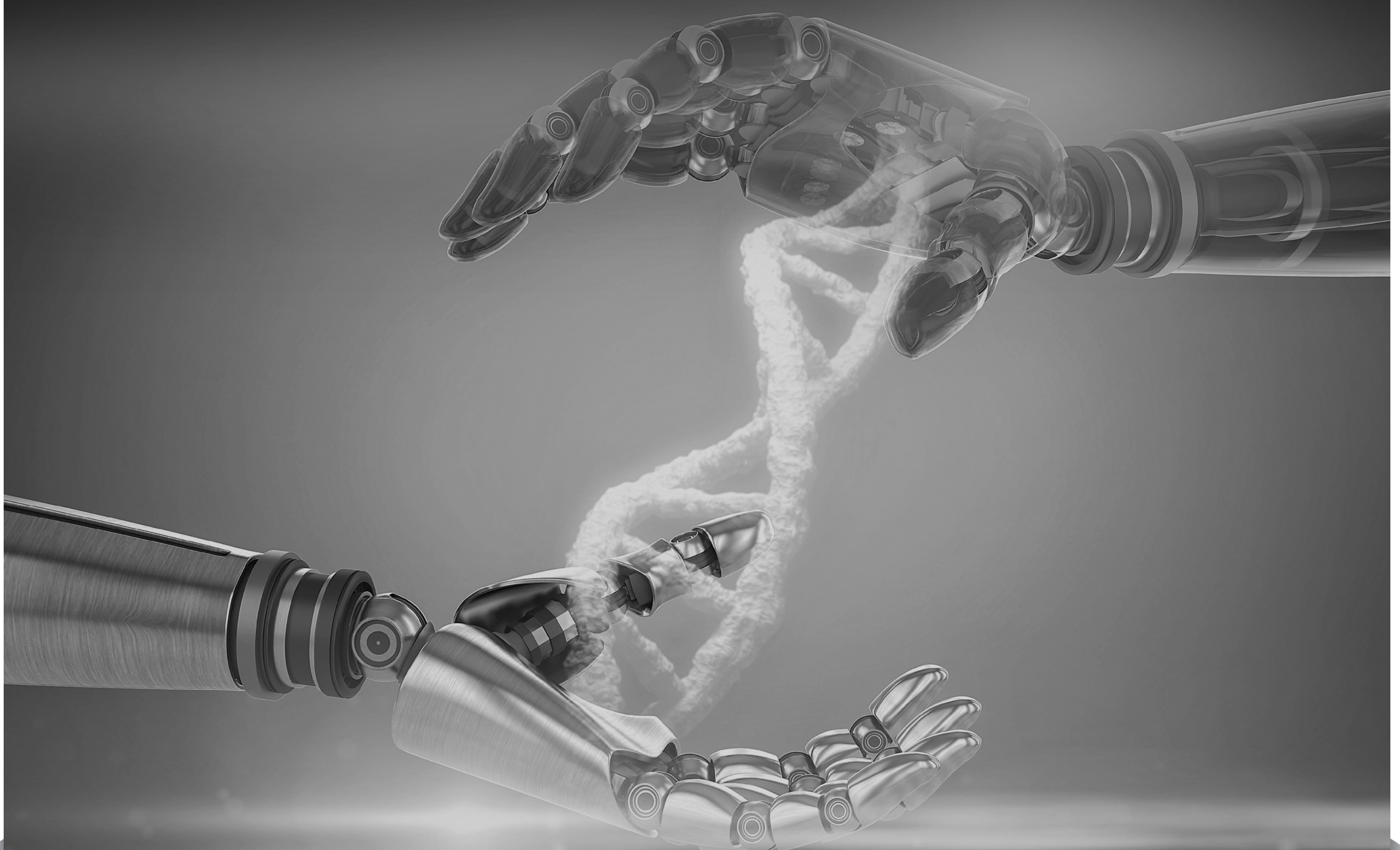
STOCKS DOWN UNDER

18 JANUARY 2022

Emerging Stocks Down Under

"I remixed a remix, it was back to normal."

- Mitchell Lee Hedberg (1968 - 2005), American stand-up comedian



HEXIMA

A new approach to an old problem

VONEX

Don't let its small size fool you

MOQ LTD

Headed for the Cloud

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A new approach to an old problem

Stocks Down Under rating: ★★★★

ASX: HXL
Market cap: A$68.2M

52-week range: A$0.14 / A$0.50
Share price: A$0.41

Headquartered in Melbourne, Hexima was one of the last clinical-stage biotechnology companies to list on the ASX in 2020. The IPO funded development of Pezadefide, now in Phase IIb clinical development for the treatment of onychomycosis, that is, fungal nail infections. While clearly not the sexiest of topics, onychomycosis is a large area of unmet medical need. Sure, onychomycosis is far from an untreatable disease, but Hexima believes that it has found a niche. You see, Pezadefide not only quickly and topically fights the infection, but it is plant-based. Full commercialisation of Pezadefide is still a few years off, but with a market capitalisation of $68.2m and a major capital raise recently completed, we believe Hexima is worth a look.

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Market cap: A$38.3M

52-week range: A$0.105 / A$0.325
Share price: A$0.115

For an established economy like Australia, there sure are a lot of fast-growing, upstart and niche telecommunications service providers. Perth-based Vonex’s niche is its focus on Small and Medium Enterprises (SMEs), and it has a strong track record of using acquisitions as a springboard for growth. What’s also interesting about Vonex is the market interest: This company has only 26.2% of the market cap of Pentanet, another Perth-based telecommunications upstart, but it has 25.5% of Pentanet’s three-month average daily value traded. Sure, $62,400 a day is far from Telstra-style liquidity, but someone is clearly paying attention.

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Share price chart

Source: Tradingview

A brief overview of terms

Before we dive into Hexima and its products, some background on a drug's clinical development. Phase II clinical trials are broken into Phase IIa and Phase IIb. Phase IIa is a highly limited study to prove 'clinical efficacy'. In other words, Phase IIa trials are proof of concept. Phase IIb trials are where we start to get to the heart of the matter. Here, the optimal dose is tested in a much larger trial, also known as 'definite dose-finding'. Suppose the Phase IIb trial works. In that case, a Phase III trial can get up and running, and that's where the big money starts to get close because usually Phase IIIs are what is needed before a drug can gain regulatory approval.

Assuming Hexima can move Pezadeftide beyond Phase IIb, how large is the potential market? Significant, as it turns out. According to Hexima, onychomycosis affects between 10% and 14% of the global population. And, according to a report by Mordor Intelligence forecasting the global onychomycosis treatment market's growth between 2021 and 2026, in 2020, the market was worth US$2.7bn and is forecasted to grow to US$3.8bn by 2026 (5.8% compounded annual growth rate). To narrow that down a bit, Hexima estimates that approximately 70% of annual onychomycosis scripts in the United States are for topical products. And that's good because Pezadeftide is a topical solution.

Dilution is out of the way for now

Hexima owns a vast library of Australian native plant material and extracts, and it uses this phytological database to develop plant-based protein and peptide technologies. Pezadeftide is just the first of these but it's now maturing into a serious drug candidate. According to Hexima's 1Q22 report, the results from the current Phase IIb are expected in the second quarter of 2022. The trial has recruited across 14 sites in Australia and New Zealand, but the United States is the holy grail of drug developers and the authority of America's FDA is recognised worldwide. This is why if Pezadeftide's Phase IIb trial is granted a clean bill of health, the company plans to run its Phase III trial in the United States, under the FDA's oversight.

As Hexima is pre-revenue and years from commercialisation at the earliest, it should come as no surprise that shareholders will be diluted along the way. In FY21, Hexima generated a loss of $6.9m and ended 1Q22 with $1.2m in cash. Fortunately for those looking to invest, the pain is already gone with a $10m capital raise for institutional investors finished on 1 November 2021 and a Share Purchase Plan (SPP) of $1m to retail investors. Accounting for these two raises leaves Hexima with slightly under two years of runway in the best case and slightly over one year in the worst case in our estimation.

Looks inexpensive

Since Hexima does not have any revenue and is unlikely to for a few years, we cannot use earnings estimates to generate a 'fair value'. What we can do is look at other clinical-stage biotechnology companies we have covered, and on that measure this one looks investable. Consider Neuroscientific Biopharmaceuticals (ASX: NSB | see 25 May 2021 report). That company has one drug in Phase I clinical trials and, at the time of our report, was valued at $43.8m. Sure, there's a $24.4m difference in valuation here, and Neuroscientific's drug has a much larger potential payout. But Neuroscientific's drug is also significantly riskier, dealing with the Central Nervous System, and that's even before we consider it's only in a Phase I trial. If Hexima is years away from commercialisation, Neuroscientific is at least double that. Therefore, we believe at $68.2m, and with its Phase IIb results due within the next six months, Hexima is worth a serious look. Four stars, but we would note that we see the company range trading from a technical perspective until its Phase IIb results are announced.

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What can a $38.3m company do?

What can a $38.3m company do? It turns out, quite a lot. Vonex provides both retail and wholesale telecommunications services, generating $18.3M in revenue in FY21, up 43% year-over-year. The retail telecommunications division did half of that but only grew 7%. This business provides prosaic stuff like telephony (focusing on Cloud-based virtual phone services and generating 64.9% of divisional revenue), internet (27.7%) and hardware (7.5%). The way this division operates is rather standard and straightforward, selling Vonex's products and services directly to Small and Medium Enterprises (SMEs).

The wholesale telecommunications division is where the action is at for Vonex. This part of the company generated $8.8m in revenue in FY21, 120% more than in FY20. The growth was across all four service lines: telephony (generating 26.1% of divisional revenue), internet (55.7%), hosted PBX (17.6%) and hardware (1%). Hosted PBX is Vonex's proprietary Cloud-based phone system and it's been a huge favourite with customers over the years. The difference between wholesale and retail (besides switching hosted PBX with cabling), is that wholesale sells its services on a 'white label' model. For those not familiar with the concept, a white label allows a company to place its name and logo on Vonex's services, claiming it as its own.

Significant cash does not equal no dilution

If it is not yet clear why the market is paying so much attention to this tiny telecommunication services provider, perhaps the 30 September 2021 cash balance will help clarify things. As of the end of 1Q22, Vonex had a whopping $10.3m in cash. Yes, that's right, as of 1Q22, Vonex had 26.9% of its total market capitalisation in cash. That's a great war chest for further acquisitions. Management views acquisitions as a vital part of Vonex's growth strategy, and when Vonex is acquiring, it's not just buying customers, it's buying businesses with a distinct competitive advantage or opportunity, usually technological or geographic in nature, that can benefit its customers in new ways. Consider the recent Direct Business and Voiteck acquisitions as good examples.

The Direct Business transaction, announced in August 2021, will see 5,250 new business customers move onto Vonex's platform (to be completed in 2HY22). But the potential for new business is the most exciting part of these new customers. According to management in its 1Q22 report, only 4% of those customers currently purchase mobile and 27% purchase an internet product alongside PBX. Compared to its existing SME customers, where 18% purchase mobile and 56% purchase internet services, management is confident it can close this gap.

The Voitech acquisition was announced on 14 December 2021 and completed on 5 January 2022. The purchase price was $2.2m in cash and 4,983,246 shares issued at $0.11. However, the sale price will rise by $2.75m (in cash) if specific EBITDA targets are met in FY22 and FY23. Voiteck adds additional clients to Vonex's book - approximately 10,000 new PBX users, for example - bringing the total to over 90,000. But the 'springboard' rationale behind the acquisition was the company accelerating its geographic expansion. You see, Voiteck had an established (and physical) presence in Adelaide's CBD. Why go through the process of setting up an operation when you can easily co-opt one and gain control over an EBITDA profitable operation at the same time?

Expanding outside of its home territory

Vonex has revenue and EBITDA forecasts for FY23 provided by only one analyst tracked in S&P Capital IQ's database. The analyst places FY23's EBITDA growth at 29.7% ($8.3m), assuming FY22 can generate the company's first EBITDA profit of $6.4m from FY21's loss of $2.4m. In our view, FY22 generating an EBITDA profit of $6.4m is more than reasonable, especially after the acquisition of Voiteck's EBITDA profitable operation ($600,000 on a trailing 12-month basis as of 14 December 2021).

Vonex now has two major markets to expand into, and we expect additional South Australian-based acquisitions before FY23 is over. Therefore, even if Vonex's FY23 EV/EBITDA multiple were 20x, we would rate the stock four-stars. But the FY23 EV/EBITDA multiple is only 4.3x, exceedingly below what we would consider fair value, especially considering the last three month's average daily liquidity of $62,400. One suspects the share price will follow the liquidity shortly. Four stars.

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Old horse, a new race

Founded in 1990, MOQ Limited's early years were during the Dotcom Bubble, helping businesses adopt and integrate digital technology. MOQ must have done something right because it is still around a generation later. Starting in FY19, it shifted its focus from traditional technology sales and refocused on the Cloud and cyber security.

Cloud computing allows files and software to be accessed remotely from anywhere with an internet connection. This feature not only removes the need for organisations to have large amounts of onsite computer storage but enables collaboration across multiple locations. So, it comes as no surprise that it's an industry that has been growing at a rapid pace over the last few years. A Research and Market's report published on 10 August 2021 forecasts the global Cloud computing market to grow at a Compounding Annual Growth Rate (CAGR) of 19.1% between 2021 and 2028 to US$1.3tn.

To help organisations facilitate this change from local to Cloud, MOQ has invested heavily in creating a close partnership with Microsoft. If this is putting all your eggs in one basket, the odds favour it. You see, Microsoft (NASDAQ: MSFT) is the world's second-largest Cloud services provider, with a 19% global market share. This puts it right behind world leader Amazon Web Services (AWS), which has managed to capture 32% of the global market with a seven-year head start. Many people who buy or sell things on Amazon (NASDAQ: AMZN) are yet to realise that AWS is considered to be Amazon's most valuable asset, not the online retail platform that got it all started.

With Windows already the Operating System (OS) of choice for most businesses, Microsoft has a considerable advantage over AWS that has helped Microsoft's Azure Cloud service grow faster than AWS for at least three years now. When the Australian government looked to streamline Cloud access across its federal agencies in 2019, it chose Microsoft Azure, not AWS. We believe this decision can help Microsoft Azure become the Cloud platform of choice for Australian enterprises large and small in the years ahead.

Our heads are not in the Cloud…yet

MOQ has had to invest significantly to change its focus to Cloud services and is working hard to become an accredited Microsoft Specialisation Partner and Azure Expert. In August 2019, MOQ acquired Wardy IT Solutions for $7.5m, and in July 2021 it acquired Dienst Consulting for $3.8m. Wardy helped MOQ expand its Microsoft product data analytics. The Dienst acquisition has allowed MOQ to push into the Western Australian market and expand its cyber security division. To finance the Dienst acquisition, MOQ sold Skoolbag, its school communication app, to Skilligence in September, as that app was no longer core to the business.

Despite the COVID-19 lockdowns, only 55% of Australian businesses are currently using Cloud services, according to the latest information from the Australian Bureau of Statistics (ABS). That's a huge opportunity for MOQ. So is the opportunity with government agencies. With the Queensland Treasury as a client, we believe MOQ is in a strong position to grow in this space.

Another area that MOQ has been working hard on expanding is recurring services revenue. Winning additional government contracts would be an important step in this regard, since government agencies usually don't change providers easily. In FY21, the company grew recurring services revenue 8.9% to account for 30.7% of total revenue ($71.1m).

Is profit on the horizon?

MOQ's Cyber Security operations will become its own line of business next year alongside the existing Digital Services and Foundation Services lines. Last year thousands of Australian businesses were targeted by China after Australia called for an independent inquest into the origin of COVID-19. Tensions with China don't look like they'll ease any time soon, and we believe that this area will see significant growth in the next decade.

MOQ's net loss after tax was effectively flat in FY21, declining slightly from an adjusted net loss of $1.3m (excluding $13.3m one-off impairment expense) in FY20 to just below $1.3m (not adjusted), on the back of 9.1% revenue growth to $71m. Most of this growth was driven by a 14% increase in Cloud and digital services revenue. EBITDA (excluding FY20's impairment) grew 18% to $3.4m, so profitability doesn't seem far away.

It's not a one-horse race

Although MOQ looks well placed to benefit from the shift to a more digital workplace, it is by no means the only player in the game. In fact, pretty much every competitor in this space saw the Cloud coming and shifted focus long before MOQ did. For a good example, consider Empired (see 20 April 2021 report), recently acquired by Capgemini. That company, profitable for the last two years of its independent life, grew off the back of a Microsoft partnership. Empired's revenue was $186m in FY21, which represented 12% year-over-year growth – a little faster than MOQ's FY21 growth. Other homegrown competitors to MOQ have been acquired, most notably ASG Group, which was bought by NRI, a Japanese IT consulting firm, for $350m in 2016.

So why can MOQ succeed? Well, it's not just big enterprises in Australia that need the help it can provide. It's smaller ones as well. The businesses that MOQ has acquired all have established relationships, and it's reasonable to expect MOQ to be able to leverage off that base. If it succeeds, the upside for the shareholders will be significant. There's no consensus numbers available, but using FY21's numbers, the company is only trading at the moment at 0.4x EV/revenue and 9.2x EV/EBITDA. That's low for this kind of company and we believe it accommodates the risk. So, it's four stars from us.

Pitt Street Research Pty Ltd

95 Pitt Street, Sydney, NSW 2000, Australia

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