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# DroneShield Limited (DRO)

It's all about momentum

**Recommendation**  
**Buy** (unchanged)  
**Price**  
**\$0.225**  
**Target (12 months)**  
**\$0.30** (previously \$0.24)

**GICS Sector**  
**Capital Goods**

**Expected Return**

Capital growth	<b>33%</b>
Dividend yield	<b>0%</b>
Total expected return	<b>33%</b>

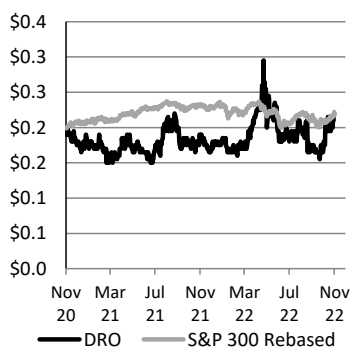
**Company Data & Ratios**

Enterprise value	<b>\$90.7m</b>
Market cap	<b>\$97.3m</b>
Issued capital	<b>432.5m</b>
Free float	<b>~94%</b>
Avg. daily val. (52wk)	<b>\$217,275</b>
12 month price range	<b>\$0.155 - \$0.30</b>

**Price Performance**

	(1m)	(3m)	(12m)
Price (A\$)	0.17	0.21	0.18
Absolute (%)	33.33	4.76	25.71
Rel market (%)	26.06	3.08	30.22

**Absolute Price**



SOURCE: IRESS

**Pipeline conversion**

DRO has so far demonstrated an impressive ability to convert sales opportunities into revenue with a number of material contract announcements through CY22. The company is exhibiting significant momentum as we near the end of the year having announced 4 contracts in excess of \$750K AUD since September 1, received from a diverse customer base including the US, Europe and Asia. The company's most recent comments (see announcement 13/10/2022) identified a pipeline of ~\$50m for the remainder of CY22 and ~\$180m for CY23 onwards. The size and frequency of contracts throughout CY22 offer some validation of this pipeline and provide us with greater confidence for CY23 and beyond.

**US market penetration**

The company has made significant strides in its endeavour to establish itself as a leading player in the US, the largest counter-drone customer in the market. Highlights in recent months include 1) a record \$1.8m US DoD contract for the DroneGun MKIII, 2) recommended (as part of the SAIC consortium) by the US DoD as one of three approved counter-drone solutions to be deployed at US military bases and 3) receipt of its first US based R&D contract (supporting Quantum) from the US DoD. The most encouraging aspect of these contracts is the validation of the company's product range (portable, fixed site, R&D) from the US DoD. A key upcoming catalyst for the company will be greater detail on the deployment of its technology at US military bases following the US DoD recommendation, namely the timeline and number of bases.

**Investment View: PT up 25% to \$0.30, Maintain BUY**

While there is no change in our forecasts we have updated each valuation used in the determination of our price target to reflect improved confidence in the sales pipeline and validation of the company's product offering. We have reduced the WACC in the DCF to 10%, increased the terminal growth rate to 4% and moved to a flat 2.0x EV/Revenue multiple. The net result is a 25% increase in the PT to \$0.30, which is a 33% premium to the current share price and we maintain our BUY recommendation.

**Earnings Forecast**

Year End 31 Dec	CY21	CY22e	CY23e	CY24e
Revenue (\$m)	10.6	16.0	24.2	35.1
EBITDA (\$m)	-5.9	-5.1	-2.2	0.7
NPAT (underlying) (\$m)	-5.3	-3.8	0.2	2.5
NPAT (reported) (\$m)	-5.2	-3.8	0.2	2.5
EPS (cps)	-1.3	-0.9	0.1	0.6
EPS growth (%)	NM	NM	NM	1027%
PE (x)	NM	NM	420.6	37.3
FCF Yield (%)	-7%	-3%	0%	2%
EV/EBITDA (x)	NM	NM	NM	123.0
Dividend (¢ps)	0.0	0.0	0.0	0.0
Yield (%)	0.0	0.0	0.0	0.0
Franking (%)	0.0	0.0	0.0	0.0
ROE(%)	NM	NM	2%	17%

SOURCE: BELL POTTER SECURITIES ESTIMATES

# Forecast and Valuation Changes

## No changes to forecasts

There is no change in our forecasts.

A summary of our key forecasts is shown below.

Figure 1 - Key forecasts						
Year end 31 Dec	CY22e	Change	CY23e	Change	CY24e	Change
Total revenue (A\$m)	16.0	<i>no change</i>	24.2	<i>no change</i>	35.1	<i>no change</i>
EBITDA	-5.1	<i>no change</i>	-2.2	<i>no change</i>	0.7	<i>no change</i>
NPAT	-3.8	<i>no change</i>	0.2	<i>no change</i>	2.5	<i>no change</i>
<b>Diluted EPS</b>	<b>-0.9c</b>	<i>no change</i>	<b>0.1c</b>	<i>no change</i>	<b>0.6c</b>	<i>no change</i>
DPS	0.0c	<i>no change</i>	0.0c	<i>no change</i>	0.0c	<i>no change</i>

SOURCE: BELL POTTER SECURITIES ESTIMATES

## 25% increase in PT to \$0.30

While there is no change in our forecasts we have updated the key assumptions in each of the valuations used to determine our price target.

The change in each valuation and the impact on our PT calculation is shown below.

	Old (as at 26-Sep-22)			New (as at 11-Nov-22)		
	Valuation per share	% weighting	Price target	Valuation per share	% weighting	Price target
<b>Methodology</b>						
DCF	\$ 0.38	50%	\$ 0.19	\$ 0.47	50%	\$ 0.24
EV/Revenue	\$ 0.10	50%	\$ 0.05	\$ 0.13	50%	\$ 0.06
<b>Total</b>			<b>\$ 0.24</b>			<b>\$ 0.30</b>

SOURCE: BELL POTTER SECURITIES ESTIMATES

We have now moved to a flat 2.0x EV/Revenue multiple to reflect the company's increasing momentum following multiple contract announcements, which results in a modest increase in valuation.

Additionally, we have reduced the WACC from 10.6% to 10.0% and increased the terminal growth rate from 3% to 4% in light of greater short term visibility and significant de-risking of the sales pipeline. This drives an increase in the DCF valuation.

The net result is a 25% increase in our PT to \$0.30, which is a 33% premium to the current share price and we maintain our BUY recommendation.

# DroneShield Limited (DRO)

## Company Description

DroneShield Limited (DRO) is an Australian defence manufacturer specialising in counter-drone technology. DRO provides an end-to-end counter-drone solution that integrates proprietary artificial intelligence software with a suite of hardware products utilised to detect, identify and defeat aerial, ground and maritime threats. The company's products are largely in-house technology and include handheld, vehicular and fixed installations. DRO's customers primarily include military and intelligence, as well as law enforcement, critical infrastructure and commercial parties globally.

DroneShield was founded in the U.S on the 10<sup>th</sup> January 2014. The company quickly shifted its operations to Australia with the goal of listing on the ASX, which occurred on the 4<sup>th</sup> November 2015.

## Investment Thesis

We maintain our BUY on DroneShield. Our investment thesis is based on:

- **Valuation:** Our 12 month price target on DroneShield is \$0.30. The price target is generated from a blend of two valuation methodologies we apply to the company: EV/Revenue and DCF. The price target is a 33% premium to the current share price and the total expected return is the same given there is no forecast dividend yield.
- **Solid revenue momentum:** DRO has demonstrated strong earnings momentum in recent periods, with CY21 revenue (\$10.6m) growing at a 3-year CAGR of ~107% and increasing +89% YoY. This is forecast to continue with a particularly strong 2H22 providing momentum into CY23.
- **Structural growth in the market:** Increasing hostilities globally are broadly driving a significant increase in defence budgets with aggregate military expenditure exceeding \$2 trillion USD for the first time in 2021. Asymmetric warfare, including drones and counter-drone defence, is one of the fastest growing subsets within this growing military market - the core competency of DRO.
- **Opportunity for expansion into adjacent markets:** DRO's experience with AI/ML technologies in the counter-drone market has provided the opportunity to apply its capabilities to the broader field of Electronic Warfare, which has the potential to be an extremely lucrative opportunity for the company to expand outside its core business.

## Key Risks

Key downside risks to our estimates and valuation include (but are not limited to):

- **Failure to retain existing clients or attract new customers:** Failure to retain existing customers or attract new customers will severely impact revenue growth and the overall financial performance of the company.
- **Research & Development Risk:** If the company lags the rest of the market in its product development it may have an adverse effect on the company's future operations.
- **Competition Risk:** DRO operates in a competitive market including large multi-national defence contractors who have extensive resources and scale

Table 1 - Financial summary

Profit & Loss (A\$m)						Dronesield Limited								
	CY20	CY21	CY22e	CY23e	CY24e						Year End 31 Dec			
<b>Year Ending 30 June</b>						<b>Share Price:</b>						<b>\$0.225</b>	<b>Target Price:</b>	<b>\$0.30</b>
<b>Revenue</b>	<b>5.5</b>	<b>10.6</b>	<b>16.0</b>	<b>24.2</b>	<b>35.1</b>	<b>No. of issued shares (m):</b>	<b>432.5</b>	<b>Market cap:</b>				<b>\$97.3m</b>		
<i>Change</i>	<i>59%</i>	<i>91%</i>	<i>51%</i>	<i>51%</i>	<i>45%</i>									
Cost of sales	- 1.8	- 2.8	- 4.8	- 7.0	- 9.8									
<b>Gross profit</b>	<b>3.7</b>	<b>7.7</b>	<b>11.2</b>	<b>17.1</b>	<b>25.3</b>									
<i>Gross margin</i>	<i>67%</i>	<i>73%</i>	<i>70%</i>	<i>71%</i>	<i>72%</i>									
Other income/(expense)	0.3	0.3	0.2	-	-									
<b>Expenses (excl. D&amp;A, int.)</b>	<b>- 10.8</b>	<b>- 14.5</b>	<b>- 17.0</b>	<b>- 19.3</b>	<b>- 24.6</b>									
<b>EBITDA</b>	<b>- 6.1</b>	<b>- 5.9</b>	<b>- 5.1</b>	<b>- 2.2</b>	<b>0.7</b>									
Depreciation and amortisation	- 0.6	- 0.5	- 0.7	- 0.6	- 0.7									
<b>EBIT</b>	<b>- 6.8</b>	<b>- 6.4</b>	<b>- 5.8</b>	<b>- 2.8</b>	<b>0.0</b>									
Net interest (expense)/revenue	0.0	0.0	0.0	-	-									
<b>Pre-tax profit</b>	<b>- 6.8</b>	<b>- 6.4</b>	<b>- 5.8</b>	<b>- 2.8</b>	<b>0.0</b>									
Income tax benefit/(expense)	0.9	1.1	2.0	3.0	2.5									
<b>Underlying NPAT</b>	<b>- 5.9</b>	<b>- 5.3</b>	<b>- 3.8</b>	<b>0.2</b>	<b>2.5</b>									
Abs & extras.	0.0	0.1	-	-	-									
<b>Reported NPAT</b>	<b>- 5.9</b>	<b>- 5.2</b>	<b>- 3.8</b>	<b>0.2</b>	<b>2.5</b>									
<b>Cashflow (A\$m)</b>						<b>Valuation Ratios</b>								
EBITDA	-6.1	-5.9	-5.1	-2.2	0.7		CY20	CY21	CY22e	CY23e	CY24e			
Change in working capital	1.5	-0.4	1.2	-0.1	-0.3	Basic EPS (cps)	-2.0	-1.3	-0.9	0.1	0.6			
<b>Gross cash flow</b>	<b>-4.7</b>	<b>-6.3</b>	<b>-3.9</b>	<b>-2.2</b>	<b>0.4</b>	Diluted EPS (cps)	-2.0	-1.3	-0.9	0.1	0.6			
Income tax refunded/(paid)	0.0	0.0	2.0	3.0	2.5	EPS growth (%)	NM	NM	NM	NM	1027%			
<b>Operating cash flow</b>	<b>-4.7</b>	<b>-6.3</b>	<b>-1.9</b>	<b>0.8</b>	<b>2.9</b>	PE(x)	NM	NM	NM	NM	420.6			
Payments for PPE	-0.8	-0.5	-0.6	-0.7	-0.8	EV/Sales (x)	15.6	8.2	5.4	3.6	2.5			
Payments for Intangibles	0.0	0.0	0.0	0.0	0.0	EV/EBITDA (x)	NM	NM	NM	NM	123.0			
<b>Investing cash flow</b>	<b>-0.8</b>	<b>-0.5</b>	<b>-0.6</b>	<b>-0.7</b>	<b>-0.8</b>	EV/EBIT (x)	NM	NM	NM	NM	1872.3			
Net Proceeds from issue of shares	16.1	0.0	0.0	0.0	0.0	FCF per share	-1.4	-1.6	-0.6	0.0	0.5			
Net proceeds of borrowings	0.7	0.0	0.0	0.0	0.0	FCF yield %	-6.2%	-7.2%	-2.7%	0.1%	2.2%			
Repayment of borrowings	-0.6	0.0	0.0	0.0	0.0	NTA per share (\$ps)	0.05	0.04	0.03	0.03	0.04			
Payment of lease liabilities	-0.1	-0.1	-0.3	0.0	0.0	PNTA (x)	4.5	6.1	7.7	7.6	6.3			
Other	0.2	0.0	0.0	0.0	0.0	Book value (\$ps)	0.05	0.04	0.03	0.03	0.04			
<b>Financing cash flow</b>	<b>16.3</b>	<b>-0.1</b>	<b>-0.3</b>	<b>0.0</b>	<b>0.0</b>	Price/Book (x)	4.5	6.0	7.7	7.6	6.3			
<b>Net change in cash</b>	<b>10.9</b>	<b>-6.9</b>	<b>-2.8</b>	<b>0.1</b>	<b>2.1</b>	DPS (cps)	0.0	0.0	0.0	0.0	0.0			
Cash at start of period	5.5	16.3	9.5	6.9	6.9	Payout ratio %	0.0%	0.0%	0.0%	0.0%	0.0%			
Exchange rate impact	-0.1	0.1	0.1	0.0	0.0	Dividend Yield %	0.0%	0.0%	0.0%	0.0%	0.0%			
<b>Cash at end of period</b>	<b>16.3</b>	<b>9.5</b>	<b>6.9</b>	<b>6.9</b>	<b>9.1</b>									
<b>Balance Sheet (A\$m)</b>						<b>Performance Ratios</b>								
Cash and cash equivalents	16.3	9.5	6.9	6.9	9.1		CY20	CY21	CY22e	CY23e	CY24e			
Trade and other receivables	3.7	0.9	3.5	4.8	5.3	EBITDA Margin (%)	-111.0%	-56.1%	-31.6%	-9.0%	2.0%			
Inventories	2.0	6.9	6.2	4.8	5.3	EBIT Margin (%)	-122.4%	-60.9%	-36.0%	-11.5%	0.1%			
PPE	0.8	1.0	1.0	1.1	1.2	NPAT Margin (%)	-106.0%	-50.3%	-23.6%	0.9%	7.3%			
Intangibles	0.0	0.0	0.0	0.0	0.0	Net debt/(cash)	- 7.7	- 9.3	- 6.6	- 6.7	- 8.8			
Right-of-use assets	0.2	-	0.7	0.7	0.7	ROE (%)	-29.9%	NM	NM	1.8%	16.5%			
<b>Total assets</b>	<b>23.1</b>	<b>18.3</b>	<b>18.2</b>	<b>18.4</b>	<b>21.5</b>									
Trade and other payables	0.9	0.5	1.2	1.2	1.8	<b>Segmentals (A\$m)</b>								
Lease Liabilities	0.3	1.6	0.9	0.9	0.9	<b>Revenue</b>								
Provisions	0.2	0.5	0.5	0.5	0.5	Hardware sales	4.7	7.2	12.8	18.1	24.6			
Borrowings	0.1	0.2	0.1	0.1	0.1	R&D Revenue	0.1	2.8	2.2	4.1	7.0			
Other	2.0	0.1	2.9	2.9	2.9	Subscription services	0.0	0.2	0.8	1.7	3.2			
<b>Total liabilities</b>	<b>3.5</b>	<b>2.8</b>	<b>5.6</b>	<b>5.6</b>	<b>6.1</b>	Other Revenue	0.7	0.3	0.2	0.2	0.4			
<b>Net Assets</b>	<b>19.6</b>	<b>15.6</b>	<b>12.7</b>	<b>12.9</b>	<b>15.4</b>	<b>Total Revenue</b>	<b>5.5</b>	<b>10.6</b>	<b>16.0</b>	<b>24.2</b>	<b>35.1</b>			
Share capital	37.3	37.0	37.0	37.0	37.0	<b>Revenue Breakdown</b>								
Other reserves	7.8	5.3	5.2	5.2	5.2	Hardware sales	85%	68%	80%	75%	70%			
Accumulated losses	(25.5)	(26.7)	(29.5)	(29.3)	(26.7)	R&D Revenue	2%	27%	14%	17%	20%			
<b>Total shareholders' equity</b>	<b>19.6</b>	<b>15.6</b>	<b>12.7</b>	<b>12.9</b>	<b>15.4</b>	Subscription services	0%	2%	5%	7%	9%			
						Other Revenue	12%	3%	1%	1%	1%			
						<b>Interim Results</b>								
							1H21	2H21	1H22	2H22e				
						Revenues	6.7	3.9	3.7	12.3				
						EBITDA	-0.2	-5.7	-4.4	-0.6				
						EBIT	-0.5	-5.9	-4.9	-0.8				
						NPAT	-0.5	-4.9	-4.9	1.2				

SOURCE: BELL POTTER SECURITIES ESTIMATES

**Recommendation structure**

**Buy:** Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

**Hold:** Expect total return between -5% and 15% on a 12 month view

**Sell:** Expect <-5% total return on a 12 month view

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