UPDATE REPORT ***5 August 2019***

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 as of 11 June 2019: *Teoh Hock Chai@ Tew Hock Chai* *40.3%* *Dr Yeong Cheong Thye@ Yeong Yue Chai* *5.2%*			
Market / Sector:	*Main / Finance*	***Stock Code:*** ***Bloomberg Ticker:***	*5228* *ELK MK*
Market Capitalisation:	*RM481m*	***Recommendation:***	*BUY*
Target Price:	*RM 1.80*	***Expected Capital Gain:*** ***Expected Div Yield:*** ***Expected Total Return:***	*11.1%* *5.4%* *16.5%*
Current Price:	*RM 1.62*		
Analyst: Bryan Chan/ Teo Joo Tse *| Tel: +603 2163 3200; Email: chanb@bcta.com.my / jootse@bcta.com.my*			

Key Stock Statistics	**2018**	**2019**	**2020F**	**2021F**
EPS (sen)	8.7	11.1	12.8	14.5
P/E (x)	18.6	14.6	12.6	11.2
EPS ex-EI (sen)	15.7	17.1	19.9	23.0
P/E ex-EI (x)	10.3	9.5	8.1	7.1
Net Dividend/Share (sen)	6.5	7.0	7.7	8.7
NTA/Share (RM)	1.33	1.39	1.44	1.50
Book Value/Share (RM)	1.33	1.39	1.44	1.50
Issued Capital (mil shares)	298.4	296.1	296.1	296.1
52-weeks Share Price Range (RM)				1.13-1.74
Estimated free float				30.9%
Average volume (shares)				239.2k

Per Share Data	**2018**	**2019**	**2020F**	**2021F**
Year-end 30 Sept				
Book Value/Share (RM)	1.33	1.39	1.44	1.50
Operating CF/Share (sen)	(8.6)	(18.2)	16.3	16.4
EPS (sen)	8.7	11.1	12.8	14.5
Net Dividend/Share (sen)	6.5	7.0	7.7	8.7
P/E (x)	18.6	14.6	12.6	11.2
P/Cash Flow (x)	(18.8)	(8.9)	10.0	9.9
P/Book Value (x)	1.22	1.17	1.13	1.08
Dividend Yield (%)	4.0	4.3	4.7	5.4
Payout Ratio (%)	74.5	63.0	60.0	60.0
ROE (%)	6.5	8.2	9.1	9.9
Net Gearing (%)	0.7	24.3	17.8	36.0

P&L Analysis (RM mil)	**2018**	**2019**	**2020F**	**2021F**
Revenue	104.1	123.4	142.3	164.7
EBITDA	38.4	49.0	58.0	67.3
Depreciation & amort	(0.6)	(0.9)	(1.0)	(1.4)
Pre-tax Profit	35.3	43.8	51.1	57.7
Net Profit	25.9	32.9	37.9	42.9
EBITDA Margin (%)	36.9	39.7	40.8	40.9
Pre-tax Margin (%)	33.9	35.5	35.9	35.0
Net-Margin (%)	24.9	26.7	26.7	26.0

1. Investment Highlights/Summary

- We recently met up with the management and came away with positive notions. The Company has successfully penetrated the higher segment with car value up to RM35,000 and aims to raise portfolio contribution from that segment to 50% by FY21 from the current 20%.
- Supported by the newly announced RM1 billion Medium Term Notes, we are convinced that its net HP receivables will continue to grow 20% per annum at least for the next 4 years. NPL, thus far, has not been a concern as it has improved from a high of 2.2% in FY14 to a low of 0.8% in FY19. As a result, its credit loss charges remained low at 3.8% in FY19.
- We thus assumed annual HP disbursements of RM267m and RM321m for FY20-21E. Our earnings estimate for FY20 has been revised higher from RM34.2m to RM37.9m due to higher net HP receivable growth from 15% to 20% while net profits for FY21E is introduced at RM42.9m.
- We continue to like ELKDesa for its sustainable HP growth as well as its attractive dividend yield. Management has delivered a proven track record and the market potential remains large. The stock's financial ratios will likely exhibit improvement in the coming years as more leverage is employed in expanding its business. BUY recommendation maintained. We roll-over our book benchmark from FY20E to FY21E, with TP of RM1.80 based on higher P/BV ratio of 1.2x from 1.0x previously. We believe the stock has potential to re-rate in the mid to longer term as more leverage is employed and profitability ratios continue to improve.

2. Financial Results

	FY19 RMm	FY18 RMm	Chg %
Revenue	123.4	104.1	18.5
Impairment Allowance	(17.5)	(20.7)	(15.5)
Finance cost	(4.3)	(2.4)	75.8
Pre-tax Profit	43.8	35.3	24.0
Net Profit	32.9	25.9	27.0
Core Profit without Impairment	46.1	41.1	12.1
Pre-tax Margin (%)	35.5	33.9	
Net-Margin (%)	26.7	24.9	
Core Margin (%)	37.4	39.5	

- To recap the last announcement of full year results, the group's FY19 net profit of RM32.9m came in within our expectations, making up 103% of our full year estimate of RM31.9m. Revenue was slightly higher at RM123.4m by 4.3% of our estimates.

- Compared to the corresponding period last year, both FY19 revenue and net profit improved by 18.5% and 27.0% y-o-y, respectively. Core net profit registered lower y-o-y growth of 12.1% due to the exclusion of lower impairment allowance impact which declined 15.5% y-o-y. Core margin marked a 2.1ppt decline to 37.4% due to higher finance costs and other expenses.

- HP segment registered a y-o-y revenue and PBT growth of 16.2% and 22.8%, respectively. The top-line improvement was mainly due to increase in hire purchase portfolio. Meanwhile, its PBT margin improved 2.8ppt to 50.5% mainly attributable to lower impairment allowance, which offset the higher finance costs and higher staff costs from expansion. Credit loss charge decreased from 5.45% to 3.81% due to drastic growth in hire purchase receivable and stable domestic economic environment.

- Its furniture segment, primarily targeting the domestic wholesale market, registered a stellar revenue growth of 24.0% y-o-y while PBT grew 61.6% y-o-y to RM0.96m. Albeit that relative profit remains not too significant, its topline contribution has grown 1.4ppt to 31.2% in FY19. Gross profit margin saw a marginal decline from 37.4% to 36.5%. Impairment allowance increased RM0.31m to RM0.58m mainly due to slower payment from furniture dealers. Other expenses also increased by 17% to RM12.3m mainly due to higher operating expenses which is in tandem with the higher sales.

3. Corporate Updates

- We recently met up with the management and came away with positive notions.

- Historically its hire purchase portfolio had mainly focused on second-hand vehicle value of up to RM20,000. The Company has successfully penetrated the higher segment of second-hand vehicle with value ranging from RM20,000 to RM35,000. In FY19, this segment has grown to account for 20% of its hire purchase portfolio. Management aims to further expand this segment to account for 50% of its hire purchase portfolio by FY21. ELKDesa covers a niche market, and targets buyers of lower priced second-hand vehicles within the age profile of 6 to 15 years old, and with engine capacity of less than 2,400cc. Its clientele and business segments are not normally targeted by the main financial institutions, and as such ELKDesa does not compete with them directly. As a result, management remains positive and confident that in both the category of RM20,000 and the higher range to RM35,000 market segments are niche and growth is expected to endure, supported by the availability of fresh fund.

- Over the years, ELKDesa has been conservatively growing its hire purchase portfolio, mainly funded by the equity capital. Net hire purchase receivable grew at an average of 14.2% over the past 5 years, supported by a 5-year compounded annual growth rate of 19.7% in shareholders' fund. The Company recently announced its maiden foray into the debt capital market through the establishment of a Medium-Term Notes (MTNs) programme of up to RM1.0 billion in nominal value via the Premier Auto Assets Berhad. It is a special purpose vehicle that was set up by the Company as the issuer for a tenure of 10 years.

On 19 July 2019, the Company completed the first tranche of Senior MTNs totalling RM105m, comprising RM85m of Class A MTNs rated AAA and RM20.0m of Class B MTNs rated AA3 by RAM Rating Services Berhad. We view this move positively as it will provide fresh fund to grow the hire purchase portfolio and effectively enhance the return of equity (ROE) by utilizing reasonable amount of borrowings at an attractive rate at below 5% versus an average hire purchase rate of 9%. As at end-FY19, net gearing remained low at 0.24x as compared to its closest peer – RCE Capital at approximately 2.0x with higher ROE at high-teens. Just by raising its net gearing from 0 to 0.24x, ELKDesa delivered a 1.7ppt higher ROE at 8.2% in FY19.

- Besides hire purchases, the Company also cross-sells both motor and non-motor insurance to the hirers through its subsidiary, namely ELK-DESA Risk Agency which is an insurance agent for Tokio Marine Insurans (Malaysia) Bhd and Berjaya Sompo Insurance Bhd. In 2018, it was rated as the top agent in Tokio Marine. Although earnings contribution is small, the insurance premium production and commission have been growing healthily at a 4-year CAGR of 5.4% and 4.2% respectively and are expected to track behind the hire purchase growth.

- ELK-Desa Furniture Group started operations about 4 years ago as a furniture retailer and wholesaler. Management viewed this venture as a potential stepping stone to explore opportunities in the furniture hire purchase business should it be feasible. The roll-out will be similar to its current model, where market penetration will be undertaken through furniture sellers or dealers to capture a bigger pie of the market within a short period of time.

  Management has emphasised that this is merely a pilot project for now, and that the core focus remains in the second-hand vehicle hire purchase operation. The furniture segment is profitable, and top line growth is expected to maintain at double digit, with earnings margin expected to improve through scalability.

4. Earnings Outlook

- ELKDesa is a major independent hire purchase financier for motor vehicles. It is the market leader in the niche segment of entry-level small second-hand cars. The Company has registered healthy organic growth on the back of steady demand for its hire purchase loans. The Company also diversified into furniture business in 2015, but this has yet to contribute significantly. The Company has been conservative in their approach to the business, emphasizing more on quality rather than volume when growing its portfolio. It has also strategically grown its borrowings at a manageable pace to further fuel growth.

- ELKDesa's net HP receivables have been expanding at a CAGR of 14.2% due to steady demand for its hire purchase loans, and relatively low market penetration rate - It is estimated that ELKDesa is financing about 0.6% of the total used-passenger cars registered in KL and Selangor. Supported by the RM1 billion MTNs, we are convinced that growth in its net HP receivables will rise to 20% per annum at least for the next 4 years. To ensure the integrity of the Company's HP assets, all non-performing loans (NPL) have been fully impaired in the financial statements and NPL has improved from a high of 2.2% in FY14 to a low of 0.8% in FY19. As a result, its credit loss charges improved from 6.3% in FY17 to 3.8% in FY19.

- A dividend policy of distributing not less than 60% of net profits was announced in 2015. The Company has also been paying above 60% in the past four years with an average payout ratio of 69.5%. This makes the stock attractive as it has been paying more than 5% dividend yield continuously for all these years since FY13. For FY20-21E, we conservatively assume the Company maintains its 60% dividend payout per annum, which translates to 7.7-8.7 DPS or an attractive yield of 4.7-5.4%. Note that a final single tier dividend of 3.5sen for FY19 is going-ex on 15 August 2019.

- Near to medium term, we believe the Company will continue to perform, especially given 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, supported by borrowings. We view this positively as the Company has traditionally been conservative on utilising leverage, resulting in low ROEs. We assumed annual HP disbursements of RM267m and RM321m for FY20-21E on the back of a 20% annual growth rate in net HP receivables or RM588m and RM705m for FY20-21E respectively. As a result, our earnings estimate for FY20 has been revised higher from RM34.2m to RM37.9m due to revision of higher net HP receivable growth from 15% to 20% while net profits for FY21E is introduced at RM42.9m.

5. Valuation and Recommendation

- We continue to like ELKDesa for its sustainable high HP growth as well as its attractive dividend yield. Management has delivered a proven track record and the market potential remains large. The stock's financial ratios will likely exhibit improvement in the coming years as more leverage is employed in expanding its business. We maintain our BUY recommendation and roll-over our book value benchmark from FY20E to FY21E, with TP of RM1.80 based on higher P/BV ratio of 1.2x from 1.0x previously. We believe the stock has potential to re-rate in the mid to longer term as more leverage is employed and profitability ratios continue to improve.

Peer Comparison

	Mkt Cap	P/E	P/NAV	Div Yield	ROE	N.Gearing	Loan Growth	NPL	FYE
ELK Desa	RM481m	14.6x	1.2x	4.3%	8.2%	0.2x	22.4%	0.8%	Mar 19
AEONCR	RM4.1b	11.6x	2.7x	2.7%	23.7%	4.2x	13.3%	2.0%	Feb 19
RCECAP	RM560m	5.9x	1.0x	5.4%	16.4%	1.9x	5.2%	n/a	Mar 19
Simple Average	n/a	10.7	1.6x	4.1%	16.1%	2.1x	n/a	n/a	n/a
Weight Average	n/a	11.3x	2.4x	3.1%	21.5%	3.6x	n/a	n/a	n/a

**Prices were as of 1 August 2019*

Share Price Chart

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)

This report has been prepared by BCT Asia Advisory SdnBhd pursuant to the Mid and Small Cap Research Scheme ("MidS") administered by Bursa Malaysia Berhad. This report has been produced independent of any influence from Bursa Malaysia Berhad or the subject company. Bursa Malaysia Berhad and its group of companies disclaims any and all liability, howsoever arising, out of or in relation to the administration of MidS and/or this report.

The information and opinion in this document has been obtained from various sources believed to be reliable. This publication is for information purpose only, and must not be relied upon as authoritative or taken in substitution for the exercise of judgment. This document is not to be construed as an offer or a solicitation of an offer to buy or sell any securities. Opinions expressed in this publication are subject to change without notice and any recommendation herein does not have regard to the specific investment objectives, financial situation and the particular needs of any specific addressee. No representation, express or implied, is made with respect to the accuracy, completeness or reliability of the information or opinions in this publication. Accordingly, neither we nor any of our affiliates nor persons related to us accept any liability whatsoever for any direct, indirect or consequential losses (including loss and profit) or damages that may arise from the use of information or opinions in this publication.

BCT Asia Advisory SdnBhd and its related companies, their associates, directors, connected parties and/or employees may own or have positions in any securities mentioned herein or any securities related thereto and may from time to time add or dispose of or may materially be interested in any such securities. BCT Asia Advisory SdnBhd and its related companies may from time to time perform advisory, investment, communications or other services for, or solicit such advisory, investment, communications or other services from any entity mentioned in this report. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest.