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XTEK Limited (XTE)

Mixed bag

Recommendation
Buy (unchanged)
Price
\$0.41
Target (12 months)
\$0.80 (previously \$0.88)

GICS Sector
Capital Goods

Expected Return

Capital growth	95%
Dividend yield	0%
Total expected return	95%

Company Data & Ratios

Enterprise value	\$33.1m
Market cap	\$41.7m
Issued capital	101.8m
Free float	94%
Avg. daily val. (52wk)	\$179,169
12 month price range	\$0.36-\$0.77

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	0.41	0.45	0.38
Absolute (%)	0.00	-8.38	9.33
Rel market (%)	-0.57	-11.81	0.31

Absolute Price



SOURCE: IRESS

FY23 Guidance Update

XTE this morning provided updated FY23 guidance, including an upgrade to previous revenue guidance. Upgraded revenue guidance is now between \$86m and \$88m, representing an increase of approximately ~50% on FY22 (\$58.2m) and ahead of BPe (\$83.9m). New unadjusted EBITDA guidance is \$9.0m - \$10.5m, with the lower end of the range in-line with FY22 unadjusted EBITDA (\$8.97m) and the upper end of the range below FY22 underlying EBITDA (\$11.5m).

Downward pressure on EBITDA margins

The difference in unadjusted and underlying EBITDA in the FY22 result was largely driven by the ~\$2.5m impairment on the *ViroLens* inventory however, at this stage, the company has not flagged any material impairments in the FY23 result, thus we anticipate unadjusted and underlying EBITDA to be largely in-line. Based on this assumption, it is prudent to compare the EBITDA guidance to FY22 underlying EBITDA (\$11.5m). The guidance range implies an EBITDA margin of between 10.4% - 11.9%, which is disappointing versus an underlying margin of 19.7% in FY22.

Revenue upgrade, EBITDA downgrade

We have upgraded our FY23 revenue (\$87.8) by 4%, which is at the upper end of the guidance range. We have chosen to leave revenue forecasts in future years unchanged until greater visibility is provided. The reduction in EBITDA margin for 2H23 was largely driven by lower gross margins, increased revenue contribution from the lower margin Technology division and increased opex due to inflationary pressures. We have updated our forecast margins accordingly, which has resulted in EBITDA downgrades of -23%, -31% and -27% in FY23, FY24 and FY25 respectively.

Investment View: PT down 9% to \$0.80, retain BUY.

We have updated each valuation used in the determination of our price target for the forecast changes as well as market movements and time creep. The net result is a 9% decrease in our PT to \$0.80 and we retain our BUY recommendation.

Earnings Forecast

Year End 30 Jun	FY22	FY23e	FY24e	FY25e
Revenue (\$m)	58.2	87.6	89.6	94.8
EBITDA (\$m)	11.5	10.5	13.2	15.8
NPAT (underlying) (\$m)	8.2	6.9	8.8	10.3
NPAT (reported) (\$m)	5.7	6.9	8.8	10.3
EPS (cps)	6.3	7.6	9.7	11.2
EPS growth (%)	nm	21%	27%	16%
PE (x)	6.5	5.4	4.2	3.7
FCF Yield (%)	83%	nm	nm	26%
EV/EBITDA (x)	2.9	3.2	2.5	2.1
Dividend (¢ps)	0.0	0.0	0.0	3.2
Yield (%)	0%	0%	0%	8%
Franking (%)	0%	0%	0%	0%
ROE(%)	24%	17%	17%	18%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Forecast and Valuation Changes

Downward pressure on EBITDA margins

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Based on this assumption, it is prudent to compare the EBITDA guidance to FY22 underlying EBITDA (\$11.5m). The guidance range implies an EBITDA margin of between 10.4% - 11.9%, which is disappointing versus an underlying margin of 19.7% in FY22.

We have upgraded our FY23 revenue (\$87.8) by 4%, which is at the upper end of the guidance range. We have chosen to leave revenue forecasts in future years unchanged until greater visibility is provided.

The reduction in EBITDA margin for 2H23 largely driven by lower gross margins, increased revenue contribution from the lower margin Technology division and increased opex due to inflationary pressures. We have updated our forecast margins accordingly, which has resulted in EBITDA downgrades of -23%, -31% and -27% in FY23, FY24 and FY25 respectively.

We have also delayed our dividend assumptions, we now forecast the company will pay its first dividend in FY25.

A summary of the changes in our key forecasts is shown below.

Figure 1 - Change in key forecasts

Year end 30 June	FY23e	Change	FY24e	Change	FY25e	Change
Total revenue (A\$m)	87.6	4%	89.6	no change	94.8	no change
EBITDA	10.5	-23%	13.2	-31%	15.8	-27%
NPAT	6.9	-25%	8.8	-33%	10.3	-29%
Diluted EPS (cps)	7.6	-25%	9.7c	-33%	11.2c	-29%
DPS	0.0	no change	0.0c	-100%	3.2c	-28%

SOURCE: BELL POTTER SECURITIES ESTIMATES

PT down 9% to \$0.80

We have updated each valuation used in the determination of our price target for the forecast changes as well as market movements and time creep. Our DCF is based on FY24 estimates to be consistent with a 12 month price target. We allocate an equal weighting to each valuation to account for discrepancy in each valuation method.

Figure 2 - Change in valuations and impact on PT

	Old (as at 27-Feb-23)			New (as at 29-Jun-23)		
	Valuation per share	% weighting	Price target	Valuation per share	% weighting	Price target
Methodology						
DCF	\$ 0.98	40%	\$ 0.39	\$ 1.11	33%	\$ 0.37
EV/ EBITDA	\$ 0.81	40%	\$ 0.32	\$ 0.63	33%	\$ 0.21
PE ratio	\$ 0.87	20%	\$ 0.17	\$ 0.66	33%	\$ 0.22
Total			\$ 0.88			\$ 0.80

SOURCE: BELL POTTER SECURITIES ESTIMATES

The net result is a 9% decrease in our PT to \$0.80 so we retain our BUY recommendation.

XTEK Limited (XTE)

Company Description

XTEK Limited (XTE) is an Australian defence manufacturer of advanced ballistics protection equipment and supplier of cutting edge military technologies. XTE's ballistics division manufactures helmets, hard armour plates, soft armour and shields under the HighCom brand at its two facilities in Adelaide, South Australia and Ohio, USA. The technology division acts as a re-seller for Australian and international OEM's as well as a supplier of XTE proprietary technologies. The company's customers primarily include military, law enforcement, government agencies and commercial parties.

Investment Thesis

We maintain our BUY on XTEK Limited. Our investment thesis is based on.

- **Undemanding Valuation:** Our 12 month price target on XTE is \$0.80, which is a blend of three valuation methodologies; PE ratio, EV/EBITDA and DCF. The price target is >15% premium to the current share price and the total expected return is the same given there is no forecast dividend yield.
- **Unique product offering:** The company's key competitive advantage is the superior quality of its lightweight, high-performance ballistics protection equipment produced using its proprietary 'XTclave' manufacturing technology. The company's most advanced helmets and hard armour plates satisfy the highest levels of the NIJ quality standards and we anticipate a gradual revenue uplift from the higher price point on these products as sales improve through FY23 and FY24.
- **Strong revenue growth and higher margin sales:** During FY22, the company transitioned to a direct and channel sales based model to include a greater mix of sustainable higher margin sales. Coinciding with consistent contracts wins, XTE recorded FY22 revenue of \$58.2m, increasing 105% YoY (FY21 \$28.3m). Further, the company's gross margin increased to 47%, an 18% increase YoY (FY21 29%).

Key Risks

Key downside risks to our estimates and valuation include (but are not limited to):

- **Product Risk:** The inherent value of the XTE business is its claim to the lightest and strongest ballistics products in the market. If it is found that competitors are able to readily manufacture products of similar or superior quality, the company's product offering will suffer, which will have an adverse impact on sales growth.
- **Research & Development Risk:** A key competitive advantage for XTE is its proprietary XTclave technology. If the company is unable to maintain market leadership in advanced technologies or lags the rest of the market in its product development it may have an adverse effect on the company's future operations.
- **Competition Risk:** The market in which XTE participates is competitive with a wide range of participants including large multi-national defence contractors who have extensive resources and scale.

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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