Securities

BURSA MidS AFFIN HWANG CAPITAL

Out think. Out perform.

Some room for new growth

We recently met up with ELK's management to get an update on the business strategy moving forward and a review of ELK's 9MFY18 results. Management has been more upbeat lately, shifting their hire purchase strategy to include financing higher value used-cars, while looking at restructuring the furniture business' core operations. Though management's initiatives sound optimistic, we make no changes to our earnings forecasts at the moment. Maintain HOLD with an unchanged TP of RM1.18.

Vertical expansion in hire purchase financing to drive growth

Management recently indicated that their strategy moving forward would be to focus on financing used cars with values of RM35,000 and below. This will be in addition to the current strategy of focusing only on used cars with values of RM20,000 and below. We believe that this diversification will contribute positively to ELK's receivables growth, while remaining within ELK's prudent risk appetite.

Furniture segment yet to bear fruit, refocusing on the home ground

ELK is currently undertaking an operational restructuring in the furniture segment to refocus their sales in the domestic market. In addition to their retail outlets, management indicated plans to partner with other dealers and expand their wholesale distribution to drive sales.

Future EPS dilution could be minimized through leverage

ELK's 9MFY18 EPS declined by 9.9% yoy as a result of dilutive effect of a RM54m rights issue (completed in Sept 2017), which had caused the weighted average number of shares to increase by 21%. In our view, future EPS dilution could be minimzed through leverage as management expands its business. As at Dec2017, ELK's group gearing level is at 0.12x and has ample room to gear-up

Reiterate HOLD rating, Price Target unchanged at RM1.18

We maintain our **HOLD** rating and **12-month Price Target** of **RM1.18**, which is pegged to a 13x P/E multiple on our CY18E EPS. We do note that strategy shifts in both the hire purchase and furniture segments could provide upside potential to our earnings estimates. Downside risk – high cost-of-living may cause higher defaults. Upside risk – strict credit approvals to control NPLs.

Earnings & Valuation Summary

FYE 31 Mar (RMm)	2016A	2017A	2018E	2019E	2020E
Revenue	64.2	94.5	109.8	120.5	129.9
Net operating income	25.5	30.2	32.8	37.8	43.1
Pretax profit	25.3	30.6	32.1	36.7	40.7
Net profit	18.8	23.0	24.4	27.9	30.9
EPS (sen)	12.9	10.7	8.8	9.8	10.8
EPS growth (%)	(14.6)	(17.0)	(17.9)	11.5	10.9
FD EPS (sen)	7.9	9.2	8.2	9.3	10.3
PER (x)	17.6	14.4	13.6	12.2	11.0
FD PER (x)	19.2	15.7	14.5	12.7	11.5
ROE (%)	6.5	7.0	6.6	6.8	7.4
BV / share	2.20	1.55	1.46	1.45	1.49
P/BV	0.54	0.77	0.82	0.82	0.80
DPS (sen)	6.8	6.8	6.0	6.8	7.6
Dividend Yield (%)	5.7	5.7	5.0	5.7	6.4
Affin/Consensus (x)			N/a	N/a	N/a

Source: Company, Bloomberg, Affin Hwang forecasts

Company Update

ELK-Desa

ELK MK
Sector: Finance

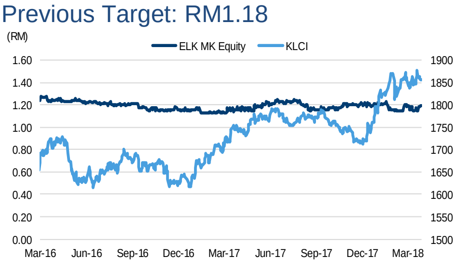
RM1.19 @ 29 March 2018

HOLD (maintain)

Upside: -0.8%

Price Target: RM1.18

Previous Target: RM1.18



Price Performance

	1M	3M	12M
Absolute	-0.8%	0.0%	0.8%
Rel to KLCI	-0.8%	-3.2%	-4.9%

Stock Data

Issued shares (m)	285.6
Mkt cap	339.8/87.8
Avg daily vol - 6mth	0.1
52-wk range (RM)	1.14-1.26
Est free float	38.2%
BV per share (RM)	1.36
P/BV (x)	0.87
Net cash/(debt)	5.45
ROE (2018E)	6.6
Derivatives (ICULS)	20.7
Shariah Compliant	No

Key Shareholders

Eng Lee Kredit	32.2%
Amity Corporation SD	5.4%

Source: Affin, Bloomberg

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Still banking on hire purchase financing

Vertical expansion strategy to further drive hire purchase division

ELK has primarily differentiated itself in used-car financing by focusing on the niche area of vehicles valued at RM20,000 and below. At a recent meeting with management, we learnt that there has been a vertical shift in business as it now has including financing of used vehicles valued at RM35,000 and below. Currently, this segment (<RM35,000) makes up a very small portion of ELK's total loan portfolio. We gather that this horizontal expansion into higher valued used vehicles is still within the prudent risk appetite of ELK's management, taking into consideration the type of cars purchased within this range which primarily consists of national cars and other non-national cars with minimal or slower depreciation value (around 6-15 years of age). The area of focus however, remains in the Klang Valley area.

Our quick check with a popular online marketplace for new and used cars, Carlist.my (Fig 1) shows that the market for cars priced below RM35,000 a unit is almost twice the size of cars priced at below RM20,000. As such, expansion into this new pricing range could well have a meaningful impact on ELK's earnings, should we see receivables growth double from our current forecast of 12.1% for FY19E and 7.7% in FY20E. However, we have not priced-in any potential increase in our receivables growth forecast of 13.6% for FY2018E, pending further developments post 4QFY2018.

Fig 1: Almost half of used-vehicles listed are priced under RM35k

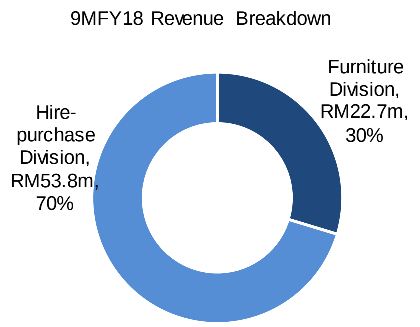
Used Vehicle Price	No. of listings	% of total
Below RM35k	32,626	46.3%
Below RM20k	17,268	24.5%
Total	70,423	100.0%

Source: Carlist.my

9MFY18 earnings driven by growth in hire-purchase receivables

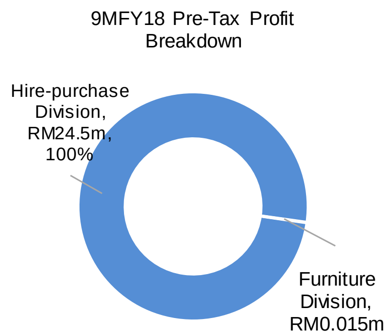
Used-car hire purchase financing continues to be ELK's bread and butter, contributing 70% of revenue and virtually 100% of pre-tax profit for 9MFY18. Hire purchase receivables grew by an annualized 14.3% for 9MFY18 and at a 5-year CAGR of 12.9% from 2012-2017. It is also supported by a steady and lucrative effective interest rates of 17.0-18.17%.

Fig 2: FY17 revenue contribution



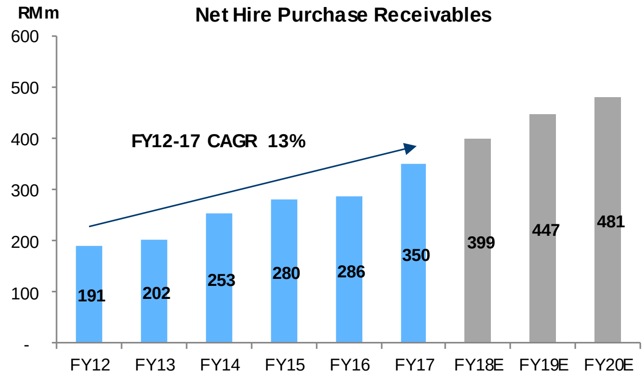
Source: Company data, Affin Hwang

Fig 3: FY17 pre-tax profit contribution



Source: Company data, Affin Hwang

Fig 4: Continued strong growth in net hire purchase receivables expected

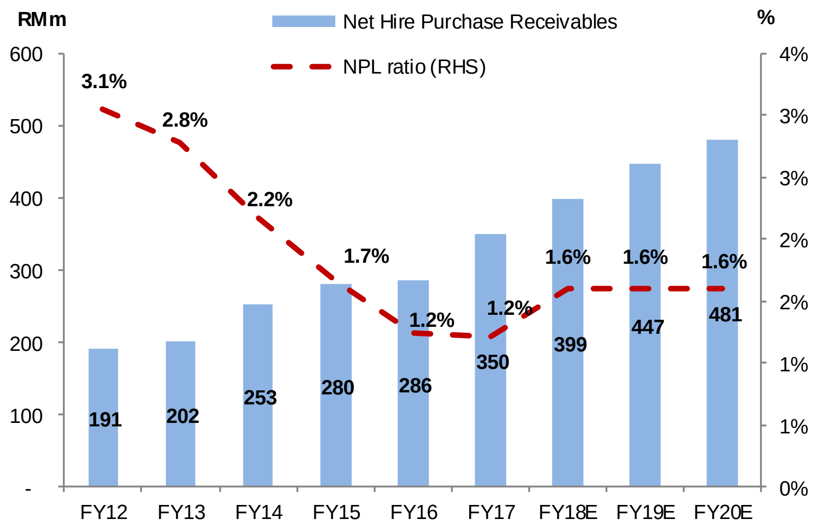


Source: Company data, Affin Hwang

Comfortable NPL ratio expected for FY18E

In view of weak consumer sentiment and higher cost of living, especially for the lower-income group, we keep our NPL forecasts for FY18E at 1.6%, which is slightly higher than FY2016 (1.2%) but lower than its 5-year average of 1.82%. However, we do take note that ELK has a stringent credit policy and remains highly selective in its criteria for financing, which should keep NPL ratios at relatively low levels.

Fig 5: Forecasting a 1.6% NPL ratio for FY2018E



Source: Company data, Affin Hwang

Furniture trading and manufacturing – still in the doldrums

Furniture sales has been relatively sluggish, with 9MFY18 revenue coming in at RM22.7m compared to RM21.6m in 9MFY17 (+5% yoy). Higher operating expenses and higher impairment allowances due to collection problems especially from their export markets caused 9MFY18 profit before tax to plunge by 90% yoy.

Fig 6: Furniture segment 9M revenue and pretax profit

RM ('000)	9MFY17	9MFY18	YoY Growth (%)
Revenue	**21,622.5**	**22,687.0**	**5.0**
Pretax Profit	**158.1**	**15.5**	**-90.2**

Source: Company data

Management has guided that the strategy for the furniture segment is to refocus on the domestic market and rely less on exports – a move in which could aid in reducing operating costs and step-up collections. This focus on the domestic market will also be followed by expansion of the wholesale distribution and partnering with other dealers in the Klang Valley to drive topline growth. We however, remain conservative given the soft market condition though we believe that a turnaround in the furniture operations could significantly contribute to the group's pre-tax profit.

Valuation & Financials

Future EPS dilution could be minimized through leverage

The RM54m rights issue (completed in Sept 2017) and conversion of ICULs (outstanding balance 20.7m units out of 100m units) had resulted in a 21% increase in weighted average number of shares as at Dec2017. This had caused the 9MFY18 EPS to decline by 9.9% yoy.

In our view, future EPS dilution could be minimzed through leverage as management expands its business.. As at Dec2017, ELK's group gearing level is at 0.12x and has ample room to gear-up (closest peer Aeon Credit has a gearing level of 3.7x as at Nov2017).

Maintain HOLD, target price of RM1.18

We maintain a **HOLD** rating on ELK with a 12-month Price Target of RM1.18, which is derived by pegging a 13x P/E multiple to our CY18E EPS of 9.0 sen. Our P/E multiple of 13x is derived based on the average P/E multiple of ELK over the past 1 year (of which, is not comparable to peers due to ELK's illiquidity in the market).

Positive catalysts

Apart from relying on organic growth (based on an annual receivables growth of circa 10-13% p.a.), we believe that an operational restructuring which ELK is currently undertaking for its furniture segment and diversifying its hire-purchase product range could provide catalysts for growth in both segments and provide upside potential to our EPS growth forecasts. In addition, the money-lending license recently obtained would help the group diversify its income in the medium to long-term. On the costs side, reduction in backroom operations through digitization efforts could also be another potential factor that boosts operating income through lowering overheads.

Key risks

Weak consumer sentiments and higher costs of living, especially for the lower income group which makes up the bulk of accounts under ELK, could increase the risk of defaults, putting upward pressure on ELK's NPL ratio. As their focus remains in the Klang Valley, exposure to the mass mid to low-income market is deemed to be relatively high-risk due to their low capacity to mitigate the rising living cost in urban cities.

However, we note that management has continued to maintain strict credit approvals and provides affordably structured repayment schemes that ensured that the monthly repayments are not overly-cumbersome.

ELK-Desa Resources – FINANCIAL SUMMARY

Profit & Loss Statement

FYE 31 Mar (RMm)	2016	2017	2018E	2019E	2020E
Revenue	**64.6**	**95.1**	**110.5**	**120.8**	**131.3**
- HP financing & related income	56.4	66.1	74.5	83.0	91.6
- Furniture division	8.2	29.1	36.0	37.8	39.7
Operating expenses	(39.1)	(64.9)	(76.4)	(81.8)	(87.9)
EBITDA	**26.0**	**30.8**	**33.4**	**38.5**	**43.7**
EBIT	**25.5**	**30.2**	**32.8**	**37.8**	**43.1**
Net Finance Costs	(0.2)	0.3	(0.8)	(1.1)	(2.4)
Pre-tax Profit	**25.3**	**30.6**	**32.1**	**36.7**	**40.7**
Taxation	(6.5)	(7.6)	(7.7)	(8.8)	(9.8)
Profit After Tax	**18.8**	**23.0**	**24.4**	**27.9**	**30.9**

Balance Sheet Statement

FYE 31 Mar (RMm)	2016	2017	2018E	2019E	2020E
Plant and Equipment	6.9	7.2	7.5	8.0	8.0
Deferred Tax Assets	6.3	3.9	3.9	3.9	3.9
Receivables	194.3	243.3	298.9	330.6	367.6
Non-current Assets	**207.4**	**254.4**	**310.3**	**342.4**	**379.4**
Inventories	1.9	6.7	8.1	9.7	10.2
Trade Receivables & Others	2.4	9.9	11.9	12.5	13.0
Hire Purchase Receivables	81.7	94.9	85.8	100.6	97.0
Prepayments & Others	1.0	1.9	1.9	1.9	1.9
Cash and bank balances	77.4	14.6	53.4	11.3	8.4
Current Assets	**164.5**	**127.9**	**161.1**	**135.9**	**130.4**
	164.5	127.9	161.1	135.9	130.4
TOTAL ASSETS	**371.9**	**382.3**	**471.4**	**478.4**	**509.8**
ICULS - Liability component	16.2	4.2	3.7	3.7	3.7
Block discounting payables	4.0	12.1	22.0	20.0	30.0
Non-current liabilities	**20.2**	**16.3**	**25.7**	**23.7**	**33.7**
Trade Payables	11.6	14.9	18.6	19.6	20.5
Other Payables and accruals	5.5	4.8	5.2	5.2	5.2
Block discounting payables	11.5	9.7	12.7	10.0	20.0
Overdrafts	-	0.5	2.0	3.0	3.0
Taxation	1.8	2.0	2.0	2.0	2.0
Current liabilities	**30.5**	**31.9**	**40.5**	**39.7**	**50.7**
Share Capital	184.8	243.1	299.7	299.7	299.7
Reserves	66.6	81.8	98.4	108.1	118.6
ICULS - Equity component	83.3	25.9	23.9	23.9	23.9
Treasury Shares	(13.4)	(16.7)	(16.7)	(16.7)	(16.7)
Shareholders Funds	**321.2**	**334.1**	**405.2**	**414.9**	**425.4**
TOTAL EQUITY & LIABILITY	**371.9**	**382.3**	**471.4**	**478.4**	**509.8**

Receivables (RMm)	2016	2017	2018	2019	2020
Hire Purchase	286.2	350.5	398.7	446.8	481.3
Total Receivables	**286.2**	**350.5**	**398.7**	**446.8**	**481.3**
Growth rate (%)	*2.3*	*22.4*	*13.8*	*12.1*	*7.7*

Operating Income Breakdov	2016	2017	2018	2019	2020
Hire Purchase	47.3	54.1	61.5	69.4	76.1

Receivables Yield (%)	2016	2017	2018	2019	2020
Hire Purchase	17.4%	17.6%	17.0%	17.0%	17.0%

Key Financial Ratios

FYE 31 Mar (RMm)	2016	2017	2018E	2019E	2020E
Returns and efficiency:					
ROE (%)	6.5%	7.0%	6.6%	6.8%	7.4%
ROA (%)	5.3%	6.1%	5.7%	5.9%	6.3%
Net Profit Margin (%)	29.3%	24.3%	22.2%	23.1%	23.8%
Cost-to-income ratio (%)	60.9%	68.7%	69.6%	67.9%	67.7%
Asset Quality:					
Gross NPL ratio (%)	1.2%	1.21%	1.60%	1.60%	1.60%
Credit Cost (bps)	544.0	575.4	660.1	644.3	660.0
Loan Loss Cover (%)	286%	289%	291%	382%	494%
Leverage Ratio:					
Debt Service Ratio (x)	9.7	27.5	16.7	16.7	15.8
Net Debt/Equity (x)	0.1	0.1	0.1	0.1	0.1
Investment statistics					
PBT growth (%)	-0.7%	20.7%	4.9%	14.5%	10.9%
Net earnings growth (%)	-0.1%	22.4%	5.9%	14.5%	10.9%
EPS growth (%)	-14.6%	-17.0%	-17.9%	11.5%	10.9%
Fully-diluted EPS growth (%)	-21.3%	16.3%	-10.6%	14.2%	10.7%
PER (X)	9.3	11.2	13.6	12.2	11.0
FD PER (X)	15.1	13.0	14.5	12.7	11.5
EPS (sen)	12.9	10.7	8.8	9.8	10.8
FD EPS (sen)	7.9	9.2	8.2	9.3	10.3
BV/share (RM)	2.20	1.55	1.46	1.45	1.49
P/BV	0.5	0.8	0.8	0.8	0.8
Net DPS (sen)	6.8	6.8	6.0	6.8	7.6
Net yield (%)	5.7%	5.7%	5.0%	5.7%	6.4%
Dividend payout (%)	73%	65%	70%	70%	70%

Cash Flow Statement

FYE 31 Mar (RMm)	2016	2017	2018E	2019E	2020E
EBIT	**25.5**	**30.2**	**32.8**	**37.8**	**43.1**
Depreciation & Amortization	0.4	0.6	0.6	0.6	0.6
Allowance for impairment	16.3	20.9	26.3	28.8	31.8
Working capital changes	(27.7)	(91.3)	(51.1)	(50.3)	(35.5)
Taxes paid	(5.5)	(7.8)	(7.7)	(8.8)	(9.8)
Interest expense paid	(4.7)	(4.0)	(2.0)	(2.3)	(2.7)
Others	1.0	(0.1)	(20.4)	(25.7)	(29.9)
Cash Flow from Operations	**5.4**	**(51.6)**	**(21.4)**	**(19.8)**	**(2.4)**
Capex	(1.5)	(0.9)	(0.3)	(0.5)	-
Sale / (Purchase) of investments	-	0.0	-	-	-
Interest Received	2.4	1.4	1.2	1.1	0.3
Fixed Deposits	(15.3)	26.0	-	-	-
Cash Flow from Investing	**(14.4)**	**26.6**	**(0.3)**	**(0.5)**	**-**
Dividends paid	(14.9)	(15.4)	(15.2)	(18.2)	(20.5)
Term Loan raised/(repaid)	(21.6)	6.4	13.9	(3.7)	20.0
Equity raised	70.0	-	61.9	(0.0)	(0.0)
Share buy-back	(13.3)	(3.3)	-	-	-
Cash flow from Financing	**20.1**	**(12.4)**	**60.6**	**(21.9)**	**(0.5)**
Net Cash Flow	**11.1**	**(37.3)**	**38.9**	**(42.1)**	**(2.9)**
Effects of overdraft	**26.0**	**0.5**	**-**	**-**	**-**
Cash at Start of Year	**40.3**	**51.4**	**14.6**	**53.4**	**11.3**
Cash at End of Year	**77.4**	**14.6**	**53.4**	**11.3**	**8.4**

Source: Company data, Affin Hwang estimates

Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +10% over a 12-month period
HOLD	Total return is expected to be between -5% and +10% over a 12-month period
SELL	Total return is expected to be below -5% over a 12-month period
NOT RATED	Affin Hwang Investment Bank Berhad does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation

The total expected return is defined as the percentage upside/downside to our target price plus the net dividend yield over the next 12 months.

OVERWEIGHT	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
NEUTRAL	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
UNDERWEIGHT	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

This report is printed and published by:
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