ELK-Desa Resources (ELK MK)

Cease coverage
Up/Downside: -

Price Target: -
Previous Target (Rating): RM1.54 (HOLD)

FMCO impact weakened 1QFY22 results

- **ELK-Desa's 1QFY22 net profit came in at RM5m (+300% yoy; -65% qoq) and was deemed below our expectations, accounting for 13.2% of our FY22E net profit forecast**
- **Outstanding hire-purchase receivables continued to decline as ELK stayed cautious while the impact of the FMCO and high COVID-19 cases had severely dampened demand for used-car financing. We saw net credit cost spiking up in 1QFY22 compared to some recoveries seen in 4QFY21**
- **We are ceasing coverage on ELK due to its lack of liquidity and as we reprioritize our resources**

1QFY22 results came in below our expectations

ELK's 1QFY22 PAT came in at RM5m, higher by +300% yoy but was 65% lower qoq, largely attributable to changes in impaired loan provisions. In 1QFY22, provisions of RM8.3m were down by 41.2% yoy though rose by 31% qoq as a result of a higher level of pre-emptive buffer set aside in 1QFY21, while in 4QFY21, there was also a significant amount of recoveries from its collection due. In terms of receivables net credit cost (NCC), 1QFY22 came in at an annualized 645bps vs. 900bps in 1QFY21 and 91bps in 4QFY21. As a result of the reinstatement of the lockdown, under a stricter FMCO and with higher number of COVID-19 cases, we saw outstanding receivables weaker, at lower by 10% yoy and 2.7% qoq.

Assumptions based on our last report

In our last report dated 5 June 2021, we had FY22E-24E assumptions of 5.5-6.0% for ELK's receivables growth and NCC of 350-375bps. In ELK's FY21 annual report, management disclosed that its gross NPL ratio had spiked up from 1.4% (FY20) to 4.9%, which we believe was underpinned by a huge backlog of accounts which have been credit-impaired while ELK could not repossess these cars due to the restriction on repossession activities imposed by the government.

Cease coverage due to liquidity issue and reprioritizing of resources

We cease coverage on ELK due to a lack of liquidity and interest, while simultaneously reprioritizing our resources. Our last rating on ELK was **HOLD** with a PT of **RM1.54** (premised on a 5-year mean P/E of 12x on CY22E EPS of 12.8 sen). In the near term, we do not foresee a robust expansion in ELK's receivables book, as management remains prudent in its approach though the demand for used cars may see a comeback once the states of Selangor and Kuala Lumpur enter the recovery phase.

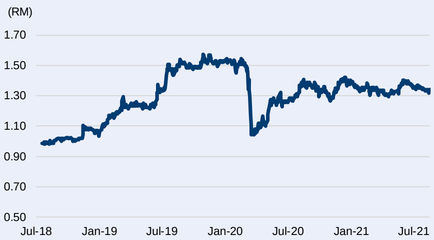
Earnings & Valuation Summary

FYE 31 Mar	2020	2021	2022E	2023E	2024E
Revenue (RMm)	148.0	143.8	148.5	153.3	160.4
Net operating income (RMm)	60.0	56.4	59.9	61.8	66.0
Pretax profit (RMm)	47.5	46.0	49.9	51.3	54.6
Net profit (RMm)	34.9	35.3	37.9	39.0	41.5
EPS (sen)	11.8	11.9	12.8	12.9	13.7
FD EPS (sen)	11.8	11.9	12.6	12.9	13.7
FD EPS growth (%)	7.7	0.9	6.1	2.2	6.4
FD PER (x)	11.4	11.3	10.6	10.4	9.8
ROE (%)	8.3	8.1	8.4	8.3	8.4
P/BV (x)	0.94	0.90	0.87	0.83	0.80
Net DPS (sen)	7.25	7.25	7.8	8.0	8.5
Dividend Yield (%)	5.4	5.4	5.8	6.0	6.3
Chg in EPS (%)			-	-	-
Affin/Consensus (x)			NA	NA	NA

Source: Company, Affin Hwang estimates

"Though downside risks on asset quality are well-buffered, ELK is still playing it safe"

Share price performance



	1M	3M	12M
Absolute (%)	-0.7	-1.5	-7.6
Rel KLCI (%)	-0.4	2.8	-3.9

	BUY	HOLD	SELL
Consensus	-	1	-

Stock Data

Sector	Financial services
Issued shares (m)	297.2
Mkt cap (RMm)/(US$m)	398.7/94
Avg daily vol - 6mth (m)	0.1
52-wk range (RM)	1.32-1.48
Est free float	34.7%
Stock Beta	0.74
Net cash/(debt)	(53.9)
ROE (FY22E)	6.5%
Derivatives	Nil
Shariah Compliant	No
FTSE4Good Constituent	No
FBM EMAS (Top 200)	N/A
ESG Rank	
ESG Risk Rating	29.1

Key Shareholders

Teo Hock Chai	37.5%
Amity Corporation	5.1%

Source: Bloomberg, Affin Hwang, Bursa Malaysia, ESG Risk Rating Powered by Sustainalytics

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Fig 1: Results Comparison

FYE Mar (RMm)	1QFY21	4QFY21	1QFY22	QoQ % chg	YoY % chg	Comments
Revenue	**30.4**	**38.8**	**31.4**	*(19.0)*	*3.2*	
- Hire purchase	23.5	23.5	22.9	*(2.6)*	*(2.5)*	1QFY22 hire purchase income declined 2.5% yoy and 2.6% qoq as HP receivables outstanding were 10% lower yoy and 2.7% lower qoq.
- Furniture	6.9	15.3	8.5	*(44.3)*	*22.5*	Furniture sales dipped qoq due to the impact of the FMCO, though improved yoy.
Operating expense	(24.9)	(21.8)	(22.2)	*1.7*	*(11.1)*	The group incurred higher cost of goods sold (for the furniture unit); impaired loan allowances were 41% lower yoy though significantly higher qoq; and other expenses were 31% higher yoy
Other income	0.5	3.2	0.2	*(92.9)*	*(57.6)*	
EBIT	**6.0**	**20.1**	**9.4**	*(53.1)*	*57.1*	
EBIT margin (%)	*19.8*	*51.9*	*30.1*	*(21.8)*	*10.3*	1QFY22 EBIT margin declined sharply qoq due to the higher impaired loan allowances (due to a recovery in 4QFY21).
Net finance cost	(3.3)	(2.6)	(2.5)	*(2.4)*	*(23.4)*	
Pre-tax Profit	**2.7**	**17.5**	**6.9**	***(60.6)***	***155.2***	Pre-tax profit from the hire purchase segment at RM7.1m while furniture was loss-making at RM0.2m
Taxation	(1.5)	(3.4)	(1.9)	*(42.3)*	*32.5*	
Tax rate (%)	*54.2*	*19.2*	*28.1*	*8.9*	*(26.0)*	
Net profit	**1.2**	**14.2**	**5.0**	*(64.9)*	*300.2*	Results were below our expectations. Accounted for 13.2% of our FY22E net profit forecast
Core net profit	**1.2**	**14.2**	**5.0**	*(64.9)*	*300.2*	
EPS (sen)	**0.42**	**4.77**	**1.67**	*(64.9)*	*299.9*	
Core EPS (sen)	**0.42**	**4.77**	**1.67**	*(64.9)*	*299.9*	
DPS (sen)	**-**	**4.75**	**-**	*n.m.*	*n.m.*	
Net yield (%)	-	3.5	-	*n.m.*	*n.m.*	

Source: Affin Hwang, Company

Important Disclosures and Disclaimer

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

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