IFS Capital

(IFS SP/I49.SI)

Full recovery ahead

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- IFS Capital Limited (IFS) provides commercial finance services such as factoring, hire-purchase/leasing, loans, government-assisted schemes and trade/export finance to SMEs. The group also provides bonds, guarantees and general insurance through its subsidiary ECICS Limited.
- **Hit on financials due to Covid-19.** Profits were growing steadily from 2016 to 2019, with an average growth rate of 13.4% per annum. However, things took a turn in 2020 when Covid-19 hit, with PATMI decreasing by 88% YoY to only S$0.8mn (from S$6.5mn core PATMI in 2019), respectively.
- **2021, a better year ahead.** We expect to see a rebound in 2021 and full recovery by 2022 as global economic growth picks up momentum.
- **Maintain OUTPERFORM.** Our fair value of S$0.29 is based on 0.6x 2021F BVPS.

YE Dec SGD mn	2019A	2020A	2021F	2022F	2023F
Net Interest Income	25.3	21.0	22.5	24.4	26.1
PATMI	9.4	0.8	4.6	4.8	4.9
Net Profit Growth	-48%	-92%	483%	4%	1%
EPS (SGD cents)	2.5	0.2	1.2	1.3	1.3
Return on Equity	5.8%	0.5%	2.6%	2.7%	2.7%
Return on Assets	3.5%	0.3%	1.6%	1.8%	1.8%
NAV (SGD Cents)	47.6	46.7	48.0	49.3	50.5
P/B(x)	0.4	0.4	0.4	0.4	0.4
P/E(x)	7.4	88.0	15.1	14.5	14.3
Wgt. Avg. shares, diluted	376	376	376	376	376
DPS (SGD Cents)	0.78	0.20	0.43	0.45	0.45
Div Yield (%)	4.2	1.1	2.3	2.4	2.4

Source: Company Data, KGI Research

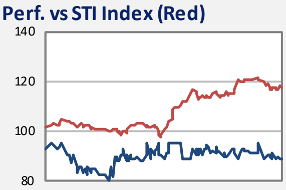
Outperform - Maintained

Price as of 3 Aug 21 (SGD)	0.19
12M TP ($)	0.29
Previous TP ($)	0.30
Upside (%)	54.8

Performance (Absolute)	
1 Month (%)	-0.5
3 Month (%)	-2.1
12 Month (%)	-5.6

Trading data	
Mkt Cap ($mn)	70
Issued Shares (mn)	376
Vol - 3M Daily avg (mn)	0.0
Val - 3M Daily avg ($mn)	0.0
Free Float (%)	32.6%

Perf. vs STI Index (Red)



Major Shareholders	
Lim Hua Min	60.3%
Dymon Asia Private Equity	6.9%

Previous Recommendations	
31-Mar-20	OP S$0.30
2-Jan-19	OP S$0.29
17-Oct-18	OP S$0.29

SME lending business is still key revenue driver. The bulk of business generated in 2020 was contributed by the credit financing segment, which made up 82.7% of total net operating income, an increase from 74.9% in 2019. However, PBT generated from the credit financing segment was slightly offset by losses incurred from the insurance segment, resulting in a lower PBT recorded for the year.

On the road to recovery. We expect financing to recover steadily in 2021 amid the backdrop of an improving economy. However, while Singapore has done relatively well due to broad government support, other countries such as Thailand may still lag. On an overall basis, we see revenue being more resilient than initially expected when the pandemic first hit.

Figure 1: Operating income and PBT by segments (YoY)

	Credit Financing	Insurance	Private Equity & other investments	Total
2020				
Total Operating Income	27,397	5,352	371	33,120
PBT	8,414	(6,247)	370	2,537
2019				
Total Operating Income	34,376	8,144	3,406	45,926
PBT	17,430	(4,227)	3,140	16,343

Source: Company data, KGI Research

Insurance segment gaining momentum. While IFS's insurance arm has been loss making, it was on the positive trend of reducing the losses from 2018 to 2019. However, there were two significant performance bonds that were called in 2020, both related to the construction industry, which amounted to around S$4.5mn. Excluding these two performance bonds, losses at its insurance segment would have reduced YoY to around S$2.2mn compared to losses of around S$4.9mn in 2019 and S$5.5mn in 2018.

Investment income. There was an 85% dip in investment income from S$4.9mn in 2019 to S$709k in 2020, due to lower returns from equity investments in 2020 as a result of the volatility in the financial markets. Amid accommodative monetary and fiscal policies, we expect financial markets to remain buoyant and therefore offer better returns in 2021.

Going digital. The group currently has three digital offerings to serve consumers and SMEs. On the consumer side, it has Friday Finance (www.fridayfinance.sg) which focuses on financial wellness at an affordable and transparent pricing. Its loan marketplace Lendingpot (www.lendingpot.com) connects SMEs with relationship managers from up to 45 financial institutions in Singapore to find the best business loan. They have introduced new tools including property robo-valuation and loan-matching services.

Valuation & Action: We maintain our OUTPERFORM recommendation on IFS, driven by the recovery of its lending business. We assign a target price of $0.29 to IFS, based on 0.6x FY20F BVPS.

Risks: Increase in net claims from its insurance business and an economic slowdown are key risks. Meanwhile, a faster than-expected rise in interest rates would impact IFS's cost of borrowings and net interest margins.

Turnaround for SEA region in 2021. The group's main revenue segment in 2020 is attributable to Singapore and Thailand, with 50% and 42% contribution, respectively. Geographical focus is consistent with 2019 as well, with 53% and 37% revenue coming from Singapore and Thailand respectively. Despite the hit to 2020's financials due to Covid-19, we expect gradual recovery in 2021 for SEA regions, especially for Singapore. Thailand may still face challenges this year but will likely catch up by 2022.

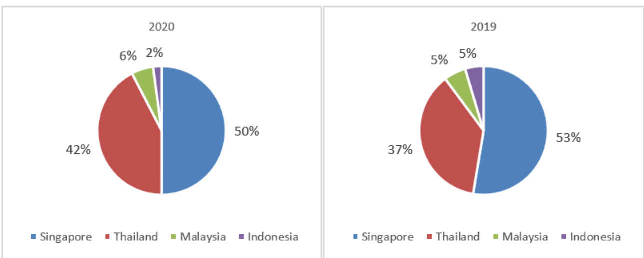
Singapore. Singapore experienced a 5.4% contraction of GDP in 2020 but reported a 1.3% expansion in 1Q21, with the biggest growth contribution coming from the manufacturing sector which reported an expansion of 10.7%. Singapore's 2021 GDP forecast is expected to be around 4% to 6%, driven by quick rollout of vaccinations and a shorter round of heightened measures (1 month in May-June 2021). With Singapore's economy expected to strengthen from 2020 and as confidence returns, the growth of SMEs will ultimately be a good source of new business for IFS's credit financing business.

Thailand. For Thailand on the other hand, the situation is not as optimistic when compared to Singapore. Being a country highly reliant on tourism, pandemic control is of crucial importance to keep its economy running. In 2020, Thailand's GDP contracted by 6.1% and the growth forecast for 2021 was lowered to between 1.5% and 2.5%, from the initial range of 2.5% to 3.5%. This was due to a third wave of infections, resulting in the country going into another forced lockdown in April 2021.

On a positive note, Thailand has started vaccinations in June 2021 and is aiming to open its borders by the end of this year once more than 70% of its population is vaccinated.

IFS Thailand still profitable despite challenging environment. While 2020's revenue from Thailand was significantly impacted by Covid-19, this segment was still profit making. 2021 might see a similar result with softer growth, but we expect that 2022 would see an acceleration as the country reopens for travel and tourism.

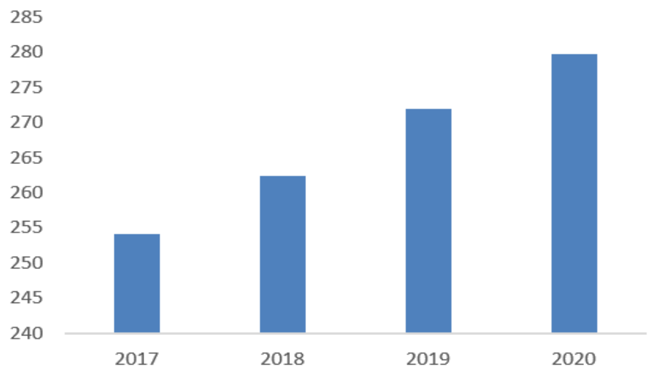
Figure 2: Net income split by geographical location



Source: Company data, KGI Research

Consistent SME growth in Singapore. As IFS's main revenue generator is from credit financing to SME businesses, the consistent growth rate of SME businesses would provide a positive structural tailwind. Despite the pandemic and proposal of a global minimum tax rate of 15% announced by the Group of Seven (G7) nations in 2021, Singapore still remains an attractive hub for SMEs and we expect this growing trend to continue in 2021 and in the coming years.

Figure 3: SME growth in Singapore

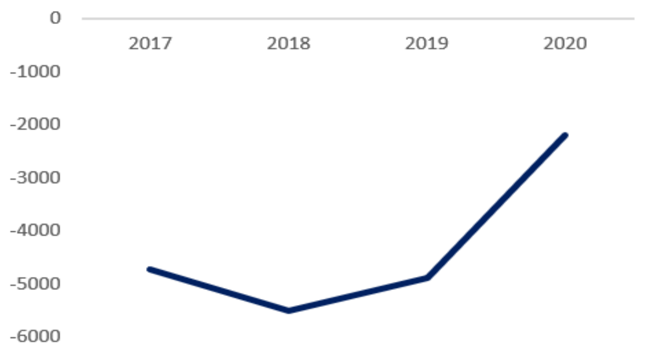


Source: Department of Statistics, Singapore

Insurance segment gaining momentum. IFS's insurance arm has been loss making but is turning around as losses have been consistently reduced YoY. Included in 2020's losses of S$6.6mn were 2 significant performance bond calls related to the construction industry which amounted to S$4.5mn.

Trend showing a turnaround. We have excluded the losses from the 2 performance bonds for fair comparison to establish the trend pattern. The group has also embarked on a more stringent approach to its insurance business as a means to reduce such future losses. The first approach includes stricter control on customer selection and the second, mainly the non-renewal of bonds which have matured unless 100% collateral is provided. The group has de-risked their bond portfolio as at 31 December 2020, and we expect insurance losses to gradually decrease, and eventually turn profitable.

Figure 4: Insurance net losses YoY



Source: Company data, KGI Research

Investment income. There was an 85% dip in investment income from S$4.9mn in 2019 to S$709k in 2020, due to lower returns from the stock market in 2020 as a result of the volatility. As the global economy has started to recover, and amid an accommodative global fiscal and monetary regime, we expect better returns going forward.

Figure 5: Investment income YoY

Source: Company data, KGI Research

Valuation

We maintain our Outperform recommendation on IFS in view of its rapid recovery, driven by growth in its factoring business. We assign a target price of S$0.29 to IFS Capital, based on a FY21F P/B of 0.6x and a FY21F BVPS of S$0.48. We believe that the worst is over for IFS and expect IFS to trade at a higher P/B, closer to its peer average as it expands its balance sheet.

P/B valuation more meaningful. In terms of relative valuations, P/B basis would be more meaningful as earnings-based valuations can be volatile for small-mid cap finance companies. Singapore finance companies trade at an average of 0.6x P/B against low single-digit ROEs.

Lack of comparable peers. There is a lack of direct comparable in the Singapore market in terms of funding profile. Although there are other financing companies such as Hong Leong Finance and Singapura Finance, we note that they target different segments of the market (e.g., car financing, property loans). The provision of short-term funding for SMEs makes up the majority of IFS' operating profit and growth driver.

Key assumptions for our revenue/earnings model

•Factoring and lending business to benefit from broad-based economic recovery in Southeast Asia and from a better regulatory environment from 2022 onwards.

•Growth for factoring and lending business in Singapore to eventually recover. Singapore's total factoring volume grew by a CAGR of 32% from 2010 to 2016 and we expect IFS to continue benefitting from this trend post the pandemic.

•Thailand is the largest significant growth driver and the most profitable entity in the IFS group, pre-pandemic. In 2018, operating income and assets in the country increased by 13% YoY and 7% respectively. IFS owns a 73.1% effective stake in IFS Capital (Thailand), which is listed on the Stock Exchange of Thailand.

•Malaysia and Indonesia's combined contribution to the group is expected to be less than 10% of net operating income in 2021. However, we are positive on their long-term prospects given long-term structural tailwinds to their economies.

•We expect net claims from insurance business to subside after termination of certain policies (mainly auto-related) and as it becomes more selective of clients. Going forward, credit financing segment will drive revenues while insurance segment to remain flat as the new management for ECICS Limited continues to turn it around.

Figure 2: Peer comparison

Company	Last Price	Market Cap (S$mn)	Return on Equity (%) FY-1	Return on Equity (%) Last FY	P / B (x) Last FY	Div Yield (%) Last FY	Div Yield (%) FY+1	Gearing (x) Current
Ifs Capital Ltd	**SGD 0.19**	**72**	**5.8**	**0.5**	**0.47**	**2.9**	**4.1**	**1.7**
Local Credit Financing Firms								
Hong Leong Finance Ltd	SGD 2.43	1,088	3.3	3.3	0.6	5.6	-	1.2
Sing Investments & Finance	SGD 1.47	232	5.2	5.2	0.6	2.7	-	1.2
Singapura Finance Ltd	SGD 0.84	133	1.9	1.9	0.5	1.8	-	1.3
Average			3.4	3.4	0.6	3.4	-	1.2

Source: Bloomberg, KGI Research

KGI's Ratings	Rating	Definition
	Outperform (OP)	We take a positive view on the stock. The stock is expected to outperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
	Neutral (N)	We take a neutral view on the stock. The stock is expected to perform in line with the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
	Underperform (U)	We take a negative view on the stock. The stock is expected to underperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon
	Not Rated (NR)	The stock is not rated by KGI Securities.
	Restricted (R)	KGI policy and/or applicable law regulations preclude certain types of communications, including an investment recommendation, during the course of KGI's engagement in an investment banking transaction and in certain other circumstances.

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