

# RCE Capital Bhd (RCE MK)

## Of good ESG standing

### Maintain BUY call with higher TP of MYR3.06 (+10%)

In our view, RCE is a responsible lender. It does carry out related party transactions (RPT) but we do not believe they are a cause for concern. Cost of funds has troughed but we do not expect it to rise in the near term. Rolling forward our valuation base year to end-CY22E from end-CY21E and ascribing an unchanged 1.2x P/BV, we raise our TP to MYR3.06 from MYR2.78. Potential re-rating catalysts are RCE obtaining Shariah status and raising its DPR policy (FY3/20A: 35%). Maintain BUY call.

### A lot more measured in its financing these days

In Jul 2013, Bank Negara Malaysia instituted macro prudential measures to rein in high household debt levels. Post-Jul 2013, non-bank financial institutions (NBFI) can only disburse personal financing with tenures of ≤10 years (≤25 years previously). Furthermore, the debt service ratio of customers was capped at 60%. Coupled with its in-house credit scoring model put in place in CY13, the average personal financing of RCE's customers eased from c.MYR30,000 in FY3/13 to c. MYR20,000 currently.

### Carries out RPTs but not a cause of concern

As at end-FY3/20, RCE has deposits of MYR594.6m (96% of total deposits, cash and bank balances) and borrowings of MYR300.1m (18% of total borrowings) with **AMMB Holdings (AMM MK, HOLD, CP: MYR3.01, TP: MYR3.40)**. AMMB is 13%-owned by Tan Sri Azman Hashim (TSAH). Cempaka Empayar, RCE's largest shareholder, is controlled by TSAH. That said, our preliminary calculations indicate that the deposits/borrowings attract reasonable interest rates of approximately 2%/3% respectively.

### +ve earnings revisions still possible going forward

RCE's earnings have benefitted greatly from falling cost of funds, as exemplified by easing Overnight Policy Rates (OPR). Our view is that Bank Negara Malaysia has come to the end of its OPR cut cycle ([link](#)). That said, we also do not expect BNM to hike the OPR soon as the Federal Reserve has signalled that it will remain dovish until CY23 ([link](#)). Thus, RCE can roll forward old sukuk at higher profit rates with new ones at lower profit rates. Our earnings estimates are unchanged for now.

FYE Mar (MYR m)	FY19A	FY20A	FY21E	FY22E	FY23E
Operating income	200	221	238	246	256
Pre-provision profit	155	172	186	193	202
Core net profit	96	111	118	122	128
Core FDEPS (MYR)	0.28	0.32	0.33	0.34	0.36
Core FDEPS growth(%)	7.6	13.5	3.9	3.8	4.6
Net DPS (MYR)	0.09	0.11	0.12	0.12	0.13
Core FD P/E (x)	5.8	4.7	8.0	7.7	7.4
P/BV (x)	1.0	0.8	1.2	1.1	1.0
Net dividend yield (%)	5.5	7.4	4.4	4.6	4.8
Book value (MYR)	1.71	1.92	2.14	2.37	2.61
ROAE (%)	17.3	17.6	16.6	15.5	14.7
ROAA (%)	4.7	4.7	4.7	4.7	4.6
Consensus net profit	-	-	117	125	129
MKE vs. Consensus (%)	-	-	0.8	(1.8)	(1.2)

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# BUY

Share Price MYR 2.63  
12m Price Target MYR 3.06 (+21%)  
Previous Price Target MYR 2.78

### Company Description

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

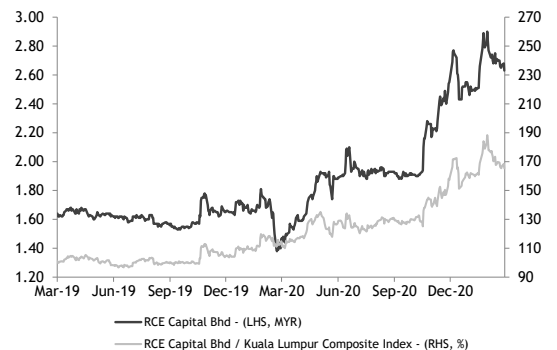
### Statistics

52w high/low (MYR)	2.90/1.44
3m avg turnover (USDm)	0.3
Free float (%)	28.4
Issued shares (m)	358
Market capitalisation	MYR942.4M USD229M

### Major shareholders:

Cempaka Empayar Sdn. Bhd.	51.1%
RCE Capital Bhd.	6.0%
Rockwills International Group Bhd	4.5%

### Price Performance



	-1M	-3M	-12M
Absolute (%)	(9)	3	88
Relative to index (%)	(12)	5	46

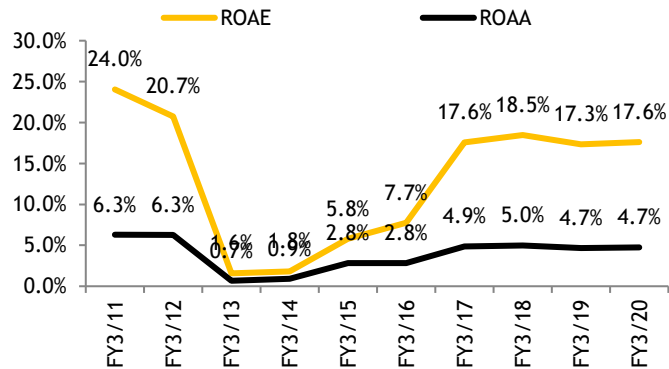
Source: FactSet

**ESG**  
Tear Sheet Insert

## Value Proposition

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

### ROE and ROA

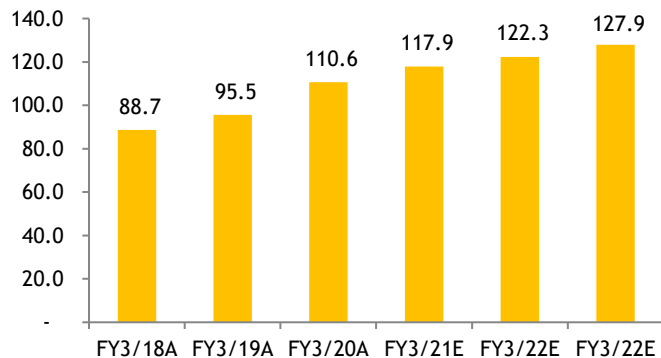


Source: Company

## Financial Metrics

- Introduced a better credit scoring model in CY13. Forecast gross financing growth of 3% p.a. over the next three years.
- Average financing yields may be peaking at 14-15% but average cost of funds is falling.
- Asset quality better than before. New financing are smaller in size (<MYR20k) and their NPF ratios are low (<2%).
- Forecast stable three-year forward core net profit CAGR of 5% p.a.
- There is room for dividends to surprise to the upside as its DPR policy is only 20-40%.

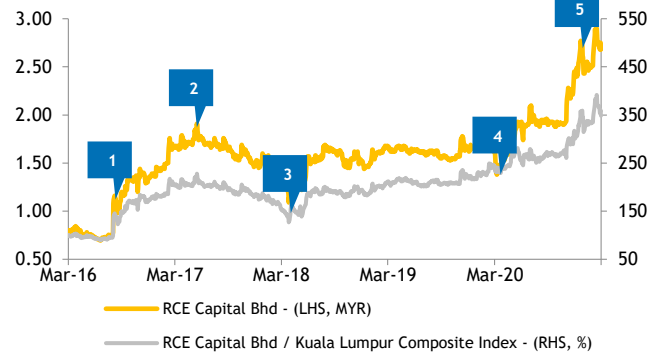
### Core net profit (MYRm)



Source: Company (historical), Maybank Kim Eng (forecasts)

## Price Drivers

### Historical share price trend



Source: Company, Maybank Kim Eng

1. 1QFY17 net profit surged 86% YoY as FY17 revenue grew 39% YoY.
2. FY17 net profit surged 98% YoY as FY17 revenue grew 38% YoY.
3. Concerns arise that the government may reduce the size of the civil service.
4. Movement Control Order lengthened time to process new customers, resulting in less financing disbursed.
5. 2QFY21 net profit grew 22% YoY to a record high of MYR33m.

## Swing Factors

### Upside

- Easing competition - competitors have been reducing their exposure to personal financing.
- Lower cost of funds - 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 customers' total indebtedness.

### Downside

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

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## Business Model & Industry Issues

- Being a non-bank financial institution (NBFI), RCE does not have a large environmental footprint. That said, we opine that it has a large social footprint by way of responsible financing.
- NBFIs were a lot more carefree in disbursing financing before Jul 2013. In Jul 2013, Bank Negara Malaysia instituted macro prudential measures to rein in high household debt levels caused by the aforementioned.
- Since then, reflecting RCE's broad transition to more socially-responsible lending parameters, tenure of its financing is capped at 10 years (25 years previously) and debt service ratio of its customers is capped at 60%.
- In CY13, RCE also put in place an in-house credit scoring model that precludes RCE from over-lending to particular customers. As a result, average financing/customer has eased from c.MYR30,000 in FY3/13 to c. MYR20,000 currently.
- To be sure, RCE does carry out related party transactions (RPT) as it places deposits and borrows from AMMB Holdings which is 13%-owned by Tan Sri Azman Hashim, the controlling shareholder of RCE.
- That said, interest rates on the aforementioned deposits and borrowings do not appear unfair to us or detrimental to minority shareholders. All in all, we rate RCE's ESG credentials vis-à-vis its core business as commendable.

## Material E issues

- No major environmental issues. Cut paper utilisation per headcount by 20% to c.6,000 in FY3/20.
- The above was achieved via emails reminding employees to "Think before you Print" and printing on both sides.
- Cut electricity consumption psf to 1.0 kWh from 1.1 kWh although RCE expanded its office space by 33% in FY3/20.
- Part of the reason for the above is due to the extensive use of energy saving light bulbs.

## Material S issues

- RCE is guided by Bank Negara Malaysia's (BNM) guidelines for responsible financing.
- In Jul 2013, BNM instituted macro prudential measures to rein in high household debt levels.
- Since then, tenure of its financing is capped at 10 years and debt service ratio of its customers is capped at 60%.
- In-house credit scoring model put in place in CY13 precludes RCE from over-lending to a customer.
- As a result, average financing/customer has eased from c.MYR30,000 in FY3/13 to c. MYR20,000 currently.
- Technical and soft skills trainings provided to sales team to promote responsible financing.
- Extends study grants to students pursuing the Association of Chartered Certified Accountants qualification.
- To date, RCE has extended MYR406,000 in study grants to 28 students.
- An overwhelming 70% of RCE's employees are women.

## Key G metrics and issues

- BOD comprises 1 Non-Independent Non-Executive Chairman (NINEC), 3 Non-Independent Non-Executive Directors (NINED) and 5 Independent Directors (ID).
- Largest shareholder is Cempaka Empayar Sdn Bhd, which is controlled by Tan Sri Azman Hashim (TSAH).
- NINEC, Shahman Azman is a son of TSAH. NINED, Shalina Azman is a daughter of TSAH.
- Only 1 of the 9 BOD members is a woman, the aforementioned Shalina Azman.
- FY3/20 directors' remuneration accounted for <1% of FY3/20 net profit.
- Deloitte PLT is the independent auditor. They have been appointed for >10 years.
- There are 4 BOD level committees. 2 are chaired by IDs (i.e. Audit and Nomination & Remuneration)
- 2 are chaired by the NINEC (i.e. Employees' Share Scheme and Sustainability Management).
- Carries out RPTs with AMMB Holdings (AMMB), which is 13%-owned by TSAH.
- As at end-FY3/20, RCE has deposits of MYR594.6m and borrowings of MYR300.1m with AMMB.
- That said, interest rates on the aforementioned deposits and borrowings appear fair to us.
- RCE hired PricewaterhouseCoopers Consulting to review its related party transactions.

FYE 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Key Metrics</b>					
Core P/E (x)	5.8	4.7	7.8	7.5	7.2
Core FD P/E (x)	5.8	4.7	8.0	7.7	7.4
P/BV (x)	1.0	0.8	1.2	1.1	1.0
P/NTA (x)	1.0	0.8	1.3	1.2	1.1
Net dividend yield (%)	5.5	7.4	4.4	4.6	4.8
<b>INCOME STATEMENT (MYR m)</b>					
Islamic banking income	164.2	187.0	202.0	209.2	218.1
Other income	35.8	34.2	35.5	36.6	37.7
<b>Total non-interest income</b>	<b>200.0</b>	<b>221.2</b>	<b>237.6</b>	<b>245.8</b>	<b>255.8</b>
Operating income	200.0	221.2	237.6	245.8	255.8
Staff costs	(21.4)	(24.2)	(25.2)	(25.9)	(26.7)
Other operating expenses	(23.8)	(25.0)	(25.9)	(26.7)	(27.4)
<b>Operating expenses</b>	<b>(45.2)</b>	<b>(49.2)</b>	<b>(51.1)</b>	<b>(52.6)</b>	<b>(54.1)</b>
<b>Pre-provision profit</b>	<b>154.8</b>	<b>172.0</b>	<b>186.4</b>	<b>193.3</b>	<b>201.7</b>
Other allowances	(23.7)	(23.1)	(27.7)	(28.5)	(29.4)
Associates & JV income	0.0	0.0	0.0	0.0	0.0
<b>Pretax profit</b>	<b>131.1</b>	<b>148.9</b>	<b>158.7</b>	<b>164.7</b>	<b>172.3</b>
Income tax	(35.6)	(38.3)	(40.8)	(42.4)	(44.3)
<b>Reported net profit</b>	<b>95.5</b>	<b>110.6</b>	<b>117.9</b>	<b>122.3</b>	<b>127.9</b>
<b>Core net profit</b>	<b>95.5</b>	<b>110.6</b>	<b>117.9</b>	<b>122.3</b>	<b>127.9</b>
<b>BALANCE SHEET (MYR m)</b>					
Cash & deposits with banks	492.4	620.2	699.4	780.2	863.3
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
Financing and advances	1,602.4	1,692.9	1,740.6	1,790.9	1,844.5
Fixed assets	4.5	7.3	8.7	10.1	11.4
Intangible assets	47.3	47.3	47.3	47.3	47.3
Other assets	79.5	63.3	63.3	63.3	63.3
<b>Total assets</b>	<b>2,226.1</b>	<b>2,431.0</b>	<b>2,559.3</b>	<b>2,691.7</b>	<b>2,829.9</b>
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	1,005.2	1,059.1	1,060.0	1,060.0	1,060.0
Other borrowings	280.8	429.1	478.5	530.5	584.2
Other liabilities	356.6	269.5	269.8	270.0	270.3
<b>Total liabilities</b>	<b>1,642.6</b>	<b>1,757.7</b>	<b>1,808.3</b>	<b>1,860.5</b>	<b>1,914.5</b>
Share capital	154.5	172.2	172.2	172.2	172.2
Reserves	429.1	501.1	578.7	659.0	743.2
Shareholders' funds	583.5	673.4	751.0	831.3	915.4
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	583.5	673.4	751.0	831.3	915.4
<b>Total liabilities &amp; equity</b>	<b>2,226.1</b>	<b>2,431.0</b>	<b>2,559.3</b>	<b>2,691.7</b>	<b>2,829.9</b>

FYE 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Key Ratios</b>					
<b>Growth (%)</b>					
Net interest income	na	na	na	na	na
Non-interest income	6.2	10.6	7.4	3.5	4.0
Operating expenses	9.4	8.9	3.9	2.9	2.9
Pre-provision profit	5.3	11.1	8.4	3.7	4.3
Core net profit	7.7	15.8	6.6	3.8	4.6
Gross loans	5.2	5.3	3.0	3.0	3.0
Customer deposits	na	na	na	na	na
Total assets	19.8	9.2	5.3	5.2	5.1
<b>Profitability (%)</b>					
Non-int. income/Total income	100.0	100.0	100.0	100.0	100.0
Cost/income	22.6	22.2	21.5	21.4	21.1
<b>Liquidity (%)</b>					
Loans/customer deposits	na	na	na	na	na
<b>Asset quality (%)</b>					
Gross NPF	4.4	4.1	4.3	4.4	4.4
<b>Capital adequacy (%)</b>					
CET1	na	na	na	na	na
Tier 1 capital	na	na	na	na	na
Risk-weighted capital	na	na	na	na	na
<b>Returns (%)</b>					
ROAE	17.3	17.6	16.6	15.5	14.7
ROAA	4.7	4.7	4.7	4.7	4.6
Shareholders equity/assets	26.2	27.7	29.3	30.9	32.3

Source: Company; Maybank

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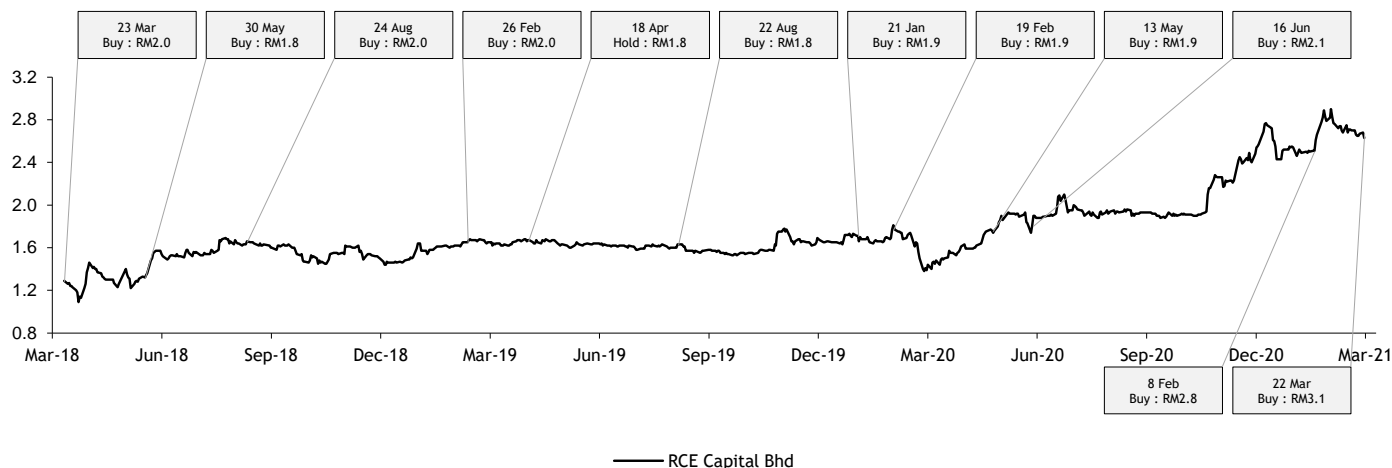
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