

19 April 2024

## Dropsuite Limited (DSE)

BUY

Share Price: A\$0.30

Revisiting our longer-term margin assumptions

Target Price:

A\$0.32

DSE's 1Q24 result, while implying a revenue run-rate below our estimate, is still indicative of a business that is growing at a pace more than its broader market. With DSE continuing to invest ahead of the curve, but within the confine of remaining profitable, we are confident this trend will continue, and be supplemented in time by operating leverage. Reiterate Buy and \$0.32ps TP.

### Another solid quarter

- DSE reported 1Q24 figures slightly below our estimates, with this due largely to a lower-than-expected net user gain (-73k versus our estimate of 109k). This appears to be due to churn of 5%, versus 3% historically.
- Notwithstanding this, the overall trend remains positive, with DSE's ARR increasing 7% in USD terms (to \$25m) and 9% in AUD terms (to \$38m). We forecast a CY24 EOP ARR of US\$29.9m (previously US\$30.7m).
- While DSE has stated that the higher level of customer churn is due to competitive pressures, most notably in EMEA, current investments in after-market service and new product are expected to mitigate this headwind.
- Despite the weaker-than-expected 1Q24 revenue run rate, DSE reported a solid Op. CF of \$0.4m, in line with our forecasts. DSE's net cash was \$24.9m as at the end of 1Q24.

### Downward revision to CY26 forecasts

- While our CY24 and CY25 forecasts remain intact, we have cut our CY26 EPS estimate by 10.4%. The reflects a more modest ramp up of operating leverage, allowing for further incremental growth opex beyond CY25.

### Comparing DSE with US-listed N-ABLE

- With our investment case for DSE resting largely on the realisation of significant operating leverage on a 10-year view, we have compared our forecasts with N-ABLE's reported incremental EBITDA margins.

### Reiterate Buy rating and \$0.32ps TP

- We believe DSE has the products, business model and capital to exceed system growth (~25% p.a.) within its target market (data back-up and archiving) over the next two years.
- Given DSE's ability to leverage its strong balance sheet to supplement what we expect to be a strong multi-year organic growth profile with M&A, we reiterate our Buy rating and \$0.32ps TP (5.0x CY24 EV/sales).
- Consistent with DSE's partner-led business model and growth strategy, the key share price catalysts include (i) better-than-expected sales, (ii) a sooner-than-expected normalisation in growth opex, and (iii) strategic M&A.

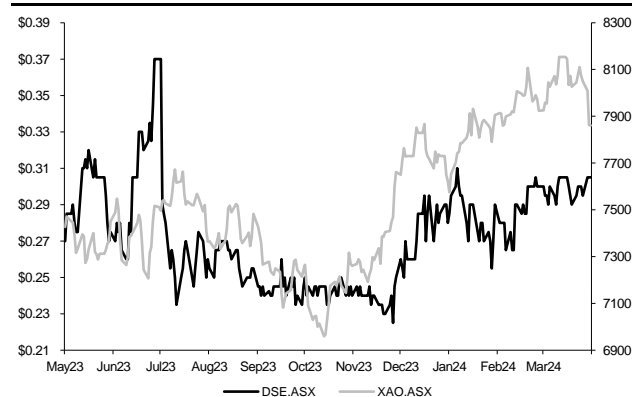
### Company Data

Shares – ordinary (M)	696.1
Dilution (M)	14.8
Total (fully diluted) (M)	710.9
Market capitalisation (\$M)	205.3
12-month low/high (\$)	0.22 - 0.39
Average monthly turnover (\$M)	3.5
GICS Industry	Software

### Financial Summary (fully diluted/normalised)

Year End	December	2022A	2023A	2024F	2025F	2026F
Revenue (A\$m)		20.7	30.6	40.7	51.7	61.4
Costs (A\$m)		19.4	29.5	39.4	49.9	58.3
EBITDA (A\$m)		1.3	1.1	1.3	1.8	3.1
NPAT (A\$m)		1.5	1.6	1.9	2.4	3.6
EPS (¢)		0.2	0.2	0.3	0.3	0.5
EPS Growth (%)		>100.0	7.8	15.9	24.3	50.3
PER (x)		142.2	130.5	111.3	89.6	59.6
FCF (A\$m)		0.9	2.1	1.8	1.6	3.0
FCF per share (cps)		0.1	0.3	0.3	0.2	0.4
Price to FCF (x)		242.5	96.8	113.6	129.6	72.4
EV (A\$m)		185.6	183.3	183.6	184.5	184.4
EV/EBITDA		148.3	165.9	145.1	99.9	59.4
Payout ratio (%)		0.0	0.0	0.0	0.0	0.0
Dividend (¢)		0.0	0.0	0.0	0.0	0.0
Net Yield (%)		0.0	0.0	0.0	0.0	0.0
Franking (%)		0.0	0.0	0.0	0.0	0.0

### DSE – performance over one year



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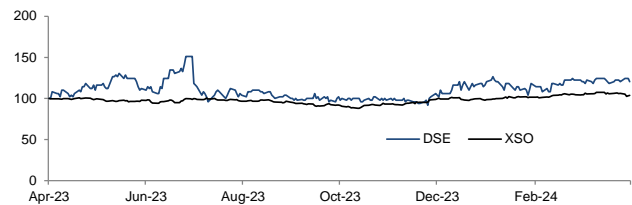
## Analysis

### Dropsuite Year End December

#### MARKET DATA

Recommendation		Buy
Price	A\$	0.30
Price target (12-month)	A\$	0.32
52 week high / low	A\$	0.22 - 0.39
Market capitalisation	A\$m	205.3
Shares on issue (basic)	no.	696.1
Performance rights	no.	14.8
Other equity	no.	0.0
Shares on issue (diluted)	no.	710.9

#### 12-MONTH SHARE PRICE PERFORMANCE



#### INVESTMENT FUNDAMENTALS

	2022A	2023A	2024F	2025F	2026F
Underlying net profit	\$m 1.5	1.6	1.9	2.4	3.6
<b>Reported net profit</b>	<b>\$m 1.5</b>	<b>1.6</b>	<b>1.9</b>	<b>2.4</b>	<b>3.6</b>
Reported EPS (diluted)	€ 0.2	0.2	0.3	0.3	0.5
<b>Normalised EPS (diluted)</b>	<b>€ 0.2</b>	<b>0.2</b>	<b>0.3</b>	<b>0.3</b>	<b>0.5</b>
...Growth	% >100.0	7.8	15.9	24.3	50.3
<b>Normalised diluted PER</b>	<b>x 142.2</b>	<b>130.5</b>	<b>111.3</b>	<b>89.6</b>	<b>59.6</b>
Adjusted Op. CF per share	€ 0.1	0.3	0.3	0.3	0.4
Adjusted FCF per share	€ 0.1	0.3	0.3	0.2	0.4
<b>Price to free cash flow per share</b>	<b>x 242.5</b>	<b>96.8</b>	<b>113.6</b>	<b>129.6</b>	<b>72.4</b>
Free cash flow yield	% 0.4	1.0	0.9	0.8	1.4
Dividend per share	€ 0.0	0.0	0.0	0.0	0.0
Payout ratio	% 0.0	0.0	0.0	0.0	0.0
Yield	% 0.0	0.0	0.0	0.0	0.0
Franking	% 0.0	0.0	0.0	0.0	0.0

Enterprise value	\$m 185.6	183.3	183.6	184.5	184.4
EV/EBITDA	x 148.3	165.9	145.1	99.9	59.4
EV/EBIT	x 155.8	208.5	165.7	109.7	63.0
Price to book (NAV)	x 8.4	7.5	7.2	6.7	6.1
Price to NTA	x 8.4	7.5	7.2	6.7	6.1

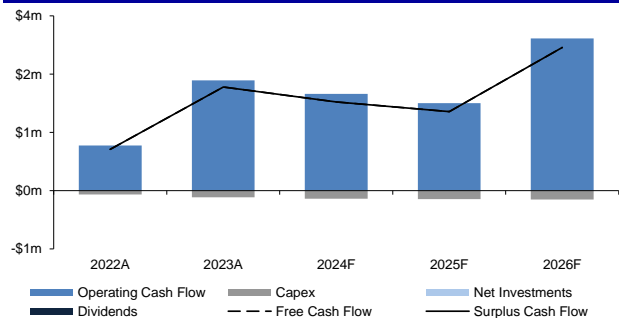
#### KEY RATIOS

	2022A	2023A	2024F	2025F	2026F
EBITDA margin	% 6.0	3.6	3.1	3.6	5.1
EBIT margin	% 5.8	2.9	2.7	3.2	4.8
Underlying net profit margin	% 7.0	5.2	4.6	4.6	5.8
Return on average equity	% 14.1	16.3	17.9	18.4	18.4
Return on average assets	% 12.6	15.9	17.7	18.4	18.7
Net tangible assets per share	€ 3.5	3.9	4.1	4.4	4.8
Net debt / (cash)	\$m (22.3)	(24.3)	(26.1)	(27.7)	(30.7)
Interest cover (EBIT / net interest)	x n/a	n/a	n/a	n/a	n/a
Leverage (net debt / EBITDA)	x n/a	n/a	n/a	n/a	n/a
Gearing (net debt / net debt plus equity)	% n/a	n/a	n/a	n/a	n/a

#### DUPONT ANALYSIS

	2022A	2023A	2024F	2025F	2026F
Net Profit Margin	% 7.7	9.3	11.0	12.6	14.0
Asset Turnover	x 1.5	1.4	1.3	1.2	1.1
Return on Assets	% 11.3	13.0	14.4	15.0	15.2
Financial Leverage	x 1.2	1.3	1.2	1.2	1.2
<b>Return on Equity</b>	<b>% 14.1</b>	<b>16.3</b>	<b>17.9</b>	<b>18.4</b>	<b>18.4</b>

#### CASH FLOW SUMMARY



#### PROFIT AND LOSS

	2022A	2023A	2024F	2025F	2026F
Total revenue	\$m 20.7	30.6	40.7	51.7	61.4
<b>EBITDA</b>	<b>\$m 1.3</b>	<b>1.1</b>	<b>1.3</b>	<b>1.8</b>	<b>3.1</b>
Depreciation & amortisation	\$m 0.1	0.2	0.2	0.2	0.2
EBIT	\$m 1.2	0.9	1.1	1.7	2.9
Net interest	\$m (0.3)	(0.7)	(0.8)	(0.7)	(0.7)
Non-operating income	\$m 0.0	0.0	0.0	0.0	0.0
Pretax Profit	\$m 1.5	1.6	1.9	2.4	3.6
Tax expense	\$m 0.0	0.0	(0.0)	0.0	0.0
Minorities	\$m 0.0	0.0	0.0	0.0	0.0
<b>Reported NPAT</b>	<b>\$m 1.5</b>	<b>1.6</b>	<b>1.9</b>	<b>2.4</b>	<b>3.6</b>
Significant items	\$m 0.0	0.0	0.0	0.0	0.0
Underlying NPAT	\$m 1.5	1.6	1.9	2.4	3.6

#### GROWTH PROFILE

	2022A	2023A	2024F	2025F	2026F
Operating revenue	% 76.8	48.1	32.8	27.2	18.6
EBITDA	% >100.0	(11.7)	14.5	46.0	67.9
EBIT	% >100.0	(26.2)	26.0	51.8	74.1
Operating NPAT	% >100.0	9.2	17.7	26.3	52.2
Normalised EPS	% >100.0	7.8	15.9	24.3	50.3
DPS	% 0.0	0.0	0.0	0.0	0.0

#### BALANCE SHEET

	2022A	2023A	2024F	2025F	2026F
Cash	\$m 22.3	24.3	26.1	27.7	30.7
Receivables	\$m 4.1	5.9	7.7	9.8	11.7
Inventory	\$m 0.0	0.0	0.0	0.0	0.0
Other	\$m 0.4	0.7	0.7	0.7	0.7
Current	\$m 26.8	30.8	34.5	38.2	43.0
Prop, plant & equip	\$m 0.1	0.1	0.1	0.2	0.2
Goodwill	\$m 0.0	0.0	0.0	0.0	0.0
Other	\$m 0.1	0.2	0.3	0.4	0.5
Non current	\$m 0.1	0.4	0.5	0.6	0.7
<b>Total assets</b>	<b>\$m 26.9</b>	<b>31.2</b>	<b>35.0</b>	<b>38.8</b>	<b>43.7</b>
Accounts Payable	\$m 2.5	3.2	5.1	6.5	7.7
Borrowings	\$m 0.0	0.0	0.0	0.0	0.0
Other	\$m 0.2	0.5	0.6	0.7	0.8
<b>Total liabilities</b>	<b>\$m 2.7</b>	<b>3.8</b>	<b>5.7</b>	<b>7.2</b>	<b>8.5</b>
Net assets	\$m 24.2	27.4	29.2	31.6	35.2
Equity	\$m 24.2	27.4	29.2	31.6	35.2
Minorities	\$m 0.0	0.0	0.0	0.0	0.0
<b>Shareholder's equity</b>	<b>\$m 24.2</b>	<b>27.4</b>	<b>29.2</b>	<b>31.6</b>	<b>35.2</b>
Shares on issue	m 689.9	696.1	710.9	719.6	729.2

#### CASH FLOW

	2022A	2023A	2024F	2025F	2026F
EBITDA	\$m 1.3	1.1	1.3	1.8	3.1
Change in working capital	\$m (1.4)	(1.0)	(0.0)	(0.7)	(0.6)
Net interest	\$m 0.2	0.7	0.8	0.7	0.7
Tax paid	\$m 0.0	0.0	0.0	0.0	0.0
Other	\$m 0.9	1.5	0.0	0.0	0.0
<b>Operating cash flow</b>	<b>\$m 0.9</b>	<b>2.3</b>	<b>2.0</b>	<b>1.8</b>	<b>3.1</b>
Capital expenditure	\$m (0.1)	(0.1)	(0.2)	(0.2)	(0.2)
Acquisitions/divestment/other	\$m 0.0	0.0	0.0	0.0	0.0
<b>Investing cash flow</b>	<b>\$m (0.1)</b>	<b>(0.1)</b>	<b>(0.2)</b>	<b>(0.2)</b>	<b>(0.2)</b>
<b>Free cash flow</b>	<b>\$m 0.9</b>	<b>2.1</b>	<b>1.8</b>	<b>1.6</b>	<b>3.0</b>
Equity	\$m 0.0	0.0	0.0	0.0	0.0
Increase / (decrease) in borrowings	\$m 0.0	0.0	0.0	0.0	0.0
Dividend/other	\$m 0.0	0.0	0.0	0.0	0.0
<b>Financing cash flow</b>	<b>\$m 0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Net cash flow</b>	<b>\$m 0.9</b>	<b>2.1</b>	<b>1.8</b>	<b>1.6</b>	<b>3.0</b>

Source: Petra Capital

## A closer look at our DSE margin estimates

One of the more refreshing, albeit becoming more common place now, things about DSE is its intent to grow off a profitable base. This position was reiterated in DSE’s 1Q24 update, with management stating that it remains focussed on, among other things, increasing its investment in R&D and go-to-market capabilities to sustain growth, such that CY24 EBITDA and Op. CF will be in line with CY23.

While this makes sense, DSE has also previously stated that at some point, likely in CY25 or CY26, the company will stabilise its growth opex in a bid to realise operating leverage inherent in a business like DSE. As a reference point, we have summarised N-ABLE’s reported revenue and margin figures over recent periods in Figure 1.

**Figure 1: N-ABLE revenue growth, EBITDA margin and incremental EBITDA margin (US\$m)**

Year end 31 December	4Q22	4Q23	CY22	CY23
Revenue	95.8	108.4	371.8	421.9
Revenue growth		13.2%		13.5%
Adjusted EBITDA	22.5	28.3	77.0	98.3
EBITDA margin	23.5%	26.1%	20.7%	23.3%
Incremental EBITDA margin		45.9%		42.5%

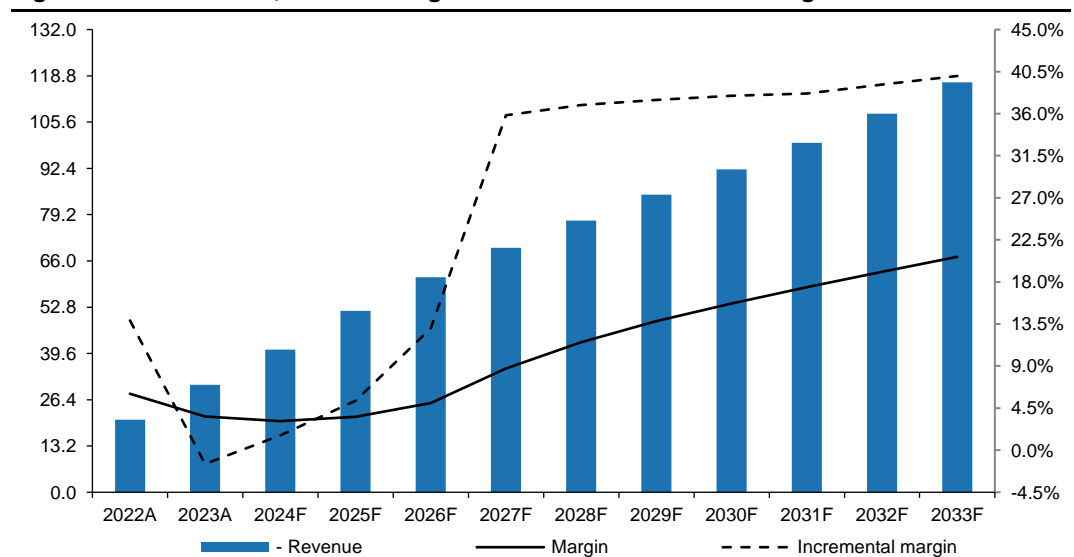
Source: Company reports

The data above shows that while N-ABLE is growing at a slower run-rate than DSE, albeit off a much larger revenue base, it is still generating margin gains, both quarter on quarter and year on year, with the incremental EBITDA margin tracking at ~40%. While DSE is a long way from matching N-ABLE’s revenue base, EBITDA margin and operating leverage, it is currently investing to do so.

It is also worth noting that, based on Bloomberg consensus data, N-ABLE is currently trading at a CY24 EV/revenue multiple of 5.3x (and an EV/EBITDA multiple of 15.1x). While our current EBITDA margin assumption (i.e., 20.7% in CY33) is below N-ABLE’s CY23 EBITDA margin of 23.3%, it will all depend on how successful DSE is at sustaining its current revenue growth run-rate.

As summarised in Figure 2, we expect DSE to switch from its current focus on incremental growth opex to incremental EBITDA margin (i.e., operating leverage) in CY26, with the latter exceeding 30% from CY27, and reaching 40% in CY33. This is still below N-ABLE’s current incremental margin, with this taking into account DSE’s intent to ultimately move to a hybrid storage model.

**Figure 2: DSE revenue, EBITDA margin and incremental EBITDA margin forecasts**



Source: Company reports, Petra Capital

We have summarised our earnings forecast revisions for DSE in Figure 3. Note that the key change is our view that the incremental margin benefit will take longer than previously expected to be realised. Our updated view is intended to be more conservative and reflects the fact that DSE is still at an early stage in its business maturity profile.

**Figure 3: DSE earnings forecast revisions**

Year End Dec	2024F			2025F			2026F		
	Old	New	Δ	Old	New	Δ	Old	New	Δ
EBITDA (A\$m)	1.3	1.3	0%	1.8	1.8	0%	4.8	3.1	-35%
NPAT (A\$m)	1.9	1.9	0%	2.4	2.4	0%	5.2	3.6	-31%
EPS ¢	0.3	0.3	0%	0.3	0.3	0%	1.4	1.2	-10%
DPS ¢	0.0	0.0	0%	0.0	0.0	0%	0.0	0.0	0%
FCF (A\$m)	1.7	1.8	5%	1.6	1.6	1%	4.6	3.0	-36%

Source: Petra Capital



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