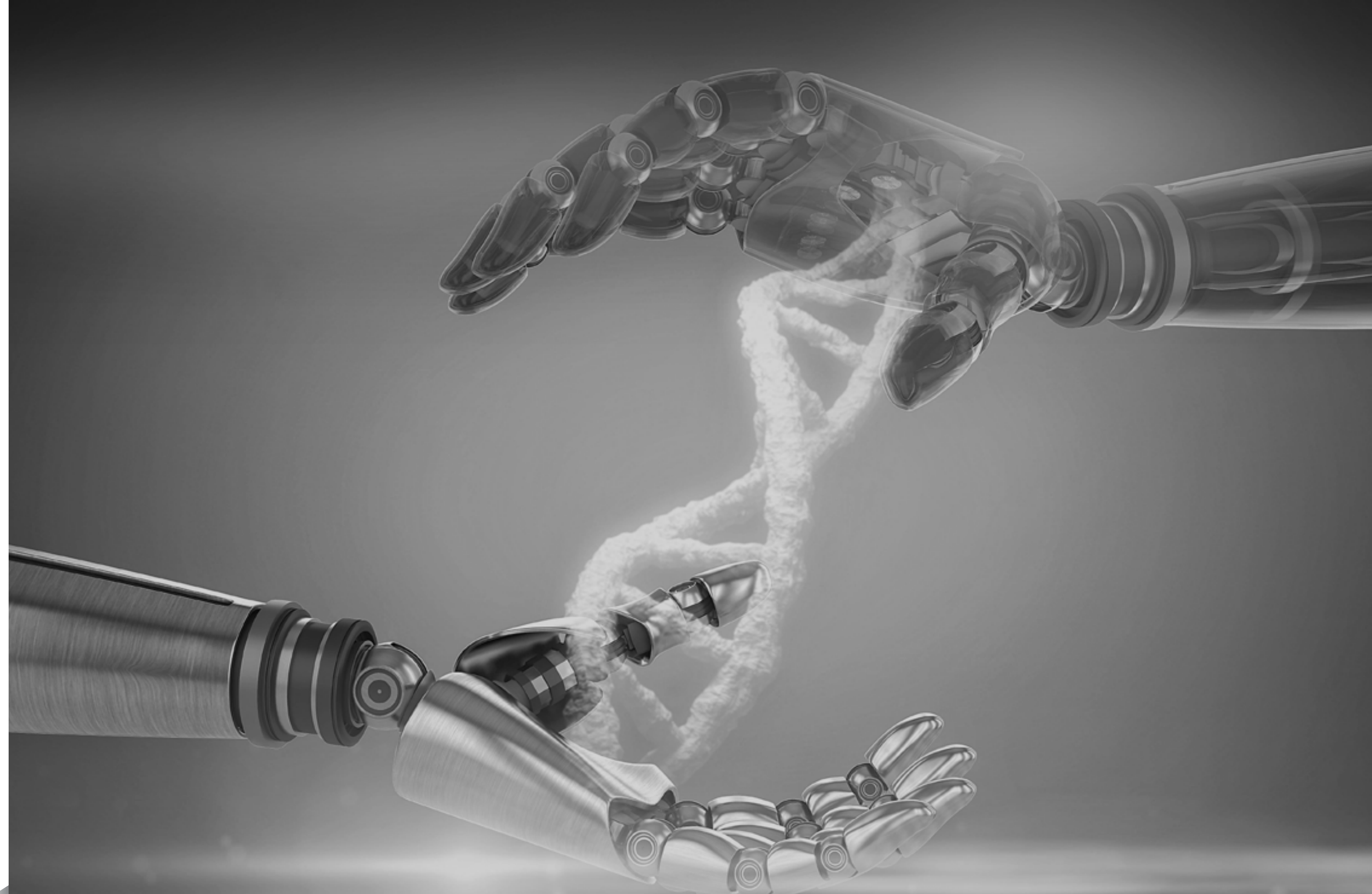
STOCKS DOWN UNDER

9 FEBRUARY 2021

Emerging Stocks Down Under

"If necessity is the mother of invention, then play is its father."

- Steven Johnson (Born 1968), American science author



NITRO SOFTWARE

2020 ate the cheese

TESSERENT

A Cyber Security roll up

EMERGE GAMING

Finally emerged

NITRO SOFTWARE

2020 ate the cheese

Stocks Down Under rating: ★★

ASX: NTO
Market cap: A$ 590M

52-week range: A$0.73 / A$3.66
Share price: A$ 3.10

Headquartered in San Francisco not far from the city's financial district, Nitro Software is the Next Big Thing in PDFs. Specifically, it develops and sells a suite of software products aimed at increasing business productivity and collaboration through being able to edit PDFs and other advanced documents. This company is yet to generate a profit but has delivered consistent revenue growth and is currently used by more than two-thirds of Fortune 500 companies. Nitro has truly built a better mousetrap, but does that mean the stock has any cheese left in it?

READ MORE

TESSERENT

A Cyber Security roll up

Stocks Down Under rating: ★★★★

ASX: TNT
Market cap: A$ 335M

52-week range: A$0.025 / A$0.44
Share price: A$ 0.335

Melbourne-based Tesserent is among the largest Cyber Security plays listed on the ASX. The share price has had a very good run since July 2020, but currently seems stuck in a trading range between 30 and 40 cents. But that 30-cent lower boundary seems to provide a strong support level on the chart. So, what needs to happen from a fundamental point of view for Tesserent to break out of its 40-cent chain?

READ MORE

EMERGE GAMING

Finally emerged

Stocks Down Under rating: ★★★★

ASX: EM1
Market cap: A$ 41.4M

52-week range: A$0.004 / A$0.17
Share price: A$ 0.047

This is our second article on the Perth-based eSports hopeful Emerge Gaming, but our first since the company came out of its trading suspension. Emerge was under a trading suspension for over a month due to ASX concerns around the credibility of its marketing connections. One could make the case that the Exchange was being overly cautious. Since the recommencement of trading Emerge stock has been cut in half. So, our readers might be wondering, why do we still think this is a four star stock?

READ MORE

NITRO SOFTWARE

2020 ate the cheese

Stocks Down Under rating: ★★

ASX: NTO
Market cap: A$ 590M

52-week range: A$0.73 / A$3.66
Share price: A$ 3.10

Headquartered in San Francisco not far from the city's financial district, Nitro Software is the Next Big Thing in PDFs. Specifically, it develops and sells a suite of software products aimed at increasing business productivity and collaboration through being able to edit PDFs and other advanced documents. This company is yet to generate a profit but has delivered consistent revenue growth and is currently used by more than two-thirds of Fortune 500 companies. Nitro has truly built a better mousetrap, but does that mean the stock has any cheese left in it?

Share price chart

Source: Tradingview

Hitting the PDF suite spot

Due to the company being based in the United States, Nitro operates on a calendar year basis, not Australia's financial year. In this modern world that we operate in almost everything is sent in a PDF. According to Nitro, 70% of all email attachments are PDFs. To clarify, we cannot confirm this statistic independently, but we find it highly plausible. Despite the extreme prevalence of PDFs in our daily business and personal lives, editing a PDF is often an extremely complicated or even impossible task for many of us. Nitro estimates that only one in ten workers are equipped with a PDF editor.

This is the need that Nitro is attempting to fill. The company has two main product offerings, Nitro Pro and Nitro Sign. Nitro Sign is a new, and not so new, product. It is more or less a spin-off of Nitro's original mission, allowing the easy and secure signing of PDFs. Therefore, Nitro Sign has been a long-standing part of Nitro Pro. Management has decided that the demand was such that offering it as a stand-alone product without subscribing to Nitro Pro was worth the effort. Nitro Sign was released during June 2020 and offered to businesses for free during the last six months of 2020.

The foundation Nitro Pro suite is focused on making PDF's not just signable, but much more manageable and collaboration-friendly. With Nitro Pro, an organisation can edit, convert, combine, search, annotate and build PDF files. Additionally, Nitro Pro has safety and security features, like its ability to highlight the differences between two documents and the functionality to password protect as well as redact information directly in the PDF. The product is also fully interrogatable with Dropbox, Google Drive, OneDrive, SharePoint 365 and Box.

Profitability nowhere to be seen, but cash is king

For investors, Nitro's main risk, in our view, is that despite the market expecting revenue to more than double from an estimated US$40.6m during 2020 to US$83.5m during 2024, profitability is not within sight. The market forecasts Nitro will still produce an EBITDA loss of US$2m during 2024, although that will be better than the estimated US$4.9m for 2020. While there is no profitability timetable available, we are not concerned this will lead to consistent dilution of shareholder equity as Nitro has produced a net cash inflow from operating activities. During 3Q20, the company generated US$0.4m in net cash from operating activities and ended the quarter with US$44.4m in cash and has no debt on the balance sheet.

The need is there

2020 was a fantastic year for Nitro as the stock more or less doubled. This was due to a number of factors, but we believe the main catalyst was the market's appetite for companies that would benefit from employees working from home. The ability with Nitro to edit and collaborate on PDF's through the Cloud fits squarely into the work-from-home theme and the market rode this company hard. We believe Nitro has found a real need in the modern workplace and has developed a product that ticks all the necessary boxes.

Our issue is the stock's current valuation. We don't think 14% revenue growth for 2020 warrants an EV/Revenue anywhere close to the current valuation of 10x. Let's face it: The second half of 2020 saw a crazy hot bull market and while we certainly agree with the market about the potential of the product, we think the bull went a little too crazy on Nitro. To summarise, Nitro may have built a better mousetrap, but 2020 ate all the cheese. Two stars for now.

TESSERENT

A Cyber Security roll up

Stocks Down Under rating: ★★★★

ASX: TNT
Market cap: A$ 335M

52-week range: A$0.025 / A$0.44
Share price: A$ 0.335

Melbourne-based Tesserent is among the largest Cyber Security plays listed on the ASX. The share price has had a very good run since July 2020, but currently seems stuck in a trading range between 30 and 40 cents. But that 30-cent lower boundary seems to provide a strong support level on the chart. So, what needs to happen from a fundamental point of view for Tesserent to break out of its 40-cent chain?

Share price chart

Source: Tradingview

Acquisitions a go-go

Tesserent is clever combination of a number of companies with specific expertise in certain areas of the Cyber Security space. In the last few years, the company acquired and integrated a number of companies, including Pure Security, Rivium, North Security, Seer Security, Airloom, Ludus Security, iQ3 and Lateral Security. The acquisition of New Zealand-based Lateral Security late last year represented Tesserent's first step into the New Zealand market. This step was complement by the Optic Security joint venture, also based in New Zealand.

In its current form, Tesserent offers full service, enterprise-grade Cyber Security and networking solutions targeted at mid-market enterprise and government customers as well as critical infrastructure across Australia and New Zealand. Aside from Government, one of the company's key target markets is the Banking & Finance sector, where Cyber Security, or the lack thereof, has always been an issue.

Growing explosively, but limited financial insight

Tesserent's so-called Cyber 360 strategy aims to provide customers with an end-to-end security solution for their digital assets. This services includes security reviews and audits, implementation of required security measures as well as ongoing monitoring and scanning of customers' systems. The great thing for customers is that Tesserent provides a turn-key solution, which includes sourcing of the relevant software and services from third-party suppliers. And the fact that Tesserent is qualified for Government and defense assets should give enterprise customers an additional sense of security.

Given the increasing number of Cyber attacks globally and in Australia, we expect demand for Tesserent's services will continue to be strong for a very long time. So, we definitely see the merits of a Cyber Security roll up play that's listed on the ASX.

What we don't like about Tesserent is the fact that it is not breaking out how the individual companies are performing post-acquisition. We only get to see the overall revenue number for the company, so we can't track individual performances and potentially identify bad acquisitions. It would be better if the company broke out the performances of its acquisitions in more detail, even if only for the first 12 months after acquisition.

On the flip side, a roll up strategy implies that there will be plenty of cost savings to be had as acquisitions are being integrated. So we believe there is strong potential to see Tesserent drive down costs aggressively, resulting in attractive EBITDA growth going forward.

On the right track, financially

Tesserent became substantially EBITDA-positive in 1Q21 (ending September 2020) to the tune of $405k, following a $17k positive number in 4Q20. In the most recent quarter the company exceeded the $1m barrier when it reported an EBITDA profit of $1.4m. This compares to $1.7m negative in the same quarter last year. So Tesserent is definitively on the right track.

There is currently no broker coverage of Tesserent and no revenue or EBITDA estimates. But going by the company's annual revenue run rate of $110m per the end of 2020, the shares are currently trading at a trailing Price/Sales ratio of 4x at the current market capitalisation of $435m which includes deep in-the-money options. Keep in mind that we've used run-rate revenue, not actual revenues. Tesserent expects to be at a revenue run rate of $150m by mid-2021, so that P/S multiple would drop to roughly 2.9x, which we believe is not too high. But remember that it will take about 12 months for that revenue run rate to show up as actual revenues in the Profit & Loss account assuming no further acquisitions.

So, what's our verdict on Tesserent? Given the expected strong demand for Cyber Security services going forward, we expect the company will have no trouble finding new customers and signing new deals. We'd like Tesserent to be more transparent when it comes to the performance of its acquisitions, but we see the merits in its roll up strategy.

In our view, Tesserent is worth a punt, especially if the stock manages to break that 40-cent resistance level. Four stars from us.

EMERGE GAMING

Finally emerged

Stocks Down Under rating: ★★★★

ASX: EM1
Market cap: A$ 41.4M

52-week range: A$0.004 / A$0.17
Share price: A$ 0.047

This is our second article on the Perth-based eSports hopeful Emerge Gaming, but our first since the company came out of its trading suspension. Emerge was under a trading suspension for over a month due to ASX concerns around the credibility of its marketing connections. One could make the case that the Exchange was being overly cautious. Since the recommencement of trading Emerge stock has been cut in half. So, our readers might be wondering, why do we still think this is a four star stock?

Share price chart

Source: Tradingview

A quick review of the industry where Emerge expects to enjoy strong upside

eSports is a massive and growing industry worldwide. For those not familiar with this new industry, imagine you are watching a soccer game, but instead of soccer, you are watching competitive video games like Counterstrike, Call of Duty, Fortnite, etc. In 2016, the worldwide eSports market achieved revenues of US$493m and that grew to US$1.1bn in 2019. The Fortnite Celebration Cup, Clash of Clans World Championship and Formula 1 racing simulator's World's Fastest Gamer tournament all offered grand prizes of US$1m in 2020. Business Insider believes that the Compound Annual Growth Rate (CAGR) for total viewership will be a healthy 9% between 2019 and 2023, which is significant given that in 2019 there were already 454m people watching globally. eSports might seem hard to understand for some who prefer 'real sports', but it's an emerging industry already, with a significant amount of monetary backing and a huge growth trajectory. The main issue, and opportunity, right now is there is no standardisation of platform, tournament style, etc. The industry needs to figure out how things will be run going forward.

What is the basis for an emergence?

So far during FY21, the company has made a number of launches from its eSports tournament platform, ArcadeX. However, Emerge remains a start-up company. It produced a loss of $1.3m from only $31,095 in revenue during FY20. Developing an eSports platform is not easy; the product not only needs to be highly resistant to exploits and hacks, but also needs to be available across effectively all viewing platforms. ArcadeX will ultimately to be available on smartphones, tablets, consoles, PC's and Smart TV's.

The company is also developing a mobile social gaming platform called Miggster, which has achieved over 6m pre-registrations as of 28 October 2020. This is the company's platform designed with mobile use in mind, which management believes will be a significant part of eSports' future viewership. Miggster was released on 14 November 2020 and as of 31 December 2020 had achieved 50,000 paying subscribers. While it is unclear as to the date this was achieved, after 31 December 2020, Miggster achieved over 100,000 paying subscribers with an approximate 76% of those paying subscribers opting for an annual subscription.

Emerge launched its Casual Gaming Tournament Platform, MTN Arena, in July 2020 exclusively in South Africa. In the four months since the product launched, it generated around $30,000 in revenue. Since then, the company has drastically expanded its offering with its Technologia de Impacto Multiple S.L. (TIM) partnership, announced on 10 September 2020. TIM itself is not so important. The interesting bit in this agreement guarantees 100,000 subscribers within six-months and, therefore, promises to generate US$850,000 in revenue per month, or $10.2m annually. As of 31 December 2020, MTN Arena had registered approximately 80,000 new subscribers since its launch.

An overly cautious regulator?

The issue with regulation in any form is that it requires, at times, a degree of over caution. Its unavoidable. That means that the regulators will occasionally halt the trading of a company and request more information. As we discussed in our last report, on 30 October 2020, the ASX placed Emerge into suspension from official quotation pending a response to the ASX's queries around the company's relationship with TIM we mentioned above. The issue was TIM uses Crowd1 to achieve Miggster's pre-registrations and multiple regulatory agencies in the United States and New Zealand have issued warnings about Crowd1's methods.

We thought that the concerns were likely overblown and fortunately for both Emerge, investors and our readers, they were overblown as proven by the company's most recent announcement statistics. Mainly due to the clients acquired under Miggster's launch, the company ended 31 December 2020 with $12.3m in cash. Management estimates that after all expenses, the net balance of its cash will be $3.1m. While it is unclear if this means the company is currently profitable, we believe it is an important step in that direction at least.

The right direction

Unfortunately, there are still no concrete projections for FY21's full-year results. However, we do know that, as of 22 January 2021, the company had revenues of at least $9m with a strong positive trajectory. Taking that $9m as a basis for an EV/Revenue calculation, the company is currently trading at a multiple of 4.4x. We believe with the growth in both subscribers and revenue that we have seen so far for FY21, a full year EV/Revenue ratio of 4.4x would be well within reason. This company is heading in the right direction and we believe investors have a lot to look forward to. It is still four stars for us.

Pitt Street Research Pty Ltd

95 Pitt Street, Sydney, NSW 2000, Australia

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