

17 November 2023

Financial Services | Diversified Financial Services

ELK-Desa Resources (ELK MK)

Sell (from Neutral)

Valuations Overstretched; D/G To SELL

Target Price (Return): MYR1.05 (-20%)
Price (Market Cap): MYR1.31 (USD128m)
ESG score: 3.1 (out of 4)
Avg Daily Turnover (MYR/USD) 0.06m/0.01m

- **Downgrade to SELL from Neutral, new MYR1.05 TP from MYR1.20, 20% downside.** ELK-Desa Resources' 1HFY24 (Mar) net profit of MYR17.3m missed expectations for the second consecutive quarter, due to soft furniture segment contributions and higher-than-expected impairment allowances. While its share price has appreciated well YTD, it does not appear to be supported by earnings, which have underperformed expectations. As valuations now appear overstretched, we downgrade the stock to a SELL.
- **Results review.** ELK's 1HFY24 net profit of MYR17.3m (-40% YoY) missed expectations at 39% and 43% of our and Street full-year estimates. The miss largely arose from weaker contributions from the furniture unit and higher-than-expected impairment allowances from the hire purchase (HP) business. However, positives came in the form of higher net interest income (+8% YoY), in tandem with good growth in HP receivables. An interim DPS of 2 sen was declared, implying a yield of 1.5%.
- **Resumption in HP receivables growth.** ELK's HP receivables at 30 Sep 2023 stood at MYR589m, up 13% YoY (+2% QoQ). This is tracking management's guidance to grow receivables by >10% in FY24, despite the rather sluggish start in 1Q. Moving forward, the group expects demand for used cars to remain robust, and had drawn down c.MYR50m in new borrowings YTD to fund the expected receivables growth. While finance costs have spiked up (+48% YoY in 1HFY24), the group's gearing ratio of 0.4x remains manageable, in our view.
- **Easing credit costs.** Credit costs in 2QFY24 eased QoQ to 3.6% from 4.7%, in line with guidance for quarterly credit costs of 3-4%. We believe the sequential improvement was due to a resumption of repossession activities. 1HFY24 credit cost of 4.4%, however, still ran ahead of guidance. While repossessed vehicles were sold for an unspecified loss, the net impaired loans ratio halved to 0.96% in Sep 2023, from 1.92% in Mar 2023.
- **Furniture – another disappointing quarter.** Furniture sales dropped 8% YoY in 1HFY24 on stiff competition. Margins were also impacted by unfavourable FX rate movements, as c.30% of ELK's purchases are denominated in USD. The furniture segment booked a PBT of MYR1.0m in 1H, down 58% YoY, and contributed <5% of group PBT (FY23: 10%).
- **Forecasts and TP.** We cut FY24-26F earnings by 5-14% as we factor in higher HP credit costs and softer furniture revenue assumptions. Our TP drops to MYR1.05 (from MYR1.20), and includes an unchanged 2% ESG premium. Given the stretched valuation (near +2SD from 5-year mean) and subdued YTD earnings performance, we downgrade our call to a SELL. Upside risks would stem from lower-than-expected impairment allowances and a significant rebound from the furniture segment.

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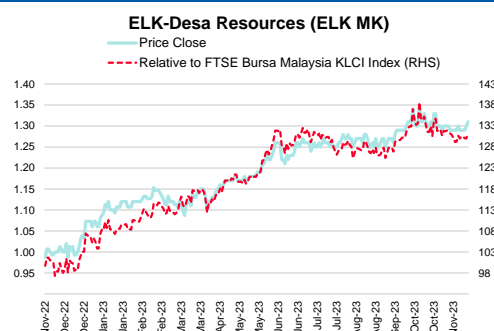


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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	23.6	0.0	3.1	11.0	32.7
Relative	25.5	(1.9)	2.9	8.0	31.4
52-wk Price low/high (MYR)	0.99 – 1.35				



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 mainly finances the purchases of used vehicles. It began reporting emissions data in FY23, and is continually investing in solar power generators for use at its Kuala Lumpur headquarters to reduce reliance on purchased electricity. The group will also look to enhance its emissions data collection to ensure more accurate data is presented in its annual reports.

S: GOOD

Each used vehicle financed is subject to mandatory inspection prior to approval, to ensure the safety of customers. Most of the hire purchase division's customers come from B40/lower-M40 backgrounds. The division is also well diversified, comprising 72% females and a balanced ethnicity split (HP division only). The company has comprehensive plans in place to ensure workplace safety, health and wellbeing are safeguarded at all times.

G: EXCELLENT

The company 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.

Forecasts and Valuation	Mar-22	Mar-23	Mar-24F	Mar-25F	Mar-26F
Reported net profit (MYRm)	26	48	39	45	48
Net profit growth (%)	(27.0)	85.4	(19.4)	16.4	6.5
Recurring net profit (MYRm)	26	48	38	45	48
Recurring EPS (MYR)	0.06	0.10	0.08	0.10	0.10
BVPS (MYR)	0.98	1.04	1.08	1.12	1.16
DPS (MYR)	0.02	0.05	0.05	0.06	0.07
Recurring P/E (x)	23.12	12.48	15.50	13.30	12.49
P/B (x)	1.33	1.26	1.22	1.17	1.13
Dividend Yield (%)	1.8	3.8	4.0	4.7	5.0
Return on average equity (%)	5.8	10.4	8.0	9.0	9.2

Source: Company data, RHB

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Financial Exhibits

Asia	Financial summary (MYR)	Mar-22	Mar-23	Mar-24F	Mar-25F	Mar-26F
Malaysia	EPS	0.06	0.11	0.08	0.10	0.11
Financial Services	Recurring EPS	0.06	0.10	0.08	0.10	0.10
ELK-Desa Resources	DPS	0.02	0.05	0.05	0.06	0.07
ELK MK	BVPS	0.98	1.04	1.08	1.12	1.16
Sell						
Valuation basis	Valuation metrics	Mar-22	Mar-23	Mar-24F	Mar-25F	Mar-26F
GGM-derived intrinsic value with zero ESG overlay.	Recurring P/E (x)	23.12	12.48	15.50	13.30	12.49
Key GGM assumptions are:	P/B (x)	1.3	1.3	1.2	1.2	1.1
i. Cost of equity of 9.3%;	Dividend Yield (%)	1.8	3.8	4.0	4.7	5.0
ii. Sustainable ROE of 8.7%;						
iii. 3.5% long-term growth.						
Key drivers	Income statement (MYRm)	Mar-22	Mar-23	Mar-24F	Mar-25F	Mar-26F
Key drivers include:	Interest income	79	89	102	112	120
i. Hire purchase receivables growth;	Interest expense	(10)	(9)	(12)	(13)	(16)
ii. Low impairment allowances on HPR;	Net interest income	70	80	91	99	104
iii. Profits from furniture business.	Non interest income	52	68	65	71	75
	Total operating income	122	148	156	169	179
	Overheads	(64)	(77)	(78)	(85)	(91)
	Pre-provision operating profit	57	71	77	85	89
	Loan impairment allowances	(22)	(7)	(26)	(25)	(25)
	Other impairment allowances	(0)	(1)	(0)	(0)	(0)
	Pre-tax profit	35	63	51	59	63
	Taxation	(9)	(16)	(12)	(14)	(15)
	Reported net profit	26	48	39	45	48
	Recurring net profit	26	48	38	45	48
Key risks	Profitability ratios	Mar-22	Mar-23	Mar-24F	Mar-25F	Mar-26F
The upside risks include:	Return on average assets (%)	4.1	7.5	5.4	5.8	5.7
i. Stronger-than-expected HPR growth;	Return on average equity (%)	5.8	10.4	8.0	9.0	9.2
ii. Lower-than-expected credit costs;	Return on IEAs (%)	14.0	14.9	15.3	15.3	15.3
iii. Softer-than-expected performance of its furniture business.	Cost of funds (%)	6.1	5.5	5.6	5.6	5.7
	Net interest spread (%)	7.9	9.4	9.7	9.7	9.6
	Net interest margin (%)	12.3	13.5	13.6	13.5	13.2
	Non-interest income / total income (%)	42.8	45.8	41.9	41.8	41.8
	Cost to income ratio (%)	52.9	52.1	50.3	50.1	50.6
	Credit cost (bps)	413	123	403	353	330
Company Profile	Balance sheet (MYRm)	Mar-22	Mar-23	Mar-24F	Mar-25F	Mar-26F
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.	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)	(53)	(58)	(63)
	Net loans to customers	468	575	628	681	724
	Total net IEAs	511	586	648	704	751
	Total non-IEAs	71	107	88	105	124
	Total assets	582	693	736	809	875
	Other interest-bearing liabilities	117	199	213	261	305
	Total IBLs	117	199	213	261	305
	Total non-IBLs	17	22	33	39	41
	Total liabilities	135	221	246	300	347
	Share capital	345	351	351	351	351
	Shareholders' equity	448	472	490	509	528
Shareholders (%)	Asset quality and capital	Mar-22	Mar-23	Mar-24F	Mar-25F	Mar-26F
Eng Lee Kredit	Reported NPLs / gross cust loans (%)	9.9	7.4	5.0	5.0	5.0
Amity Corporation	Total provisions / reported NPLs (%)	94.8	104.9	155.0	157.0	160.0
Teo Siew Lai						

Source: Company data, RHB

Emissions And ESG

Trend analysis

ELK's Scope 1 emissions are immaterial, while it has yet to report Scope 3 emissions (internal and financed). The increase in emissions recorded in FY23 (Mar) was largely due to the reopening of the economy post-pandemic.

Emissions (tCO2e)	Mar-21	Mar-22	Mar-23
Scope 1	-	-	-
Scope 2	239	175	255
Scope 3	-	-	-
Total emissions	239	175	255

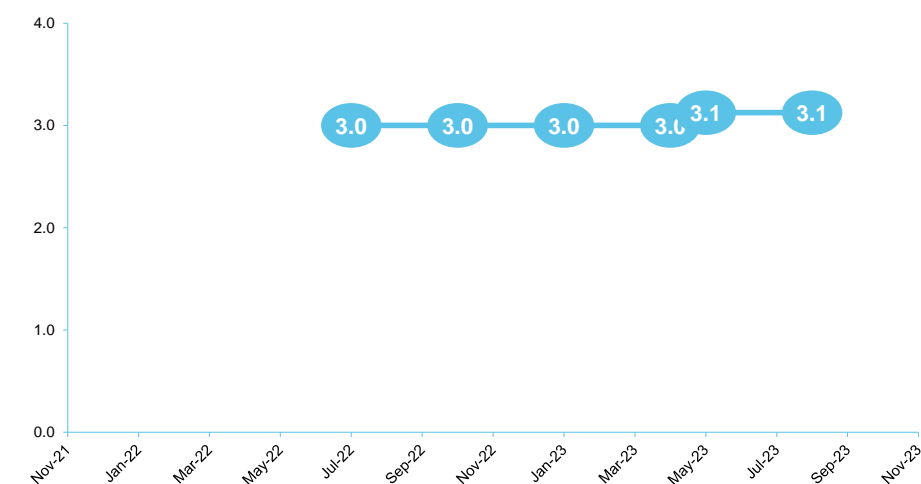
Source: Company data, RHB

Latest ESG-Related Developments

ESG research: ELK's FY23 annual report included an independent research report on ESG in the Malaysian used car industry, which suggests that the industry is still ESG-compatible despite being a laggard in adoption.

Less reliance on purchased electricity: ELK is undertaking efforts to install solar-powered generators for use in its Kuala Lumpur headquarters, which will reduce its reliance on purchased electricity and directly lower Scope 2 emissions.

ESG Rating History



Source: RHB

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Figure 1: ELK-Desa – summary of 2QFY24 and 1HFY24 Results

FYE Mar (MYRm)	2Q FY23	1Q FY24	2Q FY24	QoQ (%)	YoY (%)	1H23	1H24	YoY (%)	Comments – 1H24 vs 1H23
Revenue	36.0	39.2	39.2	0.1	8.8	75.0	78.4	4.5	
<i>HP division</i>	24.1	26.7	27.4	2.6	13.9	48.6	54.2	11.5	Driven by robust HP receivables growth (+13% YoY).
<i>Furniture division</i>	11.9	12.4	11.8	(5.4)	(1.5)	26.4	24.2	-8.3	Slower sales amid stiff competition and soft demand for furniture products
Cost of Sales	(6.9)	(7.8)	(7.7)	(2.1)	11.1	(16.2)	(15.5)	-4.2	
Gross Profit	29.1	31.3	31.5	0.6	8.2	58.8	62.9	6.9	
<i>Gross margin (%)</i>	80.8	80.0	80.4			78.4	80.2		
Non-IT	0.5	0.5	0.5	(6.3)	(14.8)	1.1	1.0	-12.3	
Overhead expenses	(10.3)	(11.1)	(11.3)	1.8	9.3	(20.7)	(22.3)	7.7	
EBIT	19.4	20.8	20.7	(0.2)	7.0	39.1	41.5	6.0	
<i>EBIT margin</i>	53.7	53.0	52.8			52.2	52.9		
Finance costs	(2.1)	(2.6)	(3.0)	17.4	41.7	(3.8)	(5.6)	47.5	In tandem with the 26% YoY increase in block discounting drawn down
PIOP	17.2	18.2	17.7	(2.7)	2.7	35.3	35.8	1.5	
Impairment allowances	(2.0)	(7.1)	(5.8)	(17.2)	>100	3.3	(12.9)	-493.7	Better-than-expected recovery in collections, likely helped by the Employees Provident Fund special withdrawal programme in 1HFY23.
<i>Ann. credit costs (bps)</i>	128	472	360			(145)	442		Above its guidance of 300-400bps on an annual basis
PBT	15.2	11.1	11.8	6.5	(22.3)	38.6	22.9	-40.6	
<i>HP division</i>	14.1	10.1	11.8	16.0	(16.6)	36.1	21.9	-39.3	
<i>Furniture division</i>	1.1	1.0	0.1	(92.9)	(93.9)	2.5	1.0	-58.4	
Tax expenses	(3.7)	(2.6)	(3.0)	14.4	(19.3)	(9.5)	(5.6)	-41.0	
<i>ETR (%)</i>	24.3	23.5	25.2			24.6	24.4		
Net earnings	11.5	8.5	8.8	4.0	(23.3)	29.1	17.3	-40.5	At 39% and 43% of our and Street full-year estimates.
<i>Net margin (%)</i>	32.0	21.7	22.6			38.8	22.1		
Other key data and ratios									
Net HP receivables (MYRm)	521.1	574.5	588.8	2.5	13.0				13% YoY growth is tracking management's guidance for >10% growth in FY24
Net debt/equity (x)	0.3	0.4	0.4						
ROAE (%) – annualised	10.0	7.3	7.5			12.7	7.3		
ROAA (%) – annualised	7.0	4.8	4.8			9.2	4.8		
CIR (%) – hire purchase	29.2	28.9	30.4			28.8	29.7		

Source: Company data, RHB

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Figure 2: Revisions in full-year earnings forecasts

FYE Mar	Net profit (MYR m)			PBT (MYR m) – HP division			PBT (MYR m) – Furniture division		
	Previous	Revised	% Chg	Previous	Revised	% Chg	Previous	Revised	% Chg
2024F	44.5	38.4	-13.6	53.3	48.0	-10.1	6.0	2.6	-56.3
2025F	47.8	44.8	-6.3	57.1	55.3	-3.1	6.7	3.6	-4.6
2026F	50.4	47.7	-5.3	60.2	58.6	-2.6	7.0	4.2	-40.7

Source: Company data, RHB

Figure 3: Revisions in key assumptions

FYE Mar	Net HP receivables (MYR m)			Credit costs (bps) – HP division			Revenue (MYR m) – Furniture		
	Previous	Revised	% Chg	Previous	Revised	bps Chg	Previous	Revised	% Chg
2024F	632.7	627.6	-0.8	327	403	77	59.9	50.1	-16.4
2025F	687.2	680.9	-0.9	340	353	13	64.1	55.1	-14.0
2026F	731.5	724.5	-1.0	322	330	8	67.3	59.0	-12.4

Source: Company data, RHB

Valuation and TP

Our TP of MYR1.05 (from MYR1.20) is based on a GGM-derived fair value P/BV of 0.91x on CY24F BVPS. Our GGM model inputs were maintained aside from our ROE assumption, which were lowered to 8.7% from 9.6% in tandem with the forecast changes.

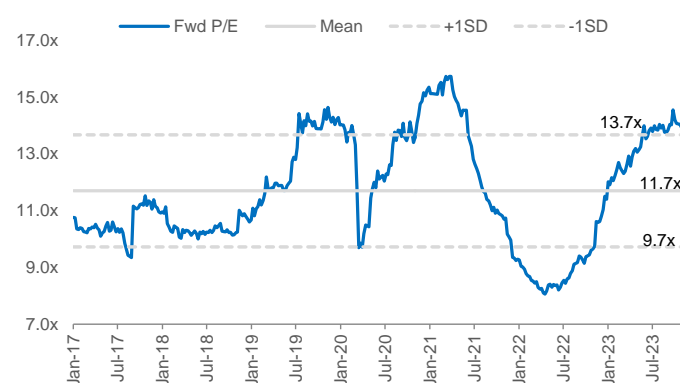
After a 21% YTD gain, the stock is now trading at a stretched P/BV of 1.2x, near +2SD from the 5-year mean. However, the valuation appears to be running ahead of earnings, which have underperformed YTD so far. We downgrade the stock to a SELL.

Figure 4: ELK-Desa – GGM valuation summary

Cost of equity (COE) computation:		Sustainable ROE (%)	8.7
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)	0.91
Cost of equity - CAPM (%)	9.3	BVPS – CY24F	MYR1.11
		Intrinsic value	MYR1.01
ESG premium/(discount) (%)	2.0	ESG premium/(discount)	MYR0.02
		TP (rounded)	MYR1.05

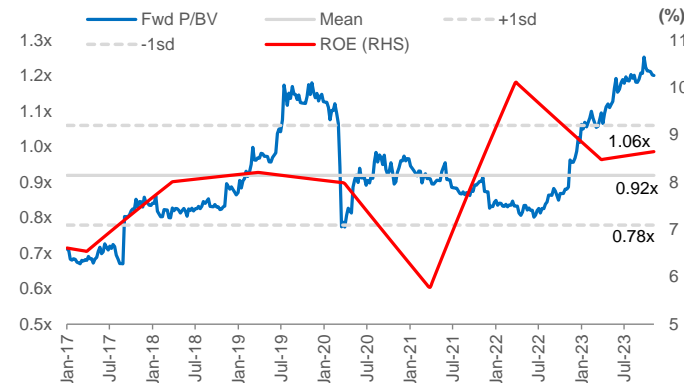
Source: Company data, RHB

Figure 5: ELK-Desa's 12-month forward P/E



Source: Bloomberg, RHB

Figure 6: ELK-Desa's 12-month forward P/BV and ROE



Source: Bloomberg, RHB

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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

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