Equity | Malaysia | Non-Bank Financials

28 May 2019

RCE Capital

A good finish

Buy

Price
RM1.63

Target Price
RM1.98 (from RM1.95)

Market Data

Bloomberg Code	RCE MK
No. of shares (m)	340.9
Market cap (RMm)	555.6
52-week high/low (RM)	1.72 / 1.30
Avg daily turnover (RMm)	0.4
KLCI (pts)	1,614.6

Source: Bloomberg, KAF

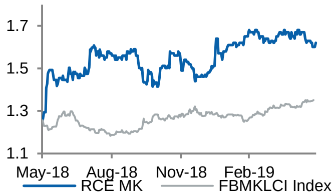
Major Shareholder (%)

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

Source: Bloomberg, KAF

Performance

	3M	6M	12M
Absolute (%)	(3.0)	3.8	22.6
Rel Market (%)	2.6	8.5	34.8



Source: Bloomberg, KAF

Analyst

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We maintain our Buy recommendation on RCE Capital (RCE) with a revised price target of RM1.98 (from RM1.95) based on a higher GGM valuation. The receivable and interest income growth target for FY20F-21F is *c*.5%. Despite a lower average lending spread, we expect this to pick up starting in FY21F on a further drawdown of its new sukuk programme with a lower effective yield of *c*.5.0%. RCE has adopted a dividend payout ratio target range of 20-40% of its net profit. Based on the FY19 payout ratio, this translates into dividend yields of 5-6% in FY20-21F. RCE is trading at a PBR 0.9x FY19F, which is below its three-year average PBR of 1.1x. We estimate that it offers a sustainable ROE of *c*.16% in FY20-21F.

Financial Highlights

FYE Mar	2017	2018	2019	2020F	2021F
Revenue (RMm)	nm	nm	nm	nm	nm
Core net profit (RMm)	78.9	88.7	95.5	98.4	106.3
EPS (Sen)	54.8	26.0	28.0	28.9	31.2
EPS growth (%)	99.5	(52.6)	7.7	3.0	8.1
DPS (Sen)	7.0	7.0	9.0	9.3	10.0
PE (x)	3.0	6.3	5.8	5.6	5.2
Div yield (%)	4.3	4.3	5.5	5.7	6.2
ROE (%)	17.6	18.5	17.3	16.0	15.4
PBV(x)	0.5	1.1	1.0	0.9	0.8

Source: Company, KAF

A good finish. RCE recorded net profit of RM96m in FY19 (101% of our forecast), +8% yoy on the back of higher operating income and a lower impairment allowance charged to its P&L. The group reported 6% yoy operating income growth in FY19, which trails 10% full-year growth in FY18. The allowance for impairment charged to the P&L was 20% lower yoy.

Contraction in lending spread. RCE's average lending yield stood at 13.1% (FY18: 13.4%) while its average funding cost was 5.4% (FY18: 5.5%). Consequently, its average lending spread stood at 7.7% (FY18: 7.9%). Despite the lower average lending spread, we expect this spread to pick up starting in FY21F on a further drawdown of its new sukuk programme with a lower effective yield of c.5.0%. All things considered, we expect its average lending spread to be in the range of 7.5-7.7% in FY20-21F.

Lower funding cost from new sukuk programme. In March 2019, management announced the establishment of a sukuk programme via Zamarad. The first issuance was in March, 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 an effective yield of c.5.5%. Overall, at the group level, its average funding cost was c.5.5% in FY18.

However, for 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 to support its funding activities for c.5 years. Therefore, with the 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 expected a higher impairment loss on receivables to be charged in its income statement (previous assumption: 1.9% of its receivables) as per FY18. However, in FY19, only c.1.5% of receivables were charged to the P&L. Following the latest trend, our new assumption for the impairment loss to be charged to its income statement is 1.5% of its receivables.

Uptick in NPL but coverage ratio remains high. RCE's NPL ratio stood at 4.4%, an uptick from 4.1% in FY18 as gross receivables grew c.1% yoy while its NPLs grew c.6% yoy. Despite the higher NPL ratio, RCE's coverage ratio remains high, at 172%. We believe this is justified as consumer financing is unsecured.

Higher dividend payout. A dividend per share (DPS) of 5.0 sen was declared in 4Q18. The total DPS for FY18 is 9.0 sen, making up 32% of the dividend payout. This was above our DPS estimate for FY18, i.e. 7.0 sen as we assumed a lower payout of 27% in FY19. We estimate DPS to be 9.3 sen for FY20F. Our estimate is based on the same payout ratio as FY19, i.e., 32% payout.

Valuation. RCE is trading at PBR 0.9x FY19F, which is below its 3-year average PBR 1.1x. Currently the banks are, on average, trading at around 1.2-1.4x PBR. We think the valuation is attractive considering that it is trading below its 3-year average PBR and at a discount to the banks. Our PT of RM1.98 (based on GGM) implies a PBR of 1.1x. Maintain Buy.

Table 1: Quarterly trends

Year to 31 March	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	% chg		Cumulative			KAF	
RM m	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19	qoq	yoy	2018	2019	% chg	2019F	2019/F
Interest and fee income	64	63	63	65	67	67	1%	7%	246	263	7%	261	100%
Interest expense	(17)	(18)	(19)	(19)	(20)	-20	0%	12%	-69	-78	13%	-74	106%
Net interest and fee income	**47**	**45**	**45**	**46**	**47**	**47**	**1%**	**4%**	**177**	**185**	**5%**	**188**	**98%**
Non-interest income	2	3	4	4	4	4	-6%	27%	12	15	32%	12	126%
Operating income	**49**	**48**	**48**	**49**	**51**	**51**	**0%**	**6%**	**188**	**200**	**6%**	**200**	**100%**
Operating expenses	(10)	(11)	(11)	(11)	(12)	-12	1%	11%	-41	-45	9%	-44	103%
Underlying profit	**38**	**38**	**37**	**39**	**39**	**39**	**0%**	**4%**	**147**	**155**	**5%**	**156**	**99%**
Provisions	(8)	(8)	(6)	(7)	(4)	-6	60%	-20%	-30	-24	-20%	-31	76%
Exceptionals	0	0	0	0	0	0	nm	nm	0	0	na	na	na
Pre-tax profit	**30**	**30**	**31**	**31**	**35**	**33**	**-6%**	**11%**	**117**	**131**	**12%**	**125**	**105%**
Taxation	(7)	(7)	(8)	(8)	(10)	-10	-8%	35%	-29	-36	24%	-31	116%
Net profit	**23**	**23**	**23**	**23**	**25**	**24**	**-6%**	**10%**	**89**	**96**	**8%**	**94**	**101%**

Source: Company, KAF

Income Statement

FYE Mar (RMm)	2017	2018	2019	2020F	2021F
Net interest income	128.5	149.2	156.2	160.7	172.7
Non-interest income	43.2	39.1	43.8	46.0	48.3
Total income	**171.7**	**188.3**	**200.0**	**206.6**	**221.0**
Operating costs	(43.1)	(41.3)	(45.2)	(46.7)	(50.0)
Pre-prov operating profit	128.6	147.0	154.8	159.9	171.0
Provision charges	(27.1)	(29.5)	(23.7)	(24.9)	(26.1)
Pre-tax profit	**101.5**	**117.4**	**131.0**	**135.0**	**145.9**
Taxation	(22.5)	(28.7)	(35.6)	(36.6)	(39.6)
Net Profit	**79.0**	**88.7**	**95.5**	**98.4**	**106.3**

Balance Sheet

FYE Dec (RM m)	2017	2018	2019	2020F	2021F
Consumer financing	1,412	1,525	1,599	1,679	1,763
Factoring and confirming	6	4	4	4	3
Deposits with financial institutions	143	170	276	287	302
Plant and equipment	9	6	5	5	5
Goodwill on consolidation	47	47	47	49	52
Other investments	0	0	0	0	0
Deferred tax assets	39	39	42	44	46
Other receivables and deposits	30	40	38	199	196
Asset held for sale	0	0	0	0	0
Cash and bank balances	17	28	217	52	71
Total Assets	**1,702**	**1,859**	**2,226**	**2,317**	**2,437**
Borrowings	1,214	1,298	1,605	1,628	1,674
Payables and accruals	44	33	26	27	29
Hire purchase	1	1	1	1	1
Deferred tax liabilities	1	0	0	0	0
Tax liabilities	2	6	10	10	10
Total Liabilities	**1,261**	**1,340**	**1,642**	**1,667**	**1,715**
Share capital	25	31	135	135	135
Redeemable convertible preference shares	0	0	0	0	0
Reserves	416	488	449	516	588
Total Shareholders' Equity	**441**	**519**	**584**	**651**	**723**
Total Liabilities & Equity	**1,702**	**1,859**	**2,226**	**2,317**	**2,437**

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.

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