BCT Asia advisory

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4Q FYE MAR 2018 RESULTS REPORT ***25 May 2018***

Name of PLC: *ELK-Desa Resources Bhd (ELKD)*	***PLC Website:*** *www.elk-desa.com.my*
Business Summary: *Involved in hire purchase financing for used motor vehicles, insurance agency business and furniture business*	
Top Three Shareholders: *Teoh Hock Chai@ Tew Hock Chai 30.5%* *Dr Yeong Cheong Thye@ Yeong Yue Chai 8.7%*	

Market / Sector:	*Main / Finance*	***Stock Code:*** ***Bloomberg Ticker:***	*5228* *ELK MK*
Market Capitalisation:	*RM 347.3m*	***Recommendation:***	*BUY*
Target Price:	*RM 1.42*	***Expected Capital Gain:***	*22.4%*
		Expected Div Yield:	*5.8%*
Current Price:	*RM 1.16*	***Expected Total Return:***	*28.2%*

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Key Stock Statistics	**2017**	**2018**	**2019F**	**2020F**
EPS (sen)	10.0	8.7	9.6	10.7
P/E (x)	11.6	13.4	12.1	10.9
EPS ex-EI (sen)	10.0	8.7	9.6	10.7
P/E ex-EI (x)	11.6	13.4	12.1	10.9
Net Dividend/Share (sen)	6.8	6.8	6.8	6.8
NTA/Share (RM)	1.45	1.33	1.42	1.53
Book Value/Share (RM)	1.45	1.33	1.42	1.53
Issued Capital (mil shares)	230.3	298.4	298.4	298.4
52-weeks Share Price Range (RM)				1.14-1.26
Estimated free float				36.5%
Average volume (shares)				94,340

Per Share Data	**2017**	**2018**	**2019F**	**2020F**
Year-end 30 Sept				
Book Value/Share (RM)	1.45	1.33	1.42	1.53
Operating CF/Share (sen)	(20.6)	(8.6)	(3.3)	4.4
EPS (sen)	10.0	8.7	9.6	10.7
Net Dividend/Share (sen)	6.8	6.8	6.8	6.8
P/E (x)	11.6	13.4	12.1	10.9
P/Cash Flow (x)	(5.6)	(13.5)	(35.3)	26.4
P/Book Value (x)	0.8	0.87	0.81	0.76
Dividend Yield (%)	5.8	5.8	5.8	5.8
Payout Ratio (%)	67.6	77.7	70.3	63.3
ROE (%)	7.0	7.1	6.7	6.8
Net Gearing (%)	3.4	0.7	1.3	-2.8

P&L Analysis (RM mil)	**2017**	**2018**	**2019F**	**2020F**
Revenue	94.5	104.1	110.4	120.0
EBITDA	30.8	38.4	40.4	44.4
Depreciation & amort	(0.6)	(0.6)	(0.6)	(0.6)
Pre-tax Profit	30.6	35.3	37.7	41.9
Net Profit	23.0	25.9	28.6	31.8
EBITDA Margin (%)	32.6	36.9	36.6	37.0
Pre-tax Margin (%)	32.4	33.9	34.2	34.9
Net-Margin (%)	24.3	24.9	25.9	26.5

1. 4QFY18 Results Highlight

	4Q FY18 RMm	**4Q FY17 RMm**	**Chg %**
Revenue	27.7	24.9	11.5
Impairment Allowance	(4.5)	(5.5)	
Finance cost	(0.7)	(0.3)	
Pre-tax Profit	10.8	8.2	31.6
Net Profit	7.9	6.4	23.2
Pre-tax Margin (%)	39.0	33.0	
Net Margin (%)	28.6	25.8	

- The Company's 4QFY18 revenue improved 11.5% y-o-y to RM27.7m while net profit jumped by 23.2% y-o-y to RM7.9m. The good set of results is attributable to both Hire Purchase (HP) and furniture division.

- For HP segment, revenue grew 11.0% y-o-y to RM19.3m as HP receivables registered a notable growth of 14.5% y-o-y from RM338.2m to RM387.3m. PBT surged by 29.3% y-o-y to RM10.4m as impairment allowance reduced by 17.6% y-o-y.

- As for furniture segment, its revenue grew 12.5% y-o-y to RM8.4m due to the increase of local sales. PBT registered further growth of 106.4% y-o-y as its GP margin expanded from 36.3% to 38.5%.

- On q-o-q basis, the Company's revenue grew 7.0% driven mainly by furniture segment, which grew 12.3%. Net profit improved 13.0% buoyed by both HP and furniture segments. HP's PBT grew 8.5% on lower impairment allowance while furniture segment turned profitable.

FY18 Results Highlight

	FY18 RMm	FY17 RMm	Chg %
Revenue	104.1	94.5	10.2
Impairment Allowance	(20.7)	(20.2)	2.9
Finance	(2.4)	(1.1)	
Pre-tax Profit	35.3	30.6	15.6
Net Profit	25.9	23.0	12.7
Pre-tax Margin (%)	33.9	32.3	
Net-Margin (%)	24.9	24.3	

- In FY18, revenue increased 10.2% y-o-y to RM104.1m driven by HP division. The segment revenue improved 11.7% y-o-y while furniture division increased only 6.9% y-o-y. Overall net profit improved 12.7% y-o-y in line with margin improvement on the back of higher turnover at the furniture division, and lower credit loss charge for the HP segment.

- HP's revenue improved 11.7% y-o-y mainly due to increase in hire purchase portfolio. Impairment allowance increased 2.9% but the credit loss charge decreased from 6.32% in FY17 to 5.45%. The improvement was mainly attributable to the group's concerted efforts in credit recovery. Due to larger HP portfolio, its PBT margin improved from 46.2% in FY17 to 47.7% in FY18 despite higher staff and finance costs. Hence, PBT grew 15.5% to RM34.9m.

- Furniture's revenue grew 6.9% on the back of stronger domestic sales. Its PBT improved 16.3% y-o-y mainly attributable to a 2 ppt GP margin expansion to 37.4%.

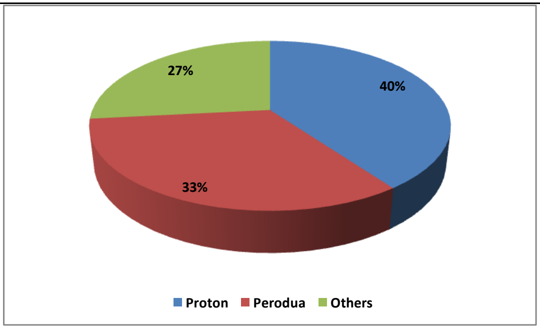
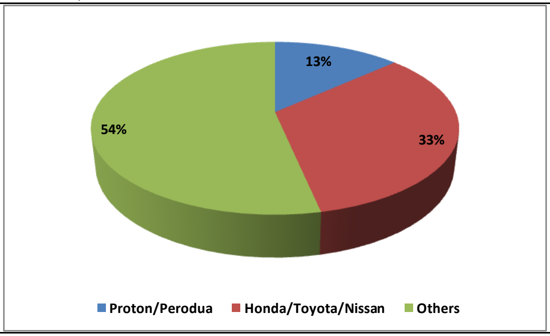
- The Company declared 3.5sen dividend (subject to shareholders' approval), bringing total dividends to 6.75sen/share for the year. This translates to an attractive dividend yield of 5.8%.

- The group's net profit of RM25.9m came in slightly above our expectation, making up 106.1% of our full year estimate of RM24.4m. As a result, we have tweaked our FY19 earnings estimates higher by 10% from RM25.9m to RM28.6m.

2. Corporate Updates

- ELKD has predominantly been targeting the buyers of small value second-hand cars under 2,200 c.c. and 15 years old & below while capping its hire purchase financing amount to not more than RM20,000 per hirer to spread out the credit risk. However, the Company is now expanding its coverage and allocating 10% of its portfolio to target hire purchase financing amount between RM20,000 and RM35,000.

- We have done a sample study by compiling the used car listings from one of the Malaysia's top used car site. Out of the sample size of 30 listings, we reckon that selling prices below RM20,000 are typically under the brand of Proton, followed by Perodua. By raising the financing to RM35,000, the coverage of car brands will be widened substantially. Under the category of between RM20,000 and RM35,000, the Japanese carmaker including Honda, Toyota and Nissan has overtaken the national brand, making up 33% of the pie.

Breakdown by brands for the category of selling prices below RM20,000	Breakdown by brands for the category of selling prices between RM20,000 and RM35,000
	

We believe this move will capture more of the growing preferred brands such as Perodua, Honda and Toyota, which is evidenced by the improvement of market share in 2017. These three will well serve as growth segment in the coming years. We also understand that these brands actually have lower default rate as compared to national car segment.

- ELKD's net HP receivables have been expanding at a CAGR of 12.9% due to steady demand for its hire purchase loans, and relatively low market penetration rate - It is estimated that ELKD is financing less than 1% of the total used-passenger cars registered in KL and Selangor. In FY17, the Company made a conscious decision to increase its portfolio and net HP receivables rose 22.4% y-o-y to RM350.5m. Its annual disbursement also jumped 60.5% y-o-y to RM173.6m. FY18 net HP receivables grew 14.5% y-o-y. Given the expansion in coverage of used car, we believe 15% growth for FY19-20 is achievable.

- Meanwhile, we understand that the Company has no immediate concrete plans for the money lending licence that they obtained in November 2017 yet. However, we believe this licence would open up different opportunities for future business expansion. Management's approach to any new businesses is conservative, hence any impact will likely be realised only in the longer term.

3. Earnings Outlook

- Given its low market penetration rate, we believe the Company will continue to do well, especially the new coverage area of growth. We believe net receivables will continue to trend higher underpinned by management's direction to expand its HP portfolio. The net gearing of the Company is near to net cash position hence its balance sheet is able to support this expansion. For now, we are projecting annual HP disbursements of RM200m and RM240m for FY19-20E. Correspondingly, we assume net HP receivables of RM460m and RM530m for FY19-20E respectively. We also project a low single digit revenue and net profit growth for furniture segment for the next 2 years.

- As mentioned earlier, we have tweaked our FY19 earnings estimates higher by 10% from RM25.9m to RM28.6m. We also introduce our FY20 earnings forecast of RM31.8m which represents an earnings growth of 11.2%.

- Due to the recent change in political landscape in Malaysia, there are potential risks to our earnings forecast in FY19-20. Consumer sentiment may turn more cautions in the near term, and impact our growth assumptions.

4. Valuation and Recommendation

- ELKD is currently trading at a relatively high PE of 13x versus RCE Capital of 5.0x. ELKD's higher PE, in our opinion, is a reflection of its conservative capital management, where its financial performance could be significantly stronger if management employed higher leverage in conducting its business.

Additionally, investors at this juncture are pricing the stock on a yield basis, where its healthy dividend stream lends support to the share price at current levels.

- Post adjustment, we are upgrading our TP from RM1.17 to RM1.42 based on unchanged 1x P/BV ratio. The dividend yield of about 5.8% will continue to support ELKD's share price, and a narrowing of the yield that investors are willing to accept, in light of its positive earnings growth, will underpin upside for the stock.

- Hence, we are upgrading our HOLD recommendation to BUY. We are positive on the stock as we believe management has ample capacity to leverage more aggressively to drive its HP business. In addition, its management is highly experienced, the market potential is still vast and largely untapped, and the stock's financial ratios will likely exhibit improvement in the coming years.

<u>Share Price Chart</u>

Disclosures/Disclaimer

Investment ratings:
Buy (generally >10% upside over the next 12 months)
Hold (generally negative 10% downside to positive 10% upside over the next 12 months)
Sell (generally >10% downside over the next 12 months)

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