

Dropsuite Ltd

Software and Services

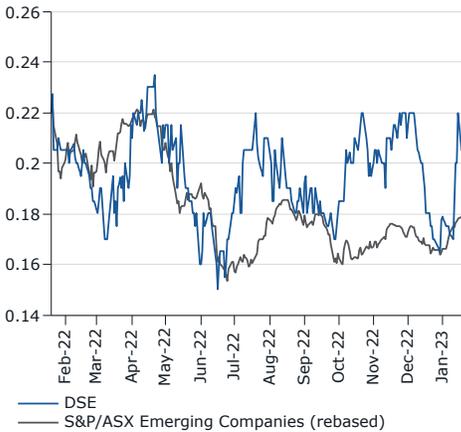
Owen Humphries | Analyst | Canaccord Genuity (Australia) Ltd. | ohumphries@cgf.com | +61.2.9263.2702

Rating BUY unchanged	Price Target A\$0.34 ↑ from A\$0.32
DSE-ASX	Price A\$0.22

Market Data

52-Week Range (A\$) :	0.15 - 0.24
Market Cap (A\$M) :	149.4
Shares Out. (M) :	679.3
Dividend /Shr (A\$) :	0.00
Dividend Yield (%) :	0.0
Enterprise Value (A\$M) :	127
Cash (A\$M) :	22.3
Long-Term Debt (A\$) :	0.0

FYE Dec	2021A	2022E	2023E	2024E
Sales (A\$M)	11.7	19.7	27.7↑	34.5↑
Previous	-	-	27.4	34.2
Gross Profit (A\$M)	7.5	12.5	17.9	22.2
EBITDA (A\$M)	0.4	1.6	2.5↑	3.7↑
Previous	-	-	2.0	2.8
EBIT (A\$M)	0.4	1.6	2.5↑	3.7↑
Previous	-	-	2.0	2.8
Net Income Adj (A\$M)	0.4	1.7↑	2.5↑	3.7↑
Previous	-	1.6	2.0	2.8
Net Debt (Cash) (A\$M)	(22)	(23)	(26)↓	(29)↓
Previous	-	-	(25)	(28)
EV/Sales (x)	10.9	6.4	4.5	3.5



Source: FactSet

Priced as of close of business 19 January 2023

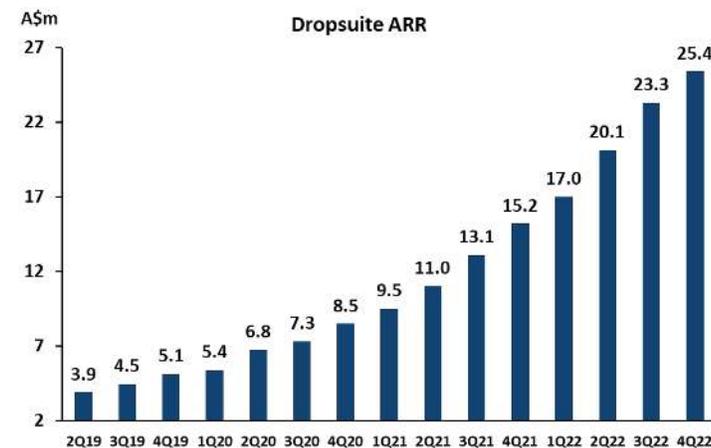
Dropsuite is a global cloud software platform founded in 2012 that provides cloud-based email and website backup, archiving and recovery solutions.

4Q22 +67% ARRg; multiple tailwinds at play

DSE printed another stellar quarter, with ARR slightly ahead of expectations and the company maintaining its FCF mantra. Bond yields are down and we believe growth should come back in vogue, with DSE remaining one of the fastest-growing small-cap stocks on the ASX. If we roll forward 24 months, on the current valuation (EV \$130m) and growth trajectory (>+50% p.a. revg), DSE would trade on ~2.5x gross profit, which is unheard of for a rule-of-80 stock. Ongoing migration to the cloud (particularly O365), increasing adoption of cloud recovery solutions (~20% of SME have an email back-up product) and ongoing market share gains for DSE should drive above-trend growth (industry growth +24% p.a.), in our view.

Earnings revisions: We make modest increases to our FY23E (7%), FY24E(6%) and FY25E (4%) ARR forecasts, noting DSE has remained in an upgrade cycle since we initiated on the stock, suggesting upside risk to our forecasts. We make limited changes to our EBITDA forecasts.

- **ARR increased to \$25.4m** (+10% qoq, +67% pcp [+58% cc]), in line with our estimate (CGe \$25m). This represents an incremental ARR uplift of \$2.1m in AUD terms, a ~20% beat to our quarterly incremental forecast of \$1.8m. Key ARR drivers of **ARPU and users** are both moving in the right direction, with ARPU +4% qoq to A\$2.26 (CGe \$2.27) and the incremental gross user adds of 63k, bringing the total user base to 935k. A one-off churn of 11k customers (due to legacy partner deactivation) moderated user growth; however, this has supported a shift to a higher ARPU and remains within DSE 3% p.a. churn target.
- **Gross profit margins** unexpectedly expanded 4ppts to 70% in the quarter (66% 3Q22; 64% 2Q22). The gross profit margin illustrates the operating leverage to growth given the limited S&M spending as well as the continued benefit of reduced cloud/storage costs.
- **OCF** of \$0.5m continues to trend positively, in line with the company's profitability mantra, translating to ~10% FCF margins. DSE has seen ARR increase threefold over the past 24 months which, paired with various product releases, has justified investment in headcount (+15% qoq) and marketing (+80% qoq). The company reported A\$22m cash, which is sufficient to support internal development or inorganic opportunities.
- DSE launched its QuickBooks Online backup solution in the quarter, which caters to 8m users, growing >15% p.a. The new product will be at a higher ARPU price point with DSE expecting to monetise the product from April 2023.



Source: Company reports

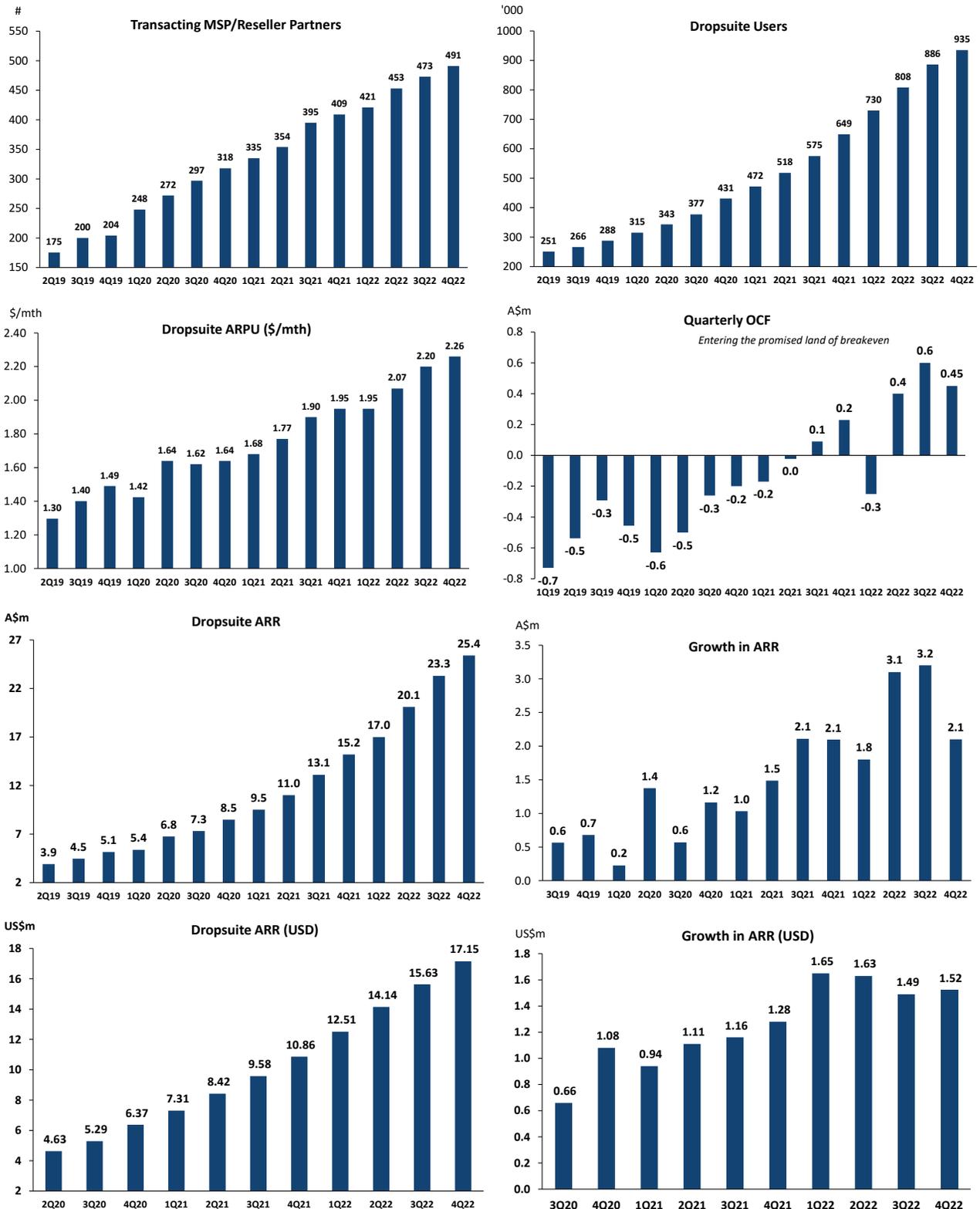
DSE is emerging as one of the fastest-growing SaaS stocks on the ASX. Almost all of DSE's revenue comes from highly predictable, recognised subscriptions from its MSP customers with negligible churn. We maintain our BUY recommendation and increase our price target to \$0.34 (from \$0.30) following the roll forward of our DCF model.

Figure 2: P&L assumptions, Balance sheet, and cash flow summary

Profit & Loss		1H19A	2H19A	FY19A	1H20A	2H20A	FY20A	1H21A	2H21A	FY21A	1H22E	2H22E	FY22E	1H23E	2H23E	FY23E
Partners	#	175	204	204	272	318	318	335	409	409	453	508	508	558	608	608
New partners added	#		29		68	46	114	17	74	91	44	55	99	50	50	100
Users	'000	251	288	288	343	431	431	518	649	649	808	931	931	1028	1108	1108
User Growth	'000		37.1		55.0	88.0	143.0	87.0	131.0	218.0	159.0	123.0	282.0	97.2	80.0	177.3
Users/partner	'000	1,430	1,412	1,412	1,261	1,355	1,355	1,546	1,587	1,587	1,784	1,833	1,833	1,843	1,823	1,823
ARPU	A\$/mth	1.30	1.49	1.49	1.64	1.64	1.64	1.77	1.95	1.95	2.07	2.28	2.28	2.35	2.44	2.44
ARR	A\$m	3.9	5.1	5.1	6.8	8.5	8.5	11.0	15.2	15.2	20.1	25.4	25.4	28.9	32.4	32.4
ARR growth	A\$m		1.2		1.6	1.7	3.3	2.5	4.2	6.7	4.9	5.3	10.2	3.5	3.5	7.0
Group Revenue	A\$m	2.3	2.4	4.7	3.2	3.9	7.1	5.0	6.8	11.7	8.9	10.9	19.7	13.0	14.8	27.7
COGS	A\$m	0.7	0.9	1.7	1.1	1.3	2.5	1.6	2.5	4.2	3.3	3.9	7.3	4.6	5.3	9.9
Gross Profit	A\$m	1.6	1.5	3.0	2.1	2.6	4.6	3.3	4.2	7.5	5.6	6.9	12.5	8.3	9.5	17.9
Gross profit margin	%	68%	61%	64%	65%	66%	65%	67%	62%	64%	62%	64%	63%	64%	64%	64%
Total Opex	A\$m	2.7	2.7	5.4	3.0	3.3	6.3	3.3	3.9	7.2	5.1	5.8	10.9	7.0	8.4	15.3
EBITDA	A\$m	-1.1	-1.3	-2.3	-0.9	-0.8	-1.7	0.0	0.4	0.4	0.5	1.1	1.6	1.4	1.1	2.5
Depreciation and Amortisation	A\$m	-0.4	-0.4	-0.8	-0.4	-0.1	-0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
EBIT	A\$m	-1.5	-1.7	-3.2	-1.3	-0.9	-2.2	0.0	0.3	0.4	0.5	1.2	1.6	1.3	1.2	2.5
Net Interest	A\$m	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
NPBT	A\$m	-1.5	-1.7	-3.1	-1.3	-0.9	-2.1	0.0	0.3	0.4	0.5	1.2	1.7	1.3	1.2	2.5
Tax Expense	A\$m	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
NPAT (normalised)	A\$m	-1.5	-1.7	-3.1	-1.3	-0.9	-2.1	-0.1	0.0	0.0	0.3	1.2	1.7	1.3	1.2	2.5
Balance Sheet		1H19A	2H19A	FY19A	1H20A	2H20A	FY20A	1H21A	2H21A	FY21A	1H22E	2H22E	FY22E	1H23E	2H23E	FY23E
Cash	A\$m	0.0	0.0	1.4	3.0	2.5	2.5	2.4	21.6	21.6	21.6	23.2	23.2	24.5	25.6	25.6
Receivables	A\$m	0.0	0.0	0.8	1.2	1.4	1.4	1.8	1.8	2.2	3.0	3.0	3.0	3.0	3.0	3.0
PPE	A\$m	0.0	0.0	0.0	0.0	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Intangibles	A\$m	0.0	0.0	0.5	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	A\$m	0.0	0.0	0.1	0.2	0.2	0.2	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4
Assets	A\$m	0.0	0.0	2.9	4.5	4.3	4.3	4.5	23.8	24.1	25.0	26.7	26.7	28.0	29.1	29.1
Payables	A\$m	0.0	0.0	0.9	1.0	1.3	1.3	1.6	1.6	2.0	2.3	2.3	2.3	2.3	2.3	2.3
Provisions	A\$m	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest bearing liabilities	A\$m	0.0	0.0	0.1	0.1	0.1	0.1	0.2	0.2	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Other	A\$m	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Liabilities	A\$m	0.0	0.0	1.1	1.1	1.4	1.4	1.8	1.8	2.2	2.6	2.6	2.6	2.6	2.6	2.6
Equity	A\$m	0.0	0.0	1.8	3.4	2.5	2.5	2.7	22.0	21.9	22.5	23.6	23.8	25.1	26.3	26.3
ROE	%			-174.9%	-74.0%	-69.9%	-84.4%	-5.3%	0.4%	-0.1%	1.4%	5.0%	7.0%	5.3%	4.5%	9.5%
Financial leverage ratio	x			1.6	1.3	1.7	1.7	1.7	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Cash Flow Statement		1H19A	2H19A	FY19A	1H20A	2H20A	FY20A	1H21A	2H21A	FY21A	1H22E	2H22E	FY22E	1H23E	2H23E	FY23E
EBITDA	A\$m	-1.1	-1.3	-2.3	-0.9	-0.8	-1.7	0.0	0.4	0.4	0.5	1.1	1.6	1.4	1.1	2.5
Working Capital	A\$m	1.1	1.3	0.5	-0.4	0.3	-0.2	-0.1	0.0	-0.1	-0.6	0.6	0.0	0.0	0.0	0.0
Net Interest paid	A\$m	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Income taxes paid	A\$m	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net operating cash flows	A\$m	0.0	0.0	-1.8	-1.3	-0.5	-1.8	-0.1	0.4	0.3	-0.1	1.8	1.7	1.4	1.1	2.5
PPE	A\$m	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	-0.1	0.0	0.0	-0.1	0.0	0.0	-0.1
Development costs	A\$m	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other/Acquisitions	A\$m	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net investing cash flows	A\$m	0.0	-0.1	0.0	0.0	-0.1	0.0	0.0	-0.1							
Proceeds from issue of securities	A\$m	0.0	0.0	0.0	2.9	0.0	2.9	0.0	18.9	18.9	0.0	0.0	0.0	0.0	0.0	0.0
Net borrowings	A\$m	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net financing cash flows	A\$m	0.0	0.0	0.0	2.9	0.0	2.9	0.0	18.9	18.9	0.0	0.0	0.0	0.0	0.0	0.0
Net change	A\$m	0.0	0.0	-1.8	1.6	-0.5	1.1	-0.1	19.2	19.1	-0.1	1.7	1.6	1.3	1.1	2.4
Cash at beginning of period	A\$m	0.0	0.0	3.2	1.4	2.9	1.3	2.5	2.4	2.5	21.6	21.5	21.6	23.2	24.5	23.2
Cash at end of period	A\$m	0.0	0.0	1.4	3.0	2.4	2.4	2.4	21.6	21.6	21.5	23.2	23.2	24.5	25.6	25.6

Source: Company reports, Canaccord Genuity estimates

Figure 3: Key charts



Source: Company reports, Canaccord Genuity estimates

Appendix: Important Disclosures

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Investment Recommendation

Date and time of first dissemination: January 19, 2023, 01:56 ET

Date and time of production: January 19, 2023, 01:56 ET

Target Price / Valuation Methodology:

Dropsuite Ltd - DSE

DCF methodology (\$0.30ps, Ke 13%, β 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 backup 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 backup 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 01/19/23)

Rating	Coverage Universe		IB Clients
	#	%	%
Buy	615	64.81%	25.53%
Hold	159	16.75%	14.47%
Sell	14	1.48%	0.00%
Speculative Buy	150	15.81%	40.67%
	949*	100.0%	

*Total includes stocks that are Under Review

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BUY: The stock is expected to generate risk-adjusted returns of over 10% during the next 12 months.

HOLD: The stock is expected to generate risk-adjusted returns of 0-10% during the next 12 months.

SELL: The stock is expected to generate negative risk-adjusted returns during the next 12 months.

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

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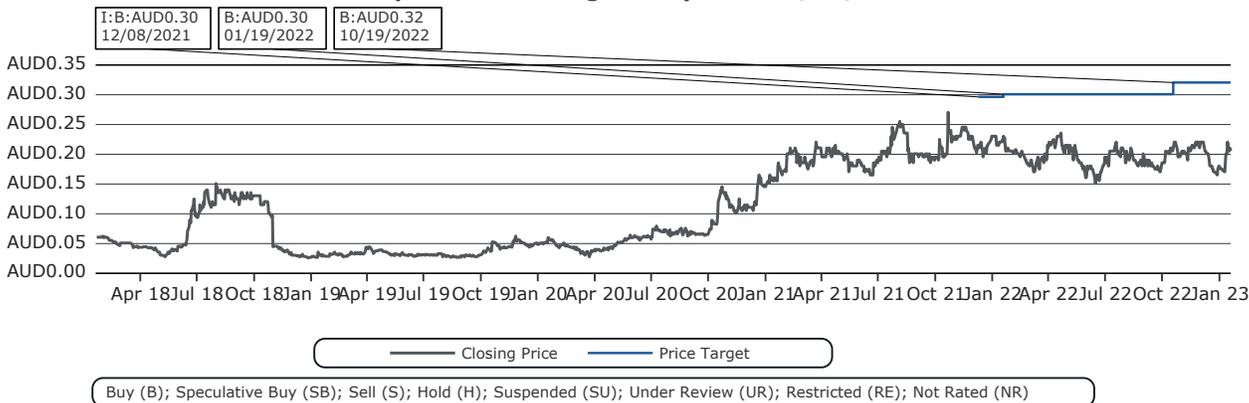
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Dropsuite Ltd Rating History as of 01/18/2023



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