24 August 2023

Financial Services | Diversified Financial Services

ELK-Desa Resources (ELK MK)

Neutral (Maintained)

A Soft Start To FY24

Target Price (Return):	MYR1.20 (-4%)
Price (Market Cap):	MYR1.25 (USD122m)
ESG score:	3.1 (out of 4)
Avg Daily Turnover (MYR/USD)	0.08m/0.02m

- **Keep NEUTRAL and MYR1.20 TP, 4% downside with c.5% FY24F (Mar) yield.** ELK-Desa Resources' 1QFY24 net profit of MYR8.5m missed expectations on the back of subdued hire purchase receivables (HPR) growth, higher impairment allowances, and a weak performance from the furniture segment. That said, we remain confident on the group's HPR growth prospects and asset quality strategies, and look forward to a stronger performance in the coming quarters.
- **A soft start to FY24.** ELK recorded a net profit of MYR8.5m in 1QFY24, missing our and consensus estimates. The variance mainly came from higher-than-expected hire purchase impairment allowances, as (annualised) credit costs of 4.72% came in above its guidance of 3-4%. YoY, net profit halved in the absence of impairment allowance reversals, due to exceptional collection productivity in 1QFY23. QoQ, greater HP revenue (+2%) and opex savings (-10%) led to a bottomline growth of 14%.
- **Flat HPR growth, although not alarming.** ELK's HPR as at 30 Jun stood at MYR574m (flat QoQ, +14% YoY). Management explained that this was mostly deliberate, as it was conservative with disbursements over the festive period to protect asset quality. The group reiterated its 10-15% HPR growth target for the year, which we deem to be achievable, given the continued strong demand for used cars.
- **Uptick in impairments.** The jump in credit costs in 1QFY24 was partly due to slower repayments during the quarter, likely due to the festive season. As a result, the net impaired loans ratio rose to 2.25% from 1.92% in 4QFY23. Net impaired loans should begin to trend downward once repossession activities get up to speed, ie around 2QFY23 onwards. Further out, the group will aim to improve its engagement with borrowers, while investments in digitalisation should assist borrowers in making more timely repayments.
- **Disappointing quarter for the furniture segment.** Furniture sales dropped 14% YoY (-11% QoQ), and fell short of our and management's expectations. Coupled with higher staff costs, this led to a disappointing PBT of MYR1m for the furniture segment – the lowest level since 4QFY22. As 2Q tends to see seasonally softer sales, we expect to see downside risks to our forecasts, but note that the furniture segment only contributes 10% of group PBT (revenue: 34%).
- **Forecasts and TP.** We make no changes to our forecasts for now, pending the analysts' briefing on 7 Sep 2023. However, we note the downside risks, given the underperformance in 1QFY24. Our unchanged TP MYR1.20 is based on a GGM-derived P/BV of 1.05x, with an ESG premium of 2% incorporated. While the counter's current P/BV of 1.2x (+2SD from 5-year mean) appears high, we believe its popularity among dividend-seeking retail investors should continue to support its valuation at such levels.

Forecasts and Valuation	Mar-22	Mar-23	Mar-24F	Mar-25F	Mar-26F
Reported net profit (MYRm)	26	48	45	48	51
Net profit growth (%)	(27.0)	85.4	(6.8)	7.5	5.3
Recurring net profit (MYRm)	26	48	44	48	50
Recurring EPS (MYR)	0.06	0.10	0.10	0.11	0.11
BVPS (MYR)	0.98	1.04	1.07	1.11	1.16
DPS (MYR)	0.04	0.07	0.06	0.07	0.07
Recurring P/E (x)	22.06	11.91	12.78	11.89	11.28
P/B (x)	1.27	1.21	1.17	1.12	1.08
Dividend Yield (%)	2.9	5.2	4.9	5.2	5.5
Return on average equity (%)	5.8	10.4	9.3	9.7	9.8

Source: Company data, RHB

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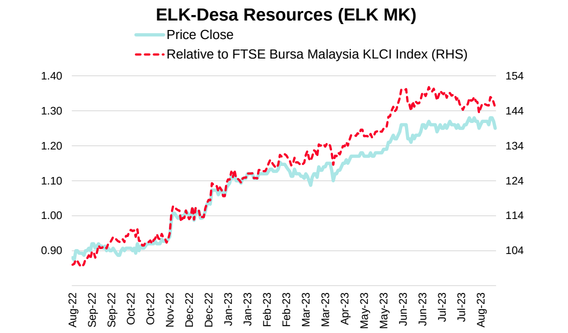
Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	17.9	(0.8)	3.3	9.6	42.0
Relative	21.6	(2.7)	1.3	10.8	44.9
52-wk Price low/high (MYR)					0.87 – 1.28



Source: Bloomberg

Overall ESG Score: 3.1 (out of 4)

E: GOOD

ELK-Desa financing has low exposure to high-environmental-risk sectors, as it is largely related to the purchases of used vehicles. The company recorded a 24% decrease in electricity consumption in FY22, and completed the installation of solar panel systems in its offices, which will be operational from early FY23 onwards. Digitisation efforts are also underway to reduce its usage of paper and printers.

S: GOOD

Each used vehicle that is financed is subject to mandatory inspection prior to approval, to ensure the safety of its customers. Most of the hire purchase division's customers come from B40/lower-M40 backgrounds. The division is also well-diversified, with 71% made up of women and a balanced ethnicity split. The company has comprehensive plans in place to ensure that workplace safety, health and wellbeing are safeguarded at all times.

G: EXCELLENT

ELK-Desa has in place policies and a framework to ensure ethical business, integrity and transparency are practiced, as well as a whistleblowing programme. Board member responsibilities are revised and published annually. The Board meets around five times a year.

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Financial Exhibits

Asia
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Financial Services
ELK-Desa Resources
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Neutral

Valuation basis

GGM-derived intrinsic value with zero ESG overlay. Key GGM assumptions are:
i. Cost of equity of 9.3%;
ii. Sustainable ROE of 9.6%;
iii. 3.5% long-term growth.

Key drivers

Key drivers include:
i. HPR growth;
ii. Low impairment allowances on HPR;
iii. Better profits from the furniture business.

Key risks

The downside risks include:
i. Weaker-than-expected HPR growth;
ii. Higher-than-expected credit costs;
iii. Weaker-than-expected performance of its furniture business.

Company Profile

ELK-Desa Resources is a financial services company that provides hire purchase financing with a focus on financing for used motor vehicles. As an extension, the company also cross-sells general insurance products from leading insurance brands to its hire purchase customers. On top of its financing operations, the company also operates a furniture trading business. ELK-Desa Resources currently employs approximately 250 individuals, with most of its business operations centred in the Klang Valley.

Shareholders (%)

Eng Lee Kredit	32.8
Amity Corporation	5.1
Teo Siew Lai	3.5

Financial summary (MYR)	**Mar-22**	**Mar-23**	**Mar-24F**	**Mar-25F**	**Mar-26F**
EPS	0.06	0.11	0.10	0.11	0.11
Recurring EPS	0.06	0.10	0.10	0.11	0.11
DPS	0.04	0.07	0.06	0.07	0.07
BVPS	0.98	1.04	1.07	1.11	1.16

Valuation metrics	**Mar-22**	**Mar-23**	**Mar-24F**	**Mar-25F**	**Mar-26F**
Recurring P/E (x)	22.06	11.91	12.78	11.89	11.28
P/B (x)	1.3	1.2	1.2	1.1	1.1
Dividend Yield (%)	2.9	5.2	4.9	5.2	5.5

Income statement (MYRm)	**Mar-22**	**Mar-23**	**Mar-24F**	**Mar-25F**	**Mar-26F**
Interest income	79	89	102	113	122
Interest expense	(10)	(9)	(12)	(13)	(16)
Net interest income	**70**	**80**	**91**	**99**	**105**
Non interest income	52	68	75	80	83
Total operating income	**122**	**148**	**166**	**179**	**189**
Overheads	(64)	(77)	(85)	(91)	(96)
Pre-provision operating profit	**57**	**71**	**81**	**89**	**92**
Loan impairment allowances	(22)	(7)	(21)	(24)	(25)
Other impairment allowances	(0)	(1)	(0)	(1)	(1)
Pre-tax profit	**35**	**63**	**59**	**64**	**67**
Taxation	(9)	(16)	(15)	(16)	(17)
Reported net profit	**26**	**48**	**45**	**48**	**51**
Recurring net profit	**26**	**48**	**44**	**48**	**50**

Profitability ratios	**Mar-22**	**Mar-23**	**Mar-24F**	**Mar-25F**	**Mar-26F**
Return on average assets (%)	4.1	7.5	6.2	6.2	6.0
Return on average equity (%)	5.8	10.4	9.3	9.7	9.8
Return on IEAs (%)	14.0	14.9	15.3	15.4	15.4
Cost of funds (%)	6.1	5.5	5.6	5.6	5.7
Net interest spread (%)	7.9	9.4	9.8	9.8	9.7
Net interest margin (%)	12.3	13.5	13.6	13.6	13.4
Non-interest income / total income (%)	42.8	45.8	45.2	44.5	44.2
Cost to income ratio (%)	52.9	52.1	51.0	50.6	51.0
Credit cost (bps)	413	123	327	340	322

Balance sheet (MYRm)	**Mar-22**	**Mar-23**	**Mar-24F**	**Mar-25F**	**Mar-26F**
Total gross loans	517	624	680	739	787
Other interest earning assets	43	11	20	23	26
Total gross IEAs	560	635	700	762	814
Total provisions	(48)	(48)	(48)	(52)	(56)
Net loans to customers	468	575	633	687	732
Total net IEAs	511	586	653	710	758
Total non-IEAs	71	107	85	102	120
Total assets	582	693	737	812	878
Other interest-bearing liabilities	117	199	215	263	308
Total IBLs	117	199	215	263	308
Total non-IBLs	17	22	35	43	44
Total liabilities	135	221	250	306	352
Share capital	345	351	351	351	351
Shareholders' equity	448	472	487	506	526

Asset quality and capital	**Mar-22**	**Mar-23**	**Mar-24F**	**Mar-25F**	**Mar-26F**
Reported NPLs / gross cust loans (%)	9.9	7.4	4.5	4.5	4.5
Total provisions / reported NPLs (%)	94.8	104.9	155.6	155.6	157.8

Source: Company data, RHB

Results At a Glance

Figure 1: ELK-Desa – Summary of 1Q24 Results

FYE Mar (MYRm)	1Q FY23	4Q FY23	1Q FY24	*QoQ (%)*	*YoY (%)*	Comments
Revenue	**39.0**	**40.3**	**39.2**	***(2.8)***	***0.6***	
HP division	*24.5*	*26.2*	*26.7*	*1.9*	*9.1*	YoY growth in tandem with the rise in HPR (+14% YoY).
Furniture division	*14.4*	*14.1*	*12.4*	*(11.5)*	*(13.9)*	Missed management's expectations due to absence of strong *Aidil Fitri* sales. 2Q furniture sales tend to be seasonally softer.
Cost of Sales	(9.3)	(8.7)	(7.8)	*(10.1)*	*(15.6)*	YoY drop in furniture cost of sales due to improved freight rates.
Gross Profit	**29.7**	**31.6**	**31.3**	***(0.8)***	***5.6***	
Gross margin (%)	*76.2*	*78.4*	*80.0*			
Other income	0.5	0.3	0.5	*47.4*	*(9.7)*	
Overhead expenses	(10.4)	(12.3)	(11.1)	*(10.1)*	*6.1*	YoY rise mainly due to higher staff costs.
EBIT	**19.8**	**19.6**	**20.8**	***5.9***	***4.9***	
EBIT margin (%)	*50.8*	*48.7*	*53.0*			
Finance costs	(1.7)	(2.6)	(2.6)	*1.3*	*55.0*	YoY finance costs up, in tandem with the increased drawdown of block financing (+65% YoY).
PIOP	**18.1**	**17.0**	**18.2**	***6.6***	***0.3***	
Impairment allowances	5.3	(7.1)	(7.1)	*nm*	*nm*	1QFY23 collections benefitted from the Employees Provident Fund special withdrawal scheme, which was one-off in nature.
Annualised credit costs (bps)	*(392)*	*436*	*472*			
PBT	**23.4**	**10.0**	**11.1**	***11.6***	***(52.5)***	
HP division	*22.0*	*8.4*	*10.1*	*20.4*	*(53.9)*	
Furniture division	*1.4*	*1.5*	*1.0*	*(36.7)*	*(29.4)*	
Tax expenses	(5.8)	(2.5)	(2.6)	*5.9*	*(54.9)*	
ETR (%)	*24.7*	*24.7*	*23.5*			
Net earnings	**17.6**	**7.5**	**8.5**	***13.5***	***(51.7)***	At 19% and 20% of our and consensus full-year estimates.
Net margin (%)	*45.2*	*18.6*	*21.7*			
Other key data and ratios						
Net HP receivables (MYRm)	502.2	575.1	574.5	*(0.1)*	*14.4*	Flat YTD growth due to a deliberate slowdown in disbursements. Management is maintaining its 10-15% target for the year.
Net debt / equity (x)	0.2	0.4	0.4			
ROAE (%) – annualised	15.6	6.4	7.3			
ROAA (%) – annualised	11.7	4.3	4.8			
CIR (%) – hire purchase	28.4	36.7	28.9			

Source: Company data, RHB

Valuation and TP

Our unchanged TP of MYR1.20 is based on a GGM-derived fair value P/BV of 1.05x on CY24F BVPS. No changes were made to our forecasts and GGM model inputs, pending the company's analyst briefing on 7 Sep.

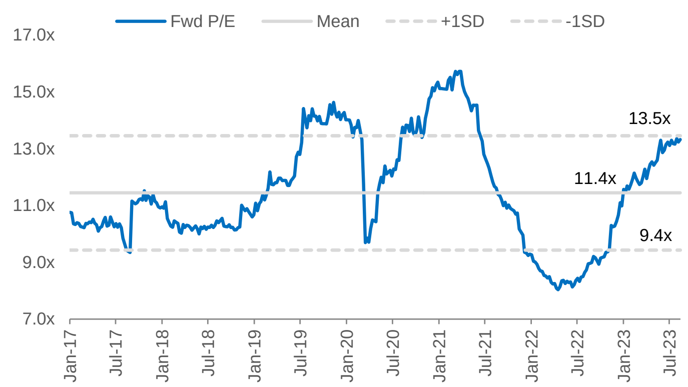
We maintain our NEUTRAL call on the counter, as we believe the group's generous dividend payouts (>60% of net earnings) provide a valuable defensive option in the current uncertain market environment. While its current P/BV of 1.2x (over +2SD from 5-year mean) appears high, we believe the stock's popularity among dividend-seeking retail investors should continue to support its valuation at such levels.

Figure 2: ELK-Desa – GGM valuation summary

Cost of equity (COE) computation:		Sustainable ROE (%)	9.6
Risk free rate (%)	4.0	COE (%)	9.3
Equity premium (%)	5.3	Long-term growth (g)	3.5
Beta (x)	1.0	Implied P/BV (x)	1.05
Cost of equity - CAPM (%)	9.3	BVPS – CY24F	MYR1.10
		Intrinsic value	MYR1.16
ESG premium/(discount) (%)	2.0	ESG premium/(discount)	**MYR0.02**
		TP (rounded)	**MYR1.20**

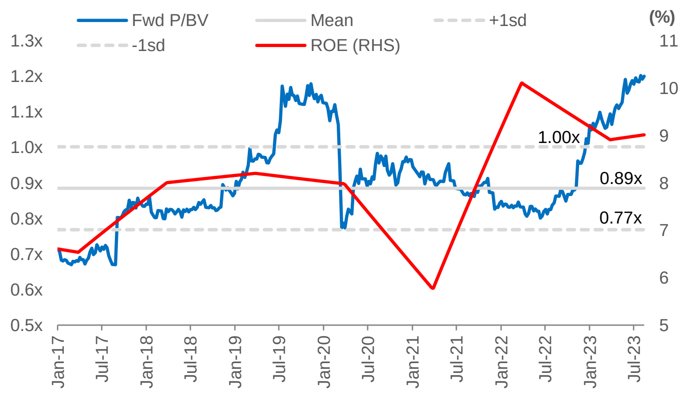
Source: Company data, RHB

Figure 3: ELK-Desa's 12-month forward P/E



Source: Bloomberg, RHB

Figure 4: ELK-Desa's 12-month forward P/BV and ROE



Source: Bloomberg, RHB

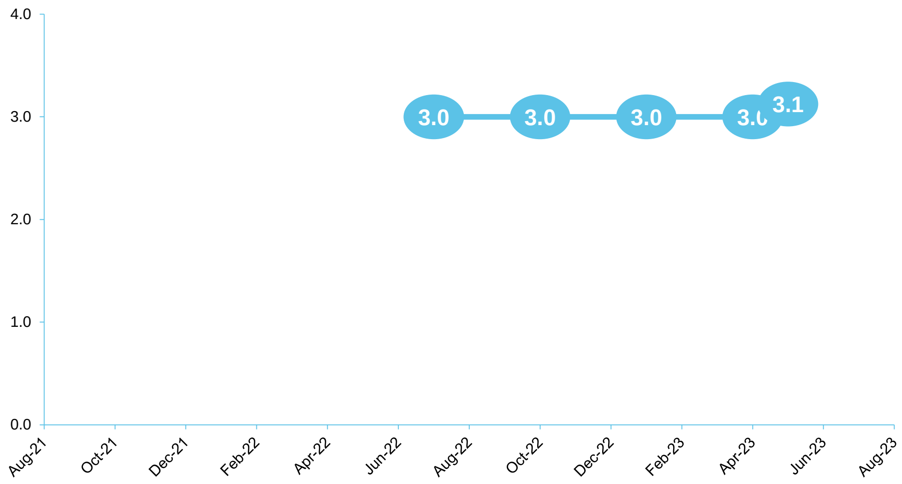
Recommendation Chart

Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2023-08-06	Neutral	1.20	1.28
2023-05-23	Neutral	1.20	1.21
2023-04-07	Neutral	1.15	1.12
2023-02-16	Buy	2.00	1.13
2022-11-16	Buy	1.80	0.99
2022-08-21	Neutral	1.60	0.90
2022-07-17	Neutral	1.30	0.85

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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Buy:	Share price may exceed 10% over the next 12 months
Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
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Not Rated:	Stock is not within regular research coverage

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