

28 May 2018

Buy

Price
 RM1.33

Target Price
 RM1.85 (from RM1.80)

Market Data

Bloomberg Code	RCE MK
No. of shares (m)	341.2
Market cap (RMm)	452.2
52-week high/low (RM)	1.88 / 1.06
Avg daily turnover (RMm)	0.5
KLCI (pts)	1,775.8

Source: Bloomberg, KAF

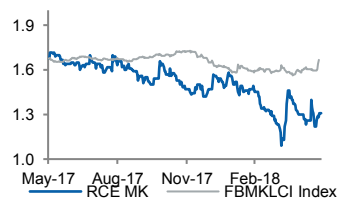
Major Shareholder (%)

Cempaka Empayar	(61.1%)
National Trust Fund	(1.7%)
Cheam Heng Ming	(1.1%)
Free Float	102.2

Source: Bloomberg, KAF

Performance

	3M	6M	12M
Absolute (%)	(8.3)	(11.3)	(27.3)
Rel Market (%)	(4.1)	(14.4)	(27.5)



Source: Bloomberg, KAF

RCE Capital Bhd

Ahead of expectation

We maintain our Buy recommendation on RCE Capital (RCE) with a revised TP of RM1.85 based on a higher GGM valuation. The receivable and interest income growth targets for FY19F-20F range between 5-7% and 5-8%, respectively. RCE has adopted a dividend payout ratio target within a range of 20% to 40% of its net profit in FY19F. Based on the FY18 payout ratio, this translates into dividend yields of 5-6% in FY19-20F. RCE is trading at a PER of 5.0x FY19F, which is at its -1s.d of its 3-year average PER. It offers a high ROE of c.17% in FY19F.

Financial Highlights

FYE Mar	2016	2017	2018	2019F	2020F
Revenue (RMm)	126.4	171.7	188.3	202.2	212.1
Core net profit (RMm)	39.6	78.9	88.7	90.5	95.0
EPS (Sen)	11.6	23.1	25.9	26.5	27.8
EPS growth (%)	9.3	99.5	12.3	2.1	4.9
DPS (Sen)	14.0	3.0	7.0	7.1	7.5
PE (x)	11.5	5.8	5.1	5.0	4.8
Div yield (%)	10.5	2.3	5.3	5.4	5.6
ROE (%)	7.7	17.6	18.5	16.9	16.8
PBV(x)	1.0	1.0	0.9	0.8	0.8

Source: Company, KAF

A good finish. RCE recorded net profit of RM89m in FY18 (107% of our forecast), +12% yoy on the back of higher operating income. The group reported 10% yoy operating income growth in FY18, which trails 36% full-year growth in FY17. The double-digit income growth is mainly due to income growth in the consumer financing segment i.e., +10% yoy.

Contraction in lending spread. RCE's average lending yield stood at 13.4% (FY17: 12.7%) while its average funding cost was 5.5% (FY17: 5.5%). Consequently, its average lending spread stood at 7.9% (FY17: 7.2%). Despite the improvement in its lending spread, we forecast the spread to contract going forward due to higher borrowing costs.

With the overnight policy rate (OPR) hike earlier this year, we expect the average funding cost from its borrowings to increase by 30-40bps. As an indicator, its weighted average interest rate (WAEIR) on its borrowings ranged from 5.1-6.2% in FY18 (FY17: 4.7-6.0%). However, we believe that its average lending yield will remain stable at c.13.4-13.5%. This is as per the management strategy not to compete on rates. All things considered, we expect its average lending spread to contract further to 7.6% in FY19F.

An improvement in NPL and coverage ratio. RCE's NPL ratio stood at 4.1%, a slight improvement from 4.2% in FY17 due to improved asset quality. Its receivables grew c.8% yoy while its NPL only grew c.4% yoy.

RCE's coverage ratio was 178%. This is a significant 6ppts improvement from FY17. This was expected as the management has adopted stringent risk management and a prudent provisioning policy. Its coverage ratio is much higher than that of banks at <100%. We believe this is justified as consumer financing is unsecured in nature with no collateral.

New government's plan to axe 17k civil servants: marginal impact. The new government has announced it intends to lay off 17k contracted officers (civil servants) as part of its initiative to reduce government expenditure. The government has in fact begun to lay off civil servants who are political appointees as part of the efforts to downsize the civil service. However, the government also added that civil servants in the low income group would be spared and potentially relocated.

Analyst

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As most of RCE's clientele are from the bottom 40% of the income group (B40), we believe this move will only have a marginal impact on RCE. According to the management, the impact will only be minimal. At most, the amount impacted will be RM10m of its portfolio, or <1% of its portfolio.

The management has stated that it will maintain its cautious stance in the current environment of economic uncertainties and digital transformation. It is focusing on ensuring quality growth in its loans and receivables and believes RCE will be able to sustain or improve its financial performance in FY19. All things considered, we expect its receivables to grow in the range of 5-7% in FY19-20F.

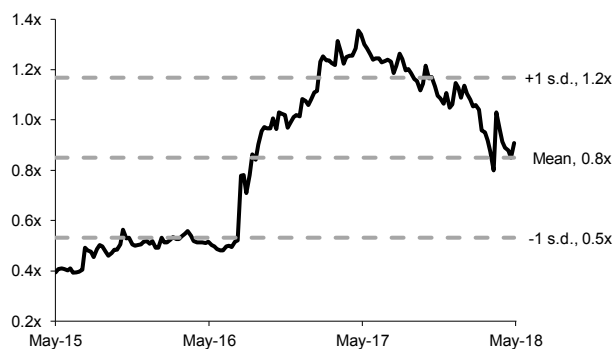
Adoption of dividend payout policy. In 4Q18, RCE announced the adoption of a dividend payout ratio within a range of 20% to 40% of its net profit in the coming financial years. A dividend per share (DPS) of 4.0 sen was declared in 4Q18. The total DPS for FY18 is 7.0 sen making up 27% of the dividend payout. This was above our DPS estimate for FY18, i.e. 3.0 sen. We estimate DPS to be 7.1 sen for FY19F. Our estimate is based on the same payout ratio as FY18, i.e., 27% payout.

Valuation. RCE is trading at a PER of 5.0x FY19F, which is its -1s.d of its 3-year average PER of 6.0x. RCE is trading at a discount to its local peer AEON Credit (ACSM MK, RM15.10, Buy), which is trading at a PER of 11.6x FY19F. We believe ACSM is trading at a higher valuation as it offers a higher ROE of c.19% (RCE: c.17%) and higher receivables growth (double-digit growth).

However, we also believe that RCE deserves to trade at a higher valuation, i.e., a PER of 7.0x FY19F, than its current level as it offers a generous dividend payout that translates into a dividend yield of c.5-6% (ACSM: c.3-4%).

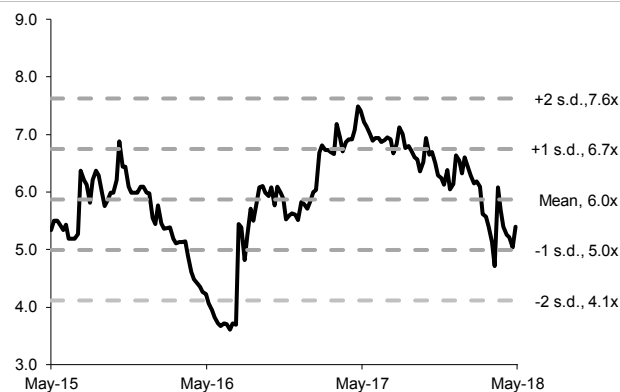
Maintain Buy. We reiterate our Buy recommendation on RCE Capital (RCE) with a revised TP of RM1.85 based on a higher GGM valuation as we roll forward our valuation to FY19F. Our TP implies a PER 7.0x FY19F, which is around +1s.d of its 3-year average PER.

Exhibit 1: PB Band chart



Source: Company, KAF, Bloomberg

Exhibit 2: PE Band chart



Source: Company, KAF, Bloomberg

Table 1: Quarterly trends

Year to 31 March	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	% chg		Cumulative			KAF	
	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18	qoq	yoy	FY17	FY18	% chg	2018F	12M/F
Interest and fee income	58	57	57	62	64	63	-1%	10%	223	246	10%	254	97%
Interest expense	(16)	(12)	(17)	(17)	(17)	(18)	4%	45%	-61	-69	13%	-76	91%
Net interest and fee income	42	45	40	45	47	45	-3%	1%	162	177	9%	178	99%
Non-interest income	2	2	3	4	2	3	82%	40%	10	12	19%	11	108%
Operating income	45	47	43	49	49	48	0%	3%	172	188	10%	189	99%
Operating expenses	(12)	(11)	(9)	(12)	(10)	(11)	4%	-5%	-43	-41	-4%	-47	87%
Underlying profit	33	36	34	37	38	38	-1%	5%	129	147	14%	142	104%
Provisions	(9)	(7)	(6)	(7)	(8)	(8)	-8%	10%	-27	-30	9%	-35	84%
Exceptionals	0	0	0	0	0	0	nm	nm	0	0	na	na	na
Pre-tax profit	24	29	27	30	30	30	0%	4%	101	117	16%	107	110%
Taxation	(2)	(8)	(6)	(8)	(7)	(7)	0%	-7%	-23	-29	27%	-24	121%
Net profit	22	21	21	22	23	23	0%	8%	79	89	12%	83	107%

Source: Company, KAF

RCE Capital Bhd

Income Statement

FYE Mar (RMm)	2016	2017	2018	2019F	2020F
Net interest income	110.7	128.5	149.2	157.2	164.9
Non-interest income	15.7	43.2	39.1	45.0	47.2
Total income	126.4	171.7	188.3	202.2	212.1
Operating costs	(41.3)	(43.1)	(41.3)	(44.4)	(46.6)
Pre-prov operating profit	85.1	128.6	147.0	157.8	165.6
Provision charges	(30.9)	(27.1)	(29.5)	(38.0)	(39.9)
Pre-tax profit	54.2	101.5	117.4	119.8	125.7
Taxation	(14.6)	(22.5)	(28.7)	(29.3)	(30.7)
Net Profit	39.6	79.0	88.7	90.5	95.0

Balance Sheet

FYE Dec (RM m)	2016	2017	2018	2019F	2020F
Consumer financing	1,260	1,412	1,525	1,622	1,706
Factoring and confirming	8	6	4	3	2
Deposits with financial institutions	153	143	170	180	189
Plant and equipment	8	9	6	7	7
Goodwill on consolidation	47	47	47	50	53
Other investments	0	0	0	0	0
Deferred tax assets	33	39	39	42	44
Other receivables and deposits	25	30	40	43	45
Asset held for sale	1	0	0	0	0
Cash and bank balances	15	17	28	29	31
Total Assets	1,551	1,702	1,859	1,976	2,076
Borrowings	1,029	1,214	1,298	1,381	1,450
Payables and accruals	44	44	33	35	37
Hire purchase	0	1	1	1	1
Deferred tax liabilities	1	1	0	0	0
Tax liabilities	19	2	6	7	7
Total Liabilities	1,094	1,261	1,340	1,424	1,496
Share capital	116	25	31	31	31
Redeemable convertible preference shares	0	0	0	0	0
Reserves	341	416	488	521	549
Total Shareholders' Equity	457	441	519	552	581
Total Liabilities & Equity	1,551	1,702	1,859	1,976	2,076

Key Ratios

FYE Mar	2016	2017	2018	2019F	2020F
ROE (%)	7.7	17.6	18.5	16.9	16.8
ROA (%)	3.1	5.6	5.8	5.6	5.6
Average Lending Yield	12.4	12.7	13.4	13.5	13.4
Cost of funds	5.8	5.5	5.5	5.9	5.8
Net Interest Margin	6.7	7.3	7.9	7.6	7.5
Int Income/Total Income	87.6	74.9	79.3	77.8	77.7
Non-int/Total Income	12.4	25.1	20.7	22.2	22.3
Cost to Income	32.7	25.1	22.0	22.0	22.0

Source: Bloomberg, 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.

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