

Date	31 <sup>st</sup> October 2019
Sector	Defence
Rating	Not Rated
Analyst	Erik Bergseng
Share Price Close (30/10/2019)	\$0.78

Third-Party Consensus Target	\$0.90
Third-Party Consensus Group	2 Firms

Refer to the table at the end of this update

Trading Data	
52-Week Range	0.345-0.965
Ordinary Shares Outstanding	52,734,742
Market Capitalisation (undiluted, \$m)	40.98m
Enterprise Value (\$m)	35.78m
Avg Daily Trading Volume (30 days)	145,996

Source: Thomson Reuters

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# XTEK Limited (XTE.ASX)

**Coverage Update** “Long term SUAS contract secured, Significant uplift in revenues reported for FY18/19, Australian Space Agency Agreement.”

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## XTEK secures SUAS repair & maintenance contract

**The Announcement:** On the 26<sup>th</sup> September 2019, XTEK Ltd (XTE.ASX, XTEK) announced that it signed an exclusive support service agreement for additional spare parts, repair and maintenance of the Australian Defence Force’s AeroVironment WASP Small Unmanned Aerial System (SUAS) fleet.<sup>1</sup> The contract is for an initial term of 3 years with multiple options to extend through to 2026 and is anticipated to be worth up to A\$5m per year in revenues to XTEK.

**Context:** In November 2018, XTEK announced that it had invested in the installation of a sophisticated repair facility in Canberra capable of electronic and composite repairs for SUAS.<sup>2</sup> Consequently, XTEK had become the owner and operator of the only repair facility for AeroVironment WASP AE SUAS outside of the United States. As stated in our initiation report, we believed that this repair facility gave XTEK the great likelihood of securing future maintenance and repair work from the ADF for its fleet. This has now occurred.

**Significance:** Although the anticipated annual revenues of this contract (~A\$5m) may not appear significant compared to XTEK’s existing annual revenue base (A\$37.9m for FY18/19), XTEK have stated that maintenance and repair work carries a higher profit margin compared to other business segments.<sup>3</sup> If each option is exercised, it could generate ~A\$35m of this higher margin revenue to XTEK over a period of 7 years. Furthermore, we believe that management have demonstrated foresight by planning and establishing a SUAS repair facility in Canberra in order for XTEK to capture this higher margin repair and maintenance revenue stream.

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<sup>1</sup> <https://www.asx.com.au/asxpdf/20190926/pdf/448wp2qz1j67j1.pdf>

<sup>2</sup> <https://www.asx.com.au/asxpdf/20181122/pdf/440jd0rgndrvy5.pdf>

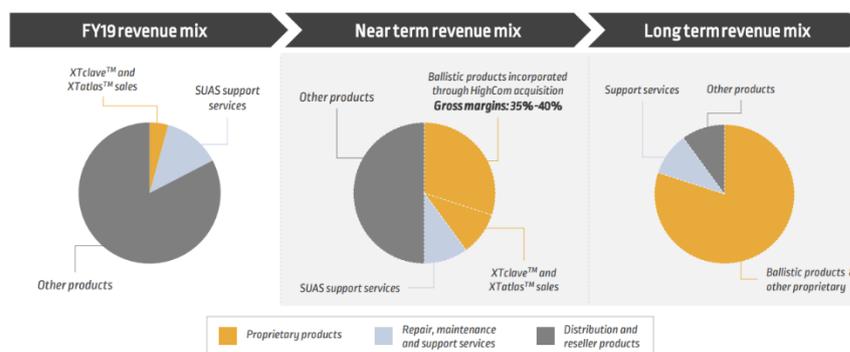
<sup>3</sup> <https://www.asx.com.au/asxpdf/20190830/pdf/4481shvznsclj18.pdf>, slide 16

## Significant uplift in revenues demonstrated in FY18/19

On the 29<sup>th</sup> August 2019, XTEK released its unaudited preliminary final report for FY18/19, which showed an 119% uplift in revenue on the PCP (A\$17.3m to A\$37.9m), a 45% uplift in gross profit on the PCP (A\$4.7m to A\$6.9m) and a 106% uplift on EBITDA<sup>4</sup> on the PCP (A\$0.2m to A\$0.5m).<sup>5</sup>

**Our thoughts:** As mentioned in our previous update, XTEK had shown evidence of strong revenue momentum. In XTEK's June 2019 investor presentation, revenue guidance for FY18/19 had increased to A\$30m (contracted) to a high case of A\$35m (high case forecast)<sup>6</sup>. This was up from previous revenue guidance of A\$20m (contracted) to a high case of A\$26m (high case forecast) which was indicated in October 2018.<sup>7</sup> The final result for FY18/19 (A\$37.9m) has landed well in excess of the upper guidance provided in June 2019 of A\$35m.

Although gross profit margins have fallen from 27.2% to 18.2% from FY17/18 to FY18/19, XTEK have signalled that it is positioning the company towards higher margin products and services over the longer term. Thus, future gross margin performance will likely become less impacted by large revenue and low margin products such as the re-sale of Aerovironment SUAS. Ignoring the recent higher-margin SUAS maintenance contract, ballistic products incorporated through the HighCom Armour Solutions ("HighCom") business are expected to carry gross margins of 35%-40%<sup>8</sup> which will begin to be reflected in future reporting periods as its acquisition is now complete.



Source: XTEK Presentation August 2019<sup>9</sup>

<sup>4</sup> FY18/19 EBITDA incorporates R&D expense of A\$1.6m and no R&D tax incentive. FY17/18 EBITDA incorporates R&D tax expense of A\$1.2m and R&D tax incentive of A\$0.5m. EBITDA adjusted for R&D expense and R&D tax incentive FY18/19: A\$2.1m, FY17/18: A\$0.9m.

<sup>5</sup> <https://www.asx.com.au/asxpdf/20190829/pdf/4480ppm8jkb4n8.pdf>

<sup>6</sup> <https://www.asx.com.au/asxpdf/20190603/pdf/445knfx8cgt40.pdf>

<sup>7</sup> <https://www.asx.com.au/asxpdf/20181018/pdf/43zcmx93cf25f3.pdf>

<sup>8</sup> <https://www.asx.com.au/asxpdf/20190830/pdf/4481shvzncsjl8.pdf>, slide 24.

<sup>9</sup> <https://www.asx.com.au/asxpdf/20190830/pdf/4481shvzncsjl8.pdf>

Furthermore, XTEK have stated the HighCom could potentially serve as a launchpad for the commercialisation of XTclave into the U.S. market, a wholly owned proprietary technology which would be expected to carry higher margins if commercialised.<sup>10</sup> XTEK have stated that it is targeting production capacity of up to US\$20m of revenue from XTclave in early CY2020.<sup>11</sup> Finally, XTAtlas, as a software solution, would naturally carry high gross profit margins and could contribute meaningfully toward the bottom line with further sales. For these reasons we believe there is scope for longer term gross profit margin improvement.

### Australian Space Agency Agreement

On the 26<sup>th</sup> July 2019, XTEK signed a Joint Statement of Strategic Intent and Cooperation with the Australian Space Agency.<sup>12</sup> According to Dr. Megan Clark, the Head of the Australian Space Agency, the agreement is consistent with the goal of growing the local Australian space sector from a \$3.9bn to \$12bn industry over the next 10 years while creating up to 20,000 space jobs. We believe that this agreement, while not immediately material to XTEK, nonetheless represents a formal agreement within another market vertical beyond the defence markets for XTclave. This agreement is also another form of validation for XTEK's XTclave technology, which follows the validation provided from earlier agreements made with Heckler & Koch<sup>13</sup>, Skykraft<sup>14</sup> and the Department of Defence.<sup>15</sup>

<sup>10</sup> <https://www.asx.com.au/asxpdf/20190830/pdf/4481shvznscjl8.pdf>, slide 4

<sup>11</sup> <https://www.asx.com.au/asxpdf/20190830/pdf/4481shvznscjl8.pdf>

<sup>12</sup> <https://www.asx.com.au/asxpdf/20190726/pdf/446wz03dfvldp2.pdf>

<sup>13</sup> <https://www.asx.com.au/asxpdf/20190501/pdf/444rf228cd2xjb.pdf>

<sup>14</sup> <https://www.asx.com.au/asxpdf/20190612/pdf/445s90vlyrvdhr.pdf>

<sup>15</sup> <https://www.asx.com.au/asxpdf/20190624/pdf/44626qc8k359q5.pdf>

## Coverage History

Name	Date	Close Price	Download
Initiation Report	06/03/2019	\$0.385	<a href="https://mawsongraham.com.au/get/xte-research">https://mawsongraham.com.au/get/xte-research</a>
Coverage Update	18/07/2019	\$0.47 (17/07/2019 Close Price)	<a href="https://mawsongraham.com.au/get/xte-update-0719">https://mawsongraham.com.au/get/xte-update-0719</a>
Coverage Update	31/10/2019	\$0.80 (30/10/2019 Close Price)	<link to be generated>

## Third Party Research

Third Party Analyst / Broker	Last Release	Price Target	Download
Patersons Securities	31/08/2018	\$0.95	<a href="http://rsrch.us/xte-patersons">http://rsrch.us/xte-patersons</a>
Altor Capital	15/07/2019	\$0.85	Link Unavailable
<u>2 Firms</u>		<u>Consensus</u> <u>\$0.90</u>	

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Rating	Return Expectations In 12 Months
Buy	Greater than +10% above the Benchmark
Hold	Between -10% and +10% of the Benchmark
Sell	Less than -10% below the Benchmark
Not Rated	The analyst has refrained from making a recommendation as a commercial relationship or conflict of interest may exist.

Benchmark is S&P ASX Emerging Companies Index (SPAXEC) unless otherwise defined.

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