

22 August 2022

Financial Services | Diversified Financial Services

ELK-Desa Resources (ELK MK)

Buy (From Neutral)

Recovery Is In Session; Upgrade To BUY

Target Price (Return): MYR1.60 (+19%)
Price (Market Cap): MYR1.35 (USD91.4m)
ESG score: 3.00 (out of 4)
Avg Daily Turnover (MYR/USD) 0.12m/0.03m

- **Upgrade to BUY from Neutral, new MYR1.60 TP from MYR1.30, 19% upside with c.5% yield.** ELK-Desa Resources' 1QFY23 (Mar) results came in above expectations, at 63% of our and Street full-year forecasts. The beat came from a MYR5m reversal of impairment allowances, and improvements in both the hire purchase (HP) and furniture divisions. We believe a recovery scenario is finally underway for the company, and upgrade our stock rating as a result.
- **Results review.** ELK-Desa's 1QFY23 results are stronger than expected, with net earnings of MYR17.6m coming in at 63% of our and Street full-year forecasts. The strong results beat was mainly due to a MYR5.3m reversal of impairment allowances, thanks to a recovery in collection productivity from the hire purchase (HP) division. Annualised ROAE stood at 15.6%, against the previous quarter's 3.8% (1QFY22: 4.6%).
- **HP segment.** HP receivables rose by 7% QoQ (YoY: -1%), marking a turnaround following eight straight quarters of decline. As a result, net interest income grew by 16% QoQ (YoY: +14%). 1QFY23 also saw a significant drop in non-performing accounts, as customers returned to their repayment schedules following the full reopening of the economy. Customers' repayability was also boosted by the Employees Provident Fund special withdrawal programme, per management. A MYR5.4m reversal of impairment allowances was made, leading to negative (annualised) credit costs of -392 bps (4QFY22: +508 bps, 1QFY22: +572 bps), and a PBT of MYR22m for the quarter, up >200% QoQ and YoY.
- **Furniture segment.** Revenue surged 70% YoY (flat QoQ), largely due to the low 1QFY22 base as a result of lockdown measures. PBT for the quarter stood at MYR1.4m (1QFY22: MYR0.2m loss, 4QFY22: MYR0.8m profit), making up 47% of our full-year forecast for the division. Furniture segment contributions formed 5.9% of the group's PBT for the quarter.
- **We lift FY23-25 forecasts by 13-24%** after imputing the latest financials. This is driven by upward revisions in both divisions (Figures 2 and 3) after the group recorded stronger-than-expected results. Guidance for HP receivables growth of 5-10% in FY23F was kept, which we deem conservative, as the company has already achieved 7% YTD growth in the first quarter alone. As such, we lift our receivables growth forecast to 12% from 3%. Our new FY23F earnings would generate a full-year ROAE of 7.64% (from 6.14%) – which points to an encouraging improvement.
- **Upgrade to BUY with a new TP of MYR1.60** (from MYR1.30), based on 1.0x FY23F P/BV with a parity ESG premium/discount. The resounding earnings beat leads us to believe that the company has finally entered recovery mode. The stock is trading at 0.89x FY23F P/BV – a significant discount to its non-bank peers' 1.4-1.6x. Its FY22-FY25F earnings CAGR of 17% is higher than its peers' 3-11%. This, coupled with a dividend yield of 5%, makes for an attractive BUY.

Analysts

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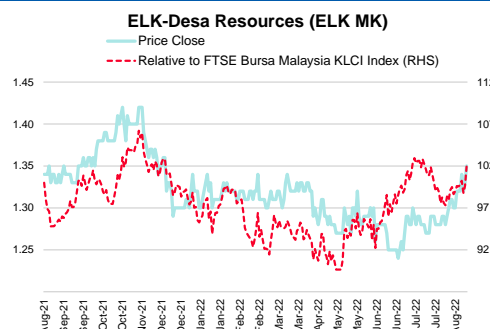


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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	2.3	6.3	4.7	2.3	0.7
Relative	6.3	1.0	7.6	8.5	1.4
52-wk Price low/high (MYR)				1.24 – 1.42	



Source: Bloomberg

Overall ESG Score: 3.00 (out of 4)

E: GOOD

ELK-Desa financing has low exposure to high-environmental-risk sectors, as it mainly finances the purchases of used vehicles. The company recorded a 24% decrease in electricity consumption in FY22, and has completed the installation of solar panel systems in its offices, which will be operational beginning FY23. Digitisation efforts are also underway to reduce its reliance on paper and print.

S: GOOD

Each used vehicle financed is subject to mandatory inspection prior to approval, to ensure the safety of its customers. Most of the hire purchase division's customers come from B40/lower-M40 backgrounds. The division is also well-diversified, ie 70% made up of women, and a balanced split between the ethnicities. The company has comprehensive plans in place to ensure that workplace safety, health and wellbeing are safeguarded at all times.

G: EXCELLENT

The company has in place policies and a framework to ensure ethical business, integrity and transparency are practiced, as well as a whistleblowing programme. Board member responsibilities are revised and published annually. The Board meet around five times a year.

Forecasts and Valuation	Mar-21	Mar-22	Mar-23F	Mar-24F	Mar-25F
Reported net profit (MYRm)	35	26	35	39	41
Net profit growth (%)	0.9	(27.0)	34.7	12.0	6.0
Recurring net profit (MYRm)	35	26	35	39	41
Recurring EPS (MYR)	0.12	0.09	0.12	0.13	0.14
BVPS (MYR)	1.49	1.50	1.55	1.61	1.66
DPS (MYR)	0.07	0.05	0.07	0.08	0.08
Recurring P/E (x)	11.34	15.58	11.57	10.33	9.75
P/B (x)	0.91	0.90	0.87	0.84	0.81
Dividend Yield (%)	5.4	3.9	5.3	5.9	6.2
Return on average equity (%)	8.2	5.8	7.7	8.3	8.5

Source: Company data, RHB

Financial Exhibits

[illegible]

Source: Company data. RHB

Results At a Glance

Figure 1: ELK-Desa – summary of 1Q23 results

FYE Mar (MYRm)	1QFY22	4QFY22	1QFY23	QoQ (%)	YoY (%)	Comments
Revenue	31.4	36.0	39.0	8.3	24.2	Higher contributions from both the hire purchase (+7% YoY, +14% QoQ) and furniture (+70% YoY, flat QoQ) divisions.
<i>HP division</i>	22.9	21.4	24.5	14.3	7.2	
<i>Furniture division</i>	8.5	14.5	14.4	(0.5)	70.0	
Cost of Sales	(5.8)	(10.0)	(9.3)	(7.4)	60.4	
Gross Profit	25.6	25.9	29.7	16.0	25.6	
<i>Gross margin (%)</i>	81.6	72.1	76.2			
Non-IT	0.6	0.8	0.5	(33.2)	(9.2)	
Overhead expenses	(8.0)	(10.9)	(10.4)	(4.6)	29.5	
EBIT	18.1	15.8	19.8	25.1	9.1	
<i>EBIT margin</i>	57.8	44.0	50.8			
Finance costs	(2.9)	(1.7)	(1.7)	0.7	(42.4)	YoY, finance costs decreased after paring down borrowings throughout FY22.
PIOP	15.2	14.2	18.1	27.9	18.9	
Impairment allowances	(8.3)	(6.6)	5.3			Reversal arising from better-than-expected recovery in collections following the EPF special withdrawal programme.
<i>Annualised credit costs (bps)</i>	572	508	(392)			
PBT	6.9	7.5	23.4	>100	>100	
<i>HP division</i>	7.1	6.8	22.0	>100	>100	
<i>Furniture division</i>	(0.2)	0.8	1.4	82.2	>100	
Tax expenses	(1.9)	(3.4)	(5.8)	71.7	197.4	
<i>ETR (%)</i>	28.1	44.7	24.7			
Net earnings	5.0	4.2	17.6	>100	>100	
<i>Net margin (%)</i>	15.8	11.6	45.2			
Diluted net earnings	5.0	4.2	17.6	>100	>100	At 63% of our and Street full-year estimates.
Other key data and ratios						
Net HP receivables (MYRm)	508.9	468.1	502.2			7% YTD growth is already within management's 5-10% guidance for the full year.
Net debt / equity (x)	0.3	0.1	0.2			
ROAE (%) – annualised	4.6	3.8	15.6			
ROAA (%) – annualised	3.0	2.9	11.7			
CIR (%) – hire purchase	25.7	35.2	28.4			

Source: Company data, RHB

Figure 2: Revisions to our full-year earnings forecasts

FYE Dec	Net profit (MYR m)			PBT (MYR m) – HP division			PBT (MYR m) – Furniture division		
	Previous	Revised	% Chg	Previous	Revised	% Chg	Previous	Revised	% Chg
2023F	27.9	34.7	24.3	35.9	44.8	24.9	2.9	3.4	17.8
2024F	32.9	38.9	18.2	41.9	49.8	18.9	3.8	4.2	10.7
2025F	36.5	41.2	12.9	46.8	52.9	13.0	3.9	4.4	10.9

Source: Company data, RHB

Figure 3: Revisions to our key assumptions

FYE Dec	Net HP receivables (MYR m)			Credit costs (bps) – HP division			Revenue (MYR m) – Furniture		
	Previous	Revised	% Chg	Previous	Revised	bps Chg	Previous	Revised	% Chg
2023F	483.5	524.1	8.4	425	300	-125	50.1	51.0	1.7
2024F	525.6	565.7	7.6	352	295	-57	55.1	55.6	0.8
2025F	571.5	609.3	6.6	315	292	-23	57.9	58.4	0.8

Source: Company data, RHB

Valuation and TP

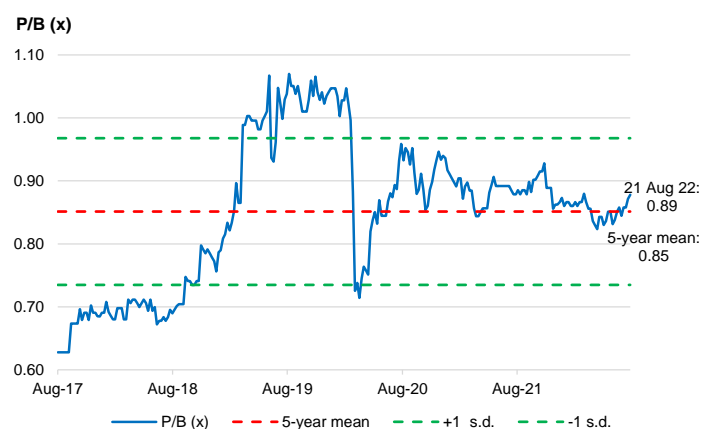
Our new GGM-derived TP of MYR1.60 (from MYR1.30) is based on a P/BV of 1.0x on FY23F book value, slightly above +1SD from its 5-year historical mean. We believe the premium-to-mean is justified, given that the stock was trading at >1x between FY19-FY20 when it last recorded receivables growth. The stock currently has a market valuation of 0.89x FY23F P/BV, which is well below its peer range of 1.4-1.6x. With an ESG score of 3.0 (in line with the country median), we ascribe a 0% premium or discount to the stock to derive our TP.

Figure 4: ELK-Desa – GGM valuation summary

Cost of equity (COE) computation:		Sustainable ROE (%)	8.1
Risk free rate (%)	4.0	COE (%)	8.0
Equity premium (%)	4.0	Long-term growth (g)	2.5
Beta (x)	1.0	Implied P/BV (x)	1.03
Cost of equity - CAPM (%)	8.0	BVPS – FY23F	MYR1.52
		Intrinsic value	MYR1.57
ESG premium/(discount) (%)	0	ESG premium/(discount)	MYR0.00
		TP (rounded)	MYR1.60

Source: Company data, RHB

Figure 5: ELK-Desa's historical P/B



Source: Bloomberg, RHB

Figure 6: ELK-Desa's historical P/E



Source: Bloomberg, RHB

Recommendation Chart

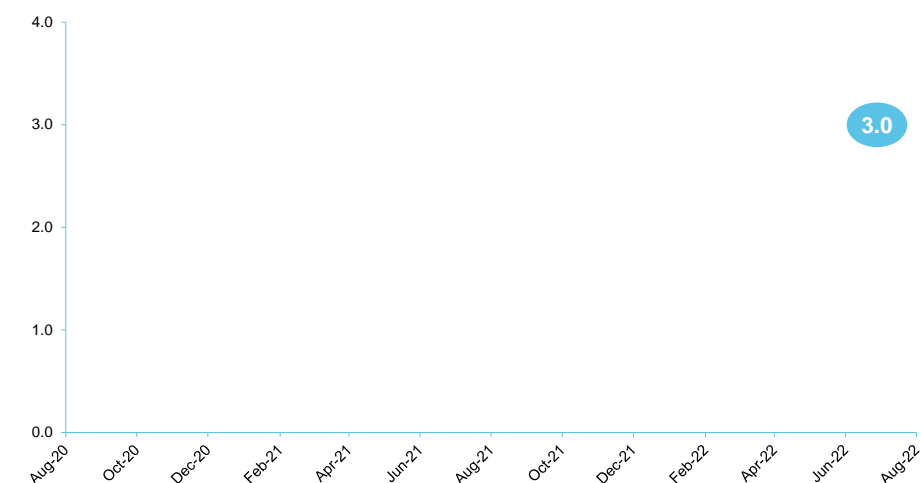


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2022-07-17	Neutral	1.30	1.27

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
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Not Rated:	Stock is not within regular research coverage

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