

18 April 2024

# Dropsuite Ltd

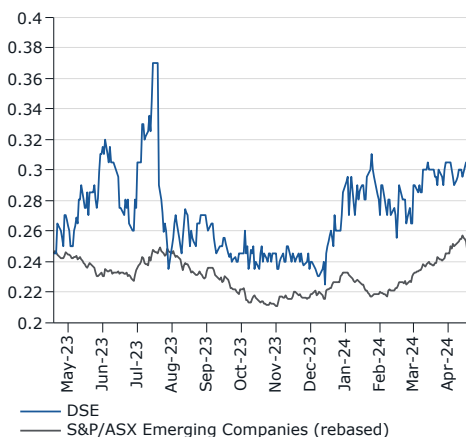
## Software and Services

Rating <b>BUY</b> unchanged	Price Target <b>A\$0.40</b> unchanged
DSE-ASX	Price <b>A\$0.31</b>

### Market Data

52-Week Range (A\$) :	0.22 - 0.39
Market Cap (A\$M) :	210.6
Shares Out. (M) :	679.3
Dividend /Shr (A\$) :	0.00
Dividend Yield (%) :	0.0
Enterprise Value (A\$M) :	186.1
Cash (A\$M) :	24.5
Long-Term Debt (A\$) :	0.0

FYE Dec	2023A	2024E	2025E	2026E
Sales (A\$M)	29.9	39.8↑	51.1↑	62.2
Previous	-	39.6	50.6	-
Gross Profit (A\$M)	20.5	27.3	35.0	42.6
EBITDA (A\$M)	2.6	2.8↓	4.8↓	6.9
Previous	-	3.4	5.4	-
EBIT (A\$M)	2.6	2.7↓	4.7↓	6.8
Previous	-	3.4	5.3	-
Net Income Adj (A\$M)	2.6	2.7↓	4.7↓	6.8
Previous	-	3.4	5.3	-
Net Debt (Cash) (A\$M)	(25)	(27)↑	(32)↑	(39)
Previous	-	(28)	(33)	-
EV/Sales (x)	6.2	4.6	3.5	2.8



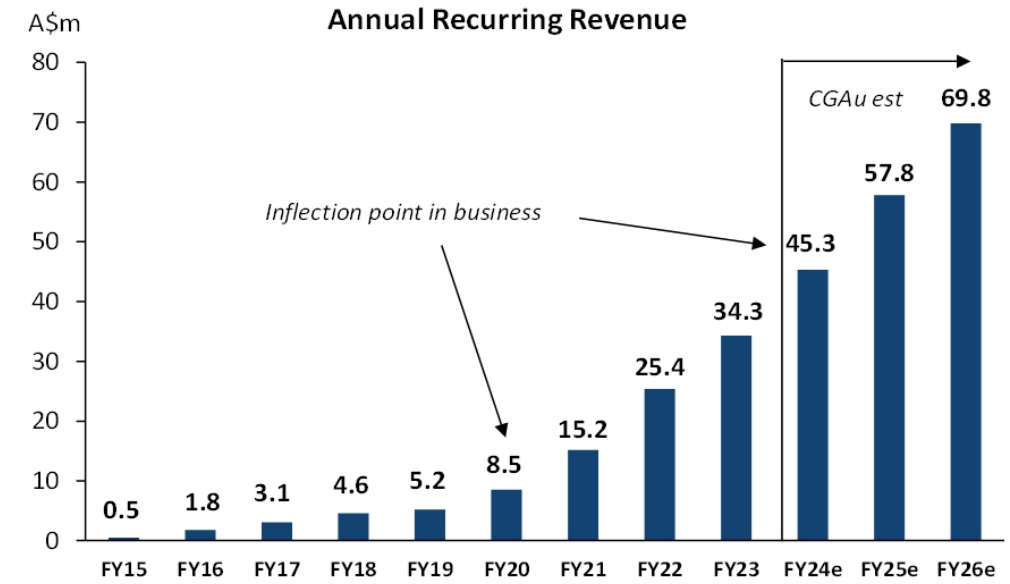
Priced intraday 18 April 2024

Dropsuite is a global cloud software platform founded in 2012 that provides cloud-based email and website back-up, archiving and recovery solutions.

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## ARR continues to grow (+33% yoy); multiples continue to fall (<4x FY25E revenue)

- 1Q24 ARR increased +9% [+7% cc] and +33% pcp to A\$37.6m (CGe \$37m) or US\$24.6m.** The incremental quarterly ARR add of A\$3.3m (US\$1.6m) was a record for DSE and compares positively to our forecast of A\$2.7m. ARR growth was driven from user add growth of +22%, ARPU growth of +8% and FX benefit of +1%. Run-rating DSE's incremental 1Q24 ARR sees FY24 ARR growth of >A\$13m relative to our estimates of A\$11m, supporting incremental upgrades.
- Net user additions of 73k** (4Q23: 47k, 3Q32: 33k) to 1.24m (+22% yoy) was a touch lighter than we had expected with the company noting it has experienced elevated competition in EMEA (25% revenue) which impacted pricing/net adds. Nevertheless, the company exited 1Q24 strongly which should translate to improved user adds in 2Q/3Q, in our view. Direct transacting partners also increased by a record 40 net adds (FY23 avg 32 net adds) to now stand at 660, with indirect transacting partners now >4,000. This aids the network effect of the business as MSPs incrementally roll existing SME clients onto DSE at contract renewals. DSE noted it retains a "strong pipeline" of MSP opportunities with its market share remaining small at <4% and announced new partnership agreement with two large cybersecurity companies Proofpoint/SentinelOne expected to contribute strongly to growth.
- ARPU of A\$2.53/US\$1.66m increased +3%/+1% qoq** and +10%/+8% against the pcp aided by product mix and lower ARPU Latam partner churning in CY23 (~10% of users).
- Gross profit margins of 69%** (CGe 1H24 69%) is consistent with expectations with DSE retaining the opportunity to shift to a private cloud driving gross profit margins towards 80%. We expect this to be a key initiative in CY25.
- DSE generated FCF of +\$0.4m** (4Q23 \$0.3m, 1Q23 \$0.2m) despite historically being a high outflow period and closed the quarter with **net cash of \$25m**. Management reiterated it expects to pursue "high conviction M&A opportunities" having been the underbidder of a transaction in 2H23 and passed on 2x opportunities in the quarter. DSE expects to maintain "profitability broadly in line with FY23 levels" (i.e. EBITDA ~\$3m; FCF ~\$2m).
- Our view** – DSE financials continue to go bottom left to top right, exhibiting continued momentum in scale. We are buoyed that the company has exited 1Q strongly, with 2Q/3Q likely to continue to drive an acceleration in user adds and ARR growth. The stock trades on an FY25E EV/revenue multiple of 3.5x, which remains undemanding given the quality metrics of DSE's financials (revenue growth, FCF margins). Realising the benefits of its investments in FY23 (+51% opex growth), strategic M&A (\$25m net cash), network effects of its larger partner network (>4k) and new product initiatives (Partner Serv, GovCloud, accounting backup, streamlined MSP onboarding) should see DSE maintain its above trend growth, in our view. We retain our BUY recommendation and \$0.40 price target.

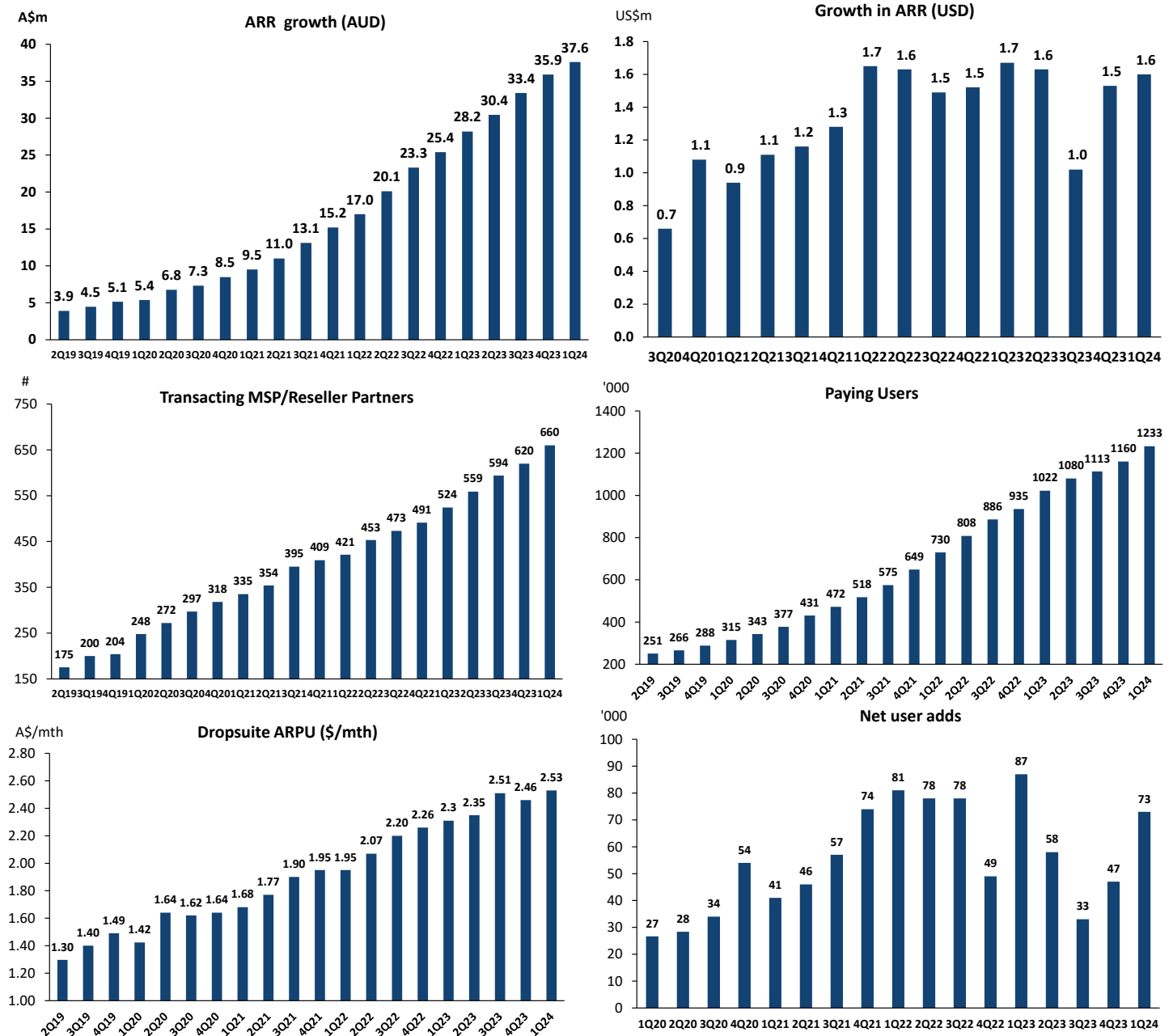


**Figure 1: Dropsuite (DSE-AU) financial summary**

Dropsuite (DSE)						Share Price Market Cap					\$ 0.31 \$ 210.6
Profit & Loss (\$m)	2022A	2023A	2024F	2025F	2026F	Valuation ratios	2022A	2023A	2024F	2025F	2026F
						EPS (cps)	0.2	0.1	0.2	0.3	0.4
ARR	25.4	34.3	45.3	57.8	69.8						
Sales Revenue	21.0	29.9	39.8	51.1	62.2	Enterprise Value (\$m)	188	186	183	179	172
COGS	-7.1	-9.4	-12.5	-16.1	-19.6	EV/ARR	7.4	5.4	4.0	3.1	2.5
Gross Profit	13.9	20.5	27.3	35.0	42.6	EV/Revenue	9.0	6.2	4.6	3.5	2.8
Opex	-11.8	-17.8	-24.5	-30.2	-35.7	EV/Gross Profit	13.6	9.1	6.7	5.1	4.0
EBITDA	2.1	2.6	2.8	4.8	6.9	EV/GPAPA (gp after S&M)	13.6	9.1	6.7	5.1	4.0
D & A	-0.1	-0.1	-0.1	-0.1	-0.1	EV / EBITDA (x)	nmf	nmf	nmf	37.4	24.9
EBIT	2.1	2.6	2.7	4.7	6.8	P/E (x)	nmf	nmf	nmf	nmf	nmf
Net Interest Expense	0.0	0.0	0.0	0.0	0.0	DPS (cps)	0.0	0.0	0.0	0.0	0.0
NPBT	2.1	2.6	2.7	4.7	6.8	Payout ratio (%)	0%	0%	0%	0%	0%
Tax expense	0.0	0.0	0.0	0.0	0.0						
NPAT (Normalised)	2.1	2.6	2.7	4.7	6.8	Dupont Analysis	2022A	2023A	2024F	2025F	2026F
Significant items	-0.6	0.0	0.0	0.0	0.0	Net Profit Margin	7.0%	8.6%	6.9%	9.2%	11.0%
NPAT (Reported)	1.5	2.6	2.7	4.7	6.8	Asset Turnover	0.8	1.0	1.2	1.3	1.4
						ROA (%)	5.4%	8.3%	8.2%	12.3%	15.2%
Gross Profit Margin (%)	66.2%	68.5%	68.5%	68.5%	68.5%	Financial Leverage	1.1	1.1	1.1	1.1	1.1
EBITDA Margin (%)	10.1%	8.8%	7.0%	9.3%	11.1%	ROE (%)	6.1%	9.4%	11.0%	14.8%	14.8%
EBIT Margin (%)	9.8%	8.6%	6.9%	9.2%	11.0%						
NPAT Margin (%)	7.0%	8.6%	6.9%	9.2%	11.0%	Balance Sheet ratios	2022A	2023A	2024F	2025F	2026F
						Net Debt (cash)	-22.3	-24.5	-27.2	-31.9	-38.7
Cash Flow (\$m)	2022A	2023A	2024F	2025F	2026F	NTA per share (\$)	0.0	0.0	0.0	0.1	0.1
Operating EBITDA	2.1	2.6	2.8	4.8	6.9	Price / NTA (x)	8.7	7.7	6.9	5.8	5.8
- Interest & Tax Paid	0.2	0.0	0.0	0.0	0.0	Shares on issue (m)	679.3	679.3	679.3	679.3	679.3
+/- change in Work. Cap.	-1.4	-0.5	0.0	0.0	0.0	EFPOWA (m)	679.3	679.3	679.3	679.3	679.3
- other	0.0	0.0	0.0	0.0	0.0						
Operating Cashflow	0.9	2.1	2.8	4.8	6.9	Assumptions	2022A	2023A	2024F	2025F	2026F
- Other Capex	-0.1	-0.1	-0.1	-0.1	-0.1	Revenue growth	79.0%	42.5%	33.3%	28.4%	21.7%
- Intangibles/other	0.0	0.0	0.0	0.0	0.0	Gross profit margin	66.2%	68.5%	68.5%	68.5%	68.5%
- Acquisitions	0.0	0.0	0.0	0.0	0.0	Opex growth	64.3%	71.3%	36.9%	42.6%	37.2%
Free Cashflow	0.9	2.0	2.7	4.7	6.8						
- Ord Dividends	0.0	0.0	0.0	0.0	0.0	Users ('000)	935.0	1160.0	1446.5	1739.7	1980.2
- Equity /other	0.0	0.0	0.0	0.0	0.0	MSP (#)	491	620	740	840	940
Net Cashflow	0.9	2.0	2.7	4.7	6.8	ARPU (A\$)	2.3	2.5	2.6	2.8	2.9
Cash at beginning of period	21.6	22.5	24.5	27.2	31.9	ARR (A\$m)	25.4	34.3	45.3	57.8	69.8
+/- borrowings / other	0.0	0.0	0.0	0.0	0.0						
Cash at end of period	22.5	24.5	27.2	31.9	38.7	Interim Analysis	2H22A	1H23A	2H23A	1H24E	2H24E
						Revenues	12.1	14.1	15.8	18.5	21.3
Balance Sheet	2022A	2023A	2024F	2025F	2026F	Gross profit	8.3	9.7	10.7	12.7	14.6
Cash	22.3	24.5	27.2	31.9	38.7	EBIT	1.6	1.0	1.5	1.3	1.5
Debtors	4.1	5.4	5.4	5.4	5.4	EBIT margin (%)	13.2%	7.3%	9.7%	6.9%	6.9%
Inventory	0.0	0.0	0.0	0.0	0.0	DPS	1.0	3.0	3.0	5.0	6.0
PPE	0.1	0.1	0.1	0.1	0.1						
Intangibles	0.0	0.0	0.0	0.0	0.0	Board of Directors / Substantial Shareholders					
Other assets	0.5	0.8	0.8	0.8	0.8	Board of Directors	shareholding	%			
Total Assets	26.9	30.8	33.6	38.3	45.1	Theodore Hnarakis (NEC)	11.8	1.7%			
Deferred Revenue	0.1	0.1	0.1	0.1	0.1	Charif Elansari (CEO)	29.5	4.3%			
Trade Creditors	2.5	3.3	3.3	3.3	3.3	Dr Bruce Tonkin (NED)	1.5	0.2%			
Unearned income	0.0	0.0	0.0	0.0	0.0	Eric Martorano (NED)	0.0	0.0%			
Other Liabilities	0.1	0.1	0.1	0.1	0.1						
Total Liabilities	2.8	3.5	3.5	3.5	3.5						
NET ASSETS	24.2	27.3	30.7	36.0	36.0						

Source: Company reports, Canaccord Genuity estimates

**Figure 2: Key charts**



Source: Company reports, Canaccord Genuity estimates

# Appendix: Important Disclosures

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## Investment Recommendation

Date and time of first dissemination: April 17, 2024, 22:26 ET

Date and time of production: April 17, 2024, 22:26 ET

## Target Price / Valuation Methodology:

Dropsuite Ltd - DSE

DCF methodology (\$0.30ps, Ke 13%,  $\beta$  1.5x, ERP 5.5%): Our terminal value incorporates a long-term cash EBIT margin of 35% (gross profit margin 65%, steady state S&M expense 5%, capex/G&A 25%) on our FY26E ARR expectations of \$46m (+25% CAGR).

## Risks to achieving Target Price / Valuation:

Dropsuite Ltd - DSE

### SMB spending headwinds

DSE's MSP partners sell directly to SMEs, and any change in SMB spending levels, or propensity to spend on cloud technology, could create headwinds for DSE. Further COVID-19 waves/restrictions, or a broader economic recession impacting spending patterns will be a headwind for DSE.

### M&A risks

DSE holds a strong balance sheet and been open with investors about the potential for bolt-on acquisitions. While we do not anticipate transformation deals, DSE has not been acquisitive in the past and thus this new strategy poses a risk to investors.

### Reputational harm

A successful cyberattack could have a negative impact on DSE's reputation and its ability to sign on new partners. While DSE has never had a breach and states its data encryption and storage capability is military grade, any breach would be a major business risk.

### Competitive markets

DSE operates in the competitive data management and back-up space with larger well-funded competitive with diverse products. DSE differentiates itself in the market by purely focusing in on MSPs, and longer term we believe the data back-up space could become more competitive.

### Inability to sign new MSP partners

DSE has materially increasing its distribution partners over the last three years. If DSE's product or prices become less competitive it may struggle to onboard new MSPs and this could impact its revenue profile.

### Revenue concentration

66% of DSE revenues are sourced from its top 10 distribution partners. The high level of concentration risk and potential for these to churn poses a risk to our revenue and earnings forecasts.

## Distribution of Ratings:

### Global Stock Ratings (as of 04/17/24)

Rating	Coverage Universe		IB Clients
	#	%	%
Buy	613	66.13%	22.51%
Hold	138	14.89%	10.14%
Sell	12	1.29%	8.33%
Speculative Buy	156	16.83%	46.79%
	927*	100.0%	

\*Total includes stocks that are Under Review

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**NOT RATED:** Canaccord Genuity does not provide research coverage of the relevant issuer.

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\*As of January 1, 2024, the Ratings History Chart will reflect the new Canaccord Genuity Ratings System as defined above.

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### Dropsuite Ltd Rating History as of 04/17/2024



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