

CORPORATE COMMENTARY

On the June Quarterly Appendix 4C

Department 13 International Ltd (ASX : D13) (“D13” or “the Company”) a cutting-edge developer of communications and software systems, is pleased to provide an update on activities and cash flows for the period ended 30 June 2017.

Introduction to Department 13

- D13 is an innovative, technology company focussing on wireless and mobile technologies to create solutions that transform networks and communications.
- Drones (or Unmanned Aerial Vehicles) have proliferated in the market for consumer and prosumer applications. Unfortunately, some drones are being used for nefarious purposes.
- D13’s MESMER system utilises technology for manipulating wireless protocols which allows users to take control of wireless communication system, with the aim of protecting from drones physically harming people, damaging and disrupting critical infrastructure, and stealing IP.
- The mission is to be the market leader in counter drone technology.

Key Highlights for June Quarter

- Four (4) MESMER 1.5 system sales to customer through the Australian distributor, EPE.
- One (1) MESMER 1.5 system sale to South East Asian based customer.
- Appointment of MESMER distributors in Monaco and France.
- Demonstrations of MESMER system to a range of government and commercial customers in Europe, Middle East, Asia and United States including participation in US Department of Defence Black Dart.
- Expanded patent portfolio with 2 new patent additions over the quarter.
- Manufacturing partner Core Source Technologies completed tooling and production processes.
- Appointment of Tim Davies as Non-Executive Director.
- Closing cash balance of A\$4.93M following capital raise of A\$5.5M during the June Quarter.

Outlook for Future Quarters & Events Subsequent

- D13 has now agreed final terms for a US\$10m working capital facility to support purchase orders of MESMER systems and bulk purchase of long lead items to speed up delivery to end customers. The initial term of the US\$10m Facility is 18 months, is subject to customary conditions including final formal documentation, and has the ability to be significantly increased in size to smooth cash flows and working capital needs arising from potential rapid growth in MESMER system orders.
- Manufacturing partner Core Source Technologies has commenced production of MESMER systems in July 2017 and is ready to meet expected increase in Purchase Orders over next six months.
- First delivery of MESMER 1.5 systems to Australian Distributor schedule for late August 2017.
- Second delivery of MESMER 1.5 system on schedule for September 2017.
- Funds from the sales of five MESMER 1.5 systems in the June quarter are expected to be delivered during Q3 and Q4 2017, resulting in an improvement in recorded revenue over the remainder of 2017.
- Follow up evaluation and trials booked out to September 2017 following June Quarter demonstrations.
- D13 expects to receive multiple purchase orders for MESMER 1.5 system over the next six months following evaluations and trials over the September Quarter.
- Cancellation of 284M Performance Shares (32% of issued capital of shares, performance rights and options) in July 2017.

The past three months have been encouraging for D13, with validation of the MESMER product achieved through the first purchase orders from both government and commercial customers during the June Quarter. Additionally, D13 conducted a series of demonstration trials for new clients from Asia, Europe, Middle East and United States over the June Quarter.

Initial feedback on the MESMER 1.5 system has also been encouraging, with more advanced evaluation trials booked throughout the September Quarter. D13 believes that these evaluation trials will lead to further purchase orders from clients over the remainder of 2017.

Department 13 – Background of MESMER Drone Solution

Over 700,000 Drones were sold and registered with the US Federal Aviation Authority (FAA) in 2016. Drone sales in the US are forecast to increase exponentially over the next 5 years to reach 7M units by 2020.

Both governments and corporations are increasingly concerned over the credible threat drones present to critical infrastructure environments such as cities, energy facilities, prisons, sporting events and international borders. In the military arena, drones can also act as a “cheap air force”, providing surveillance, reconnaissance and attack capabilities through the weaponization of drones.

Throughout 2017, there have been an increase in news events surrounding the use of drones and their negative impact on both commercial and government operations globally. These events include:

- ISIS fighters used a commercial drone over the city of Mosul in Iraq, which dropped a small bomb and left 1 Iraqi soldier dead. This incident was reported as one of dozens of attacks on troops utilizing weaponised commercial drones (February 2017).
- Transport Canada has banned the use of drones within 9km of airports, all drone flights at night hours and over 90 meters high during daytime hours. Total impact incidents over past 12 months have increased by 400% (March 2017).
- Australian Transport Board has opened an investigation into the possible collision of a drone with an aircraft at secondary Adelaide airport (July 2017). Report published in January 2017 indicated 12 incidents of aircraft-drone impacts since 2015.
- In the UK, total number of incidents involving drones has increased 13-fold from 283 in 2014 to 3,456 in 2016 (April 2017).
- London's Gatwick airport was closed twice over the weekend and flights were diverted due to drones flying too close the airport sparking safety fears (July 2017).
- Of concern is the rise of drug smuggling over international borders with drones, as well as their use to smuggle both drugs and weapons into prisons globally.

D13's MESMER product offers the best solution to both detect, control and safely land dangerous or illegal drones that present a credible threat to populations and infrastructure. MESMER is also a safer route to drone defence than both kinetic (missile) and jamming gun approaches adopted by D13's key competitors.

MESMER is a highly effective tool in military environment to protect soldiers and government assets, and can be easily integrated into existing drone defence systems to offer stronger protection from drone attacks.

Upgrade to MESMER 1.5 System

During the June Quarter, the Company's product development team successfully upgraded the platform to the MESMER 1.5 system. The key features included an advance in total drone detection range by up to 400% compared with MESMER 1.0. Other key improvements include expanded operational frequencies (433MHz, 915MHz, 2.4GHz, and 5.8GHz) and a new, single unit form factor. This new form factor allows for easier deployment of MESMER in fixed-site, vehicle, and man-portable applications.

First Delivery of Mesmer System

After 18 months of product development, D13 was pleased to announce the first sales purchase (five units) of MESMER 1.5 by two customers during the June Quarter. This included a multiple system purchase by a single customer through the Australian distributor EPE. D13 management is confident that following the successful delivery and integration of the MESMER system into this client's drone defense platform, additional MESMER orders will be received.

In addition, a South East Asian client will receive delivery of a single MESMER 1.5 system in September 2017, and has indicated an intention to purchase multiple systems subject to successful testing and integration with their existing drone detection capabilities.

Purchase Orders for five (5) MESMER 1.5 systems sales during the June Quarter have payment terms of 30 days following delivery of the MESMER unit to each client. With delivery expected in August and September, Department 13 is scheduled to receive payment in September and October.

MESMER 1.5 hardware and first year software sales licence fees will deliver net sales up to US\$400,000 per unit, with additional follow-on licence fees per year.

Strong Interest from Customers with Evaluations already booked for September Quarter

Over the June Quarter, D13 has delivered MESMER system trials to both government and commercial customers throughout Asia, Middle East, Australia, Europe and United States. At each demonstration event, clients have been impressed with the performance of the MESMER product and strength of D13's unique detection and mitigation approach.

In many cases, clients have requested a follow up evaluation trial before committing to an initial system purchase. Current discussions with clients on initial purchase orders are in the range of a minimum of 1-5 MESMER units, with exception of 2 large government clients that have indicated potential orders significantly above this range.

D13 has numerous MESMER evaluations booked for in the September Quarter and D13 is confident of securing further MESMER system orders over the remainder of 2017.

Appointment of Additional Distributors

D13 has expanded its sales efforts with the establishment of distributors in Asia, Central America, South America and Europe. D13 has signed exclusive distributor agreements with the following partners to sell MESMER systems into the associated countries:

- EPE Equipment (EPE) – trading as Zangold Pty Ltd – Australia and NZ
- Heath and Lee Services Co Ltd – Thailand and Indonesia
- Phoenix Group Panama S.A – Mexico, Honduras, Costa Rica, Panama, Columbia, Chile, Peru
- Scopex SARL – France
- JCPX Development – Monaco

Appointment of Core Source Technologies as Manufacturing Partner

During the June Quarter, D13 appointed Core Source Technologies, a local Maryland firm, to be the key manufacturing partner for the MESMER system. Core Source Technologies has a reputation for delivering high precision prototypes and systems for large commercial and government clients. Additionally, Core Source Technologies has the necessary capabilities and capacity to meet any significant increase in orders that may be secured following completion of multiple evaluations and trials throughout the September Quarter.

All tooling and production planning was completed during the June Quarter for the MESMER product, with production for existing Purchase Orders (received during the June Quarter) expected to be completed by early August 2017.

Core Source Technologies is also currently producing an additional 7 MESMER 1.5 systems that will be used by D13 for product testing, trials and evaluations, and immediately sales for new clients.

Expansion of Patent Portfolio

During the June Quarter, D13 was granted 2 additional patents that further strengthen their technology advantage in the drone mitigation and communication networking field.

Specifically, the company's wireless fingerprint patent relates to enhancing the security of the counter drone solution by preventing the ability of dangerous drone operators to identify and attack MESMER. In the communication field, this patent presents revenue opportunities through strengthening the cyber security for mobile phones and laptops.

The second patent technology significantly increases battery life for radio transmitters, including mobile phones, computers and drones. D13 sees the potential of strong IP licencing opportunities of this technology.

Moving forward, D13 aims to improve investor education of the strength of the patent portfolio through the issue of a Quarterly update to shareholders outlining the key patents and current efforts to monetise these patents through licensing sharing agreements with other communication companies.

Capital Structure & Management

During the June Quarter, D13 raised A\$5.5M through a share placement in May 2017. As at 30 June 2017, D13 has a net cash balance of A\$4.93m.

On 13 July 2017, shareholders approved cancellation of 284 million performance shares for nil consideration in D13. This represents 32% of the total issued capital of shares, performance rights and options. The cancellation of these performance shares has now largely reduced share dilution impact to the benefit of all shareholders of Department 13.

Whilst D13 has relied solely upon equity financing throughout the development stage of the MESMER product over the past two years, the Company believes the addition of a working capital facility to fund the working capital (inventory and purchase orders) is more appropriate as D13 moves into production stage.

D13 has agreed to final terms on a US\$10M working capital facility that will be used to fund working capital requirements for purchase orders over the next 18 months.

The additional funding will allow D13 to hold sufficient long-lead item inventory to produce MESMER systems. The forward purchase of these items will allow D13 to gradually reduce total production and delivery times from the current 120 days to below 90 days over the next 6 months. Increasing the speed of system delivery to the clients is a critical goal of D13 over the remainder of 2017. The company aims to complete and announce the securing of this working capital facility in the September Quarter.

Outlook

Following a successful June Quarter, in which D13 received the first Purchase Orders for the MESMER 1.5 system, and after successful demonstrations and with subsequent follow up evaluations to clients in Europe, Middle East, United States, Australia and Asia, the Company is confident of an acceleration in sales order over the remainder of 2017.

CEO of Department 13, Jonathan Hunter commented "The Company continues to see strong demand for trials and evaluations of the MESMER system as clients learn more about the strength of the product particularly over other drone defense systems. Importantly, these trials and evaluation requests are coming from both government and commercial clients, demonstrating the flexibility of MESMER across all environments. We have started to and will continue to strengthen our Board, Operations and Capital Management in expectation of continued growth in sales over coming quarters and years."

-ENDS-

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About Department 13

Based in Maryland, Department 13 (D13) was founded in 2010 by a team of former military operators, scientists and engineers who apply proprietary innovative advanced technology to emerging requirements. D13 is developing cutting-edge software and communication systems that have the potential to transform the networking and communication fields as well as current applications in drone defense, mobile phone IT security and secure enhanced Android phone systems. D13 is engaged with multiple counter UAS projects to provide strategic solutions for civil, military and commercial security requirements. D13 has 15 patents and 23 patent applications in the development of wireless protocol manipulation and communication networking software with applications in drone defense, local area and wide area cellular communications and networking, enhanced data bandwidth for all digital communications, cyber security for mobile devices and sophisticated RF technology applications (radiometrics). For more information about D13, please visit www.department13.com or follow us on Twitter (@D13ASX), LinkedIn and YouTube.

Appendix 4C

Quarterly report for entities subject to Listing Rule 4.7B

Introduced 31/03/00 Amended 30/09/01, 24/10/05, 17/12/10, 01/09/16

Name of entity

Department 13 International Ltd

ABN

36 155 396 893

Quarter ended ("current quarter")

30 June 2017

Consolidated statement of cash flows		Current quarter \$A'000	Year to date (12 months) \$A'000
1. Cash flows from operating activities			
1.1 Receipts from customers		251	839
1.2 Payments for			
(a) research and development		(470)	(2,802)
(b) product manufacturing and operating costs		(45)	(193)
(c) advertising and marketing		(200)	(563)
(d) leased assets		-	-
(e) staff costs		(998)	(2,616)
(f) administration and corporate costs		(1,088)	(3,145)
1.3 Dividends received (see note 3)		-	-
1.4 Interest received		8	26
1.5 Interest and other costs of finance paid		-	-
1.6 Income taxes paid		-	-
1.7 Government grants and tax incentives		-	-
1.8 Other (GST received, prepayment)		28	57
1.9 Net cash from / (used in) operating activities		(2,514)	(8,397)

2.	Cash flows from investing activities		
2.1	Payments to acquire:		
	(a) property, plant and equipment	(13)	(356)
	(b) businesses (see item 10)	-	-
	(c) investments	-	-
	(d) intellectual property	-	-
	(e) other non-current assets	-	-
2.2	Proceeds from disposal of:		
	(a) property, plant and equipment	-	-
	(b) businesses (see item 10)	-	-
	(c) investments	-	-
	(d) intellectual property	-	-
	(e) other non-current assets	-	-
2.3	Cash flows from loans to other entities	-	-
2.4	Dividends received (see note 3)	-	-
2.5	Other (provide details if material)	-	-
2.6	Net cash from / (used in) investing activities	(13)	(356)

3.	Cash flows from financing activities		
3.1	Proceeds from issues of shares	5,544	12,044
3.2	Proceeds from issue of convertible notes	-	-
3.3	Proceeds from exercise of share options	-	-
3.4	Transaction costs related to issues of shares, convertible notes or options	(272)	(659)
3.5	Proceeds from borrowings	-	-
3.6	Repayment of borrowings	-	-
3.7	Transaction costs related to loans and borrowings	-	-
3.8	Dividends paid	-	-
3.9	Other (provide details if material)	-	-
3.10	Net cash from / (used in) financing activities	5,272	11,385

4.	Net increase / (decrease) in cash and cash equivalents for the period	2,745	2,632
4.1	Cash and cash equivalents at beginning of quarter/year to date	2,330	2,513
4.2	Net cash from / (used in) operating activities (item 1.9 above)	(2,514)	(8,397)
4.3	Net cash from / (used in) investing activities (item 2.6 above)	(13)	(356)
4.4	Net cash from / (used in) financing activities (item 3.10 above)	5,272	11,385
4.5	Effect of movement in exchange rates on cash held	(150)	(220)
4.6	Cash and cash equivalents at end of quarter	4,925	4,925

5.	Reconciliation of cash and cash equivalents at the end of the quarter (as shown in the consolidated statement of cash flows) to the related items in the accounts	Current quarter \$A'000	Previous quarter \$A'000
5.1	Bank balances	1,033	500
5.2	Call deposits	3,892	1,830
5.3	Bank overdrafts	-	-
5.4	Other (provide details)	-	-
5.5	Cash and cash equivalents at end of quarter (should equal item 4.6 above)	4,925	2,330

6.	Payments to directors of the entity and their associates	Current quarter \$A'000
6.1	Aggregate amount of payments to these parties included in item 1.2	116
6.2	Aggregate amount of cash flow from loans to these parties included in item 2.3	-
6.3	Include below any explanation necessary to understand the transactions included in items 6.1 and 6.2	
N/A		

7. Payments to related entities of the entity and their associates	Current quarter \$A'000
7.1 Aggregate amount of payments to these parties included in item 1.2	178
-7.2 Aggregate amount of cash flow from loans to these parties included in item 2.3	-
7.3 Include below any explanation necessary to understand the transactions included in items 7.1 and 7.2	

Amounts included in item 7.1 relate to fees payments to key management personnel.

8. Financing facilities available <i>Add notes as necessary for an understanding of the position</i>	Total facility amount at quarter end \$A'000	Amount drawn at quarter end \$A'000
8.1 Loan facilities	- (see 8.4)	-
8.2 Credit standby arrangements	-	-
8.3 Other (please specify)	-	-
8.4 Include below a description of each facility above, including the lender, interest rate and whether it is secured or unsecured. If any additional facilities have been entered into or are proposed to be entered into after quarter end, include details of those facilities as well.		

A US\$10m working capital facility has been agreed under a binding term sheet and is available subject to customary conditions, including finalising the formal agreement. The facility is unsecured but the lender has the right to require partial security over individual customer purchase orders. The initial term is 18 months and the amount of the facility is capable of being increased.

9. Estimated cash outflows for next quarter	\$A'000
9.1 Research and development	470
9.2 Product manufacturing and operating costs	1,234
9.3 Advertising and marketing	150
9.4 Leased assets	-
9.5 Staff costs	900
9.6 Administration and corporate costs	860
9.7 Other (provide details if material)	-
9.8 Total estimated cash outflows	3,614

10.	Acquisitions and disposals of business entities (items 2.1(b) and 2.2(b) above)	Acquisitions	Disposals
10.1	Name of entity	-	-
10.2	Place of incorporation or registration	-	-
10.3	Consideration for acquisition or disposal	-	-
10.4	Total net assets	-	-
10.5	Nature of business	-	-

Compliance statement

- 1 This statement has been prepared in accordance with accounting standards and policies which comply with Listing Rule 19.11A.
- 2 This statement gives a true and fair view of the matters disclosed.

Sign here: Kevin Kye
(Director/Company secretary)

Date: 31 July 2017

Print name: Kevin Kye

Notes

1. The quarterly report provides a basis for informing the market how the entity's activities have been financed for the past quarter and the effect on its cash position. An entity that wishes to disclose additional information is encouraged to do so, in a note or notes included in or attached to this report.
2. If this quarterly report has been prepared in accordance with Australian Accounting Standards, the definitions in, and provisions of, *AASB 107: Statement of Cash Flows* apply to this report. If this quarterly report has been prepared in accordance with other accounting standards agreed by ASX pursuant to Listing Rule 19.11A, the corresponding equivalent standard applies to this report.
3. Dividends received may be classified either as cash flows from operating activities or cash flows from investing activities, depending on the accounting policy of the entity.