PITT STREET RESEARCH

Credit Intelligence Limited

Earnings quadrupled

Share Price: A$0.029

Valuation range: A$0.06-0.08

ASX: CI1

Sector: Commercial & Professional Services

4 March 2020

Credit Intelligence (ASX: CI1) delivered a very strong 1H FY20 result. Revenue rose 116% YoY to A$6.1m and profit after tax increased by a remarkable 355% YoY to A$1.3m. EPS also lifted by approximately 333% YoY to 0.13 cents. The overall growth is supplemented by the consolidation and integration of the recent acquisitions in the Singapore credit funding market which have performed strongly over the 6 months ending December 2019. Backing out the acquisition growth component, CI1's underlying organic revenue growth was still at an impressive 34% which reflects advancement in its Hong Kong business.

COVID-19 is a near to medium term profit driver

Given CI1's counter-cyclical operating model, the business performs more favourably under adverse economic circumstances. The recent coronavirus outbreak has spun the global economy into a state of downturn and uncertainty. As the performance of businesses across the world continue to deteriorate, the level of bankruptcy filings should in our opinion elevate. Accordingly, we see coronavirus as a unique catalyst that will drive CI1's near-term profitability.

Valuation reiterated at A$0.06 – 0.08 per share

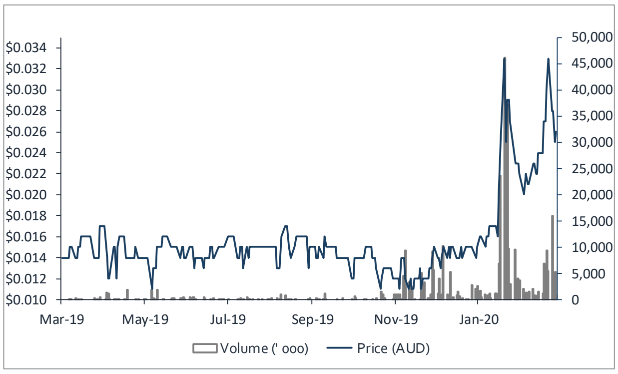
We have revised our near-term revenue forecasts to factor in the upside risk from the coronavirus event. We also revised our FY20 estimates for the Singapore business in line with updated company guidance. Overall, our valuation range remains largely intact at A$0.06 – 0.08 per share.

Year to June (A$)	2018A	2019A	2020F	2021F	2022F
Sales (mn)	4.9	6.2	13.8	19.5	22.3
YoY growth	28.8%	27.3%	120%	41.7%	14.3%
Adj. EBITDA (mn)	2.4	1.3	3.6	7.7	8.7
Net Profit (mn)	2.0	0.9	1.9	3.5	4.0
Adj. EBITDA Margin (%)	48.8%	21.6%	26.4%	39.3%	38.9%
ROA (%)	40.6%	7.0%	6.4%	9.9%	10.1%
Adj. EPS	0.27c	0.11c	0.18c	0.33c	0.38c
EPS	-0.03c	0.06c	0.18c	0.33c	0.38c
EV/Sales	1.5x	1.4x	1.6x	0.9x	0.6x
EV/EBITDA	3.0x	6.6x	6.1x	2.3x	1.5x
P/E	6.0x	13.9x	14.7x	8.0x	6.9x

Source: Company, Pitt Street Research

Market Cap. (A$ m)	30.8
# shares outstanding (m)	1,060.4
# share fully diluted	1,103.9
Market Cap Ful. Dil. (A$ m)	32.0
Free Float	23.0%
12 months high/low	0.033 / 0.011
Avg. 12M daily volume ('1000)	1,917
Website	www.ci1.com.au

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



Source: Thomson Eikon, Pitt Street Research

Valuation metrics	
DCF (A$)	0.094-0.131
Relative Valuation (P/E) (A$)	0.029-0.034
Equal weighted average (A$) per share	0.061-0.083

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CI1 delivered a very strong 1H FY20 result

Group revenue up +116% YoY

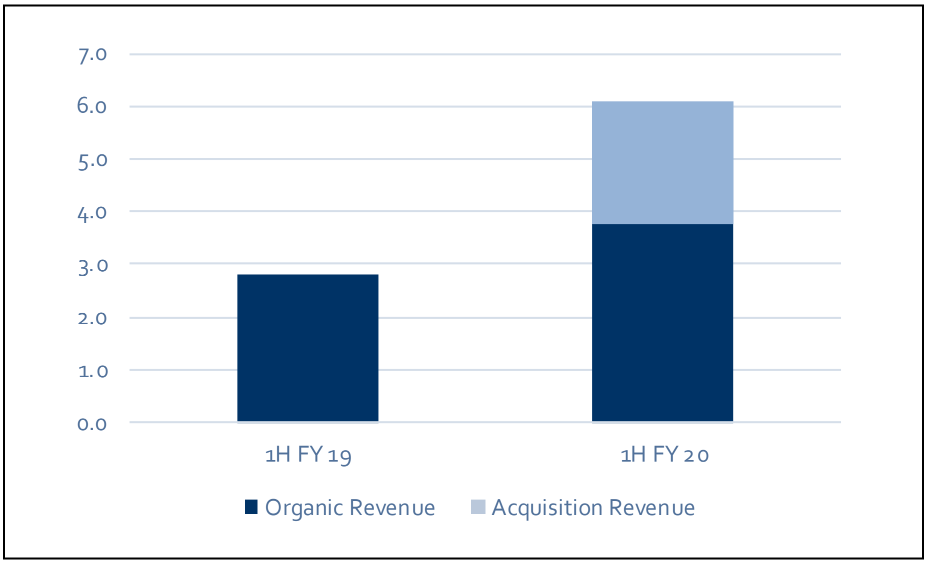
For the 6 months ended December 2019, CI1's group revenue rose 116% to A$6.1m, in which organic growth accounted for approximately 34% with the residual 82% growth coming from the two recent Singapore acquisitions (Figure 1).

Strong revenue growth of 116% (organic growth ~34% + acquisitions ~82%)

The solid organic growth underscores the strong performance of CI1's Hong Kong segment, with its core business of Bankruptcy and Individual Voluntary Agreement (IVA) continuing to perform well amid the ongoing domestic social and political unrest and more recently, the outbreak of COVID-19.

Embedded in the acquisitions growth are the strong turnovers generated by the two profitable Singapore-based finance companies, ICS Funding Pte Limited (ICS) and Hup Hoe Credit Pte Limited (HHC), both of which CI1 acquired 60% interests in on 28 June 2019 and 30 September 2019 respectively. Accordingly, CI1's 1H FY20 Singapore revenue of A$2.3m included a full 6 months revenue of ICS and a full 3 months revenue of HHC. Additionally, CI1 noted that both ICS and HHC have expanded their lending base and loan books since acquisitions and are on track to exceed the profit guarantee for the period to 30 June and 30 September 2020 respectively.

Figure 1: Group revenue split YoY (A$m)



Source: Pitt Street Research, Company Reports

Group profit after tax jumps +355% YoY; EPS up 333% YoY

A fourfold YoY increase in earnings

On the bottom line, CI1 also had a significant YoY improvement of +355%, which resulted in an uplift in its group profit after tax (PAT) to approximately A$1.3m. Figure 2 below dissects 1H FY20 group revenue to show where the sub-revenue streams were originated.

Net profit margin more than doubled YoY

Backing out the profits contributed by ICS and HHC, CI1's underlying organic profit component which is driven entirely by its Hong Kong business still rose +182% YoY from A$0.3m to A$0.8m. Group net profit margins more than doubled from 9.8% in the previous corresponding period to 20.7%. Margins improvement were largely due to operational leverage as CI1's Hong Kong business continues to scale on the backdrop of a deteriorating domestic market, as well as efficiencies due to a reduction in operating costs.

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Moreover, we view the expansion of CI1's group margins also partially attributable to the cost synergies yielded from the company's recent acquisitions.

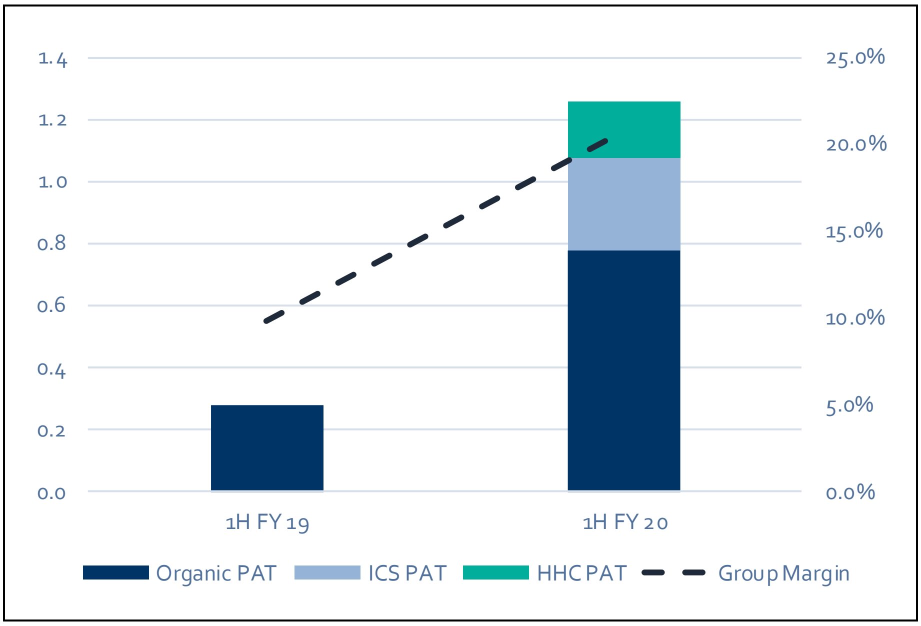
EPS up 333% YoY

On an EPS level, the two Singapore accretive acquisitions have enhanced CI1's 1H FY20 EPS to increase by +333% from 0.03 cents to 0.13 cents.

CI1 continuously generates positive operating cashflow

Furthermore, CI1's group operating cashflow also improved markedly by +237% from A$0.2m to A$0.8m, thereby strengthening its balance sheet.

Figure 2: Group Profit After Tax split YoY (A$m)



Source: Pitt Street Research, Company Reports

COVID-19 acts as near-term structural growth tailwind

The beginning of CY20 has witnessed the global outbreak of a respiratory illness caused by a new virus known as the COVID-19. As at the date of this research report, over 2,800 people globally have died as a result of contracting the virus[1].

COVID-19 is a positive catalyst for CI1 in driving its short to medium term profitability

Despite its ongoing devastating impact on economies and businesses worldwide, we view the coronavirus as a unique structural growth driver for CI1 by virtue of the company's business model. Unlike other businesses that have underperformed under such adverse circumstances, we share the same view as management that CI1 will, on the contrary, outperform primarily due to its counter-cyclical business model where the company's profitability increases in economic downturns and uncertainty.

Positive correlation between impacts of COVID-19 and number of bankruptcy filings

As at 21 February 2020, there are at least 50 confirmed cases in Hong Kong who have contracted the coronavirus[2]. Due to the respiratory nature of the disease, people are encouraged to stay indoors and have had their Chinese New Year holiday extended as part of the prevention measures. As such, outdoor activities have been minimal and production chain was put on halt. This has caused serious economic repercussions including supply chain disruption as well as slowdown in consumption rates, which are expected to elevate the number of indebtedness and bankruptcy filings over the near-

[1] https://www.worldometers.info/coronavirus/
[2] https://www.npr.org/sections/goatsandsoda/2020/02/13/805511970/it-s-not-easy-for-anyone-coronavirus-disrupts-life-and-work-in-hong-kong

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term. Accordingly, we view the coronavirus as a catalyst in driving CI1's near-term profitability. Hence, we expect a material upside in 2H FY20. If the coronavirus develops into a short-term issue, it is likely in our opinion that bankruptcy cases will be stretched into FY22, which will in turn elevate CI1's revenue base.

Eyeing for an accretive acquisition in Australia

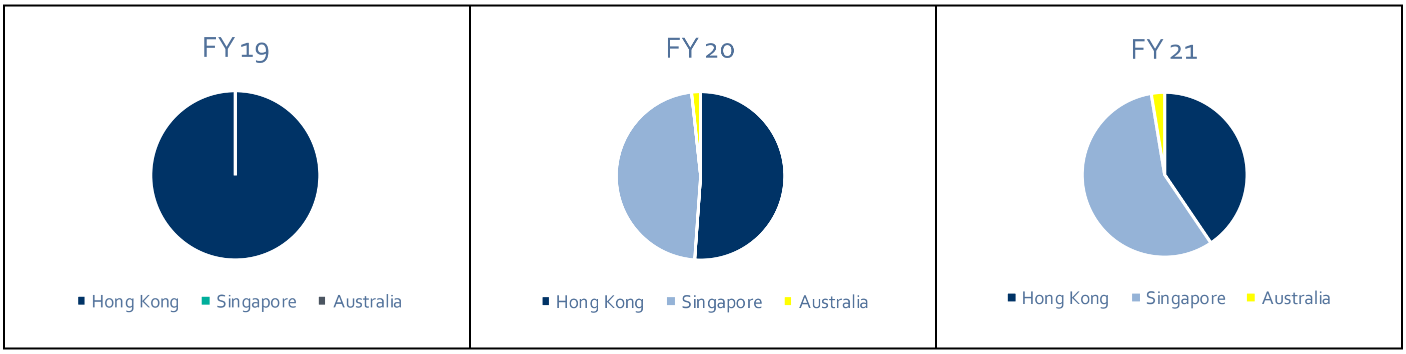
A potential Australian acquisition coming…

Acquisitions and regional expansion are a major part of the management strategy and a key growth driver for CI1. Impressed by the accretive impact and the performance of the recent Singapore acquisitions, management will continue to seek accretive acquisitions that harness its operating model.

Currently, CI1 is eyeing to opportunistically acquire a business operating in the Australia debt restructuring and credit funding market to geographically diversify its existing revenue streams. With an approximate A$3.1m in cash and new equity as a funding option, CI1 is financially equipped to execute an acquisition with a multiple size similar to its recent acquired targets. We view CI1's new market acquisition strategy positively and believe it can deliver market share and earnings growth over the short to medium-term.

Figure 3 below breaks up CI1's group revenue by geography and displays our regional revenue forecasts for FY20 and FY21.

Figure 3: CI1 revenue split by geography



Source: Pitt Street Research, Company Reports

Appointment of a prominent ex-Sydney banker as Director

On 25 February 2020, CI1 appointed Mr Mark Paton as an independent Non-Executive Director of the company. Mr Paton will chair the Audit and Risk Committee of the Company.

With over 30 years' experience gained in the Australian banking and financial markets including 10 years with ANZ Banking Group where he was Group Managing Director Corporate and 15 years with Westpac Banking Corporation where he was a General Manager for 5 years, Mr Paton will significantly contribute to the growth of CI1 in Australia and New Zealand.

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Forecast changes

COVID-19 creates near-term upside risk to CI1's valuation

Overall, we have made the following changes to our forecasts (Figure 4):

- For the Hong Kong business, we have uplifted the growth rates of new bankruptcy and IVA cases for FY20 and FY21 by +12.5% and +7% respectively. These adjustments are made to factor in near-term upside risk stemmed by the adverse economic impact of the coronavirus. Given the coronavirus' lagged effect on bankruptcy filings, we expect to see growth in new case volumes to peak mid-FY21, after which growth should moderate as we expect coronavirus to cease late Q1 FY21. In terms of the length of the coronavirus outbreak, we have benchmarked this figure against the Severe Acute Respiratory Syndrome (SARS) epidemic but have assumed a slight extension to the recovery timeframe due the magnitude and severity of the coronavirus over SARS. If the recovery period turns out to be longer than what we expect, bankruptcy filings will likely be stretched into FY22, bringing further short-term upside to CI1.
- On ICS, we have increased our FY20 profit after tax forecasts to S$1.0m. On HHC, we have trimmed it down to approximately S$0.5m. These revisions will bring our forecasts in line with an updated profit guidance released by the company on 20 January 2020.
- We have increased the number of ordinary shares by approximately +4% to 1,060 million to incorporate the new issuance on vesting of the Class A Performance Shares and Rights on 10 February 2020.

Figure 4: Forecast changes

CI1: Forecast changes		FY20			FY21	
Years ended Jun (A$m)	Old	New	Change	Old	New	Change
Group Revenue	14.2	13.8	-3.0%	19.2	19.5	1.6%
Hong Kong	6.9	7.0	1.6%	7.6	7.9	4.0%
Singapore	7.0	6.5	-7.5%	11.1	11.1	0.0%
Australia	0.2	0.2	0.0%	0.5	0.5	0.0%
Group Revenue Growth	127.1%	120.4%	-6.7%	35.4%	41.7%	6.3%
Adj. EBITDA	4.9	3.6	-25.6%	7.6	7.7	1.1%
Adj. PAT	2.3	1.9	-16.5%	3.4	3.5	1.7%

Source: Pitt Street Research, Company Reports

Valuation range remains intact

Based on our forecast revisions, our DCF returned a base case valuation of 9.44 cents (previous: 9.24 cents) and an optimistic case valuation of 13.11 cents (previous: 12.79 cents).

On relative valuation, we also adjusted our base case FY21 P/E multiple from 9.7x to 9.3x and optimistic FY21 P/E multiple from 11.7x to 11.1x to reflect a slight de-rating in some of the peer multiples.

Overall, our blended valuation range remains largely unchanged at A$0.06 to A$0.08 per share.

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

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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.

Cheng Ge, analyst on this report, supports Marc and Stuart with equities research at Pitt Street Research.

- Cheng obtained a B.Com in Finance and LL.B from University of New South Wales, in 2013, and has passed all three levels of the CFA Program.
- Prior to joining Pitt Street Research, he has worked for several financial services firms in Sydney, where his focus was on financial advice.
- He joined Pitt Street Research in January 2020.

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