

RCE Capital Bhd (RCE MK)

Giving credit where credit is due

Maintain BUY call and MYR1.80 TP

We expect RCE's gross loans to grow by mid-single digits and expect profit spreads to expand thanks to falling cost of funds. Our FY20/FY21/FY22 core net profit estimates are tweaked -1%/+0%/+1%. Our TP is premised on 0.87x end-CY20E P/BV which is close to the five year average 12-month forward P/BV of 0.86x. We continue to favour RCE for its cheap valuations, high ROEs and high dividend yields. With this report, we transfer coverage to Shao Yang.

Still confident of mid-single digits loans growth

Ministry Of Finance budgeted for only 1% increase in federal government emoluments for CY20 but we believe RCE can still grow its gross loans by mid-single digits. RCE's presence in civil servants personal financing is still low as we estimate that it only has a 2% market share but there is still a lot of room to grow. It helps a lot that its main competitors (Bank Rakyat, MBSB and BSN) are reducing their exposure to personal financing.

Expect average lending rates to plateau

We estimate that most of its new loans are priced at 7.99% profit rate (effective: c. 13.2%). Against a 1QFY3/20 average lending yield of 14.1%, we expect RCE's average lending yields to plateau moving forward. Loans priced at 6.5% profit rate (effective: c. 11.0%) were introduced in Apr 2019 for low risk customers but we do not believe that they will negatively pressure average lending yields by much as their take up has been modest.

Cost of funds falling rapidly though

That said, we still expect profit spreads to expand due to falling cost of funds. We note that RCE's average cost of funds has been trending downwards of late, tracking MGS 10-year yields. In fact, every sukuk tranche that RCE recently issued has been priced at subsequently lower profit rates. The Zamarad sukuk third tranche was priced at 4.51% or 41bps lower than the first one, which was issued less than eight months ago, and against an average of 5.51% for the earlier Al-Dzahab bonds.

FYE Mar (MYR m)	FY18A	FY19A	FY20E	FY21E	FY22E
Operating income	188	200	210	224	236
Pre-provision profit	147	155	163	174	184
Core net profit	89	96	100	106	113
Core FDEPS (MYR)	0.26	0.28	0.28	0.30	0.32
Core FDEPS growth(%)	9.0	7.6	0.7	6.9	6.3
Net DPS (MYR)	0.07	0.09	0.09	0.09	0.09
Core FD P/E (x)	4.7	5.8	5.6	5.2	4.9
P/BV (x)	0.8	1.0	0.8	0.7	0.7
Net dividend yield (%)	5.7	5.5	5.7	5.7	5.7
Book value (MYR)	1.52	1.71	1.90	2.12	2.36
ROAE (%)	18.5	17.3	16.1	15.3	14.7
ROAA (%)	5.0	4.7	4.4	4.4	4.5
Consensus net profit	-	-	100	106	112
MKE vs. Consensus (%)	-	-	(0.0)	0.3	0.8

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BUY

Share Price MYR 1.57

12m Price Target MYR 1.80 (+23%)

Previous Price Target MYR 1.80

Company Description

RCE Capital is principally involved in the provision of general loan financing services.

Statistics

52w high/low (MYR)	1.68/1.44
3m avg turnover (USDm)	0.1
Free float (%)	27.7
Issued shares (m)	369
Market capitalisation	MYR579.2M
	USD140M

Major shareholders:
Cempaka Empayar Sdn. Bhd. 56.3%
RCE Capital Bhd. 5.5%
Employees Provident Fund 2.3%

Price Performance



 -1M
 -3M
 -12M

 Absolute (%)
 2
 (3)
 2

 Relative to index (%)
 (0)
 (1)
 10

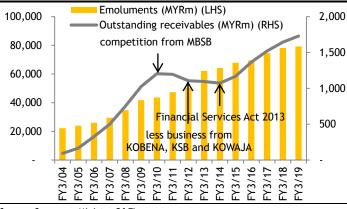
-RCE Capital Bhd / Kuala Lumpur Composite Index - (RHS, %)

Source: FactSet

Still confident of mid-single digits loans growth

As RCE is principally involved in the provision of personal financing, the ultimate borrowers being civil servants, its gross loans outstanding is highly correlated to federal government emoluments (R²: 0.9) (Fig. 1). During the tabling of Budget 2020 on 11 Oct 2019, Ministry Of Finance budgeted for only 1% increase in federal government emoluments for CY20 (Fig. 2). Correspondingly, we expect RCE's loan growth to flatten out at about 5% in FY20/21.

Figure 1: RCE outstanding gross loans vs. emoluments



Source: Company, Ministry Of Finance

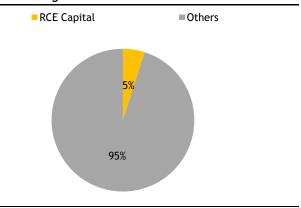
Figure 2: Federal government operating expenditure

MYRb	CY17	CY18	CY19E	CY20E
Emoluments	77.0	80.0	82.0	82.6
Retirement charges	22.8	25.2	26.6	27.1
Debt service charges	27.9	30.5	33.0	34.9
Grants & transfers to state governments	7.1	7.6	7.6	7.7
Supplies & services	34.7	35.3	30.2	38.5
Subsidies & social assistance	22.4	27.5	23.6	24.2
Asset acquisition	0.5	0.4	0.7	0.7
Refunds & write-offs	1.0	0.9	0.9	1.0
Grants to statutory bodies	14.0	13.8	13.2	15.3
Others	10.3	9.8	44.5	9.0
Total	217.7	231.0	262.3	241.0

Source: Ministry Of Finance

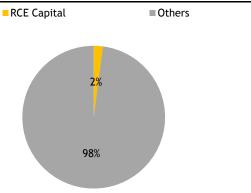
In our view, RCE's presence in civil servants personal financing still has a lot of room to grow. Although RCE has 80k customers, they account for only 5% of the civil service (Fig. 3). Bank Negara estimates that 97% of all civil servants borrow. According to the 1HCY18 Financial Stability Report, end-Feb 2018 total outstanding civil servants debt stood at MYR236b. Of this amount, MYR80b or 34% was in the form of personal financing. RCE's end-4QFY3/18 gross loans balance of MYR1.6b accounts for only 2% of total outstanding civil servants personal financing debt (Fig. 4).

Figure 3: Percentage of civil servants who borrow from RCE



Source: Company, Statistics Department

Figure 4: Civil servants personal financing by lender*



^{*} as at end-Feb 2018

Source: Company, Bank Negara Malaysia, Maybank Kim Eng

November 6, 2019

Civil servants personal financing has historically been dominated by Bank Kerjasama Rakyat (Bank Rakyat), Malaysia Building Society (MBS MK, Not Rated) (MBSB), Bank Simpanan Nasional (BSN) and Bank Islam (BIMB MK, Not Rated). As at end-CY18, their total outstanding gross personal financing stood at MYR100b. Note that they do extend personal financing to non-civil servants. That said, Bank Rakyat, MBSB and BSN have been reducing their loans exposure to personal financing over the last three years (Fig. 5). We gather that they are trying to diversify their loans portfolio lest it be overly reliant on personal financing.

Figure 5: Personal financing by lender

	CY16	CY17	CY18
Outstanding personal financing	gross loans (MYRb)		
Bank Rakyat	55.7	56.0	54.9
MBSB Bank	22.8	21.4	20.6
Bank Simpanan Nasional	11.3	10.7	10.8
Bank Islam	11.2	12.4	13.8
Total	101.0	100.5	100.0
Outstanding personal financing	gross loans as % of tot	<u>al</u>	
Bank Rakyat	80%	79%	78%
MBSB Bank	65%	63%	59%
Bank Simpanan Nasional	51%	47%	45%
Bank Islam	28%	29%	30%

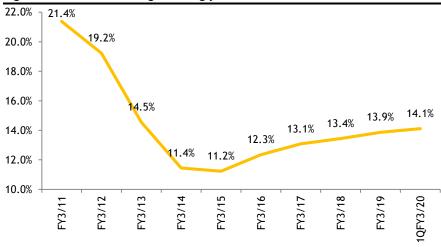
Source: Bank Rakyat, MBSB, BSN, Bank Islam

This is the opportunity that we gather RCE can capitalise on to grow its loans market share. Even though Bank Islam has been increasing its loans exposure to personal financing, the net decrease in the aforementioned non-bank financial institutions' total outstanding personal financing gross loans of MYR1.0b from CY16 to CY18 accounts for ~60% of RCE's end-1QFY3/20 gross loans outstanding of MYR1.8b (Fig. 5). Thus, we opine that it is not overly demanding for RCE's loans balance to grow 4-5% p.a. by filling the aforementioned 'gap'. We forecast FY20/FY21/FY22 gross loans to grow of +5%/+5%/+4% (unchanged).

Expect lending yields to plateau

Ever since RCE introduced risk-based pricing of its loans (i.e. lower profit rate for low risk customers/higher profit rate for high risk customers) in end-CY15, its average lending yields have been trending upwards. We gather that most of its new loans were priced at 7.99% profit rate (effective: circa 13.2%). Other loans are priced at profit rates of 6.50% (effective: c. 11.0%), 6.99% (effective: c. 11.7%), 8.99% (effective: c. 14.6%) and 9.99% (effective: c. 16.0%). We estimate that the 1QFY3/20 average lending yield was 14.1%, and we project average lending yields to plateau moving forward (Fig. 6).

Figure 6: Estimated average lending yields



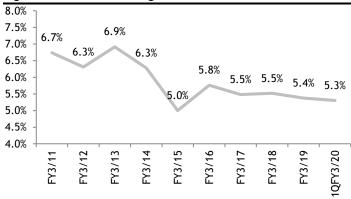
Source: Company, Maybank Kim Eng

Loans priced at 6.5% profit rate (effective: c. 11.0%) were introduced in Apr 2019 for low risk customers. If relatively more customers take up these loans, average lending yields will be negatively pressured but credit costs will also ease. By our estimates, <20% of RCE's new borrowers will be paying 6.50% and 6.99% profit rate (effective: c. 11.0-11.7%). This assures us that any negative pressure on RCE's average lending yields will be minimal. We forecast FY20/FY21/FY22 average lending yield of 14.2%/14.2%/14.2% (14.0%/14.2%/14.4% previously).

Cost of funding falling rapidly though

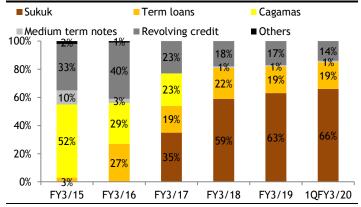
Although we expect average lending yields to peak, we still expect profit spreads to expand due to falling cost of funds. Tracking Malaysia Government Securities 10-year yields, we note that RCE's average cost of funds has been trending downwards of late (Fig. 7 & 8). In fact, every sukuk tranche that RCE recently issued has been priced at subsequently lower profit rates (Fig. 10). The Zamarad sukuk third tranche was priced at 4.51% or 41bps lower than the first one. We forecast FY20/FY21/FY22 average cost of funds of 5.4%/5.3%/5.3% (5.4%/5.7%/5.9% previously).

Figure 7: Estimated average cost of funds



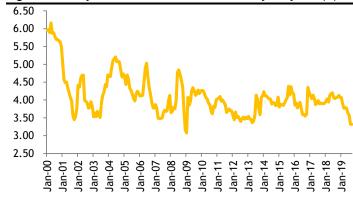
Source: Company, Maybank Kim Eng

Figure 9: Composition of debt financing



Source: Company

Figure 8: Malaysia Government Securities 10-year yield (%)



Source: Bloomberg

Figure 10: Outstanding sukuk issued by RCE

Sukuk	Profit rate	Principal (MYRm)
Al Dzahab	5.51%	770
Zamrad - first tranche	4.92%	240
Zamrad - second tranche	4.54%	100
Zamrad - first tranche	4.51%	120
	5.22%	1,230

Source: Company

Earnings estimates relatively unchanged

Our gross loans growth and credit cost forecasts are unchanged. We expect credit cost to tick up from FY20 onwards due to higher cost of living pressures. We expect inflation to accelerate from 0.8% this year to 2.0% next year as fuel subsidies are removed. We now forecast FY20/FY21/FY22 average lending yield of 14.2%/14.2%/14.2% (14.0%/14.2%/14.4% previously) as we expect upside to be capped by new loans priced at 6.5% profit rate (effective: c. 11.0%). That said, we now forecast lower FY20/FY21/FY22 average cost of funds of 5.4%/5.3%/5.3% (5.4%/5.7%/5.9% previously) due to falling sukuk profit rates. All in all, our FY20/FY21/FY22 core net profit estimates are only tweaked -1%/+0%/+1%.

Figure 11: Major assumptions

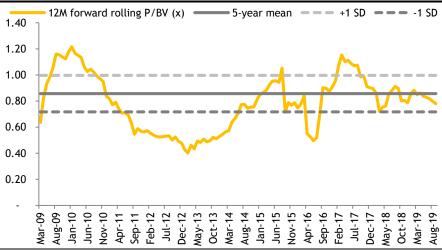
	FY3/18A	FY3/19A	FY3/20E	FY3/21E	FY3/22E
Gross loans growth	8.0%	5.2%	5.0%	5.0%	4.0%
Estimated average lending yield (A)	13.4%	13.9%	14.2%	14.2%	14.2%
Estimated average cost of funds (B)	5.5%	5.4%	5.4%	5.3%	5.3%
Estimated average interest spread (C=A-B)	7.9%	8.5%	8.8%	8.8%	8.8%
Credit cost as % of average gross loans	1.9%	1.4%	1.5%	1.5%	1.5%

Source: Maybank Kim Eng

Maintain BUY call and MYR1.80 TP

Seeing that we barely changed our core net profit estimates, we maintain our MYR1.80 TP on RCE. Our TP is premised on 0.87x end-CY20E P/BV which is close to the five year average 12-month forward P/BV of 0.86x (Fig. 12). Coupled with 13.0 sen DPS to be paid from now until end-CY20 (9.0 sen in FY20 and 4.0 sen in 1HFY21), we expect 23% upside potential. Maintain BUY. We continue to favour it for its cheap valuations (<10x PER, <1.0x P/BV), high ROEs and high dividend yields. We opine that there is upside potential for dividend yields as we are employing DPR assumptions of 27-31% only (DPR policy: 20-40%).

Figure 12: RCE 12M forward rolling P/BV (x)



Source: Company, Maybank Kim Eng, Bloomberg

PER wise, RCE is the cheapest amongst its listed non-banking financial institution (NBFI) peers. While MBSB may offer higher dividend yields, we gather that this is because it is employing >50% DPR. Note that MBSB's 1HCY19 net profit plunged 53% YoY to MYR190m due to a surge in credit cost (link). To be sure, **AEON Credit Service (M) (ACSM MK, Not Rated)** (AEON Credit) offers superior ROEs compared to RCE. That said, it offers markedly lower dividend yields compared to RCE. Thus, we do not believe that RCE should trade at >50% discount to AEON Credit's P/BV valuations.

Figure 13: Peer comparison table

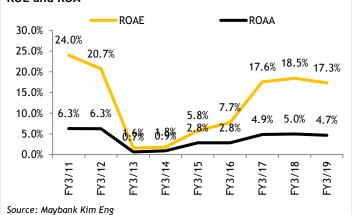
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Company	Last price	Mkt cap	PER (x)		P/BV (x)		ROE		Dividend yield					
	MYR	MYRm	CY18A	CY19E	CY20E	CY18A	CY19E	CY20E	CY18A	CY19E	CY20E	CY18A	CY19E	CY20E
RCE Capital	1.57	579.0	6.2	5.9	5.5	1.0	0.9	0.8	17.6%	16.4%	15.5%	5.4%	5.7%	5.7%
AEON Credit Service (M)	15.18	3,850.0	11.1	12.5	11.2	2.5	2.3	2.0	23.1%	19.3%	19.0%	2.9	2.7	3.0
Malaysia Building Society	0.88	5,908.0	9.2	11.2	9.9	0.7	0.7	0.7	8.6%	6.6%	7.2%	5.7	6.6	7.2

Source: Maybank Kim Eng, Bloomberg

Value Proposition

- RCE Capital provides personal financing, the ultimate borrowers being civil servants.
- With a gross loans balance of just MYR1.8b, we estimate that its market share is only 2%.
- Non-performing loans kept in check thanks to nondiscretionary direct salary deductions.
- Competitive advantage lies in fast loan processing turnaround time of 48 hours.
- ROE generation surpasses that of the average for the overall banking industry.

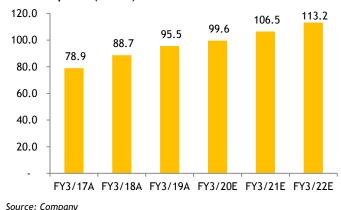
ROE and ROA



Financial Metrics

- Introduced a better credit scoring model in 2013. Forecast gross loans growth of 4-5% p.a. over the next three years.
- Average lending yields may be peaking at 14% but average cost of funds is falling.
- Asset quality better than before. New loans are smaller in size (<MYR20k) and their NPL ratios are low (<2%).
- Forecast stable three year forward core net profit CAGR of 6% p.a.
- There is room for dividends to surprise to the upside as its DPR policy is only 20-40%.

Core net profit (MYRm)



Price Drivers



Source: Company, Maybank Kim Eng

- Proposed special interim DPS of 10.5 sen. Still paid a final DPS of 3.5sen.
- 2. Proposed capital repayment of MYR0.075/shr and 4-into-1 share consolidation.
- 1QFY17 net profit surged 86% YoY as FY17 revenue grew 39% YoY.
- FY17 net profit surged 98% YoY as FY17 revenue grew 38% YoY.
- 5. Concerns arise that the government may reduce the size of the civil service.

Swing Factors

Upside

- Easing competition competitors have been reducing their exposure to personal financing.
- Lower interest rates we estimate that every 25bps reduction in cost of funds will accrete 3% to earnings.
- Access to CCRIS if RCE Capital gains access to CCRIS, it can better assess borrowers' total indebtedness.

Downside

- High household debt Household debt to GDP is elevated at >80% and may crimp borrowers' repayment ability.
- Need to leverage RCE Capital cannot take deposits and thus, has to assume debt to finance its loans.
- Asset-liability duration mismatch borrowers' repayment may not match RCE Capital's debt repayment.

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FYE 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Key Metrics					
Core P/E (x)	4.7	5.8	5.4	5.1	4.8
Core FD P/E (x)	4.7	5.8	5.6	5.2	4.9
P/BV (x)	0.8	1.0	0.8	0.7	0.7
P/NTA (x)	0.9	1.0	0.9	0.8	0.7
Net dividend yield (%)	5.7	5.5	5.7	5.7	5.7
INCOME STATEMENT (MYR m)					
Interest income	218.5	242.2	259.7	272.6	284.9
Interest expense	(69.4)	(78.1)	(87.5)	(89.3)	(90.7)
Net interest income	149.2	164.2	172.1	183.3	194.1
Islamic banking income	na	na	na	na	na
Other income	39.1	35.8	38.3	40.2	42.0
Total non-interest income	39.1	35.8	38.3	40.2	42.0
Operating income	188.3	200.0	210.4	223.5	236.1
Staff costs	(22.4)	(21.4)	(22.9)	(24.1)	(25.2)
Other operating expenses	(18.9)	(23.8)	(24.3)	(25.4)	(26.5)
Operating expenses	(41.3)	(45.2)	(47.2)	(49.5)	(51.7)
Pre-provision profit	147.0	154.8	163.2	174.0	184.5
Loan impairment allowances	(29.6)	(23.7)	(26.6)	(27.9)	(29.2)
Associates & JV income	0.0	0.0	0.0	0.0	0.0
Pretax profit	117.4	131.1	136.6	146.1	155.3
Income tax	(28.7)	(35.6)	(37.1)	(39.6)	(42.1)
Reported net profit	88.7	95.5	99.6	106.5	113.2
Core net profit	88.7	95.5	99.6	106.5	113.2
BALANCE SHEET (MYR m)					
Cash & deposits with banks	197.2	492.4	532.7	572.3	617.9
Sec. under resale agreements	0.0	0.0	0.0	0.0	0.0
Derivatives financial assets	0.0	0.0	0.0	0.0	0.0
Dealing securities	0.0	0.0	0.0	0.0	0.0
Available-for-sale securities	0.0	0.0	0.0	0.0	0.0
Investment securities	0.0	0.0	0.0	0.0	0.0
Loans & advances	1,528.5	1,602.4	1,680.2	1,760.4	1,826.8
Fixed assets	6.2	4.5	4.5	4.5	4.5
Intangible assets	47.3	47.3	47.3	47.3	47.3
Other assets	79.5	79.5	79.5	79.5	79.5
Total assets	1,858.8	2,226.1	2,344.3	2,464.1	2,576.1
Derivatives financial instruments	0.0	0.0	0.0	0.0	0.0
Subordinated debt	0.0	0.0	0.0	0.0	0.0
Other securities in issue	766.9	1,005.2	1,225.2	1,325.2	1,425.2
Other borrowings	230.4	280.8	106.1	49.7	(21.1)
Other liabilities	342.2	356.6	357.0	357.7	358.4
Total liabilities	1,339.5	1,642.6	1,688.3	1,732.7	1,762.5
Share capital	44.7	154.5	160.0	160.0	160.0
Reserves	474.6	429.1	496.0	571.4	653.6
Shareholders' funds	519.3	583.5	656.0	731.4	813.6
Preference shares	0.0	0.0	0.0	0.0	0.0
Minority interest	0.0	0.0	0.0	0.0	0.0
Total equity	519.3	583.5	656.0	731.4	813.6
Total liabilities & equity	1,858.8	2,226.1	2,344.3	2,464.1	2,576.1

FYE 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Key Ratios					
Growth (%)					
Net interest income	14.5	10.1	4.8	6.5	5.9
Non-interest income	(5.6)	(8.3)	6.9	5.0	4.4
Operating expenses	(4.1)	9.4	4.6	4.8	4.3
Pre-provision profit	14.3	5.3	5.4	6.6	6.0
Core net profit	12.3	7.7	4.2	6.9	6.3
Gross loans	8.0	5.2	5.0	5.0	4.0
Customer deposits	na	na	na	na	na
Total assets	9.2	19.8	5.3	5.1	4.5
Profitability (%)					
Non-int. income/Total income	20.8	17.9	18.2	18.0	17.8
Cost/income	21.9	22.6	22.4	22.2	21.9
Liquidity (%)					
Loans/customer deposits	na	na	na	na	na
Asset quality (%)					
Gross NPL	4.1	4.4	4.5	4.7	4.9
Loan loss coverage	178.0	172.1	170.1	167.0	164.1
Capital adequacy (%)					
CET1	na	na	na	na	na
Tier 1 capital	na	na	na	na	na
Risk-weighted capital	na	na	na	na	na
Returns (%)					
ROAE	18.5	17.3	16.1	15.3	14.7
ROAA	5.0	4.7	4.4	4.4	4.5
Shareholders equity/assets	27.9	26.2	28.0	29.7	31.6

Source: Company; Maybank

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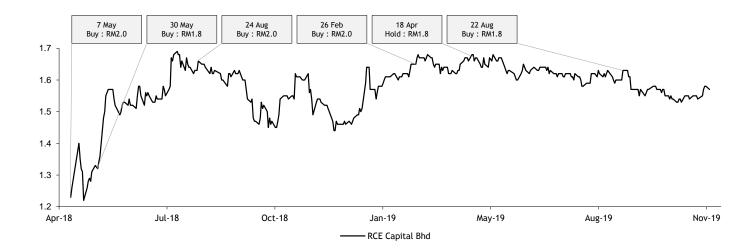
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November 6, 2019

Historical recommendations and target price: RCE Capital Bhd (RCE MK)



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