



## Another quarter of growth

Share Price: A\$0.016

Delta Drone International (ASX: DLT) achieved another positive quarter in Q2 FY22. It recorded Annual Recurring Revenue (ARR) of \$1.71m, up 30% QoQ, and Total Contract Value (TCV) of \$3.8m, up 29%. The highlight of the quarter was the signature of a contract with Red 5 subsidiary Greenstone Resources for drone surveying services in WA. This contract is for a 3-year term with a TCV of \$1.01m and ARR of \$336k to the King of the Hills and Darlot Mines. During Q2, the company signed a couple of other non-material contracts and in Q3, it unveiled a contract with Assmang for drone surveying services at its Khumani Iron Ore Mine in South Africa. At the end of July, DLT's ARR was nearly \$2m. ARR and TVC are new metrics, these were reported by DLT for the first time in their Q2 FY2022 quarterly report.

### Commercial drone surveying & mapping set for growth

We think DLT's share price has suffered from a lack of investor understanding about commercial drones generally and their specific use in surveying and mapping. The upcoming IPO of \$47m Silicon Valley company Nightingale Systems on the ASX may help with the former. As for the latter, we think this can happen as DLT continues to win new clients and contract renewals and the industry grows. We have estimated the Australian commercial drone surveying and mapping market is \$216.4m and will reach \$324.8m by CY2026.

### Valuation range of A\$0.05–0.09 per share

We maintain the valuation range for DLT at A\$0.05 per share base case and A\$0.09 bull case using a DCF model, assuming particular levels of market penetration – see page 5 for further details. We remain optimistic on the growth trajectory in the years ahead. The key risks to our thesis are (1) aviation regulations in different geographies, (2) execution risk, and (3) lower adoption within new markets.

Year to Dec (AUD)	CY21a	CY22e	CY23e	CY24e	CY25e
Sales (mn)	4.6	7.0	11.5	16.7	28.0
EBITDA (mn)	(1.6)	(0.5)	0.6	2.0	5.2
Net Profit (mn)	(3.6)	(0.6)	0.3	1.4	3.0
EPS (cents)	(0.71)	(0.12)	0.06	0.28	0.60
DPS (cents)	NM	NM	NM	NM	NM
EV/Sales	2.0x	0.3x	0.3x	0.3x	0.2x
EV/EBITDA	NM	NM	16.9x	4.8x	1.8x
P/E	NM	NM	24.3x	5.4x	2.5x

Estimates: Pitt Street Research

ASX: DLT

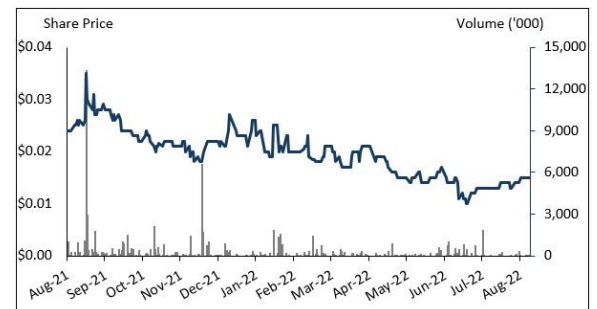
Sector: Technology Hardware & Equipment

22 August 2022

Market cap. (A\$m)	8.2
# shares outstanding (m)	511.6
# shares fully diluted (m)	580.1
Market cap full. dil. (A\$m)	9.3
Free float	34.1%
52-week high/low (A\$)	0.040 / 0.012
Avg. 12M daily volume ('1000)	322.7
Website	<a href="https://dlti.com.au">https://dlti.com.au</a>

Source: Company, Pitt Street Research

### Share price (A\$) and avg. daily volume (k, r.h.s.)



Source: Pitt Street Research, Refinitiv Ikon

Valuation metrics	
DCF fair valuation range (A\$)	0.05–0.09
Discount rate	12.2%
Assumed terminal growth rate	2.0%

Source: Pitt Street Research

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Analysts: Marc Kennis, Nick Sundich

Tel: +61 (0)4 3483 8134

[Marc.Kennis@pittstreetresearch.com](mailto:Marc.Kennis@pittstreetresearch.com)

[Nick.Sundich@pittstreetresearch.com](mailto:Nick.Sundich@pittstreetresearch.com)



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*It was another positive quarter for DLT, capped off with the signature of its first long-term customer in Australia, Red 5.*

## DLT achieves another quarter of growth

DLT reported its results for the quarter ending 30 June 2022 (Q2 FY22) on 25 July and it was another positive quarter for the company – capped off with the signature of its first long-term customer in Australia, Red 5. The company's revenue from continuing operations was \$1.44m, up 7% QoQ. Of this amount, 29% was Annual Recurring Revenue (ARR). ARR was \$1.71m, up 30% QoQ and Total Contract Value (TCV) was \$3.8m, up 29%.

Compared to 12 months ago (Q2 FY21), cash receipts were only up 1%. However, given results in the prior corresponding period included ParaZero (which DLT recently divested from). The exclusion of Parazero from cash receipts in this quarter along with timing of collections has meant that statutory cash receipts are down 26% from Q1. If Parazero had been excluded from Q1 results, Q2 would have been 28% higher.

## Key contracts signed

Only a few days after our last update on DLT, published on 5 June, the company signed a contract with Red 5 subsidiary Greenstone Resources for drone surveying services in WA. The contract is for a 3-year term with a TCV of \$1.01m and ARR of \$336k to the King of the Hills Mine and Darlot Mine. In DLT's recent update it also disclosed a couple of individual non-material contracts signed during the quarter including a 3-year contract with Seriti Coal in South Africa worth \$252k TCV and \$112k ARR, and an 18-month extension of its existing contract with Exxaro for its Belfast coal mine in South Africa, worth \$278k TCV and \$185k ARR.

*DLT's ARR has grown to nearly \$2m at the end of July.*

On 27 July, 2 days after releasing its June quarterly, DLT signed a contract renewal with Assmang for drone surveying services at its Khumani Iron Ore Mine in South Africa. Drone services will include survey mapping and blast inspections at Khumani. This recent extension grows the company's ARR to nearly \$2m at the end of July.

## Commercial drones have significant potential

We think one of the reasons DLT's share price has not grown is because investors think drones are just a fad, or only used by amateurs – at least when the word 'drone' is used rather than more professional terms such as UAVs.

Yet, as we noted in our initiation report on DLT, drones are increasingly being relied on by professional industries including defence and mining. Deloitte has estimated that the overall drone market in Australia is \$5.5bn and that by 2040, the economic impact of drones can reach \$14.5bn and support 5,500 full-time equivalent jobs by 2040. This is because of the versatility of drones and UAVs for assessments, monitoring and even hazard identification and mitigation, not to mention their cost-effectiveness.

Australian investors' understanding of commercial drones might be helped by the upcoming IPO of Nightingale Intelligent Systems. Although this business is focused on the military sector, it is an important milestone for the ASX because of the size of the company (with an anticipated market capitalisation on a fully diluted basis of \$47.3m-\$50m) and because it is the first company of its kind to receive FAA exemptions, allowing both Night-time and Multi-Drone operations.



## Surveying and mapping are growing uses for drones

In our model for DLT, based on the Australian Drone Market Report by industry intelligence company Droneii, we have estimated the size of the commercial drone surveying and mapping market in Australia to be \$216.4m. The report estimated that in 2021, there was US\$78.9m turnover for mapping and US\$65.4m for surveying. These figures equate to US\$144.2m which accounts for 31% of the industry's total turnover of US\$471.3m. Using a USD/AUD exchange rate of US\$1=A\$1.31, this derives a value of \$189m in 2021. We assumed 14.5% CAGR from CY21 to CY25 which derives \$216.4m in CY22. By CY25, we think it will reach \$324.8m – at which point we think further growth is possible but for conservatism's sake did not model further growth between CY26 and CY30 (where our model ends).

We also modelled the South Africa market where DLT has a more significant presence, but DLT is aiming for higher growth in the Australian market. In South Africa, mapping and surveying is US\$16m and US\$13.3m respectively. Using the same USD/AUD exchange rate, this derives a value of A\$38.4m in 2022. At current exchange rates of A\$1=ZAR11.5, this equates to 443m ZAR. We have also assumed 14.5% CAGR through to CY25 which implies A\$66m industry turnover by that year.

## New performance metrics

It has been a rough time for equity markets in 2022, particularly for companies that are not profitable. We think investors have become particularly sceptical of companies that use metrics such as Annual Recurring Revenue (ARR) and Total Contract Value (TCV) with a perception that these are being used to make companies appear to be performing better than they actually are. This perception is wrong, particularly with respect to DLT, but it is one that investors may think is particularly true when companies switch across to these metrics having not previously done so.

It is indeed the case that ARR and TCV are metrics applicable over a longer term than quarterly cash receipts so will naturally be larger. We note that although Annual Recurring Revenue is more common in respect of software businesses with subscription business models. But this metric can give investors an insight into the longer-term relationships a business has with its customers. We think for DLT to achieve nearly \$2m in ARR is a solid achievement as it is a relatively early stage in market penetration and ARR will continue to grow as DLT's market share increases. We also believe these will begin to be reflected in quarterly cash flows.



## Valuation: DLT has significant upside potential

In our initiation report dated 7 March we initiated coverage at \$0.05 per share base case and \$0.09 per share bull case based on a DCF model that forecasts cash flows through to CY2030 assuming achieving particular market shares.

To restate, we forecasted DLT's future revenues primarily based on its Data Services operations in Australia, South Africa and the Rest of the World. No material value was ascribed to its Drone Safety and Legal (DSL) business segment. Although South Africa is currently its strongest market, and modelled a further uplift there, we assumed significant growth in Australia. Specifically, we assumed a gradually increasing market share over time – 2% in CY23, 2.5% in CY24 and reaching 9% by CY30. We assumed 14.5% growth in the general market size from \$189m in CY21 to \$324.8m in CY26, then assuming stagnation up to CY30.

As for South Africa, we started with a 9% market share in CY21, growing to 11% in CY22, 13% in CY23 before reaching 14% in CY24 and modelling modest 0.1% annual growth in market share up to CY30. We also assumed 14.5% growth in the size of the commercial drone surveying and mapping market up to CY26 which would see a \$66m market by CY26. As for the rest of the world, we have only modelled revenue from CY24, and although the market is forecast to be \$15.4bn in that year, we only assumed a very small 0.01% market share. From CY25 onwards we assumed a constant \$17.7bn market size and gradually growing market share to 0.09% by CY30. At this point revenue would be \$15.9m, more than forecasted revenue from South Africa (\$9.6m) but still less than Australia (\$29.2m).

Our bull cases used the same market sizes but made more optimistic market penetration cases – by CY30, 15% in Australia, 20% in South Africa and 0.15% in the rest of the world. In both cases, we assumed profitability in CY23 and assumed exchange rates of \$1.31 USD/AUD and 11.36 ZAR/AUD.

**Figure 1: DCF valuation**

Base Case		Bull Case	
Valuation (AUD)		Valuation (AUD)	
Present value of FCF	9.2	Present value of FCF	17.1
Present value of Terminal FCF	21.7	Present value of Terminal FCF	35.1
<b>Enterprise Value (m)</b>	<b>30.9</b>	<b>Enterprise Value (m)</b>	<b>52.1</b>
Net debt (cash)	(0.9)	Net debt (cash)	(0.9)
<b>Equity value (m)</b>	<b>31.8</b>	<b>Equity value (m)</b>	<b>53.0</b>
Diluted shares	580.1	Diluted shares	580.1
<b>Implied price (A\$)</b>	<b>0.05</b>	<b>Implied price (A\$)</b>	<b>0.09</b>
Current price (A\$)	0.02	Current price (A\$)	0.02
Upside (%)	265.7%	Upside (%)	509.4%

Source: Pitt Street Research



## Catalysts

We think DLT can be re-rated based on the following factors:

- Continued growth in revenue and market share, particularly in Australia.
- New contract wins with mining industry heavyweights, as well as renewals with existing clients.
- Investors coming to understand DLT's business model and the industry's potential.
- The sustaining of the current recovery in equity markets from the June 2022 lows.

## Risks

The main risks to our investment thesis include the following:

- **Regulatory risk:** Global regulations on drones vary across countries; while some countries are opening up and creating opportunities for commercial drone usage, others are less enthusiastic.
- **Integration risk:** There is a risk that management might not be able to extract the expected synergies from the integrated DLT/Arvista entity.
- **Execution risk:** Successful scaling of the business, as well as the acquisition of new customers in a completely new geography, requires considerable effort and investment. The company needs to appeal to people and establish the fact that the brand can be trusted
- **Slow offtake in most of the markets:** Even though permits to fly drones over urban areas has regularly been granted across the globe, the offtake has been limited. Not many large scale operations have taken off globally mainly due to considerable amount of risk involved in it – possibility of the drone malfunctioning and crashing cannot be ignored. DLT will have to overcome technological challenge and change of mind set for the end-user to expand operations.



## Appendix I – Analyst Qualifications

Marc Kennis, lead analyst on this report, has been covering the Semiconductor sector as an analyst since 1997.

- Marc obtained an MSc in Economics from Tilburg University, Netherlands, in 1996 and a post graduate degree in investment analysis in 2001.
- Since 1996, he has worked for a variety of brokers and banks in the Netherlands, including ING and Rabobank, where his main focus has been on the Technology sector, including the Semiconductor sector.
- After moving to Sydney in 2014, he worked for several Sydney-based brokers before setting up TMT Analytics Pty Ltd, an issuer-sponsored equities research firm.
- In July 2016, with Stuart Roberts, Marc co-founded Pitt Street Research Pty Ltd, which provides issuer-sponsored research on ASX-listed companies across the entire market, including Technology companies.

Nick Sundich is an equities research analyst at Pitt Street Research.

- Nick obtained a Bachelor of Commerce/Bachelor of Arts from the University of Sydney in 2018. He has also completed the CFA Investment Foundations program.
- He joined Pitt Street Research in January 2022. Previously, he worked for over three years as a financial journalist at Stockhead.
- While at university, he worked for a handful of corporate advisory firms.

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