

## IFS Capital Ltd

### Regional Factors Pay Off

IFS Capital Ltd ("IFS") announced FY10 results on 24<sup>th</sup> February 2011. IFS's top and bottom line were up 9.9% and 19.8% respectively. The credible total performance was led by strong regional growth outside of Singapore, particularly in Indonesia, Malaysia and Thailand. We maintain our Invest rating and upgrade its intrinsic value of \$0.640, representing a 13% upside over its last closing price of \$0.500

#### Key Development:

- Higher profits for the year were driven by IFS's operational drivers: interest income and fee and commission income. Net interest margin increased from 6.5% in FY10 compared to 5.4% in FY09. IFS had lower net earned premium due to lower write back in provision of unexpired risks. Operating expenses rose due to an increase in staff costs, depreciation and amortization costs. Staff costs were up mainly due to increased headcount and provision for employee benefits set aside by its Thai subsidiary.
- IFS's Thai subsidiary completed its IPO on 5<sup>th</sup> August 2010 of 120 million new shares at the offer price of THB1.35 per share. This results in the reduction of the Group's aggregate shareholding from 98.2% to 73.1%. The subsidiary had increased fee and commission revenue due to higher factoring volume.
- Gross operating income generated from operations outside of Singapore experienced strong YoY growth of 22.2% (FY10: \$15.0m vs FY09: \$12.3m).
- ECICS Ltd, a wholly owned subsidiary of IFS, received higher insurance commission and investment income for the year 2010.

## Invest

- Intrinsic Value S\$0.640
- Prev Closing S\$0.500

#### Main Activities

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

#### Financial Highlights

| (Y/E Dec) S\$m   | FY09 | FY10 | FY11F |
|------------------|------|------|-------|
| Net Interest Inc | 13.1 | 19.1 | 22.3  |
| Net Earned Prem  | 5.8  | 3.4  | 3.6   |
| Fee and Comm     | 6.4  | 7.5  | 7.8   |
| Inv & Other Inc  | 3.7  | 1.8  | 4.9   |
| Net Profit       | 6.6  | 7.9  | 7.9   |

Source: SIAS Research estimate

#### Key ratios (FY11F)

|                  |      |
|------------------|------|
| Return on Equity | 5.3% |
| Return on Asset  | 1.8% |
| Debt/Equity      | 1.84 |
| Price/Earnings   | 12.3 |
| Price/Book       | 0.65 |

Source: SIAS Research Estimate

#### Indexed Price Chart

Green (FSSTI)  
White (IFS Capital)



Source: Bloomberg

52wks High-Low S\$0.580-0.450  
Number of Shares 150.4m  
Market Capitalization S\$75.2m

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## Steady Growth in Financial Performance

**Impressive 2010 earnings for IFS:** On a YoY basis, IFS posted a significant increase in NPAT of 19.8% (FY10: \$7.9m vs FY09:\$6.6m). IFS also showed improvements in their performance ratios compared to prior year with ROE and ROA increasing to 5.5% and 2.2% - a surge of 3.8% and 15.8%. We also noted that IFS had also deleveraged over the years. Management had stated that they had focused on liquidity due to the financial crisis but would be focusing more on business operations looking ahead.

**Figure 1: Results Overview**

|                          | Results |      |      | Growth |       |
|--------------------------|---------|------|------|--------|-------|
|                          | FY08    | FY09 | FY10 | FY09   | FY10  |
| Return on Equity         | 6.6%    | 5.3% | 5.5% | -20.0% | 3.8%  |
| Return on Total Assets   | 2.0%    | 1.9% | 2.2% | -13.6% | 15.8% |
| Earnings per Share (cts) | 5.3     | 4.3  | 4.7  | -18.9% | 9.3%  |
| NAV per share (cts)*     | 80.5    | 84.5 | 88.2 | 5.0%   | 4.4%  |
| Leverage (times)         | 2.2     | 1.7  | 1.3  | -15.0% | 23.5% |
| Gearing (times)          | 1.7     | 1.4  | 1.1  | -17.6% | 21.4% |

Source: Company, SIAS Research

\*Reclassified NAV using current weighted average shares outstanding

IFS's main driver of growth on a business segment basis is from net interest income which grew 45.7% from \$13.1m to \$19.1m. The increase in net interest income was mainly due to higher recoveries of interest previously suspended and recognition of current and prior years' interest repayments, as well as the full consolidation effects of the Thai subsidiary income.

The two other business segments, non-interest income and net earned premium revenue, experienced a decline of 8.0% and 40.0% respectively. The lower non-interest income is attributable to a fair value loss on a derivative for hedging and available-for-sale (AFS) quoted investment. However, the corresponding fair value for the hedged investment was recognized in the comprehensive income and restated within equity in the fair value reserve which translates to an aggregate increase in mark-to-market value of its investment portfolio.

Net premium revenue saw a 40% (FY10: \$3.5m vs FY09:\$5.8m) YoY decline due to lower write back in provision for unexpired risks. The higher write back in 2009 was due to actuarial reduction in expected future loss factor on the bonds and guarantee business. We note that the decline in gross margin for both business segments do not affect the business's underlying cashflow.

### Leading performer in the sector

**IFS value prospects strong:** A sector comparison between IFS and its competitors indicates that IFS had created more value to its shareholders' wealth during the past few years with an IRR (accounting for dividends, rights and share bonuses) of 18.82%. Its market ratios are also significantly below its industrial peers which are most likely attributable to a discount on its market size.

**Figure 2: Sector Comparatives**

| Company                    | Price  | Market Cap<br>(S\$ m) | P/B  | P/E  | 5 years<br>dividends IRR |
|----------------------------|--------|-----------------------|------|------|--------------------------|
| IFS Capital                | \$0.50 | 75.2                  | 0.53 | 10.8 | 18.8%                    |
| Singapore Reinsur. Corp    | \$0.30 | 181.6                 | 0.89 | 13.6 | 8.2%                     |
| Sing Investments & Finance | \$1.69 | 176.5                 | 0.82 | 10.0 | 22.6%                    |
| Singapura Finance          | \$1.58 | 125.4                 | 0.77 | 12.8 | 15.7%                    |
| Hong Leong Finance         | \$2.86 | 1259.5                | 0.81 | 11.3 | 5.8%                     |

Source: SIAS Research, Bloomberg

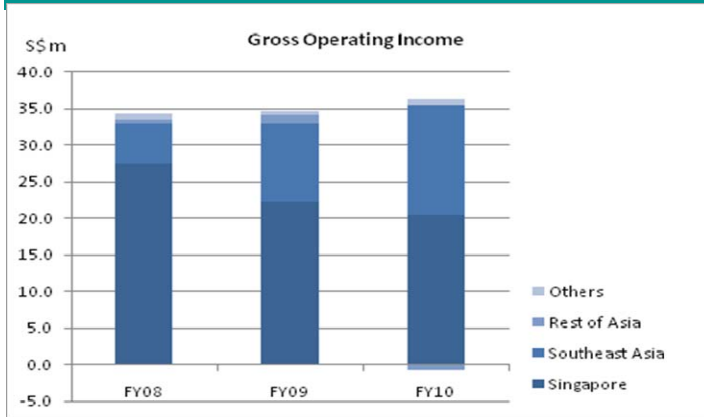
### Strong regional operations growth

**Regional Operations Main Driver of Growth:** IFS's regional operations outperformed, netting a 47.9% increase YoY in PAT. The gross operating income for the Southeast Asia operations increased from S\$10.7m to S\$14.8m – a 39% increase YoY. Operating margins had not changed significantly YoY. The nominal increase in operating expenses could be attributed to the increase in staff costs and provision for employee benefits set aside by the Thai subsidiary.

IFS's regional operations' profitability will continue to persist over time as the barriers to entry for these markets remain high due to "nationalistic" reasons. IFS had gathered experienced locals in key management positions which help to react in the dynamics of local market as well as to satisfy the "nationalistic" requirements.

Going forward, IFS continues to seek to expand its services organically in these countries such as money-lending in Malaysia and to obtain the necessary operating licenses for them. We believe that IFS's expansion into these markets will continue to add value to its shareholders as margins and domestic business in the target markets are expected to remain firm and funding cost expected to remain low.

**Figure 3: Group Geographic Segments Overview**



Source: SIAS Research, Company

**Figure 4: Regional Operations (Indonesia, Malaysia and Thailand)**

|  | Results (S\$ m) |       |       | Margins (%) |      |      |
|--|-----------------|-------|-------|-------------|------|------|
|  | FY08            | FY09  | FY10  | FY08        | FY09 | FY10 |
| Net Interest Income                      | 1.68            | 5.57  | 8.06  | 68%         | 69%  | 68%  |
| Non-Interest Income                      | 0.78            | 2.45  | 3.79  | 32%         | 31%  | 32%  |
| Total Income                             | 2.46            | 8.02  | 11.85 | 100%        | 100% | 100% |
| Operating Expenses                       | -1.74           | -4.38 | -6.24 | -71%        | -55% | -53% |
| Operating Profit before Allowances       | 0.72            | 3.64  | 5.61  | 29%         | 45%  | 47%  |
| Allowances for Loan Losses               | -0.34           | -0.80 | -1.80 | -14%        | -10% | -10% |
| Profit before Tax                        | 0.38            | 2.84  | 4.43  | 15%         | 35%  | 37%  |
| Share of after-tax Results of Associates | 1.89            | 0.47  | 0.00  | 77%         | 6%   | 0%   |
| Tax                                      | 0.03            | -1.15 | -1.23 | 1%          | -14% | -10% |
| Profit after Tax                         | 2.30            | 2.16  | 3.20  | 94%         | 27%  | 27%  |

Source: Company

### Prospects ahead

Looking forward, IFS plans to further expand operations in Malaysia and Indonesia where margins and domestic business remain firm. Increased regional business activities will bring future profit to its business. ECICS Ltd, a wholly owned subsidiary of IFS, plans to continue expanding into its new maid insurance business.

**Key risks** for IFS's regional operations would be government responses to inflation through market cooling measures which may decrease earnings growth.

Overall, we believe that IFS's earnings performance will persist in the future due to the increased profitability of regional growth over time. Maintain: **Invest**

**Figure 5: Financial Forecasts and Estimates**

| S\$ m                          | FY08   | FY09   | FY10   | FY11F  | FY12F  | FY13F  |
|--------------------------------|--------|--------|--------|--------|--------|--------|
| Net Interest Income            | 11.1   | 13.1   | 19.1   | 22.3   | 26.0   | 30.3   |
| Net Earned Premium Revenue     | 3.8    | 5.8    | 3.5    | 3.6    | 3.8    | 4.0    |
| Fee & Commission income        | 6.4    | 6.4    | 7.5    | 7.8    | 8.2    | 8.6    |
| Investment & Other Income      | 4.9    | 3.7    | 1.8    | 4.9    | 3.9    | 3.9    |
| Net Profit                     | 8.0    | 6.6    | 7.9    | 7.9    | 9.2    | 11.2   |
| Total Current Assets           | 262.4  | 247.6  | 230.0  | 356.6  | 448.2  | 542.2  |
| Total Non-Current Assets       | 131.0  | 105.7  | 95.7   | 68.8   | 27.0   | 27.4   |
| Total Current Liabilities      | 211.1  | 180.0  | 166.1  | 217.8  | 253.5  | 329.7  |
| Total Non-Current Liabilities  | 61.4   | 45.7   | 17.7   | 57.9   | 62.8   | 69.9   |
| Total Equity                   | 121.0  | 127.5  | 141.9  | 149.7  | 158.9  | 170.1  |
| Cash from Operating Activities | 39.8   | 95.2   | 44.8   | 110.7  | 137.9  | 166.7  |
| Cash from Investing Activities | 17.5   | -12.2  | -5.2   | 0.8    | 1.0    | 1.2    |
| Cash from Financing Activities | -69.1  | -81.4  | -32.6  | -62.0  | -68.3  | -74.8  |
| Net change in cash             | -11.9  | 1.6    | 6.9    | 49.5   | 70.5   | 93.1   |
| Return on Common Equity (%)    | 6.6%   | 5.3%   | 5.5%   | 5.3%   | 5.8%   | 6.6%   |
| ROA (%)                        | 2.2%   | 1.8%   | 2.2%   | 1.8%   | 1.9%   | 2.0%   |
| Debt/Equity (%)                | 225.2% | 177.0% | 129.6% | 184.1% | 199.0% | 234.9% |
| Current Ratio                  | 124.3% | 137.6% | 138.5% | 163.8% | 176.8% | 164.5% |
| EPS (S cents)                  | 5.9    | 4.3    | 4.7    | 5.2    | 6.1    | 7.4    |
| BV/Share (S cents)             | 80.4   | 84.8   | 94.3   | 99.6   | 105.7  | 113.1  |

Source: SIAS Research estimates

**Figure 6: Economic Profit Model**

| S\$ m                 | FY10  | FY11F | FY12F          | FY13F  |
|-----------------------|-------|-------|----------------|--------|
| EBIT                  | 6.5   | 9.5   | 11.1           | 13.4   |
| Tax on EBIT           | 1.1   | 1.6   | 1.9            | 2.3    |
| NOPLAT (Company)      | 5.4   | 7.9   | 9.20           | 11.16  |
| Invested Capital      | 287.8 | 358.9 | 403.92         | 488.74 |
| % of Debt             | 0.5   | 0.6   | 0.6            | 0.7    |
| % of Equity           | 0.5   | 0.4   | 0.4            | 0.3    |
| WACC                  |       | 5.1%  | 5.0%           | 4.7%   |
| Capital Charge        |       | 18.3  | 20.1           | 23.1   |
| Economic Profit       |       | -10.4 | -10.9          | -12.0  |
| Terminal              |       |       |                |        |
| Discount Rate         |       | 1.00  | 0.91           | 0.87   |
| Present Value         |       | -9.9  | -9.9           | -10.4  |
| Book Value            | 141.9 |       | Risk Free      | 3.0%   |
| Explicit Value        | -30.1 |       | Beta           | 0.7    |
| Terminal Value        | 350.5 |       | Market RP      | 7.5%   |
| Value of Firm (S\$ m) | 96.5  |       | Cost of Equity | 8.2%   |
| Number of Shares (m)  | 150.4 |       | Cost of Debt   | 3.5%   |
| Value per share (S\$) | 0.640 |       | LT Growth      | 1.5%   |

Source: SIAS Research estimates

**Rating Definition:**

**Increase Exposure** – The current price of the stock is significantly lower than the underlying fundamental value 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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**IMPORTANT DISCLOSURE:**

**SIAS Research Pte Ltd received compensation for conducting this valuation research. The estimated fair value of the stock is a statement of opinion, and not statement of fact or recommendation on the stock.**

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