

10 February 2021

Financial Services | Banks

RCE Capital (RCE MK)

Buy (Maintained)

Your All-Weather Pick; Keep BUY

Target Price (Return): MYR3.00 (+20%)
Price: MYR2.51
Market Cap: USD221m
Avg Daily Turnover (MYR/USD) 1.23m/0.30m

- **Keep BUY, new TP of MYR3.00 from MYR2.80, 20% upside with c.5% FY21 (Mar) yield.** RCE Capital's 9MFY21 PATAMI came in ahead of our and Street estimates. Management, being more prepared for MCO 2.0, has not seen any major adverse impact on operations. Applications, disbursement and collection remain healthy. We increase FY21-23F earnings by 5-6%. We value the stock at 1.2x FY22F P/BV (above +1SD), and believe it deserves a re-rating, given its consistent delivery in both earnings and dividend payments.
- **9MFY21 results beat expectations.** RCE recorded MYR90.6m in PATAMI (+10% YoY) for 9MFY21, beating our (82%) and Street (79%) full-year estimates. PIOP grew 8% YoY on positive jaws – income grew 5% but opex declined 4% YoY – while the CIR ratio stood at 21% (9MFY20: 23.1%). Annualised ROE, however, dropped to 17.2%, due to the lower leverage ratio.
- **3QFY21 earnings drivers.** PATAMI grew 5% QoQ or 12% YoY to MYR34.8m, which is a record for the lender. PIOP fell 2% QoQ (but rose 7% YoY) despite its operating income growth of 2% QoQ – lifted mainly by NII, which ticked up by 2% QoQ. RCE saw an increase in early settlement income, as a result of a rise in refinancing activities. Opex jumped 20% QoQ on one-off expenses relating to employee share options, while CIR was higher at 21.7% from 18.3% a quarter ago. Credit cost was significantly lower at 46bps (2QFY21: 127bps) due to changes in the macro-economic variable. Meanwhile, 9MFY21 credit cost dropped by 3bps YoY to 109bps.
- **Other highlights.** Gross financing expanded 1.7% QoQ to MYR1.83bn. Asset quality remained steady – the GIL ratio was at 4.0% (2QFY21: 4.2%). We also learned that RCE has been using FTSE Russell's scoring criteria in its ESG-related matters. A dedicated team would collect data, thereby ensuring that RCE's ESG initiatives meet the FTSE4Good Index requirements.
- **Update and outlook.** Management is more prepared for this second MCO, and has not seen any major adverse impact on operations. Applications, disbursements and collection remain healthy. Credit cost could be QoQ higher in 4QFY21F, as management has to refine the expected credit loss model to factor in a possibly lower GDP. That said, while we do not expect the higher credit cost to result in asset quality slippages, we do anticipate FY22F credit cost to normalise on the vaccine-precipitated recovery.
- **We raise FY21-23F earnings by 5-6% on lower credit cost and cost of fund assumptions.** We believe our FY21F credit cost of 124bps (9MFY21: 109bps) leaves sufficient room to cushion the potentially higher credit cost in 4QFY21, on the lower GDP growth outlook due to MCO 2.0. Our TP rises to MYR3.00, implying 1.2x FY22F P/BV (above +1SD from the mean).

Analysts

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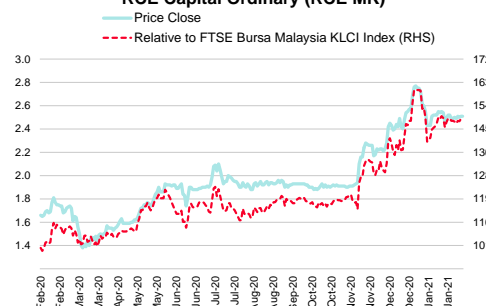
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(8.7)	3.3	30.1	31.4	51.2
Relative	(6.2)	6.2	26.0	30.9	49.2
52-wk Price low/high (MYR)				1.38 – 2.77	

RCE Capital Ordinary (RCE MK)



Source: Bloomberg

Overall ESG Score: 3.1 (out of 4)

E: Good

Some green initiatives undertaken by RCE include a lock-print policy implemented to limit and reduce paper wastage. As a result, a 20.0% reduction in paper utilisation per headcount was recorded in FY20. Electricity consumption per square foot also dropped, due to the extensive use of energy-saving lights.

S: Good

RCE practises responsible lending by ensuring the customers are aware of their obligations and commitments when financing is obtained. It is also imperative that they use the financing for legitimate purposes. The product features are clearly disclosed to the borrowers for their consideration. Financing will only be disbursed after obtaining their unambiguous acceptance of our offer.

G: Excellent

RCE's board comprises eight members, who are entirely non-executive directors. Four are non-independent directors (including the chairman) and four are independent directors.

Note:

Small cap stocks are defined as companies with a market capitalization of less than USD1bn.

Forecasts and Valuation	Mar-19	Mar-20	Mar-21F	Mar-22F	Mar-23F
Reported net profit (MYRm)	96	111	117	125	131
Net profit growth (%)	7.7	15.8	6.1	7.0	4.3
Recurring net profit (MYRm)	96	111	117	125	131
Recurring EPS (MYR)	0.28	0.32	0.33	0.36	0.37
BVPS (MYR)	1.71	1.94	2.18	2.46	2.75
DPS (MYR)	0.09	0.11	0.12	0.12	0.13
Recurring P/E (x)	8.96	7.89	7.50	7.01	6.72
P/B (x)	1.47	1.30	1.15	1.02	0.91
Dividend Yield (%)	3.6	4.4	4.8	4.8	5.2
Return on average equity (%)	17.3	17.6	16.3	15.5	14.3

Source: Company data, RHB

Financial Exhibits

Asia	Financial summary (MYR)	Mar-19	Mar-20	Mar-21F	Mar-22F	Mar-23F
Malaysia	EPS	0.28	0.32	0.33	0.36	0.37
Financial Services	Recurring EPS	0.28	0.32	0.33	0.36	0.37
RCE Capital	DPS	0.09	0.11	0.12	0.12	0.13
RCE MK	BVPS	1.71	1.94	2.18	2.46	2.75
Buy						
	Valuation metrics	Mar-19	Mar-20	Mar-21F	Mar-22F	Mar-23F
Valuation basis	Recurring P/E (x)	8.96	7.89	7.50	7.01	6.72
Our GGM assumptions are:	P/B (x)	1.5	1.3	1.2	1.0	0.9
i. CoE of 12.8%;	Dividend Yield (%)	3.6	4.4	4.8	4.8	5.2
ii. ROE of 15.4%; and						
iii. 2% long-term growth rate.						
	Income statement (MYRm)	Mar-19	Mar-20	Mar-21F	Mar-22F	Mar-23F
Key drivers	Interest income	234	257	268	280	288
Our FY21 forecasts are most sensitive to changes in:	Interest expense	(78)	(82)	(85)	(88)	(89)
i. Financing margins;	Net interest income	156	175	184	192	199
ii. Impairment allowances; and	Non interest income	39	46	48	50	52
iii. Growth in receivables.	Total operating income	195	221	232	241	251
	Overheads	(45)	(49)	(52)	(54)	(57)
	Pre-provision operating profit	150	172	179	187	194
	Loan impairment allowances	(18)	(23)	(23)	(20)	(20)
	Pre-tax profit	131	149	156	167	174
	Taxation	(36)	(38)	(39)	(42)	(44)
	Reported net profit	96	111	117	125	131
	Recurring net profit	96	111	117	125	131
	Profitability ratios	Mar-19	Mar-20	Mar-21F	Mar-22F	Mar-23F
Key risks	Return on average assets (%)	4.7	4.7	4.6	4.6	4.6
The downside risks include:	Return on average equity (%)	17.3	17.6	16.3	15.5	14.3
i. Higher-than-expected credit cost;	Return on IEAs (%)	12.2	12.2	11.9	11.9	11.8
ii. Weaker-than-expected financing growth; and	Cost of funds (%)	5.4	4.9	4.7	4.7	4.6
iii. Weaker-than-expect net financing margins.	Net interest spread (%)	6.9	7.3	7.2	7.2	7.1
	Net interest margin (%)	8.2	8.3	8.2	8.1	8.1
	Non-interest income / total income (%)	19.8	20.9	20.8	20.6	20.7
	Cost to income ratio (%)	23.2	22.2	22.6	22.4	22.6
	Credit cost (bps)	110	130	124	104	100
Company Profile						
RCE Capital provides general financing services to civil servants, and repayments are done via direct salary deductions. Its wholly-owned EXP Payment unit offers payroll collection management services for government departments under the purview of the Accountant General's Department.						
	Balance sheet (MYRm)	Mar-19	Mar-20	Mar-21F	Mar-22F	Mar-23F
	Total gross loans	1,729	1,820	1,866	1,965	2,049
	Other interest earning assets	279	364	444	438	438
	Total gross IEAs	2,009	2,184	2,309	2,403	2,487
	Total provisions	(130)	(130)	(138)	(145)	(152)
	Net loans to customers	1,599	1,690	1,728	1,820	1,897
	Total net IEAs	1,878	2,054	2,171	2,258	2,335
	Total non-IEAs	348	377	499	527	591
	Total assets	2,226	2,431	2,670	2,785	2,926
	Other interest-bearing liabilities	1,605	1,714	1,871	1,892	1,930
	Total IBLs	1,605	1,714	1,871	1,892	1,930
	Total non-IBLs	38	43	35	32	32
	Total liabilities	1,643	1,758	1,907	1,925	1,962
	Share capital	154	172	179	185	191
	Shareholders' equity	584	673	763	860	964
	Asset quality and capital	Mar-19	Mar-20	Mar-21F	Mar-22F	Mar-23F
	Reported NPLs / gross cust loans (%)	4.4	4.1	4.7	4.6	4.6
	Total provisions / reported NPLs (%)	172.1	173.0	159.1	160.3	161.3

Source: Company data, RHB

Results At a Glance

Figure 1: RCE – Summary of 3QFY21 and 9MFY21 results

FYE Mar (MYRm)	3QFY20	2QFY21	3QFY21	% QoQ	% YoY	9MFY20	9MFY21	% YoY	Comments – 3QFY21 vs 2QFY21
NII	44.9	50.5	51.7	2.3	15.1	129.0	142.6	10.5	
Interest income	65.2	70.2	71.6	2.0	9.8	190.0	203.2	7.0	Higher QoQ on higher early settlement income.
Interest expense	(20.3)	(19.7)	(20.0)	1.4	(1.9)	(61.0)	(60.7)	(0.5)	Lower QoQ on both lower borrowings and cost of fund.
Non-II	12.4	10.5	10.6	0.4	(14.8)	34.8	30.0	(13.7)	
Non-II/Total income (%)	21.7	17.3	17.0			21.3	17.4		
Operating income	57.3	61.1	62.3	1.9	8.6	163.8	172.6	5.3	
Overheads	(11.6)	(11.2)	(13.5)	20.5	16.0	(37.9)	(36.2)	(4.4)	Up QoQ due to one-off employee share option scheme expense.
CIR (%)	20.3	18.3	21.7			23.1	21.0		
PIOP	45.7	49.9	48.8	(2.2)	6.7	125.9	136.4	8.3	
Impairment on financings	(4.7)	(5.7)	(2.1)	(63.6)	(55.8)	(14.9)	(14.9)	0.5	
Credit cost	105	127	46			112	109		Lower QoQ on change in macroeconomic variables.
Pre-tax profit	41.0	44.2	46.7	5.7	13.9	111.1	121.4	9.3	
Tax	(10.0)	(11.2)	(11.9)			(28.8)	(30.9)	(10.0)	
ETR (%)	24.4	25.3	25.5			25.9	25.4	24.4	
Net earnings	31.0	33.0	34.8	5.3	12.2	82.3	90.6	10.1	
Other key data and ratios									
Gross financing	1,807.4	1,802.2	1,832.8	1.7	1.4				
Total borrowings	1,570.2	1,534.5	1,677.0	9.3	6.8				
Gross impaired financing	(129.9)	(131.4)	(128.1)	(2.5)	(1.4)				
Total assets	2,254.3	2,293.2	2,454.6	7.0	8.9				
Shareholders' funds	644.0	717.5	734.4	2.4	14.0				
ROAA	5.6%	5.8%	5.9%			4.9%	4.9%		
ROAE	19.5%	18.9%	19.2%			17.9%	17.2%		
GIL ratio	4.3%	4.2%	4.0%						

Source: Company data, RHB

Earnings estimate revisions

We fine-tune FY21-23F earnings by 5-6%, mainly on lower credit cost and cost of funds assumptions. We believe our FY21F credit cost of 124bps (9MFY21: 109bps) leaves sufficient room to cushion the potentially higher credit cost in 4QFY21, which in turn is premised on the glum GDP growth outlook triggered by MCO 2.0.

Figure 2: RCE – revisions to our forecasts

FYE Mar	Net profit (MYRm)			EPS (MYR)			DPS (MYR)		
	Previous	Revised	% Chg	Previous	Revised	% Chg	Previous	Revised	% Chg
2021F	110.4	117.3	6.3%	0.32	0.33	6.3%	0.12	0.12	0.0%
2022F	119.0	125.5	5.4%	0.34	0.36	5.4%	0.12	0.12	4.3%
2023F	124.9	130.8	4.7%	0.4	0.37	4.7%	0.12	0.13	8.3%

Source: RHB

Valuation

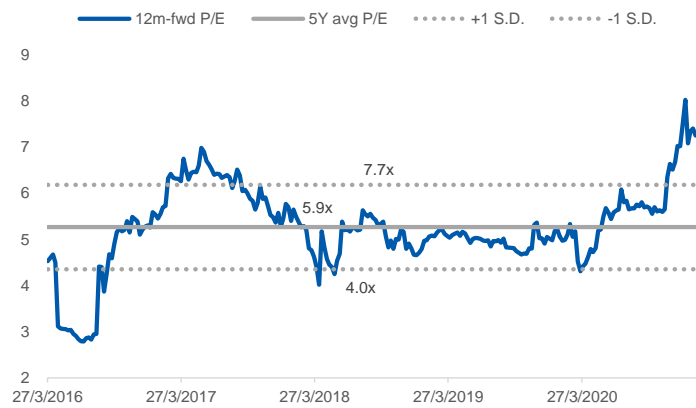
We raise our GGM-derived TP to MYR3.00 from MYR2.80, reflecting 1.2x FY22F P/BV or above +1SD from the historical mean. We believe RCE deserves the re-rating, given its solid track record even in times of great economic uncertainty. RCE remains our Top Pick among the non-bank lenders, due to its resilient asset quality and consistent delivery in both earnings and dividend payments.

Figure 3: RCE's GGM valuation

Cost of equity (COE) computation:		Sustainable ROE (%)	15.4
Risk free rate (%)	2.9	COE (%)	12.8
Equity premium (%)	7.4	Long-term growth (g)	2.0
Beta (x)	1.4	Implied P/BV (x)	1.24
Cost of equity - CAPM (%)	12.8	BVPS – FY22F	MYR 2.46
		Target price	MYR 3.03
		TP (rounded)	MYR 3.00

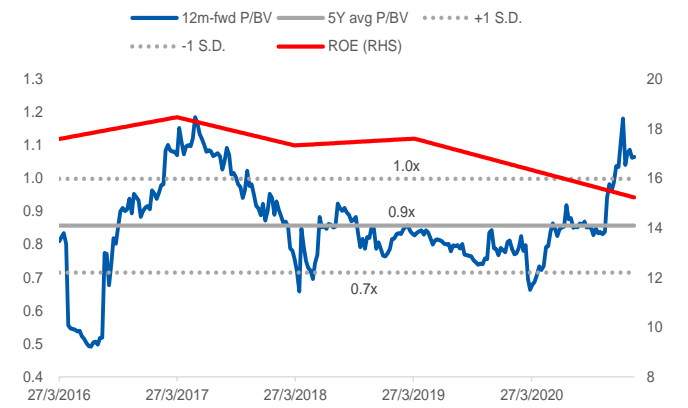
Source: Company data, RHB

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
2020-12-08	Buy	2.80	2.45
2020-07-06	Buy	2.50	1.92
2020-06-16	Buy	2.20	1.81
2020-03-15	Buy	2.10	1.50
2020-02-19	Buy	2.20	1.77
2020-01-10	Buy	2.10	1.72
2019-08-16	Not Rated	na	1.60

Source: RHB, Bloomberg

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Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
Neutral:	Share price may fall within the range of +/- 10% over the next 12 months
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Not Rated:	Stock is not within regular research coverage

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