

22 November 2022

Financial Services | Banks

RCE Capital (RCE MK)

Neutral (from Buy)

Fairly Valued After The Recent Rally; D/G NEUTRAL

Target Price (Return): MYR1.95 (10.2%)
 Price (Market Cap): MYR1.77 (USD283m)
 ESG score: 3.10 (out of 4)
 Avg Daily Turnover (MYR/USD) 0.35m/0.08m

- **D/G to NEUTRAL from Buy with a new GGM-derived MYR1.95 TP from MYR1.92, 10% upside and c.5% yield.** 1HFY23 (Mar) results met our and Street's estimates but with a surprise special dividend of 18 sen/share declared (additional yield of +10%). While we expect the share price to rise as a reaction, the recent price rally leads us to believe that the stock is already fairly valued at c.1.5x P/BV – above +1SD from its 5-year mean.
- **1HFY23 earnings within expectations.** RCE Capital recorded net earnings of MYR68.8m – in line with our and Street's forecasts. Earnings growth was a positive 2.7% YoY, largely driven by higher net interest and non-Il (+3% and +11%) but offset by an increase in impairment allowances. ROAE at half time stood at 16.3%. The company declared an interim dividend of 5 sen/share on top of a special dividend of 18 sen/share as a general reward to shareholders.
- **Financing growth is a pleasant surprise.** Gross financing at 30 Sep stood at MYR1.96bn (+6% YoY, +4% YTD) against our previous forecast of 4% for the full year. Management claims that appetite for financing among civil servants remains strong despite increasing pressure on cost of living and the rising interest rate environment. While no specific guidance was provided, management is hopeful that RCE's financing growth can track the wider banking industry's, which is growing at a mid-single-digit rate.
- **Slight improvement in asset quality.** RCE recorded impairment allowances of MYR6.9m in 2QFY23 – down 16% QoQ, but up almost tenfold vis-à-vis 2QFY22. Recall that early provisions were made for civil servants – mostly teachers and healthcare sector workers – exiting public service in 1Q, with the same trend continuing into 2Q but to a lesser extent. Regardless, repayment trends from customers appear to be stable and within expectations, with credit costs of 142bps in 2Q having more or less normalised back to pre-pandemic levels of 100-200bps.
- **Forecasts and valuation.** Our forecasts remain relatively unchanged, as increased financing growth assumptions are largely mitigated by higher credit costs. Our TP rises slightly to MYR1.95, which includes a 2% ESG premium as per our in-house methodology. After a recent share price rally (+15% in the past month), we believe the stock is fairly valued at 1.48x P/BV, given that it is trading over +1SD from its 5-year mean, with RCE's defensive attributes – particularly its resilient salary deduction scheme and prudent asset quality controls – already priced in. We downgrade the stock to NEUTRAL as a result.
- **Key risks** include higher-than-expected credit costs and weaker-than-expected financing growth. The converse, including favourable regulatory changes, present upside risks.

Analysts

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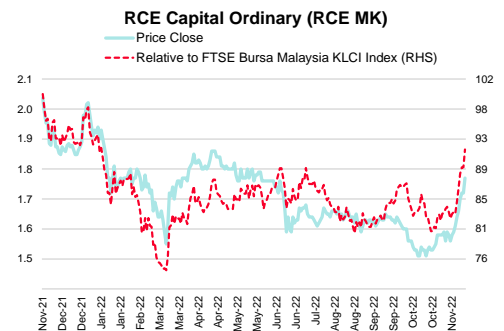


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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(10.6)	15.7	9.3	(1.7)	(12.0)
Relative	(3.0)	15.6	13.1	4.8	(6.9)
52-wk Price low/high (MYR)	1.51 – 2.04				



Source: Bloomberg

Overall ESG Score: 3.10 (out of 4)

E: GOOD

The Group maintains transparent and detailed disclosures of its Scope 1 and Scope 2 emissions, which has recorded a decent reduction of 3% between FY22 (Mar) and FY20. Fosters a culture of green volunteerism through its Green Warriorz Team, and has designated e-waste containers on office floors to encourage proper disposal of e-waste such as unused gadgets and batteries.

S: GOOD

RCE outsources auditing of its IT systems to ensure competency standards are met. The Group, in collaboration with Yayasan Azman Hashim, also provides study grants and scholarships to deserving underprivileged students to pursue Chartered Accountancy certifications. To date, MYR524,000 has been distributed under the programme.

G: EXCELLENT

Board comprises of 9 non-executive directors, 5 of whom are independent directors. Board members have a maximum allowed tenure of 9 years, to facilitate Board refreshment. However, in FY22, there was a one-off incident of non-compliance in relation to a late payment of service tax due to administrative delay, but that has since been resolved.

Note:

Small cap stocks are defined as companies with a market capitalisation of less than USD0.5bn.

Forecasts and Valuation	Mar-21	Mar-22	Mar-23F	Mar-24F	Mar-25F
Reported net profit (MYRm)	125	133	136	140	147
Net profit growth (%)	12.7	6.9	1.8	3.1	5.4
Recurring net profit (MYRm)	125	133	136	140	147
Recurring EPS (MYR)	0.18	0.18	0.19	0.19	0.20
BVPS (MYR)	1.13	1.19	1.34	1.48	1.64
DPS (MYR)	0.07	0.07	0.08	0.08	0.09
Recurring P/E (x)	9.74	9.73	9.56	9.27	8.80
P/B (x)	1.57	1.49	1.32	1.19	1.08
Dividend Yield (%)	4.0	4.2	4.5	4.5	4.8
Return on average equity (%)	17.2	16.2	14.6	13.5	12.9

Source: Company data, RHB

Financial Exhibits

Asia	Financial summary (MYR)	Mar-21	Mar-22	Mar-23F	Mar-24F	Mar-25F
Malaysia	EPS	0.18	0.18	0.19	0.19	0.20
Financial Services	Recurring EPS	0.18	0.18	0.19	0.19	0.20
RCE Capital	DPS	0.07	0.07	0.08	0.08	0.09
RCE MK	BVPS	1.13	1.19	1.34	1.48	1.64
Neutral						
	Valuation metrics	Mar-21	Mar-22	Mar-23F	Mar-24F	Mar-25F
Valuation basis	Recurring P/E (x)	9.74	9.73	9.56	9.27	8.80
Our GGM assumptions are:	P/B (x)	1.6	1.5	1.3	1.2	1.1
i. CoE of 11.4%;	Dividend Yield (%)	4.0	4.2	4.5	4.5	4.8
ii. ROE of 14%;						
iii. 3.5% long-term growth rate.						
Key drivers	Income statement (MYRm)	Mar-21	Mar-22	Mar-23F	Mar-24F	Mar-25F
Our FY23 forecasts are most sensitive to changes in:	Interest income	273	275	291	299	314
i. Growth in receivables;	Interest expense	(81)	(80)	(85)	(91)	(95)
ii. Impairment allowances;	Net interest income	192	194	206	208	219
iii. Financing margins.	Non interest income	39	45	53	56	58
	Total operating income	232	239	259	264	278
Key risks	Overheads	(49)	(51)	(51)	(53)	(56)
The downside risks include:	Pre-provision operating profit	183	189	208	211	222
i. Higher-than-expected credit cost;	Loan impairment allowances	(16)	(12)	(26)	(24)	(24)
ii. Weaker-than-expected financing growth;	Pre-tax profit	167	177	182	188	198
iii. Weaker-than-expect net financing margin.	Taxation	(43)	(44)	(46)	(48)	(50)
	Reported net profit	125	133	136	140	147
The converse represents upside risk.	Recurring net profit	125	133	136	140	147
	Profitability ratios	Mar-21	Mar-22	Mar-23F	Mar-24F	Mar-25F
Company Profile	Return on average assets (%)	5.1	5.1	4.8	4.7	4.7
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.	Return on average equity (%)	17.2	16.2	14.6	13.5	12.9
	Return on IEAs (%)	11.7	10.9	11.2	11.2	11.2
	Cost of funds (%)	4.8	4.6	4.6	4.8	4.9
	Net interest spread (%)	7.0	6.2	6.6	6.3	6.3
	Net interest margin (%)	8.3	7.7	7.9	7.8	7.8
	Non-interest income / total income (%)	17.0	18.9	20.5	21.2	21.0
	Cost to income ratio (%)	21.1	21.1	19.7	20.0	20.1
	Credit cost (bps)	85.1	62.0	133.1	114.9	111.3
	Balance sheet (MYRm)	Mar-21	Mar-22	Mar-23F	Mar-24F	Mar-25F
	Total gross loans	1,845	1,879	2,011	2,111	2,217
	Other interest earning assets	625	702	604	631	660
	Total gross IEAs	2,471	2,581	2,615	2,743	2,877
	Total provisions	(124)	(115)	(129)	(141)	(153)
	Net loans to customers	1,721	1,764	1,882	1,970	2,063
	Total net IEAs	2,346	2,466	2,485	2,602	2,724
	Total non-IEAs	144	260	401	448	498
	Total assets	2,491	2,725	2,887	3,050	3,222
	Other interest-bearing liabilities	1,671	1,804	1,858	1,914	1,971
	Total IBLs	1,671	1,804	1,858	1,914	1,971
	Total non-IBLs	46	49	49	50	50
	Total liabilities	1,717	1,853	1,907	1,963	2,022
	Share capital	188	201	213	226	239
	Shareholders' equity	774	872	980	1,086	1,200
	Asset quality and capital	Mar-21	Mar-22	Mar-23F	Mar-24F	Mar-25F
	Reported NPLs / gross cust loans (%)	4.0	3.8	3.8	3.8	3.8
	Total provisions / reported NPLs (%)	168.4	162.8	169.1	175.9	182.1

Source: Company data, RHB

Results At A Glance

Figure 1: RCE – summary of 2QFY23 and 1HFY23 Results

FYE Mar (MYRm)	2Q FY22	1Q FY23	2Q FY23	QoQ (%)	YoY (%)	1H FY22	1H FY23	YoY (%)	Comments – 1HFY23 vs 1HFY22
NII	43.2	48.8	49.3	1.0	14.1	94.9	98.2	3.4	
Interest income	63.7	69.2	71.0	2.5	11.4	135.3	140.2	3.6	Driven by robust receivables growth (+6% YoY).
Interest expense	(20.5)	(20.4)	(21.6)	6.1	5.7	(40.4)	(42.0)	4.1	In line with increased <i>sukuk</i> funding (+9% YoY).
Non-II	10.7	14.0	17.2	22.1	60.5	21.7	31.2	43.5	Fee income from increased refining activities by customers.
<i>Non-II/total income (%)</i>	19.8	22.3	25.8			18.6	24.1		
Operating Income	53.9	62.9	66.5	5.7	23.3	116.6	129.3	10.9	
Overhead expenses	(11.0)	(11.8)	(11.0)	(6.4)	0.7	(23.4)	(22.8)	(2.3)	
<i>CIR (%)</i>	20.3	18.8	16.6			20.0	17.7		
PIOP	42.9	51.1	55.4	8.5	29.1	93.3	106.5	14.2	
Impairment on financing	(0.7)	(8.2)	(6.9)	(16.2)	>100	(3.8)	(15.1)	>100	Pre-emptive provisions made for civil servants that retired early or have left the service.
<i>Ann. credit costs (bps)</i>	16	173	142			44	167		
PBT	42.2	42.9	48.6	13.2	15.1	89.5	91.5	2.2	
Taxation	(10.7)	(10.7)	(12.0)			(22.5)	(22.7)		
<i>ETR (%)</i>	25.3	24.9	24.8			25.2	24.8		
Net earnings	31.5	32.2	36.5	13.4	15.8	66.9	68.8	2.7	In line with our and Street's forecasts.
Other key data and ratios									
Gross financing	1,852.1	1,904.7	1,957.6	2.8	5.7				Management guides for financing to track growth of the banking industry.
Total borrowings	1,696.2	1,847.0	1,844.3	(0.1)	8.7				
Gross impaired financing	(120.3)	(118.3)	(120.2)	1.6	(0.1)				
Total assets	2,567.3	2,767.3	2,807.4	1.5	9.4				
Shareholders' funds	825.3	875.0	911.7	4.2	10.5				
ROAA (%)	4.9%	4.7%	5.2%			5.3%	5.2%		
ROAE (%)	15.7%	14.8%	16.4%			18.3%	16.3%		

Source: Company data, RHB

Figure 2: Revisions in full-year earnings forecasts

FYE Mar	Net profit (MYRm)			PBT (MYRm) – HP division			PBT (MYRm) – Furniture division		
	Previous	Revised	% Chg	Previous	Revised	% Chg	Previous	Revised	% Chg
2023F	136.3	135.6	-0.5	0.19	0.19	-0.5	0.08	0.26	>100
2024F	139.1	139.8	0.5	0.19	0.19	0.5	0.09	0.08	-5.9
2025F	146.9	147.3	0.3	0.20	0.20	0.3	0.09	0.09	-5.6

Source: Company data, RHB

Valuation and TP

Our new TP of MYR1.95 from MYR1.92 is based on a GGM-derived fair value P/BV of 1.44x on a 12-month blended forward BVPS. This compares against the other non-bank lenders' P/BV multiples of around 1-1.2x.

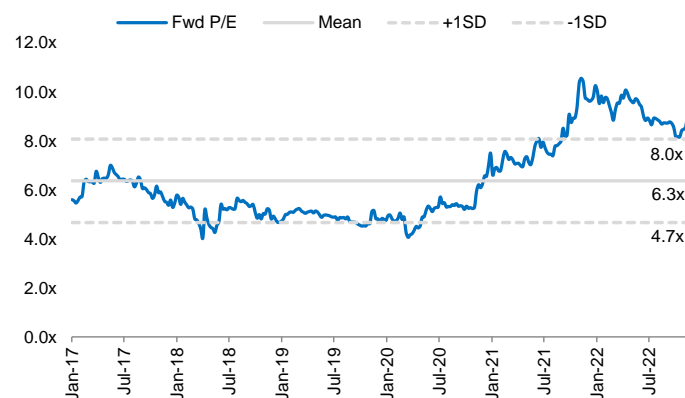
After a recent share price rally, we believe the stock is fairly valued, given that it is trading at over +1SD from its 5-year mean, with RCE's defensive attributes already priced in. However, we do not discount some further upward movement of the share price as a reaction to the special dividend announcement. Our recommendation changes to NEUTRAL from a Buy.

Figure 3: RCE's GGM valuation summary

Cost of equity (COE) computation:		Sustainable ROE (%)	14.0
Risk free rate (%)	4.0	COE (%)	11.4
Equity premium (%)	6.4	Long-term growth (g)	3.5
Beta (x)	1.2	Implied P/BV (x)	1.34
Cost of equity – CAPM (%)	11.4	BVPS – 12-month forward	MYR1.43
		Intrinsic value	MYR1.91
ESG premium/(discount) (%)	2.0	ESG premium/(discount)	MYR0.04
		TP (rounded)	MYR1.95

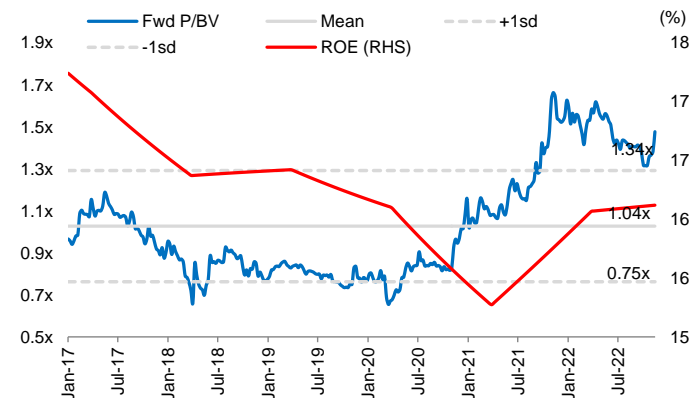
Source: Company data, RHB

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



Source: Bloomberg, RHB

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



Source: Bloomberg, RHB

Recommendation Chart

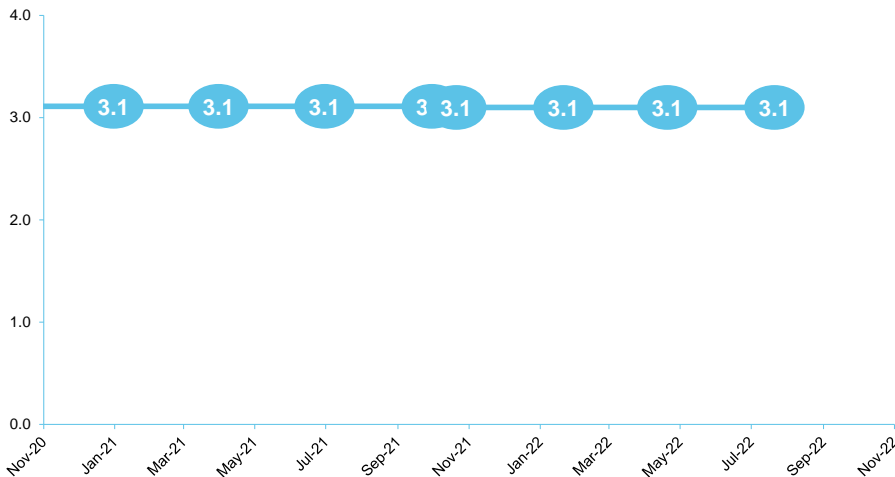


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
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
2020-12-08	Buy	2.80	1.29
2020-08-18	Buy	2.50	1.02
2020-07-06	Buy	2.50	1.01
2020-06-16	Buy	2.20	0.95
2020-03-15	Buy	2.10	0.79
2020-02-19	Buy	2.20	0.93
2020-02-19	Buy	2.20	0.93
2020-01-10	Buy	2.10	0.90

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

RHB Guide to Investment Ratings

Buy:	Share price may exceed 10% over the next 12 months
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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Sell:	Share price may fall by more than 10% over the next 12 months
Not Rated:	Stock is not within regular research coverage

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