08 Apr 2019

RCE Capital

Raising earnings and price target

Buy

Price
RM1.65

Target Price
RM1.95 (from RM1.85)

Market Data

Bloomberg Code	RCE MK
No. of shares (m)	341.8
Market cap (RMm)	557.1
52-week high/low (RM)	1.72 / 1.06
Avg daily turnover (RMm)	0.5
KLCI (pts)	1,645.1

Source: Bloomberg, KAF

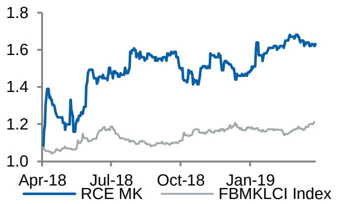
Major Shareholder (%)

Cempaka Empayar	(60.7%)
EPF	(2.9%)
Cheam Heng Ming	(1.1%)
Free Float	101.0

Source: Bloomberg, KAF

Performance

	3M	6M	12M
Absolute (%)	10.1	3.8	49.5
Rel Market (%)	11.8	13.0	65.1



Source: Bloomberg, KAF

Following a company visit, we maintain our Buy recommendation on RCE Capital (RCE) with a higher target price of RM1.95 based on our GGM valuation. We raised our earnings for FY19-20F by 3-9% to mainly reflect lower effective funding cost (from new sukuk programme – Zamarad) and lower allowance for impairment loss on receivables. Overall, these translate to higher sustainable ROE over our forecast periods of c.17% (from 16%). RCE offers decent dividend payout of 20-40%. Based on historical payout of 27%, the implied yield is c.4-5% based on current share price. RCE is trading at PBR 0.9x FY19F, below its 3-year average PBR 1.1x.

Financial Highlights

FYE Mar	2016	2017	2018	2019F	2020F
Revenue (RMm)	126.4	171.7	188.3	198.9	222.5
Core net profit (RMm)	39.6	78.9	88.7	93.7	104.8
EPS (Sen)	11.6	23.1	25.9	27.4	30.4
EPS growth (%)	9.3	99.5	12.3	5.6	10.9
DPS (Sen)	14.0	3.0	7.0	7.4	8.2
PE (x)	14.1	7.1	6.3	5.9	5.4
Div yield (%)	8.6	1.9	4.3	4.5	5.0
ROE (%)	8.7	17.9	17.1	16.9	16.6
PBV(x)	1.2	1.3	1.1	0.9	0.8

Source: Company, KAF

Lower funding cost from new sukuk programme. In Mar-19, the management has announced the establishment of a sukuk programme via Zamarad. The first issuance was in Mar-19 with total issuance of c.RM265m (total sukuk programme: RM2.0b). This issuance is collateralised by its receivables i.e., personal financing facilities extended to civil servants. The previous sukuk programme under Al Dzahab Assets (RM900m) was issued with effective yield of c.5.5%. Overall at the group level, its average funding cost was c.5.5% in FY18.

However, from the Zamarad sukuk, the expected effective yield is c.5.0%. Based on the utilisation of its previous Al Dzahab sukuk, we expect the new sukuk facilities would support its funding activities for c.5 years. Therefore, with lower effective yield, we expect its overall average funding cost to improve by 10bps every year. We estimate its funding cost to be in the range of 5.4-5.5% in FY19-20F.

Lower allowance for impairment loss on receivables. In our previous assumptions, we expect a higher impairment loss on receivables to be charged in its income statement (previous assumption: 2.3% of its receivables) following MFRS9. However, with the improvement in its receivables quality, lower impairment is required, thus creating the offsetting effect. Our new assumption for the impairment loss to be charged to its income statement is 1.9% of its receivables.

Raising earnings forecast. Overall, we raise our earnings for FY19-20F by 3-9% to mainly reflect the above-mentioned adjustments. With lower funding cost, we expect RCE's NIM to improve by 10bps in FY19F. In addition, with lower allowance for impairment loss on receivables, the amount charged to income statement had reduced by 15-18% in FY19-20F. As a result, the group's earnings were revised upward by 3-9% in FY19-20F. Overall, we arrive at net profit forecasts of RM94m for FY19F and RM104m for FY20F, implying a two-year CAGR of 8%.

Subscription to Credit Culture's private debt notes. Earlier this year, RCE announced a proposed subscription of private debt notes up to the nominal value of SGD40m (c.RM120m) from Credit Culture (CC), a Singapore-based Fintech start-up. The notes comprise 2 equal tranches of SGD20m (c.RM60m) each. The securities are collateralised by CC's customer

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loan receivables (1-to-1 ratio). In addition, RCE has the call option to subscribe for some equity stakes in the enlarged issued shares of CC.

The coupon rate for the first tranche of SGD20m (c.RM60m) is 10% per annum whilst the coupon rate for the second tranches will be determined at a later stage. As the subscription is only expected to be completed in 1QFY20F, we expect the coupon payment to only contribute c.3/4 of its annual coupon payment in FY20F.

In the event that RCE exercises its call option to acquire equity stakes in CC, we believe that this initiative would benefit RCE. This is because it may potentially lead to an amalgamation of technology in loan application processes, among others. The technology may be applicable to RCE's local money-lending business, we believe.

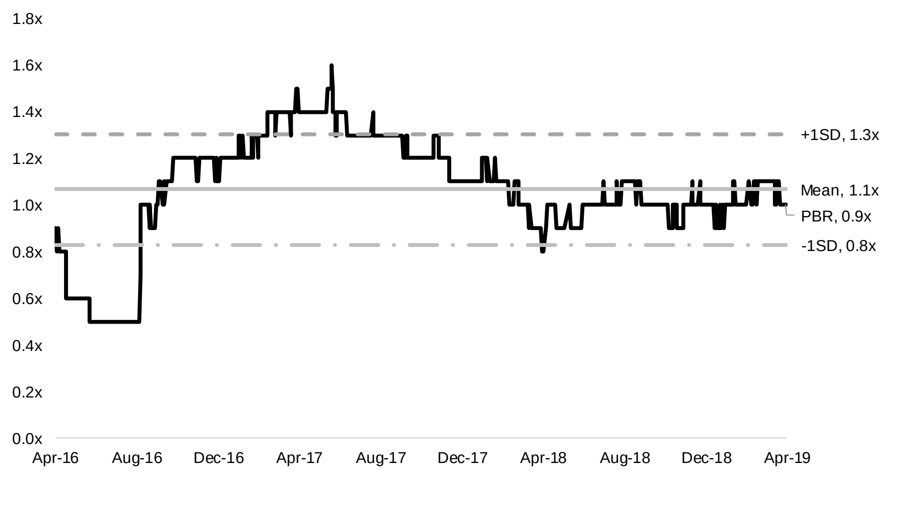
Prudent lending practices to maintain healthy asset quality. The management expects to at least maintain its asset quality by enhancing its credit scoring application, thorough portfolio review, and close monitoring of all receivables. Its stringent credit discipline is supported by a comprehensive credit scoring model. In this model, it (1) assesses and evaluates applicants' creditworthiness and (2) reviews applicants' behavioural repayment and patterns regularly to ensure they remain relevant. The management expects to at least maintain its NPL ratio at c.4.1%.

It has also consistently attained its coverage ratio above 100%. The management expects to maintain its coverage ratio in the range of 178-180%. We believe that its high coverage ratio is justified as consumer financing is unsecured in nature with no collateral. We are positive on the management's strategy, i.e. quality loans remain a guiding principle for receivables growth.

Recap on its personal financing profile. The average ticket size for its personal financing (PF) to civil servants is c.RM16k with average tenure of c.8 years. Most of its customers earn more than RM3k per month, of whom most are teachers. Almost half of its customers are in the range of 30-45 years of age. RCE's exposure towards contracted workers (civil servants) is small i.e., they only represent c.0.6% of its total receivables.

Valuation. RCE is trading at PBR 0.9x FY19F, which is below its 3-year average PBR 1.1x. Currently the banks, on average, are trading at around 1.2-1.4x PBR. We think that the valuation is attractive considering that it is trading below its 3-year average PBR and at a discount to the banks. Our TP of RM1.95 (based on GGM) implies a PBR of 1.1x. Maintain Buy.

Exhibit 1: PBR trend



Source: Bloomberg , KAF

Income Statement

FYE Mar (RMm)	2016	2017	2018	2019F	2020F
Interest Income	110.7	128.5	149.2	154.5	174.3
Interest Expense	(47.9)	(61.4)	(69.3)	(74.7)	(80.8)
Net Interest Income	110.7	128.5	149.2	154.5	174.3
Islamic banking income	0.0	0.0	0.0	0.0	0.0
Total Non-Interest Income	126.4	171.7	188.3	198.9	222.5
Total income	237.1	300.2	337.5	353.4	396.8
Overhead Expenses	(41.3)	(43.1)	(41.3)	(43.7)	(48.8)
Operating Profit	**85.1**	**128.6**	**147.0**	**155.2**	**173.7**
Loan loss provisioning	(30.9)	(27.1)	(29.6)	(31.3)	(34.0)
Impairment & others	0.0	0.0	0.0	0.0	0.0
Associates contributions	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Pretax profit	54.2	101.5	117.4	124.0	139.7
Tax	(14.6)	(22.5)	(28.7)	(30.3)	(34.9)
Minority interests	0.0	0.0	0.0	0.0	0.0
Net profit	39.6	78.9	88.7	93.7	104.8

Balance Sheet

FYE March (RM m)	2016	2017	2018	2019F	2020F
Consumer financing	1,260	1,412	1,525	1,601	1,741
Factoring and confirming	8	6	4	2	1
Deposits with financial institutiona	153	143	170	182	205
Plant and equipment	8	9	6	7	8
Investment in properties	0	0	0	0	0
Goodwill on consolidation	47	47	47	51	57
Other investments	0	0	0	0	0
AFS financial assets	0	0	0	0	0
Deferred tax assets	33	39	39	42	48
Other receivables and deposits	25	30	40	66	122
Asset held for sale	1	0	0	0	0
Cash and bank balances	15	17	28	45	63
Total Assets	**1,551**	**1,702**	**1,859**	**1,995**	**2,244**
Borrowings	1,029	1,214	1,298	1,363	1,531
Payables and accruals	44	44	33	35	40
Hire purchase	0	1	1	1	2
Deferred tax liabilities	1	1	0	0	0
Tax liabilities	19	2	6	7	8
Total Liabilities	**1,094**	**1,261**	**1,340**	**1,407**	**1,580**
Share capital	116	25	31	31	31
Redeemable convertible preference shares	0	0	0	0	0
Reserves	341	416	488	556	632
Total Shareholders' Equity	**457**	**441**	**519**	**588**	**664**
Total Liabilities & Equity	**1,551**	**1,702**	**1,859**	**1,995**	**2,244**

Source: Company, KAF

Disclosure Appendix

Recommendation structure

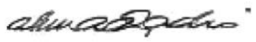
Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%.

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.

Disclaimer



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