

GICS: Financials/Specialized Finance

Business Summary: IFS Capital is a financial institution whose core activities evolve around the provision of financial services such as commercial and structured finance, private equity investments as well as credit insurance, bonds and guarantees.

Country of Incorporation: Singapore

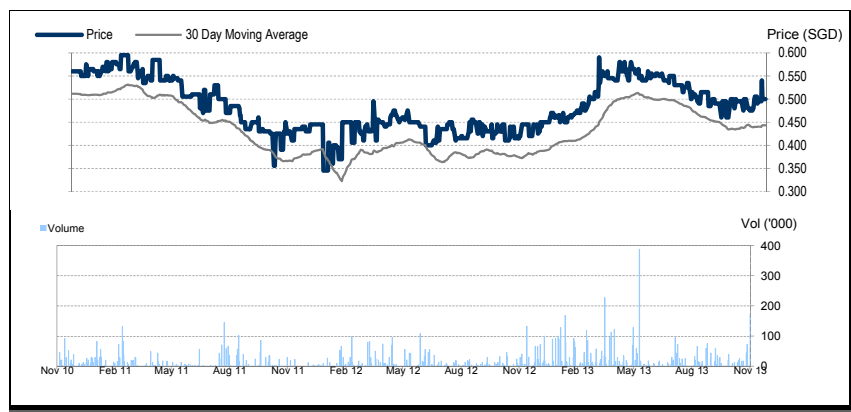
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Key Stock Statistics

52-week Share Price Range (SGD)	0.38 - 0.54
Avg Vol - 12 months ('000 shares)	21.2
Price Performance (%)	
- 1 month	0.0
- 3 month	-3.2
- 12 month	13.9
No. of Outstanding Shares (mln)	150.4
Free Float (%)	50.8
Market Cap (SGD mln)	67.7
Enterprise Value (SGD mln)	246.3
Major Shareholders (%)	
Phillip Assets Pte Ltd	41.0
SMRT Road Holdings	6.9

Per Share Data

FY Dec.	2012	2013E	2014E
Book Value (SG cents)	92.61	92.77	95.48
Cash Flow (SG cents)	5.8	2.1	5.2
Reported Earnings (SG cents)	5.1	1.4	4.5
Dividend (SG cents)	2.0	0.5	1.8
Payout Ratio (%)	39.5	39.5	39.5
PER (x)	8.8	32.8	10.1
P/Cash Flow (x)	7.8	21.7	8.7
P/Book Value (x)	0.5	0.5	0.5
Dividend Yield (%)	4.4	1.2	3.9
ROE (%)	5.6	1.5	4.8
Net Gearing (%)	141.1	161.3	180.2

Strong fee income and investment gains cost drive profits

- 3Q13 results in line.** IFS broadly met our expectations in 3Q with net profit at SGD2.83 mln (+27.2% YoY). The overall improved performance was driven by strong fee income growth (+23.5% YoY) and investment gains of SGD1.67 mln (vs. SGD0.35 mln in 3Q12) and stable net interest margin (NIM) of 6.0%. NIM surprised positively, and we think IFS' focus on small and medium enterprise (SME) clients provides it the flexibility to raise rates. Net interest income grew a muted 4.9% YoY as loan (includes factoring) volumes fell 1% YoY due to repayments of SGD23 mln in Singapore. We think the slowdown in loan volume is temporary and expect growth to pick up as IFS continues to add new clients.
- Signs of stress at its international operations.** Net interest income grew a stable 17.2% YoY, while fee income growth was robust at 32.9% YoY at its international operations. However, net profit for the segment fell 11.5% YoY due to a jump in provision for loan losses (+337% YoY). Asset quality was under stress at its Malaysian and Indonesian operations (mining related). Management indicates the provisions are largely technical and expects recoveries going into 2014.
- Faster-than-expected insurance premium income offset by higher provisions.** Gross written premiums grew 100.2% YoY (51.3% YoY in 9M13) driven by strong bond and guarantee business volumes (+130% YoY in 9M13), while credit insurance volume lagged (+19% YoY in 9M13). We think the bond and guarantee business gets a boost from the launch of related new insurance products. However, net earned premium income fell 52.0% YoY (-30.6% YoY in 9M13) due to higher provisions for unexpired risk. As such, 3Q13 net profit for insurance fell 79.2% YoY.
- Staff costs remain benign.** 3Q13 staff cost increased less than expected at 0.8% YoY. We think staff costs may continue to be benign, despite a rise in headcount as IFS has the flexibility to adjust performance related bonus payments.
- Book value dampened by translation losses.** Book value fell to SGD0.88 (-1.1% QoQ) due to translation losses and fair value losses in its available for sale portfolio.

Earnings Outlook

Revenue Drivers:

- We expect the international operations to drive growth, while loan growth in Singapore is steady and supported by the strength in the SME sector. In Indonesia, IFS plans to focus on factoring as the leasing business is hit by the slower mining activity. In Thailand, while domestic consumption is weak, the export sector is recovering and is expected to drive factoring volumes. Meanwhile, Malaysia continues to benefit from post-election government spending. We expect overall loans to grow 10% YoY in 2014.
- The insurance operations continue to expand its product offerings with the launch of Contractors All Risks and Work Injury Compensation insurance in 3Q13. In addition, IFS plans to leverage on its credit insurance clients and launch cargo insurance over the next few months. We think the new products launched in 2H13 complement the existing portfolio well and we expect them to boost overall premium income growth.
- We expect fee income strength to be sustained as factoring volumes remain robust and IFS' insurance operations cede increasing business to re-insurers. Management maintains its policy to cede out around 50% of the insurance business. Meanwhile, we expect investment income to be stable as IFS reduced its exposure to equity investments to SGD7.6 mln. (vs. SGD18.6 mln end-2012)

Margin Outlook:

- We expect the rising share of international operations to lend support to its relatively high NIM. IFS' NIM is driven by Indonesia, followed by Singapore and Thailand. We forecast relatively muted NIM pressure of 12 bps in 2014 as IFS has the flexibility to raise rates for its SME clients.
- We expect operating costs to rise 5.4% YoY in 2014 as it continues to expand its international operations and increases the headcount for the factoring business.

Bottomline:

- We expect net profit to rebound in 2014 due to a low base and credit cost normalizing to 3% (forecast 6% in 2013). We think IFS' focus on the SME sector increases the uncertainty in its credit costs should economic growth slow. Our forecasts assume fee and investment income growth of 10%.
- We believe there is room for an upside to our forecasts for the insurance operations that assume premium income growth of 7% with relatively flat net profits. Main risks to our forecast include: (i) slowing growth in Indonesia and rising competitive pressures in Thailand that may see potentially rising credit costs and (ii) potential currency translation losses due to SGD strength vs. regional currencies, which may negatively impact book value.

Earnings Performance

FY Dec. / SGD mln	3Q13	3Q12	% Change
Reported Revenue	12.4	11.6	7.6
Reported Operating Profit	5.4	4.8	12.8
Depreciation & Amortization	-0.3	-0.5	-25.1
Net Interest Income / (Expense)	NA	NA	NA
Reported Pre-tax Profit	3.8	3.5	8.7
Reported Net Profit	2.8	2.2	27.2
Reported Operating Margin (%)	43.7	41.7	-
Reported Pre-tax Margin (%)	30.5	30.2	-
Reported Net Margin (%)	22.8	19.3	-

Source: Company data

Profit & Loss

FY Dec. / SGD mln	2011	2012	2013E	2014E
Reported Revenue	36.0	42.7	43.2	47.2
Reported Operating Profit	13.4	15.1	15.1	16.1
Depreciation & Amortization	-2.2	-2.1	-2.1	-2.1
Net Interest Income / (Expense)	NA	NA	NA	NA
Reported Pre-tax Profit	8.8	12.0	4.2	10.1
Effective Tax Rate (%)	12.8	26.4	20.0	20.0
Reported Net Profit	7.0	7.6	2.1	6.7
Reported Operating Margin (%)	37.4	35.3	34.9	34.1
Reported Pre-tax Margin (%)	24.6	28.1	9.6	21.3
Reported Net Margin (%)	19.3	17.9	4.8	14.2

Source: Company data, S&P Equity Research

Key Financial Performance

FY Dec.	2011	2012	2013E	2014E
Revenue Growth(%)	1.3	18.7	1.2	9.3
Operating Profit Growth(%)	-4.0	11.9	0.2	6.5
Net Profit Growth(%)	-2.1	9.6	-72.9	225.5
EPS Growth(%)	-2.1	10.9	-73.1	225.5
EPS 3-Year CAGR(%)	-10.4	2.0	-33.6	-0.9

Source: Company data, S&P Equity Research

Key Fundamentals

FY Dec.	2009	2010	2011	2012
ROE (%)	5.3	5.5	5.2	5.6
ROA (%)	1.9	2.4	2.0	1.9
Pay out (%)	31.4	31.8	37.8	39.5

Valuation

Our fair value estimate for IFS is unchanged at SGD0.52 to SGD0.56 based on a weighted blend of dividend discount and PBV valuations. Our valuations factor in long-term loan growth of 7.5%, with rising share of international business expected to keep net interest margin relatively stable. We have attached a target 2013 PBV of 0.8x based on a 30% discount to the median PBV of a select basket of overseas finance companies and 10% discount to the Singapore companies. The higher discount for the overseas peers largely reflects IFS' position in these markets that are relatively new to it and where it needs to build up scale.

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