

## ELK-Desa Resources Bhd

### Reputable hire purchase financier

- ELK-Desa Resources Bhd (ELK) is a reputable hire purchase financier backed by over 1,000 extensive dealers' network in the underserved niche used motor vehicle industry, registering 11.5% CAGR in HP receivables between FY17-21.
- Capitalising on low gearing, ELK is in a position to expand hirers' base by tapping into the debt capital market as soon as the crisis is over, while exercising prudence execution to preserve the asset quality and achieve steady growth.
- We initiate coverage on ELK with a BUY call and fair value of RM1.52, based on 0.95x P/B pegged to its forward FY23f book value per share of RM1.60.

### Investment Highlights

- **Reputable hire purchase financier in niche market.** We like ELK's position as (i) a prudent hire purchase financier focused on the niche used car market, (ii) it has more than 17 years' experience in the competitive industry and (iii) its extensive dealer network comprised of more than 1,000 dealers. Meanwhile, a report by Ken Research suggested that the Malaysian used cars market is anticipated to witness a CAGR of 2.1% during 2020-2025 in terms of number of used cars sold.
- **Strong growth in hire purchase receivables.** ELK registered a CAGR of 11.5% on hire purchase receivables in FY17-21 with a healthy asset quality. Non-performing loan (NPL) ratio has been declining over the past years and became on par with the financial institution in FY19. The NPL ratio has declined in 1QFY22 after a spike in FY20-21 due to Covid-19 pandemic.
- **Ample potential to leverage up.** ELK's gearing at 0.44 in FY21 was significantly lower than that of the peers' average at 3.12, implying its relatively successful efforts in debt level management. The low gearing ratio gives it ample potential to leverage up and expand its hire purchase business.

**Fig #1 Financial highlights**

FYE Dec (RM m)	FY19	FY20	FY21	FY22f	FY23f
Revenue	123.4	148.0	143.8	158.6	186.1
EBITDA	47.7	60.0	59.6	62.1	73.3
PATMI - Core	32.9	34.9	35.3	37.4	43.2
PATMI - Reported	32.9	34.9	35.3	37.4	43.2
Revenue growth (%)	18.5%	19.9%	-2.9%	10.3%	17.3%
Core PATMI growth (%)	27.0%	6.0%	1.1%	5.9%	15.7%
Core EPS (sen)	11.1	11.7	11.9	12.6	14.5
P/E (x)	12.7	12.0	11.9	11.2	9.7
DPS (sen)	7.0	7.2	7.3	7.5	8.7
Dividend yield (%)	5.0%	5.1%	5.1%	5.4%	6.2%
P/B (x)	1.0	1.0	0.9	0.9	0.9
ROE (%)	8.2%	8.3%	8.1%	8.3%	9.3%
Net Gearing (%)	0.2	0.5	0.2	0.3	0.5

Source: Company, M+ Online, Bloomberg

### Initiation Coverage

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Share price	RM1.41
Target price	RM1.52
Previous TP	-
Capital upside	7.8%
Dividend return	6.2%
Total return	14.0%

### Company profile

Principally involved in the hire purchase (HP) financing for used car motor vehicles and furniture trading.

### Stock information

Bursa Code	5228
Bloomberg ticker	ELK MK
Listing market	MAIN
Share issued (m)	300.0
Market Cap (m)	423.0
52W High/Low	1.48 / 1.32
Est. Free float	34.7
Beta	0.5
3-mth avg vol ('000)	78.5
Shariah compliant	No

### Major shareholders

	%
ENG Lee Kredit Sdn Bhd	32.8
Amity Corp Sdn Bhd	5.1
Teo Siew Lai	3.5

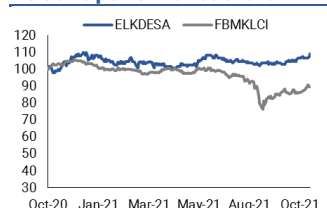
### Share price vs. KLCI (%)

	1M	3M	12M
Hist. return	3.7	4.4	1.4
Absolute	0.0	-0.5	-4.5
Relative			

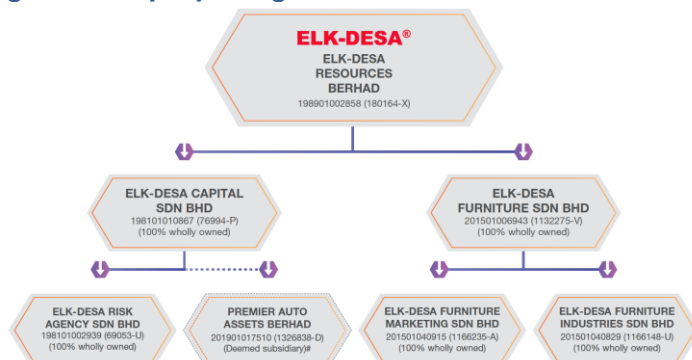
### Earnings snapshot

FYE (Dec)	FY21	FY22f	FY23f
PATMI (m)	35.3	37.4	43.2
EPS (sen)	11.9	12.6	14.5
P/E (x)	11.9	11.2	9.7

### Relative performance chart



**Fig #2 Company background**



Source: Company

- **More than 17 years of experience in the hire purchasing industry.** ELK is a non-bank financial institution founded in 2004, principally involved in the provision of hire purchase solutions for used car motor vehicles. The group made its debut on the Main board of Bursa Malaysia Securities Bhd in 2012, and subsequently ventured into furniture business in July 2015. ELK operates its hire purchase and furniture divisions via ELK-Desa Capital Sdn Bhd and ELK-Desa Furniture Sdn Bhd respectively.
- **Expanding car dealers' network with focus in Klang Valley.** ELK expands its hire purchase business primarily through referral from its extensive dealers' network. Over the years, the group has widened its network of motor vehicle dealers of over 1,000 in 2021. Meanwhile, Klang Valley remains as its main targeting area as Selangor and Kuala Lumpur accounted the largest market share in terms of used car sales volume.
- **Business strategies focused on business sustainability...** ELK embedded a prudent approach in the selection of used vehicle to ensure better asset quality over quantity, this has allowed the group to lower its non-performing loan (NPL) ratio over years prior to the pandemic.
- **...with a solid dividend policy.** Meanwhile, the group is committed to deliver its dividend policy of distributing not less than 60.0% of the group's annual net profits.
- **Ventured into furniture division.** ELK ventured into the furniture business in July 2015. In FY16-21, the group has successfully expanded its distributing network from more than 300 to over 800 furniture retail outlets. The hire purchase business, however remains as its core, representing over 90% of earnings in FY17-21.

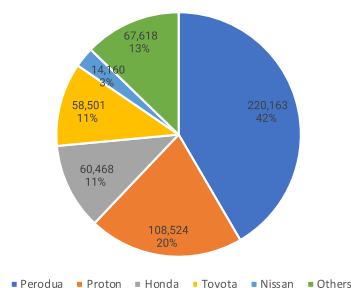
## Business Model

- **Hire purchase financing.** Hire purchase financing is ELK's core business, comprising 64.9% or RM93.3m of the group's revenue in FY21. In terms of net profit, hire purchase financing makes up 90.6% of its bottom line in FY21. As a natural extension of its hire purchase business, ELK also offers general insurance products through its wholly-owned subsidiary, ELK-Desa Risk Agency Sdn Bhd.

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- **Targeting small value financing market.** The group targets specifically the used motor vehicles buyers who are seeking small value financing, which include low-to-middle income and self-employed individuals, which is a niche market underserved by the typical financial institution. The financing amount was capped at RM35,000 and the rate was fetched based on vehicle age and borrower's profile.
- **Focusing on top 5 vehicle brands.** According to Ken Research, Perodua is the market leader in Malaysia accounting for 32.0% of the sales of used cars by volume, followed by Proton, Toyota, Honda and Nissan due to strong brand value, reliability, and higher retention value. ELK's primary focus on these 5 vehicle brands of used vehicles allows the group to capture huge portion of the market share. Similarly, in the year 2020 for the new car sales, the abovementioned 5 vehicle brands accounted for 85% of the total car sales.

**Fig #3 Vehicle sales performance in Malaysia, 2020**



Source: paultan.org, M+ Online

- **Readily available source of funds.** ELK sources its funds via block discounting payable, medium term notes, ICULS, and bank overdrafts, bearing interest at rates ranging from 3.25% to 5.49% per annum in FY21. Meanwhile, the effective hire purchase interest rate was around 17.0%. To expand its hire purchase financing business, ELK tapped into the debt capital market for borrowings in FY20 via the 10-year medium term notes (MTN) programme of up to RM1.00bn in nominal value.

**Fig #4 Source of funds, FY17-21**

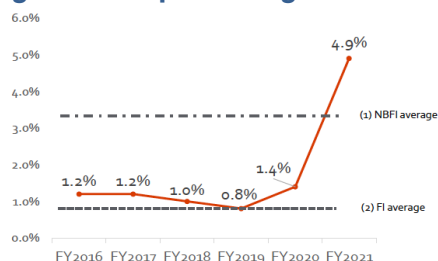
Source of funds	2017	2018	2019	2020	2021	FY21 Interest rate (%)
Block discounting payable - secured	82.2%	95.7%	99.5%	59.1%	64.7%	4.73-5.49
Medium term notes	0.0%	0.0%	0.0%	34.6%	27.7%	4.65-5.35
Borrowings - Others	0.0%	0.0%	0.0%	6.2%	7.4%	4.15-4.97
ICULS - liability component	15.8%	4.3%	0.5%	0.1%	0.1%	3.25
Bank overdrafts	2.0%	0.0%	0.0%	0.0%	0.0%	4.97
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	

Source: Company, M+ Online

- **A better asset quality over years prior to Covid-19 pandemic.** ELK's stringent credit management policy, coupled with its broad hirer base, which saw an expansion of 37.5% to 44,000 in FY17-20, have allowed the group to reduce credit risk and have a better control on its asset quality. Prior to the pandemic (FY17-FY19), its non-performing loan (NPL) ratio has seen declining from 1.2% to 0.8%, which was significantly lower than the non-bank financial institution average and on par with the typical financial institution average. As a result, its loan loss coverage has increased from 289.0% to 359.0% over the same period, providing a strong buffer for the group against future credit losses.

- **Challenging operating landscape during pandemic.** Intermittent lockdowns in Malaysia have affected ELK's hire purchase operations and the hirers' ability to fulfil their repayment commitment. As at 31<sup>st</sup> March 2021, the group's NPL ratio increased to 4.9% while its loan loss coverage declined to 121.0%, which still provides a strong buffer against future credit losses.

**Fig #5 Non-performing loan ratio comparison, FY16-FY21**



Source: Company, M+ Online

(1) Based on two closest listed non-bank financial institution (NBFI) average (Source: company data)

(2) Based on purchase of passenger cars only (Source: BNM)

- **Stable growth in asset quality.** To preserve the quality of its assets, ELK (i) remained firm in minimising its credit risk via broad hirer base, (ii) further enhanced its credit management policy while monitoring repayments closely, and (iii) offered assistance to those eligible borrowers such as paying a minimum monthly instalment for a specified period. Notably, the group is not impacted by interest payments waiving during the moratorium period.

**Fig #6 Asset quality, FY17-21**

Asset quality	2017	2018	2019	2020	2021
Hirer base	32,000	34,000	38,500	44,000	41,000
Average outstanding net hp receivables per hirer (RM)	11,000	12,000	13,000	14,300	13,500
Non-performing loans ratio (NPL) (%)	1.2%	1.0%	0.8%	1.4%	4.9%
Loan loss coverage (%)	289%	342%	359%	220%	121%

Source: Company, M+ Online

- **Furniture division.** ELK's furniture division focuses on the domestic wholesale market, distributing furniture products manufactured by local or overseas manufacturers under its own house brand ELK-DESA. Its extensive dealers' network comprises of more than 800 furniture retailers throughout Malaysia. Besides, ELK has two furniture retail showrooms located in Klang, Selangor.

**Fig #7 Furniture division**



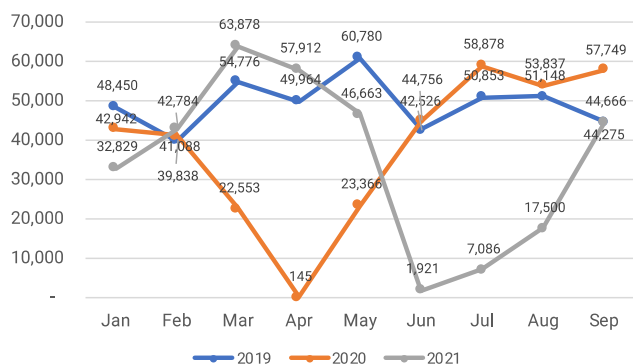
Source: Company, M+ Online



## Outlook

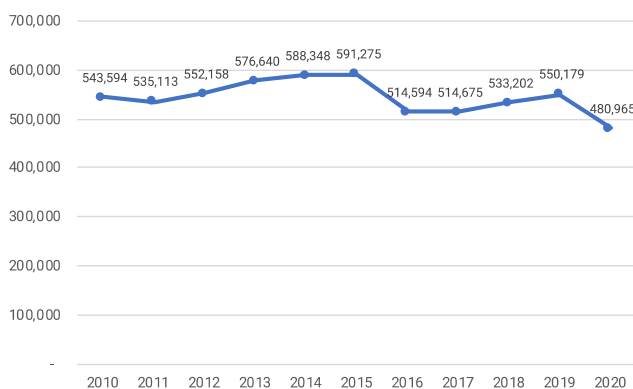
- Focus on assets quality while gradually increasing the hire purchase receivables.** In the most recent quarter ended 30<sup>th</sup> June 2021 (1QFY22), ELK's hire purchase receivables declined 10.4% YoY to RM508.9m as hire purchase disbursements were tightened, which was in line with the group's strategy to exercise prudence to preserve asset quality. Nevertheless, its net profit jumped 116.2% YoY, thanks to the lower impairment allowance in hire purchase segment resulted from a decrease in non-performing accounts. Whilst investors may see encouraging collection trend following the economic reopening, ELK looks forward to gradually increase its hirer base while maintaining its cautious stance.
- Favourable market environment supports growth.** As illustrated in the graph below, the reopening of automotive market since mid-August 2021 has driven Malaysia's total motor vehicle sales by 153.0% MoM to 44,275 in September 2021. According to Federation of Motor and Credit Companies Association of Malaysia, the annual sales of used car has been hovering around 400,000 units, accounting for around 65.0%-85.0% of the sales of new cars hovering (more than 500k in the recent years, except 2020 due to Covid-19 pandemic). Hence, the recovery in sales of new vehicles bodes well for used car demand as well as ELK's hire purchase business.

**Fig #8 Malaysia's monthly motor vehicles sales**



Source: CEIC Data, M+ Online

**Fig #9 New passenger vehicles registered in Malaysia, 2010-2020**



Source: Malaysian Automotive Association, M+ Online

- **In position to grow hire purchase business.** Once the Covid-19 crisis is over, we expect ELK to draw more funds into the group via the RM1.00bn MTN programme established in FY20, facilitating further expansion for the hire purchase business. Meanwhile, ELK's low gearing ratio at 0.44 in FY21 provides the group with the flexibility to tap further into the debt capital market.

**Fig #10 Gearing ratio comparison FY21**

Company	2021
ELK-Desa Resources Bhd	0.44
RCE Capital Bhd	2.16
Aeon Credit Service (M) Bhd	4.08
<b>Avg ex-ELK-Desa Resources Bhd</b>	<b>3.12</b>

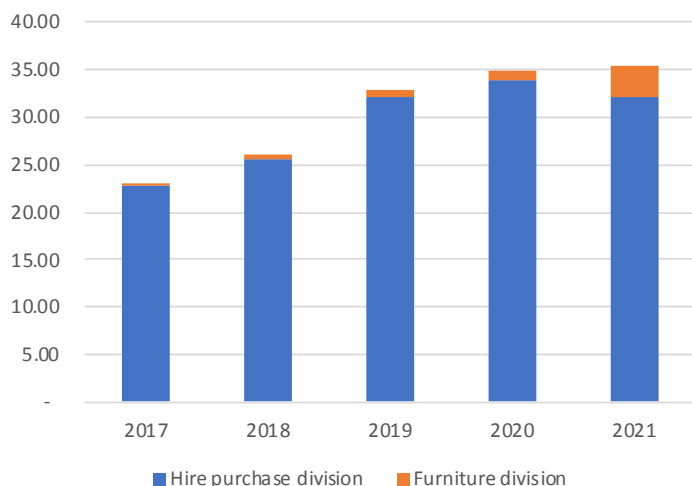
Source: Company, M+ Online, Bloomberg

- **Aims to focus on overcoming supply chain issues for furniture division.** The demand for home furniture is expected to remain resilient as new lifestyle will see more people working or studying from home. However, supply chain disruptions and rising material costs may continue to hamper the industry. ELK aims to focus on overcoming these supply chain issues by working closely with suppliers.

## Financials

- **Decent earnings growth at 11.3% CAGR in FY17-21.** Core net profit stood within the range of RM23.0-35.3m, with more than 90.0% contributed by the hire purchase division. The growth in FY17-20 was mainly boosted by the larger hirer base and higher hire purchase receivables, while the growth in FY21 was attributed from the higher net income from furniture division due to better repayment effort by furniture dealers.

**Fig #11 ELK-Desa's net profit by division, FY17-FY21 (RM'm)**



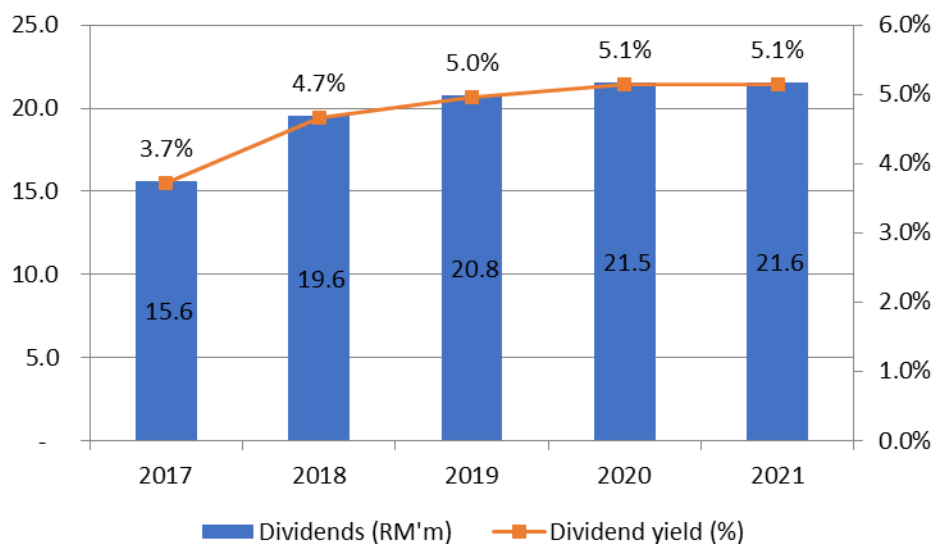
Source: Company, M+ Online

- For FY22-23f, we expect bottomline to grow by 5.9% and 15.7% YoY to RM37.4m and RM43.2m, respectively. In 1HFY22, we may expect ELK maintaining the level of hire purchase receivables with prudence instead of driving receivables growth, but we reckon the hirer base will expand gradually in the subsequent quarters following the reopening of economic activities. For FY23f, the economy should normalise towards pre-pandemic activity levels. Meanwhile, we reckon that the hire purchase disbursement will loosen and gearing level will be higher.

## Valuations

- At RM1.41, ELK is trading at P/B of 0.92x and 0.88x for FY22f and FY23f, respectively. We assigned a P/B of 0.95x to FY23f book value per share of RM1.60, arriving a fair value of RM1.52. The assigned target P/B represents a 35% discount to the average P/B of non-bank financial institutions listed on Bursa Malaysia.
- Attractive dividend yields.** ELK's dividend yield has been increasing from 3.7% to 5.1% in FY17-FY21 in tandem with its net profit growth. Moving forward, we expect the group to uphold its dividend policy of distributing not less than 60% of the net profits, bringing the dividend yield to 5.4% and 6.2% respectively in FY22f-23f.

**Fig #12 ELK-Desa's dividend yield, FY17-21**



Source: Company, M+ Online

**Fig #13 Peers comparison**

Company	Market Group	FYE	Price (RM)	Market Cap (RM'm)	P/E (x)		P/B (x)		Gross DY (%)	ROE (%)	ROA (%)
					FY22	FY23	FY22	FY23			
ELK-Desa Resources Bhd	MAIN	Mar	1.41	419.0	11.2	9.7	0.9	0.9	6.19	9.0	5.8
RCE Capital Bhd	MAIN	Mar	3.34	1219.4	9.5	9.0	1.4	1.4	3.89	18.7	5.7
Aeon Credit Service (M) Bhd	MAIN	Feb	13.88	3543.7	9.8	10.2	1.8	1.6	3.49	29.3	4.9
Avgex-ELK-Desa Resources Bhd					9.7	9.6	1.6	1.5	3.69	24.0	5.3

Source: Company, M+ Online

## Investment risks

- **Dependence on economic environment in Malaysia.** Both hire purchasing and furniture divisions are dependent on economic condition which is correlated to consumer confidence and spending habits. Any further lockdowns may dampen the demand in motor vehicles market and furniture industry, eventually affect ELK's bottomline.
- **Failure to preserve asset quality.** ELK's hire purchasing business faces credit risks that arise from hirers' ability to fulfil loan obligation. Failure to preserve asset quality may lead to higher risks of default by hirers and subsequently drives its non-performing loans ratio.
- **Regulated under the Hire Purchase Act 1967.** Any unfavourable terms of amendment to the Hire Purchase Act 1967 could potentially post challenges for the ELK's hire purchase business, if the group is unable to react quickly to the changes.

## Financial Highlights

Income Statement						Balance Sheet					
FYE Dec (RM m)	FY19	FY20	FY21	FY22f	FY23f	FYE Dec (RM m)	FY19	FY20	FY21	FY22f	FY23f
Revenue	123.4	148.0	143.8	158.6	186.1	Cash	31.4	91.6	86.6	87.8	61.2
EBITDA	47.7	60.0	59.6	62.1	73.3	Receivables	488.0	624.3	540.1	584.7	695.0
EBIT	46.8	57.7	56.9	58.2	68.8	Inventories	11.1	12.4	9.1	14.1	16.1
Net finance income/ (cost)	(2.9)	(10.2)	(10.9)	(9.1)	(11.9)	PPE	10.7	10.6	11.1	11.1	11.0
Associates & JV	-	-	-	-	-	Others	6.5	11.6	16.1	13.6	12.6
Profit before tax	43.8	47.5	46.0	49.2	56.9	Assets	547.6	750.6	663.0	711.2	796.0
Tax	(10.9)	(12.6)	(10.7)	(11.8)	(13.7)	Debits	114.9	299.8	195.8	226.8	292.0
Net profit	32.9	34.9	35.3	37.4	43.2	Payables	13.9	11.2	8.1	10.9	12.5
Minority interest	-	-	-	-	-	Others	7.8	14.5	17.3	16.7	17.4
Core earnings	32.9	34.9	35.3	37.4	43.2	Liabilities	136.6	325.5	221.2	254.4	321.9
Exceptional items	-	-	-	-	-	Shareholder's equity	343.2	344.3	344.4	344.4	344.4
Reported earnings	32.9	34.9	35.3	37.4	43.2	Minority interest	-	-	-	-	-
						Equity	410.9	425.1	441.8	456.8	474.1
Cash Flow Statement						Valuation & Ratios					
FYE Dec (RM m)	FY19	FY20	FY21	FY22f	FY23f	FYE Dec (RM m)	FY19	FY20	FY21	FY22f	FY23f
Profit before taxation	43.8	47.5	46.0	49.2	56.9	Core EPS (sen)	11.1	11.7	11.9	12.6	14.5
Depreciation & amortisation	0.9	2.3	2.7	3.8	4.5	P/E (x)	12.7	12.0	11.9	11.2	9.7
Changes in working capital	(110.7)	(163.7)	64.3	(47.7)	(111.1)	DPS (sen)	6.99	7.25	7.26	7.55	8.73
Share of JV profits	-	-	-	-	-	Dividend yield	5.0%	5.1%	5.1%	5.4%	6.2%
Taxation	(10.9)	(12.6)	(10.7)	(11.8)	(13.7)	BVPS (RM)	1.38	1.43	1.49	1.54	1.60
Others	4.3	8.4	8.9	2.3	0.7	P/B (x)	1.0	1.0	0.9	0.9	0.9
Operating cash flow	(54.0)	(92.8)	132.2	(4.2)	(62.7)	EBITDA margin	38.6%	40.5%	41.5%	39.1%	39.4%
Net capex	(4.3)	(0.9)	(1.8)	(1.2)	(1.2)	EBIT margin	37.9%	39.0%	39.6%	36.7%	37.0%
Others	1.3	(64.4)	13.8	-	-	PBT margin	35.5%	32.1%	32.0%	31.0%	30.6%
Investing cash flow	(3.0)	(65.5)	8.3	(3.2)	(3.2)	PAT margin	26.7%	23.6%	24.5%	23.6%	23.2%
Changes in borrowings	62.0	184.8	(103.9)	31.0	65.2	Core PAT margin	26.7%	23.6%	24.5%	23.6%	23.2%
Issuance of shares	35.7	1.2	0.1	-	-	ROE	8.2%	8.3%	8.1%	8.3%	9.3%
Dividends paid	(20.8)	(21.5)	(21.6)	(22.4)	(25.9)	ROA	6.5%	5.4%	5.0%	5.4%	5.7%
Others	(38.8)	(13.0)	(12.2)	-	-	Net gearing	20.3%	49.0%	24.7%	30.4%	48.7%
Financing cash flow	38.2	151.4	(137.6)	8.5	39.3						
Net cash flow	(18.9)	(6.9)	2.8	1.2	(26.6)						
Forex	-	0.0	(0.0)	-	-						
Others	-	67.1	(7.8)	-	-						
Beginning cash	50.3	31.4	91.6	86.6	87.8						
Ending cash	31.4	91.6	86.6	87.8	61.2						

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