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DIVERSIFIED FINANCIALS

23 November 2022

Expert call – Bright outlook for credit card industry

- **Rapid rise in India's credit card spends and cards outstanding over the last five years; millennials to form the next leg of growth**
- **MDR review unlikely to entail harsh caps considering the need to balance customer protection and industry risk**
- **Reduction in revolver segment has resulted in sharper industry focus on low-risk EMI segment**

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Key takeaways from our call with Shailendra Singh, MD & CEO of BOB Financial Solutions (BOB Financial, unlisted), a wholly owned subsidiary of Bank of Baroda.

Swift growth but RBI keeping close tabs: Credit card spends in India clocked a 24% CAGR over FY17-FY22 to Rs 9.7tn and crossed Rs 1tn in each of the first six months of FY23 (April to September). Similarly, credit cards outstanding grew at a 20% CAGR to 73.6mn and remain strong even after accounting for the drop induced by the Jul'22 RBI guidelines (mandating closure of cards that have been inactive for over a year). BOB Financial expects millennials to drive growth, being fairly well educated and digital savvy.

Industry does not expect harsh MDR curbs: With respect to the RBI's proposed reduction in merchant discount rate (MDR), interactions between the credit card industry and central bank are ongoing. The industry does not anticipate harsh MDR curbs considering that this fee helps the industry mitigate risks due to the unsecured nature of credit cards. That said, any capping of MDR would impact spend-related reward points and other cost outflows.

EMIs take centerstage as revolvers decline: Covid-19 has induced several changes in the industry, including tighter credit limits in the context of credit scores or income criteria. This has driven down revolvers in the industry from 35-40% of receivables to late-20% levels, in line with the conscious efforts of issuers. Thus, card companies are banking on EMI customers who opt to pay in equated monthly installments spread over a 6/12-month period. Assuming 25-30% of the receivables base is EMI-based and is charged an APR plus modest processing fee, the segment delivers a yield of 21-22%, which has a lower risk than the revolver segment.

BOB Financial on a strong growth path: BOB Financial has expanded its market share in cards outstanding from 0.4% at end-FY17 to 1.9% at end-H1FY23, with the banking distribution channel playing an important role. Apart from targeting the parent bank's customer base, the company also collaborates with various partners to offer co-branded cards.

Recommendation snapshot

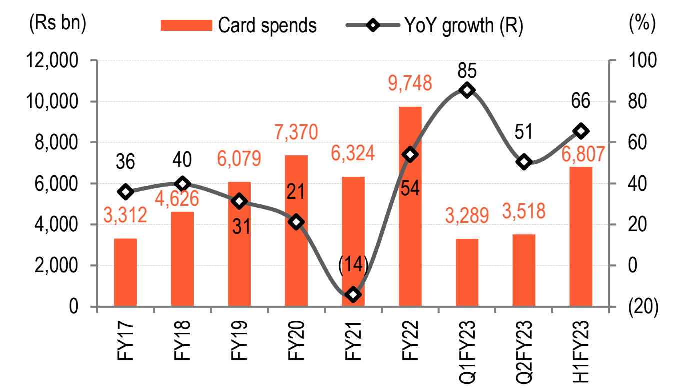
Ticker	Price	Target	Rating
SBICARD IN	799	1,139	BUY

Price & Target in Rupees | Price as of 22 Nov 2022

Swift growth in India's credit card spends

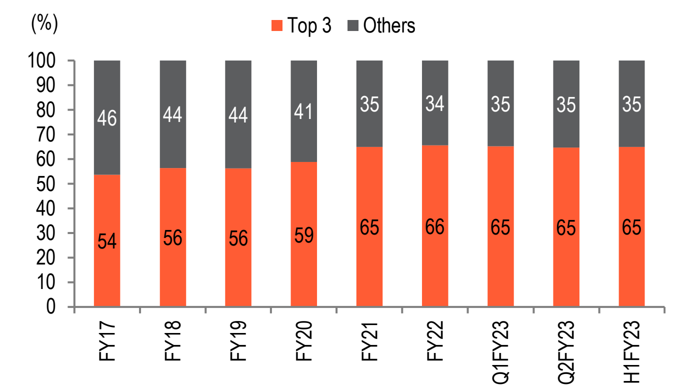
Credit card spends in India clocked a 24% CAGR over FY17-FY22 to Rs 9.7tn. Over this period, monthly spends reached Rs 1tn only twice – in Oct'21 and Mar'22. In FY23 YTD, however, sector spends have clocked in at Rs 1tn in each of the first six months (April to September) – a key positive. Higher online (ecommerce) spends also continue to drive growth in credit card spends. The top 3 players – HDFC Bank, SBI Card and ICICI Bank – have strengthened their positions, raising their combined market share from 54% in FY17 to 65% in H1FY23.

Fig 1 – Strong growth in credit card spends



Source: Company, BOBCAPS Research

Fig 2 – Top 3 players gained market share

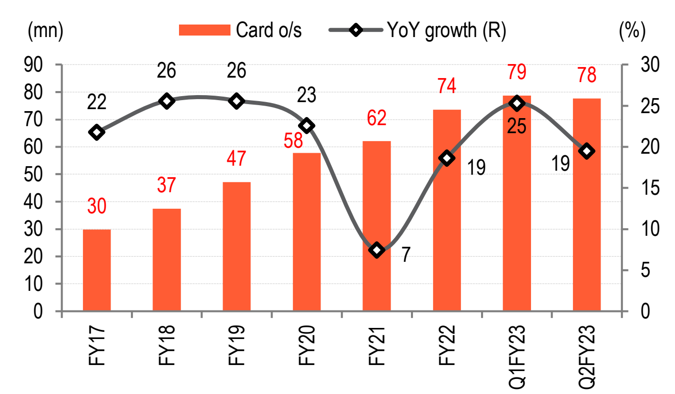


Source: Company, BOBCAPS Research | Note: The Top 3 includes HDFC Bank, SBI Card and ICICI Bank

Growth in cards outstanding but expect volatility ahead

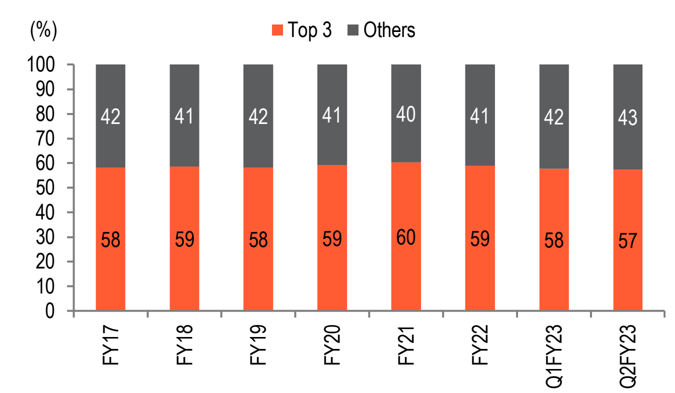
Credit cards outstanding have posted a robust 20% CAGR over FY17-FY22 to 73.6mn. At end-Q2FY23, this number increased to 77.7mn, albeit lower than the Q1FY23 figure of 78.7mn due to the new RBI guidelines that came into effect on 1 Jul 2022 mandating initiation of account closure for cards inactive for over a year, after intimating the cardholder. Per the new rules, if no reply is received from the cardholder within a period of 30 days, the card issuer must close the card account, subject to payment of all dues by the cardholder. Accordingly, BoB Financial expects volatility in card outstanding numbers in coming months.

Fig 3 – Card o/s growth rebounds in FY22 and FY23 YTD



Source: Company, BOBCAPS Research

Fig 4 – Top 3 market share has remained flat



Source: Company, BOBCAPS Research | Note: The Top 3 includes HDFC Bank, SBI Card and ICICI Bank

Key industry trends

BOB Financial offered interesting insights into various industry trends, including high-growth customer segments and card categories, as well as its regulatory outlook. Key highlights:

- **Millennials to lead growth:** Millennials are likely to play an important role in the growth of credit cards as they are educated, tech-savvy and tend to make better use of various schemes and offers. For instance, spending on consumer durables and electronic goods using the 6/12-month EMI option is currently a trend.
- **Systemic changes behind decline in revolver segment:** The Covid pandemic has induced several changes in the industry, including tighter credit limits in the context of credit scores or income criteria. This has driven down revolvers in the industry from 35-40% of receivables to late-20% levels, in line with the conscious efforts of issuers.
- **EMI segment gaining prominence:** Card companies are making customised EMI offers after observing customer behaviour and using predictive analysis that taps into credit bureau data. Assuming 25-30% of the receivables base is currently EMI-based and is charged an APR plus modest processing fee, the segment delivers a weighted average IRR or yield of 21-22%. A key benefit is that this yield comes at a lower risk than the revolver segment. In general, 15-20% of overall EMI receivables are contributed post purchase.
- **BNPL limited to low-ticket transactions:** The buy-now, pay-later (BNPL) category generally offers easy availability of low credit limits. However, credit cards are more useful in terms of larger transactions, cashback offers and convenience.
- **Industry does not expect harsh MDR curbs:** Interactions with RBI are ongoing and the industry recently submitted a white paper on MDR to the central bank. The industry does not expect a harsh decision (MDR cut) and believes any outcome will be based on a proper consultation process and a weighing of pertinent factors, such as the risks borne by the industry on credit cards (being an unsecured product). However, in the event that MDR is capped, spend-related reward points and other cost outflows would be adversely affected.
- **Transparency key to compliance:** The credit card business is regulated by the RBI and customer protection remains at the heart of various guidelines. Regarding APR, the company indicated that transparency is key and that customers must be kept abreast of any such charges. In the BNPL segment, compliance is key, with the RBI clamping down on products involving three parties – a prepaid card, a lending NBFC and a fintech, as these did not meet existing regulations.
- **Risk-based insurance cover not prevalent:** Per the company, there is no prevalent use case for a credit risk insurance-based cover. However, companies do have a fraud cover for every card.
- **Profitability dependent on scale:** A higher profit base gives players the opportunity to accommodate the different variants of a credit card portfolio. Also, by building a loan book, a card company will not only earn higher returns (ROE) but can also mitigate the risk factor attached to a large revolver base.

BOB Financial – On a strong growth trajectory

BOB Financial has grown from 0.13mn credit cards outstanding in FY17 to 1.5mn in H1FY23, expanding its market share from 0.4% to 1.9%.

- **Sourcing:** BOB Financial targets the 140mn-150mn-strong customer franchise of its parent, Bank of Baroda. The company intends to have a deeper engagement with the bank's CASA (current account, savings account) customer base by cross-selling credit cards. In terms of open market sourcing, growth comes from co-branded partnerships.
- **Diversification:** BOB Financial's cards business is currently skewed towards the self-employed. The company is looking to diversify towards the salaried segment by tapping the country's armed forces.
- **Key markets:** The company's credit cards business comes primarily from tier-2 cities, indicating that card use is no longer limited to metro or tier-1 cities.
- **Receivables mix:** In terms of receivables, 50% comes from transactors, 32-35% from revolvers and 15% is EMI-based.
- **Costs:** Customer acquisition and credit cost are major costs for the company, but high digital sourcing helps bolster operational efficiency.
- **Peer comparison:** BOB Financial believes it is not fully comparable to SBI Card because the latter's growth trajectory was built in a different environment and a different ecosystem. The company also indicated that its lack of a personal loan product does not put it at a disadvantage to peers because the nature of a credit card and accompanying offers is similar to taking a subvention from a manufacturer or dealer.

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BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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