

21 November 2024

Financial Services | Banks

RCE Capital (RCE MK)

Sell (Maintained)

Valuations Still Stretched; Still SELL

Target Price (Return): MYR1.25 (-28%)
 Price (Market Cap): MYR1.73 (USD567m)
 ESG score: 3.0 (out of 4)
 Avg Daily Turnover (MYR/USD) 1.57m/0.36m

- **Maintain SELL, new MYR1.25 TP from MYR1.35 (ex-bonus issue adjustments), 28% downside.** RCE Capital's 1HFY25 (Mar) results missed expectations on the back of lower-than-expected financing growth. While the revision to civil servants' salaries points towards a rosier outlook in FY26, we think the current >+2SD P/BV is still unjustified. As such, we maintain our SELL rating on valuation grounds.
- **Results review.** RCE's 2QFY25 net profit of MYR27.8m (-8% QoQ, -27% YoY) brought the 1HFY25 figure to MYR58.2m (-23% YoY) – this formed 37% and 39% of our and consensus' full-year estimates. The main drag on earnings came from lower-than-expected non-II (due to softer-than-expected financing growth), which led to a 9% YoY drop in total operating income. 2QFY25 opex also rose by a sharp 46% QoQ (YoY: +37%) due to the annual issuance of shares to staff under the group's employees' share scheme – this amounted to an additional MYR5.2m in staff costs during the quarter. All in, 1HFY25 ROE stood at 14.2% (1HFY24: 17.7%). The group announced an interim DPS of 3 sen (76% payout), down from the 1HFY24 interim DPS of 4 sen (78% payout, adjusted for bonus issue).
- **Still in a tough operating environment...** RCE's gross financing receivables shrank by 1% QoQ (YoY: -1%) in 2QFY25. This comes to us as no surprise, as management had guided that the operating environment for civil servant financing has been challenging over the past year – the group is seeing an influx of lower credit score applicants, and has had to pare down disbursements to maintain its asset quality. Positively, however, we are beginning to see credit costs moderate back to c.1.2% per quarter, compared to the 1.5-2.0% range over the past three quarters.
- **... but hopeful of better days ahead.** According to management, the near-term trajectory for financing growth still looks mixed, but it is hopeful of growth beyond that, especially with the increment to civil servants' salaries effective Dec 2024 (ie the tail end of RCE's 3QFY25). Should this be the case, we think earnings can meaningfully pick up in FY26 onwards, especially if credit costs can be kept in check.
- **Forecasts.** Given the soft 1HFY25, we cut FY25 earnings by 14%, mostly from lower financing growth and non-financing income assumptions. However, our FY26-27F earnings are cut by a softer 3%, as we expect non-financing income to pick up in tandem with disbursements.
- **Our TP drops to MYR1.25 (from MYR1.35) post-adjustments to our earnings forecasts, and includes an unchanged 0% ESG premium.** Despite expectations of a better FY26, we think that RCE's current P/BV of 2.8x (over +2SD) is running well ahead of the company's fundamentals – which justifies our unchanged SELL rating on the counter.

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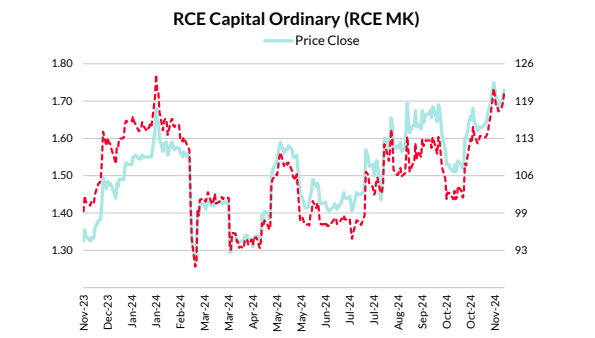


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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	13.1	8.1	9.8	10.2	32.6
Relative	3.2	11.0	12.5	12.0	22.9
52-wk Price low/high (MYR)				1.27	-1.75



Source: Bloomberg

Forecasts and Valuation	Mar-23	Mar-24	Mar-25F	Mar-26F	Mar-27F
Reported net profit (MYRm)	139	139	134	159	165
Net profit growth (%)	4.2	(0.0)	(3.5)	18.5	4.0
Recurring net profit (MYRm)	139	139	134	159	165
Recurring EPS (MYR)	0.09	0.09	0.09	0.11	0.11
BVPS (MYR)	0.55	0.56	0.59	0.61	0.64
DPS (MYR)	0.15	0.07	0.07	0.08	0.08
Recurring P/E (x)	18.37	18.48	18.94	15.98	15.36
P/B (x)	3.16	3.09	2.95	2.81	2.71
Dividend Yield (%)	8.6	4.3	4.0	4.7	4.9
Return on average equity (%)	16.5	17.0	15.8	18.0	18.0

Source: Company data, RHB

Overall ESG Score: 3.0 (out of 4)

E: GOOD

RCE's emissions intensity (on both an absolute and per employee basis) dropped in FY24 (Mar), underpinned by proactive climate change management strategies. The group has also begun reporting its Scope 3 emissions in FY24 based on cross-sector tools provided by the GHG Protocol.

S: GOOD

RCE places strong focus on employee development. Staff members enjoyed an average of 32 training hours in FY23, vs 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 (ex-CEO) are independent directors. All members are non-executive. Board members have a maximum allowed tenure of nine years, to facilitate its refreshment.

Financial Exhibits

Asia	Financial summary (MYR)	Mar-23	Mar-24	Mar-25F	Mar-26F	Mar-27F
Malaysia	EPS	0.09	0.09	0.09	0.11	0.11
Financial Services	Recurring EPS	0.09	0.09	0.09	0.11	0.11
RCE Capital	DPS	0.15	0.07	0.07	0.08	0.08
RCE MK	BVPS	0.55	0.56	0.59	0.61	0.64
Sell						
	Valuation metrics	Mar-23	Mar-24	Mar-25F	Mar-26F	Mar-27F
Valuation basis	Recurring P/E (x)	18.37	18.48	18.94	15.98	15.36
Our GGM assumptions are:	P/B (x)	3.2	3.1	2.9	2.8	2.7
i. CoE of 10.3%;	Dividend Yield (%)	8.6	4.3	4.0	4.7	4.9
ii. ROE of 17.5%;						
iii. 3.5% long-term growth rate.						
	Income statement (MYRm)	Mar-23	Mar-24	Mar-25F	Mar-26F	Mar-27F
Key drivers	Interest income	281	291	304	319	338
Our FY25 forecasts are most sensitive to changes in:	Interest expense	(90)	(99)	(103)	(109)	(115)
i. Growth in receivables;	Net interest income	190	192	201	209	223
ii. Impairment allowances;	Non interest income	71	89	70	101	104
iii. Financing margins.	Total operating income	261	281	271	311	326
	Overheads	(49)	(66)	(63)	(68)	(73)
	Pre-provision operating profit	213	215	208	242	253
Key risks	Loan impairment allowances	(29)	(30)	(30)	(31)	(33)
The upside risks include:	Pre-tax profit	184	185	179	212	220
i. Greater-than-expected financing growth;	Taxation	(45)	(46)	(45)	(53)	(55)
ii. Lower-than-expected credit costs;	Reported net profit	139	139	134	159	165
iii. Stronger-than-expected net financing margin.	Recurring net profit	139	139	134	159	165
	Profitability ratios	Mar-23	Mar-24	Mar-25F	Mar-26F	Mar-27F
Company Profile	Return on average assets (%)	4.9	4.7	4.4	4.9	4.9
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 equity (%)	16.5	17.0	15.8	18.0	18.0
	Return on IEAs (%)	10.3	10.1	10.4	10.5	10.5
	Cost of funds (%)	4.6	4.7	4.7	4.8	4.8
	Net interest spread (%)	5.7	5.4	5.6	5.7	5.7
	Net interest margin (%)	7.0	6.7	6.9	6.9	6.9
	Non-interest income / total income (%)	27.1	31.6	25.8	32.6	31.8
	Cost to income ratio (%)	18.7	23.4	23.3	21.9	22.5
	Credit cost (bps)	147	147	140	140	140
	Balance sheet (MYRm)	Mar-23	Mar-24	Mar-25F	Mar-26F	Mar-27F
	Total gross loans	2,021	2,100	2,142	2,271	2,430
	Other interest earning assets	854	800	822	845	869
	Total gross IEAs	2,875	2,900	2,964	3,116	3,299
	Total provisions	(122)	(128)	(139)	(152)	(167)
	Net loans to customers	1,899	1,973	2,003	2,119	2,263
	Total net IEAs	2,753	2,772	2,825	2,964	3,131
	Total non-IEAs	194	223	306	320	304
	Total assets	2,947	2,996	3,131	3,284	3,435
	Other interest-bearing liabilities	2,092	2,120	2,226	2,337	2,454
	Total IBLs	2,092	2,120	2,226	2,337	2,454
	Total non-IBLs	50	46	45	46	47
	Total liabilities	2,141	2,166	2,271	2,383	2,501
	Share capital	202	202	202	202	202
	Shareholders' equity	806	830	860	901	935
	Asset quality and capital	Mar-23	Mar-24	Mar-25F	Mar-26F	Mar-27F
	Reported NPLs / gross cust loans (%)	3.8	3.7	3.8	3.8	3.8
	Total provisions / reported NPLs (%)	157.8	165.8	171.2	176.5	181.1

Source: Company data, RHB

Results At a Glance

Figure 1: Summary of 2QFY25 and 1HFY25 results

FYE Mar (MYRm)	2Q FY24	1Q FY25	2Q FY25	QoQ (%)	YoY (%)	1HFY24	1HFY25	YoY (%)	Comments
Net profit income	48.6	46.5	47.2	1.5	(2.9)	94.7	93.7	(1)	
Profit income	73.2	72.0	73.0	1.3	(0.4)	144.3	145.0	0	
Profit expense	(24.6)	(25.6)	(25.8)	0.9	4.7	(49.6)	(51.3)	3	
Non-profit income	24.3	15.9	17.9	12.6	(26.4)	45.8	33.8	(26)	In tandem with the lower financing disbursements
<i>Non-Il/Total income (%)</i>	33.4	25.5	27.5			32.6	26.5		
Operating Income	72.9	62.4	65.1	4.3	(10.8)	140.5	127.5	(9)	
Overhead expenses	(15.2)	(14.2)	(20.8)	46.3	36.7	(29.0)	(34.9)	21	2Q opex included MYR5.2m in charges related to the annual issuance of shares to staff. In the past several years, this was typically done in 3Q.
<i>CIR (%)</i>	20.8	22.7	31.9			20.6	27.4		
PIOP	57.8	48.2	44.3	(8.0)	(23.2)	111.5	92.5	(17)	
Impairment on financing	(6.9)	(7.7)	(6.4)	(17.9)	(7.4)	(11.6)	(14.1)	22	The spike in 1HFY25 credit costs is attributable to the rising number of civil servants retiring early, exiting the civil service, or going bankrupt. While early retirements and exit trends are unpredictable, the group has worked to curb the bankruptcy cases, resulting in lower impairment allowances in 2Q.
<i>Ann. credit costs (bps)</i>	133	148	123			117	138		
PBT	50.9	40.4	38.0	(6.1)	(25.4)	99.9	78.4	(21)	
Taxation	(12.6)	(10.1)	(10.2)			(24.8)	(20.3)		
<i>ETR (%)</i>	24.8	25.0	26.7			24.8	25.8		
Net Earnings	38.2	30.3	27.8	(8.2)	(27.2)	75.1	58.2	(23)	Formed 37% and 39% of our and consensus full-year estimates.
Other key data and ratios									
Gross financing	2,086.6	2,074.4	2,057.4	(0.8)	(1.4)				Receivables growth stalled due to the rising number of applications among lower credit score customers. This includes civil servants that are engaged in a rising trend of compressed financing.
Total borrowings	2,139.9	2,162.6	2,050.6	(5.2)	(4.2)				
Total assets	3,014.5	3,002.3	2,923.8	(2.6)	(3.0)				
Shareholders' funds	825.2	804.2	835.1	3.8	1.2				
ROAA (%)	5.1%	4.0%	3.8%			5.2%	4.0%		
ROAE (%)	19.0%	14.8%	13.6%			17.7%	14.2%		

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
2025F	155.5	133.9	-13.9	0.11	0.09	-13.9	0.08	0.07	-13.9
2026F	163.5	158.7	-3.0	0.11	0.11	-3.0	0.08	0.08	-3.0
2027F	170.1	165.0	-3.0	0.12	0.11	-3.0	0.09	0.08	-3.0

Note: *Post 1-for-1 bonus issue adjustment
Source: Company data, RHB

Valuation and TP

Our new TP of MYR1.25 (from MYR1.35 post-bonus issue adjustment) is based on a GGM-derived P/BV of 2.05x (from 2.15x), and includes 0% ESG premium/discount. Key changes to our model inputs include ROE (17.5%, vs 18.2% previously) and BVPS (MYR0.61, vs MYR0.62 previously (post-bonus issue adjustment)), both in line with forecast changes.

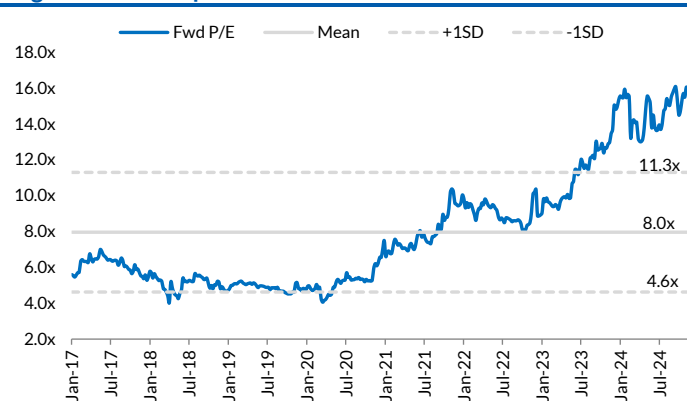
While earnings should improve in FY26, we retain our SELL call on the counter on valuation grounds – at c.2.8x P/BV (over +2SD from mean) against 16-18% ROE. We think that this counter is overvalued, especially as dividend yields of 4-5% are not extraordinary.

Figure 3: GGM valuation

Cost of equity (COE) computation:		Sustainable ROE (%)	17.5
Risk free rate (%)	4.0	COE (%)	10.3
Equity premium (%)	5.5	Long-term growth (g)	3.5
Beta (x)	1.2	Implied P/BV (x)	2.05
Cost of equity - CAPM (%)	10.3	BVPS - CY25F	MYR0.61
		Intrinsic value	MYR1.25
ESG premium/(discount) (%)	0.0	ESG premium/(discount)	MYR0.00
		TP (rounded)	MYR1.25

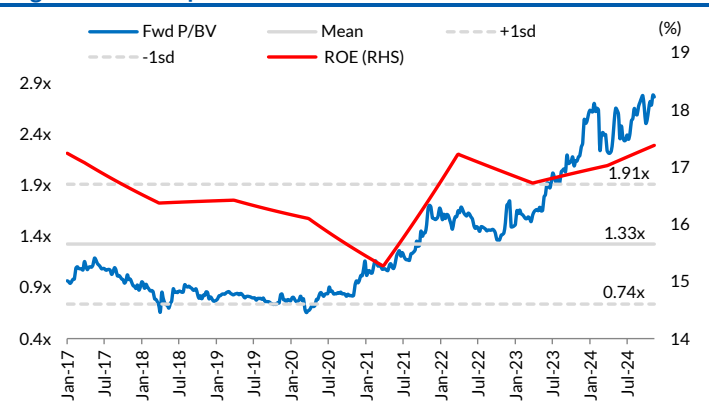
Source: Company data, RHB

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

Emissions And ESG

Trend analysis

RCE began disclosing Scope 3 emissions in its FY24 annual report. Meanwhile, Scope 1 and Scope 2 emissions declined slightly YoY as a result of its various climate change management strategies.

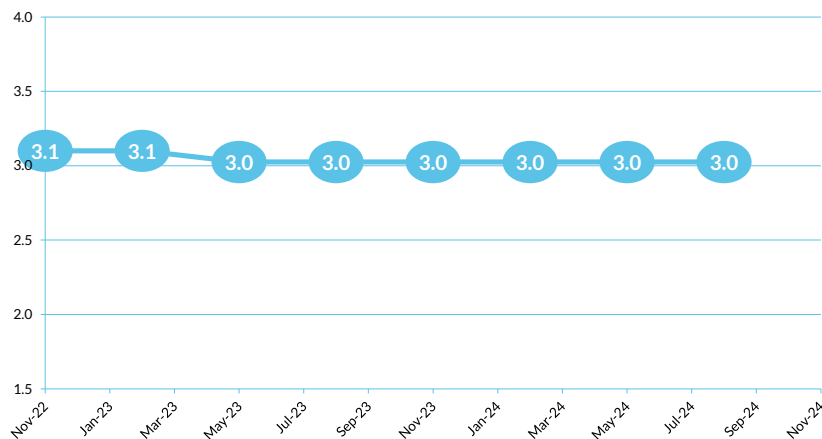
Emissions (tCO2e)	Mar-22	Mar-23	Mar-24
Scope 1	16	19	22
Scope 2	150	155	152
Scope 3	-	-	377
Total emissions	166	174	551

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 received an average of 32 training hours per employee, reflecting 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
2024-08-16	Sell	2.70	1.57
2024-05-27	Sell	2.40	1.45
2024-02-08	Sell	2.40	1.57
2024-01-12	Sell	2.30	1.55
2023-11-23	Sell	2.30	1.34
2023-08-15	Neutral	2.20	1.14
2023-05-24	Neutral	1.95	1.00
2023-02-15	Neutral	1.95	0.93
2022-11-22	Neutral	1.95	0.94
2022-08-12	Buy	1.92	0.82
2022-05-31	Buy	2.00	0.88
2022-02-25	Buy	1.90	0.85
2021-11-10	Neutral	3.90	1.01
2021-08-12	Buy	3.20	0.72
2021-05-26	Buy	3.20	0.72

Source: RHB, Bloomberg

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