3 MARCH 2020

Stocks Down Under

Here's something to think about: How come you never see a headline like "Psychic Wins Lottery"?'

- Jay Leno (b. 1950), American comedian

JUMBO INTERACTIVE

Always thinking big, even in a bear market

CLEAN TEQ

Green lights ahead

HUB24

A silver medalist?

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Always thinking big, even in a bear market

Stocks Down Under rating: ★★

ASX: JIN
Share price: A$ 11.33
Market cap: A$ 718M

They say a picture is worth a thousand words. And in the case of the Brisbane-based Jumbo Interactive, it couldn't be more true. Over the last four months, investors who rolled the dice on the digital lottery provider have seen their bet come up snake eyes. The stock is down over 60% since the $27.88 high of 16 October 2019, as a 60x multiple became too much for even growth investors to stomach. However, Jumbo Interactive, whose slogan is Always Thinking Big, remains committed to the long term. At some point – although not now – this stock is going to be a sure bet. For now, it's better to wait before buying one's next ticket.

READ MORE

CLEAN TEQ

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ASX: CLQ
Share price: A$ $0.19
Market cap: A$ 165.7M

As global economies continue to shift from fossil fuels to green energy, the Melbourne-based Clean TeQ is at the forefront of the secular change. A leader in metals recovery and industrial water treatment, Clean TeQ's proprietary ion exchange technology helps ease the environmental burden from large infrastructure and mining projects. Through its Clean-iX resin technology, Clean TeQ provides pollution control services for miners in the base metals, precious metals and rare earth elements industries. Clean TeQ's stock has plunged nearly 87% from its November 2017 peak but once the current bearish environment turns it could represent good buying given it is reaching an old support level at around 10-12 cents.

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Share price: A$ 9.62
Market cap: A$ 632M

Buy the dip or sell the rally? Increase your stock exposure or hide out in bonds? Complex questions like these require complex answers. And that's where HUB24 comes in. Headquartered in Sydney, HUB24 is not a bank – nor does it claim to be. However, the diversified financial services company is home to one of the fastest growing investment management platforms on the market. Trusted by portfolio managers and advisors alike, HUB24's interface provides access to more than 1,000 managed funds and more than 200 professionally managed portfolios. But does HUB24 deserve a spot in your portfolio? Not right now given the bear market we're in, and the high current multiple of the stock.

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Share price chart

Source: Tradingview

Positioned well in a growth market

Positioning itself at the forefront of a growing industry, Jumbo Interactive is poised to grab a larger piece of the gambling pie. As consumers shift to online platforms, Jumbo Interactive continues to increase its customer base by leveraging its proprietary mobile offerings – which account for 75% of customer engagement. The company is also attracting new players through a unique gaming experience, guaranteed prize payouts and jackpot alerts. The emphasis on mobile is also creating a loyal customer base, where players can buy tickets from anywhere at any time. And by strategically marketing its platform to a younger audience, the company remains on track to reach $1bn in sales by FY22.

With Jumbo Interactive still in the early innings of its expansion, the company is increasing its footprint across the United States, Latin America, Asia and Europe. In November of 2019, Jumbo acquired Gatherwell Limited, a U.K. lottery manager for GBP 5 million. With roughly 130,000 tickets sold per week through its platform, the acquisition provides access to a stable market, while allowing Jumbo Interactive to advertise its products to U.K. customers.

The global traction also adds synergies to Jumbo Interactive's charity lottery operations. And with a potential market size of roughly 3.5bn, there is still tremendous room to grow the company's digital base.

Leading gaming technology

With the launch of its SaaS division "Powered by Jumbo," the company now offers lottery services to other players in the industry. Allowing customers to automate their marketing campaigns, manage payments and access real time sales and reporting data, the SaaS platform allows customers to manage and grow their lottery operations more effectively.

Available across geographic regions, Powered by Jumbo remains a significant growth driver for the company. In August of 2019, it licensed its Powered by Jumbo technology to Mater Lotteries, as well as non-profit charity, the Endeavour Foundation. In December of 2019, the company also signed a five-year licensing agreement with Deaf Services, another leading Australian lottery provider. Currently, SaaS companies only account for 7% of the global lottery market. But with the online revolution spreading across all major industries, Jumbo Interactive is poised to capitalize on this future growth.

Furthermore, Jumbo Interactive's most popular, and most profitable, operation "OZ Lotteries," has over two million customers and processes more than $150 million in lottery ticket sales per year. And after introducing its new Powerball format in FY19, Jumbo Interactive was able to complete two $100m jackpots – one in FY19 and the other in FY20.

Why this stock has been so unlucky?

So, if the opportunity is so good, how come the stock is down so heavily since October?

Blame the earnings guidance from 20 December 2019, when Jumbo told the market that in the December HY 2019, total transaction value (TTV) and revenue would rise 27% and 24% respectively, however NPAT would only rise 15% due to increased business development activity and one-off costs related to the Gatherwell acquisition. The good news was that Jumbo's underlying EBITDA margin is expected to return to previous levels in FY21.

The market didn't like the December 2019 guidance because up until then the numbers had looked very good. In FY19, revenue increased 64% to $65.2m, while EBITDA more than doubled to $40.2m. Jumbo Interactive's EBITDA margin also increased from 48.8% to 61.6%, as efficient marketing and diligent cost management reduced the company's cost per lead from $17.28 to $13.81. The number of new customers also increased by 106% to 444,004 (versus the previous 12 months), while active customer accounts increased by 74% to 761,863. For the rest of FY20 Jumbo believes jackpot demand will continue to drive sales, while they also forecast new additions to the Powered by Jumbo platform.

Since October 2019 Jumbo's multiple has come down to more reasonable levels. On FY20 forecasts it's now at a P/E of 24x dropping to 15x by FY22. We believe that as FY21 approaches this company can re-rate based on Jumbo's leadership in the online gaming space as more customers pivot in this direction. For now, though, we think the stock is still absorbing the FY20 earnings slowdown and is also being caught up in the generally bearish climate for stocks. Hence, our two-star rating.

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Source: Tradingview

Governments and businesses commit to a green future

With climate change dominating the headlines, ESG is more important now than ever. Both governments and business are prioritizing clean energy, with the EU committing to a climate-neutral economy by 2050. The strategy compliments The Paris Agreement, which aims to limit global warming to no more than 2°C, while the European Green Deal also aims to reduce greenhouse emissions by investing in renewable technologies and sustainable solutions.

Filling a large void in the market, Clean TeQ launched its Sunrise, nickel, cobalt and scandium project in New South Wales. By combining the company's mineral resources with its proprietary ion exchange extraction and purification technology, Clean TeQ provides access to raw materials that produce lithium-ion batteries and provide lightweight aluminium alloys to key transportation markets.

Furthermore, the company is doing it at a lower cost than other producers. Just as important, a Definitive Feasibility Study (DFS) was completed in June of 2018, which highlighted the project as a sustainable, long-life and low-cost source of high purity cobalt and nickel sulphates.

Right now, Clean TeQ remains focused on completing its Front End Engineering and Design (FEED) operations – which will allow the company to better assess risks at its Sunrise project. However, the expected completion date is still up in the air.

Clean TeQ Water remains in high demand

Clean TeQ water helps miners meet regulatory requirements by purifying and recycling wastewaters that have been contaminated during the extraction process. At the end of FY19, Clean TeQ concluded the engineering, delivery and construction of its Continuous Ionic Filtration (CIF) plant in Oman. As the world's first commercial sized CIF plant, Clean TeQ CEO Sam Riggall called the breakthrough a "strong validation of our proprietary continuous ion exchange technology." Similarly, at the Fosterville Gold Mine in Victoria, Clean TeQ supplies two million litres per day in water filtration services. And in a joint venture with Ionic Industries – a leader in graphene technologies – the two partnered to develop graphene oxide-based water membranes, which researchers estimate could have a market size of US$8.2b by 2023.

Looking forward, Clean TeQ plans to continue growing its business through joint ventures and by developing new technologies that create sustainable solutions for its customers.

Revenue continues to accelerate

While Clean TeQ's expenses increased in FY19 – leading to a net loss of $18m – the company's revenue grew by 12% to $4.7m. Revenue growth was driven by new contracts within its water division and Clean TeQ is still in the early innings of commercializing its business. Because of this, we believe Clean TeQ has plenty of room for future growth.

And though profitability has been a struggle for the company over the last few years – and a significant driver of the share price decline – the secular shift toward green energy is increasing Clean TeQ's customer base by the day. As more businesses face pressure from stakeholders to reduce their carbon footprint, Clean TeQ has the infrastructure in place to capitalize on the growing demand. Conversely, the high barriers to entry and significant R&D spending required, limits competitors' ability to mimic Clean TeQ's proprietary technology. And with Clean TeQ's stock trading near the mid-point of its 52-week range, we believe there is significant upside in the stock.

However, markets have been in a bad frame of mind lately. That's why there might be a little more downside to go in Clean TeQ's share price. Once the stock drops to the previous long-term support level of 10-12 cents we think it could be worth a revisit. For those with a long-term view, this is one to follow given the clean energy revolution that's set to take place over the next decade.

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Source: Tradingview

Competition remains challenging

With fierce competition across the sector, pricing pressure is affecting the dominant players. And as HUB24 looks to scale its platform, volume will come at the expense of operating leverage. Furthermore, as other players vie for client assets – such as leading Victoria-based wealth manager Netwealth – it's become harder for HUB24 to attract new customers. To combat the issue, HUB24 plans to transition away from its incumbent platform in FY20 and prioritize new corporate relationships.

The strategy may pay off, as regulatory changes by the Financial Services Royal Commission makes transferring funds from traditional wealth managers to online platforms easier than ever. Moreover, Australia has the fourth largest pension fund market in the world – with mandatory contributions expected to rise to 12% by 2025 – so HUB24 has plenty of room to carve out a competitive moat. And as traditional financial advisors continue to exit the marketplace, HUB24 predicts that its managed accounts division will reach $11.5bn by 2020.

Expanding its client base

In FY20, HUB24 is betting big on its broker network. In H1, the company signed 17 new distribution agreements and partnered with Aberdeen Standard Investments – a U.K. asset manager – to develop a digital engagement tool. The technology allows Aberdeen's clients to integrate with HUB24's platform and access customizable advice and product solutions. The pilot project – which is expected to launch at the end of FY20 – will also allow Aberdeen to provide a range of savings, investment and retirement solutions on HUB24's platform.

In FY19, HUB24's advisor-base increased by 32% to 398. The company also obtained 84 new licenses, demonstrating strong demand for the platform. Management also remains dedicated to further expansion, with a $26bn funds under administration (FUA) target forecasted for FY21.

However, HUB24 isn't immune to bad press. Following two consecutive rate cuts by the RBA in June and July of 2019, questions swirled about the usefulness of HUB24's cash accounts. While the company described the news as misleading – considering the company's platform administrative fee encompasses many other services – critics alleged that HUB24's administrative fees leave investors with negative interest rates on their savings.

Fundamentals remain in question

In the December FY19 quarter, HUB24 added 29 new portfolios to its platform, while net inflows increased by 79% to $2.5bn (versus December of FY18). FUA increased to $15.8bn, while the company leveraged its existing relationship with advisors to increase HUB24's market share from 1.3% to 1.6%. Consolidated revenue also increased by 14.7% to $96.36m. However, net earnings fell by 2.9% to $7.16m and HUB24's EBITDA margin declined to 52.5%. And with HUB24 still in the development stage, we expect EBITDA to decline further in FY20.

Also concerning, Investment Trend's December 2019 Platform Benchmarking and Competitive Analysis Report said that Netwealth continues to lead the market – followed by HUB24 as a close second. Investment Trend's senior analyst King Loong Choi also said that the gap between the top few platforms is narrower than ever. However, HUB24 was given the Best Functionality award, with Choi saying "HUB24 made the most notable managed accounts-related improvements in 2019."

But with competition rising and no clear winner in the platform sweepstakes, we remain neutral to slightly positive on HUB24's future prospects. Without a doubt, the platform provides a valuable service and customer feedback has been overwhelmingly positive.

However, the battle for the top spot remains fierce and unpredictable. And while consolidation may be the future for several industry players, right now, the fight for supremacy will lead to volatile shareholder returns. That's not the kind of environment where you want to be holding a stock on an FY20 P/E of 43x. That may drop to 22x by FY22 but still looks a bit expensive.

Pitt Street Research Pty Ltd

95 Pitt Street, Sydney, NSW 2000, Australia

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