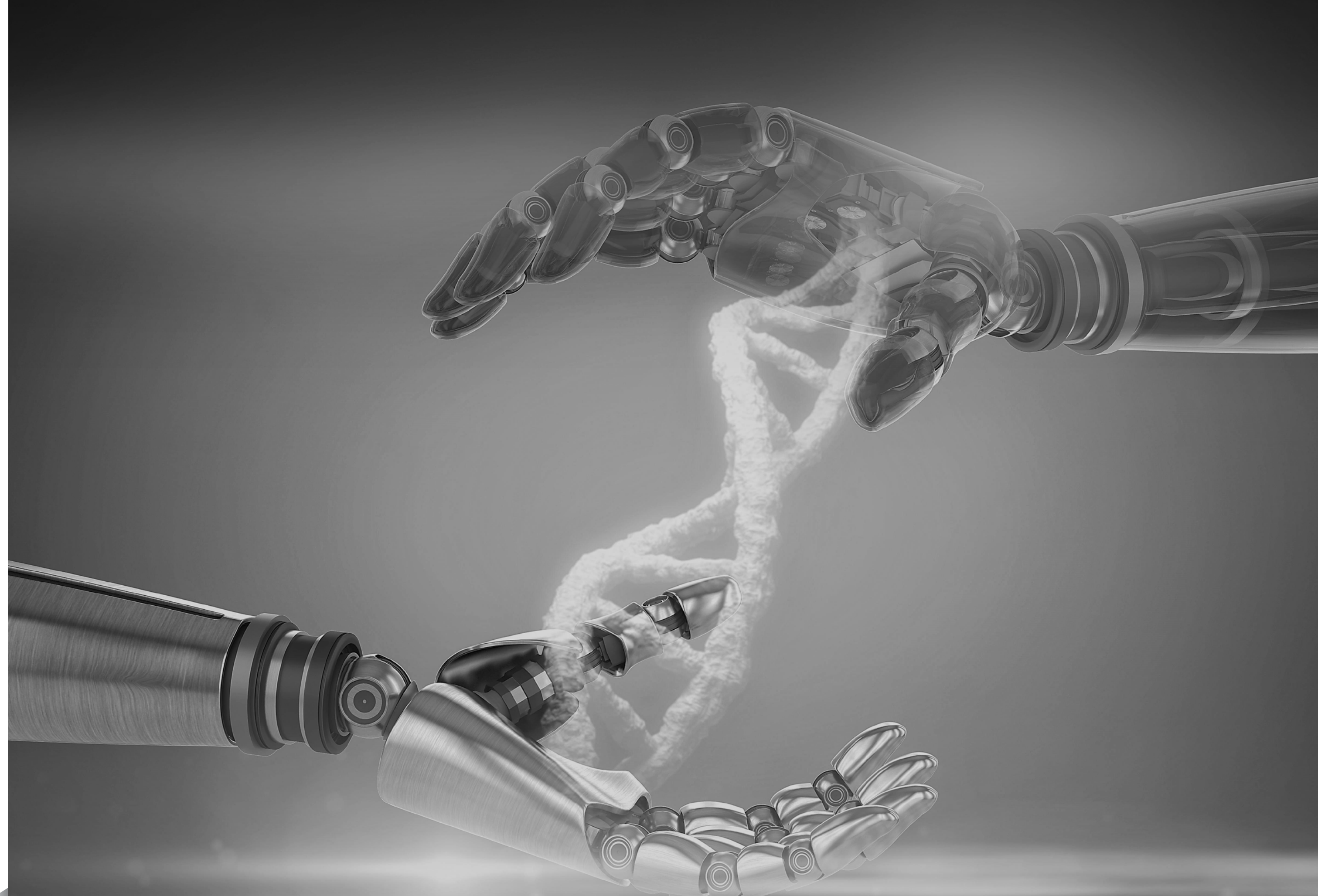
STOCKS DOWN UNDER

4 MAY 2021

Emerging Stocks Down Under

When you reach the end of your rope, tie a knot in it and hang on.

- Franklin D. Roosevelt (1882 - 1945), 32nd President of the United States



IMMUTEP

The only way is up

READCLOUD

Time to turn the page

ECS BOTANICS

Sunlight is free

IMMUTEP

The only way is up

Stocks Down Under rating: ★★★★

ASX: IMM
Market cap: A$ 309M

52-week range: A$0.135 / A$0.63
Share price: A$ 0.45

Immutep has been involved in the emerging field of cancer immunotherapy for many years. You may remember it under its old name of Prima. However, when it was still called Prima Biomed, it acquired the French biotech Immutep SA in 2014. From that moment the company really got a head of steam behind it. Seven years later the clinical data from Immutep's programmes is looking very interesting.

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ASX: RCL
Market cap: A$ 42.6M

52-week range: A$0.255 / A$0.845
Share price: A$ 0.345

Textbooks are expensive, which has led to discrepancies in the quality of educational resources available to different school systems in advanced countries. Fortunately, technology has provided a solution in the form of e-books, but we could be doing more to facilitate classroom learning. Enter Victoria-based ReadCloud, whose e-reading platform allows for collaborative, real-time features, such as live annotation and a vast, cross-platform library encompassing the world's leading publishers. FY21 is a crucial year for ReadCloud as the market expects the company to turn the page to profitability. With strong execution and an innovative product, we believe the company can do it.

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Share price chart

Source: Tradingview

LAG-3 validation

All of Immutep's work is based around LAG-3 (or Lymphocyte Activation Gene-3) immunotherapy in the treatment of cancer and autoimmune disease. LAG-3, which the company calls an immune checkpoint molecule, is a protein which controls signalling between two specific immune cells – T cells and antigen presenting cells (APCs) - to regulate the body's immune response. LAG-3 therapy actually has two modes of action, which is the immunostimulation of APCs to activate immune response to cancer antigens, and the immunosuppression of T cells to inhibit incorrect signalling.

The company's current research into LAG-3 immunotherapy was given a boost from a completely different source last month. Bristol Myers Squibb (BMS), a New York-based global pharmaceutical company worth a mere $40bn, released the results from its Phase 2/3 trials evaluating LAG-3 products on the immune response in patients with untreated melanoma. According to that study, the use of anti-LAG-3 antibodies in combination with Opdivo – a drug used in lung cancer treatment – extended Progression-Free Survival. This has positive flow-on benefits for Immutep and its investors who are suddenly much more confident in the success of the company's LAG-3 therapies. The Immutep share price is now up to 44 cents.

Advancing beyond cancer treatments

Given that it was Immutep which basically pioneered the clinical use of the LAG-3 protein, the company has every reason to celebrate the flow-on effects of BMS' success. Immutep's clinical method varies a little from BMS' in that the company's lead drug candidate, Eftilagimod Alpha (or Efti), works through APC activation to strengthen the white blood cell response, but the end goal of boosting immunity is the same. So far, Efti is showing promise: Immutep's Phase 2 study in metastatic breast cancer, called AIPAC, showed that APC activation delivers a meaningful increase in overall survival rates with prolonged survival linked to an increase in white blood cells. While Efti is now into late-stage studies in metastatic breast cancer as a monotherapy, of perhaps even greater interest is the combination with Keytruda against various cancers (lung, neck and head carcinoma). Keytruda, a blockbuster from Merck, is a checkpoint inhibitor similar to Opdivo, and so, like the BMS study we mentioned above, the company expects the positive response rate to be higher with the Efti/Keytruda combination than Keytruda alone.

As a cancer-fighting drug, Efti has clear value across cancer indications, with the AIPAC clinical study providing an avenue to treat metastatic breast cancer – of which the market value alone is about US$29.9bn. What's interesting about Efti is that it represents a 'pipeline in a product' – meaning that it could be utilised in a number of indications beyond cancer. Though it was always the intention to factor in autoimmune diseases, there is now a window to boost the immune response of patients with early stage COVID-19 symptoms prior to serious deterioration. As Efti is the only APC activator being evaluated against COVID-19, it could bring substantial implications for future treatment and provide yet another market avenue.

The market for cancer-fighting drugs like Keytruda is huge – Merck made US$14.4bn in sales revenue just from Keytruda in 2020 – but the existence of 'long COVID' combined with rising cases makes this an equally promising area. Long COVID (or post-COVID syndrome) is reported by patients as debilitating symptoms lasting long after the virus and those symptoms are similar to those in autoimmune diseases, such as chronic fatigue. That is a potential game changer in the autoimmune disease market – set to be worth US$145bn by 2025.

Fast-tracking Efti

Because of the list of clinical work with Efti, Immutep's new licensing and collaboration agreement with LabCorp will help fast track the development of lab tests as well as faster entry to the immuno-oncology market using LAG-3 technology. Fortunately, the company has substantial cash at $59.4m as of December 2020, with revenue coming from a few out-licensed LAG-3 programs in the pipeline with Novartis, Merck and GSK.

In the short-term, the validation of LAG-3 therapy through BMS' Phase 2/3 data presents Immutep with a much more exciting path forward with ongoing data expected throughout 2021. We also like the potential for the long-term COVID response. But for the company and its investors, Efti's commercialisation and expansion is the main game right now. Four stars.

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More than just an eReader

Calling ReadCloud's platform just an eReader is like calling the sun just a big ball of fire in the sky. The company's platform currently exists as a standalone application for a computer, tablet or smartphone. Once downloaded, users gain access to two separate systems depending on their needs: schools and Vocational Education and Training courses (VET). Currently, the platform is only available to Australian schools, universities and secondary students.

For schools and universities, a licence to use ReadCloud's platform grants access to over 200,000 eBooks from major publishers, like McGraw Hill Education, one of the world's largest textbook publishers. To be clear, the licensing fee does not cover each eBook's cost but rather the use of the platform. In fact, eBook sales generated $2.4m during 1HY21, 69% of the period's $3.5m in total revenue. Licensing fees generated $441,882 and support fees totalled $313,972, representing 22% and 32% of total sales respectively. Why would an educational institution pay for the pleasure of purchasing an eBook? The truth is that ReadCloud's eBook library makes the platform usable, while the enhanced annotations are what makes it unique.

ReadCloud's enhanced annotations system sits on top of each eBook in its library and allows for both real-time and private edits. Historically, annotations have been text on top of a specific paragraph, word, etc. and this is far from a special feature; your Kindle eReader can do that. What truly sets this platform apart is the ability to add in annotations of drawings, videos and pictures with the same ease as you would with simple text. These annotations can be set to private or shared in real-time with a class, allowing for more specific questions to be asked, drastically increasing the utility students get out of a reading assignment. There are many additional features, but the last one we are going to mention is linking. Each annotation is linked to a specific point in the text and this point can be shared through a link via email, text message, etc. When the recipient opens the link, their ReadCloud platform will open directly to the page with the annotation.

In total, the school division generated $3.1m during 1HY21, a mere 6% increase year-over-year. However, we believe the reason for this low growth number is related to the combination of publisher discounts in support of COVID-19 relief and schools delaying orders as they waited until 2HY21 to see what the climate was. Therefore, we expect growth to pick up strongly during 2HY21 for this division. While we don't have broken out revenue figures for the third quarter yet, it is important to note that during 3Q21, the number of direct full-curriculum school users rose 21.7% year-over-year to 56,000. The company's reseller continued to suffer problems from COVID-19, bringing the total growth of new students down to 2.7% (113,000 including VET) year-over-year during 3QY21. Based on management's comments we believe the reseller is likely to rebound during 4Q21.

Turning reading into a vocation

The other end-users of ReadCloud's platform are secondary students looking to take Vocational Education and Training courses (VET) as ReadCloud's platform currently offers slightly over 600 classes through the Australian Institute of Education and Training. Students here gain access to all the advantages of the eReader's technology and allow teachers to modify each course to their style and needs. Interestingly, teachers can see how long their students are spending on each page or what words they look up in the dictionary.

The VET division is a relatively new venture for ReadCloud, which started to generate revenue during 2HY19. Sales have grown relatively quickly, to $430,000 in 1HY21, a 58% increase year-over-year. There is a minor quirk investors need to be aware of when it comes to the VET division, though. The vast majority of annual revenue is generated during the second half of the year. This is due to invoicing rather than anything else. Management invoices the majority of its annual revenue during the second half of the year, even if the work was started during the first half. Additionally, we know that 3Q21 saw the number of users rise 50% year-over-year to 12,000. During FY20, the only full-year data we have, over 90% of annual revenue was generated during the second half of the financial year. So, be aware of this seasonality in ReadCloud's top line.

The crucible is here

Unsurprisingly, ReadCloud saw significant growth during the COVID-19 era. Mid to late 2020 turned out to be the best proof of concept management could have asked for and, therefore, we believe the company is unlikely to lose the clients it acquired during this period. The market is currently forecasting ReadCloud to be EBITDA breakeven in FY21, compared to an EBITDA loss of $160,000 during FY20.

Additionally, during 1HY21 ReadCloud's overall EBITDA loss declined 32% to $474,463 on the back of the School and University division generating its first EBITDA profit. When we combine these results with our expectation that approximately 90% of the VET division's revenue will be generated during 2HY21 and the expected reduction in COVID-19 textbook discounts, we believe the market's EBITDA breakeven forecast is likely to be a conservative estimate. We expect ReadCloud to beat the consensus EBITDA forecast.

Over the next two years, EBITDA is forecast to grow to $2.5m during FY22, followed by 68% during FY23. We don't believe ReadCloud's COVID-19 growth was a flash in the pan. Instead, we believe it offered a proof of concept for a platform bringing education into the 21st century. Therefore, assuming FY21 generates at least a breakeven result, we are confident that the market's EBITDA forecasts for future years are within reason.

Fortunately for subscribers to Stocks Down Under, we believe the general market is not currently aware of ReadCloud's potential. This has led to the company being valued significantly below what we believe is a reasonable valuation at 3.8x, 2.6x, and 2x EV/EBITDA for FY21, FY22 and FY23 respectively. So, four stars from us.

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Share price chart

Source: Tradingview

A budding idea

A quick refresher about the difference between cannabis and hemp. They're the same species, but the plant we usually just call cannabis today, and used to call 'marijuana', is Cannabis indica, while hemp is Cannabis sativa. The main difference (particularly under medical law) is the presence of tetrahydrocannabinoid (THC), which the chemical Space Cowboys value for the 'high'. The quantity of THC in hemp is low (0.3% or less), making it useful for all sorts of products, like paper, clothing and food products. From ECS' view from its base in Tasmania, hemp is set to be a thoroughly profitable (and sustainable) product: the company is already positioned to supply its retail products to major retailers (Woolworths, IGA) as well as its produce to local farmers and manufacturers.

With existing products available, the next step is diversification. The company recently announced its intention to acquire Murray Meds, a Victorian-based cannabis cultivation company. Although Murray Meds does its work in north-western Victoria, the outdoor/tunnel style production practised is similar to ECS' hemp farm, which in the company's investors eyes was deemed a good fit: the share price went above 7 cents in February. Instead of dry, hot country Victoria, ECS will trial outdoor cannabis production in Tasmania.

Not just for hippies anymore

Hemp in Australia today is a growth market, although it has taken some time for people to take it seriously. Hemp protein was legalised in Australia in 2017 and continues to crop up in new age recipes everywhere. If you're an inner-city hipster who's a fan of brunch, you won't have to look far for a hemp seed salad or hemp protein meat substitute (veganism is also on the up), but it's more than a cool trend: hemp has broadly accepted nutritional benefits in the form of protein, minerals and vitamins to prevent inflammation and boost metabolism.

The global market for plant-based meat is forecast to grow in value to US$28bn by 2025 (CAGR 15% from 2020-25), while plant-based snacks could be worth US$78bn by 2028. Importantly, as plant-based alternatives like hemp require less intensive farming practices (less chemicals, fertiliser and water), there's an obvious advantage in a reduced carbon footprint and lower costs as well as for ECS.

While it's hard to imagine that Tasmania's climate is hot enough for outdoor cannabis production, the midland region of Tasmania – with its rich soil, natural sunlight and temperate climate – has been very effective for hemp. ECS is now in its third harvest down there. ECS needs Tasmanian hemp growers to deliver because it is rapidly growing sales, with the December 2020 quarter revenue coming in close to $600,000. While that might not be a huge number, the $6m capital raise to complete the Murray Meds acquisition is aimed at pushing sales and revenues higher.

Murray Meds's outdoor growth model for its cannabis produce will also provide a useful framework for ECS' pilot work growing cannabis in Tasmania. Murray Meds is one of the only companies successfully growing dry flower in low-cost conditions. As outdoor cultivation comes with lower costs than indoor work, the company is looking at a lower-cost, large-scale development with a $3m price tag. Expected to be up-and-running this year, ECS' three-stage plan will begin with 2,000kg CBD-only dry flower cultivation until revenues creep higher and expenses clear to trigger Stage 2 production of 16,000kg and Stage 3 production of 32,500kg (CBD and THC).

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The company's approach is as much a market-value approach as it is an industry approach and the move into diversified hemp and cannabis production and sales is almost expected given the more relaxed regulatory environment in Australia. If the outdoor test plant in Tasmania does well, there's both literal and figurative room to expand production capacity by stage 3. It should be remembered that the acquisition brings Murray Meds' existing deals and products – including an agreement to provide UK-based Armour Group with cannabis oil for an estimated $500,000 in revenue for the first year – so you'd be right for thinking that ECS is coming out of this with best practice and a solid path to more cash.

Other than becoming another of a small number of actual cannabis producers in Australia (the country's supply is 90% imports), ECS' three-stage plan opens another path beyond CBD into THC production and this could mean an even greater diversity of products than exists in its hemp range. While the focus has been on food products, hemp and cannabis will likely be used in ECS' future applications, such as cosmetics/supplements, crude oil and other isolates for use in things like food additives. With an established hemp business, it just makes sense to make cannabis the next component.

ECS stock has eased back since the February high (no pun intended). However, we think there's more life in this one. The upside from Murray Meds as well as the new production methods and steady growth in the hemp range, all suggest a good 2021. With the stock now back near a support level around 4.4 cents, this stock is four stars, in our view.

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