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**RESULTS UPDATE**

FBMKLCI: 1,612.94
Friday, August 16, 2024
Sector: Finance



# Elk-Desa Resources Bhd

**TP: RM1.30 (+7.4%)**

## *Lower YoY Net Profit due to Rise in Impairment Allowance*

*Last Traded: RM1.21*

**HOLD (ESG: ★★★)**

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### *Review*

- Elk-Desa reported a 4.3% decline in 1QFY25 net profit to RM8.1mn. The weaker YoY results are due to an increase in the impairment allowance, which rose to RM9.8mn vs RM7.1mn a year ago. With that, Elk-Desa's results came at the lower end of our estimates, with the PBT accounting for 20% of our full-year forecast. The slight variance was due to a higher-than-expected impairment allowance.

- QoQ, the group's net profit slipped by 16.2% on the back of a 1.6% QoQ decline in revenue, along with a 39.5% rise in impairment allowance, higher expenses (+5.6% QoQ) and finance costs (+7.7% QoQ).

- YoY, the 1QFY25 revenue grew by 17.1% due to better contributions from both the hire purchase and furniture segments. Revenue in the furniture segment rose by 22% YoY, attributed to higher demand from the domestic wholesale market in East Malaysia. The increase is in line with management's efforts to penetrate the markets in Sabah and Sarawak. Despite that, the segment's gross profit margin narrowed from 37% to 36% in 1QFY25, attributed to higher selling and distribution costs resulting from higher shipping costs to East Malaysia. However, management also noted that the impairment allowance for the segment climbed by 151% to RM0.14mn owing to slower repayment from furniture dealers this quarter.

- YoY revenue from the hire purchase segment grew by 15% YoY. The hire purchase receivables widened by some 4% QoQ to RM668.3mn as of 30 June 2024. The HP segment's 3M PBT slipped by 1% YoY to RM10.0mn from RM10.1mn a year ago, attributed to an increase in the impairment allowance.

- In 1QFY25, the credit loss charge increased to 1.43% from 1.18%. Management attributes the higher impairment allowance to slower hirer repayment and higher losses incurred from selling repossessed vehicles. However, given the increase in the level of repossession activities, the net impaired loans ratio improved to 0.52% from 0.56% as of 31 March 2024.

- Overall operating expenses expanded YoY due to higher selling, distribution and staff costs from both the HP and furniture segments. The cost-to-income ratio stood little changed at around 29%.

- Within expectations, the group's bank borrowings increased by 51% YoY, attributed to the higher drawdown of block discounting facilities to support the increase in hire purchase receivables. With that, Elk-Desa's gearing levels rose to 0.63x vs 0.52x last year.

### *Impact*

- Aligning our forecast to the 1QFY25 results by raising the credit loss charge assumption, we tweaked our FY25/26/27 net profit forecasts to RM38.0/39.8/42.5mn from RM41.1/42.2/44.5mn previously.

| Share Information | |
|---|---|
| Bloomberg Code | ELK MK |
| Stock Code | 5228 |
| Listing | Main Market |
| Share Cap (mn) | 454.8 |
| Market Cap (RMmn) | 550.3 |
| 52-wk Hi/Lo (RM) | 1.35/1.16 |
| 12-mth Avg Daily Vol ('000 shrs) | 454.8 |
| Estimated Free Float (%) | 35.466139 |
| Beta | 0.3 |
| **Major Shareholders (%)** | |
| | Eng Lee Kredit - 31.0% |
| | Amity Corp - 5.0% |

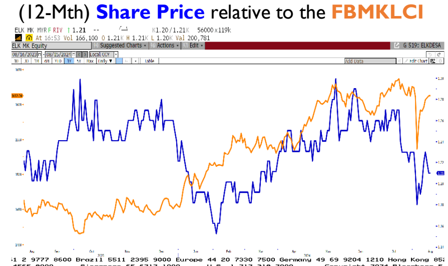
| Forecast Revision | FY25 | FY26 |
|---|---|---|
| Forecast Revision (%) | (7.7) | (5.6) |
| Net profit (RMm) | 38.0 | 39.8 |
| Consensus | 41.0 | 44.1 |
| TA's / Consensus (%) | 92.6 | 90.4 |
| Previous Rating | Sell (Upgraded) | |
| Consensus Target Price (RM) | | 1.2 |

| Scorecard (%) | | |
|---|---|---|
| vs TA | 20 | Within |
| vs Consensus | 20 | Within |

| Financial Indicators | FY25 | FY26 |
|---|---|---|
| Net Debt / Equity (%) | 62.0 | 70.3 |
| ROA (%) | 4.4 | 4.2 |
| NTA/Share (RM) | 1.1 | 1.1 |
| Price/NTA (x) | 1.1 | 0.0 |

| Share Performance (%) | | |
|---|---|---|
| **Price Change** | **ELK** | **FBM KLCI** |
| 1 mth | (1.6) | 4.5 |
| 3 mth | (3.2) | 5.4 |
| 6 mth | 1.5 | 11.9 |
| 12 mth | 0.6 | 14.8 |

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



*Source: Bloomberg*

## Outlook

- Overall demand for used-car hire purchase financing remained robust. The YoY increase in impairment allowances aligns with our expectations that credit charge trends will increase. Nevertheless, management remains vigilant regarding potential downside risks, including the rising cost of living and constrained disposable incomes, particularly within the M40 and B40 segments, which could impact borrowers' ability to meet their obligations. Management intends to further reduce the impaired loan ratio by proactively engaging with the customers and ramping up recovery efforts.

- In the furniture segment, ELK-Desa is looking to sustain organic growth through the domestic wholesale market. Currently, the company distributes its furniture products to over 800 furniture retailers across Malaysia, emphasising Sabah and Sarawak. Additionally, the group is actively seeking higher-quality yet affordable furniture options to address potential constraints on consumers' disposable incomes.

## Valuation

- We lower Elk-Desa's TP to RM1.30/share from RM1.35/share. Our valuation is based on 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. However, given that the risk-reward potential has widened due to the recent decrease in the share price, we upgraded Elk-Desa from sell to HOLD.

**Table 1: Earnings Summary (RMmn)**

| FYE Mar (RMmn) | | 2023 | 2024 | 2025F | 2026F | 2027F |
|---|---|---|---|---|---|---|
| Revenue | | 155.24 | 167.78 | 175.89 | 188.85 | 205.09 |
| Gross profit | | 121.33 | 132.04 | 138.11 | 147.51 | 159.18 |
| EBITDA | | 77.56 | 66.30 | 69.05 | 74.14 | 79.12 |
| EBITDA margin | (%) | 49.96 | 39.52 | 39.25 | 39.26 | 38.58 |
| EBIT | | 74.89 | 63.79 | 66.60 | 71.60 | 76.74 |
| PBT | | 63.31 | 49.04 | 49.94 | 52.43 | 55.93 |
| PAT | | 47.74 | 36.66 | 37.95 | 39.85 | 42.51 |
| Core profit | | 47.74 | 36.66 | 37.95 | 39.85 | 42.51 |
| Core EPS | (sen) | 10.50 | 8.06 | 8.35 | 8.76 | 9.35 |
| PER | (x) | 11.53 | 15.01 | 14.50 | 13.81 | 12.95 |
| Gross dividend | (sen) | 6.50 | 5.00 | 5.00 | 5.00 | 5.00 |
| Dividend yield | (%) | 5.37 | 4.13 | 4.13 | 4.13 | 4.13 |
| ROE | (%) | 10.39 | 7.68 | 7.73 | 7.87 | 7.93 |

**Table 2: 1QFY25 Results Analysis (RMmn)**

| FYE 31 Mar (RM mn) | 1QFY24 | 4QFY24 | 1QFY25 | QoQ | YoY | YTD FY24 | YTD FY25 | YoY |
|---|---|---|---|---|---|---|---|---|
| Revenue | 39.2 | 46.6 | 45.9 | (1.6) | 17.1 | 39.2 | 45.9 | 17.1 |
| Other income | 0.5 | 0.6 | 1.0 | 54.5 | 99.3 | 0.5 | 1.0 | 99.3 |
| Cost of inventories sold | (7.8) | (11.3) | (9.7) | (14.2) | 24.0 | (7.8) | (9.7) | 24.0 |
| Depreciation of PPE & ROU assets | (0.6) | (0.6) | (0.6) | (2.5) | (8.3) | (0.6) | (0.6) | (8.3) |
| Impairment allowance | (7.1) | (7.4) | (9.8) | 32.5 | 39.5 | (7.1) | (9.8) | 39.5 |
| Other expenses | (10.4) | (11.3) | (11.9) | 5.6 | 14.4 | (10.4) | (11.9) | 14.4 |
| Finance costs | (2.6) | (3.5) | (3.8) | 7.7 | 46.2 | (2.6) | (3.8) | 46.2 |
| Share of results of associates | 0.0 | 0.0 | (0.0) | n.m | n.m | 0.0 | (0.0) | n.m. |
| Profit before taxation | 11.1 | 13.1 | 11.0 | (16.1) | (1.1) | 11.1 | 11.0 | (1.1) |
| Taxation | (2.6) | (3.4) | (2.9) | (15.9) | 9.3 | (2.6) | (2.9) | 9.3 |
| Net profit | 8.5 | 9.7 | 8.1 | (16.2) | (4.3) | 8.5 | 8.1 | (4.3) |

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## *Sector Recommendation Guideline*

**OVERWEIGHT:** The total return of the sector, as per our coverage universe, exceeds 12%.

**NEUTRAL:** The total return of the sector, as per our coverage universe, is within the range of 7% to12%.

**UNDERWEIGHT:** The total return of the sector, as per our coverage universe, is lower than 7%.

## *Stock Recommendation Guideline*

**BUY** : Total return of the stock exceeds 12%.
**HOLD** : Total return of the stock is within the range of 7% to12%.
**SELL** : Total return of the stock is lower than 7%.
**Not Rated**: The company is not under coverage. The report is for information only.

**Total Return of the stock** includes expected share price appreciation, adjustment for ESG rating and gross dividend. Gross dividend is excluded from total return if dividend discount model valuation is used to avoid double counting.

**Total Return of the sector** is market capitalisation weighted average of total return of the stocks in the sector.

## *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. | +5% premium to target price |
| ★★★★ | **(60-79%)** | : Above adequate integration of ESG factors into most aspects of operations, management and future directions. | +3% premium to target price |
| ★★★ | **(40-59%)** | : Adequate integration of ESG factors into operations, management and future directions. | No changes to target price |
| ★★ | **(20-39%)** | : Have some integration of ESG factors in operations and management but are insufficient. | -3% discount to target price |
| ★ | **(<20%)** | : Minimal or no integration of ESG factors in operations and management. | -5% discount to target price |



**Kaladher Govindan – Head of Research**

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