

16 Feb 2023

Hold

Price
 RM1.85

Target Price
 RM2.00

Market Data

Bloomberg Code	RCE MK
No. of shares (m)	741.1
Market cap (RMm)	1,371.0
52-week high/low (RM)	1.91 / 1.37
Avg daily turnover (RMm)	1.1
KLCI (pts)	1,488.2

Source: Bloomberg, KAF

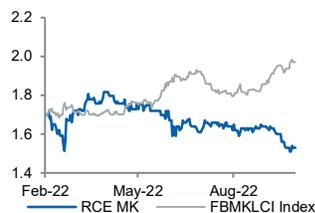
Major Shareholder (%)

Cempaka Empayar	(55.0%)
EPF	(2.4%)
Cheam Heng Ming	(1.1%)
Free Float	121.2

Source: Bloomberg, KAF

Performance

	3M	6M	12M
Absolute (%)	23.2	24.7	18.2
Rel Market (%)	20.1	26.0	27.0



Source: Bloomberg, KAF

Analyst

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RCE Capital

3Q23 results within expectations

We downgrade RCE Capital (RCE) from a Buy to a Hold with an unchanged GGM-derived valuation of RM2.00. Our TP, which is based on a sustainable ROE of 14.5%, cost of equity of 10.5% and long-term growth of 3%, implies a P/B of 1.5x. While RCE is expected to register stable earnings growth in a range of 3% - 5% supported by sustainable loan growth of around 5%, we view that it has reflected in its current P/B valuation of 1.5x, which is above +2SD. As such, we believe that the upside potential to its share price is capped. 9M23 results are well within expectations, accounting for ~76% of the FY23 projection. Net profit was supported by higher fee and early settlement income, cushioning the impact of higher impairments during the period.

Financial Highlights

FYE Mar	2021	2022	2023F	2025F	2025F
Operating income (RMm)	232.1	239.6	250.0	261.9	274.5
Net profit	124.6	133.2	137.1	144.6	151.1
EPS (sen)	17.0	18.2	18.7	19.8	20.6
EPS growth (%)	12.7	6.9	3.0	5.5	4.5
Net DPS (sen)	6.4	10.4	7.5	7.9	8.3
Net yield (%)	3.5	5.6	4.1	4.3	4.5
PER (x)	10.9	10.2	9.9	9.3	9.0
PB (x)	1.7	1.6	1.4	1.3	1.2
ROE (%)	17.2	16.2	15.0	14.5	13.9

Source: Company, KAF

9M23 results within expectations.

RCE reported a net profit of RM35.2m in 3Q23 (+1.4% YoY), driven by higher fee income (+45.7% YoY), cushioning the impact of higher impairment by >100%.

3Q23 net profit was lower by 3.7% QoQ nonetheless, in the combination with flattish income growth and higher staff costs by 65.7% QoQ in relation to ESS expense incurred. This is however offset by a 20.3% lower impairment loss.

For cumulative 9M23 results, RCE reported a slight increase in net profit of RM103.9m (+2.3% YoY), mainly due to higher fee and early settlement income, thanks to the ongoing sales campaign. Overall, results were in line with our and consensus expectations, meeting ~76% of full-year FY23 earnings estimates.

Higher impairments, but on a declining trend.

Higher impairments were seen during the period, mainly due to changes in employment trends, i.e., higher retirement and the shift in employment status particularly among workers in the healthcare and education sector. That said, the impairments were falling 16.2% in 2Q23 and 20.3% in 3Q23 respectively, after the peak in 1Q23 as receivables' quality position remained stable in the current quarter.

Coverage ratio remained high >100%.

RCE's coverage ratio remained high at 148% as of 9M23 though the trend was lower as compared to >170% before the year 2020. This was explained by an improvement in the quality of its receivables. To note, the ratio is still relatively higher than industry average of ~110% as management's practices of stringent risk management and prudent provisioning policy are remaining in focus.

Financing growth expanded 6.3% YoY.

As of 9M23, RCE's financing growth expanded by 6.3% YoY. Management observations is that the necessity for financing among civil servants remains strong despite the current pressure on the cost of living and the rising interest rate environment.

Downgrade to Hold.

We maintain our TP of RM2.00 based on a sustainable ROE of 14.5%, cost of equity of 10.5% and long-term growth of 3%, implying a P/B of 1.5x. While RCE is expected to register stable earnings growth in a range of 3% - 5% supported by sustainable loan growth of around 5%, we view that it has reflected in its current P/B valuation of 1.5x, which is above +2SD. As such, we downgrade our call to Hold.

Table 1: Quarterly trends

Year to 31 March	Sep-21	Dec-21	Mar-22	Jun-22	Mar-22	Dec-22	% chg		Cumulative			KAF	
RM m	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	QoQ	YoY	9M22	9M23	% chg	2021F	9M/F
Interest and fee income	69.8	76.9	74.7	77.7	81.8	81.6	-0.2%	6.1%	224.8	241.0	7.2%	313.9	76.8%
Interest expense	(20.4)	(19.9)	(20.1)	(20.3)	(21.6)	(22.8)	5.6%	14.2%	(60.2)	(64.7)	7.5%	(85.4)	75.8%
Net interest and fee income	49.4	56.9	54.7	57.3	60.2	58.8	-2.3%	3.2%	164.6	176.3	7.1%	228.6	77.1%
Non-interest income	4.6	5.5	5.7	5.6	6.3	7.3	15.2%	32.6%	14.7	19.3	31.3%	21.4	90.0%
Operating income	54.0	62.5	60.4	62.9	66.5	66.1	-0.6%	5.8%	179.2	195.6	9.1%	250.0	78.2%
Operating expenses	(11.0)	(14.3)	(13.1)	(11.8)	(11.1)	(14.6)	31.3%	2.2%	(37.8)	(37.5)	-0.6%	(53.1)	70.7%
Underlying profit	42.9	48.2	47.3	51.1	55.4	51.5	-7.0%	6.9%	141.5	158.0	11.7%	196.9	80.3%
Allowance for impairment	(0.7)	(1.9)	(5.9)	(8.2)	(6.9)	(5.5)	-20.3%	193.8%	(5.7)	(20.5)	261.2%	(14.4)	142.4%
Exceptional	0.0	0.0	0.0	0.0	0.0	0.0	n.a.	n.a.	0.0	0.0	n.a.	n.a.	n.a.
Pre-tax profit	42.2	46.4	41.4	42.9	48.6	46.1	-5.2%	-0.6%	135.8	137.5	1.3%	182.5	75.4%
Taxation	(10.7)	(11.7)	(9.9)	(10.7)	(12.0)	(10.9)	-9.5%	-6.6%	(34.2)	(33.6)	-1.8%	(45.4)	74.0%
Net profit	31.5	34.7	31.5	32.2	36.5	35.2	-3.7%	1.4%	101.6	103.9	2.3%	137.1	75.8%

Source: Company, KAF

Disclosure Appendix

Recommendation structure

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

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