Drone contract drives FY23 guidance

XTEK has announced a A$27m order that it expects to deliver in late 2H FY23. It has also provided the first guidance for FY23 revenue - A$82m (MST Access FY23 estimate is A$85m). Adding today's order to 1H FY23 revenue guidance of A$47m, means that only a further A$8m of revenue is required for XTE to hit its FY23 revenue guidance. Today's order from the Australian Defence Force is for small, unmanned aircraft systems (SUAS) in the. We have increased our FY23 revenue forecast by 13% while our gross margins and earnings remain broadly unchanged.

Upgrading our revenue forecast

At XTEK's recent AGM, the CEO noted that the pipeline of new sales remains at A$130m and included significant new sales opportunities. Given that current guidance is only A$8m above the aggregate of 1H guidance and today's announced order (which will be delivered in 2H FY23), we have upgraded our revenue forecasts for the Group from A$85m to A$96m.

Technology division – services as well as sales

Revenue in XTEK's Technology division is a combination of sales of third-party products, like that announced today, and service contracts covering maintenance and spare parts on that equipment. We think it is likely that XTEK will also receive a service contract to support these products. Service contracts are typically 8 – 15% p.a. of the original product sale amount and operate for 5 – 10 years.

Technology division margins

We had previously estimated gross margins in the Technology division to be 35% in FY23, being a mix of product sales and service contracts. We estimate that the service contracts have higher margins than product sales. With the estimated mix in the Technology division in FY23 now tilted towards product sales, we have decreased our FY23 gross margins for this division from 33% to 23%.

Forecasts and valuation

While our earnings forecasts remain broadly unchanged, our valuation increases by 12% as we roll forward to include both FY23 and FY24 earnings, as well as update the market multiple. We value XTEK at A$0.94 (previously A$0.84). Refer to page 4 for a discussion of risks to our valuation.

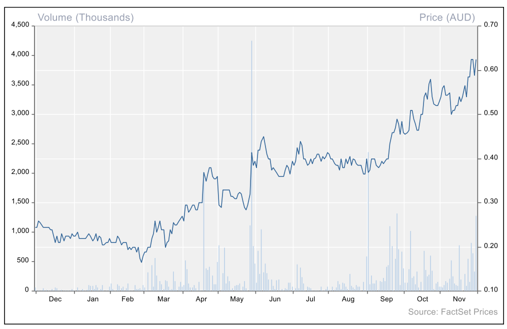
XTEK provides front-line equipment for defence and law enforcement personnel. It manufactures body armour and helmets and has exclusive agency agreements for distribution of unmanned aerial and ground vehicles from which it has also built a service and support business. XTEK has also developed an innovative technology (XTclave) for use in body armour and helmets that it is now commercialising. It has operations in Australia and the US, but also has an international sales presence.

https://www.xtek.net/

Stock	XTE.ASX
Price	A$0.70
Market cap	A$70.4m
Valuation	A$0.94 (previously A$0.84)

Next News
Next 3 months: Half-yearly report

XTE Share Price (A$)



Source: FactSet

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Figure 1: Financial summary

Year End 30 June		FY21A	FY22A	FY23E	FY24E	FY25E
Core PE	**x**	**nm**	**8.6x**	**4.4x**	**4.3x**	**4.5x**
EV/EBITA*	x	nm	2.8x	3.1x	2.3x	1.6x
EV/EBITDA	**x**	**nm**	**2.4x**	**2.8x**	**2.1x**	**1.5x**
Div yield	%	0.0%	0.0%	1.8%	5.0%	7.3%
FCF Yield	%	nm	13.1%	25.1%	25.8%	25.0%

Stock information	
Share Price ($)	$0.70
Market capitalisation (SOI) ($m)	70.4
Valuation ($)	**$0.94**
Shares on issue (weighted avg)	100.6
Shares on issue (diluted) (m)	100.6

Profit & Loss Statement	$m	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue		**28.3**	**58.1**	**95.8**	**94.3**	**98.1**
Change pcp	%	-33.7%	105.1%	64.8%	-1.5%	4.0%
Gross Profit		**8.1**	**27.4**	**35.4**	**39.2**	**41.1**
Gross margin	%	28.7%	47.2%	37.0%	41.6%	41.9%
Overheads		-11.5	-16.4	-18.0	-18.5	-18.5
EBITDA		**-3.0**	**11.5**	**17.8**	**21.1**	**23.0**
EBITDA margin	%	-10.7%	19.8%	18.6%	22.4%	23.4%
D&A		-1.1	-1.7	-1.7	-1.7	-1.7
Net interest expense		-0.2	-0.2	-0.2	-0.2	-0.2
Tax and adjustments		0.4	-1.4	0.0	-2.9	-5.3
NPAT (underlying)		**-4.0**	**8.2**	**15.9**	**16.3**	**15.8**
Significant, discontinued et.al		0.0	-2.5	0.0	0.0	0.0
NPAT (reported)		-4.0	5.7	15.9	16.3	15.8

	Dec-19	Jun-20	Dec-20	Jun-21	Dec-21	Jun-22
Revenue	**16.0**	**26.7**	**12.4**	**15.9**	**11.5**	**46.6**
Change pcp	91%	-9%	-23%	-40%	-7%	304%
Gross Profit	**-2.0**	**3.3**	**-3.1**	**0.6**	**-3.4**	**14.9**
Gross margin	-13%	12%	-25%	3%	-29%	32%

Performance ratios	FY22A	FY23E	FY24E	FY25E
ROE (%)	16.5%	32.1%	25.8%	21.1%
ROIC (%)	36.0%	46.3%	33.3%	25.3%
Interest cover (EBITDA)	nm	nm	nm	nm
Capex/Depreciation	187%	187%	187%	187%
Days Working Capital	-221	125	179	179

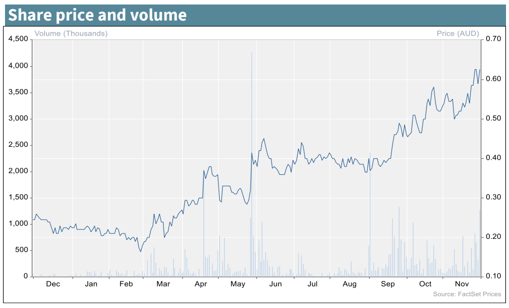
Per Share Data		FY21A	FY22A	FY23E	FY24E	FY25E
Ave. diluted shares outstanding	m	69	101	101	101	101
Underlying EPS	**cps**	**-5.8**	**8.2**	**15.8**	**16.2**	**15.7**
growth pcp	%	-1083%	-242%	93%	3%	-3%
Reported EPS	cps	-5.8	5.7	15.8	16.2	15.7
growth pcp	%	-1083%	-199%	177%	3%	-3%
DPS	cps	0.0	0.0	3.2	4.9	5.2
Payout (on underlying)	%	0%	0%	20%	30%	33%

Segments	FY22A	FY23E	FY24E	FY25E
Revenue				
Ballistics	47.0	60.8	67.6	72.8
Technology	11.1	35.0	26.7	25.3
Group Revenue	**58.1**	**95.8**	**94.3**	**98.1**
Gross Profit #				
Ballistics	23.5	27.3	30.4	32.8
Technology	3.9	8.1	8.8	8.3
Group Gross Profit	**27.4**	**35.4**	**39.2**	**41.1**
Gross Margin #				
Ballistics	50.0%	45.0%	45.0%	45.0%
Technology	35.2%	23.0%	33.0%	33.0%
Group Gross Margin	**47.2%**	**37.0%**	**41.6%**	**41.9%**

Segments are MST Access estimates

Balance sheet	$m	FY21A	FY22A	FY23E	FY24E	FY25E
Cash & Deposits		5.9	36.2	13.8	19.8	29.4
Receivables		1.9	10.6	6.6	6.5	6.7
Inventory		10.7	16.4	23.2	29.3	30.3
PP&E (incl. ROUA)		11.9	12.2	13.2	14.2	15.2
Intangibles		1.2	1.7	1.7	1.7	1.7
Other Assets		0.8	1.3	0.0	0.0	0.0
Total Assets		**32.4**	**78.5**	**58.4**	**71.5**	**83.3**
Payables		5.9	40.6	6.6	6.0	6.2
Borrowings (incl. lease liabilities)		4.4	2.1	2.1	2.1	2.1
Provisions/ other (incl. lease liabilities)		0.6	1.0	0.2	0.2	0.2
Total Liabilities		**11.0**	**43.7**	**8.8**	**8.2**	**8.4**
Shareholders' Funds		**21.4**	**34.8**	**49.6**	**63.2**	**74.9**
Net Debt		**-1.5**	**-34.2**	**-11.7**	**-17.8**	**-27.4**

Share price and volume



Cashflow statement	$m	FY21A	FY22A	FY23E	FY24E	FY25E
EBITDA		-3.0	11.5	17.8	21.1	23.0
Net interest		0.0	-0.2	-0.2	-0.2	-0.2
Tax paid		0.4	-1.4	0.0	-2.9	-5.3
Working capital movements		3.9	14.6	-36.7	-6.6	-1.1
Other/ Prepayments		-1.5	1.4	0.0	0.0	0.0
Operating CF		**-0.3**	**26.0**	**-19.1**	**11.4**	**16.4**
Capital expenditure		-8.4	-1.9	-2.2	-2.2	-2.2
Asset sales		0.0	0.0	0.0	0.0	0.0
Acquisitions		0.0	0.0	0.0	0.0	0.0
Other		0.0	0.0	0.0	0.0	0.0
Investing CF		**-8.4**	**-1.9**	**-2.2**	**-2.2**	**-2.2**
Net borrow + princ. lease payments		0.5	-1.2	0.0	0.0	0.0
Dividends paid		0.0	0.0	-1.2	-3.2	-4.7
New share issues		11.2	7.0	0.0	0.0	0.0
Financing CF		**11.7**	**5.8**	**-1.2**	**-3.2**	**-4.7**
Effect of FX Rate Changes on Cash		-0.2	0.4	0.0	0.0	0.0
Net change in cash		**2.8**	**30.3**	**-22.4**	**6.0**	**9.6**

Company description

XTEK provides front-line equipment for defence and law enforcement personnel. It manufactures body armour and helmets and has exclusive agency agreements for distribution of unmanned aerial and ground vehicles from which it has also built a service and support business. XTEK has also developed an innovative technology (XTclave) for use in body armour and helmets that it is now commercialising. It has operations in Australia and the US, but also has an international sales presence.

Source: Company, MST Access

Investment thesis

Key revenue drivers for XTEK come from the sale of body armour and helmets to defence and law enforcement - primarily in the US and in other countries. The war in Ukraine created short-term demand for these products that has allowed XTEK the opportunity to build global delivery credibility. Additionally, revenue growth will also come from the sale of third-party unmanned ground and aerial vehicles to Australian Defence.

Longer term underlying margin growth in the Ballistics division is likely to come as a result of an increase in direct and reseller sales with private label sales showing much more limited growth. We expect that this will be supported through the provision of higher volumes of products based on the proprietary XTclave technology.

Additional drivers of value for the Group are the restructure and strategic refocus undertaken by the current CEO, and the growth in the Ballistics division (HighCom) sales and margins from leveraging its channel to deliver XTclave based products. XTclave characteristics provide competitively priced lighter weight body armour and more complex shapes give it particularly important advantages in female body armour and helmets.

Global geopolitical trends in the Asia-Pacific and in Europe have given cause for reassessment of defence spending in XTEK's key markets of the US and Australia. The war in Ukraine has likely catalysed the decisions to increase long term spending on defence. As recent sales have shown, this war has created demand for high quality personal protective equipment allowing HighCom to deliver to customers outside its usual sales geographies.

Over the last five years we have seen a steady and consistent shift in Australian Defence attitudes about procurement. This will increase the support for Australian manufacturing and services in the delivery of Defence contracts. We expect that will support demand for XTEK's unmanned ground and aerial vehicles and their on-going maintenance through its Technology division. XTEK's strong history as a value-added reseller and support provider to Defence will underpin its growth.

XTEK completed the commissioning of its XTclave manufacturing plant in Adelaide in April 2021. Using the pilot plant, XTEK completed its first major order of $2m to Finland in 2020. While able to offer competitively priced lightweight body armour, its ability to deliver high strength complex profile products make it ideal for female body armour and helmets. Particular configurations allow it to meet the US based standard, III++, with product development underway targeting Level IV protection, as well as other configurations at Level III+.

Local sales of unmanned vehicles in Australia to Defence will arise as XTEK wins supply contracts. It is currently bidding on c.$50m of contracts expected to be awarded over the next 2 years.

The SUAS order – impact on revenue and margins

XTEK has announced an order for the delivery of A$27m worth of drones (SUAS) to the Australian Defence Force (Army). Delivery and therefore revenue recognition is expected late in 2H FY23. This compares with FY22 revenue of only A$11m from the Technology division. Historically, the sale of product to Defence has been followed with maintenance and parts agreements, which carry much higher margins than the initial product sale. We would expect this to be the case for this sale.

As a result of this order, the FY23 revenue mix in the Technology division is expected to look somewhat different to what is assumed in our forecasts with overall gross margins in this division now expected to be 23% (previously 33%). With the revenue mix in the Technology division reverting back to more normal levels, we have margins reverting back to 33% in FY24 and beyond.

Forecast Ballistics margins are 45% compared to our estimate of 55% on the Ukraine orders, but only 25% historically when 80% of sales in this division were "white label". We are now seeing major orders for ballistic product (such as the US$3.5m that was recently delivered) being direct (or through reseller channels) where margins are much higher than white label product.

Forecasts and valuation

Forecasts

While our FY23 revenue estimate has increased by 13%, revenue in future years and earnings in all the forecast periods have changed little (between -6% and 0%).

Figure 2: Earnings changes

	Revenue (A$m)			Gross Profit (A$m)			EBITDA (A$m)			Underlying NPAT (A$m)			EPS (cps)		
	Current	Previous	% Chg	Current	Previous	% Chg	Current	Previous	% Chg	Current	Previous	% Chg	Current	Previous	% Chg
FY23E	**96**	85	13.3%	**35**	35	-0.3%	**18**	18	-0.5%	**16**	16	-0.6%	**16**	16	-0.6%
FY24E	**94**	97	-2.8%	**39**	40	-3.0%	**21**	22	-5.5%	**16**	17	-6.0%	**16**	17	-6.0%
FY25E	**98**	101	-2.9%	**41**	42	-3.1%	**23**	24	-5.4%	**16**	17	-5.9%	**16**	17	-5.9%

Source: MST Access

Valuation summary

Our valuation methodology has remained unchanged. We roll forward our valuation, using 50% weighting to FY23 and FY24 forecasts, and a discounted market multiple. These changes result in a 12% increase in our valuation from A$0.84 to A$0.94.

Figure 3: Valuation summary

Market Multiple NTM EV/EBITDA	x	8.5	Net Debt (cash) at 30 Jun-23	A$m	-11.7
Discount	%	50%	Equity Value	A$m	94.4
Multiple applicable to XTEK	**x**	**4.3**	Diluted Shares on Issue	m	100.6
Avg FY23 / FY24 EBITDA	A$m	19.4	**Equity Value per share**	**A$**	**0.94**
Enterprise Value at 30 Jun-22	**A$m**	**82.6**	*… premium to current share price*		*36%*

Source: MST Access

Risks

- Revenues have grown rapidly on the back of large orders. There is a risk that the company is unable to continue to leverage the credibility that delivery of these orders has given them, and revenue declines.
- The Technology division relies primarily on winning of tenders with Defence (in Australia). While XTEK has a strong track record of supply and maintenance contracts with Defence, there is no guarantee that it will continue to win tenders or win them at the rate it has in the past.
- A risk to our forecasts is that the characteristics of the XTclave product (strength, weight, thickness, cost) are insufficient to provide the level of competitive advantage that make it meaningfully attractive to customers.
- New iterations of XTclave products are required to meet NIJ certification to ensure acceptance of the products by large parts of the market. Failure to do so will significantly reduce its potential market, and may result in sales being too low to justify the current share price.
- A key risk to our forecasts is that the characteristics of XTclave proposed products are matched by competing products. Development of lightweight products based on UHMWPE is forecast to be the fastest growing segment of body armour with significant funds being invested in the development of products lighter, thinner products that can be delivered at lower price points. There is also significant investment in other technologies, including new materials which, if successful, may also affect the relative attractiveness of XTclave products.
- There is a risk that the substantial surplus cash on the balance sheet is applied to value destructive acquisition or organic growth based expenditure. This would result in a reduction in our valuation (given we include the value of that cash in our valuation) and a marking down of the market's perception of board and management.

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