

Outthink. Outperform.

## 2020 outlook remains intact

Our investment thesis on ELK-Desa remains unchanged. We continue to like the company, which has a special niche in the financing of mass-market used cars in the Klang Valley. Its key strengths, e.g. expertise in the hire-purchase financing business, strong dealer network, robust receivables growth (through leverage) and sound credit management – all work to boost the group's earnings and ROE (10% in FY21E from 8% in FY19). We believe that there is still ample opportunity for ELK-Desa to tap into the used car market – robust Proton and Perodua sales in 2H19 indicate that the mass market is not facing severe constraints and that the B40 and M40 consumption spending are still intact. We reaffirm our BUY call and TP of RM1.98 (at 13x CY20E EPS).

### National car sales in 2019 continue to gain ground – a good sign

The robust national car sales in 2019 is a good sign and bodes well for ELK's prospects. It is highly likely that whenever car owners (the B40 and M40 groups) need to upgrade, they would first dispose of their existing cars in the used-car market. This is where hire-purchase (HP) financing players such as ELK will finance the transactions at rates of 8.75-10%.

### ELK could be playing catch-up with Aeon Credit

Based on our comparison of ELK's HP receivables with that of its closest peer, Aeon Credit (which is 5x bigger than ELK), we believe that there is potential for ELK to catch up over the years through the use of leverage. Based on a hypothetical scenario, should ELK make full use of its outstanding MTN facility (~RM850m), it could double its balance sheet and achieve a pre-tax profit of RM85m, based on gross receivables of RM1.4bn (as against current gross receivables of below RM600m).

### Reiterating BUY rating and Target Price of RM1.98

We reiterate our **BUY** call and **12-month Target Price** of **RM1.98** (based on a 13x target P/E multiple on our CY20E EPS). We are upbeat on ELK-Desa's prospects as it remains a prudent mass-market HP-financing player in the Klang Valley. We also see better dividend payouts in line with an expansion in earnings, estimated at a 3-year forward CAGR of 15.6%. 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	58.2	72.5	82.4
Pretax profit	35.3	43.8	50.7	61.6	66.8
Net profit	25.9	32.9	38.6	46.8	50.8
EPS (sen)	9.9	11.2	13.1	16.0	17.3
EPS growth (%)	(7.2)	13.3	17.3	21.5	8.5
FD EPS (sen)	9.4	10.9	12.8	15.5	16.8
PER (x)	16.4	14.4	12.3	10.1	9.4
FD PER (x)	17.2	14.8	12.7	10.4	9.6
ROE (%)	7.1	8.1	9.2	10.7	11.0
BV / share	1.39	1.39	1.46	1.54	1.61
P/BV	1.17	1.17	1.11	1.06	1.01
DPS (sen)	6.8	7.0	7.9	9.6	10.4
Dividend Yield (%)	4.2	4.3	4.9	5.9	6.4
Chg in EPS (%)			-	-	-
Affin/Consensus (x)			NA	NA	NA

Source: Company, Bloomberg, Affin Hwang forecasts

## Company Update

# ELK-Desa

ELK MK

Sector: Finance

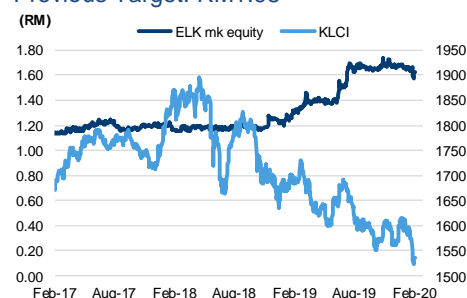
RM1.62 @ 4 Feb 2020

BUY (maintain)

Upside: 22%

Price Target: RM1.98

Previous Target: RM1.98



## Price Performance

	1M	3M	12M
Absolute	-2.4%	-4.7%	23.7%
Rel to KLCI	2.4%	-0.5%	35.6%

## Stock Data

Issued shares (m)	297.1
Mkt cap (RMm)/(US\$m)	421/101
Avg daily vol - 6mth (m)	0.1
52-wk range (RM)	1.13-1.48
Est free float	38.2%
BV per share (RM)	1.41
P/BV (x)	1.15
Net cash/(debt) (RMm)	(153.5)
ROE (2020E)	8.1
Derivatives (ICULS)	6m
Shariah Compliant	No

## Key Shareholders

Teoh Hock Chai	37.5%
Amity Corporation SD	5.2%

Source: Affin, Bloomberg

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## Cautious sentiment, but with room to grow

### Investment thesis on ELK-Desa Resources – ripe for further expansion

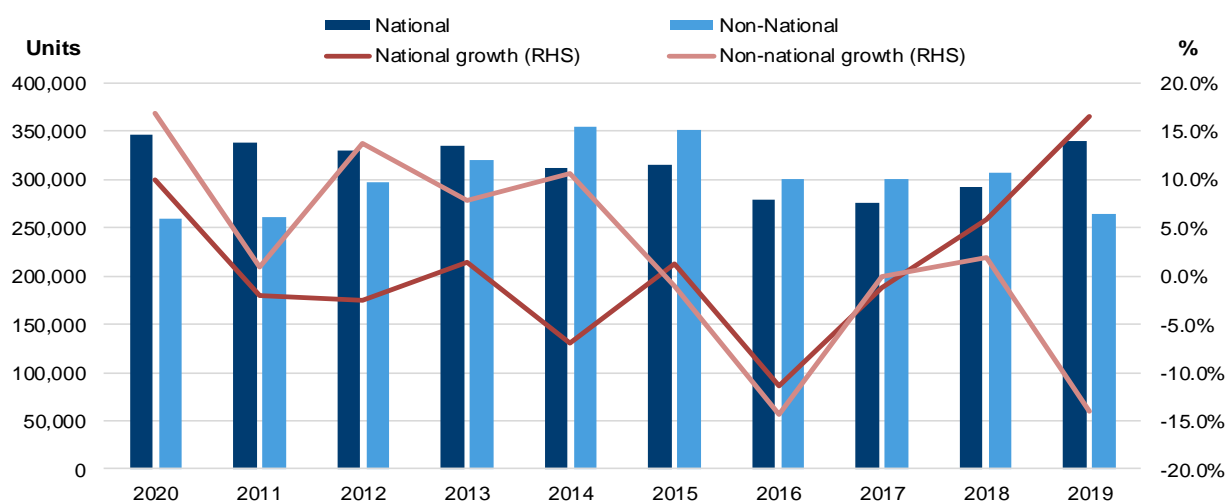
Our key investment thesis on ELK-Desa Resources (ELK) remains unchanged. We expect its ROE to rise further from 8% in FY19 to 9% in FY20 and 11% in FY21, as a niche mass-market used-car financing player in the Klang Valley. We believe that at the current price (RM1.62), its valuation is still very compelling at P/E multiples of 12.3x FY20E and 10.1x FY21E. Similar peers have P/E multiples averaging 9.5-11x (Aeon Credit; ACSM MK, RM12.9, BUY) and 5.3-5.7x (RCE Capital) for FY20-21E. Nonetheless, its share price has been relatively flat in the past 6 months, hovering around RM1.60-1.70 vs. RM1.40 (prior to the news) after announcement of a 10-year RM1bn Medium Term Notes programme (in July 2019).

To recap, we believe that receivables growth will remain robust for ELK from FY20-22E as the used-car market in the Klang Valley remains robust (at over 5m cars) while the number of Proton and Perodua cars is growing continually. Secondly, we believe that with leverage, ELK could grow at the pace at which its closest peer, Aeon Credit Service Malaysia, had been able to over the years.

### National car sales in 2019 continued to gain ground – a good sign

Looking at the auto sector total industry volumes (TIV) in 2019 (Fig 1), total sales were 604.3k units, up just 0.9% yoy. However, national car sales have been more robust (+16.6% yoy) vis-à-vis the non-national makes (down 14% yoy). For instance, Proton, with a market share of 16.6%, saw its sales volume grow 55% yoy while Perodua (with a market share of 40%) reported a 6% yoy growth in sales volume in 2019.

**Fig 1: National and non-national auto total industry volumes (TIV) in 2019 and growth rate**



Source: Company, Affin Hwang

In our view, robust national car sales are a good sign for ELK's prospects as it implies that the mass market (the B40 and M40 groups) are not facing huge constraints despite the high cost of living in the Klang Valley (Kuala

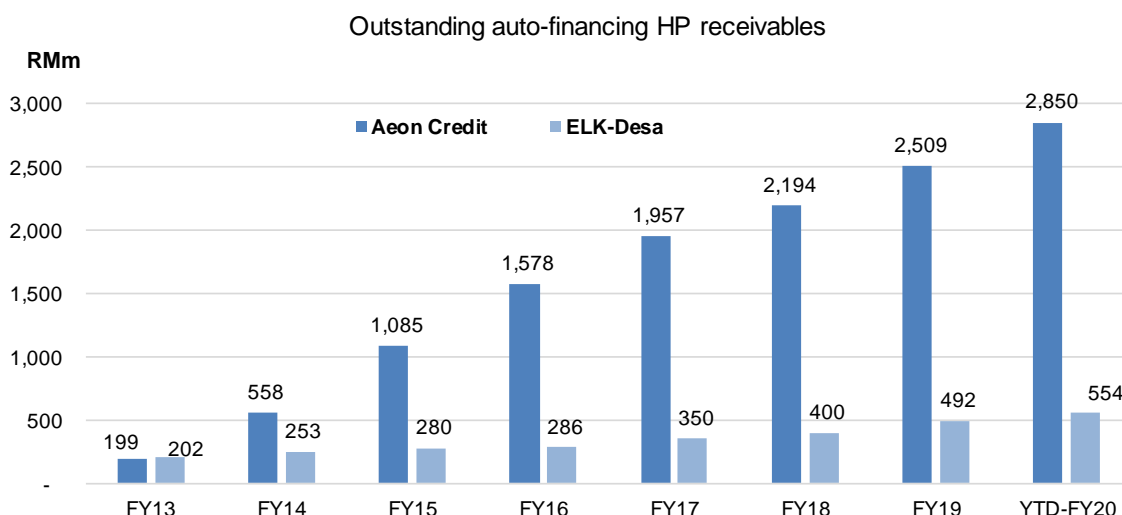
Lumpur & Selangor). It is highly likely that whenever car owners need to upgrade, they would first dispose of their existing cars in the used-car market. We believe that this bodes well for Hire-Purchase (HP) financing players such as ELK, which focus largely on financing used cars in the price range of RM35,000 and below (at rates between 8.75% and 10%).

#### ELK could be playing catch-up with Aeon Credit

Based on our comparison of ELK's HP receivables with that of its closest peer, Aeon Credit (which is 5x bigger than ELK), we believe that there is potential for ELK to catch up over the years. Based on Fig 2, both companies started at the same level back in 2012, but Aeon Credit made use of leverage and saw much faster growth compared to ELK, which had traditionally grown by new equity capital injection.

*(Note: Peer Aeon Credit's stronger auto-finance HP receivables were also partially driven by its expansion in other states outside Klang Valley)*

**Fig 2: Comparison of auto-financing HP receivables between ELK and Aeon Credit**



Source: Company, Affin Hwang

#### ELK's balance sheet could double up in size, with full use of MTN

Assuming it fully utilises its outstanding MTN facility (~RM850m), it could easily double the size of its balance sheet from RM700m to RM1.55bn, perhaps in 6 years' time. We expect its net-debt ratio, which stood at 0.37x as at Sept19, to expand to 2.4x under this scenario.

Based on a hypothetical scenario where ELK's receivables rise to RM1.4bn (compared to current outstanding receivables of below RM600m), this potentially translates into an annual interest income of RM238m based on an effective interest rate of 17% p.a.. While taking into account a cost-to-income ratio of circa 33% (which also comprises a net credit cost charge of 4%) and finance cost of 5.25%, this effectively works out to a pre-tax profit of RM85m for ELK (vis-à-vis our FY20E pre-tax profit estimate of RM50.7m). Our estimates also indicate that ELK's ROE could expand from circa 9-10% to 14-15%.

## Valuation & Financials

### Reaffirm BUY call and Target Price at RM1.98

We reaffirm our **BUY** rating and 12-month **Target Price** of **RM1.98** (pegged to a target P/E multiple of 13x applied to our CY20E EPS of 15.25 sen). We remain upbeat on ELK-Desa's prospects as we see it as a prudent mass-market HP-financing player in the Klang Valley. We also foresee a potential re-rating of the stock through expansion in the ROE. At present, ELK's dividend payouts are based on a payout policy of at least 60%.

### Steady market demand as economic conditions remain favourable

In our view, industry dynamics remain in favour of ELK-Desa, which operates in a relatively steady used-car financing market. Demand (primarily from the mass market) is not significantly affected by global trade and geopolitical uncertainties. At present, the country's economic conditions remain favourable for the B40 and M40 groups to thrive as most remain employed. Meanwhile, its business model, which takes advantage of affordably-structured repayment schemes for the low-income to middle-income group, is one of the determining factors that drives demand for the used-car market.

ELK has differentiated itself in used-car financing by focusing on the niche area of vehicles valued at RM35,000 and below, which is also largely a segment which banks do not favour. Another potential growth area or catalyst for ELK could be expansion outside the Klang Valley.

## Key risks

### Risk of default likely to rise in tandem with cost of living

Most of the HP hirers (accounts) under ELK are largely in the low-to-medium income group, which consists mainly of blue-collar workers, business traders, government employees (armed forces, teachers, office workers) and fresh graduates. Exposure to the mass market is deemed to be of a higher risk due to the borrowers' limited capacity to mitigate the rising cost of living in cities.

## ELK-Desa Resources – FINANCIAL SUMMARY

### Profit & Loss Statement

FYE 31 Mar (RMm)	2018	2019	2020E	2021E	2022E
<b>Revenue</b>	<b>105.5</b>	<b>125.4</b>	<b>143.9</b>	<b>164.5</b>	<b>186.6</b>
- HP financing & related income	73.1	97.4	102.8	120.9	141.4
- Furniture division	31.0	38.5	39.7	41.7	43.8
- Other Income	1.4	2.0	1.4	1.9	1.5
Operating expenses	(68.5)	(77.9)	(85.3)	(91.5)	(104.0)
<b>EBITDA</b>	<b>37.6</b>	<b>48.4</b>	<b>58.9</b>	<b>73.1</b>	<b>83.1</b>
<b>EBIT</b>	<b>37.0</b>	<b>47.5</b>	<b>58.2</b>	<b>72.5</b>	<b>82.4</b>
Net Finance Costs	(1.7)	(3.7)	(7.4)	(10.9)	(15.6)
<b>Pre-tax Profit</b>	<b>35.3</b>	<b>43.8</b>	<b>50.8</b>	<b>61.6</b>	<b>66.8</b>
Taxation	(9.4)	(10.9)	(12.2)	(14.8)	(16.0)
<b>Profit After Tax</b>	<b>25.9</b>	<b>32.9</b>	<b>38.6</b>	<b>46.8</b>	<b>50.8</b>

### Balance Sheet Statement

FYE 31 Mar (RMm)	2018	2019	2020E	2021E	2022E
Plant and Equipment	7.2	10.7	10.8	10.8	10.8
Deferred Tax Assets	3.6	3.3	3.3	3.3	3.3
Hire Purchase Receivables	281.9	357.4	444.3	516.1	570.2
<b>Non-current Assets</b>	<b>292.7</b>	<b>371.4</b>	<b>458.4</b>	<b>530.2</b>	<b>584.3</b>
Inventories	8.5	11.1	11.6	12.2	12.8
Trade Receivables & Others	11.3	12.8	13.2	13.8	14.4
Hire Purchase Receivables	105.4	119.0	140.0	147.9	169.3
Prepayments & Others	2.1	1.8	1.8	1.8	1.8
Cash and bank balances	50.3	31.4	98.4	14.9	40.9
<b>Current Assets</b>	<b>177.6</b>	<b>176.1</b>	<b>265.0</b>	<b>190.6</b>	<b>239.3</b>
<b>TOTAL ASSETS</b>	<b>470.3</b>	<b>547.6</b>	<b>723.4</b>	<b>720.8</b>	<b>823.6</b>
Others	2.3	0.6	2.8	2.8	2.8
Borrowings	29.4	64.1	142.0	100.0	180.0
<b>Non-current liabilities</b>	<b>31.7</b>	<b>64.7</b>	<b>144.8</b>	<b>102.8</b>	<b>182.8</b>
Trade Payables	13.6	13.9	14.7	15.4	16.2
Other Payables and accruals	4.8	5.2	6.6	6.6	6.6
Borrowings	21.2	50.2	123.0	140.0	140.0
Overdrafts	-	-	3.0	3.3	3.6
Taxation	2.7	2.5	2.5	2.5	2.5
<b>Current liabilities</b>	<b>42.2</b>	<b>71.9</b>	<b>149.9</b>	<b>167.9</b>	<b>169.0</b>
Share Capital	307.4	343.2	343.2	343.2	343.2
Reserves	88.4	60.9	78.7	100.1	121.8
ICULS - Equity component	17.3	6.9	6.9	6.9	6.9
Treasury Shares	(16.7)	-	-	-	-
<b>Shareholders Funds</b>	<b>396.4</b>	<b>410.9</b>	<b>428.8</b>	<b>450.2</b>	<b>471.8</b>
<b>TOTAL EQUITY &amp; LIABILITY</b>	<b>470.3</b>	<b>547.6</b>	<b>723.4</b>	<b>720.8</b>	<b>823.6</b>

Receivables (RMm)	2018	2019	2020E	2021E	2022E
<b>Hire Purchase Receivables</b>	<b>400.4</b>	<b>492.4</b>	<b>594.3</b>	<b>688.0</b>	<b>798.3</b>
Growth rate (%)	14.3	23.0	20.7	15.8	16.0
Operating Income (RMm)	2018	2019	2020E	2021E	2022E
Hire Purchase	62.3	84.9	87.6	103.6	121.9
Receivables Yield (%)	16.6%	19.0%	17.0%	17.0%	17.0%

### Key Financial Ratios

FYE 31 Mar (RMm)	2018	2019	2020E	2021E	2022E
<b>Returns and efficiency:</b>					
ROE (%)	7.1%	8.1%	9.2%	10.6%	11.0%
ROA (%)	6.1%	6.5%	6.1%	6.5%	6.6%
Net Profit Margin (%)	24.9%	26.6%	27.1%	28.8%	27.4%
Cost-to-income ratio (%)	65.8%	63.1%	59.9%	56.3%	56.2%
<b>Asset Quality:</b>					
Gross NPL ratio (%)	1.0%	0.8%	1.0%	1.0%	1.0%
Credit Cost (bps)	550.0	380.0	355.1	355.8	368.0
Loan Loss Cover (%)	342%	359%	510%	701%	900%
<b>Leverage Ratio:</b>					
Debt Service Ratio (x)	15.3	11.2	5.4	5.1	5.2
Debt/Equity (x)	0.13	0.28	0.63	0.54	0.69
<b>Investment statistics</b>					
PBT grow th (%)	15.5%	24.0%	16.1%	21.1%	8.6%
Net earnings grow th (%)	12.6%	27.0%	17.5%	21.1%	8.6%
EPS grow th (%)	-7.2%	13.3%	17.5%	21.1%	8.6%
Fully-diluted EPS grow th (%)	9.4%	15.8%	17.3%	21.0%	8.5%
PER (X)	16.4	14.4	12.3	10.2	9.4
FD PER (X)	17.2	14.8	12.6	10.4	9.6
EPS (sen)	9.9	11.2	13.2	16.0	17.3
FD EPS (sen)	9.4	10.9	12.8	15.5	16.8
BV/share (RM)	1.52	1.40	1.46	1.53	1.61
P/BV	1.1	1.2	1.1	1.1	1.0
Net DPS (sen)	6.8	7.0	7.9	9.6	10.4
Net yield (%)	4.2%	4.3%	4.9%	5.9%	6.4%
Dividend payout (%)	76%	63%	60%	60%	60%
<b>Cash Flow Statement</b>					
FYE 31 Mar (RMm)	2018	2019	2020E	2021E	2022E
<b>EBIT</b>	<b>37.0</b>	<b>47.5</b>	<b>58.2</b>	<b>72.5</b>	<b>82.4</b>
Depreciation & Amortization	0.6	0.9	0.6	0.6	0.6
Allowance for impairment	20.7	17.5	20.4	24.5	29.4
Working capital changes	(52.9)	(66.0)	(83.0)	(114.7)	(111.5)
Taxes paid	(9.4)	(10.9)	(12.2)	(14.8)	(16.0)
Interest expense paid	(2.4)	(4.3)	(10.7)	(14.3)	(15.8)
Others	(7.4)	(52.2)	(42.9)	10.1	6.1
<b>Cash Flow from Operations</b>	<b>(13.8)</b>	<b>(67.4)</b>	<b>(69.5)</b>	<b>(36.1)</b>	<b>(24.8)</b>
Capex	(0.1)	(3.4)	(0.1)	(0.6)	(0.6)
Sale / (Purchase) of investments	-	-	-	-	-
Interest Received	1.2	1.1	0.3	0.6	0.2
Fixed Deposits	-	-	-	-	-
<b>Cash Flow from Investing</b>	<b>1.1</b>	<b>(2.3)</b>	<b>0.2</b>	<b>(0.0)</b>	<b>(0.4)</b>
Dividends paid	(17.3)	(20.7)	(20.8)	(25.4)	(29.2)
Term Loan raised/(repaid)	26.4	62.0	154.0	(24.7)	80.3
Equity raised	54.4	2.1	(0.0)	(0.0)	(0.0)
Share buy-back	-	16.7	-	-	-
<b>Cash flow from Financing</b>	<b>63.5</b>	<b>43.5</b>	<b>133.3</b>	<b>(50.1)</b>	<b>51.2</b>
<b>Net Cash Flow</b>	<b>50.8</b>	<b>(26.2)</b>	<b>64.0</b>	<b>(86.2)</b>	<b>26.0</b>
Effects of overdraft	(15.1)	7.4	-	-	-
<b>Cash at Start of Year</b>	<b>14.6</b>	<b>50.3</b>	<b>31.4</b>	<b>95.4</b>	<b>9.1</b>
<b>Cash at End of Year</b>	<b>50.3</b>	<b>31.4</b>	<b>95.4</b>	<b>9.1</b>	<b>35.1</b>

Source: Company data, Affin Hwang estimates

## Important Disclosures and Disclaimer

### Equity Rating Structure and Definitions

<b>BUY</b>	Total return is expected to exceed +10% over a 12-month period
<b>HOLD</b>	Total return is expected to be between -5% and +10% over a 12-month period
<b>SELL</b>	Total return is expected to be below -5% over a 12-month period
<b>NOT RATED</b>	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.*

<b>OVERWEIGHT</b>	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
<b>NEUTRAL</b>	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
<b>UNDERWEIGHT</b>	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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