

16 August 2024

Financial Services | Banks

RCE Capital (RCE MK)

Sell (Maintained)

A Soft Start To FY25F; SELL

Target Price (Return): MYR2.70 (-17.4%)
 Price (Market Cap): MYR3.27 (USD540m)
 ESG score: 3.0 (out of 4)
 Avg Daily Turnover (MYR/USD) 1.55m/0.34m

- Maintain SELL, new MYR2.70 TP from MYR2.40, 17% downside, c.5% FY25F (Mar) yield.** RCE Capital's 1QFY25 results disappointed as a result of slower-than-expected disbursements, which we expect will pick up later in the year. The group's longer-term prospects look good, as it is a prime beneficiary of the revision to civil service wages, though near-term challenges remain. Our call is premised on valuation grounds.
- Results review.** RCE's 1QFY25 net profit of MYR30.3m (-18% YoY, +4% QoQ) missed expectations, forming 19%/20% of our/consensus' full-year estimates. The key deviation from our numbers mainly came from lower-than-expected operating income (-8% YoY, -7% QoQ) as a result of softer financing disbursements during the quarter affecting both profit and non-profit incomes. Opex growth was a mild 3% YoY (QoQ: -19%), though impairment allowances, as guided, were up 64% YoY (QoQ: -25%).
- Deliberately slower financing growth?** RCE's gross financing receivables stood at MYR2.07bn at end-Jun 2024, a decline of 1% QoQ (YoY: +1%). This aligns with management's guidance for muted financing growth in the near-to-medium term, as it shifts its focus towards asset quality. Moving forward, the impending salary increase for civil servants could lead to an acceleration in financing growth, though we note that this is set to take effect only in Dec 2024, or late-3QFY25 for RCE. We continue to forecast receivables growth in the mid-single digits for the group, with a pick-up in FY26F.
- Is asset quality under pressure?** The group's impairment allowances spiked 64% YoY (QoQ: -25% off a high base) in 1QFY25. The YoY increase is expected, as management had flagged that exits from the civil service had been elevated over the past 12 months. In a similar vein, the non-performing financing ratio rose to 4.2% from 4.0% in the previous quarter (Jun 2023: 3.7%). While exit trends are unpredictable, we think the impending revision to civil service wages could help to improve the attractiveness of the civil service over the long run and help curb some of the early exit cases, hence leading to lower impairment allowances moving forward.
- A short-term trading opportunity?** The Prime Minister is expected to unveil more details on the revised civil servants' remuneration scheme later today, with increments rumoured to be 15-42.7%. Given RCE's strong niche in the civil servant financing space, we think the counter could garner near-term investor interest. However, we flag that the benefits from the revision will only likely be felt beginning 3QFY25 at the earliest, and that the group is still coping with significant challenges (eg fraud, early exits) in the meantime.
- Forecasts unchanged,** but our TP rises to MYR2.70 (from MYR2.40) after updating our model inputs. Our TP includes an unchanged zero ESG premium/discount.

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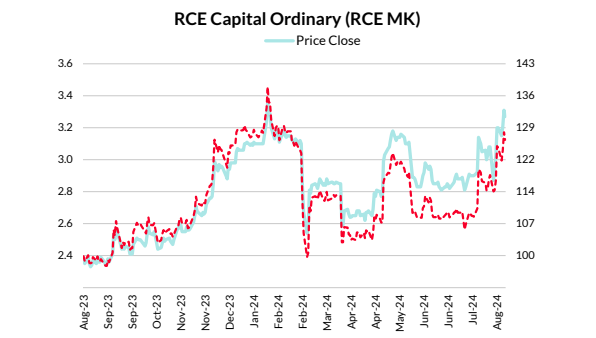


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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	6.9	12.4	4.1	5.5	43.4
Relative	(4.0)	13.4	3.5	0.0	32.9
52-wk Price low/high (MYR)				2.33	-3.36



Source: Bloomberg

Forecasts and Valuation	Mar-23	Mar-24	Mar-25F	Mar-26F	Mar-27F
Reported net profit (MYRm)	139	139	156	163	170
Net profit growth (%)	4.2	(0.0)	12.1	5.1	4.1
Recurring net profit (MYRm)	139	139	156	163	170
Recurring EPS (MYR)	0.19	0.19	0.21	0.22	0.23
BVPS (MYR)	1.10	1.13	1.19	1.25	1.31
DPS (MYR)	0.12	0.15	0.16	0.17	0.17
Recurring P/E (x)	17.27	17.27	15.41	14.66	14.08
P/B (x)	2.97	2.89	2.74	2.61	2.49
Dividend Yield (%)	3.6	4.6	4.9	5.1	5.3
Return on average equity (%)	16.5	17.0	18.2	18.2	18.1

Source: Company data, RHB

Overall ESG Score: 3.0 (out of 4)

E: GOOD

RCE's emissions intensity (on both an absolute and per employee basis) demonstrated a decrease in FY24 (Mar) underpinned by the group's proactive climate change management strategies. The group has also begun reporting its Scope 3 emissions in FY24 based on cross-sector tools provided by the GHG Protocol.

S: GOOD

RCE places strong focus on employee development - its employees enjoyed an average of 32 training hours in FY23, compared to 24 hours in FY22. The group, in collaboration with Yayasan Azman Hashim, provides study grants and scholarships to deserving underprivileged students to pursue Chartered Accountancy certifications. To date, MYR572,000 has been distributed under the programme.

G: EXCELLENT

Four out of eight members of the Board of Directors (ex-CEO) are independent directors, while all members are non-executive. Board members have a maximum allowed tenure of 9 years, to facilitate board refreshment.

Financial Exhibits

Asia	Financial summary (MYR)	Mar-23	Mar-24	Mar-25F	Mar-26F	Mar-27F
Malaysia	EPS	0.19	0.19	0.21	0.22	0.23
Financial Services	Recurring EPS	0.19	0.19	0.21	0.22	0.23
RCE Capital	DPS	0.12	0.15	0.16	0.17	0.17
RCE MK	BVPS	1.10	1.13	1.19	1.25	1.31
Sell						
	Valuation metrics	Mar-23	Mar-24	Mar-25F	Mar-26F	Mar-27F
Valuation basis	Recurring P/E (x)	17.27	17.27	15.41	14.66	14.08
Our GGM assumptions are:	P/B (x)	3.0	2.9	2.7	2.6	2.5
i. CoE of 10.3%;	Dividend Yield (%)	3.6	4.6	4.9	5.1	5.3
ii. ROE of 18.2%; and						
iii. 3.5% long-term growth rate.						
	Income statement (MYRm)	Mar-23	Mar-24	Mar-25F	Mar-26F	Mar-27F
Key drivers	Interest income	281	291	308	325	345
Our FY25 forecasts are most sensitive to changes in:	Interest expense	(90)	(99)	(103)	(109)	(115)
i. Growth in receivables;	Net interest income	190	192	205	216	230
ii. Impairment allowances; and	Non interest income	71	89	96	102	104
iii. Financing margins.	Total operating income	261	281	301	318	334
	Overheads	(49)	(66)	(63)	(68)	(73)
	Pre-provision operating profit	213	215	237	250	261
Key risks	Loan impairment allowances	(29)	(30)	(30)	(32)	(34)
The upside risks include:	Pre-tax profit	184	185	207	218	227
i. Greater-than-expected financing growth;	Taxation	(45)	(46)	(52)	(54)	(57)
ii. Lower-than-expected credit costs; and	Reported net profit	139	139	156	163	170
iii. Stronger-than-expect net financing margin.	Recurring net profit	139	139	156	163	170
	Profitability ratios	Mar-23	Mar-24	Mar-25F	Mar-26F	Mar-27F
Company Profile	Return on average assets (%)	4.9	4.7	5.1	5.1	5.0
RCE provides general financing services to civil servants	Return on average equity (%)	16.5	17.0	18.2	18.2	18.1
- repayments are done via direct salary deductions. Its	Return on IEAs (%)	10.3	10.1	10.4	10.5	10.5
wholly-owned EXP Payment unit offers payroll	Cost of funds (%)	4.6	4.7	4.7	4.8	4.8
collection management services for government	Net interest spread (%)	5.7	5.4	5.6	5.7	5.7
departments under the purview of the Accountant	Net interest margin (%)	7.0	6.7	6.9	7.0	7.0
General's Department.	Non-interest income / total income (%)	27.1	31.6	31.9	32.1	31.2
	Cost to income ratio (%)	18.7	23.4	21.0	21.4	22.0
	Credit cost (bps)	147	147	140	140	140
	Balance sheet (MYRm)	Mar-23	Mar-24	Mar-25F	Mar-26F	Mar-27F
	Total gross loans	2,021	2,100	2,205	2,338	2,501
	Other interest earning assets	854	800	822	845	869
	Total gross IEAs	2,875	2,900	3,027	3,183	3,370
	Total provisions	(122)	(128)	(140)	(154)	(170)
	Net loans to customers	1,899	1,973	2,066	2,184	2,332
	Total net IEAs	2,753	2,772	2,888	3,029	3,201
	Total non-IEAs	194	223	258	273	264
	Total assets	2,947	2,996	3,146	3,302	3,464
	Other interest-bearing liabilities	2,092	2,120	2,226	2,337	2,454
	Total IBLs	2,092	2,120	2,226	2,337	2,454
	Total non-IBLs	50	46	45	46	47
	Total liabilities	2,141	2,166	2,271	2,383	2,501
	Share capital	202	202	202	202	202
	Shareholders' equity	806	830	875	919	964
	Asset quality and capital	Mar-23	Mar-24	Mar-25F	Mar-26F	Mar-27F
	Reported NPLs / gross cust loans (%)	3.8	3.7	3.8	3.8	3.8
	Total provisions / reported NPLs (%)	157.8	165.8	166.9	173.0	178.3

Source: Company data, RHB

Results At a Glance

Figure 1: RCE – summary of 1QFY24 results

FYE Mar (MYRm)	1Q FY24	4Q FY24	1Q FY25	QoQ (%)	YoY (%)	Comments
Net profit income	46.1	47.3	46.5	(1.8)	0.8	
Profit income	71.1	72.4	72.0	(0.5)	1.3	QoQ decline in tandem with the slight shrinkage in the receivables book.
Profit expense	(25.0)	(25.1)	(25.6)	1.8	2.3	
Non-profit income	21.4	19.7	15.9	(19.2)	(25.7)	Likely due to lower disbursements in 1QFY25.
Non-profit income/Total income (%)	31.7	29.4	25.5			
Operating income	67.5	67.0	62.4	(6.9)	(7.6)	
Overhead expenses	(13.8)	(17.5)	(14.2)	(19.1)	2.7	
CIR (%)	20.5	26.2	22.7			
PIOP	53.7	49.5	48.2	(2.5)	(10.3)	
Impairment on financing	(4.7)	(10.3)	(7.7)	(24.9)	64.2	YoY increase likely a result of a greater number of exits from the civil service.
Ann. credit costs (bps)	93	196	148			
PBT	49.0	39.1	40.4	3.4	(17.4)	
Taxation	(12.1)	(10.1)	(10.1)			
ETR (%)	24.7	25.7	25.0			
Net earnings	36.9	29.1	30.3	4.3	(17.8)	Forms 19%/20% of our/consensus estimates.
Other key data and ratios						
Gross financing	2,045.4	2,100.4	2,074.4	(1.2)	1.4	Guidance is for RCE to track the growth of the wider banking system, though disbursements could slow in the near-term.
Total borrowings	2,197.0	2,119.6	2,162.6	2.0	(1.6)	
Total assets	3,026.2	2,995.6	3,002.3	0.2	(0.8)	
Shareholders' funds	787.1	829.8	804.2	(3.1)	2.2	
ROAA (%)	4.9%	3.8%	4.0%			
ROAE (%)	18.5%	14.2%	14.8%			

Source: Company data, RHB

Valuation and TP

Our new TP of MYR2.70 is based on a GGM-derived fair value P/BV of 2.15x (from 2.01x) on RCE's CY25F BVPS. Key model changes include: i) A lower CAPM-derived cost of equity of 10.3% (from 10.8%) in tandem with our updated house assumptions; and ii) a higher BVPS assumption of MYR1.24 (from MYR1.18) after rolling forward our valuation year to CY25 from CY24. No changes were made to our earnings estimates.

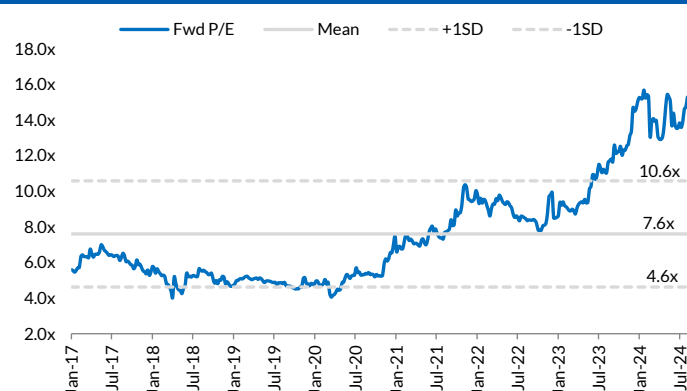
The announcement of further details on the revised civil servants' remuneration packages could continue to garner investor interest and keep near-term valuations elevated. However, at c.2.6x P/BV against our 18% forecast ROE for FY25-27F, we still think RCE's valuations look overstretched.

Figure 2: GGM valuation

Cost of equity (COE) computation:		Sustainable ROE (%)	18.2
Risk free rate (%)	4.0	COE (%)	10.3
Equity premium (%)	5.5	Long-term growth (g)	3.5
Beta (x)	1.2	Implied P/BV (x)	2.15
Cost of equity - CAPM (%)	10.3	BVPS - CY25F	MYR1.24
		Intrinsic value	MYR2.67
ESG premium/(discount) (%)	0.0	ESG premium/(discount)	MYR0.00
		TP (rounded)	MYR2.70

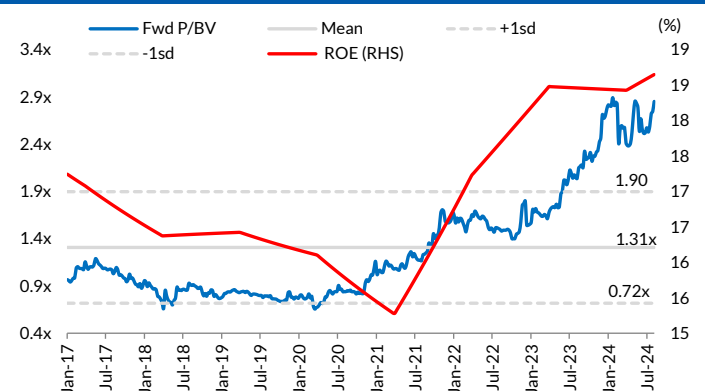
Source: Company data, RHB

Figure 3: RCE Capital's 12-month forward P/E



Source: Bloomberg, RHB

Figure 4: RCE Capital's 12-month forward P/BV vs ROE



Source: Bloomberg, RHB

Emissions And ESG

Trend analysis

RCE began disclosing Scope 3 emissions in the FY24 annual report. Meanwhile, Scope 1 and Scope 2 emissions showed a slight YoY decline as a result of its various climate change management strategies.

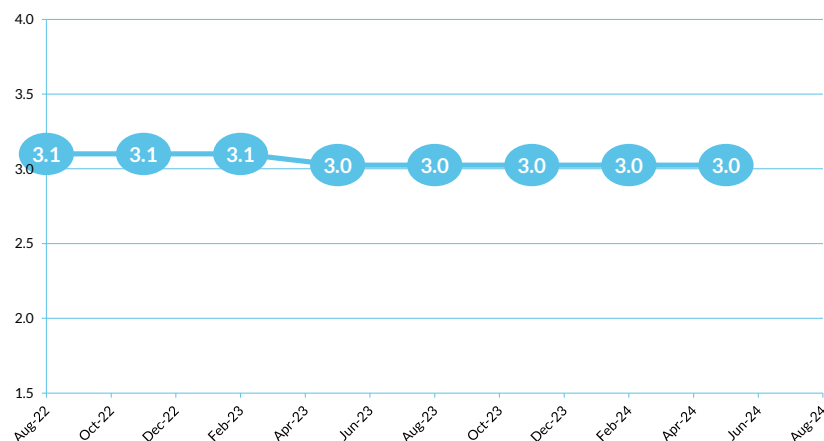
Emissions (tCO2e)	Mar-22	Mar-23	Mar-24
Scope 1	16	19	22
Scope 2	150	155	152
Scope 3	-	-	377
Total emissions	166	174	551

Source: Company data, RHB

Latest ESG-Related Developments

- **Scope 3 emissions reporting:** RCE plans to introduce its (internal) Scope 3 emissions data in its FY24 annual report to be released in mid-2024.
- **Emphasis on employee development:** RCE's employees enjoyed an average of 32 training hours per employee, an increase of 8 hours YoY, on topics such as leadership development, regulatory and technical skills, and special interest topics.

ESG Rating History



Source: RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2024-05-27	Sell	2.40	2.89
2024-02-08	Sell	2.40	3.14
2024-01-12	Sell	2.30	3.10
2023-11-23	Sell	2.30	2.68
2023-08-15	Neutral	2.20	2.28
2023-05-24	Neutral	1.95	1.99
2023-02-15	Neutral	1.95	1.85
2022-11-22	Neutral	1.95	1.87
2022-08-12	Buy	1.92	1.64
2022-05-31	Buy	2.00	1.76
2022-02-25	Buy	1.90	1.69
2021-11-10	Neutral	3.90	2.02
2021-08-12	Buy	3.20	1.43
2021-05-26	Buy	3.20	1.43
2021-02-09	Buy	3.00	1.32

Source: RHB, Bloomberg

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Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
Neutral:	Share price may fall within the range of +/- 10% over the next 12 months
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