

23 November 2023

Financial Services | Banks

RCE Capital (RCE MK)

Sell (from Neutral)

What Goes Up...; D/G To SELL

- D/G to SELL from Neutral, new MYR2.30 TP (from MYR2.20), 15% downside.** RCE Capital's 1HFY24 (Mar) net profit of MYR75.1m came in line with ours and consensus' expectations. After a 41% share price gain since late May, the counter is trading near +3SD from its 5-year mean P/BV. As RCE continues to chart stable, albeit soft, earnings and receivables growth, our downgrade is mainly premised on valuation grounds.
- Results review.** 2QFY24 net profit of MYR38.2m (+5% YoY, +4% QoQ) brought 1HFY24 net profit to MYR75.1m (+9% YoY). Net profit income was softer YoY due to higher profit expenses (+18% YoY from greater *sukuk* funding), though this was offset by higher fee income (+47% YoY) driven by greater disbursements. Credit costs came in at 113bps (1HFY23: 157bps), in line with 100-200bps guidance. All in, results were in line with expectations, forming 51% and 53% of ours and Street's full-year projections. An interim DPS of 8 sen was declared, implying a 3% yield.
- Maintaining receivables growth pace.** RCE's gross financing receivables stood at MYR2.08bn as at 30 Sep 2023 – up 3% YTD (+6% YoY, +2% QoQ). This is in line with the group's aspirations to track the wider growth of the banking system, which printed YTD growth rate of 3% (+4% YoY, +1% MoM). We understand there has been no change to the guidance, though RCE could outperform the banking system come the end of its financial year, given the group's decent growth momentum – YoY gross receivables growth has been maintained at >5% for 5 consecutive quarters, vs RHB's forecast of 4-4.5% YoY growth for the banking system in CY23.
- Continuous improvement in asset quality.** Stage 3 provisions – which we use as a proxy for gross impaired financing – has been on a downtrend since the peak in 1QFY23. The figure stood at 3.6% at end-2QFY24 (1QFY23: 4%). Meanwhile, credit costs of 113bps in 1HFY24 came in at the lower end of the guided range of 100-200bps for FY24. As RCE provides stage 3 provisions immediately upon customers' exit from civil service, we believe the government's initiatives to boost the attractiveness of the civil service is positive for the group's asset quality.
- Has share price run ahead of valuations?** Post revisions to its dividend policy in late May 2023, RCE's share price had gained 41%. While some of the share price increase may have been done with yields in mind, we believe the market may have overreacted, as consensus earnings forecast adjustments in that time have not been as dramatic (less than +5%).
- No changes to FY24-26F forecasts** as results were in line. Our TP is lifted to MYR2.30 (from MYR2.20) after rolling forward our base year to CY24. As business fundamentals still appear sound, our downgrade is mainly premised on valuation grounds – against a FY25F ROE of 17%, P/BV of 2.2x (near +3SD from mean) appears overstretched.

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)	14.89	14.31	13.52	13.16	12.54
P/B (x)	2.27	2.47	2.32	2.17	2.04
Dividend Yield (%)	2.8	4.4	4.8	4.9	5.2
Return on average equity (%)	16.2	16.5	17.7	17.0	16.8

Source: Company data, RHB

Target Price (Return): MYR2.30 (-15.1%)
 Price (Market Cap): MYR2.71 (USD425m)
 ESG score: 3.0 (out of 4)
 Avg Daily Turnover (MYR/USD) 0.90m/0.19m

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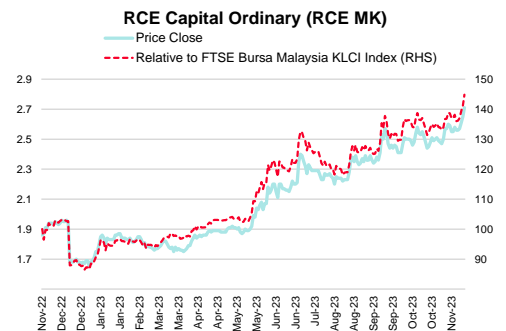


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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	60.4	11.1	15.3	42.6	44.9
Relative	63.1	10.1	15.0	40.0	43.9
52-wk Price low/high (MYR)	1.65 – 2.71				



Source: Bloomberg

Overall ESG Score: 3.0 (out of 4)

E: GOOD

RCE's emissions intensity (per employee) demonstrated a decrease in FY23 (Mar) despite the full reopening of the economy post-pandemic. The group has also committed to disclosing its internal Scope 3 emissions in its FY24 annual report, in line with the Bursa Malaysia Enhanced Sustainability Reporting Framework.

S: GOOD

RCE places strong focus on employee development - its employees enjoyed an average of 32 training hours in FY23, compared to 24 hours in FY22. The Group, in collaboration with Yayasan Azman Hashim, provides study grants and scholarships to deserving underprivileged students to pursue Chartered Accountancy certifications. To date, MYR572,000 has been distributed under the programme.

G: EXCELLENT

4 out of 8 members of the Board of Directors (ex-CEO) are independent directors, while all members are non-executive. Board members have a maximum allowed tenure of 9 years, to facilitate Board refreshment.

Note:

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

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
RCE Capital	DPS	0.07	0.12	0.13	0.13	0.14
RCE MK	BVPS	1.19	1.10	1.17	1.25	1.33
Sell						
	Valuation metrics	Mar-22	Mar-23	Mar-24F	Mar-25F	Mar-26F
Valuation basis	Recurring P/E (x)	14.89	14.31	13.52	13.16	12.54
Our GGM assumptions are:	P/B (x)	2.3	2.5	2.3	2.2	2.0
i. CoE of 10.8%;	Dividend Yield (%)	2.8	4.4	4.8	4.9	5.2
ii. ROE of 17.2%; and						
iii. 3.5% long-term growth rate.						
	Income statement (MYRm)	Mar-22	Mar-23	Mar-24F	Mar-25F	Mar-26F
Key drivers	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;	Net interest income	194	190	199	207	218
ii. Impairment allowances; and	Non interest income	45	71	74	79	83
iii. Financing margins.	Total operating income	239	261	273	287	301
	Overheads	(51)	(49)	(52)	(55)	(58)
	Pre-provision operating profit	189	213	221	232	243
Key risks	Loan impairment allowances	(12)	(29)	(25)	(30)	(32)
The downside risks include:	Pre-tax profit	177	184	196	201	211
i. Higher-than-expected credit cost;	Taxation	(44)	(45)	(49)	(50)	(53)
ii. Weaker-than-expected financing growth; and	Reported net profit	133	139	147	151	158
iii. Weaker-than-expect net financing margin.	Recurring net profit	133	139	147	151	158
The converse represents upside risk.						
	Profitability ratios	Mar-22	Mar-23	Mar-24F	Mar-25F	Mar-26F
Company Profile	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
	Balance sheet (MYRm)	Mar-22	Mar-23	Mar-24F	Mar-25F	Mar-26F
	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
	Asset quality and capital	Mar-22	Mar-23	Mar-24F	Mar-25F	Mar-26F
	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: Summary of 2QFY24 and 1HFY24 results

FYE Mar (MYRm)	2Q FY23	1Q FY24	2Q FY24	QoQ (%)	YoY (%)	1HFY23	1HFY24	YoY (%)	Comments
Net profit income	49.3	46.1	48.6	5.4	(1.5)	98.2	94.7	(3.5)	
Profit income	71.0	71.1	73.2	3.0	3.2	140.2	144.3	2.9	Driven by robust receivables growth (+6% YoY).
Profit expense	(21.6)	(25.0)	(24.6)	(1.4)	13.8	(42.0)	(49.6)	18.0	In line with increased <i>sukuk</i> funding (+16% YoY).
Non-profit Income	17.2	21.4	24.3	13.7	41.9	31.2	45.8	46.6	Higher fee income from successful sales campaigns.
<i>Non-Il/Total income (%)</i>	25.8	31.7	33.4			24.1	32.6		
Operating Income	66.5	67.5	72.9	8.0	9.7	129.3	140.5	8.6	
Overhead expenses	(11.0)	(13.8)	(15.2)	9.9	37.5	(22.8)	(29.0)	27.0	Inched up slightly due to costs related to sales campaigns (non-recurring).
<i>CIR (%)</i>	16.6	20.5	20.8			17.7	20.6		
PIOP	55.4	53.7	57.8	7.5	4.2	106.5	111.5	4.7	
Impairment on financing	(6.9)	(4.7)	(6.9)	45.7	0.1	(15.1)	(11.6)	(23.1)	Hefty pre-emptive provisions made in 1QFY23 for civil servants that retired early or have left the service. Departures from civil service have since normalised.
<i>Ann. credit costs (bps)</i>	142	93	133			157	113		
PBT	48.6	49.0	50.9	3.9	4.8	91.5	99.9	9.2	
Taxation	(12.0)	(12.1)	(12.6)			(22.7)	(24.8)		
<i>ETR (%)</i>	24.8	24.7	24.8			24.8	24.8		
Net Earnings	36.5	36.9	38.2	3.7	4.7	68.8	75.1	9.2	51%/53% of ours/Street's full-year estimates.
<u>Other key data and ratios</u>									
Gross financing	1,957.6	2,045.4	2,076.9	1.5	6.1				Management guides for financing growth to track the growth of the banking industry (RHB forecast: c.4-4.5% YoY in CY23).
Total borrowings	1,844.3	2,197.0	2,139.9	(2.6)	16.0				
Total assets	2,807.4	3,026.2	3,004.8	(0.7)	7.0				
Shareholders' funds	911.7	787.1	825.2	4.8	(9.5)				
ROAA (%)	5.2%	4.9%	5.1%			5.0%	5.0%		
ROAE (%)	16.4%	18.5%	19.0%			15.4%	18.4%		

Source: Company data, RHB

Valuation and TP

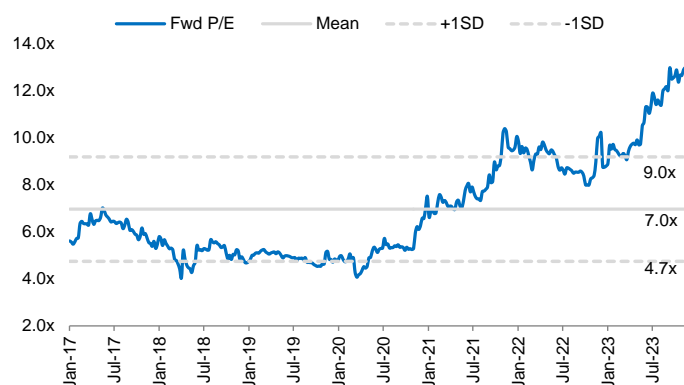
Our new TP of MYR2.30 (from MYR2.20) is based on an unchanged GGM-derived P/BV of 1.87x – this compares against the other non-bank lenders’ 1.0-1.3x range. Our TP was lifted after rolling forward our valuation year to CY24F. While we believe RCE deserves to trade at a premium to peers, given its best-in-class ROE of >17%, we reckon the market has more than adequately priced this in. Our downgrade to SELL (from Neutral) is mainly premised on valuation grounds, as the group’s business fundamentals – namely growth and asset quality – still appear sound.

Figure 2: GGM valuation

Cost of equity (COE) computation:		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	MYR1.23
		Intrinsic value	MYR2.30
ESG premium/(discount) (%)	0.0	ESG premium/(discount)	MYR0.00
		TP (rounded)	MYR2.30

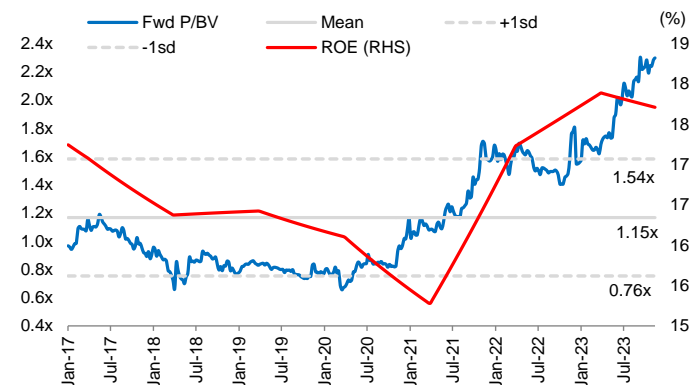
Source: Company data, RHB

Figure 3: RCE Capital’s 12-month forward P/E



Source: Bloomberg, RHB

Figure 4: RCE Capital’s 12-month forward P/BV vs ROE



Source: Bloomberg, RHB

Emissions And ESG

Trend analysis

RCE's total emissions intensity decreased to 0.87 tCO2e per employee in FY23 from 0.93 in FY22. The group plans to disclose Scope 3 emissions in its FY24 annual report.

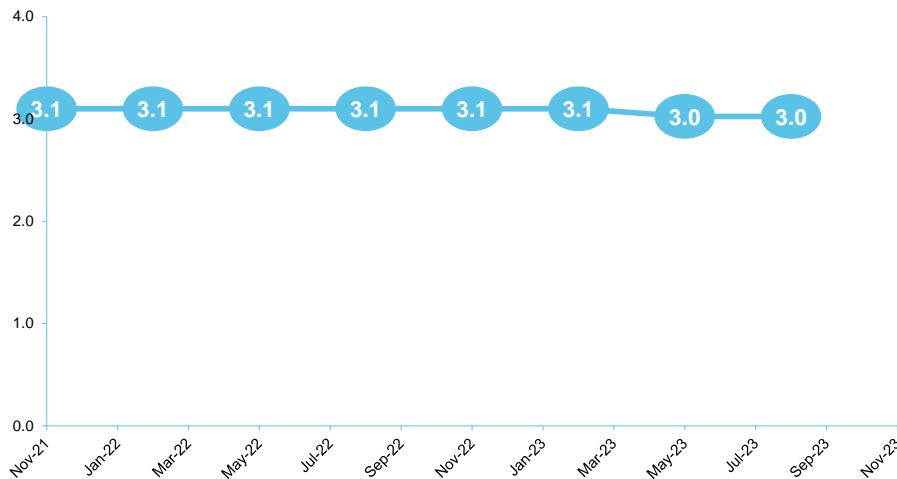
Emissions (tCO2e)	Mar-21	Mar-22	Mar-23
Scope 1	16	16	19
Scope 2	154	150	155
Scope 3	-	-	-
Total emissions	170	166	174

Source: Company data, RHB

Latest ESG-Related Developments

- **Scope 3 emissions reporting:** RCE plans to introduce its (internal) Scope 3 emissions data in its FY24 annual report to be released in mid-2024.
- **Emphasis on employee development:** RCE's employees enjoyed an average of 32 training hours per person, an increase of 8 hours YoY, on topics such as leadership development, regulatory and technical skills, and special interest topics.

ESG Rating History



Source: RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2023-08-15	Neutral	2.20	2.28
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

Source: RHB, Bloomberg

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Buy:	Share price may exceed 10% over the next 12 months
Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
Neutral:	Share price may fall within the range of +/- 10% over the next 12 months
Take Profit:	Target price has been attained. Look to accumulate at lower levels
Sell:	Share price may fall by more than 10% over the next 12 months
Not Rated:	Stock is not within regular research coverage

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