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XTEK's US venture

Alan Kohler speaks with Philippe Odouard, the Managing Director of XTEK - the Canberra based military supplier, about a recent acquisition the company made in America and its plans for the future.

By Alan Kohler · 19 Sep 2019

Philippe Odouard is the Managing Director of XTEK, the Canberra based military supplier.

They've just recently made an acquisition in America of a supplier of protective equipment to law enforcement agencies in particular; it's a relatively small business but it gives them a foothold into the United States for their products that are being made in Australia, and they also get a factory there as well, so I thought it'd be worth talking to them about that.

Also, they have a drone business, which has obviously been in the news lately. Their drones don't carry bombs, apparently – I asked him about that – but they do carry cameras and that's where they're getting their revenue from. They doubled revenue in the past 12 months basically in the drone business. They haven't really started selling their body armour and helmets yet.

Very interesting business, XTEK, and certainly plenty of interest in this area around the world.

Here's Philippe Odouard, the Managing Director of XTEK.

Philippe, XTEK recently bought a company in the US called HighCom. Can you tell us, why did you do that? Was it for distribution or have they got some technology that you need?

Yes, it's certainly news to see an Australian company buying a US one, it's normally the opposite, but yes, it's great news. The purpose of this is two-fold. One, is it's an entry into the US market and the US market is the biggest in the western world, it's half the defence market in the western world, so if you want to start somewhere the US is a good place to start. The fact that their manufacturing is giving us an advantage because if you want to sell to defence in the US you need to produce... Without that facility, we couldn't basically open up the military market. But they give us an opening immediately in terms of the law enforcement market, which is their specialty and they really have most of their work on that.

And it's very much a distribution sort of a market. We have 18,000 police forces in the US, so to service them all is a very massive undertaking. The good thing is that a lot of it is actually... stock, so that means that as soon as we're ready to deliver basically we can tap into that market and sell pretty much as soon as the factory – which should be ready by the end of the year – as soon as the factory is actually ready. So, to answer your question, access to the military market short-term distribution into the US market. In terms of technology, they bring a sort of the run of the mill cost-efficient technology. That is okay, for instance for a great part of law enforcement. We bring a much better technology to service the higher levels of the market, typically the higher level of the policy on one side, but also the military.

So, no, they don't bring anything particularly important in terms of technology. We bring that and that's part of the synergies between the two organisations.

But are you going to make your product in their factory, is that the idea?

Medium-term, yes. At present, for the police, it can come from Australia. As we go and we get into the military, it's going to be done in the US.

What did you mean by getting the factory ready by the end of the year? Is that to make their products or your products, why isn't the factory ready now?

To come back on the technology, we've been developing the technology for quite some time, for quite a few years actually, and we're now getting to the production phase, so to be able to deliver in larger quantities to clients, we need a factory to sort of make the production. So we've decided to make it in Adelaide, where our research centre is already based, so we've given a long-term lease. And we're basically working on setting up that factory with a machine that can produce commercial quantities. That factory should be operational from the end of this year and then from then on, we can start producing our technology.

And your body armour is lighter weight, is it, than HighCom's?

Typically, than HighCom's, but also typically from the competitors as well. It's not only the body armour that we make, it's also helmets which is an area in which we have a very significant advantage on everyone else.

Because your helmets stop an AK-47 bullet, right?

That's correct, yes, that's the main difference. You probably know, all the military helmets in operations with armies across the world are basically stopping fragments on one side and 9 mm pistol rounds, they're not designed to sort of stop AK-47 rounds and therefore, you are very much at a disadvantage. Some of their helmets are actually stopping 762-MSC, which is the AK-47 typical round, but they tend to be very complex, very heavy, some are using titanium, some are

using... that's something that you put on top of a normal helmet and it probably multiplies the weight by two, so it's a very cumbersome way to do it.

What we propose is a fully integrated helmet in one piece that does the job basically. We've been working with one of the army technical units in the US to sort of test that helmet for the past two or three years, we've done a number of those for them for testing, and the test came out very, very positive. Not only do we know it works but we have sort of a stamp of approval from the technical services of special operations in particular. It's not a pie in the sky possibility, it's something tested by the right people in the US.

Yes, but have they put in an order yet?

It takes a bit longer than that. But we're on the way, there needs to be another phase to sort of productionise the thing and improve the design a bit further, which we're working on with them, and hopefully, then we'll have something that we can sell to the military. But no one in real position is actually producing anything of that nature, so it's a very promising thing and the interest in the army was actually pretty massive in there. So, of course, we would then sell it across the world. That would be very positive as well for us.

Just before we get off the helmets, how much are you going to sell these helmets for?

Well, it's hard to say how much the helmet sells for and we don't have a public price at this stage, but helmet sales retail for $1,500 dollars, something like this – that gives you a bit of a benchmark if you like. How many? Well, as many as we can. It really depends on requirements and something like this, very new and non-existent in terms of protection... that will make a lot of new existing helmets reasonably obsolete, so that might push a renewal of large amounts of helmets in the not too distant future. That should be a big market for us.

How strong is your patent protection on this? And anyway, even with patent protection, isn't it the case that somebody's going to kind of match your technology at some point fairly soon? The jump that you've got in weight and strength can only last so long, right?

Well, yes and no. It's not as if we have the technology that is easy to reproduce. The main reason why we get those results is linked to the process that we use and we've worked on that for 10 years. We have patents that are quite strong, we have a lot of know-how in terms of how to make these parts and how to sort of process as well in addition to patents. We've made sure that making the machine, we don't sort of contract a whole lot to one party, you know, they might disappear with the technology. It's done in bits and pieces of people that don't have the complete picture. So we have a number of ways to protect our technology, which we believe are pretty efficiency.

But, basically it's the technology itself and we have a patent that is quite strong. A couple of people have tried to sort of copy us and they didn't get there, really. It's interesting to see it. People are attempting to do things in the world now but they are not successful. As I said, it took us ten years of work to get there.

Yes, okay. Just back to the body armour now, what sort of market share does HighCom have of the law enforcement market in the US? What's their position?

HighCom is actually a small player in there. We couldn't afford to buy some of the majors in there, but it's a very good position because they have an excellent reputation, their products have shown to be very consistent and never been recalled. It is very frequent to have issues with manufacturers of these kinds of things. HighCom is rather conservative and are very thorough in their approach. They have a, as I say, a well-priced, run of the mill range of products serving probably a small percentage of the market, 3 per cent of the market, but are very well known in the market and reasonably popular. So, for us as an entry, it's a fantastic way to do it. If we had

to sort of master the way to address 18,000 police forces in the US out of Australia, I can tell you it would have been impossible.

Does HighCom focus on a particular geographic area or a particular type of police force? Is it like Sheriffs only or something like that?

No, no, they basically sell all over the US. They have a full range of products, which is also very good. They do shields, they do soft armour, hard armour, helmets… They have a full range of products and some of them we're already looking at for other ventures, depending on some requirements we have because at the end of the day, we have a good range and as I said, very reasonably priced. They are quite profitable. Out $10 million dollars turnover, they cleared about $1.4 million last year, so net-net profits are – they are profitable, which is also another thing which for us is of great importance because it's an accretive acquisition from day one, which is always a good thing to do.

The consideration for HighCom is 4 million XTEK shares, $1.8 million cash and a future earn-out. How big is the potential earn-out and over what period?

The earn-out is for the year, this CY from 2019, and it's five shares per dollar of profit beyond USD$900,000 which is the profit they did last year, which is pretty much in line with the multiple that we pay for the company which is about 2.6 times profit. If you think of it, we're having a multiple of 2.6 is actually a reasonable price, but the fact that we give them quite a few of our shares, is actually giving them the participation to the upside of the synergies of the two companies are going to generate. That's why we've accepted a reasonably low multiple, because they play in the synergies and in the upside. I think it's a very good deal for everyone. They participate in the growth we achieved this year, which is...

One thing that interests me about your body armour product is whether it's possible to sell outside of both law enforcement and military. I mean, it occurs to me that if you've got a lightweight thin material that protects the body from bullets, I'm wondering whether ordinary people are going to start wearing it and sending their children to school in it. Are you looking at that kind of market as well?

You have to be pretty sick to sort of think about that, but yes, I mean that's the reality, unfortunately. In particular, for instance, we know there is a market for the fire brigades, they are actually clients of HighCom at the present time.

Are people shooting at firemen?

Well if you buy those kinds of things, possibly. I mean, if you think of it, when you have an exchange of fire, for whatever reason, you tend to have fires being triggered, so you wait for the end of the shooting to sort of get the fire people in play, or do you sort of equip them to protect them and start the work right away? I think that's the concept more than anything else. But for kids at school, I mean, possibly. We'll have to see.

Are you thinking about a small-sized version of what you're doing for children?

That's not front of mind at this stage, but if there is a market we'll see. It would be very sad if that happens, frankly.

Well, I'll tell you what, if I had kids in America I'd be thinking about it.

Yes, well if it's necessary we'll do it. It's still sad that kids are exposed to these kind of things, but you're right, if you can defend against it, not an issue, absolutely.

Well, it's not as if they're going to get rid of their guns in a hurry.

I won't get into this, this debate is a bit dangerous. I think a few presidents in the past have had problems with it. That's what it is.

Let's talk about the law enforcement market then. Can you give us a picture of that market in the US, the police forces? I mean, how many suppliers are there and how competitive is that market?

It's reasonably competitive in terms of the number of people that are servicing it. I mean, you have 800,000 police officers. You have, as I said before, 18,000 police forces with each of them buying separately. But the number of manufacturers is not that big. You probably only have – I think it's about half a dozen of manufacturers. Vests from HighCom, for instance, are resold under other names as well. People are doing some rebranding to sell it under their brand name, which is fine, there's no problem. They're not competitors as such, but as I say, in terms of manufacturers, it's a small number, half a dozen or so.

Do they also supply the military? Are they all combined markets or are they kind of separately supplied?

Don't know what you mean by separately supplied. They're not focused very much on the military market because their plates are probably not up to the specifications that the military are buying, so that's where we get in, if you like. Our plates are definitely in the military range in terms of performance. It's next to performance here because I mean, all their plates are stopping the threats that the military are looking for, it's just the weight of it. The of it has to be much lighter than what they have in their range. Our products with our technology are actually answering that particular requirement. The potential for growth in that sector is actually quite big. There are some specificities and length of time in terms of getting acceptance of a new product and getting it to be specified, getting to a tender which typically will be much, much bigger than the kind of quantities that they do. But it's a very similar approach, it's government procurement.

Do you have the lightest body armour or plates on the market?

It's hard to say, because it depends on the threat, depends on a number of factors. But we're right up there in the best, absolutely.

Right, and for the military particularly, the weight is the key factor, right?

Yes, that's correct, yes.

Can you give us a sense of your market position? Do you look at market share in global terms or individual countries? How do you benchmark and look at your position?

Well, remember that we don't have a machine that produces goods at the present time, so we may have ambitions in terms of market share, but we don't have a market share for the moment.

Okay, right, sorry.

We have a lot of contacts with the military and the sort of tests and things that we've done with the military in the US, but also with the military in a number of other countries, have shown a lot of positives and we believe we have a very light product and the militaries that we've met have basically said so as well, so it's validated by customers who have looked at the product, tested the product and we are testing and engaged with a very large number of potential clients directly from here. But again, it really depends now on, can we respond to tenders, and if we do win some of them, can we supply? Hence, the importance of the factory I was talking about.

You are making good revenue though, where are you making the revenue from? In 2019 yeah, $37.8 million revenue, positive cash flow, where's that all coming from?

That's double what we did last year and double again what we did two years ago, so yes, it's a very good growth. Most of it is actually coming from our drone business. We've been successful in winning a contract called LAND 129 Phase 4a, which is a small drone to the army in Australia. We sell a drone that weighs about 1.3 kilos and has an endurance of about 45 minutes or so. We're basically delivering large quantities as we speak, so that is actually pushing our turnover around. We're working on the maintenance of those now that they have been delivered and we continue to deliver them next year as well. But there's a lot of them coming back in maintenance which is a very lucrative market. Knowing that for an overall budget of about $40 million for the supply of those, they have a budget equivalent of about $40 million again over the next five to seven years to repair them. So, yes, it's going to continue being a good market in the next few years.

What do the drones do?

They typically give you a, what is called an ISAR perspective, which is Intelligence Surveillance and Reconnaissance capability. You send them over a village that you want to survey before you do anything. It gives us an enormous amount of intelligence real-time on the drone itself. We've also developed a piece of software that picks up the full-motion video out of the drone and converts that into a real-time map. And we have that predictive software as ways to store those maps and compare the map that you've just created from the mission you undertake with pictures of previous maps that have been taken an hour, two hours, three hours before. That gives you a real change perspective in terms of what's happening on the battlefield.

The drone is not giving you that, it's the combination of the drone and our product, our software, our product is actually giving you much more of a, what we call actionable intelligence. That means the soldier knows what's going on in real-time, well beyond his own visual range and can analyse it in detail compared to what has happened before, just to give you one of the main uses.

But you're not putting bombs in them? I'm asking obviously because of what happened in Saudi Arabia last weekend?

No, no, we're not putting bombs in them. I mean, they're 1.3 kilos, we have a payload of about a few hundred grams. It wouldn't be a very big bomb. I don't think we'd destroy an oilfield with one of ours! [Laughs]

Oh well, it would seem that warfare to some extent is going to shift to drones. It could be a lucrative business.

Well, absolutely. It's amazing how – Australia has been a bit slow to pick it up, by the recognition of the Government itself. I remember a conference where the project manager of the drone business were basically saying, "We've been testing drones for the last ten years and nothing much happens." That was two or three years ago. Now they start to have real quantities and I can tell you the use of those is just blossoming. There are more and more uses in terms of what you can do with it, the sort of size, the sort of applications. Compared to the initial quantities we got, they've used drones in a number of new applications that we didn't know was possible.

There is an exploration in terms of how you put the drones to work in the military environment, that is rather incredible and a lot of it is coming when you start operating them and you sort of say, "Oh, can it do this?", "Can it do that?". And yes, you basically being the incumbent on that sort of size of drones is an extremely good position to be in. It is very, very good, I agree. It's really protecting the soldiers. I mean, if you know what's on the other side that you cannot see with your own eyes, it really helps you.

Sure. I mean, do you think that there's more in the drone business for you, to develop a larger range of drones?

Yes, we're bidding on a number of contracts that have been led by the Commonwealth. We actually sold a complete system of the drone plus our software to New Zealand recently. Yes, it's actually quite a very buoyant sort of market, definitely.

Very good, well it's been great talking to you, Philippe, thank you very much.

Thank you very much for your interest.

That was Philippe Odouard, the Managing Director of XTEK.

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