



## FY20 earnings up 384% YoY

Leading debt-restructuring provider Credit Intelligence (ASX: CI1) has delivered a stronger than expected result for the year ended June 2020. Group operating revenue rose 125% YoY to A\$13.6M and profit after tax accelerated by 384% YoY to A\$2.5M. EPS also grew by 317% YoY to 0.25 cents. DPS was 0.10 cents, which represented a payout ratio of approximately 40%. At the group level, growth is fuelled by the consolidation of the recent Singapore acquisitions, both of which have delivered FY20 results exceeding their profit guidance. Backing out acquisitive growth, CI1's underlying organic revenue still grew a solid 22% YoY, underscoring the robustness of its core Hong Kong business.

### Recurring COVID outbreaks create upside for CI1

We regard the recent, second wave of COVID outbreaks that took place in Victoria and Hong Kong as favourable to CI1 due to its counter-cyclical business model. Absent a vaccine, these outbreaks have highlighted the potential recurring nature of COVID waves across the world and their repercussions on the global economy. For instance, Australia has just officially recorded its first recession in nearly three decades and we believe the second lockdown across its Victorian state due to the second COVID wave could hamper the country's economic recovery.

### Valuation range remains largely intact

Our valuation remains largely intact at A\$0.08 – 0.10 per share (previously: A\$0.07 – 0.10 per share) based on a blended methodology (50:50 DCF and P/E). Key risks we see in CI1 are: (1) large fiscal support continuing across the globe; (2) Australian acquisition not performing to expectations and (3) availability of a COVID vaccine.

Year to June (A\$)	2019A	2020A	2021F	2022F	2023F
Sales (M)	6.2	14.0	21.0	24.0	27.1
YoY growth	27.3%	123.6%	50.5%	14.2%	13.1%
EBITDA (M)	1.0	5.6	8.5	9.7	11.3
Net Profit (M)	0.5	3.6	5.6	6.8	7.9
EBITDA Margin (%)	15.8%	40.3%	40.4%	40.6%	41.6%
ROA (%)	7.0%	9.7%	10.5%	11.5%	11.9%
EPS	0.06c	0.25c	0.31c	0.39c	0.47c
EV/Sales	1.8x	2.4x	1.1x	0.7x	0.4x
EV/EBITDA	11.6x	6.0x	2.7x	1.8x	1.0x
P/E	13.9x	11.4x	7.8x	6.1x	5.1x

Source: Company, Pitt Street Research

Share Price: A\$0.024

Valuation range: A\$0.08 – 0.10

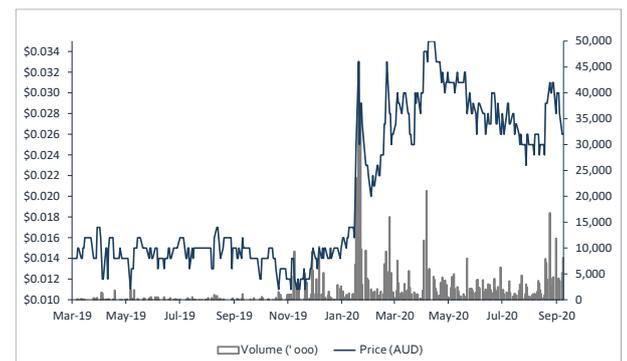
ASX: CI1

Sector: Commercial & Professional Services

10 September 2020

Market Cap. (A\$ m)	28.8
# shares outstanding (m)	1,199.3
# share fully diluted	1,242.8
Market Cap Ful. Dil. (A\$ m)	29.8
Free Float	26.7%
12 months high/low	0.04 / 0.01
Avg. 12M daily volume ('000)	2,912
Website	<a href="http://www.ci1.com.au">www.ci1.com.au</a>

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



Source: Thomson Eikon, Pitt Street Research

Valuation metrics	
DCF (A\$)	0.12 – 0.15
Relative Valuation (P/E) (A\$)	0.03 – 0.04
Equal weighted average (A\$) per share	0.08 – 0.10

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## Strong FY20 revenue and earnings uplift

### Group revenue up +125% YoY

For the 12 months ended June 2020, CI1's group operating revenue increased by 125% YoY to A\$13.6M, of which incremental organic revenue accounted for approximately A\$1.3M, with another A\$6.2M coming from the two Singapore acquisitions completed in 2019 (Figure 1).

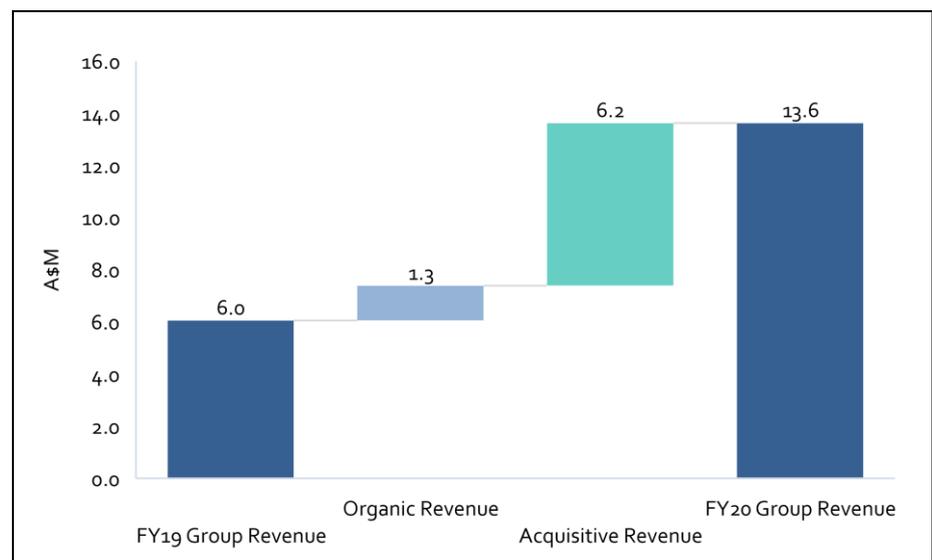
The +22% YoY uplift in underlying organic revenue reflected the strong growth for CI1's core Hong Kong business of bankruptcy administration and individual voluntary arrangement, driven by the domestic social and political unrest and the outbreak of COVID.

Backing out the organic growth contribution, acquisitive growth for FY20 amounted to +103% YoY, which reflected the strong revenue and earnings performance of the two recently acquired Singapore businesses (ICS & HHC), with both businesses having delivered on their promises and exceeded their profit guarantee expectations for FY20.

CI1's Australian acquisition of Chapter Two Holdings, completed at the start of FY21 (see our earlier report "[CI1 enters Australia](#)"), did not impact the group results for FY20, but is expected to bring acquisitive growth and synergies to the group for FY21.

**Top line growth of +125% YoY**  
(organic growth ~22% + acquisitive growth ~103%)

Figure 1: Group operating revenue split YoY (A\$M)



Source: Company Reports, Pitt Street Research

### Group NPAT up +384% YoY; EPS up +317% YoY

Following successful integrations of HHC and ICS, CI1's operating EBITDA and NPAT grew significantly by +470% YoY and +384% YoY respectively (Figure 2).

Margins at the operating EBITDA and NPAT levels also expanded materially, which we think was predominantly driven by cost synergies realised from the successful M&A integrations, coupled with the firm's overall operational efficiency as the business continues to scale up its operations against the backdrop of a global recessionary environment.

EPS jumped markedly by +317% YoY from 0.06 cent to 0.25 cent, reflecting strong earnings accretion as a result of the HHC and ICS acquisitions. As CI1

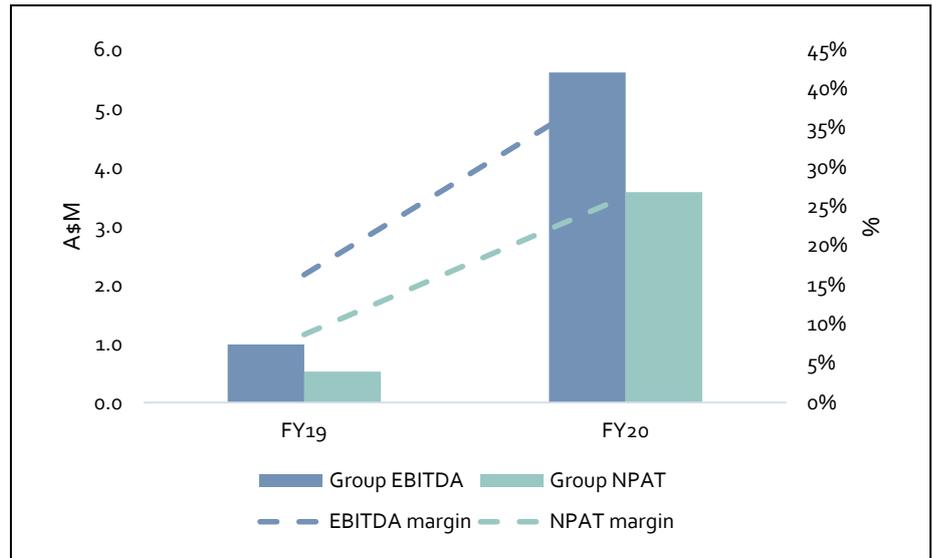
**Significant YoY expansion in earnings and margins**



mostly deploys cash in making its acquisitions, its share base consequently experienced reduced dilutive impact, which further explains its significant YoY growth in EPS.

The balance sheet also strengthened due to improved cash earnings of A\$1.3M for FY20, resulting in cash reserves of A\$3.1M as at 30 June 2020. This should allow CI1 to fund its future expansion in the Australia and Singapore markets, in our view.

Figure 2: Group EBITDA and NPAT and margins comparison



Source: Company Reports, Pitt Street Research

## The Australian economy taking a severe beating

On 2 September 2020, Australia is officially in recession for the first time in 29 years after reporting a 7% contraction in the June quarter GDP of 2020. This occurred right after a 0.3% fall in the March quarter GDP.

Figure 3 breaks up the June quarter GDP growth mix, within which we can see that household consumption was the key growth detractor. This also has been reflected in an increase in household saving ratio from 6.0% to 19.8% over the June quarter as consumers cut spending on goods and services due to COVID shutdown or restrictions placed on businesses. Additionally, private business investment also contracted 6.5% over the June quarter (vs. -0.8% in the March quarter) as most businesses pushed back on their expansion plans to conserve cash.

Looking ahead to the September quarter, we expect to see some recovery in the domestic economy due to relaxation of COVID lockdown across most states and territories, except for Victoria where the lockdown remains in force due to the outbreak of a second COVID wave. Looking further ahead to the December quarter, we expect growth to remain muted as government stimulus is expected to be reduced by the end of September, the result of which could will likely impact household cashflow and spending, which in turn could soften business trading conditions, potentially resulting in elevated job losses.

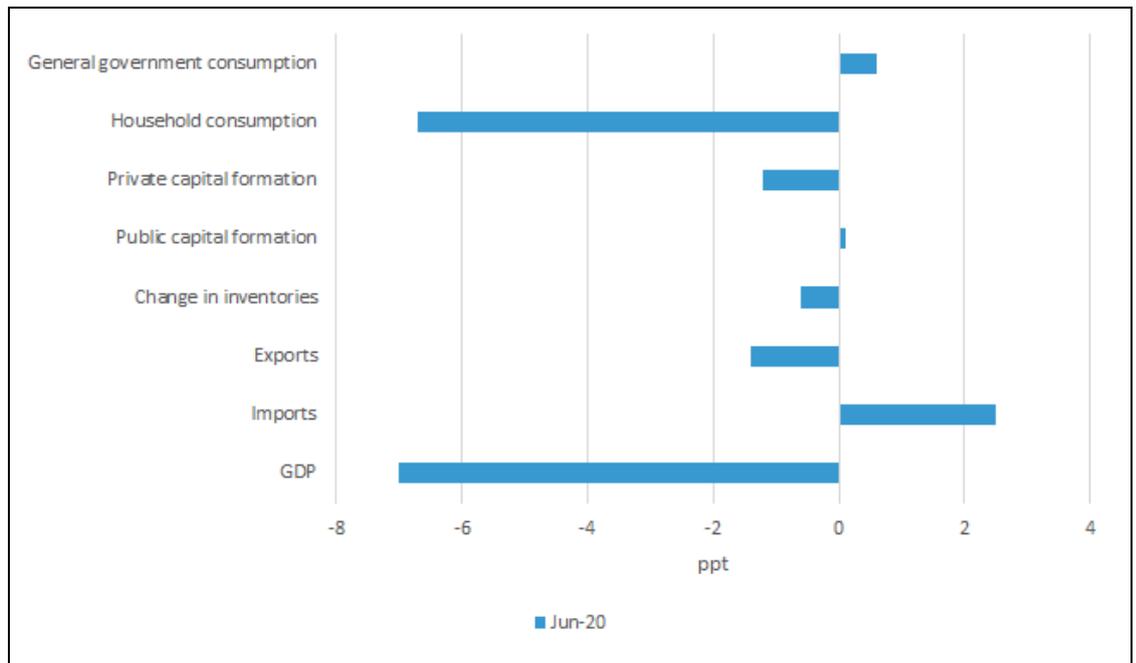
Moreover, we think the Victorian second COVID wave signifies the potential risk of a second outbreak eventuating in other capital cities of Australia and globally, the occurrence of which will significantly hamper economic growth

**-7% decline in June quarter GDP, officially marking an Australian recession since mid-1990**



and recovery. On balance, we maintain our view that in the absence of a vaccine, the domestic economic growth will be slow and gradual. If a second or third COVID wave eventuates, many businesses may struggle to survive, which we believe will translate positively for the Australian debt management business that CI1 recently acquired.

Figure 3: Contribution to GDP growth for 2Q20, seasonally adjusted

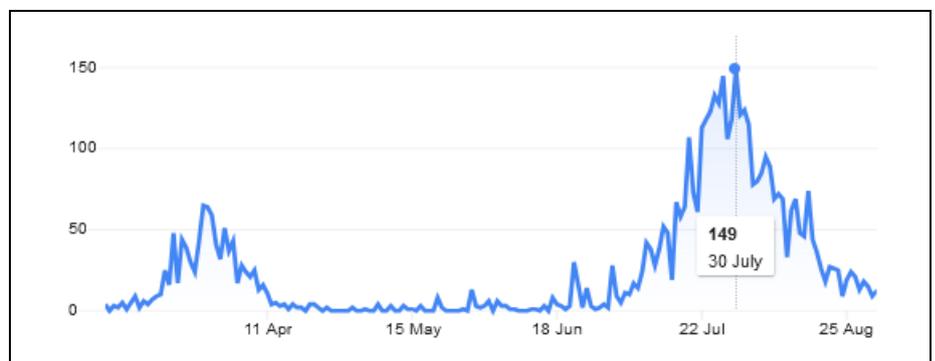


Source: ABS

## Recurring COVID outbreak in Hong Kong highlights CI1's counter-cyclical business model

In addition to current social and political unrest, Hong Kong has also recently experienced a second COVID wave (Figure 4), during which the city was placed in lockdown and business services were temporarily closed.

Figure 4: New COVID cases in Hong Kong



Source: Wikipedia

As shown, the magnitude of the second outbreak was substantially larger than the first one, which implies a larger impact on the local economy. As



*Potential ongoing COVID outbreak could put businesses on verge of bankruptcy, which would work favourably in CI1's counter-cyclical business model*

*We have expanded our near-term market share assumption for the Hong Kong segment as the business continues to drive penetration in the local debt solutions market due to its increased brand awareness and COVID-induced tailwind*

reasoned above, should there be an occurrence of a third or even fourth COVID wave happening in the country, we think many local businesses could potentially enter bankruptcy as they would struggle to generate cashflows in a locked down economy. This recurring and potentially devastating impact on local businesses and the economy highlights CI1's counter-cyclical business model, and as such we think the company will continue to benefit from the COVID-induced tailwind.

## Forecast changes

We have made the following changes to our forecasts (Figure 5):

- CI1's core bankruptcy administration revenue of A\$7.3M for FY20 has exceeded our expectations by +6% (vs. our forecast of A\$6.9M). Assuming an uplift in average pricing per case due to inflation, this would represent a 24% increase versus our initial forecast for the number of new bankruptcy cases in Hong Kong for FY20. Therefore, we lift our forward case numbers to include the incremental cases won, which are expected to generate recurring revenues over the medium term.

In addition, we increase our bankruptcy case growth for the Hong Kong segment from 8% to 20% for FY21 to price in the second COVID outbreak that took place at the start of FY21 (Figure 4) and its repercussions on the local businesses and economy. We also slightly expand our expected CI1's market share from 17.8% to 18.8% for FY21 as the business continues to gain momentum and brand awareness against the backdrop of the pandemic.

Due to COVID's lagged effect on business failures, we expect bankruptcy cases in Hong Kong to now peak around 3Q21, provided that no further COVID outbreaks will occur. At this stage, we have not factored in any further potential outbreaks post FY21 as we are cautiously optimistic that a vaccine may become available sometime before then.

- In Australia, we note that total bankruptcy cases have declined by -18.8% YoY for FY20<sup>1</sup>. Paradoxical to a COVID-induced recession, we think the fall in bankruptcy cases over the FY20 period was largely due to the significant amount of stimulus support provided by the government to businesses and individuals. This was further enhanced by mortgage deferrals and early withdrawal of superannuation, all of which resulted in consumers having access to cashflows and being able to spend. However, as fiscal support is expected to be reduced by the end of September, coupled with the second COVID outbreak in Victoria, we think the overall business trading environment will remain subdued in the near term, and as such we maintain our bankruptcy case growth for FY21, noting, however, that our total expected bankruptcy case numbers for FY21 have been trimmed down due to lower than expected case volumes for FY20.
- We update our balance sheet for FY20 to include A\$0.3M of lease liabilities (due to the introduction of AASB 16) and A\$3.5M due to related parties. As both of those liabilities are interest-bearing, we model interest expenses to be incurred over our forecast horizon. The introduction of these new interest expenses is therefore expected to weigh on forward bottom line earnings. This explains why our FY21 and FY22 NPAT forecasts have been slightly trimmed downward.
- Finally, we also slightly adjust our WACC from 10.5% to 10.2% to account for the introduction of debt.

<sup>1</sup> <https://www.afsa.gov.au/statistics/annual-statistics>



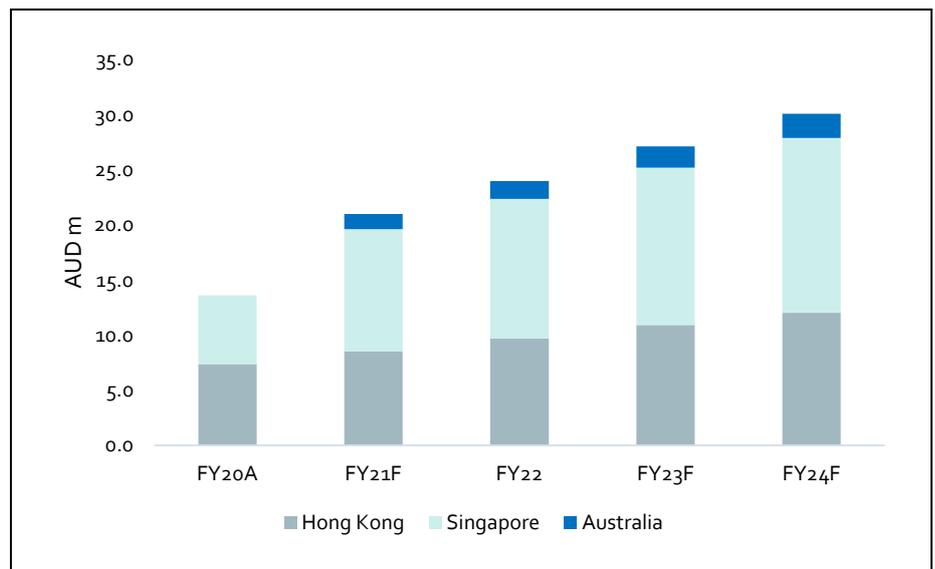
Figure 5: Changes to forecast

CI1: Forecast changes		FY21			FY22		
Years ended Jun (A\$m)	Old	New	Change	Old	New	Change	
Group Revenue	20.4	21.0	3.0%	23.2	24.0	3.4%	
Hong Kong	7.9	8.6	8.3%	8.8	9.7	10.3%	
Singapore	11.1	11.1	0.0%	12.7	12.7	0.0%	
Australia	1.5	1.4	-6.8%	1.8	1.6	-9.6%	
Group Revenue Growth	51.3%	50.5%	-0.8%	13.5%	14.2%	0.7%	
EBITDA	8.4	8.5	1.1%	9.6	9.7	1.4%	
NPAT	6.0	5.6	-6.2%	6.9	6.8	-1.5%	

Source: Pitt Street Research

Figure 6 below displays our revised revenue forecasts by geography for the CI1 group over the FY21 to FY24 period.

Figure 6: CI1's revenue forecasts by geography



Source: Pitt Street Research



## Valuation range remains largely intact

Based on our forecast revisions, our DCF returned a base case valuation of 11.9 cents (previous: 10.9 cents) and an optimistic case valuation of 15.2 cents (previous: 15.1 cents).

The slight expansion in our DCF valuation range is predominantly driven by the near-term upward revision in our Hong Kong bankruptcy case growth and the resultant higher free cash flow levels, offset by the slight pull-back in the expected case volumes in Australia.

On relative valuation, we adjusted our base case FY21 P/E multiple from 9.3x to 10.4x due to higher peer group multiples while our bullish case P/E multiple for FY21 is increased from 11.2x to 12.5x. Our peer group rerate was broadly driven by Resurs Holding AB (STO: RESURS) from 6.4x to 7.6x, which we think was caused by recovering economy and improving investor sentiment.

However, our FY21 EPS has been slightly trimmed downward from 0.37 cents to 0.31 cents due to the imposition of interest expenses and an expanded share base. Overall, this translates to a narrower relative valuation range of 3.24 – 3.89 cents (previous: 3.47 – 4.16 cents).

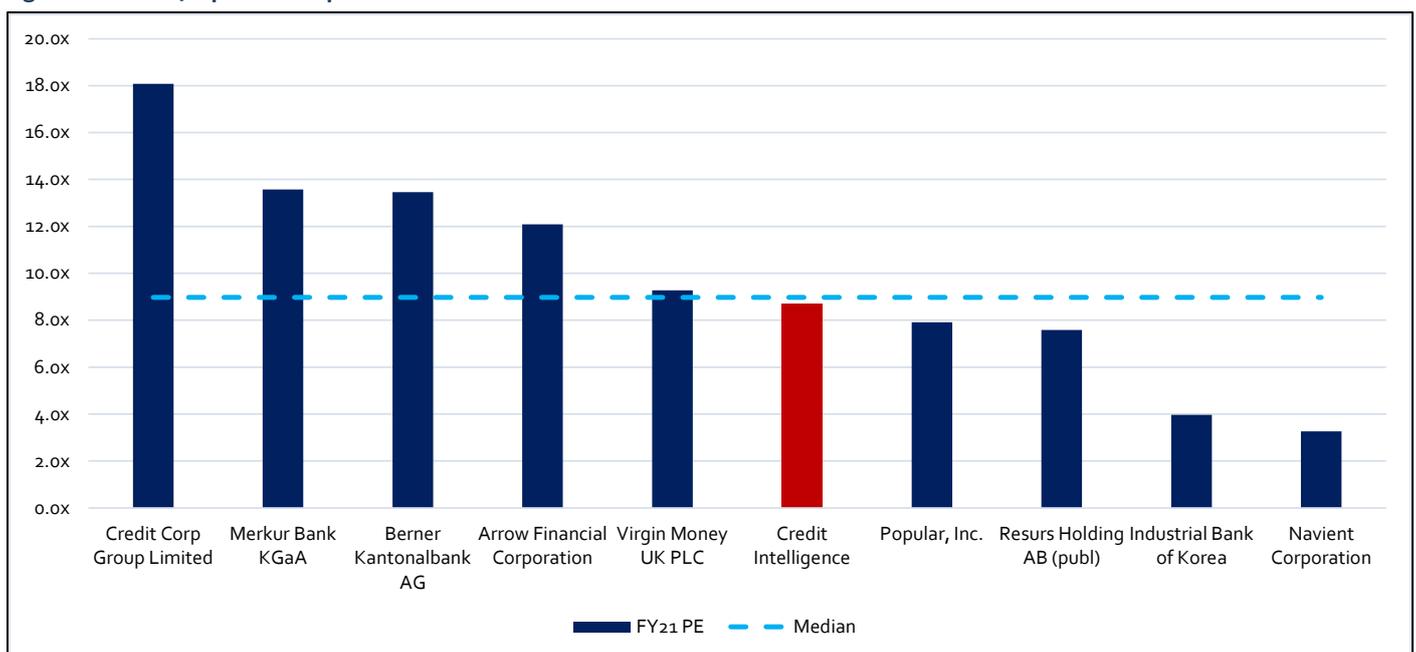
Figure 7 shows a summary of FY21 P/E multiple of CI1's peers. Currently, CI1 trades slightly below its peer group median. Given the structural tailwinds the business is facing, coupled with the upcoming synergies from its recent Australian acquisition, we believe the CI1 shares are deserving of a higher earnings multiple than the price currently being offered by the market.

Overall, our blended valuation range remains largely intact at A\$0.08 – 0.10 per share (previous: A\$0.07 – 0.10 per share).

On our revised forecasts, CI1 is trading on an attractive P/E multiple of 8.7x for FY21, falling to 6.8x for FY22.

Please refer to [www.pittstreetresearch.com](http://www.pittstreetresearch.com) for our initiating coverage on CI1, including an elaborate valuation and discussion of risk factors for CI1.

Figure 7: FY21 P/E peer multiples



Source: Pitt Street Research



## Analyst certification

Cheng Ge, lead analyst on this report, is an equities research analyst 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.

Marc Kennis 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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