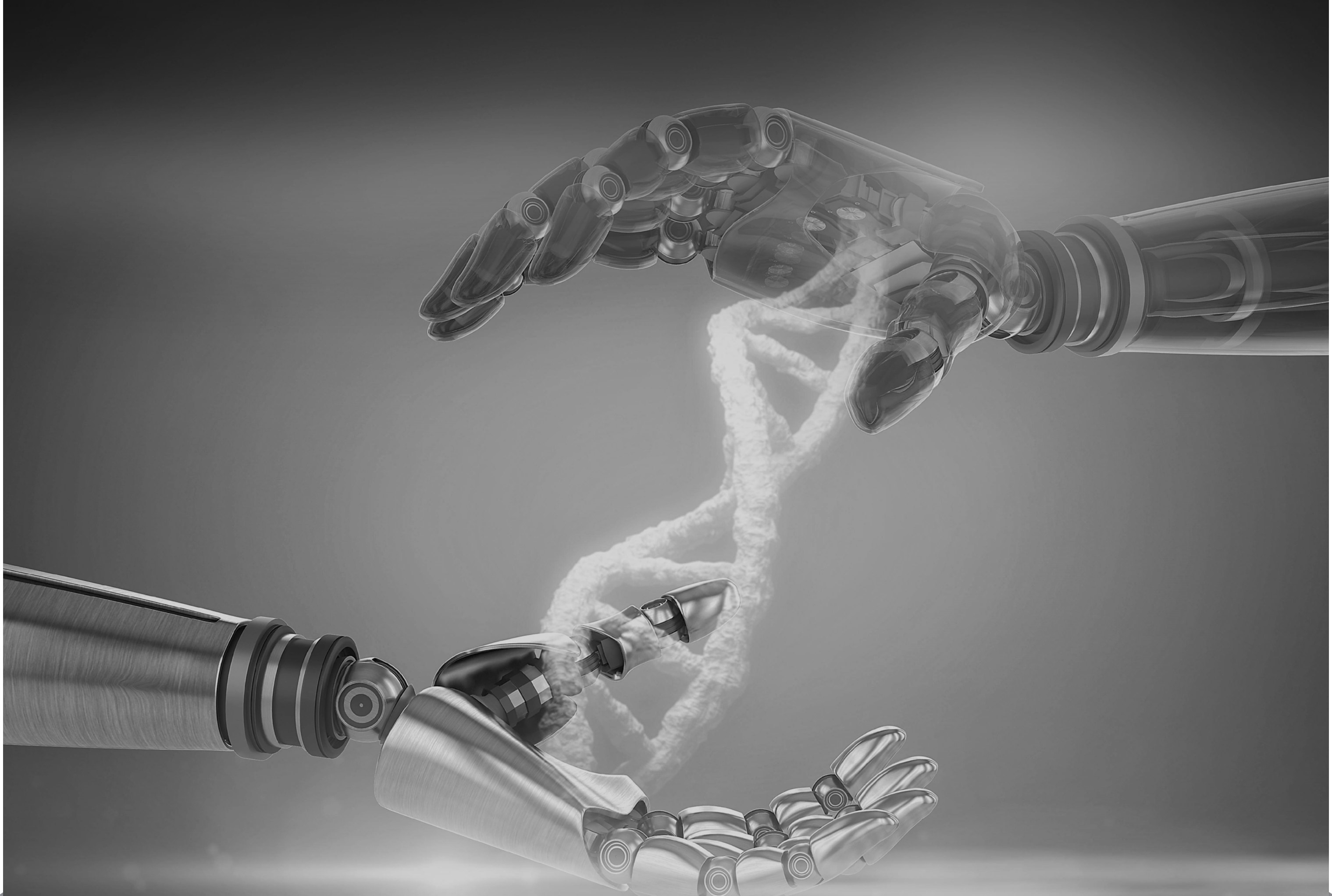
STOCKS DOWN UNDER

6 APRIL 2021

Emerging Stocks Down Under

"The poets have been mysteriously silent on the subject of cheese."

- GK Chesterton (1874 - 1936), English writer and philosopher



CRESO PHARMA
Alter your perception

IKEGPS GROUP
Not a group we want to be invested in

AVA RISK GROUP
Making risk profitable

CRESO PHARMA

Alter your perception

Stocks Down Under rating: ★★★★

ASX: CPH
Market cap: A$ 200M

52-week range: A$0.024 / A$0.48
Share price: A$ 0.21

As the first medicinal cannabis company to import medicinal cannabis into Australia, Creso Pharma is using its position in cannabis-friendly Canada to unlock new distribution opportunities for its growing range of CBD-based products. In its quest to remove the stigma from alternative therapies, the company is now targeting psychedelic therapies to address the widening mental health gap. Although investors seemed lukewarm to the new direction, Creso is confident further evidence-based research and development in psychedelic medicine will lead to better products, better health outcomes and an end to outdated policies.

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Stocks Down Under rating: ★★

ASX: IKE
Market cap: A$ 117M

52-week range: A$0.60 / A$1.24
Share price: A$ 0.90

Headquartered in Wellington, New Zealand, the IkeGPS Group is an innovative, cloud-based technology company. What's so interesting about IkeGPS is that its products help utilities, communications companies and engineering service providers collect, analyse and manage utility pole and overhead asset information. This niche is one that IkeGPS knows well and the company has managed to embed itself with some major clientele like AT&T. But the company is not yet profitable and has a long way to go. So, should you imbed your portfolio with some IkeGPS, or will you get lost?

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ASX: AVA
Market cap: A$ 108M
Dividend yield: 4.4% (0% Franked)

52-week range: A$0.10 / A$0.78
Share price: A$ 0.47

Sydney-based AVA Risk Group is an organisation that thrives on risk. In fact, the more risk in the world, the greater the AVA Risk Group stands to profit. 1HY21 was off to a roaring start. In fact, AVA won the Financial Times High-Growth Companies award for the Asia-Pacific region and the Financial Review Fast 100 award during 2020. The company operates under two divisions; technological security and high value transport, both of which are experiencing significant growth. With the world becoming a more dangerous place, now might be the time to invest in risk.

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Share price chart

Source: Tradingview

Since it dropped into the Canadian market with the acquisition of Mernova Medicinal Inc in 2017, Creso Pharma has been working on expanding its global footprint with its vast portfolio of medicinal cannabis and hemp products. The company's strategy revolves around four areas – therapeutics, nutraceuticals, animal health products and topicals – with products ranging from CBD-oil, food supplements, pet feed and topical ointments. With its cannabis cultivation facility based in Nova Scotia, Creso and Mernova have a 3-Phase plan to expand the facility and open new avenues into the US, European and Canadian markets.

While the use of cannabis and cannabinoids in nutraceuticals and pet food is quite novel, the evidence for CBD-based therapeutics is already there: CBD has been shown to be beneficial for a number of diseases and conditions including epilepsy, schizophrenia and cancer. As the global market for medicinal cannabis has grown to US$8bn, Creso is not only looking to experiment with therapeutic uses for cannabis, but also to change attitudes, which is maybe why the company is concentrating on another divisive area in psychedelic medicine.

The company announced its intention to acquire Halucenex Life Sciences Inc., a Canadian Psychedelic-Assisted Psychotherapy (PAP) company, which focuses on using psychedelic (or hallucinogenic) medicine to treat PTSD, depression and other mental health disorders. Psychedelic therapies involve the controlled trial of psychedelic drugs (such as LSD, MDMA and psilocybin – the active ingredient in magic mushrooms) to trigger changes in someone's mental state without disruptive effects. The acquisition means that Creso Pharma will become the first psychedelic medicine company on the ASX.

A perfect time to raise awareness

Apart from having the coolest company name ever, Halucenex is an appealing acquisition for Creso as it provides a first-mover advantage into the psychedelic medicines sector – an emerging market that is potentially worth up to US$100BN (A$129BN) in due course. It's also widening the scope of its therapeutic mission: where medicinal cannabis largely addresses the unmet need in physical health and wellbeing, psychedelic medicine may address the unmet need in mental health. The unmet need in this case is treatment resistance when standard medications (such as antidepressants) don't result in an improvement in depressive symptoms or only provide a short-term solution. Despite the advances in the treatment of depression and PTSD, an estimated 10-30% of patients exhibit treatment resistance and the limited effectiveness of treatments continues to be highlighted – particularly in the wake of a major pandemic.

As the economic burden of mental illness is predicted to reach US$16 trillion – that's trillion, not billion – by 2030, the growth in psychedelic medicines is expected to create a bottleneck in the supply chain of psilocybin as other pharmaceutical companies decide to get in on the action. While Halucenex's short-term focus will be the start of Phase 2 clinical trials examining psilocybin's role in combating treatment resistant depression in veterans with PTSD, Creso's long-term initiative will be building its distribution network to become a cannabis/psychedelic company. And that includes opportunities in Australia. Although the company's revenue experienced a 32% drop in line with COVID-19, to $2.45m in the December 2020 quarter, new regulatory shifts are opening new opportunities, including the decriminalisation of cannabis in the US and the TGA's decision to allow low-dose CBD products for over-the-counter sales in Australia.

Be the change you want to see

Halucenex is expected to be granted a dealer's licence by the end of March, which will permit the company to possess and conduct research and development, with the Phase 2 trial slated to begin in the third quarter. By coming under Creso's wing, Halucenex is joining a company with established product development and distribution networks, and that network gets larger by the day. Creso now has range of potential sales agreements throughout North and South America to boost sales, which is already up 740% on the previous quarter. It's cash position of $6m will also help with product expansion.

Creso's acquisition of Halucenex is part of a larger strategy to ride the wave of changes in public policy and it's clear that tide is turning when it comes to psychedelics: the Australian government just announced a A$15m competitive grant toward psychedelic research in the treatment of mental illness. While research into the effects of psychedelics on mental health is hardly new – it goes back as far as the 1950s – today's attitudes combined with evidence-based products could push an acceptance of clinical psychedelic treatments in the same way Creso has managed with medical cannabis. Four stars.

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What is an Ike?

IkeGPS generates revenue through the sales of its utility and communications hardware and software products to companies currently involved in the broadband fibre and cellular roll out in the United States. This includes the IKE 4, a mobile tool designed to measure poles and wires quickly. IKE Field and Office is end-to-end pole software that connects field data to the back office through the cloud. Another product, IKE Analyse compiles all of this measurement data for ease of use. If clients need additional fieldwork help, IkeGPS has the engineers, fielders and project managers ready for hire to complete the projects in question.

IkeGPS is currently used by several major companies, ranging from AT&T, Verizon, COX, CableONE and many more. These companies pay IkeGPS in six main ways: product sales, IKE rentals, IKE solution, IKE subscription, pole loading licence and subscription, and services. IkeGPS is not yet profitable and unfortunately it saw its net loss before tax decline to $2.5m from $1.1m during 1HY21. Total revenue declined during 1HY21, to $4.4m from $5.3m. We believe this decline is due to COVID-19 causing significant delays and cancellations of infrastructure projects across the United States. Unfortunately, it is unclear when these projects will be back up and running as COVID-19 continues to rampage across the United States.

IkeGPS' 3Q21 results were disappointing with $2.1m of revenues generated, bringing revenue for the first 9 months of FY21 to a total of $6.5m. However, the outlook for 4Q21 was more positive, with management expecting over $3m in revenue during this quarter alone. The hope is that this means 4Q21 will prove to be the turning point as the United States begins to get back to work. Signs seem to be pointing to yes, but this is still uncertain despite the company having signed around $3m in new contracts in the first five weeks of the quarter.

Dilution is a concern

As we mentioned before, IkeGPS is far from profitable. In order to fund its operations, the company has been forced to issue a rather large amount of stock over the last couple of years. In FY18, $3.9m worth of common stock was issued, $6m during FY19, $6.3m during FY20 and $23m during 1HY21, all with a gradually rising share price. With losses accelerating so far during FY21, we are concerned that the company will need to continue issuing equity going forward. Investors need to be aware of this when looking to purchase the company's stock.

Lots of risk and uncertainty

We already went over the dilution risk, but there is one other risk we must discuss before we move onto valuation. The average three-month daily volume traded is currently only 70,000 shares. Using last Thursday's closing price of $0.90, that only amounts to $63,000 in traded value per day. If things go south for some reason, IkeGPS' shares will be hard to get out of.

The market doesn't expect a full recovery during the last few months FY21 and is looking past that, towards FY22. The current revenue estimates for FY21 and FY22 are $8.8m and $14m, respectively. This would imply a decline of 3.4% during FY21 and growth of 63% during FY22 year-over-year. Clearly, the market is expecting a strong recovery in the United States during FY22 and we happen to agree.

This recovery translates into a solid improvement in EBITDA from negative A$4.95m in FY21 to negative A$2.75m in FY22. And FY23 should be the year that IkeGPS turns EBITDA-positive, albeit marginally at A$0.82m.

The company's FY22 EV/Revenue ratio is slightly high at 7.4x, and we're bit concerned about the company's liquidity and the risk of further dilution. Additionally, a lot can go wrong between now and the company becoming EBITDA-positive about 18 months from now. We believe there are more interesting and attractive Emerging Small Caps Down Under to invest in, so it's two stars from us.

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Share price chart

Source: Tradingview

The world has become a much more dangerous place over the last decade as criminal and state cyber capabilities have exponentially accelerated. According to Check Point's Live Cyber Threat Map on 18 March 2021, there had already been 53.5m attacks worldwide by 1:47 PM that day. This includes malware, exploit and phishing attacks. To highlight just how dangerous the cyber world can get, in 2015, it was revealed that the Chinese government had succeeded in hacking the United States' Office of Personnel Management. In doing so, they stole the database holding background information on current, former and prospective federal employees and others for whom a background check was conducted. The need for businesses, individuals and governments to protect their digital assets has arguably become more important and more difficult than the need to protect their physical assets.

However, the protection of physical assets is also in high demand. Investors are still buying loads of physical assets with global art sales reaching $67.4bn in value during 2018. And the United States Mint ran out of silver and gold bullion coins during a large part of 2020. Just because demand for cybersecurity is on the rise doesn't mean that demand for transporting high-value physical assets is falling.

Fighting the good fight

The current situation might sound scary, but it has turbocharged demand for the security industry. In fact, AVA earned $35.2m in revenue and $12m in EBITDA during 1HY21, an increase of 72% and 454%, respectively. The company earns its revenue through two main divisions: technological and transportation. The majority of revenue is generated through the transportation unit, i.e. $18.4m during 1HY21. However, due to the higher costs associated with physical security, its EBITDA of $3.8m during 1HY21 is less than what the technological division generated ($8.2m). The transportation division offers fully insured, door to door, international transportation of high-risk valuables, precious metals and currency. The company can offer this service in over 100 countries with offices in New York, London, Frankfurt, Dubai and Singapore.

The technological division offers two types of services: Future Fibre Technologies and BQT Solutions. The Future Fibre Technologies segment focuses on fibre optic and physical parameter intrusion detection. The company's systems are currently deployed across 70 different countries for Transport, Government, Military, Oil and Gas, and Utility sectors. The systems are able to determine when a network or parameter has been breached or is about to be breached.

The BQT Solutions segment focuses on door locks, more specifically, smart and card readers, biometric solutions, electric locks and other access control products. These systems are offered custom or 'off the shelf' for the military, governments, businesses and individuals. Combined, this division generated $16.6m in revenue and $8.2m in EBITDA during 1HY21.

Growth in securing the future

The world needs security. With the strong increase in cyber and physical attacks on hospitals, government agencies and major corporations during the pandemic, the world has realised that a pandemic was not the only thing it wasn't prepared for.

Security offers a significant commercial opportunity for those organisations that can offer it in a way that matches the needs of prospective clients. We believe AVA Risk Group is one of these organisations ready to benefit. This was further highlighted by the company seeing accelerated growth during 1HY21. The market is currently expecting EBITDA growth of 159% during FY21 to $20.3m. However, we believe this might prove to be too low given that the company generated $12m in EBITDA during 1HY21 alone.

However, even with this conservative EBITDA growth estimate, its FY21 EV/EBITDA ratio is 4.7x. With the future looking strongly bullish for this industry and what we consider to be an undervalued stock, it's a four-star rating for us.

Pitt Street Research Pty Ltd

95 Pitt Street, Sydney, NSW 2000, Australia

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