

XTEK: Armouring up militaries

Alan Kohler speaks to the CEO of XTEK, Philippe Odouard, about the company's plan to capitalise on the American law enforcement market, its contract with the Finnish army, and its loan from CBA which is being used to build a new production line for helmets.



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Philippe Odouard is the CEO of XTEK, the military protection company that makes armour.

There's been a bit going on with the company, so I thought it was time to catch up with Philippe to get some details of what they've been doing. They've signed a contract with the Finnish army and also borrowed some money from the Commonwealth Bank to build a new production line, so I thought it would be a good idea to get some detail. Maybe they're going to start making some decent profits.

Here's Philippe Odouard, who is the CEO of XTEK.



Philippe, perhaps to begin with, could you bring us up to date with your cash situation? You put out a March quarter update but there were no kind of details on cash in there. What's the situation now, how much cash have you got?

The cash is actually in reasonable shape. It's pretty hard to sort of give you a figure when I don't give it to the whole of the market. But you've seen that we've secured a loan with the

Commonwealth Bank for \$2.5 million dollars, so cash is okay on one side and we have enough money with that loan to sort of fund the investments we need to do and the working capital we need to have, so it's pretty positive.

Why don't you have to give it to the whole market? I don't understand how you get out of doing an Appendix 4C cash flow report each quarter.

We don't report every quarter, we report every half-year and we give the cash then, yes, absolutely, and we will at the end of July.

Okay. You had some wins lately. Just bring us up to date with what you've done. The loan from the Commonwealth Bank was a specific purpose loan, right?

Yes, because we sort of planned a number of things in terms of investment, in particular, to sort of manage to produce large quantities of helmets, we needed to top up the cash so that we could do that investment which is sizeable. At the present time, we can do that alignment, we can do a medium amount and a small amount of helmets, especially on what we call the pre-forming, that's the first operation that takes a flat stack of plies and puts them into the shape of a helmet. So we need a number of presses to do a large number of those and as you know, what we're trying to do, not go for small quantities, but go for the market, really.

Can we have some detail on that? You've got a contract for these helmets, right?

At the present time, we have distribution channels through the acquisition we did in September last year in HighCom in the US. HighCom is actually a company that has been manufacturing armour, helmets and plates, and soft armour as well, and has had a very wide distribution network with mainly in law enforcement in the US. These people are basically ready to pick up what we can deliver and set. They're very actively engaged in the market, but we're now getting very close to being able to deliver smaller quantities to start with and then much larger as we go.

We have access to the largest market in the world. The US is 40 per cent of the world market. Law enforcement – 800,000 officers is 18,000 agencies that buy separately. It's a very, very large market on its own and they consume tens of thousands of helmets a year. We are basically ready, we have the people, these products are on the website of HighCom. They are pushing the salesforce across the US to start the sales, so yes, we are ready to go. As you've seen as well, in terms of other markets, we've signed a contract with the Finnish defence forces for about 4,000 plates that we delivered before the end of the year. Now, we have serious contracts on foot and we're getting more. Remember, that a lot of what we do in terms of law enforcement, particularly in the US, is a very, very short delivery time. They tend to sell a lot out of stock, so that's pretty much immediate, all within a month or two, so it comes really quickly. We expect quantities to grow very substantially and very quickly.

But to be clear, the deal with the helmets is not a contract, you're just going onto the website of this outfit in the US and you expect that to lead to sales, right? That's correct?

No. It is on the website that it's there for sale, but we have a network of distributors that we work with actively and we sort of court for specific opportunities. We have about 15-20 different distributors over there that basically sell to the 18,000 agencies. As I say, they go from a few units to thousands of units, it depends on the opportunity.

The \$2.5 million from the Commonwealth Bank is to build a pressing line to be able to produce more of these things, right?

Yes, that's correct. It actually transforms a flat stack of material into a semi-spherical shape of a helmet. This then goes into our [X-Glove] that actually consolidate this, increase the temperature and make it a solid shape that withstand rounds.

How many would you be able to make?

With one machine we're planning to be able to generate up to \$40 million dollars a year. When we have a turnover this year of about \$45 million, that's definitely a very substantial amount. We're planning in the medium term to have a second line in the US because we have a factory there and when you want to sell to the military in the US you need to produce there. We'll have a second line in the US, that means the two lines together can give you \$80 million dollars of turnover.

Did you say that you have \$40 million sales or that you plan to have the \$40 million sales?

We have the capacity to make \$40 million in sales.

Okay, and how many items is that? What's the per item cost?

That's why I've expressed it in that way, which is something that investors can understand. If you talk quantities, it depends – we can do plates that sell for about \$400 dollars, we can do helmets that sell for \$1,300 to \$1,500 dollars. But we can do less helmets than plates.

This line, the production line, actually does plates as well as helmets? I thought it was just helmets.

No, the preform line that we're funding with the Commonwealth Bank is for helmets. The machine that we have installed in our facility in Adelaide – and remember, we opened up the facility in February, has the main machine which is what is called the [X-Glove] that is really the process that we have that is unique and patented.

That's your IP, right?

That's right, yes. That machine can produce the \$40 million. We've got presses that are a lot cheaper that feed into this, basically.

Right, that then feeds to the helmet line, is that right?

Those presses are used for helmets, yes. To do plates, we have all the equipment already, so we don't need to invest anymore.

I get that. The helmets sell for \$1,300 to \$1,500 dollars, is that right?

Well, it depends on what circumstances, what equipment on them, what specifications we need. Yes, that gives you a rough idea.

How does that price compare with the competitive helmets in The United States?

Well, the beauty of this is that the helmet in question really has very few competitors. Most helmets or nearly all helmets at the present time are protecting against fragments and pistol rounds, not against rifles. Our helmets are actually protecting against a rifle at what we call muzzle velocity, that means point-blank on the helmet. And there's very few of those that are available. Some of them are made out of titanium and cost a fortune and weigh an enormous amount. Others are just putting what we call applique, so it's a sort of ceramic that you put on top of your normal helmet.

All of those weight 2.5 kilos, ours weigh about 1.5-1.4. That's a huge difference and when you know that a helmet on the head of someone beyond 1.6 kilos is starting to produce some issues

in your neck in the long-term or worse, if you jump with a parachute for instance in the very short-term. It's really a massive difference.

It sounds like you're going for the American law enforcement market first, is that correct?

Yes, that's correct because we have a very large market for that, and people exposed to rifles in the US is very large. We protect against AK-47 rounds, you don't find very many of those in the public and in the rest of the world because we have laws that are a lot stricter. But in the US, you go to any demonstration, they have them. That's the first market we go to...

And what do you think your potential market share of that particular market might be?

Well, it's hard to say. We'll fill out 80 million without much of an issue, I can tell you that...

\$80 million dollars?

Yes. And of course, we go as well for the military in a number of other countries. Military normally takes a lot longer. We did a lot with the military here, that's our bread and butter in Australia. Even small contracts can take months, if not years. The Finnish defence force's, for instance, took us two and a half years to – we knew it was happening, it took us that length of time to get there. You need to have the short-term thing that the law enforcement can give you and the medium-term one that the military worldwide can actually offer.

The deal with Finland is for the plates, right?

Correct, yes.

That's an actual contract, can you tell us the detail of that contract?

Well, I've mentioned it in the press release, we're talking about something around just a bit less than \$2 million dollars to be delivered before the end of the calendar year. These are very, very light plates, typically, they do the job of a plate which frees up to 30 per cent more heavy. That's why people are particularly attracted to that because, in general terms, the technology we offer is bringing much lighter items, basically, to the soldier or the law enforcement person.

The Finnish army isn't one of the big armies of the world. I just wonder, how come it turn out to be Finland who bought the things first?

Who knows? We've been in touch with them, they've been interested from day one. Our agent in Europe is actually in Finland, so that probably helps.

Right, okay, I imagine you expect now if that works and Finland's happy with these things, other military forces will be interested in picking them up as well, is that what you think?

Absolutely, and we've been very active on the market for a number of months, if not years, to sort of prime the orders like this. The Finnish army is actually maybe a small army, but it's a very sophisticated one. They happen to have probably the longest border with Russia. These guys are feeling very threatened and they're very, very careful in what they buy because they have a big neighbour that is not always as friendly as you want, so it's a very, very good reference. When you talk to people outside in other countries, for them to see the Finnish having placed an order like this is normally a very, very good sign because they try and protect their people to the nth degree and they are very close to a potential threat.

Do you have a sales pipeline you can tell us about?

At this stage, it's hard to say. We're talking to a lot of people and these are maturing slowly, as I mentioned, so, no, it's not possible to give you much more than that.

When does your business planning have you at cash breakeven?

The company is not burning cash, the company has been in operation for about 30 years or so. We've been profitable in the last three years and in terms of cash, for operation, we're not burning cash.

Maybe I'm looking at something incorrectly. The half-yearly had a negative cash flow?

Well, yes, that's the seasonality of our sales. Typically, our cycle of sales – and remember that a lot of what we're doing at the present time tends to be more on the drone side. We have a large contract with the Australian army on this. Typically, our operation tends to go with the cycle of the budget – the budget is actually decided in May, normally, of each year. People start to enquire on what they want in July/August, place orders before the end of the calendar year and we deliver towards the end of the financial year. The first half is normally very quiet, the second half is very busy.

This year, we had a bit more activity on the first half, but definitely, the second half is really making your year, and so as we speak we deliver a lot of things and we believe that we will continue that trend. Typically, if you look at the past, the first half tends to be negative and but we normally catch up with what's happening in the second half.

Right, okay, well that explains it. Could you give us a sense of, if you do manage to sell \$40 million dollars' worth that you're going to produce of the helmets this year, how much of that falls to the bottom line, what's your margin?

We expect the typical margins that you get in defence, 8 to 10 per cent net. That's what we expect typically.

I expected it would be more than that, that's pretty tight margins, heavens!

[Laughs] Well, this is the real world, you know?

Bloody hell, this is high-tech material, gee!

Well, yes, sure, but don't believe that defences are paying premiums, they've turned to be very tight with the taxpayers' money and 10 per cent net is not a bad margin at all. You can live quite well on it.

No, of course, that's right. Your profit for the full year, June 2019 profit was – let's look it up...

Not that amount.

No, no, but I'm just interested because – I mean, what sort of difference the margin on \$40 million dollars would make to your profits?

Very, very substantial. What happened is that our typical business before used to be mainly in distribution. That means, we buy things from overseas and resell it to defence here. That is a low-margin business, that's why probably I'm happy with 10. But I mean, I've been in defence for a long, long time and that's what normally people do. The model that we had before of distribution is something that we want to diversify from because it's very low margin. The way to do this is have good products where you have IP and you own the IP and then you're capable of

selling it worldwide. So, we sort of invested for the last few years, trying to keep still in the black, but with very modest profit.

The fact that we've now got a fair bit of maintenance on these UAV drones, is enhancing our profit. The fact that we have these new products coming up in terms of mainly the plates and helmets, are helping to sort of push us into much more healthy gross margins and net margins already from next financial year. So, yes, it's a change in the model which goes from a low margin business to a high margin business, which is what we wanted to do and which is very important for our shareholders.

It's interesting that you decided to fund the production line for the helmets with a loan. Why didn't you raise equity?

Normally, we raise equity because banks wouldn't give us money. We're a small organisation, most of the time banks are basically saying, "No, you're not a good risk." And the only way you can fund yourself is through equity, and we've done that in the past of course. What happened there is we had three years of profit, we went to the bank and said, "This is what we want to do, will you help us?" and they basically said, "Yes." We asked for \$1.8 million and they gave us \$2.5 million.

How much are they charging in interest?

It's not public, but it's very competitive. It's slightly more than a home loan but not very much more.

Less than 10 per cent?

Oh, yes, much less!

[Laughs]

But, so, in the end, we get money and we don't dilute our shareholders, so in the end, it's a really good thing to do. Being able to borrow, for us, was the best news possible because that means we can get large banks behind us. I mean, Commonwealth Bank is not exactly a small entity. The level of confidence that that shows from a bank that is, by definition, very risk-averse, is actually very, very good news. On the other side, we can see that other people are looking at our share very positively for what we do, about \$40 million dollars of turnover. We're talking about a market cap I think has just gone above \$40 million because we had a big increase in the last few days. But if you listen to Morningstar, for instance, it will give us a fair value at 94 cents and the share is at the present time at 75 cents, shows that there is a lot of confidence from people that are very serious in the market.

Well, it's been great talking to you again, Philippe, thank you very much.

My pleasure, Alan.

That was Philippe Odouard, the CEO of XTEK.

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