

16 October 2023

# Dropsuite Ltd

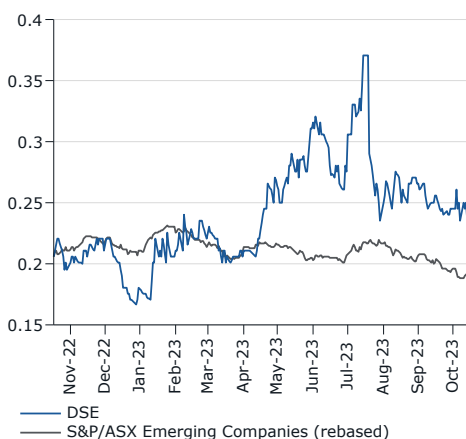
## Software and Services

Rating <b>BUY</b> unchanged	Price Target <b>A\$0.38</b> unchanged
DSE-ASX	Price <b>A\$0.24</b>

### Market Data

52-Week Range (A\$) :	0.16 - 0.39
Market Cap (A\$M) :	159.6
Shares Out. (M) :	679.3
Dividend /Shr (A\$) :	0.53
Dividend Yield (%) :	0.0
Enterprise Value (A\$M) :	134.6
Cash (A\$M) :	25.0
Long-Term Debt (A\$) :	0.0

FYE Dec	2022A	2023E	2024E	2025E
Sales (A\$M)	21.0	30.1↑	39.4↑	50.6↑
Previous	-	28.3	38.1	49.3
Gross Profit (A\$M)	13.9	20.6	27.0	34.6
EBITDA (A\$M)	2.1	2.8	5.8↑	9.0↓
Previous	-	-	5.7	10.9
EBIT (A\$M)	2.1	2.7	5.7	8.9↓
Previous	-	-	-	10.9
Net Income Adj (A\$M)	2.1	2.7	5.7	8.9↓
Previous	-	-	-	10.9
Net Debt (Cash) (A\$M)	(22)	(25)	(31)	(40)↑
Previous	-	-	-	(42)
EV/Sales (x)	6.6	4.5	3.3	2.4



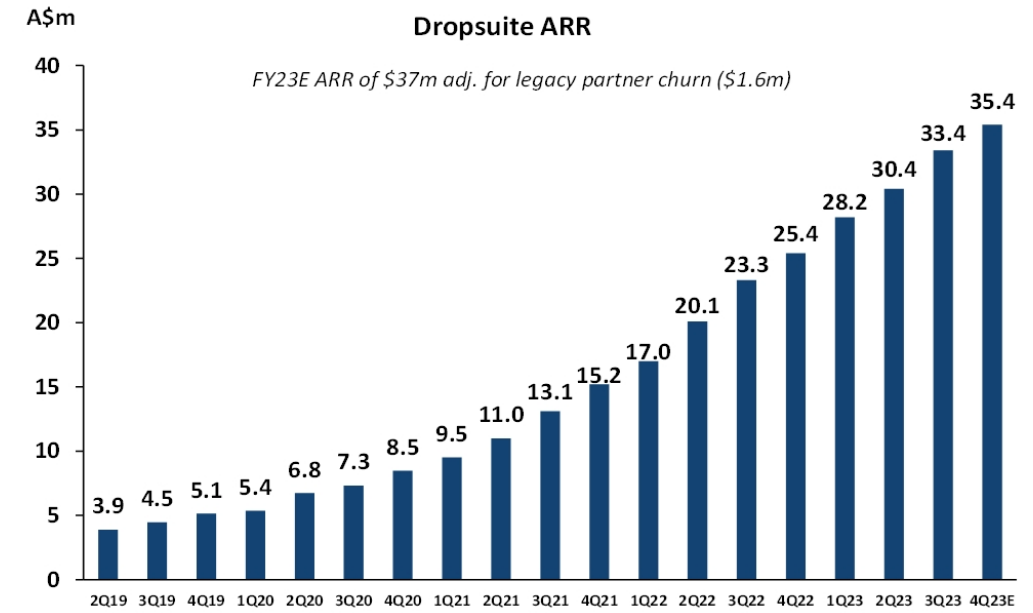
Priced intraday 16 October 2023

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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## 3Q23 ARRg +44% pcp, +17% FCF margins, scale continues to build

- 3Q23 ARR increased +10% qoq and +44% pcp to \$33.4m [CGe \$32m, +4% beat]** with the incremental quarterly ARR increase of +A\$3m above its previous three-year trend of A\$2m/qtr. This implies +7% upside to our previous FY23 forecasts (\$34m). **ARPU increased +9% qoq to \$2.57/mth** (+5% in USD), supported by: i) currency tailwinds (+4% qoq growth USD terms); ii) ongoing shift to higher ARPU product mix (Archiving) and; iii) churn of a low ARPU legacy customer (53k user churned in 3Q23 at APRU of US\$0.7/mth). We estimate an FY23E ARR drag of US\$0.9m/A\$1.6m from this legacy partner (118k churned users in FY23 x US\$0.7/mth x 0.62 FX adj.) and excluding this one partner, FY23E ARR would be tracking closer to \$37m representing adj. ARR growth of +44% (vs +40% reported). DSE provided guidance that its MSP partner churn remains <3% p.a.
- Cash flow remains strong with FCF of +\$1.4m representing FCF margin of +17%** with cash of \$25m. Cash costs held broadly flat qoq illustrating DSE's operating leverage to growth. **Gross margins held stable at ~68%** (1H23: 69%, 3Q23: 66%) with upside from moving to a private cloud hosting environment (i.e. gp margins >80%). **Gross user adds was a near record at 86k** (prev. record 1Q23 87k); however, net adds of 33k was impacted by legacy churn. We expect 4Q gross adds to be in line with the 3Q, with legacy partner user churn to be completed by 4Q23.
- Direct MSPs increased to 594** (+35 partners added) with incremental indirect/transacting partners increasing +209 to ~4k. The network effect from MSP partners should become increasingly valuable as user penetration expands within this partner network. TD Synnex is fully integrated and first customers have been onboarded and should support growth into FY24, in our view. TD Synnex is one of the world's largest distributors with >20k reseller partners.
- DSE maintains its belief that the MFSTs Syntex launch and accompanying back-up product announced in 2022 will have limited impact on its growth and market opportunity due to: i) the enterprise nature of MFST Syntex product; ii) limited true data independence given lack of separation of back-up data from operational data; and iii) its back-up product ingrained in a relatively expensive AI tool (i.e. >US\$8/mth).
- In our view, +44% ARRg coupled with +17% FCF margins remains one of the best metrics on the ASX** and thus deserves a premium multiple (CGe FY24E EV/ARR 2.8x). We see the potential for DSE's ARRg to accelerate into FY24, and thus could be a driver of a multiple re-rate, as it: i) monetises recently launched products (Govcloud, Quickbooks); ii) cycles the legacy user churn (CGe FY23E: \$1.6m ARR drag); iii) reaps the benefits of its reinvestment in S&M (CGe +53% opex growth in FY23E); and iv) drives user growth from onboarding TD Synnex.
- Our valuation remains unchanged at \$0.38/share, with modest upgrades to our growth forecasts offset by incorporating a higher discount rate. We maintain our BUY recommendation.



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

Dropsuite (DSE)						Share Price \$ 0.24 Market Cap \$ 159.6					
Profit & Loss (\$m)	2021A	2022A	2023F	2024F	2025F	Valuation ratios	2021A	2022A	2023F	2024F	2025F
ARR	15.2	25.4	35.4	45.4	58.4	EPS (cps)	0.0	0.2	0.1	0.4	0.6
Sales Revenue	11.7	21.0	30.1	39.4	50.6	Enterprise Value (\$m)	138	137	134	129	120
COGS	-4.2	-7.1	-9.5	-12.4	-15.9	EV/ARR	9.1	5.4	3.8	2.8	2.1
Gross Profit	7.5	13.9	20.6	27.0	34.6	EV/Revenue	11.8	6.6	4.5	3.3	2.4
Opex	-7.2	-11.8	-17.8	-21.2	-25.6	EV/Gross Profit	18.3	9.9	6.5	4.8	3.5
EBITDA	0.4	2.1	2.8	5.8	9.0	EV/GPAPA (gp after S&M)	18.3	9.9	6.5	4.8	3.5
D & A	0.0	-0.1	-0.1	-0.1	-0.1	EV / EBITDA (x)	nmf	nmf	nmf	nmf	nmf
EBIT	0.4	2.1	2.7	5.7	8.9	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	0.4	2.1	2.7	5.7	8.9	Payout ratio (%)	0%	0%	0%	0%	0%
Tax expense	0.0	0.0	0.0	0.0	0.0						
NPAT (Normalised)	0.4	2.1	2.7	5.7	8.9	Dupont Analysis	2021A	2022A	2023F	2024F	2025F
Significant items	-0.4	-0.6	0.0	0.0	0.0	Net Profit Margin	-0.3%	7.0%	9.1%	14.5%	17.7%
NPAT (Reported)	0.0	1.5	2.7	5.7	8.9	Asset Turnover	0.5	0.8	1.0	1.1	1.1
						ROA (%)	-0.1%	5.4%	8.7%	15.3%	19.4%
Gross Profit Margin (%)	64.5%	66.2%	68.5%	68.5%	68.5%	Financial Leverage	1.1	1.1	1.1	1.1	1.1
EBITDA Margin (%)	3.3%	10.1%	9.3%	14.7%	17.8%	ROE (%)	-0.1%	6.1%	9.8%	16.9%	21.0%
EBIT Margin (%)	3.0%	9.8%	9.1%	14.5%	17.7%						
NPAT Margin (%)	-0.3%	7.0%	9.1%	14.5%	17.7%	Balance Sheet ratios	2021A	2022A	2023F	2024F	2025F
Cash Flow (\$m)	2021A	2022A	2023F	2024F	2025F	Net Debt (cash)	-21.6	-22.3	-25.2	-30.9	-39.8
Operating EBITDA	0.4	2.1	2.8	5.8	9.0	NTA per share (\$)	0.0	0.0	0.0	0.0	0.1
- Interest & Tax Paid	0.0	0.2	0.0	0.0	0.0	Price / NTA (x)	6.6	6.6	5.7	4.7	3.7
+/- change in Work. Cap.	-0.1	-1.4	0.0	0.0	0.0	Shares on issue (m)	679.3	679.3	679.3	679.3	679.3
- other	0.0	0.0	0.0	0.0	0.0	EFPOWA (m)	616.7	679.3	679.3	679.3	679.3
Operating Cashflow	0.3	0.9	2.8	5.8	9.0						
- Other Capex	-0.1	-0.1	-0.1	-0.1	-0.1	Assumptions	2021A	2022A	2023F	2024F	2025F
- Intangibles/other	0.0	0.0	0.0	0.0	0.0	Revenue growth	64.7%	79.0%	43.8%	30.7%	28.4%
- Acquisitions	0.0	0.0	0.0	0.0	0.0	Gross profit margin	64.5%	66.2%	68.5%	68.5%	68.5%
Free Cashflow	0.2	0.9	2.7	5.7	8.9	Opex growth	13.6%	64.3%	71.3%	36.9%	21.0%
- Ord Dividends	0.0	0.0	0.0	0.0	0.0						
- Equity /other	18.9	0.0	0.0	0.0	0.0	Users ('000)	649.0	935.0	1151.7	1392.2	1688.1
Net Cashflow	19.1	0.9	2.7	5.7	8.9	MSP (#)	409	491	609	709	809
Cash at beginning of period	2.4	21.6	22.5	25.2	30.9	ARPU (A\$)	2.0	2.3	2.6	2.7	2.9
+/- borrowings / other	0.0	0.0	0.0	0.0	0.0	ARR (A\$m)	15.2	25.4	35.4	45.4	58.4
Cash at end of period	21.5	22.5	25.2	30.9	39.8						
Balance Sheet	2021A	2022A	2023F	2024F	2025F	Interim Analysis	1H21A	2H21A	1H22A	2H22A	1H23E
Cash	21.6	22.3	25.2	30.9	39.8	Revenues	5.0	6.8	8.9	12.1	14.1
Debtors	2.2	4.1	5.4	5.4	5.4	Gross profit	3.3	4.2	5.6	8.3	9.7
Inventory	0.0	0.0	0.0	0.0	0.0	EBIT	0.0	0.3	0.5	1.6	1.0
PPE	0.0	0.1	0.1	0.1	0.1	EBIT margin (%)	0.5%	4.9%	5.5%	13.2%	7.3%
Intangibles	0.0	0.0	0.0	0.0	0.0	DPS	0.0	0.0	0.0	1.0	3.0
Other assets	0.3	0.5	0.8	0.8	0.8						
Total Assets	24.1	26.9	31.5	37.2	46.1	Board of Directors / Substantial Shareholders					
Deferred Revenue	0.1	0.1	0.1	0.1	0.1	Board of Directors	Shareholding		%		
Trade Creditors	2.0	2.5	3.3	3.3	3.3	Theodore Hnarakis (NEC)	11.8		1.7%		
Unearned income	0.0	0.0	0.0	0.0	0.0	Charif Elansari (CEO)	29.5		4.3%		
Other Liabilities	0.1	0.1	0.1	0.1	0.1	Dr Bruce Tonkin (NED)	1.5		0.2%		
Total Liabilities	2.3	2.8	3.5	3.5	3.5						
NET ASSETS	21.8	24.2	28.0	33.7	42.6						

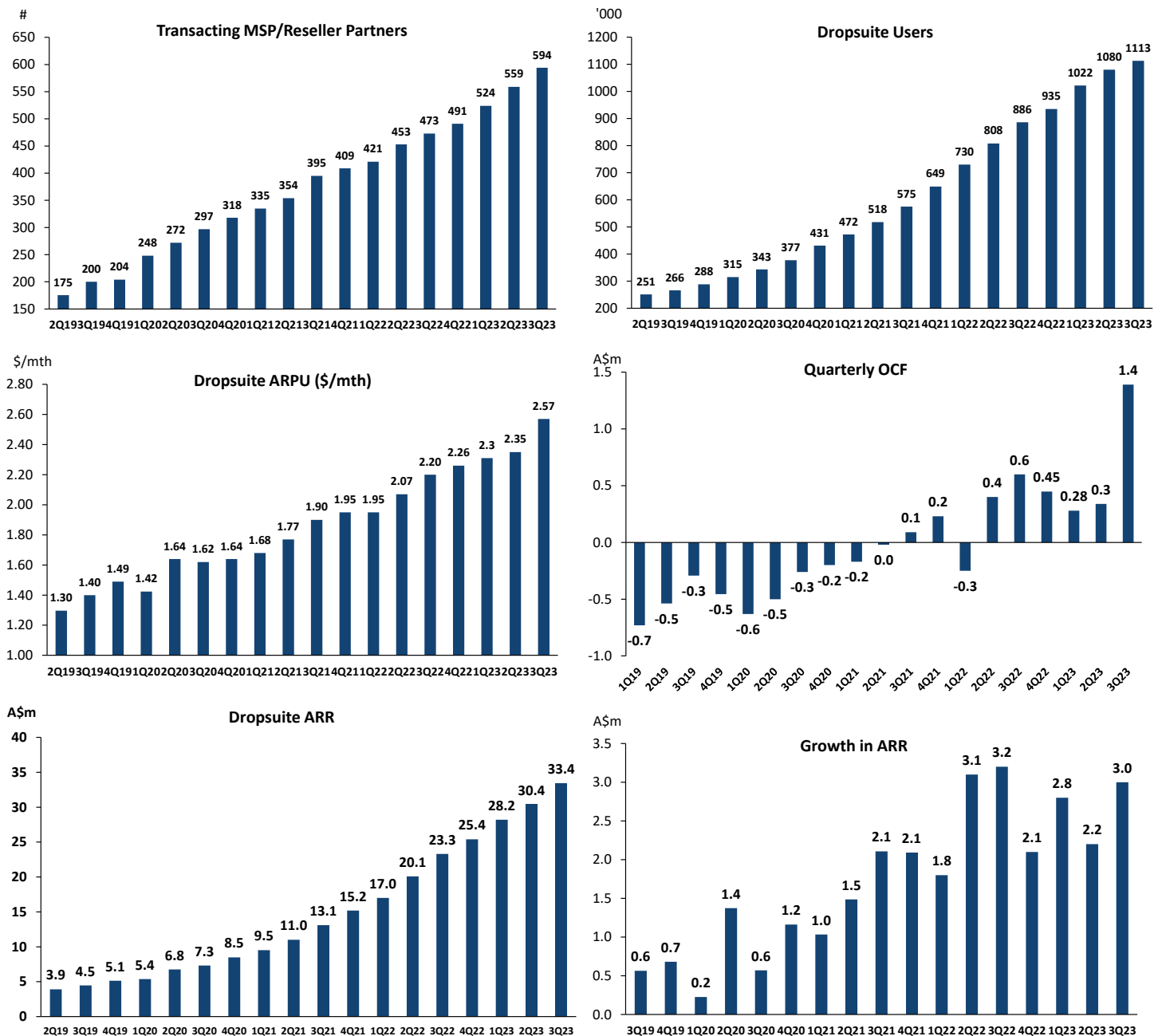
Source: Company reports, Canaccord Genuity estimates

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

Profit & Loss		FY19A	1H20A	2H20A	FY20A	1H21A	2H21A	FY21A	1H22A	2H22A	FY22A	1H23	2H23E	FY23E	1H24E	2H24E	FY24E
Partners	#	204	272	318	318	335	409	409	453	491	491	559	609	609	659	709	709
New partners added	#		68	46	114	17	74	91	44	38	82	68	50	118	50	50	100
Users	'000	288	343	431	431	518	649	649	808	935	935	1080	1152	1152	1276	1392	1392
User Growth	'000		55.0	88.0	143.0	87.0	131.0	218.0	159.0	127.0	286.0	145.0	71.7	216.7	124.4	116.2	240.5
Users/partner	'000	1,412	1,261	1,355	1,355	1,546	1,587	1,587	1,784	1,904	1,904	1,932	1,891	1,891	1,936	1,964	1,964
ARPU	A\$/mth	1.49	1.64	1.64	1.64	1.77	1.95	1.95	2.07	2.26	2.26	2.35	2.56	2.56	2.64	2.72	2.72
ARR	A\$m	5.1	6.8	8.5	8.5	11.0	15.2	15.2	20.1	25.4	25.4	30.4	35.4	35.4	40.4	45.4	45.4
ARR growth	A\$m		1.6	1.7	3.3	2.5	4.2	6.7	4.9	5.3	10.2	5.0	5.0	10.0	5.0	5.0	10.0
Group Revenue	A\$m	4.7	3.2	3.9	7.1	5.0	6.8	11.7	8.9	12.1	21.0	14.1	16.0	30.1	18.4	20.9	39.4
COGS	A\$m	1.7	1.1	1.3	2.5	1.6	2.5	4.2	3.3	3.7	7.1	4.4	5.1	9.5	5.8	6.6	12.4
Gross Profit	A\$m	3.0	2.1	2.6	4.6	3.3	4.2	7.5	5.6	8.3	13.9	9.7	10.9	20.6	12.6	14.3	27.0
Gross profit margin	%	64%	65%	66%	65%	67%	62%	64%	62%	69%	66%	69%	68%	68%	68%	68%	68%
Total Opex	A\$m	5.4	3.0	3.3	6.3	3.3	3.9	7.2	5.1	6.7	11.8	8.7	9.2	17.8	10.1	11.1	21.2
EBITDA	A\$m	-2.3	-0.9	-0.8	-1.7	0.0	0.4	0.4	0.5	1.6	2.1	1.1	1.7	2.8	2.5	3.2	5.8
Depreciation and Amortisation	A\$m	-0.8	-0.4	-0.1	-0.5	0.0	0.0	0.0	0.0	0.0	-0.1	0.0	0.0	-0.1	0.0	0.0	-0.1
EBIT	A\$m	-3.2	-1.3	-0.9	-2.2	0.0	0.3	0.4	0.5	1.6	2.1	1.0	1.7	2.7	2.5	3.2	5.7
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	0.0
NPBT	A\$m	-3.1	-1.3	-0.9	-2.1	0.0	0.3	0.4	0.5	1.6	2.1	1.0	1.7	2.7	2.5	3.2	5.7
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	0.0
NPAT (normalised)	A\$m	-3.1	-1.3	-0.9	-2.1	-0.1	0.0	0.0	0.3	1.6	1.5	0.8	1.7	2.7	2.5	3.2	5.7
Balance Sheet		FY19A	1H20A	2H20A	FY20A	1H21A	2H21A	FY21A	1H22A	2H22A	FY22A	1H23	2H23E	FY23E	1H24E	2H24E	FY24E
Cash	A\$m	1.4	3.0	2.5	2.5	2.4	21.6	21.6	21.6	22.3	22.3	23.0	24.6	25.2	27.7	30.8	30.9
Receivables	A\$m	0.8	1.2	1.4	1.4	1.8	1.8	2.2	3.0	4.1	4.1	5.4	5.4	5.4	5.4	5.4	5.4
PPE	A\$m	0.0	0.0	0.2	0.2	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Intangibles	A\$m	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	0.0	0.0	0.0
Other	A\$m	0.1	0.2	0.2	0.2	0.3	0.3	0.3	0.4	0.5	0.5	0.8	0.8	0.8	0.8	0.8	0.8
Assets	A\$m	2.9	4.5	4.3	4.3	4.5	23.8	24.1	25.0	26.9	26.9	29.3	31.0	31.5	34.0	37.2	37.2
Payables	A\$m	0.9	1.0	1.3	1.3	1.6	1.6	2.0	2.3	2.5	2.5	3.3	3.3	3.3	3.3	3.3	3.3
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	0.0
Interest bearing liabilities	A\$m	0.1	0.1	0.1	0.1	0.2	0.2	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other	A\$m	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Liabilities	A\$m	1.1	1.1	1.4	1.4	1.8	1.8	2.2	2.6	2.7	2.7	3.4	3.4	3.4	3.4	3.4	3.4
Equity	A\$m	1.8	3.4	2.5	2.5	2.7	22.0	21.9	22.5	24.2	24.2	25.8	27.8	27.7	30.2	33.5	33.5
ROE	%	-174.9%	-74.0%	-69.9%	-84.4%	-5.3%	0.4%	-0.1%	1.4%	6.6%	6.1%	3.2%	6.2%	9.9%	8.3%	9.6%	17.1%
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	1.1	1.1	1.1
Cash Flow Statement		FY19A	1H20A	2H20A	FY20A	1H21A	2H21A	FY21A	1H22A	2H22A	FY22A	1H23	2H23E	FY23E	1H24E	2H24E	FY24E
EBITDA	A\$m	-2.3	-0.9	-0.8	-1.7	0.0	0.4	0.4	0.5	1.6	2.1	1.1	1.7	2.8	2.5	3.2	5.8
Working Capital	A\$m	0.5	-0.4	0.3	-0.2	-0.1	0.0	-0.1	-0.6	-0.8	-1.4	-0.7	0.0	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	0.2	0.2	0.3	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	0.0
Net operating cash flows	A\$m	-1.8	-1.3	-0.5	-1.8	-0.1	0.4	0.3	-0.1	1.0	0.9	0.6	1.7	2.8	2.5	3.2	5.8
PPE	A\$m	-0.1	0.0	0.0	0.0	0.0	0.0	-0.1	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-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	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	0.0
Net investing cash flows	A\$m	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Proceeds from issue of securities	A\$m	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	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	0.0
Net financing cash flows	A\$m	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	0.0	0.0	0.0
Net change	A\$m	-1.8	1.6	-0.5	1.1	-0.1	19.2	19.1	-0.1	1.0	0.9	0.5	1.7	2.7	2.5	3.2	5.7
Cash at beginning of period	A\$m	3.2	1.4	2.9	1.3	2.5	2.4	2.5	21.6	21.5	21.6	22.4	23.0	22.5	25.2	27.7	25.2
Cash at end of period	A\$m	1.4	3.0	2.4	2.4	2.4	21.6	21.6	21.5	22.5	22.5	23.0	24.6	25.2	27.7	30.8	30.9

Source: Company reports, Canaccord Genuity estimates

**Figure 3: Key charts**



Source: Company reports, Canaccord Genuity estimates

# Appendix: Important Disclosures

## Analyst Certification

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Individuals identified as "Sector Coverage" cover a subject company's industry in the identified jurisdiction, but are not authoring analysts of the report.

## Investment Recommendation

Date and time of first dissemination: October 15, 2023, 22:42 ET

Date and time of production: October 15, 2023, 22:42 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 10/15/23)

Rating	Coverage Universe		IB Clients
	#	%	%
Buy	613	67.36%	23.16%
Hold	119	13.08%	10.08%
Sell	14	1.54%	7.14%
Speculative Buy	155	17.03%	49.68%
	910*	100.0%	

\*Total includes stocks that are Under Review

## Canaccord Genuity Ratings System

**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.

"Risk-adjusted return" refers to the expected return in relation to the amount of risk associated with the designated investment or the relevant issuer.

## Risk Qualifier

**SPECULATIVE:** Stocks bear significantly higher risk that typically cannot be valued by normal fundamental criteria. Investments in the stock may result in material loss.

## 12-Month Recommendation History (as of date same as the Global Stock Ratings table)

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### Dropsuite Ltd Rating History as of 10/13/2023



## Past performance

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