Credit Intelligence Limited

Hong Kong's political unrest drives growth

Share Price: A$0.012

Valuation range: A$0.06-0.08

ASX: CI1

Sector: Commercial & Professional Services

22 November 2019

Acquisitions to support geographical expansion

Credit Intelligence (ASX:CI1) recently announced the acquisition of two Singapore-based credit funding institutions – ICS Funding Pte Ltd and Hup Hoe Credit Pte Ltd. These deals provide CI1 access to the credit funding market of Singapore for personal and corporate loans. CI1 will now have two additional advantages: (i) additional stream of high-margin revenue; (ii) scope for aggressive expansion in a new geography.

HK economic slowdown provides opportunity

As the socio-political situation in Hong Kong becomes more difficult, the volatile economic conditions will support CI1's revenue growth. As the situation remains uncertain, lower consumer spending, declining corporate investment and subdued business activity will propel insolvency filings. Further, the advancement of its recently launched app will help handle a huge volume of cases, thereby supporting margin expansion.

Valuation increased to A$0.06 – 0.08 per share

We have altered our assumptions and included the impact of two new acquisitions as well as the unexpected boost to business from the Hong Kong turmoil. We now value CI1 at A$0.06 per share base case (was A$0.048) and A$0.08 per share in a more optimistic scenario (was A$0.071). Our valuation is based on a blend of DCF and P/E-based relative valuation methods.

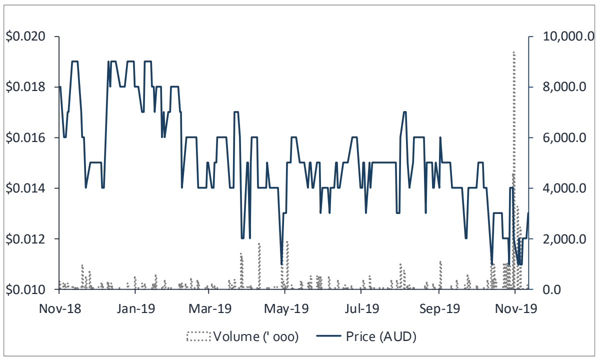
Year to June (A$)	2018A	2019A	2020F	2021F	2022F
Sales (mn)	4.9	6.2	14.2	19.2	21.8
YoY growth	28.8%	27.3%	127%	35.4%	13.5%
Adj. EBITDA (mn)	2.4	1.3	4.9	7.6	8.5
Net Profit (mn)	2.0	0.9	2.3	3.4	3.9
Adj. EBITDA Margin (%)	48.8%	21.6%	34.4%	39.5%	39.1%
ROA (%)	40.6%	7.0%	7.4%	9.6%	9.7%
Adj. EPS	0.27c	0.11c	0.22c	0.33c	0.38c
EPS	-0.03c	0.06c	0.22c	0.33c	0.38c
	0.18c	0.12c	0.11c	0.17c	0.19c
EV/Sales					
EV/EBITDA	1.5x	1.4x	0.4x	0.1x	nm
P/E	3.0x	6.6x	1.2x	0.2x	nm

Source: Company, Pitt Street Research

Market Cap. (A$ m)	13.2
# shares outstanding (m)	1,017.1
# share fully diluted	1,103.9
Market Cap Ful. Dil. (A$ m)	14.4
Free Float	9.0%
12 months high/low	0.02 / 0.01
Avg. 12M daily volume ('1000)	400.1
Website	www.ci1.com.au

Source: Company, Pitt Street Research

Share price (A$) and avg. daily volume (k, r.h.s.)



Source: Thomson Eikon, Pitt Street Research

Valuation metrics	
DCF (A$)	0.09–0.125
Relative Valuation (P/E) (A$)	0.03-0.036
Equal weighted average (A$) per share	0.06-0.08

Source: Pitt Street Research

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Spreading its wings in the credit funding space

With the acquisition of two finance companies in Singapore, Credit Intelligence Limited (ASX:CI1) has fast-tracked its expansion into the Asia Pacific region. The acquisition of the 60% stake in ICS Funding (ICS) was completed in June 2019, while the acquisition of 60% stake in Hup Hoe Credit (HHC) was completed in September 2019.

CI1 completed the acquisition of two finance companies – ICS Funding and HHC – in Singapore, in 2019

Established in 2015 (ICS) and 2014 (HHC), both these companies are relatively young. HHC is primarily focussed on providing personal loans, while ICS offers credit financing to SMEs (small & medium enterprises). Both these acquisitions are expected to be earnings accretive. CI1 intends to infuse capital of ~S$5m each in ICS and HHC. While ICS was acquired using cash (upfront payment and on a 12 months instalment basis) and CI1 scrip, HHC was acquired in a one-off cash and scrip transaction with a 12-month lock-in period. These two institutions provide CI1 with opportunity to tap the relatively fast-moving Singapore credit funding sector. It provides cross-selling opportunities to CI1 for its traditional insolvency filing services. CI1 has also decided to exit its previously announced JV with Arrow Business Consultants Pte Ltd (Singapore), which was not yielding the desired results.

Entering Singapore's credit funding market – a divergent path full of opportunities

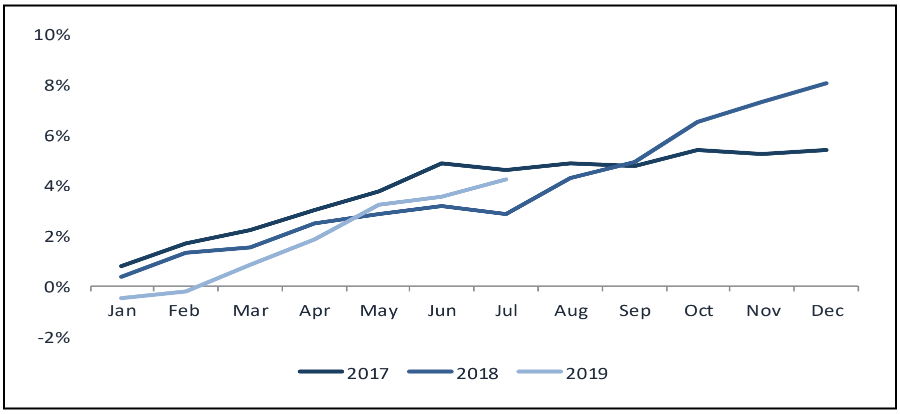
Singapore is witnessing a robust industry loan growth rate, +3.7% in Jan–Jul 2019. Following the decline in mortgage and consumer lending, the industry loan growth rate has remained buoyant amid uncertain economic conditions (Figure 1). In line with the number of M&A deals being inked, corporate activity has heightened in Singapore. This has resulted in higher demand for funding support. Mortgage loan growth has remained flat in the country, following restricted consumer spending. Business loan growth has been led by the manufacturing, building, construction and transport sectors.

M&A deals, cash flow financing, SME lending and hire-purchase agreements have kept funding

Considering that a lot of SMEs will be the eventual beneficiaries in the business loan growth environment, we believe CI1's new acquisitions will prove to be beneficial for the company.

Apart from introducing an independent revenue stream, we expect CI1 to benefit from cross-selling of insolvency services and bankruptcy filing services through these new credit funding institutions. This is another attempt to expand the area of operations beyond Hong Kong, something the company was unable to achieve through its previous JV.

Figure 1: Singapore has robust corporate loan growth



Source: Singapore Business Review, Pitt Street Research

The company is seeking acquisitions across Asia Pacific and Australia

Substantial financial muscle to support further acquisitions

With the HHC and ICS acquisitions under its umbrella, CI1 is exploring opportunities to expand its operations beyond the mature market of Hong Kong. It is eager to expand into the Asia Pacific debt restructuring and credit funding market with businesses that are synergistic to its existing operating model. It also aims to establish its Australian operations as and when a suitable opportunity arises. As a significant portion of the two recent acquisitions was paid in CI1 scrip, the company retains its financial muscle to make further bolt-on acquisitions. It is noteworthy that the company has a healthy profitable base in Hong Kong, which would aid in funding future transactions in the near-to-medium term.

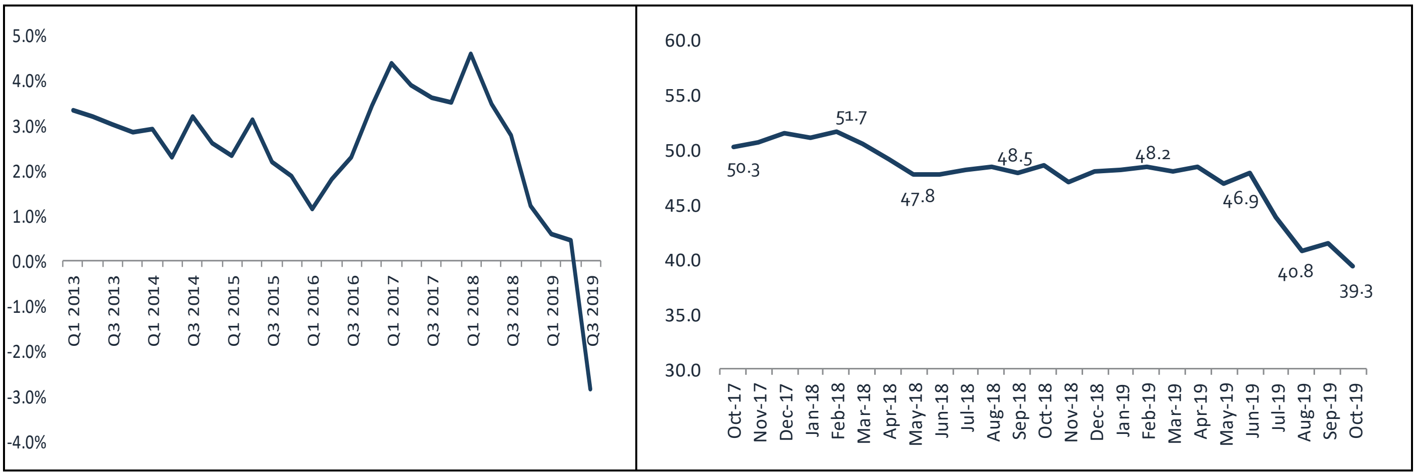
Political unrest pushing Hong Kong into recession – opportunities galore for CI1

Civil protests hurting the economy

Business activity across Hong Kong witnessed one of the sharpest falls in the last 10 years; Oct 2019 PMI stood at 39.3

As the ongoing civil protest mounts in Hong Kong, its economic conditions are witnessing a massive blow (Figure 2). Following five months of social and political unrest, Hong Kong's GDP contracted 2.9% in Q3 2019 (Q2: +0.4%; Q1: +0.6%). The social unrest has triggered a major disruption in spending, resulting in a first-in-10-years decline in private consumption (-3.5% YoY in real terms). In Q3 2019, commercial property sales dropped ~57% YoY, while employment levels in the F&B sector hit a six-year low. According to the spokesperson of the Hong Kong Special Administrative Region (HKSAR) government, the economy has entered into a technical recession after contracting for two successive quarters (QoQ).

Figure 2: Real GDP growth in Hong Kong is suboptimal (YoY); business activity (PMI) continues to deteriorate rapidly



Source: DataStream, Statista, Pitt Street Research

Economic problem beneficial for CI1's business; Q1 revenue jumps +78% YoY

CI1's business operations are inversely related to economic conditions and uncertainties. The slowdown in private spending and consumption rates due to the China–US tariff war and socio-political turmoil is expected to lead to a multi-fold jump in indebtedness and bankruptcy filings. This, we expect, will support CI1 in expanding its business operations.

As the slowing economic activity has a lagged effect on bankruptcy filings (3–6 months), CI1 is expected to see a jump in the number of cases in H2 FY2020. Excluding the ICS business, in Q1 FY2020, CI1 reported a +78% YoY jump in revenue and 7x increase in net profit, primarily due to the increase in number of cases appointed and discharged (Figure 3). The significant expansion in the group's net margin re-establishes the rationale that economic turmoil in Hong Kong is actually strongly driving business growth.

Figure 3: Stellar results posted by the group in the quarter ending September 2019

(In AUD million)	CI1 (group excluding ICS)			ICS Funding Pte Ltd		
	Q1 FY 20	Q1 FY 19	YoY	Q1 FY 20	Q4 FY 19	QoQ
Revenue	2,179	1,227	77.6%	653	545	19.8%
Profit After Tax	688	86	700.0%	456	248	83.9%
Profit Margin	31.6%	7.0%	2457 bps	69.8%	45.5%	2433 bps

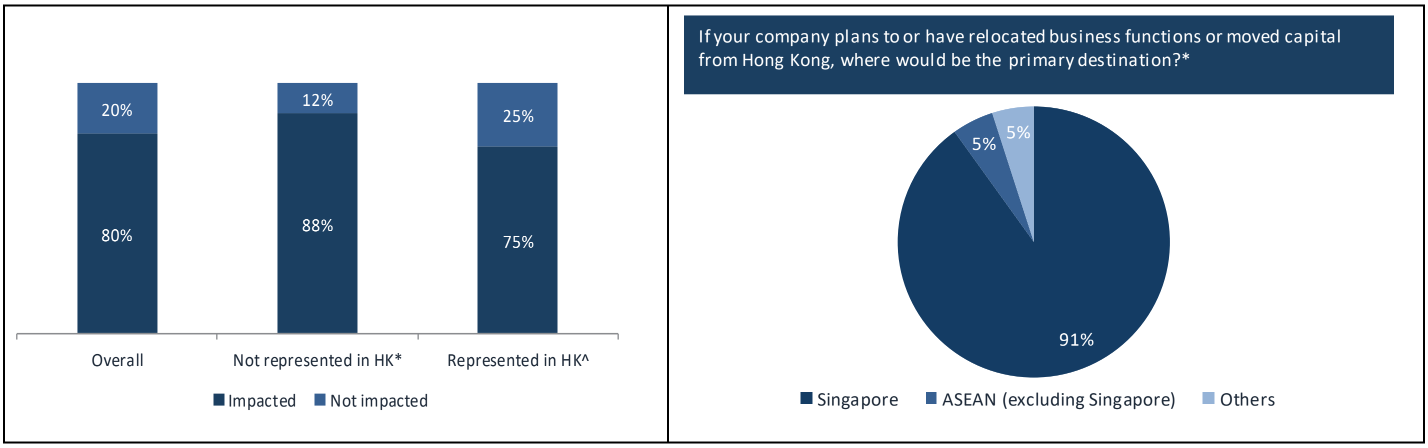
Source: Pitt Street Research

Singapore to benefit from Hong Kong's economic chaos

According to a survey by the American Chamber of Commerce in Singapore, published in early September 2019, the ongoing socio-political unrest has severely affected Hong Kong's reputation as a regional business centre. The majority of respondents feel that Singapore stands to benefit due to the prolonged turmoil in Hong Kong (Figure 4). According to a news report in the Financial Times (dated 12 September 2019), companies that were planning to establish operational centres/Asia Pacific headquarters in Hong Kong are now moving towards Singapore. Many financial institutions are also choosing Singapore as part of their business continuity plans. In the medium term, this is expected to accelerate otherwise-fragile economic conditions in Singapore at the expense of Hong Kong. In the short term, a lot of seminars, conferences and tourists have already opted for Singapore as an alternative destination, affecting the related industry in Hong Kong.

CI1's operations in Hong Kong are inversely related to economic disruption and operations in Singapore are correlated with economic prosperity. This means that, either way, CI1 is expected to benefit from this unique situation.

Figure 4: Businesses in Hong Kong are getting impacted and preferring Singapore as an alternative destination



** 43 responses from those who don't have offices in HK;*
^ 77 responses from those who have offices in HK
Source: AmCham Singapore Survey (Aug 19), Pitt Street Research

Note: Out of the 22 responses filtered by companies which are represented in HK and have plans/considering to move out of HK*

Re-rating CI1 as its revenue base expands

Exponential revenue growth expected post acquisitions

We have remodelled our assumptions and included the impact of the two new Singaporean acquisitions (ICS and HHC). These two deals provide CI1 access to Singapore's credit funding market, which is in sync with CI1's objective of expanding in the Asia Pacific region. The overall revenue growth is expected to witness a significant jump of ~127% in FY20E, mainly driven by the high-margin businesses of ICS and HHC (Figure 5).

Figure 5: Changes in our estimates after factoring in the new acquisitions

(In AUD million)	Change in estimates (Annual)					
	FY 2020		FY 2021		FY 2022	
	Old	New	Old	New	Old	New
Revenue	7.5	14.2	8.7	19.2	9.8	21.8
Adj. EBITDA	3.9	4.9	4.6	7.6	5.3	8.5
Adj. PAT	2.6	2.3	3.1	3.4	3.5	3.9

Source: Pitt Street Research

In FY2020, only 9 months of HHC's revenue will be

For modelling purpose, we have assumed S$5m of capital infusion in ICS and HHC each, with deployment in a staggered manner. We have consolidated ICS and HHC into our financials and have made sufficient provision for minority interest. Considering that HHC's acquisition was completed only in Sep-end, we have consolidated HHC for only 9 months in this financial year.

We expect Singapore to contribute ~50% of group's total revenue from FY2020 onwards (Figure 7). Over FY2020-2024, ICS is expected to register a revenue growth of 10% CAGR, while HHC's revenue is expected to grow at 18% CAGR. Overall, the Singapore business (Figure 6) is likely to register a revenue CAGR of 22.6%, over the same period. The average EBITDA margin from Singapore business will be ~47% over FY2020-2024.

Figure 6: Financial assumptions for Singapore operations

Singapore (AUD, Year end Jun)	FY 20E	FY 21E	FY 22E	FY 23E	FY 24E
Total Revenue	7,014,907	11,053,182	12,655,703	14,279,321	15,847,880
Adj. EBITDA	3,281,350	5,510,013	5,914,052	6,493,129	7,029,956
% of Revenue	*46.8%*	*49.9%*	*46.7%*	*45.5%*	*44.4%*

Source: Pitt Street Research

We also expect the Hong Kong business to sustain current momentum and register a revenue growth of 8.3% CAGR over FY2020-2024. The average EBITDA margin from Hong Kong business is expected to accelerate to ~30% over the same period (FY2019: 21.6%).

We expect the Australian business operations to start making a meaningful contribution from FY2020 onwards (Figure 7).

Figure 7: Region-wise percentage revenue breakdown

Revenue contribution (%)	FY 18	FY 19	FY 20E	FY 21E	FY 22E
Hong Kong	100.0%	100.0%	48.8%	39.7%	38.1%
Australia	0.0%	0.0%	1.7%	2.7%	3.8%
Singapore	0.0%	0.0%	49.5%	57.6%	58.1%

Source: Pitt Street Research

New valuation range of A$0.06 – 0.08 per share

With the shift towards a higher-margin credit funding business, along with an opportunity to cross-sell its traditional insolvency filing services, the outlook remains encouraging for CI1. Consequently, we have revisited peer-based valuation (P/E) and DCF calculations.

We have now expanded our peer set to include competition from the personal loans and corporate financing space. We now have three sets of peers — local professional service players, personal loan institutions and SME-focussed wholesale banking financial institutions. For the personal loan and wholesale banking peer group we have players that are operating in the mature markets of London, the US etc., similar to Singapore (Figure 8).

Figure 8: Peer Group valuation

Company Name	Ticker	FY-end	Market Cap (A$ m)	P/E FY 20	P/E FY 21
Pioneer Credit	ASX:PNC	June	156.0	7.5x	NA
Credit Corp Group Limited	ASX:CCP	June	1,818.9	21.8x	18.9x
Collection House Limited	ASX:CLH	June	168.4	6.9x	5.9x
Average				***12.1x***	***12.4x***
FSA Group Limited	ASX:FSA	June	128.8	8.3x	7.7x
Navient Corporation	NasdaqGS:NAVI	Sept	4,683.7	5.8x	5.0x
Resurs Holding AB (publ)	OM:RESURS	Sept	1,685.0	8.9x	7.7x
Popular, Inc.	NasdaqGS:BPOP	Sept	7,916.9	8.3x	8.5x
Arrow Financial Corporation	NasdaqGS:AROW	Sept	799.1	14.7x	13.4x
Average				***9.2x***	***8.5x***
1pm plc	AIM:OPM	May	55.0	4.9x	4.1x
Merkur Bank KGaA	XTRA:MBK	Sept	89.2	18.3x	13.4x
Berner Kantonalbank AG	SWX:BEKN	June	2,974.1	14.5x	13.9x
Industrial Bank of Korea	KOSE:A024110	June	8,727.7	4.4x	4.5x
Virgin Money UK PLC	LSE:VMUK	March	3,858.8	5.7x	5.9x
Average				***9.6x***	***8.4x***
Overall Average				***10.3x***	***9.7x***

Source: S&P Capital IQ, Pitt Street Research

The company's peer group is valued at an average P/E multiple of 9.7x for FY2021E. Applying that same multiple to CI1 would yield an equity value of A$0.030 per share.

Considering that CI1 is a relatively mature business, looking to expand into new geographies, and is leveraging its technological superiority through the case management platform, we think a premium to the sector average multiples can be applied. The new operations also provide significant cross-sell opportunity vis-a-vis competition.

Further, since CI1 is expanding using acquisitions and not green-field projects, the execution risk seems limited. Consequently, in our optimistic case, we have applied a 20% premium to the peer average. In our bull case scenario CI1 would yield an equity value of A$0.036 per share (Figure 9).

Figure 9: Relative valuation in our base and optimistic case scenario

Equity value determination (A$)		Equity value determination (A$)	
P/E Multiple	9.7	P/E Multiple	11.7
Adj. EPS FY 21E (A$ cents)	0.31	Adj. EPS FY 21E (A$ cents)	0.31
Implied price (A$ cents)	**3.00**	**Implied price (A$ cents)**	**3.60**
Current price (A$ cents)	**1.20**	Current price (A$ cents)	**1.20**
Upside (%)	*149.7%*	Upside (%)	*199.6%*

Source: Pitt Street Research

Based on our assumption of a capital infusion of S$5m each in ICS and HHC to ramp up operations, we believe there is room for very strong growth in NOPAT. As the company expands its existing services to the customers of ICS and HHC, and gets more cases due to the Hong Kong turmoil, we expect this to translate into substantially higher NOPAT over time.

Our DCF model yields an 10.47% WACC for CI1 (risk-free rate of 1.3%, Beta of 1.2 and an equity risk premium of 7.7%). Applying that discount rate to our free cash flow projections through FY2029 and using a terminal growth rate of 2%, CI1 yields a value of A$0.09 per share (Figure 10).

In our view, of the two valuation methods (DCF and relative valuation) deployed, DCF seems to provide a more realistic picture for CI1. Amid the scenario where capital is expected to be infused in a phased manner, its true potential can be deciphered over a long-term period.

Figure 10: DCF value in A$ cents using various WACCs

Sensitivity Analysis									
WACC	**10.47%**								
Terminal Growth Rate	**2.00%**				Change in WACC				
Implied Price (AUD cents)	**9.01**	*8.0%*	*9.0%*	*10.0%*	*10.47%*	*11.0%*	*12.0%*	*13.0%*	*14.0%*
Change in Terminal Growth Rate	*0.50%*	11.23	9.82	8.71	8.27	7.82	7.09	6.48	5.97
	1.50%	12.26	10.55	9.24	8.73	8.22	7.40	6.72	6.16
	2.00%	12.90	10.99	9.56	**9.01**	8.45	7.57	6.86	6.26
	2.50%	13.66	11.50	9.91	9.31	8.71	7.76	7.00	6.38
	3.00%	14.58	12.09	10.32	9.66	9.00	7.98	7.16	6.50
	3.50%	15.69	12.79	10.79	10.05	9.33	8.22	7.34	6.64
	4.00%	17.09	13.64	11.34	10.51	9.71	8.49	7.54	6.79

Source: Pitt Street Research

Our fair value of A$0.06 per share has been derived from a weighted average valuation methodology, which assigns equal weight to P/E-based relative valuation and DCF calculation. In our bull case scenario, our equally weighted average valuation is A$0.08 per share (Figure 11).

Figure 11: Weighted average valuation in base case and bull case scenario

Base Case	Weights (%)	Share price (A$ cents)	Bull Case	Weights (%)	Share price (A$ cents)
DCF	50.0%	9.01	DCF	50.0%	12.46
Relative valuation	50.0%	3.00	Relative valuation	50.0%	3.60
Composite Value (A$ cents)		**6.00**	**Composite Value (A$ cents)**		**8.03**
Current Price (A$ cents)		1.20	Current Price (A$ cents)		1.20
Upside/ Downside (%)		**400.1%**	**Upside/ Downside (%)**		**568.8%**

Source: Pitt Street Research

Risks

In our view, there are five main risks associated with investing in CI1:

1. Banking risk: With the acquisitions of ICS and HHC, CI1 has forayed into the traditional credit funding segment in Singapore. This has altogether different market dynamics vis-à-vis its existing core business in Hong Kong. Besides, the IMF has recently downgraded global economic growth estimate to 3% in 2019, the weakest since the 2008 financial crisis. Thus, a softening global economy may dent the outlook of the credit growth which typically moves in tandem with the economy.
2. Execution risk: As CI1 invests more in improving its IT systems and marketing activities after expanding in Australia and Singapore, uncontrolled cost escalation could negatively impact valuation. Management's ability to execute strategy will be scrutinised as CI1 expands into new geographies and new market segments.
3. Regulatory risk: Each country has different bankruptcy laws. CI1 has experience mainly in the home market of Hong Kong. Understanding new and distinct market regulations may prove tricky and entail a long gestation period to breakeven.
4. Collaboration risk: As CI1 expands into new geographies, the country-specific partner it chooses will be highly critical. Any slips or errors of judgment may result in delays in geographical expansion and potentially a decline in the company's valuation.
5. Capital raising risk: As CI1 is expected to infuse capital into new businesses, there exists a risk of delay in capital raising. Any delay in raising capital and subsequent deployment may negatively impact business ramp-up affecting our valuations.

Please refer to www.pittstreetresearch.com for our initiating coverage on CI1.

Analyst certification

Marc Kennis, lead analyst on this report, has been covering the semiconductor sector as an analyst since 1997.

- Marc obtained an MSc. in Economics from Tilburg University, Netherlands, in 1996, and a post graduate degree in investment analysis in 2001.
- Since 1996, he has worked for a variety of brokers and banks in the Netherlands, including ING and Rabobank, where his main focus was on the technology sector, including the semiconductor sector.
- After moving to Sydney in 2014, he worked for several Sydney-based brokers before setting up TMT Analytics Pty Ltd, an issuer-sponsored equities research firm.
- In July 2016, with Stuart Roberts, Marc co-founded Pitt Street Research Pty Ltd, which provides issuer-sponsored research on ASX-listed companies across the entire market, including technology companies.

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