

Dropsuite Ltd (DSE)

Rating: Buy | Risk: High | Price Target: \$0.35

17 October 2023

3Q23: Operating cashflow a highlight, FY23 outlook reiterated. Maintain Buy.

Key Information

Current Price (\$ps)	0.24
12m Target Price (\$ps)	0.35
52 Week Range (\$ps)	0.17 - 0.37
Target Price Upside (%)	45.8%
TSR (%)	45.8%
Reporting Currency	AUD
Market Cap (\$m)	171.7
Sector	Information Technology
ASX 200 Weight (%)	0.01%

Fundamentals

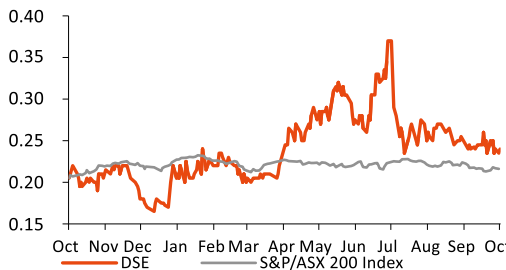
YE 30 Jun (AUD)	FY22A	FY23E	FY24E	FY25E
Sales (\$m)	20.7	29.3	37.2	44.2
NPAT (\$m)	1.5	2.0	2.9	2.8
EPS (cps)	0.2	0.3	0.4	0.4
EPS Growth (%)	638.7%	33.4%	41.8%	(5.5%)
DPS (cps) (AUD)	0.0	0.0	0.0	0.0
Franking (%)	0%	0%	0%	0%

Ratios

YE 30 Jun	FY22A	FY23E	FY24E	FY25E
P/E (x)	92.9	85.7	60.5	63.9
EV/EBITDA (x)	117.0	100.3	63.1	56.5
Div Yield (%)	0.0%	0.0%	0.0%	0.0%
Payout Ratio (%)	0.0%	0.0%	0.0%	0.0%

Price Performance

YE 30 Jun	1 Mth	2 Mth	3 Mth	1 Yr
Relative (%)	(2.4%)	(5.4%)	(31.3%)	13.1%
Absolute (%)	(5.9%)	(7.7%)	(35.1%)	17.1%
Benchmark (%)	(3.5%)	(2.3%)	(3.8%)	4.0%



Price performance indexed to 100

Source: FactSet

Major Shareholders

Topline Capital Management LLC (Investme	26.1%
Glory Wealth Group Ltd.	7.1%
FEARO TRACY ANNE	5.4%

Event

DSE has released its 3Q business update. Key highlights included 1) user growth, excluding the deactivation of a legacy partner, accelerated QoQ; 2) despite the headwind from this partner, our FY23 ARR forecast of \$36.1m still looks achievable; and 3) cash generation was a key highlight. Our forecasts have not changed materially. DSE will host an investor day tomorrow, which should provide more insight on its opportunity, product roadmap and go-to-market strategy. DSE remains a key "growth software" pick. Maintain Buy.

Highlights

- Key metrics** – 3Q ARR of \$33.4m grew +44% YoY and +10% sequentially. In US\$ terms, ARR grew +37% YoY and +5% seq (vs +10% in 1Q and +9% in 2Q). Sequentially, users grew +3% and US\$ ARPU +4%. DSE added +35 direct partners and +209 Indirect, while partner revenue churn remained <3%. Gross margins delivered at 68% broadly steady vs prior quarters. DSE delivered gross free cashflow of +\$1.2m a record for the group, with receipts of \$8.1m (+57% YoY) and payments of \$6.9m (+49%). Headcount was disclosed at ~100 steady on the prior quarter. DSE closed 3Q with \$24.6m cash and no debt (vs \$23m at 2Q).
- Highlights** – user growth excluding the deactivation of a legacy partner accelerated, despite the headwind from this partner our FY23 ARR forecast of \$36.1m still looks achievable and cash generation was a key highlight. 1) Users grew sequentially +3% but included 53k users deactivated from a legacy partner. Excluding this impact we estimate users grew +9% sequentially (+86k added) which encouragingly showed acceleration vs the +8% in 2Q (ramping sales, new partner, new products etc). DSE expect the remaining ~40k users from this partner will be deactivated in 4Q, which provides a short-term headwind. 2) Despite this, we believe our FY23 ARR forecast for \$36.1m still looks achievable. Based on the current FX rates (63c), this implies ARR of US\$22.8m. To achieve this forecast, DSE would need to grow u/lying users by +9% (in-line with 3Q) and hold ARPU constant at ~US\$1.64. This would imply 34% YoY growth in FY23, despite the headwind of deactivating over 100k users. 3) cash generation was a key highlight and de-risks the FY23 guidance. While receipts slightly benefited from timing, cost growth is being conservatively managed, despite growing users and expanding products. Both staff costs and headcount were flat sequentially, and while we expect net hiring in both 4Q and into FY24, we think this validates the operating leverage potential of DSE's business over the longer term.
- Outlook/Forecasts** – DSE reiterated FY23 guidance that it expects to deliver positive EBITDA and operating cashflow. Achieving these metrics are now supported by a strong 3Q cash result and cost growth that is being conservatively managed, despite growing users and expanding products. Our forecasts have not changed materially. We still view our FY23 ARR forecast of \$36.1m (+42% growth) as achievable, despite the deactivation of legacy users, provided FX rates remain around current levels.

Recommendation

We reiterate our Buy rating and 35c PT. Based on our forecasts, DSE is currently trading on an FY23 EV/Revenue multiple of 5.1x. Our PT implies 7.8x which we feel is justified based on its combo of strong growth and profitability relative to peers.

Jules Cooper | Senior Analyst

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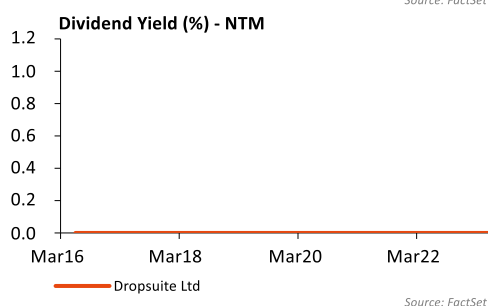
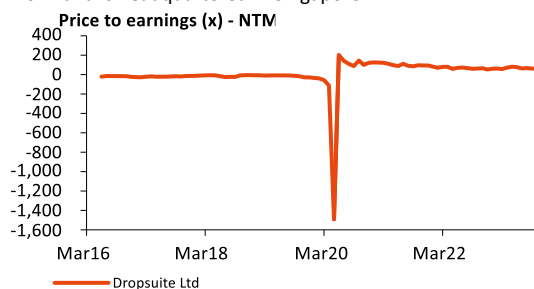
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Dropsuite Ltd Information Technology Software & Services FactSet: DSE-AU / Bloomberg: DSE AU

Key Items	Data
Recommendation	BUY
Risk	HIGH
Price (\$ps)	0.24
Target Price (\$ps)	0.35
52 Week Range (\$ps)	0.17 - 0.37
Shares on Issue (m)	715.4
Market Cap (\$m)	171.7
Enterprise Value (\$m)	146.5
TSR (%)	45.8%

Valuation NPV	Data
Beta	1.10
Cost of Equity (%)	9.1%
Cost of Debt (net) (%)	0.0%
Risk Free Rate (%)	3.0%
Terminal Growth (%)	3.5%
WACC (%)	9.1%
Valuation (\$m)	227.5
Valuation per share (cps) (AUD)	0.32

Dropsuite (DSE) is a leading partner-centric, data backup, archiving and compliance vendor for small and medium sized businesses globally. Its suite of backup solutions cover websites, email, servers and productivity suites including Microsoft 365 and Google Workplace. DSE was founded in 2011 and is headquartered in Singapore.



Financial Year End: 30 June

Investment Summary (AUD)	FY21A	FY22A	FY23E	FY24E	FY25E
EPS (Reported) (cps)	(0.0)	0.2	0.3	0.4	0.4
EPS (Underlying) (cps)	0.0	0.2	0.3	0.4	0.4
EPS (Underlying) Growth (%)	107.8%	638.7%	33.4%	41.8%	(5.5%)
PE (Underlying) (x)	nm	92.9	85.7	60.5	63.9
EV / EBIT (x)	847.6	122.8	106.7	66.0	59.7
EV / EBITDA (x)	699.5	117.0	100.3	63.1	56.5
DPS (cps) (AUD)	0.0	0.0	0.0	0.0	0.0
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Franking (%)	0%	0%	0%	0%	0%
Payout Ratio (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Free Cash Flow Yield (%)	0.3%	0.6%	1.6%	2.2%	2.3%
Profit and Loss (AUD) (m)	FY21A	FY22A	FY23E	FY24E	FY25E
Sales	11.7	20.7	29.3	37.2	44.2
Sales Growth (%)	64.6%	76.8%	41.4%	27.1%	18.8%
EBITDA	0.2	1.3	1.5	2.3	2.5
EBITDA Margin (%)	1.8%	6.2%	5.0%	6.1%	5.6%
Depreciation & Amortisation	0.0	(0.1)	(0.1)	(0.1)	(0.1)
EBIT	0.2	1.2	1.4	2.2	2.3
EBIT Margin (%)	1.5%	5.9%	4.7%	5.8%	5.3%
Net Interest	0.0	0.3	0.6	0.7	0.8
Pretax Profit	0.2	1.5	2.0	2.9	3.1
Tax	0.0	0.0	0.0	0.0	(0.4)
Tax Rate (%)	0.0%	0.0%	0.0%	0.0%	(12.0%)
Minorities	0.0	0.0	0.0	0.0	0.0
NPAT Underlying	0.2	1.5	2.0	2.9	2.8
Significant Items	(0.2)	0.0	0.0	0.0	0.0
NPAT Reported	0.0	1.5	2.0	2.9	2.8
Cashflow (AUD) (m)	FY21A	FY22A	FY23E	FY24E	FY25E
EBIT	0.2	1.2	1.4	2.2	2.3
Tax Paid	0.0	0.0	0.0	0.0	(0.4)
Net Interest	0.0	0.2	0.6	0.7	0.8
Change in Working Capital	0.1	(1.5)	(0.3)	(0.5)	(0.5)
Depreciation & Amortisation	0.0	0.1	0.1	0.1	0.1
Other	0.0	0.9	1.2	1.5	1.8
Operating Cashflow	0.3	0.9	2.9	3.9	4.2
Capex	(0.1)	(0.1)	(0.1)	(0.1)	(0.2)
Acquisitions and Investments	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Investing Cashflow	(0.1)	(0.1)	(0.1)	(0.1)	(0.2)
Free Cashflow	0.4	0.9	2.8	3.8	4.0
Equity Raised / Bought Back	18.9	0.0	0.0	0.0	0.0
Dividends Paid	0.0	0.0	0.0	0.0	0.0
Change in Debt	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Financing Cashflow	18.9	0.0	0.0	0.0	0.0
Net Change in Cash	19.1	0.9	2.8	3.8	4.0
Balance Sheet (AUD) (m)	FY21A	FY22A	FY23E	FY24E	FY25E
Cash	21.6	22.3	25.2	29.0	33.0
Accounts Receivable	2.2	4.1	5.8	7.3	8.7
Other Current Assets	0.2	0.4	0.7	0.7	0.7
PPE	0.0	0.1	0.1	0.1	0.1
Goodwill & Intangibles	0.0	0.0	0.0	0.0	0.0
Investments	0.0	0.0	0.0	0.0	0.0
Other Non Current Assets	0.1	0.1	0.1	0.1	0.1
Total Assets	24.1	26.9	31.9	37.2	42.6
Accounts Payable	2.0	2.5	3.5	4.5	5.3
Short Term Debt	0.0	0.0	0.0	0.0	0.0
Long Term Debt	0.0	0.0	0.0	0.0	0.0
Income Taxes Payable	0.0	0.0	0.4	0.4	0.4
Other	0.2	0.2	0.3	0.4	0.4
Total Liabilities	2.2	2.7	4.2	5.3	6.2
Total Shareholder Equity	21.9	24.2	27.6	32.0	36.5
Ratios	FY21A	FY22A	FY23E	FY24E	FY25E
ROE (%)	1.5%	6.4%	7.7%	9.6%	8.1%
Gearing (%)	(7,309.8%)	(1,178.7%)	(1,052.7%)	(975.2%)	(947.7%)
Net Debt / EBITDA (x)	(100.7)	(17.5)	(17.3)	(12.8)	(13.4)

Key metrics

Figure 1: Key quarterly metrics

	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23
ARR	9.6	11.0	13.1	15.2	17.0	20.1	23.3	25.4	28.2	30.4	33.4
ARR (US\$)	7.3	8.4	9.6	10.9	12.5	14.1	15.6	17.2	18.8	20.5	21.5
Gross margin	67%	67%	64%	62%	63%	64%	64%	70%	69%	69%	68%
Receipts	2.3	2.4	2.9	3.4	3.7	4.3	5.2	5.6	6.1	6.7	8.1
Payments	-2.3	-2.4	-2.8	-3.2	-4.0	-4.0	-4.6	-5.3	-6.0	-6.5	-6.9
Gross FCF	0.0	0.0	0.1	0.2	-0.3	0.4	0.5	0.3	0.1	0.1	1.2
Partners	335	354	395	409	421	453	473	491	524	559	594
Users	472000	518000	575000	649000	730000	808000	886000	935000	1020000	1080000	1113000
ARPU	1.68	1.77	1.9	1.95	1.95	2.07	2.2	2.26	2.31	2.35	2.57
ARPU (US\$)	1.29	1.35	1.39	1.40	1.43	1.45	1.47	1.53	1.54	1.58	1.65

Source: Company reports, Shaw and Partners analysis

Forecast changes

Figure 2: Forecast changes

Changes to Estimates A\$m	Old 2023	New 2023	Delta	Old 2024	New 2024	Delta	Old 2025	New 2025	Delta
Revenue	29.3	29.3	0%	37.2	37.2	0%	44.2	44.2	0%
Opex	-26.6	-26.6	0%	-33.5	-33.5	0%	-40.0	-40.0	0%
Op EBITDA	2.6	2.6	0%	3.7	3.7	0%	4.2	4.2	0%
SBP	-1.2	-1.2	0%	-1.5	-1.5	0%	-1.8	-1.8	0%
EBITDA	1.5	1.5	0%	2.3	2.3	0%	2.5	2.5	0%
PBT	2.0	2.0	0%	2.9	2.9	0%	3.1	3.1	0%
NPAT	2.0	2.0	0%	2.9	2.9	0%	2.7	2.8	0%
Operating cashflow	2.1	2.9	37%	3.7	3.9	6%	4.0	4.2	5%
Capex	-0.1	-0.1	0%	-0.1	-0.1	0%	-0.2	-0.2	0%
Free cashflow	2.0	2.8	39%	3.5	3.8	6%	3.8	4.0	5%
Net cash (debt)	24.4	25.2	3%	28.0	29.0	4%	31.8	33.0	4%
Total cash costs	-26.6	-26.6	0%	-33.5	-33.5	0%	-40.0	-40.0	0%
Cash EBITDA (ex SBP)	2.6	2.6	0%	3.7	3.7	0%	4.2	4.2	0%

Source: Shaw and Partners analysis

Risks to rating and price target

Top line growth does not deliver

We think our forecasts have been framed conservatively and that the risk lies to the upside through FY25. However, a tougher macro environment could impact demand for email backup and archiving solutions, sold to SMBs via MSPs. Further, our medium-term revenue growth relies on the successful launch of new products. Lastly, DSE is growing fast and scaling rapidly, which brings its own unique set of challenges. Any of these factors could result in DSE not delivering the forecast growth we expect, which may impact operating leverage, efficiency optics and sentiment.

Loss of a material partner

As a partner-centric software vendor, DSE sells its solutions via hundreds of direct resellers and thousands of indirect MSPs. It is likely that within DSE's top 10 partners, some could be generating revenues in excess of a couple of million. The loss of any material partner, could result in DSE not delivering the forecast growth we expect, which may impact operating leverage, efficiency optics and sentiment.

Competition risks

DSE operates in a growing and attractive market. If other back-up vendors were to aggressively invest in or price their products, to gain market share, then this could result in DSE not delivering the forecast growth we expect, which may impact operating leverage, efficiency optics and sentiment.

Demand risks may impact sentiment

In 2022, small-cap software fell -26% lagging the ASX Small Ords (-21%) and the US peer group (-35%), as inflation, rising rates, geopolitical disruption and recession risks all impacted. Whilst valuations have corrected and software's fundamentals generally remain strong, there is potential for a macro slowdown to impact demand in the short-term. This may impact perceptions of software's relative growth and quality attributes, which could negatively impact sector sentiment and valuations.

Rating Classification

Buy	Expected to outperform the overall market
Hold	Expected to perform in line with the overall market
Sell	Expected to underperform the overall market
Not Rated	Shaw has issued a factual note on the company but does not have a recommendation

Risk Rating

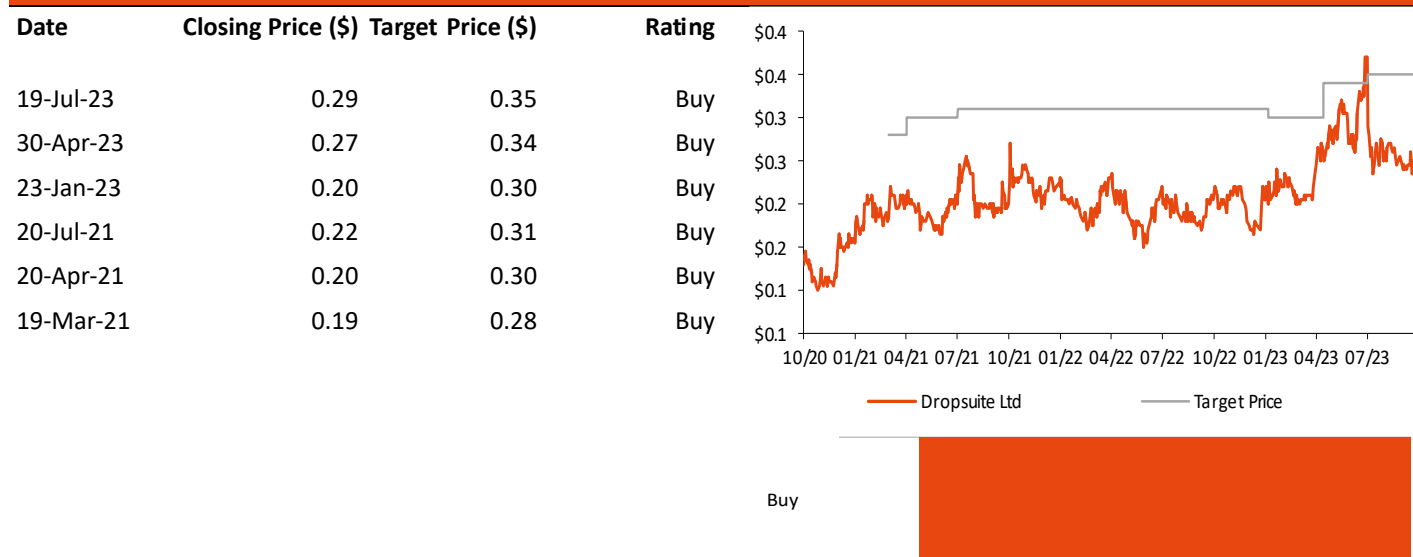
High	Higher risk than the overall market – investors should be aware this stock may be speculative
Medium	Risk broadly in line with the overall market
Low	Lower risk than the overall market

RISK STATEMENT: Where a company is designated as ‘High’ risk, this means that the analyst has determined that the risk profile for this company is significantly higher than for the market as a whole, and so may not suit all investors. Clients should make an assessment as to whether this stock and its potential price volatility is compatible with their financial objectives. Clients should discuss this stock with their Shaw adviser before making any investment decision.

Distribution of Investment Ratings

Rating	Count	Recommendation Universe
Buy	74	96%
Hold	2	3%
Sell	1	1%

History of Investment Rating and Target Price - Dropsuite Ltd



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