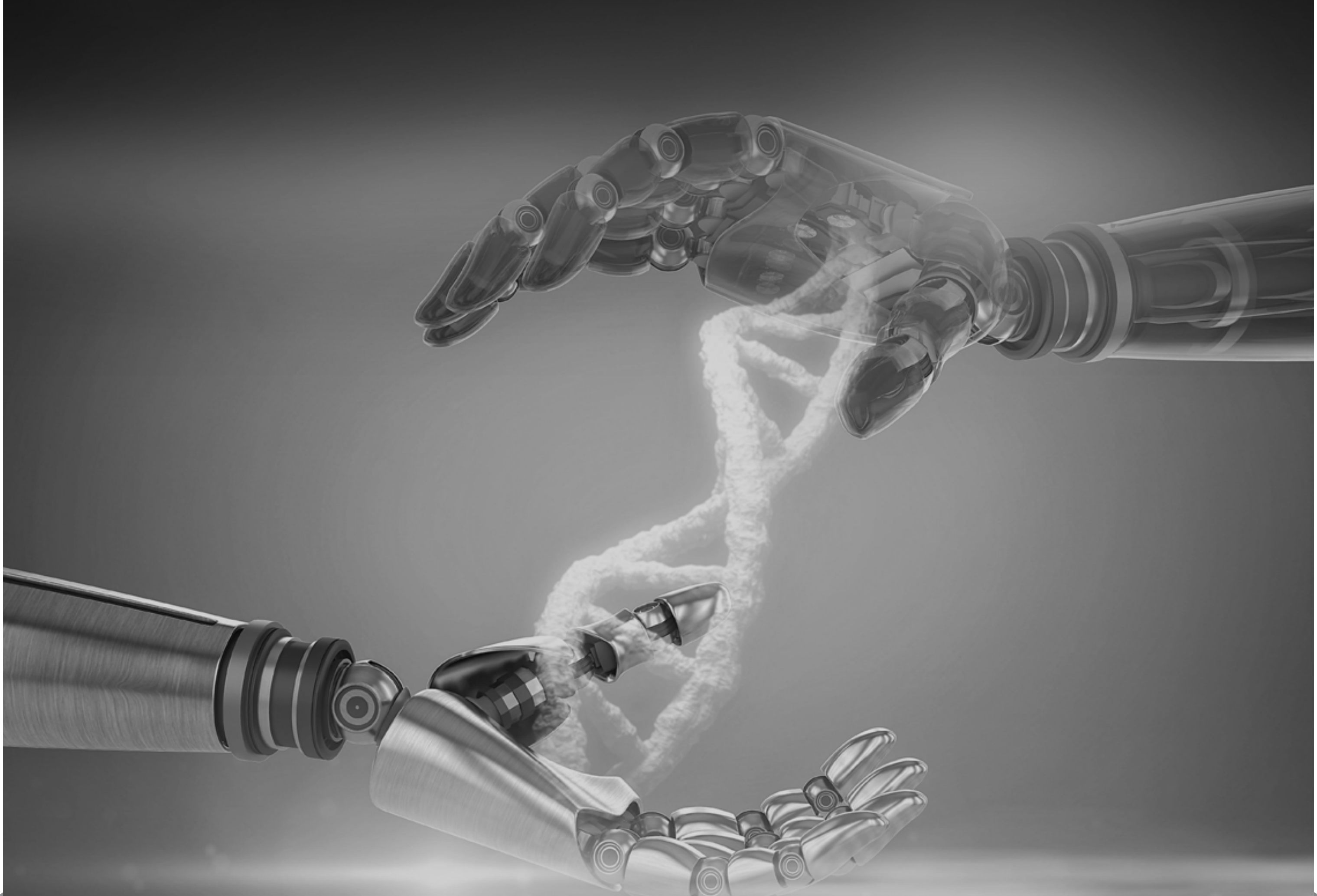
STOCKS DOWN UNDER

29 JUNE 2021

Emerging Stocks Down Under

“In my house dirty dishes are like rabbits, they keep multiplying.”

- Unknown source (but could have come from Marc or Stuart)



KLEOS SPACE

Out of this world

DIGITAL WINE VENTURES

A lot more than meets the eye

FATFISH GROUP

Too fat for us

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Stocks Down Under rating: ★★★★

ASX: KSS
Market cap: A$151M

52-week range: A$0.22 / A$1.00
Share price: A$0.94

Kleos Space is headquartered in Luxembourg. Yes, that's right, there are more companies involved in the race to capitalise on space than SpaceX, Blue Origin and Virgin Galactic. Although, Kleos is not looking to put people in space, but rather capitalise on the need for additional satellite infrastructure for the digital age. We think this race has just begun with Kleos' first successful satellite cluster already in orbit and EBITDA profit on the horizon.

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ASX: DW8
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52-week range: A$0.018 / A$0.21
Share price: A$0.079

Headquartered in Sydney is an organisation trying to make Australia the wine logistics capital of the world through technological innovation. Digital Wine Ventures has created a new marketplace called WINEDEPOT and while the company is not yet profitable, it has clearly struck a nerve in the marketplace judging by its growth rate. At first glance it might seem like this company is overvalued, but dig a little deeper and it's clear that Digital Wine Ventures is just getting started.

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Share price chart

Source: Tradingview

The great space race

On 4 October 1957, the world's first artificial satellite, Sputnik 1, was launched into orbit by the Soviet Union and it changed everything. it's been over 50 years since that launch and we have yet to master putting a satellite into orbit successfully a 100% of the time. Despite massive improvements in everything from safety to heat shielding, a launch is still far from a sure thing. Despite everybody talking about the potential profits, very few private companies have successfully placed an artificial satellite into orbit.

2020, the year everything changed

Kleos Space was founded in 2017 by a group of space engineers to develop and launch a group of nano satellites to sell its services to commercial organisations and government entities. Nano satellites are different from conventional, larger satellites as they are usually around the size of a shoebox and cost a fraction of their larger counterparts.

Due to the risks involved in launching satellites, a company needs to prove it can successfully place a satellite in orbit before it can be taken seriously by the investor community. For anybody who doubted Kleos' ability, 2020 was the year they ate a big slice of humble pie, because, despite the challenges of COVID-19, the company launched its first satellite cluster from India in November.

The company calls this cluster its Scouting Mission satellites and their purpose is to collect data over the world's major shipping regions. The company has two additional Scouting Mission satellite clusters that it believes will be ready for launch later in 2021 and they are already fully funded.

So how do you make money off satellite clusters? There are certainly many different ways, but Kleos has chosen the Data-as-a-Service business model. Much like the Software-as-a-Service model, the company sells access to the same data to multiple sources. This means the company can generate scalable revenue without being forced to expand its operating costs. However, the company has not generated any revenue as of yet.

Risks are still abound

The fact that Kleos has successfully launched its first satellite cluster takes a large amount of risk out of the company, in our opinion. As we mentioned above, this is rocket science and many companies have failed to launch even a single satellite into orbit. However, don't be mistaken in thinking that all of the risk has disappeared.

First of all, Kleos does not own the rockets it uses to launch its satellites into orbit. Instead, it leases the required space on rockets from commercial launching companies. This means that the maintenance of those rockets is out of Kleos' hands and rockets still risk exploding on take-off, even with all the advancements made in the last 50 years.

Developing and manufacturing these satellites costs tens of millions of dollars. A single explosion causing a loss of a satellite cluster would be devastating to the company in terms of both time and money lost. No amount of insurance money can make up for lost time.

If that was not bad enough, debris is increasingly becoming a concern. Despite the fact that the human race has only been shoot things into space for slightly over 60 years at this point, we have certainly clogged up the joint. Making the crowding worse is how careless we have been with our artificial satellites after their useful life is over. Due to the speeds at which this debris travels around the earth, even something as small as a five-cent coin could utterly destroy what it comes into contact with. While modern satellites are equipped to avoid this debris, it is far from a foolproof system. Even once the satellites are in orbit, there is still significant risk.

Profits just over the horizon

For the time being, Kleos is fully funded with a strong balance sheet. Since the successful launch of its first satellite cluster in November 2020, the company has created a pipeline of over 160 government and commercial entities across the USA, UK, EU, Latin and South America, Middle East, South Pacific and Australia looking to purchase data. We believe the company is certainly in the fast lane to profitability, but how much is the question.

Unfortunately, management has given little to no guidance on this point, but until things are fully squared away, we believe they are just cautious. The market, on the other hand, has made some projections. The consensus among analysts is that with its current satellite cluster and two others set for launch at the end of 2021, Kleos is slated to generate an EBITDA profit of $17.3m during FY22. This would be a sharp increase from a $5.6m loss during FY20 and a $5.6m estimated profit during FY21. However, when you consider that FY22 is the first full year of revenue generation from all planned satellite clusters this kind of EBITDA growth seems well within reason to us.

Based on this EBITDA estimate, which implies more than 200% EBITDA growth in FY22, the company is currently trading at an FY22 EV/EBITDA ratio of just 7.9x. And based on how popular space currently is as an investment we believe this is a rather severe undervaluation, even factoring in all the risks we mentioned. Kleos has made it this far, and now it's time to see just how big its orbit can become. Four stars from us.

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Source: Tradingview

Turning wine into cash

Digital Wine Ventures aims to make wine ordering for those involved in wine and beverage distribution easier. The company is currently doing this through its online market platform called WINEDEPOT (yes, all caps). The marketplace allows for easy sales to trade managers as well as consumers and makes it easier to manage inventory, orders and payments. Unfortunately, the company is not yet profitable with a loss of $2.4m in 1HY21, an increase of 186% compared to 1HY20. However, revenue has been skyrocketing as the company continues to expand. During 1HY21, revenue increased 1,042% to $991,333 due to the company seeing strong growth in the number of cases sold on WINEDEPOT's marketplace.

Moving into 3Q21 growth has continued. During this period alone, revenue jumped 431% to $768,000, or 77.5% of 1HY21's total revenue. Additionally, the company set a record for number of cases shipped after volume grew 696% year-over-year to 61,939.

Despite all of these impressive achievements, we believe the most significant part of 3Q21 was the launch of its dedicated delivery fleet. We believe this is an essential part of the value-add proposition of WINEDEPOT's marketplace and offers customers the ability to outsource their logistics network. We believe this will prove to be a lucrative venture, especially if the eBay deal, which we elaborate on below, is finalised.

Sharing is caring

Digital Wine has decided that the path to success lies down the road of partnerships and they have been creating them like there was no tomorrow. Between March and May 2021 alone, the company announced three separate partnerships; with Ebay, Bibendum and Earlypay. The main focus of these three partnerships was to expand the market size and ease with which customers can list their products. For example, the 26 March 2021 eBay Memorandum of Understanding (MoU) laid out the plan for a partnership to be finalised between the two companies. Under the MoU, Digital Wine's subsidiary WINEDEPOT customers will be able to list directly on eBay without an account. Orders would still be processed by WINEDEPOT, but they would be placed through eBay. It is important to note that an MoU is not binding and either party can backout at any time, but we believe this will be a win-win for both eBay and Digital Wine Ventures.

On 30 March 2021, the company announced it had formed a foundation agreement with Bibendum Wine Co for the company to list its products on WINEDEPOT MARKET and have its large trade network of trade buyers use the service. In exchange, WINEDEPOT will provide incentives to trade buyers, access to its delivery fleet as well as its logistical services. Bibendum is a massive operation with 160 local and international wine and spirits producers currently represented by the company. We believe this partnership exposes Digital Wine Ventures to a massive new customer base.

In its latest announcement, on 3 May 2021, WINEDEPOT indicated a partnership with Earlypay Limited (ASX: EPY) to create LIQUIDITY, a credit system for buyers on its marketplace. We mostly see this as a value-add, rather than a game changer, but it is likely to draw more users to WINEDEPOT's marketplace and increase the Average Order Value (AOV).

Like a nice wine, expensive, but worth it

Just like a nice wine, Digital Wine Ventures is certainly far from cheap with its Trailing 12-months EV/Revenue ratio of 125x. However, when we look at the explosive growth the company has experienced over the last 12 months, the renewed focus of Australian wineries on the domestic market and the company's new partnerships, we think the valuation is likely on the low side. When we look at the direction the company is taking, we really can't see anything that we think should be different.

There is certainly strong dilution risk for the shares in the near to medium term as Digital Wine Ventures is unlikely to be profitable in the next few years, but we don't see any insolvency risk. Don't get us wrong, this is a risky company as it is pre-profit and has yet to solidify its place in the market. However, for investors willing to take on that sort of risk, this is certainly one to look at. Four stars from us at Stocks Down Under.

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Share price chart

Source: Tradingview

Not everybody can list on the ASX

Not everybody with a corporate filling can IPO on the ASX. Companies typically need to pass minimum standards. To be accepted for admission, a company needs a minimum of 300 non-affiliated investors whose ownership is at least $2,000 each, a free float of 20% and it needs to pass either the profit or asset test. While we won't go in the details of this, it's clear that for a true start-up, an IPO on the ASX is not practical or not even in its best interest. Public shareholders can be ruthless and rarely are the Annual General Meetings of publicly traded companies used as teaching moments for executives. Companies that are too small to list and require guidance typically go to an investment fund, like the Fatfish Group, that has experience mentoring and investing in small start-ups. Not only does an investment fund bring cash, but it brings guidance and connections.

The funds exposed

Since it was founded in 2011, Fatfish has invested in companies based around the world and operates through two funds. The company's subsidiary, Fatfish Medialab in Singapore, invests in tech-based start-ups through its accelerator, a program designed to quickly teach founders the ropes of business and their industry, allowing for controlled, but quick expansion of the business. As an official partner of the i.jam funding scheme by the Media Development Authority of Singapore (MDA), Medialab can co-invest with the MDA on investments of up to SGD250,000 ($243,081) in early-stage companies in exchange for equity. These start-ups are then placed in Medialab's accelerator.

The Venture Capital division focuses on more mature start-ups, but ones that are still only at a Series A funding round. While a Series A round of funding typically does have a specific dollar restriction, due to its requirement as the first major round of outside funding for the company, the amounts are not typically more than a couple million. However, this is a rule of thumb, not a hard rule. This division not only has a larger investment mandate, but also a larger geographical focus. The Venture Capital division has invested in companies across Asia, Australia and Sweden, assisting them with a combination of capital and expertise to help them expand rapidly. The fund's speciality is expansion in the Southeast Asia region.

The portfolio, a brief overview

Currently, Fatfish has investments across three categories: Buy Now Pay Later (BNPL) and fintech solutions, digital media and venture and investments. The BNPL and fintech solutions portfolio currently holds five companies ranging from an AI-powered online insurance marketplace in Malaysia (Fatberry), to a BNPL firm for Small and Medium Enterprises (SMEs) based in Singapore (Smartfunding.SG), to a Swedish fintech cryptocurrency provider (quickbit).

The digital media portfolio currently holds two companies, one of which has separately listed on the ASX. iCandy Interactive is currently listed on the ASX under the ticker ICI and was an example of a company Fatfish brought to IPO. The second company is Esports Players League, a global esports tournament and platform provider focused on the ordinary gamer community.

The venture and investments portfolio is the largest, featuring eight different companies, none currently listed on the ASX. To name three, Minerium is a company focused on running large scale blockchain mining facilities. iSecrets is an e-commerce platform that sells cheap mobile cases and accessories in the Nordic region with over 5m products sold. The last example is Lunch Actually, an Asian dating platform targeting busy professionals looking for a relationship.

Flash, but no smoke

Fatfish certainly has a lot of investments in some interesting companies, but we unfortunately don't see anything that is overly special at this time. And keep in mind that most of these companies are in their infancy. Unfortunately, Fatfish is not a massive money-maker, generating an EBITDA loss of $589,000 during 2020. Meanwhile, the company is trading at a trailing 12-month EV/Revenue ratio 115.8x, far above what we would consider an acceptable risk-reward ratio. Given that most portfolio companies will take at least several more years to mature, we believe it's simply too early to invest in Fatfish at the moment. For investors looking for early access to Asian tech companies, this is a three-star stock, in our view.

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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