

15 August 2023

Financial Services | Banks

## RCE Capital (RCE MK)

## Neutral (Maintained)

### Steady As She Goes

Target Price (Return): MYR2.20 (-1.3%)  
 Price (Market Cap): MYR2.23 (USD354m)  
 ESG score: 3.0 (out of 4)  
 Avg Daily Turnover (MYR/USD) 1.30m/0.28m

- Maintain NEUTRAL, new MYR2.20 TP from MYR1.95, c.6% FY24F (Mar) yield.** RCE Capital's 1QFY24 results were in line with expectations, with greater non-profit income and improving credit costs being the standout points. Receivables growth and asset quality prospects appear sound, though we believe the market has already priced this in – the counter is currently trading close to +3SD above its 5-year mean P/BV.
- 1QFY24 results in line.** RCE's first quarter net earnings of MYR36.9m (14% YoY) came in at 26% and 27% of ours and Street's estimates. Higher profit expense (+22% YoY) – due to drawdown of new *sukuk* facilities at higher rates – brought net profit income down 6% YoY, though this was offset by greater non-profit income (+52% YoY) and lower impairment allowances (-42% YoY). Net earnings grew 6% QoQ, again on the back of lower impairment allowances (-42%), though this was slightly mitigated by higher opex (+21%). 1QFY24 ROE stood at 18.5%, up from 14.8% in 1QFY23 and 17.7% in 4QFY23.
- Healthy receivables growth.** Gross financing receivables increased 7% YoY (QoQ: +1%), outpacing the banking system's loans growth of 4% during the same period. This has translated into stronger non-profit income, and should also bring in higher profit income in due time. Recall that in 2HFY23, RCE had increased profit rates on its new financing products as a countermeasure against its rising cost of funds. Moving forward, it will continue to track the banking system growth (RHB forecast: c.5% in CY23).
- Credit costs were a pleasant surprise.** 1QFY24 impairment allowances of MYR4.7m led to credit costs of 93bps (annualised), slightly below the guidance of 100-200bps. We understand this was due to changes made to the expected credit loss (ECL) model assumptions. Given the strong showing in 1Q, we lower FY24F credit costs to 120bps from 145bps, but maintain FY25-26F at 140bps for now. Overall, we deem RCE's asset quality to be holding up well, as NPLs (using balance of Stage 3 provisions as a proxy) have been showing a stable-to-decreasing trend for the past four quarters.
- Forecasts and TP.** We lift FY24-26F by 1-4% as we factor in lower credit costs (for FY24F) and higher non-profit income assumptions (for all three years). We also lower our cost of equity assumption to 10.8% (from 11.5%) due to the improved stability in the group's asset quality. Our TP is lifted to MYR2.20 as a result, and includes zero ESG premium/discount as our ESG score of 3.0 for the group is in line with the country median. Currently trading at c.1.9x P/BV (almost +3SD from its 5-year mean), we believe the counter's valuation is looking stretched, though a decent yield of c.6% should continue to lend support to the share price.

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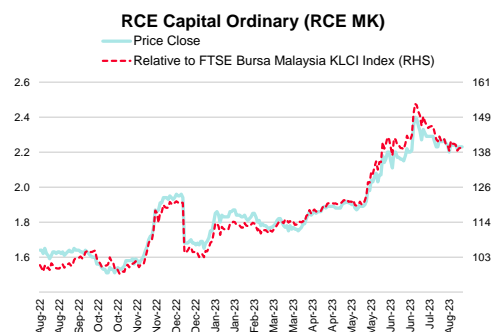


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#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	32.0	(2.6)	18.6	20.5	36.0
Relative	34.6	(5.8)	16.2	22.3	39.3
52-wk Price low/high (MYR)				1.51	– 2.40



Source: Bloomberg

#### Overall ESG Score: 3.0 (out of 4)

##### E: GOOD

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

##### S: GOOD

RCE outsources auditing of its IT systems to ensure 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 capitalisation of less than USD0.5bn.

Forecasts and Valuation	Mar-22	Mar-23	Mar-24F	Mar-25F	Mar-26F
Reported net profit (MYRm)	133	139	147	151	158
Net profit growth (%)	6.9	4.2	5.8	2.7	5.0
Recurring net profit (MYRm)	133	139	147	151	158
Recurring EPS (MYR)	0.18	0.19	0.20	0.21	0.22
BVPS (MYR)	1.19	1.10	1.17	1.25	1.33
DPS (MYR)	0.07	0.12	0.13	0.13	0.14
Recurring P/E (x)	12.25	11.78	11.13	10.83	10.32
P/B (x)	1.87	2.03	1.91	1.79	1.68
Dividend Yield (%)	3.4	5.3	5.8	6.0	6.3
Return on average equity (%)	16.2	16.5	17.7	17.0	16.8

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-22	Mar-23	Mar-24F	Mar-25F	Mar-26F
Malaysia	EPS	0.18	0.19	0.20	0.21	0.22
Financial Services	Recurring EPS	0.18	0.19	0.20	0.21	0.22
<b>RCE Capital</b>	DPS	0.07	0.12	0.13	0.13	0.14
RCE MK	BVPS	1.19	1.10	1.17	1.25	1.33
Neutral						
	<b>Valuation metrics</b>	<b>Mar-22</b>	<b>Mar-23</b>	<b>Mar-24F</b>	<b>Mar-25F</b>	<b>Mar-26F</b>
<b>Valuation basis</b>	Recurring P/E (x)	12.25	11.78	11.13	10.83	10.32
Our GGM assumptions are:	P/B (x)	1.9	2.0	1.9	1.8	1.7
i) CoE of 10.8%;	Dividend Yield (%)	3.4	5.3	5.8	6.0	6.3
ii) ROE of 17.2%; and						
iii) 3.5% long-term growth rate.						
	<b>Income statement (MYRm)</b>	<b>Mar-22</b>	<b>Mar-23</b>	<b>Mar-24F</b>	<b>Mar-25F</b>	<b>Mar-26F</b>
<b>Key drivers</b>	Interest income	275	281	303	317	331
Our FY24 forecasts are most sensitive to changes in:	Interest expense	(80)	(90)	(104)	(110)	(114)
i) Growth in receivables;	<b>Net interest income</b>	<b>194</b>	<b>190</b>	<b>199</b>	<b>207</b>	<b>218</b>
ii) Impairment allowances; and	Non interest income	45	71	74	79	83
iii) Financing margins.	<b>Total operating income</b>	<b>239</b>	<b>261</b>	<b>273</b>	<b>287</b>	<b>301</b>
	Overheads	(51)	(49)	(52)	(55)	(58)
	<b>Pre-provision operating profit</b>	<b>189</b>	<b>213</b>	<b>221</b>	<b>232</b>	<b>243</b>
<b>Key risks</b>	Loan impairment allowances	(12)	(29)	(25)	(30)	(32)
The downside risks include:	<b>Pre-tax profit</b>	<b>177</b>	<b>184</b>	<b>196</b>	<b>201</b>	<b>211</b>
i) Higher-than-expected credit cost;	Taxation	(44)	(45)	(49)	(50)	(53)
ii) Weaker-than-expected financing growth; and	<b>Reported net profit</b>	<b>133</b>	<b>139</b>	<b>147</b>	<b>151</b>	<b>158</b>
iii) Weaker-than-expect net financing margin.	<b>Recurring net profit</b>	<b>133</b>	<b>139</b>	<b>147</b>	<b>151</b>	<b>158</b>
The converse represents upside risk.						
	<b>Profitability ratios</b>	<b>Mar-22</b>	<b>Mar-23</b>	<b>Mar-24F</b>	<b>Mar-25F</b>	<b>Mar-26F</b>
<b>Company Profile</b>	Return on average assets (%)	5.1	4.9	4.8	4.7	4.8
RCE provides general financing services to civil servants – repayments are done via direct salary deductions. Its wholly-owned EXP Payment unit offers payroll collection management services for government departments under the purview of the Accountant General's Department.	Return on average equity (%)	16.2	16.5	17.7	17.0	16.8
	Return on IEAs (%)	10.9	10.3	10.3	10.4	10.4
	Cost of funds (%)	4.6	4.6	4.8	4.8	4.9
	Net interest spread (%)	6.2	5.7	5.5	5.5	5.5
	Net interest margin (%)	7.7	7.0	6.8	6.8	6.8
	Non-interest income / total income (%)	18.9	27.1	27.2	27.7	27.6
	Cost to income ratio (%)	21.1	18.7	19.1	19.2	19.2
	Credit cost (bps)	62.0	147.1	120.0	140.0	140.0
	<b>Balance sheet (MYRm)</b>	<b>Mar-22</b>	<b>Mar-23</b>	<b>Mar-24F</b>	<b>Mar-25F</b>	<b>Mar-26F</b>
	Total gross loans	1,879	2,021	2,122	2,228	2,317
	Other interest earning assets	702	854	878	903	928
	Total gross IEAs	2,581	2,875	3,000	3,131	3,245
	Total provisions	(115)	(122)	(128)	(141)	(155)
	Net loans to customers	1,764	1,899	1,994	2,087	2,163
	Total net IEAs	2,466	2,753	2,871	2,990	3,091
	Total non-IEAs	260	194	295	279	286
	Total assets	2,725	2,947	3,166	3,269	3,376
	Other interest-bearing liabilities	1,804	2,092	2,259	2,304	2,350
	Total IBLs	1,804	2,092	2,259	2,304	2,350
	Total non-IBLs	49	50	51	52	52
	Total liabilities	1,853	2,141	2,310	2,356	2,403
	Share capital	201	202	203	204	206
	Shareholders' equity	872	806	857	913	974
	<b>Asset quality and capital</b>	<b>Mar-22</b>	<b>Mar-23</b>	<b>Mar-24F</b>	<b>Mar-25F</b>	<b>Mar-26F</b>
	Reported NPLs / gross cust loans (%)	3.8	3.8	3.8	3.8	3.8
	Total provisions / reported NPLs (%)	162.8	157.8	159.2	166.3	175.6

Source: Company data, RHB

## Results At a Glance

Figure 1: RCE – summary of 1QFY24 results

FYE Mar (MYRm)	1Q FY23	4Q FY23	1Q FY24	QoQ (%)	YoY (%)	Comments
<b>Net profit income</b>	<b>48.8</b>	<b>45.1</b>	<b>46.1</b>	<b>2.3</b>	<b>(5.6)</b>	
Profit income	69.2	70.5	71.1	0.9	2.7	Management expects profit income to pick up, as the effect of the repricing of new loans beginning 2HFY23 starts to flow through.
Profit expense	(20.4)	(25.4)	(25.0)	(1.7)	22.4	
<b>Non-profit Income</b>	<b>14.0</b>	<b>20.9</b>	<b>21.4</b>	<b>2.2</b>	<b>52.4</b>	In line with the strong financing receivables growth, driven partly by the group's successful sales campaigns.
<i>Non-profit income/Total income (%)</i>	22.3	31.7	31.7			
<b>Operating income</b>	<b>62.9</b>	<b>66.0</b>	<b>67.5</b>	<b>2.3</b>	<b>7.4</b>	
Overhead expenses	(11.8)	(11.4)	(13.8)	21.0	17.1	Mostly driven by higher staff costs due to an increase in staff headcount.
<i>CIR (%)</i>	18.8	17.3	20.5			
<b>PIOP</b>	<b>51.1</b>	<b>54.6</b>	<b>53.7</b>	<b>(1.6)</b>	<b>5.1</b>	
Impairment on financing	(8.2)	(8.2)	(4.7)	(42.1)	(42.5)	
<i>Ann. credit costs (bps)</i>	173	163	93			
<b>PBT</b>	<b>42.9</b>	<b>46.4</b>	<b>49.0</b>	<b>5.5</b>	<b>14.2</b>	
Taxation	(10.7)	(11.6)	(12.1)			
<i>ETR (%)</i>	24.9	25.0	24.7			
<b>Net Earnings</b>	<b>32.2</b>	<b>34.8</b>	<b>36.9</b>	<b>5.8</b>	<b>14.4</b>	Forms 26%/27% of ours/consensus estimates.
<b>Other key data and ratios</b>						
Gross financing	1,904.7	2,020.9	2,045.4	1.2	7.4	Guidance is for RCE to track the growth of the wider banking system, which we estimate to grow at c.5% in CY23.
Total borrowings	1,847.0	2,091.5	2,197.0	5.0	18.9	
Total assets	2,767.3	2,946.8	3,026.2	2.7	9.4	
Shareholders' funds	875.0	805.7	787.1	(2.3)	(10.0)	
ROAA (%)	4.7%	4.8%	4.9%			
ROAE (%)	14.8%	17.7%	18.5%			

Source: Company data, RHB

Figure 2: Revisions to our full-year earnings forecasts

FYE Mar	Net profit (MYRm)			EPS (MYR)			DPS (MYR)		
	Previous	Revised	% Chg	Previous	Revised	% Chg	Previous	Revised	% Chg
2024F	141.0	146.9	4.2	0.19	0.20	4.2	0.13	0.13	4.2
2025F	148.5	150.9	1.6	0.20	0.21	1.6	0.13	0.13	1.6
2026F	156.2	158.4	1.4	0.21	0.22	1.4	0.14	0.14	1.4

Source: Company data, RHB

## Valuation and TP

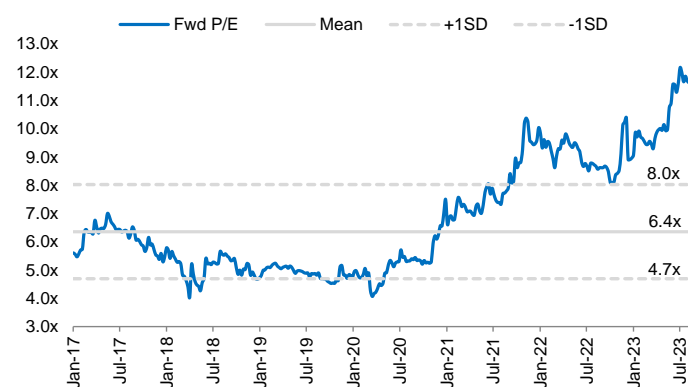
Our new TP of MYR2.20 is based on a GGM-derived fair value P/BV of 1.87x on RCE's CY24F BVPS. This compares against the other non-bank lenders' valuations of c.1.0-1.2x. We believe RCE deserves to trade at a premium to its peers, given its best-in-class ROE of more than 17%, though we believe the market has already priced this in, along with RCE's defensive attributes (resilient salary deduction scheme, prudent asset quality controls, and attractive dividend yields) and other positives. We maintain our NEUTRAL call on the counter.

Figure 3: GGM valuation

<b>Cost of equity (COE) computation:</b>		Sustainable ROE (%)	17.2
Risk free rate (%)	4.0	COE (%)	10.8
Equity premium (%)	5.9	Long-term growth (g)	3.5
Beta (x)	1.2	Implied P/BV (x)	1.87
Cost of equity - CAPM (%)	10.8	BVPS – CY24F	MYR1.19
		Intrinsic value	MYR2.22
ESG premium/(discount) (%)	0.0	ESG premium/(discount)	MYR0.00
		<b>TP (rounded)</b>	<b>MYR2.20</b>

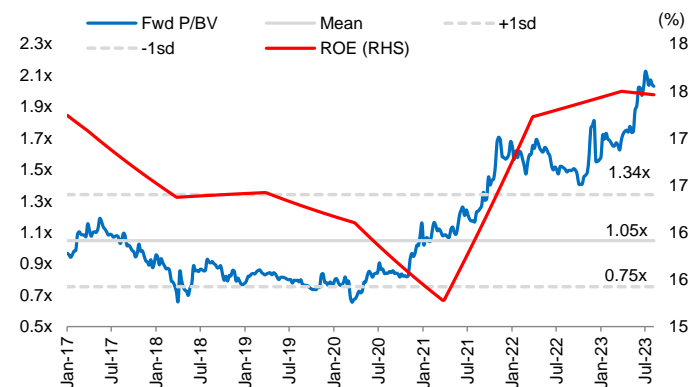
Source: Company data, RHB

Figure 4: RCE Capital's 12-month forward P/E



Source: Bloomberg, RHB

Figure 5: RCE Capital's 12-month forward P/BV vs ROE



Source: Bloomberg, RHB

## Recommendation Chart

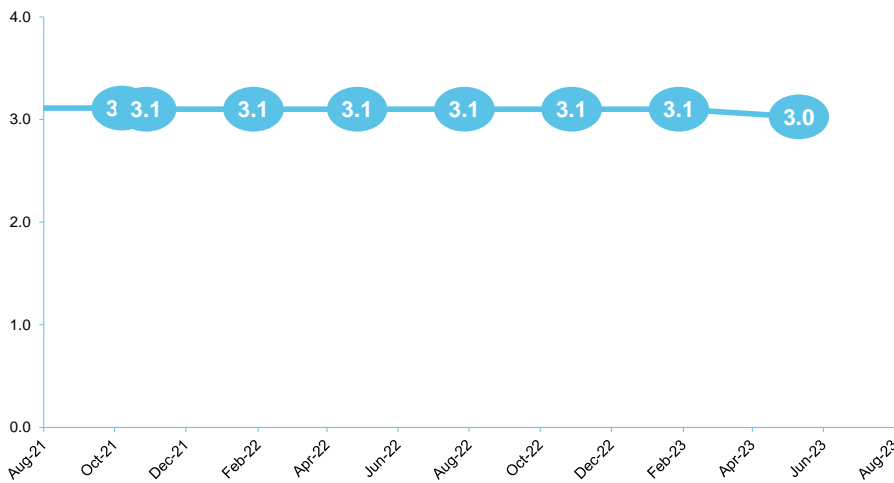


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2023-05-24	Neutral	1.95	1.99
2023-02-15	Neutral	1.95	1.85
2022-11-22	Neutral	1.95	1.87
2022-08-12	Buy	1.92	1.64
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

Source: RHB, Bloomberg

## ESG Rating History



Source: RHB

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