Maybank IB Research

RCE Capital Bhd (RCE MK)

Still room to grow

Very decent valuations

With the stock trading at a FYE3/19E PER of just 6x and a PBV of 0.9x (ROE: 16.8%), valuations are undemanding for RCE, especially since dividend yields are also a decent 4.5%. There is still room for growth since RCE commands a market share of just about 1.5% of the civil servant financing market. We maintain our BUY call with an unchanged TP of MYR1.76, pegged to a CY19 P/BV of 1x.

Still much room for growth

Based on our estimates, with a loan receivables book of just MYR1.5b, RCE's market share of the civil servant financing market is just about 1.5% and with 75k borrowers in its portfolio, this accounts for just about 5% of the civil servant workforce. Even if the size of the civil service is capped, there is still room for growth we believe, especially since some of the lenders have scaled back on such activity. We project more moderate loan growth of 6-7% p.a. over the next three years for RCE.

Asset quality improving, minimal MFRS9 impact

RCE's asset quality has been improving, with its gross NPL ratio trending down from as high as 11% back in FY11 to just 4.1% end-Mar 2018. It sets aside about 3% of collective allowances per annum, and as a result, its loan loss coverage (LLC) is very comfortable at 178%, which compares against an average of 115% (including regulatory reserves) for its commercial banking peers. Meanwhile, the estimated impact of MFRS9 to RCE's retained earnings is just MYR6.2m (-1.6%). Credit costs are expected to come in marginally higher than the 187bps in FY18 and we have already factored in a higher credit cost of 210bps in FY19.

Funding profile has improved

Today, sukuk accounts for 59% of the group's total funding, which is positive, because it allows RCE to lock in a substantial part of its funding at fixed rates over the longer term. With a net gearing ratio of 2.2x, there is still much room to leverage up.

| FYE Mar (MYR m) | FY17A | FY18A | FY19E | FY20E | FY21E |
|------------------------|-------|-------|-------|-------|-------|
| Operating income | 167 | 188 | 202 | 214 | 226 |
| Pre-provision profit | 124 | 147 | 157 | 167 | 177 |
| Core net profit | 74 | 89 | 92 | 95 | 98 |
| Core EPS (MYR) | 0.24 | 0.26 | 0.26 | 0.27 | 0.28 |
| Core EPS growth (%) | 94.0 | 8.8 | (0.6) | 3.2 | 3.4 |
| Net DPS (MYR) | 0.03 | 0.07 | 0.07 | 0.07 | 0.07 |
| Core P/E (x) | 4.8 | 6.2 | 5.9 | 5.7 | 5.5 |
| P/BV (x) | 1.0 | 1.1 | 0.9 | 0.8 | 0.8 |
| Net dividend yield (%) | 2.6 | 4.4 | 4.6 | 4.6 | 4.6 |
| Book value (MYR) | 1.16 | 1.46 | 1.62 | 1.82 | 2.02 |
| ROAE (%) | 16.4 | 18.5 | 16.8 | 15.5 | 14.4 |
| ROAA (%) | 4.5 | 5.0 | 4.8 | 4.6 | 4.5 |
| Consensus net profit | - | - | 91 | 95 | 98 |
| MKE vs. Consensus (%) | - | - | 0.8 | 0.0 | (0.0) |

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BUY

Share Price MYR 1.52

12m Price Target MYR 1.76 (+16%)

Previous Price Target MYR 1.76

Company Description

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

Statistics

| 52w high/low (MYR) | 1.76/1.09 |
|------------------------|-----------|
| 3m avg turnover (USDm) | 0.2 |
| Free float (%) | 28.7 |
| Issued shares (m) | 356 |
| Market capitalisation | MYR541.1M |
| | USD135M |

58.3%

3.9%

1.6%

Major shareholders: Cempaka Empayar Sdn. Bhd. RCE Capital Bhd.

Bank Negara Malaysia Price Performance



 -1M
 -3M
 -12M

 Absolute (%)
 16
 18
 (11)

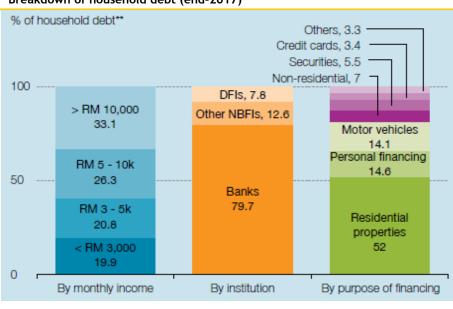
 Relative to index (%)
 23
 30
 (6)

Source: FactSet

RCE commands just 1.5% market share

According to BNM's 2017 Financial Stability and Payment Systems Report, personal financing accounted for 14.6% of the total household debt as at end-2017. This essentially implies that as at end-Dec 2017, personal financing (PF) amounted to about MYR167b of the total household debt of MYR1,140b.

Breakdown of household debt (end-2017)



Source: BNM

Of the MYR167b PF market, Bank Rakyat commands an estimate 38% market share, by our estimates. Commercial banks, ex-Bank Islam, make up another 34%, with Bank Islam and Bank Simpanan Nasional (BSN) accounting for 7% and 6% respectively. With an outstanding receivables book of MYR1.6b, RCE's market share is just 1%.

Of the players below, the largest lenders to the government civil service would be Bank Rakyat, MBSB and BSN, while the commercial banks are not large players in this space. Bank Islam lends primarily to government civil servants, but its portfolio comprises financing to employees of government-linked companies and members of the public as well. If we were to strip out the commercial banks from the equation, RCE's exposure to government civil servant financing would be just about 1.5%.

Breakdown of personal financing by lender (end-2017)

| | . , , | |
|------------------------------|---------|------------|
| | MYR'm | % of total |
| Bank Rakyat | 63,307 | 37.9% |
| Commercial banks ex-Bk Islam | 56,996 | 34.1% |
| MBSB | 22,506 | 13.5% |
| Bank Islam | 12,368 | 7.4% |
| Bank Simpanan Nasional | 10,295 | 6.2% |
| RCE Capital | 1,613 | 1.0% |
| Total | 167,086 | 100.0% |

Source: Companies, BNM, MKE

Accounts for about 5% of civil servant workforce

Based on public reports, there are approximately 1.6 million civil servants in Malaysia. As at end-Mar 2018, RCE had 75k borrowers in its portfolio, which essentially implies an estimated 5% of the workforce.

Against outstanding receivables of MYR1.6b, this works out to be about MYR22k per borrower, and this amount has held steady over the past three years.

Breakdown of household debt (end-2017)

| | FY13 | FY14 | FY15 | FY16 | FY17 | FY18 |
|----------------------------|--------|--------|--------|--------|--------|--------|
| No. of borrowers ('000) | 38 | 41 | 48 | 60 | 68 | 75 |
| O/s receivables (MYR'm) | 1,070 | 1,050 | 1,168 | 1,365 | 1,522 | 1,643 |
| Receivables/borrower (MYR) | 28,158 | 25,610 | 24,333 | 22,750 | 22,382 | 21,907 |

Source: Company, MKE

There is therefore room to grow, at a moderate pace

As it stands, lending to civil servants has been slowing, especially since lenders have been encouraged to adhere more strictly to a debt service ratio of 60%. RCE's loan book expanded at a more moderate pace of 8% in FY18, from 12% in FY17, and we forecast more moderate growth of 7% in FY19 and 6% in FY20.

We are acutely aware that civil servant workforce could stagnate, if not shrink, under the current Government. Nevertheless, as we have illustrated above, RCE is still a small player in the civil servant financing space. There is market share to be gained, especially since players such as MBSB have turned less active in this space. That loan growth is now more controlled is also because RCE adheres strictly to a debt service ratio of 60% and is thus more selective in its lending criteria.

We highlight once again that RCE still **DOES NOT** have access to BNM's Central Credit Reference Information System (CCRIS) as yet, and therefore may not have the entire credit profile of a borrower.

RCE's loan growth (FY10-FY21F)

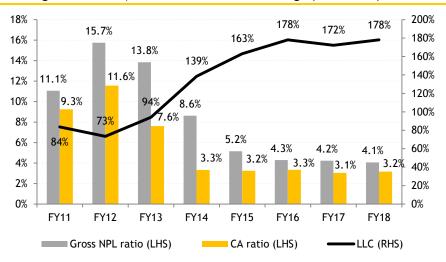


Source: Company, MKE

Asset quality improving, comfortable coverage

RCE's asset quality has been improving, with its gross NPL ratio trending down from as high as 11% back in FY11 to just 4.1% end-Mar 2018. It sets aside about 3% of collective allowances per annum, which is higher than the current BNM minimum requirement of 1% (of loans and undrawn facilities) for commercial banks. As a result, its loan loss coverage (LLC) is very comfortable at 178%, which compares against an average of 115% (including regulatory reserves) for its commercial banking peers.

RCE's gross NPL ratio, CA ratio and loan loss coverage (FY11-FY18)

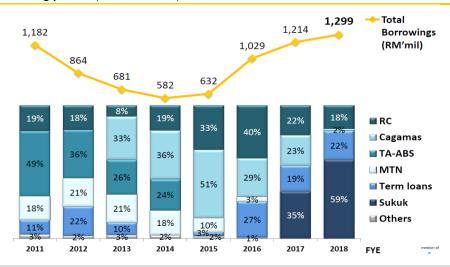


Source: Company, MKE

Funding profile has improved

RCE's funding profile had typically been short-term in the past, but this has changed over time with the issuance of Al Dzahab sukuk over the past two years. Since June 2016, management has issued five tranches of sukuk to the tune of MYR900m. Today, the sukuk accounts for 59% of the group's total funding, which is positive, because it allows the group to lock in a substantial part of its funding at fixed rates (average 5.5%) over the longer term. With a net gearing ratio of 2.2x, there is still much room to leverage up.

Funding profile (end-Mar 2018)



Source: Company, MKE

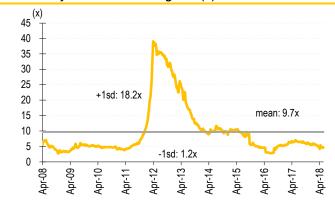
Minimal impact from MFRS9

MFRS9 kicked into effect from 1 Apr 2018 and indications are that there is minimal impact to the group. The impact to RCE's retained earnings is just MYR6.2m (-1.6%). Credit costs are expected to come in marginally higher than the 187bps in FY18 and we have already factored in such a possibility, with an assumed credit cost of 210bps in FY19.

Decent dividend yields

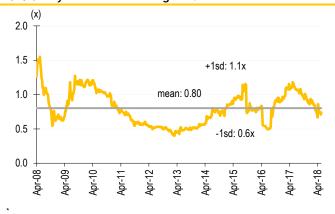
RCE raised its dividend per share payment in FY18 to 7sen from 3sen in FY17, which is a major positive. This represents a payout ratio of about 27%, which is sustainable in our view.

RCE: One-year forward rolling PER (x)



Source: Company, Maybank KE

RCE: One-year forward rolling P/BV



Source: Company, Maybank KE

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| FYE 31 Mar | FY17A | FY18A | FY19E | FY20E | FY21E |
|-------------------------------|---------|---------|---------|---------|---------|
| Key Metrics | | | | | |
| Core P/E (x) | 4.8 | 6.2 | 5.9 | 5.7 | 5.5 |
| Core FD P/E (x) | 4.8 | 6.2 | 5.9 | 5.7 | 5.5 |
| P/BV (x) | 1.0 | 1.1 | 0.9 | 0.8 | 0.8 |
| P/NTA (x) | 1.1 | 1.2 | 1.0 | 0.9 | 0.8 |
| Net dividend yield (%) | 2.6 | 4.4 | 4.6 | 4.6 | 4.6 |
| INCOME STATEMENT (MYR m) | | | | | |
| Interest income | 190.0 | 218.5 | 233.5 | 252.1 | 267.1 |
| Interest expense | (61.4) | (69.3) | (78.9) | (89.1) | (94.3) |
| Net interest income | 128.5 | 149.2 | 154.6 | 163.1 | 172.8 |
| Islamic banking income | na | na | na | na | na |
| Total non-interest income | 38.1 | 39.1 | 47.3 | 50.7 | 53.6 |
| Operating income | 166.7 | 188.3 | 201.9 | 213.8 | 226.4 |
| Staff costs | (21.4) | (22.3) | (23.2) | (24.1) | (25.0) |
| Other operating expenses | (21.7) | (19.1) | (21.9) | (23.0) | (24.1) |
| Operating expenses | (43.1) | (41.3) | (45.1) | (47.1) | (49.1) |
| Pre-provision profit | 123.6 | 147.0 | 156.9 | 166.7 | 177.3 |
| Loan impairment allowances | (22.1) | (29.6) | (35.7) | (41.7) | (48.0) |
| Pretax profit | 101.5 | 117.4 | 121.1 | 125.0 | 129.3 |
| Income tax | (22.5) | (28.7) | (29.1) | (30.0) | (31.0) |
| Reported net profit | 78.9 | 88.7 | 92.1 | 95.0 | 98.3 |
| Core net profit | 73.7 | 88.7 | 92.1 | 95.0 | 98.3 |
| Preferred Dividends | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| BALANCE SHEET (MYR m) | | | | | |
| Cash & deposits with banks | 159.3 | 197.2 | 200.6 | 251.8 | 306.1 |
| Available-for-sale securities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Loans & advances | 1,411.6 | 1,524.7 | 1,627.4 | 1,723.2 | 1,823.6 |
| 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 | 1,973.3 | 2,124.8 | 2,284.4 |
| Other liabilities | 1,260.7 | 1,339.5 | 1,395.9 | 1,477.3 | 1,563.5 |
| Total liabilities | 1,260.7 | 1,339.5 | 1,395.9 | 1,477.3 | 1,563.5 |
| Share capital | 38.1 | 44.7 | 35.6 | 35.6 | 35.6 |
| Reserves | 403.3 | 474.6 | 541.8 | 611.9 | 685.2 |
| Shareholders' funds | 441.4 | 519.3 | 577.4 | 647.5 | 720.8 |
| 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 | 577.4 | 647.5 | 720.8 |
| Total liabilities & equity | 1,702.1 | 1,858.8 | 1,973.3 | 2,124.8 | 2,284.4 |

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| FYE 31 Mar | FY17A | FY18A | FY19E | FY20E | FY21E |
|------------------------------|-------|-------|-------|-------|-------|
| Key Ratios | | | | | |
| Growth (%) | | | | | |
| Net interest income | 16.1 | 16.1 | 3.6 | 5.5 | 6.0 |
| Non-interest income | 275.7 | 2.4 | 21.1 | 7.2 | 5.7 |
| Operating expenses | 4.2 | (4.0) | 9.0 | 4.5 | 4.4 |
| Pre-provision profit | 55.4 | 18.9 | 6.7 | 6.3 | 6.4 |
| Core net profit | 86.2 | 20.4 | 3.8 | 3.2 | 3.4 |
| Gross loans | 11.6 | 8.0 | 7.0 | 6.0 | 6.0 |
| Customer deposits | na | na | na | na | na |
| Total assets | 9.8 | 9.2 | 6.2 | 7.7 | 7.5 |
| Profitability (%) | | | | | |
| Non-int. income/Total income | 22.9 | 20.7 | 23.4 | 23.7 | 23.7 |
| Cost/income | 25.8 | 22.0 | 22.3 | 22.0 | 21.7 |
| Liquidity (%) | | | | | |
| Loans/customer deposits | na | na | na | na | na |
| Asset quality (%) | | | | | |
| Gross NPL | 4.2 | 4.1 | 4.3 | 4.4 | 4.5 |
| Loan loss coverage | 172.2 | 178.0 | 175.3 | 173.6 | 171.1 |
| 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 | 16.8 | 15.5 | 14.4 |
| ROAA | 4.5 | 5.0 | 4.8 | 4.6 | 4.5 |
| Shareholders equity/assets | 25.9 | 27.9 | 29.3 | 30.5 | 31.6 |

Source: Company; Maybank

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Technical Analysis

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APPENDIX I: TERMS FOR PROVISION OF REPORT, DISCLAIMERS AND DISCLOSURES

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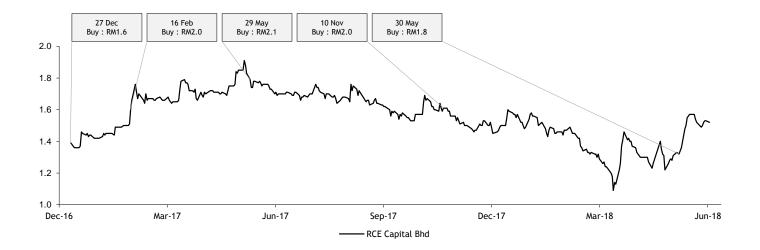
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