

RCE Capital Bhd (RCE MK)

Small cap dynamo

Maintain BUY - lift TP by 6% to MYR1.91

We are increasingly reassured of our earnings estimates for RCE and expect it to be more progressive on cash dividends. We tweak our EPS estimates marginally but lift our cash DPS estimates to 10.0sen/10.5sen/11.0sen from 9.0sen p.a. RCE may also distribute treasury shares as share DPS, we opine. We raise our target end-CY20 P/BV to 0.93x (0.87x previously) to arrive at a higher TP of MYR1.91 (MYR1.80 previously). With 17% upside potential, maintain BUY on RCE.

Increasingly confident of 4-5% loans growth p.a.

Despite flattish civil servants emoluments and weak consumer sentiment, we are increasingly confident that RCE will meet our 4-5% loans growth p.a. forecasts. RCE cannot take deposits and has to finance its loans largely with borrowings. As RCE will raise another MYR240m in borrowings by end-FY3/20 (+16% of borrowings as at end-2QFY3/20), this indicates to us that demand for its loans remain healthy and it should be able to grow its end-FY3/20 gross loans balance by at least 5% YoY.

Profit spreads still have a little room to expand

On lending yields, we understand that the profit rate profile of its new loans is still skewed to the 7.99% (effective profit rate: 13.1%) ones and above. This relieves downward pressure on our average lending yield forecasts of 14.2% p.a. going forward. On cost of funds, Zamarad sukuk tranches continue to be issued at lower-than-expected profit rates. As Malaysian Government Securities yields continue to slide, we gather that future Zamarad sukuk tranches may be issued at even lower profit rates.

Lift cash DPS estimates, Share DPS in store?

Although we tweak our FY20/FY21/FY22 EPS estimates by a marginal 0.1%/0.3%/0.4%, we lift our FY20/FY21/FY22 cash DPS estimates to 10.0sen/10.5sen/11.0sen from 9.0sen p.a. As cost of funds is getting cheaper, we opine that it is more worthwhile for RCE to finance its loans with borrowings and freeing internally generated cash to declare more cash dividends. Our calculations also indicate that RCE can distribute 1 treasury share for every 20 ordinary shares held as share dividends.

FYE Mar (MYR m)	FY18A	FY19A	FY20E	FY21E	FY22E
Operating income	188	200	211	224	237
Pre-provision profit	147	155	163	174	185
Core net profit	89	96	100	107	114
Core FDEPS (MYR)	0.26	0.28	0.28	0.30	0.32
Core FDEPS growth(%)	9.0	7.6	0.8	7.2	6.5
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	5.3
P/BV (x)	0.8	1.0	0.9	0.8	0.7
Net dividend yield (%)	5.7	5.5	5.8	6.1	6.4
Book value (MYR)	1.52	1.71	1.89	2.10	2.32
ROAE (%)	18.5	17.3	16.1	15.5	14.9
ROAA (%)	5.0	4.7	4.4	4.5	4.5
Consensus net profit	-	-	100	106	112
MKE vs. Consensus (%)	-	-	0.0	0.5	1.2

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BUY

Share Price MYR 1.71 12m Price Target MYR 1.91 (+17%)

Previous Price Target MYR 1.80

Company Description

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

Statistics

52w high/low (MYR)	1.78/1.53
3m avg turnover (USDm)	0.2
Free float (%)	32.4
Issued shares (m)	371
Market capitalisation	MYR633.8M
	USD156M

Major shareholders:
Cempaka Empayar Sdn. Bhd. 51.5%
RCE Capital Bhd. 5.5%
Employees Provident Fund 2.3%

Price Performance



 -1M
 -3M
 -12M

 Absolute (%)
 2
 10
 9

 Relative to index (%)
 4
 9
 16

-RCE Capital Bhd / Kuala Lumpur Composite Index - (RHS, %)

Source: FactSet

Increasingly confident of 4-5% loans growth p.a.

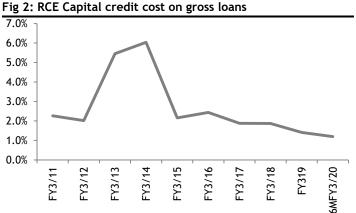
Investors will recall that as RCE does not take deposits, it has to finance its gross loans largely with borrowings. Our research quantifies the correlation coefficient between loans and borrowings at a high 0.90 (Fig. 1). From end-4QFY3/19 to end-2QFY3/20, RCE's gross loans balance grew by 3% or MYR50m. Post-2QFY3/20, RCE raised MYR120m from issuing Zamarad sukuk third tranche on 19 Nov 2019 and plans to raise another MYR120m from issuing Zamarad sukuk fourth tranche some time in Mar 2020. This indicates to us that demand for RCE's loans remains healthy. As RCE will raise another MYR240m in borrowings by end-4QFY3/20, we are increasingly confident that RCE will grow its end-4QFY3/20 gross loans balance by at least 5% YoY. We forecast end-FY20/FY21/FY22 gross loans growth of 5%/5%/4%.

Gross loans and receivables (MYRm) Total borrowings (MYRm) 2,000 1,800 1,600 1,400 1,200 1,000 800 600 400 200 FY3/10 FY3/14 FY3/15 FY3/16 FY3/18 FY3/19 FY3/12 FY3/11 FY3/17 5MFY3/20

Fig 1: RCE Capital gross loans and receivables vs. total borrowings

Source: Company

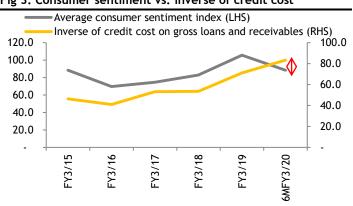
Mindful of asset quality, RCE believes its gross loans growth is measured and credit costs are contained. While we forecast FY20/FY21/FY22 credit cost on gross loans of 1.5%/1.5%/1.5%, we note that actual credit cost on gross loans has been trending lower (four quarter moving average as at 2QFY3/20: 1.2%) which is testament to the revised credit scoring model it implemented in May 2013 (Fig. 2). In our view, this is admirable given that consumer sentiment in Malaysia has been weakening of late and there tends to be an inverse relationship between credit cost on gross loans and consumer sentiment (Fig. 3). All else being equal, we estimate that every 10bps reduction in its credit cost on gross loans will accrete 1% to our EPS estimates.



* four quarters moving average

Source: Company

Fig 3: Consumer sentiment vs. inverse of credit cost



Source: Company, Malaysian Institute Of Economic Research, Maybank Kim Eng

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Profit spreads still have a little room to expand

On lending yields, we understand that the lower yielding loans priced at 6.5% profit rate (effective profit rate: 11.0%) account for a measured ~15% of all new loans disbursed. Loans priced at 6.5% profit rate were introduced in Apr 2019 for lower risk customers. We gather that the higher yielding loans priced at 7.99% (effective profit rate: 13.1%) and above remain more popular (Fig. 4). This relieves downward pressure on our FY20/FY21/FY22 average lending yield forecasts of 14.2%/14.2%/14.2% (6MFY3/20: 14.2%). We still project average lending yields to plateau at 14.2% going forward.

Fig 4: Profit rates of loans offered by RCE

Published profit rate	Effective profit rate*
6.50%	10.96%
6.99%	11.67%
7.99%	13.10%
8.99%	14.49%
9.99%	15.85%

^{*} assumes 10 year tenure

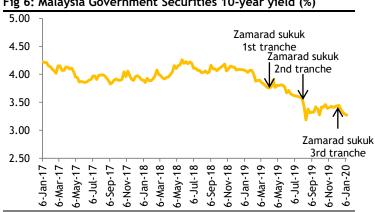
Source: Company, Maybank Kim Eng

On cost of funds, we were pleased to note that the Zamarad sukuk third tranche was actually priced at 4.26% (not 4.51%) and 66bps lower than the Zamarad sukuk first tranche (Fig. 5). We tweak our FY20/FY21/FY22 EPS estimates by a marginal 0.1%/0.3%/0.4% to account for the revised Zamarad sukuk third tranche profit rate of 4.26% and assume future Zamarad sukuk tranches will be similarly priced. That said, Malaysian Government Securities yields have fallen ~15bps since the Zamarad sukuk third tranche was issued. We do not discount the possibility that future Zamarad sukuk tranches will be priced lower than 4.26% (Fig. 6).

Fig 5: 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

Fig 6: Malaysia Government Securities 10-year yield (%)



Source: Bloomberg

For now, we still expect average profit spreads to expand from 8.5% in FY19 to 8.8% in FY20 and hover at 8.8% thereafter.

Fig 7: Major assumptions

Source: Company

	FY3/18A	FY3/19A	FY3/20E	FY3/21E	FY3/22E
Gross loans growth	8.0%	5.2%	5.0%	5.0%	4.0%
Estimated average lending yield (A)	13.4%	13.9%	14.2%	14.2%	14.2%
Estimated average cost of funds (B)	5.5%	5.4%	5.4%	5.3%	5.3%
Estimated average profit spread (C=A-B)	7.9%	8.5%	8.8%	8.8%	8.8%
Credit cost as % of average gross loans	1.9%	1.4%	1.5%	1.5%	1.5%

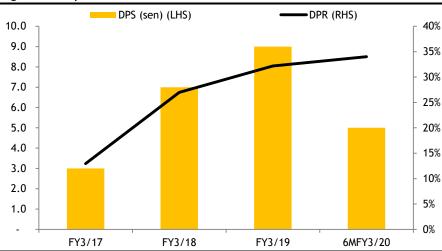
Source: Company, Maybank Kim Eng

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Lift cash DPS estimates, Share DPS in store?

While our EPS estimates are little changed, we lift our FY20/FY21/FY22 DPS estimates to 10.0sen/10.5sen/11.0sen from 9.0sen p.a. as we raise our FY20/FY21/FY22 DPR assumption to 35%/34%/33% from 31%/29%/27%. Recall that 6MFY3/20 interim DPS of 5.0sen translates into 34% DPR. Seeing that cost of funds is getting cheaper, we opine that it is more worthwhile for RCE to finance more of its gross loans with borrowings rather than internally generated cash given that cost of debt is almost always cheaper than cost of equity. This frees up internally generated cash to declare more dividends, in our view.

Fig 8: RCE Capital DPR and DPS



Source: Company

Over and above more cash dividends, we do not discount the possibility that RCE may distribute some of its treasury shares as share dividends. To date, RCE has bought back 20.4m ordinary shares that it has retained as treasury shares. These treasury shares account for 5.5% 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 2.9m treasury shares.

Fig 9: Potential treasury shares distributable as share dividends

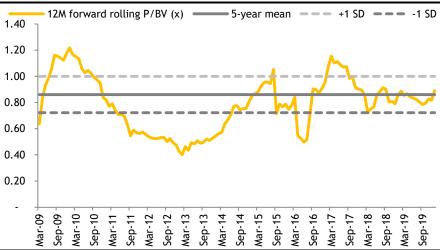
Description	m
Number of outstanding ordinary shares as at 8 Jan 2020 (A)	369.9
Number of treasury shares as at 8 Jan 2020 (B)	20.4
Number of ordinary shares after setoff as at 8 Jan 2020 (C=A-B)	349.5
Number of treasury shares distributed on basis of 1 treasury share for every 20 ordinary shares held (D=C/20)	17.5
Number of treasury shares remaining (E=B-C)	2.9

Source: Bursa Malaysia, Maybank Kim Eng

Valuation and recommendation

Reassured of our earnings estimates for RCE and expecting it to be more progressive on dividends, we believe it warranted to ascribe a higher target P/BV multiple for RCE. We raise our target end-CY20 P/BV to 0.93x (0.5x above the five year average 12-month forward P/BV) from 0.87x (in-line with five-year average 12-month forward P/BV) to arrive at a higher TP of MYR1.91 (MYR1.80 previously). As a sanity check, out target end-CY20 P/BV of 0.93x corresponds to end-CY20 P/NTA of 1.00x. At the very least, we do not believe that RCE should trade below 1.00x P/NTA given its high ROEs of ~15.0%. If RCE consistently trades below NTAPS, we opine that it may be privatised or acquired. With 17% upside potential still (6% from dividend yield), we maintain our BUY call on RCE.

Fig 10: RCE Capital rolling 12M forward P/BV

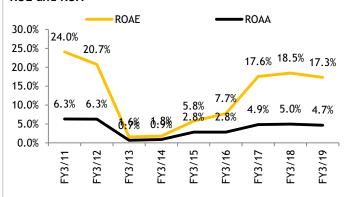


Source: Company, Maybank Kim Eng, Bloomberg

Value Proposition

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

ROE and ROA

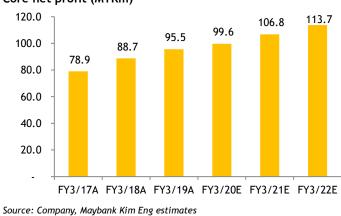


Source: Company, Maybank Kim Eng

Financial Metrics

- Introduced a better credit scoring model in 2013. Forecast gross loans growth of 4-5% p.a. over the next three years.
- Average lending yields may be peaking at 14% but average cost of funds is falling.
- Asset quality better than before. New loans are smaller in size (<MYR20k) and their NPL 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)



Price Drivers



Source: Company, Maybank Kim Eng

- 1. Proposed special interim DPS of 10.5 sen. Still paid a final DPS of 3.5sen.
- 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.
- 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.

Swing Factors

Upside

- Easing competition competitors have been reducing their exposure to personal financing.
- Lower interest rates 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 borrowers' total indebtedness.

Downside

- High household debt Household debt to GDP is elevated at >80% and may crimp borrowers' repayment ability.
- Need to leverage RCE Capital cannot take deposits and thus, has to assume debt to finance its loans.
- Asset-liability duration mismatch borrowers' 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	5.5	5.2
Core FD P/E (x)	4.7	5.8	6.1	5.7	5.3
P/BV (x)	0.8	1.0	0.9	0.8	0.7
P/NTA (x)	0.9	1.0	1.0	0.9	0.8
Net dividend yield (%)	5.7	5.5	5.8	6.1	6.4
INCOME STATEMENT (MYR m)					
Interest income	218.5	242.2	259.7	272.6	284.9
Interest expense	(69.4)	(78.1)	(87.4)	(88.9)	(90.1)
Net interest income	149.2	164.2	172.2	183.7	194.8
Islamic banking income	na	na	na	na	na
Other income	39.1	35.8	38.3	40.2	42.0
Total non-interest income	39.1	35.8	38.3	40.2	42.0
Operating income	188.3	200.0	210.5	223.9	236.8
Staff costs	(22.4)	(21.4)	(22.9)	(24.1)	(25.2)
Other operating expenses	(18.9)	(23.8)	(24.3)	(25.4)	(26.5)
Operating expenses	(41.3)	(45.2)	(47.2)	(49.5)	(51.7)
Pre-provision profit	147.0	154.8	163.3	174.4	185.1
Loan impairment allowances	(29.6)	(23.7)	(26.6)	(27.9)	(29.2)
Associates & JV income	0.0	0.0	0.0	0.0	0.0
Pretax profit	117.4	131.1	136.7	146.5	156.0
Income tax	(28.7)	(35.6)	(37.1)	(39.7)	(42.3)
Reported net profit	88.7	95.5	99.6	106.8	113.7
Core net profit	88.7	95.5	99.6	106.8	113.7
BALANCE SHEET (MYR m)					
Cash & deposits with banks	197.2	492.4	529.3	564.1	603.3
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
Loans & advances	1,528.5	1,602.4	1,680.2	1,760.4	1,826.8
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	2,340.9	2,455.9	2,561.5
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	106.1	49.7	(21.1)
Other liabilities	342.2	356.6	357.1	357.8	358.5
Total liabilities	1,339.5	1,642.6	1,688.3	1,732.7	1,762.6
Share capital	44.7	154.5	160.0	160.0	160.0
Reserves	474.6	429.1	492.6	563.2	638.9
Shareholders' funds	519.3	583.5	652.6	723.2	798.9
Preference shares	0.0	0.0	0.0	0.0	0.0
Minority interest	0.0	0.0	0.0	0.0	0.0
-	519.3	583.5	652.6	723.2	798.9
Total equity	319.1	201.7	0:17:0	//3./	

FYE 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Key Ratios					
Growth (%)					
Net interest income	14.5	10.1	4.9	6.7	6.0
Non-interest income	(5.6)	(8.3)	6.9	5.0	4.4
Operating expenses	(4.1)	9.4	4.6	4.8	4.3
Pre-provision profit	14.3	5.3	5.5	6.8	6.1
Core net profit	12.3	7.7	4.3	7.2	6.5
Gross loans	8.0	5.2	5.0	5.0	4.0
Customer deposits	na	na	na	na	na
Total assets	9.2	19.8	5.2	4.9	4.3
Profitability (%)					
Non-int. income/Total income	20.8	17.9	18.2	18.0	17.7
Cost/income	21.9	22.6	22.4	22.1	21.8
Liquidity (%)					
Loans/customer deposits	na	na	na	na	na
Asset quality (%)					
Gross NPL	4.1	4.4	4.5	4.7	4.9
Loan loss coverage	178.0	172.1	170.1	167.0	164.1
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	18.5	17.3	16.1	15.5	14.9
ROAA	5.0	4.7	4.4	4.5	4.5
Shareholders equity/assets	27.9	26.2	27.9	29.4	31.2

Source: Company; Maybank

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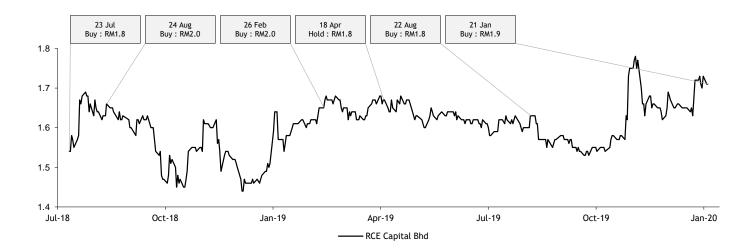
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