

KEYSTONE'S

Small-Cap Stock Report

Editor: Ryan Irvine, BBA (Finance)
Senior Analyst: Aaron Dunn, CFA

Independent Equity Advisors

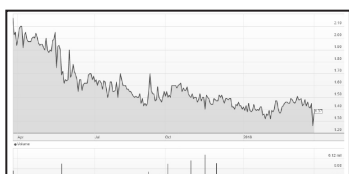
XPEL Technologies Corp.

Current Price (March 29, 2018): US\$1.59

(DAP.U:TSX-V)

RECOMMENDATION: BUY

SPECIALTY AUTO PRODUCT SMALL-CAP POSTS STRONG Q4 REVENUE GROWTH, ONE-TIME ITEMS AND GROWTH INVESTMENTS OBSCURE PROFITABILITY – REITERATE LONG-TERM BUY



Industry: Auto Tech Specialty Product Marketer/Distributor
Recommended: September 2017
Recommendation Price: US\$1.42
Current Price: US\$1.59
Market Cap: US\$43,351,777
Shares Outstanding: 27,612,597
Fully Diluted: 27,612,597

**Focus BUY
Portfolio**

SELECTED QUARTERLY DATA

Income Statement	Q4 2017	Q4 2016
Revenues:	\$20,237,336	\$13,248,744
EBITDA:	\$1,017,599	\$92,561
EBITDA Per Share:	\$0.037	\$0.003
Fully Diluted Ad. Earnings/Share:	\$0.037	\$0.003

RATINGS

VALUE	
PE (TTM):	37.61
P/S (TTM):	0.64
P/B:	3.16
Current Ratio:	1.45
D/E:	0.15

XPEL Technologies Corp. is based in San Antonio, Texas manufactures, sells and distributes, and installs after-market automotive products, including automotive paint protection film, headlight protection film, automotive window films and other related products. In the United States, Canada and parts of Europe, the company operates primarily by selling a complete turn-key solution directly to independent installers and new car dealerships which includes XPEL protection films, installation training, access to XPEL's proprietary design software, marketing support and lead generation. Additionally, the company operates six company-owned installation centers in the United States as well as one installation center each in the United Kingdom and the Netherlands that serve wholesale and/or retail customers in their respective markets. In other parts of the world, including China (20% of Q4 sales) which grew rapidly in 2017, XPEL operates primarily through third party distributors, who operate under agreement with the company to develop a market or a region under the company's supervision and direction. The company operates through 100% owned subsidiaries in Canada, the Netherlands and Mexico and through an 85% owned subsidiary in the United Kingdom.

Revisiting XPEL from a Strategic Overview Perspective

XPEL is currently executing on several key strategic initiatives to drive continued growth. In 2017, management accelerated the company's global expansion strategy with the establishment of European headquarters in The Netherlands. The company believes that establishing a local presence in this strategically important region allows XPEL to better control the delivery of products and services and capitalize on the under-penetrated opportunity in the region. The company is continuing to add locally based regional sales personnel to leverage local knowledge and relationships to expand the market.

In terms of marketing the company continues to drive global brand awareness in strategically important areas. The company seeks high visibility and premium events such as major car shows. Management also seeks out high value placement in adver-

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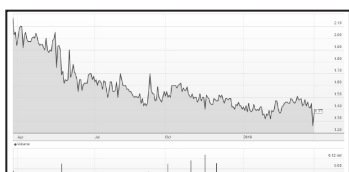
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tising media consumed by car enthusiasts to help further expand XPEL's premium brand. From the year-end conference call, it was important to note that the growth in China appears to have come largely through the company's local distributor establishing strong XPEL brand awareness over the past 4-years which is bearing fruit in terms of strong growth today. The fact the local partner is promoting the XPEL brand is far more valuable to the business in the market than just promoting a generic automotive paint protection film service.

The company also continues to expand its delivery channels by acquiring select installation facilities in key markets and/or acquiring international partners to enhance its global reach. To that end, XPEL completed two domestic acquisitions and one international acquisition during the year. These acquisitions allow the company to put its selling and operational support processes as close to the end customer as possible. A critical component of the acquisition strategy is to employ the owners of the companies acquired. This allows XPEL to leverage the owners' existing relationships in the local market which often results in an overall expansion of the market opportunity.

XPEL also continues to drive expansion of its non-automotive product portfolio. The company recently launched its new commercial/residential window film product line which opens up a large, addressable new market for the company and represents the first non-automotive product line in XPEL's history. While there is some overlap with the company's existing customers, this new product line exposes XPEL to several new channels. The company will continue to seek out non-automotive opportunities that allow it to leverage its channel, brand and technology. Window film sales accounted for 7.6% of total sales.

XPEL competes mainly against other product companies. Management believes this business is differentiated by the suite of services that surrounds its leading protective films. The company's state of the art software leads the industry with over 70,000 patterns. This design software is updated daily with new vehicle patterns often before the

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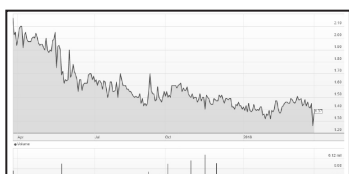
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vehicle is offered to the public. This software ensures a superior quality installation with minimal film waste which is highly valuable for XPEL's customers. The company's customer service center can answer any question and is available 24/7. XPEL also provides substantial marketing and lead generation for its customers – akin to a franchisor in many respects. XPEL supports them at various shows and events and advertise their locations on the company web site. XPEL also supports its customers by maintaining a distribution infrastructure that meets their just in time needs.

RECENT REPORTED FINANCIAL RESULTS

XPEL was recently recommended in September 2017 with the company's shares trading at US\$1.42. Following today's price increase the shares have moved to the US\$1.58 range. Following the company's Q4 2017 financial results, we review the numbers and update our rating on the stock.

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Q4 2017 revenues jumped 52.7% to US\$20.2 million year-over-year. The increase in revenues is primarily a result of increases in paint protection film and window film sales. Direct Costs of sales increased approximately US\$5.6 million over the prior year period. Direct costs include the costs of physical goods, the costs related to the company's Design Access Program software, and the costs of labor directly associated with the production of product. Included in the direct costs are one-time adjustments recorded during quarter totaling US\$0.5 million. These one-time adjustments related to the consolidation of the company's warehouse operations from three existing warehouses into a single facility. Commensurate with this consolidation, XPEL streamlined its paint protection film product mix to enhance greater efficiency and higher inventory turns within each line. Gross margin for the quarter grew 44.4% vs. prior year quarter and decreased as a percentage of sales from 23.9% to 22.6%. Adjusting for the aforementioned one-time costs related to warehouse/sku consolidation, the gross margin percentage would have been 24.9%.

Selling, general and administrative expenses increased US\$0.89 million, or 26.2%

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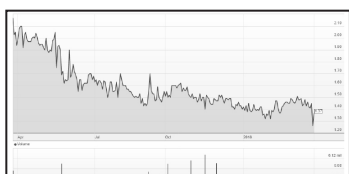
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vs. prior year quarter and decreased as a percentage of sales to 21.1% from 25.6% in the prior quarter. This increase was due mainly to increases in personnel, occupancy, sales and marketing and travel related costs to support the ongoing growth of the business as well as increases in intercompany shipping expense related to the transfer of inventory to various warehouses to support the needs of customers. Additionally, the company changed its depreciation method from double declining balance to straight line resulting in additional depreciation expense of approximately US\$0.09 million vs. prior year quarter. The company incurred one-time costs related to the restructuring of its sales and operations totalling US\$0.13 million. This restructuring will allow XPEL to scale more efficiently. Adjusting for these restructuring costs and the depreciation change, selling, general and administrative costs would have increased 19.8% and would have totaled 20.1% as a percent of sales.

EBITDA increased significantly by US\$0.925 million to US\$1.02 million versus the prior year period. Adjusting for the aforementioned one-time items, EBITDA would have increased to \$1.61 million.

Net income for the period decreased to US\$0.004 million. Adjusting for the aforementioned one-time items, net income would have increased to US\$0.45 million.

VALUATION

XPEL is a very difficult company to value based on earnings given the one-time charges and significant noise in the results over the course of 2017. 2017 was a transformational year for the company and management was focused on driving top-line growth, which could be a great strategic decision if the company addresses margin deterioration in 2018. But until the results are posted and the cash flow and earnings are booked, it is just a strategy and therein is the crux of the risk. Adjusting for one-time items, Q4 was a slight improvement and given managements significantly positive comments coming from the Q4 conference call in relation to bottom line improvements from the strategic initiatives in 2017, we should see a meaningful im-

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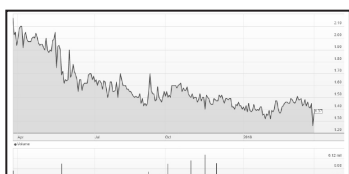
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provement in profitability as well as further top-line growth in 2018. XPEL can have significant variability in quarterly numbers, but if margins track higher the company has the ability to post US\$0.025-\$0.035 per quarter (with upside on this). Given this, if the company's underlying earnings power near term is US\$0.12 per share, given the strong growth, applying a below average market PE of 18 to the stock and would give us a fair value in the range of \$2.15 or 37% higher than the current price over the next year. This analysis will need to be confirmed by strong Q1 2018 results and a positive outlook moving forward, but the current outlook is for growth and margin improvements.

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CONCLUSION

XPEL's Q4 results showed accelerated revenue growth and were met with encouragement in the market. Revenues for the quarter grew 52.7% to US\$20.2 million, a new record. In the prior period the company did a better job communicating the expected one-time restructuring charges in the quarter, so the absence of a significant bottom line was not a shock as we saw in Q3 2017. XPEL incurred certain one-time costs totaling US\$0.6 million during the quarter related to the consolidation of its product lines, the consolidation of its three existing warehouse facilities into a single facility in San Antonio and the restructuring of its sales and operations. Adjusting for these non-recurring costs, fourth quarter gross profit as a percentage of revenue would have been 24.9%, selling, general and administrative expenses as a percentage of sales would have decreased to 20.3%, EBITDA would have been US\$1.6 million and net income would have been \$0.45 million – all significant increases from 2016. We still have a keen eye on the 24.9% gross margin figure. Stagnation or more specifically further deterioration in margins would be very concerning.

The company did finalize product consolidation efforts, its facility consolidation and sales and operations reorganization in the quarter and stated that they are seeing positive impact (we are assuming on margins) already in Q1 2018. This combined with the unexpected continued acceleration in revenue growth were the biggest posi-

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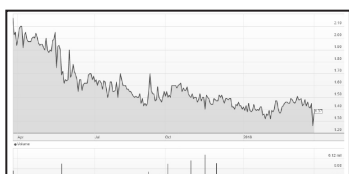
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tives to come from the Q4 announcement and could be significant growth drivers for 2018. Management stated that they expect continued strong growth in revenue and significant improvement in bottom line results in 2018. The consolidation of some of XPEL's legacy paint protection film lines allows the company to enhance product efficiency by removing lowest margin products and the working capital requirements associated with them. Management also stated it has also targeted price increases in some of its lower margin segments.

What would truly drive the stock higher would be the execution over the next 1-2 years on management's promised return to gross margins in the 30% range. While a return to 30% gross margins may be a bit aggressive, if management executes to the 28% range and continues to grow the topline, the current share price should provide a solid entry point long term. We expect to have to be patient and are looking to hold XPEL for a 2 to 3-year period at minimum.

Please Note: We reiterate our BUY rating on the stock. The shares are relatively thinly traded. As such, we would be patient and place limit orders in the current US\$1.55-US\$1.65 range. The company's shares have been a BUY on our Focus BUY list for the past 7 months and available between the US\$1.30-US\$1.50 range for most of 2018. We think the shares offer value in the current range but stress patience near term.

BV (BV/Share): Book value (book value per share)

Book value per common share calculated as total shareholder's equity less preferred equity, and divided by the number of common shares outstanding. Should the company decide to dissolve, the book value per common share indicates the dollar value remaining for common shareholders after all assets are liquidated and all creditors are paid.

D/E: Debt-to-equity ratio

A measure of a company's financial leverage calculated by dividing long term debt by shareholders equity. It indicates what proportion of equity and debt the company is using to finance its assets.

Current ratio

One of many ratios designed to evaluate short-term liquidity of a company. Calculated as current assets divided by current liabilities, this ratio gauges the level of cash resources relative to current liabilities as a measure of cash obligations.

EBITDA

Earnings before interest, taxes, depreciation, and amortization. EBITDA is calculated as revenue minus expenses (excluding tax, interest, depreciation, and amortization).

EPS: Earnings per share

A company's earnings available to common shareholders, also known as net income or net profit, divided by the number of shares outstanding.

EV: Enterprise value

Enterprise value is calculated as market capitalization less cash and equivalents, plus debt. Evaluation of EV relative to the company's trailing EBITDA is used in identifying potential takeover targets.

FCF: Free cash flow

Capital expenditures are subtracted from cash flow from operating activities to arrive at free cash flow, which intends to measure the cash available to a company after making all cash outlays necessary to maintain existing productive capacity (as measured by capital expenditures on a company's cash flow statement).

Net working capital

A measure of the company's ability to carry on its normal business comfortably and without financial stringency, to expand its operations without the need of new financing, and to meet emergencies and losses. Calculated by deducting current liabilities from the current assets.

P/B: Price-to-book ratio

Calculated as a stock's market value (current closing price) divided by its latest quarter's book value. While a lower P/B ratio could mean that the stock is undervalued, it could also serve as a sign of weak fundamentals, and as with most ratios, this varies a fair amount by industry.

PEG ratio

The price/earnings to growth, or PEG ratio is calculated as P/E ratio divided by a company's annual EPS growth. The PEG ratio is used to determine a stock's value while taking into account earnings growth.

P/FCF: Price-to-free cash flow ratio

Calculated as a company's current share price divided by its free cash flow per share (i.e., free cash flow divided by the number of company's shares outstanding) over the last four quarters (called "TTM," or "trailing 12 months" calculation). It is a measure of the market's expectations regarding a firm's future financial health.

P/S: Price-to-sales ratio

It is calculated as a stock's current market price divided by its sales (revenue) per share. When calculating this ratio, we use the company's revenue from its latest four quarters, or on a TTM basis.

ROE: Return on equity

A measure of a corporation's profitability, calculated as net income divided by shareholder's equity. ROE is often useful in comparing the profitability of a company to other firms in the same industry.

Featured companies in KeyStone's Small-Cap Stock Report are evaluated on a scale of 1 to 5 on each of the following criteria:

Value: 1 - poor investment value
5 - excellent investment value

Risk/Liquidity: 1 - high exposure to liquidity concerns
5 - low exposure to liquidity concerns

Growth: 1 - poor growth potential
5 - excellent growth potential

Overall: 1 - poor fundamental characteristics
5 - excellent fundamental characteristics

Disclosure					
Stock Holding				Other	
Companies	KeyStone	KeyStone Employees	Related Companies	Investment Banking Client	Related Company Business Relationship
XPTEL Technologies Corp.	YES	NO	NO	NO	NO