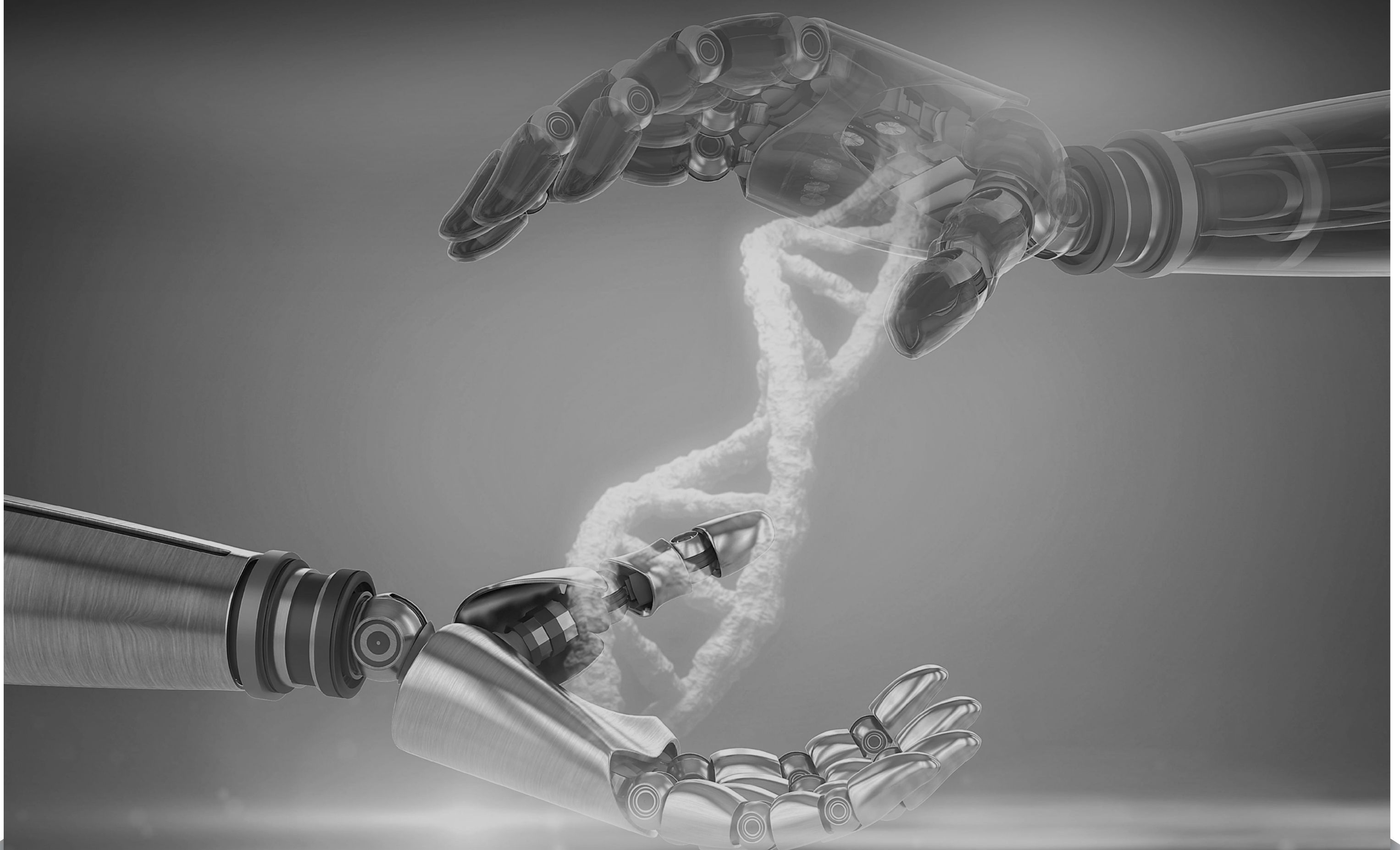
14 SEPTEMBER 2021

Emerging Stocks Down Under

> *You're only given one little spark of madness. You mustn't lose it.*
>
> **- Robin Williams (1951-2014), American actor and comedian**



99 LOYALTY

Loyalty to whom?

PAINCHEK

A painless investment

RESONANCE HEALTH

Automation will be key

99 LOYALTY

Loyalty to whom?

Stocks Down Under rating: ★★

ASX: 99L
Market cap: A$74.2M

52-week range: A$0.054 / A$0.12
Share price: A$0.059

Headquartered in Hong Kong, 99 Loyalty is a China-focused loyalty technology service provider for the financial services industry. Over the last three years, the company's share price has fallen by 52%. But it has now expanded into payment services in a bid to expand its product offerings to its existing enterprise clients. However, because of China's significant crackdown on companies with significant amounts of data at their disposal, we would not touch this company with a 99-metre pole.

READ MORE

PAINCHEK

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Stocks Down Under rating: ★★★★

ASX: PCK
Market cap: A$57.7M

52-week range: A$0.045 / A$0.105
Share price: A$0.051

PainChek is a Sydney-based Healthcare company that develops mobile applications for pain assessment in individuals. The company's primary offering is PainChek, a pain management app for patients who cannot communicate with their carers. The app makes use of video and facial recognition software to determine whether the patient is feeling pain. With optimization and commercialization, we believe PainChek could have a significant impact in the healthcare space in the next few years.

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ASX: RHT
Market cap: A$48.4M

52-week range: A$0.10 / A$0.325
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Share price chart

Source: Tradingview

Loyalty and payments

99 Loyalty has developed a platform enabling Chinese banks and insurance companies to enhance, create and manage customer loyalty programs. The company hooks its platform and systems directly into the client's systems, effectively creating a 'plug-and-play' offering. Loyalty programs are nothing new, but they have consistently increased customer satisfaction and retention while allowing significant insights into individual customer behaviour. You may get Qantas points when you shop at Woolies, but in exchange Woolies records and analysis every purchase, every trip and everything you did in its shop during your time there. This allows them to better manage everything from stock to deliveries and even store design. The same can be applied to any business, especially ones involved in such complicated transactions as financial services.

On 1 July 2021, 99 Loyalty announced it had received an Aggregated Payment Qualification (APQ) from the Payment & Clearing Association of China. This places the company in an elite group as only 170 other enterprises in China currently meet aggregated payment technology service qualification. This is just a new addition to the company's already extensive loyalty platform features. Others include games, top-up credits for mobile talk and data, access to digital multi-media streaming and coupons for restaurants, hotels and shops.

In the first half of 2021, 99 Loyalty generated 2% revenue growth year-over-year on RMB99m in total. However, the company experienced a decline in net profit from RMB3.8m to a loss of RMB16.7m ($4.1m). Management

laid the massive decline in profit not at the feet of COVID-19, but rather attributed it to a combination of increased investment in marketing and sales channel development as well as heightened regulatory requirements for the financial services industry. As 99 Loyalty is still in its early adoption and expansion phase, the company spending additional capital on marketing and sales does not concern us. However, we are quite concerned about the 'heightened regulatory requirements.'

Loyalty demanded

For those who don't pay close attention to China's domestic matters, President Xi Jinping has been making waves at home, arguably more so than he has on the international stage. Since becoming President in 2013, he has exerted significant effort, with great success, on gaining more control over a number of domestic issues than any other modern Chinese leader since Former President Mao Zedong. As part of the latest efforts, the Chinese government has been moving on the country's technology sector, specifically targeting companies that handle vast amounts of domestic user data and those involved in the financial services industry. While it is certainly true that part of this crackdown has been on bad actors and illegal labour practices, our belief is that the main motivation behind this crackdown is to gain control over the user databases and to get greater control over domestic and international Chinese capital flow.

Although, the loyalty program industry specifically has not been publicly targeted for now, this is a constantly evolving situation, affecting companies once thought to be immune from government interference, like Alibaba (HKG: 9988) and DiDi (NYSE: DIDI). So, we believe investors should be weary of any Chinese company that handles user data or is involved in financial services.

Not with a 99-metre pole

Due to a lack of company guidance and consensus earnings estimates, we have to use EV/EBITDA and EV/Revenue ratios on a trailing 12-month basis to value 99 Loyalty. Unfortunately, we don't think the current EV/Revenue and EV/EBITDA ratios of 1.8x and 9x provide investors with enough of a discount to warrant the regulatory risk potentially facing 99 Loyalty.

We expect the regulatory crackdown is still in its early stages and, at the very least, the increased expenses management mentioned during the company's 1HY21 report are likely to grow further. Therefore, we think 99 Loyalty is a two-star stock right now, at least until the Chinese crackdown reaches its conclusion.

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Share price chart

Source: Tradingview

Setting a global standard for pain assessment

PainChek, the company, was founded in 2010 and listed on the ASX in 2012. Initially called ePAT Technologies, the company was renamed PainChek to mirror its primary product in January 2018.

On the surface, PainChek, the application, is very straightforward. Health professionals use the camera on a phone or tablet to record a video of the patient. The software then does its magic and lets the professional know exactly where the patient feels pain. Behind the scenes, however, advanced Artificial Intelligence (AI) is at work. The AI uses facial recognition and an analysis of body movements and behaviour to precisely determine where the patient is in pain. The PainChek app can be downloaded from the app store on your phone. However, you need to be a registered user to access the application.

PainChek was initially developed to help patients with dementia. Even if these patients can communicate with their carers, they have difficulty describing where the pain is and its extent. However, the app can essentially be used by anyone. Children too young to communicate linguistically, for example, have emerged as another potential class of patients. However, PainChek needs to modify and optimize its software for it to work on infants effectively. According to peer-reviewed studies, PainChek is a far better pain assessment tool than any alternative out there. The company's aim is not to change clinical assessments, but rather to improve them.

In early 2018, PainChek barely had a working prototype of its app. However, by 2020, the company was expanding on a global scale. Let's look at how it accomplished that.

Faster expansion than anyone anticipated

Initially, PainChek began providing its services in Australia. The company targeted aged-care facilities, where almost 50% of residents have dementia or some form of cognitive impairment. The plan was to begin with aged-care facilities and expand to hospitals and clinicians from there.

In January 2018, the company began beta testing its Android app after it had already released its iPhone app. Globally, compared to iOS, many more people use Android, so an Android App would allow the company to begin its expansion in earnest.

PainChek received regulatory guidance from the FDA in May 2018, which suggested that the company would need to perform a clinical trial in the US. As such, the company first began expanding in Europe and Asia. This strategy paid off, as the PainChek platform was being used in both UK and Singapore by late 2019. On top of that, PainChek had also begun to move into New Zealand at the same time. It used distribution partners, such as Person Centred Software in the UK, for foreign markets. This made market entry much easier and faster. Indeed, when Pitt Street Research published research on PainChek in May 2020, it had to reassess its valuation of the company based on how quickly it was being adopted in multiple markets.

Expansion plans are in place and they are global

In July 2019, PainChek began testing PainFaces, the infant version of its software, together with the Melbourne Murdoch Children's Research Institute. This app only used facial recognition as opposed to the entire body for pain assessment. The study was completed in January 2021. The app received regulatory clearance in Australia, Europe and all other markets when PainChek was operational within a few months.

PainChek has applied for patents in markets that it cannot currently expand to and it has been granted patents in both China and the US, two potentially huge markets. It has also received numerous regulatory approvals, sowing the seeds for rapid international expansion.

In June 2021, PainChek hit its milestone of 127,000 licensed Residential Aged Care beds in Australia utilizing its technology. This means that PainChek has achieved 60% market penetration in Australia in just a few short years.

In March 2021, the company acquired CE Mark and TGA clearance for its universal app, which combines PainChek with a Numeric Rating Scale pain score to allow pain measurement in any adult patient regardless of their condition. And the infant-focused app should roll out within the next few months, or early 2022 at the latest.

The company has managed its finances very prudently. Despite expanding globally, the company has kept its costs low, with a net loss of only $12.4m in FY20 and $6.1m in FY21 (relatively small considering its expansion rate). However, don't get too excited by the decline in FY21's net loss, because it was due to an $8.2m decline in share-based payment expenses year-over-year offsetting an increase in R&D and administration expenses.

According to consensus estimates, PainChek is expected to generate an EBITDA profit for the first time in FY23, with an EV/EBITDA ratio of 17.8x in the same period and only 4x for the year after. In our opinion, this makes PainChek a four-star investment because its EBITDA is expected to grow from negative $4m in the current financial year to $2.6m in FY23 and $11.5m in FY24.

On top of that, first mover advantage is something that should never be underestimated and while we believe it is likely that competition will arise eventually, PainChek has a revolutionary product and an open road to global market penetration without any major obstacles.

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Share price chart

Source: Tradingview

Resonating with patients

While Resonance was founded in 1987, the company in its modern form began to take shape in 2005. This is when FerriScan, an MRI-based test that can measure liver iron concentration to detect iron overload disorders, was approved by the FDA for use in the US. This was also when it was given the European CE mark. Iron overload is commonly found in cancer survivors that receive multiple blood transfusions. It also has a genetic component, meaning people with family members that suffer from iron overload are more likely to suffer from it as well.

After FerriScan was approved for use, it began to provide Resonance with a consistent revenue stream. The company announced five consecutive profitable quarters at the end of 1HY09, with FerriScan accounting for nearly 80% of the company's revenue. Apart from FerriScan, the company was also researching numerous other kinds of MRI-based tests. In 2013, its second test, called HepaFat-Scan, was approved by the FDA. This scan manages NAFLD, a disease that roughly affects 25% of the western population.

Through the years, the company has updated and upgraded its tests. For example, FerriScan Rapide was introduced in September 2009, which reduced the scan time for patients by 60%. The company also launched generic services based on the two aforementioned products, such as the MRI Cardiac test, in March 2010.

While the company offers numerous services, its clinical trial diagnostic measurement and project management services form the third primary source of revenue. Pharmaceutical companies can partner with Resonance and use its expertise and its labs to perform Phase II, III and IV trials, with data shared between the partners over a secure web-based infrastructure.

Automation and optimisation

In May 2014, the company signed a contract with a university hospital in Florida to open a FerriScan facility. It also expanded its operations to the UK, Tunisia and Germany. However, the number of patients using its technologies was still relatively small and the company's financial performance suffered. Revenue increased from $2.2m in FY14 to just $2.5m in FY16, only a small increase for a company that had just launched a major new product.

In 2016, the company began trying to fix this problem. By the end of that year, FerriScan 2.0, a much more cost-effective version of FerriScan, had been in development for some time. The company began performing the necessary tests to optimize the technology for deployment and it also began to automate its tests to further reduce the costs of administering them.

By June 2017, Resonance had automated a test by developing a machine-learning prototype. The test could be used to measure liver iron concentration and the company designed the test for use in emerging markets, where conducting expensive tests is difficult due to financial constraints. Beta testing on the prototype (now called FerriSmart) began in December 2017 and it gained TGA and CE Mark clearance in July 2018, followed by an FDA clearance in December.

We scanned for problems, but didn't find any

While only accounting for a small portion of its business, Resonance's clinical trial management business continues to operate. In January 2018, the company signed two new clinical trial contracts, followed by a third one in February.

When our parent company Pitt Street Research began covering Resonance in December 2016, we mentioned how automating its test would be the best way to increase its revenues. Well, apparently the company listened. HepaFat-AI gained FDA clearance in December 2020, followed by a TGA and CE mark clearance in February 2021. The company also developed a pulmonary embolism AI solution in 2020 that performs an automated review of CT scans of patients with pulmonary embolism.

All of these efforts are showing results. Revenues increased to $2.9m in FY18, followed by $3.6m in FY19, $3.7m in FY20 and finally $3.8m in FY21. More importantly, the company is not losing money anymore. In fact, Resonance generated a respectable Net Profit After Tax of $1.27m in FY19, followed by a modest loss of $0.72m in FY20. During FY21 profits recovered strongly to $0.59m.

With $8.9m in cash as of 30 June 2021, we believe that Resonance has enough resources to automate even more of its test, reducing its costs and increasing its profits in the process. Although we don't expect a sizeable increase in the number of tests Resonance conducts over the next few years, innovation should allow the company to grow considerably.

At an Enterprise Value of $39.5m, we also don't think the valuation is too extreme for a profitable company with a healthy pipeline of clinical trials that are potentially valuation-changing. We believe there is plenty of upside.

Following a steady decline since March this year, the stock is coming up on a strong support level at $0.09, which may prove to be a good entry point. This one is four stars for us.

Pitt Street Research Pty Ltd

95 Pitt Street, Sydney, NSW 2000, Australia

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