3 January 2018

RCE Capital

On a steady growth trajectory

Buy

Price
RM1.50

Target price
RM1.80

Market data

Bloomberg code	RCE MK
No. of shares (m)	341.6
Market cap (RMm)	512.4
52-week high/low (RM)	1.88 / 1.34
Avg daily turnover (RMm)	1.0
KLCI (pts)	1,796.81

Source: Bloomberg

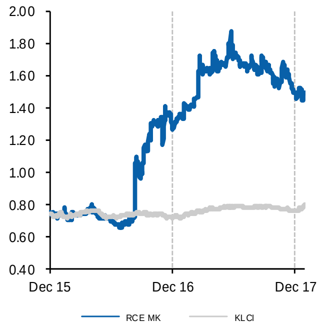
Major shareholders

Cempaka Empayar	60.7%
National Trust Fund	1.6%
Cheam Heng Ming	1.0%
Free Float	103.9M

Source: KAF

Performance

	1M	3M	12M
Absolute (%)	0	(6)	11
Rel market (%)	(4)	(8)	2



Source: Bloomberg

Analyst

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We initiate coverage of RCE Capital with a Buy rating and target price of RM1.80. We forecast RCE is on a steady growth path post-FSA implementation, and we expect its receivables to continue to grow 8-10% yoy, NPLs to remain healthy at c.4%, and continuous improvement in its liquidity. In addition, RCE's valuation looks attractive on single-digit P/E, high ROE and at a discount to its peers.

Financial Highlights

Year to Mar (RMm)	FY16	FY17	FY18F	FY19F	FY20F
Operating income	126	172	189	207	224
Net profit	40	79	83	91	98
EPS (sen)	12.3	23.8	24.3	26.5	28.7
DPS (sen)	14.0	3.0	3.0	3.0	3.0
Dividend yield (%)	9.3	2.0	2.0	2.0	2.0
PER (x)	12.2	6.3	6.2	5.7	5.2
PB (x)	1.1	1.2	1.1	1.0	0.9
ROE (%)	7.7	17.6	17.9	17.8	17.8

Source: Company, KAF * Price as of 29-December-17

Stronger footing post-FSA. Pre-FSA implementation, RCE had lower asset quality with NPLs of more than 8% and higher GIL of above 11%. Post-implementation, RCE has been increasing its impairments to improve its balance sheet. In addition, it has been more stringent in expanding its portfolio with quality loans remaining a guiding principle. We expect its NPLs to remain at a healthy c.4% and GIL at c.7%.

RCE's consumer financing receivables has grown c.12-18% yoy in FY15-17. With a stronger footing post-FSA, we forecast FY18F-20F receivables to growing moderately by 8-10% yoy. This is supported by a stable unemployment rate (hovering around 3.3-3.6% since early of 2016), higher wages (5-year CAGR: 6.3%), and the recovery in consumer sentiment.

Hefty profit margin and attractive ROE. RCE has consistently reported profit margins of above 20% in recent years. Its profit margins are on par with AEON Credit (ACSM MK, RM13.46, Hold) but higher than Malaysia Building Society (MBS MK, NR) and AEON Thana Sinsap Thailand (AEONTS TB, NR). MBS and AEONTS's profits margins are in the range of 12-16%. RCE is also attractive as it offers high ROE c.18%. Although it has a lower ROE than ACSM (ROE: c.20%), its ROE is on par with AEONTS and higher than MBS (ROE: c.4%).

Special dividend? RCE does not have a formal dividend policy but historically has maintained a DPS of 6.0 sen (before share consolidation). Nonetheless, back in FY16, RCE declared a special dividend that translated into a payout of >100. We believe it has the capacity to repeat this as it has a hefty reserve level as a result of its high retention rate i.e., >80%, high profit margin and low capex.

Within our forecast periods, we believe another special dividend is possible. Assuming that RCE is able to maintain its performance as per our forecasts i.e., 3-year CAGR of 7.5% for its net profit, while maintaining its retention rate, we estimate that its reserves will replenish to its pre-special dividend level by FY19F. Our DPS estimate for FY18F-20F of 3.0 sen excludes any special dividend.

Valuation comparison. RCE trades on a PER 6.2x FY18F, which is below its 5-year average of 7.5x and at a discount to its peers, i.e. ACSM, MBS and AEONTS. ACSM, MBS and AEONTS trade on PERs of 10.0x-16.2x FY18F (based on Bloomberg consensus). We view RCE's valuation as attractive given it trades below its 5-year average PER and at a discount to its peers.

Company Background

Core operation – Consumer financing

RCE's core business is providing personal loans (known as consumer financing segment) to civil servants in Malaysia. This is an unsecured financing option specifically designed for civil servants. Private sector employees are not eligible for such financing. Instead of the conventional way of loan repayment via banking transfer, civil servant financing repayment is made via auto-deduction from their salary on a monthly basis.

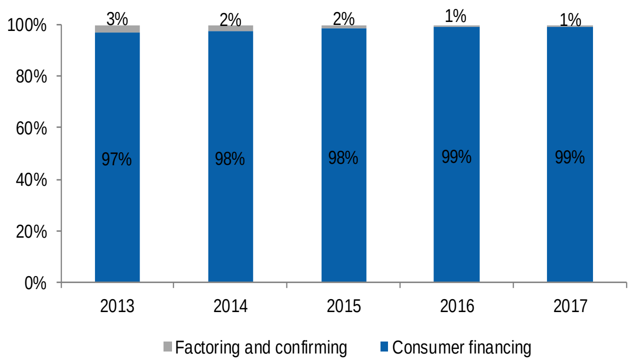
RCE enters into agreements with cooperatives and/or foundations, Biro Perkhidmatan Angkasa (Angkasa) and Accountant General's Department of Malaysia (AG), to provide unsecured Islamic financing products to civil servants. The repayments are received in the form of monthly instalments via direct salary deductions through Angkasa or EXP from the AG account.

This segment is the core operation and the main contributor to the group. The consumer financing segment comprises more than 98% of the group's receivables and revenues.

Marginal contribution from factoring and confirming operation

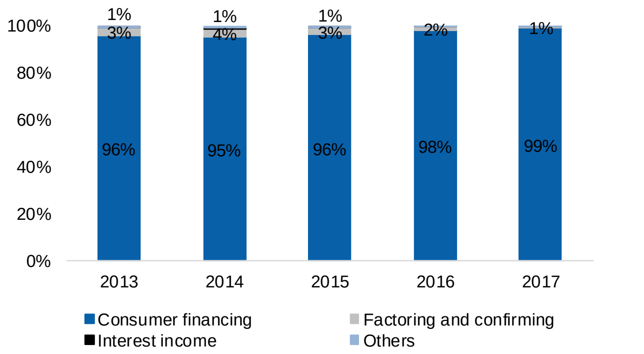
The factoring and confirming segment was an addition to the group's core operation. This segment was added to the group's portfolio in 2007. Most of the factoring and confirming businesses are from SMEs. However, the contribution to the group's portfolio is marginal, i.e. comprises c.2% of the group's receivables and revenues.

Chart 1: RCE's receivables composition



Source: Company, KAF

Chart 2: RCE's revenues composition



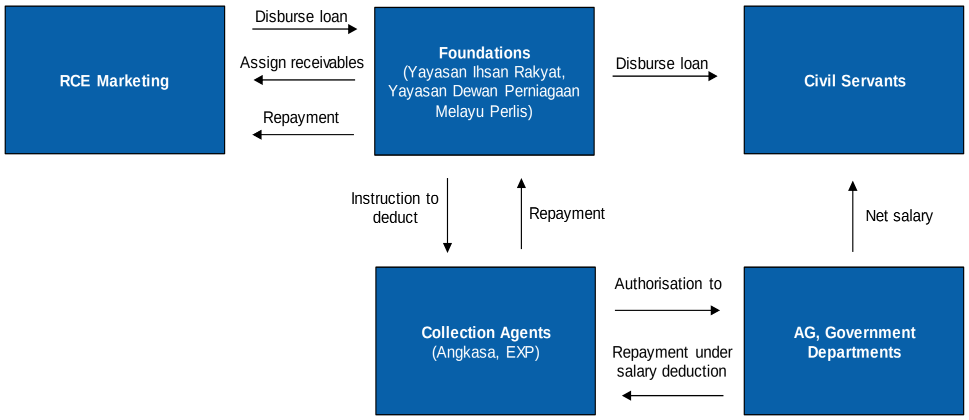
Source: Company, KAF

Collection segment complements the core operation

EXP Payment Sdn Bhd (EXP) is wholly owned by Strategi Interaksi Sdn Bhd (100% owned by RCE). EXP is in a payroll collection segment. EXP is allowed to collect payment from selected existing and potential borrowers. EXP's collection service involves managing deductions in the payroll systems of government departments under the purview of AG. RCE's venture into collections management provides an alternative channel to the existing market players. The amount of payment collected is almost equally via EXP and Angkasa.

The group has invested more than RM4.7m in capex for the development and technological enhancements of its collection management system. This is in an attempt to continuously provide greater convenience and speed to its clients. We believe that this initiative would potentially improve its collection period and, hence, its non-performing loans (NPLs). With lower NPLs, RCE would potentially be able to improve its bottom line as this would result in lower provisions (in absolute terms).

Chart 3: RCE's business model



Source: Company, KAF

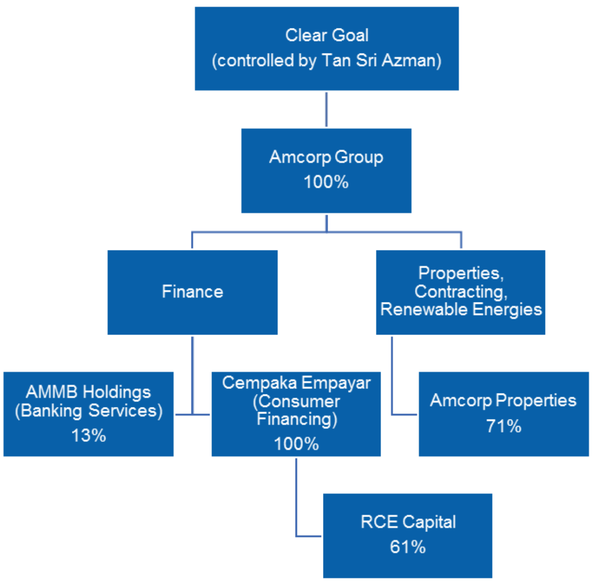
Major shareholders – Cempaka Empayar

Cempaka Empayar Sdn Bhd is the major shareholder of RCE with a 61% stake. Other shareholders are National Trust Fund with 2% stake and Cheam Heng Ming with 1%. Cempaka Empayar is a subsidiary of Amcorp Group (Amcorp). Amcorp was incorporated in Malaysia in 1910 and has a 13% stake in AMMB Holdings Berhad (AMM MK, RM4.41, Hold) and a 71% stake in Amcorp Properties Berhad (APRO MK, NR).

Amcorp is wholly owned by Clear Goal Sdn Bhd (Clear Goal). Clear Goal is controlled by Tan Sri Azman Hashim. In a nutshell, RCE's major shareholder is Tan Sri Azman Hashim through Clear Goal. RCE and AMM are related by virtue of having the same shareholder i.e., Amcorp.

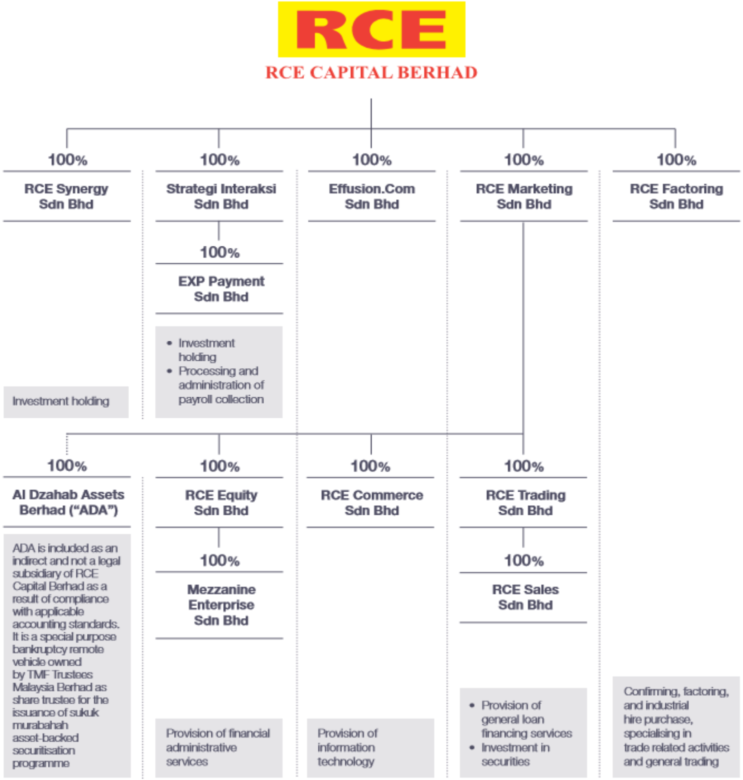
The following is the company structure of RCE.

Chart 4: RCE's company structure (1 of 2)



Source: Company, KAF

Chart 5: RCE's company structure (2 of 2)



Source: Company, KAF

Investment Thesis

We initiate coverage of RCE Capital (RCE) with a Buy rating and target price of RM1.80 based on our GGM valuation, backed by the following premises.

1) High-single-digit to low-double-digit receivables growth to support organic growth.

2) Efficient turnaround time as key competitive advantage.

3) Improvement in asset quality translates into higher profitability.

4) High average lending yield = high spread (NIM).

5) A shift in borrowing mix to capitalise on cheaper financing.

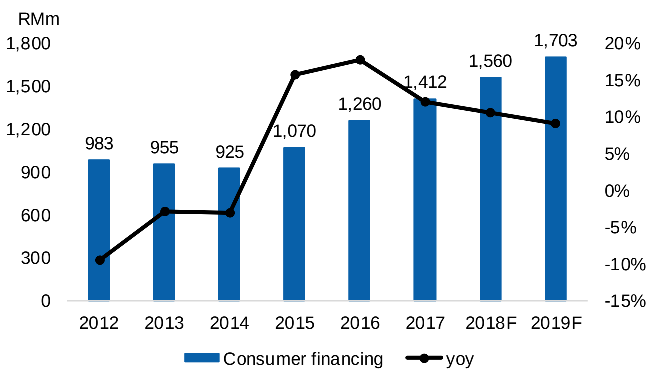
6) Narrowing gap between receivables and borrowings' maturity = improvement in liquidity.

High-single-digit to low-double-digit receivables growth to support organic growth

One of the strategies that RCE is focusing on is the expansion of its consumer financing segment with quality loans remain as guiding principle. This is equivalent of growing its interest income (top line) internally with the expansion of its quality loan receivables (corresponding assets). Post-BNM's micro measures implementation (FY14 onwards), RCE has been expanding its consumer financing receivables in the range of 12-18% yoy.

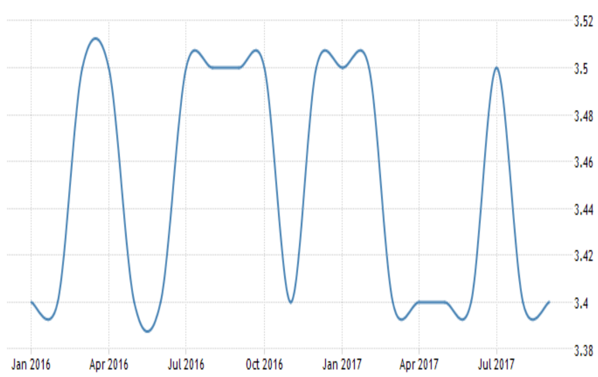
We forecast FY18F-20F consumer financing receivables to grow by 8-10% yoy range premised on stable unemployment rate (hovering around 3.3-3.6% since early of 2016), higher wages (5-year CAGR: 6.3%), and the recovery in consumer sentiment. Consumer Sentiment Index (CSI) has stayed above 70 points since early 2016 and we are in the view that it will remain above this threshold. In 3Q17, CSI stood at 77 points. Although it is not in expansion mode, i.e. above 100 points, we have seen a recovery formation from its 5-year low of 63 points in 4Q15.

Chart 6: Consumer financing and yoy growth



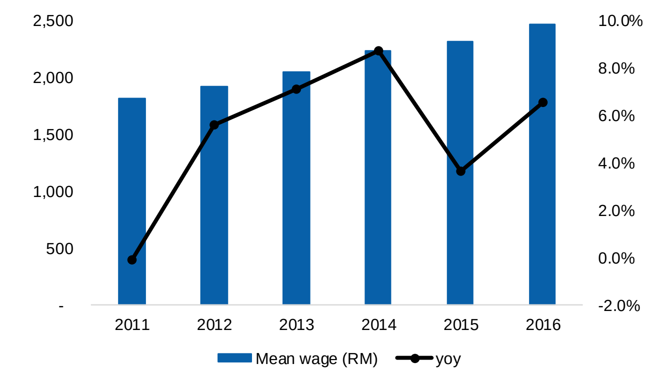
Source: Company, KAF

Chart 7: Unemployment rate (Jan 2016 – Sep 2017)



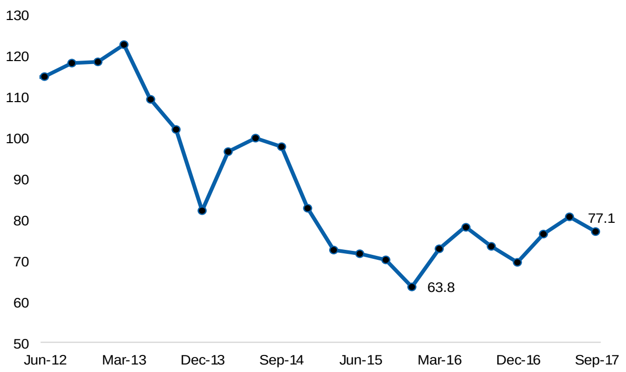
Source: Trading Economics, DOSM

Chart 8: Mean wage and yoy growth (5-year CAGR: 6.3%)



Source: Trading Economics, DOSM, KAF

Chart 9: Consumer Sentiment Index



Source: MIER, KAF

Efficient turnaround time as key competitive advantage

In addition to the expansion of consumer financing receivables with quality loans remaining a guiding principle, RCE also places emphasis on operational efficiencies. RCE believes that improvement in the operational efficiencies can be achieved via the improvement in the turnaround time from loan application to loan disbursement. Having an efficient turnaround time is seen as the main key competitive advantage for RCE against its peers. Despite fast approvals (on average around 48 hours upon the completion of loan applications), the quality of loans remains a guiding principle. For example, RCE's gross impairment loan (GIL) ratio has improved from 11.7% in FY14 to 7.2% in FY17. Refer to Chart 11.

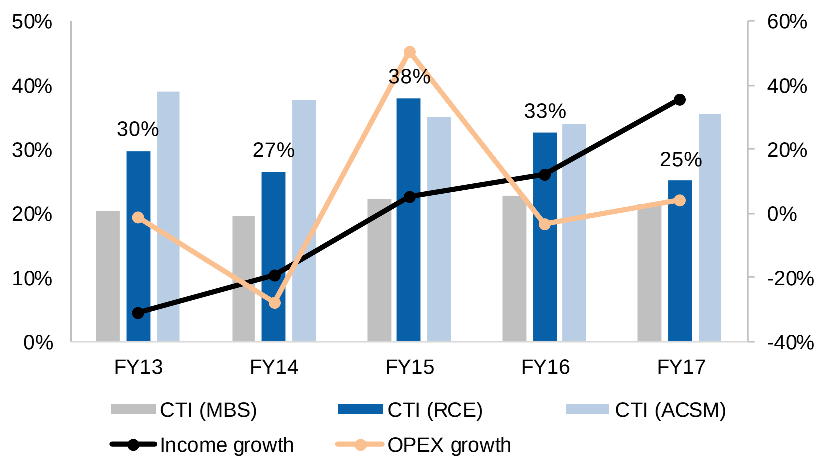
RCE is planning to enhance its turnaround time through process simplification initiatives. One of its initiatives is the implementation of Central Credit Reference Information System (CCRIS) in its reviewing process. By having access to this system, the applicants' credit trend can be viewed upon applications. This helps in filtration, division, selection, and rejection of loans. As a result, this would improve the overall loan processing turnaround time. However, the implementation of CCRIS in its operation is subject to Bank Negara Malaysia (BNM)'s approval.

In addition, in FY15 RCE completed the addition of EXP to its portfolio. As mentioned earlier, EXP's function is to collect payment from selected existing and potential borrowers from the government departments under the purview of AG. This provides convenience and speed to its clients. Hence, it has assisted in the improvement of the overall operational efficiencies.

Furthermore, there has been a change in its business arrangement on fees recognition. Previously, the fees were amortized over time. However, based on the new business arrangement, the fees have been recognised upfront since FY17. This is to streamline and to adopt to a single accounting standard.

Overall, as a result, RCE's cost-to-income (CTI) ratio fell significantly from 38% in FY15 to 25% in FY17. In addition, the ratio is in a downward trend. The growth of its overall income has exceeded the growth of its operational expense in recent years. Overall, RCE has a moderate CTI ratio compared to its peers i.e., Malaysia Building Society (MBS) and AEON Credit (ACSM).

Chart 10: Cost-to-income ratio (RCE, MBS and ACSM)



Source: Bloomberg, Company, KAF

Note: CTI ratios calculation are standardised (using in-house equation) for RCE, MBS and ACSM for better comparison across all companies

Improvement in asset quality translates into higher profitability

As of 1H18, RCE's NPL ratio stands at 4.2%. RCE has managed to maintain its healthy NPL level since FY17. This is a substantial improvement on its level historically (FY14: 8.6%). In addition, RCE's gross impairment loan (GIL) ratio has also maintained around the same level as FY17's i.e., 7.2%.

The improvement is due to its emphasis in strengthening the quality and performance of its receivables portfolio. Such improvements are achieved by enhancing its credit scoring application, thorough portfolio review, and close monitoring of all receivables.

RCE's stringent credit discipline is supported by a comprehensive credit scoring model. In this model, it (1) assesses and evaluates applicants' creditworthiness and (2) reviews applicants' behavioural repayment and patterns regularly to ensure they remain relevant.

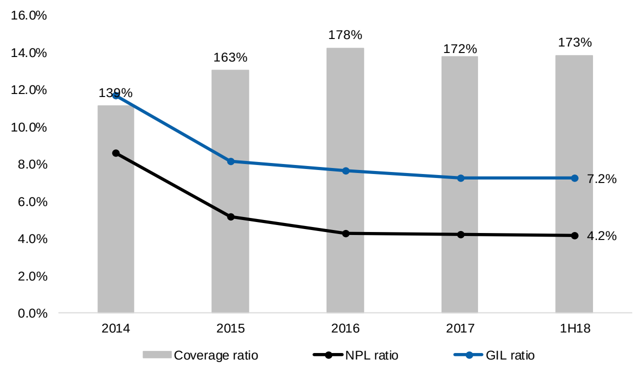
Upon thorough portfolio review, higher risk credit profiles (supported by the applicants' credit reports) are matched with higher pricing products. In addition, there is a cap of maximum exposure per customer to mitigate single customer risk. The maximum exposure allowed per customer is a debt servicing ratio (DSR) of not more than 60% of his/her net income. Portfolio performance is also regularly tracked to ensure asset quality remains at manageable levels.

Despite such improvements in its NPL, in comparison with MBS, ACSM and the banking sector its NPL ratio is considerably higher. MBSB and ACSM was able to maintain NPL ratio of below 3% while the banks are able to maintain NPL ratio of below 2% in the recent years. Note that MBS, ACSM and banks' receivables portfolio are more diverse. For instance, they provide automobile financing, motorcycle financing, consumer financing, property financing, etc. As mentioned earlier, RCE mainly provides consumer financing (>98% of its receivable portfolio). The management plans to maintain its healthy NPL ratio.

Although the NPL ratio is higher than the banking sector (which is perceived as higher risk lending practice), RCE has proven its effectiveness in managing its NPL. It has consistently attained its coverage ratio above 100% since FY14 and in recent years. In 1H18 (for the quarter ended September), its coverage ratio stands at 173%. In September 2017, the banking sector reported a coverage ratio of 81%. As of 2Q17, only BIMB Holdings (BIMB MK, RM4.40, NR) in the banking sector reported a coverage ratio of above 100%. This suggests that RCE has a stringent risk management in place and prudent provisioning policy. We believe that its high coverage ratio is justified as consumer financing is unsecured in nature with no collateral.

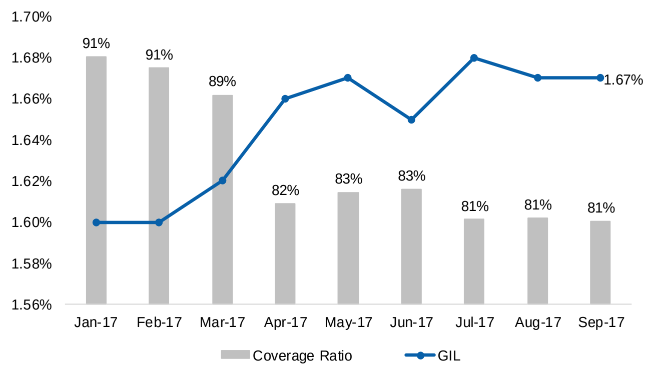
With the improvement in NPL, this would potentially improve its bottom line as lower provision (in absolute) is required. Hence, we are positive on the management's strategy, i.e. quality loans remain a guiding principle for receivables growth.

Chart 11: RCE's improvement in asset quality



Source: Company, KAF

Chart 12: Banking sector GIL and coverage ratio



Source: BNM, KAF

High average lending yield = high spread (NIM)

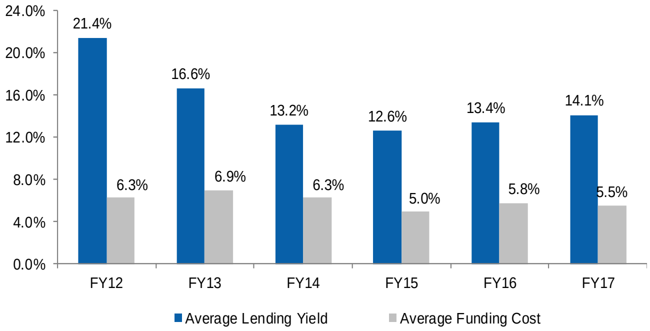
RCE does not take public deposits as a funding source. It is not under such strict regulations compared to commercial banks. However, it is regulated by the Moneylenders Act 1951 Section 17A (1). Based on the act, the interest for an unsecured loan shall not exceed 18% per annum. Hence, it has a relatively higher lending rate as compared to the banks. RCE has an average lending yield at c.14% (vs bank peers: less than 5%).

Although the yield is not as high as it was (pre-micro measures implementation: >16%), average lending yields of c.12-14% are appropriate considering its higher funding cost as compared to the banks. We expect the lending yield to maintain at around 12-14%.

The funding cost for RCE is generally higher than the banks. RCE's average funding cost is c.5-7% (banks: c.3-4%). Although its funding cost is more expensive, it has a much higher lending yield than the banks. As such, it has a better lending spread than the banks. Banks' lending spread is less than 2% while RCE has mid-to-high single-digit lending spread, i.e. in the range of 6-9% in recent years.

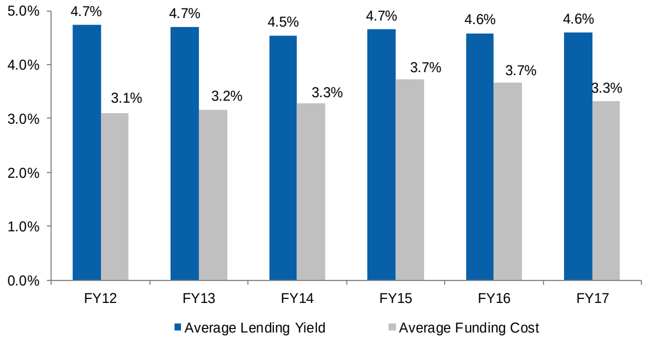
RCE's peer, ACSM, has an edge (in-term of cheaper funding) in the lending industry due to its close relationship with the Japanese banks. This is because ACSM's major shareholder is AEON Financial Services, a Japanese financial group. By having a close relationship with the Japanese banks and due to the low interest rate environment in Japan, ACSM is able to enjoy cheaper financing. In addition, as ACSM's operations are more diverse, it is able to attain a various mix of lending yields. Hence, ACSM has enjoyed a higher lending spread of c.12-13% in recent years.

Chart 13: Average lending yield and funding cost (RCE)



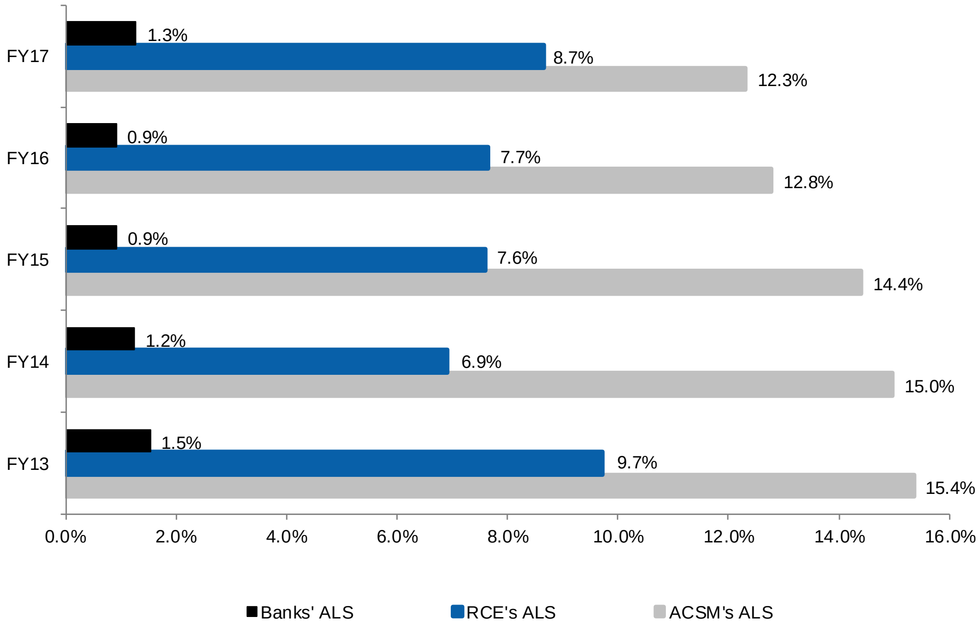
Source: Company, KAF

Chart 14: Average lending yield and funding cost (Banks)



Source: BNM, KAF

Chart 15: Average lending spread (RCE, ACSM and banks)



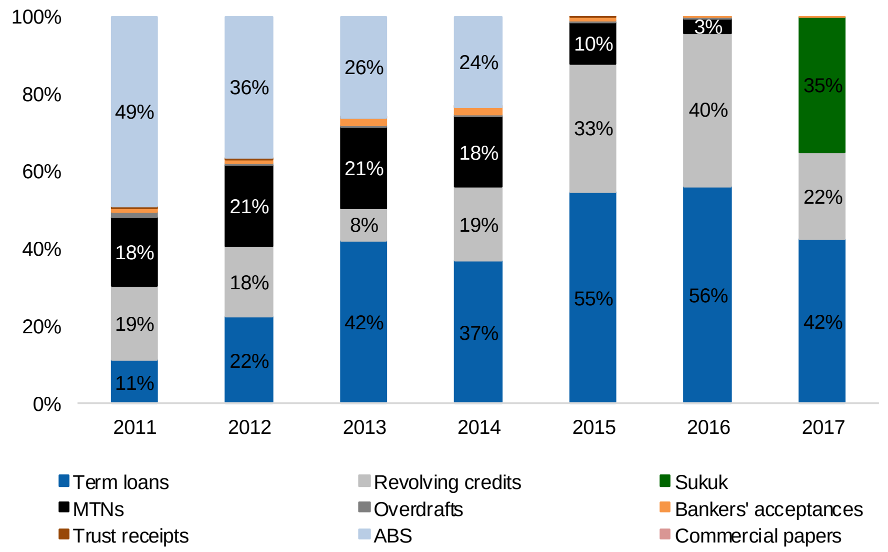
Source: Company, BNM, KAF

A shift in borrowing mix to capitalise on cheaper financing

RCE has in the past, actively reviewed its borrowings and improved its mix to ensure they remain relevant to its operation. In comparison to its borrowing pattern 7 years ago, RCE has shifted its borrowings composition from mainly relying on asset-backed securities (ABS) and medium-term notes (MTN) to term loan and sukuk. In FY11, ABS and MTN comprised c.67% of its total borrowings (FY17: 0%). For FY17, term loan and sukuk comprised c.78% of its total borrowings (FY11: c.11%). Refer to Chart 16.

We have a positive view on its strategy of shifting its borrowings towards term loan and sukuk. This is because these types of financing generally offer lower interest rate as compared to the overall RCE's borrowing portfolio. ABS and MTNs' WAEIR are in the range of 7-11% while term loan and sukuk's WAEIR are in the range of 5-7%. Refer to Table 1.

Chart 16: Borrowings mix



Source: Company, KAF

Table 1: Costs of borrowing (WAEIR)

Borrowing yield	2011	2012	2013	2014	2015	2016	2017
Term loans	7.0 - 10.8%	5.2 - 7.6%	5.4 - 7.6%	5.4%	4.2 - 5.8%	5.6 - 6.5%	5.6 - 6.4%
Revolving credits	5.2%	5.1%	5.0%	4.6%	5.0%	4.9%	4.7%
Sukuk	na	na	na	na	na	na	5.7%
MTNs	10.2%	10.7%	10.0%	9.4%	9.6%	10.1%	na
ABS	7.1%	7.0%	7.2%	7.3%	na	na	na
Others	6.1%	5.7%	4.8%	4.7%	4.8%	4.5%	5.5%

Source: Company

Narrowing gap between receivables and borrowings' maturity = improvement in liquidity

Historically, RCE has been borrowing on a short term (within 1-year) basis to finance its longer term (more than 1-year) receivables. The reason for such a decision was to capitalise on cheaper funding with lower interest rate chargeable to short-term instrument. However, this poses a risk from a liquidity standpoint.

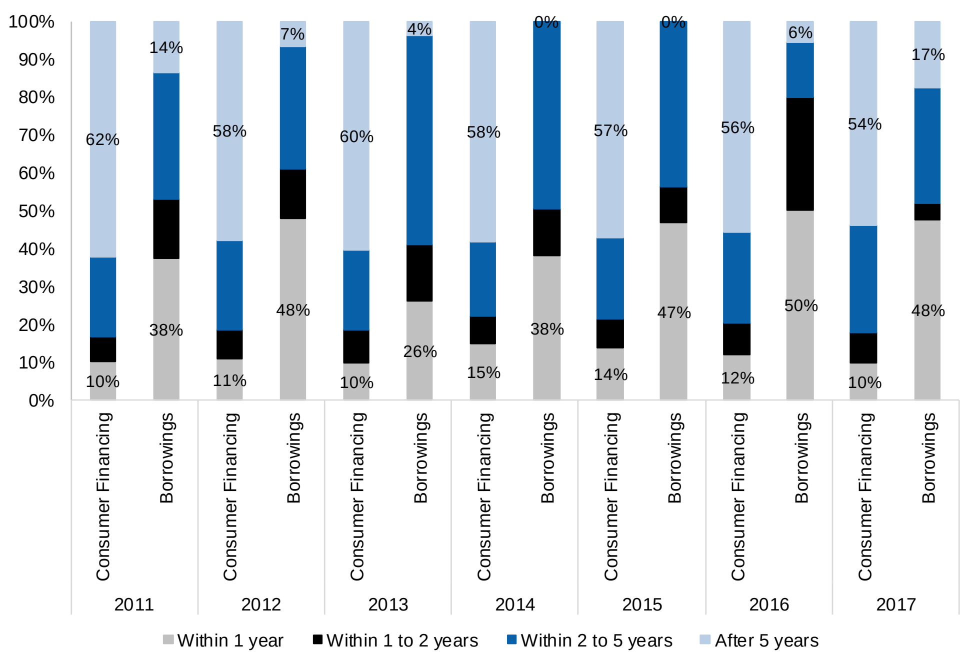
As per Chart 17, in general, RCE's short-term receivables comprise c.10-15% of total receivables. As for short-term borrowing, oftentimes it would comprise c.40-50% of total borrowings. The management was aware of the liquidity exposure and have ever since actively reviewed its borrowings. The management also places great emphasis on the repayment ability and debt maturity profiles against its receivables.

As a result, RCE has managed to narrow the maturity gap between short-term receivables (consumer financing) with short-term borrowings. Based on its 1H18's results, the short-term receivables comprise c.9% (FY17: c.10%) of total receivables, while its short-term borrowings comprise c.36% (FY17: c.48%) of total borrowings. Refer to Chart 18. This is a great improvement in a short period of time in managing its liquidity risk. We have a positive view on this as it represents a better cashflow match.

Such improvement was actually achieved via a sukuk programme. The sukuk mainly has longer-term maturity of up to 10 years of tenure. The proceeds from the sukuk issuance were mainly utilised for repayment of short term borrowings (with maturity less than a year) and for working capital purposes. By retiring short-term borrowings and issuing longer-term sukuk, this translates into the narrowing of maturity gap between short-term receivables and short-term borrowings.

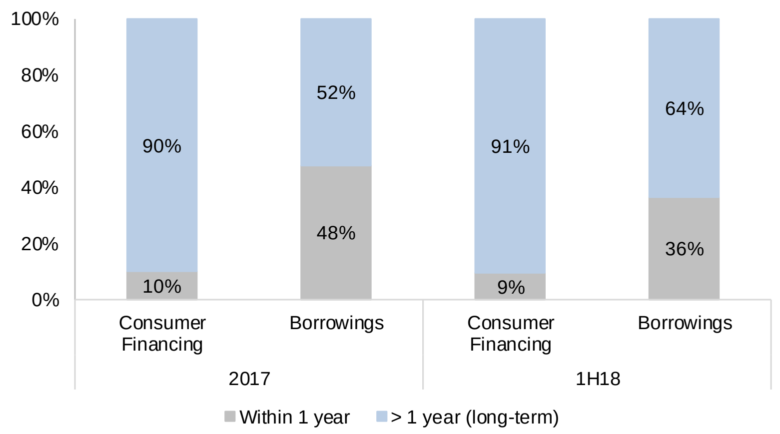
As RCE had experienced better-than-assumed default and prepayment performance, as well as good quality of receivables, RAM Holdings (a credit rating agency) had upgraded its rating on RCE's Tranche 1 (Class B) and Tranche 2 (Class B) sukuk from AA3 (stable) initially to AA1 (positive) for Tranche 1 and AA2 (positive) for Tranche 2. Following a positive outcome from the sukuk issuance, RCE is planning to have another sukuk programme in the near future. The management believes that the maturity gap will remain healthy.

Chart 17: Receivables and borrowings match (based on full FYs)



Source: Company, KAF

Chart 18: Receivables and borrowings match (as of 1H18)



Source: Company, KAF

Key risks

Credit risk – deterioration in credit worthiness of borrowers

This is a significant risk for RCE. RCE manages this risk by adopting a policy of only dealing with creditworthy counterparties and obtaining sufficient collaterals (where appropriate). The main types of collaterals obtained by RCE are as per the followings:

- Consumer financing - loans by cooperatives or corporations to their members and assignment of collection proceeds in the designated account by cooperatives.
- Factoring and confirming - land and buildings

RCE also manages its credit risk by exercising adequate credit evaluation measures and balancing its return with the underwriting receivables. It ensures that the returns are adequate to the risk underwritten. The risk is also mitigated through repayment via salary deduction from its loans and receivables. In addition, RCE does not have any significant concentration of credit risk due to its large number of underlying borrowers.

Liquidity risk – ability to meet financial obligations from payables, loans and borrowings

RCE manages this risk by maintaining sufficient level of cash (including deposits with financial institutions) and by obtaining diverse source of banking facilities from various financial institutions at a reasonable level. It also strives to maintain a balance between continuity of funding and flexibility through the use of these facilities.

RCE also to the greatest degree matches its maturity profiles of its financial assets and liabilities. RCE plans to match its assets by converting the current into non-current liabilities in order to meet its short-term obligations. In 2016, RCE has established a sukuk programme as a form of financing.

Interest rate risk – potential loss caused by movement in market volatility

RCE is exposed to interest rate risk mainly from timing differences between the maturities of its interest-bearing assets and liabilities. This risk arises from the mismatch in interest rate of the receivables and the corresponding funding mechanism.

In order to manage this risk, RCE is maintaining a mix of fixed and floating rate borrowings. RCE is also actively reviewing its borrowings, focusing on the repayment ability and maturity profiles in comparison to its receivables. By having an active participation in its borrowings, RCE is able to capitalise on cheaper funding in a low interest rate environment and achieve a certain level of protection against rate hikes.

RCE does not apply any hedging mechanism i.e., derivative instruments in managing its risks.

MFRS9 impacts on balance sheet and P&L

Malaysian Financial Reporting Standards 9 (MFRS9) is a new accounting standard that will be effective in 2018. MFRS9 addresses the classification, measurement and recognition of financial assets and financial liabilities

In relation to the impairment of financial assets, MFRS9 requires an expected credit loss model upfront, as opposed to an incurred credit loss model (from the assets that have been classified as impaired) under MFRS139. The new model requires an entity to account for expected credit losses and changes in those expected credit losses at each reporting date to reflect changes in credit risk since initial recognition.

Hence, there is no longer a need for a credit event to occur first before credit losses are recognised. RCE anticipates that the application of MFRS9 may have an impact on the amounts reported to its financial assets but not to its financial liabilities.

On the first day of adjustment (1-April-2018), RCE believes that the new accounting standard will have more impact on its balance sheet. This is because any increase in impairment losses provision will be charged to retained earnings, and hence, it will be charged off directly to the shareholders' funds. This may affect the capital ratios. However, RCE does not have capital requirement set by the regulator(s). As for the recurring charges, there may be higher impairment charged to the profit and loss statement, henceforth.

Valuation

We initiate coverage of RCE Capital (RCE) with a Buy rating and TP of RM1.80 based on our GGM valuation. We arrive at net profit forecast of RM83m for FY18F, RM91m for FY19F and RM98m for FY20F, implying a steady three-year CAGR of 7.5%.

Downside risk to our earnings forecasts would be higher-than-expected NPLs, which could elevate provision for bad and doubtful debts, resulting in lower than-expected net profit. However, RCE manages this risk by exercising adequate credit evaluation measures and balancing its return with the underwriting receivables. The risk is also mitigated through repayment via salary deduction from its loans and receivables.

RCE is trading at PER 6.2x FY18F, which is below its 5-year average PER 7.5x. RCE is trading at a discount to its peers i.e., ACSM, MBS and AEONTS. ACSM, MBS and AEONTS are trading in a PER range of 10.0x-16.2x FY18 (based on Bloomberg consensus). We think that the valuation is attractive considering that it is trading below its 5-year average PER and at a discount to its peers.

We also believe that RCE is attractive as the group offers a high ROE c.18%. Although it has a lower ROE than ACSM (ROE: c.20%), its ROE is on par with AEONTS and higher than MBS (ROE: c.4%). Refer to Table 2. We believe that the counter deserves to trade at higher PER levels given its strong performance outlook in FY18F-20F, high sustainable ROE c.18% and decent growth potential following its high-single-digit to low-double-digit financing receivables growth.

Not a dividend play but possible for dividend surprises?

RCE does not have a dividend policy but it has consistently paid out dividend per share (DPS) of 6.0 sen in the past years and 3.0 sen in the recent financial year (upon 4-to-1 share consolidation corporate exercise). As of 1H18, RCE has paid a DPS of 3.0 sen. We believe that the company has the capacity to at least maintain its dividend payout as the payout only comprises c.2-4% of its reserves.

Our dividend estimate for FY18F-20F assumes the same payout as FY17 i.e., 3.0 sen. This translates into dividend yield of c.2%. Based on our dividend assumptions, RCE offers less attractive dividend payout than its peers i.e., ACSM and MBS (dividend yields of c.2-3%) and AEONTS (dividend yield of c.3-4%).

Although it may not be that attractive due to lower dividend yield as compared to its peers, any special dividend would make the counter worthwhile to hold onto, in our view. We believe the company has the capacity to do so as it has a hefty reserve level as a result of (1) high retention rate i.e. >80% and (2) profitable operation i.e., profit margin of 20-30% of its total income in recent years.

In FY16, RCE paid a DPS of 14.0 sen. This translated into dividend yield of c.9%. We estimate that the special dividend in FY16 was paid by utilising c.30% of its reserves. Refer to Chart 20. Assuming that RCE is able to maintain its performance as per our forecasts i.e., three-year net profit CAGR of 7.5%, while maintaining its retention rate, we believe that its reserves would replenish to its pre-special dividend level by FY19F. Any special dividend in the coming year(s) would offer further upside to the counter, we believe.

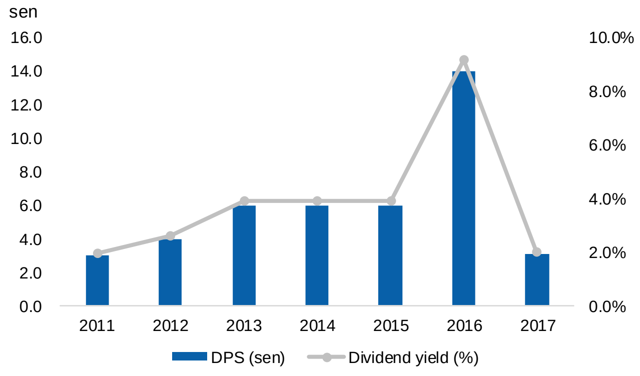
Table 2: Peers comparison

	PER (x)		PBV (x)		Return on equity (%)		Dividend yield (%)	
	2017	**2018F**	**2017**	**2018F**	**2017**	**2018F**	**2017**	**2018F**
RCE Capital	6.3	6.2	1.2	1.1	17.6	17.9	2.0	2.0
AEON Credit Service Malaysia	13.0	12.3	3.6	2.2	30.5	22.3	2.6	2.8
*Malaysia Building Society	18.3	16.2	0.7	0.8	3.4	5.3	2.9	3.0
*AEON Thana Sinsap Thailand PCL	10.5	10.0	1.8	1.6	18.6	17.8	3.3	3.5

Source: Company, Bloomberg, KAF

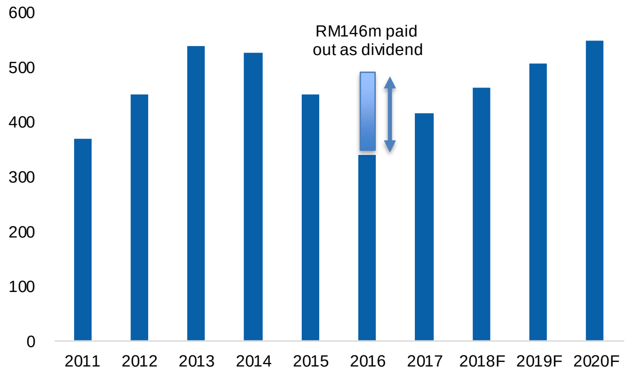
**Based on Bloomberg consensus and KAF's estimates based on closing price on 29th of December 2017. MBS' FY17 is referring to FY16 while its FY18F is referring to FY17F.*

Chart 19: DPS and yield (adjusted for capital change)



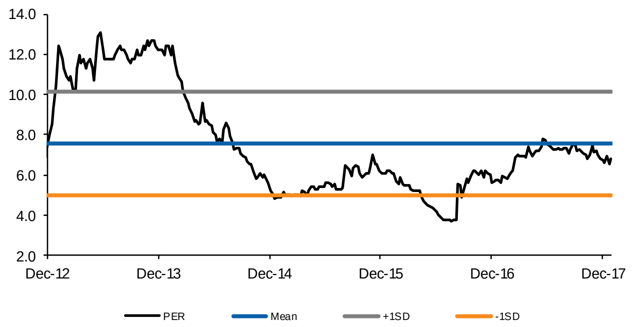
Source: Bloomberg, Company, KAF

Chart 20: Reserve account (RM m)



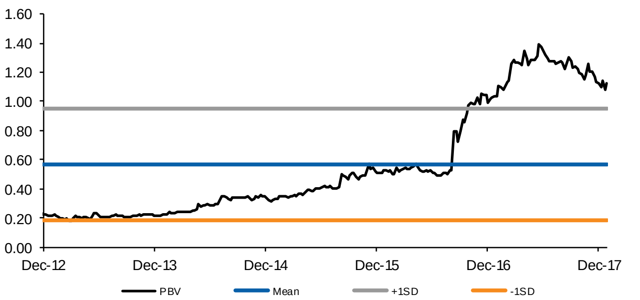
Source: Company, KAF

Chart 21: PER chart



Source: Bloomberg, KAF

Chart 22: PBV chart



Source: Bloomberg, KAF

Related information

Quarterly trend

FYE March	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	% chg		Cumulative			KAF	
RM m	**Jun-16**	**Sep-16**	**Dec-16**	**Mar-17**	**Jun-17**	**Sep-17**	**yoy**	**qoq**	**6M17**	**6M18**	**% chg**	**2018F**	**6M/F**
Interest income	52	56	58	57	57	62	10%	8%	108	119	10%	223	53%
Interest expense	(17)	(16)	(16)	(12)	(17)	(17)	1%	-2%	(33)	(34)	3%	(76)	45%
Net interest income	**35**	**40**	**42**	**45**	**40**	**45**	**14%**	**12%**	**75**	**84**	**13%**	**147**	**57%**
Non interest income	3	2	2	2	3	4	-6%	44%	5	7	30%	42	17%
Operating income	**38**	**42**	**45**	**47**	**43**	**49**	**13%**	**14%**	**80**	**91**	**14%**	**189**	**48%**
Operating expenses	(10)	(10)	(12)	(11)	(9)	(12)	-12%	34%	(20)	(21)	3%	(47)	43%
Underlying profit	**28**	**32**	**33**	**36**	**34**	**37**	**22%**	**9%**	**60**	**71**	**18%**	**142**	**50%**
Provisions	(4)	(7)	(9)	(7)	(6)	(7)	46%	9%	(11)	(14)	21%	(35)	39%
Exceptionals	0	0	0	0	0	0	nm	nm	0	0	na	na	na
Pretax profit	**23**	**26**	**24**	**29**	**27**	**30**	**17%**	**9%**	**49**	**57**	**17%**	**107**	**54%**
Taxation	(6)	(7)	(2)	(8)	(6)	(8)	9%	26%	(13)	(15)	12%	(24)	62%
Net profit	**18**	**18**	**22**	**21**	**21**	**22**	**19%**	**4%**	**36**	**43**	**19%**	**83**	**52%**

Source: Company, KAF

Bank statistics

	GIL	Coverage Ratio	Average Lending Rate	Funding Cost (3-m KLIBOR)	Average Lending Spread
Sep-16	1.26%	89%	4.6%	3.3%	1.2%
Oct-16	1.25%	90%	4.5%	3.3%	1.2%
Nov-16	1.23%	91%	4.5%	3.4%	1.1%
Dec-16	1.60%	90%	4.5%	3.4%	1.1%
Jan-17	1.60%	91%	4.5%	3.4%	1.1%
Feb-17	1.60%	91%	4.6%	3.4%	1.2%
Mar-17	1.62%	89%	4.6%	3.3%	1.3%
Apr-17	1.66%	82%	4.6%	3.4%	1.2%
May-17	1.67%	83%	4.6%	3.4%	1.2%
Jun-17	1.65%	83%	4.5%	3.4%	1.0%
Jul-17	1.68%	81%	4.6%	3.4%	1.2%
Aug-17	1.67%	81%	4.6%	3.4%	1.2%
Sep-17	1.67%	81%	4.6%	3.3%	1.4%

Source: BNM, KAF

Financial statements

Income Statement

FYE March (RM m)	2014	2015	2016	2017	2018F	2019F	2020F
Net interest income	87.6	98.1	110.7	128.5	147.2	160.9	174.1
Non-interest income	19.1	14.3	15.7	43.2	42.1	45.9	49.5
Total income	**106.7**	**112.4**	**126.4**	**171.7**	**189.3**	**206.8**	**223.6**
Operating costs	(28.4)	(42.7)	(41.3)	(43.1)	(47.5)	(51.9)	(56.1)
Pre-prov operating profit	**78.3**	**69.7**	**85.1**	**128.6**	**141.8**	**154.9**	**167.5**
Provision charges	(64.1)	(24.0)	(30.9)	(27.1)	(35.1)	(38.4)	(41.4)
Pre-tax profit	**14.2**	**45.7**	**54.2**	**101.5**	**106.7**	**116.5**	**126.1**
Taxation	(1.7)	(9.5)	(14.6)	(22.5)	(23.7)	(25.9)	(28.0)
Net Profit	**12.5**	**36.2**	**39.6**	**79.0**	**83.0**	**90.6**	**98.1**

Source: Company, KAF

Balance Sheet

FYE March (RM m)	2014	2015	2016	2017	2018F	2019F	2020F
Consumer financing	925	1,070	1,260	1,412	1,560	1,703	1,839
Factoring and confirming	21	18	8	6	4	2	1
Deposits with financial institutiona	288	41	153	143	157	172	185
Goodwill on consolidation	29	48	47	47	52	57	61
Deferred tax assets	22	18	33	39	43	47	50
Other receivables and deposits	16	17	25	30	34	37	39
Cash and bank balances	3	11	15	17	18	20	22
Others	13	12	10	8	10	10	14
Total Assets	**1,317**	**1,235**	**1,551**	**1,702**	**1,878**	**2,048**	**2,211**
Borrowings	582	632	1,029	1,214	1,339	1,460	1,576
Payables and accruals	14	28	44	44	48	52	57
Tax liabilities	4	7	19	2	2	2	2
Others	32	2	2	1	2	3	2
Total Liabilities	**632**	**669**	**1,094**	**1,261**	**1,391**	**1,517**	**1,637**
Share capital	113	117	116	25	25	25	25
Redeemable convertible preference shares	47	0	0	0	0	0	0
Reserves	525	449	341	416	462	506	549
Total Shareholders' Equity	**685**	**566**	**457**	**441**	**487**	**531**	**574**
Total Liabilities & Equity	**1,317**	**1,235**	**1,551**	**1,702**	**1,878**	**2,048**	**2,211**

Source: Company, KAF

Disclosure Appendix

Recommendation structure

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

Disclaimer

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