

## RCE Capital Bhd (RCE MK)

# D/G to HOLD but more dividends likely

### Downgrade to HOLD but raise TP to MYR2.38 (+15%)

We maintain our EPS estimates but raise DPS estimates by 2sen p.a. as DPR going forward will likely come in at 75% or 10ppts more than we had earlier expected. Given that we raised our DPS assumption by 15%, we also raise our end-CY23E target P/BV by 15% to 2.1x from 1.8x leading to a higher TP of MYR2.38 (vs. MYR2.07). With a narrowed upside of <10% after the recent share price rally, we downgrade RCE to HOLD; investors should still HOLD it for its stable and generous dividend yields of  $\geq 6.0\%$  p.a.

### Financing receivables growth still positive

We met management for an update. Recall that FY3/23A financing receivables grew 7.5% YoY, the fastest clip in 5 years, driven by civil service salary adjustments and raises. While the Government has not been guiding more salary adjustments and raises going forward, RCE still expects financing receivables growth to track banking sector loans growth (May 2023: +4.8% YoY) as demand has been resilient. Thus, we are comfortable with our FY24E financing receivables growth forecast of +4.0%.

### Maintaining earnings estimates but...

In response to rising cost of funds, RCE repriced its profit rates to 6.65%-9.99% from 5.99%-9.99% in Oct 2022. It doesn't plan to reprice again unless the OPR rises markedly above 3.00%. It helps that an upcoming sukuk tranche will be priced at 5.02% profit rate, down from the previous sukuk tranche in Nov 2022 at 5.19%, as the 10-year MGS yield is easing (Fig. 1). Credit costs also continues to moderate after waves of civil servants resigning last FY. All in all, the above are within our expectations.

### ... raise DPS estimates by 2sen p.a. (+15% to +17%)

While FY23A core DPS of 12sen translates into 63% DPR, the 2HFY23 DPS of 7sen translates into a higher 73% DPR. RCE stated that it will try to at least maintain absolute DPS going forward. Given its stable earnings outlook, we gather that this implies FY24E DPS of at least 14sen or 75% DPR or 10ppts more than we had expected. Thus, we raise DPS estimates by 2sen p.a. to reflect 75% DPR (65% previously). We now expect DY of  $\geq 6.0\%$  p.a.

| FYE Mar (MYR m)        | FY22A | FY23A | FY24E | FY25E | FY26E |
|------------------------|-------|-------|-------|-------|-------|
| Operating income       | 239   | 261   | 250   | 260   | 271   |
| Pre-provision profit   | 189   | 213   | 201   | 209   | 218   |
| Core net profit        | 133   | 139   | 136   | 142   | 148   |
| Core FDEPS (MYR)       | 0.18  | 0.19  | 0.18  | 0.19  | 0.20  |
| Core FDEPS growth(%)   | 3.3   | 3.7   | (4.0) | 4.3   | 4.2   |
| Net DPS (MYR)          | 0.11  | 0.30  | 0.14  | 0.15  | 0.15  |
| Core FD P/E (x)        | 10.2  | 9.7   | 13.0  | 12.5  | 11.9  |
| P/BV (x)               | 1.6   | 1.7   | 2.1   | 2.0   | 1.9   |
| Net dividend yield (%) | 5.8   | 16.5  | 6.0   | 6.2   | 6.4   |
| Book value (MYR)       | 1.19  | 1.10  | 1.14  | 1.19  | 1.24  |
| ROAE (%)               | 16.2  | 16.5  | 16.5  | 16.5  | 16.5  |
| ROAA (%)               | 5.1   | 4.9   | 4.5   | 4.5   | 4.5   |
| Consensus net profit   | -     | -     | 141   | 149   | 156   |
| MIBG vs. Consensus (%) | -     | -     | (3.6) | (4.9) | (5.3) |

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# HOLD

[Prior:BUY]

Share Price MYR 2.35  
12m Price Target MYR 2.38 (+7%)  
Previous Price Target MYR 2.07

### Company Description

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

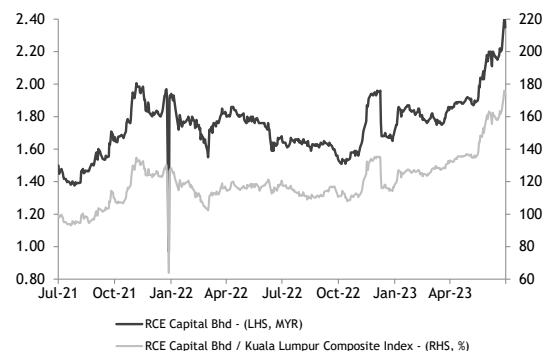
### Statistics

52w high/low (MYR) 2.40/1.51  
3m avg turnover (USDm) 0.2  
Free float (%) 30.7  
Issued shares (m) 741  
Market capitalisation MYR1.7B  
USD374M

### Major shareholders:

Cempaka Empayar Sdn. Bhd. 57.9%  
RCE Capital Berhad 1.1%  
Azman Hashim 0.2%

### Price Performance



|                       | -1M | -3M | -12M |
|-----------------------|-----|-----|------|
| Absolute (%)          | 8   | 27  | 40   |
| Relative to index (%) | 7   | 30  | 43   |

Source: FactSet

### Abbreviations

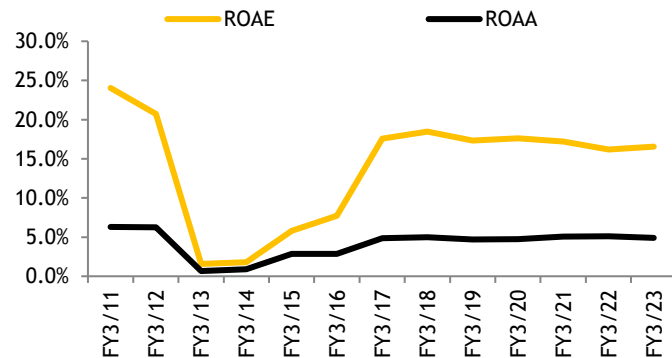
OPR = Overnight Policy Rate  
MGS = Malaysian Government Securities

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 MYR2.0b, 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.

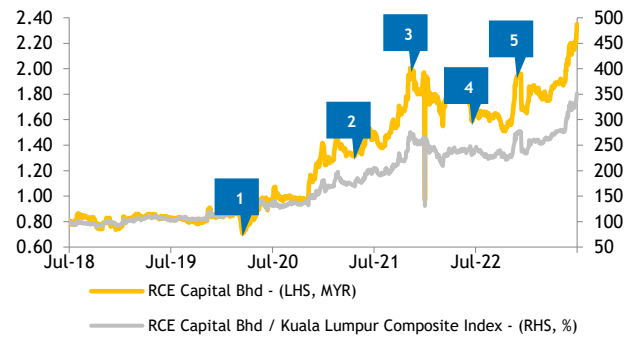
### ROE and ROA



Source: Company

## Price Drivers

### Historical share price trend



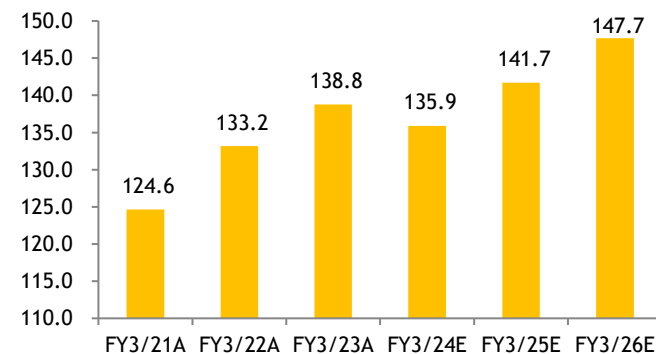
Source: Company, Maybank IBG Research

1. Movement Control Order lengthened time to process new customers applications, resulting in less financing disbursed.
2. 2QFY21 net profit grew 21% YoY to a record high of MYR33.0m.
3. Announced share DPS of 1 treasury share for 20 shares held and bonus issue of 19 shares for 21 shares held.
4. Bank Negara Malaysia raised Overnight Policy Rate by 25bps for the first time since Jul 2020.
5. Announced a huge special DPS of 18sen and higher-than expected interim DPS of 5sen.

## Financial Metrics

- Introduced better credit scoring model in 2013. We forecast gross financing CAGR of 5% 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 financing are smaller in size (<2%).
- Forecast stable three-year forward core net profit CAGR of 2% p.a.
- Recently raised DPR policy from 20-40% to 60-80%.

### Core net profit (MYRm)



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

## 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 <sup>1</sup> | N/A |
| Score Momentum <sup>2</sup>      | N/A |
| Last Updated                     | N/A |
| Controversy Score <sup>3</sup>   | 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. All in all, we rate RCE's ESG credentials vis-à-vis its core business as commendable

## Material E issues

- No major environmental issues. Cut paper utilisation per headcount by 30% to c.3,700 pieces in FY3/22.
- The above was achieved via emails reminding employees to "Think before you Print" and printing on both sides.
- FY3/22 scope 1 and 2 emissions in CO<sub>2</sub>eq tonnes per employee cut to 0.93 (FY3/21: 0.97, FY3/20: 0.96).
- Part of the reason for the above is due to the extensive use of energy saving light bulbs.

## Material S issues

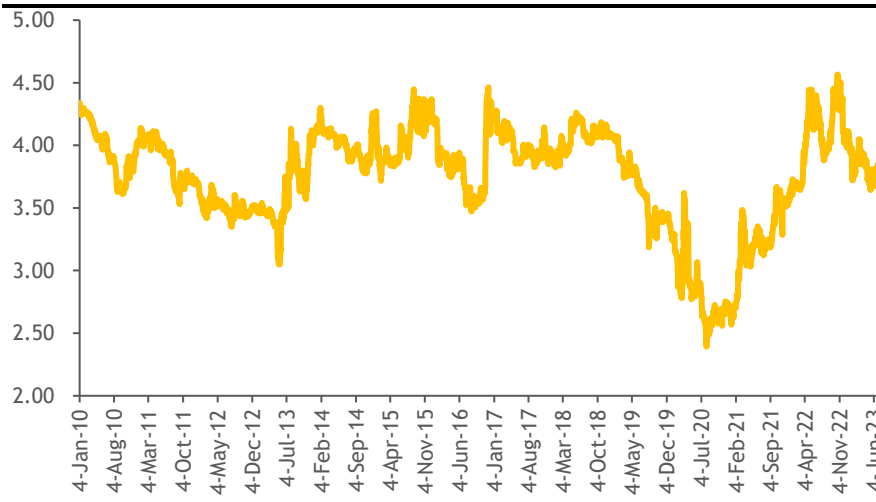
- RCE is guided by Bank Negara Malaysia's (BNM) guidelines for responsible financing.
- In Jul 2013, BNM instituted macro prudential measures to rein in high household debt levels.
- Since then, tenure of its financing is capped at 10 years and debt service ratio of its customers is capped at 60%.
- 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 MYR524,000 in study grants to 33 students.
- An overwhelming 73% of RCE's employees as at endFY3/22 are women.
- FY3/22 overall turnover rate increased to 19.3% (FY3/21: 16.8%, FY3/20: 14.9%).
- FY3/22 average training hours per employee stood at 24 (FY3/21: 8, FY3/20: 40).

## 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.
- FY3/22 directors' remuneration accounted for <1% of FY3/22 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-FY3/22, RCE has deposits of MYR586.9m and borrowings of MYR145.4m 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.

<sup>1</sup>**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. <sup>2</sup>**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. <sup>3</sup>**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).

Figure 1: 10-year MGS yield (%)



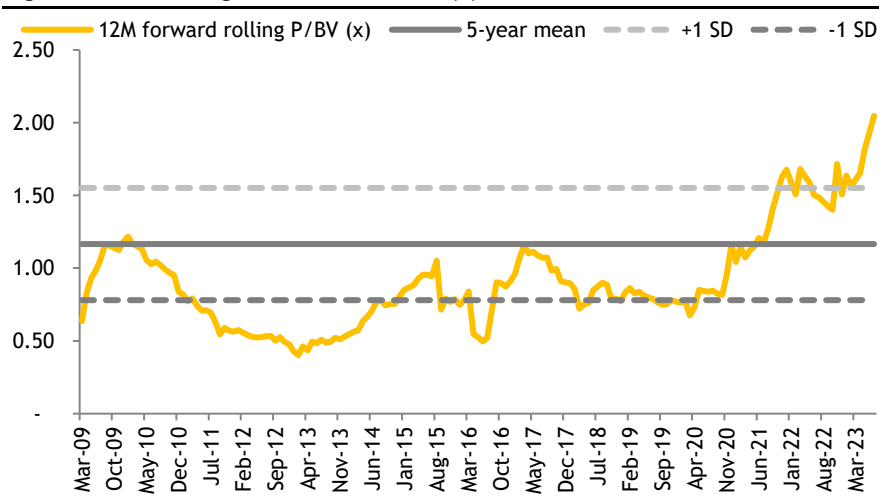
Source: Bloomberg

Figure 2: Major assumptions and estimates

|   | FY3/21A | FY3/22A | FY3/23A | FY3/24E | FY3/25E | FY3/26E |
|---|---------|---------|---------|---------|---------|---------|
| <b>Unchanged</b>                                |         |         |         |         |         |         |
| Financing receivables growth                    | 1.4%    | 1.8%    | 7.5%    | 4.0%    | 4.0%    | 4.0%    |
| Net interest margin                             | 8.7%    | 8.3%    | 7.7%    | 7.4%    | 7.4%    | 7.4%    |
| Credit cost as % of gross financing receivables | 0.9%    | 0.6%    | 1.5%    | 1.0%    | 1.0%    | 1.0%    |
| <b>Revised</b>                                  |         |         |         |         |         |         |
| Core DPR (revised)                              | 38%     | 57%     | 63%     | 75%     | 75%     | 75%     |
| Cored DPS (previous)                            | 38%     | 57%     | 63%     | 65%     | 65%     | 65%     |

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

Figure 3: RCE rolling 12M forward P/BV (x)



Source: Company, Maybank IBG Research, Bloomberg

| FYE 31 Mar                            | FY22A          | FY23A          | FY24E          | FY25E          | FY26E          |
|---------------------------------------|----------------|----------------|----------------|----------------|----------------|
| <b>Key Metrics</b>                    |                |                |                |                |                |
| Core P/E (x)                          | 10.1           | 9.6            | 12.7           | 12.2           | 11.7           |
| Core FD P/E (x)                       | 10.2           | 9.7            | 13.0           | 12.5           | 11.9           |
| P/BV (x)                              | 1.6            | 1.7            | 2.1            | 2.0            | 1.9            |
| P/NTA (x)                             | 1.6            | 1.8            | 2.2            | 2.1            | 2.0            |
| Net dividend yield (%)                | 5.8            | 16.5           | 6.0            | 6.2            | 6.4            |
| <b>INCOME STATEMENT (MYR m)</b>       |                |                |                |                |                |
| Islamic banking income                | 206.4          | 209.4          | 213.6          | 222.5          | 231.7          |
| Other income                          | 33.0           | 52.0           | 36.3           | 37.8           | 39.3           |
| <b>Total non-interest income</b>      | <b>239.4</b>   | <b>261.4</b>   | <b>250.0</b>   | <b>260.3</b>   | <b>271.0</b>   |
| <b>Operating income</b>               | <b>239.4</b>   | <b>261.4</b>   | <b>250.0</b>   | <b>260.3</b>   | <b>271.0</b>   |
| Staff costs                           | (26.6)         | (27.1)         | (27.4)         | (28.5)         | (29.6)         |
| Other operating expenses              | (24.0)         | (21.7)         | (21.9)         | (22.6)         | (23.4)         |
| <b>Operating expenses</b>             | <b>(50.6)</b>  | <b>(48.8)</b>  | <b>(49.2)</b>  | <b>(51.1)</b>  | <b>(53.0)</b>  |
| <b>Pre-provision profit</b>           | <b>188.8</b>   | <b>212.6</b>   | <b>200.7</b>   | <b>209.2</b>   | <b>218.0</b>   |
| Other allowances                      | (11.5)         | (28.7)         | (20.6)         | (21.4)         | (22.3)         |
| Associates & JV income                | 0.0            | 0.0            | 0.0            | 0.0            | 0.0            |
| <b>Pretax profit</b>                  | <b>177.2</b>   | <b>183.9</b>   | <b>180.1</b>   | <b>187.8</b>   | <b>195.7</b>   |
| Income tax                            | (44.1)         | (45.2)         | (44.2)         | (46.1)         | (48.1)         |
| <b>Reported net profit</b>            | <b>133.2</b>   | <b>138.8</b>   | <b>135.9</b>   | <b>141.7</b>   | <b>147.7</b>   |
| <b>Core net profit</b>                | <b>133.2</b>   | <b>138.8</b>   | <b>135.9</b>   | <b>141.7</b>   | <b>147.7</b>   |
| <b>BALANCE SHEET (MYR m)</b>          |                |                |                |                |                |
| Cash & deposits with banks            | 800.5          | 879.7          | 919.3          | 962.4          | 1,008.1        |
| 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        | 2,029.3        | 2,108.3        | 2,190.5        |
| 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           |
| <b>Total assets</b>                   | <b>2,725.3</b> | <b>2,946.8</b> | <b>3,062.3</b> | <b>3,184.4</b> | <b>3,312.2</b> |
| 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          | 516.6          | 602.9          | 692.7          |
| Other liabilities                     | 201.2          | 416.0          | 415.9          | 416.2          | 416.5          |
| <b>Total liabilities</b>              | <b>1,853.2</b> | <b>2,141.2</b> | <b>2,223.4</b> | <b>2,310.0</b> | <b>2,400.1</b> |
| Share capital                         | 200.7          | 201.9          | 201.9          | 201.9          | 201.9          |
| Reserves                              | 671.4          | 603.7          | 637.0          | 672.5          | 710.2          |
| Shareholders' funds                   | 872.1          | 805.7          | 839.0          | 874.4          | 912.1          |
| 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          | 839.0          | 874.4          | 912.1          |
| <b>Total liabilities &amp; equity</b> | <b>2,725.3</b> | <b>2,946.8</b> | <b>3,062.3</b> | <b>3,184.4</b> | <b>3,312.2</b> |

| FYE 31 Mar                   | FY22A | FY23A | FY24E | FY25E | FY26E |
|------------------------------|-------|-------|-------|-------|-------|
| <b>Key Ratios</b>            |       |       |       |       |       |
| <b>Growth (%)</b>            |       |       |       |       |       |
| Net interest income          | na    | na    | na    | na    | na    |
| Non-interest income          | 3.3   | 9.2   | (4.4) | 4.1   | 4.1   |
| Operating expenses           | 3.3   | (3.6) | 1.0   | 3.7   | 3.7   |
| Pre-provision profit         | 3.3   | 12.6  | (5.6) | 4.2   | 4.2   |
| Core net profit              | 6.8   | 4.2   | (2.1) | 4.3   | 4.2   |
| Gross loans                  | 1.8   | 7.5   | 4.0   | 4.0   | 4.0   |
| Customer deposits            | na    | na    | na    | na    | na    |
| Total assets                 | 9.4   | 8.1   | 3.9   | 4.0   | 4.0   |
| <b>Profitability (%)</b>     |       |       |       |       |       |
| Non-int. income/Total income | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Cost/income                  | 21.1  | 18.7  | 19.7  | 19.6  | 19.5  |
| <b>Liquidity (%)</b>         |       |       |       |       |       |
| Loans/customer deposits      | na    | na    | na    | na    | na    |
| <b>Asset quality (%)</b>     |       |       |       |       |       |
| Gross NPF                    | 3.8   | 3.8   | 3.8   | 3.8   | 3.8   |
| <b>Capital adequacy (%)</b>  |       |       |       |       |       |
| CET1                         | na    | na    | na    | na    | na    |
| Tier 1 capital               | na    | na    | na    | na    | na    |
| Risk-weighted capital        | na    | na    | na    | na    | na    |
| <b>Returns (%)</b>           |       |       |       |       |       |
| ROAE                         | 16.2  | 16.5  | 16.5  | 16.5  | 16.5  |
| ROAA                         | 5.1   | 4.9   | 4.5   | 4.5   | 4.5   |
| Shareholders equity/assets   | 32.0  | 27.3  | 27.4  | 27.5  | 27.5  |

Source: Company; Maybank IBG Research

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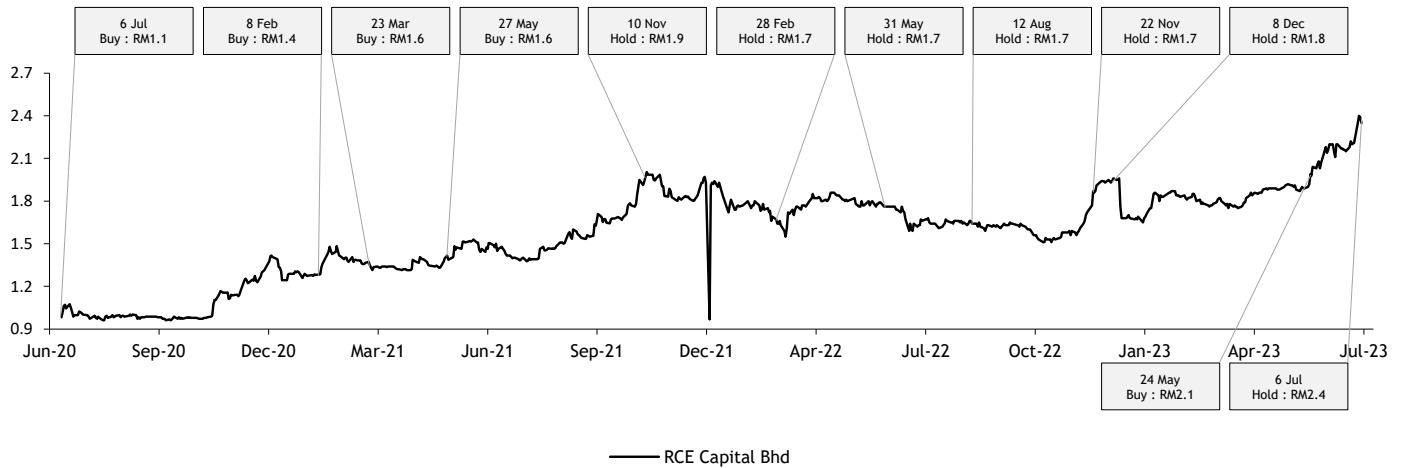
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