

24 May 2024

Financial Services | Diversified Financial Services

ELK-Desa Resources (ELK MK)

Sell (Maintained)

Strong Growth, But Challenges Remain; SELL

- **Keep SELL and MYR1.05 TP, 21% downside.** ELK-Desa Resources' FY24 results met expectations, barring a higher-than-expected effective tax rate. The hire purchase (HP) segment continues to record strong growth despite still-elevated credit costs, while the furniture segment remains beleaguered by a margin squeeze and stiff competition. Maintain SELL, on valuation grounds.
- **Results review.** 4QFY24 net profit of MYR9.7m (+30% YoY, +1% QoQ) brought the FY24 total to MYR36.7m (-23% YoY). Revenue for the full year grew 8% YoY on stronger contributions from the HP segment, although offset by a muted furniture division. Opex rose by a smaller 6% YoY and, as a result, CIR was brought down to 30% (FY23: 31%). The main YoY weakness stemmed from a normalisation of impairment allowances (>200% YoY), as ELK saw abnormal collections in 1HFY23. All in, FY24 PBT of MYR49m (-23% YoY) came within our/consensus estimates, but PAT missed due to a higher-than-expected effective tax rate. An interim DPS of 3 sen was declared, bringing the full-year total to 5 sen i.e. a 62% payout (FY23: 62%).
- **HP segment still the key driver.** HP receivables grew 12% YoY (QoQ: +4%) in FY24, in line with management's target of >10% YoY growth. We think the momentum can be sustained, especially as the strong new car sales in 2021 and 2022 start filtering through to the used car market. On funding, management sees further room to gear up to 1-1.5x, from 0.5x currently, to support future growth. At present, however, it believes a c.10% YoY growth rate strikes a good balance between growth and asset quality – given the current market conditions.
- **Impairment allowances to ease.** FY24 impairment allowances for the HP segment totalled MYR26m (+>200% YoY), translating to a credit cost of 4.4% (FY23: 1.4%). This is not overly surprising, as the figure bakes in repossession (or repo) costs following the resumption of repo activities in FY24 – as a result, the group has managed to pare its net impaired loans ratio down to 0.56%, from 1.92% in FY23. Moving forward, management will aim to bring credit costs down to 3.75-4% in FY25F – at the higher end of the group's usual 3-4% run rate.
- **Furniture segment impacted by margin squeeze.** Revenue from this business grew 20% QoQ (YoY: +18%) in 4QFY24 as a result of successful promotions held, in conjunction with the festive seasons. However, segmental GPM narrowed to 32% (3QFY24: 36%) on the back of said promotions and also adverse FX movements affecting import costs.
- **We lower FY25 and FY26 net profit forecasts by 3-7%,** mostly from higher credit costs, in line with guidance. Our TP remains unchanged after we introduced FY27 estimates, and includes an unchanged 2% ESG premium.

Forecasts and Valuation	Mar-23	Mar-24	Mar-25F	Mar-26F	Mar-27F
Reported net profit (MYRm)	48	37	42	46	48
Net profit growth (%)	85.4	(23.2)	13.0	11.2	4.7
Recurring net profit (MYRm)	48	37	41	46	48
Recurring EPS (MYR)	0.10	0.08	0.09	0.10	0.11
BVPS (MYR)	1.04	1.06	1.11	1.15	1.19
DPS (MYR)	0.05	0.05	0.06	0.06	0.07
Recurring P/E (x)	12.67	16.50	14.60	13.12	12.53
P/B (x)	1.28	1.25	1.20	1.15	1.11
Dividend Yield (%)	3.8	3.8	4.2	4.7	4.9
Return on average equity (%)	10.4	7.7	8.4	9.0	9.1

Source: Company data, RHB

Target Price (Return): MYR1.05 (-21%)
Price (Market Cap): MYR1.33 (USD129m)
ESG score: 3.1 (out of 4)
Avg Daily Turnover (MYR/USD) 0.11m/0.02m

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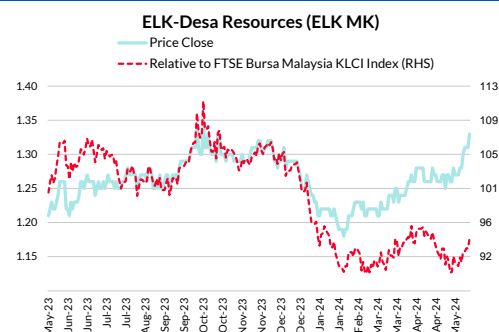


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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	6.4	4.7	9.9	0.8	9.9
Relative	(5.6)	0.4	4.7	(11.3)	(5.5)
52-wk Price low/high (MYR)				1.18	1.35



Source: Bloomberg

Overall ESG Score: 3.1 (out of 4)

E: GOOD

ELK's financing has low exposure to high-environmental-risk sectors, as it mainly finances the purchases of used vehicles. ELK began reporting its emissions data in FY23, and continuously invests in solar power generators at its Kuala Lumpur headquarters to reduce its dependence on purchased electricity. It 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 with a balanced ethnicity split (HP division only). The company has comprehensive plans to ensure workplace safety, and employee health and wellbeing are safeguarded at all times.

G: EXCELLENT

It has policies and a framework to ensure ethical business, integrity and transparency, as well as a whistleblowing programme. Board member responsibilities are revised and published annually. The Board meets around five times pa.

This report can be viewed on
www.bursamarketplace.com

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Financial Exhibits

Asia Malaysia Financial Services ELK-Desa Resources ELK MK / Sell	Financial summary (MYR)					
	EPS	Mar-23	Mar-24	Mar-25F	Mar-26F	Mar-27F
		0.11	0.08	0.09	0.10	0.11
	Recurring EPS	0.10	0.08	0.09	0.10	0.11
	DPS	0.05	0.05	0.06	0.06	0.07
	BVPS	1.04	1.06	1.11	1.15	1.19
Valuation metrics		Mar-23	Mar-24	Mar-25F	Mar-26F	Mar-27F
Recurring P/E (x)		12.67	16.50	14.60	13.12	12.53
P/B (x)		1.3	1.3	1.2	1.2	1.1
Dividend Yield (%)		3.8	3.8	4.2	4.7	4.9
Income statement (MYRm)		Mar-23	Mar-24	Mar-25F	Mar-26F	Mar-27F
Interest income		89	113	112	130	139
Interest expense		(9)	(12)	(13)	(22)	(25)
Net interest income		80	101	99	108	114
Non interest income		68	57	74	78	83
Total operating income		148	158	173	186	197
Overheads		(77)	(82)	(88)	(94)	(100)
Pre-provision operating profit		71	76	85	92	97
Loan impairment allowances		(7)	(26)	(29)	(30)	(32)
Other impairment allowances		(1)	(0)	(0)	(1)	(1)
Pre-tax profit		63	49	55	62	65
Taxation		(16)	(12)	(14)	(15)	(16)
Reported net profit		48	37	42	46	48
Recurring net profit		48	37	41	46	48
Profitability ratios		Mar-23	Mar-24	Mar-25F	Mar-26F	Mar-27F
Return on average assets (%)		7.5	4.9	4.9	4.9	4.8
Return on average equity (%)		10.4	7.7	8.4	9.0	9.1
Return on IEAs (%)		14.9	16.2	14.1	15.2	15.2
Cost of funds (%)		5.5	4.8	4.0	5.7	5.7
Net interest spread (%)		9.4	11.4	10.1	9.5	9.5
Net interest margin (%)		13.5	14.5	12.5	12.6	12.5
Non-interest income / total income (%)		45.8	35.9	42.9	42.1	42.1
Cost to income ratio (%)		52.1	51.9	50.9	50.4	50.9
Credit cost (bps)		123	400	400	390	385
Balance sheet (MYRm)		Mar-23	Mar-24	Mar-25F	Mar-26F	Mar-27F
Total gross loans		624	696	750	799	852
Other interest earning assets		11	64	74	85	97
Total gross IEAs		635	760	823	884	949
Total provisions		(48)	(54)	(59)	(64)	(68)
Net loans to customers		575	642	691	735	784
Total net IEAs		586	706	765	820	881
Total non-IEAs		107	101	141	156	168
Total assets		693	807	905	976	1,049
Other interest-bearing liabilities		199	301	363	413	465
Total IBLs		199	301	363	413	465
Total non-IBLs		22	22	37	39	41
Total liabilities		221	324	400	452	506
Share capital		351	351	351	351	351
Shareholders' equity		472	483	505	524	543
Asset quality and capital		Mar-23	Mar-24	Mar-25F	Mar-26F	Mar-27F
Reported NPLs / gross cust loans (%)		7.4	5.0	5.0	5.0	5.0
Total provisions / reported NPLs (%)		104.9	155.0	157.0	157.0	160.0

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 8.8%;	
iii. 3.5% long-term growth.	
Key drivers	
Key drivers include:	
i. Hire purchase receivables growth;	
ii. Low impairment allowances on HPR;	
iii. Profits from furniture business.	
Key risks	
Upside risks include:	
i. Stronger-than-expected HPR growth;	
ii. Lower-than-expected credit costs;	
iii. Softer-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, it 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

Source: Company data, RHB

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Figure 1: Summary of ELK's 4QFY24 and FY24 Results

FYE Mar (MYRm)	4Q FY23	3Q FY24	4Q FY24	QoQ (%)	YoY (%)	FY23	FY24	YoY (%)	Comments
Revenue	40.3	42.8	46.6	9.0	15.7	155.2	167.8	8.1	
<i>HP division</i>	26.2	29.0	30.1	3.8	14.6	100.8	113.2	12.4	Driven by robust HP receivables growth (+12% YoY).
<i>Furniture division</i>	14.1	13.8	16.6	20.1	17.9	54.5	54.5	0.1	Slower sales amid stiff competition and soft demand for furniture products.
Cost of Sales	(8.7)	(8.9)	(11.3)	27.3	29.9	(33.9)	(35.7)	5.4	
Gross Profit	31.6	33.9	35.3	4.2	11.8	121.3	132.0	8.8	
Gross margin (%)	78.4	79.2	75.7			78.2	78.7		
Non-II	0.3	0.4	0.6	53.9	91.7	1.8	2.0	9.1	
Overhead expenses	(12.3)	(11.8)	(11.9)	1.0	(3.3)	(43.4)	(46.0)	6.0	
EBIT	19.6	22.5	24.1	6.9	22.7	79.8	88.0	10.4	
EBIT margin	48.7	52.6	51.6			51.4	52.5		
Finance costs	(2.6)	(3.1)	(3.5)	13.5	37.5	(8.9)	(12.3)	37.4	In tandem with a 51% YoY increase in total borrowings.
PIOP	17.0	19.4	20.5	5.8	20.5	70.8	75.8	7.0	
Impairment allowances	(7.1)	(6.4)	(7.4)	16.0	4.8	(7.5)	(26.7)	254.7	Better-than-expected collections in 1HFY23, likely helped by the Employees Provident Fund special withdrawal programme.
Ann. credit costs (bps)	436	388	436			136	443		Above its guidance of 300-400bps on an annual basis due to a spike in 1QFY24. The elevated levels bake in cost of repossessions, which resumed in FY24.
PBT	10.0	13.0	13.1	0.8	31.6	63.3	49.0	(22.5)	At 97% and 98% of our and Street full-FY estimates.
<i>HP division</i>	8.4	12.0	12.1	0.8	44.1	57.8	46.1	(20.4)	
<i>Furniture division</i>	1.5	1.0	1.0	0.5	(36.7)	5.5	3.0	(45.6)	
Tax expenses	(2.5)	(3.4)	(3.4)	(0.0)	37.8	(15.6)	(12.4)	(20.5)	
ETR (%)	24.7	26.1	25.9			24.6	25.2		Higher than the statutory tax rate due to a higher portion of non-tax deductible expenses (eg expense provisions, impairment provisions).
Net earnings	7.5	9.6	9.7	1.1	29.6	47.7	36.7	(23.2)	
Net margin (%)	18.6	22.5	20.8			30.7	21.8		
Other key data and ratios									
Net HP receivables (MYRm)	575.1	616.1	641.7	4.2	11.6				Ahead of its FY24 target of >10%.
Net debt/equity (x)	0.4	0.4	0.5						Management is comfortable with the raising gearing level to 1-1.5x to fund growth, but does not see the need to just yet.
ROAE (%) – annualised	6.4	8.1	8.1			10.5	7.8		
ROAA (%) – annualised	4.3	5.1	5.0			7.5	5.0		
CIR (%) – hire purchase	36.7	30.9	28.4			30.8	29.6		

Source: Company data, RHB

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Figure 2: Revisions to our 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
2025F	44.8	41.7	-7.0	55.3	52.4	-5.3	3.6	3.2	-12.3
2026F	47.7	46.1	-3.4	58.6	57.8	-1.5	4.2	3.7	-10.9
2027F	na	48.3	na	na	60.1	na	na	4.3	na

Source: Company data, RHB

Figure 3: Revisions to 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
2025F	680.9	690.9	1.5	353	400	47	55.1	58.4	5.9
2026F	724.5	735.2	1.5	330	390	60	59.0	62.5	5.9
2027F	na	783.5	na	na	385	na	na	66.8	na

Source: Company data, RHB

Valuation and TP

Our TP of MYR1.05 (unchanged) is based on a GGM-derived fair value P/BV of 0.92x (near the mean) on CY24F BVPS. Key model changes include ROE (8.8%, from 8.7% after the introduction of FY27F numbers raised the 3-year ROE average) and BVPS (MYR1.10, from MYR1.11, in line with the forecast changes).

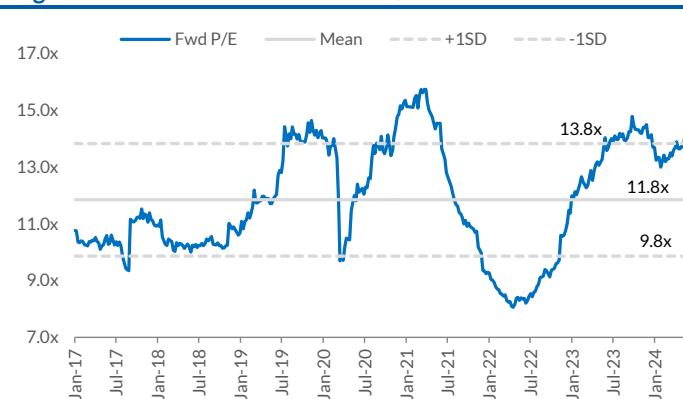
The stock is trading at c.1.2x forward P/BV (near +1.5SD from the mean), which is overvalued – especially against a 8-9% forecasted ROE. A swing factor would be a pick-up in earnings delivery, which would most likely come from greater-than-expected HP receivables growth or lower-than-expected credit costs.

Figure 4: ELK – GGM valuation summary

Cost of equity (COE) computation:			Sustainable ROE (%)	8.8
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)	0.92	
Cost of equity - CAPM (%)	9.3	BVPS – CY24F	MYR1.10	
		Intrinsic value	MYR1.01	
ESG premium/(discount) (%)	2.0	ESG premium/(discount)	MYR0.02	
		TP (rounded)	MYR1.05	

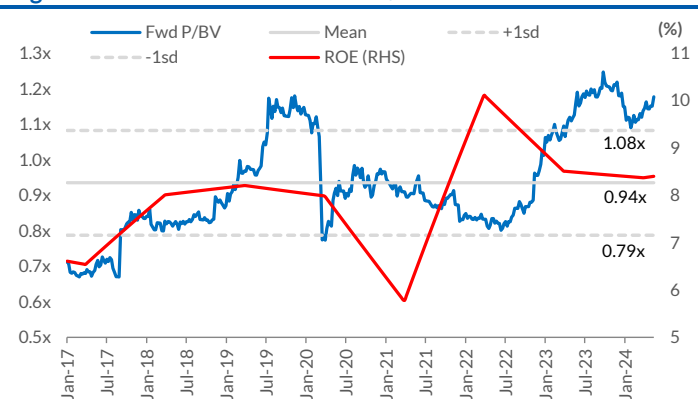
Source: Company data, RHB

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



Source: Bloomberg, RHB

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



Source: Bloomberg, RHB

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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-COVID-19 pandemic.

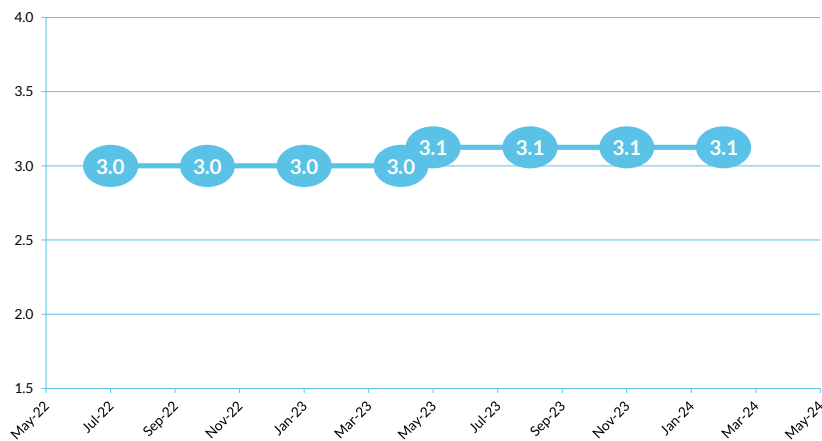
Emissions (tCO2e)	Mar-22	Mar-23	Mar-24
Scope 1	-	-	na
Scope 2	175	255	na
Scope 3	-	-	na
Total emissions	175	255	na

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 indicates that the industry is still ESG-compatible despite being a laggard in adoption.
- **Less reliance on purchased electricity:** ELK is making effort to install solar-powered generators for use in its Kuala Lumpur headquarters, which will reduce its reliance on purchased electricity and directly cut down 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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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
Neutral:	Share price may fall within the range of +/- 10% over the next 12 months
Take Profit:	Target price has been attained. Look to accumulate at lower levels
Sell:	Share price may fall by more than 10% over the next 12 months
Not Rated:	Stock is not within regular research coverage

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