BCT Asia advisory

BURSA MidS

1Q FYE MAR 2020 RESULTS REPORT ***23 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:	*RM490.1m*	***Recommendation:***	*BUY*
Target Price:	*RM 1.80*	***Expected Capital Gain:*** ***Expected Div Yield:*** ***Expected Total Return:***	*9.1%* *5.3%* *14.4%*
Current Price:	*RM 1.65*		

Analyst: Bryan Chan*| Tel: +603 2163 3200; Email: chanb@bcta.com.my*

Key Stock Statistics	**2018**	**2019**	**2020F**	**2021F**
EPS (sen)	8.7	11.1	12.8	14.5
P/E (x)	19.0	14.8	12.9	11.4
EPS ex-EI (sen)	15.7	17.1	19.9	23.0
P/E ex-EI (x)	10.5	9.7	8.3	7.2
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				30.8%
Average volume (shares)				195.22k

Per Share Data	**2018**	**2019**	**2020F**	**2021F**
Year-end 31 March				
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)	19.0	14.8	12.9	11.4
P/Cash Flow (x)	(19.2)	(9.1)	10.1	10.1
P/Book Value (x)	1.24	1.19	1.15	1.10
Dividend Yield (%)	3.9	4.2	4.7	5.3
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. 1QFY20 Results Highlight

	1Q FY20 RMm	**1Q FY19 RMm**	**Chg %**
Revenue	35.2	28.8	22.1
Impairment Allowance	(4.7)	(3.9)	19.6
Finance cost	(1.6)	(0.7)	121.4
Pre-tax Profit	12.3	10.7	14.6
Net Profit	9,3	8.1	14.9
Core Profit without Impairment	12.8	11.1	15.6
Pre-tax Margin (%)	34.9	37.2	
Net Margin (%)	26.4	27.8	
Core Margin (%)	36.4	38.4	

- 1QFY20 group revenue improved 22.1% y-o-y to RM35.2m while net profit increased by 14.9% y-o-y to RM9.3m. The good set of results was attributable to both better performance in the Hire Purchase (HP) and furniture divisions. However, a lower margin was recorded due to higher finance cost. Stripping off forex gains and impairment allowance, its core margin was 2.0ppt lower at 36.4% as compared to 38.4%, with y-o-y growth of 15.6% in core profit.

- For the HP segment, revenue grew 20.6% y-o-y to RM11.9m as HP receivables registered notable growth of 24.3% y-o-y from RM412.8m to RM513.0m. PBT improved at a lower rate of 13.0% y-o-y to RM11.9m due to higher staff costs attributed to a larger workforce post portfolio expansion, as well as higher finance cost.

Total borrowings jumped 127.6% y-o-y to RM127.4m due to a more proactive capital management strategy to leverage up for growth. This has brought on a higher drawdown of block discounting facility to finance hire purchase receivables. Meanwhile, credit loss charge remains low, decreasing further from 0.97% to 0.94% y-o-y as a result of the group's strong management in credit recovery, and also partly due to a stable domestic economic environment.

- In the furniture segment, revenue grew 25.6% y-o-y to RM11.2m driven by higher domestic sales, which remains the main focus for the business. PBT jumped 119.6% y-o-y as a result of the higher sales and greater economies of scale. Management has emphasised that this is currently just a pilot project and that the core focus remains in the HP operations. This furniture venture can potentially be a stepping stone to explore opportunities in the furniture HP business should it be feasible in the longer run.

	1Q FY20 RMm	4Q FY19 RMm	Chg %
Revenue	35.2	32.5	8.4
Impairment Allowance	(4.7)	(4.9)	(4.1)
Finance cost	(1.6)	(1.5)	10.2
Pre-tax Profit	12.3	11.4	7.6
Net Profit	9.3	8.5	9.0
Core Profit without Impairment	12.8	12.1	5.7
Pre-tax Margin (%)	34.9	35.2	
Net-Margin (%)	26.4	26.2	
Core Margin (%)	36.4	37.3	

- On q-o-q basis group revenue grew 8.4%, with the furniture segment growing 11.9% and the HP business increasing by 6.8%. PBT improved 7.6% q-o-q, partly due to 43.0% q-o-q improvement in the furniture segment's PBT, attributed to higher economies of scale and lower impairment allowance. Net profit registered a wider improvement of 9.0% q-o-q growth on lower effective tax rate of 24.5% as compare to 25.5% in 4QFY19.
- The group's 1QFY20 net profit of RM9.3m came in within our expectations, making up 24.4% of our full year estimate of RM37.9m. Hence, we are maintaining our earnings forecast. No dividend was proposed during the quarter.

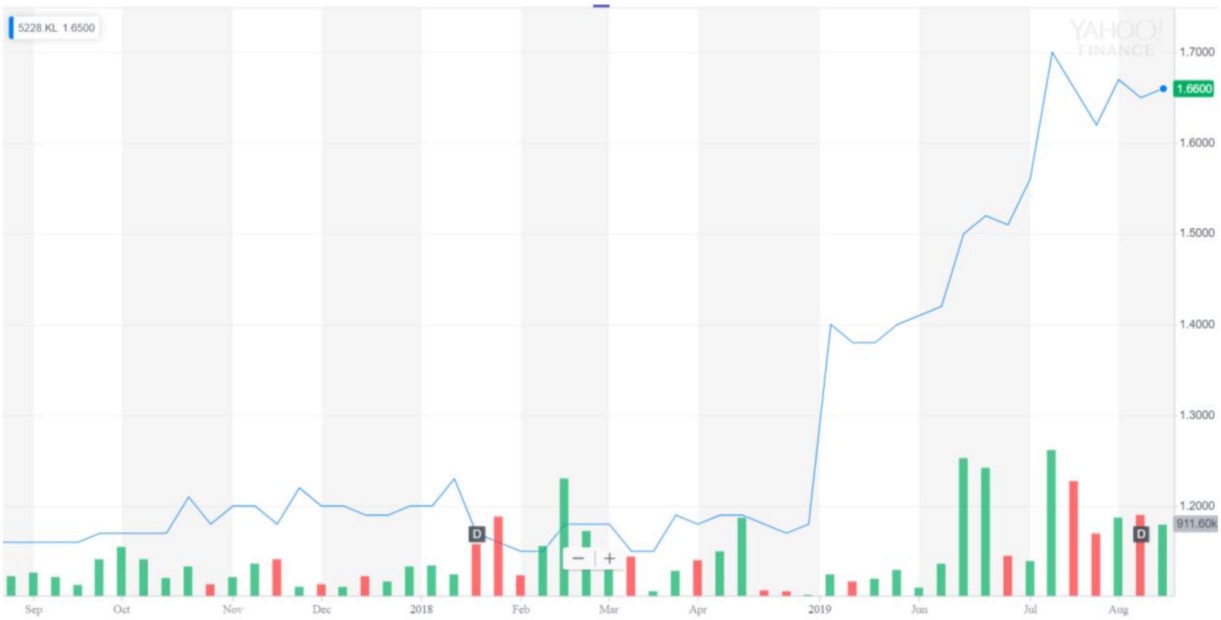
2. Earnings Outlook

- 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, delivering healthy organic growth on the back of steady demand for its HP loans. Previously relying on equity capital to grow its HP portfolio, the Group recently entered into the debt capital market with the establishment of a Medium-Term Notes (MTNs) facility of up to RM1 billion in nominal value. This has enabled the Group to broaden its HP portfolio to penetrate the segment of second-hand vehicles valued above RM20,000 to much success. Note that the Group has historically focused on second-hand vehicles valued at RM20,000 or lower.
- Medium term, this strategy of leveraging on the debt market and broadening its market segments is expected to deliver sustained growth in its net HP receivables. We view this positively as the Company has traditionally been conservative on utilising leverage, resulting in low ROEs. For now, we are projecting annual HP disbursements of RM267m and RM321m for FY20-21E. Correspondingly, we assume net HP receivables of RM588m and RM705m for FY20-21E respectively. We also project double digit revenue and net profit growth for furniture segment for the next 2 years. We maintain our earnings estimates of RM37.9m and RM42.9m for FY20-21E.

3. 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 TP of RM1.80 based on unchanged P/BV ratio of 1.2x. 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.

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)

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