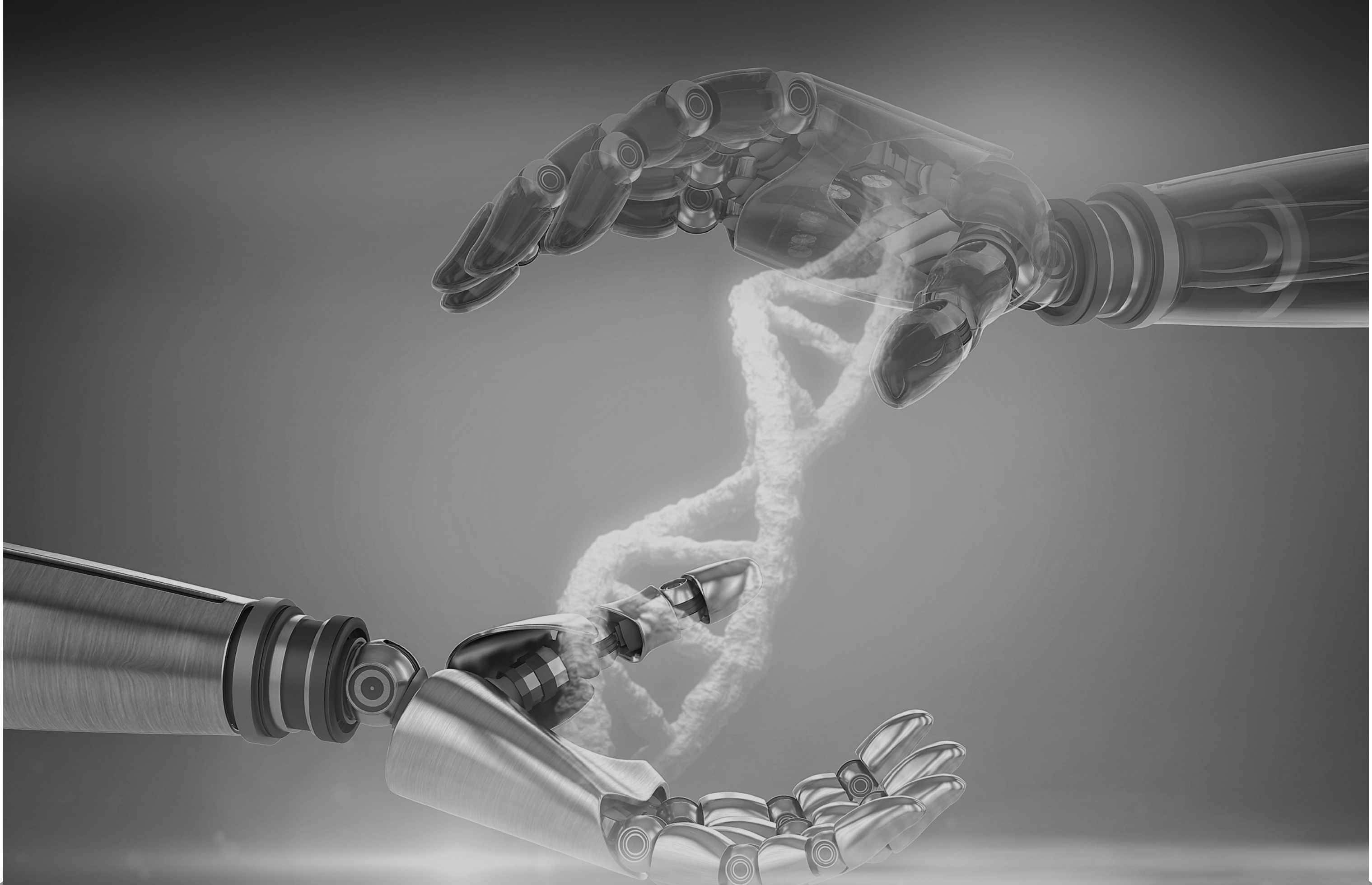
STOCKS DOWN UNDER

5 OCTOBER 2021

Emerging Stocks Down Under

"If your ship doesn't come in, swim out and meet it."

- Jonathan Winters III (1925 - 2013), American comedian



QUANTUM HEALTH GROUP

A rocky ride up

ALTERITY THERAPEUTICS

A long way to go

WHITEHAWK

Whitehawk down

QUANTUM HEALTH GROUP

A rocky ride up

Stocks Down Under rating: ★★★

ASX: QTM
Market cap: A$84.6M

52-week range: A$0.043 / A$0.105
Share price: A$0.074

The Sydney-based Quantum Health Group is an authorised distributor of Carestream, Philips, Samsung, IBA and Accuray medical imaging equipment across Australia and Asia. Shareholders have experienced quite the wild ride over the last six-months, with shares bouncing on an upwards trajectory between $0.045 and slightly under $0.08 per share. While the lack of liquidity can partially explain the volatility, there's clearly something going on. Let's dive in and see what a scan shows about this imaging equipment distributor.

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ASX: ATH
Market cap: A$69.8M

52-week range: A$0.024 / A$0.054
Share price: A$0.031

Formerly Prana Biotechnology, the Melbourne-based Alterity Therapeutics has been fighting a war against neurodegenerative diseases since it was founded in 1997. The company currently has one only drug in its pipeline, called ATH434. However, the company is not without usable assets, as Alterity has an extensive portfolio of patents covering novel compounds covering a wide range of uses. Still, ATH434 has many years and a lot of risks to get through before we reach the promised land.

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52-week range: A$0.125 / A$0.465
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Share price chart

Source: Tradingview

Yes, COVID-19 has taken a bite out of medical spending

When thinking about investments during COVID-19, one of the first ideas that come 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 the 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 countries in the Australasian region, have fared far worse (excluding New Zealand), and often have significantly less established health systems. We find it unlikely medical spending will be much better in the region outside of Australia, a boon for COVID-19 related equipment suppliers, damaging for the rest.

Everything began to shift during FY21

Moving back to the Qantum Health Group, this company is an authorised distributor of distribution and service of medical products in the field of radiology, oncology, aesthetics and environmental health in Australia and Asia. The vast majority of the company's revenues are generated by three countries: Korea ($17.3m in revenue during FY21), Thailand ($13.9m), and Australia ($17.6m). During FY21, revenue declined 6.3% to $55.7m, but EBITDA increased 15.1% to $10.7m. It seems despite the slowdown in non-COVID-19 related medical expenses, management was still able to cut its cost of sales by 14.1%. For a cut of this magnitude to occur during a time of significant supply chain pressure around the world is certainly an impressive achievement and the main reason for EBITDA's increase. While not normally worthy of note, travel expenses also declined $413,000 to $639,000 during FY21. We mention this because management has stated it believes it is unlikely travel expenses will recover post-COVID-19 due to its adoption of new communication technology during the pandemic.

The decline in cost of sales was far from a coincidence and not likely a one-off event. Quantum Health Group is in the middle of a transition towards a higher margin, recurring service model. This will see the company shift its focus towards servicing medical products, rather than distributing them. While not completely explaining away the decline in revenue during FY21, management has stated that it was part of the reason. We are certainly encouraged by the performance of this transition so far, especially during such a difficult time. This indicates that management is going down the right path for Quantus Health Group's shareholders. We should expect to see stronger results as the business moves towards normalisation.

A justified rally

Quantum Health Group is certainly one hot stock, jumping between $0.045 and just $0.07 per share before its recent spike up to $0.075 per share. While this spike would normally be a warning sign, we believe it was more a correction towards Quantum Health Group's true value and a result of its extremely low trading volume. The average daily volume was 1.4m shares, or $103,600 per day during the last three months. While this might seem far from "extremely low" it is important to point out that the vast majority of the volume over the last three months is centred around three days. The vast majority of the other trading days saw zero shares traded.

Despite the low volume, the Quantum Health Group is trading at what we would consider a reasonable trailing 12-month EV/EBITDA ratio of 8.3x. However, we would consider this fair value, not a discount due to the large liquidity risk. We believe the Quantum Health Group is making the right call in its transition, but until it gets some regular liquidity, we believe the stock deserves to trade right around its current valuation, three stars.

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Share price chart

Source: Tradingview

ATH434 promising results, but a long way to go

ATH434 is Alterity's lead (and only) drug candidate. ATH434 was developed to treat atypical Parkinsonism by reducing the abnormal accumulation of a-synuclein and tau proteins and by restoring normal iron balance in the brain. What do we mean by atypical Parkinsonism? Parkinson's disease is well known, but what is less well know is that this is just one disease in a group of disorders. This group is known as 'Parkinsonian disorders' and is overarchingly classified as a disease that cause individuals to experience slowness of movement, stiffness and tremor, etc. The most common of these is Parkinson's disease, but others include Multiple System Atrophy, Progressive Supranuclear Palsy, Dementia with Lewy Bodies, etc. Due to the additional symptoms apparent in atypical Parkinsonism, drugs for Parkinson's disease often fail to deliver meaningful results.

ATH434 is currently undergoing trials targeting Multiple System Atrophy through an oral formulation. Currently, there are no approved treatments for Multiple System Atrophy, and this is why in 2019, ATH434 was granted the coveted Orphan Drug designation both by America's Food and Drug Administration (FDA) and the comparable body in the EU. There are a number of benefits to an Orphan Drug designation, but the main one is seven years of market exclusivity in the United States and ten years in the EU. In the United States alone, Alterity estimates sales of up to US$725m, not bad for a company with a market capitalisation of $69.8m.

ATH434 has passed Phase 1 trails and is preparing for Phase 2 which is expected to start before the end of this year. If all goes according to plan, Phase 2 will be completed by the end of 2022. Clearly, ATH434 is in the early stages of its approval process and these trials are notoriously unpredictable. The fact that ATH434 is Alterity's only drug currently in development does add significant risk.

An unusually large patent portfolio

All of Alterity's patents are currently held by the company, and do not require licenses to use. We believe this is an important advantage. This means the Alterity's operations do not risk that a third party will pull the plug or that a geo-specific agreement hinders the company's potential sales. Currently, Alterity has seven patents grated and two patents pending. Not all patents are all granted in the same countries, but the list includes the EU, Australia, Japan, etc. All seven patents that have been granted have at least been grated in the United States. These seven patents cover a variety of inventions including the use of compounds in specific treatments, to the invention of novel compounds.

After FY21 had ended, on 4 August 2021, Alterity released an announcement regarding the state of its patent portfolio. The United States Patent and Trademark Office (USPTO) had granted the company's patent application No. 17/239,375. This patent has a lifespan of approximately 20-years, granting exclusivity over 80 novel compounds designed to redistribute excess iron, widely believed to play a part in many neurodegenerative diseases, especially Alzheimer's and Parkinson's.

We believe Alterity's rather large patent portfolio is an important part of the company, as it offers a potential source of revenue and a vital bedrock foundation for future drug development outside of ATH343. While management has not expressed any interest in out-licensing Alterity's patent portfolio, we believe the large scale of this portfolio reduces the company's risk slightly due to management's ability to go down the licensing route if it is required.

Liquidity is fine, depending on the day

When we review a company like Alterity, which is listed on the ASX, and on a giant exchange like the NASDAQ (NASDAQ: ATHE), we must take a closer look at the company's ASX-listed liquidity. Alterity's liquidity is rather strong on an average three-month basis at 9.2m shares traded per day. This comes out to a daily traded value of $276,000, assuming shares trade at yesterday's close of $0.031 per share. What is important to note is that shares are subject to significant swings in volume, with many days experiencing below 2m shares traded per day ($60,000 in value traded per day). Liquidity is currently not an issue on the ASX, but this not always the case, as it is not unusual for the stock to experience less than $10,000 in value traded.

While we are impressed by the progress Alterity has made on ATH434, it is far from the only drug under development for Multiple System Atrophy. According to Alterity, there are three other drugs in development, two of which are also using an oral formulation. To make matters worse, BHV-3241 developed by Biohaven is currently undergoing Phase 3 trials, which is expected to be completed in December 2021. Meanwhile, ATH343 still has many years to go. Additionally, Alterity is operating at a loss of $15.3m during FY21 and the company only has $28.1m in cash as of 30 June 2021. It is clear to us that Alterity will need to dilute shareholders a lot further before all is said and done.

Therefore, while Alterity is certainly making great strides, we believe the company currently faces too much uncertainty and risk to warrant any other rating besides three stars.

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Share price chart

Source: Tradingview

Whack-a-mole will trillions at risk

As we have discussed constantly on Stocks Down under, the cyber world is like Russia after the Soviet Union fell: Huge profit potential, but you might get shot. On 4 October 2021 at 9:40 am, Check Point's ThreatCloud had already recorded 53,355,035 attacks so far that day. Everything and everybody are fair game these days with the top targeted industry for that period being the education sector, but it varies per day.

While individuals are heavily targeted these days, they are certainly not the only victims of cyberattacks; public and private organisations are under almost constant siege. Let's look at two of the more famous and recent examples.

The first was on 2 March 2021, when Microsoft detected a series of 'zero-day exploits' being used to attack on-premise versions of Microsoft Exchange Server. A zero-day exploit may sound like something the dashing hero will do in a movie, but in the cybersecurity world it's what villains do: create vulnerabilities in a piece of software that the original developers are unaware of, and therefore get 'zero days' to fix. As Microsoft raced to patch the exploits it had detected, and the hackers realised that the time for stealth had passed, the said hackers went into overdrive. An estimated 30,000 US-based organisations had their servers compromised, and information stolen, before the patch was released.

The second examble of a cyberattack hitting organisations rather than individuals was only announced yesterday. It relates to a 2019 incident where an anonymous source began sending an unheard-of number of documents to the International Consortium of Investigative Journalists. Yes, this is the same organisation that managed the reporting behind the Panama Papers. The data includes 11.9m documents taking up 2.94 terabytes of data, going all the way back to the 1970s in what is the largest leak ever. This leak is being called, rather aptly, the Pandora Papers. The documents have been hacked from 14 different firms, including Fidelity Corporate Services, Trident Trust Company (BVI), Commence Overseas, etc. Much like the Panama Papers, these documents cover offshore accounts and include 14 current heads of state, 21 former heads of state, over 130 billionaires, and many active and retired politicians. It is important to note that not everybody who has an offshore account is doing anything illegal. But one thing is certain - anybody can be hacked.

For more information on cyber security see our 5 June 2021 article How to play the Cyber Insecurity Trend.

Large growth, but is it enough?

WhiteHawk operates what it calls an online Cybersecurity Exchange Platform offering Cyber Risk Software as a Service (SaaS) and Platform as a Service (PaaS) products and virtual services for organisations ranging from Small and Medium Enterprises (SME) to the United States government. While we won't go over all of the products and services offered by WhiteHawk, they include cyber risk monitoring, quarterly review and scoring of those risks, alerts of cyber security risk across supply chains, and so on. In a nutshell, WhiteHawk allows an organisation to keep on top of its cyber security risks, from its supply chain to its daily operations, through monitoring, prevention and organisation specific planning.

While all of this sounds fantastic, WhiteHawk has unfortunately failed to turn its offerings into tangible earnings. During 1HY21, WhiteHawk generated its highest first half revenue yet at $1.5m. This was 13.7% lower than 2HY20's revenue generated, not a good sign, since cybersecurity is not seasonal. However, this can be explained by $742,530 in revenue during 2020 being generated through a gain on an equity swap agreement rather than proceeds from goods and services.

During 1HY21, WhiteHawk's $1.1m in revenue does represent an 86.5% increase year-over-year as the company has won a few contracts during the period. However, despite the gains, the company experienced an increase in its net loss of 12% to $1.4m. Despite the announcement that the United States Federal Government renewed WhiteHawk's risk radar contract and the company has partnered with Dun & Bradstreet in a co-sell agreement after 30 June 2021, we just don't see any concrete path towards profitability.

Dilution and no profit in WhiteHawk's future

As we mentioned before, WhiteHawk is currently operating at a loss of $1.4m for 1HY21. Unfortunately, this means shareholders are in for some significant dilution in the near future, as the company only has $2m in cash as of 30 June 2021. Additionally, WhiteHawk only has a trailing three month average daily volume traded of 1.3m shares. This would not be an issue if the stock was not currently valued at $0.165 per share, resulting in a daily average value traded of only $214,500. While this is certainly higher than some of the other stocks we cover in Emerging Stocks Down Under, it is important to note that a large portion of this volume was clustered around a few major trading days.

If the above issues were not enough, the stock is currently trading at a 12-month trailing EV/Revenue ratio of 11.2x. Even with the 86.5% year-over-year growth exhibited during 1HY21, we are far from certain this is a repeatable result and therefore, WhiteHawk is a two star stock, in our view.

Pitt Street Research Pty Ltd

95 Pitt Street, Sydney, NSW 2000, Australia

Pitt Street Research Pty Ltd provides issuer-sponsored research for Small & Mid Cap companies and is founded on more than 40 years of combined experience researching companies in a range of different sectors.

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