ELK-Desa Resources Bhd

A Little-Known Financier

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	Rating	Fair Value
Last Price	-	RM1.32
Kenanga	Not Rated	RM1.30
Consensus	Trading Buy	RM1.70

INVESTMENT MERIT

We are placing a "Not Rated" call on ELKDESA with fair value of RM1.30. Its niche in providing hire purchase for used cars is expected to stay resilient having registered 5-year revenue CAGR of 12.2% (Sep 2018), which outpaced the CAGR of total registered vehicles in Klang Valley of 3.5%. Earnings from its new furniture segment may continue to be soft, but we believe focused efforts to capture market share could pay off in the long run.

Catering to a niche market. With operations mainly in the Klang Valley, ELKDESA focuses on providing hire purchase for small-value used cars. Typically a segment not prioritised by full-fledged financial institutions due to low value returns, the benefits of operating in this area include: (i) less competition, and (ii) wider consumer base (i.e. due to better affordability).

Despite being deemed as a "riskier" market, the group was able to command a non-performing loan (NPL) ratio of 1.0% in FY18 (March-ending), while its peers appeared to be registering NPL of c.2.0%. We gather that the group registered a 12.2% 5-year CAGR for its hire purchase income at FY18, whereas the total number of registered vehicles in the Klang Valley only saw a 3.5% 5-year CAGR for the same period *(source: Malaysian Automotive Association).* The sustainability in this segment could be attributed by the group's relationship with used-car dealers (currently with a network of above 1,000 dealers) which are the frontlines for the group's service *(refer to the overleaf for other fundamental comparisons against industry peer).*

Branching out to furniture. Commencing in FY16, this venture involves the wholesaling of home furniture and operations of two local showrooms, while also exporting to the ASEAN region, Middle East and North America. As at FY18, it generated sales of RM31.0m and PBT of RM0.6m (margin of 1.9%). In the near-term, management aims to continue expanding its dealer-base which we believe may incur intensive marketing spending. Still, there could be opportunity for the group to firmly establish itself in this industry, as it yet appears to be saturated in view of the segment sales growth since inception.

With near-term prospects held by the above, we believe the group is poised to demonstrate a 20%/16% top-line growth in FY19/FY20, backed by high-teens growth in both segments. We believe that transactions in the second-hand car market are less susceptible to adverse changes in consumer spending as compared to new car sales while the furniture segment could be supported by its export exposure. This could translate to a PATAMI of RM34.5m/RM37.1m (+33%/+8% YoY). **Dividend outlook could be solid as well.** While the group have a minimum 60% dividend policy, we gathered that the historical payout ratio was at an average of c.70% during the last three years. Applying this rate, we could expect FY19/FY20 to see dividends of 8.5 sen/9.0 sen, translating to yields of 6.4%/6.8%.

"Not Rated" with a fair value of RM1.30. Our Target Price is based on an ascribed 10.0x PER on its FY20E EPS of 12.9 sen. We see the stock as a predominantly finance company, hence we base our valuation on a discount from our ascribed 11.0x Fwd. PER to AEONCR (a peer in the hire purchase space, albeit with mixed exposure in other financing segments). AEONCR, in addition to being a large cap counter, commands a higher ROE of c.18% while ELKDESA's expected ROE is c.9% in FY20. However, we believe ELKDESA is compensated by its higher dividend (against AEONCR's FY19E yield of 3.1%) and exposure to a more niche and stable market segment.

Stock Information

Shariah Compliant	No
Stock Name	ELK-DESA RESOURCES
CAT Code	5228
Industry	Commercial Services
Industry Sub-sector	Commercial Serv-Finance
YTD stock price chg	10.00%
Market Cap (RM'm)	390.92
Shares Outstanding (m)	296.15
52-week range (Hi)	1.33
52-week range (Low)	1.13
3-mth avg daily vol:	177,205
Free Float	N.A.
Beta	0.47
Altman's Z-score	3.03

Major Shareholders

Hock Chai Realty Sdn Bhd	37.1%
Eng Lee Kredit	32.4%
Amity Corporation Sdn Bhd	5.2%

Financials

FY Sep (RM m)	2018A	2019E	2020E
Revenue	104.1	124.5	144.0
Gross Profit	0.0	0.0	0.0
Profit Before Tax	35.3	46.0	49.5
PATAMI	**25.9**	**34.5**	**37.1**
EPS (sen)	9.0	12.0	12.9
BV/Share (RM)	1.4	1.4	1.5
PER (x)	14.7	11.0	10.2
Price/BV (x)	1.0	0.9	0.9
Net Gearing (x)	0.0	-0.1	-0.1
DPS (sen)	6.7	8.5	9.0
Div Yield (%)	5.1%	6.4%	6.8%

Quarterly Financial Data (RM'm)	4Q18	1Q19	2Q19
Revenue	27.7	28.8	31.0
PBT	10.8	10.7	11.6
PATAMI	7.9	8.1	8.6
Basic EPS (sen)	2.8	2.8	2.9
Revenue Growth (QoQ)	7.0%	4.1%	7.5%
EPS growth (QoQ)	12.6%	1.1%	5.0%
PATAMI Margin	28.6%	28.0%	27.8%

Peers Comparisons	PER (1y-fwd)	PBV (1y-fwd)	Div. Yld	Mkt Cap (RM'm)
AEONCR	12.3	2.3	3.1%	3,987.4
MBSB	12.1	0.8	2.1%	6,357.2
RCECAP	5.9	1.0	4.8%	543.1
Average	**10.1**	**1.4**	**3.3%**	**-**
ELKDESA	11.0	0.9	6.4%	390.9
KLFIN	**11.6**	**1.2**	**4.4**	**406.0b**

Other salient points

Debt-free. From 2014 to 2017, the group underwent several fund raising exercises (i.e. an issuance of ICULS and two issuance rights shares) to raise RM225.0m. This enlarged its share base from 125m shares in FY14 to c.295m shares in 2Q19. Thanks to this, the group holds sufficient reserves to sustain its hire purchase needs without dependency on debt, drawing its interest margin to above 50% whilst industry players operate within the mid-teen levels.

Pays to be debtless? To establish some context on the merits of ELKDESA's solid credit standing to its operations, we compare it to other non-bank financial lenders, AEONCR and RCECAP, both with a net gearing position of above 2.0x in their latest financial statements. While ELKDESA registered 12.2% 5-year CAGR for its hire purchase income at FY18 with its cash positive numbers, AEONCR and RCECAP grew 23.6% and 8.1%, respectively, for the same time period. FY18 PBT margins for these companies in their respective financing segments were 47.6%, 35.1% and 47.7%. In terms of ROE, ELKDESA registered 7.4% in FY18 with AEONCR recording 19.4% and RCECAP at 18.5%.

We believe the lower ROE for ELKDESA against its peers could be attributed to its non-dependency on debt to accelerate growth. However, we also gathered that the group has a relatively lower cost of equity at 6.4%, in comparison to 8.5% for AEONCR and 10.4% for RCECAP *(source: Bloomberg)*. This could indicate that the group is efficiently operating within its working capital requirements but must sustain at manageable growth levels. Another round of funding could be sought if the group were to reach the scale of its peers.

Daily Charting – ELK-Desa Resources Bhd

Comment: ELKDESA appears to be in a rally, reaching a high of RM1.32 yesterday. The share is currently trading above all key SMAs while shorter-term SMAs are trading above longer-term key SMAs. More notably, a cup and handle pattern has formed. This coupled with encouraging upticks in key momentum indicators and increasing trading volumes of late could suggest a continuation of the rally. Should buying momentum continue, we expect the share to head North towards resistance levels at RM1.36 (R1) and RM1.43 (R2). Conversely, downside support can be found at RM1.29 (S1) and RM1.23 (S2)

About the stock:

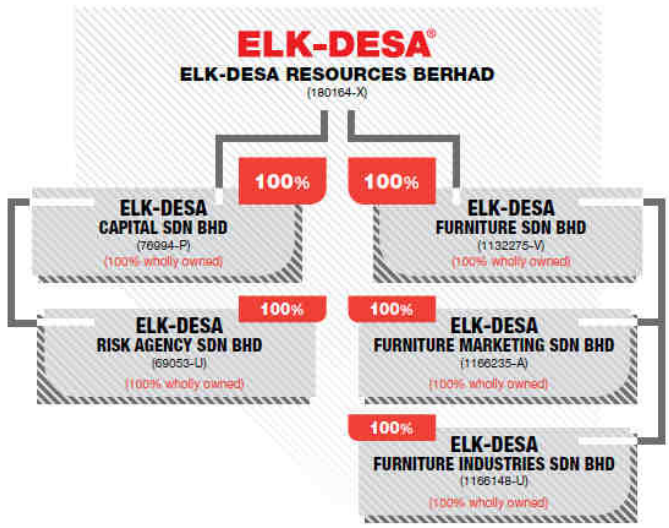
Name	:	ELK-Desa Resources Bhd
Bursa Code	:	ELKDESA
CAT Code	:	5228

Key Support & Resistance level

Resistance	:	RM1.36 (R1)	RM1.43 (R2)
Support	:	RM1.29 (S1)	RM1.23 (S2)
Outlook	:	Bullish	

Source: Kenanga Research

CORPORATE STRUCTURE



Source: Company

BUSINESS OVERVIEW

ELKDESA is primarily focused in providing hire purchase financing for the used-car market. This is supplemented with selling general insurance policies, acting as an insurance agent for several providers. The group ventured into the trading and wholesaling of home furniture in 2015.

BUSINESS SEGMENTS

ELKDESA operates within two core segment, being:

- Hire purchase financing.
- Trading and wholesaling of home furniture.

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