

17 June 2020

Financial Services | Banks

## RCE Capital (RCE MK)

**Buy** (Maintained)

All Is Well; Keep BUY

Target Price (Return): MYR2.20 (+22%)  
 Price: MYR1.81  
 Market Cap: USD149m  
 Avg Daily Turnover (MYR/USD) 0.94m/0.22m

- Keep BUY, new MYR2.20 TP from MYR2.10, 22% upside.** RCE Capital's FY20 results met expectations. 4Q20 credit cost was sharply higher due to forward-looking provisions, but asset quality remained solid. Less than 1% of its borrowers are on the moratorium, and overall collections remain healthy. Business moderated due to the Movement Control Order (MCO), but is now gradually improving. RCE remains our Top Pick for non-bank lender stocks. Its current below-book valuation is unjustified against 15% ROE and 6% FY21F (Mar) dividend yield.
- FY20 results in line.** RCE printed MYR110.6m in PATAMI for FY20 (+16% YoY). The results are in line with our (102%) and Street (103%) full-year estimates. PIOP grew 15% YoY, as NII rose 12% YoY on a healthy 5% growth in gross receivables – even though NIM narrowed by 24bps YoY, based on our estimates, while Non-II was also 20% higher YoY. Opex spending remained disciplined (+9% YoY), which resulted in positive jaws. Gross credit cost improved 11bps YoY to 130bps while NPL ratio dropped to 4.14%, from 4.38% in FY19. Full-year ROE was at a high 17.6% (FY19: 17.3%). A 6 sen final DPS was announced which brought the full-year DPS to 11 sen (1H20: 5 sen). This translates into a decent 6% yield.
- Earnings drivers.** 4QFY20 PATAMI contracted by 8.6% (+19.4% YoY). While PIOP was flat QoQ. NII grew 2.3% QoQ on 0.7% growth in gross receivables, but NIM was 41bps QoQ lower by our estimates. We believe this could be due to RCE's more targeted balance sheet expansion, in which borrowers with better risk profiles generally fetch lower asset yields. Non-II was down 8.1% QoQ on lower other revenue. CIR improved to 19.7% from 20.3% in 3QFY20, on a 3% QoQ decline in opex. Impairment charges were sharply higher QoQ (+73%) while gross credit cost also jumped to 181bps (3QFY20: 105bps), which stymied bottomline growth.
- Moratorium, credit cost and asset quality.** We gather that <1% of RCE's borrowers are on the moratorium (up to six months). The moratorium is not automatic, as borrowers have to apply for it (ie opt in). Notwithstanding, collections via salary deduction have been stable and asset quality remained sound with no spike in NPL ratio. The markedly higher provisions in 4QFY20 was mainly due to forward-looking provisions on the weakening macro-economy, rather than the deterioration in asset quality.
- Operations slowed during MCO** as both the agents and RCE staff were not allowed to meet potential customers. The situation has been gradually improving since the relaxation of MCO regulations.
- Earnings and TP.** We fine-tune FY21-22F earnings by <1% and introduce FY23 forecasts in this report. We also lift our TP slightly to MYR2.20 (from MYR2.10) mainly due to the downward revisions in risk premium. Our revised TP is based on a GGM-derived 1.08x FY21 P/BV (+1SD) against the company's ROE of c.15%.

### Analysts

Liew Wai Hoong  
 +603 9280 8859  
[liew.wai.hoong@rhbgroup.com](mailto:liew.wai.hoong@rhbgroup.com)



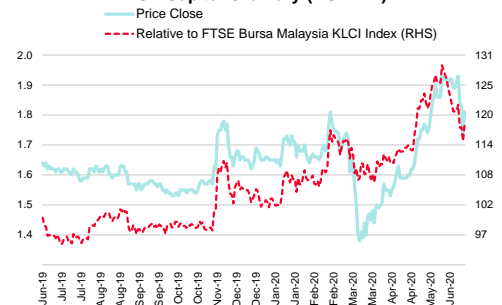
Fiona Leong  
 +603 9280 8886  
[fiona.leong@rhbgroup.com](mailto:fiona.leong@rhbgroup.com)



### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	9.7	2.8	29.3	11.0	10.4
Relative	14.2	(5.3)	10.8	14.3	17.8
52-wk Price low/high (MYR)	1.38 – 1.93				

### RCE Capital Ordinary (RCE MK)



Source: Bloomberg

Forecasts and Valuation	Mar-19	Mar-20	Mar-21F	Mar-22F	Mar-23F
Reported net profit (MYRm)	96	85	113	120	128
Net profit growth (%)	7.7	(11.3)	33.8	5.5	7.4
Recurring net profit (MYRm)	96	85	113	120	128
Recurring EPS (MYR)	0.28	0.24	0.32	0.34	0.37
BVPS (MYR)	1.71	1.94	2.18	2.44	2.73
DPS (MYR)	0.09	0.11	0.11	0.12	0.12
Recurring P/E (x)	6.46	7.42	5.59	5.30	4.94
P/B (x)	1.06	0.93	0.83	0.74	0.66
Dividend Yield (%)	5.0	6.1	6.1	6.4	6.6
Return on average equity (%)	17.3	13.5	15.8	14.8	14.2

Source: Company data, RHB

## Financial Exhibits

Asia	Financial summary (MYR)	Mar-19	Mar-20	Mar-21F	Mar-22F	Mar-23F
Malaysia	EPS	0.28	0.24	0.32	0.34	0.37
Financial Services	Recurring EPS	0.28	0.24	0.32	0.34	0.37
<b>RCE Capital</b>	DPS	0.09	0.11	0.11	0.12	0.12
RCE MK	BVPS	1.71	1.94	2.18	2.44	2.73
Buy						
Valuation basis	Valuation metrics	Mar-19	Mar-20	Mar-21F	Mar-22F	Mar-23F
GGM-derived 1.08x FY21 P/BV	Recurring P/E (x)	6.46	7.42	5.59	5.30	4.94
	P/B (x)	1.1	0.9	0.8	0.7	0.7
	Dividend Yield (%)	5.0	6.1	6.1	6.4	6.6
Key drivers	Income statement (MYRm)	Mar-19	Mar-20	Mar-21F	Mar-22F	Mar-23F
Our FY21 forecasts are most sensitive to changes in:	Interest income	234	257	270	279	292
i. Financing margins;	Interest expense	(78)	(82)	(87)	(90)	(91)
ii. Impairment allowances;	<b>Net interest income</b>	<b>156</b>	<b>175</b>	<b>183</b>	<b>189</b>	<b>200</b>
iii. Growth in receivables.	Non interest income	39	20	48	50	52
	<b>Total operating income</b>	<b>195</b>	<b>195</b>	<b>231</b>	<b>239</b>	<b>253</b>
	Overheads	(45)	(49)	(53)	(55)	(57)
	<b>Pre-provision operating profit</b>	<b>150</b>	<b>146</b>	<b>178</b>	<b>184</b>	<b>195</b>
	Loan impairment allowances	(18)	(23)	(26)	(23)	(22)
	<b>Pre-tax profit</b>	<b>131</b>	<b>123</b>	<b>153</b>	<b>161</b>	<b>173</b>
	Taxation	(36)	(38)	(39)	(41)	(45)
	<b>Reported net profit</b>	<b>96</b>	<b>85</b>	<b>113</b>	<b>120</b>	<b>128</b>
	<b>Recurring net profit</b>	<b>96</b>	<b>85</b>	<b>113</b>	<b>120</b>	<b>128</b>
Key risks	Profitability ratios	Mar-19	Mar-20	Mar-21F	Mar-22F	Mar-23F
The downside risks include:	Return on average assets (%)	4.7	3.6	4.4	4.4	4.5
i. Higher credit costs;	Return on average equity (%)	17.3	13.5	15.8	14.8	14.2
ii. Weaker net financing margins;	Return on IEAs (%)	12.2	12.2	12.0	11.9	11.9
iii. Weaker growth in receivables.	Cost of funds (%)	5.4	4.9	4.8	4.7	4.7
	Net interest spread (%)	6.9	7.3	7.2	7.1	7.1
	Net interest margin (%)	8.2	8.3	8.2	8.0	8.1
	Non-interest income / total income (%)	19.8	10.4	20.8	20.8	20.7
	Cost to income ratio (%)	23.2	25.2	23.0	23.0	22.7
	Credit cost (bps)	110	130	139	119	110
Company Profile	Balance sheet (MYRm)	Mar-19	Mar-20	Mar-21F	Mar-22F	Mar-23F
RCE Capital provides general financing services to civil servants, and 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.	Total gross loans	1,729	1,820	1,857	1,973	2,076
	Other interest earning assets	279	364	444	438	438
	Total gross IEAs	2,009	2,184	2,301	2,411	2,514
	Total provisions	(130)	(130)	(140)	(149)	(157)
	Net loans to customers	1,599	1,690	1,718	1,824	1,919
	Total net IEAs	1,878	2,054	2,161	2,262	2,357
	Total non-IEAs	348	377	530	539	582
	Total assets	2,226	2,431	2,691	2,801	2,939
	Other interest-bearing liabilities	1,605	1,714	1,893	1,913	1,949
	Total IBLs	1,605	1,714	1,893	1,913	1,949
	Total non-IBLs	38	43	35	32	32
	Total liabilities	1,643	1,758	1,928	1,945	1,982
	Share capital	154	172	179	185	191
	Shareholders' equity	584	673	763	856	957
	Asset quality and capital	Mar-19	Mar-20	Mar-21F	Mar-22F	Mar-23F
	Reported NPLs / gross cust loans (%)	4.4	4.1	4.7	4.6	4.6
	Total provisions / reported NPLs (%)	172.1	173.0	161.9	163.8	164.4

Source: Company data, RHB

## Results At a Glance

Figure 1: RCE – Summary of quarterly results

FYE Feb (MYRm)	3QFY19	2QFY19	3QFY20	% QoQ	% YoY	YTD19	YTD20	% YoY	Comments – 4QFY20 vs 3QFY20
<b>NII</b>	<b>40.1</b>	<b>44.9</b>	<b>45.9</b>	<b>2.3</b>	<b>14.5</b>	<b>156.2</b>	<b>174.9</b>	<b>12.0</b>	Up QoQ mainly on receivables growth.
Interest income	60.2	65.2	66.8	2.4	11.0	234.3	256.8	9.6	
Interest expense	(20.1)	(20.3)	(20.9)	2.6	4.0	(78.1)	(81.8)	4.8	
<b>Non-II</b>	<b>11.1</b>	<b>12.4</b>	<b>11.4</b>	<b>(8.0)</b>	<b>3.2</b>	<b>43.8</b>	<b>46.2</b>	<b>5.6</b>	
Non-II/Total income (%)	21.6	21.7	19.9			21.9	20.9		
<b>Operating income</b>	<b>51.2</b>	<b>57.3</b>	<b>57.4</b>	<b>0.1</b>	<b>12.1</b>	<b>200.0</b>	<b>221.2</b>	<b>10.6</b>	
Overheads	(11.7)	(11.6)	(11.3)	(3.0)	(3.9)	(45.2)	(49.2)	8.9	Opex well-contained, which resulted in positive jaws.
CIR (%)	22.9	20.3	19.7			22.6	22.2		
<b>PIOP</b>	<b>39.4</b>	<b>45.7</b>	<b>46.1</b>	<b>0.8</b>	<b>16.8</b>	<b>154.8</b>	<b>172.0</b>	<b>11.1</b>	
Impairment on other assets	0.0	0.0	0.0			0.0	0.0		
Impairment on financings	(6.2)	(4.7)	(8.2)	74.9	32.8	(23.7)	(23.1)	(2.7)	Sharply higher impairment charges due to additional forward-looking provisions.
Credit cost	143	105	181			141	130		
<b>Operating profit</b>	<b>33.2</b>	<b>41.0</b>	<b>37.8</b>	<b>(7.6)</b>	<b>13.8</b>	<b>131.1</b>	<b>148.9</b>	<b>13.6</b>	
Associates & others									
<b>Pre-tax profit</b>	<b>33.2</b>	<b>41.0</b>	<b>37.8</b>	<b>(7.6)</b>	<b>13.8</b>	<b>131.1</b>	<b>148.9</b>	<b>13.6</b>	
Tax	(9.5)	(10.0)	(9.5)			(35.6)	(38.3)		
ETR (%)	28.6	24.4	25.2			27.1	25.7		
<b>Net earnings</b>	<b>23.7</b>	<b>31.0</b>	<b>28.3</b>	<b>(8.6)</b>	<b>19.4</b>	<b>95.5</b>	<b>110.6</b>	<b>15.8</b>	
<b>Other key data and ratios</b>									
Gross financing	1,729.1	1,807.4	1,820.1	0.7	5.3				
Total borrowings	1,604.9	1,570.2	1,714.4	9.2	6.8				
Gross impaired financing	(130.4)	(129.9)	(130.2)	0.2	(0.1)				
Total assets	2,226.1	2,254.3	2,431.0	7.8	9.2				
Shareholders funds	583.5	644.0	673.4	4.6	15.4				
ROAA	4.5%	5.6%	4.8%			4.7%	4.7%		
ROAE	16.6%	19.5%	17.2%			17.3%	17.6%		
NPL ratio	4.4%	4.3%	4.1%						

Source: Company data, RHB

## Earnings revisions

We make no major revisions in our earnings forecasts post 4QFY20 results, and introduce the FY23F earnings forecasts.

**Figure 2: RCE – revisions to earnings forecasts**

FYE Mar	Net earnings (MYRm)			EPS (MYR)			DPS (MYR)		
	Previous	Revised	Chg (%)	Previous	Revised	Chg (%)	Previous	Revised	Chg (%)
2021F	114.2	113.4	-0.7%	0.33	0.32	-1.9%	0.11	0.11	0.0%
2022F	119.5	119.7	0.1%	0.35	0.34	-1.2%	0.12	0.12	0.0%
2023F	n.a.	128.5	n.m.	n.a.	0.37	n.m.	n.a.	0.12	n.m.

Source: RHB

## Valuation and TP

Our TP is slightly revised to MYR2.20, after we imputed a lower risk premium assumption and incorporated FY23 assumptions. Our new TP values RCE at 1.08x FY21 P/BV, which is above +1 SD from its historical mean. We believe its current valuation of less than 1x P/BV remains unjustified against RCE's c.15% ROE.

**Figure 3: RCE's GGM valuation**

<b>Cost of equity (COE) computation:</b>		Sustainable ROE (%)	14.9
Risk free rate (%)	2.9	COE (%)	13.9
Equity premium (%)	7.35	Long-term growth (g)	2.0
Beta (x)	1.5	Implied P/BV (x)	1.08
Cost of equity - CAPM (%)	13.9	BVPS – FY21F	MYR 2.05
		Target price	MYR 2.22
		<b>TP (rounded)</b>	<b>MYR 2.20</b>

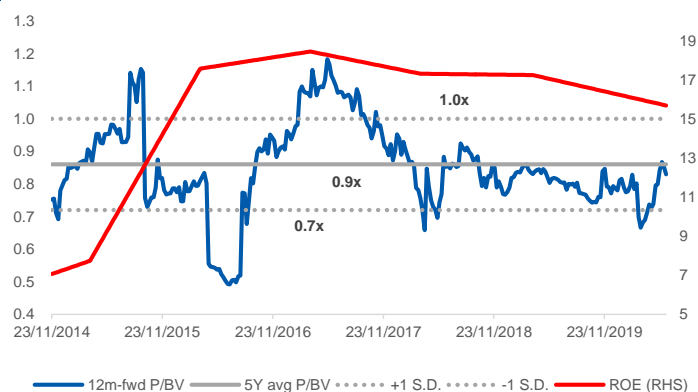
Source: Company data, RHB

**Figure 4: RCE's 12-month forward P/E**



Source: Bloomberg, RHB

**Figure 5: RCE's 12-month forward P/BV**



Source: Bloomberg, RHB

## Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2020-03-15	Buy	2.10	1.50
2020-02-19	Buy	2.20	1.77
2020-01-10	Buy	2.10	1.72
2019-08-16	Not Rated	na	1.60

Source: RHB, Bloomberg

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<b>Buy:</b>	Share price may exceed 10% over the next 12 months
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<b>Not Rated:</b>	Stock is not within regular research coverage

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#### KUALA LUMPUR

**RHB Investment Bank Bhd**  
Level 3A, Tower One, RHB Centre  
Jalan Tun Razak  
Kuala Lumpur 50400  
Malaysia  
Tel : +603 9280 8888  
Fax : +603 9200 2216

#### JAKARTA

**PT RHB Sekuritas Indonesia**  
Revenue Tower, 11th Floor, District 8  
- SCBD  
Jl. Jendral Sudirman Kav 52-53  
Jakarta 12190  
Indonesia  
Tel : +6221 509 39 888  
Fax : +6221 509 39 777

#### HONG KONG

**RHB Securities Hong Kong Ltd.**  
12<sup>th</sup> Floor, World-Wide House  
19 Des Voeux Road  
Central  
Hong Kong  
Tel : +852 2525 1118  
Fax : +852 2810 0908

#### BANGKOK

**RHB Securities (Thailand) PCL**  
10th Floor, Sathorn Square Office  
Tower  
98, North Sathorn Road, Silom  
Bangrak, Bangkok 10500  
Thailand  
Tel: +66 2088 9999  
Fax :+66 2088 9799

#### SINGAPORE

**RHB Securities Singapore  
Pte Ltd.**  
10 Collyer Quay  
#09-08 Ocean Financial Centre  
Singapore 049315  
Tel : +65 6533 1818  
Fax : +65 6532 6211