

17 February 2023

Financial Services | Diversified Financial Services

ELK-Desa Resources (ELK MK)

Buy (Maintained)

No Signs Of Slowing Down; Stay BUY

- Keep BUY, new GGM-derived MYR2.00 TP from MYR1.80, 18% upside with c.6% FY24F (Mar) yield.** ELK-Desa Resources' 9MFY23 results were a beat for the third consecutive quarter, with earnings already at a record high with one quarter to go. ELK continues to trade at c.1x P/BV – a discount to its peers' 1.2-1.4x. With receivables growth expected to be sustained and asset quality stable, we remain bullish on the counter.
- Record-high earnings at the 9-month mark.** ELK recorded 9MFY23 net earnings of MYR40.2m (doubled YoY), which accounts for 104% of our full-year forecasts. The variance came from greater-than-expected hire purchase receivables (HPR) growth and lower-than-expected impairment allowances. The group's 9MFY23 earnings have already beaten the previous full-year record of MYR35.4m achieved in FY21.
- Hire purchase segment.** HPR increased 19% YoY (QoQ: +8%) in 3Q23, which led to higher net interest income (+14% YoY, +6% QoQ). Positive JAWs during the quarter led to an improved CIR of 28.5% (2Q23: 29.2%, 3Q22: 31.0%). While impairment allowances surged 83% YoY to MYR3.78m (doubled QoQ), 3Q annualised credit cost of 256bps remains well below management's guidance of 300-400bps on an annualised basis.
- Furniture segment.** QoQ, revenue grew 18% (YoY: -11%) owing to stronger demand during the festive period. Lower staff and other operational costs drove opex down 4% QoQ (YoY: -6%). Overall, segmental PBT was steady, at MYR1.4m (+28% QoQ, -21% YoY).
- Bonus issue.** ELK announced a bonus issue of one new share for every two shares held at the entitlement date of 20 Mar 2023.
- Outlook.** HPR growth has already exceeded its guidance of 5-10% for the full year, but management is positive of even further growth. Repayment trends appear stable, but we could see a spike in credit costs in the next few quarters as the company intends on writing off some of its impaired accounts that have been idle since the beginning of the pandemic. To be cautious, we have factored in MYR1-4m of additional write-offs for FY23-25F. Notwithstanding the possible write-offs, we expect earnings delivery to remain solid – driven primarily by a strong HP segment, helped by a steady furniture segment.
- We lift FY23-25F forecasts by 13-14% as we factor in higher HPR growth assumptions, albeit slightly mitigated by increased credit costs.** Our TP rises to MYR2.00 as a result, and is based on a GGM-derived 1.3x P/BV. Our TP also bakes in a zero ESG premium/discount, in line with our in-house methodology. While record-year prospects have likely been priced in, we continue to like ELK for its steady earnings delivery, stable asset quality and generous dividend payouts.

Target Price (Return): MYR2.00 (+18%)
 Price (Market Cap): MYR1.70 (USD117m)
 ESG score: 3.00 (out of 4)
 Avg Daily Turnover (MYR/USD) 0.15m/0.03m

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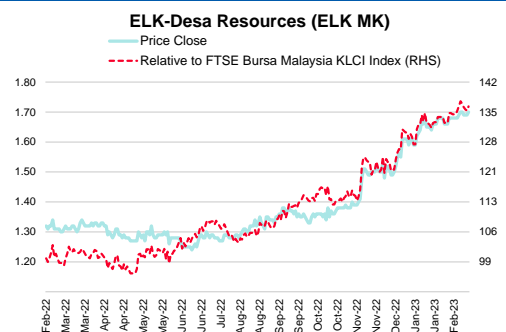


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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	6.9	3.7	14.9	26.9	28.8
Relative	7.7	4.3	12.4	29.2	36.2
52-wk Price low/high (MYR)	1.24 – 1.70				



Source: Bloomberg

Overall ESG Score: 3.00 (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 its reliance on paper and print.

S: GOOD

Each used vehicle financed is subject to mandatory inspection prior to approval, to ensure the safety of customers. Most of the hire purchase division's customers come from the B40/lower-M40 segment. The division is also well diversified, comprising 71% women, and has a balanced split between the different ethnic groups. The company has comprehensive plans in place to ensure workplace safety, as employee health and wellbeing are safeguarded at all times.

G: EXCELLENT

The company has in place policies and a framework to ensure that ethical business, integrity and transparency are practiced, as well as a whistleblowing programme. Board member responsibilities are revised and published annually. The Board meets around 5 times a year.

Forecasts and Valuation	Mar-21	Mar-22	Mar-23F	Mar-24F	Mar-25F
Reported net profit (MYRm)	35	26	45	47	50
Net profit growth (%)	0.9	(27.0)	72.4	5.9	5.4
Recurring net profit (MYRm)	35	26	44	47	50
Recurring EPS (MYR)	0.12	0.09	0.15	0.16	0.17
BVPS (MYR)	1.49	1.50	1.58	1.64	1.71
DPS (MYR)	0.07	0.05	0.09	0.10	0.10
Recurring P/E (x)	14.28	19.63	11.39	10.76	10.21
P/B (x)	1.14	1.13	1.08	1.03	0.99
Dividend Yield (%)	4.3	3.1	5.3	5.7	6.0
Return on average equity (%)	8.2	5.8	9.7	9.8	10.0

Source: Company data, RHB

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Financial Exhibits

Asia	Financial summary (MYR)	Mar-21	Mar-22	Mar-23F	Mar-24F	Mar-25F
Malaysia	EPS	0.12	0.09	0.15	0.16	0.17
Financial Services	Recurring EPS	0.12	0.09	0.15	0.16	0.17
ELK-Desa Resources	DPS	0.07	0.05	0.09	0.10	0.10
ELK MK / Buy	BVPS	1.49	1.50	1.58	1.64	1.71
Valuation basis	Valuation metrics	Mar-21	Mar-22	Mar-23F	Mar-24F	Mar-25F
GGM-derived intrinsic value with zero ESG overlay.	Recurring P/E (x)	14.28	19.63	11.39	10.76	10.21
Key GGM assumptions are:	P/B (x)	1.1	1.1	1.1	1.0	1.0
i. Cost of equity of 8.4%;	Dividend Yield (%)	4.3	3.1	5.3	5.7	6.0
ii. Sustainable ROE of 9.8%;	Income statement (MYRm)	Mar-21	Mar-22	Mar-23F	Mar-24F	Mar-25F
iii. 3.0% long-term growth.	Interest income	88	79	98	114	123
Key drivers	Interest expense	(13)	(10)	(10)	(13)	(17)
Key drivers include:	Net interest income	75	70	89	100	106
i. Hire purchase receivables (HPR) growth;	Non interest income	60	52	62	66	69
ii. Low impairment allowances on HPR;	Total operating income	134	122	151	166	175
iii. Profits from the furniture business.	Overheads	(70)	(64)	(75)	(80)	(84)
Key risks	Pre-provision operating profit	65	57	75	86	91
The downside risks include:	Loan impairment allowances	(19)	(22)	(13)	(21)	(22)
i. Weaker-than-expected HPR growth;	Other impairment allowances	(0)	(0)	(0)	(0)	(0)
ii. Higher-than-expected credit costs;	Pre-tax profit	46	35	62	65	69
iii. Weaker-than-expected performance of its furniture unit.	Taxation	(11)	(9)	(17)	(17)	(19)
Company Profile	Reported net profit	35	26	45	47	50
ELK-Desa Resources is a financial services company that provides hire purchase financing, with a focus on financing for used motor vehicles. As an extension, the company also cross-sells general insurance products from leading insurance brands to its hire purchase customers. On top of its financing operations, the company also operates a furniture trading business. ELK-Desa Resources currently employs approximately 250 individuals, with most of its business operations centred in the Klang Valley.	Recurring net profit	35	26	44	47	50
Shareholders (%)	Profitability ratios	Mar-21	Mar-22	Mar-23F	Mar-24F	Mar-25F
Eng Lee Kredit	Return on average assets (%)	5.0	4.1	7.1	6.6	6.3
Amity Corporation	Return on average equity (%)	8.2	5.8	9.7	9.8	10.0
Teo Siew Lai	Return on IEAs (%)	14.4	14.0	16.1	16.4	16.4
	Cost of funds (%)	5.2	6.1	6.3	6.4	6.6
	Net interest spread (%)	9.2	7.9	9.8	10.0	9.8
	Net interest margin (%)	12.3	12.3	14.5	14.5	14.2
	Non-interest income / total income (%)	44.4	42.8	41.0	39.5	39.3
	Cost to income ratio (%)	51.8	52.9	50.0	48.2	47.9
	Credit cost (bps)	315	413	229	327	319
	Balance sheet (MYRm)	Mar-21	Mar-22	Mar-23F	Mar-24F	Mar-25F
	Total gross loans	555	517	616	663	713
	Other interest earning assets	15	43	50	57	66
	Total gross IEAs	571	560	666	720	778
	Total provisions	(33)	(48)	(43)	(46)	(48)
	Net loans to customers	523	468	573	616	665
	Total net IEAs	538	511	623	674	730
	Total non-IEAs	125	71	58	76	90
	Total assets	663	582	681	749	820
	Other interest-bearing liabilities	196	117	187	230	275
	Total IBLs	196	117	187	230	275
	Total non-IBLs	25	17	24	30	36
	Total liabilities	221	135	211	260	311
	Share capital	344	345	351	351	351
	Shareholders' equity	442	448	470	489	509
	Asset quality and capital	Mar-21	Mar-22	Mar-23F	Mar-24F	Mar-25F
	Reported NPLs / gross cust loans (%)	4.9	9.9	4.5	4.5	4.3
	Total provisions / reported NPLs (%)	120.1	94.8	155.6	155.6	158.8

Source: Company data, RHB

Results At a Glance

Figure 1: ELK-Desa – Summary of 3QFY23 and 9MFY23 Results

FYE Mar (MYRm)	3Q FY22	2Q FY23	3Q FY23	QoQ (%)	YoY (%)	9M FY22	9M FY23	YoY (%)	Comments – 9MFY23 vs 9MFY22
Revenue	38.2	36.0	40.0	10.9	4.6	92.9	114.9	23.7	
<i>HP division</i>	22.4	24.1	25.9	7.5	15.9	63.9	74.5	16.7	Driven by robust HPR growth (+19% YoY).
<i>Furniture division</i>	15.8	11.9	14.0	17.6	(11.4)	29.1	40.4	39.0	Operations in 1HFY22 were affected by lockdowns.
Cost of Sales	(10.3)	(6.9)	(9.0)	30.1	(12.8)	(19.3)	(25.2)	30.5	
Gross Profit	27.9	29.1	31.0	6.3	11.0	73.6	89.8	21.9	
<i>Gross margin (%)</i>	73.0	80.8	77.5			79.2	78.1		
Non-IT	0.5	0.5	0.4	(22.3)	(8.4)	1.6	1.5	-5.5	
Overhead expenses	(10.3)	(10.3)	(10.4)	0.5	1.1	(24.2)	(31.1)	28.8	
EBIT	18.1	19.4	21.0	8.6	16.1	51.1	60.2	17.8	
<i>EBIT margin</i>	47.4	53.7	52.6			55.0	52.3		
Finance costs	(1.9)	(2.1)	(2.5)	18.2	36.1	(7.9)	(6.4)	-19.9	Finance costs decreased YoY after paring down on borrowings throughout FY22.
PIOP	16.2	17.2	18.5	7.4	13.8	43.1	53.8	24.7	
Impairment allowances	(2.1)	(2.0)	(3.7)	88.5	76.8	(15.8)	(0.5)	<i>nm</i>	Better-than-expected recovery in collections, likely helped by the Employees Provident Fund special withdrawal programme in 1QFY23.
<i>Ann. credit costs (bps)</i>	160	128	256			420	5		Still below the guidance of 300-400bps.
PBT	14.1	15.2	14.8	(3.1)	4.4	27.4	53.4	95.0	
<i>HP division</i>	12.3	14.1	13.3	(5.6)	8.3	25.9	49.4	90.4	
<i>Furniture division</i>	1.8	1.1	1.4	28.0	(21.3)	1.4	4.0	>100	
Tax expenses	(3.6)	(3.7)	(3.6)	(2.0)	0.7	(7.1)	(13.1)	84.0	
<i>ETR (%)</i>	25.5	24.3	24.6			26.0	24.6		
Net earnings	10.5	11.5	11.1	(3.5)	5.7	20.2	40.2	98.9	At 104% of our full-year forecast, and 103% of the Street estimate.
<i>Net margin (%)</i>	27.5	32.0	27.8			21.8	35.0		
Other key data and ratios									
Net HP receivables (MYRm)	469.3	521.1	560.3	7.5	19.4				20% YTD growth is ahead of management's 5-10% guidance for FY23.
Net debt / equity (x)	0.2	0.3	0.3						
ROAE (%) – annualised	9.6	10.0	9.6			6.1	11.8		
ROAA (%) – annualised	7.1	7.0	6.5			4.3	8.5		
CIR (%) – hire purchase	31.0	29.2	28.5			27.4	28.7		

Source: Company data, RHB

Figure 2: Revisions in full-year earnings forecasts

FYE Mar	Net profit (MYRm)			PBT (MYRm) – HP division			PBT (MYRm) – Furniture division		
	Previous	Revised	% Chg	Previous	Revised	% Chg	Previous	Revised	% Chg
2023F	38.8	44.4	14.3	50.1	56.8	13.3	3.8	4.9	27.6
2024F	41.2	47.0	14.1	52.9	59.9	13.2	4.3	4.5	4.4
2025F	43.8	49.5	13.1	56.4	64.1	13.7	4.4	4.7	6.0

Source: Company data, RHB

Figure 3: Revisions in key assumptions

FYE Mar	Net HP receivables (MYRm)			Credit costs (bps) – HP division			Revenue (MYRm) – Furniture		
	Previous	Revised	% Chg	Previous	Revised	bps Chg	Previous	Revised	% Chg
2023F	529.8	573.1	8.2	199	229	31	51.0	53.2	4.3
2024F	572.8	616.3	7.6	285	327	42	55.6	55.8	0.4
2025F	617.6	664.5	7.6	283	319	36	58.4	58.6	0.4

Source: Company data, RHB

Valuation and TP

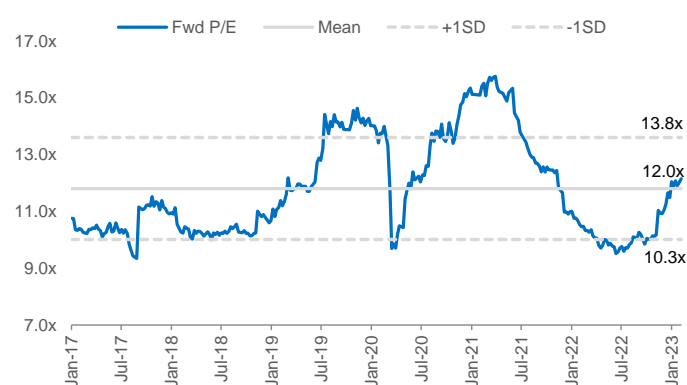
Our new TP of MYR2.00 (from MYR1.80) is based on a GGM-derived fair value P/BV of 1.26x (from 1.15x), in line with other non-bank lenders’ 1.2-1.4x. We believe the counter deserves a higher valuation, due to its strong earnings delivery, stable asset quality and solid dividend yield of c.6% for FY24F. Our TP includes a parity ESG premium/discount, as ELK’s ESG score of 3.0 is in line with the country median.

Figure 4: ELK-Desa’s GGM valuation

Cost of equity (COE) computation:		Sustainable ROE (%)	9.8
Risk free rate (%)	4.0	COE (%)	8.4
Equity premium (%)	4.4	Long-term growth (g)	3.0
Beta (x)	1.0	Implied P/BV (x)	1.26
Cost of equity - CAPM (%)	8.4	BVPS – 12-month forward	MYR1.61
		Intrinsic value	2.03
ESG premium/(discount) (%)	0	ESG premium/(discount)	MYR0.00
		TP (rounded)	MYR2.00

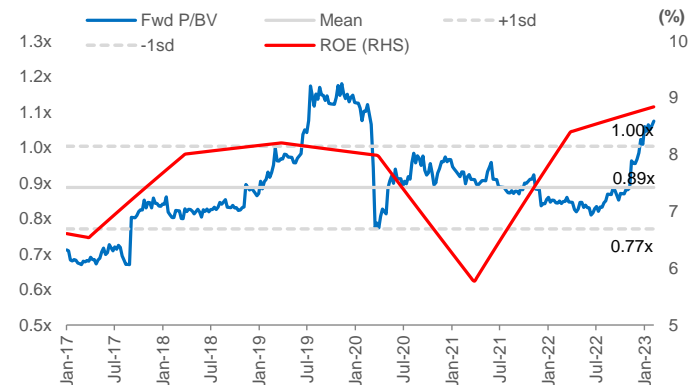
Source: Company data, RHB

Figure 5: ELK-Desa’s 12-month forward P/E



Source: Bloomberg, RHB

Figure 6: ELK-Desa’s 12-month forward P/BV vs ROE



Source: Bloomberg, RHB

Recommendation Chart

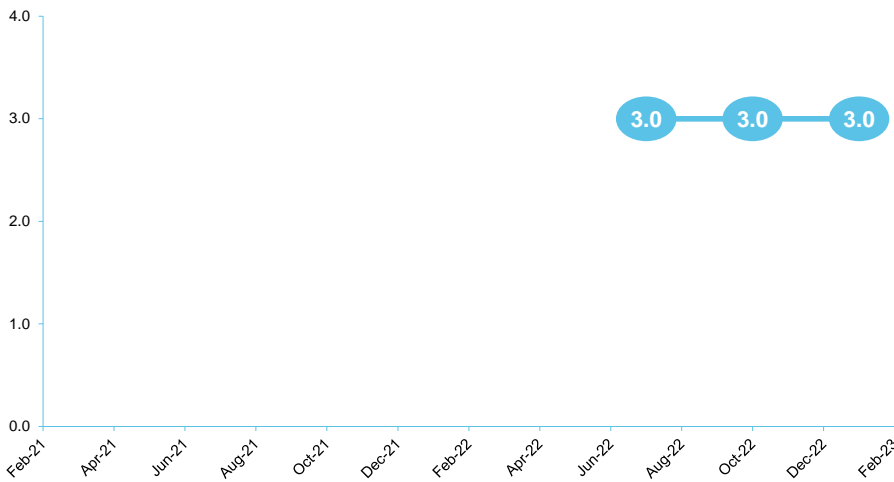


Date	Recommendation	Target Price	Price
2022-11-16	Buy	1.80	1.48
2022-08-21	Neutral	1.60	1.35
2022-07-17	Neutral	1.30	1.27

Source: RHB, Bloomberg

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

RHB Guide to Investment Ratings

Buy:	Share price may exceed 10% over the next 12 months
Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
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Not Rated:	Stock is not within regular research coverage

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