

23 February 2024

Financial Services | Diversified Financial Services

ELK-Desa Resources (ELK MK)

Sell (Maintained)

3QFY24: A Decent Showing

- **Keep SELL and MYR1.05 TP, 13% downside.** ELK-Desa Resources' 9MFY24 (Mar) results are in line with our and Street full-year estimates, especially since 4Q tends to be a seasonally strong quarter for the group. Key results highlights were sustained hire purchase (HP) receivables growth, a continued reduction in the net impaired loans ratio, and a sequential rebound in the furniture segment's numbers. Our SELL call is premised on valuation grounds.
- **Results review.** 3QFY24 net profit of MYR9.6m (-14% YoY, +9% QoQ) brought the 9MFY24 total to MYR26.9m (-33% YoY). On a cumulative basis, total revenue grew 5% YoY, aided by stronger contributions from the HP segment, albeit dragged down by a muted furniture division. Opex rose 10% on greater staff cost, but CIR remains at a manageable 30% (9MFY23: 29%). Overall, its 9MFY24 net profit forms 70% and 73% of our and the Street's estimates. Note that normally, 70% would be deemed as a miss, but we consider this to be in line, in view of a robust 4QFY23 due to the festive Lunar New Year period.
- **Growth momentum maintained.** ELK's HP receivables increased 10% YoY (QoQ: +5%), bringing the receivables book to its highest ever level of MYR616m. Management believes the growth momentum can be sustained, especially as the strong new car sales over the past two years start filtering through to the used car market. To recap, the group has a growth target of at least 10% YoY for FY24. As for funding, management sees further room to lever up (to gearing levels of 1-1.5x from 0.45x currently), but it believes a c.10% YoY growth rate strikes a good balance between growth and asset quality, given the current market conditions.
- **Higher impairment allowances are not surprising.** We do not note any significant deterioration in the group's asset quality. In fact, ELK's net impaired loans ratio decreased to 0.58% as at Dec 2023 (Mar 2023: 1.92%) as a result of repossession activities. We understand that repossession costs are recorded under impairment allowances, which would partly explain the higher YoY impairment allowances (recall that the group only resumed repossession activities in FY24).
- **Sequential rebound in the furniture segment.** The furniture segment underwent a rebound in 3Q, with revenue rising 17% QoQ (YoY: -2%) and segmental PBT back up to the MYR1m level (2QFY24: MYR0.1m). We anticipate another decent quarter in 4Q, due to seasonal factors. However, management has flagged a continued tightening of customers' disposable incomes as a key risk for segmental revenue and earnings.
- **Forecasts and TP maintained.** Our MYR1.05 TP includes a 2% ESG premium. We maintain our SELL call on valuation grounds (1.1x P/BV vs 8-9% ROE

Target Price (Return): MYR1.05 (-13%)
Price (Market Cap): MYR1.21 (USD115m)
ESG score: 3.1 (out of 4)
Avg Daily Turnover (MYR/USD) 0.07m/0.01m

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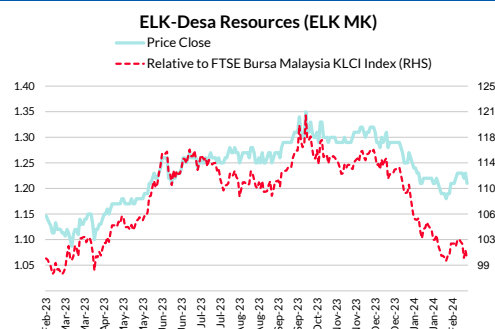


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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(3.2)	(0.8)	(8.3)	(4.7)	5.5
Relative	(9.4)	(4.4)	(14.5)	(11.2)	(0.1)
52-wk Price low/high (MYR)				1.09	1.35



Source: Bloomberg

Overall ESG Score: 3.1 (out of 4)

E: GOOD

ELK-Desa's financing has low exposure to high-environmental-risk sectors, as it mainly finances the purchases of used vehicles. The company began reporting its emissions data in FY23, and continuously invests in solar power generators for use in 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 a mandatory inspection prior to approval, to ensure the safety of its customers. Most of the hire purchase division's customers come from B40 or lower-M40 backgrounds. The division is also well diversified – 72% of workers are women and there is 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

It has policies and a framework to ensure ethical business, integrity and transparency are practiced, as well as a whistleblowing initiative. Board responsibilities are revised and published yearly. The Board meets about 5 times a year.

Note:

Small cap stocks are defined as companies with a market capitalization of less than USD0.5bn.

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)	21.35	11.53	14.31	12.29	11.54
P/B (x)	1.23	1.17	1.12	1.08	1.04
Dividend Yield (%)	2.0	4.1	4.3	5.0	5.4
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 metrics	Mar-22	Mar-23	Mar-24F	Mar-25F	Mar-26F
Valuation basis	Recurring P/E (x)	21.35	11.53	14.31	12.29	11.54
GGM-derived intrinsic value with zero ESG overlay. Key GGM assumptions are:	P/B (x)	1.2	1.2	1.1	1.1	1.0
i) Cost of equity of 9.3%;	Dividend Yield (%)	2.0	4.1	4.3	5.0	5.4
ii) Sustainable ROE of 8.7%; and						
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 the 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						
The upside risks include:	Profitability ratios	Mar-22	Mar-23	Mar-24F	Mar-25F	Mar-26F
i. Stronger-than-expected HPR growth;	Return on average assets (%)	4.1	7.5	5.4	5.8	5.7
ii. Lower-than-expected credit costs;	Return on average equity (%)	5.8	10.4	8.0	9.0	9.2
iii. Stronger-than-expected performance of its furniture business.	Return on IEAs (%)	14.0	14.9	15.3	15.3	15.3
	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
	Asset quality and capital	Mar-22	Mar-23	Mar-24F	Mar-25F	Mar-26F
	Reported NPLs / gross cust loans (%)	9.9	7.4	5.0	5.0	5.0
	Total provisions / reported NPLs (%)	94.8	104.9	155.0	157.0	160.0

Source: Company data, RHB

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Figure 1: Summary of 3QFY24 and 9MFY24 results

FYE Mar (MYRm)	3Q FY23	2Q FY24	3Q FY24	QoQ (%)	YoY (%)	9M23	9M24	YoY (%)	Comments
Revenue	40.0	39.2	42.8	9.1	7.0	114.9	121.1	5.4	
<i>HP division</i>	25.9	27.4	29.0	5.6	11.8	74.5	83.2	11.6	Driven by robust HP receivables growth (+10% YoY).
<i>Furniture division</i>	14.0	11.8	13.8	17.2	(1.8)	40.4	38.0	(6.0)	Slower sales amid stiff competition and soft demand for furniture products.
Cost of Sales	(9.0)	(7.7)	(8.9)	15.9	(1.1)	(25.2)	(24.4)	(3.1)	
Gross Profit	31.0	31.5	33.9	7.5	9.4	89.8	96.7	7.8	
Gross margin (%)	77.5	80.4	79.2			78.1	79.9		
Non-IT	0.4	0.5	0.4	(9.9)	(1.3)	1.5	1.4	(9.2)	
Overhead expenses	(10.4)	(11.3)	(11.8)	4.5	13.7	(31.1)	(34.1)	9.7	
EBIT	21.0	20.7	22.5	8.6	7.1	60.2	64.0	6.4	
EBIT margin	52.6	52.8	52.6			52.3	52.8		
Finance costs	(2.5)	(3.0)	(3.1)	1.9	22.2	(6.4)	(8.7)	37.4	In tandem with a 33% YoY increase in total borrowings.
PIOP	18.5	17.7	19.4	9.8	5.0	53.8	55.2	2.7	
Impairment allowances	(3.7)	(5.8)	(6.4)	9.6	71.8	(0.5)	(19.3)	4174.2	Better-than-expected recovery in collections in 9MFY23, likely helped by the Employees Provident Fund special withdrawal programme.
Ann. credit costs (bps)	256	360	388			5	426		Above its guidance of 300-400bps on an annual basis, due to a spike in 1QFY24.
PBT	14.8	11.8	13.0	9.9	(11.9)	53.4	35.9	(32.6)	
<i>HP division</i>	13.3	11.8	12.0	2.3	(9.6)	49.4	33.9	(31.3)	
<i>Furniture division</i>	1.4	0.1	1.0	>100	(32.9)	4.0	2.0	(49.1)	
Tax expenses	(3.6)	(3.0)	(3.4)	13.6	(6.5)	(13.1)	(9.0)	(31.4)	
ETR (%)	24.6	25.2	26.1			24.6	25.0		
Net earnings	11.1	8.8	9.6	8.7	(13.6)	40.2	26.9	(33.0)	At 70% and 73% of our and Street full-year estimates.
Net margin (%)	27.8	22.6	22.5			35.0	22.2		
Other key data and ratios									
Net HP receivables (MYRm)	560.3	588.8	616.1	4.6	10.0				10% YoY growth is in line with its FY24 target.
Net debt/equity (x)	0.3	0.4	0.4						
ROAE (%) – annualised	9.6	7.5	8.1			11.8	7.6		
ROAA (%) – annualised	6.5	4.8	5.1			8.5	4.9		
CIR (%) – hire purchase	28.5	30.4	30.9			28.7	30.1		

Source: Company data, RHB

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Valuation and TP

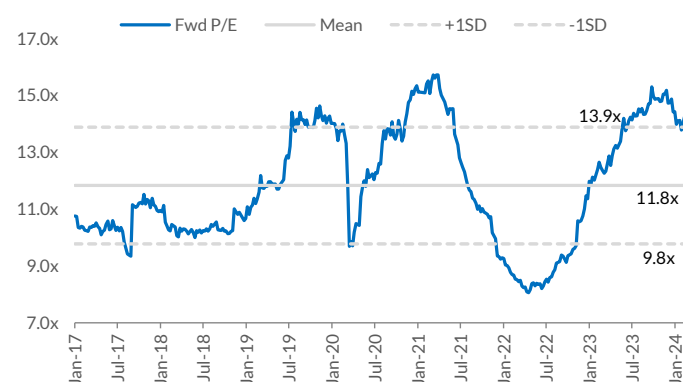
Our TP of MYR1.05 (unchanged) is based on a GGM-derived fair value P/BV of 0.91x (near the mean) on CY24F BVPS. The stock is trading at c.1.1x forward P/BV (above +1SD from the mean), which looks stretched against a 8-9% forecast ROE. However, its dividend yields of 4-5% are decent, although not particularly attractive for entry.

Figure 2: 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

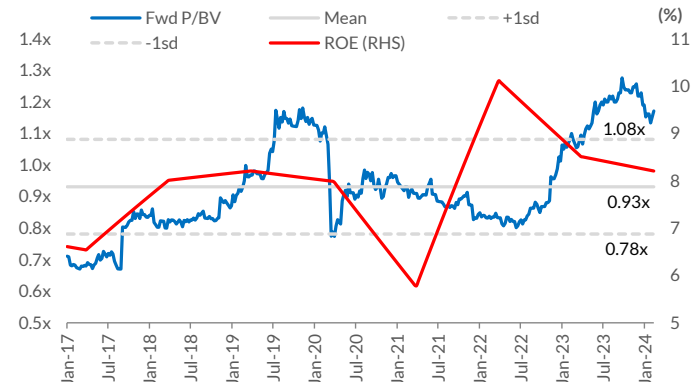
Source: Company data, RHB

Figure 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

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.

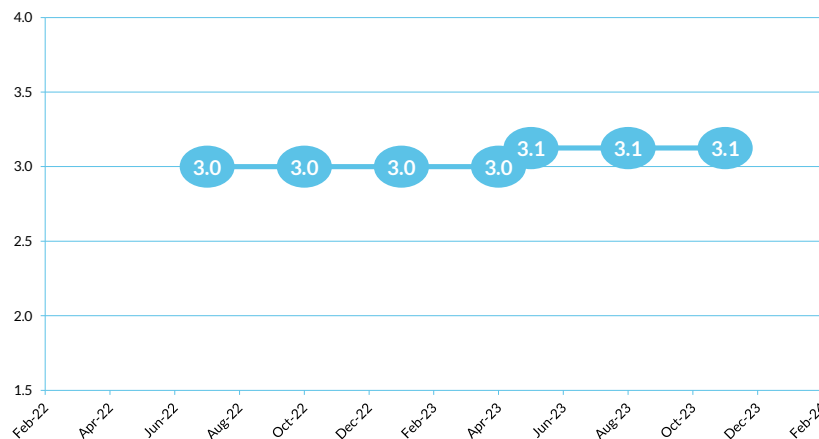
Emissions (tCO2e)	Mar-21	Mar-22	Mar-23
Scope 1	-	-	-
Scope 2	239	175	255
Scope 3	-	-	-
Total emissions	239	175	255

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

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2023-11-16	Sell	1.05	1.31
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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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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