

Company Update

RM1.41 @ 20 November 2020

"Though downside risks on asset quality are well-buffered, ELK is still playing it safe"

Share price performance



	1M	3M	12M
Absolute (%)	0.7	-2.8	-18.0
Rel KLCI (%)	-4.5	-3.9	-17.6

	BUY	HOLD	SELL
Consensus	-	1	-

Source: Bloomberg

Stock Data

Sector	Financial services
Issued shares (m)	297.2
Mkt cap (RMm)/(US\$m)	419/102.4
Avg daily vol - 6mth (m)	0.1
52-wk range (RM)	1.09-16.4
Est free float	34.8%
Stock Beta	0.74
Net cash / (debt) (RMm)	(144.5)
ROE (FY21E)	6.9%
Derivatives	Nil
Shariah Compliant	No

Key Shareholders

Teo Hock Chai	37.5%
Amity Corporation	5.2%

Source: Affin, Bloomberg

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ELK-Desa Resources (ELK MK)

HOLD (maintain)

Up/Downside: +8.5%

Price Target: RM1.53

Previous Target (Rating): RM1.40 (HOLD)

More or less business as usual, but playing it safe

- At a post-2QFY21 results briefing, management shared that collections are back to normal though it has yet to turn aggressive on receivables growth.
- We do not expect the reinstatement of the CMCO since 14 Oct20 to have a detrimental impact, in our view, unless the situation worsens and results in the need of a state of emergency. Hence, it is likely that earnings in 2HFY21 will normalize.
- Maintain HOLD with a higher PT of RM1.53 (based on a 13x P/E multiple on the CY21E EPS of 12.1 sen) after earnings revisions of 10%-16.6%. We think it is too early for any rating upgrade due to concerns of weakness in the economy as the Covid-19 pandemic persists.

Collections have been on track, though the gross NPL ratio remains elevated

ELK's management shared that receivables collections have been on track since the RMCO was implemented from 10 June20. Even the reinstatement of the CMCO from 14 Oct20 has not jeopardized collections and credit recovery efforts by ELK (which had also adopted the JomPay and ePay payment systems). Despite a high level of provisions (annualized 600bps) in 1HFY21, we continue to stay prudent in our FY21E forecasts and assumptions, with a net credit cost of 598bps. This is due to a decline in ELK's loan loss cover from 359% in FY19 to 220% in FY20, subsequent to a sudden spike in its gross NPL ratio to 1.4% (at end-Mar20 vs. 1% prior to the MCO).

Earnings forecast revisions on better receivables yields and lower funding cost

The earnings forecast revisions of +16.6%/+10%/+11.5% for FY21-23E were driven by lower provisions (FY21E) and an improved receivables yield at ~17% (vs. 16.8%) as ELK had tightened credit risk management by charging a financing rate of 10% for new HP financing (vs. between 8.75% and 10% in previous approvals). We have also lowered our funding cost assumption slightly by about 20bps for FY21E-22E (as future MTN issuances will be at a lower interest rate of 4.8%). Our new assumptions for ELK (FY21E/22E/23E) are as follows: i) receivables growth at -3.2% / +5.5% / +9.6%; and ii) net credit costs at 598bps / 534bps / 527bps. These were revised from flat / +5.7% / +4.6% for receivables growth and 633bps / 535bps / 580bps for net credit costs.

Maintain HOLD with a higher 12-month Price Target of RM1.53

We reiterate our **HOLD** rating with a higher **PT** of **RM1.53** (based on a P/E target of 13x on the CY21E EPS of 12.1 sen) from RM1.40 previously. Though management said that demand for financing of used cars continued to be resilient, it remains conservative on portfolio expansion. Meanwhile, as car repossession activities have been suspended by the government (Oct-Dec20), the risk of a further extension may also jeopardize its credit recovery effort. Downside/upside risks: weaker/improved asset quality, decline/stronger receivables growth and a spike/decline in the unemployment rate.

Earnings & Valuation Summary

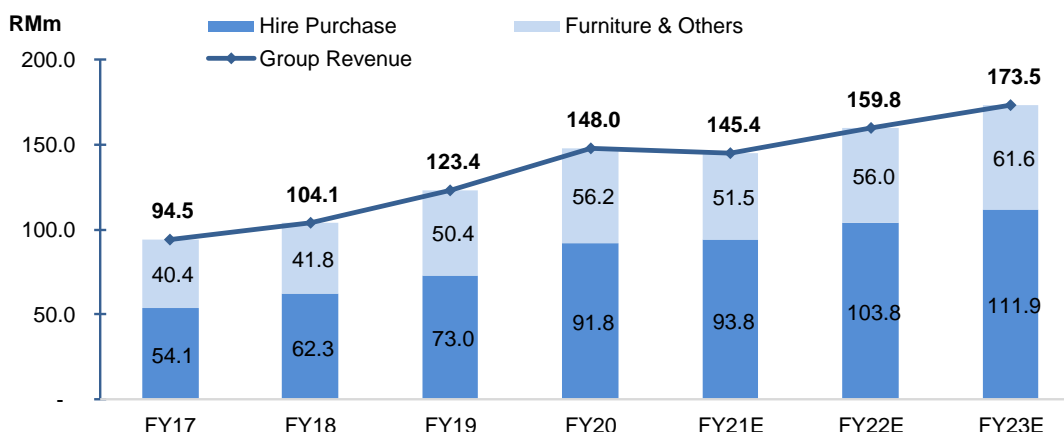
FYE 31 March	2019	2020	2021E	2022E	2023E
Revenue (RMm)	123.4	148.0	145.4	159.8	173.5
Net operating income (RMm)	47.5	60.0	49.8	59.8	66.9
Pretax profit (RMm)	43.8	47.5	38.9	46.7	51.6
Net profit (RMm)	32.9	34.9	29.6	35.5	39.2
EPS (sen)	11.2	11.8	10.1	12.1	12.9
FD EPS (sen)	10.9	11.8	9.8	11.8	12.9
FD EPS growth (%)	15.8	7.7	(16.3)	19.8	9.7
FD PER (x)	12.9	12.0	14.3	12.0	10.9
ROE (%)	8.1	8.3	6.9	8.0	8.4
P/BV (x)	1.01	1.00	0.95	0.91	0.88
Net DPS (sen)	7.0	7.25	5.5	7.0	7.8
Dividend Yield (%)	5.0	5.1	3.9	5.0	5.5
Chg in EPS (%)			+16.6	+10.0	+11.5
Affin/Consensus (x)			NA	NA	NA

Source: Company, Affin Hwang estimates

Focus Charts:

Revenue contribution from HP segment is expected to increase to 64-65% in FY21-23E vs. 60% in FY18-19

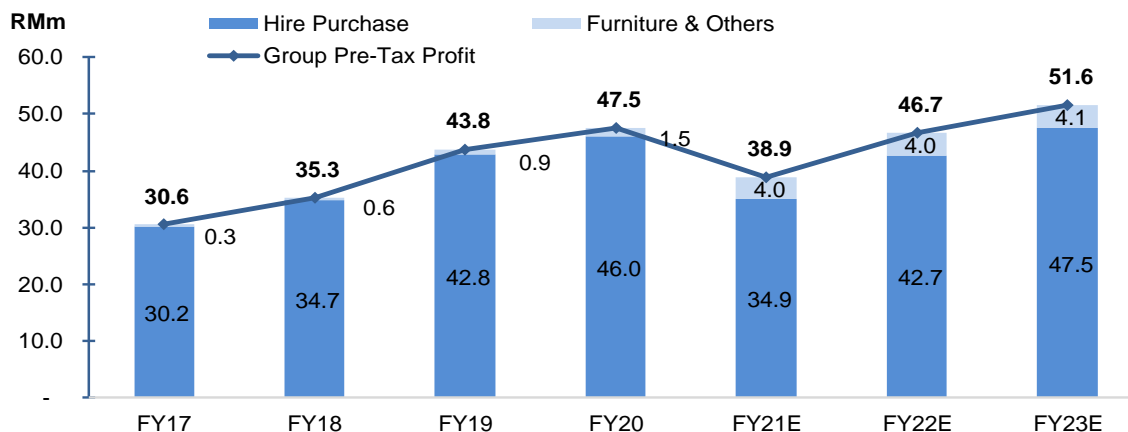
Fig 1: ELK-Desa: Revenue track record and Affin's forecasts (FY21E-23E)



Source: Company data, Affin Hwang estimates

Pre-tax profit contribution from the HP segment is expected to recover post FY21E, though our forecasts for FY22E-23E remain conservative based on a net credit cost of ~530bps and receivables growth of 5.5%-9.5% yoy

Fig 2: ELK-Desa: Pre-tax profit track record and Affin's forecasts

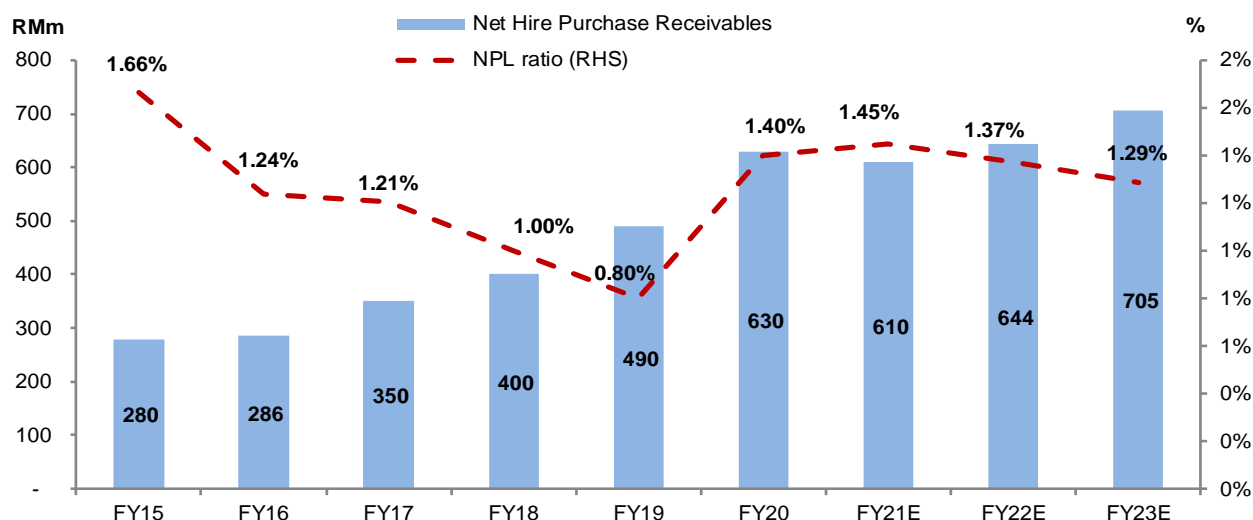


Source: Company data, Affin Hwang estimates



Our receivables growth forecasts for FY22E-23E remain conservative at 5.5%-9.5% yoy while for FY21E, we are projecting a dip of -3.2% yoy given lower HP disbursements. Management continues to shy away from being too aggressive as seen in FY19-20, whereby HP receivables growth rates were 22.4% yoy and 28.6% yoy

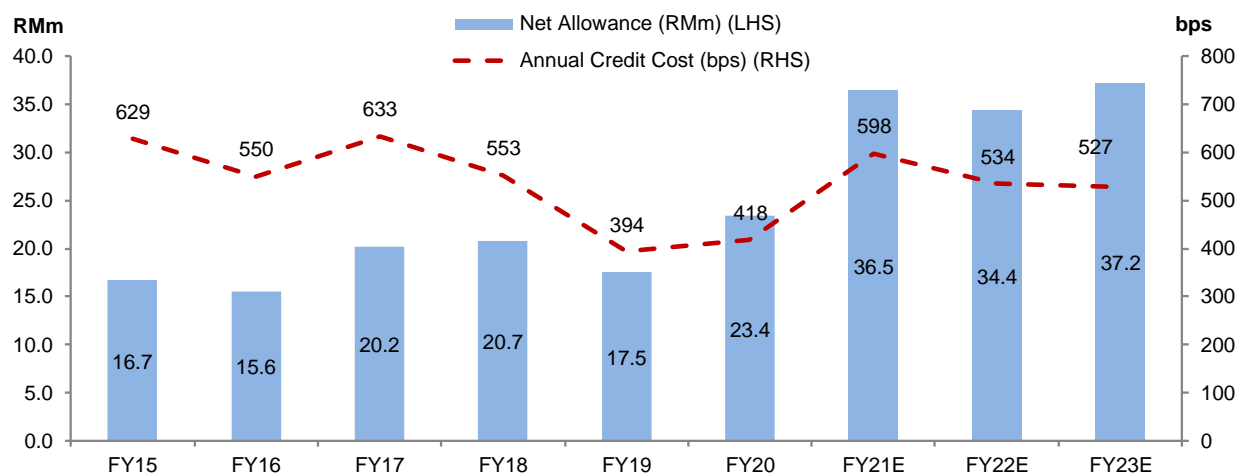
Fig 3: ELK-Desa: Size of outstanding hire-purchase receivables and gross NPL ratio with FY21E-23E forecasts



Source: Company data, Affin Hwang estimates

We maintain our conservative assumptions for FY21E-23E net credit cost, at 598bps, 534bps and 527bps respectively as we believe that management will continue to buffer up its loan loss cover from 171% FY21E to 250% in FY23E.

Fig 4: ELK-Desa: Annual net receivables impairment allowances and net credit cost with FY21E-23E forecasts



Source: Company data, Affin Hwang estimates

Financial Summary – ELK-Desa Resources

Profit & Loss Statement

FYE 31 Mar (RMm)	2019	2020	2021E	2022E	2023E
Revenue	125.4	149.4	147.3	161.8	175.6
- HP financing & related income	84.9	104.7	105.4	115.8	124.5
- Furniture division	38.5	43.3	40.0	44.0	49.0
- Other Income	2.0	1.4	1.9	2.0	2.1
Operating expenses	(77.9)	(90.7)	(96.9)	(101.8)	(108.5)
EBITDA	48.4	60.6	52.2	62.2	69.3
EBIT	47.5	60.0	49.8	59.8	66.9
Net Finance Costs	(3.7)	(11.1)	(10.9)	(13.1)	(15.2)
Pre-tax Profit	43.8	47.5	38.9	46.7	51.6
Taxation	(10.9)	(12.6)	(9.3)	(11.2)	(12.4)
Profit After Tax	32.9	34.9	29.6	35.5	39.2

Balance Sheet Statement

FYE 31 Mar (RMm)	2019	2020	2021E	2022E	2023E
Plant and Equipment	10.7	10.6	10.8	10.8	10.8
Deferred Tax Assets	3.3	5.2	5.2	5.2	5.2
Hire Purchase Receivables	357.4	466.2	429.4	453.0	504.0
Non-current Assets	371.4	484.3	447.8	471.4	522.4
Inventories	11.1	12.4	13.0	13.7	14.3
Trade Receivables & Others	12.8	16.0	13.5	14.8	16.0
Hire Purchase Receivables	119.0	144.3	165.4	173.4	178.4
Prepayments & Others	1.8	1.9	1.9	1.9	1.9
Cash and bank balances	31.4	91.6	48.9	116.8	112.3
Current Assets	176.1	266.2	242.8	320.5	322.9
TOTAL ASSETS	547.6	750.6	690.6	791.9	845.3

Others	0.6	1.4	2.2	2.2	1.8
Borrowings	64.1	167.3	50.0	110.0	160.0
Non-current liabilities	64.7	183.0	64.2	127.2	176.8

Trade Payables	13.9	11.2	11.5	11.9	12.2
Other Payables and accruals	5.2	9.6	9.6	9.6	9.6
Borrowings	50.2	113.6	160.0	180.0	150.0
Overdrafts	-	-	0.2	0.2	0.2
Taxation	2.5	3.9	3.9	3.9	3.9
Current liabilities	71.9	142.5	189.2	209.6	180.0

Share Capital	343.2	344.3	344.3	344.3	367.7
Reserves	60.9	74.9	86.0	103.9	120.8
ICULS - Equity component	6.9	5.9	6.9	6.9	-
Treasury Shares	-	-	-	-	-
Shareholders Funds	410.9	425.1	437.2	455.1	488.5

TOTAL EQUITY & LIABILITY	547.6	750.6	690.6	791.9	845.3
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Receivables (RMm)	2019	2020	2021E	2022E	2023E
Hire Purchase Receivables	490.0	630.0	609.9	643.5	705.3
Growth rate (%)	22.4	28.6	(3.2)	5.5	9.6

Operating Income (RMm)	2019	2020	2021E	2022E	2023E
Hire Purchase	73.0	91.8	101.8	103.8	111.9
Receivables Yield (%)	16.4%	16.4%	16.9%	17.0%	17.1%

Key Financial Ratios

FYE 31 Mar (RMm)	2019	2020	2021E	2022E	2023E
Returns and efficiency:					
ROE (%)	8.1%	8.3%	6.9%	8.0%	8.3%
ROA (%)	6.5%	5.4%	4.1%	4.8%	4.8%
Net Profit Margin (%)	26.6%	23.6%	20.3%	22.2%	22.6%
Cost-to-income ratio (%)	63.1%	61.3%	66.6%	63.7%	62.5%
Asset Quality:					
Gross NPL ratio (%)	0.8%	1.4%	1.4%	1.4%	1.3%
Credit Cost (bps)	393.7	417.8	598.1	534.2	527.5
Loan Loss Cover (%)	359%	222%	171%	194%	251%

Leverage Ratio:

Debt Service Ratio (x)	11.2	5.4	3.7	4.5	4.3
Debt/Equity (x)	0.28	0.71	0.52	0.68	0.67

Investment statistics

PBT growth (%)	24.0%	8.6%	-18.1%	20.0%	10.5%
Net earnings growth (%)	27.0%	6.1%	-15.2%	20.0%	10.5%
EPS growth (%)	13.3%	4.9%	-14.2%	20.0%	6.9%
Fully-diluted EPS growth (%)	15.8%	6.1%	-15.1%	19.8%	9.7%
PER (X)	12.6	12.0	14.0	11.6	10.9
FD PER (X)	12.9	12.0	14.3	12.0	10.9
EPS (sen)	11.2	11.8	10.1	12.1	12.9
FD EPS (sen)	10.9	11.8	9.8	11.8	12.9
BV/share (RM)	1.40	1.43	1.49	1.55	1.61
P/BV	1.0	1.0	0.9	0.9	0.9
Net DPS (sen)	7.0	7.3	5.5	7.0	7.8
Net yield (%)	5.0%	5.1%	3.9%	5.0%	5.5%
Dividend payout (%)	63%	62%	55%	58%	60%

Cash Flow Statement

FYE 31 Mar (RMm)	2019	2020	2021E	2022E	2023E
EBIT	47.5	60.0	49.8	59.8	66.9
Depreciation & Amortization	0.9	0.6	2.4	2.4	2.4
Allowance for impairment	17.5	23.4	36.5	34.4	37.2
Working capital changes	(63.5)	(140.8)	20.5	(35.5)	(63.6)
Taxes paid	(11.5)	(13.1)	(9.3)	(11.2)	(12.4)
Interest expense paid	(5.1)	(11.2)	(13.6)	(13.3)	(15.5)
Others	(52.2)	(40.5)	(32.2)	(33.8)	(32.9)
Cash Flow from Operations	(66.5)	(121.6)	54.1	2.8	(18.0)

Capex	(4.5)	(0.9)	(0.6)	(0.6)	(0.6)
Sale / (Purchase) of investments	0.1	-	-	-	-
Interest Received	1.3	2.4	0.6	0.2	0.3
Fixed Deposits	-	(67.0)	-	-	-
Cash Flow from Investing	(3.0)	(65.5)	(0.0)	(0.4)	(0.3)

Dividends paid	(20.7)	(20.7)	(18.5)	(17.6)	(22.3)
Term Loan raised/(repaid)	62.0	184.8	(73.2)	83.0	19.7
Equity raised	2.1	(1.3)	1.0	(0.0)	16.5
Share buy-back	16.7	-	-	-	-
Cash flow from Financing	43.5	162.8	(90.7)	65.4	13.8

Net Cash Flow	(26.0)	(24.3)	(36.7)	67.8	(4.5)
Effects of overdraft	7.2	17.4	-	-	-
Cash at Start of Year	50.3	31.4	24.5	(12.2)	55.6
Cash at End of Year	31.4	91.6	54.9	122.8	118.3

Source: Company data, Affin Hwang estimates

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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