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TA SECURITIES
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COMPANY UPDATE

FBMKLCI: 1,569.25
Friday, April 26, 2024
Sector: Finance

Elk-Desa Resources Bhd

TP: RM1.35 (+7.1%)

More Stable FY25 Earnings Envisaged

Last Traded: RM1.26

HOLD (ESG: ★★★)

Li Hsia Wong | Tel: +603-2167-9610 | liwong@ta.com.my | www.taonline.com.my

HP Receivables have surpassed pre-Covid levels

Elk Desa's hire purchase (HP) receivables have exceeded pre-Covid levels, signalling a robust recovery. In the upcoming 4Q results, we anticipate a stronger topline performance driven by increased revenue growth fueled by sustained demand in the HP portfolio. Since the economy reopened post-pandemic, Elk Desa's HP receivables have shown significant improvement, growing by 23% YoY in FY23, primarily due to its specialisation in the underserved used car financing market.

Although the growth rate has moderated to around 10% YoY recently, this is a deliberate strategy by Elk Desa to manage disbursements more prudently. As of December 31, 2023, total HP receivables stood at RM616.1mn, surpassing management's target to raise HP receivables above pre-Covid levels of RM610mn. .

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10-15% HP receivables growth envisaged

Looking ahead, we expect continued growth in HP receivables, projecting a 10% increase in both FY25 and FY26. However, management is optimistic about a potentially more robust growth rate of up to 15% per annum, driven by several factors. These include 1) increased demand for cost-effective alternatives amidst inflationary pressures, thus driving the demand for used car options, 2) a rise in the supply of used cars post-pandemic on the back of the strong pickup in TIV sales in 2022 and 2023, and 3) the growing accessibility and confidence in purchasing used cars due to the various digital used car platforms like Carro and Carsome.

Given that the HP segment contributes significantly to around 70% of revenues, we estimate that a 10% increase in HP receivables could boost the group's net profit by 4-5%. With the current net gearing level at 0.56x and room to reach a cap of 1.5x, we believe that there is potential for the group to raise total HP receivables to around RM920mn, translating to a substantial earnings lift of 20%. However, we anticipate management will maintain a conservative approach, aiming for a more sustainable growth rate of 10-15% to manage risks effectively.

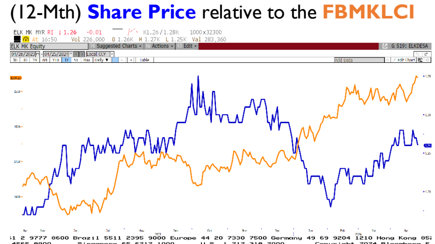
Share Information	
Bloomberg Code	ELK MK
Stock Code	5228
Listing	Main Market
Share Cap (mn)	454.8
Market Cap (RMmn)	568.5
52-wk Hi/Lo (RM)	1.35/1.15
12-mth Avg Daily Vol ('000 shrs)	65.6
Estimated Free Float (%)	36.301671
Beta	0.3
Major Shareholders (%)	
	Eng Lee Kredit - 32.2%
	Amity Corp - 5.0%

Forecast Revision	FY24	FY25
Forecast Revision (%)	-	-
Net profit (RMm)	37.3	38.7
Consensus	37.7	41.9
TA's / Consensus (%)	99.0	92.4
Previous Rating	Hold (Maintained)	
Consensus Target Price (RM)		1.16

Financial Indicators	FY24	FY25
Net Debt / Equity (%)	43.7	51.8
CFPS (sen)	(6.3)	(2.7)
Price / CFPS (x)	(19.8)	(46.8)
ROA (%)	4.8	4.7
NTA/Share (RM)	1.1	1.1
Price/NTA (x)	1.2	1.1

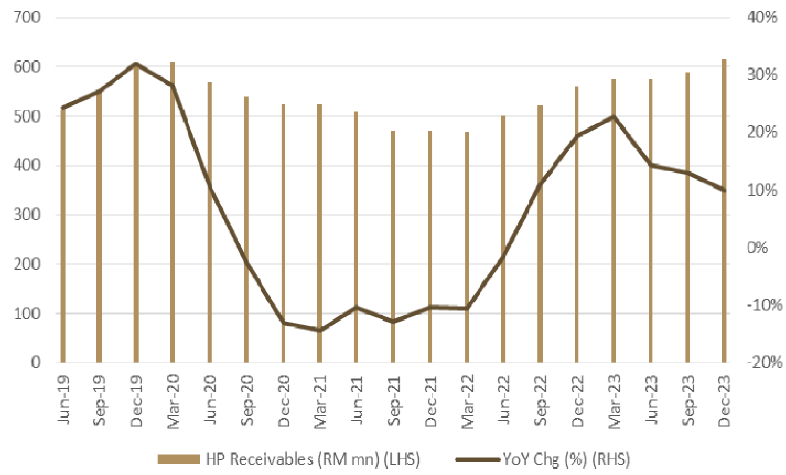
Share Performance (%)		
Price Change	**ELK**	**FBM KLCI**
1 mth	0.8	2.2
3 mth	5.9	3.7
6 mth	(1.6)	8.8
12 mth	11.5	10.8

(12-Mth) **Share Price** relative to the **FBMKLCI**



Source: Bloomberg

Figure 1: HP receivables



Source: Company, TA Research

Normalising impairment allowance trends

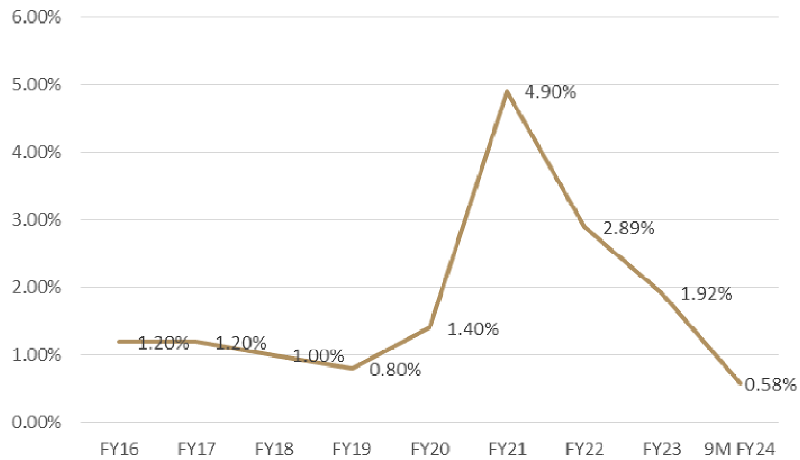
While we anticipate stronger top-line growth in the fourth quarter, we expect a softer profit growth of around 7% QoQ, reaching RM10.3mn. This projection considers Elk-Desa's return to more normalised credit loss charges in 4Q, following elevated credit loss charges throughout FY24. Year-to-date, the credit loss charge has increased to 3.05% in 9MFY24 compared to 1.04% in FY23. Management attributes this rise in impairment allowance to slower repayment from hirers and higher losses incurred from selling repossessed vehicles.

The persistently challenging macroeconomic environment poses a potential downside risk to earnings due to higher-than-expected credit loss charges. Aligning with management's guidance, we forecast the expected credit loss charge to be around 4% for FY25 and FY26, consistent with the historical average of 4.1% reported in FY20 and FY21.

Meanwhile, repossession activities have increased throughout FY24, leading to an improvement in the net impaired loans ratio from 2.25% in 1QFY24 to 0.58% in 3QFY24. Management is committed to addressing this issue by intensifying efforts to reduce the net impaired loan ratio and enhance credit recovery measures. A ramp-up in collection efforts could potentially lessen the credit loss charge to management's target of around 3.5%, which we estimate could lift our FY25-26 earnings estimates by around 7%.

Further, we believe the launch of EPF Account 3, allowing members to withdraw part of their savings at any time, is expected to benefit financing providers like Elk-Desa. Given the anticipated financial constraints faced by consumers, particularly in the M40 and B40 segments, withdrawals could improve their ability to repay loans. Drawing from past withdrawals such as i-Lestari, i-Sinar, and i-Citra, management observed that Elk-Desa encountered increased repayments, resulting in the reversal of impairment allowances.

Figure 2: Net impaired loans ratio (%)



Source: Company, TA Research

Stronger 4Q furniture sales envisaged

To recap, Elk-Desa's furniture segment has faced various challenges, as reflected in the 6% YoY decline in 9MFY24 revenues. The segment's gross profit margin has also narrowed from 37% to 35% in 3QFY24, attributed to an increase in the purchase cost of imported goods due to the weak MYR and intense competition squeezing margins.

Nevertheless, management anticipates a rebound in the segment's performance in 4Q, driven by preparations for the Hari Raya festive season in April. In the near to mid-term, management remains committed to its strategic focus, aiming for growth through wholesaling home furniture and expanding distribution to over 800 furniture retailers across Malaysia. Elk-Desa also plans to strengthen its market presence in Sabah and Sarawak, populous states with growth potential. However, we believe margins could tighten for the furniture segment due to 1) plans to increase the supply of affordable furniture to address consumer budget constraints and 2) rising shipment costs amid geopolitical risks.

In the longer term, we anticipate the recent acquisition of a small 15.5% stake in Tat Liang Holding Sdn Bhd (TLHSB) could offer synergistic benefits to Elk-Desa's furniture segment via TLHSB's 30.66% in Unico Holdings Bhd (UHB). This partnership could potentially involve providing basic furnishing for UHB's affordable housing developments in suburban areas. While specific GDV guidance is unavailable at this juncture, we note in a recent announcement that UHB possesses 103 acres of rezoned freehold land in Negeri Sembilan for mixed property development, and 15 acres in Selangor, of which 10 acres is currently pending for development order to build approximately 100 houses.

Earnings impact

We maintain our earnings estimates for FY24/25/26 ahead of the release of the upcoming 4Q results. Overall, we anticipate a softer YoY performance, with FY24 PBT expected to decline by 22.5% YoY to around RM49.0mn. This outlook aligns with the trend of weaker YoY results observed thus far, primarily driven by the increase in impairment allowance to RM19.3mn YTD, compared to RM0.5mn a year ago. Despite these challenges, Elk-Desa's 9MFY24 results remain largely within our expectations, with YTD net profit accounting for 72% of our full-year forecast.

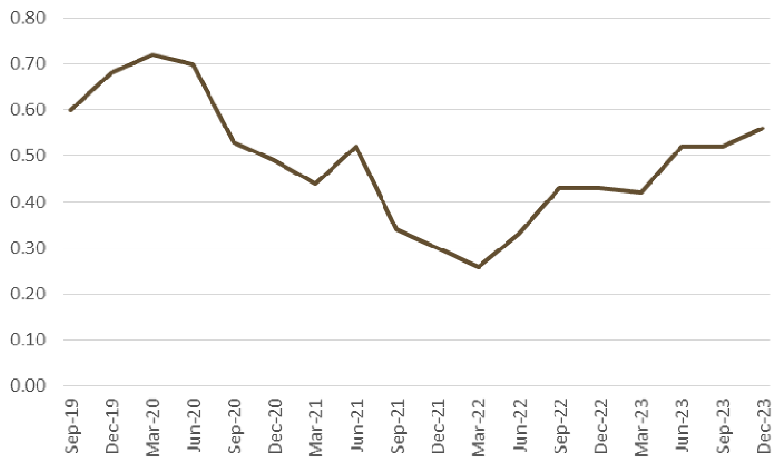
Looking ahead, we foresee earnings stabilising in FY25 and FY26. We conservatively estimate that the topline will continue to be supported by HP receivables growth of 10%. We also pencil in conservative credit loss charges of 4%. Although these projections imply more stable net profit growth of 4% and 6% for FY25 and FY26, respectively, we acknowledge potential downside risks to our assumptions.

Possible downside risks to FY25 earnings

Some possible downside risks to FY25 earnings include:

1) **Increased group bank borrowings**. This could occur due to a higher drawdown of block discounting facilities to support the increase in HP receivables. To recap, Elk-Desa's 9MFY24 gearing level had risen to 0.56x compared to 0.43x a year ago.

Figure 3: Net gearing ratio (%)



Source: Company, TA Research

2) **Potential rise in the cost of borrowings.** Despite management noting overall stability in borrowing costs, there's a possibility of increased borrowing costs, particularly if banks revise rates when older block discounting facilities mature. We estimate that a 10 bps increase in borrowing costs could reduce the group's net profit by around 0.5%.

3) **Higher-than-expected write-offs.** According to management, elevated car prices in 2022 could lead to higher write-offs, potentially increasing the loss ratio to 70% from 50%. This could also result in a downward adjustment to total net HP receivables.

4) **Collection and recovery challenges.** There may be some hiccups in collection and recovery efforts as the industry adapts to changes under new regulatory oversight by the Consumer Credit Oversight Board, expected to come into effect in 2024.

Valuation and recommendation

Rolling valuation base year to FY25, we adjust Elk-Desa's TP to RM1.35/share from RM1.28/share after tagging a 25% discount to Malaysia's average NBFI (such as AEON Credit and RCE Capital) P/B ratio of 1.6x due to Elk-Desa's smaller market cap and less superior ROEs. We maintain a HOLD recommendation on the stock.

Financial Summary (RMmn)

Profit & Loss (RMmn)

FYE Mar 31		2022	2023	2024F	2025F	2026F
Revenue		128.9	155.2	170.6	187.1	205.2
EBITDA		49.9	77.6	71.7	78.6	86.0
Dep. & amortisation		(2.7)	(2.7)	(3.4)	(3.4)	(3.5)
Net finance cost		(9.6)	(8.9)	(15.9)	(20.8)	(25.0)
PBT		34.9	63.3	49.0	50.9	54.1
Taxation		(9.1)	(15.6)	(11.8)	(12.2)	(13.0)
PAT		25.8	47.7	37.3	38.7	41.1
Core profit		25.8	47.7	37.3	38.7	41.1
GDPS	(sen)	5.3	6.5	4.0	4.0	4.0
Div Yield	(%)	4.3	5.3	3.3	3.3	3.3

Cash Flow (RMm)

FYE Mar 31	2022	2023	2024F	2025F	2026F
PBT	**34.9**	**63.3**	**49.0**	**50.9**	**54.1**
Non cash expenses	34.0	(16.9)	(12.0)	(10.3)	(9.5)
Non Operating expenses	(15.1)	(24.5)	(27.7)	(33.0)	(38.0)
Changes in WC	24.5	(4.8)	8.4	(2.6)	(2.9)
Operational cash flow	**78.3**	**17.1**	**17.6**	**5.0**	**3.7**
Capex	(1.2)	(3.0)	(4.0)	(4.0)	(4.0)
Others	59.7	0.0	0.0	0.0	0.0
Investment cash flow	**58.5**	**(3.0)**	**(4.0)**	**(4.0)**	**(4.0)**
Debt raised/(repaid)	(90.3)	30.0	(20.0)	10.0	40.0
Dividend	(20.1)	(28.6)	(22.4)	(23.2)	(24.7)
Others	0.0	0.0	0.0	0.0	0.0
Financial cash flow	**(110.4)**	**1.4**	**(42.4)**	**(13.2)**	**15.3**
Forex effect	0.0	0.0	0.0	0.0	0.0
Net cash flow	**26.4**	**15.5**	**(28.7)**	**(12.2)**	**15.1**
Beginning cash	**27.3**	**53.7**	**69.2**	**40.5**	**28.3**
Ending cash	**53.7**	**69.2**	**40.5**	**28.3**	**43.4**
Adjustments	**(41.8)**	**(50.8)**	**0.0**	**0.0**	**0.0**
Cash	11.9	18.4	40.5	28.3	43.4

Balance Sheet (RMmn)

FYE Mar 31	2022	2023	2024F	2025F	2026F
Fixed assets	11.2	33.2	33.8	34.3	34.8
HP Receivable	336.2	430.8	473.9	521.3	573.4
Others	16.1	17.7	17.7	17.7	17.7
NCA	**363.5**	**481.7**	**525.3**	**573.3**	**625.9**
Cash	11.9	18.4	40.5	28.3	43.4
Others	206.8	193.0	203.2	218.7	236.3
CA	**218.7**	**211.4**	**243.7**	**247.0**	**279.7**
Total assets	**582.3**	**693.0**	**769.0**	**820.3**	**905.6**
ST borrowings	47.1	69.5	49.5	59.5	99.5
Other liabilities	14.2	18.1	25.1	25.6	26.8
CL	**61.2**	**87.6**	**74.6**	**85.1**	**126.3**
Shareholders' funds	**447.5**	**471.8**	**486.7**	**502.1**	**518.6**
LT borrowings	70.2	129.5	203.6	228.9	256.6
Other LT liabilities	3.3	4.2	4.2	4.2	4.2
NCL	**73.5**	**133.7**	**207.7**	**233.1**	**260.7**
Total capital	**582.3**	**693.0**	**769.0**	**820.3**	**905.6**

Ratios

FYE Mar 31	2022	2023	2024F	2025F	2026F
EBITDA Margins (%)	38.7	50.0	42.1	42.0	41.9
Core EPS (sen)	8.5	10.5	8.2	8.5	9.0
EPS Growth (%)	-0.3	23.5	-21.9	3.8	6.3
PER (x)	14.4	11.6	14.9	14.3	13.5
GDPS (sen)	5.3	6.5	4.0	4.0	4.0
Div Yield (%)	4.3	5.3	3.3	3.3	3.3
Net gearing (x)	0.2	0.4	0.4	0.5	0.6
ROE (%)	5.8	10.4	7.8	7.8	8.1
ROA (%)	4.4	6.9	4.8	4.7	4.5
NTA (RM)	1.5	1.0	1.1	1.1	1.1
P/NTA(x)	0.8	1.2	1.1	1.1	1.1

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Stock Recommendation Guideline

BUY : Total return within the next 12 months exceeds required rate of return by 5%-point.
HOLD : Total return within the next 12 months exceeds required rate of return by between 0-5%-point.
SELL : Total return is lower than the required rate of return.
Not Rated: The company is not under coverage. The report is for information only.

Total Return is defined as expected share price appreciation plus gross dividend over the next 12 months. Gross dividend is excluded from total return if dividend discount model valuation is used to avoid double counting.

Required Rate of Return of 7% is defined as the yield for one-year Malaysian government treasury plus assumed equity risk premium.

ESG Scoring & Guideline

	Environmental	Social	Governance	Average
Scoring	★★★	★★★	★★★	★★★
Remark	The company has made notable efforts in reducing its environmental footprints and emissions by managing natural resources efficiently.	Providing low-interest financing for used car buyers who are generally underserved by mainstream financial institutions. While not obligated to, Elk-Desa took steps to alleviate borrowers' burdens, such as waiving overdue interest during the first year of MCO.	There is reasonable oversight in place. The workforce is well-balanced in terms of gender, ethnicity, and age groups. However, the BOD and upper management level still lacks the diversity in terms of gender. Elk-Desa is committed to upholding its 60% dividend policy.	

★★★★★ **(≥80%)** : Displayed market leading capabilities in integrating ESG factors in all aspects of operations, management and future directions.
★★★★ **(60-79%)** : Above adequate integration of ESG factors into most aspects of operations, management and future directions.
★★★ **(40-59%)** : Adequate integration of ESG factors into operations, management and future directions.
★★ **(20-39%)** : Have some integration of ESG factors in operations and management but are insufficient.
★ **(<20%)** : Minimal or no integration of ESG factors in operations and management.

As of Friday, April 26, 2024, the analyst, Li Hsia Wong, who prepared this report, has interest in the following securities covered in this report:
(a) nil

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Kaladher Govindan – Head of Research

TA SECURITIES HOLDINGS BERHAD (14948-M)

A Participating Organisation of Bursa Malaysia Securities Berhad

Menara TA One | 22 Jalan P. Ramlee | 50250 Kuala Lumpur | Malaysia | Tel: 603 – 2072 1277 | Fax: 603 – 2032 5048
www.ta.com.my