Credit Intelligence Limited

# Banking on Bankruptcy

**Share Price: A$0.018**

**Valuation range: A$0.048-0.071**

**ASX: CI1**

**Sector: Commercial & Professional Services**

**20 December 2018**

## Unique proposition in the lucrative bankruptcy services

Credit Intelligence (ASX:CI1) is a Hong Kong-based debt restructuring and personal insolvency management service provider. CI1 has been a trusted partner for global banks for over 16 years. Considering the significant number of personal insolvency cases every year as well as the lack of experienced debt restructuring consultants and bankruptcy service administrators, we believe CI1 has substantial growth opportunities.

## Highly scalable platform for bankruptcy management

CI1 is a market leader in a business that requires minimal capital. The operations are highly profitable, with net margins of ~40% and a dividend yield >10%. The fully functional IT platform and an experienced team make CI1 valuable for both regulators and financial institutions. It has recently set up joint operations with Cor Cordis and Arrow Business Consultants, to expand into Australia and Singapore respectively, both new markets for CI1. The extended network in these new markets and recurring revenues from the Hong Kong market are expected to drive a re-rating of CI1.

## Valuation range of A$0.048–0.071 per share

We value CI1 at A$ 0.048 per share base case and A$ 0.071 per share in a more optimistic scenario in which CI1 expands into additional geographies in the next few years. Our valuation is based on a blend of DCF and relative valuation methods, with conservative assumptions on the commercial expansion of the new Australian and Singapore businesses.

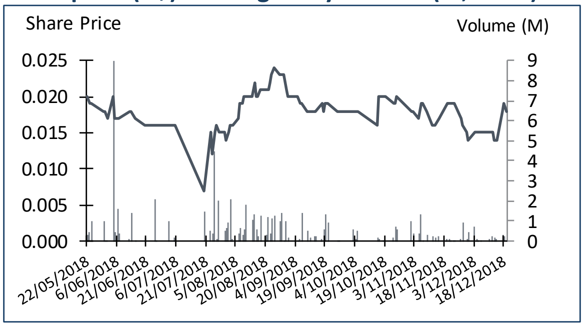
| Year to June (A$) | 2017A | 2018A | 2019f | 2020f | 2021f |
|---|---|---|---|---|---|
| Sales (m) | 3.8 | 4.9 | 6.2 | 7.5 | 8.7 |
| YoY growth (%) | | 28.8% | 26.7% | 21.3% | 14.9% |
| Adj. EBITDA (m) | 2.1 | 2.4 | 1.5 | 3.9 | 4.6 |
| Adj. Net Profit (m) | 1.8 | 2.0 | 1.1 | 2.6 | 3.1 |
| | | | | | |
| Adj. EBIT Margin (%) | 55.9% | 48.8% | 24.9% | 51.6% | 53.1% |
| ROA (%) | 127.1% | 63.0% | 23.5% | 59.4% | 63.5% |
| | | | | | |
| EPS before extr. & amort. | 0.25c | 0.27c | 0.12c | 0.30c | 0.36c |
| EPS | 0.25c | -0.03c | 0.12c | 0.30c | 0.36c |
| DPS | 0.21c | 0.18c | 0.21c | 0.28c | 0.32c |
| | | | | | |
| EV/Sales | NA | 1.7x | 1.7x | 1.4x | 1.2x |
| EV/Adj. EBITDA | NA | 3.6x | 6.7x | 2.7x | 2.3x |
| P/E | NA | 6.6x | 14.7x | 6.0x | 5.0x |
| Dividend yield % | NA | 10.4% | 11.8% | 15.3% | 17.6% |

*Source: Company, Pitt Street Research*

| | |
|---|---|
| Market Cap. (A$ m) | 14.8 |
| # shares outstanding (m) | 820.4 |
| # share fully diluted | 860.4 |
| Market Cap diluted (A$ m) | 15.5 |
| Free Float | 16.5% |
| 12 months high/low | $0.024 / $0.007 |
| Website | www.ci1.com.au |

*Source: Company, Pitt Street Research*

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




*Source: Thomson Reuters, Pitt Street Research*

| Valuation metrics base case | |
|---|---|
| DCF (A$) | 0.061 |
| Relative valuation (EV/EBITDA) (A$) | 0.035 |
| Equal weighted average (A$) per share | 0.048 |

*Source: Pitt Street Research*

***Subscribe to our research HERE***


**Analyst: Marc Kennis**

**Tel: +61 (0)4 3483 8134**

**marc.kennis@pittstreetresearch.com**

| Profit & Loss (A$m) | 2017A | 2018A | 2019f | 2020f | 2021f | 2022f | 2023f |
|---|---|---|---|---|---|---|---|
| **Sales Revenue** | **3.8** | **4.9** | **6.2** | **7.5** | **8.7** | **9.8** | **11.3** |
| Operating expenses | -1.7 | -2.5 | -4.7 | -3.6 | -4.1 | -4.6 | -5.0 |
| **Adjusted EBITDA** | **2.1** | **2.4** | **1.5** | **3.9** | **4.6** | **5.3** | **6.3** |
| Depn & Amort | 0.0 | 0.0 | 0.0 | -0.2 | -0.2 | -0.2 | -0.2 |
| **Adjusted EBIT** | **2.1** | **2.4** | **1.5** | **3.7** | **4.4** | **5.1** | **6.0** |
| Net Interest | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Profit before tax (before exceptionals)** | **2.1** | **2.4** | **1.5** | **3.7** | **4.4** | **5.1** | **6.0** |
| Tax expense | -0.3 | -0.4 | -0.5 | -1.1 | -1.3 | -1.5 | -1.8 |
| Abnormals + Minorities | 0.0 | -2.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **NPAT** | **1.8** | **-0.2** | **1.1** | **2.6** | **3.1** | **3.5** | **4.2** |

| Cash Flow (A$m) | 2017A | 2018A | 2019f | 2020f | 2021f | 2022f | 2023f |
|---|---|---|---|---|---|---|---|
| Profit after tax | 1.8 | -0.2 | 1.1 | 2.6 | 3.1 | 3.5 | 4.2 |
| Depreciation | 0.0 | 0.0 | 0.0 | 0.2 | 0.2 | 0.2 | 0.2 |
| Change in trade and other receivables | 0.0 | -0.1 | 0.0 | 0.0 | 0.0 | 0.0 | -0.1 |
| Change in other current assets | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Change in trade payables | 0.0 | 0.3 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Other operating activities | 0.0 | 1.6 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Operating cashflow** | **1.8** | **1.6** | **1.1** | **2.8** | **3.3** | **3.8** | **4.5** |
| Capex (- asset sales) | 0.0 | -0.1 | -0.4 | -0.3 | -0.2 | -0.3 | -0.3 |
| Other investing activities | -0.7 | -0.6 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Investing cashflow** | **-0.7** | **-0.7** | **-0.4** | **-0.3** | **-0.2** | **-0.3** | **-0.3** |
| Dividends (ords & pref) | 0.0 | 0.0 | -1.7 | -2.3 | -2.6 | -2.9 | -3.4 |
| Equity raised (repurchased) | 0.0 | 3.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Debt drawdown (repaid) | -1.7 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Forex impact | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net change in cash | -0.6 | 4.0 | -1.0 | 0.3 | 0.5 | 0.6 | 0.8 |
| Cash at End Period | 0.3 | 4.3 | 3.3 | 3.6 | 4.1 | 4.6 | 5.4 |
| Net Cash (Debt) | -0.3 | -4.3 | -3.3 | -3.6 | -4.1 | -4.6 | -5.4 |

| Balance Sheet (A$m) | 2017A | 2018A | 2019f | 2020f | 2021f | 2022f | 2023f |
|---|---|---|---|---|---|---|---|
| Cash | 0.3 | 4.3 | 3.3 | 3.6 | 4.1 | 4.6 | 5.4 |
| Total Assets | 1.4 | 4.8 | 4.2 | 4.6 | 5.1 | 5.8 | 6.7 |
| Total Debt | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Total Liabilities | 0.1 | 0.5 | 0.6 | 0.6 | 0.7 | 0.7 | 0.8 |
| Shareholders' Funds | 1.3 | 4.3 | 3.6 | 3.9 | 4.4 | 5.0 | 5.9 |

| Ratios (A$m) | 2017A | 2018A | 2019f | 2020f | 2021f | 2022f | 2023f |
|---|---|---|---|---|---|---|---|
| Net Debt/Equity (%) | -27.5% | -100.8% | -92.3% | -91.6% | -92.3% | -92.5% | -92.6% |
| Interest Cover (x) | nm | nm | nm | nm | nm | nm | nm |
| Return on Equity (%) | 139.7% | 70.0% | 26.6% | 68.6% | 73.5% | 74.9% | 77.9% |

## Table of Contents

## Introducing Credit Intelligence

Credit Intelligence (CI1), a Hong Kong-based and ASX-listed entity, is a diversified debt restructuring and personal insolvency management service provider. Founded in 2002, CI1 was one of the first entrants in Hong Kong's insolvency market. Working with ~30 banks and financial institutions, it structures and customizes cost-efficient debt management solutions for banks and individuals. CI1 is one of the largest players in Hong Kong's bankruptcy administration market, supported by its highly experienced staff including lawyers, accountants, and bankers.

### Insolvency services – vital and in great demand

***Bankruptcy administrative services and personal insolvency consulting are needed because of Hong Kong's strict laws***

CI1 operates through two segments – Bankruptcy Administration Services and Individual Voluntary Arrangement Services. The company serves as an outside trustee (OT) in bankruptcy proceedings to ensure impartial administration of assets in accordance with the law. CI1 also provides customized debt restructuring solutions to help avoid personal bankruptcies and help creditors recover dues. Under the Bankruptcy Ordinance of Hong Kong, a person can lose all his/her personal wealth if declared bankrupt.

By experience, government employees, such as school teachers and policemen, will lose their jobs if declared bankrupt, and hence there is personal interest in avoiding bankruptcies and paying off debts.

Thus, there is a need for professional administrators who can act on behalf of financial institutions to ensure that processes are smooth, and consultants who can help individuals manage regular payments. CI1 fulfils this critical need.

### Business operations – long-term and steady

***First-mover advantage, and in-depth industry knowledge helps in service upgrades***

Currently, CI1 is one of the two players in Hong Kong that provide insolvency services for bankruptcies where individuals have assets valued at A$36k (HK$200k) or higher. Together, the two players control ~90% of the market. Over the years, CI1 has handled ~10,000 cases as an OT. It gets ~100 new cases each month, each with a bankruptcy periods of 4–8 years, providing the company with a steady and recurring fee income. The management's extensive experience, industry knowledge, and in-depth understanding of market conditons enable the company to assess new trends, client needs, and evolving service requirements.

### Expansion across new geographies with improved efficiencies

As Hong Kong is a relatively mature market and slowly stagnating, CI1 has decided to enter a new market: Australia. Through its collaboration with Cor Cordis, one of Australia's leading insolvency advisors, CI1 has forayed into the country's debt restructuring market. In addition, the company has commenced the development of an app that is expected to bring in operational efficiency while handling increased volumes of cases.

### Business still highly undervalued

CI1 is valued at only A$11.5m. We think that the main reasons for the apparent undervaluation of CI1 are concerns related to the saturation of its Hong Kong operations and reluctance of investors to look at a bankruptcy consulting business. We look for a re-rating based on a consistent volume of cases in the home market, new market outreach, and operational efficiencies from the app, leading to steady profitability.

## Ten reasons to look at Credit Intelligence

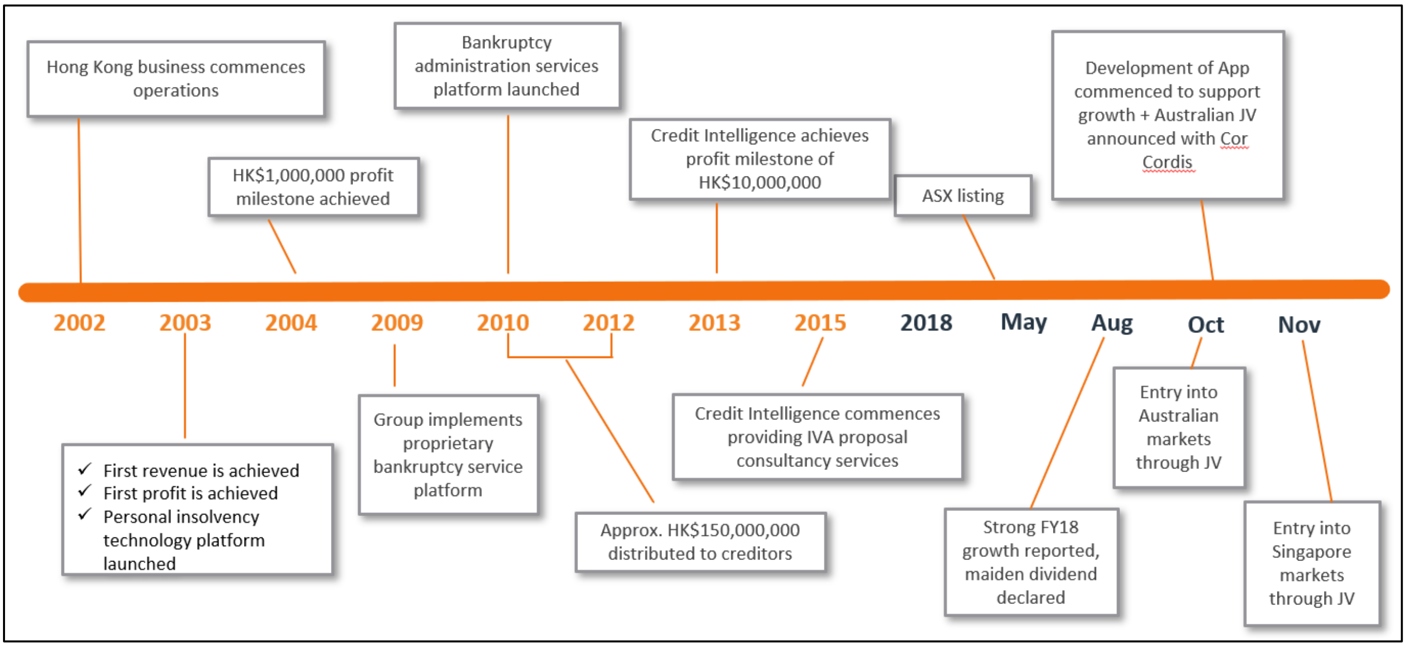
1) CI1 is one of the first companies to have ventured into the business of bankruptcy administration and personal insolvency filing across Hong Kong. It holds ~18% market share in total bankruptcy cases and >50% share in cases involving assets worth >A$36k (HK$200k).
2) CI1 has an experienced team that has been at the forefront of executing administration services for the past 16 years. The founder, Jimmie Wong, was the first to venture into bankruptcy services across Hong Kong, gathering significant knowledge about the industry.
3) The company is highly profitable, with an average adjusted net margin of >40% (past two years). With both RoE and RoA being close to 100% for the past two years (on adjusted net profit), the service business requires minimal capital investment for higher returns.
4) As Hong Kong has an increasingly high ratio (>60%) of household debt to GDP, the requirement of advisory and solutions for debt restructuring is high. Rising interest rates and expected economic downturn could lead to an increase in bankruptcy filings.
5) To expand beyond Hong Kong, CI1 has partnered with Cor Cordis and Arrow Consultants to extend its distribution network and utilize their reach to establish operations in Australia and Singapore, respectively.
6) The business is highly scalable. Having been in the business for 16 years, the company has developed well-documented processes. CI1's processes are transparent, easy, and provide enough checkpoints to raise a red flag, if needed. These organizational practices grants CI1 a unique position in an otherwise unorganized industry.
7) Relationships with regulators and financial institutions are critical in the bankruptcy administration services segment. CI1 has been able to establish trust and respect for itself among all stakeholders – creditors, regulators, and clients. Its long-standing associations with global financial institutions in Hong Kong are expected to prove highly beneficial in the long run.
8) CI1 has deployed a sophisticated IT platform to run its processes. Faster manoeuvring of cases allows for the management of high volumes with minimal staff, thus expanding efficiency. The system also records case data and notifies of any variation to the repayment plan.
9) The company is developing an enhanced fintech solution in the form of a smartphone app for improving customer experience and scalability of operations. The added features of discreet booking and ability to fill out information remotely are expected to further boost operational efficiencies.
10) We believe CI1 is currently undervalued. We value the company at A$0.048 per share in our base case scenario, using a blended valuation approach of DCF and relative valuation. We have applied realistic estimates on case volumes, tech app platform launch, and establishment of the Australian franchise network.

## Current Business Operations

### Humble beginnings

Jimmie Wong, current CEO and Managing Director, founded Credit Intelligence (CI1) in 2002 (Figure 1). Hong Kong was affected by a massive property price crash in 2002, resulting in a surge in personal debt defaulters across the geography. Many professionals and middle-class people who had invested heavily in real estate through debt financing, faced a backlash from money lenders, financial institutions, and banks due to a drop in the underlying asset value. Wong, who was running a successful law firm at that time, decided to enter the market of professional consulting for personal insolvency cases. Under the prevailing laws of Hong Kong, a professional or government employee may be liable to lose his/her job if declared bankrupt. The need for debt restructuring and managing debt situations provided CI1 the opportunity to explore the untapped market. Today, it is the leading bankruptcy administrator in Hong Kong, with an overall market share of ~17% and ~50% share in bankruptcies involving assets worth >A$36k (HK$200k).

**Figure 1: Evolution of Credit Intelligence**



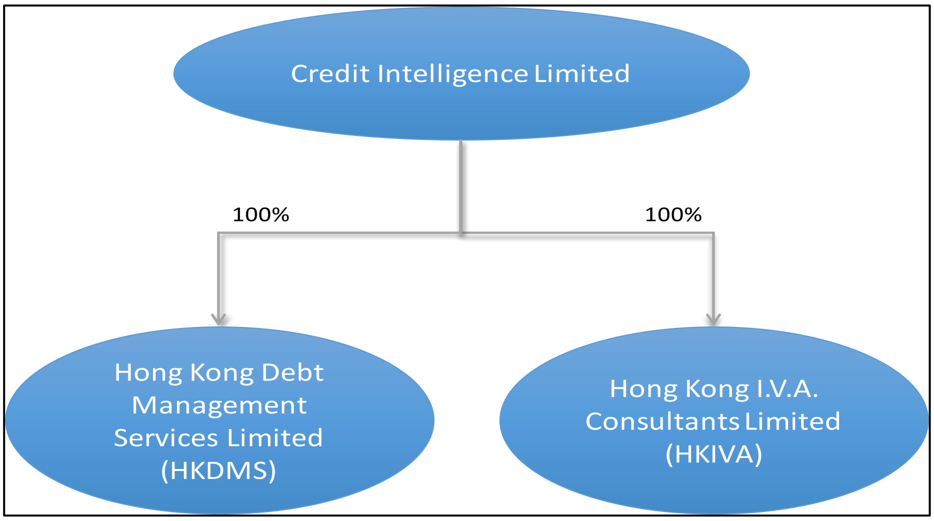

*Source: Company*

### Lean corporate structure

CI1 is the result of a reverse merger between Singapore-based and ASX-listed APAC Coal, and Hong Kong-based Credit Intelligence Holding Limited (CIH). APAC Coal, a subsidiary of Magnus Energy Group, was engaged in the coal mining business across Indonesia. In the wake of significant environmental regulations enforced by both the state and federal governments on the exploration business, APAC Coal decided to acquire a 100% stake in CIH in October 2017. In May 2018, through a reverse takeover (RTO) of APAC Coal, CI1 was formed and subsequently listed on the ASX and CIH became a wholly owned subsidiary of CI1.

Hong Kong Debt Management Services Limited (HKDMS) was registered in Hong Kong on April 28, 2003 and is CI1's main operating entity that provides bankruptcy administration services. Hong Kong I.V.A. Consultants Limited (HKIVA) is the other subsidiary of the group and provides voluntary administrative services to individual debtors who wish to avoid bankruptcy (Figure 2).

**Figure 2: Current group structure**




*Source: Company*

## First-mover advantage

CI1 enjoys the first-mover advantage in the field of bankruptcy management and insolvency consulting. Traditional players in this space are mainly law firms and collection agents who neither have the required experience nor provide all the required services. Being a one-of-its-kind operator that provides niche services, CI1 has been able to maintain long-term collaborative relationships with banks and financial institutions. It has benefited from a steady supply of work, mainly due to the long-standing trust on its services and operations.

Being one of the first entrants in the industry in 2002, CI1 has amassed a high degree of experience and established strong cooperative affiliations with regulatory organisations. This allows the group to maintain its recognition and visibility in the market. As the group expands outside its home market of Hong Kong, its long-standing experience will provide a unique proposition to counter future competition.

## Two main business lines currently

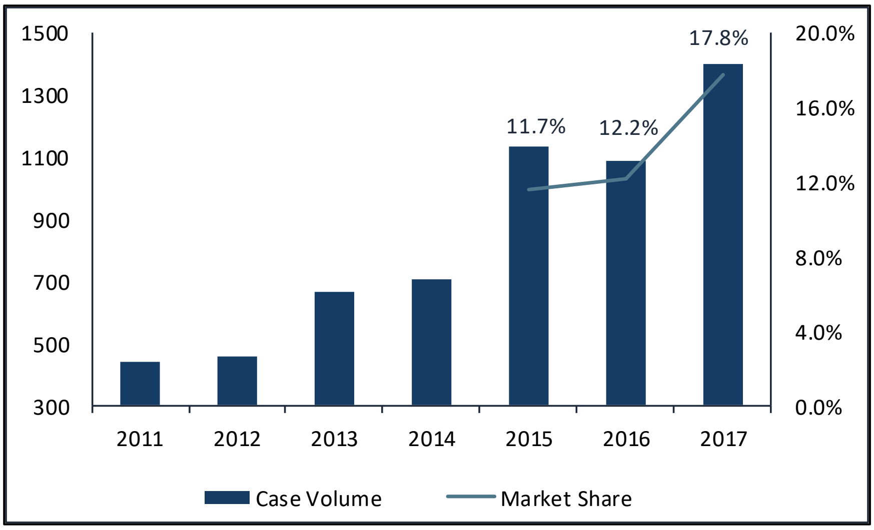
### 1) Bankruptcy Administration Services

Under the Bankruptcy Ordinance (Chapter 6 of the Laws of Hong Kong), when an individual is unable to pay debts, he/she or his/her creditors may present a petition to court for a bankruptcy order. Consequently, no proceedings can be commenced or continued against the bankrupt individual or his/her assets without the court's permission. Subsequently, an outside trustee (OT) is appointed to administer the bankruptcy estate.

CI1, through its wholly owned subsidiary, HKDMS, provides bankruptcy administration services by becoming an OT to creditors where the value of the bankrupt individual's assets is likely to exceed A$36k (HK$200k). As an OT, CI1 discharges certain duties, including realisation of assets, monitoring the income and expenses of the bankrupt individual, and making distributions to creditors when there are sufficient funds in the bankruptcy estate. On issuance of the order, as an OT, CI1 immediately takes possession of the deeds, books and documents, and all other parts of movable property.

HKDMS provides qualified and experienced employees to act as OTs. They negotiate with creditors and ensure the smooth administration of the bankruptcy estates. As an OT, CI1 must ensure equitable administration of the property pursuant to the requirements of the Bankruptcy Ordinance (Figure 3).

**Figure 3: Bankruptcies cases administered by CI1**




*Source: Company, Pitt Street Research*

***OT receives a fixed percentage of the total contribution from the bankrupt individual***

***CI1 also receives a share in the final realization of bankrupt individual's estate***

For its services, HKDMS receives a fixed percentage on the amount of contributions from the bankruptcy estate. It also receives proceeds from the realization of assets (if any). Since 2010, the fee for OTs has been fixed at 16% of the total contribution and realisation. HKDMS also receives a fixed percentage of the bankruptcy distributions, which has been set at 1% since 2010, and any remaining balance in the bankruptcy estate upon the expiration of the applicable bankruptcy period to catch up with a basic fee of HK$30,000.

## 2) Individual Voluntary Arrangement (IVA) Services

As an alternative to bankruptcy, an individual may seek to enter into a voluntary arrangement with his/her creditors by making a proposal for timely repayment of debts via monthly instalments. The proposal must first be approved by a majority of the creditors, and then a nominee is appointed to execute the proposal. The nominee collects payments and distributes them among the creditors.

***Individual voluntary insolvency is a volume-driven business with thin margins. It has specific payment schedule as per case filling stage***

CI1, through its wholly owned subsidiary, HKIVA, provides IVA services to debtors who wish to avoid bankruptcy, and proposal implementation services to nominees. An IVA is an agreement between a debtor and his/her creditors. An IVA not only helps debtors avoid bankruptcy but also provides relief from the constant demands of creditors. For a creditor, an IVA provides an end to costly enforcement proceedings and certainty on the amount of debt that will be received.

HKIVA commenced operations in 2015. It evaluates a debtor's financial position by leveraging experienced insolvency practitioners and then provides practical advice. Once the debtor has agreed to proceed, HKIVA helps initiate the formal legal process, which includes drafting the IVA proposal, liaising with relevant creditors, and processing the court application. After the proposal has been approved, a nominee will be appointed to implement the proposal. HKIVA provides support services to nominees during the implementation period, including administrative support and liaison support when communicating with creditors.

The debtor pays HKIVA a predetermined service fee in instalments at different stages of the application – a one-time fee for drafting the proposal and regular payment for support to the nominee. The fee for one individual voluntary arrangement search/compulsory winding-up search request is HK$80, and it's a low-margin volume centric business. Over the years, CI1's market share for IVA services has been stable at 2–3%.

## Proprietary case management platform drives margins

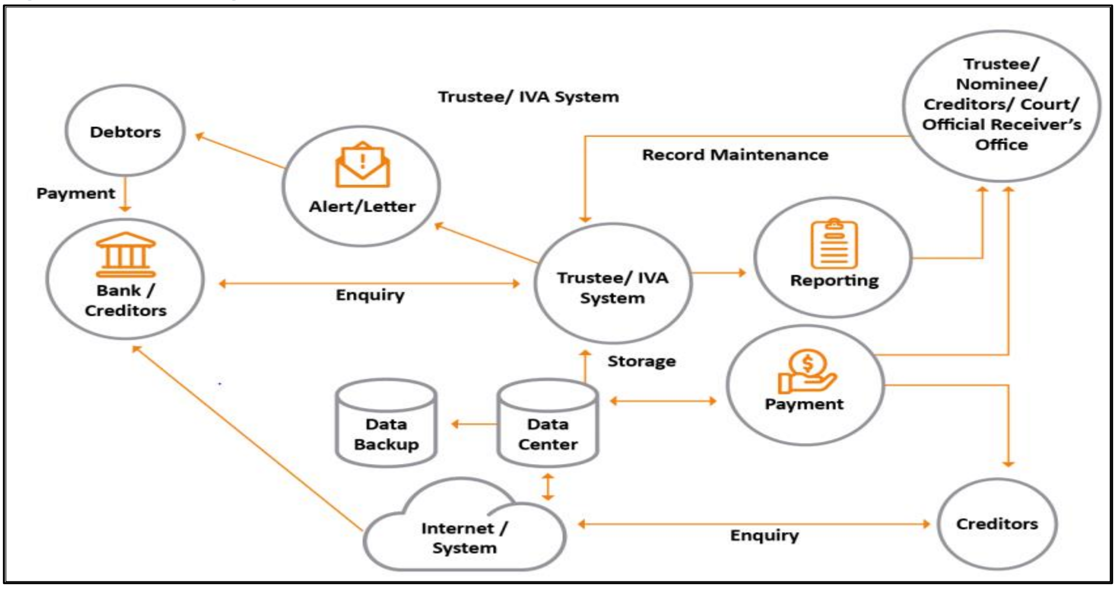
CI1 has developed a proprietary case management platform to manage cases faster. Developed over eight years, the insolvency management system allows a high number of cases to be managed with minimal staff. The platform intends to scale up operations while keeping direct labour costs in check, thereby delivering greater efficiency. Considering the number of cases managed by CI1 at any point in time, without a sophisticated IT system in place, the direct employee cost would escalate exponentially.

Additionally, the system consolidates distributions from each debtor into one distribution payment to the creditor, thereby reducing administration costs for the creditor as well as CI1.

Apart from managing administrative and employee costs, the system records case data and any variation to the repayment plan, with notification alerts. CI1's investments in graded IT systems provides banks another reason to want to work with CI1 given that the platform is professional, quick, and proactive.

As a professionally managed company dealing with process-oriented banks and financial institutions, CI1 provides periodic review reports. The case management system (Figure 4) supports CI1 with reporting features, including overdue payments, repayment progress, dividend distribution, and half-yearly/annual review reports. The system can be accessed by creditors, bringing greater transparency and enhanced trust to the process.

**Figure 4: Case Management Platform**



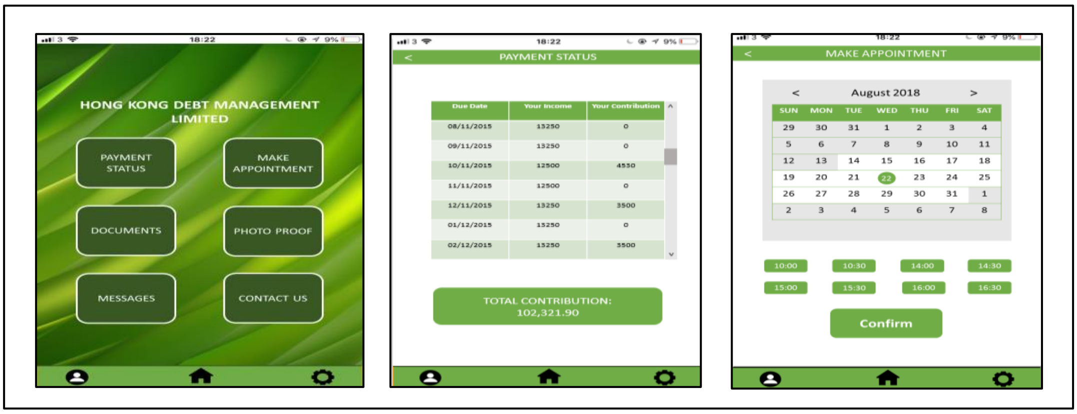

*Source: Company*

In October 2018, CI1 announced the commencement of the development of a smartphone application (Figure 5) in partnership with Hong Kong-based AppTech. Scheduled to be launched in March 2019, the app is expected to enable CI1 to provide an enhanced fintech offering and improved experience for existing and new users and help achieve greater cost efficiencies and scalability for CI1's operations and clients. Key benefits of the app are as follows:

- Discreet booking of appointments online.
- Ability to fill information forms remotely.
- Increased efficiency for CI1 staff while managing cases.

The enhancement of IT systems and the smartphone app will not only streamline operations and allow CI1 to enjoy optimal economies of scale, but also provide it a competitive advantage through enhanced customer experience.

**Figure 5: App Frames – Draft version**




*Source: Company*

## Entry into the Australian and Singapore markets through JVs

CI1 has announced two strategic alliances – with Cor Cordis (Australia's leading insolvency advisory firm) and Singapore's Arrow Business Consultants – to expand into Asia-Pacific (APAC) markets beyond Hong Kong. Through these JVs, CI1 intends to tap into growing opportunities in the Australian debt-restructuring market and fill the gap in Singapore's personal insolvency market, over the next 1–3 years.

***CI1 and Cor Cordis is a 50:50 JV***

Cor Cordis is one of the largest business advisory firms in Australia and has been providing innovative advisory, restructuring, turnaround, and insolvency solutions for the past 13 years. Its insolvency service offerings include voluntary administrations, liquidations, receiverships, mortgage possession, and bankruptcy filings. Other services include viability analysis, independent business reviews, informal debt restructuring, voluntary liquidations, business valuations, cash management, and litigation support.

***JV with Arrow will be held by CI1's subsidiary, HKIVA. This is a 51:49 partnership***

Singapore-based Arrow Business Consultants is headed by Mr Ban Chuan Neo, one of the country's senior insolvency practitioners. Previously, he led KPMG's insolvency practice in Singapore, and has also been the Managing Director at Korda Mentha Singapore, an Asia-Pacific advisory and insolvency firm operating in APAC region. Neo is highly experienced while Arrow has an extensive network of participants in the insolvency space.

Through its case management platform and JV partners market presence, CI1 plans to expand the distribution reach of its services in the two countries. Further, CI1 will consider setting up a branch network in these countries, from which it plans to leverage the JV partners' existing local businesses and merge them into one network. This collaboration is expected to benefit all the players. Cor Cordis and Arrow will benefit from CI1's experience in handling personal insolvency filings, while CI1 will benefit from an established distribution network. Despite being present in the same market, all the partners can leverage each other's strengths and grow concurrently.

***JVs are a springboard for CI1 towards geographic growth***

We believe that CI1 is well-positioned to expand into Australia and Singapore, because the insolvency laws in these countries and the English-language driven procedures are similar to those of Hong Kong. Its well-established relationships with large banks are expected to bolster CI1's expansion plans. These relationships will be a major asset in establishing credibility during business development initiatives overseas and will help CI1 gain traction quickly. Success in the Australia and Singapore markets could be a major driver for CI1 to expand into neighbouring and other Commonwealth countries.

# Business Model

## Inversely correlated with economic growth

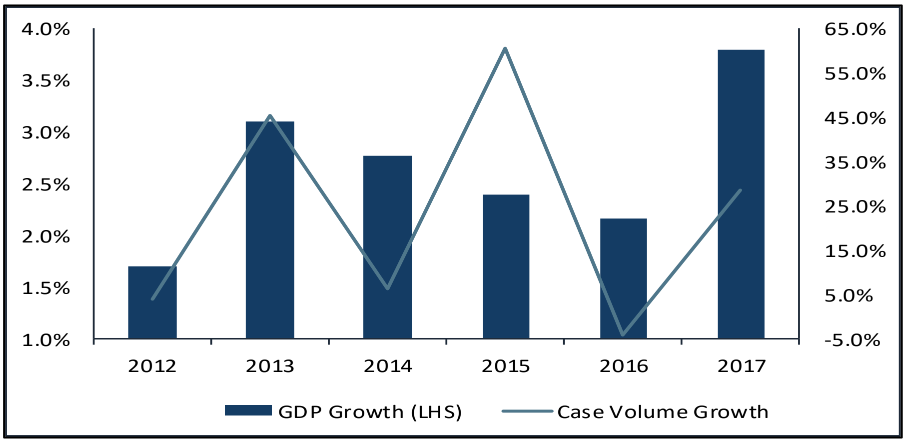
CI1's operations rely on the number of bankruptcies that occur each year in the jurisdictions in which it operates. This in turn depends on the state of the local economies (Figure 6). Consequently, a low GDP growth scenario is considered good for CI1's industry.

*CI1 is making money in both economic upturns and downturns*

Whenever CI1 is appointed as an OT on a case, it receives access to the bankrupt individual's assets. CI1 becomes the custodian of available assets and can sell the property/assets at an appropriate time, if terms are accepted by both the parties. After CI1 is appointed as an OT, it can enter into a definitive agreement to become the joint owner of the bankrupt individual's property, along with his/her partner/spouse (if any). If, during payments, the bankrupt individual defaults, CI1 can sell the property to settle the debt and keep a share of the profit. This usually happens in an economic boom scenario when property prices rise. The profit margin on the sale of property is usually 50% of the total realization.

In either case – lower or higher economic growth – CI1 has an opportunity to earn.

**Figure 6: Hong Kong GDP growth vs. CI1 case volume movement**

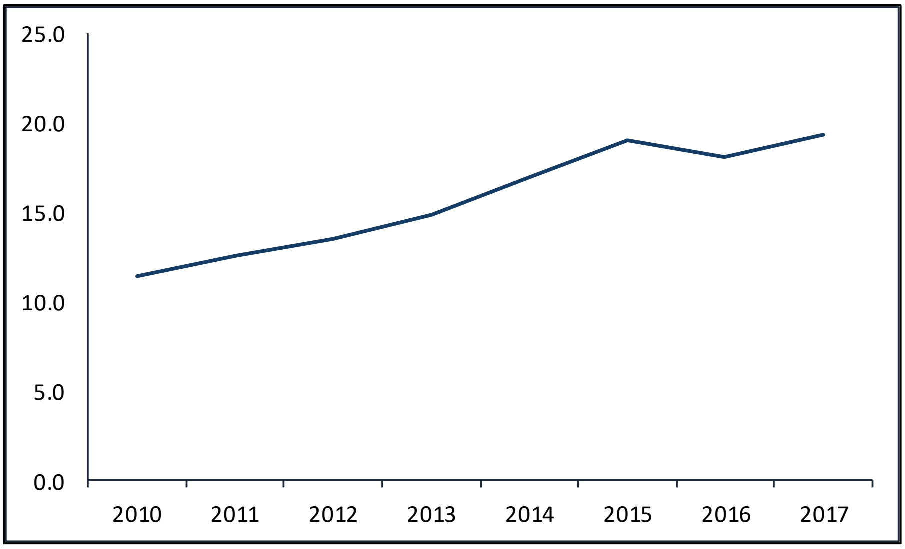



*Source: Company, Pitt Street Research*

*Rising Affordability Index indicates expanding economic unaffordability*

As Hong Kong is an expensive geography (Figure 7), there have been a consistent number of bankruptcies over the years. Since 2002, issued bankruptcy orders have grown at an average of 6.5% per year, while the GDP growth has averaged 3.8% annually.

**Figure 7: Hong Kong Affordability Index — Higher is more unaffordable**




*Source: Pitt Street Research*

## Recurring and steady income over time

*Long bankruptcy period provides CI1 with stable and regular sources of income*

Considering that the bankruptcy period for any case is 4–8 years, and CI1 receives regular payments from bankrupt individuals, the company's revenue stream remains steady and regular over time. As the bankruptcy period in some cases can go up to 8 years, the chances of any revenue deviation or volatility in payment are limited.

CI1's business is low-risk as it is not exposed to credit cycle alterations. Further, as CI1 receives a portion of the receipts from liquidating the assets in its custody, it has additional revenue-earning scope without credit risk. Liquidating of real estate assets held in trust are generally disposed of when the property prices are on the upswing. Though CI1's return is restricted due to lower returns from bankruptcy administration services, its relative risk profile is minimal.

Revenue growth is driven by the volume of cases. Due to CI1's long-standing relationship with financial institutions in Hong Kong, the volume has been steady in its home market.

## Additional revenue streams from new geographies

Over the next 2-3 years, CI1 is expected to make significant investment in expanding the network across the two new geographies of Australia and Singapore. This might lead to depressed margins, but expanded revenue streams.

The markets in Australian and Singapore provide significant growth opportunities. Benefitting from the JV and prior experience, we assume that CI1 will be able to capture 5% market share of new bankruptcy cases in FY2020E, and ~10% by FY2021E.

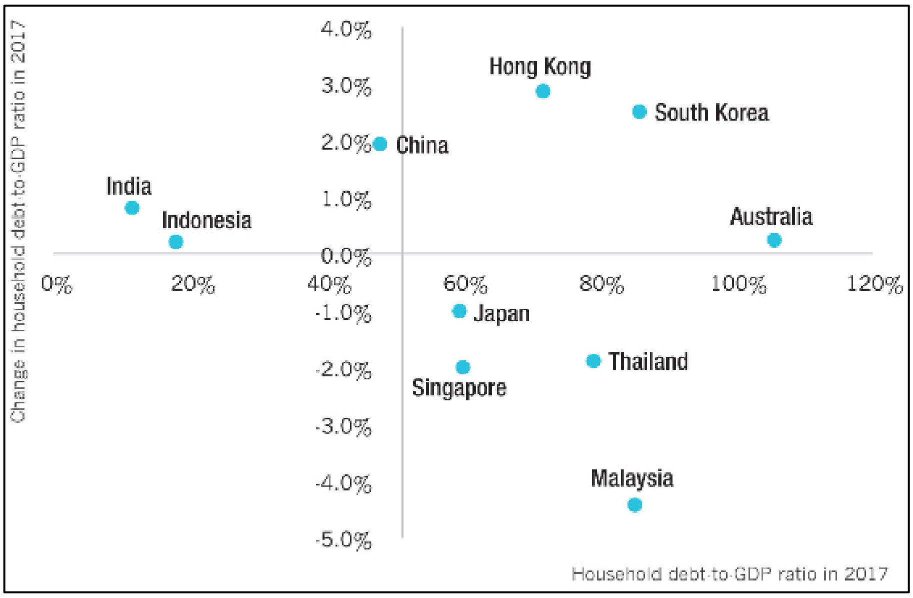
## Key Addressable Markets

### Hong Kong – well-defined bankruptcy administration processes

#### Higher Household Debt – a common phenomenon

Following the volatile global economy and weaker domestic demand in China, Hong Kong's economy has been stagnating for the past few years. While there has still been a steady growth in household income, it has been outpaced by heightened inflation, especially in housing expenses. Today, Hong Kong is one of the most debt-laden economies in Asia Pacific (Figure 8).

**Figure 8: Household Debt-to-GDP Ratio in Asia Pacific**

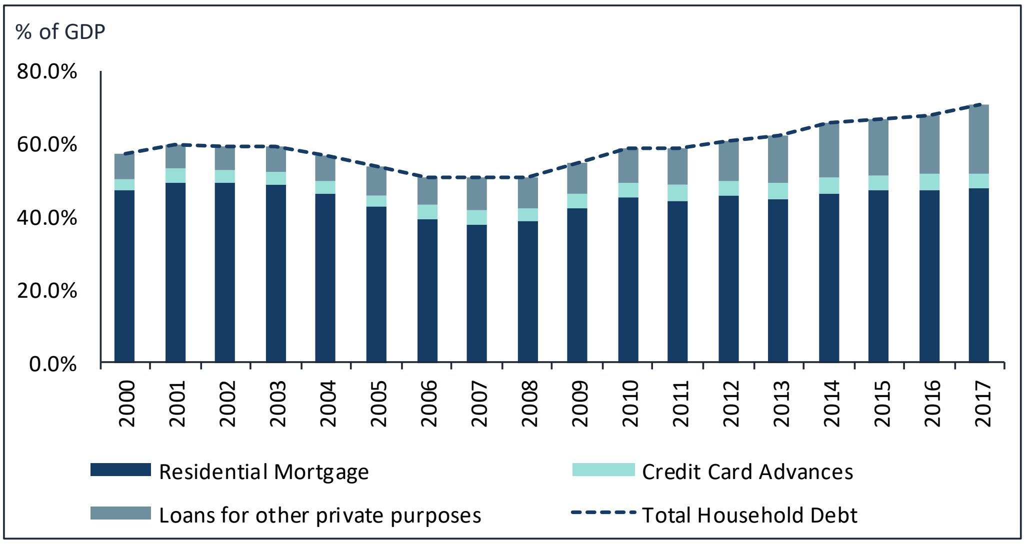



*Source: Asian Banker*

The 2008–2009 global financial crisis and household leveraging after the Asian financial crisis of 1997–1998 have caused an uptrend in household debt in Hong Kong. The total household-debt-to-GDP increased from ~35% in 1992 to 60% in 2002, before coming down to 50% in 2007 and again jumping to >60% at present. Residential mortgage loans form the bulk of the total household debt (~70%), while the rest is other personal loans (~25%) and credit card advances (~5%).

Housing in Hong Kong is among the most expensive in the world, and with rising interest rates, the ratio of mortgage repayment to household income has been increasing. Loans for other private purposes have been the main drivers of the rise in household debt over the past few years, spiking at >15% per annum over the past five years (Figure 9).

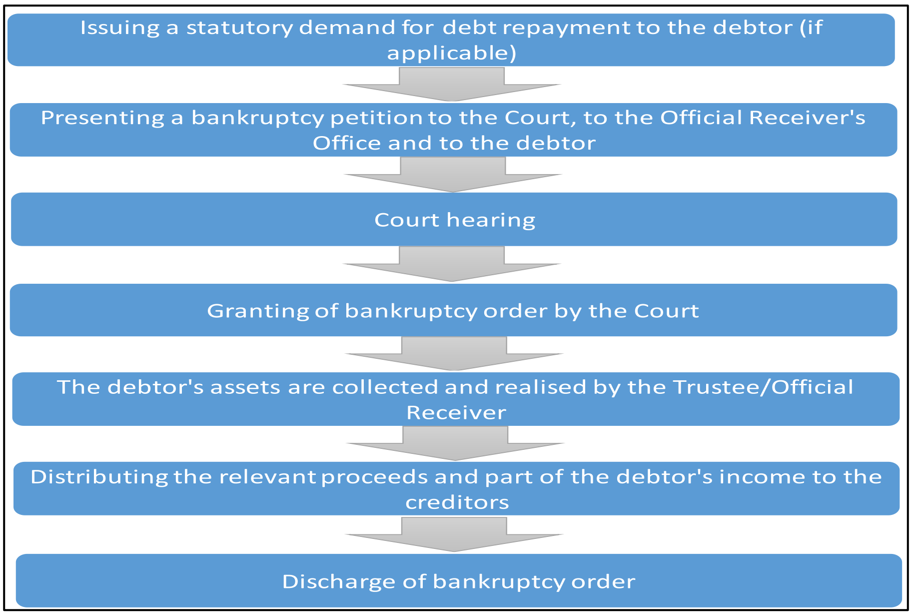
**Figure 9: Component of Household Debt in Hong Kong**




*Source: Hong Kong Monetary Authority (HKMA), Pitt Street Research*

Consequently, there has been an upward trend in personal debt and, in turn, personal insolvencies. Rising household debt is also leading to unsustainably low aggregate savings rates, which will potentially amplify the impact of adverse shocks to income and higher interest rates.

**Figure 10: Bankruptcy Case Stages in Hong Kong**




*Source: Community Legal Information Centre Hong Kong*

## Structured process makes Hong Kong a good market to operate in

Considering the high indebtedness of Hong Kong households, the number of insolvencies has been stable in the country. The Hong Kong government has drafted clear laws and procedures for managing the process relating to bankruptcies (Figure 10). The Bankruptcy Ordinance and the Bankruptcy Rules (Chapter 6A of the laws of Hong Kong) (Bankruptcy Rules) are the main legislations governing the debt management service industry in Hong Kong.

### Stagnation of bankruptcies evident

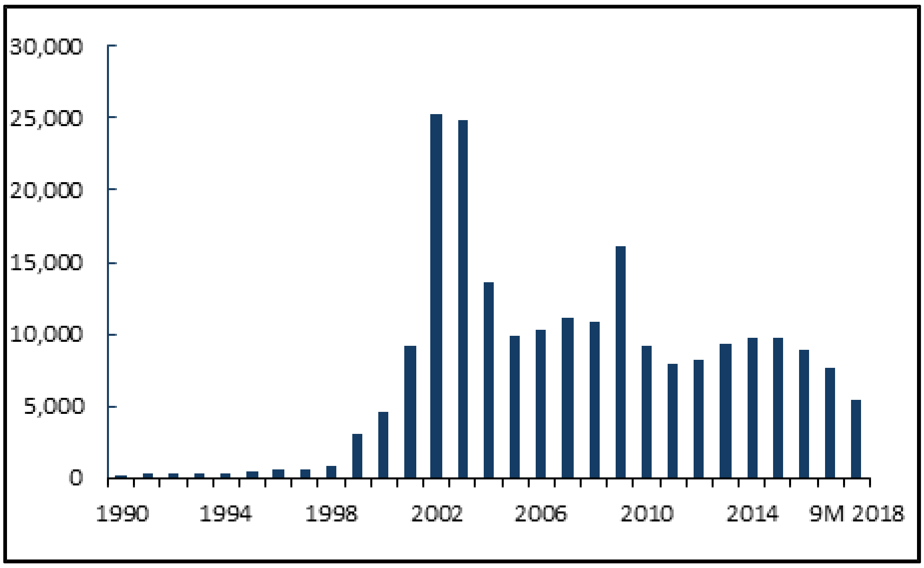
*The number of bankruptcy cases in 9M 2018 was ~7% less than in 9M 2017*

According to the Hong Kong government's Official Receiver's Office (ORO), the number of bankruptcy orders passed by courts in the country reached its peak in 2002 with 25,328 bankruptcy cases. After that, the number of insolvency cases reduced significantly, before peaking again at 16,157 in 2009, mainly due to the financial crisis of 2007–2008. Post that, the number of bankruptcies has been steadily declining. ORO recorded 8,919 such cases in 2016 (slightly above 50% of those in 2009), 7,627 in 2017, and only 5,394 bankruptcy orders in 9M 2018 (Figure 11). This depicts that the market for bankruptcy is shrinking and is not moving in favour of bankruptcy administrators. The number of IVA cases shows a similar trend. ORO recorded the highest number of approved IVA cases in 2009, totalling 3,046. Since then, the number of approved cases has declined every year, with 439 cases in 2018 (January–September).

*The number of IVA cases in 2017 was less than 20% of those recorded at the peak of 2009*

We believe that once the app platform is fully operational, greater transparency of operations will make regulators and the financial institutions to prefer CI1 over other unorganized players, resulting in expansion of market share for CI1. However, given the stagnation in the underlying market across Hong Kong, CI1 will be forced to look for opportunities in other markets/geographies, including Australia.

**Figure 11: Bankruptcy Case Declining in Hong Kong**



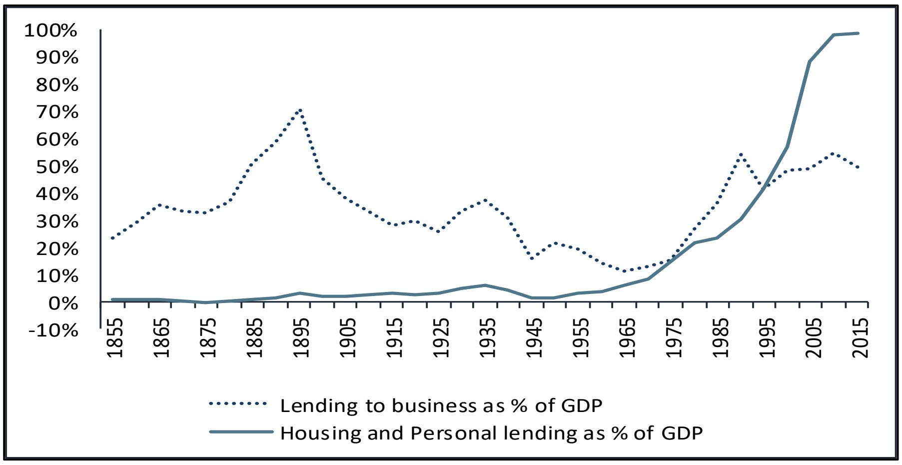

*Source: Hong Kong ORO*

## Australia – Burgeoning distressed household debt market

### Housing finance – epicentre of debt crisis

In 1997, lending to households overtook lending to businesses for the first time in Australia. This was mainly led by an increase in lending for housing and rapid growth in mortgage securitization (Figure 12). Since then, the level of household debt has expanded rapidly and is now more than twice the level of business lending.

**Figure 12: Household and Business Debt**



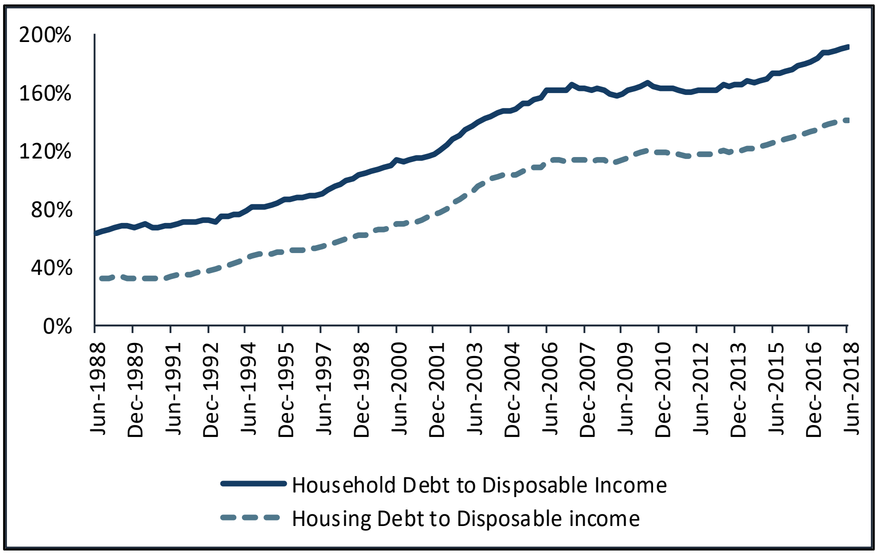

*Source: Australian Bureau of Statistics (ABS), Pitt Street Research*

*Most mortgages are on variable rates, which makes Australian households extremely vulnerable to interest rate increases*

One of the main reasons for burgeoning housing debt is because government and build-to-rent housing is relatively limited. The share of government and non-profit housing has been steadily declining from ~7% of the total housing in 1991 to 4.2% in 2016. Given that mortgage is the biggest debt for most households, additional borrowing for investment properties inevitably boosts the total debt.

According to the Reserve Bank of Australia (RBA), the value of Australian household debt has reached a record level of 190% of household disposable income by June 2018 (Figure 13). This is way too high against other G20 nations (2017) — ~109% for US, ~120% for France, ~149% for UK and ~178% for Canada. In parallel, the household savings rate in Australia is at ~1%, just a fraction of the disposable income.

**Figure 13: Household Debt to Disposable Income**




*Source: ABS, Pitt Street Research*

According to Morgan Stanley, the Household Deleveraging Risk Indicator applied by the bank labels Australia the most at risk of a deleveraging of household debt among all the G10 nations (Figure 14).

*Reserve Bank of Australia is worried about the stability of country's financial sector due to the record levels of debt held by its households*

**Figure 14: Household Debt to Disposable Income**

| | Current Leverage | Structural Vulnerabilities | Deleveraging signals | Household Deleveraging Risk Indicator |
|---|---|---|---|---|
| | Index | Index | Index | Index |
| Australia | 0.9 | 0.3 | 0.9 | **2.1** |
| Sweden | 0.8 | 0.0 | 0.3 | **1.1** |
| Canada | 0.1 | 0.0 | 1.0 | **1.1** |
| Norway | 2.1 | -0.2 | -1.1 | **0.8** |
| NZ | 0.3 | 0.4 | -0.7 | **0.0** |
| Switzerland | 0.2 | -0.7 | -0.3 | **-0.7** |
| US | -0.9 | -0.1 | -0.1 | **-1.1** |
| UK | -0.8 | -0.1 | -0.8 | **-1.7** |

Morgan Stanley household deleveraging risk **Morgan Stanley**

*Source: Morgan Stanley, News.com*

Record levels of household debts and stagnated income levels have together affected people's ability to pay back debt. As per the RBA, a majority of household wealth is in relatively illiquid assets, such as housing and superannuation. This makes it difficult to sell assets to make repayments should the economy undergo a downturn and unemployment rise. In October 2018, the ABS calculated that the total value of housing finance commitments declined by 9.9% YoY – the steepest 12-month fall since December 2010. The number of owner-occupier loans stood at -10.5% YoY – the biggest dip since February 2011.

## Debt and Personal Insolvency Agreements (PIAs) – popular instruments against bankruptcy filings historically

As per the Australian Financial Security Authority (AFSA), Q1 2018 data shows a 3.9% YoY increase in debt agreements, even as bankruptcies decreased 1.8% YoY (Figure 15). After two quarters of growth, bankruptcies returned to the long-term trend of a steady decline. Debt agreements are considered alternatives to bankruptcy and maintain appeal with debtors.

In Q1 2018, debt agreements continued to grow, at 47.1% of all personal insolvencies, up from 45.4% in Q1 2017. Debt agreements also registered a record quarterly high in New South Wales for Q1 2018. PIAs recorded their lowest quarter on record, with only 37 in Q1 2018. This is the first fall in PIAs since Q1 2016, when the previous low was 38.

---

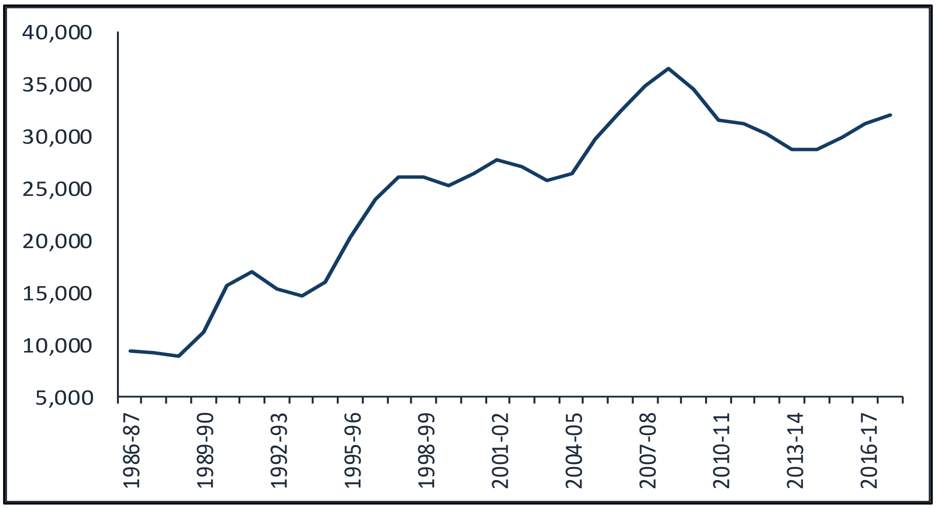
*Personal Insolvency Agreement (PIA) is a legal agreement between an incumbent and creditors. It is a flexible arrangement to settle debts without going bankrupt. PIAs are not subject to income, asset, or debt thresholds. The process involves the following:*

*a) A trustee is appointed to take control of property and to make offers to creditors;*

*b) The offer may be to pay a part or all debts via instalments or as a lump sum.*

---

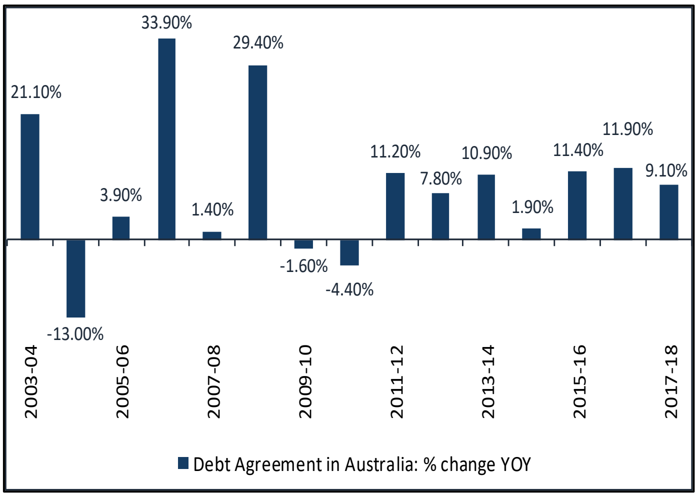
**Figure 15: Personal Insolvency Activity in Australia**

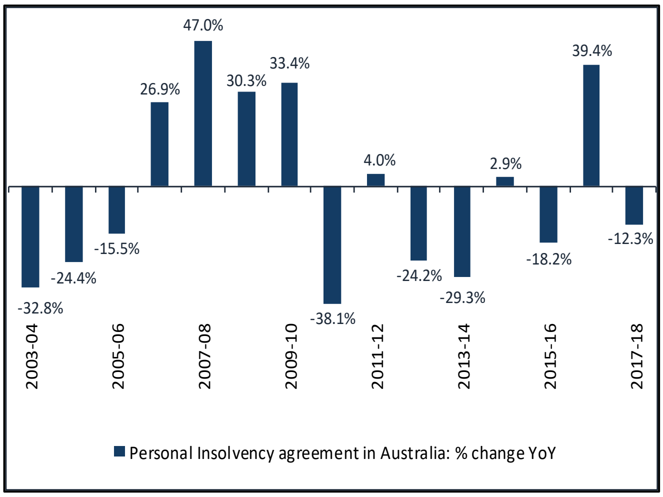



*Source: AFSA, Pitt Street Research*

In Q1 2018, 16.1% of personal insolvencies were business-related, a reduction from the 18% average in the 2017 calendar year. Consumer credit issues, in particular loss of income, unemployment, and excessive use of credit cards have increasingly become the main reasons for personal insolvency in Australia and this trend appears to be continuing in 2018 (Figure 16).

**Figure 16: Debt and Personal Insolvency Agreements in Australia**




*Source: AFSA, Pitt Street Research*

## Great opportunities for CI1 in the Australian market

According to The Wall Street Journal, the world's largest distressed-debt investors are hunting for deals in Australia as increasingly more companies are unable to repay their outstanding debt. Similarly, restricted economic activity is expected to vitiate households' ability to service their ballooning debt.

In addition, as per an amendment to the existing law, the term of bankruptcy in Australia will be reduced from three years to one year. The shortening of the term could significantly impact the current popularity of debt agreements. We believe a one-year bankruptcy will be more appealing to most consumer creditors. Consequently, amid the proposed overhaul of the Australian Insolvency Law, it will become even more important to opt for debt restructuring and insolvency filing. This will provide extended market opportunities to experienced debt-structuring service providers such as CI1.

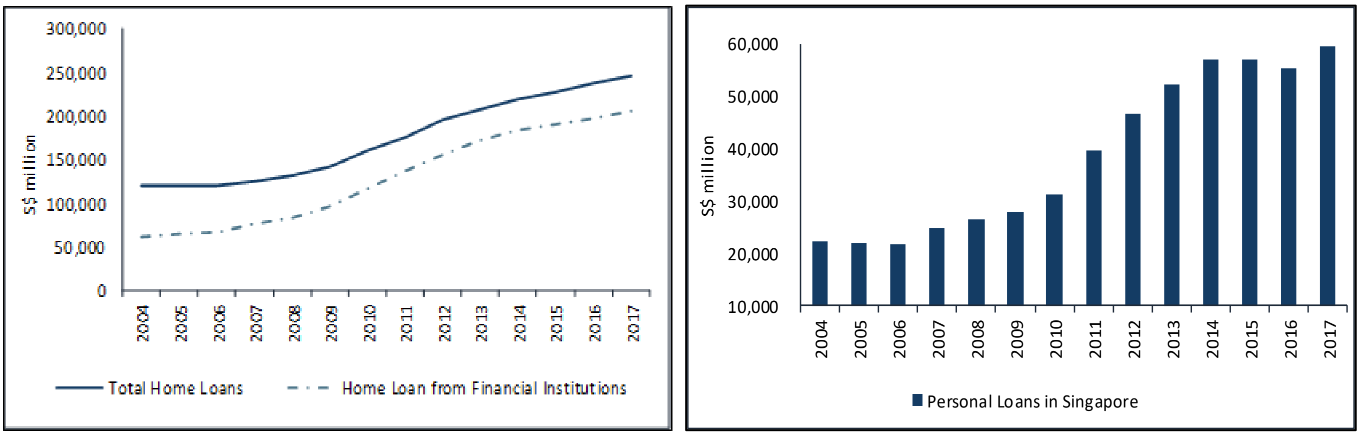
For CI1, the addressable market for insolvency solutions in Australia is much larger than that in Hong Kong. The market has low entry barriers, which make it relatively convenient for new businesses to enter. For this reason, it is fragmented, with few large players. To get a strong foothold in this market CI1 would need to rapidly create a regional branch network and establish a strong brand name, which it is trying to do in collaboration with Cor Cordis.

## Singapore – Amendment in existing bankruptcy law very helpful

### Debt-financed personal wealth is up for greater scrutiny

According to Singapore's Department of Statistics, in 2017, the country's average household debt per capita stood at US$58K, up 5% YoY. Further, credit card debt grew ~9% YoY to ~US$11bn. This is mainly because people in Singapore overstretch capacity while buying homes and use credit cards for discretionary spending (Figure 17).

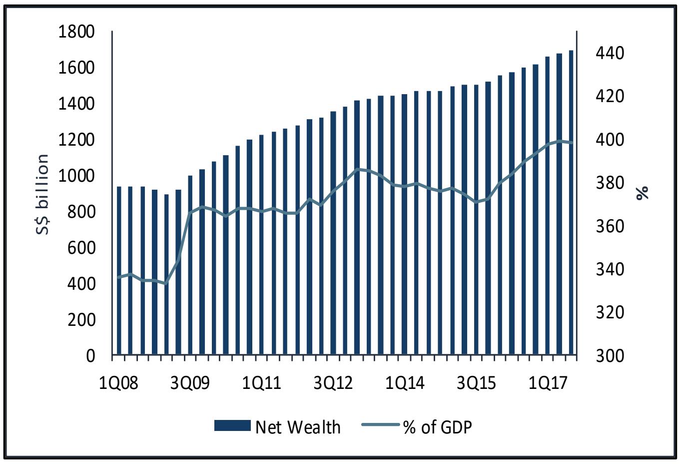
**Figure 17: Home Loans and Personal Loans in Singapore**

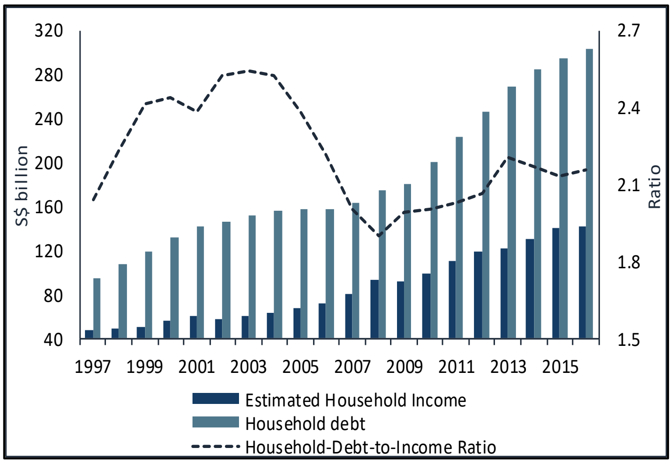



*Source: ValuePenguin, Pitt Street Research*

Consequently, over the past two decades, the household debt-to-GDP ratio has increased from 59.5% in 1995 to 72.3% in 2017 (Figure 18). Over this period, while household debt-to-total income has remained steady from 2.0x in 1997 to 2.2x in 2016, the net household wealth has been consistently high at ~4.0x GDP. However, it is imperative to note that most wealth creation is due to increased investment in real estate, which has been financed through debt. Under the current situation of limited increase in salaries, higher interest rates, a potential global economic slowdown due to trade wars, and rising inflation, the ability to effectively service debt is questionable.

**Figure 18: Home Loans and Personal Loans in Singapore**

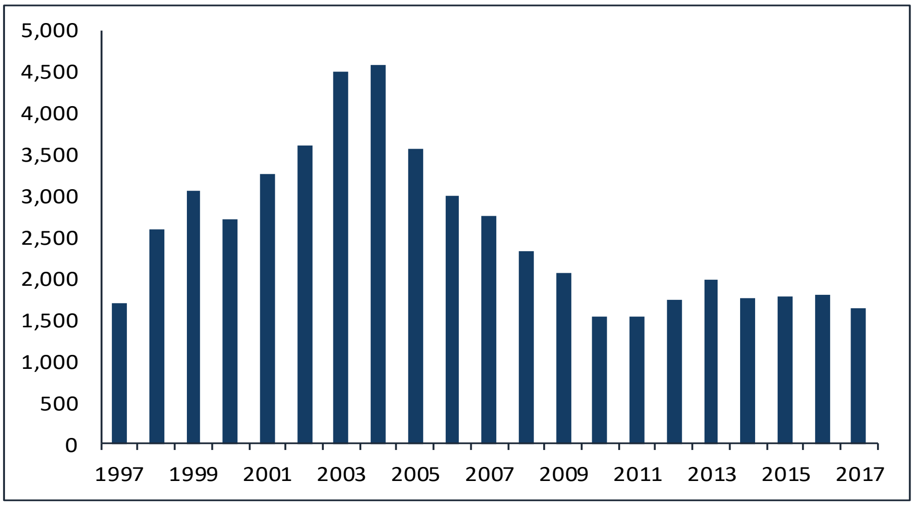



*Source: Singapore Department of Statistics, Pitt Street Research*

Consequently, personal insolvency and corporate bankruptcies in Singapore have been high (Figure 19). During 2010–2016, the number of corporate failures increased at a CAGR of 3.5%, while bankruptcy applications in Singapore have risen at a 6.6% CAGR over the past four years (July 2014-June 2018). The total number of personal bankruptcies in Singapore has come down significantly from the peak of 2005, but the growth is still consistent.

**Figure 19: Personal Bankruptcy Orders Made in Singapore**




*Source: Singapore Ministry of Law, Pitt Street Research*

## New proposed bankruptcy law is ideal for CI1 to leverage experience

***Singapore's proposed insolvency bill expands the work profile of bankruptcy trustees***

The Singapore government has recently introduced an omnibus bill in the parliament to update insolvency and debt restructuring laws. The bill intends to establish a regulatory framework for insolvency practitioners, introducing minimum qualifications, conditions for the grant, and renewal of licenses. Other disciplinary regulations include requiring institutions to nominate a private trustee in bankruptcy applications. These proposed changes to the law present significant market opportunities for CI1 to leverage its extensive experience.

*Singapore is creating an 'ecosystem' to become an international centre of debt restructuring. It intends to build international awareness and mechanisms for cross-border recognition and cooperation, alongside an enhanced restructuring regime.*

Singapore's focus on becoming a centre for international debt restructuring makes it relatively convenient for new insolvency practitioners to enter the market. Though the country currently has several large players, they are mostly fragmented, with most of them being either law firms or debt restructuring advisors. Despite a stagnant number of bankruptcies in the country, the void of a specialist bankruptcy administration service provider is difficult to fill.

However, to get a foothold in the disjointed yet competitive market, CI1 would need to establish a network and create a strong brand name. It will try to achieve this through the new alliance with Arrow Consultants.

## Other Commonwealth Markets

### UK, Canada and Malaysia — debt-laden economies facing increasing bankruptcy fillings

Over the last two decades, the household debt in all the three economies have increased significantly. According to OECD data, in 2017, the household debt-to-net disposable income for UK and Canada stands at 150% and 178%, respectively. In 2000, it was only 105% in the UK, and 114% in Canada.

On a relative basis the savings rates in these geographies have declined significantly during the same time period. According to OECD data, the household savings-to-disposable income in the UK have declined from 5.7% in 2000 to -0.9% in 2017. Similarly, for Canada, saving rates have declined from 5.3% in 2000 to 3.8 % in 2017.

Consequently, the number of bankruptcies in the two geographies have been on the rise.

## Competitive Landscape

### Very strong position in Hong Kong

Due to the need for experienced professionals, and the long gestation period in building trust with government organizations and financial institutions, the bankruptcy administration service market generally has a limited number of players. In Hong Kong, only two players actively provide OT services for insolvency cases involving assets worth >A$36k (HK$200k) – a case of duopoly in this niche segment. Overall, based on the number of cases referred to OTs in Hong Kong, CI1 has ~17% market share.

Though multiple firms provide bankruptcy administration services in Hong Kong, CI1's unique proposition is its specialized experience in having managed the OT service for the past 16 years. In addition, most the competitors are law firms and not debt restructuring consultants.

### Limited number of players in customized debt restructuring in Australia

According to the Australian Financial Security Authority (AFSA), Australia has 38 practicing registered debt agreement administrators and 219 bankruptcy trustees (Figure 20). However, it is imperative to note that most of these players are collections agents. A very limited number of players design customised debt restructuring market solutions and provide insolvency consulting services to individuals.

**Figure 20: Registered Administration Practitioners and Trustees in Australia**

| Number of practising Administrators in Australia | |
|---|---|
| **State/Territory** | **Number** |
| Australian Capital Territory | 0 |
| New South Wales | 10 |
| Northern Territory | 0 |
| Queensland | 15 |
| South Australia | 3 |
| Tasmania | 2 |
| Victoria | 5 |
| Western Australia | 3 |
| **Total** | **38** |

| Number of registered Trustees in Australia | |
|---|---|
| **State/Territory** | **Number** |
| Australian Capital Territory | 6 |
| New South Wales | 68 |
| Northern Territory | 1 |
| Queensland | 57 |
| South Australia | 12 |
| Tasmania | 7 |
| Victoria | 49 |
| Western Australia | 19 |
| **Total** | **219** |

*Source: AFSA, Pitt Street Research*

Apart from the number of law firms that offer bankruptcy administration services and collection agents providing debt collection services for financial institutions, a few debt repurchase companies sometimes double up as a bridge between bankrupt individuals and banks. However, their business operations are totally different. These debt repurchase institutions usually buy the debt from banks (often at a discount) and then restructure the payment for the debtor to pay it off. It is a non-binding agreement and works solely on the customized solutions of the firm.

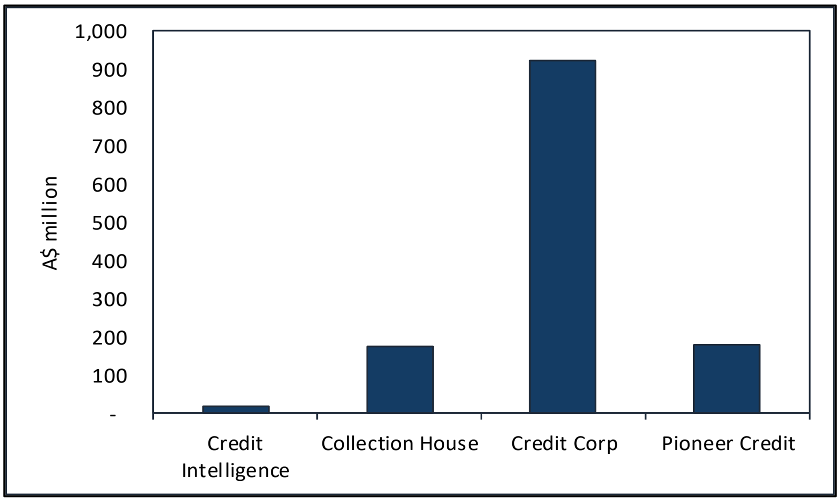
Despite the presence of multiple players, across the range of services, CI1 is a distinct operator that provides unique services to a select customer base. CI1's distinct positioning and proprietary platform enables it to easily expand in different geographies.

## Companies to watch in the debt restructuring services space

We believe three companies are comparable to CI1 (Figure 21):

- **Pioneer Credit Limited** (ASX: PNC) specializing in acquiring and servicing unsecured retail debt portfolios, the sale of non-core portfolios, brokering and introducing credit products. It acquires and services unsecured retail debt portfolios from Australia's banking and financial sectors. The company operates within the Mortgage bankers and correspondents' sector. PNC is headquartered in Perth, Australia.
- **Credit Corp Group Limited** (ASX: CCP) provides debt purchase and collection as well as consumer lending services in Australia and the US. It operates through three segments: Debt Ledger Purchasing (Australia), Debt Ledger Purchasing (US), and Consumer Lending. The company offers debt sale, contingency/agency collection, hardship and insolvency management, and local government debt recovery services, as well as various loan products. It provides financial services under the Wallet Wizard, Clear Cash, CarStart Finance, Credit 2U, and CapTrove brand names. The company is headquartered in Sydney, Australia.
- **Collection House Limited** (ASX: CLH) offers debt collection and receivables management services in Australia and New Zealand. The company operates through the Collection Services and Purchased Debt Ledgers segments. It offers debt collection services to clients in the Australasian financial services, insurance, public utility, credit, and government enterprise markets; and debt purchasing services for the banking, finance, telecommunications, and energy sectors. The company also provides receivables management, repayment arrangement management, asset location recovery and sale, hardship management, legal and insolvency, credit management training, finance brokerage, and business process outsourcing services. The company was incorporated in 1992 and is headquartered in Brisbane, Australia.

**Figure 21: Peer group market capitalization (A$ m)**




*Source: Thomson Reuters, Pitt Street Research*

# Financial Performance

## Accelerating revenue through geographic expansion

CI1 has a steady and recurring income stream through its mature business in Hong Kong. To mitigate the impact of a saturating business environment in its home country, CI1 has decided to expand geographically. This is expected to accelerate revenue growth over the next few years (Figure 22). The company has also finalised the deal with Cor Cordis as a channel partner to establish itself in the new country of operations.

**Figure 22: Percentage Revenue Breakdown and Absolute Revenue (A$ m)**

| Revenue contribution (%) | FY 17 | FY 18 | FY 19E | FY 20E | FY 21E | FY 22E | FY 23E |
|---|---|---|---|---|---|---|---|
| Hong Kong | 100.0% | 100.0% | 100.0% | 95.1% | 90.9% | 87.0% | 83.7% |
| Australia | 0.0% | 0.0% | 0.0% | 3.8% | 7.1% | 10.2% | 12.7% |
| Singapore | 0.0% | 0.0% | 0.0% | 1.1% | 2.0% | 2.9% | 3.6% |

*Source: Pitt Street Research*

### Hong Kong will continue to provide steady and recurring income

We expect the Hong Kong business to remain steady, aided by consistent expansion in market share across its bankruptcy service segment and stable new case volume growth.

***Due to the app platform, banks and regulators are expected to prefer CI1 over the unorganised players. CI1's market share in Hong Kong's bankruptcy service segment is expected to increase from ~15% now (FY2018) to ~18% by FY2021E and 19% by FY2023E***

We expect revenues from the Hong Kong operations to grow at 14% CAGR and reach A$9.4m by FY2023E (vs. A$4.9m in FY2018), aided by multiple drivers (Figure 23):

– Growth in the average number of new cases through implementation of the new app platform that supports an increasing volume of cases.

– Market share expansion across both bankruptcy and IVA services. This is expected mainly due to the ability to process a higher volume of cases through the sophisticated IT platform and the new app.

– Steady appreciation in the average fees per case due to its market-leading position and enhanced customer experience as a result of the app.

– Steady revenue growth from the number of properties being sold off in the open market.

Considering high interest rates, lower consumption levels (base effect from China), higher property prices and declining affordability in Hong Kong, we think it will not be easy for CI1 to sell properties (those in its possessions) as done in the past (~800 properties were sold in last 16 years). Hence, we have not assumed significant revenue from this source over next 2-3 years.

We expect Hong Kong to continue to account for ~84% of the overall revenue by FY2023E (Figure 23).

**Figure 23: Hong Kong Revenue Model and Assumptions**

| Revenue Model (A$, Year end June) | FY 17 | FY 18 | FY 19E | FY 20E | FY 21E | FY 22E | FY 23E |
|---|---|---|---|---|---|---|---|
| **Bankruptcy administration service** | | | | | | | |
| Revenue | 3,475,037 | 4,674,957 | 5,588,209 | 6,537,724 | 7,227,134 | 7,880,894 | 8,549,349 |
| *% growth* | | 34.5% | 19.5% | 17.0% | 10.5% | 9.0% | 8.5% |
| No. of cases | 4,977 | 6,326 | 7,370 | 8,396 | 9,028 | 9,574 | 10,085 |
| Avg. realization per case | 698 | 739 | 758 | 779 | 801 | 823 | 848 |
| **IVA service** | | | | | | | |
| Revenue | 239,653 | 119,309 | 111,448 | 105,290 | 101,055 | 98,189 | 97,048 |
| Avg. realization per case | | 414 | 425 | 436 | 448 | 461 | 475 |
| No. of cases | | 288 | 262 | 241 | 225 | 213 | 204 |
| **Selling Properties** | | | | | | | |
| Revenue | | | 513,050 | 526,902 | 541,656 | 556,984 | 803,016 |
| No. of properties sold | | | 5.0 | 5.0 | 5.0 | 5.0 | 7.0 |
| Realization per property | | 100,000 | 102,610 | 105,380 | 108,331 | 111,397 | 114,717 |
| Inflation | | | 2.61% | 2.70% | 2.80% | 2.83% | 2.98% |
| **Other Income** | 93,300 | 109,964 | - | - | - | - | - |
| **Total Revenue** | **3,807,990** | **4,904,230** | **6,212,707** | **7,169,916** | **7,869,844** | **8,536,068** | **9,449,413** |

*Source: Pitt Street Research*

### Australia and Singapore operations: Step up in revenues will take 2-3 years

Driven by the new partnerships, we expect revenues from the Australian and Singapore businesses to start ramping up in the next years (Figure 24 and 25). The revenue is projected to start kicking in from FY2020E. As CI1 builds a franchise network, the number of cases is expected to reach 60 per week by FY2021E in Australia. We expect CI1 to capture ~10% market share in both the new countries by FY2023E. As of now, we have not modelled any acquisition of an incumbent player in the new markets, which can be an additional avenue for revenue growth. By FY2023E, we expect Australia to contribute ~13% of the total revenue and Singapore to contribute ~4% of total revenue.

**Figure 24: Australia Revenue Model and Assumptions**

| Revenue Model (A$, Year end June) | FY 19E | FY 20E | FY 21E | FY 22E | FY 23E |
|---|---|---|---|---|---|
| **Total Revenue** | - | **574,865** | **1,236,111** | **1,996,131** | **2,865,565** |
| **CIL's share in Total Revenue** | - | **287,433** | **618,055** | **998,065** | **1,432,783** |
| New cases | - | 759 | 1,591 | 2,506 | 3,508 |
| % of new cases in market | 0.0% | 2.5% | 5.0% | 7.5% | 10.0% |
| Avg. Realization per case | 740 | 758 | 777 | 797 | 817 |
| Inflation | 2.24% | 2.41% | 2.52% | 2.53% | 2.54% |

*Source: Pitt Street Research*

**Figure 25: Singapore Revenue Model and Assumptions**

| Revenue Model (A$, Year end June) | FY 19E | FY 20E | FY 21E | FY 22E | FY 23E |
|---|---|---|---|---|---|
| **Total Revenue** | **-** | **155,837** | **341,568** | **552,218** | **791,097** |
| | | | | | |
| **CIL's share in Total Revenue** | **-** | **79,477** | **174,200** | **281,631** | **403,459** |
| New cases | - | 83 | 180 | 286 | 405 |
| % of new cases in market | 0.0% | 2.5% | 5.0% | 7.5% | 10.0% |
| Avg. Realization per case | 1,850 | 1,876 | 1,902 | 1,928 | 1,953 |
| Inflation | 1.2% | 1.41% | 1.40% | 1.33% | 1.30% |

*Source: Pitt Street Research*

## Short-term impact on profitability as Australia and Singapore ramp up

***Profitability is adjusted for non-recurring cost items related to ASX listing, share-based payments and reverse acquisition***

We believe CI1 will witness a steady expansion in profitability as operating leverage kicks in after the initial investment in establishment of the additional business from new geographies. Due to the requirement of increasing promotional activities and expansion of the franchise across the new countries, we anticipate profitability margins will pull back, but only for a relatively short period of time. Traditionally, CI1's operations have had high profitability margins of ~50%. The adjusted EBITDA margins are expected to reach the same levels in the next 4-5 years, but with a higher revenue base (Figure 26).

With the setting up of the online app platform, CI1 has an added network in addition to the distribution network expansion across the new geographies. As a combination, this will result in extended operational efficiency.

**Figure 26: Growth and Profitability**

| Growth and Margins (%) | FY 17 | FY 18 | FY 19E | FY 20E | FY 21E | FY 22E | FY 23E |
|---|---|---|---|---|---|---|---|
| Revenue Growth YoY | NA | 28.8% | 26.7% | 21.3% | 14.9% | 13.3% | 15.0% |
| Adj. EBITDA Margin | 55.9% | 48.8% | 24.9% | 51.6% | 53.1% | 53.5% | 55.4% |
| Adj. EBIT Margin | 55.7% | 48.5% | 24.2% | 49.2% | 50.7% | 51.5% | 53.6% |
| Adj. Net Profit Margin | 46.6% | 39.8% | 16.9% | 34.4% | 35.5% | 36.0% | 37.5% |

*Source: Pitt Street Research*

We have also factored in that operating leverage will gradually increase with employee expenses falling from 23.5% of revenue in FY2017 to 16.7% in FY2023E (Figure 27). Though diversification will require team expansion, employee benefit costs will rationalize with higher usage of the new case management app.

**Figure 27: Expense Ratios**

| Costs (%) | FY 17 | FY 18 | FY 19E | FY 20E | FY 21E | FY 22E | FY 23E |
|---|---|---|---|---|---|---|---|
| Advertising and Promotion | 0.7% | 0.6% | 16.8% | 2.9% | 4.1% | 5.0% | 5.3% |
| Employee Benefit Expense | 23.5% | 21.0% | 21.8% | 19.3% | 18.2% | 17.7% | 16.7% |
| Rents and rates | 5.1% | 5.2% | 6.8% | 6.0% | 6.4% | 6.0% | 5.9% |
| Total Operating expenses | 44.1% | 51.2% | 75.1% | 48.4% | 46.9% | 46.5% | 44.6% |

*Source: Pitt Street Research*

## Cash-rich balance sheet to support expansion

*CI1's asset-light and cash-generating business model is conducive for future growth*

CI1 is a cash-rich organization having a lean operational structure. The company has zero debt and is generating enough cash. In FY2017–18, the operating cash flow was ~75% of Adj. EBIT, and it is expected to remain same in FY2019E–2023E. Abundant availability of cash and consistent cash generation through the mature Hong Kong business are expected to help CI1 cover all its expansion-related costs through internal accruals. The return on assets over FY2017-18 was 95%, mainly due to limited investment requirements and high profitability. This is expected to remain high going forward as well (Figure 28).

**Figure 28: Balance Sheet strength and Return Ratios**

| Balance Sheet Ratios (%) | FY 17 | FY 18 | FY 19E | FY 20E | FY 21E | FY 22E | FY 23E |
|---|---|---|---|---|---|---|---|
| Net Cash to Adj. EBITDA | 16.4% | 97.8% | 247.8% | 89.4% | 83.6% | 83.0% | 80.4% |
| Net Cash to Equity | 27.5% | 100.8% | 92.3% | 91.6% | 92.3% | 92.5% | 92.6% |
| Total Cash / Total Assets | 25.0% | 90.3% | 80.1% | 79.1% | 79.9% | 80.4% | 81.1% |
| Total Liabilities / Total Assets | 9.0% | 10.4% | 13.2% | 13.7% | 13.4% | 13.0% | 12.4% |
| RoE | 139.7% | 70.0% | 26.6% | 68.6% | 73.5% | 74.9% | 77.9% |
| RoA | 127.1% | 63.0% | 23.5% | 59.4% | 63.5% | 65.0% | 68.0% |

*Source: Pitt Street Research*

## Valuation implies substantial upside in share price

In order to derive CI1's long-term value, we have used a weighted average valuation methodology, assigning equal weight to a peer-group-based sum-of-the-parts (SOTP) valuation and discounted cash flow (DCF) calculation.

Currently, we have only considered ASX-listed companies for CI1's peer group valuation. CI1 has been benchmarked against its closest ASX-listed competitors – Pioneer Credit (ASX: PNC), Credit Corp Group Limited (ASX: CCP), and Collection House Limited (ASX: CLH) (Figure 29).

**Figure 29: Peer Group Valuation**

| | | | Market Cap | EV / EBITDA | | | | |
|---|---|---|---|---|---|---|---|---|
| **Company Name** | **Ticker** | **FY-end** | **(A$ m)** | **FY 17** | **FY 18** | **FY 19E** | **FY 20E** | **FY 21E** |
| Pioneer Credit | ASX:PNC | June | 191.0 | 12.1x | 7.5x | 6.4x | 5.3x | 4.5x |
| Credit Corp Group Limited | ASX:CCP | June | 908.0 | 12.7x | 10.8x | 9.9x | 8.7x | 7.9x |
| Collection House Limited | ASX:CLH | June | 178.0 | 7.3x | 5.1x | 5.5x | 5.2x | 4.8x |
| AVERAGE | | | 425.7 | 10.7x | 7.8x | 7.3x | 6.4x | 5.7x |

*Source: Thomson Reuters, Pitt Street Research*

The company's peer group is valued at an average EV/EBITDA multiple of 6.4x for FY2020E. Applying that same multiple to CI1 would yield an EV of A$24.8m or an equity value of A$0.035 per share (Figure 30).

**Figure 30: Relative Valuation Per Share**

| **Equity value determination (A$)** | |
|---|---|
| EV / EBITDA Multiple | 6.4 |
| Adj. EBITDA 2020E | 3,887,576 |
| **Implied EV (AUD)** | **24,803,059** |
| | |
| Net debt (cash) | (3,614,948) |
| **M-Cap (A$)** | **28,418,006** |
| Share outstanding (for 2020E) | 820,427,185 |
| | |
| **Implied price (A$ cents)** | **3.46** |
| Adjusted Current price (A$ cents) | **1.80** |
| Upside (%) | *92.4%* |

*Source: Pitt Street Research*

Considering that CI1 is a relatively mature business, is 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 could be applied, also considering most of the competitors in all three geographies are essentially law firms or consultants with very limited focused on bankruptcy administration.

However, since CI1 has just started expanding into new geographies, there is execution risk. Therefore, we will only apply this premium once expansion into these two geographies is well on track and has been partly de-risked, which we expect within the next twelve months.

### DCF calculation suggests substantial long-term upside

Our DCF model yields an 10.27% WACC for CI1 (risk-free rate of 2.6%, a Beta of 1, and an equity risk premium of 7.7%). Applying that discount rate to our free cash flow projections through FY2026 and using a terminal growth rate of 2%, CI1 yields a value of A$0.061 per share (Figure 31). CI1 was listed on ASX only recently, and hence the beta was calculated using the average deleveraged beta of the peer set.

Even though there is execution risk associated with CI1's expansion into Australia and Singapore, and the Hong Kong market seems saturated, we believe that there will be room for higher growth in NOPAT as the company expands its network through and transfers its cases onto the new cost-efficient platform. In turn, this would translate into higher values over time.

**Figure 31: DCF value in A$ cents using various WACCs**

| Sensitivity Analysis | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| WACC | | 10.27% | | | | | | | | |
| Terminal Growth Rate | | 2.00% | Change in WACC | | | | | | | |
| Implied Price (AUD cents) | | 6.10 | *8.0%* | *9.0%* | *10.0%* | *10.27%* | *11.0%* | *12.0%* | *13.0%* | *14.0%* |
| Change in Terminal Growth Rate | *0.50%* | | 7.27 | 6.38 | 5.68 | 5.52 | 5.12 | 4.65 | 4.27 | 3.94 |
| | *1.50%* | | 8.01 | 6.91 | 6.08 | 5.88 | 5.42 | 4.89 | 4.45 | 4.09 |
| | *2.00%* | | 8.47 | 7.23 | 6.31 | **6.10** | 5.59 | 5.02 | 4.56 | 4.18 |
| | *2.50%* | | 9.02 | 7.61 | 6.58 | 6.35 | 5.79 | 5.17 | 4.68 | 4.27 |
| | *3.00%* | | 9.67 | 8.04 | 6.88 | 6.62 | 6.01 | 5.34 | 4.80 | 4.37 |
| | *3.50%* | | 10.48 | 8.56 | 7.23 | 6.94 | 6.27 | 5.53 | 4.95 | 4.48 |
| | *4.00%* | | 11.48 | 9.18 | 7.64 | 7.31 | 6.55 | 5.74 | 5.10 | 4.60 |

*Source: Pitt Street Research*

## Fair value of A$0.048 per share

Our fair value of A$0.048 per share has been derived from a weighted average valuation methodology, which assigns equal weight to our EV/EBITDA-based relative valuation and our DCF calculation (Figure 32). This implies a substantial upside from the current share price.

**Figure 32: Weighted Average valuation in base case (A$ cents per share)**

| Methodology | Weights (%) | Share price (A$ cents) |
|---|---|---|
| DCF | 50.0% | 6.10 |
| Relative valuation | 50.0% | 3.46 |
| **Composite Value (A$ cents)** | | **4.78** |
| Adjusted Current Price (A$ cents) | | 1.80 |
| **Upside/ Downside (%)** | | **165.7%** |

*Source: Pitt Street Research*

## CI1 valued at A$ 0.071 per share in optimistic case

Similar to the relative valuation and DCF methodologies in our base case above, we have looked at CI1's valuation in a scenario in which the company is able to continue to expand geographically in the next five years, i.e. with continued double-digit revenue growth beyond 2024.

Our equally-weighted average valuation in this scenario is A$ 0.071 per share (Figure 33).

**Figure 33: Weighted Average valuation in optimistic case (A$ cents per share)**

| Methodology | Weights (%) | Share price (A$ cents) |
|---|---|---|
| DCF | 50.0% | 9.99 |
| Relative valuation | 50.0% | 4.22 |
| **Composite Value (A$ cents)** | | **7.11** |
| Adjusted Current Price (A$ cents) | | 1.80 |
| **Upside/ Downside (%)** | | **294.8%** |

*Source: Pitt Street Research*

## Potential for re-rating: share price catalysts

CI1's stock is currently trading below our base case valuation. We have outlined several factors that may result in a rerating of CI1 going forward:

– A unique service offering and long-standing market presence driving a steady volume of cases despite maturation of the home market.

– The asset-light model, the multichannel revenue stream, and the inverse relation with economic developments of the various revenue components provide a natural hedge to the business.

– The sophisticated IT systems and the new smartphone app are expected to help develop professional, transparent, and smooth processes to scale up operations with enhanced user experiences.

– Successful entry into the Australian market as well as other Commonwealth-like markets.

Furthermore, we believe CI1 has a management team (Figure 34) capable of taking the company through the next growth stage. Jimmie Wong, CI1's founder, CEO, and MD, has practiced law in Hong Kong for over 20 years. He has been instrumental in the corporate evolution of CI1 and is a pioneer in the bankruptcy administration services domain. Executive Director King Wong brings operational experience in handling insolvency matters.

In our view, CI1's board has the kind of expertise required to build an Enterprise-level service organization. Sydney-based Non-Executive Chairman Tony Ho brings >20 years of leadership experience across various industries.

**Figure 34: CI1's Proficient Management Team**

| | Name and Designation | Profile |
|---|---|---|
|  | Tony Ho<br>**Non-Executive Chairman** | • Tony Ho is an experienced chartered accountant having more than 20 years of corporate leadership experience as directors in a wide range of industries. For 10 years he was non-executive director of ASX-listed Brazin Limited before it was privatized.<br>• He is currently Non-Executive Chairman of ASX-listed Greenland Minerals Ltd and Bioxyne Ltd, and NZX listed Truscreen Limited. |
|  | Jimmie Wong<br>**CEO and MD** | • Jimmie Wong is the founder of Credit Intelligence. He holds a Bachelor of Law degree from the University of Hong Kong and has over 20 years' experience as a leading insolvency lawyer, having served as legal adviser to numerous financial institutions and groups.<br>• He provides legal advice for cross-border takeovers and mergers, IPOs, and foreign direct investment. |
|  | King Wong<br>**Executive Director** | • King Wong is currently the COO and Executive Director of HKDMS, having joined the group in 2002. He has extensive professional experience in handling insolvency matters. He was admitted as a solicitor in Hong Kong in 2001.<br>• He was appointed CI1's bankruptcy trustee in 2004 and has been a member of the Insolvency Law Committee of the Law Society of Hong Kong since June 2015. |

*Source: Company, Pitt Street Research*

## Risks

We see four main risks related to CI1's investment thesis.

1) Saturation of the Hong Kong market: Over the years, the number of total bankruptcies in CI1's home market of Hong Kong has been declining gradually. This is partially due to individuals' reluctance to file for bankruptcy and overall consistency in the economic conditions of the territory. Going forward, this can potentially reduce the number of new cases.
2) Execution Risk: As CI1 invests more in improving its IT systems and marketing activities after expanding in Australia and Singapore, uncontrolled cost escalation would negatively impact valuation.
3) Regulatory risk: Every country has its own bankruptcy laws. CI1 has experience only in the home market of Hong Kong. Understanding new and distinct market regulations may prove tricky and may 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 slippage or error of judgment may result in delays in geographic expansion and potentially a decline in the company's valuation.

## Conclusion

CI1 has well-established business operations, has an experienced team and a superior technological platform. It has also initiated a process to expand into the similar but untapped geographies of Australia and Singapore.

Sustained expansion into new geographies, consistently increasing market share in the mature market of Hong Kong, and better operational efficiency as a result of transition to the app platform are expected to contribute to a potential re-rating of the stock.

Based on a peer group valuation and a Discounted Cash Flow calculation, we have set a valuation range of A$0.048 to A$0.071.

## SWOT Analysis

### Strengths:

- A well-established business with consistently expanding market share in a niche segment.
- An experienced team of bankruptcy administration service providers.
- Strong business links with global banks.
- Potentially low operating costs following deployment of the new case management platform app.

### Weaknesses:

- Bankruptcy saturation in main geography of operation – Hong Kong.
- High competition in Australia from established law firms and collection agents.

### Opportunities:

- Expansion in Australia through collaboration with Cor Cordis, which has a comprehensive network.
- Transferring cases onto the newly developed app to manage increased volumes with better efficiency.

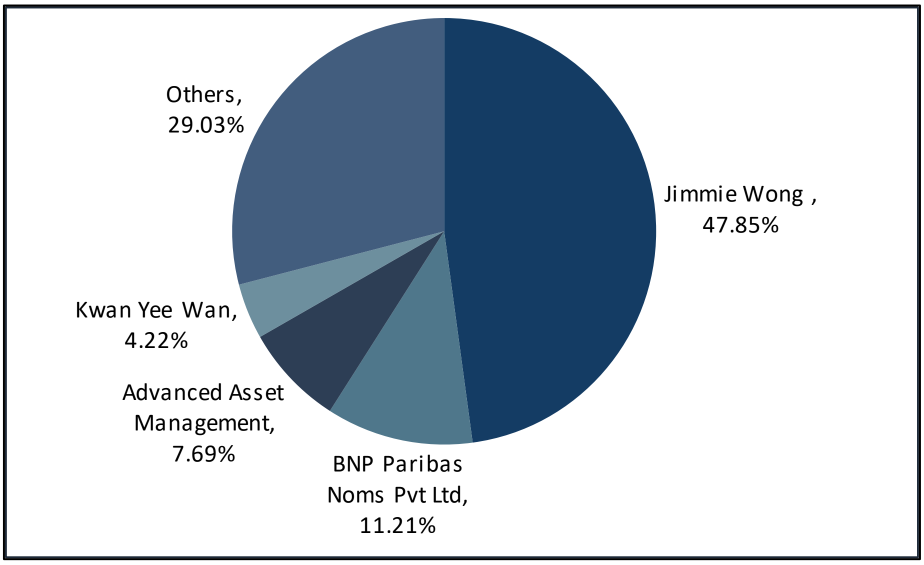
### Threats:

- Limited experience with respect to working in geographies other than Hong Kong.
- Potentially rising interest rates may dampen property prices, affecting payback capabilities of the people under bankruptcy administration as this limits property selling prices in CI1's custody.
- Negative investor perception of administration service providers as being nothing more than collection agents.

# Appendix

## Appendix I — Major shareholders

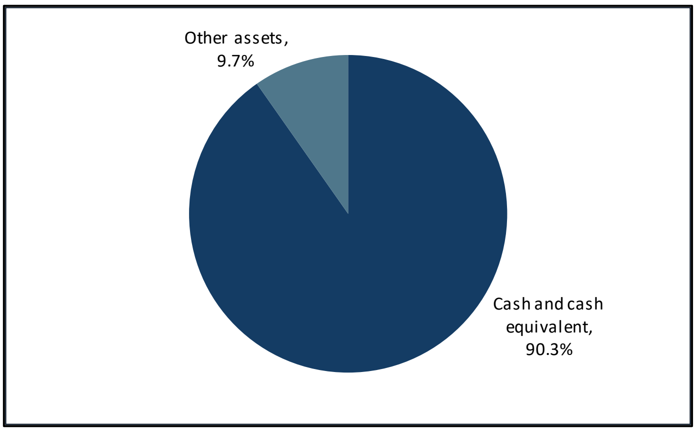
**Figure 35: Top Shareholders**

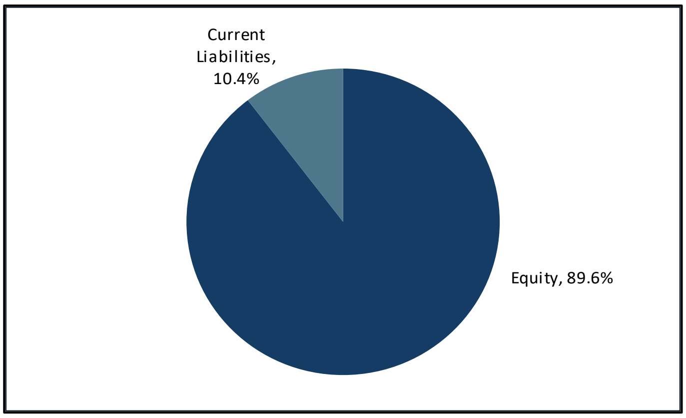



*Source: Company*

## Appendix II —Capital Structure

**Figure 36: Asset Liability Break-down^**




*Note: ^As of June 30, 2018*

*Source: Company, Pitt Street Research*

# General advice warning, Disclaimer & Disclosures

## Terms & Conditions

The information contained herein ("Content") has been prepared and issued by Pitt Street Research Pty Ltd ACN 626365615 ("Pitt Street Research"), an Authorised Representative (no: 1265112) of BR Securities Australia Pty Ltd. ABN 92 168 734 530, AFSL 456663. All intellectual property relating to the Content vests with Pitt Street Research unless otherwise noted.

## Disclaimer

The Content is provided on an as is basis, without warranty (express or implied). Whilst the Content has been prepared with all reasonable care from sources we believe to be reliable, no responsibility or liability shall be accepted by Pitt Street Research for any errors or omissions or misstatements howsoever caused. Any opinions, forecasts or recommendations reflect our judgement and assumptions at the date of publication and may change without notice. Pitt Street Research will not accept any responsibility for updating any advice, views, opinions or recommendations contained in this document.

No guarantees or warranties regarding accuracy, completeness or fitness for purpose are provided by Pitt Street Research, and under no circumstances will any of Pitt Street Research officers, representatives, associates or agents be liable for any loss or damage, whether direct, incidental or consequential, caused by reliance on or use of the Content.

## General Advice Warning

The Content has been prepared for general information purposes only and is not (and cannot be construed or relied upon as) personal advice nor as an offer to buy/sell/subscribe to any of the financial products mentioned herein. No investment objectives, financial circumstances or needs of any individual have been taken into consideration in the preparation of the Content.

Financial products are complex, entail risk of loss, may rise and fall, and are impacted by a range of market and economic factors, and you should always obtain professional advice to ensure trading or investing in such products is suitable for your circumstances, and ensure you obtain, read and understand any applicable offer document.

## Disclosures

Pitt Street Research has been commissioned to prepare the Content. From time to time, Pitt Street Research representatives or associates may hold interests, transact or hold directorships in, or perform paid services for, companies mentioned herein. Pitt Street Research and its associates, officers, directors and employees, may, from time to time hold securities in the companies referred to herein and may trade in those securities as principal, and in a manner which may be contrary to recommendations mentioned in this document.

Pitt Street Research receives fees from the company referred to in this document, for research services and other financial services or advice we may provide to that company. The analyst has received assistance from the company in preparing this document. The company has provided the analyst with communication with senior management and information on the company and industry. As part of due diligence, the analyst has independently and critically reviewed the assistance and information provided by the company to form the opinions expressed in the report. Diligent care has been taken by the analyst to maintain an honest and fair objectivity in writing this report and making the recommendation. Where Pitt Street Research has been commissioned to prepare Content and receives fees for its preparation, please note that NO part of the fee, compensation or employee remuneration paid will either directly or indirectly impact the Content provided.