

RCE Capital Bhd (RCE MK)

External headwinds

Downgrade to HOLD

While we remain positive on RCE's medium-term potential, Malaysia's potential removal from FTSE Russell's World Government Bond Index (WGBI) could weigh on near term sentiment. With this uncertainty, we downgrade RCE to HOLD with a lower TP of MYR1.80 (-20sen) on a lower FY20 PBV peg of 1x (1.1x previously). Yields of 4.8% provide support.

Funding structure has been improving

RCE relies primarily on debt to support its lending activities and to date, its net gearing ratio is comfortable at 2.0x. The shift to longer-dated Islamic bonds began with the issuance of Al-Dzahab Sukuk in March 2016 and the strength of RCE's pool of receivables is reflected in RAM's upgrade of all five tranches from AA3 initially to AA1-AAA. From FY20 onwards, the company has MYR2b worth of ABS Sukuk (Zamarad) in the pipeline. The first tranche of MYR265m was issued in March 2019 at a more attractive rate of 4.96% vs. an average 5.51% for Al-Dzahab, and this will ensure that funding costs are lowered. Moreover, it will ensure that RCE's pool of stable long-term funding increases over time, from 54% of total debt as at end-2018.

Risk of higher funding costs

An immediate uncertainty is that there are external headwinds in the form of Malaysia's potential removal from FTSE Russell's flagship World Government Bond Index (WGBI). Maybank's Fixed Income team estimates a potential outflow risk of about USD6b-8b (ie MYR24b-33b), which could depress prices and cause a spike in bond yields by 30-40bps [\[link\]](#). The impact of this is not expected to be large - just 2-3% on RCE's FY20 earnings, but at this stage, our downgrade is premised mainly on potential market volatility in the near future from this uncertainty.

Loan growth expected to hold up

RCE's share of the Government civil servant financing market has gradually improved over time, but remains below 2%, by our estimates. With some of RCE's competitors having scaled back on this business, there is room for further market share gains we believe, and we maintain our loan growth estimate of 5% in FY20-21E respectively.

FYE Mar (MYR m)	FY17A	FY18A	FY19E	FY20E	FY21E
Operating income	167	188	201	215	230
Pre-provision profit	124	147	158	170	182
Core net profit	74	89	95	101	106
Core EPS (MYR)	0.24	0.26	0.28	0.29	0.31
Core EPS growth (%)	94.0	8.8	7.3	5.3	5.3
Net DPS (MYR)	0.03	0.07	0.08	0.08	0.08
Core P/E (x)	7.4	4.7	5.9	5.6	5.4
P/BV (x)	1.5	0.8	1.0	0.9	0.8
Net dividend yield (%)	1.7	5.7	4.8	4.8	4.8
Book value (MYR)	1.16	1.46	1.61	1.81	2.03
ROAE (%)	16.4	18.5	17.5	16.5	15.5
ROAA (%)	4.5	5.0	5.0	5.0	4.9
Consensus net profit	-	-	95	103	106
MKE vs. Consensus (%)	-	-	0.9	(2.1)	(0.0)

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HOLD

[Prior:BUY]

Share Price MYR 1.66
 12m Price Target MYR 1.80 (+8%)
 Previous Price Target MYR 2.00

Company Description

RCE Capital is principally involved in the provision of general loan financing services.

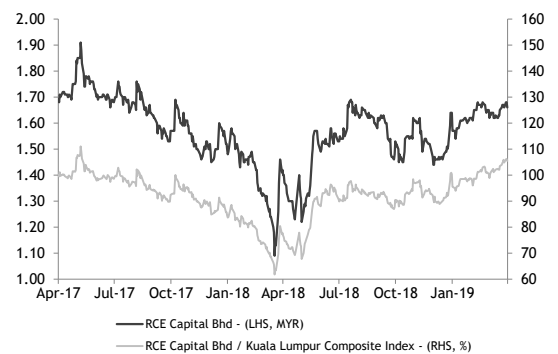
Statistics

52w high/low (MYR) 1.69/1.22
 3m avg turnover (USDm) 0.1
 Free float (%) 27.6
 Issued shares (m) 361
 Market capitalisation MYR599.5M
 USD145M

Major shareholders:

Cempaka Empayar Sdn. Bhd. 57.6%
 RCE Capital Bhd. 5.2%
 Employees Provident Fund 2.8%

Price Performance



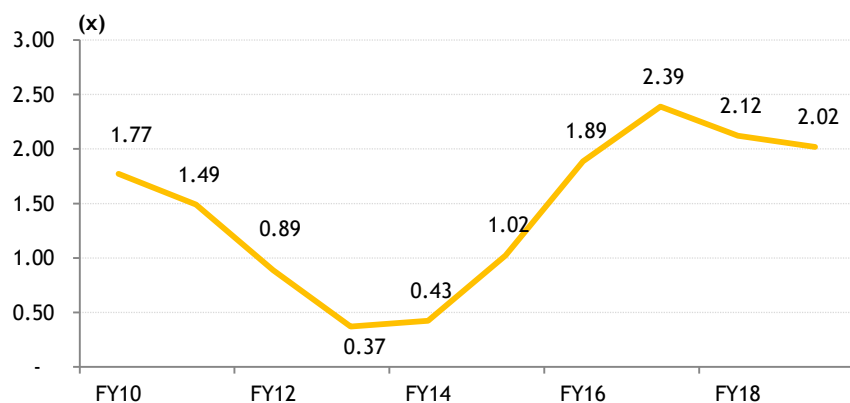
	-1M	-3M	-12M
Absolute (%)	1	1	17
Relative to index (%)	4	5	35

Source: FactSet

Funding cost has been declining

Without access to customer deposits, RCE relies primarily on debt to support its lending activities and debt totaled MYR1.4b end-2018, with a stable net gearing ratio of 2.0x, which is comfortable relative to 4x for AEON Credit.

Net gearing ratio (FY10-Dec 2018)



Source: Company, MKE

To management's credit, funding cost has dropped over time, with the pricing for some of its borrowings declining from up to 8.6% in FY05 to 5.5% in FY18.

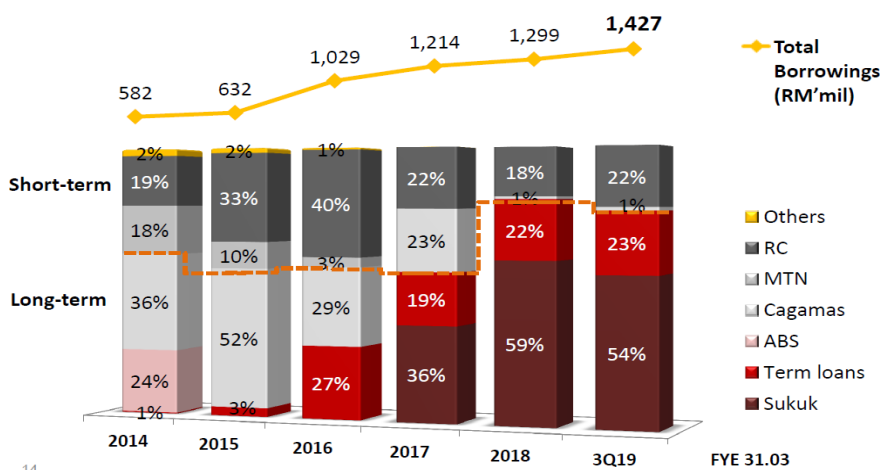
Debt funding trends and cost (FY14-Dec 2018)

2004	2005	2007	2010	2014	2015	2016	2017	2018	
1. RCE Premier		2. RCE Advance		3. Tresor Assets		4. Al Dzahab Assets		5. Zamarad Assets Berhad	
RM95 mil CPs/Bonds		RM420 mil MTNs		RM1.5 bil ABS		RM900 mil SUKUK		Up to RM2 bil ABS SUKUK	
MARC: A		MARC: A+		RAM: AAA		RAM: AAA & AA1		JLAs: AIBB, CIMB, HLIB RAM: AAA & AA2	
October 2004		December 2005		November 2007		March 2016		1st Issuance March 2019	
Fully Redeemed October 2010		Fully Redeemed March 2017		Early Redeemed September 2014		Fully Issued March 2018		4.96% (Tentative)	
6.31% - 8.56%		7.84%		6.94%		5.51%			

Source: Company

The shift to longer-dated bonds began with the issuance of Al-Dzahab Sukuk in March 2016 and all MYR900m was fully issued by March 2018, at an average profit rate of 5.51%. The strength of the issuance was reflected in Rating Agency Malaysia's (RAM) upgrade of all five tranches from AA3 initially to AA1-AAA, indicative of the quality strength of RCE's pool of receivables and its high safety for payment of financial obligations.

Composition of debt funding (FY14-Dec 2018)



Source: Company, MKE

From FY20 onwards, the company has another Sukuk programme in place - with MYR2b worth of ABS Sukuk (Zamarad) to be issued. The first tranche of MYR265m was issued in March 2019 at a more attractive rate of 4.96%, which will ensure that funding costs are lowered. Moreover, it will ensure that RCE's pool of stable long-term funding increases over time, from 54% of total debt as at end-2018.

Malaysia's potential removal from WGBI is, however, a concern

An immediate concern, however, is that there are external headwinds in the form of Malaysia's potential removal from FTSE Russell's flagship World Government Bond Index (WGBI). Maybank Investment Bank's Fixed Income team estimates a potential outflow risk of USD6b-8b (ie MYR24b-33b). Malaysia carried a 0.39% weight on the WGBI as of end-Mar 2019. The final inclusion/exclusion decision may come following the annual review in September 2019. The risk therefore is of potential foreign outflows from the bond market, which could depress prices and cause a spike in bond yields.

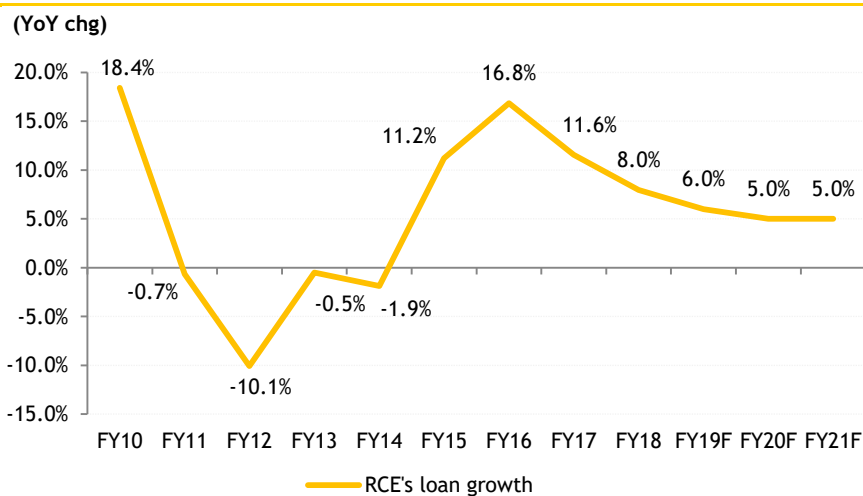
By our estimates, a 30-40bps spike in bond yields, as estimated by the Fixed Income team, would negatively impact RCE's earnings by about 2-3%.

Gaining market share, but still a small player

Just to recap RCE's loan growth trends, RCE's loan growth plunged into negative territory in FY11-FY13 from +18% in FY10, when KOWAJA, RCE's largest borrower back then, announced that it had to momentarily cease the disbursement of loans from 1 Dec 2010, pending a complete endorsement from Suruhanjaya Koperasi Malaysia (SKM), that it was in full compliance with SKM's guidelines. In FY14, RCE's loan growth remained in negative territory when Bank Negara, in July 2013, restricted the tenure on personal financing to 10 years when prior to that, RCE and other lenders in the market, were offering up to 25-year personal loans.

Having cleaned up its books by then, however, growth resumed in FY15 and hit a peak of 16.8% YoY in FY16. Loan growth has been moderating since then, and averaged just about 6.4% as at end-Dec 2018. We forecast moderate loan growth of 5% per annum over the next two years (FY20-21E).

RCE's loan growth (FY10-FY21F)



Source: Company, BNM, MKE

A point to note, however, is that if we look at the bigger picture, RCE would appear to be gaining market share from a very low base. The biggest players in the Government Civil Servant (GCS) financing space would be the likes of Bank Rakyat, Bank Simpanan Nasional (BSN), MBSB and Bank Islam. As the table below would indicate, MBSB's personal financing (PF) portfolio has been contracting for several years now, as has BSN's (in 2016-2017, 2018 data not available). Meanwhile, Bank Rakyat's personal financing portfolio up to June 2018 contracted 2% YoY. Bank Islam, on the other hand, has stepped up its PF, in order to buffer against declining margins.

RCE remains a very small player in the GCS financing space but positively, the scaling back of operations by the bigger players has allowed RCE's market share to expand from 1.2% in 2014 to 1.6% in 2017 and about 1.7% in 2018, by our estimate.

RCE had about 78,000 customers as at end-2018. Assuming 1.6m civil servants in the workforce, this would simplistically imply that about 1-in-20 civil servants are currently RCE's customers.

Loan growth for RCE versus peers (2014-2018)

(MYR m)	RCE	Bk Rakyat	MBSB	Bk Islam#	BSN	Total	RCE as % of total
2014	1,168	50,551	23,395	9,606	11,115	95,835	1.2%
2015	1,365	52,974	23,160	10,330	11,394	99,222	1.4%
2016	1,522	55,652	22,822	11,240	10,984	102,221	1.5%
2017	1,643	55,992	21,418	12,368	10,522	101,943	1.6%
2018	1,742	na	20,579	13,766	na	na	
YoY chg (%)							
2015	17%	5%	(1%)	8%	3%	4%	
2016	12%	5%	(1%)	9%	(4%)	3%	
2017	8%	1%	(6%)	10%	(4%)	(0%)	
2018	6%	(2%)^	(4%)	11%	na	na	

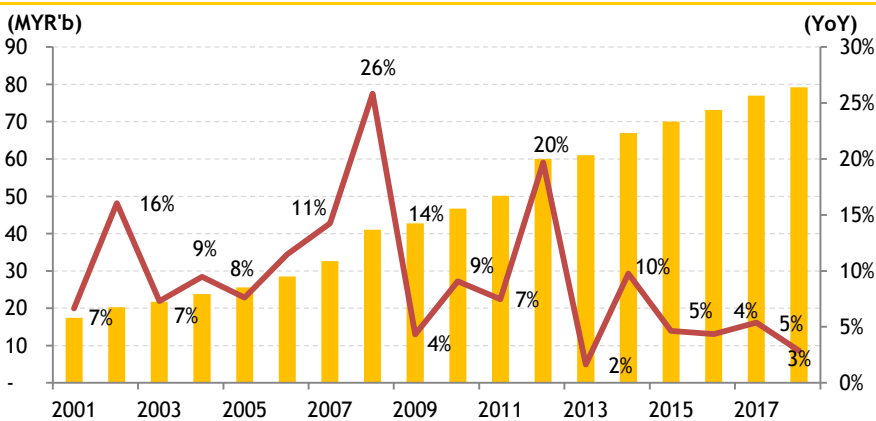
Source: Companies ^ YoY change June 2017-June 2018
Includes personal loans to GLCs and individuals as well

What is to drive growth?

As noted on the previous page, we estimate RCE’s loan growth to be 5% p.a. in FY20-21E and this, we believe, will be driven predominantly by market share gains, as RCE’s competitors scale back. One of RCE’s primary advantages over its peers is the speed of its loan disbursement which can average 48 hours, which is one of the fastest. Moreover, unlike the banks, RCE employs marketing representatives who could reach out to customers even after office hours.

As it stands, the civil service is unlikely to expand in size in the near future, given that the new Government’s priority is in managing costs. That said, emoluments are still expected to expand, though probably at a more moderate pace than before. We estimate Government emoluments to have expanded by 3% in 2018E.

Federal Government emoluments growth (2001-2018E)

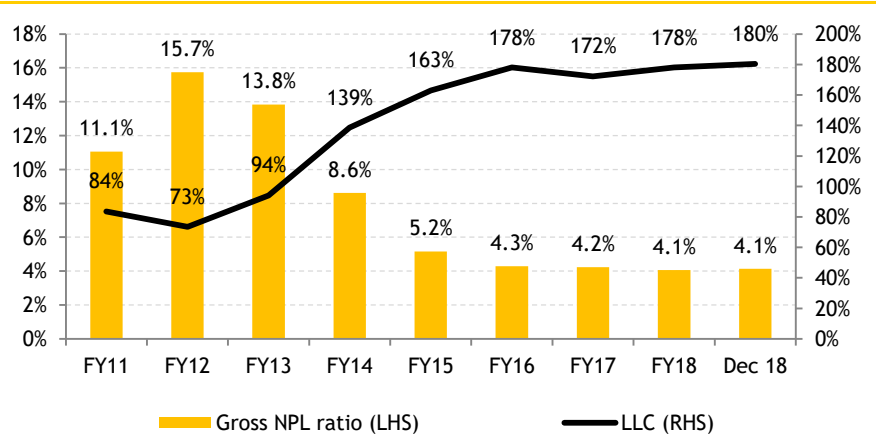


Source: BNM, MKE

Stable asset quality, high provision levels

Asset quality remains very stable, averaging just over 4% over the past four years. Provisioning policies are prudent and total loan loss coverage currently averages 180%, which is conservative, in our view.

Asset quality and provisioning levels (FY11-Dec 2018)

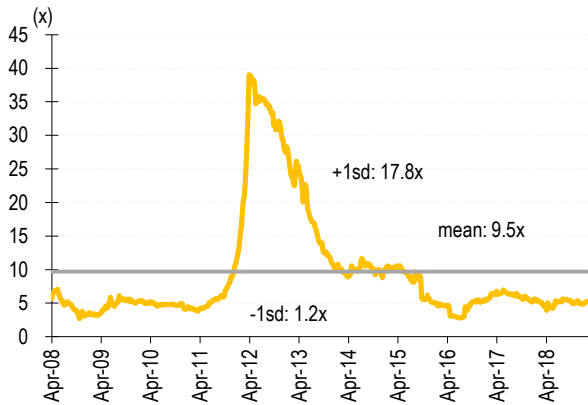


Source: Company

Risk statement

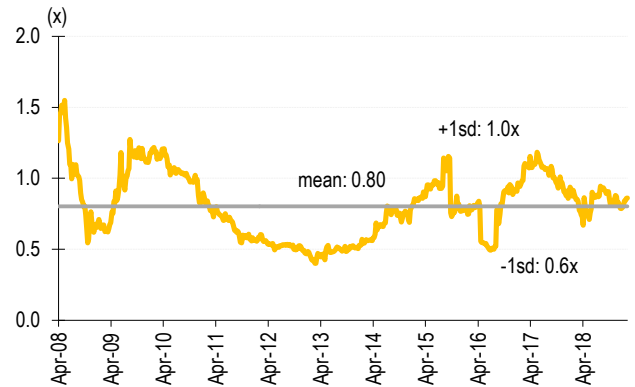
There are several risk factors for our earnings estimates, price target, and rating for RCE. Lending solely to Government civil servants, any move by the Government to curb/reduce the size of the civil service would curtail RCE's business. RCE does not have access to CCRIS just yet and thus would not be able to comprehensively assess a borrower's outstanding debt position with domestic commercial banks.

RCE: One-year forward rolling PER (x)



Source: Company, Maybank KE

RCE: One-year forward rolling P/BV



Source: Company, Maybank KE

FYE 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
Key Metrics					
Core P/E (x)	7.4	4.7	5.9	5.6	5.4
Core FD P/E (x)	7.4	4.7	5.9	5.6	5.4
P/BV (x)	1.5	0.8	1.0	0.9	0.8
P/NTA (x)	1.7	0.9	1.1	1.0	0.9
Net dividend yield (%)	1.7	5.7	4.8	4.8	4.8
INCOME STATEMENT (MYR m)					
Interest income	190.0	218.5	232.4	252.2	268.0
Interest expense	(61.4)	(69.3)	(78.5)	(87.8)	(92.1)
Net interest income	128.5	149.2	153.9	164.3	175.9
Islamic banking income	na	na	na	na	na
Total non-interest income	38.1	39.1	47.1	50.7	53.7
Operating income	166.7	188.3	201.1	215.0	229.7
Staff costs	(21.4)	(22.3)	(23.2)	(24.1)	(25.0)
Other operating expenses	(21.7)	(19.1)	(20.1)	(21.2)	(22.1)
Operating expenses	(43.1)	(41.3)	(43.3)	(45.2)	(47.2)
Pre-provision profit	123.6	147.0	157.8	169.8	182.5
Loan impairment allowances	(22.1)	(29.6)	(32.2)	(37.5)	(43.1)
Pretax profit	101.5	117.4	125.6	132.3	139.3
Income tax	(22.5)	(28.7)	(30.2)	(31.8)	(33.4)
Reported net profit	78.9	88.7	95.5	100.6	105.9
Core net profit	73.7	88.7	95.5	100.6	105.9
BALANCE SHEET (MYR m)					
Cash & deposits with banks	159.3	197.2	197.5	252.6	313.1
Available-for-sale securities	0.0	0.0	0.0	0.0	0.0
Loans & advances	1,411.6	1,524.7	1,614.0	1,693.7	1,776.5
Fixed assets	9.3	6.2	5.2	4.2	3.2
Intangible assets	47.3	47.3	47.3	47.3	47.3
Other assets	74.6	83.3	92.7	98.2	104.2
Total assets	1,702.1	1,858.8	1,956.7	2,096.1	2,244.3
Other liabilities	1,260.7	1,339.5	1,383.5	1,450.9	1,521.6
Total liabilities	1,260.7	1,339.5	1,383.5	1,450.9	1,521.6
Share capital	38.1	44.7	35.6	35.6	35.6
Reserves	403.3	474.6	537.6	609.6	687.1
Shareholders' funds	441.4	519.3	573.2	645.2	722.7
Preference shares	0.0	0.0	0.0	0.0	0.0
Minority interest	0.0	0.0	0.0	0.0	0.0
Total equity	441.4	519.3	573.2	645.2	722.7
Total liabilities & equity	1,702.1	1,858.8	1,956.7	2,096.1	2,244.3

FYE 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
Key Ratios					
Growth (%)					
Net interest income	16.1	16.1	3.2	6.7	7.0
Non-interest income	275.7	2.4	20.6	7.6	6.0
Operating expenses	4.2	(4.0)	4.7	4.5	4.3
Pre-provision profit	55.4	18.9	7.4	7.6	7.5
Core net profit	86.2	20.4	7.7	5.3	5.3
Gross loans	11.6	8.0	6.0	5.0	5.0
Customer deposits	na	na	na	na	na
Total assets	9.8	9.2	5.3	7.1	7.1
Profitability (%)					
Non-int. income/Total income	22.9	20.7	23.4	23.6	23.4
Cost/income	25.8	22.0	21.5	21.0	20.5
Liquidity (%)					
Loans/customer deposits	na	na	na	na	na
Asset quality (%)					
Gross NPL	4.2	4.1	4.2	4.2	4.3
Loan loss coverage	172.2	178.0	177.1	176.2	174.4
Capital adequacy (%)					
CET1	na	na	na	na	na
Tier 1 capital	na	na	na	na	na
Risk-weighted capital	na	na	na	na	na
Returns (%)					
ROAE	16.4	18.5	17.5	16.5	15.5
ROAA	4.5	5.0	5.0	5.0	4.9
Shareholders equity/assets	25.9	27.9	29.3	30.8	32.2

Source: Company; Maybank

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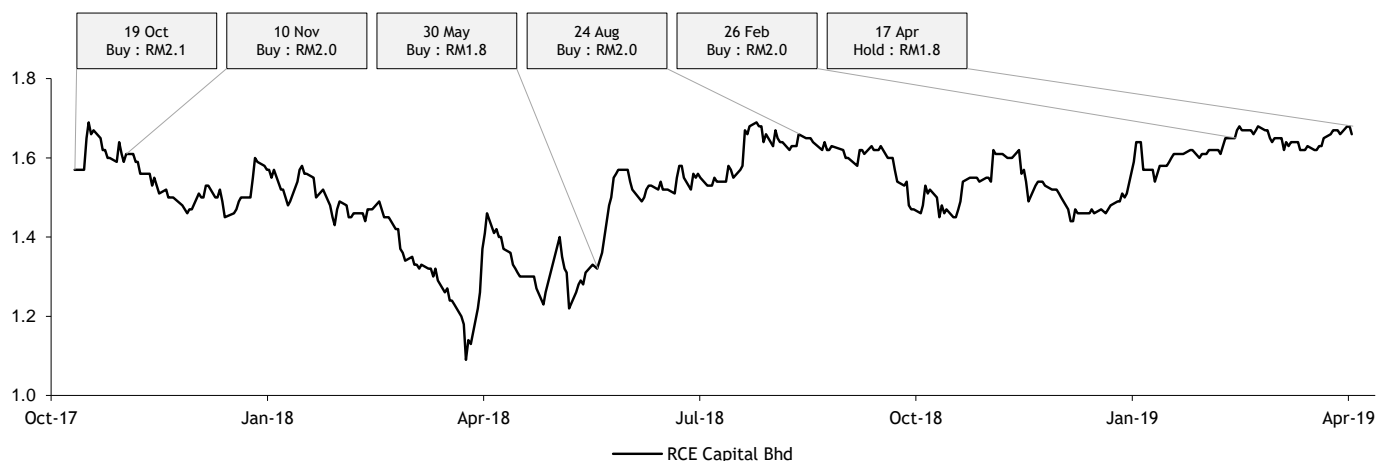
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