PUBLIC INVESTMENT BANK

PublicInvest Research ***Company Initiation*** **Monday, February 26, 2024**

KDN PP17686/03/2013(032117)

RCE CAPITAL BERHAD *Trading Buy*

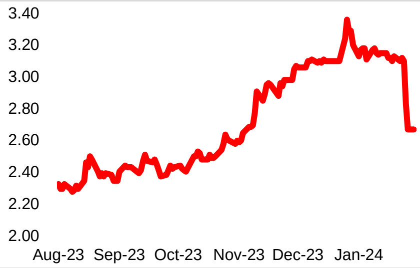
DESCRIPTION

RCE Capital is mainly involved in the general financing services to civil servants

12-month Target Price	RM2.95
Current Price	RM2.67
Expected Return	+10.5%
Previous Target Price	*N.A*

Market	Main
Sector	Consumer Finance
Bursa Code	9296
Bloomberg Ticker	RCE MK
Shariah-compliant	Yes

SHARE PRICE CHART



52 Week Range (RM)	1.75-3.40
3-Month Average Vol ('000)	1,201.7

SHARE PRICE PERFORMANCE

	1M	3M	6M
Absolute Returns	-20.5	2.3	17.7
Relative Returns	-18.9	-6.1	5.0

KEY STOCK DATA

Market Capitalisation (RMm)	1,956.7
No. of Shares (m)	732.9

MAJOR SHAREHOLDERS

	%
Cempaka Empayar SB	58.5
Woo Khai Yoon	1.5
EPF	1.5

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Stable Growth Trajectory with Attractive Dividends

RCE Capital (RCE) is generally involved in the provision of consumer financing services, with Malaysian civil servants as its end customers. The group has a unique salary deduction scheme whereby the installments are collected through monthly installments via two agents namely EXP Payment SB and Angkatan Koperasi Kebangsaan Malaysia (ANGKASA). Looking ahead, we forecast a 3-year earnings CAGR of 5%, on stable growth in financing receivables and a stable credit cost assumption. In addition, for the next 3 years, we forecast a dividend payout of c.60% as we err on the conservative side on the group's dividend payout policy of 60-80% of net profit. We believe that the recent decline in share price represents a good buying opportunity, therefore we initiate coverage on RCE with a ***Trading Buy*** call and a TP of RM2.95 based on Dividend Discount Model (DDM), implying a P/BV of 2.4x.

- **Personal financing provider.** RCE Marketing (RCEM) initially started by providing general financing services and trading of electrical home appliances. In 2006, RCEM shifted to provide consumer financing services and it has remained as the largest revenue contributor to the group, accounting for more than 95% of RCE's topline. The group is estimated to service around 78k of the total Malaysian civil servant population of 1.6m, which we believe has much room to grow given its c.5% market share. Based on the group's financing receivables of RM2bn, we estimate RCE to have a market share of c.1% in the personal financing industry. One of its main competitive advantages is the group's turnaround speed whereby RCE will be able to disburse the funds within 24 hours once approved.

- **Steady earnings growth on better asset quality.** We foresee RCE's earnings to increase at a CAGR of c.5% for FY24F-26F, on stable financing receivables growth, supported by higher civil servant emoluments. Note that civil servant emoluments grow at a 10-year CAGR of 3.9%, while RCE's financing receivables increased by a higher quantum, growing at a 10-year CAGR of c.6%. Meanwhile, we believe that RCE is able to maintain its non-performing loans (NPL) ratio at a stable level due to its unique salary deduction scheme and managements' preference to prioritize customers with better asset quality, supported by its credit scoring model. As a result, RCE's NPL ratio has been fairly stable, maintaining at c.4% for FY19-23.

- **Initiate with a Trading Buy call.** While RCE's current valuations implies that the share is trading at a premium of 2.3x P/BV, we believe that the valuation is justified given its ROE of c.17% remains attractive, as compared to the banking sector average ROE of 10-12%. We initiate coverage on RCE with a Trading Buy and a DDM derived TP of RM2.95, which implies a P/BV of 2.4x. We remain optimistic over the group's business model, as we foresee a growth in the group's financing receivables (3-year CAGR 4%), improving asset quality as well as an attractive dividend yield of c.5%.

KEY FINANCIAL SUMMARY

FYE Mar (RM'm)	2022A	2023A	2024F	2025F	2026F	CAGR
Operating Income	239.6	261.6	273.8	288.0	302.9	5.0%
Pre-provision profit	188.8	212.6	219.8	232.3	245.2	4.9%
Pre-tax profit	177.3	183.9	188.9	201.2	213.4	5.1%
Net profit	133.2	138.8	143.6	152.9	162.2	5.3%
EPS (sen)	18.0	18.7	19.4	20.6	21.9	
P/E (x)	14.9	14.3	13.8	12.9	12.2	
DPS (sen)	11.0	30.0	12.0	13.0	14.0	
Dividend Yield (%)	4.1	11.2	4.5	4.9	5.2	

Source: Company, PublicInvest Research estimates

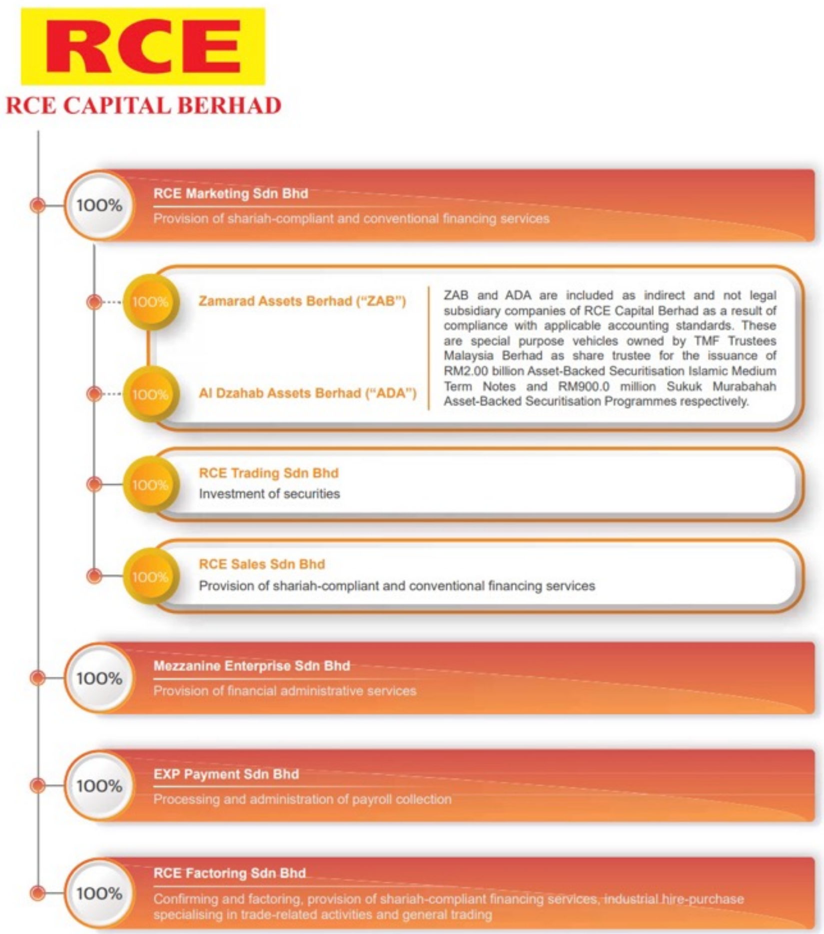
Background

RCEM has been the group's major revenue contributor

Company background. RCE Capital Berhad is an investment holding company that was listed on the Second Board of Bursa Malaysia in 1994 before being transferred to the Main Market in 2006. In 2003, RCE acquired RCEM and has been a major revenue contributor (>95%) to the group since. RCEM is primarily involved in the provision of consumer financing services to civil servants in Malaysia.

In 2007, RCE acquired RCE Factoring SB, which provides credit factoring solutions and had subsequently acquired EXP Payment SB (EXP) in 2014, which is involved in the processing and administration of payroll collection. Monthly repayments are done through a Salary Deduction Scheme where installments are deducted directly via two collection agencies, namely Biro Perkhimatan Angkasa (BPA) and EXP. This helps to ensure consistency in repayments, and a lower default rate.

Figure 1: Corp Structure

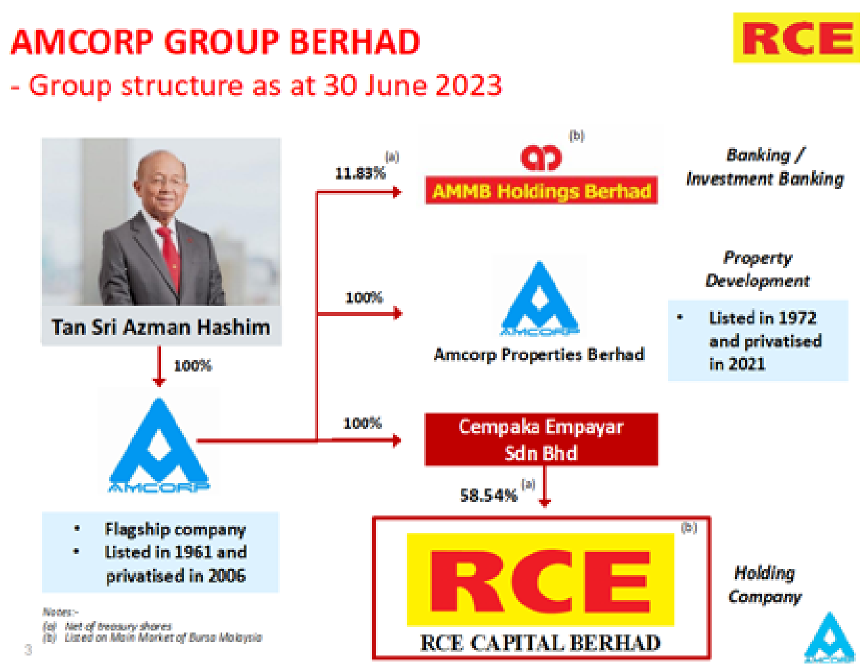


Source: Company, PublicInvest Research

Tan Sri Azman Hashim is the largest shareholder in RCE Capital

Major shareholders. Cempaka Empayar is the major shareholder of RCE, with an effective stake of 58.54%. Cempaka Empayar is wholly owned by Amcorp Group, which wholly owned by Tan Sri Azman Hashim, thus making Tan Sri the largest shareholder in RCE Capital.

Figure 2: Corp Structure



Source: Company, PublicInvest Research

Key management personnel. Mr Loh Kam Chuin was appointed as the CEO of RCE on 1st March 2010. He graduated from the University of South Australia with a Bachelor of Business-Banking and Finance. He has more than 30 years of experience in the financial services industry since joining Southern Bank Berhad in 1989. Mr Loh joined Fulcrum Capital SB in 1995 and was appointed as a Director in RCE Marketing SB in 2001.

Business Overview

Mainly involved in the provision of consumer financing services

RCE Capital. RCE Capital is principally involved in the provision of consumer financing services through its wholly-owned subsidiary RCEM where its customers are mainly Malaysian civil servants. The group is estimated to service approximately 5% (c.78k) of the total 1.6m civil servants in Malaysia. RCEM holds a Money Lending License that is approved by the Ministry of Housing and Local Government (KPKT) under the Moneylenders Act 1951.

Collaborates with 2 Foundations to provide financing services to its members

RCE mainly collaborates with 2 Foundations/ Cooperatives, namely Yayasan Ihsan Rakyat (YIR) and Yayasan Dewan Perniagaan Melayu Perlis Berhad (YYP) to provide financing services to its members.

ANGKASA and EXP Payment are the main collection agents for RCE

Collection agents. Monthly installments are collected via salary deductions that are processed by 2 main collection agents namely Angkatan Koperasi Kebangsaan Malaysia (ANGKASA) and EXP Payment. ANGKASA is at the pinnacle of all cooperatives in Malaysia. It is incorporated to unite all cooperatives in Malaysia under one federation. Both collection agents act as the code holders, where instructions will be given to the Accountant General's Department of Malaysia (AG) and other Government departments to deduct salaries of the borrowers.

Distribution channel. RCE appoints approximately 20 independent contractors to look for new customers. These marketing representatives are not under the direct employment of RCE but will be given commissions upon every successful loan application. We understand that RCE's disbursement is one of the fastest in the market, being able to disburse the funds within 24 hours. The average loan size is approximately RM15k with a maximum tenure of 10 years.

As a non-deposit taking financing institution, RCE's source of funds are mainly from sukuk and revolving credit

Therefore, its cost of funds is more expensive when compared against conventional banks

Source of funds. Given that RCE is a non-deposit taking financial institution, the group generally obtains its source of funds from the debt market by mainly leveraging on sukuk and revolving credit. As such, RCE's cost of funds is more expensive at c.4-6% against conventional banks at c.2-4%. Nevertheless, the group has a higher lending yield of c.11-13%, which results in a better lending spread of c.6-8%.

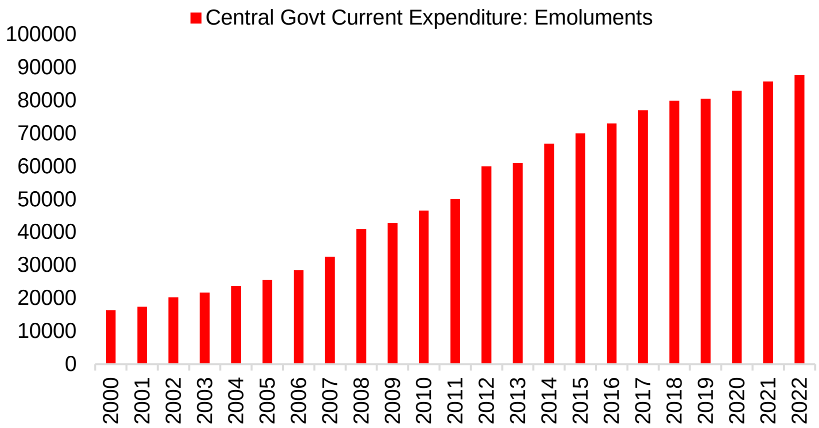
RCE's financing liabilities predominantly consists of c.20% short-term debt, with the remaining c.80% being long-term term financing and sukuk. The management has been actively trying to improve its funding mix by relying more on sukuk which resulted in a stable average 5-year Net Interest Margin (NIM) of c.8.4%.

Investment Merits

Civil service emoluments have been growing at a 10-year CAGR of 3.9%

Growth in civil servant emoluments. The emoluments among the civil service in Malaysia have been growing at a 10-year CAGR of 3.9%, as the Malaysian government has been actively looking after the welfare of the civil servants. Based on our estimates, Malaysian civil service has been growing at a CAGR of c.3.4% between 2010-2023. As such, we believe that given the growth in emoluments and number of civil servants, it should lead to an increase in demand due to the relatively safe employment prospects with the government. Growth in the Government workforce and the stability will continue to support the demand for personal loans.

Figure 3: Malaysia Civil Servant Emoluments (RM'm)



Source: Bank Negara Malaysia, PublicInvest Research

Unique salary collection model helps to maintain a consistent repayment and lower default rate

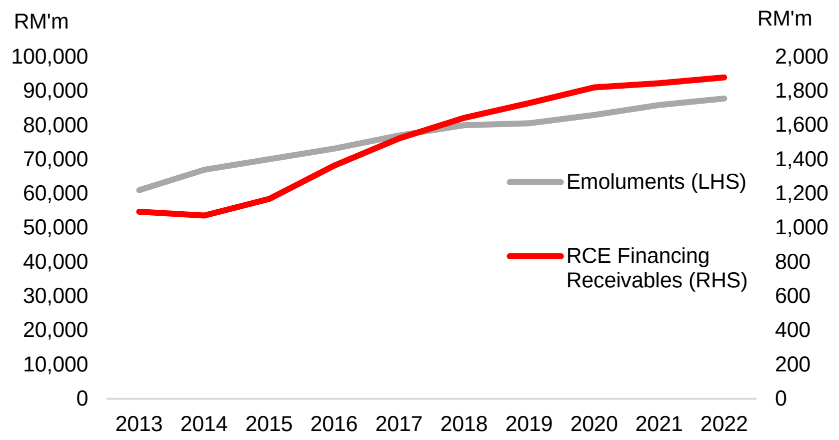
Automatic salary deduction scheme to safeguard collections. RCE's unique business model where the group is able to automatically deduct from borrowers' salaries helps to maintain consistent repayment and lower default rate. Repayments are collected by its main agents, ANGKASA and EXP Payment which will usually have a 1-3 months lag. Therefore, we believe that this distinctive collection method acts as a safety measure, which should act as a buffer to reduce the likelihood of any difficulties that arises from debt collection, given that RCE has the initial claims over the borrowers.

Financial receivables have been growing steadily, due to higher number of customers and larger civil servant emoluments

Solid financing receivables growth. RCE's financing receivables have been growing at a CAGR of 6.3% from FY13-23. We mainly attribute the growth to the increase in number of customers supported by the larger emoluments among civil servants. Going forward, we expect RCE's financing receivables growth to moderate to c.4% for FY24-26F, close to our GDP forecast amid the elevated Household Debt to GDP ratio (1HFY23: 81.9%). Meanwhile, the Federal government's plan to raise civil servants' salary in 2024 to boost the country's economy bodes well for RCE, as it could potentially lead to a boost in RCE's financing receivables given the correlation with government emoluments.

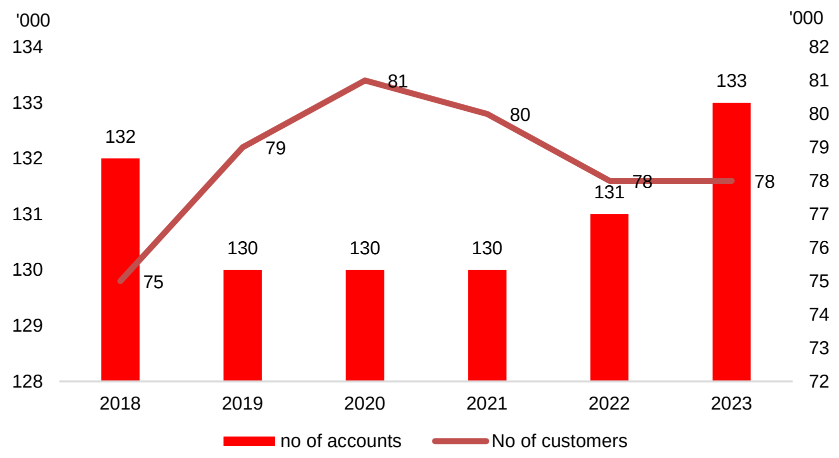
Financing receivables grew at a 10-year CAGR of 6.3% from FY13-23

Figure 4: Correlation between emoluments and receivables



Source: Bank Negara Malaysia, PublicInvest Research

Figure 5: RCE's number of accounts and customers



Source: Company, PublicInvest Research

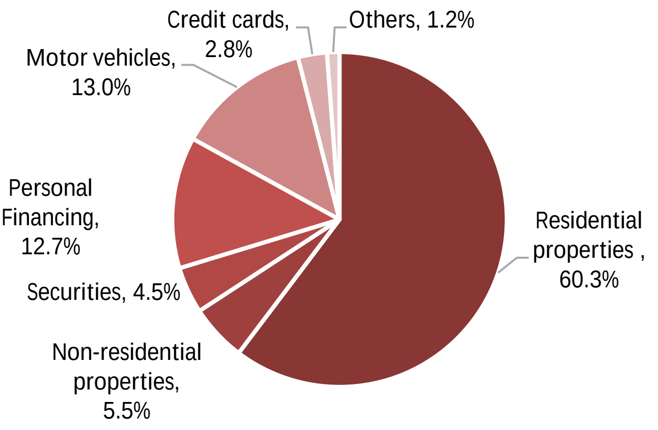
Industry Outlook

Malaysia's household debt-to-GDP ratio has remained fairly stable at 82%

Household debt. According to data from Bank Negara Malaysia (BNM), Malaysia's household loan grew at 5.4% YoY to RM1.48trn during 1H2023, with our household debt-to-GDP ratio remaining fairly stable at 81.9% (2H2022: 81.0%), mainly supposed by income and employment growth. Of the RM1.48trn worth of household debt, with housing debt having the lion's share of 60.3%. Meanwhile, personal financing accounts for 12.7% of the total household debt, amounting to c.RM188bn. Given RCE's financing receivables of RM2bn as of FY22, we estimate RCE to account for about 1.1% of the personal loans industry. Going forward, we expect household loans to continue on its growth trajectory at 4-5%, tracking our in-house GDP forecast due to the strong domestic demand whilst being supported by an uptick in employment rates and wage growth.

Housing debt is the largest component of household debt

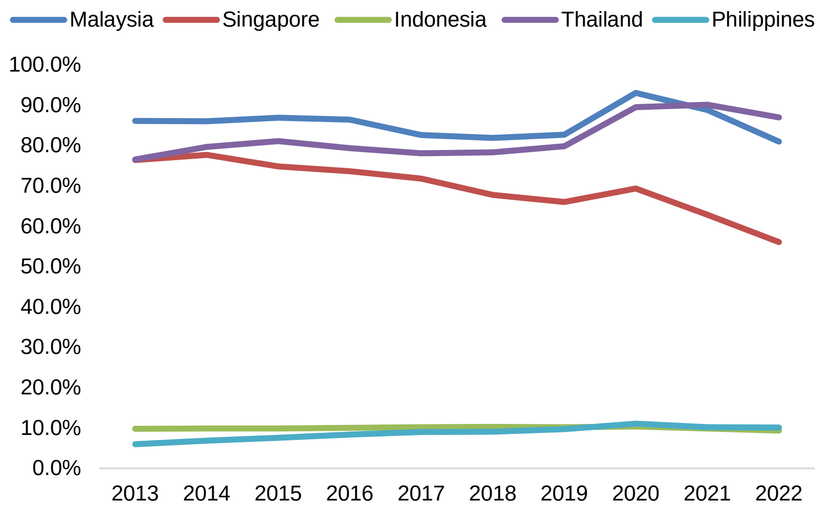
Figure 6: Composition of Household Debt



Source: Bank Negara Malaysia, PublicInvestment Research

However, Malaysia's household debt is one of the highest in the region, likely driven by skyrocketing housing prices. This remains as a concern as it indicates that Malaysians could be over-leveraged, thereby increasing the potential for loan defaults.

Figure 7: Regional Household Debt-to-GDP ratio



Source: CEIC, PublicInvestment Research

The CCA will likely focus more on regulating entities that are not regulated currently

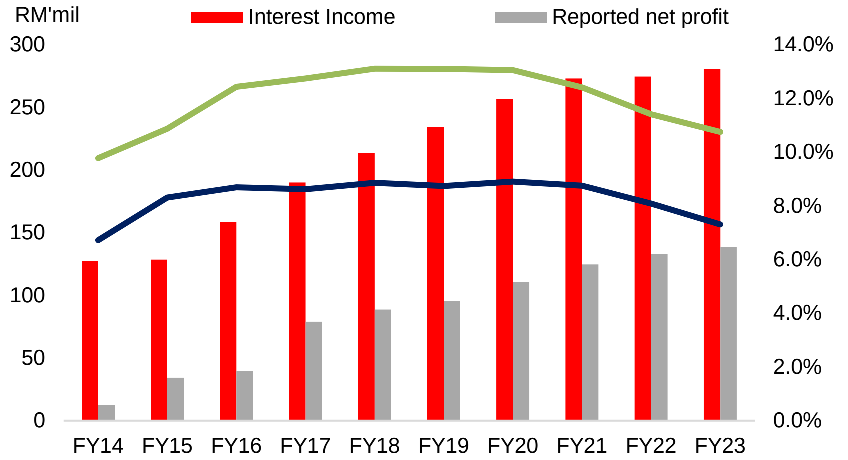
Consumer Credit Act (CCA). BNM and Securities Commission (SC) jointly drafted a bill to introduce the CCA, with an aim to strengthen the protection for consumers from non-bank credit providers and credit services. The CCA will establish a Consumer Credit Oversight Board (CCOB), whereby all credit and credit service providers will be required to obtain authorization from the CCOB which will focus on regulating entities that are currently not regulated. Nevertheless, we understand that the enactment of the CCA is unlikely to have a huge impact on RCE's business operations as the act will focus on the Buy Now Pay Later (BNPL) segment which is unregulated currently. Recall that RCE obtains its money lending license from the Ministry of Housing and Local Government.

Financial Highlights

Management continues to focus on improving its asset quality, resulting in an improvement in GIL and NPLs

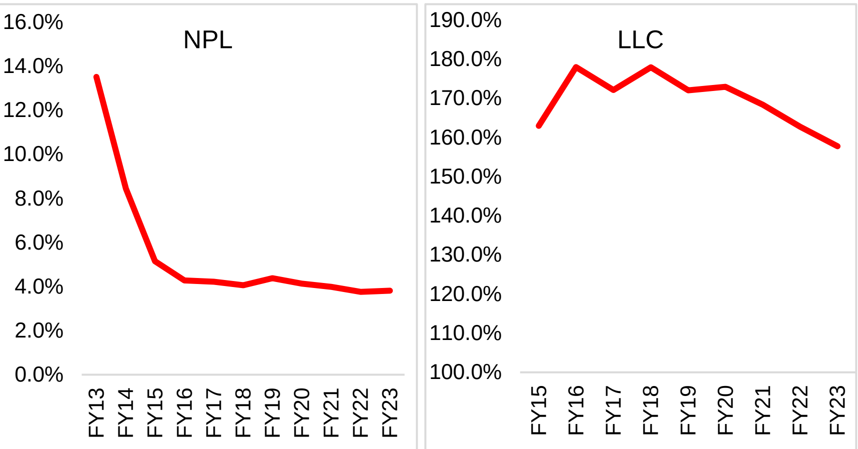
Better asset quality leads to better earnings. The group's continuous focus on improving its asset quality thanks to its own credit scoring model, and limiting the maximum Debt Service Ratio (DSR) at 60% has led to an improvement in its Gross Impairment Loan (GIL) ratio from 11.7% in FY14 to 6% in FY23. Note that RCE previously introduced a better in-house credit scoring model in CY13. In addition, the group also saw its Non-Performing Loans (NPL) ratio eased from 8.5% in FY14 to 3.8% in FY23. As a result, RCE reported a 30% 9-year CAGR in FY14-23, on the back of steady financing receivables growth, expansion in number of customers further supported by the improvement in asset quality.

Figure 8: RCE's Financial Highlights



Source: Company, PublicInvest Research

Figure 9: Non performing loans and Loan loss coverage ratio (%)



Source: Company, PublicInvest Research

Healthy loan loss coverage ratio. NPL ratio has remained stable at c.3.8-4.0% in FY20-23, from a high of c.13.5% in FY13. While the group's NPL ratio is much higher compared to the average NPL ratio of c.2% among banks, we think that the group has provided sufficient buffer for any potential risks that may arise with a Loan Loss Coverage ratio of more than 150% (FY23: 157%). We believe that it compares favourably against the banking sector as according to data from BNM, banks aggregate LLC stands at 115.8% as of 1HFY23.

Net profit fell by 2% YoY, on higher provision and impairment loss

3QFY24 results review. Despite recording a 5.7% YoY revenue growth to RM74.1m, RCE's 3QFY24 net profit fell by 1.7% YoY, to RM34.6m, dragged by higher provision and impairment loss. The uptick in impairment was mainly due to early retirement and resignations from civil servants. As a result, NPL ratio rose by 0.1 ppts QoQ to 3.8%. RCE continues to record a stable financing receivables growth of 1% QoQ to RM2.1bn albeit at a slower pace as the group's financing receivables grew by 2% QoQ in 2QFY24.

We foresee RCE's net profit to grow by 5% CAGR in FY24-26F, on stable gross receivables growth and the repricing in its product profit rates which was adjusted in 2HFY23 previously. We believe that the impact from the adjustment in product rates will only be reflected in FY24F onwards, as there will usually be a 3-6 month's lag in terms of profit recognition. The government's plan to raise civil servants' salaries in 2024 may provide a boost to RCE's financing receivables and lower turnover rate among the civil service. We believe that this could help to maintain RCE's credit cost on lower impairments. Recall that RCE's credit cost spiked in 1QFY23, dragged by the sudden increase in resignations among the civil service which led to a 39% QoQ increase in RCE's allowance for impairment loss.

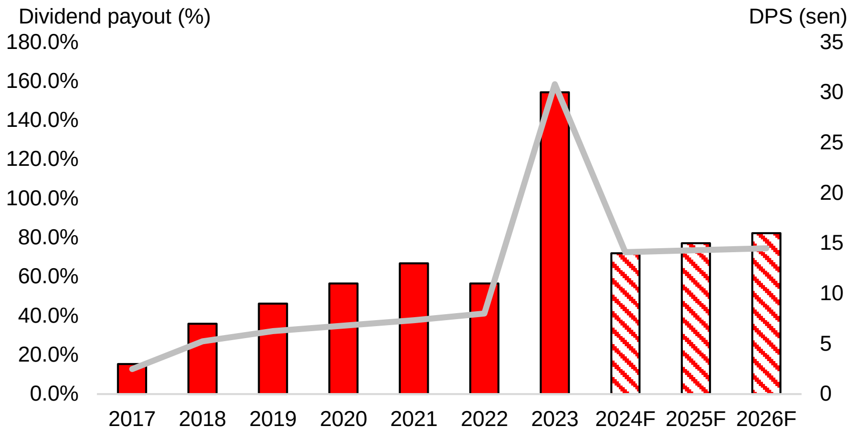
We deem RCE's net gearing ratio as manageable as it is lower when compared to its closest peer

Manageable gearing levels. As RCE is not a deposit taking financial institution, it is not surprising that RCE has higher gearing levels when compared to banks. Nevertheless, we deem RCE's net gearing ratio of 1.5x as of FY23 as manageable as compared to its closest peer, Aeon Credit (M) which has a net gearing ratio of 3.0x as of FY23. While the RM2bn ABS Sukuk program is still in place, we think that the remaining c.RM400m that has yet to be issued is unlikely to increase RCE's net gearing ratio to an alarming rate.

RCE targets to have a dividend payout ratio of 60-80% of its profits

Attractive dividend play. While the group does not have a formal dividend policy, RCE has been paying dividends consistently, with an average payout ratio of 61% for the past 5 years. This translates to dividend yield of c.5%. Dividend payout jumped to 158% in FY23, as the group declared a special dividend of 18sen. Going forward, RCE targets to have a dividend payout ratio of 60-80%.

Figure 10: Dividend Payout Ratio (%)



Source: Company, PublicInvest Research

Investment Risks

Elevated household debt remains a concern

High household debt. The main risk for RCE is the high household debt rate, as Malaysia's average household debt is at 80%, which is higher than its regional peers. The elevated household debt rate may lead to higher loan defaults among its customers. However, we think that the risk is partially mitigated by its automated salary deduction scheme.

Exodus in civil servants. RCE saw a decline in its number of customers in the last 3 years (from 81k to 78k), mainly due to the sudden increase in early retirement and resignation among the civil servants.

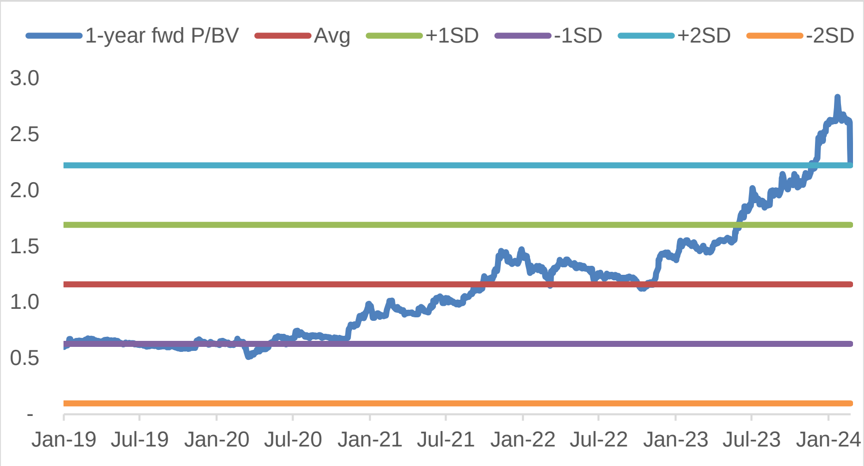
Interest rate risk. As the group predominantly obtains its funds from the debt market, RCE is exposed to interest rate risks whereby the rising interest rate environment may affect its product profit rate. Nevertheless, the group is actively reviewing its borrowings and its repayment ability whilst maintaining a healthy borrowing mix to avoid a mismatch in interest rate between its financing receivables and liabilities.

We initiate coverage with a Trading Buy call, based on a DDM derived TP of RM2.95

Valuations

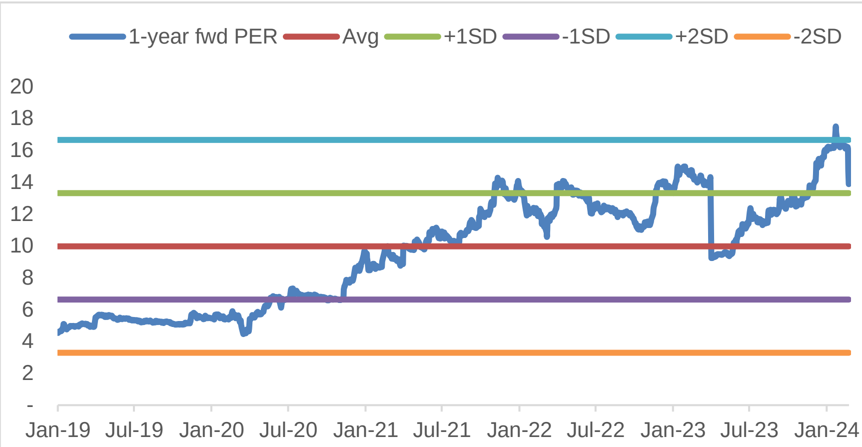
Initiate with a Trading Buy call. While RCE's current valuations implies that the share is trading at a premium of 2.3x P/BV, we believe that the valuation is justified given its ROE of c.17% remains attractive, as compared to the banking sector average ROE of 10-12%. We initiate coverage on RCE with a Trading Buy call and a DDM derived TP of RM2.95, as we believe that the recent retracement in share price represents a good buying opportunity. Key assumptions are cost of equity of 7.4%, We remain optimistic over the group's business model, as we foresee a growth in the group's financing receivables (3-year CAGR 4%), improving asset quality as well as an attractive dividend yield of c.5%.

Figure 11: RCE's forward P/BV band



Source: Bloomberg, PublicInvest Research

Figure 12: RCE's forward P/E band



Source: Bloomberg, PublicInvest Research

Table 1: Peer Comparison

Company	Share Price (RM)	Mkt Cap (RM m)	EPS (RM)		ROE (%)	ROA (%)	P/B	Div Yield (%)
			FY24	FY25				
Aeon Credit	6.30	3,216.9	0.78	0.98	1.3	16.3	3.5	4.0
Malaysia Building Society	0.775	6,372.3	0.03	0.04	0.6	4.5	0.7	11.0

Source: Bloomberg, PublicInvest Research
Share price as of 23rd Feb 2024

KEY FINANCIAL DATA

INCOME STATEMENT DATA

FYE Mar (RM'm)	2022A	2023A	2024F	2025F	2026F
Interest income	274.6	280.7	309.1	324.7	341.0
Interest expense	-80.2	-90.1	-99.8	-102.8	-105.9
Net Interest Income	**194.4**	**190.7**	**209.3**	**222.0**	**235.1**
Non-interest income	45.2	71.0	64.5	66.1	67.8
Staff costs	-26.6	-27.1	-30.3	-31.4	-32.5
Other operating expenses	-24.0	-21.7	-23.4	-24.2	-25.0
Pre-provision profit	188.8	212.6	219.8	232.3	245.2
Allowance for impairment	-11.5	-28.7	-30.9	-31.1	-31.9
Profit Before Tax	177.3	183.9	188.9	201.2	213.4
Income tax	-44.1	-45.2	-45.3	-48.3	-51.2
Net profit	**133.2**	**138.8**	**143.6**	**152.9**	**162.2**
Growth					
Interest income (%)	0.6	2.2	10.1	5.1	5.0
Pre-provision Profit (%)	3.3	12.6	3.4	5.6	5.6
Net Profit (%)	6.9	4.2	3.5	6.5	6.1

Source: Company, PublicInvest Research estimates

BALANCE SHEET DATA

FYE Mar (RM'm)	2022A	2023A	2024F	2025F	2026F
Property, Plant and Equipment	6.4	7.2	7.0	6.8	6.6
Financial Receivables	1879.2	2020.9	2101.8	2185.8	2273.3
Cash and Deposits with Banks	800.5	879.7	926.3	959.0	996.3
Other Assets	39.2	39.0	29.2	33.7	34.2
Total Assets	**2725.3**	**2946.8**	**3064.2**	**3185.4**	**3310.4**
Trade and Other Payables	34.8	36.6	36.6	36.6	36.6
Interest-bearing Debt	1804.0	2091.5	2154.3	2218.9	2285.5
Other Liabilities	14.5	13.0	13.0	13.0	13.0
Total Liabilities	1853.2	2141.2	2203.9	2268.5	2335.1
Shareholders' Equity and Minority	872.1	805.7	860.3	916.9	975.3
Total Equity and Liabilities	**2725.3**	**2946.8**	**3064.2**	**3185.4**	**3310.4**

Source: Company, PublicInvest Research estimates

PER SHARE DATA & RATIOS

FYE Mar	2022A	2023A	2024F	2025F	2026F
Book Value Per Share (RM)	1.2	1.1	1.2	1.2	1.3
P/BV	2.3	2.5	2.3	2.2	2.0
EPS (Sen)	18.0	18.7	19.4	20.6	21.9
DPS (Sen)	11.0	30.0	12.0	13.0	14.0
Payout Ratio (%)	41.2	158.4	61.9	63.0	64.0
ROA (%)	4.9	4.7	4.7	4.8	4.9
ROE (%)	15.3	17.2	16.7	16.7	16.6

Source: Company, PublicInvest Research estimates

RATING CLASSIFICATION

STOCKS

OUTPERFORM	The stock return is expected to exceed a relevant benchmark's total of 10% or higher over the next 12months.
NEUTRAL	The stock return is expected to be within +/- 10% of a relevant benchmark's return over the next 12 months.
UNDERPERFORM	The stock return is expected to be below a relevant benchmark's return by -10% over the next 12 months.
TRADING BUY	The stock return is expected to exceed a relevant benchmark's return by 5% or higher over the next 3 months but the underlying fundamentals are not strong enough to warrant an Outperform call.
TRADING SELL	The stock return is expected to be below a relevant benchmark's return by -5% or more over the next 3 months.
NOT RATED	The stock is not within regular research coverage.

SECTOR

OVERWEIGHT	The sector is expected to outperform a relevant benchmark over the next 12 months.
NEUTRAL	The sector is expected to perform in line with a relevant benchmark over the next 12 months.
UNDERWEIGHT	The sector is expected to underperform a relevant benchmark over the next 12 months.

DISCLAIMER

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