

Plenty of room to gain grounds

We remain upbeat on ELK-Desa's prospects (post meeting with management) as its focus in the mass market used-car financing business is expected to generate high-teens EPS growth in FY20-21E while its ROE is expected to expand further towards 10% from 8% in FY19. Being a relatively small player (receivables outstanding amount to 0.3% of the car-financing market in Malaysia), we see room for growth even in the Klang Valley alone, coupled with its strong support from car dealers. Ultimately, with additional leverage, ELK-Desa could potentially grow its receivables at 16%-20% p.a. Maintain BUY, PT at RM1.98 (at 13x CY20E P/E target).

Potential to leverage up given a debt-to-equity ratio of 0.28x

ELK-Desa has taken the initiative to boost its receivables growth (up 23% yoy in FY19) through block discounting of payables, which was evident by the increase in the gearing level from 0.1x in FY18 to 0.28x in FY19. Though the rise in gearing was minimal, this had partially helped to bolster FY19 net profit by 27% yoy (on an EPS basis +13.3%). With expectation of a 16-20% growth in receivables p.a. and coupled with increased leverage, we believe that FY20E-21E EPS could grow by 17.3-21.5% yoy.

A small player vis-à-vis peers, but plenty of room for growth

Compared to similar peers such as Aeon Credit and RCE Capital, whereby receivables size are far larger, we believe that ELK-Desa which operates on the same business model, has ample potential to leverage up and expand its scale. ELK-Desa's gearing ratio stands at 0.28x compared to Aeon Credit at 2.7x and RCE Capital at 2.8x as at Mar19. In our view, industry dynamics remain in favour of ELK-Desa as it operates in a relatively steady used car financing market, whereby demand (primarily from the mass market) is not significantly affected by global trade and geopolitical uncertainties.

Reiterate BUY rating, Price Target unchanged at RM1.98

We maintain our **BUY** rating and **12-month Price Target** of **RM1.98** (pegged to 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 foresee a potential re-rating of the stock through better dividend payouts and expansion in ROEs. 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)	14.3	12.7	10.8	8.9	8.2
FD PER (x)	15.0	13.0	11.1	9.1	8.4
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	1.02	1.02	0.97	0.93	0.88
DPS (sen)	6.8	7.0	7.9	9.6	10.4
Dividend Yield (%)	4.8	4.9	5.6	6.7	7.3
Chg in EPS (%)			-	-	-
Affin/Consensus (x)			NA	NA	NA

Source: Company, Bloomberg, Affin Hwang forecasts

Company Update

ELK-Desa

ELK MK

Sector: Finance

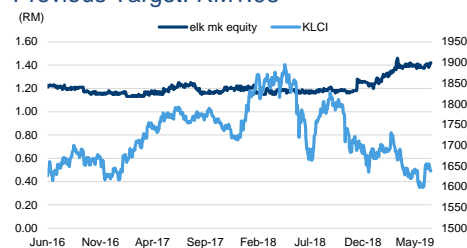
RM1.42 @ 14 June 2019

BUY (maintain)

Upside: 39.4%

Price Target: RM1.98

Previous Target: RM1.98



Price Performance

	1M	3M	12M
Absolute	2.9%	2.9%	22.4%
Rel to KLCI	0.8%	5.5%	31.6%

Stock Data

Issued shares (m)	296.5
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)	1.36
P/BV (x)	1.04
Net cash/(debt) (RMm)	(83.5)
ROE (2020E)	8.1
Derivatives (ICULS)	11.7
Shariah Compliant	No

Key Shareholders

Teoh Hock Chai	37.5%
Amity Corporation SD	5.2%

Source: Affin, Bloomberg

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A little leverage to boost market share

Potential to leverage up given a debt-to-equity ratio of 0.28x

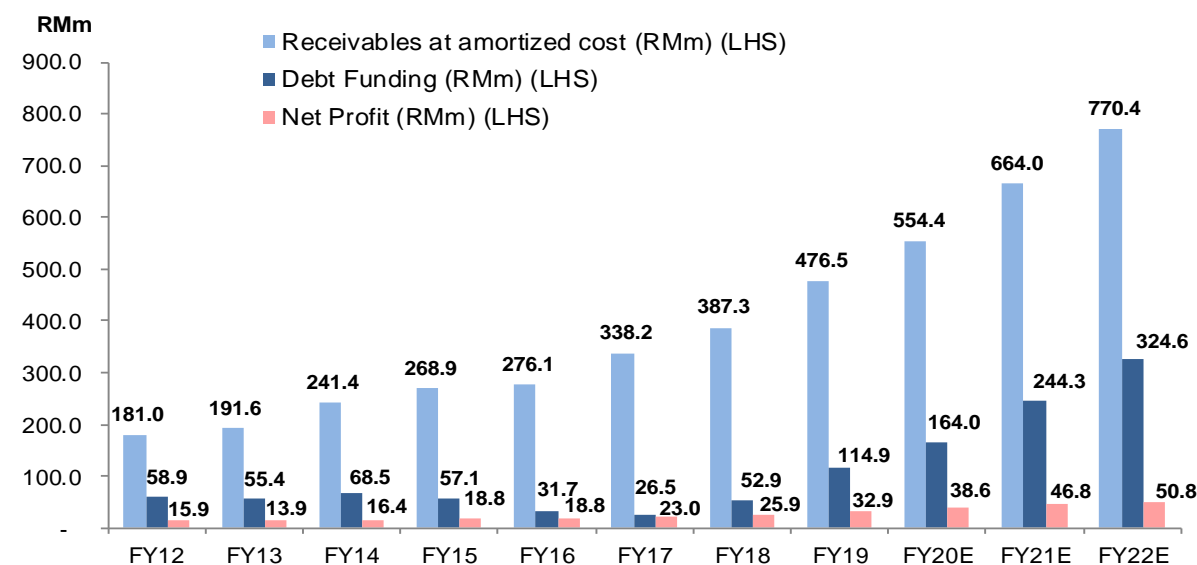
ELK-Desa's management has taken the initiative to boost its receivables growth (up 23% yoy in FY19) through block discounting of payables, which was evident by the increase in the gearing level from 0.1x in FY18 to 0.28x in FY19. Though the rise in gearing appears to be little, this had partially helped to bolster FY19's net profit by 27% yoy (on an EPS basis, +13.3%).

Funding of receivables through equities caused ROE to decline

In the past years, ELK-Desa had relied primarily on new funds raised through rights issues (ICULS and equities) in order to fund its receivables growth. To recap, subsequent to these rights issues which were completed in April 2014, October 2015 and September 2017, receivables have continued expanding at mid-teens to >20% growth p.a.. However, we note that the impact on net EPS have not been meaningful due to the dilution effects from the ICULS conversion. We saw a EPS decline of 14.6% yoy in FY16, 17% decline yoy in FY17 and 7.2% decline yoy in FY18. We believe that management had noted the decline in ROEs as well, from 10.1% in FY14 to 6.5% in FY16, while in FY19, despite a 13.3% yoy growth in EPS, ROE edged up to 8.1%.

In Fig 1, we compare ELK-Desa's historical net profits against receivables growth and the amount of total debts (which made up part of its funding profile – gearing level at 0.28x as at end-FY19).

Fig 1: ELK-Desa – growth receivables, borrowings and net profits (FY12-FY22E)



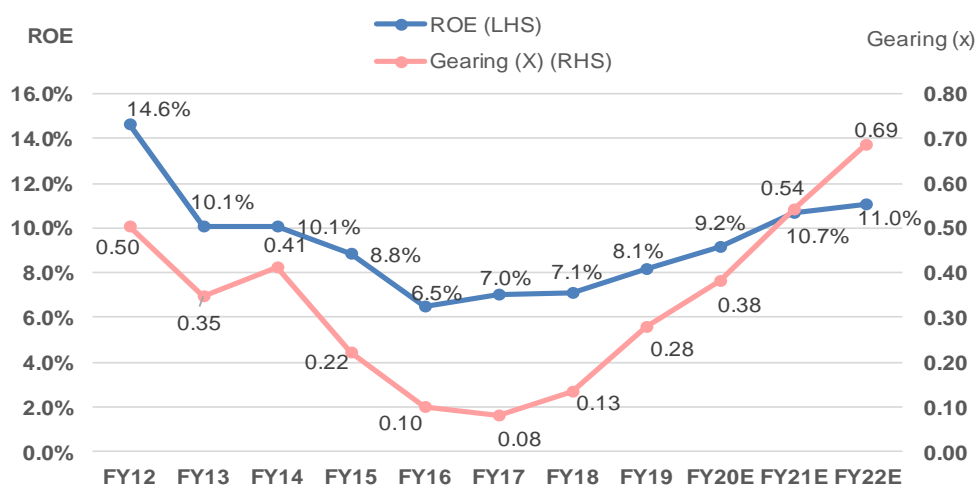
Source: Company data, Affin Hwang estimates

In Fig 2, based on ELK-Desa's gearing levels from FY12-19, which have turned relatively low after its rights issues (vis-à-vis peers such as Aeon Credit Service Malaysia and RCE Capital), this implies a potential for ELK-Desa to further leverage up in order to improve EPS growth (avoid dilution) and boost its ROE to above 10%.

A potential increase in funding will drive ROE up in tandem

In our FY20-22E forecasts, we have pencilled assumptions of increase in additional debt of RM78m in FY20E, RM109.6m in FY21E and RM106.4m in FY22E, resulting in a rise in gearing to 0.38x in FY20E, 0.54x in FY21E and further to 0.69x in FY22E. The move would help to boost receivables growth, which we currently forecast at +16.7%/+19.8%/+16.0% for FY20E/21E/22E. In tandem with the rise in gearing, we foresee an ROE expansion for ELK-Desa to 9.2% in FY20E, 10.7% in FY21E and 11% in FY22E.

Fig 2: ELK-Desa ROE and gearing profile (FY12-FY22E)

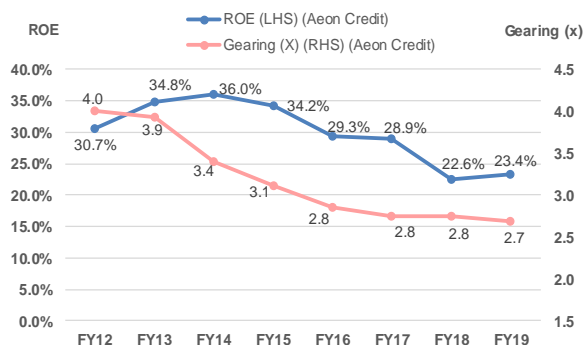


Source: Company data, Affin Hwang estimates

Similar gearing levels at Aeon Credit and RCE, but different ROEs

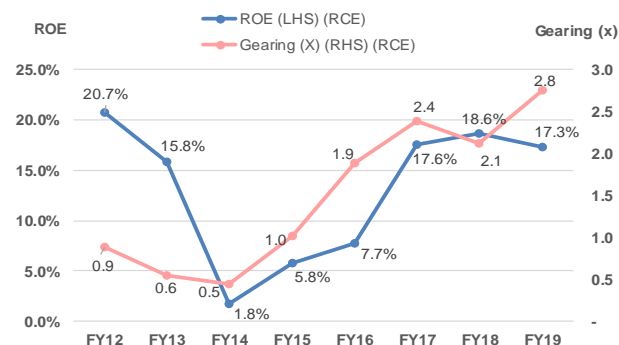
Both Aeon Credit and RCE Capital have similar gearing levels, at 2.7x-2.8x, however Aeon Credit generates higher returns for shareholders in terms of ROE, which stood at 23.4% in FY19 vis-à-vis RCE Capital at 17.3% in FY19. These are shown in Fig 3 and 4 (page 3).

Fig 3: Aeon Credit Service – gearing and ROE



Source: Company data, Affin Hwang

Fig 4: RCE Capital – gearing and ROE



Source: Company data, Affin Hwang

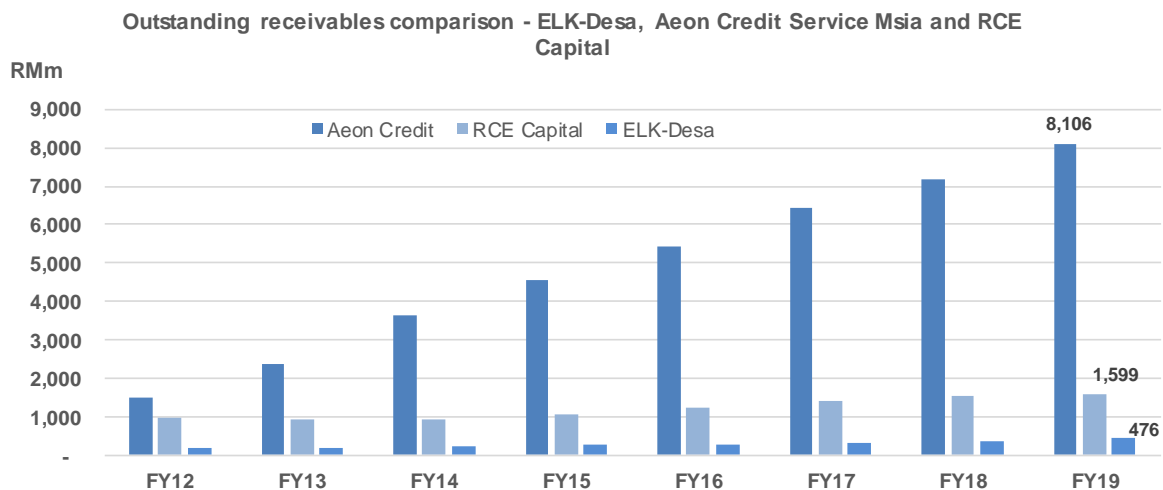
A small player vis-à-vis peers, but plenty of room for growth

Hence, we believe that ELK-Desa which operates on the same business model such as Aeon Credit and RCE Capital, has ample potential to leverage up and expand its asset base through stable means of debt-funding, such as a medium-term note programme. Although ELK-Desa remains fairly a small player against peers such as Aeon Credit and RCE Capital in terms of its receivables size (Fig 5, page 4), we believe that the growth potential remains robust in the country.

Steady market demand as economic conditions remain favourable

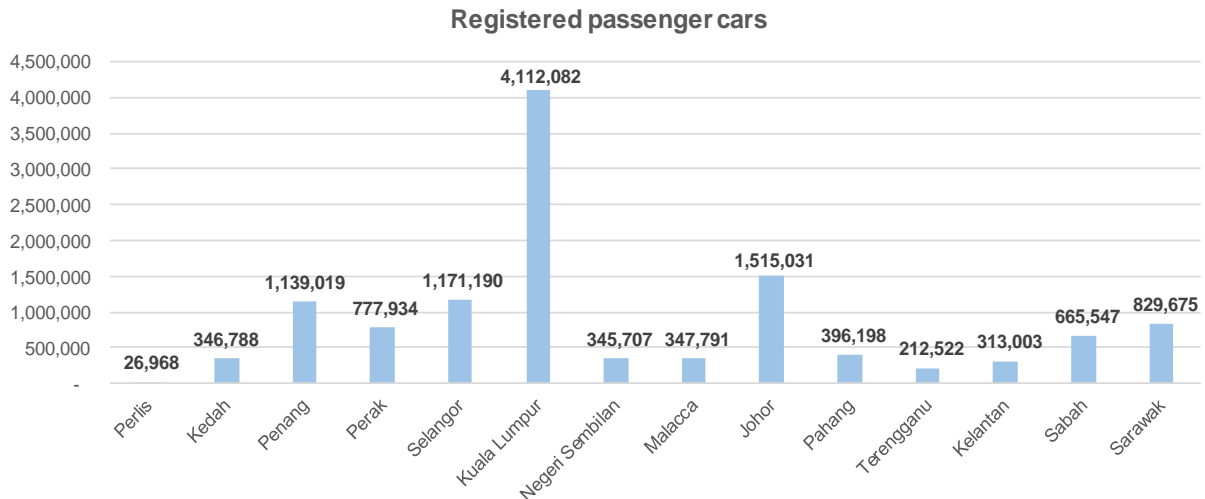
In our view, industry dynamics remain in favour of ELK-Desa, which operates in a relatively steady used car financing market. Demand (primarily from the mass market) is not significantly affected by global trade and geopolitical uncertainties. At present, the country's economic conditions remain favourable for the B40 and M40 groups to thrive as most remain employed.

Fig 5: Receivables comparison at ELK-Desa, Aeon Credit and RCE Capital



Source: Company data, Affin Hwang

ELK has primarily differentiated itself in used-car financing by focusing on the niche area of vehicles valued at RM20,000 and below. From FY19 onwards there has been a horizontal shift in business as it expanded financing for used vehicles valued at RM35,000 and below. We understand that this horizontal expansion into higher valued used vehicles is still within the prudent risk appetite of ELK's management, taking into consideration the type of cars purchased within this range which primarily consists of national cars and other non-national cars with minimal or slower depreciation value (around 6-15 years of age). The area of focus however, remains in the Klang Valley area (in the next five years).

Fig 6: Outstanding registered passenger cars in Malaysia (as at Dec2018)

Source: JPJ, Affin Hwang

Based on Fig 6, looking at the data of the outstanding registered passenger cars in Malaysia, the city of Kuala Lumpur and Selangor state are currently the key markets for ELK-Desa. An outstanding 5.2m passenger cars is still a huge market for a small player such as ELK-Desa, which on an annual basis approves circa 10,000-11,000 new accounts. In the medium term, we believe that the group may potentially expand beyond Klang Valley in to other more vibrant markets such as Penang or Johor.

Furniture trading and manufacturing contributes minimal profits

ELK-Desa's furniture segment contributed very minimal pre-tax profit of 2% to the group in FY19, as its strategy to focus on the domestic markets have worked well through expansion of the wholesale distribution and partnering with other dealers in the Klang Valley. In FY19, the revenue from the furniture segment has improved by 24% yoy. However, profits at this division was also offset by higher overheads and provisions. Management plans to continue keeping this business unit though it does not contribute significantly to the group.

Valuation & Financials

Maintain BUY, Price Target unchanged at RM1.98

We maintain our **BUY** rating and 12-month **Price Target** of **RM1.98** (pegged to a target P/E multiple of 13x 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 foresee a potential of re-rating of the stock through better dividend payouts (based on a policy of 60%) and expansion in ROEs.

In addition, the money-lending license obtained would help the group diversify its income in the medium to long-term. Default rates of ELK-Desa have continued to improve, the latest gross NPL ratio improved to 0.8% as at end-FY19 (FY18: 1.0%) as the overall receivables quality improve. Meanwhile, its business model, which takes advantage of affordable 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.

Key risks

Risk of defaults will rise in tandem with stress in cost-of-living

Most of the HP hirers (accounts) under ELK are largely the low to medium income group, who are mainly 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 higher risk due to the borrowers' limited capacity to mitigate the rising cost of living in urban cities.

ELK-Desa Resources – FINANCIAL SUMMARY

Profit & Loss Statement

FYE 31 Mar (RMm)	2018	2019	2020E	2021E	2022E
Revenue	105.5	125.4	143.9	164.5	186.6
- 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)
EBITDA	37.6	48.4	58.9	73.1	83.1
EBIT	37.0	47.5	58.2	72.5	82.4
Net Finance Costs	(1.7)	(3.7)	(7.5)	(10.8)	(15.6)
Pre-tax Profit	35.3	43.8	50.7	61.6	66.8
Taxation	(9.4)	(10.9)	(12.2)	(14.8)	(16.0)
Profit After Tax	25.9	32.9	38.6	46.8	50.8

Balance Sheet Statement

FYE 31 Mar (RMm)	2018	2019	2020E	2021E	2021E
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
Receivables	281.9	357.4	444.3	516.1	570.2
Non-current Assets	292.7	371.4	458.4	530.2	584.3
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	110.1	147.9	169.3
Prepayments & Others	2.1	1.8	1.8	1.8	1.8
Cash and bank balances	50.3	31.4	20.0	11.7	37.7
Current Assets	177.6	176.1	156.7	187.4	236.1
TOTAL ASSETS	470.3	547.6	615.2	717.6	820.4

ICULS - Liability component	2.3	0.6	1.0	1.0	1.0
Block discounting payables	29.4	64.1	90.0	100.0	260.0
Non-current liabilities	31.7	64.7	91.0	101.0	261.0

Trade Payables	13.6	13.9	14.7	15.4	16.2
Other Payables and accruals	4.8	5.2	5.2	5.2	5.2
Block discounting payables	21.2	50.2	70.0	140.0	60.0
Overdrafts	-	-	3.0	3.3	3.6
Taxation	2.7	2.5	2.5	2.5	2.5
Current liabilities	42.2	71.9	95.5	166.5	87.6

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)	-	-	-	-
Shareholders Funds	396.4	410.9	428.7	450.2	471.8

TOTAL EQUITY & LIABILITY	470.3	547.6	615.2	717.6	820.4
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Receivables (RMm)	2018	2019	2020E	2021E	2021E
Hire Purchase	400.4	492.4	574.5	688.0	798.3
Total Receivables	400.4	492.4	574.5	688.0	798.3
Growth rate (%)	14.3	23.0	16.7	19.8	16.0

Operating Income Breakdown	2018	2019	2020E	2021E	2021E
Hire Purchase	61.7	73.4	87.6	103.6	121.9

Receivables Yield (%)	2018	2019	2020E	2021E	2021E
Hire Purchase	17.0%	17.0%	17.0%	17.0%	17.0%

Key Financial Ratios

FYE 31 Mar (RMm)	2018	2019	2020E	2021E	2021E
Returns and efficiency:					
ROE (%)	7.1%	8.1%	9.2%	10.7%	11.0%
ROA (%)	6.1%	6.5%	6.6%	7.0%	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%

Asset Quality:

Gross NPL ratio (%)	1.00%	0.80%	1.00%	1.00%	1.00%
Credit Cost (bps)	550.0	380.0	355.1	355.8	368.0
Loan Loss Cover (%)	342%	359%	510%	701%	900%

Leverage Ratio:

Debt Service Ratio (x)	15.3	11.2	7.4	6.4	5.2
Debt/Equity (x)	0.13	0.28	0.38	0.54	0.69

Investment statistics

PBT growth (%)	15.5%	24.0%	15.9%	21.5%	8.5%
Net earnings growth (%)	12.6%	27.0%	17.3%	21.5%	8.5%
EPS growth (%)	-7.2%	13.3%	17.3%	21.5%	8.5%
Fully-diluted EPS growth (%)	9.4%	15.8%	17.1%	21.3%	8.4%
PER (X)	14.3	12.7	10.8	8.9	8.2
FD PER (X)	15.0	13.0	11.1	9.1	8.4
EPS (sen)	9.9	11.2	13.1	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	1.54	1.61
PBV	0.9	1.0	1.0	0.9	0.9
Net DPS (sen)	6.8	7.0	7.9	9.6	10.4
Net yield (%)	4.8%	4.9%	5.6%	6.7%	7.3%
Dividend payout (%)	76%	63%	60%	60%	60%

Cash Flow Statement

FYE 31 Mar (RMm)	2018	2019	2020E	2021E	2021E
EBIT	37.0	47.5	58.2	72.5	82.4
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)	(7.8)	(11.4)	(15.8)
Others	(7.4)	(52.2)	(16.2)	(19.8)	6.1
Cash Flow from Operations	(13.8)	(67.4)	(39.9)	(63.1)	(24.8)

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	-	-	-	-	-
Cash Flow from Investing	1.1	(2.3)	0.2	(0.0)	(0.4)

Dividends paid	(17.3)	(20.7)	(20.8)	(25.4)	(29.2)
Term Loan raised/(repaid)	26.4	62.0	49.0	80.3	80.3
Equity raised	54.4	2.1	(0.0)	(0.0)	(0.0)
Share buy-back	-	16.7	-	-	-
Cash flow from Financing	63.5	43.5	28.3	54.9	51.2

Net Cash Flow	50.8	(26.2)	(11.4)	(8.3)	26.0
Effects of overdraft	(15.1)	7.4	-	-	-
Cash at Start of Year	14.6	50.3	31.4	20.0	11.7
Cash at End of Year	50.3	31.4	20.0	11.7	37.7

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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