

Slower macro outlook to moderate growth

ELK-Desa's 9MFY20 net profit came in at RM28.3m (+16.1% yoy), underpinned by 3QFY20's net profit of RM9.4m (-1.9% qoq, +22.3% yoy). The 9MFY20 results came in within Affin's expectations. ELK's hire-purchase receivables continued to grow at a robust rate of 32% yoy, while expanding by 8.6% qoq. Based on management's prudent credit underwriting policies, overall 9MFY20 provisions, as measured by credit cost, stood at circa 360bps while 3QFY20 itself saw an increase of 82bps qoq to 431bps. Given our expectation of a moderation in the macro environment in 1H20 following the Covid-19 outbreak, we are of the view that there will be weaker credit growth (FY20E: +21% yoy; FY21E: 15% yoy) and also higher risk of NPLs. We cut our FY20-22E earnings by 5.7-9.1% to factor in higher credit costs. We maintain our BUY call, but with a lower TP of RM1.82 (at 13x CY20E EPS) from RM1.98 previously.

9MFY20 net profit up 16% yoy; receivables growth at 32% yoy

ELK-Desa reported a 3QFY20 net profit of RM9.4m, up 22.3% yoy though down by 1.9% qoq (due to a higher tax rate; 3QFY20 pre-tax profit, however, rose 3.3% qoq). The 9MFY20 net profit of RM28.3m (+16.1% yoy) was within our expectations. The robust growth was underpinned primarily by its hire-purchase (HP) receivables growth of 32% yoy, on the back of additional leverage through an MTN programme and expansion of its block-discounting facility. Its net-debt-to-equity stood at 0.46x and we believe that there is still further room for growth towards the 1.5-2.0x debt-to-equity level.

Cutting FY20-22E earnings 5.7-9% due to risk of higher NPLs

In line with our house view of a more prolonged caution in the market, we foresee that the risk of higher NPLs may creep up within the banking and non-bank operators. As such, we trim ELK's FY20E-22E earnings by 5.7-9.1% as we raise our credit-cost assumptions from 355-368bps to 407-432bps.

Maintain BUY with a revised Price Target of RM1.82 (at 13x P/E multiple)

We reiterate our **BUY** call on ELK but with a lower **12-month Target Price** of **RM1.82** (based on a 13x target P/E multiple on our CY20E EPS). That said, despite a more prolonged caution in the market, we remain upbeat on ELK-Desa's prospects as it remains a prudent mass-market HP-financing player in the Klang Valley. We also see better dividends and expansion in ROE potentially driving a re-rating of the stock. Downside risk – rise in default rates.

Earnings & Valuation Summary

FYE 31 Mar (RMm)	2018A	2019A	2020E	2021E	2022E
Revenue	104.1	123.4	142.5	162.6	185.2
Net operating income	37.0	47.5	55.2	66.9	77.0
Pretax profit	35.3	43.8	47.8	56.0	61.4
Net profit	25.9	32.9	36.3	42.6	46.7
EPS (sen)	9.9	11.2	12.4	14.5	15.9
EPS growth (%)	(7.2)	13.3	10.5	17.1	9.6
FD EPS (sen)	9.4	10.9	12.1	14.1	15.5
PER (x)	16.4	14.4	13.1	11.2	10.2
FD PER (x)	17.2	14.8	13.4	11.5	10.5
ROE (%)	7.1	8.1	8.7	9.7	10.2
BV / share	1.39	1.39	1.46	1.52	1.59
P/BV	1.17	1.17	1.11	1.06	1.02
DPS (sen)	6.8	7.0	7.4	8.7	9.5
Dividend Yield (%)	4.2	4.3	4.6	5.4	5.9
Chg in EPS (%)			(5.7)	(9.1)	(8.2)
Affin/Consensus (x)			NA	NA	NA

Source: Company, Bloomberg, Affin Hwang forecasts

Results Note

ELK-Desa

ELK MK

Sector: Finance

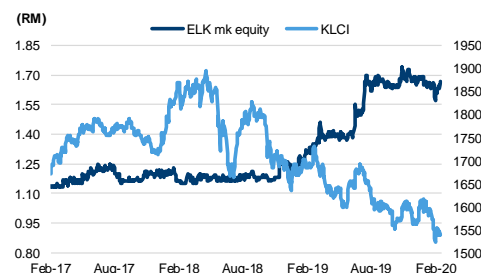
RM1.67 @ 18 Feb 2020

BUY (maintain)

Upside: 12.3%

Price Target: RM1.82

Previous Target: RM1.98



Price Performance

	1M	3M	12M
Absolute	0.6%	-3.5%	24.6%
Rel to KLCI	4.4%	0.8%	37.2%

Stock Data

Issued shares (m)	297.1
Mkt cap (RMm)/(US\$m)	496.2/119.5
Avg daily vol - 6mth (m)	0.1
52-wk range (RM)	1.31-1.77
Est free float	32.7%
BV per share (RM)	1.41
P/BV (x)	1.18
Net cash/(debt) (RMm)	(190.6)
ROE (2020E)	8.7
Derivatives (ICULS)	6m
Shariah Compliant	No

Key Shareholders

Teoh Hock Chai	37.5%
Amity Corporation	5.2%

Source: Affin, Bloomberg

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Fig 1: Results Comparison

FYE 31 Mar (RMm)	3QFY19	2QFY20	3QFY20	QoQ % chg	YoY %chg	9MFY19	9MFY20	YoY % chg	Comments
Revenue	31.1	36.6	38.7	5.5	24.2	90.9	110.5	21.5	Hire-purchase (HP) revenue remains the key top-line driver, +24% yoy for 9MFY20. Hire-purchase receivables grew by 32% yoy in 3QFY20.
- Hire Purchase	21.7	25.7	27.6	7.7	27.5	62.4	77.4	24.1	
- Furniture	9.4	11.0	11.0	0.6	16.7	28.6	33.1	15.8	
Operating expenses	(20.4)	(22.0)	(22.8)	3.9	12.0	(56.9)	(66.5)	16.9	Increase in 9MFY20 overheads due to staff costs, staff development expenses and higher COGS at the furniture division. The hire purchase impairment allowance rose by 23% yoy.
Other Income	0.5	0.8	0.7	(21.7)	41.0	1.2	2.0	70.5	Margins improved yoy as leverage was raised. Net debt-to-equity ratio stood at 0.46x as at Dec19 vs. 0.14x as at Dec18. Interest expense increased in tandem with an 85% increase in borrowings (block discounting payables and MTNs).
EBIT	11.2	15.6	16.5	6.2	47.1	35.2	45.9	30.5	
<i>EBIT margin (%)</i>	<i>36.1</i>	<i>42.5</i>	<i>42.8</i>	<i>0.28</i>	<i>6.64</i>	<i>35.2</i>	<i>41.6</i>	<i>6.4</i>	
Net Finance Cost	(1.2)	(2.7)	(3.3)	20.1	181.0	(2.8)	(7.5)	170.4	About 97% of 9MFY20 PBT from hire-purchase business. Broadly within our expectation.
Pre-Tax Profit	10.1	12.8	13.3	3.3	31.5	32.4	38.4	18.5	
Taxation	(2.4)	(3.2)	(3.8)	18.8	61.6	(8.0)	(10.0)	25.8	
Net Profit	7.7	9.6	9.4	(1.9)	22.3	24.4	28.3	16.1	Minor difference in EPS growth vs. net profit growth rate due to dilution effect of the ICULS conversion. No dividend was proposed in 3QFY20.
EPS	2.61	3.24	3.17	(2.0)	21.7	8.26	9.55	15.6	
Single-tier DPS (sen)	-	3.5	-	n.m.	n.m.	3.5	3.5	-	
Net Yield (%)	-	2.2	-	n.m.	n.m.	2.2	2.2	-	

Source: Affin Hwang, Company data

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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