Banks

Malaysia

RCE Capital Bhd (RCE MK)

Sail into this safe harbour

BUY

Share Price	MYR 1.77
12m Price Target	MYR 1.92 (+15%)
Previous Price Target	*MYR 1.94*

Maintain BUY and trim TP by 1% to MYR1.92 TP

RCE is faring well during this Covid-19 pandemic. Thus, we trim our EPS estimates by only 3-5%. In our view, RCE is one of a handful of companies that has a stable earnings outlook. It stands to benefit even more from rapidly falling interest rates. Ascribing an unchanged 0.93x end-CY20 P/BV, we trim our TP to MYR1.92 from MYR1.94. RCE offers high cash dividend yields of ~6% p.a. on low DPRs (33-34%) which can be raised. To boot, shareholders may be rewarded with special share dividends.

Faring well during this Covid-19 pandemic

As a non-bank financial institution, RCE is not required to offer moratoriums to its customers but it did. Yet, it allowed <1% of its gross financing to undergo moratorium. This is because RCE disburses 100% of its personal financing to civil servants whose salaries have been relatively unaffected by the Covid-19 pandemic. Its main collection agent, ANGKASA, has also been operating as usual. Thus, RCE is not suffering liquidity issues and can freely disburse financing.

Trim EPS estimates by only 3-5%

To be fair, we understand that the turnaround time to process new financing has increased. Also, 'expected credit loss' models under MFRS 9 will likely require RCE to recognise more credit costs (regardless of credit quality) due to the poorer Malaysian economy. Thus, we trim our FY21E/FY22E gross financing growth forecast to +3%/+3% from +5%/+4% and raise our FY20E-FY22E credit cost ratio forecasts to 1.5% from 1.2%. Yet, we trim our FY20E/FY21E/FY22E EPS estimates by only 3%/4%/5%.

Still very much a BUY in our books

Notwithstanding, we still forecast FY20E core net profit to cross the MYR100m mark. In our view, not many companies listed on Bursa Malaysia have such stable earnings growth prospects. Also, there is upside potential to earnings from lower cost of funds (COF). We estimate that every 25bps reduction in average COF will accrete 3% to earnings. After a recent spate of share buybacks, we also reiterate our view that shareholders may be rewarded with share dividends in the future.

FYE Mar (MYR m)	FY18A	FY19A	FY20E	FY21E	FY22E
Operating income	188	200	215	228	238
Pre-provision profit	147	155	167	178	187
Core net profit	89	96	103	110	115
Core FDEPS (MYR)	0.26	0.28	0.29	0.31	0.33
Core FDEPS growth(%)	9.0	7.6	3.8	7.1	4.8
Net DPS (MYR)	0.07	0.09	0.10	0.11	0.11
Core FD P/E (x)	4.7	5.8	6.1	5.7	5.4
P/BV (x)	0.8	1.0	0.9	0.8	0.8
Net dividend yield (%)	5.7	5.5	5.6	5.9	6.2
Book value (MYR)	1.52	1.71	1.90	2.12	2.34
ROAE (%)	18.5	17.3	16.6	15.9	15.0
ROAA (%)	5.0	4.7	4.5	4.7	4.7
Consensus net profit	-	-	108	114	121
MKE vs. Consensus (%)	-	-	(5.0)	(3.6)	(4.4)

Company Description

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

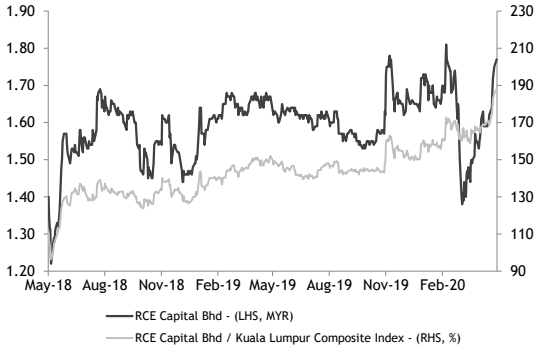
Statistics

52w high/low (MYR)	1.81/1.38
3m avg turnover (USDm)	0.3
Free float (%)	27.7
Issued shares (m)	369
Market capitalisation	MYR653.0M
	USD151M

Major shareholders:

Cempaka Empayar Sdn. Bhd.	56.3%
RCE Capital Bhd.	5.5%
Employees Provident Fund	2.3%

Price Performance



	-1M	-3M	-12M
Absolute (%)	14	7	6
Relative to index (%)	12	19	23

Source: FactSet

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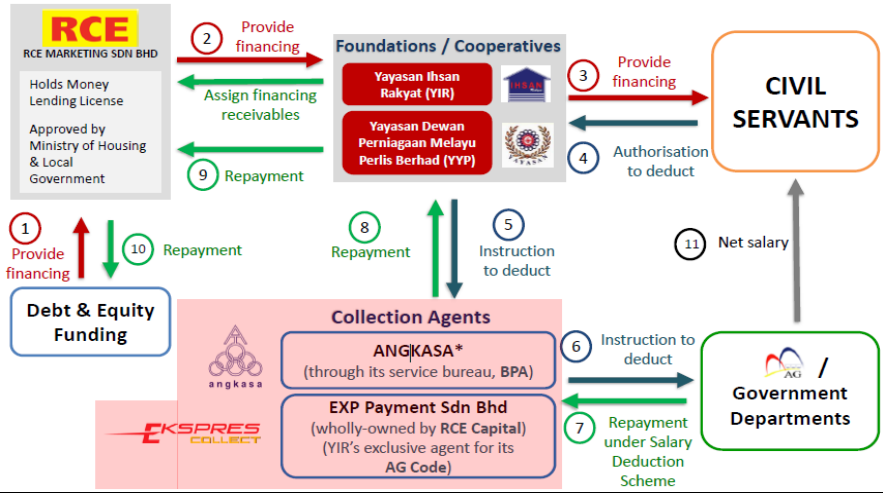
Faring well during this Covid-19 pandemic

Due to the economic havoc caused by the Covid-19 pandemic, banks are offering six month moratoriums to individual and small and medium sized enterprise customers from 1 Apr 2020. Banks will not even charge additional interest on hire purchase loans/financing during the moratorium period. While non-bank financial institutions (NBFI) are not required to offer moratoriums to their customers, our channel checks reveal that many of their customers had problems repaying their debts due to the Movement Control Order (MCO) (commenced on 18 Mar 2020) causing liquidity issues and slowing loans/financing growth for many NBFIs.

Figure 1: RCE Capital business model



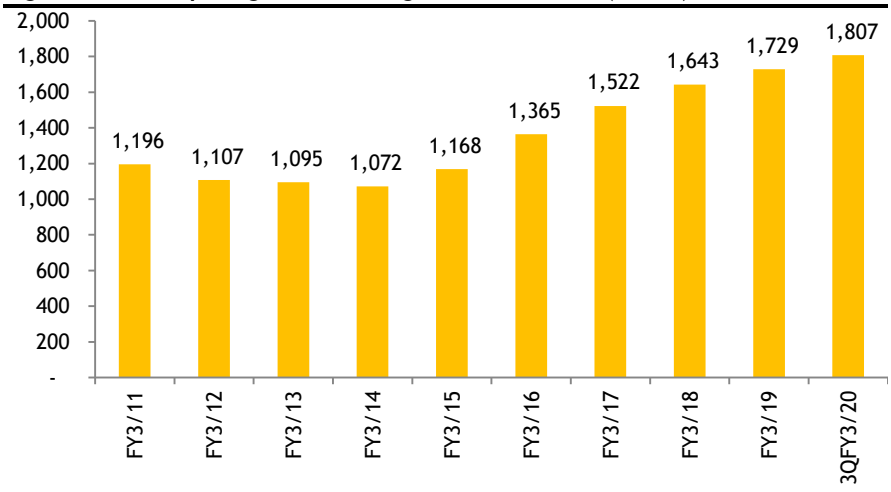
** ANGKASA is incorporated to unite all the cooperatives in Malaysia under one federation for cooperatives. It plays the role as the apex of cooperatives for the Malaysian cooperative movement.*
Source: Company

That said, we are pleased to note that RCE was relatively unscathed. As a NBFI, RCE is not required to offer moratoriums to its customers but it did. Notwithstanding, we understand that RCE allowed less than 1% of its gross financing and receivables to undergo six months moratorium. Recall that RCE (through two cooperatives) only provides personal financing to civil servants whose salaries have been relatively unaffected by the Covid-19 pandemic and MCO. We also understand that its main collection agent, ANGKASA, is operating as usual throughout the MCO. Thus, RCE is not suffering the liquidity issues that many of its peers are experiencing.

Trim EPS estimates by only 3-5%

As RCE is not suffering the liquidity issues that many NFBIs are, it can still disburse financing as it sees fit and grow its gross financing and receivables book. To be fair, we understand that the turnaround time to process applications for new financing has increased as most civil servants are confined to their homes during the MCO and this is causing them to require more time to furnish supporting documentation. Thus, we trim our FY21E/FY22E gross financing and receivables growth forecast from +5%/+4% to +3%/+3%. Our FY20E gross financing and receivables growth forecast is unchanged at +5%. Our revised FY21E gross financing and receivables growth forecast is 1ppt higher than our CY20 banking industry loans growth forecast of +2%.

Figure 2: RCE Capital gross financing and receivables (MYRm)



Source: Company

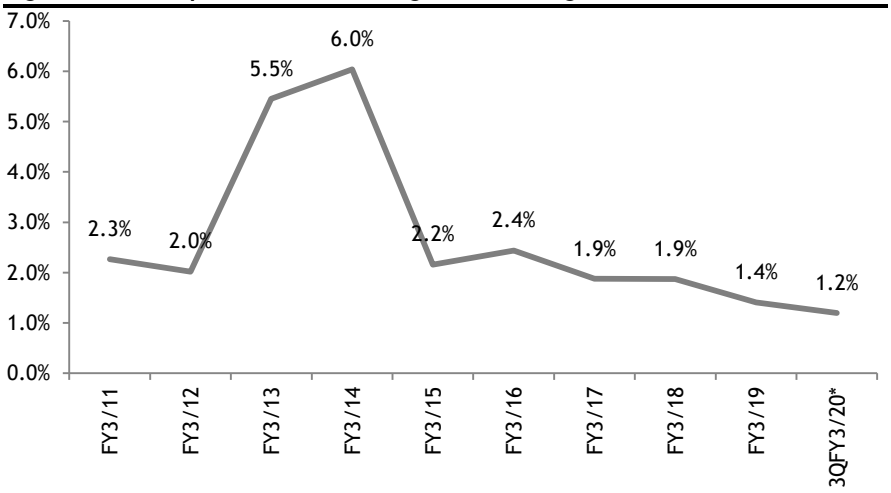
We also expect a slight uptick in credit costs going forward. Recall that RCE transitioned from an 'incurred loss model' under MFRS 139 to an 'expected credit loss model' (ECL) under MFRS 9 on 1 Apr 2018. The measurement of ECL requires:-

(i) applying significant judgements and estimates which include the identification of financing and receivables with significant deteriorations in credit quality; and

(ii) assumptions used in ECL models such as expected future cash flows, time value of money, forward looking macroeconomic factors and probability-weighted scenarios.

As we forecast the Malaysian economy to contract 3.3% in CY20, we gather that ECL models will require RCE to recognise more credit costs even though the credit quality of its financing and receivables has not deteriorated significantly. Thus, we raise our FY20E-FY22E credit cost ratio forecasts to 1.5% from 1.2%.

Figure 3: RCE Capital credit cost on gross financing and receivables



** four quarters moving average*
Source: Company

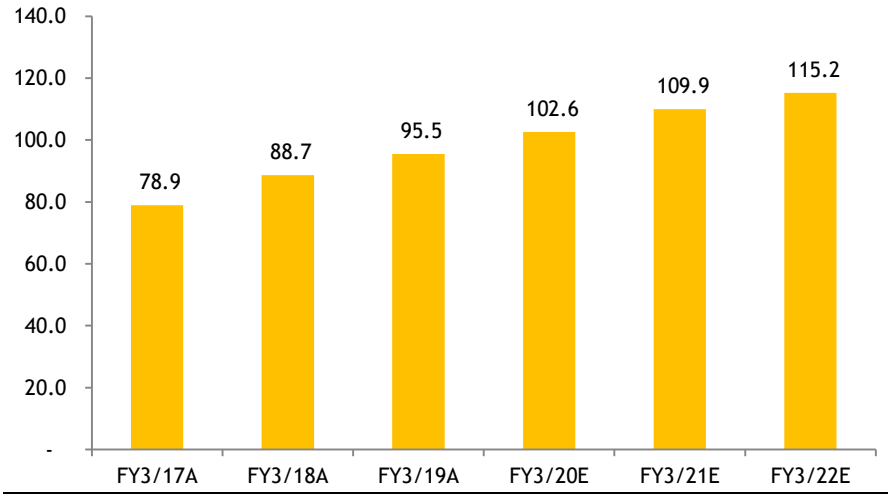
Net impact of the above is to trim our FY20E/FY21E/FY22E EPS estimates by 3%/4%/5% (Fig. 4). As the cut in our EPS estimates was minor, we leave our FY20E/FY21E/FY22E DPS estimates unchanged at 10.0sen/10.5sen/11.0sen. At its last price, RCE still offers attractive dividend yields of ~6% p.a. Despite our lower earnings estimates, we still forecast FY20E core net profit to cross the MYR100m mark and grow at 6% CAGR from FY20E to FY22E (Fig. 5). In our view, not many companies listed on Bursa Malaysia with the exception of glove companies and selected consumer companies have such stable earnings growth prospects.

Figure 4: Major assumptions and financial estimates

	FY3/18A	FY3/19A	FY3/20E	FY3/21E	FY3/22E
Previous assumptions					
Gross financing growth	8.0%	5.2%	5.0%	5.0%	4.0%
Credit cost as % of average gross financing	1.9%	1.4%	1.2%	1.2%	1.2%
Revised assumptions					
Gross financing growth	8.0%	5.2%	5.0%	3.0%	3.0%
Credit cost as % of average gross financing	1.9%	1.4%	1.5%	1.5%	1.5%
Unchanged assumptions					
Estimated average financing yield	13.4%	13.9%	14.3%	14.3%	14.3%
Estimated average cost of funds	5.5%	5.4%	5.4%	5.3%	5.3%
Previous financial estimates					
Core net profit (MYRm)	88.7	95.5	106.0	114.1	121.2
Core FD EPS (sen)	26.0	27.9	30.0	32.2	34.3
Revised financial estimates					
Core net profit (MYRm)	88.7	95.5	102.6	109.9	115.2
Core FD EPS (sen)	26.0	27.9	29.0	31.1	32.6

Source: Company, Maybank Kim Eng

Figure 5: Core net profit (MYRm)



Source: Company, Maybank Kim Eng

Still very much a BUY in our books

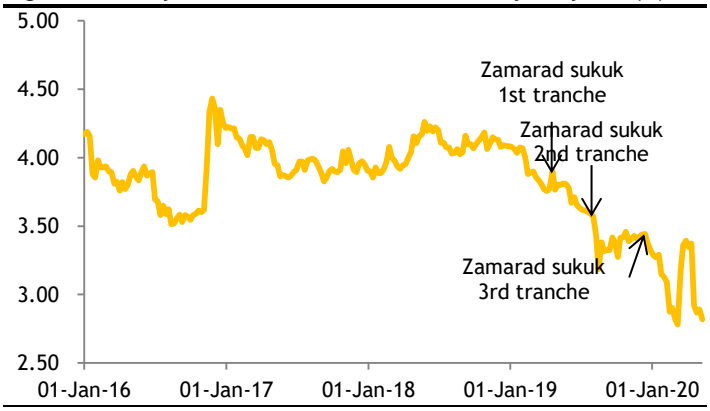
At risk of sounding like a broken record, we believe that there is still upside potential to our earnings estimates from lower cost of funds (COF). Recall that RCE has been issuing Zamarad sukuk tranches at lower and lower profit rates in tandem with Malaysian Government Securities (MGS) 10-year yields (Fig. 6 and 7). Thanks to easier monetary conditions around the world, the MGS 10-year yield has fallen to 2.8% (Fig. 7). We assume that RCE will issue future Zamarad sukuk tranches at profits rates of 4.3% which implies MGS 10-year yields of 3.4%. Assuming similar 80-90bps spreads, future Zamarad sukuk tranches maybe issued at even lower profit rates of 3.6-3.7%. All others being equal, we estimate that every 25bps reduction in average COF will accrete ~MYR3m or 3% to our earnings estimates. For now, we maintain our average COF forecasts as per Fig. 4.

Figure 6: Outstanding sukuk issued by RCE Capital

Sukuk	Issuance date	Profit rate	Principal (MYRm)
Al Dzahab	21 Jun 2016 - 16 Mar 2018	5.51%	770
Zamarad - first tranche	27-Mar-19	4.92%	240
Zamarad - second tranche	26-Jul-19	4.54%	100
Zamarad - third tranche	19-Nov-19	4.26%	120
		5.19%	**1,230**

Source: Company

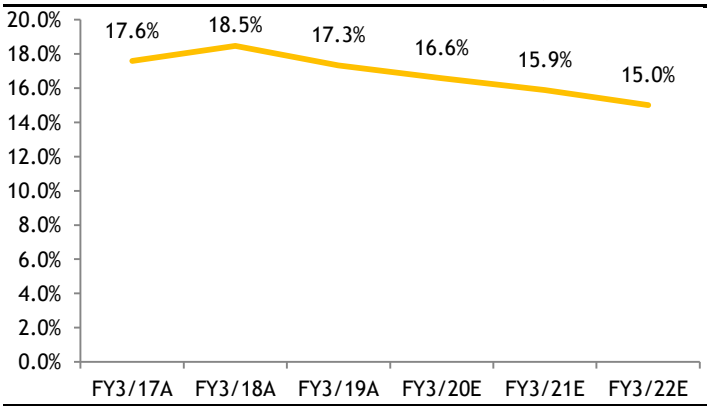
Figure 7: Malaysia Government Securities 10-year yield (%)



Source: Bloomberg

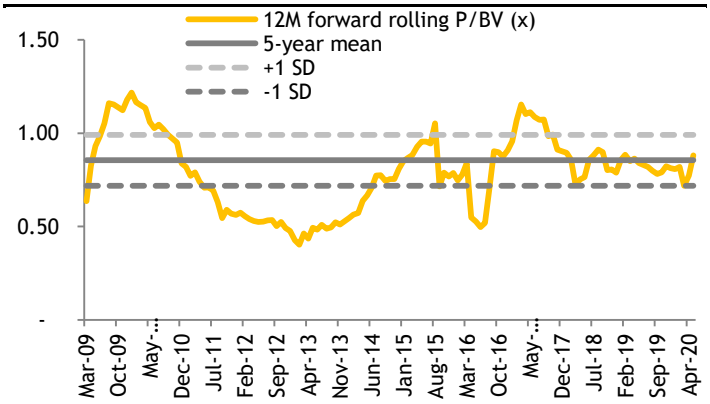
We ascribe an unchanged target end-CY20 P/BV of 0.93x (0.5x above the five year average 12-month forward P/BV) to arrive at a slightly lower TP of MYR1.92 (MYR1.94 previously). As a sanity check, our target end-CY20 P/BV of 0.93x corresponds to end-CY20 P/NTA of 1.00x. While we forecast ROAEs to ease a tad going forward, at the very least, we do not believe that RCE should trade below 1.00x P/NTA given that we forecast still high-ish ROAEs of at least 15% (Fig. 8). Moreover, RCE can improve its ROAEs by employing higher DPRs. Our DPS estimates are premised on a modest 33-34% DPR.

Figure 8: RCE Capital return on average equity (ROAE)



Source: Company

Figure 9: RCE Capital rolling 12M forward P/BV



Source: Company, Maybank Kim Eng, Bloomberg

Moreover, we maintain our view that RCE may distribute its treasury shares as share dividends. To date, RCE has bought back 22.6m ordinary shares that it has retained as treasury shares (bought back 2.2m ordinary shares in Mar 2020 alone). These treasury shares account for 6.1% of its total number of outstanding ordinary shares. Our 'back of the envelope' calculations indicate that RCE can distribute treasury shares as share dividends on the basis of 1 treasury share for every 20 ordinary shares held and still be left with 5.1m treasury shares. With 15% upside potential still (6% from cash dividend yield), we maintain our BUY call on RCE.

Figure 10: Potential treasury shares distributable as share dividends

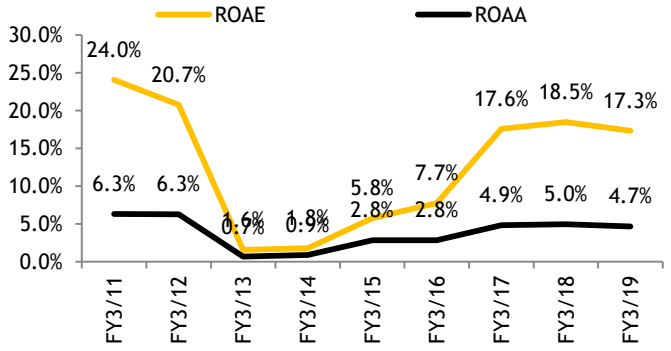
Description	m
Number of outstanding ordinary shares as at 8 May 2020 (A)	372.9
Number of treasury shares as at 8 May 2020 (B)	22.6
Number of ordinary shares after setoff as at 8 May 2020 (C=A-B)	350.3
Number of treasury shares distributed on basis of 1 treasury share for every 20 ordinary shares held (D=C/20)	17.5
Number of treasury shares remaining (E=B-C)	5.1

Source: Bursa Malaysia, Maybank Kim Eng

Value Proposition

- RCE Capital provides personal financing, the ultimate customers being civil servants.
- With a gross financing balance of just MYR1.8b, we estimate that its market share is only 2%.
- Non-performing financing kept in check thanks to non-discretionary direct salary deductions.
- Competitive advantage lies in fast financing processing turnaround time of 48 hours.
- ROE generation surpasses that of the average for the overall banking industry.

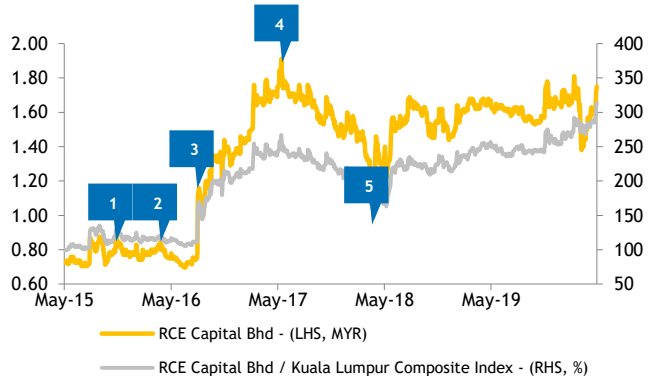
ROE and ROA



Source: Company, Maybank Kim Eng

Price Drivers

Historical share price trend



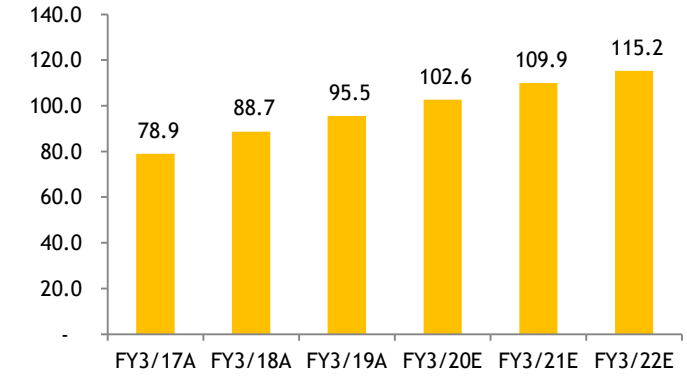
Source: Company, Maybank Kim Eng

1. Proposed special interim DPS of 10.5 sen. Still paid a final DPS of 3.5sen.
2. Proposed capital repayment of MYR0.075/shr and 4-into-1 share consolidation.
3. 1QFY17 net profit surged 86% YoY as FY17 revenue grew 39% YoY.
4. FY17 net profit surged 98% YoY as FY17 revenue grew 38% YoY.
5. Concerns arise that the government may reduce the size of the civil service.

Financial Metrics

- Introduced a better credit scoring model in 2013. Forecast gross financing growth of 3-5% p.a. over the next three years.
- Average financing yields may be peaking at 14% but average cost of funds is falling.
- Asset quality better than before. New financing are smaller in size (<MYR20k) and their NPF ratios are low (<2%).
- Forecast stable three-year forward core net profit CAGR of 6% p.a.
- There is room for dividends to surprise to the upside as its DPR policy is only 20-40%.

Core net profit (MYRm)



Source: Company, Maybank Kim Eng estimates

Swing Factors

Upside

- Easing competition - competitors have been reducing their exposure to personal financing.
- Lower cost of funds - we estimate that every 25bps reduction in cost of funds will accrete 3% to earnings.
- Access to CCRIS - if RCE Capital gains access to CCRIS, it can better assess customers' total indebtedness.

Downside

- High household debt - Household debt to GDP is elevated at >80% and may crimp customers' repayment ability.
- Need to leverage - RCE Capital cannot take deposits and thus, has to assume debt to finance its financing.
- Asset-liability duration mismatch - customers' repayment may not match RCE Capital's debt repayment.

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FYE 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Key Metrics					
Core P/E (x)	4.7	5.8	5.9	5.6	5.3
Core FD P/E (x)	4.7	5.8	6.1	5.7	5.4
P/BV (x)	0.8	1.0	0.9	0.8	0.8
P/NTA (x)	0.9	1.0	1.0	0.9	0.8
Net dividend yield (%)	5.7	5.5	5.6	5.9	6.2
INCOME STATEMENT (MYR m)					
Islamic banking income	149.2	164.2	176.5	187.9	196.3
Other income	39.1	35.8	38.6	40.1	41.3
Total non-interest income	**188.3**	**200.0**	**215.1**	**228.0**	**237.6**
Operating income	**188.3**	**200.0**	**215.1**	**228.0**	**237.6**
Staff costs	(22.4)	(21.4)	(23.2)	(24.1)	(24.8)
Other operating expenses	(18.9)	(23.8)	(24.5)	(25.5)	(26.2)
Operating expenses	**(41.3)**	**(45.2)**	**(47.7)**	**(49.5)**	**(51.0)**
Pre-provision profit	**147.0**	**154.8**	**167.4**	**178.5**	**186.6**
Other allowances	(29.6)	(23.7)	(26.6)	(27.6)	(28.5)
Associates & JV income	0.0	0.0	0.0	0.0	0.0
Pretax profit	**117.4**	**131.1**	**140.8**	**150.9**	**158.1**
Income tax	(28.7)	(35.6)	(38.2)	(40.9)	(42.9)
Reported net profit	**88.7**	**95.5**	**102.6**	**109.9**	**115.2**
Core net profit	**88.7**	**95.5**	**102.6**	**109.9**	**115.2**
BALANCE SHEET (MYR m)					
Cash & deposits with banks	197.2	492.4	496.0	535.7	578.4
Sec. under resale agreements	0.0	0.0	0.0	0.0	0.0
Derivatives financial assets	0.0	0.0	0.0	0.0	0.0
Dealing securities	0.0	0.0	0.0	0.0	0.0
Available-for-sale securities	0.0	0.0	0.0	0.0	0.0
Investment securities	0.0	0.0	0.0	0.0	0.0
Financing and advances	1,528.5	1,602.4	1,680.2	1,726.9	1,774.9
Fixed assets	6.2	4.5	4.5	4.5	4.5
Intangible assets	47.3	47.3	47.3	47.3	47.3
Other assets	79.5	79.5	79.5	79.5	79.5
Total assets	**1,858.8**	**2,226.1**	**2,307.6**	**2,394.0**	**2,484.7**
Derivatives financial instruments	0.0	0.0	0.0	0.0	0.0
Subordinated debt	0.0	0.0	0.0	0.0	0.0
Other securities in issue	766.9	1,005.2	1,225.2	1,325.2	1,425.2
Other borrowings	230.4	280.8	189.3	101.3	14.2
Other liabilities	342.2	356.6	237.4	238.1	238.6
Total liabilities	**1,339.5**	**1,642.6**	**1,651.9**	**1,664.6**	**1,678.0**
Share capital	44.7	154.5	160.0	160.0	160.0
Reserves	474.6	429.1	495.6	569.3	646.7
Shareholders' funds	519.3	583.5	655.6	729.4	806.7
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	519.3	583.5	655.6	729.4	806.7
Total liabilities & equity	**1,858.8**	**2,226.1**	**2,307.6**	**2,394.0**	**2,484.7**

FYE 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Key Ratios					
Growth (%)					
Net interest income	na	na	na	na	na
Non-interest income	9.7	6.2	7.6	6.0	4.2
Operating expenses	(4.1)	9.4	5.6	3.8	2.9
Pre-provision profit	14.3	5.3	8.1	6.6	4.5
Core net profit	12.3	7.7	7.4	7.1	4.8
Gross loans	8.0	5.2	5.0	3.0	3.0
Customer deposits	na	na	na	na	na
Total assets	9.2	19.8	3.7	3.7	3.8
Profitability (%)					
Non-int. income/Total income	100.0	100.0	100.0	100.0	100.0
Cost/income	21.9	22.6	22.2	21.7	21.5
Liquidity (%)					
Loans/customer deposits	na	na	na	na	na
Asset quality (%)					
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	18.5	17.3	16.6	15.9	15.0
ROAA	5.0	4.7	4.5	4.7	4.7
Shareholders equity/assets	27.9	26.2	28.4	30.5	32.5

Source: Company; Maybank

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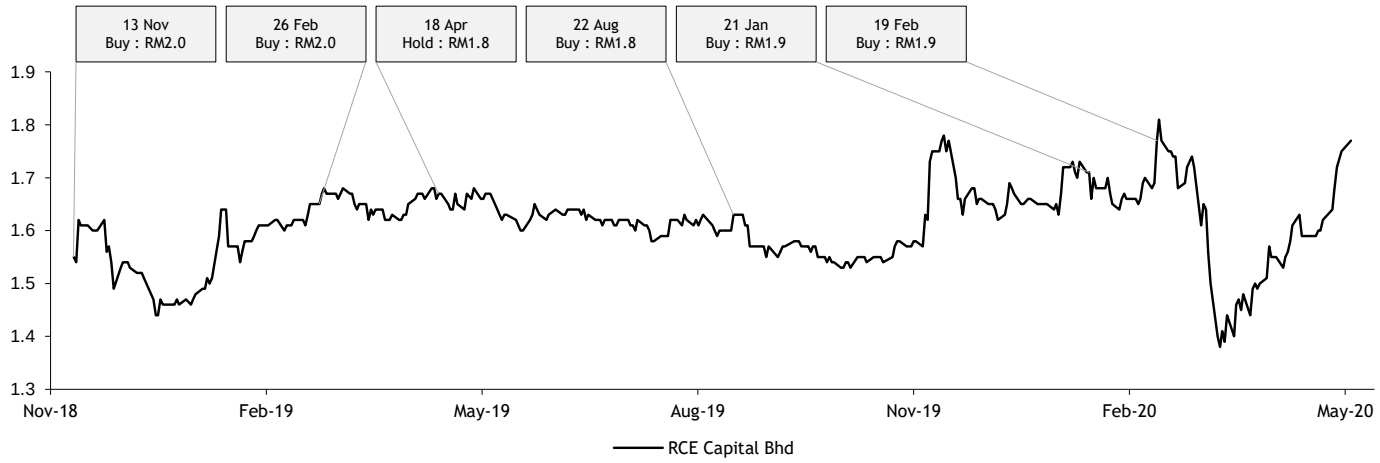

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