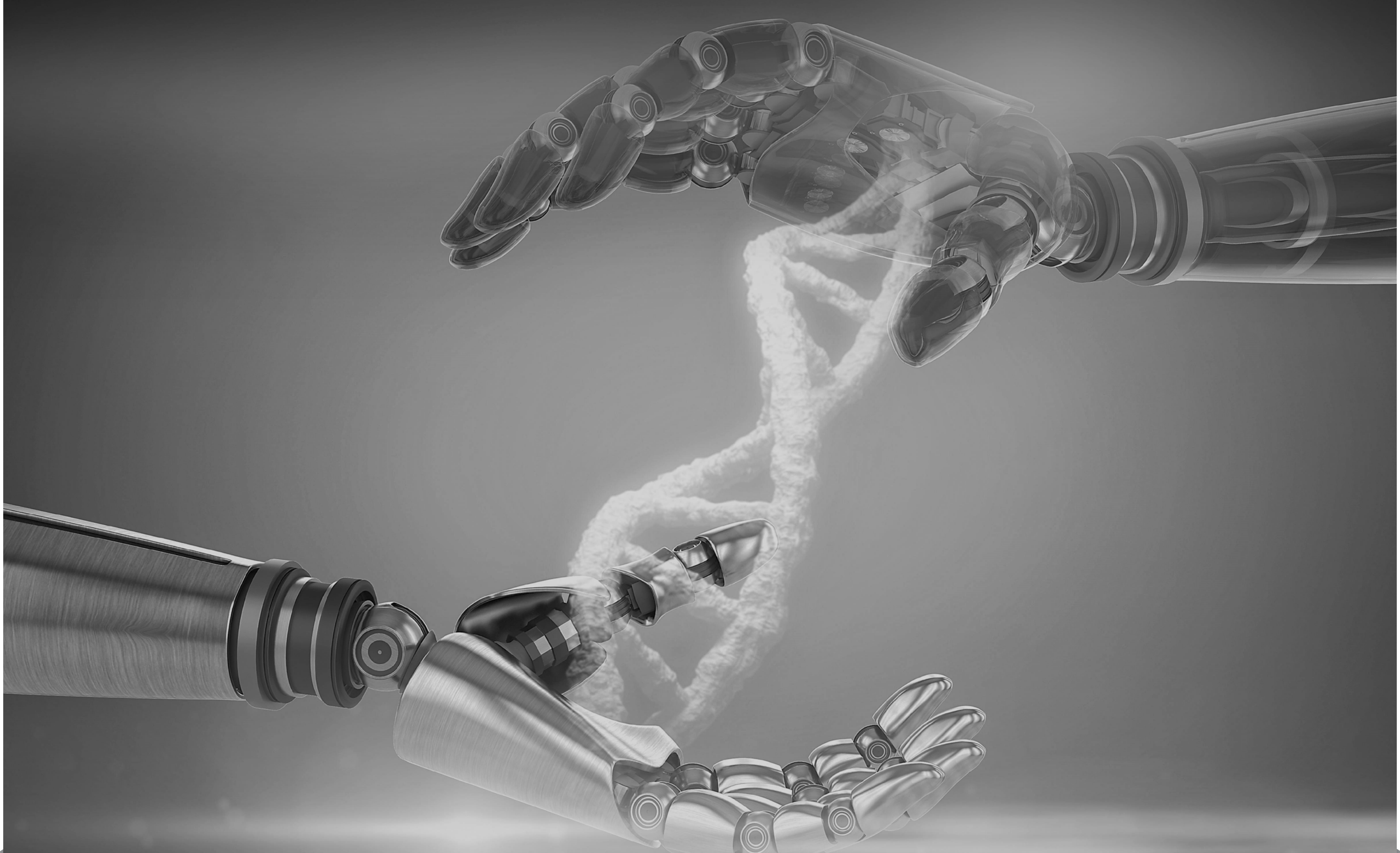
STOCKS DOWN UNDER

21 SEPTEMBER 2021

Emerging Stocks Down Under

Three things cannot be long hidden: the sun, the moon and the truth.

- Gautama Buddha (c. 558 - 491 BCE), spiritual leader who is considered the founder of Buddhism



CV CHECK

Strength to strength

COMPUMEDICS

Computing profits

BOTANIX PHARMACEUTICALS

Fixing your skin and portfolio

CV CHECK

Strength to strength

Stocks Down Under rating: ★★★★

ASX: CV1
Market cap: A$79.4M

52-week range: A$0.105 / A$0.21
Share price: A$0.18

Based in Perth, CV Check provides support services to companies in the staff hiring process. The company uses its online platform to offer verification checks ranging from credit and financial checks to qualification and police checks. The service can be used by individuals, small businesses and enterprises. However, we doubt whether there is enough demand for its core product for this to become profitable on its own. Thankfully, the company is expanding its portfolio through synergistic acquisitions.

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COMPUMEDICS

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Market cap: A$74.4M

52-week range: A$0.355 / A$0.58
Share price: A$0.40

Don't be fooled by Melbourne-based Compumedics' $74.4m market capitalisation thinking it is a young company. The company has a full suite of patent-protected products offered worldwide. Founded in 1987, Compumedics installed the first fully computerised sleep clinic in Australia the same year. Since this early success, the company has expanded into a medical device developer, manufacturer and seller, focusing on sleep, brain and ultrasonic blood-flow monitoring device applications. Since listing on the ASX in 2000 at around $1 per share, shareholders have had a tough time, but we think right now the price is more than right.

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Share price chart

Source: Tradingview

The honeymoon period

CV Check was founded in 2004 and went public in 2015. FY15 saw a substantial revenue increase to $2.6m from $1.1m in FY14. The explosive revenue growth continued for the next couple of years as the company signed key partnerships and used its capital to expand operations.

In February 2016, CV Check signed an agreement with Search Party, the Australian online recruitment marketplace. The two companies agreed to promote each other's services. According to the MoU, Search Party was to use CV Check as its recommended provider of verification requirements for the next twelve months. In May of that year, the company expanded its operations to New Zealand by acquiring Resume Check (another verification services company) for $1.86m. To fund this (and other expansion plans), the company raised $4m at $0.13 per share in July.

All of CV Check's efforts paid off, as revenue rose rapidly to $7.1m in FY16 and $10.5m in FY17. The company tried to integrate its services into major HR platforms and trialled new products involving predictive analysis with select clients. However, while the company was growing considerably, it still wasn't as fast as management's expectations. Guided revenue for FY17 was $12m, over $1.5m higher than the actual number.

FY18 was a busy year for the company. It integrated its products into SnapHire, one of New Zealand's leading Human Resources Information Systems (HRIS) providers. The company also partnered with PageUp, a similar company in Australia, leading to a revenue of $12.6m for the year.

Stumbling blocks

Until FY18, it seemed that the company would continue to grow at a rapid pace. However, CV Check had just gone through a 3-year honeymoon period after listing. Revenue stagnated and the company began to struggle. During this time, the company's main objective was to be cash flow positive, which management aimed to achieve in 1HY18. However, the company was still burning cash by the end of FY20, apparently having hit a roadblock in signing new clients. However, the company did finally have its first cash flow positive quarter in 2QY19. While this was followed by two additional cash positive quarters, the company still burned cash in FY19 as a whole.

Despite undertaking key actions, such as allowing clients to integrate CV Check into SAP SuccessFactors (a widely used human capital management software), revenue growth stalled and revenue amounted to $12.4m for FY19 and FY20.

Although the company signed numerous partnerships during this time and integrated its product with multiple platforms, including LinkedIn, CV Check knew that it would need to make significant changes in order to reignite growth. This change came about relatively recently, in February 2021 when CV Check raised $10.5m at $0.165 per share. The cash was used to acquire Bright Technologies, the Australian cloud-based workforce compliance software company. Operating on a SaaS model, Bright's revenue for FY20 was $4.9m and synergies with CV Check's existing business should help drive growth through higher customer acquisition and cross selling.

Baby steps toward profitability

We believe the Bright Technologies acquisition is a step in the right direction and the company is once again beginning to pick up steam. Total revenue for FY21 amounted to $17.5m, although a significant portion can obviously be attributed to Bright. With $12.9m in cash, the company is no longer in need of external financing for its operations. In fact, operating activities were cash flow positive in 4QY21, bringing in $585,000.

Whether or not CV Check will manage to generate a profit and hit its growth targets will depend mainly on how Bright's workforce compliance software integrates with CV Check's verification platform. If the acquisition can help the company bring in customers at the same rate as prior to FY18. CV Check shares could offer solid upside.

One thing's for sure: Management has started taking active steps to address the revenue growth stagnation of FY18 and FY19. With a strong cash position, we believe the company can make further acquisitions that complement its portfolio of HR support services. Because the platform is already integrated with major HRISs in Australia and New Zealand, we believe that a more cohesive portfolio of services is all that's needed for the company to reignite revenue growth.

Considering all this, we think CV Check is a four-star investment at the moment that has recovered from its two years of sluggish growth.

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COVID-19 is not an all-out medical bonanza

When thinking about investments during COVID-19, one of the first ideas that comes to mind is certainly anything and everything medical. However, with limited exceptions, this is a mostly flawed approach. Using Australia as an example, according to export.gov, a United States Government website for statistics on other country's spending breakdowns, approximately 70% of healthcare spending in Australia is through public hospitals. According to IBISWorld, a global research group, revenue and spending has remained stable during COVID-19 in the hospital industry, but resources have been heavily diverted to COVID-19 specific expenses, like hand sanitiser and Personal Protection Equipment (PPE).

To quote IBISWorld's report: "The COVID-19 outbreak has significantly strained public general hospital resources as operators struggle to cope with maintaining proper procedures in the face of potential shortages of preventative and medical equipment, such as face masks and hand sanitiser". To be clear, this report focuses on Australia specifically. Outside of this most recent outbreak, Australia has clearly been in the top ten countries when it comes to COVID-19 success. Other Australasian countries have fared far worse (excluding New Zealand) and often have significantly less established health systems. However, there have been bright spots in more developed regions, like Europe and the United States.

Moving back to the Compumedics, the company develops, manufactures and sells medical devices providing solutions focused on sleep, brain and ultrasonic blood-flow monitoring applications. While investors would know the company Compumedics, its clients will likely know it through the two fully-owned subsidiaries: United States-based Neuroscan and Germany-based DWL Elektronishe GmbH.

Breaking down the medics

Compumedics has four main business focuses: sleep diagnostics, neuro diagnostics clinics, neuro diagnostics research and brain blood flow diagnostics. All of these businesses provide clients with hardware and software. Interestingly, the company has a market share that still leaves plenty of room to grow. Compumedics estimates the global market currently stands at US$250m, leaving the company with 6% of global market share through its position as number one in Australia and China, but number three in the United States.

The neuro diagnostics clinics have significantly greater market share potential, mostly in the United States. According to Compumedics' own research, the estimated global market size is US$1.3bn and it currently only has a 1% slice of that.

The neuro diagnostics research business and brain blood flow diagnostics have a combined total global market of US$35m. There is not much room for growth in these businesses with approximate market shares of 30% and 35%, respectively.

So, where do we go from here? Compumedics has a rather healthy Research and Development budget of $4.4m (FY21) and they are certainly making the most of it. As management outlined in the company's FY21 report, Compumedics has a number of new products up its sleeves. For example, the company is set to release a new range of products for its neurological diagnostic and monitoring businesses. These products were supposed to be released already, but COVID-19 has caused delays with the latest estimate being late 2021 through early 2022.

Let there be profit

FY21 was unsurprisingly unimpressive, but an important milestone for Compumedics at the same time. During FY21, revenue increased 1.9% to $35.7m, which was the unsurprisingly unimpressive part. The important milestone came in the form of EBITDA and Net Profit After Tax (NPAT) after COVID-19's induced FY20 loss. During FY21, the company's generated EBITDA profitability: $2.6m EBITDA profit (up $8m year-over-year) and a $998,000 NPAT (up $6.8m year-over-year). Clearly this would be an important milestone for any company, but with the United States and Europe showing signs of increasingly normalised medical operations, we believe the company's financials are set to improve as revenue growth starts to return to normal.

While we don't have management guidance or market estimates for revenue growth in FY22, we believe the return to normal justifies the trailing 12-months EV/Revenue of 2.1x and EV/EBITDA 22.4x. Compumedics certainly has a high degree of risk from a macro perspective, a resurgence in COVID-19 cases and from the relatively small size of its operations. However, we believe the company has found an important niche that will likely benefit from medical operations returning to a degree of normalcy during FY22. Therefore, Compumedics is a four-star stock in our book.

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The largest organ can be the most challenging

Did you know that the skin is the largest organ of the human body? Despite the large surface area creating a plethora of options for where to deliver pharmaceuticals, treating the skin can be surprisingly challenging. With all the ointments, balms and ease with which we receive paper cuts, this all might sound rather counterintuitive. One of the skin's primary roles is to protect our body from the outside world, which is full of chemicals. Unfortunately, we cannot control what our skin repels, even if it's a lifesaving product. The skin's natural resistance is a constant hurdle to overcome.

There is, of course, a plethora of solutions to this problem, because this is nothing new in the field of pharmaceuticals. However, not all solutions are created equal, but we believe Botanix Pharmaceuticals has one of the better options out there: Permetrex.

So, what makes Permetrex so unique? For one, the product does not use chemicals. This makes Permetrex unique and sought after as chemicals have a tendency to dry out a patient's skin. If you have a condition like acne or atopic dermatitis, adding to your dry skin is far from an ideal treatment. If that was not enough of an incentive to use Permetrex, the product avoids what is known as the 'first-pass effect of liver metabolism'. This complicated phrase means that when a drug passes through the liver, it generally is at least partially bio-transformed, usually forcing a higher dosage. By by-passing this, Permetrex allows lower doses.

While we don't believe Permetrex's profit potential is nearly as high as the drugs Botanix currently has in development, this product is currently in the market, generating revenues for Botanix. Since this is the company's only revenue-generating product at the moment, it creates the unusual situation where an early-stage drug-developer has revenue to partially fund its research costs, which reduces the pressure to issue shares.

During FY21, Botanix saw revenue decline 36.8% to $114,038. However, we believe this was mostly due to COVID-19, rather than the market rejecting Permetrex. The global situation is improving for non-COVID-19 related medical products, but it still has a ways to go before we are back to normal.

A healthy pipeline

Botanix Pharmaceuticals has three drugs currently undergoing extensive, and so far, successful trials: BTX 1503 Gel, BTX 1702 Solution and BTX 1801 Ointment. We haven't had any updates since 4 May 2021 when management announced that BTX 1801's Phase 2a study data demonstrated that it was 'safe, well tolerated, clinically effective and successful at achieving decolonisation of Staph aureus in the nose'. Following this success, management launched the next phase of its BTX 1801 development.

The lack of updates should not be taken as a negative. Clinical trials are extensive and complicated processes, and no news can usually be taken as good news. Currently, BTX 1503 Gel, targeting moderate to severe acne, has management meeting with the FDA following the completion of its successful end of Phase 2 study. Remember, the FDA is not prioritising non-COVID-19 trials, so this will likely take longer than usual. BTX 1702 Solution is targeting Rosacea and is currently undergoing a Phase 1b study.

In our opinion, Botanix has strong Intellectual Property in development. We believe it will continue to benefit from investors' focus on CBD companies, increasing liquidity and increasing the chance that positive news will be rapidly reflected in the share price. However, we don't believe the company can get to profitability without bringing another product to market. And while trials are going well, these processes are far from certain.

Despite this caveat, with Botanix currently valued at $70m, we believe the stock is certainly worth a four-star punt.

Pitt Street Research Pty Ltd

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