EQUITY RESEARCH

VERITAS SECURITIES LIMITED

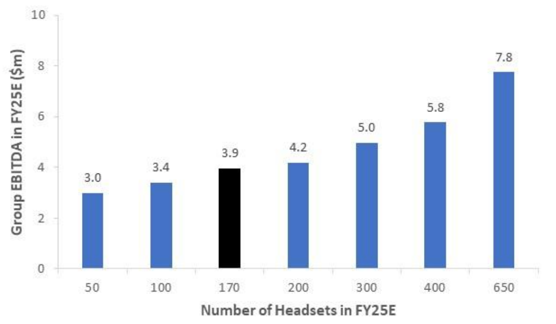
xReality Group Limited

Frontrunner in Virtual Reality Training

XRG's virtual reality software has the potential to revolutionise police and military training, an estimated US$3.4b market. We estimate the upside potential from XRG's virtual reality offering and increasing demand for the core entertainment business (following COVID) will deliver group revenue CAGR of 23% over the next 4 years. We launch coverage with a fair value of 9.5c per share.

- **Opportunity in Virtual Reality:** The global virtual reality training and simulation market size is projected to grow from US$332b in 2023 to US$973b in 2030, much of which will be attributed to military and law enforcement. Apple's announcement of the 'Vision Pro' reinforces the growth of the virtual reality segment. XRG's FREAK Entertainment and world-leading Operator software are set to harness this growth.
- **Upside potential of Operator:** The sheer size of global military and law enforcement expenditure highlights the magnitude of the potential upside that contract signings can have on revenue growth. In our view, Operator XR (Operator) is a segment leader in software and hardware quality, portability and content against peers. We forecast the number of headsets licensed to reach 170 by FY25, which underpins 33% of forecasted EBITDA growth from FY22-25. If XRG can reach 650 headsets, then the company could double group EBITDA versus our current forecast (Figure 1).
- **Entertainment earnings growth to continue:** The company's indoor skydiving brand iFLY and free roam virtual reality business FREAK Entertainment are expected to benefit from a return in demand post-COVID. We forecast revenue growth of 63% in FY23 and EBITDA margin of 13% from higher utilisation rates and streamlining of operations.
- **Fair value of 9.5c per share:** Our DCF derived fair value of 9.5c per share puts the stock on an EV/EBITDA multiple of 10.4x in FY26, which we see as fair considering the upside potential.

Figure 1. Sensitivity of FY25E EBITDA ($m) to number of Headsets



Source: Company data, Veritas estimates.

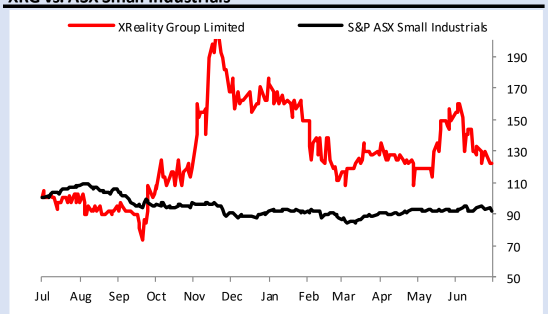
XRG.ASX **BUY**

Tuesday, 18 July 2023

Share Price	$0.042
Price Target	$0.095
Valuation Method	DCF
Market capitalisation	$19m
Enterprise value	$38m
12 month price range	$0.027 - $0.077
Average monthly t/o	1.7m
Shares on issue	446.2m
Top 20 holders	248.4m
Previous rating	Initation

Year ended June 30		FY22	FY23E	FY24E	FY25E	FY26E
Revenue	$m	6.6	10.9	12.4	14.9	18.5
Growth	%	N/A	66.3	13.5	19.7	24.3
EBITDA	$m	(3.3)	1.5	2.7	3.9	6.0
Margin	%	(50.2)	14.0	21.9	26.6	32.2
NPAT	$m	(6.9)	(1.6)	(0.6)	0.4	2.6
EPS	¢ps	(2.0)	(0.4)	(0.1)	0.1	0.6
CFPS	¢ps	(0.0)	0.3	0.6	0.7	1.2
DPS	¢ps	0.0	0.0	0.0	0.0	0.0
Franking	%	0	0	0	0	0
Dividend Yield	%	0.0	0.0	0.0	0.0	0.0
PER	x	N/A	N/A	N/A	52.9	7.3
Price/Cash Flow	x	N/A	14.8	7.2	5.7	3.4
EV/Revenue	x	5.8	3.5	3.1	2.6	2.1
EV/EBITDA	x	N/A	25.0	14.1	9.7	6.5
EV/EBIT	x	N/A	N/A	53.7	23.3	10.4
Price to book value	x	1.4	1.8	2.0	1.9	1.5

XRG vs. ASX Small Industrials



Source: Factset, Veritas

xReality Group Limited are leaders in enterprise software development for mission critical simulations for military and law enforcement. The company also develops and operates physical and digital simulations including Indoor Skydiving facilities, Virtual Reality (VR) and Augmented Reality (AR) entertainment, training, and production.

https://xrgroup.com.au/

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xReality Group Limited

Share Price: $0.042 ps **Valuation: $0.095 ps**

Financial Performance (A$m)

Year ended June 30	FY22	FY23E	FY24E	FY25E	FY26E
Revenue	**6.6**	**10.9**	**12.4**	**14.9**	**18.5**
Cost of Services	(1.5)	(1.9)	(2.4)	(2.9)	(3.7)
Gross Profit	**5.1**	**9.0**	**10.0**	**11.9**	**14.8**
Other income	0.6	0.6	0.0	0.0	0.0
Operating costs	(9.0)	(8.1)	(7.3)	(8.0)	(8.8)
EBITDA	**(3.3)**	**1.5**	**2.7**	**3.9**	**6.0**
Depreciation and amortisation	(2.1)	(1.6)	(2.0)	(2.3)	(2.3)
EBIT	**(5.4)**	**(0.1)**	**0.7**	**1.6**	**3.7**
Net interest	(1.5)	(1.5)	(1.3)	(1.3)	(1.2)
Pre-tax Profit	**(6.9)**	**(1.6)**	**(0.6)**	**0.4**	**2.6**
Tax	0.0	0.0	0.0	0.0	0.0
Profit attributable to minorities	0.0	0.0	0.0	0.0	0.0
One off items (post-tax)	0.0	0.0	0.0	0.0	0.0
Reported profit to holders	**(6.9)**	**(1.6)**	**(0.6)**	**0.4**	**2.6**

Cash Flow Statement (A$m)

Year ended June 30	FY22	FY23E	FY24E	FY25E	FY26E
EBITDA	**(3.3)**	**1.5**	**2.7**	**3.9**	**6.0**
Cash net interest	(1.5)	(1.5)	(1.3)	(1.3)	(1.2)
Cash tax (paid)/received	0.0	0.0	0.0	0.0	0.0
Working capital/other	4.8	1.2	1.2	0.6	0.7
Operating Cash Flow	**(0.1)**	**1.2**	**2.6**	**3.3**	**5.5**
Capex	(0.7)	(3.3)	(3.2)	(3.3)	(3.3)
Free Cash Flow	**(0.8)**	**(2.0)**	**(0.6)**	**(0.0)**	**2.2**
Payments on Finance Leases	(0.9)	(0.0)	0.0	0.0	0.0
Equity raised/buybacks	2.1	1.1	0.0	0.0	0.0
Net borrowings	(0.2)	(0.3)	0.0	0.0	(1.0)
Other	0.0	0.0	0.0	0.0	0.0
Net increase/(decrease) cash	**0.3**	**(1.3)**	**(0.6)**	**(0.0)**	**1.2**
Cash at beginning	1.8	2.1	0.8	0.2	0.2
Cash at end	2.1	0.8	0.2	0.2	1.4

Balance Sheet (A$m)

Year ended June 30	FY22	FY23E	FY24E	FY25E	FY26E
Cash	2.1	0.8	0.2	0.2	1.4
Receivables	0.2	1.3	1.0	1.1	1.4
Inventories	0.1	0.2	0.1	0.1	0.1
Term Deposit for Gold Coast	0.0	0.6	0.6	0.6	0.6
Other current assets	0.6	0.4	0.4	0.4	0.4
Current Assets	**2.9**	**3.2**	**2.2**	**2.4**	**3.9**
Property, Plant & Equipment	19.9	19.6	19.0	18.3	17.5
Intangibles	0.6	3.0	5.5	8.1	10.7
Right-of-use assets	12.6	12.0	11.3	10.5	9.7
Other financial assets	0.8	0.1	0.1	0.1	0.1
Other non current assets	0.0	0.0	0.0	0.0	0.0
Non Current Assets	**33.9**	**34.8**	**36.0**	**37.0**	**38.0**
Total Assets	**36.8**	**38.0**	**38.2**	**39.3**	**41.9**
Payables	2.3	2.6	3.4	4.2	5.2
Borrowings	7.7	7.5	7.5	7.5	6.5
Lease Liabilities	13.6	13.9	13.9	13.9	13.9
Provisions	1.8	1.7	1.7	1.7	1.7
Other liabilities	1.0	2.1	2.1	2.1	2.1
Total Liabilities	**26.4**	**27.8**	**28.6**	**29.4**	**29.4**
Shareholder Funds	**10.4**	**10.2**	**9.6**	**9.9**	**12.5**

Directors and Key Management Personnel		Shares	Holding
Wayne Jones	CEO & Director	35.6m	8.0%
John Diddams	Chairman	4.5m	1.0%
Kim Hopwood	Exec Director	31.3m	7.0%
Danny Hogan	Non Exec Director	18.4m	4.1%
Mark Smethurst	Non Exec Director	0.0m	0.0%
Philip Copeland	Non Exec Director	3.8m	0.9%
Stephen Tofler	CFO	2.7m	0.6%

Major Shareholders (excluding nominees)	Shares	Holding
Birkdale Holdings (QLD) Pty ltd (Stephen Baxter)	99.6m	22.3%
Wayne Jones	35.6m	8.0%
Kim Hopwood	31.3m	7.0%
Top 20 shareholders	**248.4m**	**55.7%**

Source: Company data, Veritas Research

Valuation Metrics		Valuation
Price Target (ps)	$0.095	126%
Share Price (ps)	$0.042	
FY23 EV/EBITDA (x)	25.0	
Implied FY23 EV/EBITDA (x)	40.5	62%
Implied FY24 EV/EBITDA (x)	22.9	-9%
Market Capitalisation (A$m)	19	
Enterprise Value (A$m)	38	
Share count (m)	446	

Valuation Multiples

Year ended June	FY22	FY23E	FY24E	FY25E	FY26E
P/E (x)	N/A	N/A	N/A	52.9	7.3
Price/Cash Flow (x)	N/A	14.8	7.2	5.7	3.4
EV/Revenue (x)	5.8	3.5	3.1	2.6	2.1
EV/EBITDA (x)	N/A	25.0	14.1	9.7	6.5
EV/EBIT (x)	N/A	N/A	53.7	23.3	10.4
Equity FCF yield (%)	-4.0	-10.8	-3.3	0.0	11.8
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Price to book value (x)	1.4	1.8	2.0	1.9	1.5

Per Share Data

Year ended June 30	FY22	FY23E	FY24E	FY25E	FY26E
EPS diluted - adjusted (¢ps)	**(1.92)**	**(0.37)**	**(0.13)**	**0.08**	**0.57**
EPS diluted (¢ps)	(2.02)	(0.37)	(0.13)	0.08	0.57
Cash flow per share (¢ps)	(0.02)	0.28	0.58	0.74	1.24
Free cash flow per share (¢ps)	(0.21)	(0.47)	(0.14)	(0.00)	0.50
Cash (¢ps)	0.57	0.18	0.04	0.04	0.31
Net assets (¢ps)	2.90	2.34	2.15	2.23	2.80
DPS (¢ps)	0.00	0.00	0.00	0.00	0.00
Franking (%)	0.00	0.00	0.00	0.00	0.00
Shares on issue - avg. basic (m)	344	434	446	446	446
Shares on issue - avg. diluted (m)	360	434	446	446	446

Enterprise Drivers ($Am)

Year ended June 30	FY22	FY23E	FY24E	FY25E	FY26E
Headsets Start	0	0	30	70	170
Net Additions	0	30	40	100	130
Headsets End	**0**	**30**	**70**	**170**	**300**
Headsets Growth (%)	0.0	0.0	133.3	142.9	76.5
ARR ($m)	**0.0**	**0.7**	**1.6**	**4.0**	**7.0**

Segmental ($Am)

Year ended June 30	FY22	FY23E	FY24E	FY25E	FY26E
Vertical Wind Tunnel Revenue	5.4	8.4	8.5	8.6	8.7
FREAK Revenue	0.7	1.5	1.8	2.3	2.9
Enterprise Revenue	0.1	0.3	1.2	2.8	5.5
Other Sales	0.4	0.7	0.9	1.2	1.4
Total Revenue	**6.6**	**10.9**	**12.4**	**14.9**	**18.5**
Vertical Wind Tunnel EBITDA	(1.1)	2.4	2.9	3.1	3.3
FREAK EBITDA	(0.2)	0.1	0.2	0.3	0.4
Overheads EBITDA	(1.5)	(1.2)	(1.2)	(1.5)	(1.7)
Enterprise EBITDA	(0.7)	0.1	0.8	1.9	3.8
Other Sales EBITDA	0.2	0.1	0.0	0.1	0.1
Total EBITDA	**-3.3**	**1.5**	**2.7**	**3.9**	**6.0**

Performance Ratios (%)

Year ended June 30	FY22	FY23E	FY24E	FY25E	FY26E
Operating cost margin	136.7	73.8	58.9	53.7	47.8
Gross profit growth	(9.4)	77.4	11.4	19.0	23.9
Cost growth	83.9	(10.3)	(9.4)	9.2	10.6
Tax rate	0.0	0.0	0.0	0.0	0.0
Return on capital	N/A	N/A	2.4	5.4	12.0

Cash and Debt ($m)

Gross Debt (including leases)	21.3	21.4	21.4	21.4	20.4
Net Cash (including term deposits)	2.1	1.4	0.8	0.8	2.0
Net debt/(cash) ($ m)	19.2	20.0	20.6	20.6	18.4

Contents

Enhancing lives through immersive experiences

XRG's segment include retail space Entertainment brands iFLY and FREAK as well as a virtual reality training offering for Military and Law Enforcement.

xReality Groups expertise in technology solutions and simulation brings immersive experiences to consumers and enterprise organisations across a portfolio of companies. Its business units include:

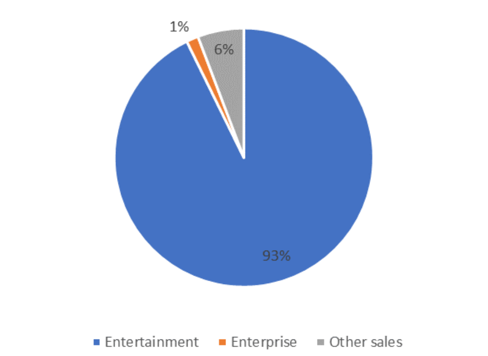
- **Entertainment**: consisting of indoor skydiving via vertical wind tunnels under the iFLY brand and 'retail scale' free roam virtual reality business FREAK Entertainment.
- **Enterprise**: developing virtual reality solutions for enterprise customers under the Operator brand for global defence and law enforcement agencies.
- **Other Sales:** food, beverage and merchandise income.

The company, previously named Indoor Skydive Australia Group Limited (ASX:IDZ), made a strategic and operational shift in August 2021, moving from primarily operating indoor skydiving facilities to building physical and digital simulations using Virtual Reality (VR) and Augmented Reality (AR). The group name was officially changed to xReality Group Ltd. in December 2021, emphasising the focus on the company's new service offerings.

XRG reported revenue of $6.6m in FY22, 93% of which was Entertainment revenue.

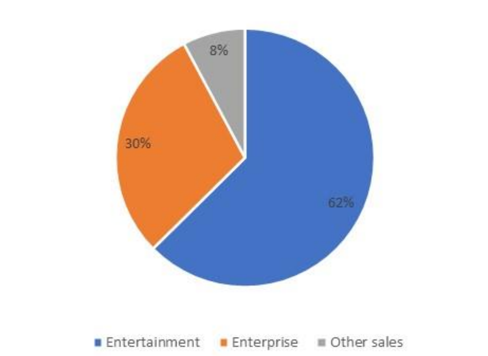
xReality Group reported sales of $6.6m in FY22, with 93% from Entertainment (Vertical Wind Tunnels and FREAK) (Figure 2). We forecast Enterprise revenue to increase to 30% of revenue in FY26 (from 1%) driven by the company securing more lucrative contracts (Figure 3).

Figure 2: XRG revenue by segment in FY22 (%)



Source: Company data

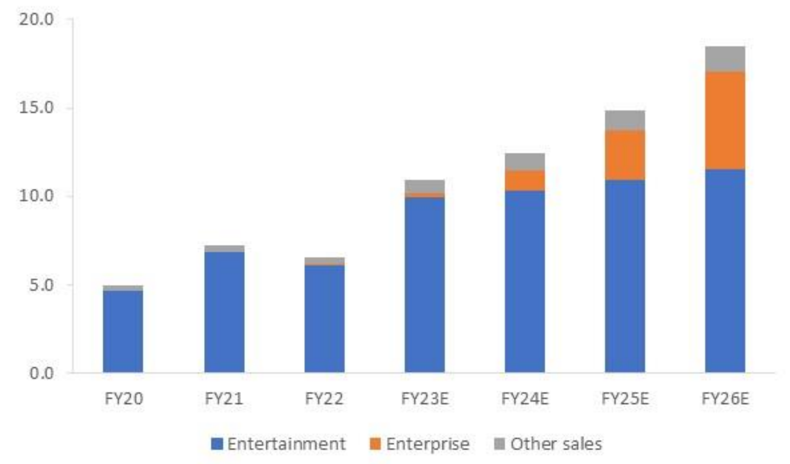
Figure 3: XRG revenue by segment in FY26 (%)



Source: Company data, Veritas estimates

We expect that Entertainment will continue its single digit growth and that Enterprise will be additive, causing a major inflection in group revenue (Figure 4).

Figure 4: XRG Segmental Revenue ($m)



Source: Company data, Veritas estimates

Wayne Jones and Danny Hogan listed Indoor Skydiving Australia in 2013.

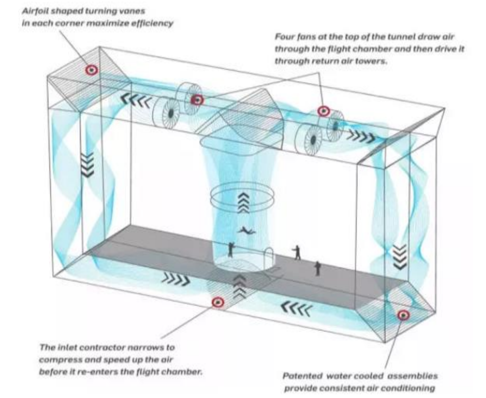
Indoor Skydiving Australia, listed in 2013 and was formed by two former Special Air Services (SAS) soldiers Wayne Jones and Danny Hogan, CEO and COO respectively. The Company's first objective following listing was to build Australia's first major indoor skydiving facility at Penrith Panthers Entertainment Complex in Western Sydney. The company in December 2019 then sought to leverage improvements in virtual reality to launch FREAK Entertainment – a multiplayer free roam virtual reality arcade centre. They now operate 2 indoor skydiving facilities and 4 FREAK locations across Australia.

Wayne and Danny's military expertise led to the launch of its new business unit, Operator XR. Operator offers training and simulation products for global defence and law enforcement agencies using Virtual Reality and Augmented Reality technologies. Along with the company's acquisition of virtual reality production company Red Cartel, XRG is able to provide fully immersive training solutions for military and law enforcement agencies.

Pioneering Indoor Skydiving in Australia

XRG was established as a training via simulation business in 2011. Its first venture was indoor skydiving, signing an exclusive contract with UK-based SkyVenture International Limited to supply their vertical wind tunnels and license their iFLY brand across Australia. SkyVenture is a world-leading manufacturer of their patented tunnels (Figure 5), operating 23 VWT's across the world and owns the iFLY brand. iFLY is Australia's sole indoor skydiving operator. The listing in 2013, raising $6.09m in new capital and $5.91m through a convertible note facility with Birkdale Holdings (a trustee of ex-Director Stephen Baxter) initiated the construction of the first facility in Penrith (Figure 6). XRG currently operates vertical wind tunnels in Sydney and the Gold Coast.

Figure 5: SkyVenture's Tunnel Design



Source: Company data

Figure 6: iFLY Penrith

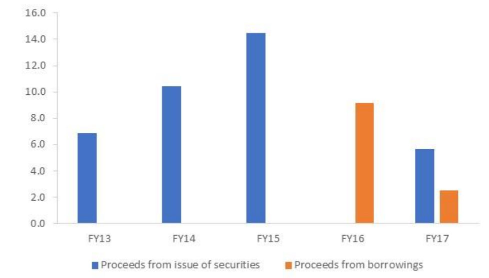
Source: Company data

The facility had immediate success, generating $1.2m in revenue and $0.4m in EBITDA in the first 3-months of operations, with an overall utilisation rate of 67% (85% in school holidays). The company subsequently raised $10.4m in FY14 for commencement of their second facility in the Gold Coast.

XRG raised over $49m in equity and debt in its first 5-years of listing.

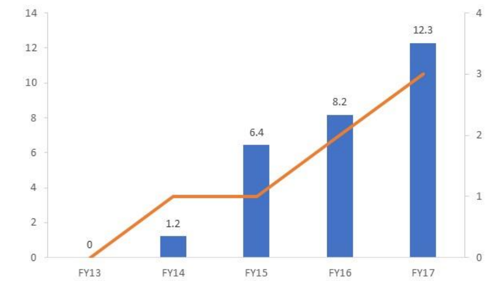
Over the next three years, the company raised $16.8m in new capital, $3.4m in rights issue and announced a $15.3m debt facility with Westpac to accelerate the construction and planning of Gold Coast, Perth, Adelaide and Entertainment Quarter, Sydney (Figure 7). From FY14-17, the company increased revenue from $1.2m to $12.3m (CAGR of 78%), opening 3 facilities over the period (Figure 8).

Figure 7: Capital and Debt raised from FY13-17



Source: Company data, Veritas

Figure 8: Revenue ($m, LHS) vs. iFLY facilities (RHS)



Source: Company data, Veritas

Contractual dispute stymied growth plans

iFLY went global in 2017, signing a MOU for development in Malaysia, China and Hong Kong.

During February 2017, following the success of its three Australian sites, the company announced a Memorandum of Understanding (MOU) had been signed for the development of an indoor skydiving facility in Malaysia. The construction of the vertical wind tunnel would use specialist Czech Republic based Strojirna Litvinov (now STRL Group) – a competitor to SkyVenture. Initial investment in the site was expected to be $1-1.25m, with XRG entitled to 60% of operational profit. A further MOU was signed for China and Hong Kong operations under their new international brand ‘AirRider’.

On 21 September 2017, the company announced they had received a formal notice from SkyVenture regarding a contractual dispute due to XRG’s expansion into South-East Asia and China. The notice pertained to XRG using a new VWT provider for the expansion whereby SkyVenture deemed it necessary for XRG to exclusively use their VWT’s in any indoor skydiving facility regardless of the location. XRG vehemently denied any such obligation and would defend any allegation. An arbitrator was appointed to hear the contractual dispute, scheduled in the United States. During this time, the Malaysian facility commenced its first flights. With legal fees set to exceed $2.5m, the group entered a $3m loan facility (and option issuance) with Birkdale Holdings (a trustee of ex-Director Stephen Baxter).

On 23 July 2018, 10 months after the initial notice was received, XRG was suspended from official quotation pending resolution of their dispute. Shortly after, long-standing Chairman Ken Gillespie resigned from the board.

Resolution of Dispute

XRG settled the dispute in September 2018 after 10 months of deliberation.

On 25 September 2018, XRG announced the group would settle with SkyVenture. Terms included:

- Pay SkyVenture US$3.79m.
- Exclusive use of SkyVenture as XRG’s worldwide supplier of wind tunnel equipment.
- Cease any activities with any other vertical wind tunnel suppliers and end the use of the AirRider brand.
- Return to its role of owner-operator of iFLY branded wind tunnels.

The founder of SkyVenture’s UK facilities, Simon Ward, also agreed to become a non-executive director. The company reported a net loss after tax in FY18 of $10.14m (vs. $0.89m in FY17), including $2.6m in impairment costs, $2.5m in legal expense and $3.5m in dispute settlement costs. Over the dispute period, the share price fell 88% to 4.5c from 37.4c (Figure 9).

Figure 9: Share price from dispute notice to resolution ($ per share)

Date Range: 1/2/17-31/12/18
Source: FactSet

Repair, Growth and Diversification

The distraction of the SkyVenture dispute for management and the failed Malaysian operations closing led to a balance sheet issue, with net debt ballooning to $10.0m in FY18 from net cash of $4.3m in FY15. Management conceded a new strategy was needed:

- **Repair**: Reduction in interest bearing debt and liabilities. Restructure of board and senior management to reduce overheads.
- **Growth**: Invest in existing activities with new digital marketing and website as well as new revenue streams with virtual reality and new facilities.
- **Diversification**: Introduction of new entertainment activities such as virtual reality.

In the following months management completed the following: Sale of Perth facility to SkyVenture, $3.4m entitlement offer, conversion of $1.2m Birkdale loan, reduction in overheads, investment in virtual reality and a board restructure, with Stephen Baxter becoming Non-Executive Chairman, Danny Hogan transitioning to a Non-Executive Director and Jon Brett and James Spenceley stepping down.

Learning from Mistakes

We believe that management have learnt from the SkyVenture experience. There is now a greater focus on owning intellectual property, self-funding growth and cash flow generation. The launch of FREAK Entertainment and its virtual reality training software Operator revitalises the business, leveraging managements experience towards sustainable expansion and profitability.

Harnessing Potential in VR Entertainment

After seeing the potential of virtual reality during visits to China, the company began the investment and subsequent launch of FREAK Entertainment in December 2019 – a free roam, multiplayer virtual reality experience. Opening in the same Penrith precinct as the original iFLY site, feedback was extremely positive:

> *"If seeing is believing in VR, then FREAK VR is planning on opening people's eyes" – Joab Gilroy, Red Bull gaming expert.*

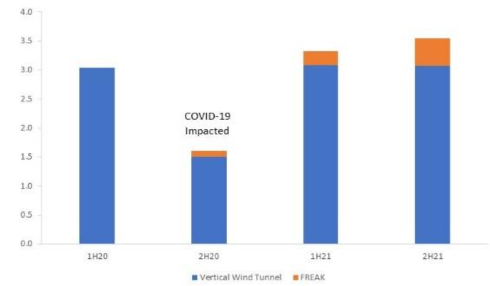
Leveraging the significant advancements in virtual reality quality, hardware compactness and gaming developments, FREAK brings a one-of-a-kind experience for people of all ages. Similar to traditional laser tag, FREAK operates in an arena style facility offering options such as free roam, escape rooms, arcade games and racing simulators. Importantly, the player experiences this in an immersive world with either zombies, aliens, ghosts, robots or many other worlds.

COVID-19 Shutdown

Revenue rebounded from $1.6m in 2H20 to $3.5m in 1H21 from the recommencement post-COVID.

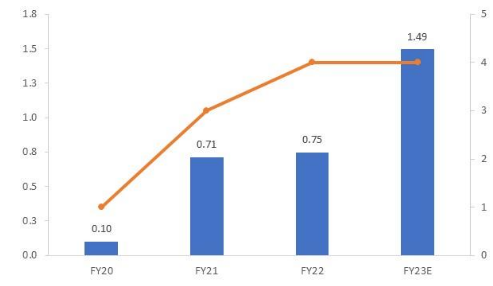
The onset of COVID-19 briefly closed operations in all iFLY and FREAK sites from March 2020 – June 2020. Revenue was weakened over the period, decreasing from $3.4m in 1H20 to $1.6m in 2H20 (Figure 10). With the recommencement of operations, 1H21 revenue increased to $3.5m, with $0.2m added from the Penrith FREAK site. Immediate positive sentiment meant an emphasis on organic expansion of FREAK, opening sites in the Gold Coast and Bondi Junction, Sydney during 1H21. Growth has continued, with 4 facilities currently open generating annualised revenue of $1.5m (Figure 11).

Figure 10: Half year revenue during COVID-19



Source: Company data, Veritas

Figure 11: Revenue ($m, LHS) vs FREAK facilities (RHS)



Source: Company data, Veritas estimates

The Future of Tactical Training

XRG launched Operator XR (Operator), a training software to global military defence (OP-1) and law enforcement (Operator LE) agencies using Virtual and Augmented Reality technologies in August 2021. XRG has developed state-of-the-art software that allows participants to be fully immersed in each scenario where teams train in the same physical and virtual space. Importantly, the products are completely portable with set up in only a few minutes in any location without the need for cameras or other bulky hardware.

XRG acquired Red Cartel for $609k for a mix of scrip and cash, to bolster the company's virtual reality content.

The origins of the software came from acquiring development team and production studio Red Cartel in August 2021 for a mix of scrip and cash worth $609k. Red Cartel bolsters the company's virtual reality content through the creation of games for FREAK, development of Operator capabilities and broadens revenue streams through IP ownership.

Further, via its Mission Rehearsal System, trainers are able to build their own room layouts, select types of enemies and create their own scenarios in response to real world targets and environments using participants personal live weapons in a secure and offline system. The true power of the system is the ability of the user to customise the interactive environment to meet the criteria of a specific training objective or a specific trainee's needs.

Hardware has been designed to replicate the participants in-field requirements to mimic the experience of real scenarios. Hardware kits include:

Figure 12: OP-1 (Military) Hardware

Source: Company data

Figure 13: Operator LE (Law Enforcement) Hardware

Source: Company data

Alongside the hardware, XRG have created a state-of-the-line After Action Review module for use in team mission rehearsal debrief – a fundamental aspect of any training program across military and law enforcement. The After-Action Review module includes features such as: review through different POV, top down or fixed internal camera angles, field of view tracking, weapon angles, eye movements and more.

Becoming Embedded in Training

Military and law enforcement are routinely required to carry firearms with the potential to use lethal force. This requires regular training to maintain firing accuracy and tactical awareness. Yet training costs can be high and training outcomes may be poor. Operator's virtual training delivers

Improved training outcomes:

- **Increased Scenario-Based Training**: Less instructors and no fixed facility requirements mean more training sessions can be conducted.
- **More Training, More Often**: The almost zero time to reset scenarios allows for more repetitions in a shorter period, meaning enhanced training efficiency.
- **Tracking Compliance**: The ability to record sessions ensures compliance with training standards and provides valuable data for improvement.
- **Reduced Retraining Costs**: The more efficient training process leads to less retraining required, saving time and money.

At a lower cost:

- **Fewer Instructors Required**: Training sessions can be run with one instructor, meaning agencies can save on personnel costs.
- **No Role Players Needed**: VR eliminates the need for role players, reducing personnel costs.
- **Reduced Training Time**: Allows for increased throughput and speed to reset scenarios, means more efficient use of time and resources.
- **Decentralised Training**: Offering more options and potential to train whenever and wherever providing increased flexibility and efficiency.
- **Lower 'Simunition' Costs**: Operator runs on gas systems (almost $0 per round) vs. traditional simunition (~$1 per round). Simunition are special cartridges that fire non-lethal projectiles, designed to simulate the recoil and accuracy of the weapon.

Individuals using virtual reality for training were four times faster to train than in the classroom and 275% more confident to apply skills according to a 2022 PwC Metaverse Survey. We view the ability to improve training outcomes to become increasingly vital financially for agencies. Between 2015-2020, the New South Wales Police in Australia paid out $100m in settlements alone for officer incidents including excessive use of force and inappropriate tactics. By investing in better training methods, agencies can potentially reduce such costs from improved performance.

It is also important to note that many police officers will experience their first de-escalation event while on active duty which may cause unwanted results such as unnecessary harm to the public or an officer. Theoretical training and group preparation can only educate an officer so much and will inevitably differ greatly to the real-life experience. Operator allows repetitive and immersive education, exposing officers to real life scenario training with different threats and different environments, meaning officers are more confident in whatever de-escalation scenario awaits in the real-world.

Well positioned in a competitive market

The size of global military and law enforcement agencies and the rise of virtual reality in training has demanded the creation of a more effective training product. Operator stands above the rest in both its Military and Law Enforcement offerings with the most compact hardware and quality software (Figure 14). Although, several companies have entered the space, offering simulation (screens) and virtual reality training, we believe Operator has developed the most realistic software for participants to meet their training needs. Combined with the slimmest hardware, ability to use in any location and functioning on a secure offline network means Operator should be the most suited provider amongst its peers.

Figure 14: Competitor Matrix for Military and Law Enforcement Peers

Military Peers	Type	Key Features	Integration to Real Weapons	Portability	Easy to Use	Visual Fidelity and Realism	Scale of Content Library	After Action Review System
OP-1 (XRG)	Virtual Reality	Uses VR headset and motion tracker, no cameras	✓	✓	✓	✓	✓	✓
Street Smarts VR	Virtual Reality	Bulky, external tracking and PC's required	X	X	X	✓	✓	✓
Adaptive VR Ltd.	Virtual Reality	Uses VR headset and motion tracker, no cameras	X	✓	✓	✓	✓	✓
Laser Shot Inc.	Simulation	Uses projector on screen	X	X	X	✓	X	✓
Inveris Training Inc.	Augmented Reality	Blends real environments with CGI characters	X	✓	X	X	✓	✓
SimCentric	Virtual Reality	No intergration with weapons	X	✓	✓	X	✓	✓
Re-Lion	Virtual Reality	Bulky, external tracking and PC's required	X	X	X	✓	✓	✓
Refense	Virtual Reality	Cameras required	X	X	X	✓	✓	✓
Asterion XR	Virtual Reality	Bulky, external tracking and PC's required	X	X	X	✓	✓	✓

Law Enforcement Peers	Description	Key Features	Integration to Equipment	Portability	Easy to Use	Visual Fidelity and Realism	Scale of Content Library	After Action Review System
Operator LE (XRG)	Virtual Reality	Large scenario library using in-service weapons	✓	✓	✓	✓	✓	✓
Axon Enterprise	Virtual Reality	Focus on weapon usage rather than de-escalation	✓	✓	✓	✓	X	✓
VirTra Inc.	Simulation	Uses 300 degrees of video screens	✓	X	X	X	✓	✓
Apex Officer	Virtual Reality	Bulky, external tracking and PC's required	X	✓	X	✓	✓	✓
Inveris Training Inc.	Virtual Reality	Bulky, external tracking and PC's required	✓	✓	X	✓	✓	✓
MILO Virtual	Simulation	Uses video screens	✓	X	X	X	X	✓
Ti Training	Simulation	Uses video screens	✓	X	X	X	✓	✓
Adaptive VR Ltd.	Virtual Reality	Bulky, external tracking and required	✓	X	X	✓	✓	✓
V-Armed	Virtual Reality	Bulky, external tracking and PC's required	✓	X	X	✓	✓	✓
Street Smarts VR	Virtual Reality	Bulky, external tracking and PC's required	✓	X	X	✓	✓	✓

Source: Veritas

Moving the Needle

We believe that even small contract wins can move the needle for revenue growth in Enterprise.

In November 2022, XRG signed its first meaningful Operator contract with the Western Australia Police Force (WAPOL) for $1.7m over 5-years. WAPOL includes 7,300 sworn officers, approximately 11% of total Australian Police Officers and 0.3% of the global total addressable market in Law Enforcement. This proves even small contract wins can move the needle for revenue growth. Combined with the scale of global military and law enforcement budgets which we estimate at US$2.1t and the size of similar deals (Figure 15) are positive indicators for growth.

In the United States, we estimate the total Military budget to be approximately $842b (3.7% of GDP) and the Law Enforcement budget to be $214b (0.9% of GDP). For US State and Local Law Enforcement alone, there are approximately 18,000 agencies consisting of 800,000 sworn officers. Operator's target market includes those with over 50 sworn officers, due to larger budgets and greater necessity for a virtual reality training module. The total target market for agencies over 50 sworn officers is 2,526 agencies (90 Federal) with over 700,000 officers (130,000 Federal).

The size of deals should not be understated. Recently the US Army signed a US$22b (AU$33b) contract over 10 years with Microsoft to create a combat-ready augmented reality headset known as an Integrated Visual Augmentation System (IVAS). It is important to note that the Operator software is hardware agnostic and may become available on this headset. Other recent substantial deals include:

Figure 15: Recent Deals in Simulation and Virtual Reality Training (AUD$m)

Date Signed	Law Enforcement Peers	Agency	Value ($m)	No. of Officers
Mar-23	Apex Officer	Rogers (Arkansas) Police Department	0.11	120
Jan-23	Apex Officer	Ingham County (Michigan) Sheriff	0.09	82
Dec-22	Inveris Training	Kendall County (Texas) Sheriff	0.17	45
Nov-22	OP-1 (XRG)	Western Australia Police (WAPOL)	1.70	7,300
Sep-22	VirTra	US Customs and Border Patrol	6.36	47,000
Sep-22	VirTra	(Unnamed) US Federal Agency	6.95	
Feb-22	Inveris Training	City of San Fernando, California	0.08	37
Jan-22	VirTra	International	2.36	
Sep-21	VirTra	Middle East	2.02	
Aug-21	VirTra	US Customs and Border Patrol	2.07	
Date Signed	**Military Peers**	**Agency**	**Value ($m)**	**No. of Officers**
Apr-23	Eolian	US Special Operations Command	14.78	70,000
Jul-22	Cole Engineering Services	US Army	8.72	482,416
Apr-22	Applied Virtual Simulation	Aus Defence Force	17.90	60,286
Mar-22	J3Seven (Parachute)	Aus Special Operations Command	4.18	2,050
Jun-21	Microsoft	US Army	32,517.92	482,416

Source: Veritas

Accordingly, competitor deal analysis suggests the average deal size can vary from US$4m for agencies with over 5,000 sworn officers to US$70k for agencies between 50-99 sworn officers. Extrapolating this to calculate a global total addressable market, whereby the US military and law enforcement budget is 40% of the world, a 1% market share is US$33.7m in ARR, whilst 5% is US$168.5m and 20% is US$673.9m (Figure 16).

Figure 16: LE and Military ARR Market Share Sensitivity (USD$m)

Total Addressable Market	ARR > Market Share Sensitivity (USD$m)					
	1%	3%	5%	10%	20%	Total Market
United States	2.73	8.19	13.65	27.30	54.61	273.04
Rest of World	4.10	12.29	20.48	40.96	81.91	409.56
Law Enforcement ARR	6.83	20.48	34.13	68.26	136.52	682.60
United States	10.75	32.24	53.74	107.48	214.96	1,074.80
Rest of World	16.12	48.37	80.61	161.22	322.44	1,612.20
Military ARR	26.87	80.61	134.35	268.70	537.40	2,686.99
United States	13.48	40.44	67.39	134.78	269.57	1,347.84
Rest of World	20.22	60.65	101.09	202.18	404.35	2,021.75
Total ARR	**33.70**	**101.09**	**168.48**	**336.96**	**673.92**	**3,369.59**

Source: Company data, Veritas

Set to disrupt the simulation training market

Interestingly, many recent contract signings in military and law enforcement have been with simulation training companies which include screens. We view this as relatively impractical, due to set up times and lack of portability. We believe Operator is primed to disrupt this market. The average sales contract cycle for Military and Federal Police is between 1-3 years and Local and State Police 2-12 months. As such, an uptick in sales could be expected in FY25 as clients using simulation products finish their existing contracts and shift onto a virtual reality offering such as Operator.

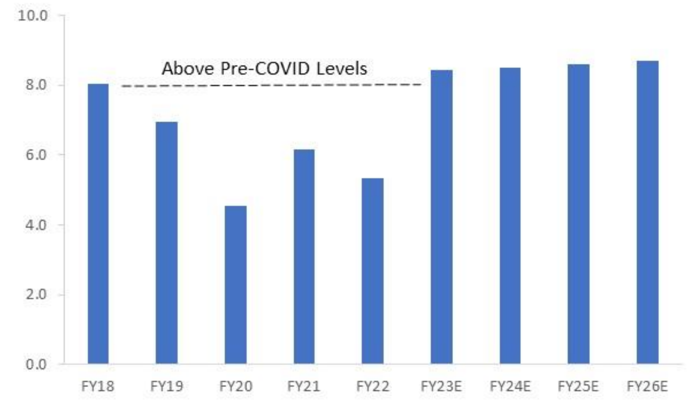
Modest Growth in Entertainment

The profitability of Vertical Wind Tunnels and FREAK is expected to fund the expansion of the Enterprise virtual reality segment.

Returning demand means VWT's revenue will return to pre-COVID levels.

For the Vertical Wind Tunnels segment, with demand normalised to pre-COVID levels we expect revenue to return. In FY18 and FY19, the company reported $8.03m and $6.94m respectively. We forecast $8.43m in FY23 as achievable after 1H23 results of $3.78m from increased demand and additional offerings (Figure 17). The company has not flagged expectation of site expansion, so we expect steady growth of low-single digits from FY24-26. Lower utilisation rates in the 12-months post-COVID means EBITDA margins have been slightly depressed. We forecast an EBITDA margin of 28% for the segment in FY23. We expect returning customer demand to increase utilisation rates as well as increased efficiencies from streamlining of operations to further increase EBITDA margins to 38% by FY26.

Figure 17: Vertical Wind Tunnels revenue returning to above pre-COVID levels ($m)

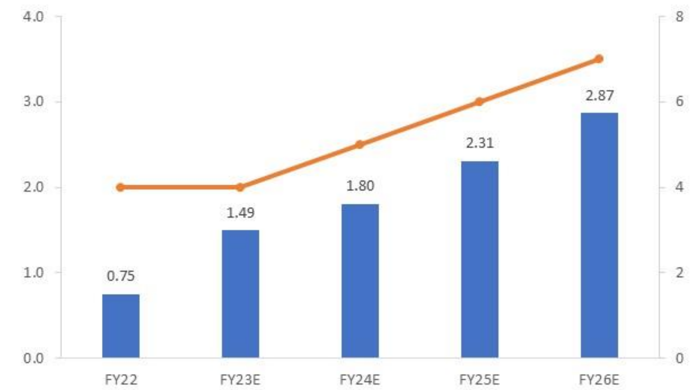


Source: Company data, Veritas estimates

New site additions and growth in virtual reality underpins FREAK revenue CAGR of 31% to FY26.

FREAK revenue is forecasted to grow faster than Vertical Wind Tunnels with the expected addition of 3 more sites by FY26. XRG reported 1H23 revenue of $0.74m, in-line with its FY22 revenue. This shows the uptake in demand for the experience, which underpins the future growth expansion of FREAK. Revenue per venue is also expected to increase to $0.40m by FY24, up from $0.32m in 1H23, from greater utilisation rates in its current venues and the expansion into larger sized sites. Increasing revenue per venue and the addition of more sites reinforces our forecasted growth CAGR of 31% to $2.87m in FY26 from $0.75m in FY22 (Figure 18). Due to greater costs on software, hardware and staff, EBITDA margins are lower than VWT's at 8% in FY23. With better utilisation and learnt efficiencies, we forecast EBITDA margins to reach 15% by FY25.

Figure 18: FREAK Revenue ($m, LHS) vs FREAK facilities (RHS)



Source: Company data, Veritas estimates

Entertainment revenue is expected to grow 63% to $9.93m in FY23 driven by better utilisation rates in VWT and growing demand in FREAK. We forecast growth to return to mid-single digits from FY24 onwards, largely driven from site expansion in FREAK. EBITDA is expected to be $1.32m in FY23 (13% margin), growing to $2.07m in FY26 (18% margin) as the company is able to realise efficiencies and streamlining of processes. Performance in this segment should give the company room for growth without the need for additional capital.

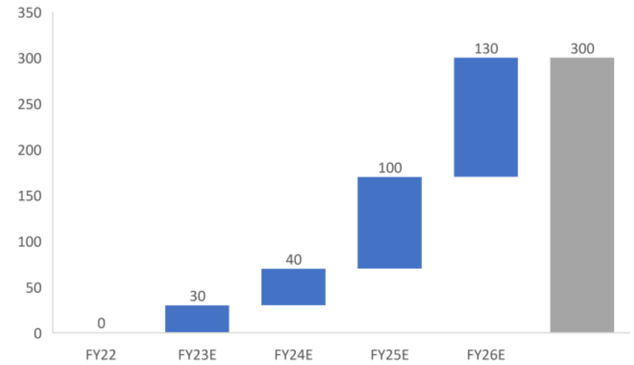
Revenue Inflection Expected in Enterprise

Operator will provide annual recurring revenue per headset licensed.

Enterprise revenue is expected to ramp up as more headsets are licensed to customers. Headsets licenses will be charged on an annual ongoing SaaS revenue basis, including the software and hardware components for each respective product.

XRG currently has one significant contract with the WAPOL and has been awarded several trials including a 6-month trial with an undisclosed National Police Force expected to be completed in September, and a first sale to the Australian Defence Force as part of a concept evaluation process. We forecast the company to add 30 headsets by FY23, another 40 in FY24 and another 100 in FY25 (Figure 19). The company expects annualised revenue per headset of $23k into the future. As such, we forecast ARR recognised for the group to increase from $0.27m in FY23 to $2.79m in FY25.

Figure 19: Forecasted Net Additions in Operator Headsets



Source: Company data, Veritas estimates

Distributing 650 headsets would mean 2x higher EBITDA than we forecast in FY25.

Significant contract wins could lead to a doubling of EBITDA forecasts in FY25.

The biggest optionality for the company, in our view, is the possibility of significant contract signings increasing the number of headsets licensed to clients. We estimate that if the company can distribute 650 headsets in FY25 then Revenue and EBITDA would be $20.4m and $7.8m respectively, 38% and 96% higher than our current forecasts (in blue) which assumes 170 headsets for the year (Figure 20). This is not outside the realm of possibility with: 1) the size of military and law enforcement agencies globally, 2) the increase in demand for virtual reality training and 3) the enhanced outcomes from training and cost savings from Operator.

Figure 20: Sensitivity of our FY25 forecasts to the number of Headsets at end of period ($m)

Number of Headsets (FY25E)	50	100	170	200	300	400	650
Enterprise Revenue ($m)							
Avg. Annual Recurring Revenue	1.4	2.0	2.8	3.1	4.3	5.5	8.4
EBITDA	1.0	1.3	1.9	2.1	2.9	3.7	5.7
Group Income Statement in FY25							
Revenue	13.5	14.0	14.9	15.2	16.4	17.5	20.4
EBITDA	3.0	3.4	3.9	4.2	5.0	5.8	7.8
Variance to our Forecasts							
Revenue	-9%	-5%	0%	2%	10%	18%	38%
EBITDA	-24%	-14%	0%	6%	26%	46%	96%

Source: Company data, Veritas estimates

EBITDA Margin estimated to exceed 30% in FY26

Modest growth in Entertainment and forecasted contract wins in Enterprise means revenue is forecast to grow to $18.5m in FY26.

The returning demand in its Entertainment businesses and expected contract signings in Operator underpins our forecasts of EBITDA growing to $6.0m in FY26 from -$3.3m in FY22. Growth in FREAK venues and initial Operator sales in FY23 is expected to support revenue growth of 66% in FY23.

The key elements to our forecasts are:

Enterprise to drive revenue growth: We forecast group revenue to grow from $6.58m in FY22 to $18.5m in FY26 (CAGR of 23%). Moderate growth in Entertainment from efficiencies in its VWT's and additional sites in FREAK is forecasted to grow the segment in mid-single digits from FY25 onwards. Entertainment is expected to see 63% growth in revenue in FY23 from returning demand increasing utilisation rates. Enterprise revenue is forecasted to ramp up as more headset licenses are distributed to customers. ARR recognised for the group is expected to increase from $0.27m in FY23 to $2.79m in FY25. We forecast Other Sales including food, beverage and merchandise to also maintain moderate growth at 20-25%. The mix of Enterprise revenue is expected to increase from 1% in FY22 to 30% in FY26.

EBITDA to reach $6.0m in FY26: EBITDA margins are forecast to increase to 14% in FY23 as margins are normalised to pre-COVID levels. Streamlining of operations in Entertainment is expected to see margins increase slightly from 13% in FY23 to 18% in FY26. Similarly, as the company is able to achieve scale in manufacturing and distribution of Operator products, we expect margins to improve from 55% in FY23 to 70% in FY26. As such, we forecast group EBITDA to increase from $1.54m in FY23 to $5.95m in FY26.

Positive net profit expected in FY25: We forecast positive net profit of $0.35m to be reached in FY25, from -$6.93m in FY22 from the improvement of EBITDA margins and growth in Operator. It is also important to note that the company has $26.5m in tax losses, which we expect to be used in order to reduce the corporate tax rate to zero over the medium term.

Capex to support growth in Enterprise: We forecast capex to increase significantly from FY22 from the investment in Operator. We expect capex of $3.26m in FY23 vs. $0.7m in FY22 as the company ramps up its development spend. Capex should remain flat from FY24-26 to support Enterprise whilst in its infancy.

Positive operating cash flow: XRG reported $1.12m in operating cash flow in 1H23. We forecast operating cash flows to remain positive into the future.

Net cash balance to remain flat in near term: Cash including term deposits is expected to remain between the range of $0.75-$1.30m from FY23-25 as the company ramps up their capital expenditure for Operator growth. It is important to note that the company has in place a $0.6m term deposit for their Gold Coast premise which is not included in the cash balance for their half and full year reports. As such, we expect an FY23 ending net cash balance of $1.38m including the $0.60 term deposit.

Repayment of finance facilities: The company has in place a 3-year loan of $3.85m with Causeway Wholesale Private Debt Income Fund with a maturity of March 2024. We expect the refinancing of this loan in full in FY24. Similarly, we expect the refinancing of the Birkdale Holdings loan of $3.81m in FY25, to allow the company sufficient cash for growth.

Experienced Management

CEO Wayne Jones brings a wealth of learnings from his 10+ years running the business.

xReality Group Co-founder and CEO, Wayne Jones, was appointed to the role during the foundation of the Indoor Skydiving business in 2011. Prior to establishing the group alongside Danny Hogan, Wayne was a Commander with the Special Air Service Regiment. His experience in skydiving and his continued involvement in the Australia Defence Force bodes well for the focussed and strategic vision for military usage of its vertical wind tunnels and Enterprise segment. Wayne is also a Member of the Australian Institute of Company Directors. Wayne currently holds 8% of shares.

Co-founder Danny Hogan transitioned from COO to Non-Executive Director in 2019.

Co-founder and Non-Executive Director Danny Hogan also joined the business during its foundation, after 21 years of military service including within the Special Air Service Regiment. Danny served as an executive director and the Chief Operations Officer from 2011 to 2019, transitioning to a non-executive role as part of the board restructure following the SkyVenture dispute.

Chairman John Diddams has held several non-executive roles in ASX companies.

Chairman John Diddams was appointed to the board in January 2022 after long-serving board member Stephen Baxter relinquished his role. John helped manage the ASX listing process for the original Indoor Skydiving Group in 2012, resigning after the successful completion of the IPO. Since then, John has held several non-executive roles in various ASX-listed companies including Experience Co (ASX:EXP), Volpara Health Technologies (ASX:VHT) and Aroa Biosurgery (ASX:ARX) in which he currently sits as a Non-Executive Director.

Kim Hopwood is essential in Operator's expansion overseas.

Kim Hopwood became Executive Director in May 2021, bringing over 20 years of experience in technology, media, and operations. Kim worked with Indoor Skydiving Group as a supplier and freelance consultant in 2012 and joined full-time in 2019. Kim has been integral in xReality's overseas expansion of its Enterprise virtual reality business and strategy. Kim currently holds 7% of shares.

NED Mark Smethurst has commanded military teams across the world.

Mark Smethurst, Non-Executive Director, joined the board with an accomplished record of commanding military teams including Special Air Service Regiment and the Deputy Commander of the Australian Special Forces Command. He also Commanded the NATO Special Forces in Afghanistan and was Deputy Chief of Operations for the US Special Operations Command. Mark brings an expansive network of defence relationships.

Avoka Co-Founder Philip Copeland joined the board in 2023, aiming to leverage his US relationships.

The most recent addition to the board, Philip Copeland as Non-Executive Director also joins as the Chair of the company's newly formed International Expansion Committee. Philip was former CEO and co-founder of Avoka Software, a business enablement platform with customers including large government agencies. Avoka was acquired by Temenos in 2018 for US$245m. Residing in Colorado, Philip will be able to leverage his US relationships to help aggressively expand Operator.

Other Shareholders

Stephen Baxter left the board in 2022 but still remains XRG's largest shareholder.

Ex-Chairman Stephen Baxter departed the company in January 2022, after joining the board in 2012. Stephen is XRG's largest shareholder with a 22% holding. Through his company Birkdale Holdings, Steve has participated in several private capital and debt raisings. As at 1H23, XRG has a loan facility of $3.95m with Birkdale, with a maturity date of September 2024.

DCF valuation gives >100% upside

The rapidness with which we estimate ARR and profitability to grow in Enterprise has swayed our valuation approach towards DCF. We believe the DCF method is the most suitable approach for valuing xReality Group as it captures the interplay of growth, margins and the utilisation of tax losses.

Our DCF derived fair value is 9.5c per share. We view the DCF approach as the most relevant valuation method.

Our DCF derived fair value for XRG is 9.5c per share, on the basis of a terminal EBITDA margin of 40% versus 14% forecast in FY23 (Figure 21) which is driven by higher growth in the Enterprise segment (c70% EBITDA margin) relative to Entertainment (c18% EBITDA margin). We also assume revenue growth fading to 2%, terminal capex to depreciation of 0.8x and a WACC of 10% reflecting the impact of higher interest rates.

Figure 21: DCF valuation for xReality Group

Year end June	Units	FY23	FY24	FY25	FY26	FY27	FY28	FY29	FY30	FY31	FY32	TV
Revenue	$m	10.9	12.4	14.9	18.5	22.0	25.5	28.5	31.4	33.3	34.6	35.3
Revenue growth	*%*	*66.3*	*13.5*	*19.7*	*24.3*	*19.0*	*16.0*	*12.0*	*10.0*	*6.0*	*4.0*	*2.0*
EBITDA	$m	1.5	2.7	3.9	6.0	7.7	9.2	10.8	11.9	13.0	13.8	14.1
EBITDA margin	*%*	*14.0*	*21.9*	*26.6*	*32.2*	*35.0*	*36.0*	*38.0*	*38.0*	*39.0*	*40.0*	*40.0*
EBIT	$m	-0.1	0.7	1.6	3.7	5.1	6.1	7.4	8.2	9.0	9.7	9.9
Tax rate	*%*	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*30*	*30*	*30*	*30*
NOPAT	**$m**	**-0.1**	**0.7**	**1.6**	**3.7**	**5.1**	**6.1**	**7.4**	**5.7**	**6.3**	**6.8**	**6.9**
D&A	$m	1.6	2.0	2.3	2.3	2.6	3.1	3.4	3.8	4.0	4.2	4.2
Margin	*%*	*14.9*	*16.1*	*15.5*	*12.2*	*12.0*	*12.0*	*12.0*	*12.0*	*12.0*	*12.0*	*12.0*
Working capital	$m	1.2	1.2	0.6	0.7	0.6	0.6	0.6	0.7	0.5	0.3	0.2
As % of incremental sales	*%*	*27.7*	*79.1*	*26.2*	*19.7*	*16.0*	*18.0*	*20.0*	*24.0*	*24.0*	*24.0*	*24.0*
Capex	$m	-3.3	-3.2	-3.3	-3.3	-3.4	-3.1	-3.4	-3.0	-3.2	-3.3	-3.4
Capex/D&A	*x*	*2.0*	*1.6*	*1.4*	*1.5*	*1.3*	*1.0*	*1.0*	*0.8*	*0.8*	*0.8*	*0.8*
FCF	**$m**	**-0.5**	**0.7**	**1.3**	**3.4**	**4.8**	**6.7**	**8.0**	**7.2**	**7.5**	**7.9**	**7.9**
Discount factor	%	91%	83%	75%	68%	62%	56%	51%	47%	42%	39%	
NPV of FCF	**$m**	**-0.5**	**0.6**	**1.0**	**2.3**	**3.0**	**3.8**	**4.1**	**3.3**	**3.2**	**3.1**	

Item	Units	Value
NPV of the forecast period	$m	23.9
NPV of terminal value	$m	38.2
NPV of cash flows	**$m**	**62.1**
Less: net debt	$m	-19.7
Less: non controlling interests	$m	0.0
Fair value of equity	**$m**	**42.4**
Fair value of equity per share	**$ps**	**0.095**
Share count	m	446

Item	Units	Value
WACC	%	10.0
Terminal growth	%	2.0
Terminal EBITDA margin	%	40.0
Terminal value nominal	$m	99
Terminal EV/Revenue	x	2.8
Terminal EV/EBITDA	x	7.0

Source: Veritas estimates

A 40% EV/Revenue discount to military peers in FY24

XRG trades at an EV/Revenue multiple of 3.1x in FY24, a 40% discount to direct Military peer average.

xReality Group currently trades on an EV/Revenue multiple of 3.1x in FY24, a 40% discount to the 5.2x average for direct military peer average (Figure 22). Our fair value of 9.5c per share puts the stock on an EV/Revenue multiple of 5.0x in FY24, in-line with the direct peer average. XRG also looks cheap on an EV/EBITDA multiple of 14.1x in FY24 versus the direct peer average of 23.3x.

Figure 22: XRG valuation versus Military Peers

Competitor	Code	Price	Mkt Cap	EV	EV/Revenue (x)				EV/EBITDA(x)				Revenue Growth (%)			
		LC$	LC$m	LC$m	FY22	FY23E	FY24E	FY25E	FY22	FY23E	FY24E	FY25E	FY22	FY23E	FY24E	FY25E
xReality Group	XRG-ASX	0.042	19	38	5.8	3.5	3.1	2.6		25.0	14.1	9.7	-9.5	66.3	13.5	19.7
VirTra, Inc.	VTSI-US	7.83	86	82	2.9	2.5	2.2		22.6	11.0	9.8		15.8	14.5	12.8	
Axon Enterprise Inc	AXON-US	194.03	14,336	14,071	11.8	9.6	8.1	7.0	60.6	48.0	36.8	26.0	37.8	22.7	19.1	15.6
Direct Peer Average					**7.4**	**6.1**	**5.2**	**7.0**	**41.6**	**29.5**	**23.3**	**26.0**	**26.8**	**18.6**	**15.9**	**15.6**
Byrna Technologies Inc.	BYRN-US	3.48	76	59	1.2	1.2	1.0			14.7	7.8		13.9	3.7	20.8	
Northrop Grumman Corp.	NOC-US	457.03	69,404	81,827	2.2	2.1	2.0	1.9	16.6	15.3	14.2	13.0	2.6	4.9	5.5	5.5
Saab AB Class B	SAAB.B-SE	584.80	78,049	75,180	1.8	1.6	1.4	1.3	13.9	12.1	10.4	8.9	7.3	15.3	11.3	10.8
Larger Military Peer Average					**1.8**	**1.6**	**1.5**	**1.6**	**15.2**	**14.0**	**10.8**	**11.0**	**7.9**	**8.0**	**12.5**	**8.1**

Source: Bloomberg consensus as of market close on 14 July 2023, Veritas estimates for XRG.

Acquisition at a premium reasonable

XRG is expected to trade on an EV/Revenue multiple of 3.5x in FY23, slightly under the 4.1x average transaction multiple for simulation and virtual reality training peers (Figure 23). Given the size of larger military listed peers, the rising demand for virtual reality training in military and law enforcement and Operator's superior offering makes a potential acquisition at a premium reasonable.

Figure 23: Recent acquisitions of military simulation and virtual reality

Completion Date	Target	Acquirer	EV (US$m)	Revenue (US$m)	EV/Sales (x)
May-22	Bohemia Interactive Simulations	BAE Systems Plc (BA-GB)	200	29	6.9
May-22	RUAG S&T	Thales (HO-FR)	N/A	95	N/A
Jul-21	L3Harris Military Training	CAE	1050	500	2.1
Jan-21	TRU Simulation + Training (TXT-US)	CAE	40	N/A	N/A
Jun-20	Inveris Training Solutions	Pine Island Capital	146	41	3.6
Average					**4.2**

Source: Company data, Veritas

RATING

BUY – anticipated stock return is greater than 10%

SELL – anticipated stock return is less than -10%

HOLD – anticipated stock return is between -10% and +10%

SPECULATIVE – high risk with stock price likely to fluctuate by 50% or more

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