STIFEL | GMP

Equity Research

# Drone Delivery Canada Corp.[1,7]

**BUY**

FLT-TSXV

December 12, 2019

Last: **C$0.81**

▼ Target: **C$3.00**

## More confident in growth prospects; but slower start

We attended an Air Canada Cargo ("ACC") event for its customers and partners, hosted at Drone Delivery Canada's ("DDC") operations centre. We gained greater visibility into customer roll-out plans, and new insight into opportunities with prospects. In summary, we continue to believe DDC can achieve $100mm in revenue, however we now expect a slower initial ramp before an acceleration in growth. As a result, we pushed our $100mm forecast and valuation to 2024 (vs 2022 prior), which reduces our target price. We continue to gain more confidence in DDC's growth prospects, and expect improving visibility on timing and financials to lower variability over time.

**Strong customer feedback:** Commercial customers said they expect to start in Q1/20 and fly one or two routes for several months before expanding. They also offered examples of significant economic benefits and growth plans. Some prospects however prefer to wait for first-movers to prove out operations, regulatory constraints and real-world economic benefits. Government-funded customers said funding approvals have started, but larger funding sources could take longer and remain uncertain. Finally, ACC signaled greater focus on international expansion, starting with the U.S.

**First revenue now expected in Q1/20:** DDC revealed in its Q3 filings (Nov. 29) that it now expects first revenue from Moose-Cree First Nation and Vision Profile in Q1/20 (vs Q4/19 prior) due to delays in federal funding and permit approvals respectively. DSV and Edmonton Airport however remain on track for Q1/20 as originally planned, supported by feedback from both customers and ACC. As of Sept. 30, DDC had $13.7mm in cash and was burning $3mm/q.

**Later start, slower ramp for revenue:** We now forecast first revenue in 2020 and growth to $100mm in 2024. This is based on a roll-out of one route per month in year one, doubling every year on average to 2024. Notably, we now aggregate our depot-to-depot routes with ACC routes, and include revenue from international licensing. We continue to expect upfront fees of up to $150k and average recurring revenue of $100k/route per year. We expect positive EBITDA in 2022, and cash to bottom at $5mm excluding options.

**Valuation**: We pushed out our valuation multiple and forecast for $100mm in revenue to 2024 vs 2022 prior, but maintained our 10x EV/Sales multiple and 10% discount rate. As a result, our target price decreases to $3.00 from $4.00 prior. We continue to see DDC as a leader in drone delivery and believe long-term investors with a tolerance for start-up risk will be well rewarded. **BUY**.

| What's Changed | Old | New |
|---|---|---|
| Rating | BUY | n.c. |
| Target | C$4.00 | C$3.00 |
| Revenue 2019E (mm) | $2.4 | $0.0 |
| Revenue 2020E (mm) | $12.9 | $5.8 |
| EBITDA 2019E (mm) | ($8.6) | ($11.8) |
| EBITDA 2020E (mm) | ($3.3) | ($7.2) |
| FCF 2019E (mm) | ($8.5) | ($12.4) |
| FCF 2020E (mm) | ($5.4) | ($7.6) |

| Share Data | |
|---|---|
| Share o/s (mm, basic/f.d.) | 176.2 / 198.4 |
| 52-week high/low | C$1.74 / C$0.62 |
| Market cap (mm) | $160.7 |
| Enterprise value (mm) | $147.0 |
| Dividend | n.a. |
| Dividend yield | n.a. |
| Projected return | 277% |

| Financial Data YE Dec. 31 | 2018 | 2019E | 2020E |
|---|---|---|---|
| Revenue (mm) | $0.0 | $0.0 | $5.8 |
| EV/Revenue | n.a. | n.a. | 25.3x |
| EBITDA (mm) | ($19.3) | ($11.8) | ($7.2) |
| EV/EBITDA | n.a. | n.a. | n.a. |
| EPS f.d. | ($0.11) | ($0.06) | ($0.03) |
| P/E | n.a. | n.a. | n.a. |
| FCF | ($10.9) | ($12.4) | ($7.6) |
| P/FCF | n.a. | n.a. | n.a. |
| Net debt | ($14.3) | ($13.6) | ($5.8) |
| Net debt/EBITDA | n.a. | n.a. | n.a. |
| Book value | $14.5 | $17.3 | $12.0 |
| P/BV | 11.1x | 9.3x | 13.4x |

*All figures in C$ unless otherwise noted*

Current Chart    Previous Research

**Deepak Kaushal, P.Eng., CFA** (416) 943-6686
dkaushal@stifel.com

**Edson Lai, CPA** (416) 941-0895
elai@stifel.com

## Key takeaways from recent open house with Air Canada Cargo customers

**Drone Delivery Canada:**

- **Progress on certification of new drones:** Management said that it is progressing on the testing and certification process on its new drones and expects three new drones to be certified by Transport Canada by the end of F2020. DDC Robin (10kg payload, 65km distance) is expected to be compliant by the end of Q1/20, the Falcon (23kg payload electric quad-copter) by the summer of 2020, and the Condor (180kg payload gas helicopter) by Q4/2020.
- **Progression towards full BVLOS:** Management is confident that it remains on track to progress to full BVLOS over time with regulators, with gradual easing of restrictions as DDC and its customers accumulate flight hours and data to support risk reduction. Management also continues to believe that its progress with Canadian regulators will help accelerate regulatory approvals in international markets when combined with strategic international partners (i.e. such as airlines or cargo operators).
- **Roll-out largely paced by customers:** DDC said it is well prepared to scale operations to support rapid revenue growth, including plans to scale personnel and manufacturing. Management believes that over time, it will be able to achieve first flight within two quarters of contract signing and support new deployments at a rate of one per month, and a drone build-rate of 2-3 per month via contract manufacturing partners. That said, DDC believes that the pace of roll-out will be largely determined by customer readiness/preference, rather than internal or regulatory constraints.

**Air Canada Cargo:**

- **Successful employee open house:** ACC said that it also held an open house to broader Air Canada management and employees, again at DDC's operations centre. ACC told us that this was attended by over 60 employees and very well received, and continued to build on positive buy-in towards ACC's drone efforts across the company.
- **Ramping up sales force:** ACC said it is in the process of hiring a half-dozen full-time sales representatives to drive growth in Canada. ACC and DDC also said they have signed international reseller agreements in 20 countries with a range of different types of parties (i.e. from individuals to agencies and companies) to assist in business development and sales.
- **International expansion rising in priority:** ACC said that it is increasing efforts towards international expansion in partnership with DDC and a growing list of reseller partners. We continued to hear that most competitors remain in one-off/research stages, and peers with any material commercial volume operate under much less stringent regulatory regimes. ACC and DDC agreed that there remains a solid first mover advantage in international markets with the U.S. market a priority, with hopes for success before the end of 2020.

**Customers:**

- **Significant economic opportunity:** Customers described the potential for material cost savings by using drones to replace high cost charter aircraft, in some cases up to 85% versus existing costs. Two customers described significant savings using drones for more efficient transportation within their internal operations, as well as for external customers. Notable, one customer said it expects drones to ultimately replace an entire distribution centre that is required to serve a single customer with just-in-time deliveries up to seven times per day, delivering profound cost savings from a change in overall network operations strategy.

- **Large expansion opportunity, largely tied to larger payload capability:** While customers said they plan to start with one or two routes for the first several months, most customers described the opportunity to expand quickly to support over 20 routes, with one customer saying it already has 10 end customers lined up to use the service. One customer with several years of experience flying drones said they could see the opportunity for 1,000s of drones in five years, and expressed confidence that regulations could evolve in step to support this. Notably, most customers said the large market opportunity is tied to larger payloads, and expect the Condor introduction in late 2020 to unlock growth.
- **Customers comfortable as early adopters:** In all cases, the customers we spoke to were comfortable being early adopters and working closely with DDC, ACC and regulators to deal with expected hiccups and teething pains. The customers we spoke to either had flat organizational structures and the ability to move quickly, were strong believers in the disruptive potential of drones and wanted to capture a first mover advantage versus slower or more bureaucratic competitors, or had significant pain points with existing solutions that could be disrupted with drones.

**Prospects:**

- **Most happy to follow first-movers:** Several prospects said they prefer to wait on the sidelines for now, despite seeing a real opportunity to take advantage of drones. These prospects preferred to wait for first-movers to prove out technical operations, regulatory constraints and real-world economics before committing to contracts. Some said they saw little opportunity for small payload drones, and preferred to wait for larger payload capabilities.
- **Some late adopters despite high immediate needs:** We spoke to one prospect in the healthcare industry that described an immediate opportunity for drones with positive social impact. However this prospect said that adoption is still years away, given high regulatory requirements in their industry and little room for failure. We were told these applications would require significant proving by pilot programs and first movers before wider spread adoption in the industry.
- **Some skepticism, eye-opening for others:** We did come across some skepticism that drone delivery could see anything beyond niche operations anytime soon in Canada. Notably however, we spoke to a couple of skeptics who seemed open to changing their views following the site tour of DDC's operations centre, which they said was positive.

## Changes to our forecasts

- **First revenue deferred to early 2020**: We pushed our expectation for first revenue to Q1/20. This is not surprising given the lack of announcements late into the year, and was revealed in DDC's recent Q3 filings where they disclosed that Moose-Cree First Nation and Vision Profile had been delayed to Q1/20 due to federal funding and local permit approvals, respectively. Revenue was initially expected for Q2 and Q4/2019 respectively. DSV and Edmonton Airport however remain on track for Q1/20. Note that we have expected high variability with the timing of first revenue, and believe the amount and timing of first revenue are less relevant in the near-term compared to strategic progress.
- **Delaying growth ramp by 1½ years**: We continue to believe DDC can grow to $100mm in revenue, however we pushed out our expectations to 2024, representing a 5-year ramp. Our prior timing was for $100mm in revenue in 2022, which assumed first revenue in H2/19 and a four-year ramp. Our current forecasts are based on expectations that DDC can deploy installations at a rate of one per month to start, and double its build-out capacity on average every year to 2024.
- **Shift in revenue drivers**: Notably, we now aggregate our depot-to-depot routes with ACC routes, and include revenue from international licensing. The implications here are lower expectations for revenue in Canada, offset by contributions from success in international markets.
- **Revenue model**: We continue to expect upfront set-up revenue of $150k/route on average and recurring revenue of $100k/route/year for ACC derived customers. For remote communities, we forecast upfront set-up costs of up to $750k per community and annual recurring revenue of up to $1.75mm per community per year. For international markets, we expect annual licensing revenue of $2mm per partner per year.

**Figure 1. GMP revenue forecast changes**

**Prior forecasts**

| Revenue Model (C$mm) | FY2019E | FY2020E | FY2021E | FY2022E |
|---|---|---|---|---|
| **Routes** | | | | |
| Remote Northern Communities | 1 | 4 | 10 | 22 |
| Depot-to-Depot | 1 | 19 | 49 | 105 |
| Air Canada Partnership | 1 | 61 | 261 | 661 |
| **Average Revenue per route per year** | | | | |
| Remote Northern Communities | $2.000 | $1.613 | $1.350 | $1.302 |
| Depot-to-Depot | $0.420 | $0.162 | $0.179 | $0.187 |
| Air Canada Partnership | $0.025 | $0.055 | $0.067 | $0.077 |
| **Revenue** | | | | |
| Remote Northern Communities | $2.000 | $6.450 | $13.500 | $28.650 |
| Depot-to-Depot | $0.420 | $3.080 | $8.760 | $19.600 |
| Air Canada Partnership | $0.025 | $3.350 | $17.600 | $51.100 |
| **Total Revenue** | **$2.445** | **$12.880** | **$39.860** | **$99.350** |

**Current forecasts**

| Revenue Model (C$mm) | FY2019E | FY2020E | FY2021E | FY2022E | FY2023E | FY2024E |
|---|---|---|---|---|---|---|
| **Routes** | | | | | | |
| Remote Northern Communities | 0 | 1 | 4 | 7 | 9 | 11 |
| Int'l License Customers | 0 | 1 | 2 | 5 | 11 | 21 |
| Air Canada Partnership | 0 | 10 | 25 | 50 | 100 | 300 |
| **Average Revenue per route/customer per year** | | | | | | |
| Remote Northern Communities | $0.000 | $2.063 | $1.656 | $1.696 | $1.722 | $1.727 |
| Int'l License Customers | $0.000 | $2.000 | $2.000 | $1.700 | $1.500 | $1.595 |
| Air Canada Partnership | $0.000 | $0.175 | $0.147 | $0.140 | $0.141 | $0.158 |
| **Revenue** | | | | | | |
| Remote Northern Communities | $0.000 | $2.063 | $6.625 | $11.875 | $15.500 | $19.000 |
| Int'l License Customers | $0.000 | $2.000 | $4.000 | $8.500 | $16.500 | $33.500 |
| Air Canada Partnership | $0.000 | $1.750 | $3.675 | $7.000 | $14.125 | $47.500 |
| **Total Revenue** | **$0.000** | **$5.813** | **$14.300** | **$27.375** | **$46.125** | **$100.000** |

*Source: Stifel GMP*

- **Margins:** We continue to expect gross margins of 55-65%, which includes margins on set-up revenues and recurring revenue. Given our new revenue ramp, we now expect EBITDA breakeven at the end of 2021, and positive EBITDA margins in 2022 and beyond.
- **Cash requirements**: FLT reported its Q3 results on Nov. 29. Quarterly results are less meaningful in our view given the early stage of the company. As of Q3/19, cash was $13.7mm and cash opex was $2.6mm (-15% QoQ), in line with our expectations and management's target of $2-2.5mm/q. Cash burn from operations remained steady at roughly $3mm per month, which management expects to maintain in 2020. In general we expect upfront set-up revenue to begin offsetting working capital requirements in 2021, and expect cash to bottom in 2020 and 2021 at roughly $5mm.
- **Commercialization expenditures expected to decrease 44%**: FLT budgeted $4.8mm for commercialization expenses for F2019 (see Fig. 2 for breakdown) and reported $2.8mm expenses to date as of Sept. 30, 2019. FLT expects these expenditures to decrease 44% YoY to $2.7mm as the bulk of the development and testing is already complete for its products and services. More importantly, these expenses do not include cost of goods sold for any of its Air Canada Cargo commercial agreements as Drone Delivery believes that cash deposits will support the current backlog.

**Figure 2. Expected commercialization expenditures**

| Expected Expenditures | 2019 Budgeted | 2019 Approx. Actual to Date | 2020 Budgeted |
|---|---|---|---|
| Scaling of Management and Sales Teams | $750,000 | $284,006 | $250,000 |
| Product Development and Commericialization | $550,000 | $1,236,757 | $250,000 |
| Commercial Testing | $2,000,000 | $1,053,534 | $1,000,000 |
| Domestic Marketing | $1,000,000 | $271,690 | $700,000 |
| Exploration for International Commericalization | $500,000 | - | 500,000 |
| **Total Expenditures** | **$4,800,000** | **$2,845,987** | **$2,700,000** |

*Source: Stifel GMP, Drone Delivery Canada*

## Valuation

Drone Delivery Canada has a market capitalization of $160mm. The stock is currently trading at C$0.81 per share, well above its initial listing price of C$0.14 and but below its most recent financing at C$1.20, its 52-week high of C$1.74 per share, and all-time high of C$2.25.

We value Drone Delivery Canada based on a future EV/Sales multiple, discounted to present value. Our target price of $3.00 is based on 10 times 2024 EV/Sales of $100mm and discounted to present value at a 10% discount rate. This implies a target EV of $606mm. Our prior target price of $4.00 was based on 10 times 2022 EV/Sales of $99.4mm and discounted to present value at a 10% discount rate. This implied a target EV of $728.9mm.

To further examine valuation, we looked at two comparable companies:

- **Zipline International (private)**: Zipline is a drone delivery startup based out of Half Moon Bay, California. The company specializes in medical product deliveries (blood samples, health kits, medical supplies, etc.) and has made over 14k drone flights so far, with operations in Rwanda and Ghana. Zipline recently raised a US$190mm Series D round at a US$1.34bn (C$1.7bn) valuation and is backed by prominent investors including Sequoia, Andreesen Horowitz, Alphabet, and Goldman Sachs. Based on trade press estimates of US$4.3mm (C$6.7mm) in annual revenue, Zipline is trading at over 300x LTM sales, which is not atypical for early stage startups.
- **Cargojet Inc (CJT-TSX, not covered)**: Cargojet is one of Canada's leading providers of overnight air cargo services. CJT currently has a market cap of $1.4bn and trades at 4x C2020 EV/Sales and 12.1x C2020 EV/EBITDA.

Out of the two comparables, we believe that Zipline is the more appropriate peer at present, while Cargojet may offer an indication of what valuation could look like as DDC achieves meaningful revenue, and sustained above-industry growth levels. That said, we see broader application for DDC's technology (air cargo, commercial depot-to-depot, first-nation communities) vs Zipline's medical products niche, and greater opportunity to expand globally, vs Cargojet's Canada-only operations.

We also note that Zipline is a private company, and venture-backed unicorns are becoming more commonplace. Given DDC offers a similar opportunity, but is a public stock accessible to a broader group of investors, a scarcity premium could result in our view.

We believe Drone Delivery Canada has clearly entered the commercialization phase of its development. In the past two years, the company achieved key milestones such as successfully completing the Transport Canada commercial pilot program in Moosonee/Moose Factory, receiving pilot approval from Transport Canada and NAV Canada, signing the company's first commercial agreement, and announcing a commercial partnership with a major airline, which we believe is a first in the drone industry. We continue to see DDC as a leading technology innovator in commercial drone delivery and believe long-term investors with a tolerance for start-up risk will be well rewarded.

## Figure 3. Comparables valuation

| | | | 12/11/2019 | Market | Enterprise | EV/SALES | | | EV/EBITDA | | | PRICE/FCF | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Companies** | | | **Price** | **Cap (M)** | **Value (M)** | **LTM** | **C2019** | **C2020** | **LTM** | **C2019** | **C2020** | **LTM** | **C2019** | **C2020** |
| **Drone Delivery Canada Corp** | **FLT-CA** | **CAD** | **0.81** | **160.7** | **147.0** | **n.a** | **n.a** | **25.3x** | **n.a** | **NA** | **NA** | **NA** | **NA** | **NA** |
| **Early Stage Tech** | | | | | | | | | | | | | | |
| AppFolio Inc Class A | APPF-US | USD | 112.27 | 3,976.7 | 4,008.6 | 16.8x | 15.7x | 12.4x | 124.0x | 109.0x | 74.8x | 118.6x | NA | NA |
| Ambarella, Inc. | AMBA-US | USD | 52.52 | 1,749.1 | 1,359.0 | 6.1x | 5.9x | 5.7x | NA | 179.3x | NA | 37.0x | 44.0x | 93.3x |
| Coupa Software, Inc. | COUP-US | USD | 148.53 | 9,365.9 | 9,294.1 | 26.3x | 25.1x | 19.5x | NA | 246.6x | 157.3x | 218.7x | 232.3x | 143.2x |
| Alteryx, Inc. Class A | AYX-US | USD | 107.61 | 6,883.4 | 6,735.9 | 19.2x | 17.2x | 13.0x | 147.6x | 119.5x | 81.2x | 328.5x | 287.1x | 152.3x |
| Kraken Robotics Inc | PNG-CA | CAD | 0.63 | 99.9 | 96.5 | 17.0x | 6.5x | 3.2x | NA | 179.3x | 29.4x | NA | NA | 18.5x |
| ParaZero Ltd. | PRZ-ASX | AUD | 0.06 | 6.0 | 5.3 | 3.6x | NA | NA | NA | NA | NA | NA | NA | NA |
| **Average** | | | | | | **14.8x** | **14.1x** | **10.7x** | **1.0x** | **166.7x** | **29.6x** | **114.9x** | **131.3x** | **101.8x** |
| **Logistics and Transportation** | | | | | | | | | | | | | | |
| Descartes Systems Group Inc. | DSG-CA | CAD | 55.08 | 4,700.6 | 4,674.7 | 11.3x | 10.8x | 9.8x | 33.4x | 31.2x | 27.0x | 37.9x | 38.0x | 28.7x |
| Cargojet Inc. | CJT-CA | CAD | 102.35 | 1,392.0 | 2,107.8 | 4.4x | 4.3x | 4.0x | 14.5x | 13.5x | 12.1x | NA | 130.8x | 19.8x |
| Canadian Pacific Railway Limited | CP-CA | CAD | 324.45 | 45,001.2 | 54,209.2 | 7.0x | 7.0x | 6.6x | 14.4x | 14.2x | 13.1x | 51.0x | 37.7x | 28.0x |
| Union Pacific Corporation | UNP-US | USD | 171.85 | 120,621.5 | 146,965.5 | 6.6x | 6.7x | 6.6x | 13.5x | 13.5x | 12.5x | 47.0x | 21.9x | 20.5x |
| Canadian National Railway Company | CNR-CA | CAD | 118.56 | 85,469.9 | 98,991.9 | 6.5x | 6.6x | 6.3x | 13.5x | 13.7x | 12.5x | 118.9x | 40.3x | 28.1x |
| Kansas City Southern | KSU-US | USD | 151.16 | 15,070.5 | 18,158.7 | 6.4x | 6.3x | 6.0x | 13.1x | 12.9x | 11.7x | 47.1x | 33.9x | 26.2x |
| **Average** | | | | | | **7.0x** | **7.0x** | **6.5x** | **17.1x** | **16.5x** | **14.8x** | **47.0x** | **50.4x** | **25.2x** |
| **FAANG Stocks** | | | | | | | | | | | | | | |
| Facebook, Inc. Class A | FB-US | USD | 200.87 | 577,300.4 | 534,587.4 | 8.0x | 7.6x | 6.2x | 16.0x | 14.1x | 12.2x | 34.7x | 30.6x | 25.4x |
| Apple Inc. | AAPL-US | USD | 268.48 | 1,213,629.7 | 1,221,096.7 | 4.7x | 4.6x | 4.4x | 16.4x | 15.7x | 14.9x | 27.1x | 20.4x | 19.0x |
| Amazon.com, Inc. | AMZN-US | USD | 1,739.21 | 876,561.8 | 907,449.8 | 3.4x | 3.3x | 2.7x | 28.5x | 22.0x | 18.4x | 43.7x | 35.3x | 25.8x |
| Alphabet Inc. Class C | GOOG-US | USD | 1,344.66 | 938,840.3 | 831,411.3 | 5.4x | 5.1x | 4.3x | 18.3x | 14.1x | 12.1x | 32.9x | 31.3x | 25.8x |
| Netflix, Inc. | NFLX-US | USD | 293.12 | 132,358.9 | 141,463.3 | 7.5x | 7.0x | 5.8x | 12.7x | 44.9x | 32.5x | NA | NA | NA |
| Alibaba Group Holding Ltd. Sponsored ADR | BABA-US | USD | 200.45 | 528,511.5 | 532,658.8 | 8.2x | 7.7x | 5.9x | 29.1x | 24.7x | 19.3x | NA | 21.1x | 21.3x |
| Microsoft Corporation | MSFT-US | USD | 151.13 | 1,165,212.3 | 1,114,550.3 | 8.6x | 8.4x | 7.5x | 19.5x | 19.0x | 16.7x | 47.5x | 29.7x | 26.7x |
| **Average** | | | | | | **6.5x** | **6.2x** | **5.3x** | **20.1x** | **22.1x** | **18.0x** | **70.0x** | **70.0x** | **70.0x** |
| **Group Average** | | | | | | **9.5x** | **9.1x** | **7.5x** | **12.7x** | **68.4x** | **20.8x** | **77.3x** | **83.9x** | **65.7x** |

*Notes: Averages exclude outliers. Estimates from FactSet and Bloomberg*

*Source: Stifel GMP, FactSet*

## Risks

**Capital requirements:** DDC is not currently generating commercial revenue. The company has raised ~$40mm of capital and has $13.7mm in cash available as of Sept. 30, 2019, versus a burn rate of ~$3mm/q. We expect partners to contribute to initial infrastructure investment and commercial revenue to begin in Q1 2020. However, timing of revenue and operating leverage are uncertain and material delays would likely require additional capital raises and potential dilution for existing shareholders.

**Regulatory uncertainty:** Requirements for the approval and licensing of commercial drone operations in Canada are evolving concurrent with the technology and applications. Changing regulations and government approval processes could delay licensing or increase requirements for DDC. This could impact timing of commercial operations and capital requirements near-term. Should DDC ultimately not receive a license for commercial BVLOS operations, or approvals for key routes, this would have a material adverse effect on the business in our view.

**Operational risk:** As DDC moves beyond the testing and pilot phase, new operational risks will rise in importance. This includes factors such as safety, reliability, on-time efficiency and customer service. Testing and simulation help, but cannot fully mitigate these risks. We believe this will require the accumulation of real-world operating experience for DDC and its customers.

**Technology risk:** The pace of innovation for both drone hardware and software systems has accelerated in recent years. While this has largely benefited DDC, new advancements must be adopted and integrated quickly if DDC is to keep costs low, expand its capabilities, and maintain its leadership.

**Competition:** Several large technology and logistics companies have invested in drone development, including the likes of Amazon, Google, UPS and DHL, while large incumbents dominate other segments of the supply chain. While we see few direct competitors to DDC today, new entrants with access to material capital have the potential to change competitive dynamics.

**Valuation risk:** At this early stage, the nature of DDC's commercial agreements and revenue model remains fluid and could change. The timing of the start and ramp of commercial revenue also remains uncertain. These factors make valuation particularly challenging and uncertain for investors, irrespective of the high risks associated with early-stage technology companies.

## Figure 4. Financial model summary

**Drone Delivery Canada**
Year ended December 31
**Income Statement (C$M)**

| | FY2019E | FY2020E | FY2021E | FY2022E | FY2023E | FY2024E |
|---|---|---|---|---|---|---|
| Total Northern Canada Revenue | 0.00 | 2.063 | 6.625 | 11.875 | 15.500 | 19.000 |
| Total Int'l Revenue | 0.00 | 2.000 | 4.000 | 8.500 | 16.500 | 33.500 |
| Total Air Canada Revenue | 0.00 | 1.750 | 3.675 | 7.000 | 14.125 | 47.500 |
| **Total Revenue** | **0.00** | **5.813** | **14.300** | **27.375** | **46.125** | **100.000** |
| **Cost of Sales** | | | | | | |
| Operating and maintainance costs | 0.00 | 2.616 | 5.291 | 10.129 | 17.066 | 37.000 |
| **Total Cost of Sales** | **0.00** | **2.616** | **5.291** | **10.129** | **17.066** | **37.000** |
| Gross Profit | 0.00 | 3.197 | 9.009 | 17.246 | 29.059 | 63.000 |
| **Gross Margin %** | **n.a.** | **55.0%** | **63.0%** | **63.0%** | **63.0%** | **63.0%** |
| **Total Expenses** | **12.125** | **10.737** | **10.860** | **10.960** | **11.042** | **11.108** |
| **Income from Ops.** | **(12.125)** | **(7.541)** | **(1.851)** | **6.286** | **18.017** | **51.892** |
| **Earnings before Tax** | **(12.482)** | **(7.541)** | **(1.851)** | **6.286** | **18.017** | **51.892** |
| **Net Income/(loss)** | **(11.941)** | **(6.169)** | **(1.535)** | **5.044** | **14.398** | **41.867** |
| **EBITDA** | (11.837) | (7.203) | (1.391) | 6.846 | 18.659 | 52.600 |
| *EBITDA %* | n.a. | *-124%* | *-10%* | *25%* | *40%* | *53%* |
| EPS | (0.07) | (0.04) | (0.01) | 0.03 | 0.08 | 0.24 |
| **EPS F.D.** | (0.06) | (0.03) | (0.01) | 0.03 | 0.07 | 0.21 |
| **Weighted Avg. Basic Shares** | 172.50 | 176.19 | 176.19 | 176.19 | 176.19 | 176.19 |
| Weighted Avg. Diluted Shares | 193.51 | 198.42 | 198.42 | 198.42 | 198.42 | 198.42 |
| **Margins %** | | | | | | |
| Gross margin | *n.a.* | *55%* | *63%* | *63%* | *63%* | *63%* |
| Operating margin | *n.a.* | *-130%* | *-13%* | *23%* | *39%* | *52%* |
| Net margin | *n.a.* | *-106%* | *-11%* | *18%* | *31%* | *42%* |
| SG&A | *n.a.* | *21%* | *8%* | *4%* | *3%* | *1%* |
| **Growth YoY %** | | | | | | |
| Total Revenue | *n.a.* | *n.a.* | *146%* | *91%* | *68%* | *117%* |
| Expenses, excl dep + amortization | *64%* | *89%* | *102%* | *102%* | *101%* | *101%* |
| Operating Income | *-37%* | *-38%* | *-75%* | *-440%* | *187%* | *188%* |
| EBITDA | *-39%* | *-39%* | *-81%* | *-592%* | *173%* | *182%* |
| **Cash used in operating activities** | **(10.565)** | **(5.631)** | **0.398** | **5.583** | **11.470** | **37.724** |
| **Cash from Investing** | **(3.119)** | **(2.000)** | **(1.000)** | **(1.000)** | **(1.000)** | **(2.000)** |
| **Cash from Financing** | **12.989** | **(0.172)** | **(0.172)** | **(0.172)** | **(0.172)** | **(0.172)** |
| **Cash at the end of period** | **13.614** | **5.811** | **5.037** | **9.448** | **19.745** | **55.298** |
| **Free Cash Flow** | | | | | | |
| Cash from Ops. | (10.565) | (5.631) | 0.398 | 5.583 | 11.470 | 37.724 |
| Capital Expenditure (Acquisition of PPE) | (1.876) | (2.000) | (1.000) | (1.000) | (1.000) | (2.000) |
| **Free Cash Flow** | **(12.441)** | **(7.631)** | **(0.602)** | **4.583** | **10.470** | **35.724** |
| YoY % change | 14.37% | -38.66% | -92.11% | -861.18% | 128.45% | 241.22% |
| FCF as a % of revenue | n.a. | -131% | -4% | 17% | 23% | 36% |
| FCF as a % of EBITDA | 105% | 106% | 43% | 67% | 56% | 68% |

*Source: Stifel GMP*

## Important Disclosures and Certifications

**Each research analyst and associate research analyst who authored this document and whose name appears herein certifies that: (1) the recommendations and opinions expressed in the research report accurately reflect their personal views about any and all of the securities or issuers discussed herein that are within their coverage universe; and (2) no part of their compensation was, is or will be, directly or indirectly, related to the provision of specific recommendations or views expressed herein.**

All relevant disclosures required by regulatory rules (including The Investment Industry Regulatory Organization of Canada) and Stifel Canada's recommendation statistics and research dissemination policies can be obtained at www.Stifel.com/Research or by calling Stifel Canada's Compliance Department.

Stifel Canada will provide, upon request, a statement of its financial condition and a list of the names of its Directors and senior officers.

The superscript(s) following the issuer name(s) mentioned in this report refers to the company-specific disclosures below. If there is no such superscript, then none of the disclosures are applicable and/or required.

**Company-Specific Disclosures:**
1. Stifel Canada or an affiliate has, within the previous 12 months, provided paid investment banking services to the issuer.
2. Stifel or an affiliate act as corporate broker and/or adviser to the Company.
3. Stifel Canada or an affiliate owns 1% or more of this issuer's securities.
4. An officer, director, or an employee of Stifel Canada or an affiliate is on the board of directors of the Company.
5. The analyst is related to an officer, director or advisory board member of this issuer.
6. The analyst has viewed the material operations of this issuer and the issuer paid all or a portion of the travel expenses associated with the analyst's site visit to its operations.
7. The analyst has viewed the material operations of this issuer.
8. The analyst and/or a member of their household has a position in this issuer's securities.
9. A member of the Board of Directors of this issuer is also a member of the Board of Directors of Stifel Canada.
10. The analyst owns this issuer's securities in a managed account but has no involvement in the investment decisions for that managed account.
11. Stifel Canada or an affiliate managed or co-managed a public offering of securities for the subject company in the past 12 months.
12. Stifel Canada or an affiliate expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months.
13. Stifel Canada or an affiliate is a market maker or liquidity provider in the securities of the subject company.

Stifel Canada Analysts are compensated competitively based on several criteria. The Analyst compensation pool is comprised of several revenue sources, including secondary trading commissions, new issue commissions, investment banking fees, and directed payments from institutional clients.

**The Stifel Canada research recommendation structure consists of the following ratings:**

**Buy:** A Buy rating reflects 1) bullish conviction on the part of the analyst; and 2) typically a 15% or greater return to target.
**Speculative Buy:** A Speculative Buy rating reflects 1) bullish conviction on the part of the analyst accompanied by a substantially higher than normal risk, including the possibility of a binary outcome; and 2) typically a 30% or greater return to target.
**Hold:** A Hold rating reflects 1) a lack of bullish or bearish conviction on the part of the analyst; and 2) typically a return of 0 to 20%.
**Reduce:** A Reduce rating reflects 1) bearish conviction on the part of the analyst; and 2) typically a 5% or lower return to target.
**Tender:** Clients are advised to tender their shares to a takeover bid or similar offer.

## Additional Disclosures

Please visit the Research Page at www.Stifel.com/Research for the current research disclosures.

The information contained herein has been prepared from sources believed to be reliable but is not guaranteed by us and is not a complete summary or statement of all available data, nor is it considered an offer to buy or sell any securities referred to herein. Opinions expressed are subject to change without notice and do not take into account the particular investment objectives, financial situation or needs of individual investors. Employees of Stifel, or its affiliates may, at times, release written or oral commentary, technical analysis or trading strategies that differ from the opinions expressed within. Past performance should not and cannot be viewed as an indicator of future performance.

As a multi-disciplined financial services firm, Stifel regularly seeks investment banking assignments and compensation from issuers for services including, but not limited to, acting as an underwriter in an offering or financial advisor in a merger or acquisition, or serving as a placement agent in private transactions.

### Affiliate Disclosures

This report has been prepared by Stifel Nicolaus Canada Inc. (“Stifel Canada”), which is authorized and regulated by the Investment Industry Regulatory Organization of Canada (“IIROC”).

“**Stifel**”, shall include our group affiliate companies: (i) Stifel, Nicolaus & Company, Incorporated (“**SNC**”); (ii) Keefe, Bruyette & Woods, Incorporated (“**KBWI**’’), which are both U.S. broker-dealers registered with the United States Securities and Exchange Commission (“**SEC**”) and members of the Financial Industry National Regulatory Authority (“**FINRA**”), respectively; (iii) Stifel Nicolaus Europe Limited (“**SNEL**”), which is authorised and regulated by the United Kingdom Financial Conduct Authority (“**FCA**”) (FRN 190412) and is a member of the London Stock Exchange and also trades under the name Keefe, Bruyette & Woods Europe (“**KBW Europe**”); (iv) our MainFirst affiliates(collectively “**MAINFIRST**’’): MainFirst Bank AG, which is regulated by the German Federal Financial Services Authority (Bundesanstalt für Finanzdienstleistungsaufsicht; “**BaFin**”), MainFirst Schweiz AG, which is regulated by the Eidgenössische Finanzmarktaufsicht (“**FINMA**”), and MainFirst Securities US Inc. which is a U.S. broker-dealer registered with the SEC and a member of FINRA; and (v) Stifel Nicolaus Canada, Inc. ("**Stifel Canada")** which is authorised and regulated by Investment Industry Regulatory Organization of Canada (IIROC), and also trades under the names Stifel GMP & Stifel First Energy.

**Registration of non-US Analysts:** Any non-US research analyst employed by Stifel Canada contributing to this report is not registered/qualified as a research analyst with FINRA and is not an associated person of the US broker-dealer and therefore may not be subject to FINRA Rule 2241 restrictions on communications with a subject company, public appearances, and trading securities held by a research analyst account.

**Country Specific and Jurisdictional Disclosures:**

**Canada:** Stifel Canada is a member of IIROC and a participant of the TSX, and TSX Venture Exchange. 145 King Street West, Suite 300 Toronto, Ontario M5H 1J8 Tel: (416) 367-8600.

**United States:** Research produced and distributed by Stifel Canada is distributed by Stifel Canada to "Major US Institutional Investors" as defined in Rule 15a-6 under the US Securities Exchange Act of 1934, as amended.

**UK and European Economic Area (EEA):** This report is distributed in the EEA by Stifel Canada. Research produced by Stifel Canada is not intended for use by and should not be made available to non-professional clients.

In jurisdictions where Stifel is not already licensed or registered to trade securities, transactions will only be affected in accordance with local securities legislation which will vary from jurisdiction to jurisdiction and may require that a transaction is carried out in accordance with applicable exemptions from registration and licensing requirements. Non-US customers wishing to effect transactions should contact a representative of the Stifel entity in their regional jurisdiction except where governing law permits otherwise. US customers wishing to effect transactions should contact their US salesperson.