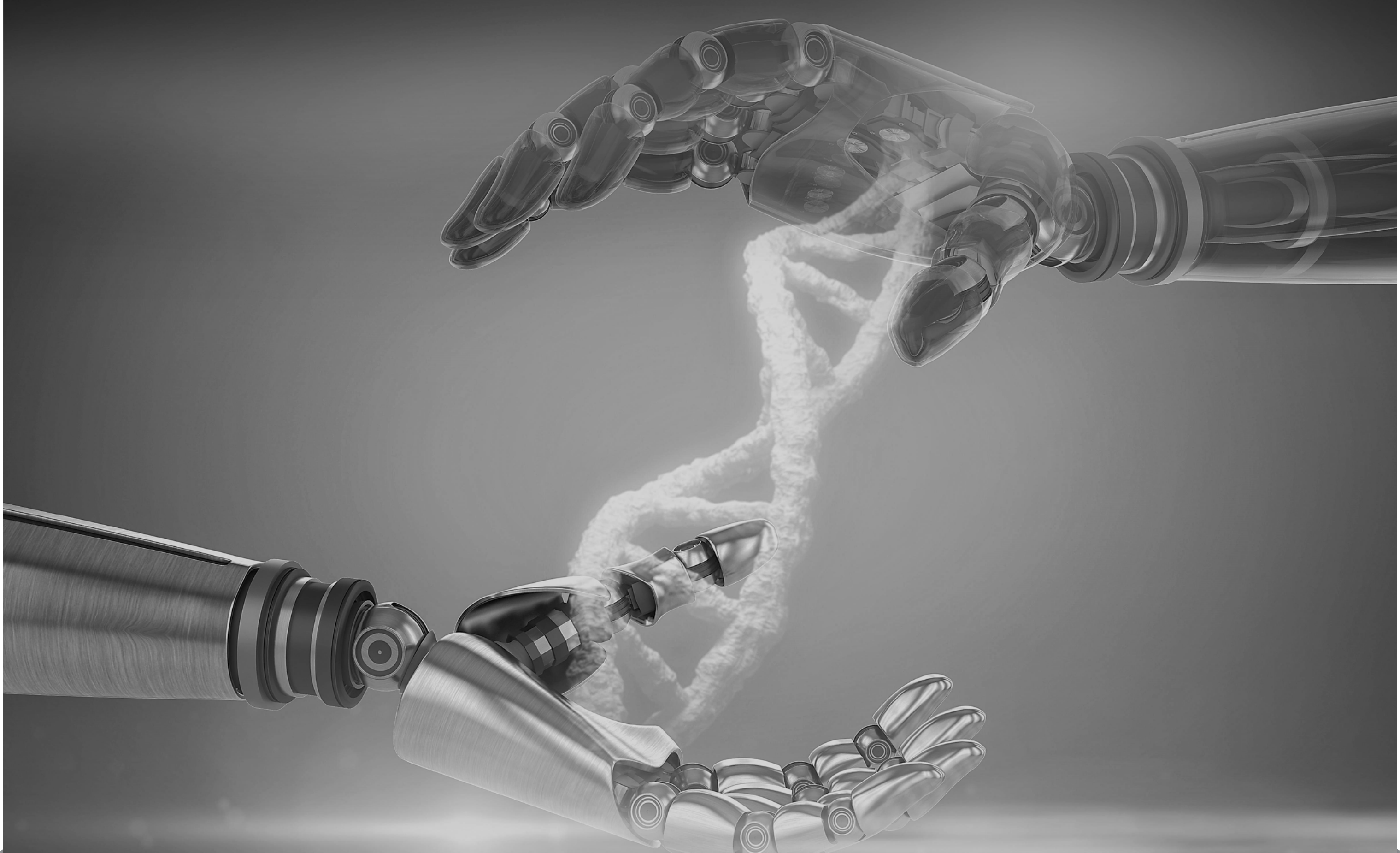
STOCKS DOWN UNDER

25 JANUARY 2022

Emerging Stocks Down Under

> *"Given an infinite universe and infinite time, all things will happen. That means that every event is inevitable, including those that are impossible."*

- Neal Oliver, character in the 2002 American independent road film 'Interstate 60'



ANTERIS TECHNOLOGIES
Expect a minor correction

BIRDDOG TECHNOLOGY
A risk, but a calculated one

ARCHTIS
The foundation is set

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Stocks Down Under rating: ★★

ASX: AVR
Market cap: A$189M

52-week range: A$4.25 / A$18.52
Share price: A$17.10

Brisbane-based Anteris Technologies develops artificial heart structural components. Last year was mostly uneventful for Anteris shareholders, at least until mid-December when the stock suddenly jumped 62.5% to $13 per share. The jump seems to be related to an Underwriting Agreement for 1.8 million options exercisable at $8 per share by 18 December 2021. Why did this agreement make the market so happy? It meant Anteris was funded for at least another year.

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52-week range: A$0.56 / A$0.76
Share price: A$0.58

The Melbourne-based BirdDog Technology listed on the ASX on 20 December 2021, after raising $33m at $0.65 per share. The company had exhibited remarkable growth in FY20 and FY21, and the IPO capital is expected to supercharge this growth into FY22 through various marketing, manufacturing, supply chain and engineering initiatives. BirdDog is a video technology developer with a strong portfolio of products already for sale. And yet, without any company forecasts or market estimates, we need to determine if with a trailing 12-month EV/EBITDA multiple of 58.1x, the market is getting BirdDog's signal loud and clear, or if things are too fuzzy.

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Share price chart

Source: Tradingview

Making hearts stronger

The famous American poet Emily Dickinson once said, 'the heart wants what it wants - or else it does not care'. Those words were written regarding love, but there's one thing we would argue the heart wants above all else…to keep beating. Anteris Technologies has made it its mission to help the heart keep on beating for as long as possible by developing artificial structural components.

Anteris has a long and rather complicated history, but we will start in 2011 when the Allied Healthcare Group was formed by merging Allied Medical and bioMD (formerly ASX: BOD). In 2013, the company rebranded for the first time as it acquired Verigen Australia, becoming Admedus. Finally, after the CardioCel and VascuCel product portfolio rights were divested in late 2019, the company changed its name to Anteris Technologies. The main purpose of this transition was to focus on its new structural heart products based on a technology called ADAPT.

ADAPT helps the heart adapt

In April 2020, a scientific journal called Frontiers in Paediatrics published Performance of the ADAPT-Treated CardioCel® Scaffold in Pediatric Patients with Congenital Cardiac Anomalies: Medium to Long-Term Outcome (received 30 September 2019). A mouthful, to be sure, but stick with us. This paper reports follow up from a Phase II study of CardioCel, the product which originally put Anteris on the map. CardioCel is bovine tissue engineered so as not to calcify when you put it inside people. That's a big deal in the tissue repair space. Anteris's investigators had taken 25 kids with 'paediatric congenital cardiac defects' – they were born with structural problems in their hearts - and repaired those defects with CardioCel. The investigators then went back a decade later – that's right, ten whole years – and found no graft failure, no thromboembolic events, no infections or device-related reinterventions and, importantly, no calcification. That's amazing because ordinarily when you put animal tissue inside people, there's a natural buildup of calcium that quickly renders the implanted tissue worthless. Anteris's foundation ADAPT technology allows animal tissue to be prepared so that this never happens.

Now you might be thinking, why are we talking about CardioCel when that product portfolio's rights were sold off in late 2019? CardioCel was indeed sold to LeMaitre Vascular (NASDAQ: LMAT), but Anteris kept the underlying ADAPT technology platform and process rights. So, ADAPT remains important to long-run growth in shareholder value.

The company has continued to expand ADAPT's certified applications. In June 2021, management announced the completion of a Proof of Concept (POC) animal test study for using ADAPT treated conduits in the carotid artery in coronary artery bypass (CABG) surgery. The POC found no evidence of calcification or inflammation.

Performing a CABG surgery can be a tricky process to begin with, as it is essentially creating a new pathway for blood to move through the body, bypassing areas that are blocked or obstructed. The carotid artery is one of the larger arteries in the human body, and, therefore, the conduits come under more pressure than in other areas of the body. This is why the lack of calcification and inflammatory responses is so promising. Anteris started a larger animal study in 2021, and while you can never be certain about the outcome of a clinical trial, we look forward to reviewing the results.

Most recently, in early January 2022, Anteris filed for patent protection for what it's calling 'ADAPT 2.0'. This new patent covers better way to sterilising tissue that allows for its safe transfer to the manufacturer. CEO Wayne Paterson explained in the announcement that 'ADAPT 2.0 will allow expanded manufacturing capacity of DurAVR at additional sites by starting the process in our Australian facility and completing valve manufacturing at our US facility, saving significant time and money in the process'. As we will go into more detail later, if there is one thing Anteris needs, it's cost savings.

DurAVR helps the heart pump

DurAVR is Anteris's Next Big Thing after CardioCel. AVR stands for Aortic Valve Replacement and Anteris has ADAPT-based products that it believes can be a breakthrough in this space. DurAVR originated when Anteris created the world's first and only '3D single-piece aortic valve'. In an early October 2020 presentation for the European Association for Cardiothoracic Surgery, management laid out the results of its First-in-Human study. The results provided that the single piece required fewer stitches, was easier to handle, and reduced the time it took for a patient to recover, removing the need for an ICU stay.

Why should investors be excited about this? Because it's now possible to cheaply and easily fix the valves that helps keep blood flowing in the correct direction through the heart. Aortic valve replacement alone could be a US$8bn market by the middle of the current decade, and Anteris has the application a lot of cardiologists and cardiac surgeons have been waiting for. On top of this, a whole portfolio of valve repair products has since developed around Anteris's technology: DurAVR Leaflet Repair (RP), DurAVR Transcatheter Heart Valve (THV) and DurAVR Surgical Heart Valve (SHV). The SHV system is under development for three valve replacement applications: stentless Aortic (First-in-Human trial), stented Aortic (POC trial) and stented Mitral (POC trial).

While we have not heard anything more recent on the SHV or RP systems, in November 2021 management announced it had successfully implanted five Transcatheter Aortic Valve Replacement (TAVR) patients with the THV system. This First-in-Human trial aims to assess the THV system for treating severe aortic stenosis. The seven-day follow-up stated that all five patients had their performance status labelled 'excellent'. We would label that an excellent start, but we still have a long way to go before commercialisation.

Commercialisation is finally closing in

Anteris does earn revenue from LeMaitre for its use of ADAPT in its CardioCel and VascuCel products, and the manufacturing agreement was recently extended to July 2023. While this is good news, it does not significantly help Anteris' considerable cash burn rate. Over the first nine months of 2021, net cash used in operating activities was $13.4m, leaving the company with $4.7m in cash as of 30 September 2021. The good news is that the necessary dilution has already occurred. In late October 2021, management announced the placement of 625,000 new shares at $8 per share. It also secured an agreement for Evolution Capital to fully underwrite $14.6m in $8 per share expiring options. Combined, this indicates the company is currently sitting on approximately $13.4m in cash - assuming 4Q21 used the same amount of cash as 3Q21.

In our view, Anteris is clearly on the right track with several promising products now working towards clinical development. All reports have released positive results, and, while it difficult to predict how clinical trials will go, the good news is Anteris does not have all its eggs in one basket.

Regarding its valuation, Anteris has a total market capitalisation of $189m, offering a trailing 12-month EV/Revenue multiple of 30.7x. While the extension of the manufacturing agreement is a promising step in the right direction, we don't expect the valuation to improve until another product is brought into commercialisation. And unfortunately, we don't have a time frame for this. The stock has recently rallied rather hard, and with the need for additional dilution likely within the next two quarters, we expect a period of pullback over the next two to three months. So, while we are fans of the company, we believe this one should remain on the investor's watchlist until the pullback is complete. Check back in a few months, but for now, this one is two stars.

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Share price chart

Source: Tradingview

Video technology is far from its final form

If you thought video technology was in its final form, BirdDog Technology is here to tell you to think again. This company's proprietary NDI technology has led to a 55-page catalogue of cameras, audio visual products and editing software that is available to buy today. NDI helps connect all of a consumer's systems, devices, and applications for the easy sharing of video, audio, and data. Impressively, NDI works across Windows, Mac and Linux software applications through free-to-download NDI software tools. But NDI and BirdDog's products are far from its final form, and one of the IPO's main goals was to help further research and development.

The BirdDog IPO, as we noted above, raised $33m at $0.65 per share. All this capital will fund the expansion mechanisms rather than repaying large debt levels. In fact, the $14m in current borrowings as of 30 June 2021 were all converted into equity at the IPO, leaving BirdDog with no other debt as of the IPO.

Growth capital

So, what exactly was the purpose of the IPO? In the first year, management estimates $19.8m of the money will be spent, with the vast majority ($11.2m) allocated to inventory build-up. Working capital gets $3.1m, research and development (includes product engineering and design) gets $1.8m and $1.9m will cover the costs of the IPO. The remaining $1.8m is split between marketing, regulatory, manufacturing and Intellectual Property (IP) management. The second year will see the remaining $13.2m spent with the majority going to inventory build-up, again ($6.3m), with $3.4m for working capital and $1.3m each for research and development and manufacturing development. The remaining $1.1m will be spent mostly on marketing, IP management, and regulatory management.

What does this tell us about management's two-year outlook for BirdDog? Well for one, BirdDog is far from finished developing its product portfolio. For another, it's clear that BirdDog believes its strong revenue growth story from the last two years is far from over. At the end of FY21, management had $9.2m in cash, $6.2m in finished goods and $5m in deposits on inventory (30% deposit with suppliers). Despite all this, management clearly believes it needs to spend 53% of the capital raised on additional inventory, rather than marketing (4.5% of capital raised).

High value and low liquidity

Sure, BirdDog only recently did its IPO, but liquidity has very quickly dried up. Since its IPO, average daily value traded has dropped to $193,800 (using 24 January 2022's closing price). While this is certainly not as low as most of the other companies covered in Emerging Stocks Down Under, $193,800 max traded in one day is no help when there is a rush out the door.

The question we need to answer is how quickly we can expect EBITDA to grow over the next few years. BirdDog is currently valued at a trailing 12-months EV/EBITDA multiple of 58.1x, indicating the market is expecting strong growth.

We expect FY22's growth to be along the lines of FY21 as we don't believe the company experienced stay-at-home related buying. Additionally, BirdDog continues to spend a large amount on research and development. While we are pleased to see that, the portion of capital from the IPO that management has slated for inventory in the next 12-months indicates to us that demand continues to be strong. But with no exact management guidance or market forecasts and such a high EBITDA multiple, there is certainly risk here. But if you have the stomach for the risk, BirdDog is certainly worth a punt, in our view. Four stars.

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Share price chart

Source: Tradingview

The ABCs of ABAC

ArchTIS was founded in 2006 but did not list on the ASX until September 2018, when the company raised $8m at $0.20 per share. With the price closing on 24 January 2022 at $0.205 per share, it would not be unreasonable to think the company has done nothing of note since its IPO. However, a closer examination of ArchTIS' operations shows that while the company has only knocked off just under $1m from its net loss after tax since FY19 (FY19: $3.9m | FY21: 3m), the foundations for future growth have been set.

But before we dive into all of that, let's review the products and services ArchTIS provides. The company's product suite offers secure collaboration tools to share data without worrying about leaks or unauthorised access. The company uses an Attribute-Based Access Control (ABAC) model that allows organisations and individuals to limit access based on specific criteria. Think of it as governmental security clearances utilised by intelligence agencies and personnel. In fact, Australian defence and intelligence organisations form a large percentage of the company's client base.

The company couples the ABAC model with secure cloud-based storage and tailor-made solutions that allow both public and private organisations to manage organisational security according to their liking. After the launch of Kojensi (the company's flagship information collaboration and sharing platform) in April 2019, its first two major clients were the Australian Attorney-General Department and the Australian Criminal Intelligence Commission. This remains an important part of ArchTIS' product portfolio, but the company is far from sitting on its laurels.

In the fast-paced cyber and information security world, those who don't constantly innovate and improve will lose out. Therefore, we were extremely pleased to see that on 9 December 2021, management announced the launch of Kojensi v2.0. The improved version of ArchTIS' flagship product includes new features like an in-app secure document viewer (which enforces read-only viewing), expanded granular search and classification controls, and a simplified set-up. But in our view, the most important feature, improved integration points, helping 'future proof' the product by creating an easy pathway for future technology integrations.

If it's good enough for the military, it's good enough for you

For security-focused software companies like ArchTIS, Australia is a fantastic proving ground. In FY21, revenue jumped 743% year-over-year to $4.6m, and sure, FY20 did see a decline in revenue due to COVID-19, but even if we compare this to FY19, the results are still impressive, with revenue increasing 350%. This growth was mostly on the back of several Australian government contract wins, proving there is still room to grow in Australia. Still, ArchTIS needs to gain a foothold outside of Australia to more quickly reach profitability. We believe the company has a strong case to make to international organisations based on its success in winning Australian government contracts. When we spoke to ArchTIS, the company summed up its pitch with the phrase, 'If it's good enough for the military, it's good enough for you'. That's a sentiment we can agree with.

Management is aware of this need for international growth and, in October 2020, made its first big move by acquiring Nucleus Cyber. ArchTIS believed it could sell its existing products to Nucleus Cyber's existing clients and Nucleus Cyber's product to its existing ones. And it believed the acquisition would provide an international foothold. Out of the $4.6m in revenue generated in FY21, $2.4m was generated through Nucleus Cyber's NC product, all within 2HY21. This was in part due to management's major update to NC and to an initiative that made NC compatible with an ArchTIS product called Kojensi. The Nucleus Cyber also allowed ArchTIS to enter into a Microsoft IP Co-sell deal, and a new United States-based Federal and Defence business unit was created. On 3 November 2021, management expanded the Microsoft partnership by making NC products available on the Microsoft Azure Marketplace.

Before we dive into describing a second acquisition of ArchTIS's, a bit of background: European organisations do not like using Microsoft encryption products due to the company's exposure to United States security laws. The privacy laws in the European Union are significantly more robust, and the United States has more-or-less smashed European trust when it comes to respecting data privacy. ArchTIS is well aware of this, and to help facilitate its European expansion, the company bought Cipherpoint's European software division on 20 September 2021. The reason for purchasing this division was twofold. Firstly, it allows the company to keep its European client's encryption keys in Europe, satisfying those who would not purchase it through Microsoft. Secondly, ArchTIS management believes the company can upsell its Cloud-based technology to Cipherpoint's clients. When we consider management's track record of predicting upsell success with its Nucleus Cyber acquisition, we are happy to take the company's word for this.

The foundation for expansion is set

1QY22 saw a continuation of FY21's strong growth, as revenue climbed 287% to $1.6m and gross margins increased 72% to $1.2m. 1QY22 was an important quarter in our view, as it showed that the foundations for international expansion set in FY21 were solid. If we were to annualise 1QY22's revenue, it would result in 39% annual growth, but we already know that FY22 will likely see growth a lot higher. On 28 October 2021, management announced it had won a contract with an Australian National Intelligence and Law Enforcement agency that will generate $449,570 in revenue. The contract has $241,500 worth of recurring revenue and is set to expire on 28 October 2022, with a five-year extension option. It is important to note that the announcement says it expires on 28 October 2021, but when we called the company, we learned it was supposed to say 28 October 2022.

ArchTIS may be riding high in revenue terms, but it is far from cash flow positive. It used $3.4m in net cash from operating activities in 1QY22, leaving 30 September's cash at $8m. The good news is that the coming dilution has already happened, as the company raised $8m in November at $0.23 per share. This gives the company approximately a year's worth of runway at its current cash burn rate. This is, however, a worst-case scenario, in our view. While we don't expect ArchTIS to become profitable within a year, we do expect its losses to continue to decline rapidly. Therefore, with a trailing 12-month EV/Revenue multiple of only 9.2x, ArchTIS is, in our mind, a clear four star growth stock.

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