Forty One Years of Independent Information and Investment Experience on the Australian and NZ Stockmarkets

Market Analysis

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June 2022 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 at least 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.

With the recent weakness in the market, all of the shares discussed below are down *at least* 80% from their annual highs, with many down over 90%. This year the scan found two main groups of shares: "Buy Now, Pay Later" (BNPL) company shares and out-of-favour, risky, debt-free, start-up technology company shares. Most were recent IPOs.

We are uncertain about the financial strength of the BNPL companies - some will likely not survive - but the whole sector is *very depressed* that it may warrant serious consideration. . . and our last selection in that group is an investment fund that invests in minority stakes in BNPL companies and holds cash equal to 90% of its share price. That has got to be an under-valued and low risk choice for this sector.

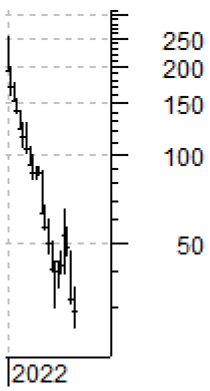
The (mainly) technology shares are generally high risk, early stage, start-ups, but share values have *already* fallen so much that most trade near - or even below - their debt-free cash in the bank. So *high-risk*, but *very under-valued*.

In addition to the shares discussed below one of our *Recommended Portfolio Shares* - **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 this company.

"Buy Now, Pay Later" Companies

No less than five "Buy Now, Pay Later" (BNPL) company shares made the initial selection. We are cautious of these businesses, but this widespread pessimism of the sector attracts our interest as a contrary-opinion investor. Note that most of these companies are losing money at a frightening rate, so *may* continue to destroy shareholder wealth . . . but most seek to become profitable within the next few years and are currently so cheap that the sector is worth at least a look.

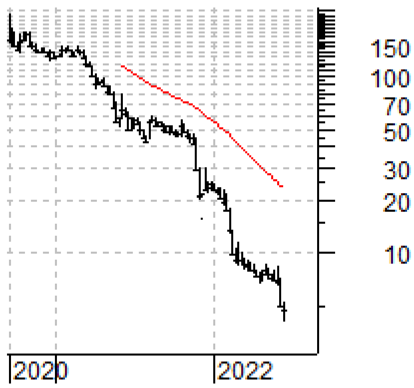
Beforepay Group (code B4P)



Beforepay Group listed on the ASX in early 2022 after an Initial Public Offering of shares at 341 cents. Just a few months later you can buy the shares at 28 cents, down 92%. This company gives people an advance against their employment income, for a 5% fee on the amount advanced.

We are not sure how successful the company will be long term, but its current market capitalisation is just $10.8 million. Accumulated losses give *negative* Shareholders Equity of $32.2 million. This looks to be the riskiest BNPL, but there were seven *insider* buys (and no sells) over the last year. A bit risky, so perhaps better options in the other BNPL shares.

Laybuy Group (code LBY)



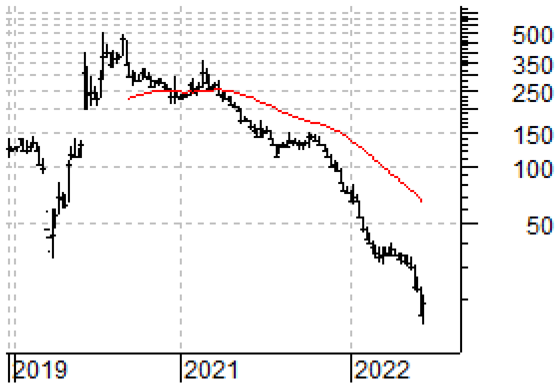
Laybuy Group is a NZ based company listing on the ASX after an IPO in September 2020 at 141 Australian cents. You can now buy the shares at around 5 cents, down 96%.

The company raised an additional A$19.5 million capital - from a placement and SPP - in mid 2021 at 50 cents per share.

Laybuy Group offers the conventional BNPL business in NZ, the UK and Australia, where purchasers can spread the cost of a purchase over six weeks.

The market capitalisation is $12.2 million, while net tangible assets are positive at $25 million! But - like many BNPL start-ups - lost NZ$10.3 million in the year to 31 March 2022 on revenues of $14.5 million.

Openpay Group (code OPY)

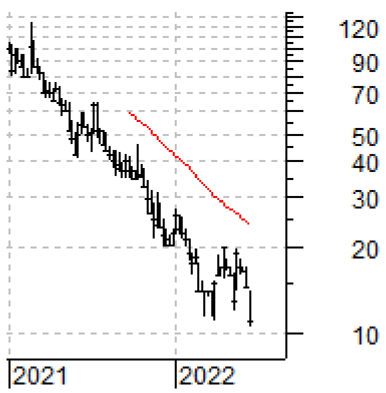


This company listed in early 2020 after an IPO at 160 cents per share. Now the shares are only 17 cents, down 89%. It later raised $33.7 million from the placement of shares at 240 cents in June 2020, another $33.7 million from a placement and SPP at 241 cents in March 2021 and $20.3 million from a placement and SPP at 24 cents last month.

Market capitalisation is $25 million, while net assets are positive at $16 million (thanks to all the capital raising!). The company seeks to become profitable by June 2023 - but that will be no easy job - as in the half year to 31 December 2021 it *lost* $42.0 million on revenues of $15.0 million

The company targets larger expenses (i.e. up to $20,000) in healthcare, veterinarian, automotive and home improvement sector, with repayment over 2-24 months. It also offers B2B SaaS "trade account management system" for other companies, which is a "capital light, low risk tech solution with high margins". It has operations Australia, NZ, the UK and the US.

Payright Ltd (code PYR)

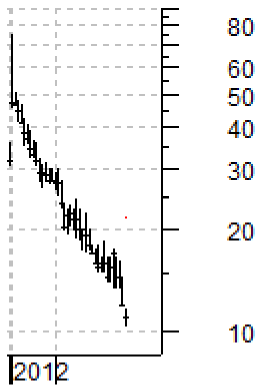


Payright listed early in 2021 after an IPO at 120 cents raised $20 million. In May 2022 its raised $1.5 million from a placement at 18 cents and $8 million from notes (convertible to shares at 22.5 cents per share) Currently the shares are down 90% at 11 cents.

This BNPL business focuses on transactions of $1000 to $20,000 for education (34% of business), retail (24%), photography (15%), home improvement (14%) and health & beauty (11%), with repayment terms up to five years.

Market capitalisation is $8.6 million and net assets are positive at $12.0 million. Like all the BNPL businesses, Payright is losing cash (and making losses) like there is no tomorrow, but has recently restructured its debt financing through a "warehouse facility". The good news is that will cut its funding costs - and current losses - in half. The bad news is that the company estimates its loan receivables need to rise 122% to $200 million just to reach break-even.

Touch Ventures (code TVL)



If you didn't like the BNPL shares above, then Touch Ventures may be for you. This is actually an "investment company" but most of its investments are minority positions (i.e. 10-40%), each worth around $10-25 million, in BNPL businesses plus some retail innovation businesses. **AfterPay** is a 26% shareholder in Touch Ventures and the companies are parties to a "collaboration agreement".

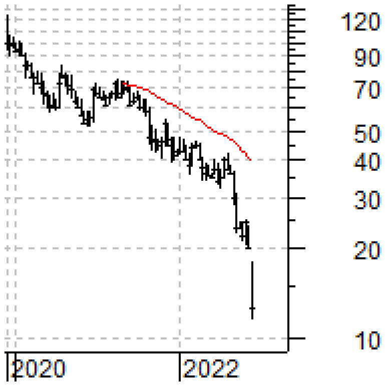
The company issued shares at 40 cents in an IPO in late 2021 and now trade around 10.5 cents, down 74% from the IPO and down 86% from their annual high of 74 cents. Cash in the bank is $67.5 million (9.4 cents per share), so the market is putting a low value on the fund's $121.3 million of investments (worth 17.1 cents per share).

The largest (unlisted) investments are in **Sendle** (an Australian and US virtual parcel courier platform), **Happay** (a BNPL business in China), **Postpay** (a BNPL business in the UAE), **Play Travel** (a BNPL travel sector business), **BASIQ** (a financial data platform to assess customer data), **Till Payments** (an Australian non-bank payments provider), **Preezie** (an Australian eCommerce customer engagement platform) and six smaller investments.

An investment company provides a spread of investments in different BNPL businesses, with limited liability (if any one investment fails) and knowledge/technology from Afterpay (a BNPL company that was acquired by **Block Inc**). There is also diversification in other innovative retail solutions businesses. Best of all we can buy this fund for little more than its cash in the bank - so we shall definitely be seeking to make an investment in this company.

Five Technology Companies

Control Bionics (CBL)



This high-tech company listed after an IPO raised $15 million from the issue of shares at 30 cents in December 2020. The shares initially traded as high as 105 cents but - with technology shares having fallen out-of-favour - are now down to 12.5 cents.

That is less than its debt-free, cash in the bank of $6.9 million (13.7 cents per share).

What does the company do? It "designs, manufactures and sells wireless wearable electromyography (EMG) based alternative augmentative communication (AAC) technology". The Science Fiction applications of this technology may be unlimited . . . but at this early stage it helps people with severe disabilities communicate via computers and devices.

Most of us communicate with devices using a finger on a touchscreen or a hand to control a mouse to point and click. If you don't have control of your hands, Control Bionics can duplicate this with a "high quality eye gaze camera" (i.e. to "point" by looking at part of a screen) and a watch-like wearable EMG device (usually worn on an arm like a watch, but any part of the body will do) that responds to slight muscle movements (i.e. equal to "clicking" a mouse).

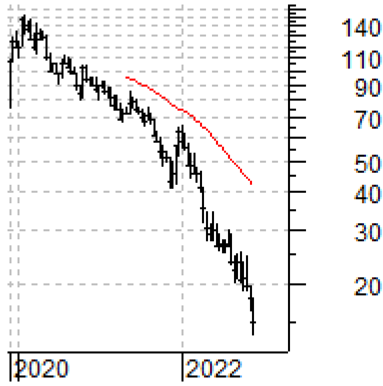
This can allow a disabled person to access computer programs. Connected to speech generating software this allows "non-verbal people with severely impaired movement to control a computer for speech generation up to 47% faster than traditional eye-gaze systems with significantly less fatigue". It could control TVs, air-conditioning, doors, etc. The company sells to people with cerebral palsy, multiple sclerosis, spinal cord injuries and ALS/MND at a cost of about $22,000 per system.

Initial sales were in Australia, expanding into the United States (which is now the biggest market) in 2017. Some sales have been made in Canada. In April this year the company entered the Japanese market via a partnership with **Double R&D Ltd**. Future plans are to enter the UK and European markets.

For the half year to 31 December 2021, revenues were up 17.8% to $2.4 million, but there was a *loss* of $3.1 million and a cash operating *deficit* of $3.6 million. March 2022 quarter receipts were $1.3 million with a cash operating *deficit* of $1.5 million and cash in the bank of $6.9 million. The company is still in a development and early growth stage.

Technology shares are out-of-favour and Control Bionics shares have been sold down to less than their cash in the bank. That is worth a small investment.

Doctor Care Anywhere Group plc (code DOC)



This UK based company provides "Virtual GP Consultation" and listed on the ASX in December 2020 after an IPO priced at A$0.80 raised A$65 million for the company (and A$37 million for selling investors). A further A$11.2 million was raised in February 2022 from a share placement at 31 cents but the SPP (seeking A$1 million) raised just A$274,240.

The shares initially rose 88% to 150 cents but have since falling 91% to 13.5 cents, only slightly more than its cash in the bank of £17.0 million (A$29.6 million or 13.0 cents per share).

In September 2021 the company acquired Australian based **GP2U Telehealth Pty** for A$11 million.

The same month it expanded operations to "self-pay" patients in the Republic of Ireland.

For the year to 31 December 2021 the company delivered 440,000 GP appointments - making it the largest telehealth business in the UK - and lifted revenues 114.7% to £25.0 million but made a *loss* £20.2 million. This business is below break-even levels, so needs to continue to grow rapidly. There were also significant expenses for sales and marketing (£3.4 million) as well as research and development (£4.8 million) in the company's technology platform.

By May 2022, GP consultations were around 50,000 per month (600,000 on an annual basis). Patients can make an appointment about 8 hours ahead (compared with a four weeks wait for a GP appointment under the NHS. Appointments can be 24 hours a day, 7 days a week, 365 days a year.

First quarter results (to 31 March 2022) show revenues up 95% to £8.6 million. The net cash operating *deficit* was £5.5 million.

Full year 2022 revenues are expected to be up at least 40-50% to £35-38 million.

This is a high risk (i.e. unprofitable, negative cashflow) business but growing rapidly with a new business model. At around its cash asset backing - and possibly depressed by year end tax selling - this is an interesting situation and worth a small investment.

FYI Resources (code FYI)

OK, this isn't a technology company, it is a former mineral exploration company that has developed an industrial process to manufacture High Purity Alumina (HPA) for use in LED lighting, batteries and other high-tech applications. The company will develop the *Cadoux Kaolin Project* to mine Kaolin and has developed a new process to produce 99.99% and 99.999% HPA.

The processing plant to produce HPA will cost US$202 million but has a Net Present Value of US$1,014 million, with a 55% Internal Rate of Return. Under a joint venture formed in October 2021, **Alcoa of Australia** will manage the development and fund around 97% of the US$250 million development budget to earn a 65% interest. FYI Resources will retain a 35% interest at little or no additional cost.

So, in a few years when this project is complete, FYI Resources will own 35% of the business worth around US$1,000 million. That is about A$500 million for its 35% interest . . . or about 137 cents per FYI Resources share.

FYI Resources will also retains full ownership of the *Cadoux Kaolin Project* and will sell kaolin to the JV for at least the next 50 years.

The shares traded up to 89 cents *before* the JV was announced. The JV is a positive and low risk development strategy for FYI Resources, removing virtually all funding risk or potential dilution from the need to issue shares to raise capital to develop the project by itself.

The company has cash in the bank of $12.1 million (3.3 cents per share) but little expenditure as Alcoa is funding the HPA development.

The market has reacted to what should be a "favourable" development by discounted the share price 83% in value! This could result in the shares being further depressed in the immediate future owing to potential tax loss selling in June and then could bounce higher over the next few months. Longer term, FYI Resources has a fully funded interest in a HPA business that should lift the share price 10-fold over the next 2-3 years!

This is a "must BUY" situation!

Mighty Kingdom (code MKL)

Just as Warren Buffet "doesn't understand technology" your Editor "doesn't understand video gaming" . . . but when *any* debt-free company's shares are trading at a 28% discount to cash in the bank, he does understand that this is an extreme of undervaluation!

The cash, of course, may disappear in operating deficits and losses - so Mighty Kingdom is not without high risk.

Mighty Kingdom raised $18 million in an IPO in April 2021 at 30 cents. A SPP in January 2022 raised $397,000 at 14.5 cents. Cash in the bank is $6.8 million (5.3 cents per share) but you can buy the shares on-market for around 3.8 cents.

Mighty Kingdom was established in 2010 and is the largest independent game developer in Australia. Historically the firm was involved in *Work for Hire* (providing contract services for other game developers) and *Licence Third-Party IP* (developing a game based on a third party brands, often for a share of revenues). Cash from the IPO was used to expand to *Develop Original IP* (its own branded games, distributed through third party publishers) and *Publish Original IP* (self publish games, develop distribution channels and receive "a greater proportion of revenues").

One competitive advantage is Mighty Kingdom's "proprietary narrative engine" which "streamlines the process of adding narrative content to a game".

The company released *Conan Chop Chop* (a co-development with Funcom, a Tencent subsidiary) in March, which was ranked No 1 for "upcoming Action Rogue-Like Games" on *Stem Next Fest* (where gamers can try playable demos). The game received good reviews during April but "initial sales were lower than expected".

In May the company entered a "technology partnership" with **Google** . . . well, actually, its a six month "work for hire" contract to develop gaming experiences for Google.

In June it signed a contract with **Lion Studios** for a one year "work for hire" for the development of a game. This contract is worth over $1 million.

The company has about 14 projects - of different types - under development.

The shares trade at 3.8 cents - less than the debt-free cash in the bank of 5.3 cents - so the shares look rather depressed, with the *market* placing a *negative* value on the game development business! This is a high risk situation, but when *Mr Market* asks if we will buy a few shares in a good business at a 28% discount to cash in the bank then our answer has to be "Yes".

Redbubble Group (code RBL)

Redbubble Group is a technology company where independent artists can sell "uncommon designs on high-quality, everyday products" on the websites Redbubble.com and TeePublic.com.

At the company's websites a customer can choose from over 60 million designs, submitted by over 600,000 artists, which can be digitally printed on over one hundred everyday products (e.g. t-shirts, coffee mugs, wall art, etc), by third-party fulfilment companies globally and shipped locally to the purchaser. Customers get a unique product and independent artists receive a payment each time a design is sold.

Overall, artists receive about 15-20% of revenues, fulfilment (i.e. product producers, digital printers, shippers) accounts for about 60% of revenues, sales and other taxes 11%, leaving a small margin to cover Redbubble Group's costs and profit.

The 60 million designs *could* be printed on over 100 products, so there are almost 6 *billion* potential products. Sales are mainly in North America (69%), Europe (13%), UK (10%), Australia/NZ (7%) and the rest of the world (1%). Sales are mainly T-shirts (41%), other Apparel (17%), Accessories (10%), Stationery (12%), Homewares (10%) and Artwork (10%).

For the year to 30 June 2021, revenues rose 57.9% to $657.3 million with a net profit of $31.2 million (11.6 cents per share), up from a small loss the previous year.

For the half year to 31 December revenues *fell* 18% to $341.6 million, with a *loss* $1 million. There was still a net cash operating surplus of $51.0 million, lifting cash on hand to $142.8 million (51.8 cents per share). The company has no interest bearing debt. Third quarter results also show a small loss.

At 78 cents the shares trade on a Price/Sales ratio of 0.39 and a Price/Earnings ratio of 6.7 (based on June 2021 profits) but currently pays no dividend. Two-thirds of the share price is represented by cash in the bank.

There are significant "network effects" that should benefit this company. More artists continue to join the network and active artists create more content, so the content library is growing at around 60% annually. A large and growing content library will help attract and grow customer numbers, creating higher sales and greater income for artists. Higher volumes will also create economies of scale and improve profitability for Redbubble Group. The company seeks to *double* annual revenues to around $1500 million over the "medium term", which it estimates will lift earnings from about 2-3% of revenues to 13-18% of revenues. That is a 10-15 fold increase!

This is a soundly financed, cash-rich, debt-free company with an excellent business model and strong potential for profit growth . . . but revenues are down slightly this year, there will be a small loss, and the shares are being dumped along with other "technology" shares.

Tax loss selling may help us buy in at a depressed price and low-valuation, but this will likely be a very long term, multi-bagger investment rather than a short term trading situation.