

RCE Capital Bhd (RCE MK)

Potential beneficiary of bonanza for civil servants?

Maintain HOLD and MYR1.65 for now

RCE's financing book may receive a boost in Jan 2023. Truth be told, RCE's earnings are more sensitive to profit spreads (i.e. yield - cost of funds) than financing growth. Notwithstanding, any easing in cost of funds coupled with faster financing growth may set the stage for more meaningful earnings accretion going forward. Maintaining our earnings estimates, MYR1.65 TP on 1.3x end-CY22E P/BV (+1.5 SD 5Y mean); HOLD.

Bonanza awaits civil servants in Jan 2023

Come Jan 2023:- (i) civil servants in Grade 11 until 56 will receive a MYR100/month increment; (ii) civil servants in Grade 56 and below will receive a special aid of MYR700; (iii) pensioners and non-pensionable veterans will receive a special payment of MYR350; (iv) maximum number of annual leave days that can be accumulated for cash awards in lieu of leave will be increased from 160 to 180; and (v) >0.5m teachers who served >10 years will get 15 special leave days a year.

Financing growth may receive a boost

The aforementioned will benefit >1.3m civil servants or c.80% of the civil service. Save for a 4-year lull between FY11 and FY14, RCE's financing receivables exhibits a strong correlation with government emoluments (Fig. 1). In our opinion, the aforementioned may catalyse RCE's financing growth (1QFY23: +2.8% YoY/+1.4% QoQ). Furthermore, it may dissuade teachers and academic staff from resigning that caused RCE's credit cost to spike 166% YoY/40% QoQ to MYR8.2m in 1QFY23.

Maintain earnings estimates for now

RCE's earnings are less sensitive to financing growth but more sensitive to profit spreads. Every 1.0ppt increase in financing growth (MIBG forecast: +3.0% p.a.) will only accrete 0.8% to earnings but every 25bps increase in profit spreads (MIBG forecast: 9.6-9.7%) will accrete 2.5% to earnings. Profit spreads have been easing on higher cost of funds (COF) as exemplified by Malaysian Government Securities 10-year yields (Fig. 2). Nevertheless, any future easing in COF coupled with faster financing growth may translate into more meaningful earnings accretion for RCE.

FYE Mar (MYR m)	FY21A	FY22A	FY23E	FY24E	FY25E
Operating income	232	239	238	242	248
Pre-provision profit	183	189	187	189	194
Core net profit	125	133	132	133	137
Core FDEPS (MYR)	0.18	0.18	0.18	0.18	0.18
Core FDEPS growth(%)	5.8	3.3	(3.4)	0.9	2.8
Net DPS (MYR)	0.07	0.11	0.08	0.08	0.08
Core FD P/E (x)	7.6	10.2	9.3	9.2	8.9
P/BV (x)	1.2	1.6	1.3	1.2	1.1
Net dividend yield (%)	5.1	5.8	4.6	4.8	4.9
Book value (MYR)	1.13	1.19	1.30	1.40	1.51
ROAE (%)	17.2	16.2	14.5	13.5	12.8
ROAA (%)	5.1	5.1	4.7	4.6	4.5
Consensus net profit	-	-	136	139	142
MKE vs. Consensus (%)	-	-	(3.2)	(4.4)	(3.6)

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HOLD

Share Price MYR 1.63
12m Price Target MYR 1.65 (+6%)
Previous Price Target MYR 1.65

Company Description

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

Statistics

52w high/low (MYR)	2.01/0.97
3m avg turnover (USDm)	0.1
Free float (%)	36.1
Issued shares (m)	740
Market capitalisation	MYR1.2B USD270M

Major shareholders:

Cempaka Empayar Sdn. Bhd.	52.9%
Rockwills International Group Bhd	4.5%
Khai Yoon Woo	2.2%

Price Performance



	-1M	-3M	-12M
Absolute (%)	(2)	(7)	8
Relative to index (%)	(3)	(4)	14

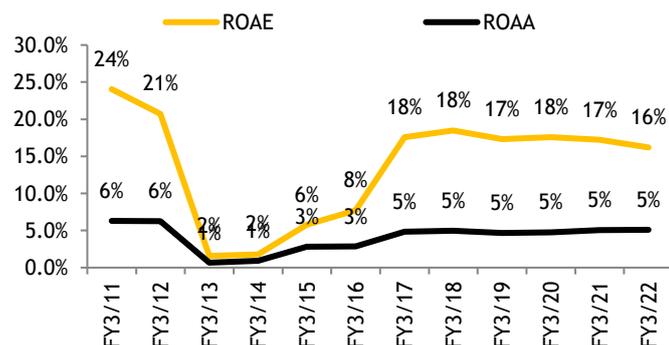
Source: FactSet

ESG@MAYBANK IBG
Tear Sheet Insert

Value Proposition

- RCE Capital provides personal financing, the ultimate customers being civil servants.
- With a gross financing balance of just MYR1.9b, 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.

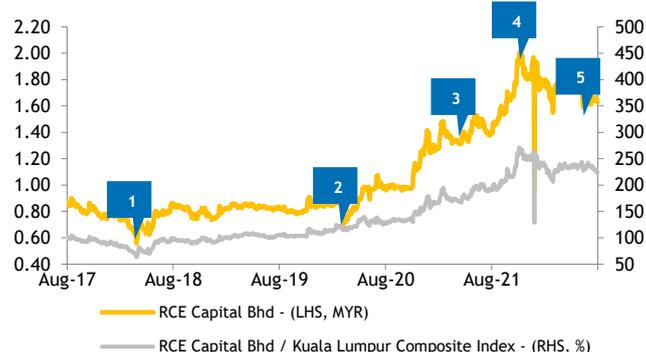
ROE and ROA



Source: Company

Price Drivers

Historical share price trend



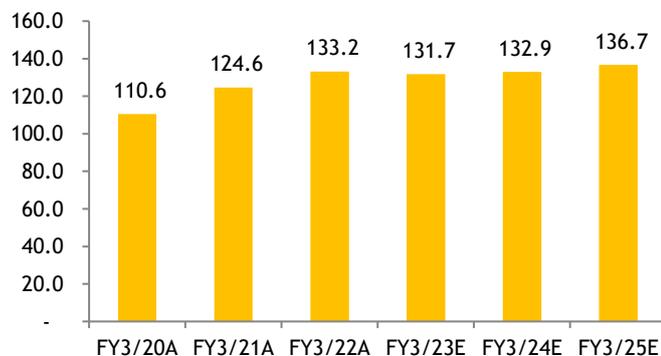
Source: Company, Maybank IBG Research

1. Concerns arise that the government may reduce the size of the civil service.
2. Movement Control Order lengthened time to process new customers, resulting in less financing disbursed.
3. 2QFY3/21 net profit grew 21% YoY to a record high of MYR33.0m.
4. Announced share DPS of 1 treasury share: 20 shares held and bonus issue of 19 bonus shares: 21 shares held.
5. Bank Negara Malaysia raised Overnight Policy Rate by 25bps for the first time since Jul 2020.

Financial Metrics

- Introduced a better credit scoring model in 2013. 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 1% 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 (historicals), Maybank IBG Research (forecasts)

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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Risk Rating & Score ¹	N/A
Score Momentum ²	N/A
Last Updated	N/A
Controversy Score ³	N/A

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 12%-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 30% to c.3,700 pieces in FY3/22.
- The above was achieved via emails reminding employees to "Think before you Print" and printing on both sides.
- FY3/22 scope 1 and 2 emissions in CO₂eq tonnes per employee cut to 0.93 (FY3/21: 0.97, FY3/20: 0.96).
- Part of the reason for the above is due to the extensive use of energy saving light bulbs.

Material S issues

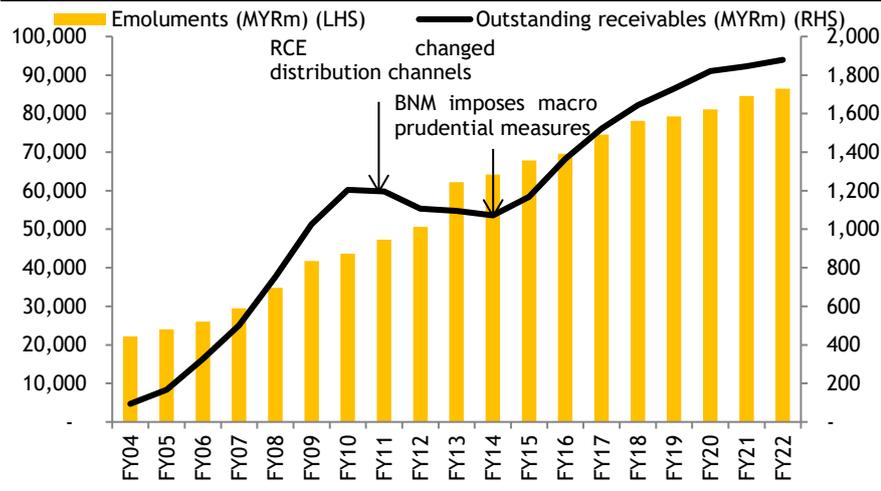
- RCE is guided by Bank Negara Malaysia's (BNM) guidelines for responsible financing.
- In Jul 2013, BNM instituted macro prudential measures to rein in high household debt levels.
- Since then, tenure of its financing is capped at 10 years and debt service ratio of its customers is capped at 60%.
- 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 MYR524,000 in study grants to 33 students.
- An overwhelming 73% of RCE's employees as at end-FY3/22 are women.
- FY3/22 overall turnover rate increased to 19.3% (FY3/21: 16.8%, FY3/20: 14.9%).
- FY3/22 average training hours per employee stood at 24 (FY3/21: 8, FY3/20: 40).

Key G metrics and issues

- BOD comprises 1 Non-Independent Non-Executive Chairman (NINEC), 3 Non-Independent Non-Executive Directors (NINED) and 4 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 8 BOD members is a woman, the aforementioned Shalina Azman.
- FY3/22 directors' remuneration accounted for <1% of FY3/22 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)
- 1 chaired by a NINED (i.e. Employees' Share Scheme) and 1 chaired by the NINC (i.e. Sustainability Management).
- Carries out RPTs with AMMB Holdings (AMMB), which is 12%-owned by TSAH.
- As at end-FY3/22, RCE has deposits of MYR586.9m and borrowings of MYR145.4m 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.

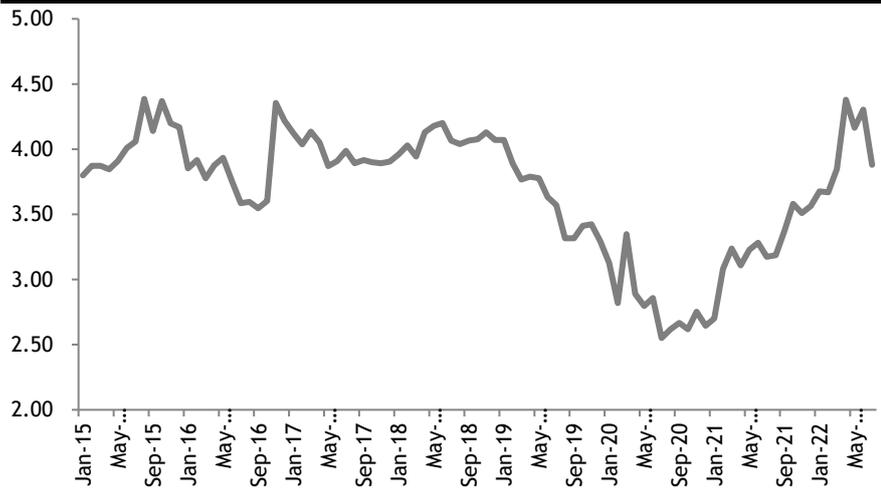
¹**Risk Rating & Score** - derived by Sustainalytics and assesses the company's exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company's enterprise value, respectively, from ESG-driven financial impacts. ²**Score Momentum** - indicates changes to the company's score since the last update - a **negative** integer indicates a company's improving risk score; a **positive** integer indicates a deterioration. ³**Controversy Score** - reported periodically by Sustainalytics in the event of material ESG-related incident(s), with the impact severity scores of these events ranging from Category 0-5 (0 - no reports; 1 - negligible risks; ...; 5 - poses serious risks & indicative of potential structural deficiencies at the company).

Figure 1: Emoluments vs RCE financing receivables



Source: Bloomberg, Company

Figure 2: Malaysian Government Securities 10-year yield (%)



Source: Bloomberg

FYE 31 Mar	FY21A	FY22A	FY23E	FY24E	FY25E
Key Metrics					
Core P/E (x)	7.5	10.1	9.1	9.0	8.7
Core FD P/E (x)	7.6	10.2	9.3	9.2	8.9
P/BV (x)	1.2	1.6	1.3	1.2	1.1
P/NTA (x)	1.3	1.6	1.3	1.2	1.1
Net dividend yield (%)	5.1	5.8	4.6	4.8	4.9
INCOME STATEMENT (MYR m)					
Islamic banking income	204.4	206.4	202.5	205.5	212.0
Other income	27.4	33.0	35.8	36.1	36.3
Total non-interest income	231.8	239.4	238.3	241.6	248.3
Operating income	231.8	239.4	238.3	241.6	248.3
Staff costs	(26.3)	(26.6)	(27.0)	(27.7)	(28.5)
Other operating expenses	(22.7)	(24.0)	(24.2)	(24.8)	(25.4)
Operating expenses	(49.0)	(50.6)	(51.2)	(52.5)	(53.8)
Pre-provision profit	182.8	188.8	187.1	189.1	194.5
Other allowances	(15.6)	(11.5)	(11.8)	(12.2)	(12.5)
Associates & JV income	0.0	0.0	0.0	0.0	0.0
Pretax profit	167.2	177.2	175.3	176.9	181.9
Income tax	(42.6)	(44.1)	(43.6)	(44.0)	(45.2)
Reported net profit	124.6	133.2	131.7	132.9	136.7
Core net profit	124.6	133.2	131.7	132.9	136.7
BALANCE SHEET (MYR m)					
Cash & deposits with banks	597.9	800.5	877.4	954.0	1,033.0
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	1,775.4	1,818.0	1,871.0	1,925.5	1,981.6
Fixed assets	7.3	6.4	6.3	6.2	6.1
Intangible assets	47.3	47.3	47.3	47.3	47.3
Other assets	62.8	53.0	53.0	53.0	53.0
Total assets	2,490.7	2,725.3	2,855.0	2,986.0	3,121.1
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	1,187.4	1,310.0	1,310.0	1,310.0	1,310.0
Other borrowings	252.9	342.0	395.1	449.8	506.5
Other liabilities	276.3	201.2	201.1	201.2	201.4
Total liabilities	1,716.7	1,853.2	1,906.1	1,960.9	2,017.9
Share capital	188.0	200.7	200.7	200.7	200.7
Reserves	586.0	671.4	748.2	824.4	902.5
Shareholders' funds	774.0	872.1	948.9	1,025.1	1,103.2
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	774.0	872.1	948.9	1,025.1	1,103.2
Total liabilities & equity	2,490.7	2,725.3	2,855.0	2,986.0	3,121.1

FYE 31 Mar	FY21A	FY22A	FY23E	FY24E	FY25E
Key Ratios					
Growth (%)					
Net interest income	na	na	na	na	na
Non-interest income	4.8	3.3	(0.4)	1.4	2.8
Operating expenses	(0.4)	3.3	1.2	2.5	2.5
Pre-provision profit	6.3	3.3	(0.9)	1.1	2.8
Core net profit	12.7	6.8	(1.1)	0.9	2.8
Gross loans	1.4	1.8	3.0	3.0	3.0
Customer deposits	na	na	na	na	na
Total assets	2.5	9.4	4.8	4.6	4.5
Profitability (%)					
Non-int. income/Total income	100.0	100.0	100.0	100.0	100.0
Cost/income	21.1	21.1	21.5	21.7	21.7
Liquidity (%)					
Loans/customer deposits	na	na	na	na	na
Asset quality (%)					
Gross NPF	4.0	3.8	3.8	3.8	3.8
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	17.2	16.2	14.5	13.5	12.8
ROAA	5.1	5.1	4.7	4.6	4.5
Shareholders equity/assets	31.1	32.0	33.2	34.3	35.3

Source: Company; Maybank IBG Research

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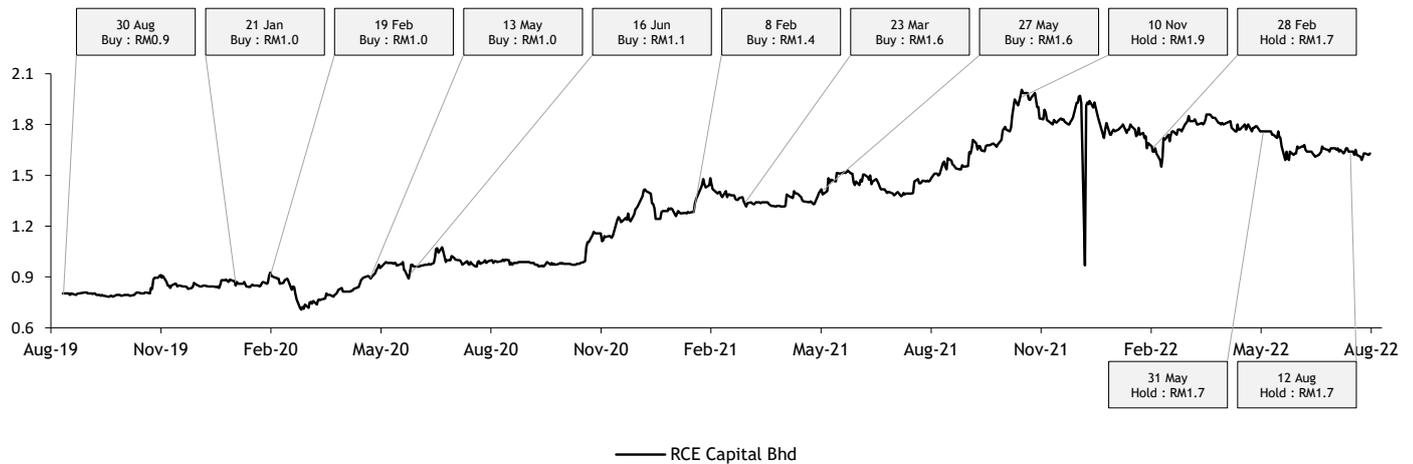
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