

Indian banks set for solid growth in credit card business

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HDFC Bank, Axis Bank and ICICI Bank along with RBL Bank have strong business propositions in the credit cards business



We believe that the Indian banks would continue to show solid growth in issuances given the demographic advantage
(Representational image)

Credit card issuances remain strong at 25% year-on-year (y-o-y) in the three months till June this year– a trend that we have broadly maintained since demonetisation. The three frontline private banks (HDFC Bank, Axis Bank and ICICI Bank) along with SBI Cards and Payments dominate this business with 70% share between them. RBL Bank is a relatively new player but is emerging strongly on the back of its partnership with Bajaj Finance. Despite strong growth in issuances, penetration is quite low at 4% as compared to 60% of population using cards.

Notwithstanding the cyclicity that is inherent to this business, we believe that the Indian banks would continue to show solid growth in issuances given the demographic advantage and strong investments in payment infrastructure.

Profitable but cyclical business

We have looked at three listed credit card companies (American Express, Capital One and Discover). A 20-30 year cycle (1991-2018) has suggested that this business can generate an average RoE of 15-25%. Card companies have built specific preferences such as the ratio of income through spends as compared to lending. Costs are primarily marketing, reward costs and other business expenses. Reward costs tend to vary depending on the business model but would be at 1-1.3% of total transaction value. The cost-income ratio is 50-75% and the charge-off rates in this business has been 3-4%.

Indian banks are probably seeing a much higher return

The card business is a highly profitable business today. It has a healthy operating leverage but we acknowledge that it is a highly cyclical business. We are probably entering into a slowdown at this point and this could see an impact on growth or profitability. Our assessment suggests that the three frontline banks along with RBL Bank have strong business propositions in the cards business. We have limited information but looking at the transactions and the outstanding loans, we see that RBL Bank and HDFC Bank probably generate a higher share of their business from lending, while Axis Bank, ICICI Bank and IndusInd Bank are probably generating a higher share of income from transaction banking on a relative basis.

Edited excerpts from Kotak Institutional Equities Research

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