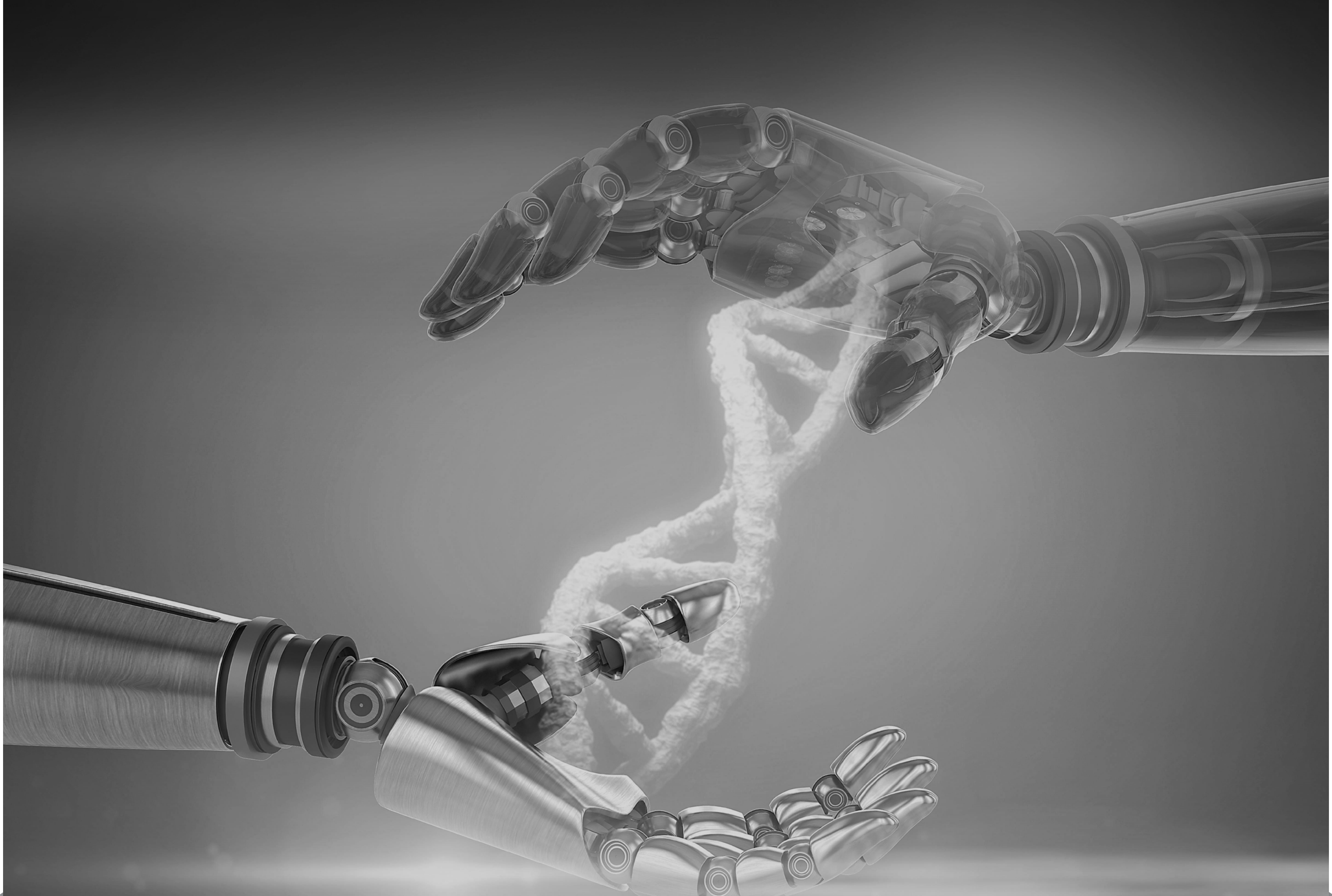
STOCKS DOWN UNDER

5 JANUARY 2021

Emerging Stocks Down Under

"I love sleep. My life has the tendency to fall apart when I'm awake, you know?"

- Ernest Hemingway (1899 - 1961), American novelist and winner of the Nobel Prize for Literature



ZELIRA THERAPEUTICS

Awake to the insomnia opportunity

ECOGRAF

Clean, green graphite

INTELLIHR

Put some HR into your portfolio

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Stocks Down Under rating: ★★★★

ASX: ZLD
Market cap: A$ 109M

52-week range: A$0.022 / A$0.14
Share price: A$ 0.09

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Share price chart

Source: Tradingview

For a long time, when Cannabis indica was just an illicit drug of abuse, no-one did much research on the medicinal properties of the plant. We now know that there's a large number of therapeutic drugs in cannabis. And medicinal cannabis is legal in most countries around the world, but medicine now has to play catch up, developing pharmaceutical-grade material that can be produced according to Good Manufacturing Practice. It then needs clinical testing to confirm that it works to treat various medical conditions.

Big market opportunities

For the companies that are going after the new indications with cannabis-based medicine, we believe the upside is tremendous. Just look at Zelira's pipeline. The lead indication is insomnia, something suffered by between 6% and 20% of the adult population, depending on what diagnostic criteria you use. Next in the pipeline is autism, which is widely believed to have a prevalence of 1% of the entire population. And then comes opioid reduction. A lot of chronic pain is managed with potentially addictive opioids and we've seen estimates that such pain afflicts 20% of the adult population. So, it's fair to say that companies like Zelira are going after billion-dollar markets.

The lead insomnia indication is looking good so far for Zelira. The company reported its first data from a Phase 1b/2a study of a cannabinoid extract called ZLT-101 in February 2020. The study, conducted at the

Centre for Sleep Science at the University of Western Australia, represented one of the first times in the world that a cannabis-based medicine had been used in insomnia. The folks from UWA tested 23 insomniacs for 14 nights with ZLT0101 and 14 nights with placebo, with a one-week period between the two. Participants were able to take a single or double dose of the medication according to their symptoms, and at their request, but this study was otherwise double-blind. The result was a statistically significant improvement compared to the placebo, based on the well-recognised Insomnia Severity Index (ISI). Indeed, the patients on the highest dose in this study recorded a 36% improvement in the ISI and they reported waking up feeling rested. And, no, the drug wasn't smoked, but given as a sublingual tablet.

Zenivol is already selling in Australia

Now, this was only a Phase 1b/2a, that is, a Phase 1 safety study, but in actual patients rather than healthy volunteers. In any case, to get this kind of improvement with only 23 patients is remarkable. Also impressive is the fact that it was enough to get the product on the market. The product, now called Zenivol, was added to Australia's Special Access Scheme for cannabis medicine by the Therapeutic Goods Administration in September 2020.

We believe the market opportunity for a product like this is strong. Ambien was a US$1.8bn franchise for Sanofi before patent expiry in 2005 and after that Sumitomo Dainippon routinely did something like half a billion dollars annually in sales for Lunesta. Those products have side effects that limit their more widespread use. Zenivol doesn't have this problem. So, we think Zenivol is headed for big things, particular as more data becomes available. Under a September 2020 agreement with Emyria (ASX: EMD), the operator of speciality cannabis medicinal clinics, Emyria will share its real-time data on Zenivol-treated patients with Zelira, expanding the knowledge base around the product.

After insomnia comes a potentially big opportunity in autism. Researchers have been experimenting with medicinal cannabis to treat various symptoms of autism for years. People on the Autism Spectrum are primarily known for their difficulties with communication, social interactions, obsessive interests and repetitive behaviours. When medicinal cannabis is tried in this setting, patients at the very least lose some of their aggression, hyperactivity and anxiety co-morbidities, as well as other things, like seizures, tics and depression that also seem to moderate. That data is, however, still fairly sparse. Zelira has worked with researchers at the world-famous Children's Hospital of Philadelphia in an observational trial in children with autism. Should that yield encouraging results, there will be a considerable upside given there's not much out there that paediatricians can prescribe to help their patients on the Spectrum. Zelira's products were added to the Special Access Scheme for autism in Australia in October 2020.

A sector back in favour

Zelira is currently only at start-up levels when it comes to revenue from Zenivol and other products. However, with the data beginning to accrue on clinical effectiveness we're expecting revenue growth in 2021. The company is funded for the foreseeable future, with $9.6m in cash as at September 2020.

As we've noted a number of times, when talking about medicinal cannabis, this sector came back into favour in 2020 after a couple of years in which investor attention was elsewhere. The recent TGA decision to place cannabidiol-based products on Schedule 3, bypassing the need for a prescription, and the recent reclassification of cannabis by the UN Commission on Narcotic Drugs both bode well for the sector in 2021, in our view.

With the broader environment for what Zelira does having just become more receptive and with Zelira itself making progress on both the clinical and commercial front, this is a four star opportunity.

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Share price chart

Source: Tradingview

Yeah, we all know the world is going to need a heck of a lot more lithium, nickel, manganese, cobalt etc because of all those new Electric Vehicles that will be going on the road between now and 2030. EcoGraf would like to remind you, however, that the most important constituent material of the lithium-ion battery is graphite. It may be a mere allotrope of carbon, but all that graphite in the anode makes up close to half the total composition of the battery.

The planet needs better graphite

Graphite is basically the 'garage' for the lithium ions being stored in the anode. When a lithium-ion battery is supplying power to a vehicle or a device, those lithium-ions are flowing from the anode to the cathode and when the battery is being charged, they are flowing back to the anode again. Graphite is used in the anode because it's proven time and again to be the best material into which lithium ions can be reversibly placed in its many layers.

There's a problem with graphite, however. The conventional way in which natural flake graphite is processed to obtain the high-purity spherical graphite needed in lithium-ion batteries isn't all that good for the planet. Getting > 99.95% purity generally requires hydrofluoric acid (HF). However, when you tell the environmental protection folks that your process requires HF, they can't sleep at night until you explain how the HF is neutralised and then recycled.

EcoGraf has what the market needs

Enter EcoGraf, with its environmentally-friendly alternative. Back when EcoGraf was called Kibaran Resources it had a flake graphite project called Epanko in the Morogoro Region of eastern Tanzania, but was talking to various experts about how to supply a 'greener' end-product that would meet the needs of the growing European market. Remember, in the new world we're moving into, companies like Tesla or VW want to know where their raw materials came from, ethically speaking. So it stood to reason they would welcome spheronised graphite that was HF-free. The consulting scientists came up with a process that needed no HF whatsoever, but instead drew out impurities from the graphite using various 'low impact' chemicals. The new process worked at modest processing temperatures, but still came in above 99.95%.

This breakthrough was first announced in September 2017 and three years later has taken EcoGraf to the point where a pilot plant in Germany can process a range of different types of graphite and reliably get the same quality end-product. Kibaran Resources came to like the process so much, it made it the primary focus, leading to the corporate name change in December 2019.

Funding needed for the first plant

EcoGraf is currently working to establish a plant at Kwinana, south of Perth, to produce 20,000 tonnes of purified graphite for use in batteries. The plant will start at 5,000 tonnes per annum at a capital cost of around US$23m, potentially expanding to 20,000 tonnes a couple of years later after another US$49m investment.

The feasibility work on this project has suggested a pre-tax NPV of US$141m at a 10% discount rate. In June 2020 EcoGraf secured the German industrial conglomerate Thyssenkrupp as an offtake partner. And, as a 12 August 2020 announcement makes clear, EcoGraf can make a better product than what's out there now. All EcoGraf needs to do is finance the project. Negotiations that have included at least one Australian government agency are ongoing.

If Kwinana gets up and running, it will be a big deal in the battery world because the new plant will be one of the first such facilities to be built outside of China. That country is the world's largest producer of graphite and currently the only producer of spherical graphite for supply to the battery market. One has to imagine that this reliance on China leaves graphite buyers feeling a bit nervous and open to getting their spheronised graphite from Australia instead.

Don't rule out a graphite mine as well

Now, EcoGraf hasn't forgotten about Epanko in its haste to become a major supplier of premium grade battery material. The Tanzanian project, which has been modelled as a producer of 60,000 tonnes of flake per year, has an NPV of US$211m at a 10% discount rate. When Tanzania settled its differences with Barrick Gold over various gold mines in the country, after a dispute that carried on for close to three years until early 2020, it basically put EcoGraf's project back in play. Which is to say, there's now a much better chance that projects like Epanko can get funded and approved. EcoGraf continues to work towards that end.

EcoGraf stock has eased back since the September 2020 false start over Tesla's Battery Day. We think that this stock has good times ahead of it given the progress that has been made at both Kwinana and Epanko. As at September 2020, the company had $2.3m cash, but we think that's no obstacle to getting financed given the solid economics of both projects. Four stars.

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Share price chart

Source: Tradingview

Ugh, another HR company?

Yes, we understand your thinking. But intelliHR has a number of significant differentiating factors that set it apart from both its competitors and the legacy systems used by many companies.

The main difference from its competitors is the detailed real-time analytics IntelliHR's platform provides. While systems provide a broad overview, IntelliHR's platform allows executives to drill down on each data point and quickly pull up a full and detailed report on each employee. These real-time reports include performance metrics, goals, which positions they have been in and every other piece of information the system has linked to that individual since they were first hired. Capterra.com has 24 reviews rating the platform 4.9/5 stars. The main standout feature referenced in almost every review was the easy to use and highly detailed analytics feauture. We believe IntelliHR truly is a case of a company building a better mousetrap and pricing it at a highly competitive rate.

IntelliHR's most basic subscription charges $6 per user, per month and it's most expensive is $16 per user, per month. To give a comparison to a well know, ASX-listed competitor, Elmo's (ASX: ELO) Small and Medium Business platform BambooHR is priced at around $22 per user, per month in Australia. While most of these companies keep their pricing opaque, our research does indicate that on pricing alone, intelliHR is leading its competitors.

Growth on steroids

Operations had an extremely strong showing during FY20 with revenue increasing 167% to $1.5m. This was due to the sharp growth in subscriber numbers, to 14,531 during FY20 from 9,451 during FY19. It's important to clarify what we mean by subscribers. Subscribers don't equal clients. In fact, IntelliHR ended FY20 with 109 clients, a 51% year-over-year increase. Subscribers are the term the company uses for the individual employees signed up to its platform. This is why subscriber growth is far larger than client growth as each client brings in far more than one subscriber.

IntelliHR is not only bringing in new clients; they are able to keep them too! As of 30 June 2020, the company's customer Net Promoter Score (NPS) increased 14% year-over-year to 74 as of FY20. The Net Promoter Score ranges from -100 to 100 and is an important metric of customer loyalty. To summarise, we believe IntelliHR not only has strong client attraction, but is able to lock them in for the long run.

One of the most important metrics when looking at this company is the contracted Annual Recurring Revenue (ARR). This is a great leading indicator for IntelliHR as, according to the company, there is generally a 6-week lag between a client signing a contract and revenue hitting the company's accounts. Therefore, contracted Annual Recurring Revenue was slightly under $2m on 30 June 2020 while total FY20's revenue was $1.5m. This represents an increase of 62.3% year-over-year and we believe a strong indication of great potential for FY21.

Revenue is mostly sourced from Australia at $935,786 (75% of the total) while the rest of the world contributed $314,685 (25%). This 25% revenue contribution is actually a very solid portion of IntelliHR's annual revenue when compared to FY19's 4% at $20,293. We believe the steps management has taken to expand into Europe and the United States will truly payoff during FY21. And while we expect Australia to continue to grow rapidly, we also expect international revenue to represent an increasingly larger piece of the pie quickly.

A great first half

On 26 November 2020, IntelliHR reported on its 1HY21 results to-date and we were impressed. The company reported year-to-date 1HY21 total subscriber growth of 148% (to 28,779) compared to 1HY20. Importantly, 51% of new subscribers were directly attributable to IntelliHR's North American expansion.

The company also reported its first United Kingdom customer. To put this in another perspective, in the last five months, IntelliHR has doubled its total contracted subscriber number and increased its contracted Annual Recurring Revenue 44% to $2.8m. We certainly do not believe this is a one-off event, but the result of an expertly executed expansion strategy. The results bode very well for the remainder of FY21 and FY22.

The COVID-19 shot in the arm

There are no current projections for how IntelliHR is expected to perform during the remainder of FY21. However, we believe it would be reasonable to extrapolate from the company's 26 November 2020 announcement that FY20's revenue growth of 167% is certainly a repeatable act during FY21. Assuming this is the case, the company is valued at an FY21 EV/Revenue multiple of 33.6x with the assumption of $4m in annual revenue for FY21. While this is certainly not cheap if we just look at the FY21 numbers, we believe the exceptionally strong revenue growth the company is exhibiting will lead to a rapid drop in its EV/Revenue multiple in the medium term.

Additionally, the company has no borrowings on the books as of 30 June 2020 and management has proven that they can execute. Putting it all together we think this is a four star stock.

Pitt Street Research Pty Ltd

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Pitt Street Research Pty Ltd is founded on more than 40 years of combined experience researching companies in a range of different sectors.

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