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Market Analysis

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June 2021 Australian Tax Loss Selling Update

The "*Tax Loss Selling*" investment strategy is based upon the theory that depressed shares can become *even more depressed* towards the end of June under selling pressure from investors seeking to realise losses (to offset against capital gains and minimise taxes) and that those depressed shares will then bounce back during July and August.

This can offer both a short term trading opportunity (i.e. buy depressed shares in June and sell in August) and depressed June prices could also be a good time to buy attractive shares as long term investments.

We ran a scan of all listed Australian shares using the following criteria: (1) the shares have fallen 60% from their annual highs (i.e. investors may have large unrealised capital losses, making these "tax loss" selling candidates), (2) a market capitalisation less than $500 million (although many are much smaller) and (3) with at least one (net) *insider* Buy trade over the last year.

The first two criteria could select a lot of *failed* or *failing* companies, while the *insider* Buy criteria should eliminate the very worst of these.

We then subjectively examined these shares looking for better quality companies. The selection that follows includes a number of out-of-favour, depressed shares in potential high growth companies . . . which could bounce back over the next couple of months but could also be suitable to hold as long term growth investments!

In addition to the shares discussed below a few of our *Recommended Portfolio Shares* - **Cynata Therapeutics** (CYP), **Greenland Minerals** (GGG) and **Integrated Research** (IRI) - also meet our criteria. So any share price weakness over the last week and a half of June could be an attractive opportunity to add to positions in these holdings.

Anglo Australian Resources (codeAAR)

Anglo Australian Resources is a rather depressed Gold Explorer. The company raised $11 million in a share placement at 17 cents in September 2020 and a further $854,000 in a *Share Purchase Plan* at the same price in October.

The company is drilling the *Mandilla East* and *Mandilla South* deposits, in May announcing a maiden Mineral Resource of 15.6Mt at 1.0 g/t Gold for 500,400 ounces. This "demonstrates large-scale open pit potential". Both deposits are open and expected to grow as assay results are received (from 9,498m of RC drilling and 2,655 m of diamond drilling) and with further drilling.

The company also owns the *Feysville Gold Project* (2.9Mt at 1.3 g/t Gold for 116,100 ounces). Combined, these two projects bring the company "closer to the critical mass necessary to evaluate an integrated gold mining and processing operation".

Cash on hand is currently $11.1 million (1.9 cents per share, 25% of the current share price) but the shares have lost almost 70% of their value since 2020 highs.

Obviously there are high risks in Gold Exploration, the main one being the need to issue new shares to finance further exploration (and later development), although the company is soundly financed at present and the current cash holding could finance activities for 5-7 years!

Bid-Ask: 7.5-7.6 cents. Last trade 7.6 cents.

Atrum Coal (code ATU)

Atrum Coal was planning to develop a high quality Hard Coking Coal mine in Alberta, Canada (for use in steel production) . . . but the government announced a review of its coal mining policies in February. The market now prices Atrum Coal shares as if the company has no future and no value. That may be true . . . but this is not a ban on coal mining but a *review* with the stated objective of "a new, modern coal policy that provides greater certainty and considers the potential development of metallurgical coal resources in a responsible and sustainable manner".

There is - at present - no alternative technology to produce iron and steel, other than in a blast furnace with ion ore and coke (from coal). Some companies are investigating the use of green hydrogen (in place of coke) but that technology is not yet commercially viable . . . and would require significant expansion of renewable energy electricity. Many news reports talk about China closing blast furnaces and "producing" steel in Electric Ark Furnaces (EAF), but an EAF recycles scrap iron and steel, it does not produce new iron/steel.

A *Coal Policy Committee* is currently seeking to design a "new coal policy" and will produce a report later this year.

Atrum Coal has reduced expenditure, suspending all on-site activities (other than on-going environmental studies) to maintain cash. At 31 March the company held cash of $4.9 million (0.8 cents per share).

This is a very depressed share that has already lost most of its value. At least one institution has dumped all of its shares. Investors may have, or could sell, before the end of June to realise tax losses, so the shares are likely near their lows this month . . with a potential bounce during July and perhaps a recovery later this year when a new coal policy is determined?

Bid-Ask: 4.5-3.9 cents (suspended but likely to trade again from Tuesday). Last trade 4.7 cents.

Aumake Ltd (code AUK)

This is a company that has repeatedly re-invented itself, both evolving its business and going through a series of name changes (and ASX codes)! Finding the right business model is never easy, especially in a changing environment.

The basic model is to sell Australian (and NZ) products to Chinese consumers. At one stage the company had physical stores in Australia and New Zealand, targeting sales to Chinese tourists. Then they added online sales. Now, with Covid-19 killing the tourist trade, the company is closing some of its physical stores. The current focus is on building its new Chinese *social e-commerce platform*.

The company raised $7 million in December from a placement at 6.0 cents. Cash at 31 March was $6.7 million (1.3 cents per share - 50% of the current share price).

The company has over 40,000 Chinese users on its database and will help Australian brands promote products to these consumers via "influencers". At present the company offers about 400 products (35% of sales are milk products and infant formula, 31% Health Supplements) but seeks to expand its product range (e.g. to include fresh fruit and seafood) and other services (e,g. real estate, education).

China has a large, growing middle class consumer market, so the potential rewards of successfully marketing to this sector could be great. There is no guarantee that Aumake will succeed but (1) they are willing to adapt and embrace new technology and (2) investors can now buy into this company at *very depressed* prices!

Bid-Ask: 2.5-2.6 cents. Last trade 2.5 cents.

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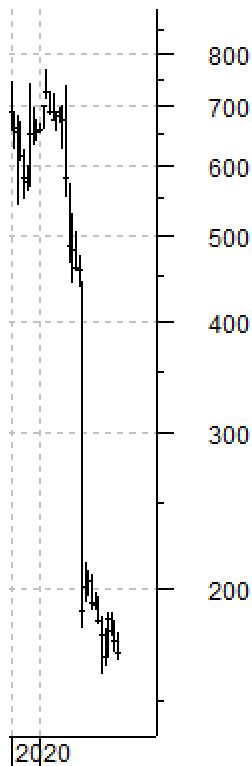
CleanSpace Holdings (code CSX)



Here is a story of extremes (all compressed into less than a year): Highs and low of valuation as the shares ride the investor emotional "roller coaster" and booms and busts in demand, revenues and profits,

CleanSpace Holdings makes respirators for healthcare and industry. Here are all the "good" and "bad" things you need to know about the company:

The company offered 29.8 million shares at 441 cents per share in an Initial Public Offering in October 2020. Only $20 million (15%) went to the company and $112 million (85%) went to existing investors who were partially selling out. That is "bad". When IPO proceeds go to existing investors (rather than to the company to finance growth and expansion) the shares usually perform poorly.

Ignoring this, investors saw a company that would benefit from Covid-19 PPE sales. On the first day of trading on the ASX, the shares traded as high as 744 cents (up 69%). That is also "bad". Excessive optimism and euphoria often coincide with the market peak. The shares did hit a new high of 769 cents in early January . . . but have since moved lower . . . significantly lower.

The half year to 31 December 2021 saw revenues up 446.6% to $39.7 million and a net profit of $13.0 million (16.9 cents per share), compared with a small loss in the same period a year earlier. The net operating cash surplus was $20.8 million, lifting the cash holding to $42.4 million (55.1 cents per share). This is all "good".

The cash holding is effectively the (unneeded and unspent) $20 million raised in the IPO plus the $20.8 million cash operating surplus. A new manufacturing facility "required minimal capital expenditure" and the business has "low capex (capital expenditure) and working capital requirements". CleanSpace has no debt. That is all "good". The company is not capital intensive and does <u>not</u> need to re-invest profits (i.e. cash) to grow the business. That cash can be used (eventually) to pay dividends, repurchase shares and/or to make acquisitions.

CleanSpace's new manufacturing facility (and after Covid-19 it will close its old facility) is capable of supporting $100 million in annual sales (from one shift working five days per week). So the business has "good" scaleability (i.e. could operate multiple shifts, if required).

51% of revenue over the last half year was from respirators and 49% (historically 40-50%) was from consumables. This is a "good" business model, with consumables providing recurring revenues which are probably less volatile than up-front respirator sales.

In March, CleanSpace shares were added to the All Ordinaries Index. That is usually considered "good" as index funds will need to buy the shares.

March quarter sales, however, were "bad" at only about $7 million. That is down 65-70% on the first half . . . with the share price also falling over 55% in one day. Of course, neither the "boom" first half nor the "bust" March quarter were normal trading periods.

In April, Independent Chairman R Weinberger purchased 24,200 shares on-market at 206 cents, lifting his holding to 74,654 shares. *Insiders* are the most knowledgeable investors so we consider on-market buying to be "good" and indicate good value in the shares.

So, the IPO sellout (at 441 cents) by existing investors and the high valuation placed on CleanSpace were not attractive, but the company has an excellent business model, recurring revenues and growth potential. Revenues and profits are, of course, rather volatile in the current environment. The company is debt-free, cashflow positive and holds <u>$42.4 million (55.1 cents per share) in cash</u>. That is 32% of the current share price in cash!

This all indicates the shares may now be at the opposite end of the investor emotional cycle. Some investors who bought at 441 cents in the IPO (or up to 744 cents and 769 cents on-market) may even seek to "cut their losses", "give up on a loser" and sell - realising a loss (which can be offset against realised gains to save tax) or perhaps with the intention of "buying back cheaper later".

To us this looks like a soundly financed, growth company, with some volatility, whose shares look very depressed. We will buy for a bounce during July/August . . . and then probably continue to hold as a long term investment!

Bid-Ask: 170-171 cents. Last trade 170 cents.

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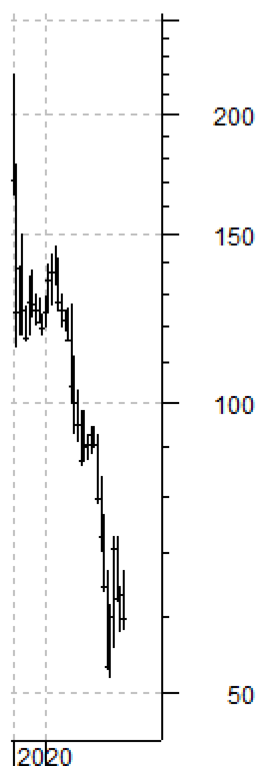
MyDeal.com.au Ltd (code MYD)



This is another recent IPO with huge emotional swings in investor sentiment! The IPO in October 2020, raising $40 million (i.e. $35 million to the company, $5 million to existing shareholders) was priced at 100 cents but the shares traded as high as 220 cents on the first day. Since then they have trended down to a recent low of 51 cents and currently trade around 59½ cents.

The company operates an online marketplace specialising in household goods from independent sellers, but seeks to build its own private label products sales.

Key performance indicators show the business is growing strongly: March 2021 quarter gross sales were $44.7 million, up 105% on the March 2020 quarter. Nine month year to date sales were up 177% at $171.4 million. Active customers (i.e. who have made a purchase over the last year) grew 157% over the last year.

The March cash operating *deficit* was $2.3 million, bringing the nine month year to date cash *deficit* to just $2.5 million - so the business is not yet cashflow positive (mainly owing to high expenditure on advertising and marketing to grow the business) but is certainly not "bleeding" cash. Cash on hand is $48.15 million (18.6 cents per share, 31% of the current share price).

Half year revenues to 31 December 2020 were up 248.3% at $21.2 million. This consists of sale commissions and other income from third party products sold, 181.5% higher at $17.1 million plus initial private label revenues of $4.1 million. There was a *loss* of $2.3 million (*minus* 0.9 cents per share), compared with a $774,443 profit in the same period a year earlier. The loss, however, is explained by a 319% increase ($10.6 million) in advertising expense to grow the business.

There are clearly risks in any high growth business, but MyDeal.com.au could be a soundly financed, attractive growth business whose shares are trading at a depressed price.

Bid-Ask: 59.0-59.5. Last trade 59.5 cents.

Oncosil Medical (code OSL)

Oncosil Medical seeks to *commercialise* its treatment for pancreatic and bile duct cancer. This involves injecting radioactive Phosphorous-32 gel directly into the tumour. This produces "more concentrated and localised beat radiation" that acts directly on the tumour.

Phosphorous-32 has a very short 14 day half-life, so decays very quickly. Beta particles can penetrate only about 1 cm in the body, so the radiation is localised with little impact on healthy body tissues. The Phosphorus-32 is manufactured in Germany but can be easily transported (as a "dangerous good" but with no special restrictions).

The *Oncosil* "device" is approved in the UK, Europe, Australia, New Zealand, Singapore, Malaysia and Hong Kong and seeking approval in the United States (together with HCPS codes for funding).

Private patients will provide some revenue and cashflow, but to fully *commercialise* this "device" will require *public* health care funding . . . and that will first require a randomised trial to compare the *Oncosil* treatments against a control group. The timeline for this is uncertain and Oncosil Medical is *hoping* that a European health agency (e.g. **GBA** in Germany or **ZIN** in the Netherlands) will sponsor such a study. The **FDA** will also require a randomised clinical trial.

For the six months to 31 December 2020, "device" revenues (all from New Zealand) was $95,576. There was a *loss* of $4.7 million.

The UK is expected to become the largest market for private patients (from 15 hospitals - with nine fully approved to provide this treatment - in London and Manchester). Switzerland, Luxembourg and Germany may also see some private sales. Cash at 31 March was $15.2 million (1.9 cents per share) but, unless revenues grow rapidly, this would fund operations for about another 18-24 months (i.e. further capital raisings are likely).

Bid-Ask: 5.9-6.1 cents. Last trade 6.1 cents.

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VIP Gloves (code VIP)

This is a small - but very rapidly growing - manufacturer of nitrile (synthetic) rubber gloves from its factory in Malaysia.

The annual global demand for rubber gloves is about 500 *billion* (and expected to grow at 12-15% over the long term) while global production is only 420 billion. With a supply *deficit*, glove prices have risen strongly over the last year, from under US$40 (per thousand) a year ago to US$50 in the September 2020 quarter, US$67 in the December 2020 quarter and US$80 in the March 2021 quarter.

Around 80% of the company's production cost is nitrile latex raw materials. Higher demand for gloves, owing to Covid-19, also drove up raw material costs over the last year but profit margins have remained steady . . . and nitrile latex prices are now declining.

VIP Gloves' factory has six production lines (with a monthly capacity of 64 million gloves), with two additional production lines currently being installed (14 million gloves).

It is also finalising council and fire department approvals (expected this month) for a second factory, which should be completed in early 2022, where eight larger production lines will be progressively installed during the second half of the 2022 calendar year. This will increase monthly capacity by a further 144 million gloves by December 2022.

In total this will lift production volumes 3½-fold from 64 million to 222 million gloves per month.

Glove manufacture is considered an "essential business" in Malaysia so production is not impacted by the current Covid-19 lockdown.

The company received *CE Mark* registration recently and *FDA* approval is expected in the near future. This will allow the company to sell into higher margin European and United States markets, through distributors and under its own brand.

For the half year to 31 December 2020, revenues rose 298.9% to $21.0 million, net profits rose 326.6% to $2,253,008 (0.3 cents per share) and an interim dividend of 0.18 cents was paid. There was a cash operating surplus of $1.8 million (compared with a *deficit* for the same period a year earlier.

March quarter results were even better with receipts of $17.2 million and a cash operating surplus of $5.8 million. Cash at 31 March (after paying a dividend of $1.2 million and capex of $1.2 million) was $3.8 million (0.5 cents per share).

The company raised $2.3 million (i.e. issued 76.5 million shares at 3.0 cents) in June 2020 to finance its current expansion phase. Investors appear to have initially been overly optimistic about this "Covid-19 business", bidding the shares up to a high of 22 cents in August 2020. Since then the shares have fallen 82% to just 3.9 cents - even as the company has lifted production volumes, revenues, profits, paid a dividend *and* progressed its expansion plans. Tax loss selling *could* be helping to depress the share price this month.

While not without risks, this is a very high growth business trading on a very low valuation. Glove prices may fall (if Covid-19 is slowing) but margins should remain steady (as raw material prices also fall). There is a global shortage of gloves and demand is forecast to grow strongly over the long term. This is a good time for VIP Gloves to be more than *tripling* production volumes.

Bid-Ask: 3.9-4.0 cents. Last trade 3.9 cents.

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