

7 August 2023

Financial Services | Diversified Financial Services

ELK-Desa Resources (ELK MK)

Neutral (Maintained)

Clear Asset Quality Strategies

- **Keep NEUTRAL and MYR1.20 TP, 6% downside with 5% FY24F (Mar) yield.** We recently hosted ELK-Desa Resources in a showcase event for retail investors and came away from the session feeling positive on the group's hire purchase receivables (HPR) growth prospects and asset quality strategies. Despite this, earnings growth is likely to be negative in FY24F due to a normalisation of credit cost, though yields still look decent at c.5%.
- **No let down in HPR growth.** In FY23, HPR grew 23% YoY against an initial guidance of 10%. For FY24F, management aims to continue growing HPR at double-digits, with a 10-15% target provided. We expect demand for used car financing to stay robust – partly thanks to higher transaction volumes on used cars driven by online trading platforms – and this should support ELK's growth ambitions moving forward.
- **Repossession to improve asset quality indicators.** ELK's GIL ratio stood at 7.4% at end-Mar 2023, down from 9.9% the year before. This is attributable to better collection productivity, especially in 1HFY23. In FY24F, the group will re-engage in repossession activities after a multi-year pause to aid in debt recovery – the group is generally able to recover 50% of the asset value upon auction. Impaired accounts can then be written off post-repossession, which should allow the group to significantly lower its GIL ratio. Credit cost guidance is for 3-4% pa which is at pre-COVID 19 levels.
- **Expanding furniture business in East Malaysia.** A key initiative in FY24F is to increase its home furniture wholesaling presence in Sabah and Sarawak. Since currently no major wholesaler operates in the two states, management believes there is market share to be captured. As we understand, gross profit margin for sales in East Malaysia should not differ too much from that in West Malaysia, ie 33-37%.
- **Unlikely to be another record year.** FY23 record-high net profit of MYR48m is unlikely to be matched in FY24, as the group benefitted from a one-off surge in repayments in 1HFY23 (leading to impairment allowance reversals). Should the group meet its HPR growth target of 10-15% and keep credit costs at 3-4%, FY24F should land slightly shy of the FY23 level.
- **We lower FY24-26F by 8-10%** in line with expectations for softer net profit YoY. Our TP is maintained at MYR1.20, as we lowered our cost of equity assumption to 9% from 10% due to improved visibility on credit costs and clear asset quality strategies. Our TP includes a 2% ESG premium based on our in-house ESG scoring methodology. We believe ELK's popularity among dividend-seeking retail investors should continue to keep its lofty valuation at current levels (over +2SD above 5-year mean P/BV).
- **Key downside risks** include weaker-than-expected HPR growth and higher-than-expected credit costs. The converse presents upside risks.

Forecasts and Valuation	Mar-22	Mar-23	Mar-24F	Mar-25F	Mar-26F
Reported net profit (MYRm)	26	48	45	48	51
Net profit growth (%)	(27.0)	85.4	(6.8)	7.5	5.3
Recurring net profit (MYRm)	26	48	44	48	50
Recurring EPS (MYR)	0.06	0.10	0.10	0.11	0.11
BVPS (MYR)	0.98	1.04	1.07	1.11	1.16
DPS (MYR)	0.04	0.07	0.06	0.07	0.07
Recurring P/E (x)	22.59	12.20	13.09	12.17	11.56
P/B (x)	1.30	1.23	1.20	1.15	1.11
Dividend Yield (%)	2.8	5.1	4.7	5.1	5.4
Return on average equity (%)	5.8	10.4	9.3	9.7	9.8

Source: Company data, RHB

Target Price (Return):	MYR1.20 (-6.2%)
Price (Market Cap):	MYR1.28 (USD128m)
ESG score:	3.1 (out of 4)
Avg Daily Turnover (MYR/USD)	0.08m/0.02m

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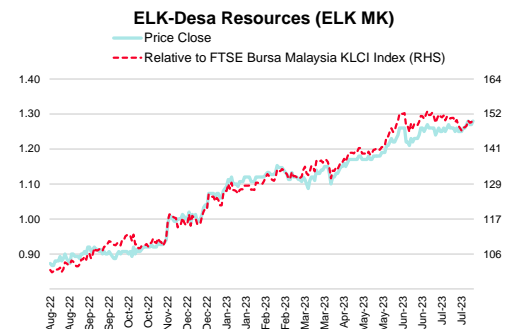


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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	20.8	3.2	9.4	14.3	47.6
Relative	24.2	(0.6)	8.1	17.3	51.8
52-wk Price low/high (MYR)				0.87 – 1.28	



Source: Bloomberg

Overall ESG Score: 3.1 (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 reliance on paper and print.

S: GOOD

Each used vehicle financed is subject to mandatory inspection prior to approval, to ensure safety of customers. Most of the hire purchase division's customers come from B40/lower-M40 backgrounds. The division is also well diversified, comprising of 71% females and a balanced ethnicity split. The company has comprehensive plans in place to ensure 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 5 times a year.

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Note:

Small cap stocks are defined as companies with a market capitalization of less than USD0.5bn.

Financial Exhibits

Asia Malaysia Financial Services ELK-Desa Resources ELK MK / Neutral	Financial summary (MYR)					
	EPS	0.06	0.11	0.10	0.11	0.11
	Recurring EPS	0.06	0.10	0.10	0.11	0.11
	DPS	0.04	0.07	0.06	0.07	0.07
	BVPS	0.98	1.04	1.07	1.11	1.16
Valuation basis	Valuation metrics					
	Recurring P/E (x)	22.59	12.20	13.09	12.17	11.56
	P/B (x)	1.3	1.2	1.2	1.1	1.1
	Dividend Yield (%)	2.8	5.1	4.7	5.1	5.4
	Income statement (MYRm)					
GGM-derived intrinsic value with zero ESG overlay. Key GGM assumptions are: i) Cost of equity of 9.0%; ii) Sustainable ROE of 9.5%; and iii) 3.5% long-term growth.	Interest income	79	89	102	113	122
	Interest expense	(10)	(9)	(12)	(13)	(16)
	Net interest income	70	80	91	99	105
	Non interest income	52	68	75	80	83
	Total operating income	122	148	166	179	189
Key drivers	Overheads	(64)	(77)	(85)	(91)	(96)
	Pre-provision operating profit	57	71	81	89	92
	Loan impairment allowances	(22)	(7)	(21)	(24)	(25)
	Other impairment allowances	(0)	(1)	(0)	(1)	(1)
	Pre-tax profit	35	63	59	64	67
Key risks	Taxation	(9)	(16)	(15)	(16)	(17)
	Reported net profit	26	48	45	48	51
	Recurring net profit	26	48	44	48	50
	Profitability ratios					
	Return on average assets (%)	4.1	7.5	6.2	6.2	6.0
Company Profile	Return on average equity (%)	5.8	10.4	9.3	9.7	9.8
	Return on IEAs (%)	14.0	14.9	15.3	15.4	15.4
	Cost of funds (%)	6.1	5.5	5.6	5.6	5.7
	Net interest spread (%)	7.9	9.4	9.8	9.8	9.7
	Net interest margin (%)	12.3	13.5	13.6	13.6	13.4
The downside risks include: i) Weaker-than-expected HPR growth; ii) Higher-than-expected credit costs; and iii) Weaker-than-expected furniture business performance.	Non-interest income / total income (%)	42.8	45.8	45.2	44.5	44.2
	Cost to income ratio (%)	52.9	52.1	51.0	50.6	51.0
	Credit cost (bps)	413	123	327	340	322
	Balance sheet (MYRm)					
	Total gross loans	517	624	680	739	787
Shareholders (%)	Other interest earning assets	43	11	20	23	26
	Total gross IEAs	560	635	700	762	814
	Total provisions	(48)	(48)	(48)	(52)	(56)
	Net loans to customers	468	575	633	687	732
	Total net IEAs	511	586	653	710	758
Eng Lee Kredit Sdn Bhd 32.8 Amity Corporation Sdn Bhd 5.1 Teo Siew Lai 3.5	Total non-IEAs	71	107	85	102	120
	Total assets	582	693	737	812	878
	Other interest-bearing liabilities	117	199	215	263	308
	Total IBLs	117	199	215	263	308
	Total non-IBLs	17	22	35	43	44
	Total liabilities	135	221	250	306	352
	Share capital	345	351	351	351	351
	Shareholders' equity	448	472	487	506	526
	Asset quality and capital					
	Reported NPLs / gross cust loans (%)	9.9	7.4	4.5	4.5	4.5
	Total provisions / reported NPLs (%)	94.8	104.9	155.6	155.6	157.8

Source: Company data, RHB

Figure 1: Revisions in full-year earnings forecasts

FYE Mar	Net profit (MYR m)			PBT (MYR m) – HP division			PBT (MYR m) – Furniture division		
	Previous	Revised	% Chg	Previous	Revised	% Chg	Previous	Revised	% Chg
2024F	48.9	44.5	-9.0	59.5	53.3	-10.4	4.8	6.0	25.2
2025F	52.9	47.8	-9.7	64.6	57.1	-11.6	6.0	6.7	10.6
2026F	54.9	50.4	-4.5	66.8	60.2	-9.9	6.3	7.0	10.6

Source: Company data, RHB

Figure 2: Revisions in key assumptions

FYE Mar	Net HP receivables (MYR m)			Credit costs (bps) – HP division			Average asset yield (%) – HP		
	Previous	Revised	% Chg	Previous	Revised	bps Chg	Previous	Revised	ppts Chg
2024F	622.4	632.7	1.7	352	327	-25	18.1	16.1	-2.0
2025F	676.0	687.2	1.7	346	340	-6	18.0	16.1	-1.9
2026F	694.5	731.5	5.3	329	322	-7	18.0	16.1	-1.9

Source: Company data, RHB

Valuation and TP

Our TP of MYR1.20 (maintained) is based on a GGM-derived fair value P/BV of 1.05x on CY24F BVPS. Changes to our GGM model inputs include: i) Cost of equity (9.3% from 10.0%, due to better earnings visibility and solid business strategies), and ii) ROE (9.6% from 10.4%, in line with lowered forecasts). Our forecasts were lowered mainly after imputing lower asset yield assumptions to better align with guidance and FY23 figures. We also lowered our credit cost assumptions after management shared its asset quality strategies.

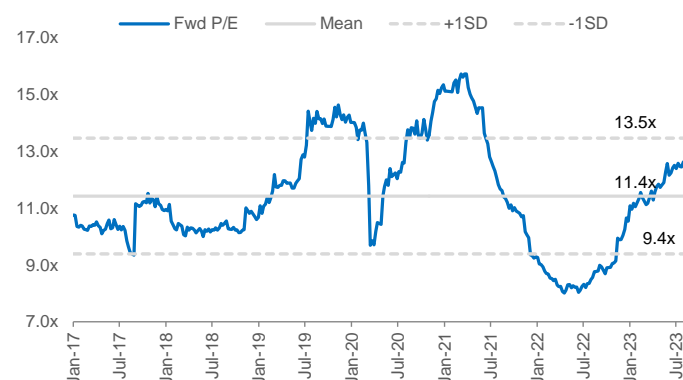
We maintain our NEUTRAL call on the counter, as we believe the group's generous dividend payouts (>60% of net earnings) provide a valuable defensive option in the current uncertain market environment. While the current P/BV level of 1.2x (over +2SD from 5-year mean) appears high, we believe the stock's popularity among dividend-seeking retail investors can continue to keep its valuation at such levels.

Figure 3: ELK-Desa – GGM valuation summary

Cost of equity (COE) computation:		Sustainable ROE (%)	9.6
Risk free rate (%)	4.0	COE (%)	9.3
Equity premium (%)	5.3	Long-term growth (g)	3.5
Beta (x)	1.0	Implied P/BV (x)	1.05
Cost of equity - CAPM (%)	9.3	BVPS – CY24F	MYR1.10
		Intrinsic value	1.16
ESG premium/(discount) (%)	2	ESG premium/(discount)	MYR0.02
		TP (rounded)	MYR1.20

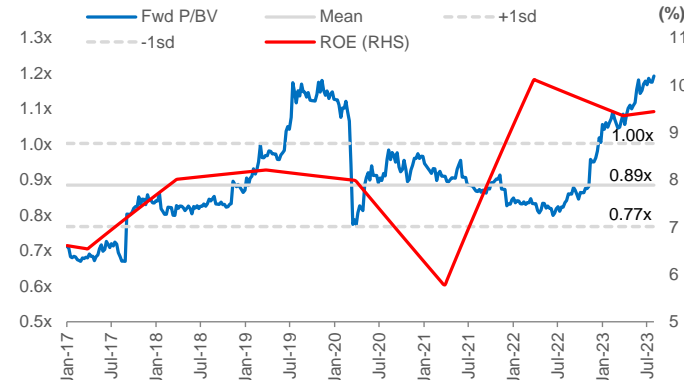
Source: Company data, RHB

Figure 4: ELK-Desa's 12-month forward P/E



Source: Bloomberg, RHB

Figure 5: ELK-Desa's 12-month forward P/BV vs ROE



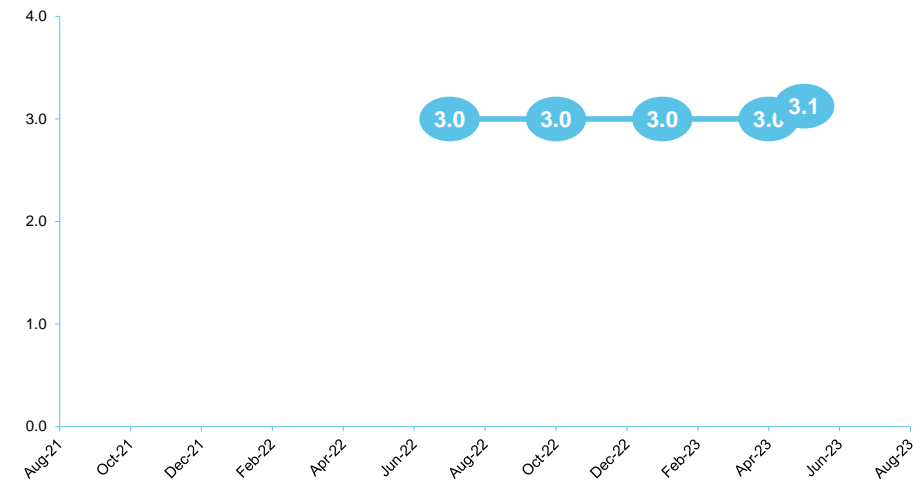
Source: Bloomberg, RHB

Recommendation Chart



Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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