

RCE Capital Bhd (RCE MK)

Windfall for civil servants a boon for RCE

Upgrade to BUY with a higher TP of MYR3.02 (+24%)

With civil servants' salaries set to rise by $\geq 13\%$ on 1 Dec 2024, we raise our post-FY24E EPS/DPS estimates by up to 10%/9%. We also raise our P/B target to 2.5x on end-CY25E BVPS (full year impact of salary raise) from 2.1x on end-CY24E BVPS, thus lifting our TP to MYR3.02 from MYR2.44; the re-rating to reflect stronger earnings and dividend prospects. As a sanity check, our FY26E DPS of 18.5sen divided by the CY25E average banking sector dividend yield of 6.0% (Fig. 5) returns an implied TP of MYR3.08.

Financing growth likely to accelerate...

Yesterday, the Prime Minister announced that the salaries of civil servants will be raised by $\geq 13\%$ on 1 Dec 2024 and this will cost the government $\geq \text{MYR}10\text{b}$ p.a. There is a strong correlation between government emoluments and RCE's financing receivables balance ($R^2:0.95$) (Fig. 1). RCE explained that it will extend more financing to civil servants if they receive higher salaries as long as their debt service ratio does not exceed 60% as per Bank Negara Malaysia guidelines.

... with credit costs likely to decelerate

Although civil servants repay their financing to RCE with non-discretionary salary deductions via ANGKASA, RCE does experience non-performing financing (NPF) receivables and credit costs if civil servants resign from the civil service or retire early. We gather that NPF ratios and credit costs have been creeping up as civil servants sought employment opportunities out of the civil service to cope with the higher cost of living. With higher salaries, it is reasonable to expect fewer of them to do so going forward.

Raise EPS by up to 10% and DPS by up to 9%

With FY24E having passed, those estimates are unchanged. We raise FY25E/FY26E financing receivables growth to 5%/10% (from 2%/2%) and lower FY25E/FY26E credit cost ratio to 1.3%/1.3% (from 1.5%/1.5%) (Fig. 2). Net impact is to raise FY25E/FY26E EPS by 4%/10% and DPS by 3%/9%. Our FY26E (full year impact of salary raise) DPS of 18.5sen implies dividend yield 6.7% or $>10\%$ above the banking sector average. We also forecast that ROAE will hit 19% by FY26E which will be the highest since FY12A (Fig. 3).

FYE Mar (MYR m)	FY22A	FY23A	FY24E	FY25E	FY26E
Operating income	239	261	283	298	322
Pre-provision profit	189	213	220	232	251
Core net profit	133	139	143	154	167
Core FDEPS (MYR)	0.18	0.19	0.19	0.21	0.23
Core FDEPS growth(%)	3.3	3.7	2.7	7.9	8.3
Net DPS (MYR)	0.11	0.30	0.16	0.17	0.19
Core FD P/E (x)	10.2	9.7	14.3	13.3	12.2
P/BV (x)	1.6	1.7	2.4	2.4	2.3
Net dividend yield (%)	5.8	16.5	5.8	6.1	6.7
Book value (MYR)	1.19	1.10	1.13	1.18	1.22
ROAE (%)	16.2	16.5	17.5	18.2	19.1
ROAA (%)	5.1	4.9	4.8	4.9	5.0
Consensus net profit	-	-	143	151	160
MIBG vs. Consensus (%)	-	-	(0.2)	2.2	4.6

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BUY

[Prior:HOLD]

Share Price MYR 2.77
12m Price Target MYR 3.02 (+15%)
Previous Price Target MYR 2.44

Company Description

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

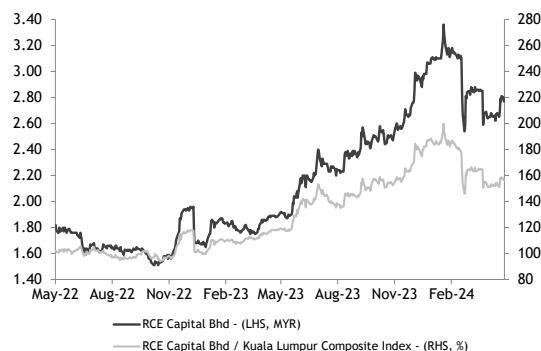
Statistics

52w high/low (MYR) 3.36/1.87
3m avg turnover (USDm) 0.7
Free float (%) 34.0
Issued shares (m) 741
Market capitalisation MYR2.1B
USD430M

Major shareholders:

Cempaka Empayar Sdn. Bhd. 57.9%
Khai Yoon Woo 1.5%
Employees Provident Fund 1.5%

Price Performance



	-1M	-3M	-12M
Absolute (%)	3	(13)	47
Relative to index (%)	1	(16)	32

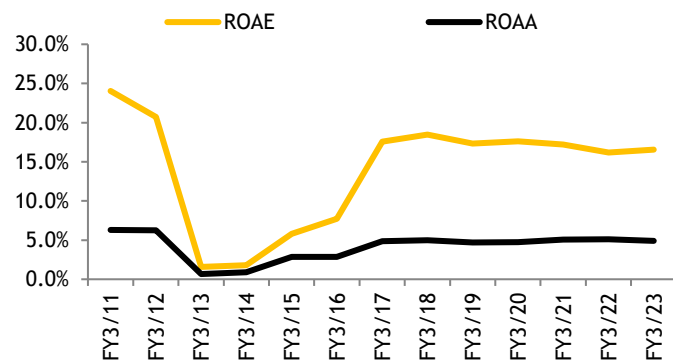
Source: FactSet

ESG@MAYBANK IBG
Tear Sheet Insert

Value Proposition

- RCE Capital provides personal financing, the ultimate customers being civil servants.
- With a gross financing balance of just MYR2.1b, we estimate that its market share is only 2%.
- Non-performing financing kept in check thanks to nondiscretionary 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

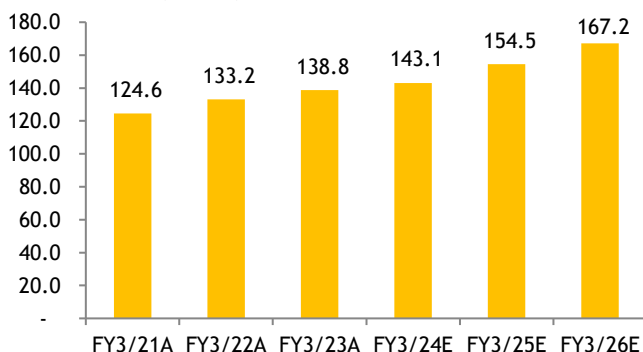


Source: Company

Financial Metrics

- Introduced better credit scoring model in 2013. We forecast gross financing CAGR of 7% p.a. over the next three years.
- Average cost of funds is rising but so is average financing yields.
- Asset quality better than before. New financings are smaller in size (<2%).
- Forecast stable three-year forward core net profit CAGR of 6% p.a.
- Recently raised DPR policy from 20-40% to 60-80%.

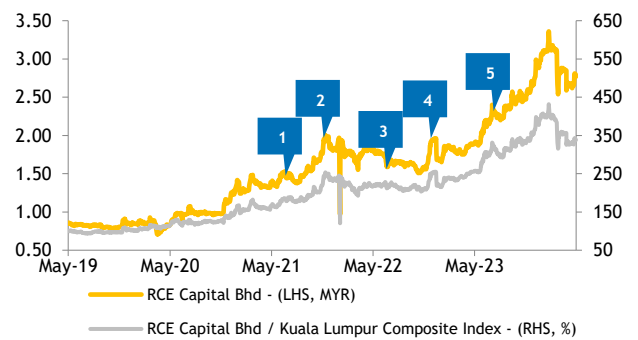
Core net profit (MYRm)



Source: Company (historicals), Maybank IBG Research (forecasts)

Price Drivers

Historical share price trend



Source: Company, Maybank IBG Research

1. 2QFY21 net profit grew 21% YoY to a record high of MYR33.0m.
2. Announced share DPS of 1 treasury share for 20 shares held and bonus issue of 19 shares for 21 shares held.
3. Bank Negara Malaysia raised Overnight Policy Rate by 25bps for the first time since Jul 2020.
4. Announced a huge special DPS of 18sen and higher-than-expected interim DPS of 5sen.
5. Announced that it raised its dividend policy from 20-40% DPR to 60-80% DPR.

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's debt repayment.

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Risk Rating & Score ¹	N/A
Score Momentum ²	N/A
Last Updated	N/A
Controversy Score ³	N/A

Business Model & Industry Issues

- Being a non-bank financial institution (NBFI), RCE does not have a large environmental footprint. That said, we opine that it has a large social footprint by way of responsible financing.
- NBFIs were a lot more carefree in disbursing financing before Jul 2013. In Jul 2013, Bank Negara Malaysia instituted macro prudential measures to rein in high household debt levels caused by the aforementioned.
- Since then, reflecting RCE's broad transition to more socially-responsible lending parameters, tenure of its financing is capped at 10 years (25 years previously) and debt service ratio of its customers is capped at 60%.
- In CY13, RCE also put in place an in-house credit scoring model that precludes RCE from over-lending to particular customers. As a result, average financing/customer has eased from c. MYR30,000 in FY3/13 to c. MYR20,000 currently.
- To be sure, RCE does carry out related party transactions (RPT) as it places deposits and borrows from AMMB Holdings which is 12%-owned by Tan Sri Azman Hashim, the controlling shareholder of RCE.
- That said, interest rates on the aforementioned deposits and borrowings do not appear unfair to us or detrimental to minority shareholders. RCE has also been a constituent of the FTSE4Good Bursa Malaysia Index since 22 Jun 2020.
- All in all, we rate RCE's ESG credentials vis-à-vis its core business as commendable. RCE scores above-average in our proprietary scoring methodology with an overall score of 71/100.

Material E issues

- No major environmental issues. Cut paper utilisation/employee by 38% to 3.7k pieces in FY3/23 vis-à-vis FY3/20.
- The above was achieved via emails reminding employees to "Think before you Print" and printing on both sides.
- FY3/23 scope 1 and 2 emissions in CO2e tonnes per employee cut to 0.87 (FY3/22: 0.93, FY3/21: 0.97).
- Part of the reason for the above is due to the extensive use of energy saving light bulbs.

Material S issues

- RCE is guided by Bank Negara Malaysia's (BNM) guidelines for responsible financing.
- In Jul 2013, BNM instituted macro prudential measures to rein in high household debt levels.
- Since then, tenure of its financing is capped at 10 years and debt service ratio of its customers is capped at 60%.
- In-house credit scoring model put in place in CY13 precludes RCE from over-lending to a customer.
- As a result, average financing/customer has eased from c. MYR30,000 in FY3/13 to c. MYR20,000 currently.
- Technical and soft skills trainings provided to sales team to promote responsible financing.
- Extends study grants to students pursuing the Association of Chartered Certified Accountants qualification.
- To date, RCE has extended MYR572,000 in study grants to 35 students.
- An overwhelming 73% of RCE's employees as at end-FY3/23 are women.
- FY3/23 overall turnover rate decreased to 16.0% (FY3/22: 17.5%, FY3/21: 18.6%).
- FY3/23 average training hours per employee stood at 32 (FY3/22: 24, FY3/21: 8).

Key G metrics and issues

- BOD comprises 1 Non-Independent Non-Executive Chairman (NINEC), 3 Non-Independent Non-Executive Directors (NINED) and 4 Independent Directors (ID).
- Largest shareholder is Cempaka Empayar Sdn Bhd, which is controlled by Tan Sri Azman Hashim (TSAH).
- NINEC, Shahman Azman is a son of TSAH. NINED, Shalina Azman is a daughter of TSAH.
- Only 1 of the 8 BOD members is a woman, the aforementioned Shalina Azman.
- FY3/23 directors' remuneration accounted for <1% of FY3/23 net profit.
- Deloitte PLT is the independent auditor. They have been appointed for >10 years.
- There are 4 BOD level committees. 2 are chaired by IDs (i.e. Audit and Nomination & Remuneration)
- 1 chaired by a NINED (i.e. Employees' Share Scheme) and 1 chaired by the NINC (i.e. Sustainability Management).
- Carries out RPTs with AMMB Holdings (AMMB), which is 12%-owned by TSAH.
- As at end-FY3/23, RCE has deposits of MYR127.1m and borrowings of MYR354.8m with AMMB.
- That said, interest rates on the aforementioned deposits and borrowings appear fair to us.
- RCE hired PricewaterhouseCoopers Consulting to review its related party transactions.

¹**Risk Rating & Score** - derived by Sustainalytics and assesses the company's exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company's enterprise value, respectively, from ESG-driven financial impacts. ²**Score Momentum** - indicates changes to the company's score since the last update - a **negative** integer indicates a company's improving risk score; a **positive** integer indicates a deterioration. ³**Controversy Score** - reported periodically by Sustainalytics in the event of material ESG-related incident(s), with the impact severity scores of these events ranging from Category 0-5 (0 - no reports; 1 - negligible risks; ...; 5 - poses serious risks & indicative of potential structural deficiencies at the company).

Quantitative Parameters (Score: 50)						
	Particulars	Unit	FY3/21	FY3/22	FY3/23	ACSM MK (FY2/23)
E	Scope 1 emissions	tCO2e	16.0	15.5	19.0	167
	Scope 2 emissions	tCO2e	154.2	150.2	155.0	2,295
	Total	tCO2e	170.2	165.7	174.0	2,462
	Scope 3 emissions	tCO2e	N/A	N/A	N/A	N/A
	Total	tCO2e	170.2	165.7	174.0	2,462
	Scope 1 & 2 emissions per employee	tCO2e	0.97	0.93	0.87	0.81
	Energy consumption	GJ	1,238.7	1,206.6	1,300.8	8,208.0
	Water consumption	m3	N/A	N/A	N/A	21,154
	Paper consumption per employee	'000 pieces	5.3	3.7	3.7	N/A
	Waste generated	kg	N/A	N/A	N/A	N/A
Waste diverted from disposal	kg	46.9	322.4	796.7	N/A	
S	% of women in workforce	%	74%	73%	73%	66%
	% of women in managerial roles	%	N/A	N/A	N/A	43%
	Sales team responsible financing training rate	%	88.0%	100.0%	100.0%	N/A
	Responsible financing articles posted on social media	posts	1	7	19	N/A
	Complaints received & resolved	number	21	7	6	N/A
	Employee turnover rate	%	18.6	17.5	16.0	14.7
	Employee training per employee	hours	8	24	32	17
G	Incidents of non-compliance	incidents	-	1	3	-
	Board salary as % of core net profit	%	0.8%	0.7%	0.7%	1.1%
	Independent directors on the Board	%	56%	50%	50%	60%
	% of profits returned to shareholders	%	38%	57%	158%	30%
	Female directors on the Board	%	11%	11%	13%	40%

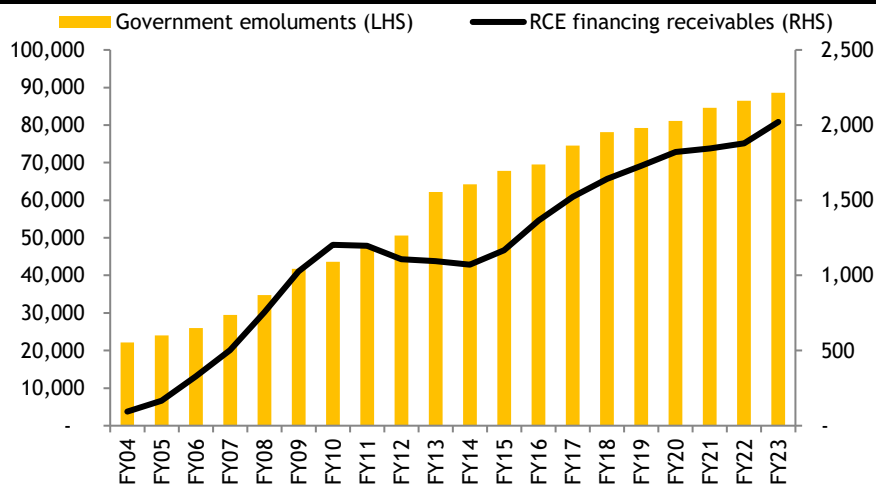
Qualitative Parameters (Score: 83)	
a) Is there an ESG policy in place and whether there is a standalone ESG committee or is it part of a risk committee?	<i>Yes. RCE has an ESG policy in place. It has a Sustainability Working Committee which reports to the Sustainability Management Committee which in turn, reports directly to the Board of Directors.</i>
b) Is the senior management salary linked to fulfilling ESG targets?	<i>Yes.</i>
c) Does the company follow the task force of climate related disclosures (TCFD) framework for ESG reporting?	<i>Yes.</i>
e) Does the company have a mechanism to capture Scope 3 emissions - which parameters are captured?	<i>No, but will report Scope 3 emissions next FY (i.e. FY3/24E).</i>
f) What are the 2-3 key carbon mitigation/water/waste management strategies adopted by the company?	<i>Switching off all office lights and equipment during breaks and before leaving office, retro-fitting LED lighting, recycling paper and avoiding unnecessary printing.</i>
g) Does carbon offset form part of the net zero/carbon neutrality target of the company?	<i>No, as RCE is not a major polluter.</i>

Target (Score: 100)		
Particulars	Target	Achieved
Reduce GHG emissions/employee by FY3/24E	1.0	0.9
Women representation on board by FY3/25E	30%	11%
Impact		
NA		
Overall Score: 71		
As per our ESG matrix, RCE Capital (RCE MK) has an overall score of 71.		

ESG score	Weights	Scores	Final Score
Quantitative	50%	50	25
Qualitative	25%	83	21
Target	25%	100	25
Total			71

As per our ESG assessment, RCE has an established framework, internal policies, and tangible mid/long-term targets. RCE's overall ESG score is 71, which makes its ESG rating above average in our view (average ESG rating = 50; refer to Appendix I for our ESG Assessment Scoring).

Figure 1: Government emoluments vs. RCE financing receivables (MYRm)



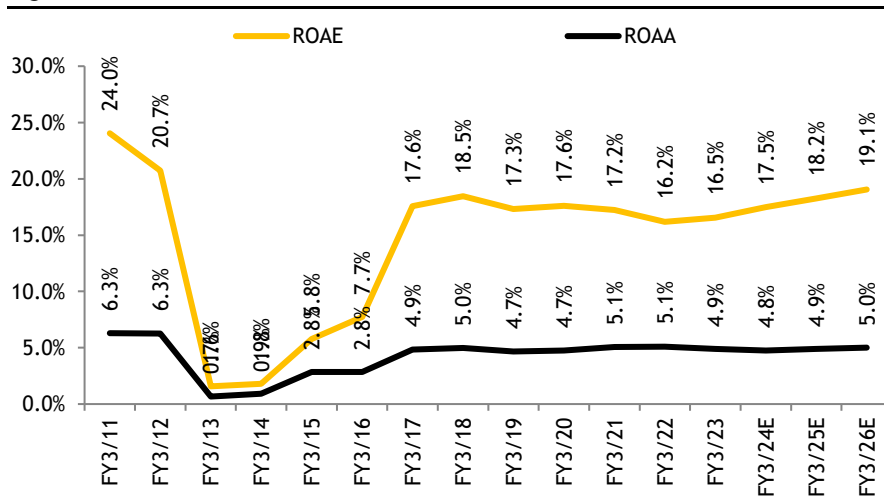
Source: Bloomberg, Company

Figure 2: Major assumptions and estimates

	FY3/24E	FY3/25E	FY3/26E
Revised			
Financing receivables growth	+5.0%	+5.0%	+10.0%
Credit cost ratio	1.5%	1.3%	1.3%
Core EPS (sen)	19.4	20.9	22.6
DPS (sen)	16.0	17.0	18.5
Previous			
Financing receivables growth	+5.0%	+2.0%	+2.0%
Credit cost ratio	1.5%	1.5%	1.5%
Core EPS (sen)	19.4	20.1	20.6
DPS (sen)	16.0	16.5	17.0

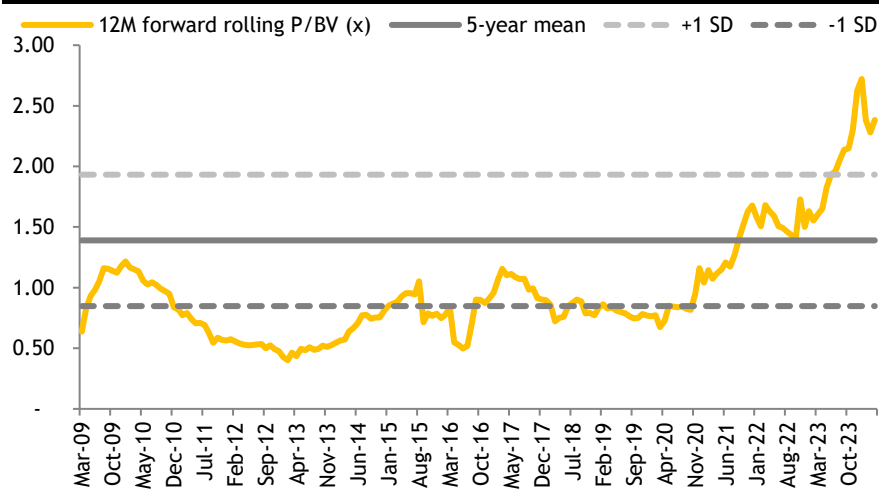
Source: Maybank IBG Research

Figure 3: RCE ROAE and ROAA



Source: Company (historicals), Maybank IBG Research (forecasts)

Figure 4: RCE rolling 12M forward P/BV (x)



Source: Company, Maybank IBG Research, Bloomberg

Figure 5: Banking sector - peer valuation summary as at 30 Apr 2024

Stock	Rec	Shr px (MYR)	Mkt cap (MYR m)	TP (MYR)	Upside (%)	PER (x) CY24E	PER (x) CY25E	P/B (x) CY24E	P/B (x) CY25E	ROAE (%) CY24E	ROAE (%) CY25E	Net yield CY24E	Net yield CY25E
Maybank *	NR	9.73	117,411	NR	NA	12.0	11.5	1.2	1.2	10.3	10.6	7.0	7.4
Public Bank	BUY	4.12	79,972	5.05	23%	11.4	10.9	1.4	1.3	12.5	12.5	4.9	5.1
CIMB	BUY	6.61	70,594	7.40	12%	9.6	9.0	1.0	0.9	10.5	10.6	5.7	6.1
HL Bank	BUY	19.30	41,837	23.00	19%	9.8	9.1	1.1	1.0	11.7	11.6	3.7	3.8
RHB Bank	HOLD	5.50	23,575	6.20	13%	8.0	7.6	0.7	0.7	9.5	9.6	7.3	7.3
HLFG	BUY	16.72	19,186	21.70	30%	6.4	6.1	0.6	0.6	10.2	9.9	3.4	3.4
AMMB	BUY	4.20	13,920	5.05	20%	8.1	7.7	0.7	0.7	9.2	8.7	4.9	5.2
ABMB	BUY	3.82	5,914	4.15	9%	8.4	7.9	0.8	0.7	9.5	9.6	5.9	6.3
BIMB	HOLD	2.56	5,802	2.75	7%	9.7	9.1	0.8	0.7	8.0	8.2	6.7	7.1
Simple avg			378,211			9.3	8.8	0.9	0.9	10.2	10.2	5.5	5.7
MC-wtd						10.4	9.9	1.1	1.1	10.8	10.9	5.7	6.0

* consensus estimates

Source: Maybank IBG Research

Appendix I

Methodology of our proprietary ESG scoring methodology.

We evaluate the ESG ratings based on quantitative, qualitative and ESG targets. We assign a score for each of these three parameters. The overall rating is based on the weighted average of the scores: quantitative (50%), qualitative (25%) and ESG target (25%).

For the quantitative, qualitative and ESG target, the sub-parameters are assigned a score - '0' for data not available, '+1' for improving trajectory, positive change, 'Yes', better than peers or a positive number if historical is not available and '-1' for declining trajectory, negative change, 'No', lower than peers or a negative number. The total of the scores of all the sub-parameters is divided by the total number of sub-parameters, to derive the score of each of the three parameters.

The sub-parameters may be different for different industries depending on the key areas to monitor for each industry. A company should achieve a minimum score of 50 for an average ESG rating.

FYE 31 Mar	FY22A	FY23A	FY24E	FY25E	FY26E
Key Metrics					
Core P/E (x)	10.1	9.6	14.2	13.1	12.1
Core FD P/E (x)	10.2	9.7	14.3	13.3	12.2
P/BV (x)	1.6	1.7	2.4	2.4	2.3
P/NTA (x)	1.6	1.8	2.6	2.5	2.4
Net dividend yield (%)	5.8	16.5	5.8	6.1	6.7
INCOME STATEMENT (MYR m)					
Islamic banking income	206.4	209.4	228.9	240.9	259.2
Other income	33.0	52.0	54.5	57.2	62.8
Total non-interest income	239.4	261.4	283.4	298.1	322.0
Operating income	239.4	261.4	283.4	298.1	322.0
Staff costs	(26.6)	(27.1)	(32.5)	(34.1)	(36.8)
Other operating expenses	(24.0)	(21.7)	(30.7)	(32.1)	(34.3)
Operating expenses	(50.6)	(48.8)	(63.2)	(66.2)	(71.1)
Pre-provision profit	188.8	212.6	220.2	231.9	250.9
Other allowances	(11.5)	(28.7)	(30.5)	(27.2)	(29.2)
Associates & JV income	0.0	0.0	0.0	0.0	0.0
Pretax profit	177.2	183.9	189.7	204.7	221.6
Income tax	(44.1)	(45.2)	(46.6)	(50.3)	(54.4)
Reported net profit	133.2	138.8	143.1	154.5	167.2
Core net profit	133.2	138.8	143.1	154.5	167.2
BALANCE SHEET (MYR m)					
Cash & deposits with banks	800.5	879.7	914.2	953.5	1,006.5
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	1,818.0	1,953.3	2,048.3	2,148.0	2,357.4
Fixed assets	6.4	7.2	7.2	7.1	7.0
Intangible assets	47.3	47.3	47.3	47.3	47.3
Other assets	53.0	59.3	59.3	59.3	59.3
Total assets	2,725.3	2,946.8	3,076.2	3,215.2	3,477.5
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	1,310.0	1,290.9	1,290.9	1,290.9	1,290.9
Other borrowings	342.0	434.3	537.5	646.0	875.9
Other liabilities	201.2	416.0	416.3	416.9	417.6
Total liabilities	1,853.2	2,141.2	2,244.7	2,353.8	2,584.4
Share capital	200.7	201.9	201.9	201.9	201.9
Reserves	671.4	603.7	629.6	659.5	691.1
Shareholders' funds	872.1	805.7	831.5	861.4	893.1
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	872.1	805.7	831.5	861.4	893.1
Total liabilities & equity	2,725.3	2,946.8	3,076.2	3,215.2	3,477.5

FYE 31 Mar	FY22A	FY23A	FY24E	FY25E	FY26E
Key Ratios					
Growth (%)					
Net interest income	na	na	na	na	na
Non-interest income	3.3	9.2	8.4	5.2	8.0
Operating expenses	3.3	(3.6)	29.7	4.7	7.4
Pre-provision profit	3.3	12.6	3.5	5.3	8.2
Core net profit	6.8	4.2	3.1	7.9	8.3
Gross loans	1.8	7.5	5.0	5.0	10.0
Customer deposits	na	na	na	na	na
Total assets	9.4	8.1	4.4	4.5	8.2
Profitability (%)					
Non-int. income/Total income	100.0	100.0	100.0	100.0	100.0
Cost/income	21.1	18.7	22.3	22.2	22.1
Liquidity (%)					
Loans/customer deposits	na	na	na	na	na
Asset quality (%)					
Gross NPF	3.8	3.8	3.8	3.8	3.8
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	16.2	16.5	17.5	18.2	19.1
ROAA	5.1	4.9	4.8	4.9	5.0
Shareholders equity/assets	32.0	27.3	27.0	26.8	25.7

Source: Company; Maybank IBG Research

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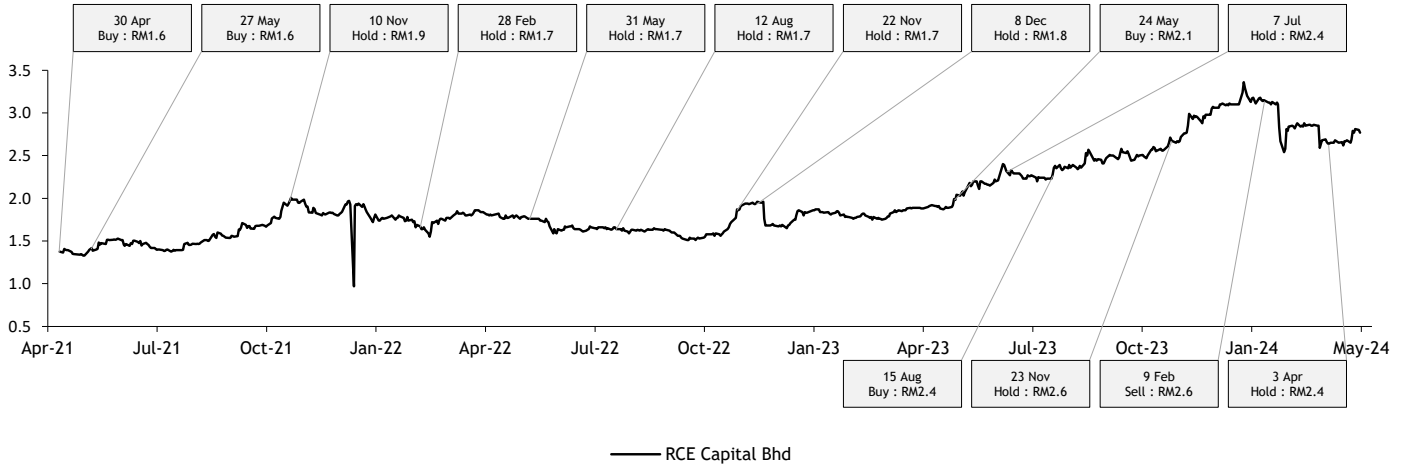
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