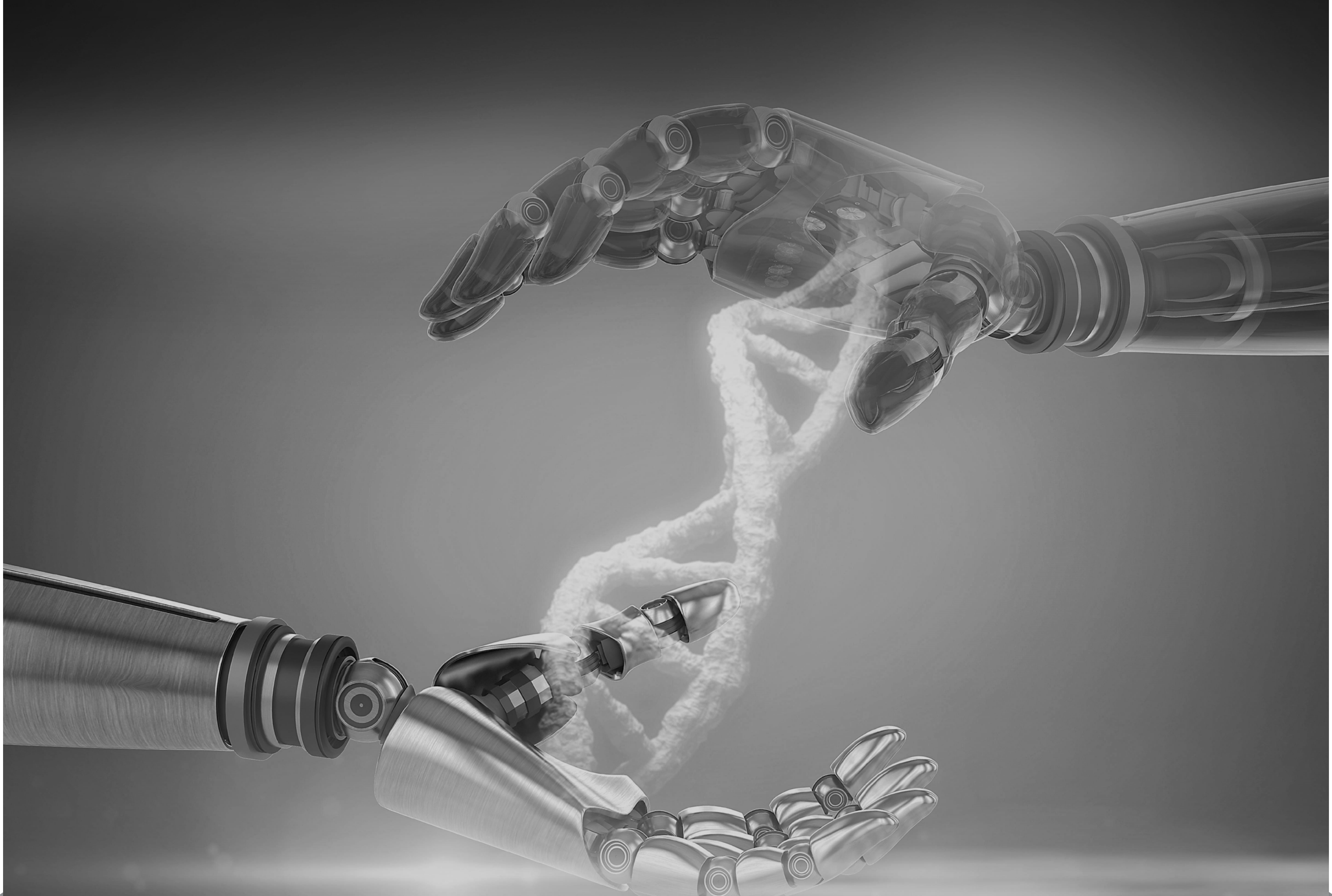
STOCKS DOWN UNDER

22 JUNE 2021

Emerging Stocks Down Under

> *What you do speaks so loud I cannot hear what you say.*

- Ralph Waldo Emerson (1803 - 1882), American philosopher



IOUPAY

Surrounded on all fronts

NUHEARA

Diversifying its way to success

TITOMIC

Titanium, reinvented

IOUPAY

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Stocks Down Under rating: ★★

ASX: IOU
Market cap: A$ 157M

52-week range: A$0.015 / A$0.85
Share price: A$ 0.27

IOUpay is a Sydney-based fintech company. With two business divisions and extensive operations in both Malaysia and Indonesia, the company is looking to expand its broad range of financial services by targeting the very attractive Buy Now, Pay Later (BNPL) segment. While the target market for BNPL services is quite large, the competition is also quite intense. Currently, the success of the company is very much dependent on how effectively IOUpay can market its new services relative to the competition.

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52-week range: A$0.012 / A$0.066
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Share price chart

Source: Tradingview

A new direction

There is no shortage of payment processors listed on the ASX. However, IOUpay can claim to be one of the oldest and one of the larger companies in its class. Founded back in 2000, IOUpay has had a significant first-mover advantage when it comes to setting up partnerships and agreements with banks and corporations across Asia.

The company, initially known as iSentric, was rebranded IOUpay on 1 October 2020. IOUpay had initially been iSentric's main product (with 17 million customers) and the company thought it better to rebrand itself as IOUpay is considered to be the main growth driver for the company in the coming years.

Currently, IOUpay provides mobile banking and digital payments services in Indonesia and Malaysia. However, many of IOUpay's partners also have a presence across the world, essentially opening the door for expansion into other markets in the future.

IOUpay's partners include the UK-based banking giant Standard Chartered and Sun Life Financial, the Canadian life insurance company. That said, it is a fairly standard payment processor, offering mobile banking, secure transaction messaging and cloud storage for mobile banking apps. Revenues have been declining since 2018, as more and more competitors have entered the market and IOUpay failed to prove that it has an advantage over the competition.

The company hopes to change that through its BNPL services. In January 2021, it acquired a money lending license from the Malaysian authorities, thereby gaining permission to set up a BNPL platform in the country. Within a month, it had signed an agreement with two payment gateways and EasyStore, one of South East Asia's largest e-commerce solutions providers. However, IOUpay had little time to rejoice, as it soon had even more competition breathing down its neck.

A little competition can hurt a lot

When IOUpay announced its intention to launch its BNPL services in Malaysia, there was a lot of interest from investors. IOUpay already had 17 million customers and it also had a clear first-mover advantage in its target market of Malaysia. Fast-forward four months later and that is no longer the case. In the weeks after IOUpay's announcement, we have seen 3 different companies enter the BNPL market in Malaysia. These include start-ups Split and Atome, along with the BNPL giant Pine Labs.

In our opinion, Pine Labs presents the biggest threat to IOUpay. While it does not have a significant market share in Malaysia at the moment, it is the largest BNPL services provider in India, with over 95% market share. With a valuation of US$2bn and over US$75m raised in December 2020, it stands ready to expend serious resources to gain a significant market share in Malaysia.

That said, IOUpay has also been strengthening its war chest for the battle ahead. In November 2020, the company raised $10m through a placement to institutional investors at $0.16 a share. While that will help the company on its path for growth in the region, we are still not convinced that IOUpay is the correct investment choice. This is because there are numerous other BNPL options available on ASX that have much greater resources at their disposal to pursue their growth strategies. Afterpay, the Melbourne-based fintech company that has been making massive inroads into BNPL as of late, has a market cap of over $35bn. It is already being included in the list of major payment processors, right alongside names like MasterCard.

OpenPay is another option, as it is a dedicated BNPL platform currently operating in Australia, New Zealand, UK and the US. With a larger total addressable market and an already diversified list of target markets, we believe both companies are much safer investments than IOUpay.

The end of the hype train

We believe most of IOUpay's share price rise earlier in the year, to a high of 70 cents mid-February, can be attributed to a lot of speculation on Reddit and other investment forums. However, even after the subsequent decline to A$0.27 yesterday, its trailing EV/Revenue multiple of 22.9x through December 2020 and its Price/Book ratio of 10.2x, we believe IOUpay is heavily overvalued.

With declining revenues in the legacy business, we believe the only viable path for growth is their foray into the BNPL segment. And while it is almost certain that IOUpay will see some increase in its revenue as it captures a portion of the BNPL market, we believe that the company does not have the resources nor the capability to compete with large peers, like Pine Labs. It is surrounded on all fronts by competitors that have more capital at their disposal and more experience in the BNPL segment. So, in our view, it is highly unlikely that the company will be able to achieve significant growth that would justify the current price. Two stars.

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Source: Tradingview

Two in one

Founded in 2015, Nuheara had always been in an identity crisis of sorts. Analysts, investors and customers have always had a tough time figuring out whether Nuheara is a hearing aid company first and a headphone company second or vice versa.

Over time, it has become obvious that Nuheara's main focus is on creating products that assist people with minor to moderate hearing loss. From earbuds such as the IQbuds MAX that can amplify human voices while cancelling ambient sound, to the IQstream TV (a streaming device) that lets each IQbuds user adjust the volume based on preference, Nuheara has carved out a niche in the hearing-aid market.

In our opinion, this is a good idea. The global wireless earbuds market may be worth around US$30bn, but it is dominated by major players such as Apple, Xiaomi, and OnePlus. These companies integrate their earbuds with other services and products, e.g. Apple Airpods simultaneously work with all your Apple devices and intelligently switch between them. Not to mention that the marketing budgets of these tech giants are many times the size of Nuheara's total market cap.

This makes it incredibly difficult for an upstart like Nuheara to compete. However, by tapping into the market for people with hearing loss, Nuheara not only swims in a much smaller pond, but it can also avail a host of other benefits.

The biggest advantage of focusing on hearing loss is the fact that Nuheara can get its products approved by health insurers. This allows potential customers to purchase Nuheara's products with their insurance plan.

Currently, Australian residents can purchase Nuheara products through the National Disability Insurance Scheme and the Australian Government Hearing Services Program. The IQbuds Pro, an upcoming product has been approved by the FDA in March 2021 for sale as a medical device in the US. This allows Nuheara to sell the device to customers with hearing loss without the need for clinical trials.

Expansion woes

Apart from the standard marketing channels, Nuheara is trying to expand in two ways. By creating new products that target different customers and through their partnership with Hewlett Packard (HP), the American technology giant.

The IQbuds Max focused on people with mild to moderate hearing loss. The new IQbuds Pro, scheduled to be released towards the end of 2021, focuses on people with severe hearing loss. This new product will expand Nuheara's target market. However, the increase is not as significant as it seems. According to the company's own data, the number of people with moderate to severe hearing loss is less than 25% of the number of people with mild to moderate hearing loss. As such, we believe the potential of IQbuds Pro from a sales perspective is much less than that of the Max variant.

What's much more interesting, in our view, is Nuheara's relationship with HP. In August 2020, Nuheara signed a collaboration agreement with HP. The first phase involved Nuheara providing software services for HP's wearable technology. In October 2020, Nuheara received its first purchase order from HP, worth A$2m, for engineering an earbud for HP's use case. While not a lot of details were provided at that time, we later learned that Nuheara had signed a 3-year supply agreement with HP and it commenced production of HP Elite Wireless Earbuds in April 2021.

We believe that this is a much more viable growth path than the release of new, Nuheara-branded, products. Not only will it guarantee a substantial increase in revenue for Nuheara, but it may also lead to other OEM partnerships that could be worth significantly more than the company's revenues from its own branded products in due course.

A new direction

Nuheara raised $11.5m in December 2020 to set up production for HP's wearables. This was done through the placement of 287.5 million shares at 4 cents a share to institutional investors. This influx of cash should not only help Nuheara market its products, but also allow it to pursue further income diversification strategies.

Despite Nuheara's claims, we believe the sales of the IQbuds have been lacklustre. Even though it had one of the best quarters in recent history, sales of the IQbuds Max were only slightly above 2,500 in the quarter ended March 2020. The company considers 'mass sales' to be its next primary objective. It seems unlikely to us that sales will see a massive boost considering the past performance.

However, we believe the deal with HP casts an entirely different light on Nuheara. From FY17 to FY20, annual revenues fell almost 30% to just over $1.7m. But revenues for 1HY21 alone amounted to almost $7m, owing to an increase in sales of IQbuds products and the collaboration with HP.

Currently, the trailing EV/Revenue multiple through December 2020 stands at 11.4x. We believe that is not too high for a tech company still in its initial growth stage. In our view, Nuheara's future does not lie in its own, branded, products, but rather in the success of the production deal with HP and any further agreements that it can sign with OEMs. Considering that it is making progress towards that goal, Nuheara seems like an undervalued company at the current valuation. Four stars from us.

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Share price chart

Source: Tradingview

Titanium, the metal of the past and the future

When the titanium mineral was discovered in 1791 by Reverend William Gregor, it was named after the ancient Titans of Greek and Roman mythology. Unlike these fallen rulers of a bygone age, titanium is both the metal of the past and the future. Titanium is truly a wonder metal and is used to make everything from pipes to the most expensive bicycles, to spacecraft. This metal is non-toxic, extremely resistant to corrosion, connects with bone and is a natural reflector of infrared and ultraviolet radiation.

When compared to stainless steel, the material is not only stronger, but has a significantly lower density at only 4,500 kg/m3. Stainless steel generally falls between 7,480 and 8,000 kg/m3, almost double the density of titanium and since the greater the density the heavier the material, this is far from insignificant. For a more relatable comparison, gold and silver have a density of 19,320 and 10,490 kg/m3, respectively. If all of this was not selling you enough on the benefits of titanium, here's one additional fact for you, titanium is the 9th most common element on Earth.

So, why do we still use steel if this wonder material exists? The answer is surprisingly simple, titanium is extremely difficult to work with. Not only due to its hardness, but the fact that its melting point is extremely high. Stainless steel melts at 1,510co, carbon steel between 1,425 and 1,540co and titanium at a whopping 1,670co. These issues have led to significantly higher prices for titanium compared to stainless steel.

Enter metal additive manufacturing, titanium's saviour

Metal additive manufacturing, also known as 3D printing, seems the be the future of complex metal manufacturing. Utilising the metal in its powdered form, companies can create complex products quickly, efficiently and in-house. Despite being in the news for the last decade, commercial 3D-printing is still in its relative infancy and costs are still too high for widespread adoption, but this is rapidly changing.

Enter Titomic with its patent protected Titomic Kinetic Fusion technology, which offers clients the ability to 3D-print titanium, steel, copper, invar, nickel and magnesium structures. For now, the company's focus continues to be on its titanium powder. The in-house developed Kinetic Fusion technology not only covers a new method of printing metal, but also the metal powder itself.

When we look at Titomic's competition, we see three main differentiating factors: Research Service Provider status, completion of the developmental phase and a partnership focused strategy. Back in April 2020, Titomic was the first additive manufacturing company to be awarded the certification of Research Service Provider (RSP) by Innovation and Science Australia. Basically, this means the company is now eligible to be hired as a "local contractor" for R&D. This Australian Government program grants off-set credits to major defence firms as part of their government contracts. With the growing importance of additive manufacturing in military contracts, we believe this will be an important source of income for Titomic in the future.

Another differentiating factor is the fact that Titomic now has a solid, proven product. While the company will continue to conduct R&D, the main product is proven and reliable. This drastically reduces the company's risk profile, in our view.

Lastly, as of 3Q21, Titomic has decided to change strategic course. Instead of focusing on selling machines, it has decided to focus on creating partnerships and joint ventures. The decision to switch strategies followed an in-house review that found that prospective customers do not want to purchase their own machines and systems for additive manufacturing. Instead, prospective customers prefer to use additive manufacturing through a partnership. Under this new go-to-market strategy, customers can embed Titomic's technology in their organisation, allowing them to share in the risk and reward of Titomic's systems with our directly purchasing the system from Titomic. Titomic will continue to sell its powder and machines directly to consumers, but this will not longer be its focus.

102x EV/Revenue? No problem.

With revenues of less than $1m in the twelve months to December, Titomic is currently trading at what seems to be an extremely high valuation at a trailing 12-month EV/Revenue multiple of 102x. However, we believe an investment in Titomic is an investment in the future earnings potential of its technology, not in its current earnings. The company has developed state of the art titanium and metal additive manufacturing technology that we believe will play an important role in Australia's defence industry. Therefore, with a current market capitalisation of $72.8m, we believe an investment in Titomic's technological edge is worth the risk. Four stars.

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