

IFS Capital Ltd

Loan Losses Likely to Decline in 2014

IFS Capital Ltd (IFS) reported a 27.5% year-on-year increase in operating profit before allowances for 4Q FY13. However, profit attributable to shareholders was hit by S\$10.9m of allowances for loan losses and impairment of other assets, resulting in a net loss to shareholders of S\$4.4m for the quarter. Higher allowances for loan losses in 2013 was due to higher specific provisions for seven clients in Singapore and Malaysia. We expect the company to revert to profitability in 1Q FY14, in the absence of such specific and large allowances.

Expect Some Recovery in 2014: IFS made S\$20.1m of allowances for loan losses and impairment of other assets for FY13. The provisions were due to S\$6.9m made against the potential loss of two major clients in Singapore, and S\$8.9m made for five major clients in Malaysia. Accordingly, the company had been prudent in providing for its full exposure to these clients, but recovery action has since commenced. Some of these clients are still operating and the company may recover a portion of its losses over time.

Core Businesses Remain Robust: Excluding these allowances, IFS had actually reported a 10% increase in operating profit to S\$17.0m in 2013 on a 5.2% increase in total income to S\$38.1m. Loan assets fell to S\$335.6m compared to S\$359.3m a year ago due to higher repayments. We expect loan assets to resume growth as the company renews its portfolio.

Our View: We adjusted our forecasts to factor in lower loan assets at the beginning of the year and lower operating costs. As a result, we now expect the company to make PATMI of S\$6.5m for FY14. This is to also take into account slower momentum in Thailand in the midst of political turmoil. Nonetheless, the company is maintaining its dividend payout for FY13. We are encouraged that the company has managed to maintain its net interest margin at around 6% in FY13. Factoring the slower than expected decline in net interest margin and the turnaround in FY14, we maintain our valuation at S\$0.570 per share.

Invest

- Intrinsic Value S\$0.570
- Prev Closing S\$0.410

Main Activities

IFS Capital Limited is an established financial institution involved in commercial, alternative and structured finance, private equity investments as well as credit insurance, bonds and guarantees. Besides Singapore, IFS also has operations in Malaysia, Indonesia and Thailand.

Financial Highlights

(Y/E Dec) S\$ m	FY12	FY13	FY14F
Net Interest Inc	19.6	20.8	19.4
Net Earned Prem	4.0	2.9	3.2
Fee and Comm	8.9	10.4	10.9
Invt & Other Inc	3.7	4.0	4.0
Net Profit	9.1	-3.7	7.5
EPS (S cents)	5.3	-3.4	4.3

Source: Voyage Research Estimates

Key ratios (FY14F)

PER	9.46
P/BV	0.47
Return on Common Equity	5.1%
Return on Assets	1.8%
Gross Debt to Common Equity	197.6%
Current ratio	1.3

Source: Voyage Research Estimates

Indexed Price Chart

Green (FSSTI)
White (IFS)



Source: Bloomberg

52wks High-Low S\$0.550 / S\$0.385
 Number of Shares 150.39m
 Market Capitalization S\$61.66m

Analyst:

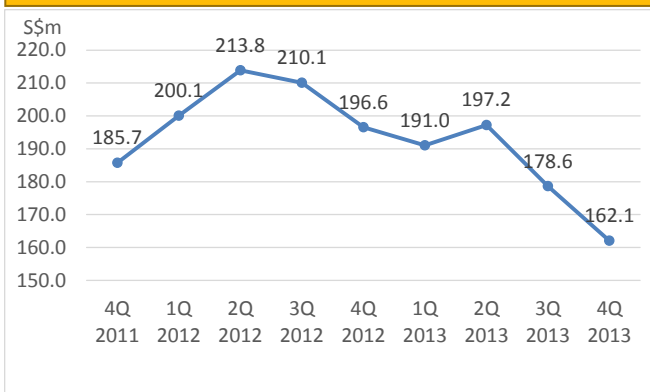
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Taking Measures to Grow Business and Reduce Risks: Regional operations, including Indonesia, Malaysia and Thailand, were actually profitable in FY13, in spite of allowances of S\$11.2m. Regional operations had a profit after tax of S\$0.27m in FY13. The company's strategy on the whole remains unchanged. IFS intends to grow the general insurance business to reduce concentration on credit risks and, at the same time, build another revenue stream. Over in Indonesia, IFS aims to take on more factoring business, rather than leasing activities.

Reasonable to Expect Loan Recovery in 2014: While the loan losses in 2013 were particularly steep, the company clarified that some of these clients are still operating and due to cash flow issues, such as dispute with end customers and project delays, were slow in making repayments. The company intends to focus only on government related projects in Malaysia, to reduce the risk of poor collections. While we have limited information on the financial health of the affected clients, we also acknowledge that SMEs have less financial resources and that tight cash flow, which may be temporary, may not necessarily be reflective of their businesses.

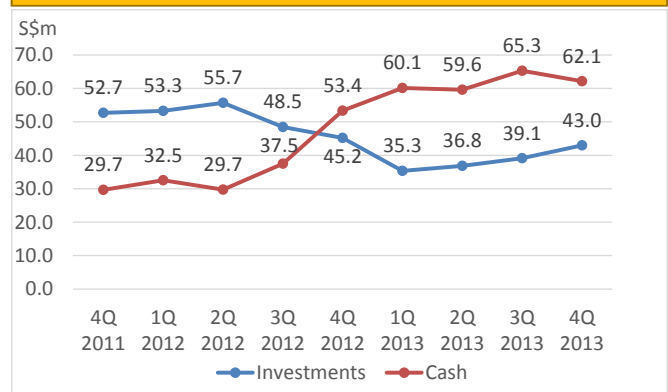
High Cash Balance to Fund Growth and Investments: IFS ended 2013 with S\$62.1m of cash and net gearing of S\$162.1m. Some of the cash will be deployed to support higher insurance volume. At the same time, even more aggressive use of this cash in investment activities to generate higher returns will help to raise the return on equity of IFS and further unlock value. The decline in cash compared to 3Q FY13 of about S\$3.2m roughly matched the increase in investments of about S\$3.9m.

Figure 1: Declining Net Borrowings



Source: Company, Voyage Research

Figure 2: Rising Cash Balance



Source: Company, Voyage Research

Valuation and Forecasts: For FY14F, we expect net interest income to decline slightly due to lower loan assets at the beginning of the year, which may be partially offset by about 10% higher net earned premium revenue. We expect allowances to be about 2% of loan assets or S\$6.4m in FY14F, versus the average of S\$3.8m in FY11 and FY12. Hence, we have factored in higher allowances in order to be conservative. These adjustments result in a forecast PATMI of S\$6.5m.

Our valuation of IFS remains unchanged as we now project a slower decline in net interest margin and reduced capital costs due to lower projected debt during our forecast horizon. Estimated invested capital fell from S\$499m to S\$398m in FY15F and S\$417m in FY16F. While WACC rose marginally, capital costs in dollar value fell by a greater proportion.

Figure 3: Results Overview

	FY13	FY12	FY11	4Q 2013	3Q 2013	2Q 2013	1Q 2013	4Q 2012
Net interest income	20.77	19.60	16.91	4.81	5.25	5.55	5.15	4.88
Net earned premium revenue	2.92	4.00	2.84	0.73	1.05	0.55	0.59	0.85
Non-interest income	14.43	12.63	11.79	3.62	4.84	3.01	2.97	3.48
Total income	38.11	36.23	31.55	9.16	11.14	9.11	8.71	9.22
Operating expenses	-20.19	-21.00	-19.44	-4.48	-5.58	-5.17	-4.98	-5.03
Operating profit before net claims and allowances	17.92	15.23	12.11	4.68	5.56	3.94	3.73	4.18
Net claims reversal/(incurred)	-0.93	0.21	1.34	0.70	-0.12	-1.45	-0.07	0.04
Allowances & impairment	-21.57	-3.06	-4.62	-10.90	-1.64	-7.61	-1.43	-0.70
Profit / (loss) before tax	-4.59	12.38	8.83	-5.51	3.80	-5.12	2.24	3.52
Tax credit / (expense)	0.88	-3.24	-1.13	1.30	-0.55	0.59	-0.46	-0.84
Profit / (loss) after tax	-3.71	9.15	7.70	-4.21	3.25	-4.53	1.78	2.68
Attributable profit / (loss)	-5.07	7.94	6.96	-4.40	2.84	-4.92	1.40	2.37
Non-Interest Income								
Fee & commission	10.40	8.94	9.57	2.50	2.68	2.86	2.37	2.23
Investment income	3.30	3.36	1.61	1.04	1.67	0.08	0.51	1.15
Other income	0.73	0.32	0.61	0.08	0.49	0.07	0.08	0.10
Selected Balance Sheet Items								
Total Receivables (1)	257.1	302.2	277.2	257.1	285.1	305.7	312.9	302.2
Other Investments	43.0	45.2	52.7	43.0	39.1	36.8	35.3	45.2
Cash	62.1	53.4	29.7	62.1	65.3	59.6	60.1	53.4
Total borrowings	224.2	249.9	215.4	224.2	244.0	256.9	251.2	249.9
Total Common Equity	127.3	139.7	134.6	127.3	131.6	133.0	142.8	139.7
Gearing (2)	1.63	1.68	1.50	1.63	1.72	1.80	1.64	1.63
Ann. Return on Avg. Com. Equity	-3.8%	5.8%	5.2%	-13.6%	8.6%	-14.3%	4.0%	6.0%
				2013	9M 2013	1H 2013	1Q 2013	2012
Net Interest Margin	6.0%	5.9%	6.5%	6.0%	6.0%	6.0%	6.0%	5.9%

(1) Total receivables refer to loans, advances, hire purchase and leasing receivables (non-current assets) and trade and other receivables (current assets). (2) Gearing = Total Borrowings / Total Equity

Source: Company, Voyage Research

Figure 4: Valuation

S\$m	FY14F	FY15F	FY16F
Profit Before Tax and Interest Expense	17.4	20.6	22.3
Tax on EBIT	-3.3	-5.4	-5.8
NOPLAT	14.0	15.2	16.5
Invested Capital	361.6	398.2	416.7
% of Debt	62.0%	64.6%	64.8%
% of Equity	38.0%	35.4%	35.2%
WACC (%)	4.3%	4.3%	4.2%
Capital Charge	15.6	17.2	17.4
Economic Profit	-1.6	-1.9	-0.9
Terminal Value			-42.5
Discount Factor	0.96	0.92	0.88
Present Value	-1.5	-1.8	-0.8
Book Value	127.3	Risk Free Rate	2.50%
Explicit Value	-4.1	Beta	0.7
Terminal Value	-37.6	Market RP	7.50%
Value of Equity	85.6	Cost of Equity	7.75%
Number of Shares (m)	150.4	Cost of Debt	3.0%
Value per share (\$)	0.570	LT Growth	2%

Source: Voyage Research

Figure 5: Financial Forecast and Estimate

	FY11	FY12	FY13	FY14F	FY15F	FY16F
Net Interest Income	16.9	19.6	20.8	19.4	20.7	21.8
Net Earned Premium Revenue	2.8	4.0	2.9	3.2	3.5	3.9
Fee & Commission Income	9.6	8.9	10.4	10.9	11.5	12.0
Investment & Other Income	2.2	3.7	4.0	4.0	4.7	4.7
Net Profit After Tax	7.7	9.1	-3.7	7.5	9.4	10.3
PATMI	7.0	7.9	-5.1	6.5	8.2	9.0
Total Current Assets	272.0	306.8	294.5	322.9	333.5	353.1
Total Non-Current Assets	121.5	125.8	104.8	115.2	125.3	128.2
Total Current Liabilities	214.6	238.6	227.6	257.6	270.8	284.8
Total Non-Current Liabilities	35.1	44.7	34.4	39.4	41.3	43.3
Total Equity	143.8	149.3	137.3	141.1	146.7	153.3
Cash from Operating Activities	-71.3	-20.8	33.4	-15.7	-2.8	-2.5
Cash from Investing Activities	-1.7	11.6	1.6	-8.1	-11.1	-1.1
Cash from Financing Activities	69.2	33.3	-25.3	29.1	9.1	9.7
Net Change in Cash	-3.8	24.0	9.7	5.3	-4.8	6.2
Return on Common Equity	5.2%	5.8%	-3.8%	5.1%	6.2%	6.5%
Return on Assets	2.1%	2.2%	-0.9%	1.8%	2.1%	2.2%
Gross Debt / Common Equity	160.1%	179.5%	176.1%	197.6%	200.7%	202.9%
Current Ratio	1.3	1.3	1.3	1.3	1.2	1.2
EPS (S cents)	4.63	5.28	-3.37	4.34	5.43	5.96
BV / Share (S cents)	89.5	92.9	84.7	86.5	89.4	92.9
P/E Ratio	8.86	7.77	NM	9.46	7.55	6.88
P/B Ratio	0.46	0.44	0.48	0.47	0.46	0.44

Casting errors may occur due to the effects of rounding.

Source: Company, SIAS Research

Rating Definition:

Increase Exposure – The current price of the stock is significantly lower than the underlying fundamental value. Readers can consider increasing their exposure in their portfolio to a higher level.

Invest – The current price of the stock is sufficiently lower than the underlying fundamental value of the firm. Readers can consider adding this stock to their portfolio.

Fairly Valued – The current price of the stock is reflective of the underlying fundamental value of the firm. Readers may not need to take actions at current price.

Take Profit – The current price of the stock is sufficiently higher than the underlying fundamental value of the firm. Readers can consider rebalancing their portfolio to take advantage of the profits.

Reduce Exposure - The current price of the stock is significantly higher than the underlying fundamental value of the firm. Readers can consider reducing their holdings in their portfolio.

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