# MANAGEMENT DISCUSSION & ANALYSIS

## BUSINESS OVERVIEW

ELK-Desa Resources Berhad ("ELK-Desa" or the "Group") is an established non-bank lender that has carved a niche as a reputable hire purchase financier in the used motor vehicles sector.

Targeting specifically buyers who are seeking small-value financing, a market segment that remains underserved by financial institutions, ELK-Desa has successfully differentiated itself in this highly competitive industry to deliver sustained profitable performance and uninterrupted dividend payouts over the last five years.

Further leveraging on its hire purchase financing expertise, the Group also cross-sells motor-related general insurance products to its hire purchase customers. These products are mainly from leading insurance brands, namely Tokio Marine Insurans (Malaysia) Berhad and Berjaya Sompo Insurance Berhad.

While its hire purchase financing business is still the Group's primary business activity and income generator, ELK-Desa is also involved in the furniture trading business. Having started operations in mid-2015, the furniture trading segment is currently focused on the wholesaling of home furniture in the domestic market.

Incorporated and based in Malaysia, ELK-Desa has been listed under the Financial Services Sector on the Main Market of Bursa Malaysia Securities Berhad ("Bursa") since 18 December 2012.

As a public listed organisation, ELK-Desa strives to enhance its appeal as a resilient counter in Bursa Malaysia in order to attract quality institutions and individual investors. That said, business sustainability has always been the Group's top priority. As such, the Group has embedded three important elements into its business operation as a guide for its sustainability goal. These elements include being mindful of its growth strategy by not expanding beyond its means and taking on higher risk, having a longer-term strategy that would create solid stable returns over a longer period and prudent practices to ensure better asset quality over quantity.

At the same time, the Group has also built itself a reputation as a reliable dividend stock amongst investors by consistently delivering dividend yield averaging approximately 5.2% per year along with a dividend payout ratio that averages around 62% per year.

## REVIEW OF FINANCIAL RESULTS, PERFORMANCE AND FINANCIAL CONDITION

The resumption of business activities and the Government's shift in focus from managing the COVID-19 pandemic to reinvigorating the economy have resulted in a positive improvement in our operating landscape.

For the financial year ended 31 March 2023 (FY2023), ELK-Desa registered a 20% increase in revenue to RM155.24 million compared to RM128.89 million last year. This increase was due to higher contributions from both the Group's hire purchase financing and furniture divisions.

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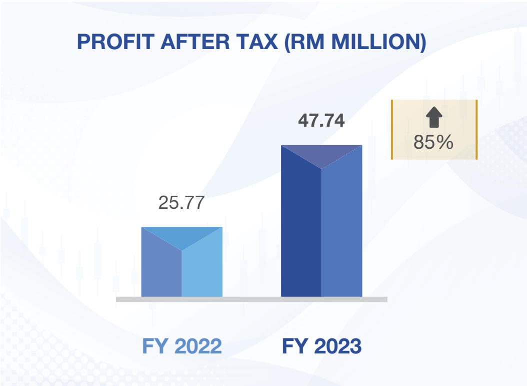
The Group's profit before tax for FY2023 increased by 81% to RM63.31 million from RM34.89 million previously while profit after tax for FY2023 increased by 85% to RM47.74 million compared to RM25.77 million a year ago. The increases in profits were mainly due to higher contribution from both hire purchase financing and furniture divisions.




In tandem with the higher profits, the Group's basic Earnings per Share ("EPS") was 10.50 sen as compared to 5.74 sen (after restatement for bonus issue) in the previous financial year.

In FY2023, the Group's total assets increased by 19% to RM693.05 million while total liabilities increased by 64% to RM221.28 million as compared to FY2022.

Total borrowings increased by 70% to RM199.00 million in FY2023, to support the growth in hire purchase receivables in the past one year. The Group's gearing as at 31 March 2023 remains at a low level of 0.42 times.

As at 31 March 2023, the shareholders' funds grew by 5% to RM471.77 million and the Net Assets per Share ("NA") stood at RM1.04. The lower NA compared to a year ago was predominantly due to the bonus issue of 151,601,337 shares in March 2023 on the basis of one new share for every two existing shares.

Return on equity ("ROE") increased from 5.8% to 10.4%. Return on assets ("ROA") also increased from 4.1% to 7.5%. The substantial increase in both metrics was a result of significantly better profits generated by the hire purchase division during the year.

## Segmental Performance – Hire Purchase Financing Division

| Hire Purchase Segment (RM) | FY2023 | FY2022 | *Variance* | *Variance* |
|---|---|---|---|---|
| Revenue | 100,758,282 | 85,300,811 | *15,457,471* | *18%* |
| Other Income | 1,588,951 | 2,019,143 | *(430,192)* | *-21%* |
| Depreciation of Property, Plant and Equipment & Right of Use Assets | (1,433,658) | (1,377,993) | *(55,665)* | *4%* |
| Impairment Allowance | (6,986,805) | (22,154,427) | *15,167,622* | *-68%* |
| Other Expenses | (27,344,671) | (21,521,323) | *(5,823,348)* | *27%* |
| **Profit before Interest & Tax** | **66,582,099** | **42,266,211** | ***24,315,888*** | ***58%*** |
| Finance Costs | (8,761,716) | (9,543,542) | *781,826* | *-8%* |
| **Profit before Tax** | **57,820,383** | **32,722,669** | ***25,097,714*** | ***77%*** |
| Credit Loss Charge | 1.2% | 4.1% | | *-2.9%* |
| Cost to Income Ratio | 30.8% | 29.4% | | *1.3%* |

ELK-Desa's hire purchase financing division remains as the Group's main income generator, contributing 91% to the Group's FY2023 earnings.

During the year under review, the division's revenue increased by 18% to RM100.76 million from RM85.30 million a year ago. Approximately 88% of the revenue was derived from hire purchase interest income, which recorded a 12% increase to RM89.10 million from RM79.20 million last year. Non hire purchase interest income increased by 91% to RM11.66 million from RM6.10 million last year, as a result of significantly higher new hire purchase disbursements in FY2023.

Other income decreased by 21% mainly due to lower interest income derived from fixed deposits and short-term funds. This can be attributed to the lower level of cash, bank balances and short-term funds during the financial year.

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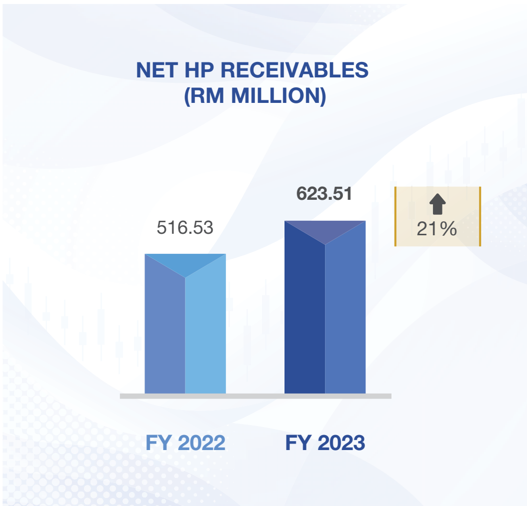
Impairment allowance decreased by 68% to RM6.99 million from RM22.15 million a year ago. Credit loss charge (i.e. Impairment Allowance over Average Net Hire Purchase Receivables) also decreased from 4.1% to 1.2%. The substantially lower impairment allowance and credit loss charge were a result of exceptionally positive recovery activities and hirers' repayment trend in the first half of the financial year.

Other expenses increased by 27% to RM27.34 million mainly due to higher operating expenses and staff costs which are in tandem with the increased level of hire purchase portfolio this year. Cost to income ratio for the hire purchase financing division remains at a manageable level of 30.8%.

Finance costs decreased by 8% to RM8.76 million as a result of the full redemption of its senior medium term notes that offset the increase in block discounting interest expenses from higher bank borrowings during the year.

Profit before tax rose by 77% to RM57.82 million, in view of the higher hire purchase revenue and lower impairment allowances that offset the higher level of operating expenses.

Net hire purchase receivables increased by 21% to RM623.51 million as at 31 March 2023. This is in tandem with the Group's strategy to bring its hire purchase receivables portfolio towards pre-pandemic levels while taking a cautious approach to protect our asset quality. Notably, net hire purchase receivables have grown at a compounded annual growth rate (CAGR) of 9% over the last five years.




In the last three years, the Group had constantly engaged with its borrowers and offered assistance to those eligible, on a case-by-case basis. As a result, these borrowers were more willing to come forward to make regular payments. Notably, the Group will continue to classify these borrowers whom we offered assistance, as impaired loan accounts when their outstanding months arrears are more than 3 months. When the loan tenure ends, these group of borrowers who continues to make regular payments will eventually be reclassed out of the impaired loan accounts.

As explained in the earlier sections, positive recovery activities and hirers' repayment trend resulted in the Group's Gross Impaired Loans ratio decreasing to 7.4% as at FY2023 compared to 9.9% in the previous year. Net Impaired Loans ratio decreased to 1.9% from 2.9% in the previous year. These improvements were achieved despite the Group's constrained debt recovery activities as a result of the Temporary Measures for Reducing The Impact of Coronavirus Disease 2019 (COVID-19) Act 2020 ("COVID-19 Act 2020") that generally protects the borrowers' interest.

Given that the chances of future movement restrictions are low as Malaysia moves towards endemicity, the Management strives to gradually bring down the impaired loans ratios to the pre-COVID levels. The Group rigorously reviews its impairment policy to ensure that adequate impairment provisions are made for potential future credit losses.

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## Segmental Performance – Furniture Division

| Furniture Segment (RM) | FY2023 | FY2022 | *Variance* | *Variance* |
|---|---|---|---|---|
| Revenue | 54,483,770 | 43,593,042 | *10,890,728* | *25%* |
| Other Income | 259,221 | 400,738 | *(141,517)* | *-35%* |
| Cost of inventories sold | (33,908,817) | (29,327,617) | *(4,581,200)* | *16%* |
| Depreciation of Property, Plant and Equipment & Right of Use Assets | (1,233,317) | (1,320,177) | *86,860* | *-7%* |
| Impairment Allowance | (553,915) | (251,952) | *(301,963)* | *120%* |
| Other Expenses | (13,403,642) | (10,866,000) | *(2,537,642)* | *23%* |
| **Profit before Interest & Tax** | **5,643,300** | **2,228,034** | ***3,415,266*** | ***153%*** |
| Finance Costs | (155,656) | (56,603) | *(99,053)* | *175%* |
| **Profit before Tax** | **5,487,644** | **2,171,431** | ***3,316,213*** | ***153%*** |

ELK-Desa's furniture division, which is currently a non-core business activity of the Group, also contributed positively during the year under review.

The total furniture revenue increased by 25% to RM54.48 million as furniture sales rebounded from business and operational disruptions caused by MCO in the previous financial year. In addition, gross profit margin improved from 33% to 38% mainly due to lower freight charges as well as our continuous effort to source for alternative products.

Other expenses increased by 23% to RM13.40 million mainly due to higher selling, distribution and staff costs which are in line with the higher level of furniture sales during the financial year.

The furniture division continued to contribute positively in its eighth year of commencing its business operations, recording a profit before tax of approximately RM5.49 million for FY2023.

## REVIEW OF OPERATIONS

### Hire Purchase Financing Division

The Group operates its hire purchase financing business via its wholly-owned subsidiary, *ELK-Desa Capital Sdn Bhd*. With two offices, one in the heart of Kuala Lumpur and the other in Klang, Selangor, the Division employs a total of 194 individuals.

As ELK-Desa's hire purchase business is centred on the small-value used car sector, which is generally not an area of focus for the typical financial institution, the Group relies on a broad hirer base as a strategy to reduce its credit risk.

As of 31 March 2023, the Group's hire purchase financing division has a hirer base of approximately 40,900 individuals. Its average outstanding net hire purchase receivables per hirer is approximately RM15,200. These numbers collectively show that the Group's credit exposure per hirer is relatively low.

Annual hire purchase disbursements increased to RM262.40 million from RM110.66 million a year ago as a result of our efforts to bring our hire purchase receivables towards pre-pandemic levels.

ELK-Desa continues to conduct its hire purchase financing business mainly through dealers. As such, the Group prides itself for having cultivated an extensive dealer network that is more than 1,000 strong.

In spite of the challenging operating landscape during the financial year, ELK-Desa has remained steadfast in fostering a close and mutually beneficial relationship with its dealers. The Group value-adds to our dealers' business by processing financing requests expeditiously and efficiently as well as paying out disbursements in a timely manner. By doing so, dealers are able to sell their used car stocks at a faster rate and have better cashflow for their operation.

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When it comes to risk management, the Group's hire purchase financing business is dependent on the economic environment that correlates to consumer confidence and spending habits. The business also faces credit risks that stem from the hirers' ability to repay instalments in a timely manner.

In view of the uncertainties brought about by the pandemic and in order to mitigate credit risks, the Group further enhanced its credit management policy while monitoring repayments very closely during the year. The Group has also remained firm in minimising its exposure to credit risk by not relying heavily on any single large hirer.

The hire purchase financing business also faces strategic risk, whereby the business may be impacted by the failure to respond to competition, changes in political, economic and regulatory conditions. On the latter, the industry is regulated under the Hire Purchase Act 1967 and the Group will be affected by any unfavourable terms of amendment to the said Act. Strategic risks are managed by paying close attention to all relevant trends and development that can potentially impact the Group's hire purchase financing business and putting in place the capability to react or adapt to changing situations quickly.

**Furniture Division**

The Group Furniture Division is spearheaded by its wholly-owned subsidiary, *ELK-Desa Furniture Sdn Bhd*. The furniture division employs 105 individuals.

Furniture products are predominantly manufactured by contract manufacturers locally and from overseas. These products are distributed by the Group under its own brand, ELK-DeSA™.

The Group Furniture Division focus on the domestic wholesale market and distribute ELK-DeSA™ furniture products to more than 800 furniture retailers throughout Malaysia.

Besides distributing our ELK-DeSA™ furniture products via our extensive dealers' network, we have two furniture retail showrooms located in Klang, Selangor. These showrooms primarily cater to customers who live in and around their respective areas.

The Division also has a small furniture assembly facility, specialising in sofa assembly, catering to the demands and requirements from our two retail showrooms and the wholesale business.

The ELK-DeSA™ brand continues to strengthen its presence in the furniture market, as many of its customers find the contemporary and urban-centric design of ELK-DeSA™ furniture and its reasonable price tag highly appealing.

Moving forward, the Group intends to grow its furniture trading business at a sustainable pace to strengthen its contribution to the Group's performance, while the hire purchase financing division will continue to be the primary income generator in the foreseeable future.

In terms of risks, the performance of the furniture industry is subject to a myriad of factors ranging from macroeconomic conditions to consumer and business confidence.

### CORPORATE DEVELOPMENTS

In December 2022, the Company proposed to undertake a bonus issue of up to 151.60 million new shares on the basis of one new share for every two existing shares. The bonus issue is to enable our valued shareholders to increase the number of shares held without incurring any additional cost, whilst maintaining their percentage of equity interests. This corporate exercise, approved by shareholders in January 2023, will also help improve the marketability of our counter leveraging on enhanced trading liquidity.

Following the completion of the bonus issue in March 2023, the Company has an enlarged issued share capital of 454.81 million shares valued at RM523.03 million as at 31 March 2023.

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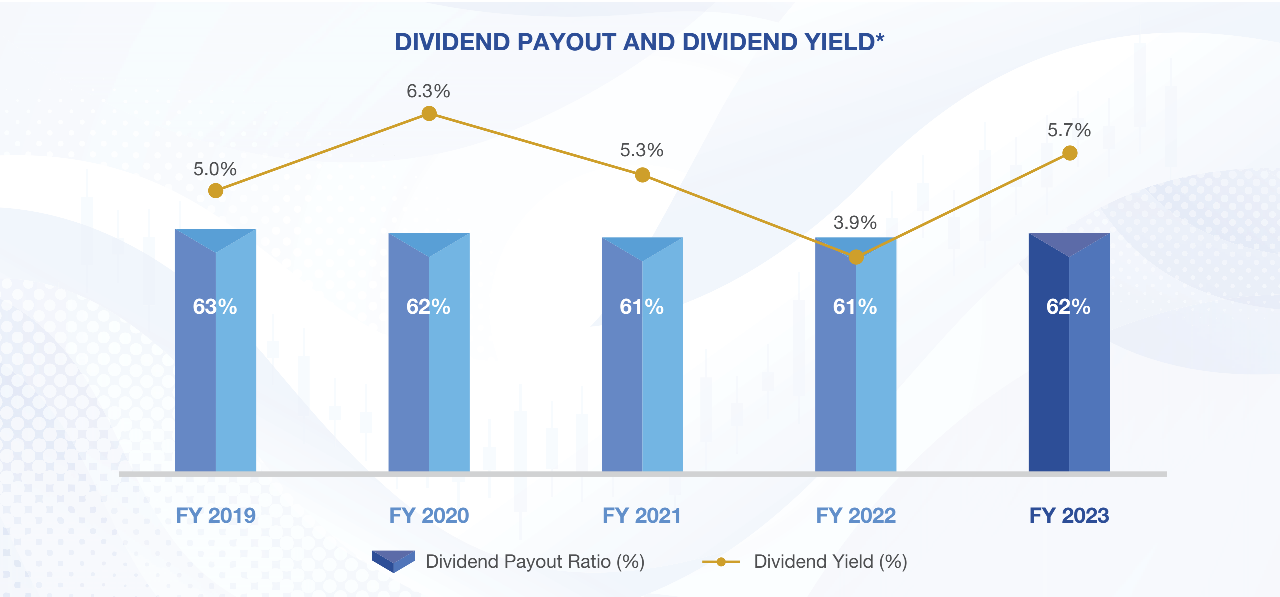
## DIVIDENDS

The Board of Directors has declared a second single tier interim dividend of 3.50 sen per share in respect of the financial year ended 31 March 2023 and the dividend was paid on 22 June 2023. With the declaration of the second interim dividend, the Board of Directors will not recommend any final dividend for the financial year ended 31 March 2023.

In addition to the first single tier interim dividend of 4.50 sen per share (3.00 sen after restatement for bonus issue), which was paid on 16 December 2022, the total dividend for the financial year ended 31 March 2023 is 6.50 sen per share (FY2022: 3.50 sen after restatement for bonus issue). This represents a dividend payout ratio of approximately 62% of the net profit, which is higher than the dividend policy of 60% set by the Board.

The Board has and will remain committed towards sustaining, if not, improving shareholders return while at the same time conserving sufficient financial resources for future expansion. ELK-Desa's consistency in distributing dividends has further solidified the counter as a reliable dividend stock amongst investors.




**Note: Dividend Yield is computed based on the share price at the end of the financial year*

## FORWARD-LOOKING STATEMENT

The Malaysian economy is expected to expand at a more moderate pace amid a challenging external environment, according to Bank Negara Malaysia's ("BNM") report for the fourth quarter of 2022. BNM indicated that domestic demand will continue to drive growth, supported by the continued recovery in the labour market and the realisation of multi-year investment projects. Nevertheless, economic uncertainties remain as a result of weaker global growth, tighter financial conditions, re-escalation of geopolitical conflicts and worsening supply chain disruptions.

In Malaysia, headline inflation continued to moderate, but core inflation has persisted above historical averages. As such, in spite of the resilient domestic economy and better job security, Malaysian consumers, especially in the M40 and B40 segments, are experiencing higher costs of living and tighter disposable incomes. This may impact their propensity to purchase 'big ticket' items such as a used car and furniture or affect their ability to repay loans.

For the Hire Purchase segment, ELK-Desa is confident that demand for used car financing will continue to out-strip supply, more so within the niche and underserved used car financing market that it operates in. The Group intends to continue to grow its hire purchase receivables in FY2024, albeit at a more moderate pace.

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In FY2023, the Group's net hire purchase receivables had recovered by 21% to RM623.51 million which is near to its pre-covid levels. In the current financial year FY2024, the Group is not expecting a similar sharp expansion in view of the macroeconomic uncertainties within its operating landscape. In addition to inflationary pressures, the used car financing industry may also require process changes to adapt to the new regulatory oversight by the Consumer Credit Oversight Board, which is expected to come into effect in 2024.

In FY2024, ELK-Desa will remain focused on reducing its impaired loans ratio, which remained relatively high due to the operational disruptions caused by the Movement Control Order as well as our adherence to the COVID-19 Act that had limited our credit recovery efforts.

For the Furniture segment, ELK-Desa will stay on track with its strategic direction to grow organically, focusing on the domestic wholesale market to distribute its furniture products to more than 800 furniture retailers throughout Malaysia, especially in Sabah and Sarawak. The Group will continue to source for quality and affordable furniture in order to address the potentially tighter disposal incomes faced by consumers.

ELK-Desa has always managed its business so that it can be sustainable in the long run. Moving forward, in its effort to create tangible value for its stakeholders, ELK-Desa aims to continuously embed key ESG (Environment, Social and Governance) elements within its business processes and practices, through constant engagement with its stakeholders.

ELK-Desa recorded a remarkably strong performance in FY2023 due to the high levels of reversal of impairment allowances in the first half of the financial year. These exceptional reversals are not expected to continue into FY2024 and as such, the Group does not expect its performance to exceed FY2023. Nevertheless, the Board of Directors remains committed towards achieving sustainable growth in FY2024.