

RCE Capital Bhd (RCE MK)

Holding straight and steady

HOLD

Share Price MYR 1.94
 12m Price Target MYR 1.75 (+5%)
 Previous Price Target MYR 1.67

Maintain HOLD call with higher TP of MYR1.75 (+5%)

Following record 2QFY23 earnings, a huge special DPS of 18sen and higher-than-expected interim DPS of 5sen, we met RCE for updates. To be sure, credit costs is easing but cost of funds is rising relative to history. Financing growth and financing yields are rebounding. All in all, we tweak our earnings estimates upwards by 3-4%. Ascribing a higher end-CY23E target P/BV of 1.5x (1.4x previously) on account of higher DPR, we raise our TP to MYR1.75 from MYR1.67. HOLD for dividends.

Credit cost easing and financing growth accelerating

Credit cost has been high-ish due to teachers and academic staff resigning in waves (Fig. 1). That said, RCE stated that the wave peaked in Jun 2022 and is easing. Also, financing growth is accelerating (2QFY23: +3% QoQ, 1QFY23: +1% QoQ) on pent up demand and salary adjustments in Jul 2022. Financing growth could receive another boost in 4QFY23 due to the MYR100 salary increment for civil servants from 1 Jan 2023 ([link](#)). Long term, RCE hopes to grow its financing receivables by c.4% p.a.

Cost of funds rising but net interest margins stable

To be sure, cost of funds is rising. Despite recently issuing sukuk at 5.19% profit rate, RCE has been veering more to revolving credits and term financing that attract lower interest/profit rates of c.4%. RCE stated that it has another c.MYR250m of revolving credit and term financing lines which it can tapped on. Moreover, RCE re-priced its financing products in Oct 2022 by more than 50bps upwards. All in all, RCE is reasonably confident that it can maintain net interest margins at c.8%.

Higher dividend payout ratio likely going forward

Over and above the special DPS of 18.0sen, recall that the first interim DPS of 5.0sen that was recently declared was also above our expectation of 3.8sen. This is because it implied 53% DPR whereas we expected 42%. RCE stated that it is considering raising its dividend policy from 20-40% DPR to maintain its ROE in the high teens in percentage terms (FY22: 16%). RCE hopes to decide on its revised dividend policy by 4QFY23 results release (i.e. May 2023).

FYE Mar (MYR m)	FY21A	FY22A	FY23E	FY24E	FY25E
Operating income	232	239	263	258	269
Pre-provision profit	183	189	208	203	211
Core net profit	125	133	137	137	142
Core FDEPS (MYR)	0.18	0.18	0.18	0.18	0.19
Core FDEPS growth(%)	5.8	3.3	0.7	(0.4)	4.2
Net DPS (MYR)	0.07	0.11	0.28	0.10	0.11
Core FD P/E (x)	7.6	10.2	10.6	10.6	10.2
P/BV (x)	1.2	1.6	1.8	1.6	1.5
Net dividend yield (%)	5.1	5.8	14.4	5.2	5.4
Book value (MYR)	1.13	1.19	1.10	1.19	1.28
ROAE (%)	17.2	16.2	16.4	16.3	15.8
ROAA (%)	5.1	5.1	5.0	4.8	4.7
Consensus net profit	-	-	134	136	142
MKE vs. Consensus (%)	-	-	2.5	0.1	0.3

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Company Description

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

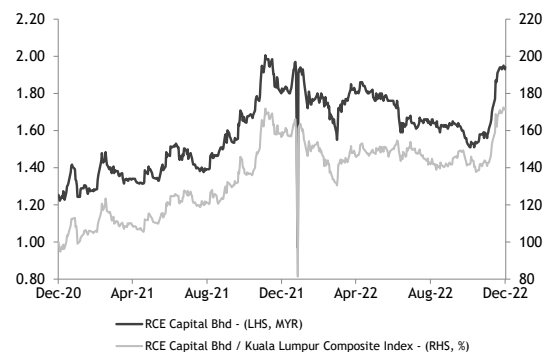
Statistics

52w high/low (MYR)	1.97/0.97
3m avg turnover (USDm)	0.2
Free float (%)	30.7
Issued shares (m)	741
Market capitalisation	MYR1.4B USD327M

Major shareholders:

Cempaka Empayar Sdn. Bhd.	53.2%
Rockwills International Group Bhd	4.5%
Khai Yoon Woo	2.2%

Price Performance



	-1M	-3M	-12M
Absolute (%)	24	18	6
Relative to index (%)	22	21	8

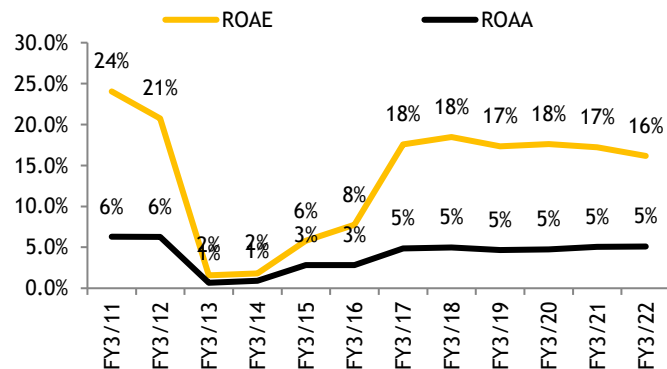
Source: FactSet

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 MYR2.0b, 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

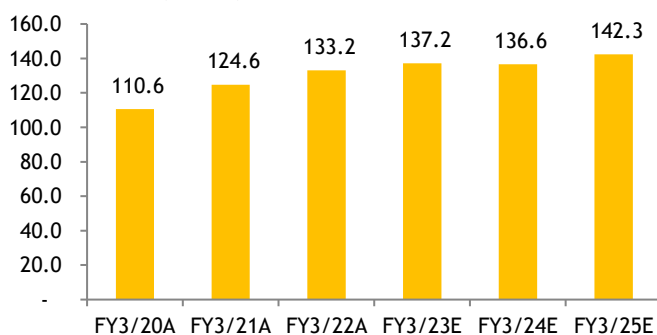


Source: Company

Financial Metrics

- Introduced better credit scoring model in 2013. We forecast gross financing CAGR of 5% p.a. over the next three years.
- Average cost of funds is rising but so is average financing yields.
- Asset quality better than before. New financing are smaller in size (<MYR20k) and RCE's NPF ratios are low (<2%).
- Forecast stable three-year forward core net profit CAGR of 2% p.a.
- There is room for dividends to surprise to the upside as its DPR policy is only 20-40%.

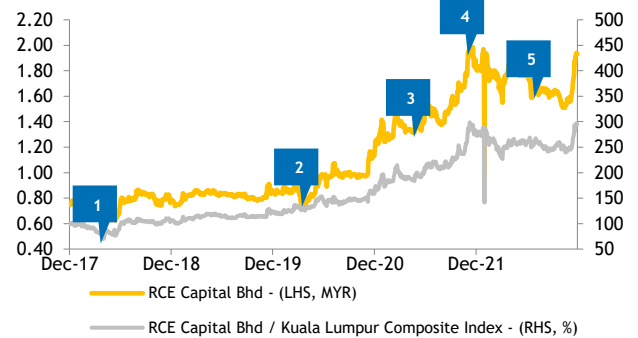
Core net profit (MYRm)



Source: Company (historicals), Maybank IBG Research (forecasts)

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 applications, 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 for 20 shares held and bonus issue of 19 shares for 21 shares held.
5. Bank Negara Malaysia raised Overnight Policy Rate by 25bps for the first time since Jul 2020.

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'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 (NBF), RCE does not have a large environmental footprint. That said, we opine that it has a large social footprint by way of responsible financing.
- NBFs 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).

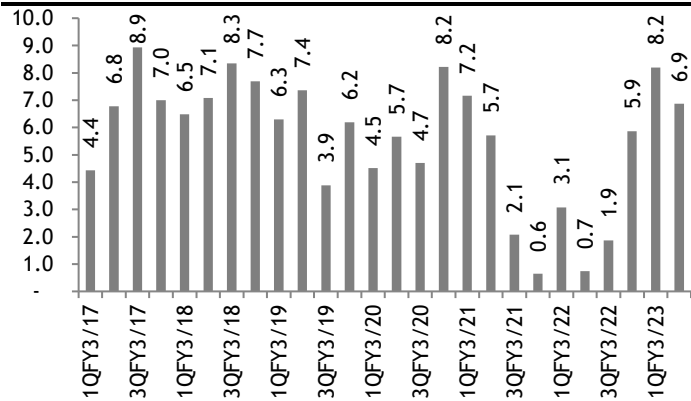
Key G metrics and issues

- 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).

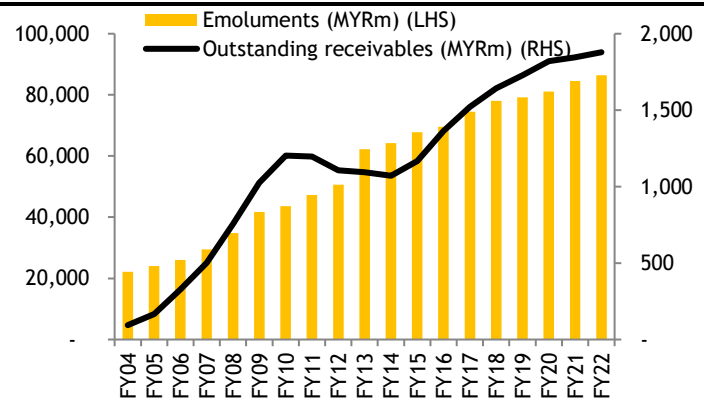
Updates

Figure 1: Net impairment loss on receivables (MYRm)



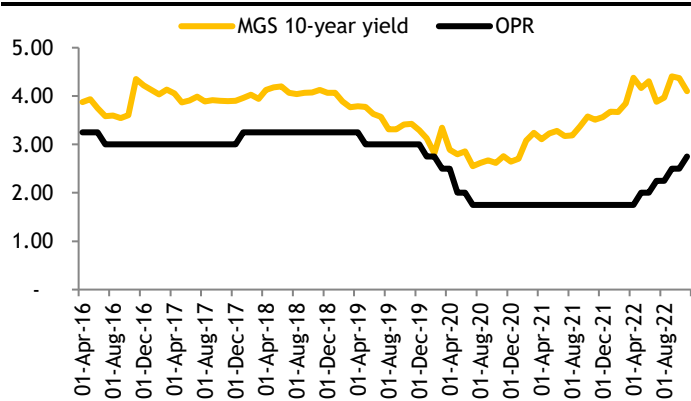
Source: Company

Figure 2: Emoluments vs. financing receivables (R²: 0.95)



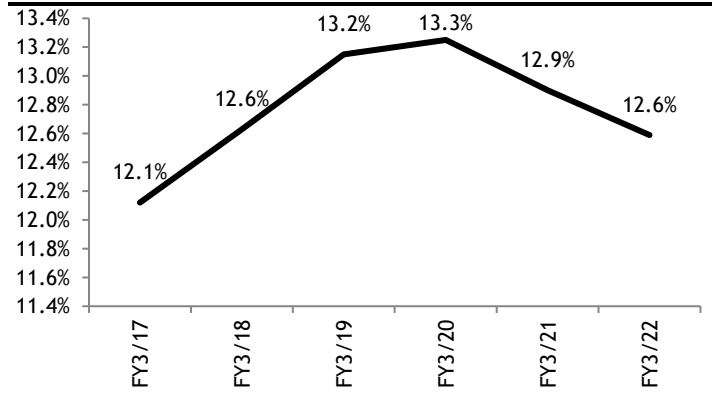
Source: Department Of Statistics, Company

Figure 3: Benchmarks for cost of funds (%)



Source: Bloomberg

Figure 4: Average yield of financing receivables



Source: Company

Financials

Figure 5: Major assumptions and estimates

	FY3/21A	FY3/22A	FY3/23E	FY3/24E	FY3/25E
Revised					
Credit cost ratio	0.9%	0.6%	1.3%	1.0%	1.0%
Financing growth	1.4%	1.8%	8.0%	4.0%	4.0%
Average yield on financing receivables	12.9%	12.6%	12.6%	12.8%	13.1%
DPR	38%	41%	53%	54%	54%
Net profit (MYRm)	124.6	133.2	137.2	136.6	142.3
Recurring DPS (sen)	6.8	10.7	10.0	10.0	10.5
Previous					
Credit cost ratio	0.9%	0.6%	0.6%	0.6%	0.6%
Financing growth	1.4%	1.8%	3.0%	3.0%	3.0%
Average yield on financing receivables	12.9%	12.6%	12.3%	12.3%	12.3%
DPR	38%	41%	42%	43%	43%
Net profit (MYRm)	124.6	133.2	131.7	132.9	136.7
Recurring DPS (sen)	6.8	10.7	7.5	7.8	8.0
Unchanged					
Average cost of funds	4.8%	4.6%	4.7%	4.9%	4.9%

Source: Company (historicals), Maybank IBG Research (forecasts)

On credit cost ratio, we raise our assumption from 0.6% p.a. to 1.3% in FY23E and 1.0% in FY24E and FY25E. Our revised assumption basically assumes that credit cost will come in at c.MYR5.0m per quarter going forward (1QFY23: MYR8.2m, 2QFY23: MYR6.9m).

On financing growth, we raise our assumption from 3.0% p.a. to 8.0% in FY23E and 4.0% p.a. in FY24E and FY25E. Our revised FY23E assumption is based on financing growing another 3.8% between end-2QFY23 and end-4QFY23 following the MYR100 p.m. salary increment for civil servants effective 1 Jan 2023. Our revised FY24E and FY25E assumption is based on management guidance.

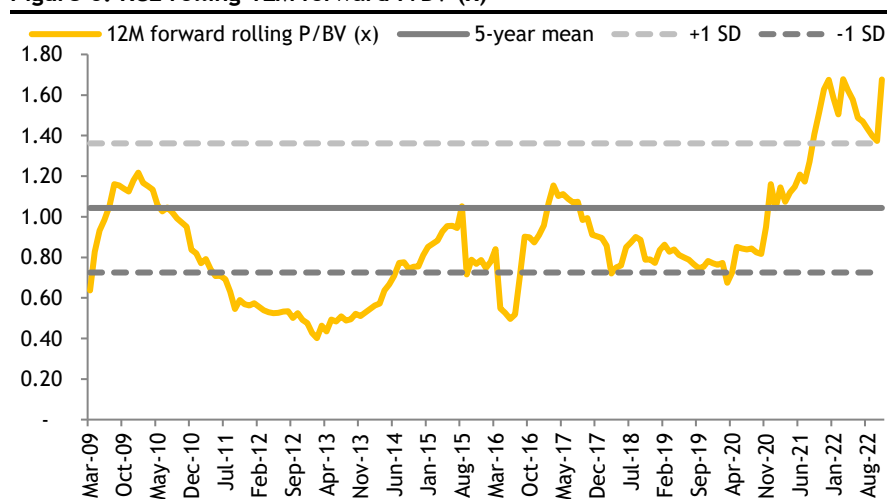
On average yield on financing receivables, we raise them by 25bps p.a. in FY24E and FY25E to reflect the fact that RCE re-priced its financing products in Oct 2022 by more than 50bps upwards. Our average cost of funds assumption is unchanged. They are still premised on our house forecast that the Overnight Policy Rate (OPR) will be hiked to 3.00% by 1QCY23 (from 2.75% currently).

On DPR, we raise them from 42-43% to 53-54% as per the recent 2QFY23 results. Net impact of the above is to tweak our FY23E/FY24E/FY25E earnings upwards by 4%/3%/4% and FY23E/FY24E/FY25E recurring dividends (i.e. ex-special dividends) from 7.5sen/7.8sen/8.0sen to 10sen/10sen/10.5sen.

Valuation

Given that we now employ 53-54% DPR or c.25% higher than before, we think it fit to raise our end-CY23E P/BV to 1.5x, which we do not believe is rich given that it is only 7% higher than our previous multiple of 1.4x. Doing so raises our TP to MYR1.75 from MYR1.67. Note that our MYR1.75 TP is ex- the special DPS of 18sen and interim DPS of 5sen. With <10% upside potential still, we maintain our HOLD call on RCE.

Figure 6: RCE rolling 12M forward P/BV (x)



Source: Company, Maybank IBG Research, Bloomberg

As a sanity check, we compare the end-CY23E P/BV of 1.5x we ascribe to RCE with that of other non-bank financial institutions. Our best comparison is **AEON Credit Service (M) (ACSM MK, CP: MYR12.86, Not Rated)** which consensus expects to generate very similar ROEs going forward. Coincidentally, ACSM is trading at 1.5x end-CY23E P/BV. Thus, we believe that our valuation multiple for RCE is fair and reasonable.

Figure 7: RCE peer comparisons as at 7 Dec 2022

	Mkt cap MYRm	ROE (%)		P/BV (x)	
		CY23E	CY24E	CY23E	CY24E
RCE Capital	1,438	16.3	15.9	1.7	1.6
AEON Credit Service (M)	3,278	16.8	15.8	1.5	1.3
Malaysia Building Society	4,303	7.5	7.6	0.5	0.4

Source: Maybank IBG Research (RCE), Bloomberg (ACSM and MBSB)

FYE 31 Mar	FY21A	FY22A	FY23E	FY24E	FY25E
Key Metrics					
Core P/E (x)	7.5	10.1	10.3	10.4	10.0
Core FD P/E (x)	7.6	10.2	10.6	10.6	10.2
P/BV (x)	1.2	1.6	1.8	1.6	1.5
P/NTA (x)	1.3	1.6	1.9	1.7	1.6
Net dividend yield (%)	5.1	5.8	14.4	5.2	5.4
INCOME STATEMENT (MYR m)					
Islamic banking income	204.4	206.4	213.2	222.0	231.0
Other income	27.4	33.0	50.2	36.4	37.8
Total non-interest income	231.8	239.4	263.4	258.4	268.9
Operating income	231.8	239.4	263.4	258.4	268.9
Staff costs	(26.3)	(26.6)	(29.3)	(29.6)	(30.8)
Other operating expenses	(22.7)	(24.0)	(26.0)	(26.2)	(27.1)
Operating expenses	(49.0)	(50.6)	(55.4)	(55.8)	(57.9)
Pre-provision profit	182.8	188.8	208.1	202.5	210.9
Other allowances	(15.6)	(11.5)	(25.4)	(20.7)	(21.5)
Associates & JV income	0.0	0.0	0.0	0.0	0.0
Pretax profit	167.2	177.2	182.7	181.8	189.4
Income tax	(42.6)	(44.1)	(45.4)	(45.2)	(47.1)
Reported net profit	124.6	133.2	137.2	136.6	142.3
Core net profit	124.6	133.2	137.2	136.6	142.3
BALANCE SHEET (MYR m)					
Cash & deposits with banks	597.9	800.5	740.0	804.4	871.6
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	1,954.5	2,030.5	2,109.6
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	2,801.1	2,941.5	3,087.7
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	485.3	562.2	642.5
Other liabilities	276.3	201.2	201.5	201.4	201.8
Total liabilities	1,716.7	1,853.2	1,996.7	2,073.6	2,154.3
Share capital	188.0	200.7	200.7	200.7	200.7
Reserves	586.0	671.4	603.7	667.2	732.7
Shareholders' funds	774.0	872.1	804.4	867.9	933.4
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	774.0	872.1	804.4	867.9	933.4
Total liabilities & equity	2,490.7	2,725.3	2,801.1	2,941.5	3,087.7

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	10.1	(1.9)	4.1
Operating expenses	(0.4)	3.3	9.5	0.8	3.7
Pre-provision profit	6.3	3.3	10.2	(2.7)	4.1
Core net profit	12.7	6.8	3.1	(0.4)	4.2
Gross loans	1.4	1.8	8.0	4.0	4.0
Customer deposits	na	na	na	na	na
Total assets	2.5	9.4	2.8	5.0	5.0
Profitability (%)					
Non-int. income/Total income	100.0	100.0	100.0	100.0	100.0
Cost/income	21.1	21.1	21.0	21.6	21.5
Liquidity (%)					
Loans/customer deposits	na	na	na	na	na
Asset quality (%)					
Gross NPF	4.0	3.8	4.0	4.0	4.0
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	16.4	16.3	15.8
ROAA	5.1	5.1	5.0	4.8	4.7
Shareholders equity/assets	31.1	32.0	28.7	29.5	30.2

Source: Company; Maybank IBG Research

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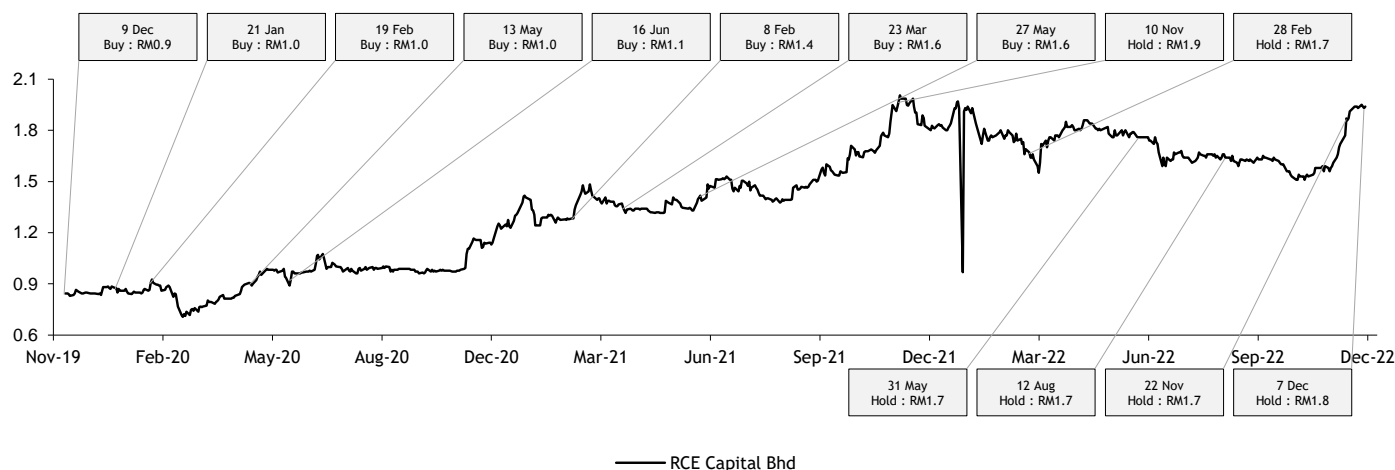
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