

19 February 2020

Financial Services | Non-Bank Financials

## RCE Capital (RCE MK)

**Buy** (Maintained)

Consistency Is Key; Stay BUY

Target Price (Return): MYR2.20 (+30%)  
 Price: MYR1.69  
 Market Cap: USD143m  
 Avg Daily Turnover (MYR/USD) 0.50m/0.12m

- **Keep BUY with a higher MYR2.20 TP from MYR2.10, 30% upside with 6% yield.** RCE Capital's 9MFY20 (Mar) net earnings beat estimates. Resilient receivable growth, lower funding costs, and well-contained credit costs were the main drivers. Valuation remains attractive, as the stock is currently trading at a mere 0.8x FY21F P/BV. Our revised TP values RCE at a GGM-derived FY21F P/BV of 1.07x against a projected FY20-22F average ROE of 16%.

- **9MFY20 beat.** RCE raked in MYR82.2m in PATAMI for 9MFY20, which accounted for 79% and 83% of our and Street's estimates. YTD PIOP grew 9% YoY, mainly lifted by robust topline growth, with NII and non-II growing 11% and 6%. Opex grew 13% YoY, but the overall CIR ratio remained well controlled at 23.1% (+6ppts YoY). Net earnings expanded faster YoY at 14.6%, thanks to 15% lower impairment charges. Credit cost improved to 112bps from 139bps over a year ago. Asset quality remained healthy, with both NPL and GIL ratios down 15bps and 26bps QoQ.

- **3QFY20 PATAMI jumped 23% YoY (+14% QoQ).** Overall business operations remained solid. NII grew 4.7% QoQ, buoyed by a 17bps expansion in NIM, based on our estimates. Lower cost of funds – from a *sukuk* issuance – contributed to the sequential improvement in margins, while the lending rate was steady QoQ. CIR improved c.260bps QoQ to 20.3% on lower staff costs and other expenses. Consequently, PIOP grew 7.6% QoQ. Impairment charges fell 18% QoQ – a testament to RCE's prudent underwriting policies and consistent recovery. Quarterly annualised credit costs further improved to 104bps from 128bps in 2QFY20. ROE stood a high 19.5% in 3QFY20 (9MFY20: 18.1%).

- **Receivables growth resilient.** Gross receivables expanded 5% YoY (+1.6% QoQ) to MYR1.8bn. RCE looks set to achieve its mid-single digit growth target for FY20. Management has not seen any slowdown in lending activities despite the softening macroeconomic environment. Applications remain robust, with no signs of a meaningful slowdown.

- **Earnings and TP.** We tweaked our FY20-21F earnings by c.4% for FY20-21F to account for slightly higher other income. Our TP is revised on the positive earnings revision. We value RCE at a GGM-derived FY21F P/BV of 1.07x against a projected FY20-22F average ROE of 16%.

- **The downside risks** to our recommendation include higher credit costs, and weaker net financing margins and growth in receivables.

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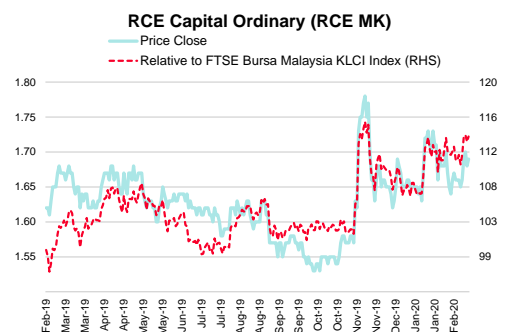


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### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	2.4	(2.3)	(3.4)	5.6	4.3
Relative	5.7	1.4	0.8	9.5	13.5
52-wk Price low/high (MYR)					1.53 – 1.78



Source: Bloomberg

Forecasts and Valuation	Mar-18	Mar-19	Mar-20F	Mar-21F	Mar-22F
Reported net profit (MYRm)	89	96	108	114	120
Net profit growth (%)	12.3	7.7	13.3	5.5	4.7
Recurring net profit (MYRm)	89	96	108	114	120
Recurring EPS (MYR)	0.26	0.28	0.31	0.33	0.35
BVPS (MYR)	1.52	1.71	1.94	2.20	2.47
DPS (MYR)	0.07	0.09	0.10	0.11	0.12
Recurring P/E (x)	6.49	6.03	5.40	5.12	4.89
P/B (x)	1.11	0.99	0.87	0.77	0.68
Dividend Yield (%)	4.2	5.3	6.2	6.5	6.8
Return on average equity (%)	18.5	17.3	17.3	16.0	14.8

Source: Company data, RHB

## Financial Exhibits

Asia	Financial summary (MYR)	Mar-18	Mar-19	Mar-20F	Mar-21F	Mar-22F
Malaysia	EPS	0.26	0.28	0.31	0.33	0.35
Financial Services	Recurring EPS	0.26	0.28	0.31	0.33	0.35
<b>RCE Capital</b>	DPS	0.07	0.09	0.10	0.11	0.12
RCE MK	BVPS	1.52	1.71	1.94	2.20	2.47
Buy						
Valuation basis	Valuation metrics	Mar-18	Mar-19	Mar-20F	Mar-21F	Mar-22F
Our GGM assumptions include:	Recurring P/E (x)	6.49	6.03	5.40	5.12	4.89
i. COE of 14.1%;	P/B (x)	1.1	1.0	0.9	0.8	0.7
ii. ROE of 14.5%;	Dividend Yield (%)	4.2	5.3	6.2	6.5	6.8
iii. 1% long-term growth.						
Key drivers	Income statement (MYRm)	Mar-18	Mar-19	Mar-20F	Mar-21F	Mar-22F
Our FY20 forecasts are most sensitive to changes in:	Interest income	214	234	259	273	289
i. Financing margins;	Interest expense	(69)	(78)	(85)	(90)	(98)
ii. Impairment allowances;	<b>Net interest income</b>	<b>144</b>	<b>156</b>	<b>173</b>	<b>183</b>	<b>190</b>
iii. Growth in receivables.	Non interest income	40	39	46	49	51
	<b>Total operating income</b>	<b>184</b>	<b>195</b>	<b>220</b>	<b>232</b>	<b>241</b>
	Overheads	(41)	(45)	(51)	(54)	(56)
	<b>Pre-provision operating profit</b>	<b>142</b>	<b>150</b>	<b>168</b>	<b>178</b>	<b>185</b>
	Loan impairment allowances	(25)	(18)	(20)	(21)	(21)
	<b>Pre-tax profit</b>	<b>117</b>	<b>131</b>	<b>148</b>	<b>157</b>	<b>164</b>
	Taxation	(29)	(36)	(40)	(42)	(44)
	<b>Reported net profit</b>	<b>89</b>	<b>96</b>	<b>108</b>	<b>114</b>	<b>120</b>
	<b>Recurring net profit</b>	<b>89</b>	<b>96</b>	<b>108</b>	<b>114</b>	<b>120</b>
Key risks	Profitability ratios	Mar-18	Mar-19	Mar-20F	Mar-21F	Mar-22F
The downside risks include:	Return on average assets (%)	5.0	4.7	4.7	4.6	4.3
i. Higher credit costs;	Return on average equity (%)	18.5	17.3	17.3	16.0	14.8
ii. Weaker net financing margins;	Return on IEAs (%)	12.2	12.2	12.4	12.1	12.1
iii. Weaker growth in receivables.	Cost of funds (%)	5.5	5.4	5.3	5.1	5.1
	Net interest spread (%)	6.7	6.9	7.1	7.0	7.0
	Net interest margin (%)	8.3	8.2	8.3	8.1	8.0
	Non-interest income / total income (%)	21.5	19.8	21.0	21.0	21.1
	Cost to income ratio (%)	22.5	23.2	23.3	23.3	23.2
	Credit cost (bps)	158	110	113	113	110
Company Profile	Balance sheet (MYRm)	Mar-18	Mar-19	Mar-20F	Mar-21F	Mar-22F
RCE provides general financing services to civil servants – repayments are done via direct salary deductions. Its wholly-owned EXP Payment unit offers payroll collection management services for government departments. This is under the purview of the Accountant General's Department.	Total gross loans	1,643	1,729	1,817	1,907	1,996
	Other interest earning assets	173	279	354	431	438
	Total gross IEAs	1,817	2,009	2,171	2,337	2,435
	Total provisions	(119)	(130)	(137)	(144)	(151)
	Net loans to customers	1,525	1,599	1,681	1,763	1,845
	Total net IEAs	1,698	1,878	2,034	2,193	2,283
	Total non-IEAs	161	348	318	455	640
	Total assets	1,859	2,226	2,352	2,648	2,924
	Other interest-bearing liabilities	1,298	1,605	1,641	1,853	2,037
	Total IBLs	1,298	1,605	1,641	1,853	2,037
	Total non-IBLs	41	38	40	35	32
	Total liabilities	1,340	1,643	1,681	1,889	2,069
	Share capital	45	154	162	168	175
	Shareholders' equity	519	584	670	759	855
	Asset quality and capital	Mar-18	Mar-19	Mar-20F	Mar-21F	Mar-22F
	Reported NPLs / gross cust loans (%)	4.1	4.4	4.5	4.7	4.6
	Total provisions / reported NPLs (%)	178.0	172.1	167.3	162.2	164.6

Source: Company data, RHB

## Results At a Glance

Figure 1: RCE – Summary of quarterly results

FYE Feb (MYRm)	3QFY19	2QFY19	3QFY20	% QoQ	% YoY	YTD19	YTD20	% YoY	Comments
<b>NII</b>	<b>40.0</b>	<b>42.9</b>	<b>44.9</b>	<b>4.7</b>	<b>12.3</b>	<b>116.1</b>	<b>129.0</b>	<b>11.1</b>	NII grew 4.7% QoQ due to NIMs improving sequentially.
Interest income	60.0	63.2	65.2	3.3	8.7	174.1	190.0	9.1	
Interest expense	(20.0)	(20.3)	(20.3)	0.5	1.5	(58.0)	(61.0)	5.1	
<b>Non-II</b>	<b>11.0</b>	<b>12.2</b>	<b>12.4</b>	<b>1.7</b>	<b>12.4</b>	<b>32.7</b>	<b>34.8</b>	<b>6.3</b>	
Non-II/total income (%)	21.6	22.1	21.7			22.0	21.3		
<b>Operating income</b>	<b>51.0</b>	<b>55.1</b>	<b>57.3</b>	<b>4.0</b>	<b>12.3</b>	<b>148.8</b>	<b>163.8</b>	<b>10.1</b>	
Overheads	(11.7)	(12.6)	(11.6)	(8.0)	(0.4)	(33.4)	(37.9)	13.4	
CIR (%)	22.9	23.0	20.3			22.5	23.1		
<b>PIOP</b>	<b>39.4</b>	<b>42.5</b>	<b>45.7</b>	<b>7.6</b>	<b>16.1</b>	<b>115.4</b>	<b>125.9</b>	<b>9.1</b>	Up 7.6% QoQ on robust topline growth and positive jaw.
Impairment on other assets	0.0	0.0	0.0			0.0	0.0		
Impairment on financings	(3.9)	(5.7)	(4.7)	(17.0)	21.2	(17.5)	(14.9)	(15.2)	
Credit cost	91	128	105			139	112		
<b>Operating profit</b>	<b>35.5</b>	<b>36.8</b>	<b>41.0</b>	<b>11.4</b>	<b>15.5</b>	<b>97.8</b>	<b>111.1</b>	<b>13.5</b>	
Associates & others									
<b>Pre-tax profit</b>	<b>35.5</b>	<b>36.8</b>	<b>41.0</b>	<b>11.4</b>	<b>15.5</b>	<b>97.8</b>	<b>111.1</b>	<b>13.5</b>	
Tax	(10.3)	(9.6)	(10.0)			(26.0)	(28.8)		
ETR (%)	29.1	26.2	24.4			26.6	25.9		
<b>Net earnings</b>	<b>25.2</b>	<b>27.2</b>	<b>31.0</b>	<b>14.1</b>	<b>23.2</b>	<b>71.8</b>	<b>82.3</b>	<b>14.6</b>	

### Other key data and ratios

Gross financing	1,720.3	1,778.8	1,807.4	1.6	5.1			
Total borrowings	1,427.2	1,478.3	1,570.2	6.2	10.0			
Gross impaired financing	(128.4)	(132.5)	(129.9)	(2.0)	1.2			
Total assets	2,027.5	2,143.1	2,254.3	5.2	11.2			
Shareholders' funds	559.8	629.4	644.0	2.3	15.0			
ROAA	5.0%	5.1%	5.6%			4.9%	4.9%	
ROAE	18.2%	17.5%	19.5%			17.7%	17.9%	
GIL ratio	7.5%	7.5%	7.2%					

Source: RHB, Company data

Figure 2: RCE – revisions to forecasts

FYE Mar	Net profit (MYRm)			EPS (MYR)			DPS (MYR)		
	Previous	Revised	% Chg	Previous	Revised	% Chg	Previous	Revised	% Chg
2020F	103.8	108.2	4.3%	0.30	0.31	4.3%	0.10	0.11	5.0%
2021F	109.5	114.2	4.3%	0.32	0.33	4.3%	0.11	0.11	4.8%
2022F	114.7	119.5	4.2%	0.33	0.35	4.2%	0.11	0.12	4.5%

Source: RHB

Figure 3: RCE's GGM valuation

<b>Cost of equity (COE) computation:</b>		Sustainable ROE (%)	15.0
Risk free rate (%)	3.4	COE (%)	14.1
Equity premium (%)	6.5	Long-term growth (g)	1.0
Beta (x)	1.65	Implied P/BV (x)	1.07
Cost of equity - CAPM (%)	14.1	BVPS – FY21F	MYR 2.08
		TP	MYR 2.22
		<b>TP (rounded)</b>	<b>MYR 2.20</b>

Source: Company data, RHB

Figure 4: RCE's 12-month forward P/E



Source: Bloomberg, RHB

Figure 5: RCE's 12-month forward P/BV



Source: Bloomberg, RHB

## Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2020-01-10	Buy	2.10	1.72

Source: RHB, Bloomberg

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<b>Buy:</b>	Share price may exceed 10% over the next 12 months
<b>Trading Buy:</b>	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
<b>Neutral:</b>	Share price may fall within the range of +/- 10% over the next 12 months
<b>Take Profit:</b>	Target price has been attained. Look to accumulate at lower levels
<b>Sell:</b>	Share price may fall by more than 10% over the next 12 months
<b>Not Rated:</b>	Stock is not within regular research coverage

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