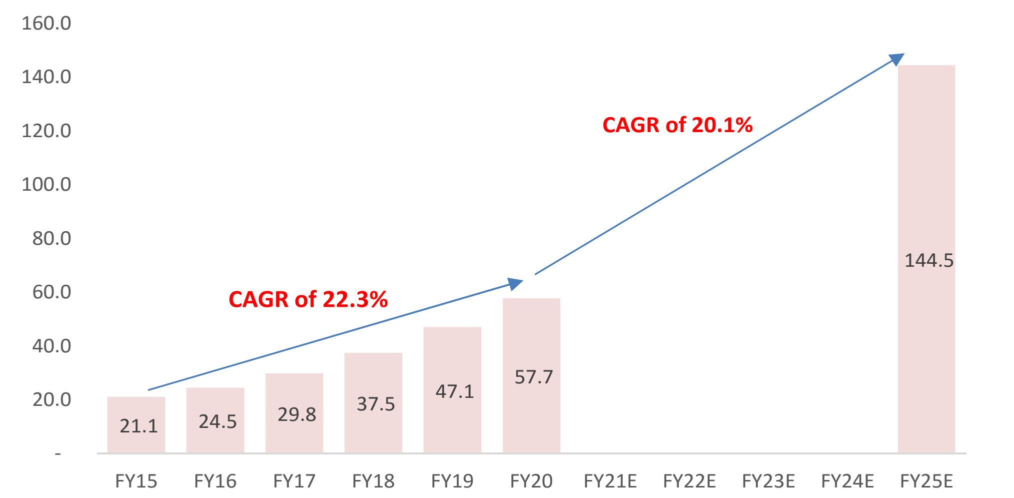
However, we believe there are several factors that support a long term structural increase in adoption and growth of credit cards business in India like - rising urbanization, increasing consumption spends, government & regulatory push towards non-cash payments, rising use of e-commerce, rising share of younger millennial's that have higher inclination to spend through cards. These structural factors have further been supported by the advent of credit bureau which have aided in analytics, data warehousing and better underwriting. Credit to Debit card ratio is merely at 7%. We believe despite the COVID-19 disruption such an under-penetrated market offers huge potential, there is reasonable scope for CIF to increase from 57.7mn currently to over ~145mn over the next 5 years, implying a strong growth of over 20%+. Credit card spends too have registered a robust growth, registering a CAGR of 30.9% over the past 5 years to reach INR 7.4 tn. This growth in spends was supported by growth in credit cards volume, which has increased over the years, while average annual spending has grown at a moderate CAGR of 7.8% over the past 5 years. We expect the credit card spends to grow at over 25% driven largely by addition of cards and rising spend per card over the medium-long term. Incrementally growth in spends per card is likely to moderate as issuers start exploiting smaller cities for growth.

Exhibit: Card holders are less than 3% of India's population and ~8.5% of customers having unique CIBIL record



Source: Company, Transunion CIBIL, Anvil Research

Exhibit: Strong probability of CIF to grow at 20%+in the medium term



Source: RBI, Anvil Research

Credit card industry in India dominated by few players – top 4 players control over 71% of market

There are a total of 74 players offering credit cards in India, with the top three private banks (HDFC Bank, ICICI Bank & Axis Bank) and SBIC, as the leading standalone credit card issuer, dominating the credit card business with a total of approximately 71.3% market share by CIF and 69.2% market share by credit card spends in FY20.

HDFC Bank is the market leader and has maintained its market share in the number of outstanding credit cards over the years with market share of 25.1%, followed by SBIC at 18.3%, ICICI Bank at 15.8% and Axis Bank at 12.1%. **The market share of SBIC in terms of total outstanding cards has continuously increased over the years from 15.0% in FY14 to 18.3% in FY20.**The Top 4 players along with RBL Bank ~4% market share now (on the back of co-branded cards) have been gaining market share, as foreign players like CITI Bank (CIF market share down to 4.8% from 12.5% in FY14 & Spends market share down to 7.2% from 17.2% in FY14) have been ceding market share.**This highlights the complexity of business, infrastructure set-up and technological sophistication required to run this business. We believe dynamics of the industry and players is unlikely to change materially in the near term.**

Exhibit: SBIC has nearly tripled its card base since FY14 and has improved market share from 15.1% to 18.3%. Second only to HDFCBK

No of Credit Cards in force		FY14	FY15	FY16	FY17	FY18	FY19	FY20	CAGR FY14-20 (%)
HDFC Bank	#mn	5.1	6	7.3	8.5	10.7	12.5	14.5	23.2%
SBI Card	#mn	2.9	3.2	3.6	4.6	6.3	8.3	10.5	29.5%
ICICI Bank	#mn	3.2	3.3	3.7	4.3	5.0	6.6	9.1	23.3%
Axis Bank	#mn	1.4	1.7	2.4	3.3	4.5	6.0	7.0	37.9%
Citi Bank	#mn	2.4	2.4	2.4	2.5	2.7	2.7	2.8	3.1%
Others	#mn	4.2	4.5	5.1	6.6	8.3	11.0	13.8	27.0%
Total	#mn	**19.2**	**21.1**	**24.5**	**29.8**	**37.5**	**47.1**	**57.7**	24.7%

% of credit cards in force	FY14	FY15	FY16	FY17	FY18	FY19	FY20
HDFC Bank	26.6%	28.4%	29.8%	28.5%	28.5%	26.5%	25.1%
SBI Card	15.1%	15.2%	14.7%	15.4%	16.8%	17.6%	18.3%
ICICI Bank	16.7%	15.6%	15.1%	14.4%	13.3%	14.0%	15.8%
Axis Bank	7.3%	8.1%	9.8%	11.1%	12.0%	12.7%	12.1%
Citi Bank	12.5%	11.4%	9.8%	8.4%	7.2%	5.7%	4.8%
Others	21.8%	21.4%	20.8%	22.3%	22.1%	23.3%	23.9%

Source: RBI & Anvil Research

Exhibit: Credit card transactions market share

No. of transactions		FY14	FY15	FY16	FY17	FY18	FY19	FY20	CAGR FY14-20 (%)
HDFC Bank	#mn	161	198	253	333	405	486	609	30.5%
SBI Card	#mn	65	78	110	155	212	280	389	43.0%
ICICI Bank	#mn	72	91	109	150	189	241	324	35.1%
Axis Bank	#mn	27	41	59	88	128	168	199	49.1%
Citi Bank	#mn	96	112	131	173	219	239	231	19.2%
Others	#mn	91	99	130	193	260	358	447	37.4%
Total	**#mn**	**512**	**619**	**792**	**1,092**	**1,413**	**1,772**	**2,198**	**33.8%**

% of number of transactions	FY14	FY15	FY16	FY17	FY18	FY19	FY20
HDFC Bank	31.4%	32.0%	32.0%	30.5%	28.7%	27.4%	27.7%
SBI Card	12.7%	12.6%	13.9%	14.2%	15.0%	15.8%	17.7%
ICICI Bank	14.1%	14.7%	13.8%	13.7%	13.4%	13.6%	14.7%
Axis Bank	5.3%	6.6%	7.5%	8.1%	9.1%	9.5%	9.1%
Citi Bank	18.7%	18.1%	16.5%	15.8%	15.5%	13.5%	10.5%
Others	17.8%	16.0%	16.4%	17.7%	18.4%	20.2%	20.3%

Source: RBI & Anvil Research

Exhibit: SBIC has been consistently gaining market share both in terms of CIF and spends. SBICs spends have witnessed a CAGR of 43.9% in the last 5 year as compared to industry spends CAGR of 30.8%.

Total Spends		FY14	FY15	FY16	FY17	FY18	FY19	FY20	CAGR FY14-20 (%)
HDFC Bank	Rs mn	457,408	577,599	749,981	974,749	1,324,039	1,704,208	2,118,981	35.9%
SBI Card	Rs mn	164,928	212,845	293,324	438,545	770,232	1,038,353	1,312,947	51.4%
ICICI Bank	Rs mn	172,036	215,646	268,101	362,055	515,331	673,006	901,034	39.3%
Axis Bank	Rs mn	88,487	136,023	183,862	287,305	443,288	620,827	767,143	54.0%
Citi Bank	Rs mn	267,476	308,629	355,839	425,583	488,652	532,185	527,198	14.5%
Others	Rs mn	406,383	471,883	585,715	818,887	1,084,785	1,510,884	1,739,134	33.7%
Total	Rs mn	**1,556,718**	**1,922,625**	**2,436,822**	**3,307,124**	**4,626,327**	**6,079,463**	**7,366,437**	**36.5%**

% of total spends	FY14	FY15	FY16	FY17	FY18	FY19	FY20
HDFC Bank	29.4%	30.0%	30.8%	29.5%	28.6%	28.0%	28.8%
SBI Card	10.6%	11.1%	12.0%	13.3%	16.6%	17.1%	17.8%
ICICI Bank	11.1%	11.2%	11.0%	10.9%	11.1%	11.1%	12.2%
Axis Bank	5.7%	7.1%	7.5%	8.7%	9.6%	10.2%	10.4%
Citi Bank	17.2%	16.1%	14.6%	12.9%	10.6%	8.8%	7.2%
Others	26.1%	24.5%	24.0%	24.8%	23.4%	24.9%	23.6%

Source: RBI & Anvil Research

Exhibit: Average Spends per transaction, SBIC is now in line with industry and has increased from Rs 2537 in FY14 to Rs 3379 in FY20

Avg. spend per transaction		FY14	FY15	FY16	FY17	FY18	FY19	FY20	CAGR FY14-20 (%)
HDFC Bank	Rs	2,841	2,917	2,964	2,927	3,269	3,507	3,481	4.1%
SBI Card	Rs	2,537	2,729	2,667	2,829	3,633	3,708	3,379	5.9%
ICICI Bank	Rs	2,389	2,370	2,460	2,414	2,727	2,793	2,783	3.1%
Axis Bank	Rs	3,277	3,318	3,116	3,265	3,463	3,695	3,851	3.3%
Citi Bank	Rs	2,786	2,756	2,716	2,460	2,231	2,227	2,280	-3.9%
Others	Rs	4,464	4,747	4,518	4,241	4,173	4,216	3,894	-2.7%
Total	Rs	**3,040**	**3,104**	**3,078**	**3,028**	**3,274**	**3,430**	**3,351**	**2.0%**

Source: RBI & Anvil Research

Exhibit: Avg. spends per card for SBIC is lower than HDFC Bank, CITI which offers significant room for improvement. Growth has been strong CAGR of 17% for SBIC

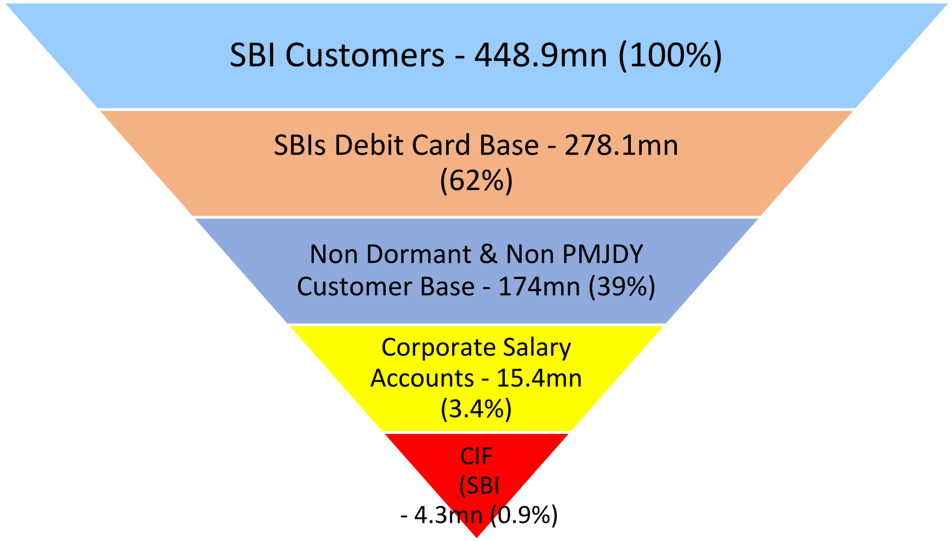
Avg. Spend per Card in Force		FY14	FY15	FY16	FY17	FY18	FY19	FY20	CAGR FY14-20 (%)
HDFC Bank	Rs	89,688	96,267	102,737	114,676	123,742	136,337	146,140	10.3%
SBI Card	Rs	56,872	66,514	81,479	95,336	122,259	125,103	124,479	17.0%
ICICI Bank	Rs	53,761	65,347	72,460	84,199	103,066	101,971	98,899	13.0%
Axis Bank	Rs	63,205	80,014	76,609	87,062	98,508	103,471	109,815	11.7%
Citi Bank	Rs	111,448	128,595	148,266	170,233	180,982	197,106	188,705	11.1%
Others	Rs	194,369	209,231	229,457	246,570	261,869	274,990	251,907	5.3%
Total	**Rs**	**162,314**	**182,147**	**198,882**	**221,640**	**246,836**	**258,214**	**255,136**	**9.5%**

Source: RBI & Anvil Research

Huge untapped potential in SBI customer base

SBIC's association with SBI provides it an unique opportunity. In addition to SBIs strong brand, it allows access to SBIs 22100+ branches and customer base of over 448mn+, of which ~ 15.4mn are corporate salary account holders. To put things in perspective, SBIC has a total card base of 10.5mn with total cards outstanding from SBI at ~ 4.3mn compared to SBIs customer base of over 448mn. While we are certainly not implying that all these 448mn customers would be eligible for credit cards, given that ~ 60% of these are either dormant or low-value PMJDY accounts.**Even if we were to assume that ~15% of the balance ~ 174mn customers, have reasonable incomes and can be converted to credit card customers that would mean SBIC has opportunity to cross sell to 6.1 x+ of its current SBI sourced customers.**

Huge customer pool of SBI customers still untapped – even corporate salary accounts are 3.6x of current SBI customer card in force for SBICs



Source:Company & Anvil Research

Low penetration of parent SBI's debit card base, ample scope for cross sell

Most credit card players in recent times have looked at exploring their existing banking relationships to expand their credit card base. One of the key drivers of CIF, transactions and receivables for credit card issuers in recent years has been rise in penetration of the banks' internal customers. HDFC Bank has taken a lead in tapping its existing customer base, with percentage of credit cards to debit cards at 45.2%. The credit card to debit card percentage for the banking system is at 7% (3.7% in FY16). SBICs penetration of SBI's debit card base (278.1mn cards) is extremely low at ~4% (1.9% in FY16), as the bank has only recently started aggressively looking inwards. We believe there is significant cross sell opportunity for SBICs here, as there is a sizeable debit card base of SBI (even excluding low income customers) which can be converted to credit card customer.

Exhibit: Low penetration of parent SBI's debit card base, there is ample scope for SBIC to cross sell

No of Credit Cards % of Debit Cards	FY16	FY17	FY18	FY19	FY20
HDFC Bank	31.6%	36.3%	43.9%	46.3%	45.2%
SBI	**1.9%**	**1.6%**	**2.2%**	**2.6%**	**3.8%**
ICICI	11.2%	11.5%	12.0%	14.8%	19.8%
Axis	15.6%	16.6%	20.1%	24.3%	28.5%
IIB	17.2%	17.4%	20.3%	22.1%	24.4%
KMB	20.4%	21.0%	17.8%	16.2%	15.5%
RBL	20.2%	48.0%	95.5%	245.6%	279.1%
System	**3.7%**	**3.5%**	**4.4%**	**5.2%**	**7.0%**

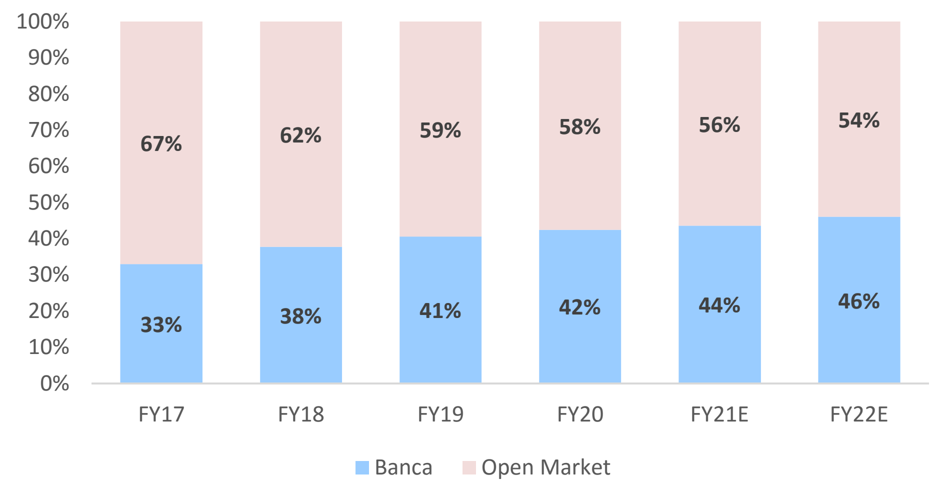
Source: RBI& Anvil Research

Incremental acquisition from SBI has been increasing over the past 3 years

While most banks had been looking at their internal customers to market credit cards, due to SBIs partnership with GE capital they were primarily focused on customer acquisition through open market. Prior to 2017, SBICs access to SBI's clientele was through physical presence of its sales force in SBIs branches. However; with the exit of GE capital and SBI becoming the major shareholder, SBIC saw a new opportunity open up in the form of exploring SBIs clientele, which would mean lower acquisition costs and better quality control.

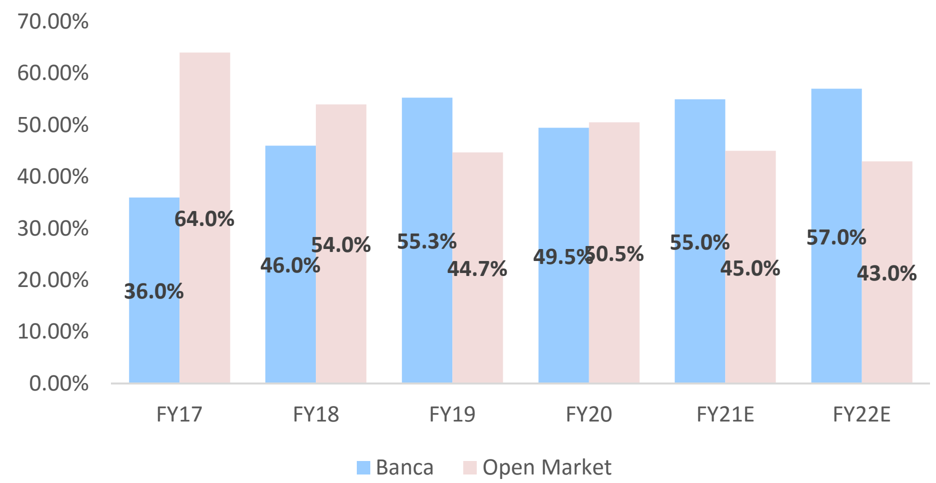
SBIC launched **'Project Shikhar'** under which SBI, SBIC and CIBIL signed a tripartite agreement for data sharing, providing SBIC the opportunity to more actively market its credit cards to SBI customers. Under this agreement SBIC would give its credit filter criteria to SBI, which then shortlists its customer database and provides the same to CIBIL. CIBIL then trims this database further based on criteria provided by SBIC. SBIC then runs its own filters on these to offer credit cards to customers of SBI. This enables SBIC to cross sell to SBI customers with lower acquisition costs and better control on credit quality. **'Project Shikhar'** has been very effective and has increased the proportion of new accounts sourced from SBI's existing customer base from 36% of its total new accounts in FY17 to 49.5% in FY20.

Exhibit: Rising share of Banca customers in CIF



Source: Company & Anvil Research

Exhibit: Incremental sourcing from SBI has been increasing



Source: Company & Anvil Research

Diversified customer acquisition strategies

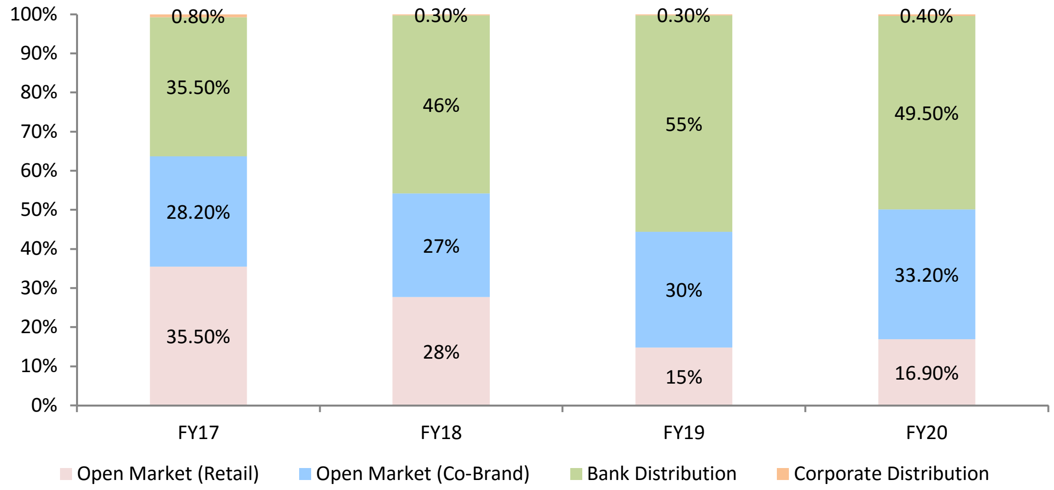
SBIC given that it's the only pure play credit card NBFC has developed a diverse distribution model to source customers.

Open market sourcing: the company has an outsourced sales staff of over 33,086 (as of Sept-2019) operating across 133 cities to generate prospective client leads through presence at over 3009 point of sales (like malls, retail stores, fuel stations, railway stations, airports, corporate parks, offices etc), tele sales (4,350 outsourced workforce) and digital channels. It works with its 11 non-bank co-brand partners and 7 co-brand bank partners using their distribution network (including its co-brand partners' retail outlets), communication channels and customer interactions for origination.

Digital Channels: SBIC complements its physical customer acquisition network with offerings across several digital channels through its website, mobile application, emails and SMS marketing. The company has launched its digital application platform Sales24 which enables SBIC to digitally carry out credit analysis of customer and provide in principle approval at point of sale. Decisions on ~45% of credit card applications in FY19 were carried out digitally by SBIC's credit decision engine without human intervention. The company has also integrated its digital customer acquisition platform with the State Bank of Indias' YONO interface, which enables SBIC to market its products to SBI Bank customers through the YONO app.

Partnership with State Bank: SBI cards partnership with State Bank of India enables it to market its cards to SBI customer base of 448mn+ across its 22100+ branch network across India, including physical presence of its outsources sales staff at SBIs branches. The benefits of the partnership were further enhanced with the launch of ProjectShikhar, a joint effort between SBI and SBIC allowing the latter to directly market its credit card products to SBI's customers.

Exhibit: Diversified distribution capabilities



Source: Company & Anvil Research

Leader in cobranded segment

Co-branded cards are cards that are offered by two organizations, one a lending institution and another non-financial group. SBIC has the highest co-brand partnerships as compared to its peers, given its experience of acquiring customers from the open market. SBIC had 21 co-brand partners (as at end of Dec-2019) in the retail, travel, fuel, fashion, healthcare, and mobility industries. Some of the company's co-brand partners are Air India, IRCTC, BPCL, Etihad Guest, Apollo, OLA and Yatra. With the entire industry has been looking at co-branded cards as a key growth driver, SBIC being the largest issuer of co-brand cards in India is well placed to benefit from this channel. The value offerings of these cards are designed specifically to address the needs of customers and ensure stickiness.

SBIC gains access to the partner's large customer base that can be issued cards to. Under a co-brand program the card company issues cards, decides the credit filters, manages the risk, owns the account and receivables, billing and collection information and supports the marketing campaign and promotions. For gaining access to the customers of the partner, the cards company pays fees to the partner.

The co-brand partner usually earns a negotiated sourcing fee based on the strength of their brand and what they can get out of the transaction. Co-brand credit cards offer benefits that are jointly built between the card company and co-brand partner. Cardholders can earn additional reward points or other benefits exclusively on co-brand partner stores / platforms, which in turn would increase the stickiness of customers for the partners' and incentivizes repeat business.

Co-branded credit cards are marketed to the partners' customers, however; they can be used by the cardholder anywhere a credit card is accepted to earn reward points and other benefits. However; they usually earn higher reward points and other benefits like special offers, discounts, preferred delivery options, frequent flier miles etc on co-brand partners' platforms, the more they transact on the co-brand platform with the co-brand card. These benefits cannot be accessed through the open market offerings of credit card.

Customer acquisition through co-branded tie ups involves payment of sourcing fee to co-brand partners, but still is cheaper than acquiring customers through the open market, but obviously more expensive than acquiring internal customers of the parent SBI.

Exhibit: SBIC is the largest co-brand issuer in India

Particulars	Number of co-branded partners	Travel	Shopping / Entertainment	Payments	Lending	Healthcare	Others
SBI Card	18	7	3	-	-	1	7
ICICI Bank	12	8	1	-	-	-	3
RBL Bank	8	1	1	-	2	1	4
HDFC Bank	6	3	1	-	1	-	1
Axis Bank	4	2	1	1	-	-	-
Citi bank	3	1	1	1	-	-	-
Amex	1	1	-	-	-	-	-
IndusInd Bank	1	1	-	-	-	-	-

Source: Company DRHP, Anvil Research

Note the number of co-branded cards may have changed over the past few months

Its credit cards portfolio is tailor-made to meet the needs of all major segments, from the "premium" cardholder category to the "affluent", "mass affluent", "mass" and "new to credit" categories. In addition, it offers highly customized corporate cards to its corporate clients that is tailor-made for specific types of purchases and functionalities

Exhibit: SBIC has increased the number of premium card offerings within its card pool

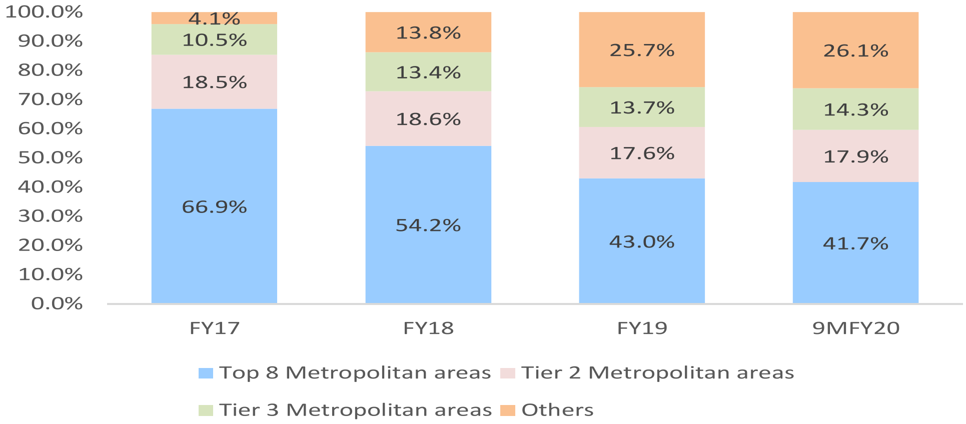
Particulars	SBI Card	HDFC Bank	ICICI Bank	Axis Bank	RBL Bank	IndusInd Bank
Total number of cards offered	46	20	33	21	30	23
% of premium cards offered	40%	20%	45%	25%	25%	70%
Premium cards offered	18	4	15	5	8	16
Range of fees for paid cards	500-5,000	500-10,000	200-10,000	250-10,000	500-5,000	250-25,000

Source: Company DRHP, Anvil Research

Moving beyond the saturated metros

The credit card market has been extremely concentrated geographically, with tier-1 cities accounting for over 75% of total credit card consumers (as per CIBIL TransUnion). Demand for credit cards has been driven by ecommerce platforms (offering cash backs & discounts), however; demonetization further accelerated growth in credit card usage. Expansion in POS machines and e-commerce boom have enabled creation of new markets and opportunity to expand customer base. Given the saturation of metros and urban centers, the contribution of new credit cards from tier 2 and tier 3 urban centers has been increasing consistently. While venturing into these towns the credit card players have primarily targeted their own liability customers. SBIC with its large open market customer acquisition strategy has been an early mover in attracting higher new to bank customers. The share of top 8 metros in incremental cards has declined from 66.9% in FY17 to 41.7% as of Dec-2020.

Exhibit: Sourcing moving away from top metros



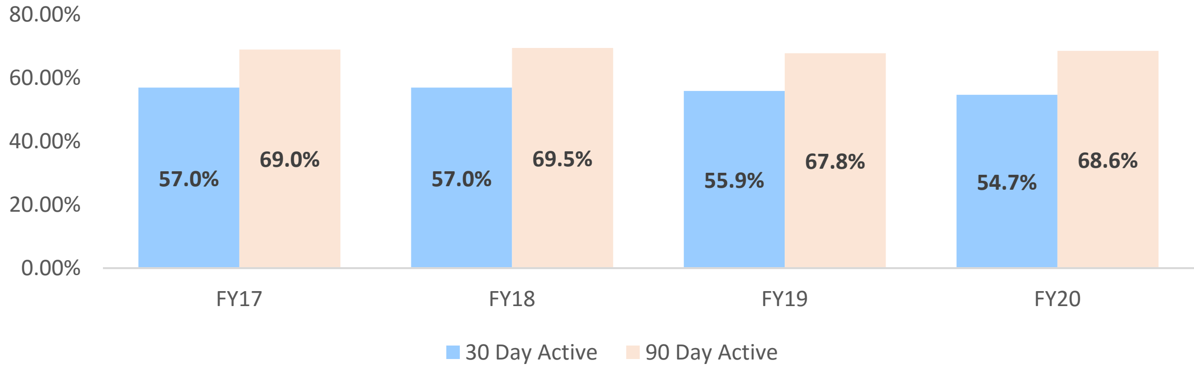
Source: Company & Anvil Research

Thrust on increasing active card user base.

SBIC has improved the quality of its active card user base and has more than doubled the spending per card in the last five years from Rs 56,872 to Rs 124,479 per annum, still lower than market leader HDFCBk at Rs 146,140. The company has been pushing aggressively to increase spend per transaction of customers through engagement with several merchants and by influencing spends.

Most top players in India's credit card market today are banks that have a large share of credit cards sourced internally, offering these cards to existing customers for free to strengthen their liability relationships. Unlike other leading players in credit card market in India, SBIC is a pure play credit card company acquiring ~50% of cards from the open market (expensive mode of acquisition) and thus it cannot afford to let the cards issued remain dormant or have low activity levels. To ensure only serious clients are on boarded and spends are maintained, the company has a strategy of issuing paid cards only (as against issuing free cards for volume growth). The card fee is charged to the customer and instead of waiving these fees, the company gives the card holder reward points or gift vouchers on first use and settlement of first bill. 55% of SBICs cards are 30 day active and 69% of the cards are 90 day active. Other players do not disclose this data, however, if we were to compare SBICs average transactions per card and average spends per card with that of ICICI & Axis, SBICs engagement levels are better.

Exhibit: Active customer base

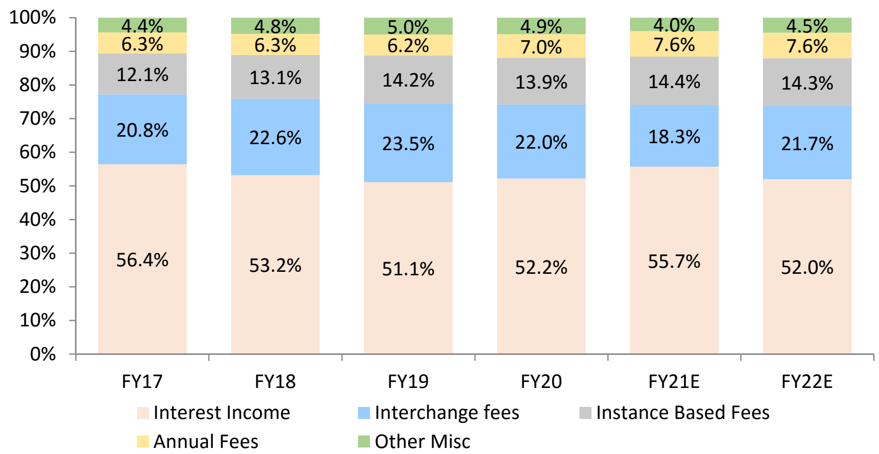


Source: Company & Anvil Research

Diverse income profile

Credit card company operates on a dual income revenue model, where the payment side of the business earns fees (interchange fees, late payment fees, annual credit card membership fees and other fees on spend) and the lending side of business will earn interest income from receivables. Fees contribute ~48% of the revenue of the company, the balance being contributed by credit linked income viz. interest Income

Exhibit: Diverse Income profile



Source: Company & Anvil Research

SBIC extends credit to its cardholders and earns Interest income from credit card loan receivables. The company's receivables can be classified into 3 segments:

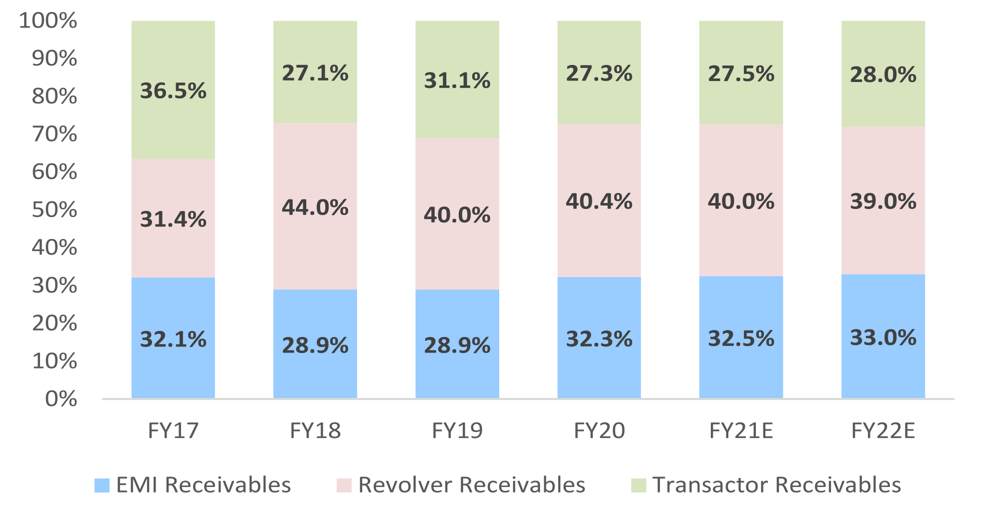
Transactor Receivables: These are the receivables that are cleared in time on or before the due date. Card spending of this sort is mainly for non-cash instant payments, earning reward points, loyalty benefits or large ticket spends and not for credit needs. The company earns no interest income on these loan receivables but earns fees.

Revolver Receivables: Revolver receivables means outstanding amount (billed & overdue) full or partial not cleared by due date. The interest rate on revolver receivables is high at ~ 36-48% and have an average duration of 2-4 months. These loans are used by borrowers to sort out their short term cash flow mismatches.

EMI Receivables: Interest charged on conversion of receivables to Equated Monthly Installments (EMIs) at the time of transaction. These type of receivables are generated by spurring consumption demand and aids consumers in making large ticket transactions. It may also be used to convert the revolver receivables, to facilitate repayments of outstanding dues. Interest rates on these loans range from 14-24%.

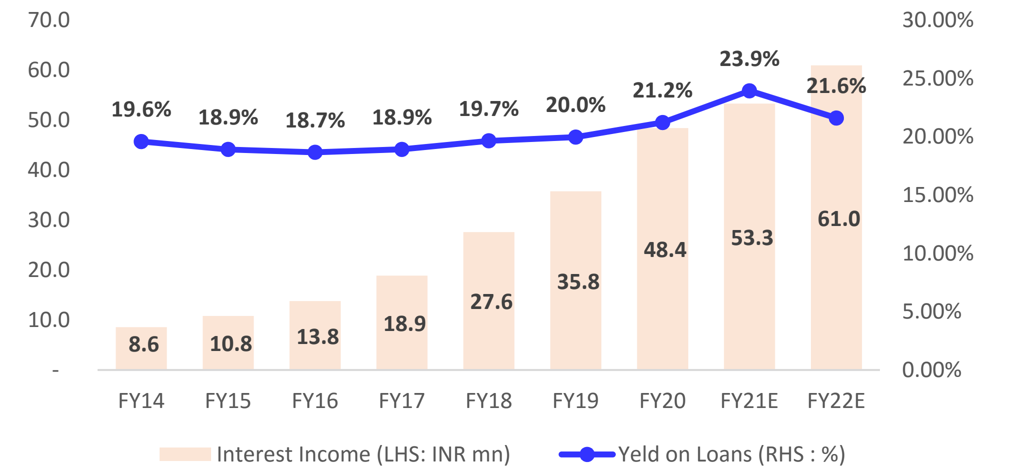
The company does not disclose its loan receivable mix but only discloses the share of EMI loans. Based on reasonable yield assumptions we are able to reasonably estimate the loan mix. Roughly receivables are equally split between transactors, revolvers and EMIs. Going forward we believe that while the share of transactors is likely to remain stable the share of EMI based loans to increase steadily. Consequently yield on loans should decline but stability in interest income to increase.

Exhibit: Receivable mix



Source: Company & Anvil Research

Exhibit: Trend in interest income and loan yields



Source: Company & Anvil Research

The payment side of business earns fees on CIF and spends, SBIC incentivizes customers with reward points, promotions etc to increase customer spends and earn fees. Following are the various fees that accrue to the credit card business:

Spend based fees: These are primarily earned through Merchant Discount Rate (MDR) paid by the payment network to the card issuer. MDR paid by the merchant is roughly ~2%, of which ~ 1.5% goes to the issuer and the balance 0.5% is shared by the merchant acquiring bank (owner of POS used to swipe the card) and card network operator (viz. VISA, Mastercard). Spend based fees constitute ~ 46% of the fees and ~22% of the total income.Spends per card for SBIC has been stagnating after registering a strong CAGR of 24% between FY14-FY18 in line with the industry. The company is incrementally focused on increasing spends of its already carded base from open market channel, improve share of premium cards within its portfolio, promote higher online spends and better target its reward program to incentivize spends.

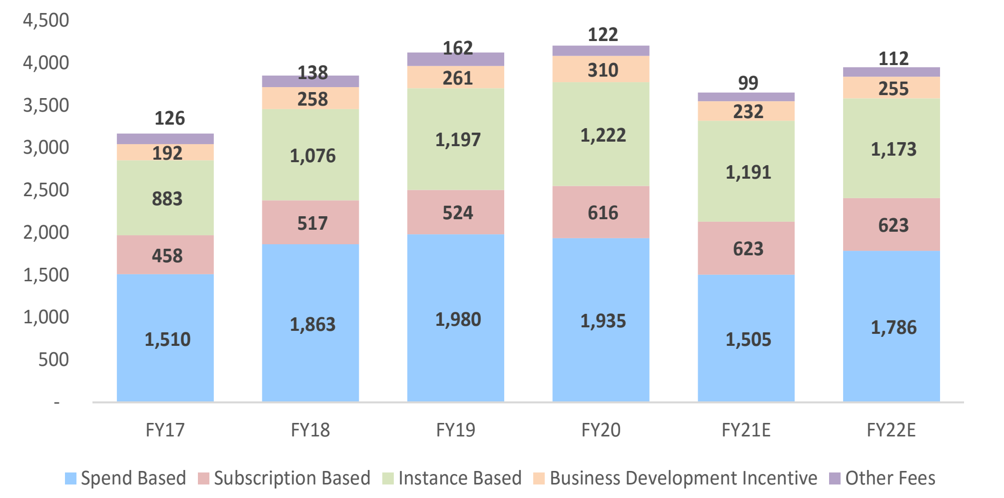
Subscription based fees:accrue to the company through sign up and annual renewal fees. Primary driver for these fees are the size of the CIF and mix of cards (premium / mass market). More than 95% of SBICs cards are fee-paying cards with membership fees ranging from Rs 500 to Rs 5,000 and averaging ~ Rs 600/ card, leading to healthy subscription fees Subscription based fees contribute ~ 7% of the company revenues.

Instance based fees: Include penalty and charges based on events like late payment or over-limit fees, reward redemption fees, cash withdrawal fees and processing charges. Instance based fees contribute ~14% to the company revenues.

Business Development Incentive income: These are incentives paid primarily by the network operator (VISA. Mastercard) on achieving certain milestones on spends etc. These may also be paid by the cobrand partner based on the spends or volume of transactions achieved on co-brand partner networks.

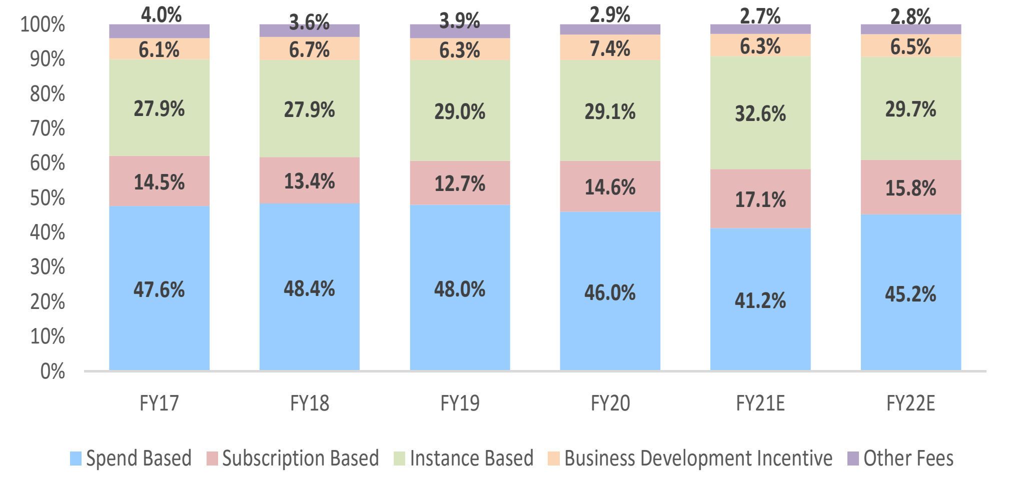
Miscellaneous fees: include service / maintenance charges, balance transfer fees (transfer of debt from one credit card to another) and commission based income earned from marketing of third party products (life insurance, accident cover, health insurance, card protection etc)

Exhibit: SBIC fees per card



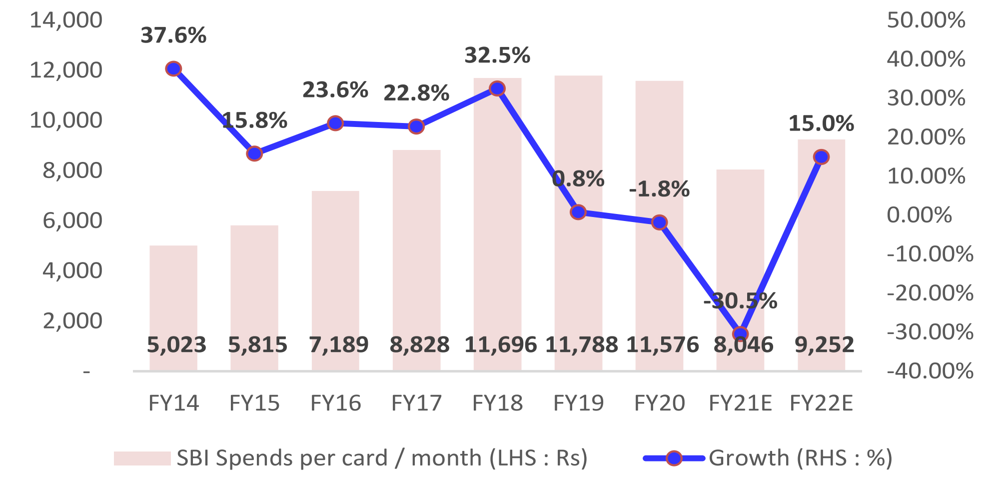
Source: Company & Anvil Research

Exhibit: Break up of fee income for SBIC



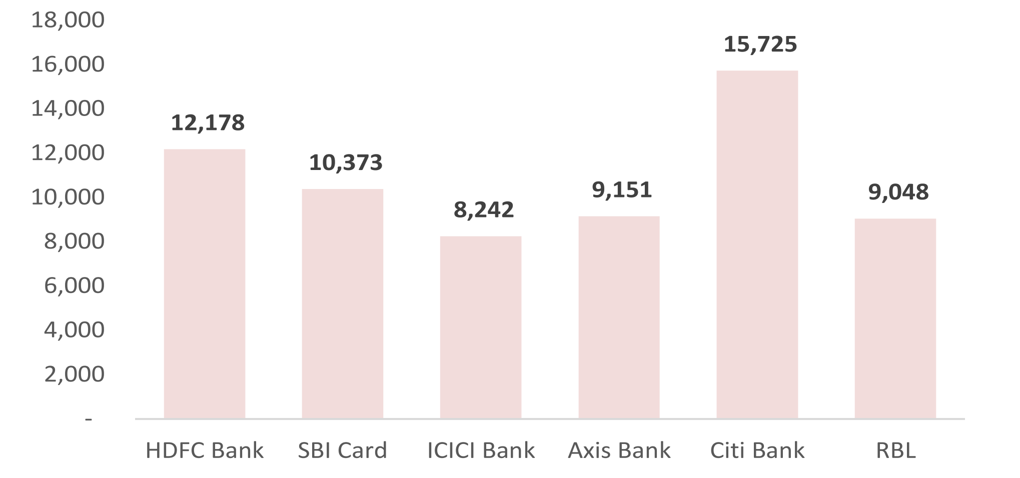
Source: Company & Anvil Research

Exhibit: Spend growth has come off, after registering strong growth over FY14-18



Source: Company & Anvil Research

Exhibit: SBI has higher spends than peer banks except for HDFCBk



Source: Company & Anvil Research

Operating Leverage has scope for improvement

Credit card business is a high customer engagement business and requires higher opex as compared to other retail business. As at the end of FY20, ~37% of SBICs costs are fixed (Employee Expenses, admin expenses, power and fuel, printing, postage and stationery costs, professional and consulting fees, advertising costs, data processing costs and other expenses) while the remaining 63% are variable and linked to addition of CIF and growth in spends. The various components of costs are as follows.

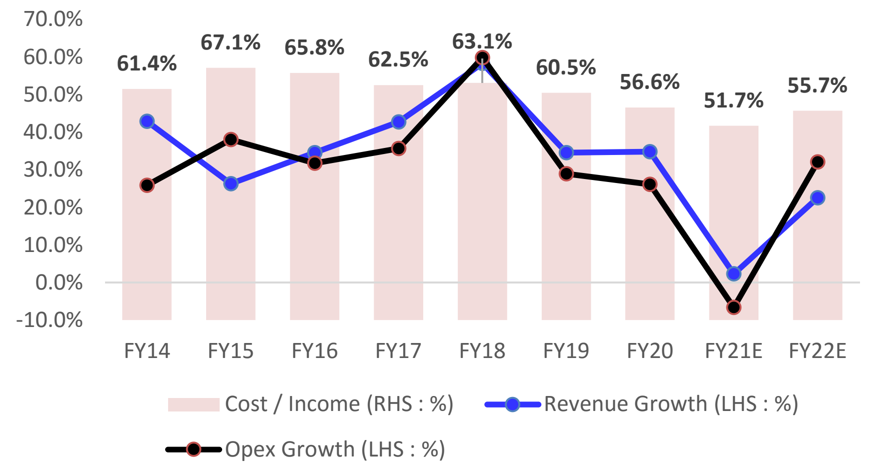
Sales promotion costs: Sales promotion costs include acquisition costs (incurred to acquire customers through various channels) and marketing costs comprising of costs incurred for promotions, discounts, cashbacks offered or any other benefits offered to the card holder. Most card issuers have been depending on banca channel for acquisition, consequently the acquisition costs for new customers have been lower. However; as the market deepens and expands to newer markets and dependence on open market operations increases the costs are expected to increase.

Reward Points Redemption Costs: Reward points are used to incentivize higher volumes by the cardholders and creating customer stickiness. Reward redemption costs are influenced by the volume of cards eligible for rewards, the percentage of customers using up the reward points and claiming the rewards, the nature of tie ups with the partners for redemption of rewards, and the effective cost per reward point, which is generally influenced by the card type and attributes. The cost for these rewards is estimated based on an actuarial valuation and cost of redemption.

Card transaction charges: these are charges and levies paid to the payment networks for transaction charges and other services.

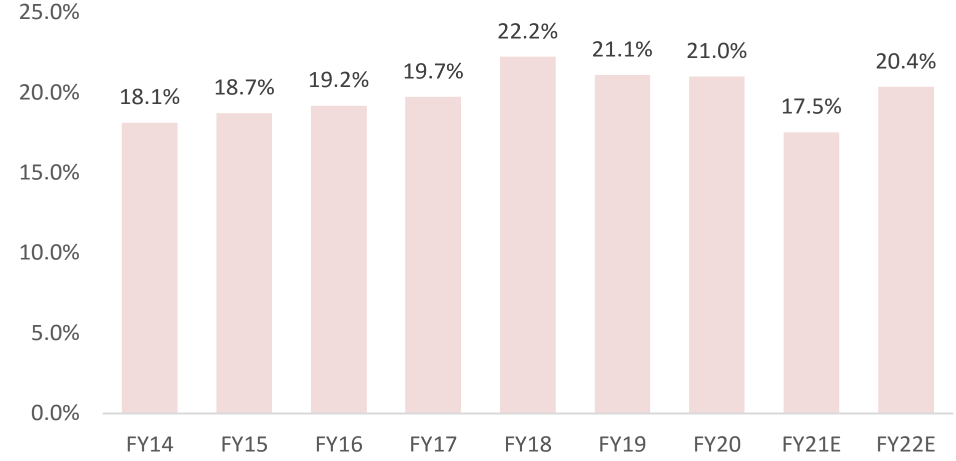
SBIC's opex growth has been on the higher side given its higher acquisition costs (large open market acquisition) and reward expenses, however; due to the strong growth in revenues the company's cost to income ratio has been moderating. We believe cost ratios are likely to improve gradually as it builds scale and pushes spends. SBIC has sourced ~58% of its CIF from open market operations, which entails higher costs (2x of banca channel) and lower throughput. Most other leading credit card players have been focused on the banca channel to cross-sell cards to its captive customer base, consequently having a lower costs of customer acquisition and risk of delinquency. As SBIC's incremental focus is skewed towards sourcing cards from the parent SBIs customer base through the banca channel, acquisition costs are expected to be lower with a lower breakeven period of ~1.5 years as compared to 2 years for open market customers. However, Banca customers have relatively lower spends/revolve rates, consequently, SBIC is planning to concentrate on increasing spends of existing card customers (as against new to card customers) and sourcing greater share of premium customers from the open market. Additionally, the company has made significant investments in core technology systems and building peripheral applications (FY17-FY19 Rs 520mn), to support the banks growing credit card portfolio. The company has back tested its systems to support 3x-5x of current level of business volumes, which provides the company a robust foundation for future growth.

Exhibit: Strong income growth aids moderation in Cost / Income



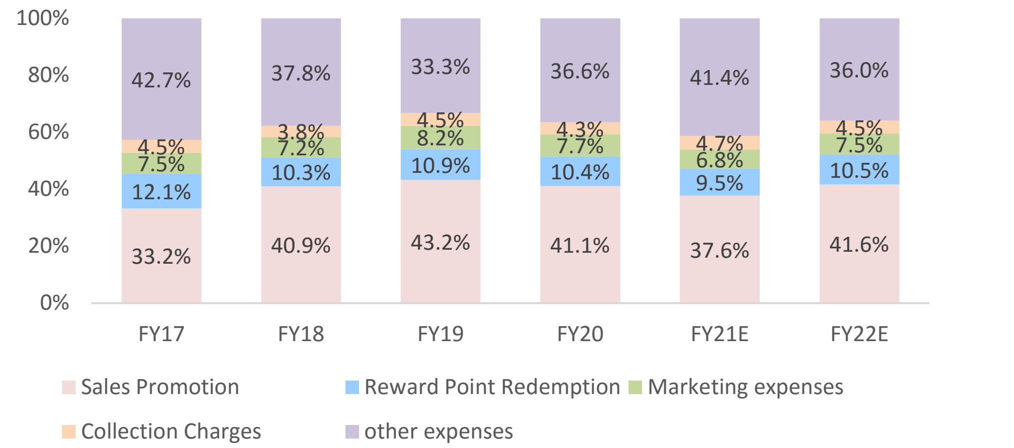
Source: Company & Anvil Research

Exhibit: Opex / Assets for SBIC remains high. Strategy is to drive down cost with banca sourcing and increasing receivables per card



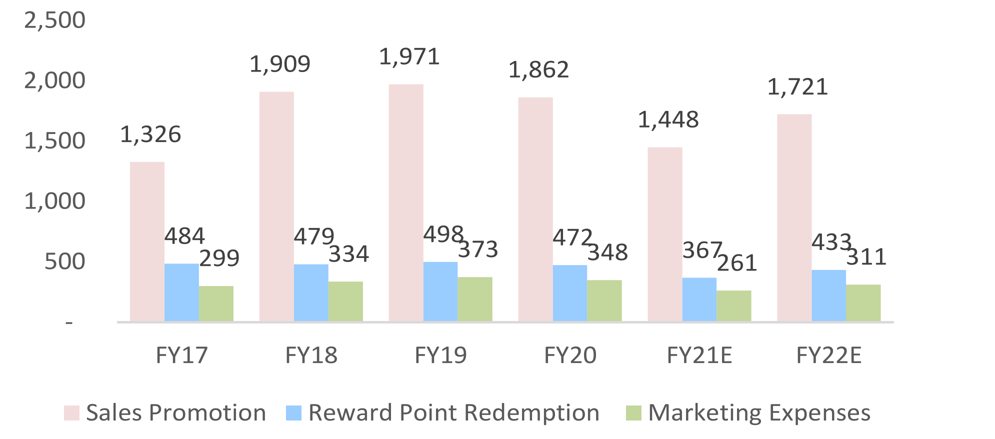
Source: Company & Anvil Research

Exhibit: Acquisition Spends & marketing costs account for ~59% of costs



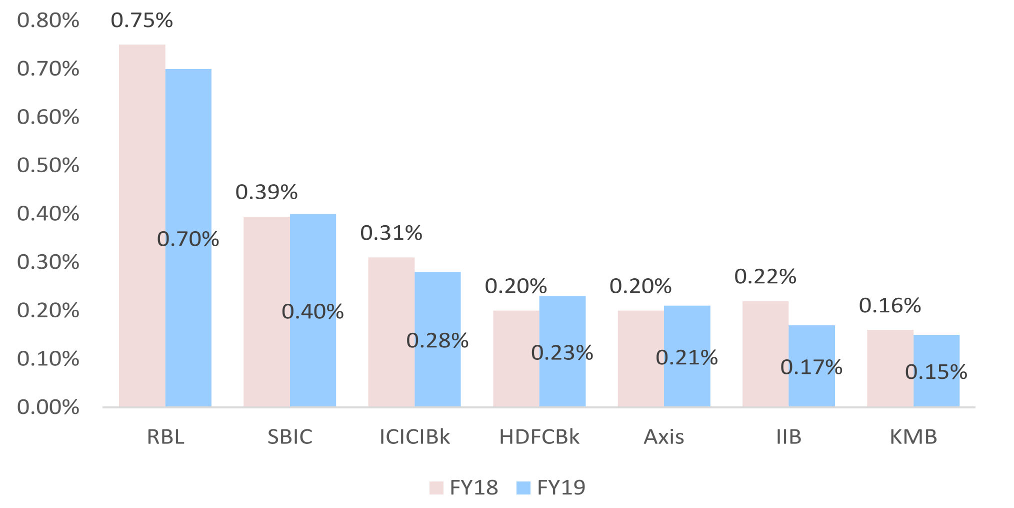
Source: Company & Anvil Research

Exhibit: Acquisition costs & spend based costs per card growth needs to be curtailed



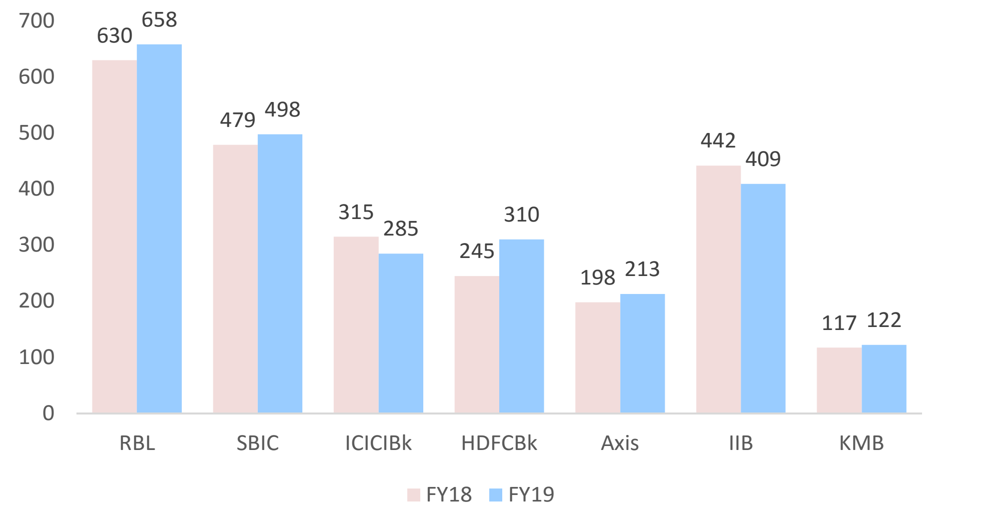
Source: Company & Anvil Research

Exhibit: SBIC has an aggressive reward program, translating into higher spends but also high costs



Source: Company & Anvil Research

Exhibit: Rewards per card in force for SBIC is higher than most leading players



Source: Company & Anvil Research

Anvil

Asset Quality & Growth both likely to be impacted in near term, expected to rebound sharply post FY21

Management commentary on COVID-19 disruption in Q4FY20 concall

Asset Quality & Moratorium:

- ~ 8.4% or ~0.82mn customers of SBICs customers having outstanding receivables of ~ INR 38bn (15.7% of receivables) have opted for the moratorium on credit card dues as of March, 2020.25% of the customers who opted for moratorium in March, 2020 have made part/ full payments in April, 2020. However; the proportion of customers that opted for moratorium increased to 12.3% in April, 2020, of these 24% of customers have made part / full payment in May, 2020. As of 22nd May, 2020, ~11.8% of customers have opted for moratorium. The impact of further extension of moratorium till August, 2020 is still not ascertained by the company.
- The company has done a sensitivity analysis of its portfolio and based on the stress test (building in peak losses) it has taken specific COVID-19 related provisions of INR 4.89bn.
- SBIC has taken several initiatives to protect its book like reducing credit limit, blocking cards, restricting transaction categories, limiting cash withdrawal and enhancing security.

Business momentum:

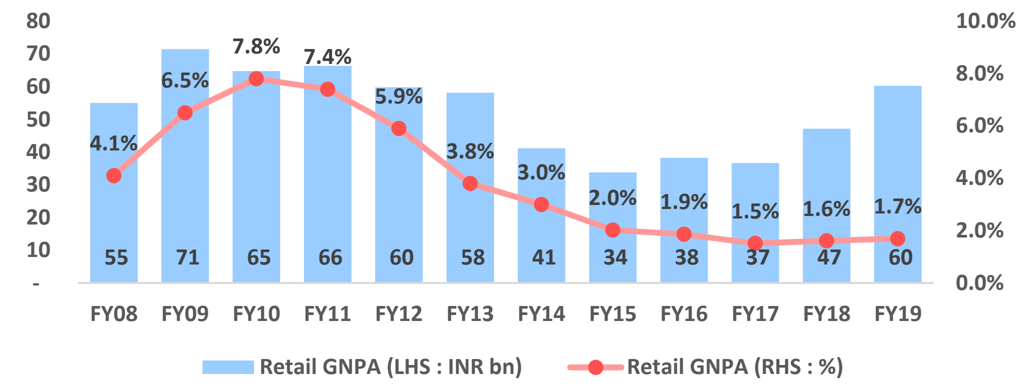
- SBIC used to add ~ 10,000 accounts per day pre-COVID, the same dropped significantly to ~1,000 accounts per day in April, 2020 due to impact of lockdown. However; the company issued a total of 27000 new cards in April, 2020 largely from the existing pipeline of applications already under processing. The run rate of card additions further improved in May,2020 to ~ 2,500 cards per day due to relaxations in restrictions. The company has indicated that as of June, 2020 all sourcing channels have been activated and sourcing has been normalized as much as possible.
- Daily average spends have declined from ~ Rs 2.9bn in Q4FY20 to ~ Rs 1.75bn in May, 2020 and activity had further improved in last week of May, 2020 with average daily spends at ~ Rs 2bn. The rise in spends in May, 2020 was driven by online spends ~55% of spends vis-à-vis ~44% in Q4FY20. Some of the major online categories contributing to spends were groceries, utilities & service and top point of sales categories were fuel, electronics, health & wellness.
- Spends in certain categories like travel, hospitality and entertainment have obviously contracted to almost negligible levels. However; the company witnessed new categories seeing a pickup like health, pharmacies and education.
- Repayments from retail customers are higher than retail spends, leading to a decline in transactor receivables.

Our discussions with banks and company indicate that the borrowers have been mindful of taking moratorium in high interest rate products like credit cards, which we believe is a positive.

ICICI Banks Retail NPA experience

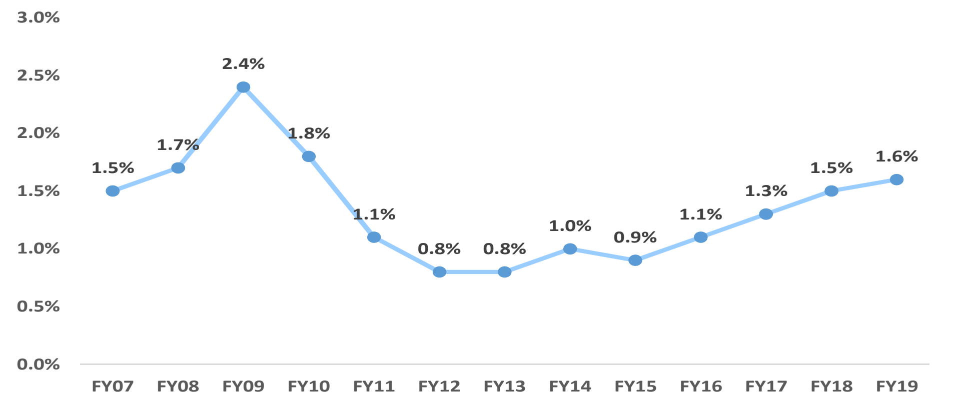
We do not have cross cycle data for system level retail unsecured NPAs, thus we could use ICICI Bank as a proxy. ICICI Banks Retail GNPAs shot up to ~7.8% and credit costs more than doubled to ~250bps between FY09-11. However; we don't expect the retail NPAs in the current cycle to scale up to the levels of the previous one, due to significant presence of bureaus, growth has been much less aggressive than the previous cycle and higher customer & geographic diversification.

Exhibit: ICICI banks spike in retail NPAs during previous cycle



Source: ICICI Bank 20-F filing, Anvil

Exhibit: HDFC Banks retail NPA trend too saw spike in FY09



Source: HDFC Bank 20-F filing, Anvil

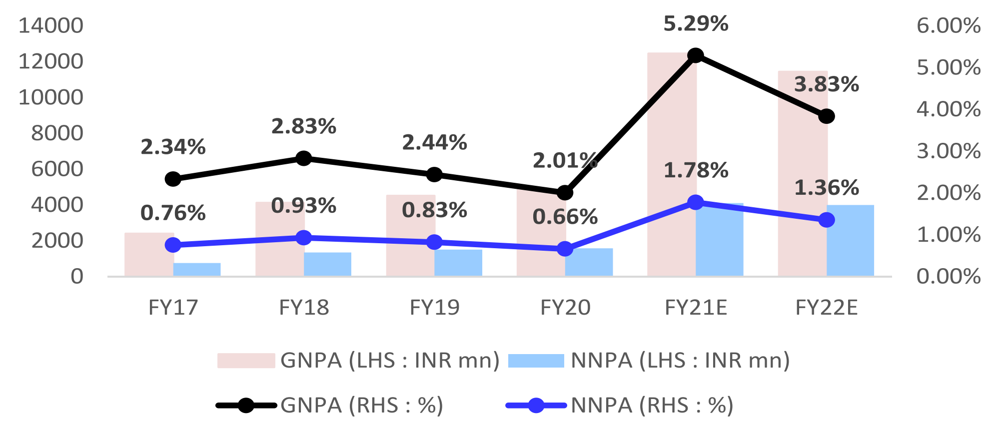
Asset Quality & Growth likely to be impacted in near term, expected to rebound sharply post FY21

The sudden onset of COVID-19 and the abrupt slowdown has resulted in disruptions, which are likely to impact growth and asset quality of the credit card industry as well as SBIC. We estimate SBICs, credit card spends to decline 15% (5 year CAGR of 44%) and CIF growth to decline to 10% YoY (5 year CAGR of 27%) in FY21E before they start normalizing over the medium term. We note that even post GFC there was a 5% decline in card spends, post which the same witnessed a sharp rebound registering a growth of 22%.

Asset quality for SBIC too is likely to be impacted adversely due to adverse impact of lock down on customer cash flows and disruption in the company's collection and recovery efforts.We note that the company acquires a large part ~50% of customers through open market operations, a conservative estimate on asset quality and credit costs is warranted. We factor in elevated credit costs of 12.8% on the back of already conservative build up in provisions in FY20 of 9.5%. Post which we expect credit costs to revert back to long term averages. We believe our assumptions are conservative and draw comfort from the following:

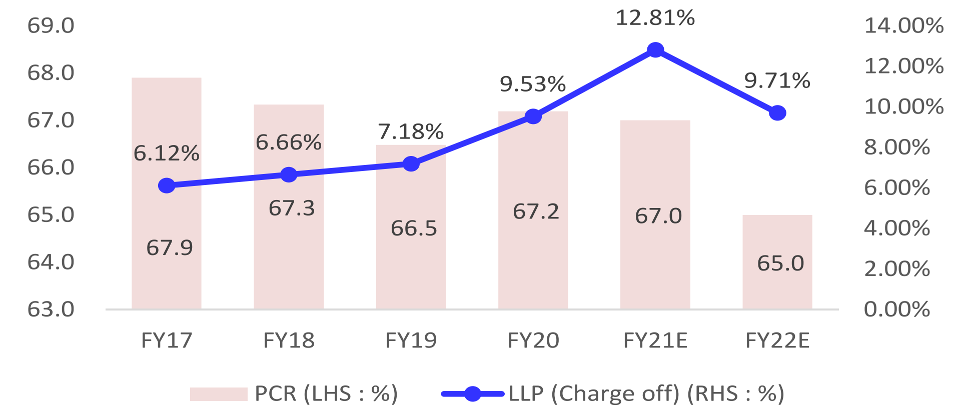
1. India's credit card industry and so also SBIC is too low in the penetration curve and the company is still carding high quality customers. ~85% of the company's customers are from the salaried segment and further ~70% of the remaining 15% are self-employed professionals, where the risk of NPAs has been historically lower. The caveat being extremely high job losses owing to persistently weak economic activity.
2. Experience from previous down turn experienced post GFC, indicates credit costs surged to ~8-10%.
3. Company has the flexibility to convert its revolver loans to EMIs, for customers facing short term liquidity challenges
4. Since the evolution of credit bureaus, retail consumers have been extremely conscious of their credit scores impacting future loan eligibility, which has acted as a major restraint on willingness to default.
5. SBICs in-depth approach to credit analytics and periodic credit monitoring, coupled with extensive collection infrastructure.
6. Strong capital position Tier 1 (17.7%) and operating profits ~16% of assets, provides cushion to provide for any shocks in asset quality.

Exhibit: Asset quality near term disruption



Source: Company & Anvil Research

Exhibit: Credit costs to spike in FY21 due to economic slow down (320bps higher)

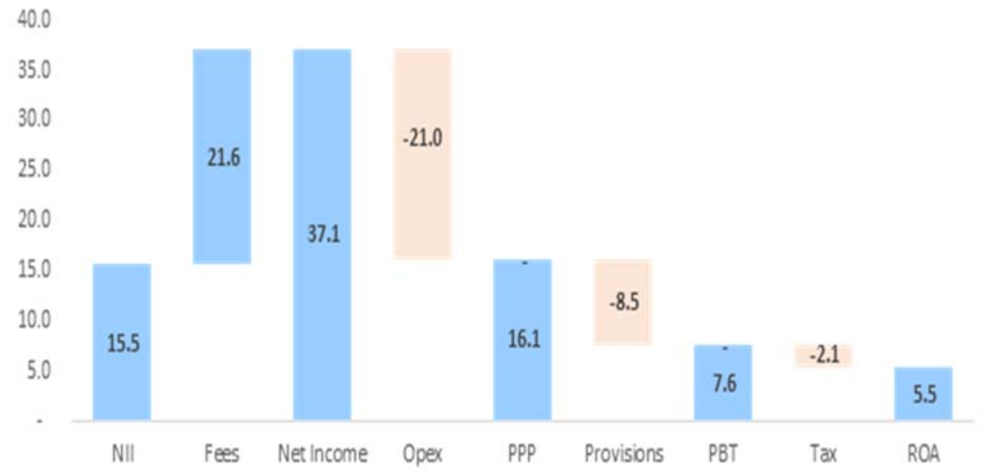


Source: Company & Anvil Research

Superior return ratios to revert to normalize levels of 25%+ post FY21

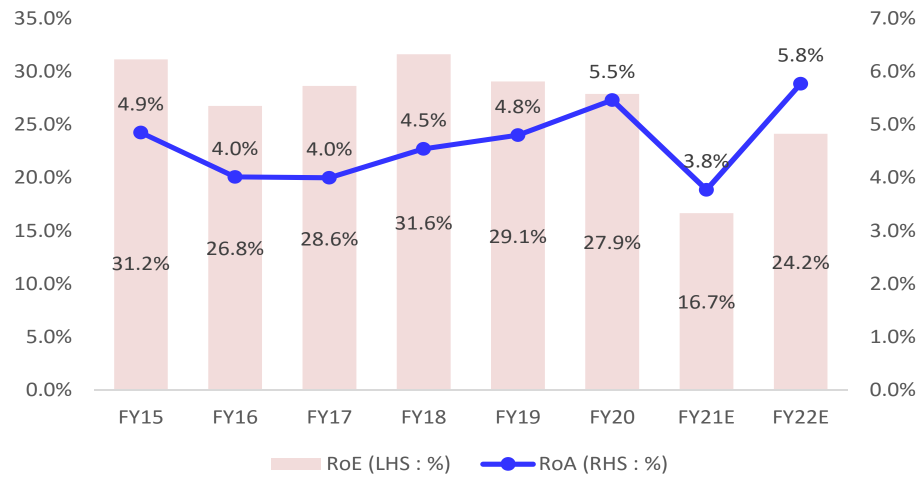
SBIC commands a strong RoA, aided by superior NIMs and fees with contained credit costs.The key driver of RoA expansion between FY18-20 have been improvement in operational efficiency with cost to income decreasing from 22.2% in FY18 to 21% and fee income increasing from 19.7% of average assets in FY18 to 21.6% in FY20. Despite one-off high provisions in FY20, the company reported RoA of 5.5%. With the onset of COVID-19 and subsequent impact on asset quality and growth, return ratios are likely to shrink in FY21E. However; with focus on improving operational leverage, driving spends per card and improving proportion of EMI loans in receivables is likely to bring stability to its ROAs. SBIC has one of the highest ROEs amongst Indian Financials. The company has on an average reported RoEs of over 25%+ in the last 6 years. We believe the structural drivers of profitability are in place providing high visibility on sustainability of RoEs. Despite a spike in credit costs in FY21E, we expect the company to report healthy ROEs of 16.7% driven by its strong operating profits, post which we expect ROEs to revert to normalize levels ~ 25%.

Exhibit: Despite one-off high provisions SBIC reported RoAs of 5.5% in FY20 aided by strong operating profits and reduction in tax



Source: Company & Anvil Research

Exhibit: SBICs superior operating profitability profile to result in superior return ratios



Source: Company & Anvil Research

Valuations

We believe FY21 will be a tough year for the company because of the huge economic disruption leading to a short-term impact in business momentum, however, the long-term growth story remains intact due to its unique positioning and huge scope for growth. **We use Residual Income model to arrive at our fair value. Our assumptions for arriving at fair value are - cost of equity of 12.9% are risk free rate of 5.5%, equity risk premium of 5.5%, long term sustainable growth of 6% and a beta of 1.4. We have assumed a higher cost of equity (12.93%) as compared to 11.5% for private banks, to factor in the relatively untested experience of retail asset quality cycle, risks of regulatory intervention and impact on growth & profitability from COVID-19 (unsecured business). We Initiate Coverage on SBIC with a BUY rating and a Target Price of Rs821 using Residual Income Model (P/E –39.8x & P/BV of 8.7x FY22E). Valuations appear rich when compared to other financials, but given the fact that SBIC will be the only unique pure play credit card company with visibility of sustainable 25%+ RoE and 30% compounding of earnings, premium valuations should sustain.**

Exhibit: Residual Income Model

(Rs mn)	FY20	FY21	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29	FY30	FY38	FY39	FY40
PAT	12,448	9,612	16,728	23,730	31,322	35,749	45,263	56,732	71,149	89,197	111,790	307,047	323,386	333,391
Growth (%)	44.3%	-22.8%	74.0%	41.9%	32.0%	14.1%	26.6%	25.3%	25.4%	25.4%	25.3%	7.4%	5.3%	3.1%
Dividend	939	961	1,673	2,373	3,132	3,575	4,526	5,673	7,115	8,920	11,179	30,705	32,339	33,339
Dividend Payout (%)	7.5%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
Closing NW	53,412	62,063	77,118	98,475	126,665	158,839	199,576	250,635	314,669	394,946	495,557	2,088,251	2,379,298	2,679,350
Capital Charge for The year	4,629	6,904	8,022	9,968	12,728	16,371	20,530	25,795	32,395	40,671	51,047	234,189	269,906	307,524
Residual Income	**7,819**	**2,709**	**8,706**	**13,763**	**18,594**	**19,378**	**24,733**	**30,937**	**38,755**	**48,526**	**60,743**	**72,858**	**53,480**	**25,867**
Growth (%)		-65.4%	221.4%	58.1%	35.1%	4.2%	27.6%	25.1%	25.3%	25.2%	25.2%	-14.3%	-26.6%	-51.6%
RoE (%)	23.3%	15.5%	21.7%	24.1%	24.7%	22.5%	22.7%	22.6%	22.6%	22.6%	22.6%	14.7%	13.6%	12.4%
Discounting Factor	1.0	1.1	1.3	1.4	1.6	1.8	2.1	2.3	2.6	3.0	3.4	8.9	10.1	11.4
PV of Residual Income	**7,819**	**2,399**	**6,827**	**9,557**	**11,435**	**10,552**	**11,927**	**13,211**	**14,656**	**16,250**	**18,013**	**8,171**	**5,311**	**2,275**
Sum of PV of Residual Income														**246,743**
Terminal Value														**446,911**
Net worth														**77,118**
Target MCAP														**770,773**
Target Price														821
CMP														695
Upside / (Downside) - %														**18.1%**

Exhibit: Target Price Sensitivity

		Terminal Growth				
		4.0%	**5.0%**	**6.0%**	**7.0%**	**8.0%**
CoE	**10.9%**	1,139	1,257	1,424	1,675	2,097
	11.9%	893	966	1,064	1,201	1,408
	12.9%	714	761	**821**	901	1,014
	13.9%	580	611	649	698	764
	14.9%	478	498	523	555	595

Exhibit: Valuation comparison with global credit card companies. SBIC is the fastest growing company in an underpenetrated market, justifying premium valuations

Country	Company	CMP	MCAP	Revenue CAGR		PAT CAGR		EPS		RoA		BV		ROE		P/E		P/BV	
				(CY16-CY19)	(CY 19-22E)	(CY16-CY19)	(CY 19-22E)	CY20E	CY21E	CY20E	CY21E	CY20E	CY21E	CY20E	CY21E	CY20E	CY21E	CY20E	CY21E
		(unit)	(USD mn)	(%)	(%)	(%)	(%)	(unit)	(unit)	(%)	(%)	(unit)	(unit)	(%)	(%)	(x)	(x)	(x)	(x)
USA	Amex	93	74,870	8.2	7.0	7.9	3.0	3.0	7.0	1.4	3.5	27	29	10.6	26.4	31.1	13.2	3.5	3.2
USA	Capital One	60	27,278	10.0	1.6	7.3	-2.9	-2.0	7.9	-0.3	0.9	116	125	-2.3	5.6	-29.5	7.6	0.5	0.5
USA	Discover Financial	48	14,748	7.4	-8.7	13.9	-3.9	2.0	6.1	0.6	2.0	32	35	5.3	17.2	23.5	7.8	1.5	1.4
South Korea	Samsung Card Co	28,400	2,752	-1.9	4.5	-0.7	3.3	3,156	3,550	1.6	1.6	56,800	58,504	5.0	5.0	9.0	8.0	0.5	0.5
Japan	Credit Saison Co	1,139	1,964	5.2	5.2	16.4	8.4	218.9	274.0	1.2	1.2	3,276	3,505	6.9	8.1	5.2	4.2	0.3	0.3
Japan	Aeon Financial Services Co	1,128	2,265	5.7	12.0	15.8	-6.4	161.1	188.0	0.8	0.8	564	564	9.0	10.0	7.0	6.0	2.0	2.0
Thailand	Aeon Thana Sinsap	112	892	9.4	6.9	15.4	9.7	12.2	15.2	3.2	4.1	85	94	17.0	19.0	9.1	7.3	1.3	1.2
Thailand	Krungthai Card PCL	30	2,497	12.7	10.5	36.0	8.0	2.1	2.3	6.4	6.7	9	10	25.0	25.0	14.2	13.2	3.4	3.0
India	**SBI Cards**	**695**	**8,706**	**40.5**	**12.4**	**49.5**	**15.9**	**10.2**	**17.8**	**3.8**	**5.8**	**65.9**	**81.6**	**27.9**	**16.7**	**67.9**	**39.0**	**10.6**	**8.5**

Source: Bloomberg estimates, Anvil research estimates for SBIC. SBIC estimates are for FY21E & FY22E

Risks

Threat from UPI

UPI is an instant real-time payment system developed by National Payments Corporation of India (NPCI) aimed at facilitating inter-bank transactions and works by instantly transferring funds between two bank accounts on a mobile platform. As per RBI data, the aggregate volume of transactions through UPI has already surpassed that of credit and debit card transactions. However, in terms of value, UPI remains small given its typically restricted ticket size (~Rs 1700-3500).We believe credit cards not only provide the convenience factor but also deferred payment/credit facility as well. In addition, they offer attractive reward/discounting programs and dispute resolution mechanism unlike UPI, and thus, in our view, credit cards will remain a preferred mode of payment for consumers and face little competition from UPI.

Exhibit: Credit cards have additional value proposition over UPI and e-wallets making it a favored payment mode

	CREDIT CARDS	E-WALLETS	UPI	PPI	DEBIT CARD
Description	Credit card provides a line of credit that an individual can access through the card.	E-wallets is a service that allows users to make payments for transactions made online	UPI is an instant real time payment system facilitating inter bank transactions.	PPIs are tied directly to value stored on such instruments paid by the holder.	Debit cards are tied directly to individual's bank account
KYC Requirement	Full KYC required	Minimum KYC requirement up to Rs 10,000; Full KYC required for above Rs 10,000	Full KYC required	Minimum KYC requirement up to Rs 10,000; Full KYC required for above Rs 10,000	Full KYC required
Limit	Amount gets deducted from the limit provided to the card holder	Load wallets with amount user is willing to spend	No need to load any amount as the transaction directly goes through the bank balance	Load instruments with amount user is willing to spend	No need to load any amount as the transaction directly goes through the bank balance
Usage	Payments for online transactions, cash withdrawal at ATMs, POS terminals	Payments for online transactions	Payments for online transactions	Payments for online transactions, cash withdrawal at ATMs, POS terminals	Payments for online transactions, cash withdrawal at ATMs, POS terminals
Avg. Transaction amt.	~ Rs.3400	~Rs 450	~Rs. 1700	~Rs.630	~Rs.1300
Credit	Credit facility provided with interest free period.(Up to 50 days)	Credit through EMI facility provided in some cases but has no interest free period	No credit facility	No credit facility	Credit through EMI facility provided in some cases but has no interest free period
Rewards	Discounts/ cashback & reward points on amount spent.	Discounts/ cashback on transactions made.	Discounts/ cashback on transactions made.	Discounts/ cashback on transactions made.	Discounts/ cashback on amount spent through card
Transaction dispute management	Money is not blocked but is instantly deducted from customer credit limit.	Money is blocked instantly. Deducted from customer account	Money is blocked instantly. Deducted from customer account	Money is blocked instantly. Deducted from customer account	Money is blocked instantly. Deducted from customer account

Source: Company RHP & Anvil Research

Risk of losing parent support

SBIC enjoys several advantages from its association with parent SBI. The company uses the parents brand in all its cards, borrowings from SBI is ~67% of the company's borrowings and enjoys pricing advantages derived from its promoter's size while dealing with third parties. SBIC also gains access to the parent's large branch network and customer base, offering significant opportunities to cross sell. ~50% of SBIC's incremental sourcing is from SBI customers. However; given that SBI continues to hold ~70% of the company it would be beneficial for the parent to continue to maintain its arms-length dealing with SBIC and continue to earn steady income through royalty fees (2% of its net profit or 0.2% of total income, whichever is higher) and monetize at future date at higher market cap.

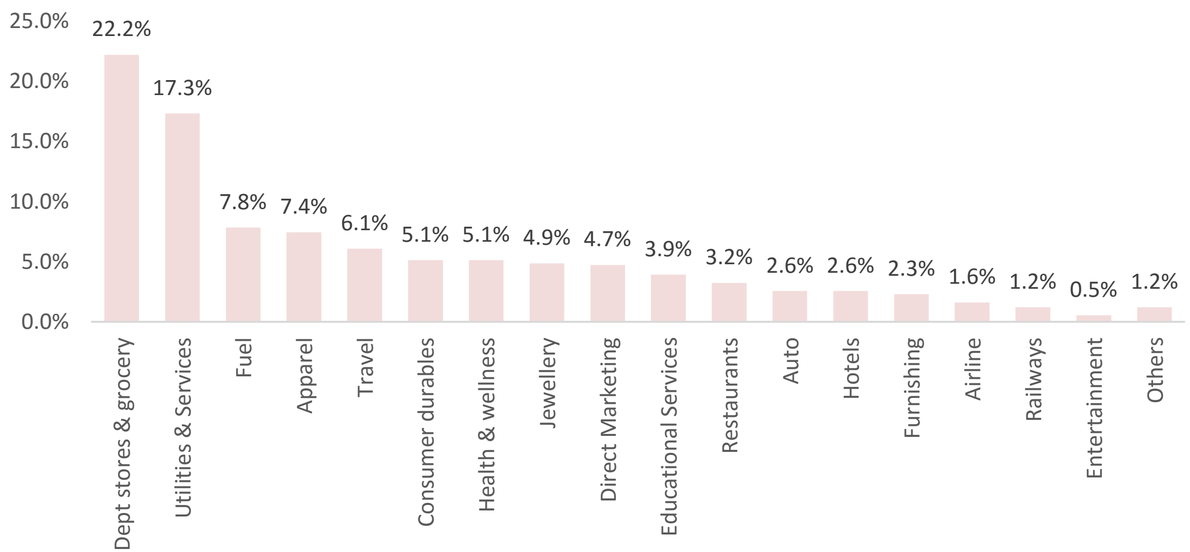
Risk from regulatory intervention on MDR

Any actions from regulator to limit interchange fees that are earned from MDR, or cut in MDR would have adverse impact of SBICs profitability, given that the company makes significant revenue from interchange fees. A committee set up by the RBI in the past to promote digital payments in India had proposed to decrease Interchange fee by 15bps on credit card transactions and has already waived MDR charges on transactions via Rupay Debit cards and UPI. However; we believe the risk of regulatory action on credit cards is limited as unlike debit cards, credit cards take credit risk, profile of credit card customers does not raise protection concerns and also the fact that the regulator is likely to look at the entire payment eco system which includes merchant acquisition business which is loss making or has thin profits.

Prolonged slowdown in economic activity due to COVID-19

Prolonged economic slowdown due to COVID-19 could adversely impact spends, demand for credit, repayment capability of cardholders, impacting asset quality and resulting in higher credit costs. Some of the large spend segments like travel, fuel, hotels, dining out etc are likely to be a drag on overall spends in the near term. Discretionary spends are initially on the rise due to pent up demand and are expected to moderate post the initial euphoric pick up.

Exhibit: Mix of retail spend categories



Source: Company & Anvil Research

Key Financials

Profit & Loss

(Rs mn)	FY17	FY18	FY19	FY20E	FY21E	FY22E
Interest income	18,882	27,600	35,757	48,413	53,311	60,960
Interest expense	5,284	7,115	10,172	13,009	13,056	15,499
Net interest income	**13,597**	**20,485**	**25,585**	**35,404**	**40,255**	**45,461**
Growth YoY (%)	*43.1*	*50.7*	*24.9*	*38.4*	*13.7*	*12.9*
Fee & other Income	15,829	26,102	37,111	49,110	46,163	60,462
Total Income	**29,426**	**46,587**	**62,696**	**84,514**	**86,417**	**105,924**
Operating expenses	18,390	29,393	37,903	47,815	44,644	58,974
PPP	**11,036**	**17,194**	**24,793**	**36,699**	**41,773**	**46,950**
Growth YoY (%)	*56.3*	*55.8*	*44.2*	*48.0*	*13.8*	*12.4*
Provisions	5,320	8,001	11,477	19,402	28,871	24,497
PBT	**5,716**	**9,193**	**13,316**	**17,296**	**12,903**	**22,453**
Tax	1,988	3,182	4,689	4,848	3,290	5,726
PAT	**3,729**	**6,011**	**8,627**	**12,448**	**9,612**	**16,728**
Growth YoY (%)	*31.4*	*61.2*	*43.5*	*44.3*	*-22.8*	*74.0*

Balance Sheet

(Rs mn)	FY17	FY18	FY19	FY20E	FY21E	FY22E
Equity share Capital	7,850	7,850	8,372	9,390	9,390	9,390
Reserves & Surplus	6,638	15,681	27,445	44,023	52,478	67,192
Net Worth	**14,488**	**23,531**	**35,817**	**53,412**	**61,868**	**76,582**
Borrowings	82,684	114,128	136,505	173,649	169,252	214,402
Other Liabilities	10,478	19,201	30,074	25,966	25,309	32,060
Total Liabilities	**107,650**	**156,860**	**202,396**	**253,028**	**256,429**	**323,044**
Cash & Bank balances	2,829	4,727	7,768	6,760	16,008	18,489
Investment	0	0	15	15	14	18
Loans & Advances	99,829	140,455	179,087	228,116	222,700	282,107
Fixed & Other assets	4,992	11,678	15,527	18,137	17,706	22,429
Total Assets	**107,650**	**156,860**	**202,396**	**253,028**	**256,429**	**323,044**

Key Ratios

(Rs mn)	FY17	FY18	FY19	FY20E	FY21E	FY22E
Valuations						
EPS	4.7	7.7	10.3	13.3	10.2	17.8
BV	18.5	30.0	42.8	56.9	65.9	81.6
P/E	146.3	90.8	67.4	52.4	67.9	39.0
P/BV	37.7	23.2	16.2	12.2	10.5	8.5
RoA	4.0	4.5	4.8	5.5	3.8	5.8
RoE	28.6	31.6	29.1	27.9	16.7	24.2
Growth (%)						
NII	43.1	50.7	24.9	38.4	13.7	12.9
Non Interest Income	42.4	64.9	42.2	32.3	-6.0	31.0
PPP	56.3	55.8	44.2	48.0	13.8	12.4
PAT	31.4	61.2	43.5	44.3	-22.8	74.0
Loans	35.0	40.7	27.5	27.4	-2.4	26.7
Assets	36.6	45.7	29.0	25.0	1.3	26.0
Net Worth	25.4	62.4	52.2	49.1	15.8	23.8
Cards in Force	27.8	37.0	31.7	27.1	10.0	22.8
Spends	22.8	32.5	0.8	-1.8	-27.2	21.0
Profitability (%)						
Yield on Advances	21.7	23.0	22.4	23.8	23.7	24.2
Cost Of Funds	7.4	7.2	8.1	8.4	7.6	8.1
Spread	14.3	15.7	14.3	15.4	16.0	16.1
NIM	15.2	16.5	15.4	16.8	17.0	16.9
Cost / Income	62.5	63.1	60.5	56.6	51.7	55.7
Non Interest Income / Net Income	53.8	56.0	59.2	58.1	53.4	57.1
NII / Net Income	46.2	44.0	40.8	41.9	46.6	42.9
Balance Sheet strength (%)						
GNPA (%)	2.3	2.8	2.4	2.0	5.3	3.8
NNPA (%)	0.8	0.9	0.8	0.7	1.8	1.4
Provision Coverage (%)	67.9	67.3	66.5	67.2	67.0	65.0
Provisions / Avg.Advances	5.7	6.0	6.4	8.5	11.3	8.5
Capital Adequacy (%)						
CAR (%)	15.7	18.3	20.0	22.4	26.3	25.5
Tier 1 (%)	11.3	12.4	14.7	17.7	21.5	21.7

(Rs mn)	FY17	FY18	FY19	FY20E	FY21E	FY22E
Per Card						
Average Loans	101,464	143,233	182,099	231,376	239,280	297,562
Average Number of cards	4.60	6.30	8.30	10.55	11.60	14.25
Spends	434,361	764,896	1,032,648	1,309,150	1,120,386	1,581,716
Spends Per Card	94,426	121,412	124,415	124,114	96,547	111,029
Growth in Spends / Card	15.9	28.6	2.5	-0.2	-22.2	15.0
Transactions	147	210	278	349	269	412
Transactions / Card	32	33	34	33	23	29
Growth in Transactions / Card	4.9	4.3	0.3	-1.3	-30.0	25.0
Loans / Card	22,057	22,735	21,940	21,936	20,619	20,887
Revenue / Card	7,546	8,524	8,779	9,246	8,572	8,523
NII / Card	2,956	3,252	3,083	3,356	3,469	3,191
Non Interest Income / Card	3,441	4,143	4,471	4,656	3,978	4,244
Opex / Card	3,998	4,666	4,567	4,533	3,847	4,140
RoA Tree						
Interest Income	20.3	20.9	19.9	21.3	20.9	21.0
Interest Expended	5.7	5.4	5.7	5.7	5.1	5.3
NII	**14.6**	**15.5**	**14.2**	**15.5**	**15.8**	**15.7**
Other Income	17.0	19.7	20.7	21.6	18.1	20.9
Net Income	**31.6**	**35.2**	**34.9**	**37.1**	**33.9**	**36.6**
Opex	19.7	22.2	21.1	21.0	17.5	20.4
PPP	**11.8**	**13.0**	**13.8**	**16.1**	**16.4**	**16.2**
Provisions	5.7	6.0	6.4	8.5	11.3	8.5
PBT	**6.1**	**7.0**	**7.4**	**7.6**	**5.1**	**7.7**
Tax	2.1	2.4	2.6	2.1	1.3	2.0
RoA	**4.0**	**4.5**	**4.8**	**5.5**	**3.8**	**5.8**
Leverage(x)	7.2	7.0	6.1	5.1	4.4	4.2
RoE	**28.6**	**31.6**	**29.1**	**27.9**	**16.7**	**24.2**