

9 February 2024

Financial Services | Banks

## RCE Capital (RCE MK)

**Sell** (Maintained)

### Fundamentals Sound, But Valuation Still Stretched

- **Keep SELL, with new MYR2.40 TP from MYR2.30, 24% downside.** RCE Capital's 9MFY24 (Mar) results came in line with our and consensus expectations. Key positives were the robust non-profit income and receivables growth, slightly offset by higher credit costs in 3QFY24. Our stance on the counter remains - while the group continues to be fundamentally sound, its valuation still appears stretched.
- **9MFY24 results in line.** 3QFY24 net profit of MYR34.6m (-2% YoY, -10% QoQ) brought the 9MFY24 total to MYR109.7m (+6% YoY) - meeting our and Street full-year forecasts. Cumulatively, total income grew 9% thanks to stronger non-profit income (+38%), whereas net profit income stayed flat. The bottomline impact, however, was mitigated by higher opex (+29%). On a QoQ basis, 3QFY24 was hit by higher impairment allowances (+21%). All in, 9MFY24 ROE stood at 18.2% (9MFY23: 16.9%). No dividend was declared.
- **Robust receivables growth, softer yields.** RCE's financing receivables added 6% YoY in 3QFY24 (QoQ: +1%), ahead of the banking system's +5% YoY. However, average asset yields were down by an estimated 50bps in 9MFY24, due to lagged effects from profit rate adjustments. Management revised its profit rate higher in Oct 2022, and yields have begun improving on a sequential basis, though net profit margin (NPM) will take time to recover to management's comfort level of 7-8% (9MFY23: c.6.7%).
- **Higher credit costs not a concern.** 3QFY24 saw credit costs inch up sequentially to 159bps from 133bps (3QFY23: 111bps). We learnt that this was due to exits from the civil service, mainly the education sector. While exit trends are unpredictable, management is not overly concerned, and is confident that the group can obtain the necessary recoveries. It also has an estimated financing loss coverage of c.153% for buffer.
- **Potential impact from one-off civil servants' incentive.** Civil servants in Malaysia are expected to receive a one-off incentive payment worth MYR1,000-2,000 on 23 Feb 2024. This could halt receivables growth momentum in 4QFY24 due to early repayments and/or softer demand for financing. Nevertheless, management does not view this as a long-term negative, and looks forward to the civil service wage revision, which should be completed by the end of the year and is positive for long-term growth.
- **We raise FY25F-26F net profit by 4% on improving asset yields, but keep FY24F flat.** Our TP is lifted to MYR2.40 (from MYR2.30), and includes an unchanged 0% ESG premium/discount. We maintain our SELL call on valuation grounds - at 2.6x P/BV vs 17-18% ROE, we believe the stock's valuation is overstretched.

Forecasts and Valuation	Mar-22	Mar-23	Mar-24F	Mar-25F	Mar-26F
Reported net profit (MYRm)	133	139	147	157	164
Net profit growth (%)	6.9	4.2	5.9	7.0	4.5
Recurring net profit (MYRm)	133	139	147	157	164
Recurring EPS (MYR)	0.18	0.19	0.20	0.21	0.22
BVPS (MYR)	1.19	1.10	1.16	1.22	1.28
DPS (MYR)	0.07	0.12	0.15	0.16	0.17
Recurring P/E (x)	17.25	16.58	15.65	14.63	13.99
P/B (x)	2.63	2.86	2.71	2.57	2.44
Dividend Yield (%)	2.4	3.8	4.8	5.1	5.4
Return on average equity (%)	16.2	16.5	17.8	18.0	17.9

Source: Company data, RHB

Target Price (Return):	MYR2.40 (-24%)
Price (Market Cap):	MYR3.14 (USD482m)
ESG score:	3.0 (out of 4)
Avg Daily Turnover (MYR/USD)	2.69m/0.57m

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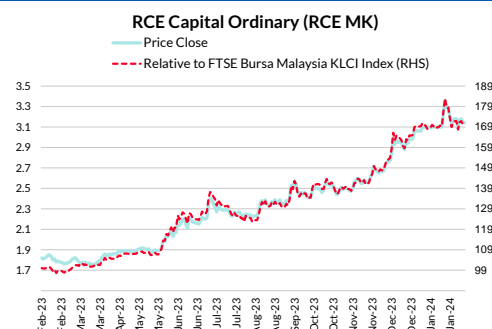


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#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	2.6	1.6	20.8	40.2	72.5
Relative	(1.4)	0.5	17.0	36.0	69.7
52-wk Price low/high (MYR)				1.75	-3.36



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

Four out of eight 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 nine years, to facilitate Board refreshment.

#### Note:

Small cap stocks are defined as companies with a market capitalisation 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
<b>RCE Capital</b>	DPS	0.07	0.12	0.15	0.16	0.17
RCE MK	BVPS	1.19	1.10	1.16	1.22	1.28
Sell						
	<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)	17.25	16.58	15.65	14.63	13.99
Our GGM assumptions are:	P/B (x)	2.6	2.9	2.7	2.6	2.4
i. CoE of 10.8%;	Dividend Yield (%)	2.4	3.8	4.8	5.1	5.4
ii. ROE of 17.9%;						
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	295	317	333
Our FY24 forecasts are most sensitive to changes in:	Interest expense	(80)	(90)	(100)	(106)	(112)
i. Growth in receivables;	<b>Net interest income</b>	<b>194</b>	<b>190</b>	<b>195</b>	<b>211</b>	<b>221</b>
ii. Impairment allowances;	Non interest income	45	71	84	91	98
iii. Financing margins.	<b>Total operating income</b>	<b>239</b>	<b>261</b>	<b>279</b>	<b>302</b>	<b>319</b>
	Overheads	(51)	(49)	(56)	(62)	(67)
	<b>Pre-provision operating profit</b>	<b>189</b>	<b>213</b>	<b>223</b>	<b>240</b>	<b>251</b>
<b>Key risks</b>	Loan impairment allowances	(12)	(29)	(27)	(30)	(32)
Upside risks include:	<b>Pre-tax profit</b>	<b>177</b>	<b>184</b>	<b>196</b>	<b>210</b>	<b>219</b>
i. Greater-than-expected financing growth;	Taxation	(44)	(45)	(49)	(52)	(55)
ii. Lower-than-expected credit costs;	<b>Reported net profit</b>	<b>133</b>	<b>139</b>	<b>147</b>	<b>157</b>	<b>164</b>
iii. Stronger-than-expect net financing margin.	<b>Recurring net profit</b>	<b>133</b>	<b>139</b>	<b>147</b>	<b>157</b>	<b>164</b>
<b>Company Profile</b>	<b>Profitability ratios</b>	<b>Mar-22</b>	<b>Mar-23</b>	<b>Mar-24F</b>	<b>Mar-25F</b>	<b>Mar-26F</b>
RCE Capital 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 assets (%)	5.1	4.9	4.8	4.9	4.8
	Return on average equity (%)	16.2	16.5	17.8	18.0	17.9
	Return on IEAs (%)	10.9	10.3	10.1	10.3	10.4
	Cost of funds (%)	4.6	4.6	4.6	4.6	4.6
	Net interest spread (%)	6.2	5.7	5.5	5.8	5.8
	Net interest margin (%)	7.7	7.0	6.6	6.9	6.9
	Non-interest income / total income (%)	18.9	27.1	30.0	30.2	30.6
	Cost to income ratio (%)	21.1	18.7	20.1	20.4	21.2
	Credit cost (bps)	62.0	147.1	130.0	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)	(130)	(143)	(157)
	Net loans to customers	1,764	1,899	1,992	2,085	2,160
	Total net IEAs	2,466	2,753	2,869	2,988	3,088
	Total non-IEAs	260	194	290	331	396
	Total assets	2,725	2,947	3,159	3,319	3,484
	Other interest-bearing liabilities	1,804	2,092	2,259	2,372	2,490
	Total IBLs	1,804	2,092	2,259	2,372	2,490
	Total non-IBLs	49	50	51	52	52
	Total liabilities	1,853	2,141	2,310	2,423	2,543
	Share capital	201	202	203	204	206
	Shareholders' equity	872	806	849	895	941
	<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	161.8	168.8	178.0

Source: Company data, RHB

## Results At a Glance

Figure 1: Summary of 3QFY24 and 9MFY24 results

FYE Mar (MYRm)	3Q FY23	2Q FY24	3Q FY24	QoQ (%)	YoY (%)	9MFY23	9MFY24	YoY (%)	Comments
<b>Net profit income</b>	<b>47.2</b>	<b>48.6</b>	<b>50.0</b>	<b>2.8</b>	<b>5.9</b>	<b>145.4</b>	<b>144.7</b>	<b>(0.5)</b>	
Profit income	70.1	73.2	74.1	1.1	5.7	210.2	218.4	3.9	Driven by robust receivables growth (+6% YoY)
Profit expense	(22.8)	(24.6)	(24.1)	(2.2)	5.4	(64.9)	(73.7)	13.5	In line with increased sukuk funding (+5% YoY) made on higher rates
<b>Non-profit income</b>	<b>18.8</b>	<b>24.3</b>	<b>23.4</b>	<b>(3.9)</b>	<b>24.3</b>	<b>50.0</b>	<b>69.1</b>	<b>38.2</b>	Higher early settlements and income from fixed deposits
Non-III/Total income (%)	28.5	33.4	31.9			25.6	32.3		
<b>Operating Income</b>	<b>66.0</b>	<b>72.9</b>	<b>73.4</b>	<b>0.6</b>	<b>11.1</b>	<b>195.4</b>	<b>213.8</b>	<b>9.4</b>	
Overhead expenses	(14.5)	(15.2)	(19.2)	26.6	32.5	(37.3)	(48.2)	29.1	Inched up slightly due to costs related to employees' share scheme issuances. Bonus payments have been accrued throughout the year
CIR (%)	22.0	20.8	26.2			19.1	22.5		
<b>PIOP</b>	<b>51.5</b>	<b>57.8</b>	<b>54.2</b>	<b>(6.2)</b>	<b>5.1</b>	<b>158.0</b>	<b>165.6</b>	<b>4.8</b>	
Impairment on financing	(5.5)	(6.9)	(8.3)	21.1	52.1	(20.5)	(19.9)	(3.0)	QoQ rise due to early retirements/exits from the civil service, particularly the education sector
Ann. credit costs (bps)	111	133	159			142	129		
<b>PBT</b>	<b>46.1</b>	<b>50.9</b>	<b>45.8</b>	<b>(9.9)</b>	<b>(0.5)</b>	<b>137.5</b>	<b>145.7</b>	<b>6.0</b>	
Taxation	(10.9)	(12.6)	(11.3)			(33.6)	(36.0)		
ETR (%)	23.6	24.8	24.6			24.4	24.7		
<b>Net Earnings</b>	<b>35.2</b>	<b>38.2</b>	<b>34.6</b>	<b>(9.6)</b>	<b>(1.7)</b>	<b>103.9</b>	<b>109.7</b>	<b>5.5</b>	75%/74% of our/Street full-year estimates
<b>Other key data and ratios</b>									
Gross financing	1,978.5	2,086.6	2,106.8	1.0	6.5				Ahead of banking industry's growth of 5.3% YoY in CY23
Total borrowings	2,086.1	2,139.9	2,194.7	2.6	5.2				As at 31 Dec 2023, average borrowing rates range between 4.4-5.0% pa (31 Dec 2022: 3.6-4.8% pa)
Total assets	2,908.7	3,014.5	3,049.7	1.2	4.8				
Shareholders' funds	771.8	825.2	805.9	(2.3)	4.4				
ROAA (%)	4.9%	5.1%	4.6%			4.9%	4.9%		
ROAE (%)	16.7%	19.0%	17.0%			16.9%	18.2%		

Source: Company data, RHB

Figure 2: Yield and NPM trending higher sequentially, but down YoY, currently below the 7-8% target level

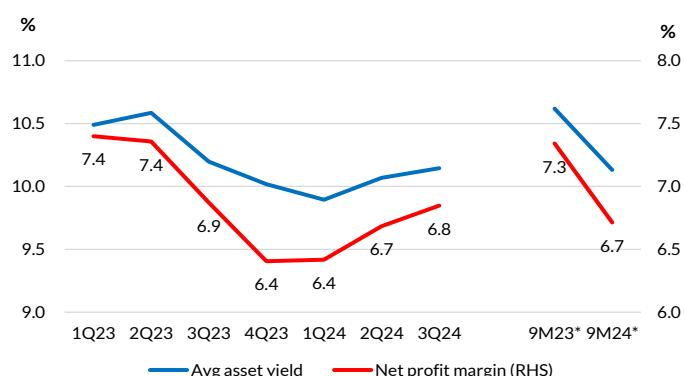
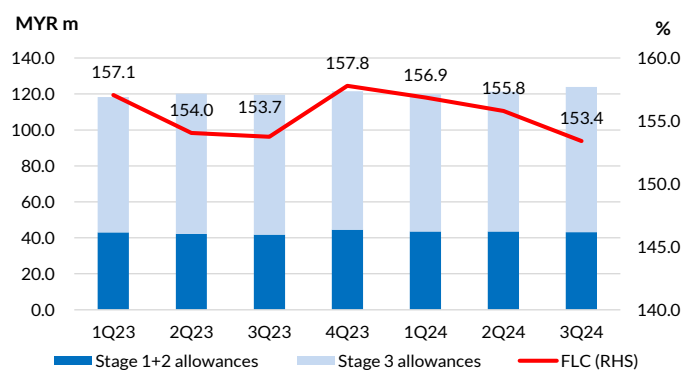
Note: \*Refers to annualised numbers  
Source: Company data, RHB

Figure 3: RCE has ample financing loss coverage to shield from unexpected spikes in impairment allowances



Source: Company data, RHB

Figure 4: 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	146.9	147.0	0.1	0.20	0.20	0.1	0.15	0.15	0.1
2025F	150.9	157.3	4.3	0.21	0.21	4.3	0.15	0.16	4.3
2026F	158.4	164.5	3.8	0.22	0.22	3.8	0.16	0.17	3.8

Source: Company data, RHB

Valuation and TP

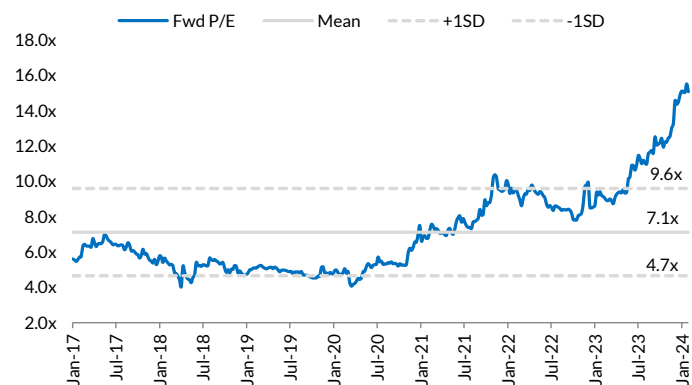
Our new TP of MYR2.40 (from MYR2.30) is based on a GGM-derived P/BV of 1.97x (from 1.91x), and includes a 0% ESG premium/discount. Our ROE assumption (17.9% from 17.2%) is raised after incorporating our forecast changes. While the stock’s fundamentals are holding up well, we retain our SELL call on valuation grounds – at 2.6x P/BV (over +3SD from mean) against 17-18% ROE, we view the counter as potentially overvalued.

Figure 5: GGM valuation

<b>Cost of equity (COE) computation:</b>		Sustainable ROE (%)	17.9
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)	1.97
Cost of equity - CAPM (%)	10.8	BVPS – CY24F	MYR1.21
		Intrinsic value	MYR2.38
ESG premium/(discount) (%)	0.0	ESG premium/(discount)	MYR0.00
		<b>TP (rounded)</b>	<b>MYR2.40</b>

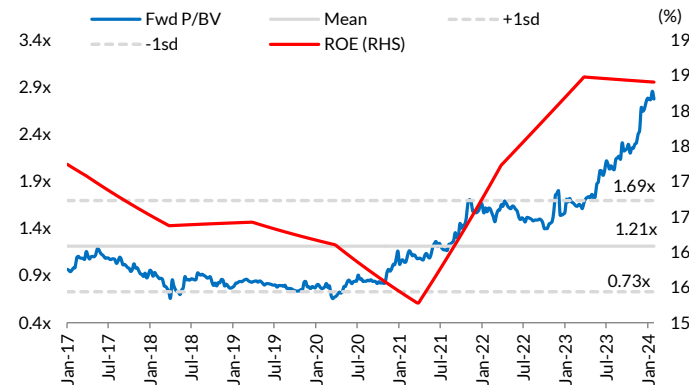
Source: Company data, RHB

Figure 6: RCE’s 12-month forward P/E



Source: Bloomberg, RHB

Figure 7: RCE’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 tCO<sub>2</sub>e per employee in FY23 from 0.93 tCO<sub>2</sub>e in FY22. The group plans to disclose Scope 3 emissions in its FY24 annual report.

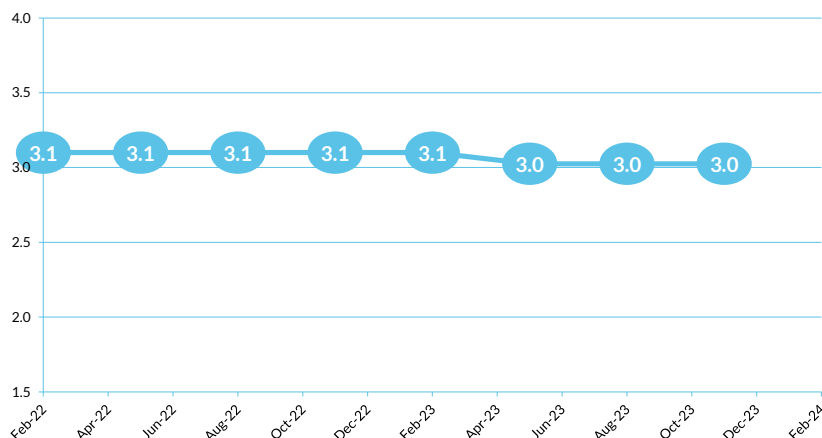
Emissions (tCO <sub>2</sub> e)	Mar-21	Mar-22	Mar-23
Scope 1	16	16	19
Scope 2	154	150	155
Scope 3	-	-	-
<b>Total emissions</b>	<b>170</b>	<b>166</b>	<b>174</b>

Source: Company data, RHB

## Latest ESG-Related Developments

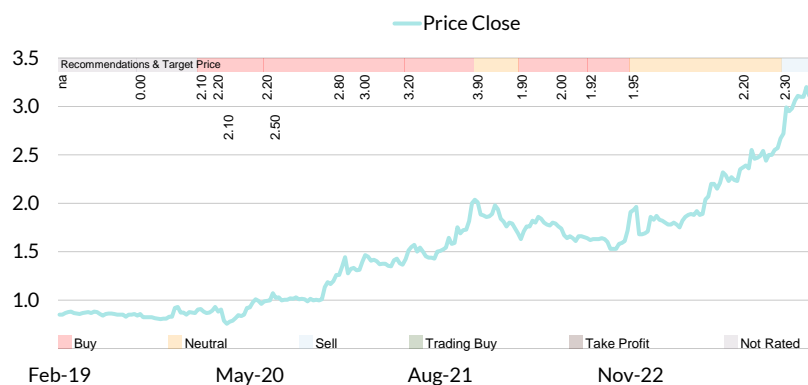
- **Scope 3 emissions reporting:** RCE plans to introduce its (internal) Scope 3 emissions data in its FY24 annual report to be released in mid-2024.
- **Emphasis on employee development:** RCE's employees enjoyed an average of 32 training hours per employee, an increase of eight hours YoY, on topics 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
2024-01-12	Sell	2.30	3.10
2023-11-23	Sell	2.30	2.68
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

Source: RHB, Bloomberg

## RHB Guide to Investment Ratings

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

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