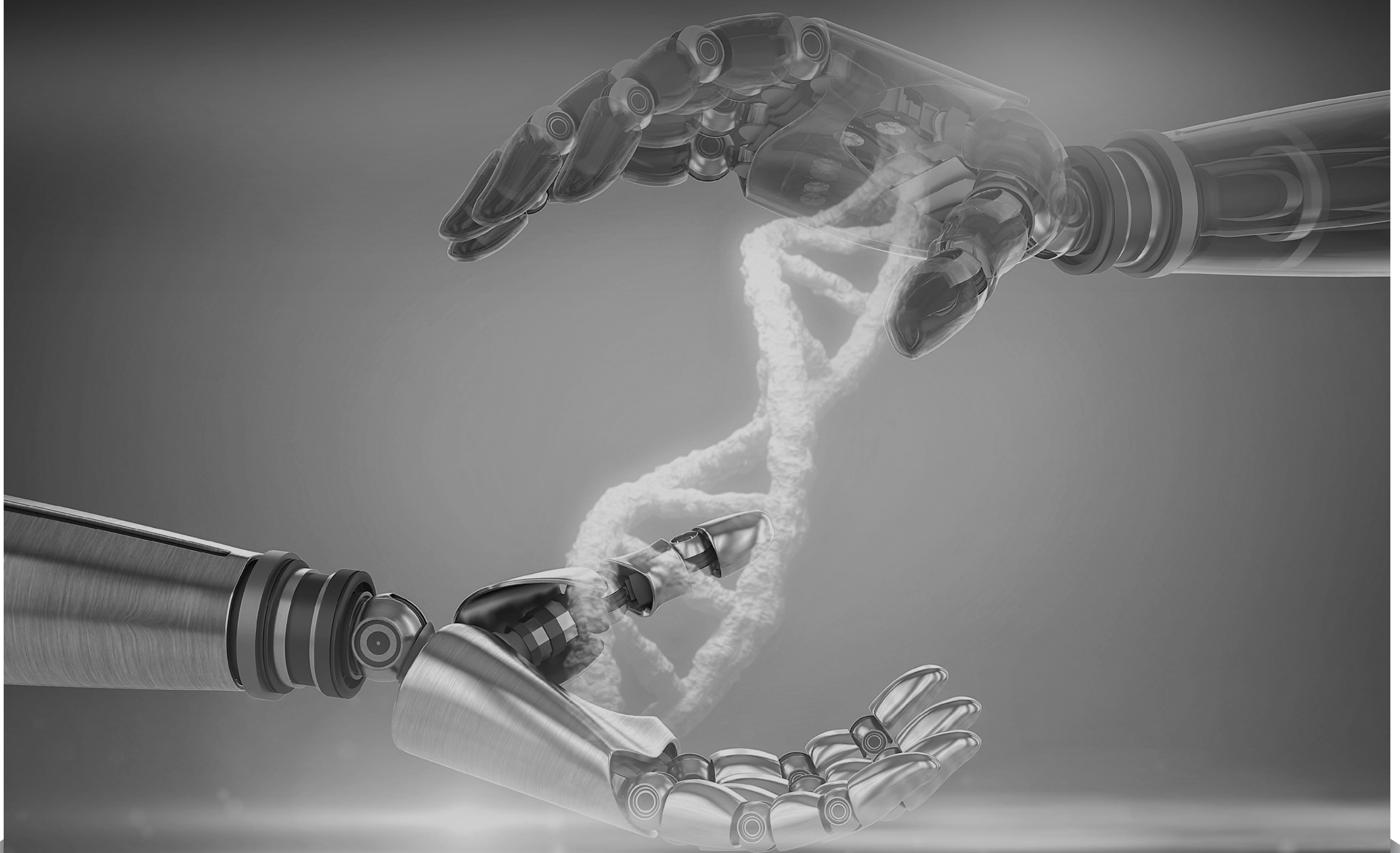
30 NOVEMBER 2021

Emerging Stocks Down Under

"Trying is the first step toward failure."

- Homer Simpson (b. 1987), American actor



NEARMAP

Medium term upside in a downtrend

CLARITY PHARMACEUTICALS

A clear winner

PACIFIC EDGE

The premium corner

NEARMAP

Medium term upside in a downtrend

Stocks Down Under rating: ★★★★

ASX: NEA
Market cap: A$787M

52-week range: A$1.52 / A$2.79
Share price: A$1.60

We last reported on Sydney-based Nearmap on 31 January 2020, making it one of the first companies to be covered by Stocks Down Under. At the time, the company's share price was plummeting following an earnings miss before COVID-19 hit. The stock was trading at $1.71 per share at the time of a more recent review and now the stock is in the middle of a new rout. It has dropped from its recent high of $2.26 and the question is whether Nearmap's shares, like its airborne cameras, can ever escape earth's gravity?

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CLARITY PHARMACEUTICALS

A clear winner

Stocks Down Under rating: ★★★★

ASX: CU6
Market cap: A$144M

52-week range: A$0.83 / A$1.71
Share price: A$0.90

Clarity Pharmaceuticals is a Sydney-based radiopharmaceutical company. It develops imaging products for the detection and treatment of various cancers. The company uses its proprietary SAR technology and is currently in the clinical stage with numerous products based on SAR that can be used to diagnose, stage and treat various forms of cancers. Formed in 2010, the company is slowly nearing the commercial stage and recently went through a successful IPO to accelerate product development.

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ASX: PEB
Market cap: A$963M

52-week range: A$1.15 / A$1.61
Share price: A$1.16

Based in Dunedin, New Zealand, Pacific Edge Limited focuses on developing tools for diagnosis and prognosis of various cancers. The company currently operates internationally, although most of its operations are concentrated in Australia, New Zealand, Singapore and the US (with the US having the largest share). The company has a lot of products under its Cx line that target bladder, colorectal, melanoma and endometrial cancers. With revenues surging, it seems that the company is finally on the cusp of profitability. However, despite it's very promising future, it may be too overpriced at the moment.

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Share price chart

Source: Tradingview

Airplane-based aerial imaging

Nearmap was founded in 2007 in the city of Perth by Stuart Nixon and it was in this same year that the company took its first aerial photographs. The company had an unusual path to an ASX-listing. In 2012, ASX-listed Ipernica acquired the company, making Nearmap the primary entity. The company has grown quickly, reaching $77.6m in revenue, but still operated at a loss after tax of $14.9m in FY19, right before COVID-19 hit.

So, what exactly does Nearmap due to generate tens of millions in revenues a year? At its core, Nearmap sells the most valuable commodity of our modern world, information. Nearmap provides organisations with a constant stream of up-to-date aerial images through a subscription service. Nearmap not only grants its clients access to standard images, but a whole range of imaging types, from 3D to geospatial.

The company manages to take these images on an ongoing basis through the use of its patented aerial camera system. Using small airplanes to fly over cities, towns, mining sites and other areas of interest, this system allows for images to be taken in significantly more detail (allowing exact measurements to be taken off the images) and faster than most other available alternatives. In today's world, up-to-date information is king and the organisation with the most up-to-date information is able to make better-informed and faster decisions. This is what Nearmap provides to its customers.

Turning technology to revenue

Nearmap operates on a subscription basis. Instead of selling or renting out its arial photography fleet, the company charges a fee to view its entire historical catalogue of data and images. The costs and benefits of each different subscription are confidential and unfortunately, we can only find estimates varying from $79 for a personal subscription (limited to 50mb per week) to between $500 to $50,000 for commercial subscriptions, e.g. for solar panel and utility companies. Nearmap has even developed an AI system to allow customers to plug Nearmap's data directly into the client's system, allowing new information to be automatically uploaded and requests for additional information to be handled quickly.

Upward potential in a longer term downtrend

Management believes that the best way to offer the market guidance into its future results is through its Annual Contract Value (ACV). During its AGM on 11 November 2021, management provided ACV guidance for the full year FY22, with ACV expected to be between $150m and $160m, on a constant currency basis. This would represent growth between 12.1% and 19.6%, as FY21's ACV came in at $133.8m (initial guidance was $120m-$128m), which wasn't very well received by the market judging by the more than 12% share price decline on that day.

If you are wondering how that translates to EBITDA, during FY21 it resulted in $24.3m in EBITDA (56.7% growth compared to FY19). During FY19, the ACV to EBITDA percentage was 14.6% and during FY21 it was 18.2%. Nearmap hasn't provided any EBITDA margin guidance, but if we use the average of the two (16.4%) we can estimate that Nearmap's FY22 EBITDA will be between $24.6m and $26.2m.

The market consensus has Nearmap's FY22 EBITDA at $23.1m. Using this market consensus, the FY22 EV/EBITDA ratio is currently 29.1x, which is very expensive if we just look at this year's EBITDA growth that is actually expected to be down 5% compared to FY21. However, looking at FY23, which starts in seven months, we can see the market is currently expecting an EBITDA growth of no less than 85%. Combine that with FY23's EV/EBITDA multiple of 15.7x, and a very different valuation picture emerges, i.e. at 0.18 Nearmap is very cheap on our beloved EV/EBITDA-to-EBITDA-growth metric.

Make no mistake, though. Nearmap stock is in a downtrend that started in June 2019 when it hit a high of $4.29. A week before the recent AGM, the stock touched the downward sloping resistance level at $2.30 and has since fallen below $1.60. Notwithstanding the current market turmoil that has rattled Tech investors in particular, we see medium term upside to a range of roughly $1.90 to $2.00, i.e. 20% to 25% upside for investors who don't shy away from a risky punt. For those daredevils, we think Nearmap is a four-star opportunity.

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Copper is used in medicines too

Clarity Pharmaceuticals uses various copper isotopes based on its proprietary SAR technology to diagnose and treat various diseases. SAR enables targeted 'theranostic' radiopharmaceuticals, with the copper-64 isotope being used for diagnosis and copper-67 for treatment.

SAR is highly targeted and only works with certain patients. A PET scan can reveal whether the isotope is targeting the tumour or healthy tissue. The copper isotope is kept in a chelator (bifunctional cage) to prevent it from leaking into the body. A targeting molecule then attaches itself to tumour-specific receptors on cancer cells, allowing the copper isotope to destroy the cancer cell through radiation.

The major competitive advantage of copper isotopes is that they can precisely target the cancer cells, but they are much more effective relative to other methods (according to tests and clinical trials).

The company's lead product, SARTATE, is undergoing Phase-IIa trials in Australia and Phase-I trials in the US. Phase-I is usually when a therapy is tested to ensure that it is safe for use. Phase-II massively expands its scope and makes sure that the therapy works. The company expects to conclude Phase-IIa in Australia in the next twelve months and expects to enter Phase-IIa in the US.

SARTATE is used to treat cancers with the Somatostatin Receptor 2, allowing the therapy to have multiple applications. And while SARTATE is the most advanced in its development, it is not the company's only therapy currently undergoing trials.

A wide pipe and a big IPO

SAR-bisPSMA functions in a manner quite similar to SARTATE. However, SAR-bisPSMA is used for diagnosing, staging and treating cancers that express the prostrate-specific membrane antigen. The therapy is currently in Phase-I in Australia and the IND-enabling phase in the US, which is essentially when companies provide data and seek approval to begin trials with the FDA.

The last therapy in the company's pipeline is SAR-Bombesin, used for cancers that express the gastrin-releasing peptide receptor. The therapy is currently in Phase-I in Australia and undergoing preclinical trials in the US. Clarity Pharmaceuticals expects its secondary targets to be ready to enter Phase-IIa in Australia and Phase-I in the US within the next twelve months.

Clarity Pharmaceuticals is also conducting undisclosed testing for multiple therapies, with one in the IND-enabling phase and the others at the beginning of preclinical trials.

We believe the company's strategy to run two concurrent trials, in the US and Australia, is a smart move, as data from the Australian trials can fast track trials in the US. On the other hand, the US trials can provide the company's therapies worldwide access as a seal of approval from the FDA carries a lot of weight with other drug administration authorities.

Clarity Pharmaceuticals listed on the ASX in August 2021, raising $92m at $1.40 per share, implying a market capitalisation of more than $358m at the time. The company plans to use the funds to focus on its US-based clinical trials and the development and testing of currently undisclosed therapies.

The company's share price has fallen slightly since the IPO. However, this is not due to any specific news released by the company. In fact, work on the therapies is continuing rapidly, with the company partnering with Evergreen Theragnostics, a US-based radiopharmaceutical contract manager, to manufacture Targeted Copper Theranostics for Clarity's US-based trials in September.

Pedal to the metal

The company's clinical trial results have all been positive so far. Considering that the undisclosed therapies are probably based on the SAR technology, we wouldn't be surprised to hear more good news from the company in the coming months.

It is still a few years away from commercialising its therapies and the risks with a product inserting a radioactive isotope in the human body are obviously very high. However, the commercial applications for a therapy that can target multiple cancers are enormous. That is why we believe the company is valued so high relative to other companies with similar pipelines.

Consensus estimates point to the company commercialising SAR in FY24, with expected sales of over $56m. Analysts expect the company to be profitable as soon as it achieves commercialisation, with FY24 EBITDA of around $23m and FY25 EBITDA of $125m (!). This means that the company is currently trading at about 9x FY24 EBITDA, making it an absolute steal. Importantly, 30 September 2021's cash balance was $101.7m on net cash outflows of $3.6m for the quarter, giving the company plenty of runway. Mind you, EBITDA for FY22 and FY23 is negative $18.5m and negative $22m respectively, so that cash position will dwindle substantially before the company becomes EBITDA positive.

These longer-term estimates place a lot of faith in Clarity Pharmaceuticals successfully launching its therapies within the next three years. Considering the risks associated with SAR and clinical trials in general, we would rate Clarity Pharmaceuticals a high-risk, four-star investment.

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Share price chart

Source: Tradingview

Let's begin with the bladder, shall we?

Pacific Edge has been around since 2001 and has been targeting cancer diagnostics since the beginning. The company only listed on the ASX in September 2021, trading exclusively on the NZX previously.

The company's primary product is Cxbladder, a non-invasive genomic urine test that makes use of gene expression markers and clinical risk factors to determine the presence of bladder cancer. Cxbladder has four different variants, each used for a specific use case.

Cxbladder Detect can use a tiny sample of urine to gauge the presence of bladder and urinary tract cancers. The test's competitive advantage is its accuracy and cost-effectiveness. Cxbladder Triage, on the other hand, makes use of numerous markers to accurately determine patients with a low probability of bladder cancer, thereby avoiding the need for urological evaluation.

Cxbladder Resolve is a product used for patients at risk of having aggressive bladder cancer. It is typically used in conjunction with other tests to determine which patients require or may require expedited treatment. Lastly, Cxbladder Monitor helps monitor patients with bladder cancer and can detect if the disease is recurring (the chances of bladder cancer recurring are very high).

Cxbladder began to make waves in the healthcare market in the early 2010s, with numerous agreements signed with provider networks in the US. Newer product variants were released as the decade passed, each adding a new use case for the product. Pacific Edge spent the last ten years bringing its products to as many markets as possible.

The time is now

Overall, it has taken the company almost twenty years to achieve its vision, but it seems Pacific Edge is finally there. By the beginning of 2021, the company had an extensive presence in Oceania, Asia and the US. The US is by far the company's largest market, accounting for 78% of sales in FY20. When Pacific Edge listed on the ASX in September 2021, it also detailed its plans to raise capital to the tune of NZ$60m (including a retail offer of NZ$20m) in order to accelerate the company's growth in the US.

While it has a first-mover advantage when it comes to urothelial cancer, Pacific Edge is still trying to branch out into other fields as well. For one, the company has plans to provide similar detection and monitoring services for colorectal cancer through Cxcolorectal, which is a prognostic gene signature used to detect stage II and III colorectal cancer. The product has successfully completed clinical trials in Europe and Pacific Edge is currently in the process of commercially launching the product.

The company is also currently conducting pre-clinical trials for products that can diagnose and manage gastric cancer and provide prognoses for melanoma. While the Cxbladder is the company's main product, and the only one that will drive growth in the short term, expanding the product pipeline should supplement this growth in the future.

The market is a bit overzealous

The problem with Pacific Edge is that it has been hitting all of its milestones and achieved widespread commercial success to the point that the stock's valuation is just too rich at the moment.

The company is currently valued at over $1bn, but looking at the numbers, that is simply not justifiable. For FY20, total sales amounted to NZ$4.4m and they increased to NZ$10.1m in FY21. They hit NZ$6.7m for 1HY22 (ended 30 September 2021), which is a 66% year-over-year increase. While that is a huge jump if you look at the percentages, the revenues pale in comparison to the company's market capitalisation.

Of course, valuations for high-growth companies are based on their future revenue and earnings projections. However, the consensus estimates do not paint a pretty picture right now. Pacific Edge is still losing money at a rapid rate (NZ$14.2m in FY21 and NZ$9m for 1HY22) and is a long way off from becoming EBITDA positive. Yet, the stock is valued at a whopping 30.4x EV/Revenue for FY23 and 14.5x for FY24. That is way too high for even the folks at Stocks Down Under who don't usually shy away from these types of companies.

While Pacific definitely has an edge in the market due to its first-mover advantage, we think this is a two-star stock at the moment due to valuation concerns.

Pitt Street Research Pty Ltd

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