

12 August 2022

Financial Services | Banks

RCE Capital (RCE MK)

Buy (Maintained)

1QFY23: Weighed Down By Higher Provisions

Target Price (Return): MYR1.92 (+16%)
 Price (Market Cap): MYR1.66 (USD273m)
 ESG score: 3.10 (out of 4)
 Avg Daily Turnover (MYR/USD) 0.34m/0.08m

- **Stay BUY, new MYR1.92 TP from MYR2.00, 16% upside with c.5% FY23F (Mar) yield.** RCE Capital's 1QFY23 results missed expectations, mainly due to the conservative impairment of accounts. We expect provisions to normalise in the quarters ahead, as asset quality stabilises and recovery efforts are being stepped up. This, coupled with sustained financing demand, point to better earnings ahead. Contrary to concerns, we believe NIM compression would be manageable, given mitigation efforts by management.
- **1QFY23 results missed estimates.** 1QFY23 net profit of MYR32.2m (+2% QoQ, -9% YoY), accounted for c.24% of our and consensus FY23F earnings. The YoY decline was mainly due to the full impairment of accounts that dropped off from the salary deduction scheme. PIOP grew by a modest 1.5% YoY, as lower income from early settlements led to a 5.5% YoY drop in net fund-based income, which offset the 27% YoY growth in other income. 1QFY23 ROAE was 14.8% vs 14.7% in 4QFY22.
- **Asset quality.** Impairment allowances spiked to MYR8.2m in 1QFY23 (4QFY22: MYR5.9m), matching the 4QFY20 peak seen during the COVID-19 pandemic. Management attributed this to the conservative full provisioning of exposures to borrowers that had left the civil service. There were noticeable resignations and early retirements within the academic and healthcare sectors. GILs rose 6.5% QoQ, lifting the GIL ratio to 4.0% vs 3.8% 4QFY23. Efforts are being made to recover the outstanding balances, which would result in write-backs, if successful. Management remains vigilant on asset quality, notwithstanding the improvement seen in July.
- **Demand for financing still strong.** Gross financing grew 1.4% QoQ (FY22: +1.8% YoY), helped by the economic reopening. Management believes growth is sustainable, given the strong momentum in financing applications. RCE has also launched some campaigns to capture the lending opportunity. We have pencilled in loan growth of 4% for FY23F.
- **Working to manage NIM pressures.** With all of RCE's financing receivables on fixed rates, against 71.5% of its financing liabilities being on fixed rates as well, the rising interest rate environment would have a negative impact on NIM. To mitigate the NIM pressures, RCE is focusing on higher-profit rate products to boost asset yields, while the utilisation of floating rate revolving credits has helped to lower funding costs. These measures should help keep NIM compression manageable.
- **Earnings and TP.** With 1QFY23 PIOP within our expectations and credit cost likely to normalise, we make no changes to our FY23-25F earnings, for now. Our TP drops to MYR1.92 (from MYR2.00), as we refreshed our GGM assumptions for heighten macroeconomic risks. Our TP also incorporates a 2% premium to our intrinsic value for its ESG score of 3.10, based on our in-house proprietary methodology.
- **The downside risks** to our call includes: i) Higher-than-expected credit cost, and ii) weaker-than-expected financing growth and net financing margins.

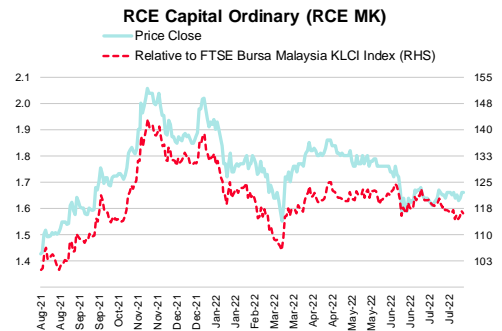
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(16.1)	1.2	(7.8)	(7.3)	16.2
Relative	(12.1)	(4.4)	(4.6)	(2.6)	16.1
52-wk Price low/high (MYR)				1.43	2.06



Source: Bloomberg

Overall ESG Score: 3.10 (out of 4)

E: GOOD

The group maintains transparent and detailed disclosures of its Scope 1 and Scope 2 emissions, which has recorded a decent reduction of 3% between FY22 (Mar) and FY20. It also fosters a culture of green volunteerism through its Green Warriorz Team, and designated e-waste containers on office floors to encourage the proper disposal of e-waste such as unused gadgets and batteries.

S: GOOD

RCE outsources the auditing of its IT systems to ensure that competency standards are met. The group, in collaboration with Yayasan Azman Hashim, also provides study grants and scholarships to deserving underprivileged students to pursue chartered accountancy certifications. To date, MYR524,000 has been distributed under the programme.

G: EXCELLENT

The Board comprises nine non-executive directors, five of whom are independent directors. Board members have a maximum allowed tenure of nine years, to facilitate Board refreshment. However, in FY22, there was a one-off incident of non-compliance in relation to a late payment of service tax due to administrative delay, but that has since been resolved.

Note:

Small cap stocks are defined as companies with a market capitalization of less than USD0.5bn.

Forecasts and Valuation	Mar-21	Mar-22	Mar-23F	Mar-24F	Mar-25F
Reported net profit (MYRm)	125	133	136	139	147
Net profit growth (%)	12.7	6.9	2.3	2.0	5.6
Recurring net profit (MYRm)	125	133	136	139	147
Recurring EPS (MYR)	0.18	0.18	0.19	0.19	0.20
BVPS (MYR)	1.13	1.19	1.15	1.11	1.06
DPS (MYR)	0.07	0.07	0.08	0.09	0.09
Recurring P/E (x)	9.13	9.12	8.92	8.74	8.28
P/B (x)	1.47	1.39	1.44	1.50	1.57
Dividend Yield (%)	4.3	4.5	4.8	5.1	5.4
Return on average equity (%)	17.2	16.2	15.9	16.8	18.5

Source: Company data, RHB

See important disclosures at the end of this report

Market Dateline / PP 19489/05/2019 (035080)

Financial Exhibits

Asia	Financial summary (MYR)	Mar-21	Mar-22	Mar-23F	Mar-24F	Mar-25F
Malaysia	EPS	0.18	0.18	0.19	0.19	0.20
Financial Services	Recurring EPS	0.18	0.18	0.19	0.19	0.20
RCE Capital	DPS	0.07	0.07	0.08	0.09	0.09
RCE MK	BVPS	1.13	1.19	1.15	1.11	1.06
Buy						
	Valuation metrics	Mar-21	Mar-22	Mar-23F	Mar-24F	Mar-25F
	Recurring P/E (x)	9.13	9.12	8.92	8.74	8.28
	P/B (x)	1.5	1.4	1.4	1.5	1.6
	Dividend Yield (%)	4.3	4.5	4.8	5.1	5.4
Valuation basis						
Our GGM assumptions are:						
i. CoE of 11.8%;						
ii. ROE of 17.0%;						
iii. 3.5% long-term growth rate.						
	Income statement (MYRm)	Mar-21	Mar-22	Mar-23F	Mar-24F	Mar-25F
	Interest income	273	275	288	294	309
	Interest expense	(81)	(80)	(88)	(91)	(95)
	Net interest income	192	194	200	203	215
	Non interest income	39	45	52	55	57
	Total operating income	232	239	252	258	272
	Overheads	(49)	(51)	(53)	(55)	(57)
	Pre-provision operating profit	183	189	200	203	215
	Loan impairment allowances	(16)	(12)	(17)	(17)	(18)
	Pre-tax profit	167	177	183	187	197
	Taxation	(43)	(44)	(47)	(48)	(50)
	Reported net profit	125	133	136	139	147
	Recurring net profit	125	133	136	139	147
	Profitability ratios	Mar-21	Mar-22	Mar-23F	Mar-24F	Mar-25F
	Return on average assets (%)	5.1	5.1	5.0	5.0	5.3
	Return on average equity (%)	17.2	16.2	15.9	16.8	18.5
	Return on IEAs (%)	11.7	10.9	11.2	11.2	11.3
	Cost of funds (%)	4.8	4.6	4.8	4.8	4.9
	Net interest spread (%)	7.0	6.2	6.4	6.4	6.4
	Net interest margin (%)	8.3	7.7	7.8	7.8	7.8
	Non-interest income / total income (%)	17.0	18.9	20.6	21.2	21.0
	Cost to income ratio (%)	21.1	21.1	20.9	21.3	21.0
	Credit cost (bps)	85.1	62.0	87.7	82.6	84.1
	Balance sheet (MYRm)	Mar-21	Mar-22	Mar-23F	Mar-24F	Mar-25F
	Total gross loans	1,845	1,879	1,954	2,052	2,155
	Other interest earning assets	625	702	604	631	660
	Total gross IEAs	2,471	2,581	2,558	2,684	2,815
	Total provisions	(124)	(115)	(120)	(125)	(131)
	Net loans to customers	1,721	1,764	1,834	1,927	2,023
	Total net IEAs	2,346	2,466	2,438	2,558	2,684
	Total non-IEAs	144	260	313	216	112
	Total assets	2,491	2,725	2,751	2,774	2,796
	Other interest-bearing liabilities	1,671	1,804	1,858	1,914	1,971
	Total IBLs	1,671	1,804	1,858	1,914	1,971
	Total non-IBLs	46	49	49	50	50
	Total liabilities	1,717	1,853	1,907	1,963	2,022
	Share capital	188	201	213	226	239
	Shareholders' equity	774	872	844	811	774
	Asset quality and capital	Mar-21	Mar-22	Mar-23F	Mar-24F	Mar-25F
	Reported NPLs / gross cust loans (%)	4.0	3.8	3.8	3.8	3.8
	Total provisions / reported NPLs (%)	168.4	162.8	161.7	0.0	0.0

Source: Company data, RHB

Results At a Glance

Figure 1: RCE – 1QFY23 results summary

FYE Mar (MYRm)	1QFY22	4QFY22	1QFY23	% QoQ	% YoY	Comments – 1QFY23 vs 1QFY22
Net fund based income	51.7	50.3	48.8	(2.8)	(5.5)	Down YoY, mainly due to lower income from early settlements.
Financing income	71.6	70.4	69.2	(1.6)	(3.3)	
Financing expense	(19.9)	(20.1)	(20.4)	1.4	2.5	
Non-fund based income	11.1	10.1	14.0	39.4	27.0	Higher placement fees from cash balances with banks.
Non-fund based inc/Total income (%)	17.6	16.7	22.3			
Operating income	62.7	60.3	62.9	4.2	0.2	
Overheads	(12.4)	(13.1)	(11.8)	(9.6)	(4.9)	Lower YoY, on the reduction in fees for financing facilities.
CIR (%)	19.8	21.6	18.8			
PIOP	50.3	47.3	51.1	8.0	1.5	
Impairment on financings	(3.1)	(5.9)	(8.2)	39.9	>100	Spike in provisions due to full provisions for accounts that have dropped off the salary deduction scheme.
Credit cost	67	125	173			
Pre-tax profit	47.3	41.4	42.9	3.5	(9.2)	
Tax	(11.9)	(9.9)	(10.7)			
ETR (%)	25.1	23.9	24.9			
Net earnings	35.4	31.5	32.2	2.2	(8.9)	
Gross financing	1,853.4	1,879.2	1,904.7	1.4	2.8	
Total borrowings	1,718.2	1,804.0	1,847.0	2.4	7.5	
Gross impaired financing	(123.4)	(115.1)	(118.3)	2.7	(4.2)	
Total assets	2,576.7	2,725.3	2,767.3	1.5	7.4	
Shareholders' funds	787.1	872.1	875.0	0.3	11.2	
ROAA	5.6%	4.7%	4.7%			
ROAE	18.1%	14.7%	14.8%			
GIL ratio	4.0%	3.8%	4.0%			

Source: Company data, RHB

Valuation and TP

We lower our TP to MYR1.92 from MYR2.00 after refreshing our GGM assumptions – namely a higher equity risk premium, given the heightened macroeconomic headwinds. The TP includes an ESG premium of 2% (unchanged), based on RHB's in-house methodology.

Our intrinsic value of MYR1.88 is based on a GGM-derived P/BV of 1.63x.

Figure 2: RCE – GGM valuation with ESG overlay

Cost of equity (COE) computation:		Sustainable ROE (%)	17.0
Risk free rate (%)	4.0	COE (%)	11.8
Equity premium (%)	6.8	Long-term growth (g)	3.5
Beta (x)	1.2	Implied P/BV (x)	1.63
Cost of equity - CAPM (%)	11.8	BVPS – 12mth forward	MYR1.16
		Intrinsic value	MYR1.88
ESG premium/(discount) (%)	2.0	ESG premium/(discount)	MYR0.04
		TP (rounded)	MYR1.92

Source: Company data, RHB

Recommendation Chart

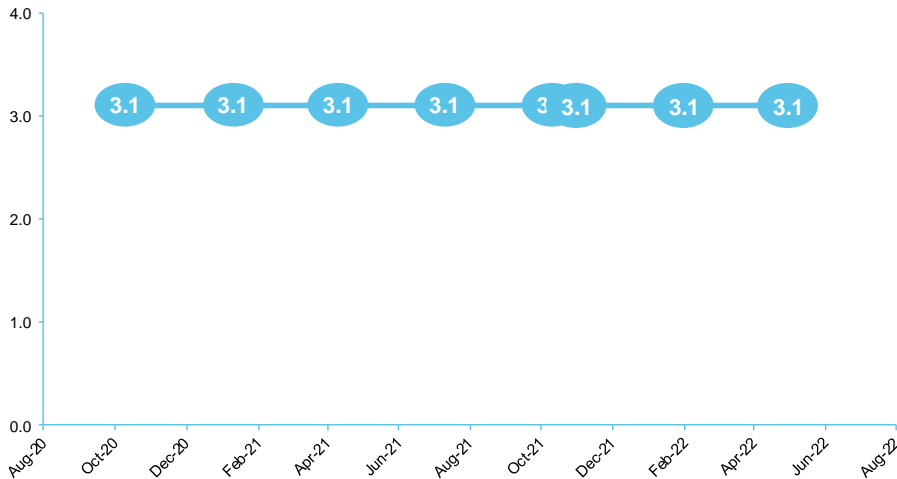


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2022-05-31	Buy	2.00	1.76
2022-02-25	Buy	1.90	1.69
2021-11-10	Neutral	3.90	2.02
2021-08-12	Buy	3.20	1.43
2021-05-26	Buy	3.20	1.43
2021-02-09	Buy	3.00	1.32
2020-12-08	Buy	2.80	1.29
2020-08-18	Buy	2.50	1.02
2020-07-06	Buy	2.50	1.01
2020-06-16	Buy	2.20	0.95
2020-03-15	Buy	2.10	0.79
2020-02-19	Buy	2.20	0.93
2020-02-19	Buy	2.20	0.93
2020-01-10	Buy	2.10	0.90
2019-08-16	Not Rated	na	0.84

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
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Not Rated:	Stock is not within regular research coverage

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