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XTEK Ltd

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XTEK reaffirms fiscal 2018 revenue guidance while broker forecasts new products to drive strong growth

XTEK Ltd (ASX:XTE) recently reaffirmed its revenue guidance for fiscal 2018.

The developer and manufacturer of protection, military and surveillance products continues to win new contracts in realising mid-range revenue guidance of about $14 million.

Management is forecasting revenues to be in a range between $11 million and $18 million.

Managing director Philippe Odouard said: "We are excited with our continued progress, accelerating the commercialisation of our world-class product suite.

"Strong growth is forecast across all our capabilities as we further develop our product pipeline and endeavour to leverage increased defence spending both in Australia and internationally.

"Our standing with the Australian Defence Force (ADF) and a number of key international customers positions us well for rapid near-term revenue growth."

Price target implies substantial upside

Patersons analyst Jon Scholtz is slightly above the mid-point of XTEK's revenue guidance with his base case forecast of $15.5 million.

The broker initiated coverage of the stock in February with a speculative buy recommendation and a price target of $1.15.

At that stage, XTEK was trading just shy of 70 cents with Scholtz's price target implying upside of about 70%.

However, the company's shares have retraced over the last six weeks to trade in the vicinity of 50 cents.

This could represent a buying opportunity given that there have been important positive developments occur which may have been missed.

The price target now implies upside of 130%.

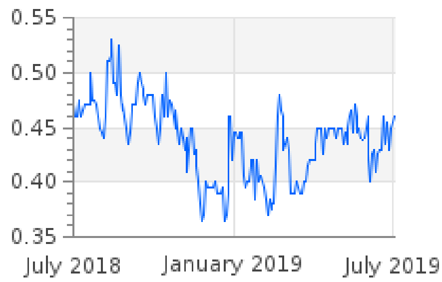
New products to drive revenue growth

Another factor to take into consideration is the recent release of new proprietary products XTclave™ and XTatlas™ which Scholtz hasn't factored into his projections.

That said, revenues from these products are more likely to impact fiscal

Price:	A$0.46
Market Cap:	A$18.67M

1 Year Share Price Graph



Share Information

Code:		XTE
Listing:		ASX
52 week	**High**	**Low**
	A$0.53	**A$0.35**
Sector:		**Tech**
Website:		**www.xtek.net**

Company Synopsis:
XTEK Ltd (ASX:XTE) is focused on the delivery of protection and sustainment solutions for the government, law enforcement, military and commercial sectors.

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2019/2020 revenues.

Ongoing revenues will be generated by some of the established market leading weapons such as the XTEX TAC2 sniper rifle shown below.

Scholtz is forecasting base case revenues of $22 million in fiscal 2019, which according to his margins should deliver a net profit of $1.2 million.

This represents earnings per share of 3.1 cents indicating the company is trading on a PE multiple of about 16.

While this could be seen as a fairly appropriate multiple for a small emerging company, it arguably doesn't take into account the group's medium to long-term growth profile.

It is also worth noting that it is a steep discount to the industry average PE multiple of 27.

Strong relationship with Australian Defence Force

XTEK has already made significant ground in terms of forging relationships with high profile clients such as the ADF, as well as State police.

There is also demand for the company's products from overseas.

While the end markets are often confidential, the recent sale of certain equipment to FY Composites is important as it is known to supply the Finnish Defence Force, as well as other European clients.

While further expansion into overseas markets would be welcomed, it is worth noting that there is already strong ongoing support from the ADF.

Recurring revenue to increase

Supply contracts traditionally extend over a period of at least three years with revenues also generated from maintenance and support activities over a five to seven-year period.

As the company's sales build over time, there will be a marked increase in the level of recurring revenue that is generated from maintenance, repair and the provision of parts.

This will assist in providing a level of earnings predictability which can offset the sometimes lumpy sales revenue patterns that can be a function of contract timing.

Reaching a point where there is consistency of revenues is often the line in the sand where companies are valued in line with their growth potential.

Five-fold increase in net profit in 2020

With XTEK for example, Scholtz is forecasting a substantial uptick in earnings in fiscal 2020 with base case net profit increasing from $1.2 million in 2019 to $6.4 million in 2020.

This represents earnings per share of 16 cents, implying a heavily discounted PE multiple of about three relative to the company's current trading range.

XTEK shapes up as one of those companies that could appeal to forward-looking investors targeting stocks that have niche market positions early in their growth cycle.

Parallels with Electro Optic Systems

On this note, it is worth comparing another player, Electro Optic Systems Hldg Ltd (ASX:EOS) that has been operating in this space for more than a decade.

Similar to XTEK, the company has had well-credentialled proprietary technology with broad applications including military.

There are even some similarities in the type of products they offer with a focus on remotely controlled/robotic technology used in military engagement and surveillance.

This appears to be a step-change in the industry, one which has been driven by the need for stealth and the desire to limit casualties.

This has been accommodated by innovation in mobility and the use of more resilient materials by companies like XTEK and EOS.

EOS's journey

Step back to 2004/2005 and you can see from the share price chart below that investors recognised EOS's potential.

Its share price more than doubled between mid-2004 and early 2005.

However, it slumped and remained suppressed for a long period of time despite the fact that the company was making positive ground in terms of developing new technologies in collaboration with a high-profile client in the US Army.

The other aspect to note in the historical financials table below is that over the last 10 years the company has generated nominal revenues.

Technology eventually drives top line

But EOS was always about its proprietary technology and there was strong evidence that a sizeable payday would come.

Unfortunately, some investors became impatient, and the troughs in the chart indicate that selling created some outstanding buying opportunities for patient investors.

The case study below is a snippet, but it highlights the fact that the award of a $410 million contract by the US Army had been a development in the making for more than a decade.

While taking in how things unfolded for EOS, keep in mind the fact that XTEK is already at a stage where it will be generating revenues similar to EOS's fiscal 2017 top line.

If Patersons' base case projections of revenues nearly doubling from $22 million in fiscal 2019 to $41.5 million in fiscal 2020 are realised, one would expect a rerating.

XTEK's market capitalisation is $20 million compared with EOS's market capitalisation of $285 million

Electro Optic Systems Case Study

Excerpt from ASX announcement dated January 30, 2018

'Electro Optic Systems has been awarded an AU$410 million contract to supply significant quantities of its new R-400S-Mk2 remote weapons systems to an overseas customer.

This contract brings sales of this new EOS product to AU$600 million in the first 12 months of product release.

In opening remarks, Dr Greene (CEO) said: "**This new weapon system was initiated in 2005 under a US Army contract** to develop next-generation weapon systems. After 7 years of development and 4 years of testing around the world in many harsh environments, **the new system entered production in 2017."**

"All **$600 million of new contracts are deliverable in monthly shipments from 2018-2022** and follow-on awards for additional equipment, spare parts, servicing and support are expected.'

Continued government support

EOS's significant share price rally in 2016/2017 was triggered by the award of a contract for 45 units of EOS remote weapons systems to those with new performance levels developed by the group.

This stemmed from the company's established relationship with the ADF, similar to that forged by XTEK.

XTEK's sales to the broader Homeland Security instrumentalities in Australia could increase substantially in the coming years.

While XTEK's shares have retraced recently it is worth noting it's trading patterns over the last two years.

There is much less volatility than was the case with EOS over the course of a decade, suggesting this may be a temporary retracement.

ADF recognised supplier

An ADF recognised supplier, XTEK is listed on the ADF register as an approved maintenance facility and is a member of the Defence Industry Security Panel.

Additionally, management and staff have distinguished military and police backgrounds and extensive experience in the Homeland Security sector.

The Australian Government has stated the agenda to provide key military hardware to the global defence market.

It has also provisioned funds to help local defence companies in their manufacturing and export efforts.

Patersons noted that the Turnbull government is said to be spending $200 billion over 10 years on defence industries.

Record December half revenues

XTEK achieved record revenue for the half-year ended December 31, 2017.

In addition, XTEK finished the 2017 calendar year with record orders in hand of $42 million, the highest in the history of the company.

It was also debt free with $4.5 million in cash as at February 21, 2018, which management said was a well-funded position to be in for the remainder of fiscal 2018.

With new products such as the XTclave™ and XTatlas™ already gaining attention/orders from the US military, the ADF and other global enterprises, the group's order pipeline could increase exponentially.

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