

11 November 2020

Financial Services | Banks

RCE Capital (RCE MK)

Buy (Maintained)

Consistent But Never Boring; Keep BUY

Target Price (Return): MYR2.50 (28.9%)
 Price: MYR1.94
 Market Cap: USD169m
 Avg Daily Turnover (MYR/USD) 0.41m/0.10m

- **Maintain BUY with unchanged TP MYR2.50, 29% upside and c.6% yield.** RCE Capital's 1HFY21 (Mar) results came in within expectations. Topline recovered QoQ as business operations are now back to pre-COVID levels. A 6 sen interim DPS was declared, implying 38% payout ratio. RCE is largely unaffected by the re-imposition of the Conditional Movement Control Order (CMCO), with both the underlying demand and asset quality still resilient. At 0.8x FY22F P/BV, we estimate RCE is still undervalued despite the consistent deliveries in both earnings and dividends.

- **1HFY21 within expectations.** RCE Capital printed MYR55.8m PATAMI during 1HFY21 (+9% YoY) which was in line with our and consensus estimates. PIOP grew healthily +9% YoY on 8% YoY higher NII and 13% YoY lower opex, despite non-ll declined 13% YoY. Half time provisions jumped 26% YoY due to the MYR2.6m macro overlay booked in 1QFY21. 1HFY21 ROE stood at 16.1% vs 1HFY20's 16.9%. A 6 sen interim DPS was declared (1HFY20 DPS: 5 sen), implying a payout of 38%.

- **2QFY21 earnings drivers.** PATAMI rebounded strongly in 2QF21 (+21% YoY/+45% QoQ) as business operations recovered to pre-COVID levels. PIOP increased 32% QoQ – both NII and non-ll rebounded 25% and 18% QoQ. CIR improved to 18.3% (2QFY21: 23.4%) on the strong topline growth and QoQ flat opex. Provisions normalized 20% QoQ due to the absence of any macro overlays made during the quarter; 2QFY21 credit cost was 32bps QoQ lower at 127bps. Annualized ROE jumped to 18.9% from 13.5% a quarter ago.

- **Receivables and asset quality.** Receivables started to grow again during 2QFY21 (+0.8% QoQ) after shrinking 1.8% QoQ in 1QFY21. Asset quality was steady. The NPL ratio drifted slightly lower to 4.2% (1QFY21: 4.4%).

- **Other highlights.** We learned that business operations were largely unaffected by the re-imposition of the CMCO. Underlying demand for credit remains healthy with applications back to pre-COVID level. Processing is taking longer, namely the employer verification part, as most civil servants are working from home. We believe this is just a slight inconvenience to RCE and borrowers and is hardly a concern. While provisions normalized this quarter, management reiterated that further macro overlays will depend on the GDP forecast, although the underlying asset quality is expected to be resilient.

- **Earnings and TP.** We made no changes to our earnings forecasts and TP of MYR2.50 post 2QFY21 results. Our GGM-derived TP values RCE Capital 1x FY22F P/BV, which is +1SD of its historical mean.

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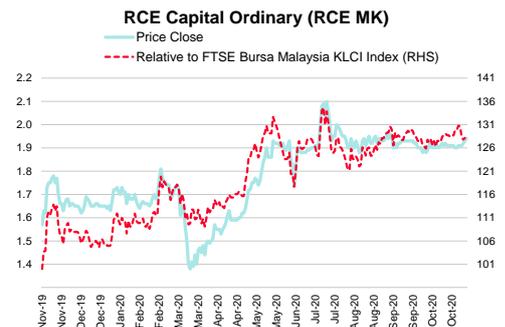


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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	17.6	0.5	3.2	10.9	22.8
Relative	21.7	0.9	6.2	0.6	28.1
52-wk Price low/high (MYR)				1.38	– 2.10



Source: Bloomberg

Forecasts and Valuation	Mar-19	Mar-20	Mar-21F	Mar-22F	Mar-23F
Reported net profit (MYRm)	96	111	110	119	125
Net profit growth (%)	7.7	15.8	(0.2)	7.9	4.9
Recurring net profit (MYRm)	96	111	110	119	125
Recurring EPS (MYR)	0.28	0.32	0.32	0.34	0.36
BVPS (MYR)	1.71	1.94	2.17	2.43	2.71
DPS (MYR)	0.09	0.11	0.11	0.12	0.12
Recurring P/E (x)	6.92	6.10	6.16	5.71	5.44
P/B (x)	1.13	1.00	0.89	0.80	0.72
Dividend Yield (%)	4.6	5.7	5.7	5.9	6.2
Return on average equity (%)	17.3	17.6	15.4	14.8	13.9

Source: Company data, RHB

Note:

Small cap stocks are defined as companies with a market capitalization of less than USD1bn.

Financial Exhibits

Asia	Financial summary (MYR)	Mar-19	Mar-20	Mar-21F	Mar-22F	Mar-23F
Malaysia	EPS	0.28	0.32	0.32	0.34	0.36
Financial Services	Recurring EPS	0.28	0.32	0.32	0.34	0.36
RCE Capital	DPS	0.09	0.11	0.11	0.12	0.12
RCE MK	BVPS	1.71	1.94	2.17	2.43	2.71
Buy						
	Valuation metrics	Mar-19	Mar-20	Mar-21F	Mar-22F	Mar-23F
Valuation basis	Recurring P/E (x)	6.92	6.10	6.16	5.71	5.44
Our GGM assumptions are:	P/B (x)	1.1	1.0	0.9	0.8	0.7
i. CoE of 14.4;	Dividend Yield (%)	4.6	5.7	5.7	5.9	6.2
ii. ROE of 14.7%; and						
iii. 2% long-term growth rate						
	Income statement (MYRm)	Mar-19	Mar-20	Mar-21F	Mar-22F	Mar-23F
Key drivers	Interest income	234	257	268	279	287
Our FY21 forecasts are most sensitive to changes in:	Interest expense	(78)	(82)	(87)	(91)	(91)
i. Financing margins;	Net interest income	156	175	181	188	196
ii. Impairment allowances; and	Non interest income	39	46	48	49	52
iii. Growth in receivables.	Total operating income	195	221	229	238	248
	Overheads	(45)	(49)	(53)	(55)	(57)
Key risks	Pre-provision operating profit	150	172	176	183	190
The downside risks include:	Loan impairment allowances	(18)	(23)	(27)	(23)	(22)
i. Higher credit costs;	Pre-tax profit	131	149	149	160	168
ii. Weaker net financing margins; and	Taxation	(36)	(38)	(38)	(41)	(43)
iii. Weaker growth in receivables.	Reported net profit	96	111	110	119	125
	Recurring net profit	96	111	110	119	125
Company Profile						
RCE provides general financing services to civil servants - 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.	Profitability ratios	Mar-19	Mar-20	Mar-21F	Mar-22F	Mar-23F
	Return on average assets (%)	4.7	4.7	4.3	4.3	4.4
	Return on average equity (%)	17.3	17.6	15.4	14.8	13.9
	Return on IEAs (%)	12.2	12.2	11.9	11.8	11.7
	Cost of funds (%)	5.4	4.9	4.8	4.8	4.7
	Net interest spread (%)	6.9	7.3	7.1	7.1	7.0
	Net interest margin (%)	8.2	8.3	8.1	8.0	8.0
	Non-interest income / total income (%)	19.8	20.9	20.9	20.8	20.8
	Cost to income ratio (%)	23.2	22.2	23.2	23.1	23.2
	Credit cost (bps)	110	130	149	119	110
	Balance sheet (MYRm)	Mar-19	Mar-20	Mar-21F	Mar-22F	Mar-23F
	Total gross loans	1,729	1,820	1,866	1,965	2,049
	Other interest earning assets	279	364	444	438	438
	Total gross IEAs	2,009	2,184	2,309	2,403	2,487
	Total provisions	(130)	(130)	(142)	(151)	(159)
	Net loans to customers	1,599	1,690	1,724	1,814	1,890
	Total net IEAs	1,878	2,054	2,168	2,253	2,328
	Total non-IEAs	348	377	521	545	603
	Total assets	2,226	2,431	2,688	2,798	2,931
	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	760	852	950
	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	163.3	166.5	168.3

Source: Company data, RHB

Results At a Glance

Figure 1: RCE – Summary of 2QFY21 and 1HFY21 results

FYE Mar (MYRm)	2QFY20	1QFY21	2QFY21	% QoQ	% YoY	1HFY20	1HFY21	% YoY	Comments – 2QFY21 vs 1QFY21
NII	42.9	40.3	50.5	25.2	17.8	84.1	90.9	8.1	
Interest income	63.2	61.4	70.2	14.3	11.2	124.7	131.6	5.5	
Interest expense	(20.3)	(21.1)	(19.7)	(6.7)	(2.9)	(40.6)	(40.7)	0.3	Lower QoQ as the cheaper <i>sukuk</i> funding helped lower cost of fund.
Non-II	12.2	8.9	10.5	18.1	(13.6)	22.4	19.5	(13.2)	Recovered QoQ as MCO impacted non-II in 1QFY21.
Non-II/Total income (%)	22.1	18.1	17.3			21.0	17.6		
Operating income	55.1	49.3	61.1	23.9	10.8	106.5	110.3	3.6	
Overheads	(12.6)	(11.5)	(11.2)	(2.8)	(11.4)	(26.3)	(22.7)	(13.5)	
CIR (%)	23.0	23.4	18.3			24.6	20.6		
PIOP	42.5	37.8	49.9	32.1	17.4	80.3	87.6	9.2	
Impairment on financings	(5.7)	(7.2)	(5.7)	(17.5)	4.4	(10.2)	(12.9)	26.5	Lower QoQ in the absence of macro overlay provisions in 2QFY21.
Credit cost	128	159	127			0	0		
Pre-tax profit	36.8	30.6	44.2	43.7	19.5	70.1	74.7	6.7	
Tax	(9.6)	(7.8)	(11.2)			(18.8)	(18.9)		
ETR (%)	26.2	25.4	25.3			26.8	25.3		
Net earnings	27.2	22.8	33.0	43.7	20.7	51.3	55.8	8.9	
Other key data and ratios									
Gross financing	1,778.8	1,788.2	1,802.2	0.8	1.3				
Total borrowings	1,478.3	1,531.2	1,534.5	0.2	3.8				
Gross impaired financing	(132.5)	(131.8)	(131.4)	(0.2)	(0.8)				
Total assets	2,143.1	2,269.7	2,293.2	1.0	7.0				
Shareholders' funds	629.4	680.4	717.5	5.4	14.0				
ROAA	5.1%	3.9%	5.8%			4.7%	4.7%		
ROAE	17.5%	13.5%	18.9%			16.9%	16.1%		
GIL ratio	4.4%	4.4%	4.2%						Asset quality remained resilient.

Source: Company, RHB

Valuation

Our GGM-derived TP of MYR2.50 values RCE Capital at 1.0x FY22F P/BV which is +1SD from its historical mean. We believe RCE is still being undervalued despite its consistent earnings deliveries. RCE remains our top pick among the non-bank lenders on its resilient asset quality.

Figure 2: RCE's GGM valuation

Cost of equity (COE) computation:		Sustainable ROE (%)	14.7
Risk free rate (%)	2.9	COE (%)	14.4
Equity premium (%)	7.4	Long-term growth (g)	2.0
Beta (x)	1.6	Implied P/BV (x)	1.0
Cost of equity - CAPM (%)	14.4	BVPS – FY22F	MYR 2.42
		Target price	MYR 2.49
		TP (rounded)	MYR 2.50

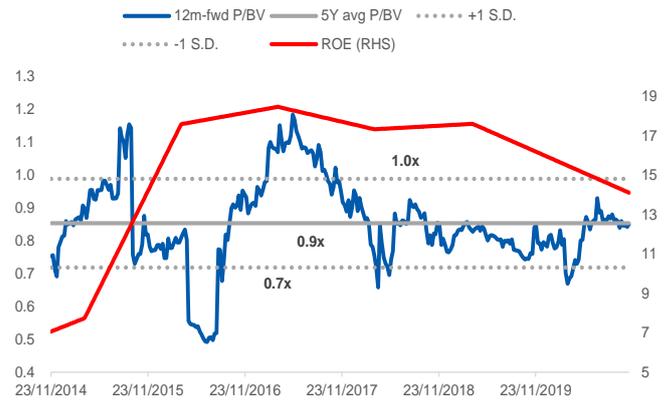
Source: Company data, RHB

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



Source: Bloomberg, RHB

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



Source: Bloomberg, RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2020-07-06	Buy	2.50	1.92
2020-06-16	Buy	2.20	1.81
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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