STOCKS DOWN UNDER

7 DECEMBER 2021

Emerging Stocks Down Under

> *I wish the world was twice as big - and half of it was still unexplored.*
>
> - Sir David Attenborough (b. 1926), English broadcaster and author

LUMOS DIAGNOSTICS

Banking on FDA approval

RHINOMED

Stampeding towards profitability

CHANGE FINANCIAL

Time for a change

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Banking on FDA approval

Stocks Down Under rating: ★★★★

ASX: LDX
Market cap: A$137M

52-week range: A$0.77 / A$1.50
Share price: A$0.85

Headquartered in South Melbourne, Lumos Diagnostics IPOed on the ASX on 5 July 2021 at $1.25 per share, raising $63m. The company develops rapid point-of-care diagnostic tests, as well as proprietary digital readers. The company currently has three products on the market and an additional five in development. Unfortunately for early shareholders, the stock has done rather poorly since its IPO, diving 27.2% to $0.91 per share and while the market consensus calls for revenue to almost double to $45.7m by FY24, the company is expected to still be operating at a loss by that time.

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Market cap: A$73.6M

52-week range: A$0.10 / A$0.485
Share price: A$0.29

Headquartered in Melbourne, Rhinomed is a medical device developer that uses its family of over 60 global patents to sell and further research nasal related products and breathing solutions. Looking at FY21's earnings paints a less than favourable picture, especially when the stock is valued at 16.2x trailing 12-month EV/Revenue. However, this is a classic case of "past performance is not indicative of future performance". Instead of focusing on FY21's revenue and profit figures, we need to look closely at events subsequent to FY21.

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Share price chart

Source: Tradingview

The products driving the Lumos train

Fast, accurate and cost-effective testing has been in the spotlight since COVID-19, but the need for these products and services existed well before the pandemic and spans the entire medical industry. For example, one of Lumos Diagnostics' three active products is FebriDx, a rapid test that can not only tell if a patient has a microbial infection, but also if it is viral or bacterial.

Over the last decade, one of the major concerns by the world-wide medical community has been antibiotic overuse. Over time, the diseases treated by antibiotics build up resistance to certain treatments. How quickly this resistance is developed and how widely it will spread is determined by how frequently antibiotics are used, especially if there is no need for them. According to the World Health Organisation, "antibiotic resistance is one of the biggest threats to global health, food security and development today", and "antibiotic resistance occurs naturally, but misuse of antibiotics in humans and animals is accelerating the process". Antibiotics should only be prescribed if the infection is bacterial in nature and will be useless if it is viral.

The rapid test developed by Lumos Diagnostics has the potential to not only speed up the diagnostics process, but also help eliminate unnecessary antibiotic prescriptions. This is a top priority for the worldwide healthcare community, especially in the United States where the majority of FebriDx revenue is expected to be derived (revenue is currently only generated in the UK, Germany and Canada).

Lumos has also developed a rapid COVID-19 Antigen Test Solution called CoviDx. The test has been confirmed to work with all variants so far discovered and sales have already been generated in Europe.

The third product is a proprietary, digital Point-of-Care (PoC) test reader. This product includes a mobile application as well as a digital system to read the results of the test. We would be surprised if this grew to become a standalone product and while we think it will be an important revenue driver going forward, we expect only existing clients will be interested.

An overview of future growth

Before we dive into the regulatory updates since Lumos released its FY21 results, we need to briefly go over the company's current product development pipeline (an additional four are in the early feasibility stage). Currently, Lumos has five products in development. Management has not released a timeline for the full commercialisation of its pipeline products, although ViraDx is slated for regulatory submission during FY22.

ViraDx is being developed as a rapid test for influenza A, B or COVID-19. FebriDx Multi-Use and FebriDx Digital are being developed as multi-use versions of Lumos' FebriDx product. UriDx is a rapid test for patients who potentially have a urinary tract infection. And lastly, SepsiDx is a test for potential bloodstream infections.

Unfortunately, on 22 September 2021, Lumos released some disappointing new to the market. It seems the United States Federal Food and Drug Administration (FDA) had deprioritised the company's request for an Emergency Use Authorisation (EUA) for CoviDx. To be clear, this is not a denial of CoviDx's overall application, but it does mean that it is not going to be fast tracked by the FDA. The United States is a major market for these kinds of tests and the delay is certainly not good news for Lumos shareholders when the company is not expected to generate a profit for at least the next three years (more on that later).

Additionally, the FDA deprioritising CoviDx's review process is a strong indication to us at Stocks Down Under that the market is likely already heavily saturated with competing products. Therefore, we believe it is unlikely that CoviDx will have an easy time gaining market share in the future. As we mentioned above, CoviDx is already available for sale in the European Union through a CE Mark approval and on 3 November 2021, the company announced it was now approved for sale in Canada as well.

The Lumos train is still a few stops too early

During 1Q22, Lumos used $7.9m in cash for operating activities (management forecasts $5.5m in future quarterly cash burn). Combine this with a one-time $23.4m financing activity left the company with $24.6m in cash as of 30 September 2021. Unfortunately, the current market consensus has Lumos generating an EBITDA loss of $12m during FY22, $8.8m during FY23 and $3.2m during FY24. Importantly, FY22's EBITDA loss is based on expected revenue of $25.7m, growing 2.8% year-over-year and Lumos made no announcements of significant contract wins. The market expectation that revenue will almost double to $45.7m by the end of FY24 seems to hinge on FebriDx being granted US FDA approval during FY22 and Lumos quickly winning large contracts following that approval. But there is certainly no guarantee that the US FDA will grant approval, so this is a key risk for the company, and investors.

Still, Lumos shares are trading at FY22, FY23 and FY24 EV/Revenue multiples of 3.4x, 2.6x and 1.9x, respectively, which we believe is very reasonable for a, potentially, high growth company that is already generating revenues. So, for those who are willing to take a punt on FebriDx being granted FDA approval in FY22, Lumos might be of interest. Therefore, we are giving Lumos a four-star rating, but keep in mind that if the US FDA decision goes against the company, investors will be in for a world of pain.

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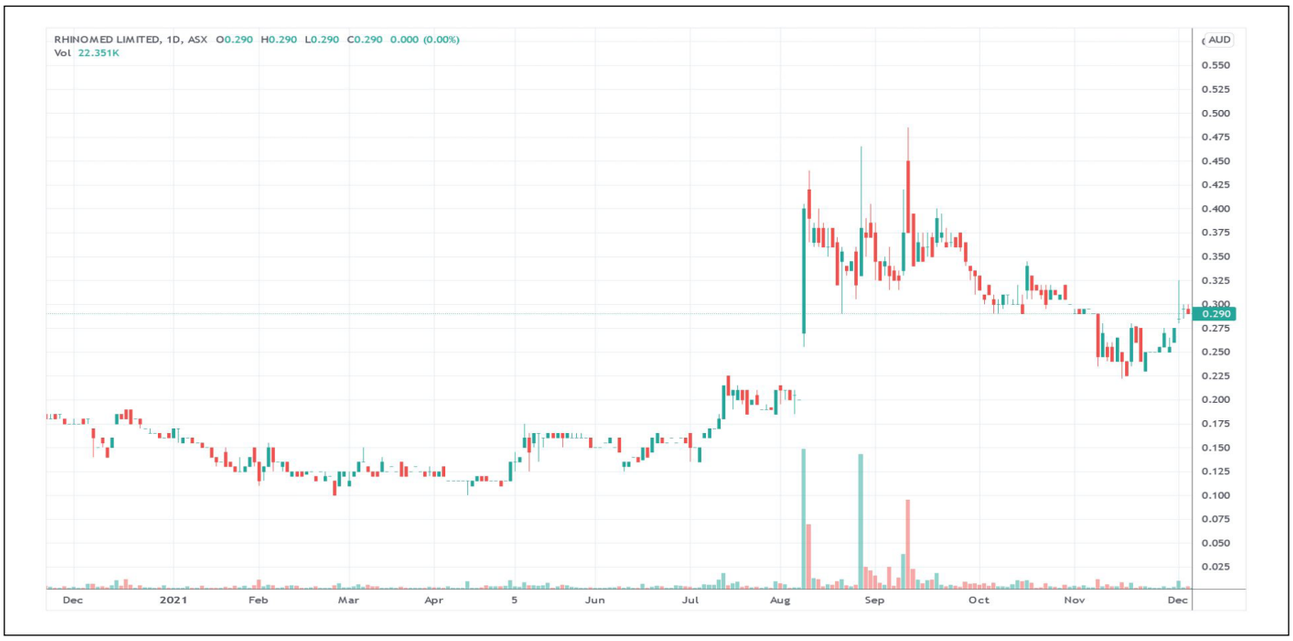

Source: Tradingview

The nose knows

Rhinomed's best-known product is called Mute, a nasal breathing device that is designed to allow for increased airflow through the nose while sleeping. The small, medium and large packs retail for $29.95 and include three devices good for 30 nights.

Along similar lines is Turbine, except instead of being used while sleeping, Turbine is for use while exercising or for focused breathing. Similar to Mute, the product also comes in small, medium and large packs with three products good for ten uses each.

The third product is Pronto, a rechargeable (up to ten times) vapor inhaler that has two forms, sleep and clear. Clear uses six essential oils to help clear a stuffy nose while sleep uses four oils to help people relax and sleep. Both of these products sell for $27.95 for both the small and medium sizes.

Rhinomed's latest product is Rhinoswabs, which is not available for retail customers, but is sold to governments and the medical industry. These swabs allow for the collection of nasal test samples for COVID-19 testing and comes in two forms, standard and junior. Before we dive into what makes the swabs unique, it is important to know that both of these swaps are approved for sale in Europe, the United States and Australia. What sets these swabs apart from the many competing products is the larger surface area for collection and the dual swab heads. The design cuts down on discomfort, time (both nostrils are done at the same time) and pain drastically. The junior model is also designed to have fun aspects like smiles and

moustaches that sit on the child's face while inserted. As anybody who has gotten a swab knows, it can be a rather painful experience, so we can imagine there is strong demand for a quicker, less painful swab for adults as well as children.

Rhinomed is operating at a loss, and a rather considerable one at that. After generating $4.7m in revenue during FY21 (FY20: $4.4m), the company ended up with a net loss after tax of $8.6m (FY20: $7.3m loss). However, if you remove the $2.3m total increase in marketing, employee and research and development expenses, the company's loss would have declined by $917,525. With a growing catalogue of medical products and devices, we believe this shows that the increase in Rhinomed's operating loss was a strategic decision, rather than evidence of a declining business.

During FY21, the company had four products on the market with at least 66.7% of FY21's sales coming from three US-based customers. It is important to note that, while not named, management made it clear all three companies are large, which means there is room to grow sales at these companies. Obviously, losing a big customer is potentially a big risk if you have three of them accounting for two-thirds of sales. Therefore, Rhinomed is actively looking to diversify its revenue base.

How we know FY22 will see significant growth

All of these products and devices sound great, but revenue still only increased 6.8% year-over-year during FY21. So, why should we care? Well, as we mentioned in the introduction, instead of focusing on FY21's revenue and profit figures, we need to look closely at events subsequent to FY21. The first thing we want to cover is the difference between 1Q22's revenue and sales orders. During 1Q22, Rhinomed generated $1.7m in revenue, an impressive 41.7% increase year-over-year. This revenue increase was driven by a combination of Rhinoswab sales and a 210% increase in Mute shipments in the United States over the last 26 weeks as the product has risen to become the #1 internal nasal dilator in the US. However, what is truly impressive are the company's sales orders that reached $4.2m during 1Q22 alone. Keep in mind that Rhinomed generated only $3.9m in revenue for all of FY21.

With the Australian Victorian government placing an order of 1m Rhinoswabs on 10 September 2021 after a 1m order was placed by the NSW government on 11 August 2021, we expect Rhinoswab to see significant growth during FY22. And when we combine this with the company's other product lines, it seems that FY22 will be a year to remember for Rhinomed investors.

How's the valuation?

So, we know how substantial FY22's growth is shaping up to be, but how is Rhinomed's valuation? In the absence of broker forecasts all we have to go by is the company's trailing 12-month EV/Revenue of 16.2x, which is extremely high. However, as we have seen, in the past quarter Rhinomed raked in orders that exceeded last year's total revenues. So, with three more quarters to go in the current financial year, it's fair to assume a very substantial jump in revenues, which would bring down the forward EV/Revenue multiple quite a bit. Additionally, with Rhinoswab sales just starting to ramp up, we expect the company will see attractive revenue growth in the next few years. Rhinomed is four stars in our book.

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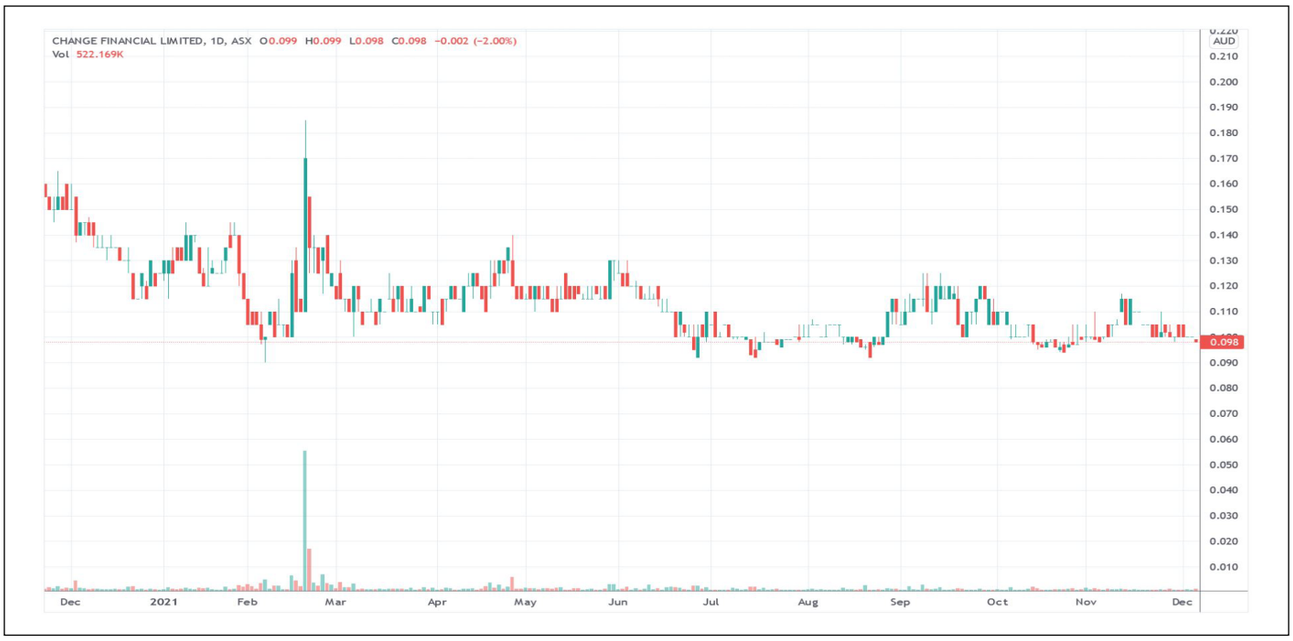

Source: Tradingview

Processing what its processes

Change Financial has two main products generating a total of US$6.3m in revenue in FY21: Vertexon (60% of annual revenue) and Paysim (35%). But what exactly do these two products do? Starting with the company's main breadwinner, Vertexon, this product is effectively a white label payment platform that is currently used by ME Bank, BDO and UpChange. If you don't know what white label means, let us explain. Vertexon has three main customers: ME Bank is a fully digital bank that currently operates as a subsidiary of the Bank of Queensland (ASX: BOQ | see 20 September 2021 report). If the Bank of Queensland rings a bell, it's because it has been one of our favourite turnaround bank stocks at Stocks Down Under for over a year now. But back to ME Bank, the company uses Vertexon's platform to issue over 450,000 card products and to allow a copy of the physical card to be stored in all common digital wallets, like Apple, Google and Samsung Pay. BDO Unibank (OTCMKTS: BDOUY) is the Philippines' largest bank and uses Vertexon's platform for its Buy Now Pay Later (BNPL) offering. Lastly, UpChange is a prepaid Mastercard-based offering by the Central Bank of Kansas City, an FDIC registered United States bank. All three of these company's take the Vertexon platform and, to put it simply, pay for the right to slap their name on it as well as pay for maintenance and upkeep.

Paysim is in many ways the opposite of Vertexon. Instead of facilitating transactions, Paysim puts a client's payment platform through rigorous testing to ensure that all systems are in compliance, in working order and can process transactions at adequate speeds. This system is also used to test any new features or other products in development before they are released to the public.

While we don't have a revenue breakdown by region for each major product, we do have an overall revenue breakdown by region and we believe it is important to briefly mention. During FY21, the biggest part of Change Financial's revenue was generated in Southeast Asia (46%). A further 26% of total revenue was generated in the Oceania region, 17% in LATAM, 8% in the United States and the remaining 3% was classified as rest of the world.

We have lift-off

In a move that we hope will see a drastic increase in customer diversification, as well as revenue growth, on 10 November 2021 Change Financial announced an expansion of its Paysim product, Paysim API. Paysim has already seen wide adoption, currently being used by over 130 different banks and fintechs in over 30 different countries. PaySim API is scheduled to launch during 2Q22 and is currently being client-tested by a 'Big Four Australian bank'. The new API system is just one of the new features Change Financial is planning to roll out for PaySim, and we believe it will become a vital addition to the software as it facilitates the automation of load, stress and regression testing making clients' lives significantly easier. With the wide range of adoption, foot already in the door with a major Australian bank and additional features in the pipeline, we are quite bullish on PaySim's future prospects for FY22 and FY23.

Ready to breakout

Change Financial's shares have been trading mostly sideways for the last three years and the stock is currently valued at a trailing 12-month EV/Revenue multiple of 3.9x, which we believe is a bit expensive for a stock that isn't growing too fast, i.e. 4.5% growth in Annual Recurring Revenue (ARR) from 4Q21 to 1Q22. Remember, ARR isn't sales, but it's an indication of full year sales in the next twelve months.

However, the company may be on the right track with PaySim. With the launch of PaySim API slated for the end of 1HY22 we are expecting a series of new client announcements during 2HY22. In other words, the market may be underestimating FY22's full year ARR and total revenue growth potential. Although the last three years haven't been great for shareholders, we are willing to give Change Financial the benefit of the doubt given the PaySim API launch. So, this is one is four stars for the true believers.

Pitt Street Research Pty Ltd

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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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