ShawandPartners
an EFG company

Dropsuite Ltd (DSE)

Rating: Buy | Risk: High | Price Target: $0.28

Phishing for the next big BaaS player

Key Information	
Current Price ($ps)	0.18
12m Target Price ($ps)	0.28
52 Week Range ($ps)	0.03 - 0.21
Target Price Upside (%)	55.6%
TSR (%)	
Reporting Currency	AUD
Market Cap ($m)	101.7
Sector	Information Technology
Avg Daily Volume (m)	0.2
ASX 200 Weight (%)	0%

Fundamentals

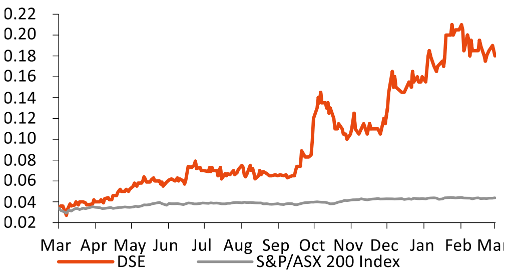
YE 31 Dec (AUD)	FY20A	FY21E	FY22E	FY23E
Sales ($m)	7.0	11.1	16.9	25.4
NPAT ($m)	(2.1)	(0.5)	1.3	4.5
EPS (cps)	(0.4)	(0.1)	0.2	0.8
EPS Growth (%)	38.3%	75.8%	336.4%	249.3%
DPS (cps) (AUD)	n/a	n/a	n/a	n/a
Franking (%)	0%	0%	0%	0%

Ratios

YE 31 Dec	FY20A	FY21E	FY22E	FY23E
P/E (x)	(36.6)	nm	79.5	22.8
EV/EBITDA (x)	n/a	n/a	n/a	n/a
Div Yield (%)	n/a	n/a	n/a	n/a
Payout Ratio (%)	n/a	n/a	n/a	n/a

Price Performance

YE 31 Dec	1 Mth	2 Mth	3 Mth	1 Yr
Relative (%)	(13.5%)	10.8%	37.5%	400.4%
Absolute (%)	(14.3%)	12.5%	38.5%	429.4%
Benchmark (%)	(0.8%)	1.7%	1.0%	29.0%



Price performance indexed to 100 *Source:*

Major Shareholders	
Topline Capital Management LLC (Investme	18.3%
GMO GlobalSign Holdings KK	0.6%
APPEL PETER A	0.2%

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Event

We initiate on Dropsuite (ASX: DSE) with a Buy Recommendation and Price Target of $0.28 per share (55.6% upside).

Highlights

- **Market leading cloud-based solutions across the globe** – DSE is a leading provider of cloud-based data backup, archiving and compliance solutions globally. DSE operates in the Backup-as-a-Service (BaaS) market and distributes via its 300+ Channel Partners to >430k users across North America, Europe and APAC. DSE delivered $8.5m in ARR at Dec-20 (+62.5% YoY or +77.8% YoY constant currency) and plans to propel growth further through extending product functionality and entering new horizontals.
- **Suite of key metrics accelerating** – DSE has delivered impressive growth across its suite of key metrics, including highlights as follows (December YE):

  1) ARR: DSE's ARR was $8.5m at Dec-20 (+62.5% YoY or +77.8% constant currency) and consistently accelerated over the last 6 quarters from $3.9m in 2Q19. Shaw estimates ARR of $12.9m (+52.1% YoY) and $19.4m (+50.4% YoY) in FY21e and FY22e respectively.

  2) ARPU: ARPU has expanded from $1.00 per month/User in FY18 to $1.64 at FY20 which was +8.8% YoY or +19.1% constant currency, which is significantly above industry standard and underpins significant ARR and User growth.

  3) Partners and Users: Partners are key to distributing DSE's products and services to Users and grew to 318 at FY20 (+38.3% YoY), with concentration in the top 10 pleasingly declining to 70% from 95% in FY17. Shaw estimates Users of 0.60m (+40.0% YoY) and 0.84m (+40.0% YoY) in FY21e and FY22e respectively.
- **Product expansion opportunities** – DSE currently operates in the SME space. Shaw anticipate a push into large Enterprise in 2H22e which should contribute material levels of ARR. Other opportunities could include government sector expansion, email continuity, data governance and increased product reach (i.e. Slack, Salesforce, CRM).
- **Covid, WFH and cyber-attacks shine the spotlight on BaaS** – Covid has catapulted digital workplaces and the WFH culture well beyond the status quo. This movement has seen cyber-attacks accelerate; 40% of SMEs managing their own network will be accessed by hackers and >50% won't even know they were attacked (*source: Gartner Group*). Cyber-attacks often prove catastrophic with 60% of SMEs that are hacked going out of business within 6 months of the attack (*source: National Cybersecurity Alliance*).

  The market for BaaS providers such as DSE is massive and is forecast to grow at a 24% CAGR to US$22.2bn by 2025, whilst currently 84% of US companies don't backup their SaaS application data (*source: Allied Market Research*).
- **Approaching cashflow breakeven a re-rate catalyst** – We rarely see companies of DSE's size and growth profile approaching cash flow breakeven at such an early stage, demonstrating positive unit economics. Shaw estimates cashflow breakeven in 2H21e, which is in line with the company's announced target and a re-rating catalyst in our view.
- **Accelerating ARR profile alongside favourable ARRG dynamics** – DSE is currently trading on an EV/ARR multiple of 11.7x which is a 26.9% discount to our peer set average. However, we prefer ARRG (ARR to growth ratio) which factors in DSE's 77.8% YoY constant currency ARR growth and sees DSE trading at a 71.3% discount to our peer set average. We utilise an equal weighting of forward ARR multiple and DCF methodologies to derive our Price Target of $0.28 per share.
- **Risks** – Technological change, competition, growth aspirations, cash burn, User churn, small cap illiquidity, data breach and key board and management risk, among others.

Recommendation

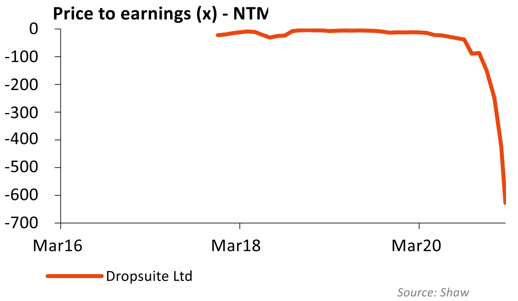
DSE offers exposure to a rapidly expanding ARR base that is approaching scale. Drivers and catalysts are plentiful and include growth across DSE's suite of metrics, favourable industry dynamics and product expansion opportunities. **Initiate with Buy recommendation.**

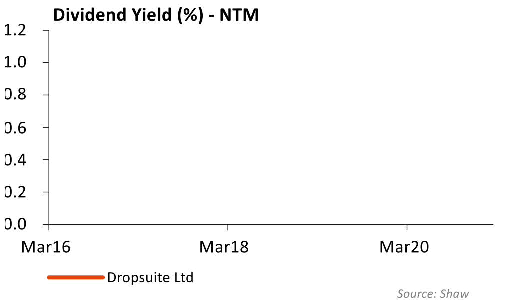
Dropsuite Ltd
Information Technology
Software & Services
FactSet: DSE-AU / Bloomberg: DSE AU

Key Items	Data
Recommendation	BUY
Risk	HIGH
Price ($ps)	0.18
Target Price ($ps)	0.28
52 Week Range ($ps)	0.03 - 0.21
Shares on Issue (m)	565.0
Market Cap ($m)	101.7

Company Description

Dropsuite is a cloud-based software solution enabling businesses and organisations globally to easily backup, recover and protect their important business information. Dropsuite has a strong focus and commitment to advanced, secure, and scalable cloud technologies.





Financial Year End: 31 December

Investment Summary (AUD)	FY19A	FY20A	FY21E	FY22E	FY23E
EPS (Reported) (cps)	**(0.6)**	**(0.4)**	**(0.1)**	**0.2**	**0.8**
EPS (Underlying) (cps)	**(0.6)**	**(0.4)**	**(0.1)**	**0.2**	**0.8**
EPS (Underlying) Growth (%)	nm	38.3%	75.8%	336.4%	249.3%
PE (Underlying) (x)	**(7.5)**	**(36.6)**	**nm**	**79.5**	**22.8**
Franking (%)	0%	0%	0%	0%	0%
Free Cash Flow Yield (%)	(8.7%)	(2.3%)	(0.4%)	1.2%	3.9%

Profit and Loss (AUD) (m)	FY19A	FY20A	FY21E	FY22E	FY23E
Sales	4.7	7.0	11.1	16.9	25.4
Sales Growth (%)	*(10.3%)*	*50.1%*	*58.6%*	*51.3%*	*50.4%*
EBITDA	**(2.4)**	**(1.7)**	**(0.5)**	**1.3**	**4.5**
EBITDA Margin (%)	*(50.2%)*	*(23.6%)*	*(4.6%)*	*7.6%*	*17.6%*
Depreciation & Amortisation	(0.8)	(0.5)	0.0	0.0	0.0
EBIT	**(3.2)**	**(2.2)**	**(0.5)**	**1.3**	**4.5**
EBIT Margin (%)	*(67.9%)*	*(30.7%)*	*(4.9%)*	*7.6%*	*17.6%*
Net Interest	0.0	0.0	0.0	0.0	0.0
Pretax Profit	(3.1)	(2.1)	(0.5)	1.3	4.5
Tax	0.0	0.0	0.0	0.0	0.0
Tax Rate (%)	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
NPAT Underlying	**(3.1)**	**(2.1)**	**(0.5)**	**1.3**	**4.5**
Significant Items	0.0	0.0	0.0	0.0	0.0
NPAT Reported	**(3.1)**	**(2.1)**	**(0.5)**	**1.3**	**4.5**

Cashflow (AUD) (m)	FY19A	FY20A	FY21E	FY22E	FY23E
EBIT	(3.2)	(2.2)	(0.5)	1.3	4.5
Tax Paid	0.0	0.0	0.0	0.0	0.0
Net Interest	0.0	0.0	0.0	0.0	0.0
Change in Working Capital	0.3	(0.3)	0.1	0.1	(0.2)
Depreciation & Amortisation	0.8	0.5	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Operating Cashflow	**(2.0)**	**(1.8)**	**(0.4)**	**1.4**	**4.2**
Capex	(0.1)	0.0	0.0	0.0	0.0
Acquisitions and Investments	0.0	0.0	0.0	0.0	0.0
Disposal of Fixed Assets/Investments	0.0	0.0	0.0	0.0	0.0
Investing Cashflow	**(0.1)**	**0.0**	**0.0**	**0.0**	**0.0**
Free Cashflow	**(2.1)**	**(1.8)**	**(0.4)**	**1.4**	**4.2**
Equity Raised / Bought Back	0.0	2.9	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
Financing Cashflow	**0.0**	**2.9**	**0.0**	**0.0**	**0.0**
Net Change in Cash	**(2.1)**	**1.1**	**(0.4)**	**1.4**	**4.2**

Balance Sheet (AUD) (m)	FY19A	FY20A	FY21E	FY22E	FY23E
Cash	1.4	2.5	2.1	3.4	7.6
Accounts Receivable	0.8	1.4	1.9	3.1	4.7
Inventory	0.0	0.0	0.0	0.0	0.0
Other Current Assets	0.1	0.1	0.2	0.3	0.5
PPE	0.0	0.0	0.0	0.0	0.0
Goodwill & Intangibles	0.5	0.0	0.0	0.0	0.0
Other Non Current Assets	0.1	0.1	0.1	0.1	0.2
Total Assets	**2.9**	**4.1**	**4.3**	**7.0**	**13.0**
Accounts Payable	1.0	1.3	1.9	3.3	4.6
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	0.0	0.0	0.0
Other	0.1	0.1	0.2	0.3	0.5
Total Liabilities	**1.1**	**1.4**	**2.1**	**3.6**	**5.2**

Ratios	FY19A	FY20A	FY21E	FY22E	FY23E
Gearing (%)	(380.9%)	(1,330.3%)	(2,669.6%)	131,045.0%	(3,142.0%)
Net Debt / EBITDA (x)	0.6	1.5	4.0	(2.7)	(1.7)

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SECTION 1: CORE DRIVERS AND CATALYSTS

Our investment thesis for Dropsuite (DSE) is driven by the following:

Material above market ARR growth profile

DSE is currently delivering an ARR growth profile far exceeding our peer set average. Our preferred metric of ARRG (ARR to growth ratio) factors in a company's ARR growth and sees DSE trading at a material discount to our peer set. DSE is also experiencing significant growth across its suite of key metrics including ARPU, Channel Partners and Users.

Product competitive advantages

DSE's products and services are perceived as market leading versus larger and more mature competitors. DSE and several of its Channel Partners see the company as superior in terms of user interface, features, functionality, reliability and value for money. Given its current size and culture, DSE is agile and has the ability to adapt to changing market conditions, implement new features and dynamically capitalise on market trends.

Entry into further markets likely

DSE currently operates in the SME space, with Shaw anticipating a push into large Enterprise which should contribute materially to DSE's ARR profile. Other opportunities include government sector expansion, email continuity, data governance and application extensions (i.e. Slack, Salesforce and CRM).

Cash flow breakeven

Shaw estimate cashflow breakeven for DSE in 2H21e which is in line with the company's announced internal target and view this as a major re-rate catalyst. This will see DSE producing free cashflows that can be used for reinvestment into product capabilities, or for potentially accretive M&A opportunities.

Structural industry tailwinds driving growth

Covid has catapulted digital workplaces and the WFH culture well beyond the status quo. This movement has seen cyber-attacks accelerate; 40% of SMEs managing their own network will be accessed by hackers, and >50% won't even know they were attacked (*source: Gartner Group*). Cyber-attacks often prove catastrophic with 60% of SMEs that are hacked going out of business within 6 months of the attack (*source: National Cybersecurity Alliance*).

The market for Backup-as-a-Service (BaaS) providers such as DSE is massive and is forecast to grow at a 24% CAGR to US$22.2bn by 2025, whilst 84% of US companies don't backup their SaaS application data (*source: Allied Market Research*).

Potential M&A and inbound interest

With a number of corporate and strategic transactions taking place in the BaaS sector, we see DSE having the potential to undertake industry consolidation. Additionally, given its increasing growth profile and global exposure, DSE may also attract acquisitive interest from larger BaaS and cyber market competitors or participants.

SECTION 2: VALUATION

- In undertaking our valuation, we rely upon an equal weighting of:
  1) Target ARR multiple having regard to our comparable company analysis with respect to ASX-listed companies.
  2) Cashflow based valuation through a discounted cash flow (DCF) model.
- The output of our combined valuation methodologies produces our view on DSE's valuation and 12-month Price Target of $0.28 per share.

2.1 Target ARR multiple (comparable peers' analysis)

- DSE has exposure to a variety of industry segments and businesses requiring cloud backup and archiving services.
- We note the business model is most broadly exposed to SaaS-based software providers and have conducted our comparable analysis on this basis.
- We have built a domestic comparable peers table that is based upon the following:
  - Software and recurring earnings-based business models.
  - Variety of domestic and international levers.
  - High margin companies at scale.
  - Diverse range of sectors, with many exhibiting above market growth.

Figure 1: Peers table

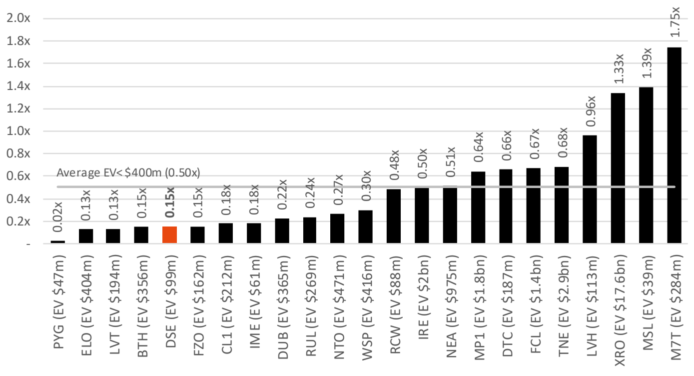
Company	Sector / focus	Last price	Market cap	EV	EV/ARR		ARRG[1]	EV/Sales			EV/EBITDA		
					Latest	YoY Δ		FY	FY+1	FY+2	FY	FY+1	FY+2
Dropsuite	**Data backup solutions**	**$0.18**	**$102m**	**$99m**	**11.7x**	**77.8%**	**0.15x**	**14.1x**	**8.9x**	**5.9x**	**na**	**na**	**77.2x**
9 Spokes	Data mgmt software	$0.02	$31m	$26m	**6.6x**	**(11.1%)**	**na**	3.5x	2.8x	1.9x	na	89.2x	15.3x
Altium[2]	Software solutions	$26.82	$3.5bn	$3.4bn	**66.0x**	**(4.7%)**	**na**	13.3x	13.6x	12.0x	38.1x	36.5x	31.8x
Bigtincan	Sales and marketing	$0.91	$376m	$356m	**7.4x**	**49.4%**	**0.15x**	8.8x	6.5x	5.2x	na	na	na
Catapult	Sports solutions	$1.90	$381m	$347m	**13.3x**	**(1.5%)**	**na**	3.5x	3.8x	3.2x	35.5x	31.3x	20.2x
Class[2]	SMSF software	$1.73	$213m	$212m	**4.3x**	**24.6%**	**0.18x**	4.3x	4.2x	3.7x	10.2x	10.2x	8.9x
Damstra[2]	Workforce mgmt	$1.12	$209m	$187m	**16.0x**	**24.3%**	**0.66x**	7.2x	6.8x	5.0x	na	31.3x	18.5x
Dubber[2]	Call recording software	$1.66	$424m	$365m	**22.7x**	**101.3%**	**0.22x**	30.9x	17.5x	9.9x	na	na	na
Elmo	HR technology	$5.23	$467m	$404m	**5.4x**	**42.7%**	**0.13x**	7.1x	5.9x	4.5x	na	na	na
Family Zone[2]	Cyber safety software	$0.46	$178m	$162m	**14.4x**	**94.8%**	**0.15x**	17.0x	11.5x	5.7x	na	na	na
FINEOS[2]	Software solutions	$4.56	$1.4bn	$1.4bn	**23.6x**	**35.1%**	**0.67x**	7.8x	8.9x	8.0x	94.2x	111.8x	72.1x
ImExHS	Healthcare software	$2.19	$66m	$61m	**6.0x**	**33.0%**	**0.18x**	3.9x	4.1x	2.9x	na	na	26.2x
IRESS[2]	Fintech software	$9.36	$1.8bn	$2bn	**4.0x**	**8.1%**	**0.50x**	3.6x	3.2x	3.0x	14.7x	13.8x	12.9x
LiveHire	HR technology	$0.44	$131m	$113m	**28.8x**	**30.0%**	**0.96x**	27.6x	20.8x	11.4x	na	na	na
LiveTiles	HR technology	$0.23	$205m	$194m	**3.0x**	**22.8%**	**0.13x**	4.5x	3.4x	2.3x	na	173.4x	13.6x
Mach7	Healthcare software	$1.23	$288m	$284m	**27.8x**	**15.9%**	**1.75x**	16.0x	12.1x	9.3x	na	98.6x	32.3x
Megaport	Software solutions	$11.98	$1.9bn	$1.8bn	**24.0x**	**37.4%**	**0.64x**	25.1x	21.9x	15.5x	na	na	266.1x
MSL Solutions	Sales and marketing	$0.12	$40m	$39m	**2.2x**	**1.6%**	**1.39x**	1.8x	na	na	19.0x	na	na
Nearmap	Software solutions	$2.15	$1.1bn	$975m	**9.2x**	**17.9%**	**0.51x**	8.6x	8.5x	7.2x	47.8x	50.5x	40.9x
Nitro[2]	Software solutions	$2.62	$530m	$471m	**17.0x**	**64.0%**	**0.27x**	7.6x	7.7x	6.5x	na	na	na
PayGroup	HR technology	$0.67	$55m	$47m	**2.6x**	**111.9%**	**0.02x**	2.9x	na	na	32.6x	na	na
RightCrowd	Workforce mgmt	$0.40	$89m	$88m	**31.3x**	**64.7%**	**0.48x**	7.0x	na	na	na	na	na
RPMGlobal	Mining solutions	$1.29	$296m	$269m	**14.6x**	**61.4%**	**0.24x**	4.0x	3.6x	2.9x	82.4x	29.8x	24.1x
Technology One[2]	Software solutions	$9.35	$3bn	$2.9bn	**21.9x**	**32.0%**	**0.68x**	9.7x	9.1x	8.4x	27.2x	24.0x	20.8x
Whispir[2]	Telco software	$3.69	$431m	$416m	**8.8x**	**29.2%**	**0.30x**	8.5x	7.9x	6.3x	na	na	na
Xero	Accounting software	$117.74	$17.3bn	$17.6bn	**20.0x**	**15.0%**	**1.33x**	22.6x	17.8x	14.6x	91.9x	71.6x	52.0x
Peers (all)													
Average					**16.0x**	**36.0%**	**0.52x**	10.3x	9.2x	6.8x	44.9x	59.4x	43.7x
Median					**14.4x**	**30.0%**	**0.39x**	7.6x	7.8x	6.0x	35.5x	36.5x	24.1x
DSE premium/(discount) to peers (all)													
Premium/(discount) to average					**(26.9%)**	**41.8%**	**(71.3%)**	37.5%	(2.9%)	(13.5%)	na	na	76.6%
Premium/(discount) to median					**(18.4%)**	**47.8%**	**(61.6%)**	86.9%	13.8%	(2.5%)	na	na	219.8%
Peers (EV <$400m)													
Average					**13.4x**	**41.5%**	**0.50x**	9.5x	8.1x	5.3x	36.0x	66.2x	19.9x
Median					**13.3x**	**30.0%**	**0.22x**	4.5x	5.4x	4.4x	32.6x	31.3x	19.3x
DSE premium/(discount) to peers % (EV <$400m)													
Premium/(discount) to average					**(12.4%)**	**36.3%**	**(69.9%)**	48.3%	10.0%	11.2%	na	na	288.0%
Premium/(discount) to median					**(11.9%)**	**47.8%**	**(32.7%)**	214.5%	66.2%	34.9%	na	na	298.9%

[1] ARRG refers to "average recurring revenue growth" and is a proxy for the more traditional PEG ratio (price earnings to growth); [2] Under coverage by Shaw and Partners

Source: FactSet consensus estimates, company announcements, Shaw and Partners analysis

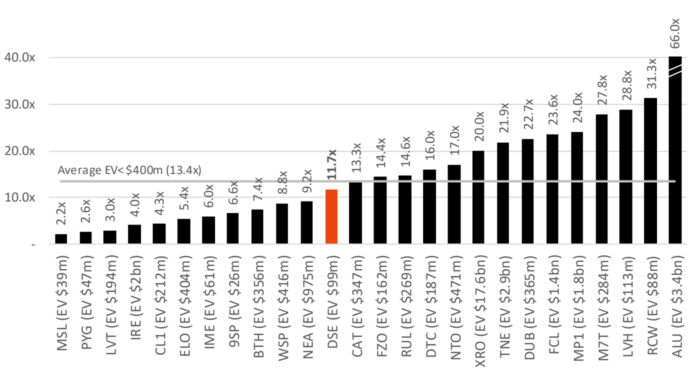
- In general, we note the following:
  - DSE is trading at a historical EV/ARR multiple of 11.7x, which represents a 26.9% discount to the peer group's latest average historical EV/ARR multiple of 16.0x.
  - Nonetheless, Shaw prefers to place a greater weighting towards its own ARRG methodology (annual recurring revenue to growth ratio). We view ARRG as a proxy or replacement for the more traditional PEG ratio (price/earnings to growth ratio). **DSE's ARRG ratio is 0.15x, which represents a 71.3% discount to the peers' average and a 69.9% discount to the average of peers with an EV <$400m.**
  - Some of the peers' ARR growth profiles includes acquisitive contributions and therefore may appear more attractive compared to businesses with higher levels of organic ARR growth. Additionally, some peers may also have non-recurring revenue, which is reflected in their respective EV/Sales multiple.
  - Although off a smaller base, we note DSE's ARR is growing materially faster than the peer group. ARR grew 77.8% YoY in FY20 on a constant currency basis, versus peers' which grew at an average 36.0%.
  - In general, DSE is at an earlier stage of revenue generation and sales cycle conversion than the selected peers in our view.

Figure 2: ARRG multiple (ranked) – lower = more attractive



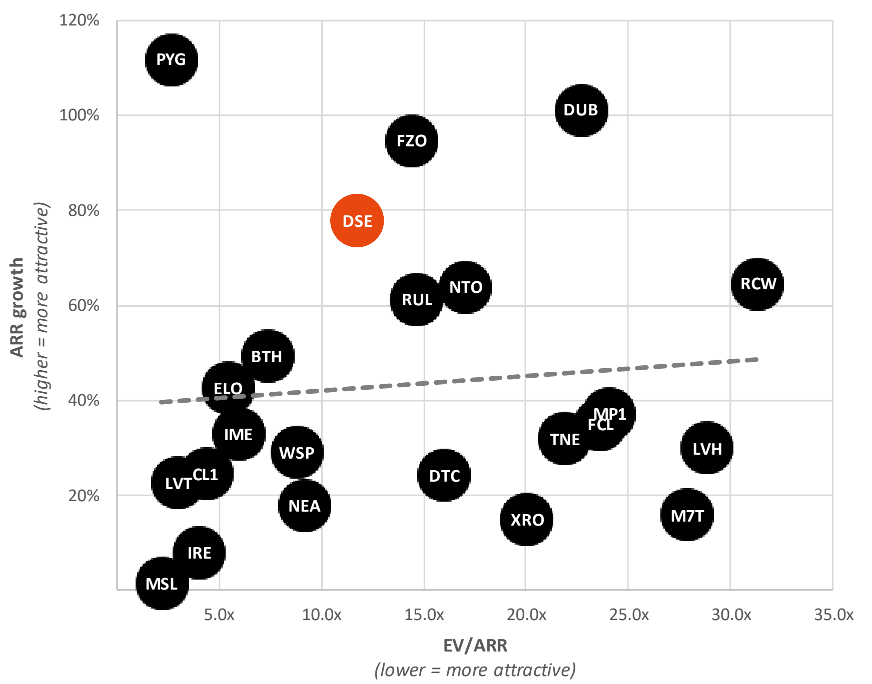
Source: FactSet, company announcements, Shaw and Partners analysis

Figure 3: EV/ARR multiple (ranked) – lower = more attractive



Source: FactSet, company announcements, Shaw and Partners analysis

Figure 4: EV/ARR and ARR growth matrix (excludes negative ARR growth companies)



Source: FactSet, company announcements, Shaw and Partners analysis

- We have applied what we view as a relatively conservative forward multiple of 7.5x to DSE's FY23e ARR in order to account for lower (although moderate) growth and a level of maturity in the group's operations.
- We note that our forward EV/ARR multiple assumption of 7.5x represents a significant discount to DSE's current historical trading multiple of 11.7x.
- Recurring revenue-based peers typically trade at higher multiples with respect to ARR arising from organic growth (distinct from inorganic or acquired ARR).
- We see DSE as having an above average organic ARR growth profile over our forecast horizon versus ASX listed peers.
- In order to derive the output for DSE's valuation of $0.26 per share on an ARR multiple basis, we applied a conservative ARR multiple of 7.5x on FY23e ARR of $29.0m, discounted at our WACC of 11.4% (refer to **Figure 7** for assumptions).

Figure 5: Target ARR assumptions and output

Variable	Value
FY23e ARR	$29.0m
Target ARR multiple	7.5x
Enterprise value (EV)	**$217.7m**
Net (debt)/cash	$7.6m
Fully diluted shares	607.0m
Value per share	$0.35
Time	2.8 years
WACC	11.4%
Valuation (per share)	**$0.26**

Source: Shaw and Partners analysis

Figure 6: Target ARR sensitivity analysis

ARR (FY23e) \ Exit ARR multiple (FY23e)	6.0x	6.5x	7.0x	7.5x	8.0x	8.5x	9.0x
$25.2m	$0.18	$0.19	$0.21	$0.22	$0.24	$0.25	$0.27
$26.4m	$0.18	$0.20	$0.22	$0.23	$0.25	$0.26	$0.28
$27.6m	$0.19	$0.21	$0.23	$0.24	$0.26	$0.28	$0.29
$29.0m	$0.20	$0.22	$0.24	$0.26	$0.27	$0.29	$0.31
$30.5m	$0.21	$0.23	$0.25	$0.27	$0.29	$0.31	$0.32
$31.9m	$0.22	$0.24	$0.26	$0.28	$0.30	$0.32	$0.34
$33.4m	$0.23	$0.26	$0.28	$0.30	$0.32	$0.34	$0.36

Source: Shaw and Partners analysis

2.2 Discounted cash flow (DCF)

- In formulating our DCF we undertake ~10 years of financial forecasts and apply a terminal value to our valuation to form our DCF output.
- We expect that DSE has the potential to deliver 50%+ EBITDA margins at scale. We note that incremental gross profit is approaching a ceiling of ~70% in our view, with the majority of leverage being delivered at the operating expenses level.
- We present our DCF key assumptions, output and sensitivity in the below figures.

Figure 7: DCF assumptions and output

Variable	Value
Cost of equity	12.3%
Cost of debt (post tax)	5.3%
WACC	**11.4%**
Inflation	2.5%
Terminal growth rate	2.5%
Operational NPV	$187.1m
Net cash (debt)	($2.1m)
Total NPV	$185.0m
Fully diluted shares on issue	607.0m
Valuation (per share)	**$0.30**

Source: Shaw and Partners analysis

Figure 8: DCF sensitivity analysis

Terminal growth \ WACC	9.9%	10.4%	10.9%	11.4%	11.9%	12.4%	12.9%
1.0%	$0.35	$0.32	$0.30	$0.28	$0.26	$0.24	$0.23
1.5%	$0.36	$0.33	$0.31	$0.28	$0.26	$0.25	$0.23
2.0%	$0.37	$0.34	$0.32	$0.29	$0.27	$0.25	$0.24
2.5%	$0.39	$0.36	$0.33	$0.30	$0.28	$0.26	$0.24
3.0%	$0.41	$0.37	$0.34	$0.32	$0.29	$0.27	$0.25
3.5%	$0.43	$0.39	$0.36	$0.33	$0.30	$0.28	$0.26
4.0%	$0.46	$0.41	$0.38	$0.34	$0.31	$0.29	$0.27

Source: Shaw and Partners analysis

- A key tenement in our investment thesis and forecasts is that the group has invested materially in growth resources, international investment and product capabilities.
- We expect DSE to continue investing and reaching profitability by FY22e across an accelerated growth profile.
- The net result of our DCF is a valuation of $0.30 per share. This is fully diluted and inclusive of all options and performance rights outstanding.

2.3 Valuation conclusion

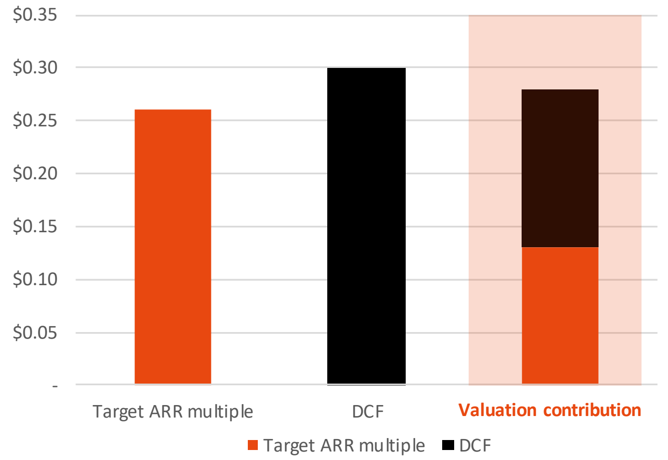
- We elect to utilise an equal weighting of the multiple of ARR and DCF methodologies to derive our valuation. The net result is a valuation and 12-month Price Target of $0.28 per share, which supports our recommendation of Buy with High Risk.
- In general, we see our valuation as supported by the following:
  - Valuation broadly in line with the peer group ARR multiples, however DSE is growing at a material premium to comparables.
  - Globally significant operations being accelerated by Covid as a change event, which we see as likely accelerant to material User and ARR growth over the medium to long term.
  - Further investor interest over time as market capitalisation, scale and profile rises.
  - Likely robust gross and EBITDA margins at scale.

Figure 9: Valuation summary table

Method	Valuation	Weight	Value
Target ARR multiple	$0.26	50%	$0.13
DCF	$0.30	50%	$0.15
Valuation (per share)			**$0.28**

Source: Shaw and Partners analysis

Figure 10: Valuation summary chart



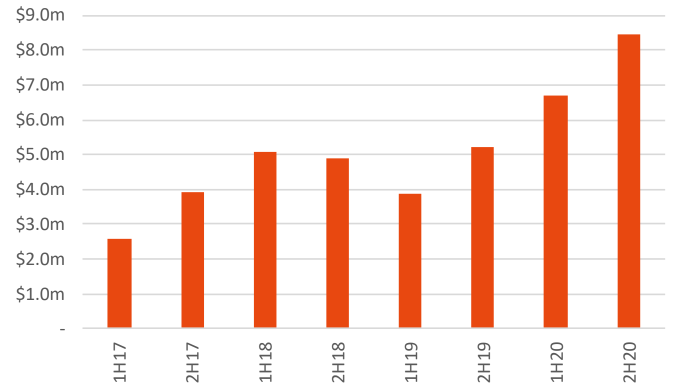
Source: Shaw and Partners analysis

SECTION 3: BUSINESS OVERVIEW

3.1 Products, solutions and revenue model

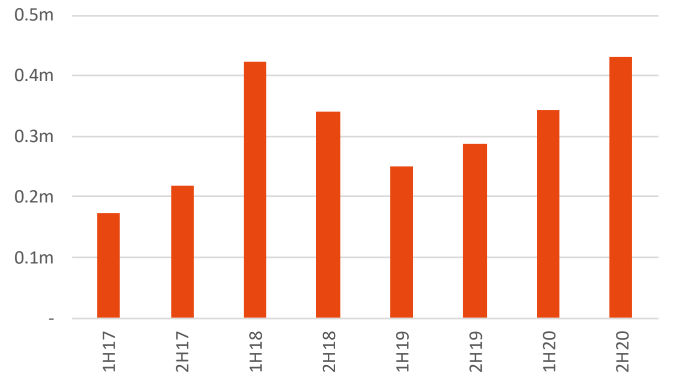
- DSE offers a cloud-based software solution which enables organisations globally to easily backup, recover and protect their important business information.
- DSE operates in the Backup-as-a-Service (BaaS) market. BaaS providers connect organisations to cloud solutions in order to perform backups, replacing on-premise alternatives which typically require resource intensive IT teams.
- Distribution of DSE's solutions is undertaken predominantly through Channel Partners or resellers who typically earn a margin of ~20% - 30% on sales, with the company delivering its products through 318 Partners (as at January 2021).
- DSE is currently delivering AU$8.5m in ARR (at Dec-20), which is primarily made up of revenues from SME Users.
- The business has experienced rapid growth and adoption across its product suite, in particular Office 365 backup, G Suite Gmail backup and email archiving.
- Further opportunities to expand the User base exist, including launch of the large Enterprise offering commencing in the second half of 2022, increased application functionality (i.e. the potential for Slack, Salesforce or other CRM applications), data governance and business continuity.

Figure 11: DSE – annual recurring revenue (ARR)



Source: Company data & Shaw and Partners

Figure 12: DSE – number of Users



Source: Company data & Shaw and Partners

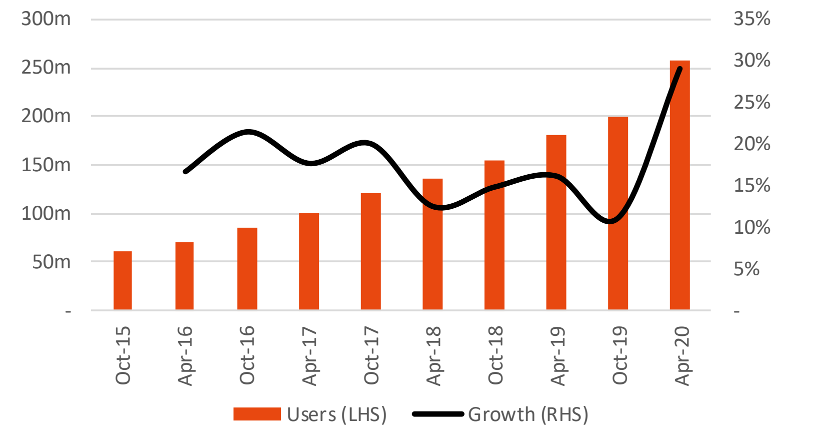
- A summary of DSE products and solutions is presented below, followed by more fulsome key product discussion on subsequent pages:

Product / solution	Functionality and use case
Office 365 Backup	Backup for various Microsoft Office 365 applications
G Suite Backup	Backup engineered for 100% data protection and recovery
Compliance	Automation of archiving for regulatory/legal compliance
eDiscovery	Tools for legal proceedings and regulatory compliance
Insights BI	Transform email data sets into actionable reports
Ransomware	Fully recoverable copies of business data
Email Backup	Protect and recover business critical email data
Email Archive	Preserve and search emails for fast retrieval
Website Backup	Backup, recover, monitor and protect website data

Microsoft Office 365 Backup

- Microsoft does not guarantee retrieval of content or data across their Office 365 suite. Instead, Microsoft recommends using third-party backup solutions in order to provide coverage for this deficiency.
- Human error is the main cause of cyber security breaches and may occur as a result of phishing scams or other events. Office 365 data is susceptible to deletion, corruption or being held hostage by ransomware.
- Microsoft's Office 365 product suite has significantly risen in popularity, especially since the proliferation of Covid and the work-from-home (WFH) phenomenon.
- Office 365 Backup by DSE covers a range of applications including Exchange Online, OneDrive, SharePoint, Groups, Teams, calendars, contacts and tasks.

Figure 13: Number of Office 365 active users

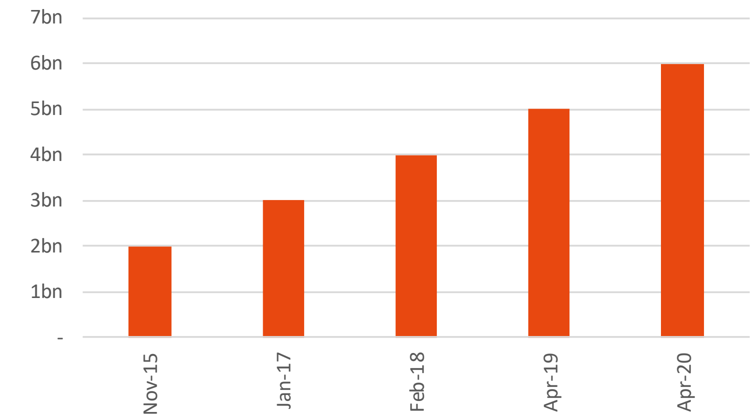


Source: Microsoft

G Suite and Email Backup

- DSE's Email and G Suite Backup solutions ensure critical business email data is backed up safely and securely.
- Despite the assumption by many users, Google does not automatically back up their users' data. This means that accidental or malicious loss of G Suite or Gmail data may lead to the loss of business-critical information or data. DSE's solution can assist with the backup and restoration of such data.
- Equally, email data loss caused by user error, hacking and malicious deletion can result in the loss of critical business information.
- Additionally, regulated industries including finance, healthcare and legal services require higher grade archiving from specialised solutions providers such as DSE.
- With numerous large-scale hacking events, backup and security have become increasingly important. The SolarWinds event which took place in 2020 was arguably the largest and most sophisticated attack ever experienced, which saw hackers gain access to organisations including the US commerce and Treasury departments.
- In today's digital age alongside greater reliance on technology and increasingly sophisticated attacks, experts have posited that it's no longer about if you'll be hacked, it's about when.

Figure 14: Number of paid G Suite accounts



Source: Google, Statista

Email Archive

- DSE's Email Archive solution is cloud-based and helps organisations store, safeguard, manage and discover data from various email systems. Emails, attachments, calendars and related files are archived through DSE's solution, ensuring reliable storage.
- The Email Archive solution also provides a compliance module which is appealing for companies in regulated industries, such as healthcare and finance. This allows businesses to store and search on several years' worth of email and other data for discovery or investigative purposes.
- Archiving is conducted in addition to backup and includes powerful search functionality and business intelligence (BI) insights to assist with potential legal cases, customer complaints, regulatory requirements or audits. all emails are:
  - Securely backed up.
  - Professionally archived and searchable.
  - Discoverable and accessible.

Website Backup

- DSE's Website Backup is a cloud-based website, database backup and monitoring service that securely backs up, recovers, monitors and protects website data. The solution is cloud-based and boasts military-grade security.
- Features of Website Backup include:
  - Automated backup and AES 256-bit encryption through secure cloud servers.
  - Migrate and restore data.
  - Blacklist monitoring.
  - Monitor site availability.
  - One-click restore.
  - Ransomware protection.

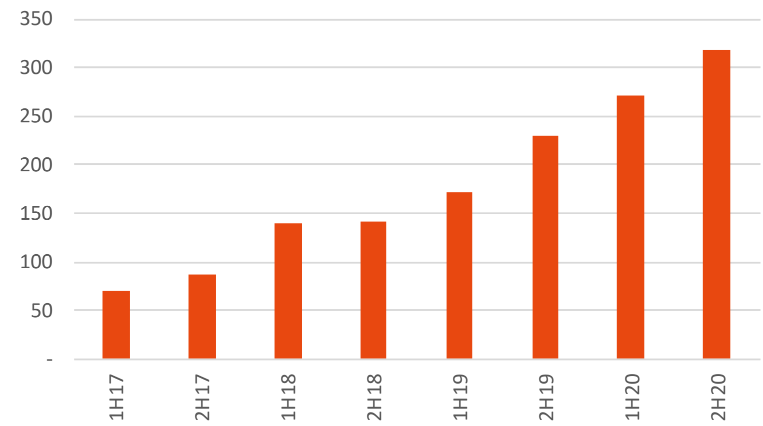
3.2 Channel Partners

- DSE operates under a partnership model whereby Channel Partners are responsible for distributing and provisions DSE products and services.
- A Managed Service Provider (MSP) is a technology services vendor that acts as an outsourced IT department, delivering a range of IT services via monthly or annual contracts, which are usually priced on a per seat basis. MSPs are tasked with selection, procurement, management and implementation of technology stacks for their customers.
- SME's are a core user of MSP services, as they are typically resource constrained and therefore rely on an outsourced style IT model. This allows SMEs to focus on running their business and is characterised by predicable IT expenditure on an operating basis. Given the proliferation of technology, SaaS adoption and the work from home (WFH) phenomenon, the MSP model has gained further traction.
- DSE utilises Partners for distribution, whilst focussing its own resources on training, marketing, technical support, development and product enhancements.
- IT expenditure consumes an average 14% of SMEs' total budget, with an average spend of $117 per employee (*source: Datto*).

Figure 15: Sample of DSE Channel Partners

Source: Company data

Figure 16: Number of DSE Channel Partners



Source: Company data & Shaw and Partners

3.3 The DSE competitive advantage

- Whilst there are several backup solution providers in market, not all are created equal and typically compete across the following categories:
  - User interface ease of navigation.
  - East of Partner integration.
  - Encryption level or grade.
  - Value for money.
  - Customer service.
  - Features and functionality.
  - Ease of set up, speed and reliability.
- DSE was named a gold medallist and the leading Email Backup Solutions provider in SoftwareReviews Data Quadrant survey in May 2020, ranking above several larger competitors.

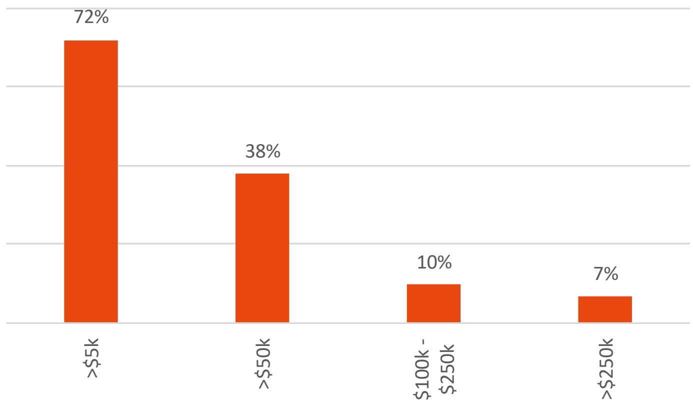
Figure 17: DSE is a leading Backup Solutions provider

Source: SoftwareReviews – Data Quadrant May 2020

3.4 Product and solutions use case

- The use cases of DSE products and solutions are plentiful and varied. Across the company's spectrum of products, use cases extend to disaster recovery, data restoration, regulatory compliance (i.e. GDPR), functionality for document discovery and business efficiency.
- We highlight some statistics across cyber-attacks to underscore the importance of cloud focussed backup solutions:
  - 30,000 websites are hacked every day (*source: WebARX*).
  - 40% of SMEs that manage their own network will have their network accessed by a hacker, and more than 50% won't even know they were attacked (*source: Gartner Group*).
  - Cyber-attacks can prove catastrophic; 60% of SMEs that are hacked go out of business within six months of the attack (s*ource: National Cybersecurity Alliance*).
  - 200,000 privacy breach cases reported in first year of General Data Protection Regulation (*GDPR*) regulation (*source: The Register*).
- The financial repercussions of cyber-attacks are vast, with 53% of US businesses reporting a cyber-attack in the past year, with 7% spending >$250k in response (*source: Insurance Journal*).

Figure 18: Spending by bucket in response to ransomware and cyber attacks



Source: Insurance Journal

SECTION 4: KEY ASSUMPTIONS AND FINANCIALS

We model DSE on a quarterly basis and utilise several drivers including number of Users, ARPU and churn to generate our financial forecasts. We model DSE over 10 financial years and see our assumptions in general as being conservative, particularly in the context of the deep global opportunity.

Figure 19: Key assumptions and forecasts

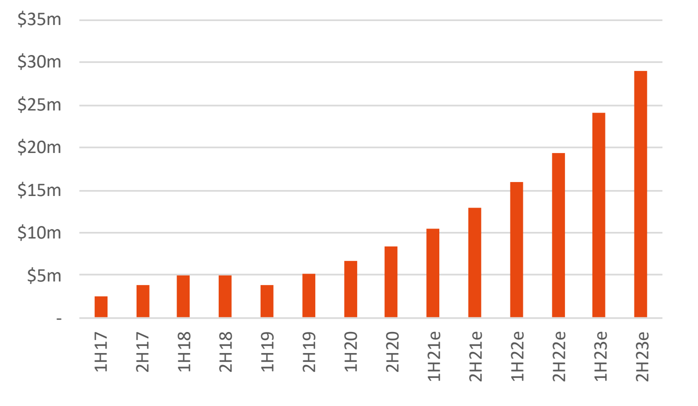
		FY17 Dec17	1H18 Jun18	2H18 Dec18	FY18 Dec18	1H19 Jun19	2H19 Dec19	FY19 Dec19	1H20 Jun20	2H20 Dec20	FY20 Dec20	1H21e Jun21	2H21e Dec21	FY21e Dec21	1H22e Jun22	2H22e Dec22	FY22e Dec22	1H23e Jun23	2H23e Dec23	FY23e Dec23
Core drivers																				
ARR																				
ARR (AUD)	*AUD*	**$3.9m**	$5.1m	$4.9m	**$4.9m**	$3.9m	$5.2m	**$5.2m**	$6.7m	$8.5m	**$8.5m**	$10.6m	$12.9m	**$12.9m**	$16.0m	$19.4m	**$19.4m**	$24.1m	$29.0m	**$29.0m**
ARR (USD)	*USD*	**$3.0m**	$3.8m	$3.5m	**$3.5m**	$2.7m	$3.6m	**$3.6m**	$4.6m	$6.4m	**$6.4m**	$7.9m	$9.7m	**$9.7m**	$12.0m	$14.5m	**$14.5m**	$18.1m	$21.8m	**$21.8m**
ARPU (monthly)																				
ARPU (AUD)	*AUD*	**$1.24**	$1.00	$1.20	**$1.20**	$1.28	$1.50	**$1.50**	$1.63	$1.64	**$1.64**	$1.72	$1.80	**$1.80**	$1.87	$1.93	**$1.93**	$1.97	$2.00	**$2.00**
ARPU (USD)	*USD*	**$1.14**	$0.75	$0.86	**$0.86**	$0.89	$1.04	**$1.04**	$1.13	$1.23	**$1.23**	$1.29	$1.35	**$1.35**	$1.40	$1.45	**$1.45**	$1.48	$1.50	**$1.50**
Users and Partners																				
Users	*m*	**0.22m**	0.42m	0.34m	**0.34m**	0.25m	0.29m	**0.29m**	0.34m	0.43m	**0.43m**	0.52m	0.60m	**0.60m**	0.72m	0.84m	**0.84m**	1.03m	1.22m	**1.22m**
Channel Partners	*#*	**87**	140	142	**142**	172	230	**230**	272	318	**318**	369	420	**420**	450	480	**480**	500	520	**520**
Financials																				
Profit and loss																				
Sales revenue	*AUD*	**$2.6m**	$1.9m	$3.4m	**$5.2m**	$2.3m	$2.4m	**$4.7m**	$3.2m	$3.8m	**$7.0m**	$5.0m	$6.1m	**$11.1m**	$7.6m	$9.3m	**$16.9m**	$11.5m	$13.9m	**$25.4m**
Gross profit	*AUD*	**$2.0m**	$1.5m	$2.5m	**$4.0m**	$1.6m	$1.4m	**$3.0m**	$2.0m	$2.5m	**$4.6m**	$3.3m	$4.0m	**$7.3m**	$5.0m	$6.1m	**$11.1m**	$7.6m	$9.2m	**$16.7m**
Underlying EBITDA	*AUD*	**($1.9m)**	($0.8m)	($0.2m)	**($1.0m)**	($1.1m)	($1.3m)	**($2.4m)**	($0.9m)	($0.8m)	**($1.7m)**	($0.5m)	($0.0m)	**($0.5m)**	$0.4m	$0.9m	**$1.3m**	$1.7m	$2.8m	**$4.5m**
Underlying NPAT	*AUD*	**($2.2m)**	($0.8m)	($0.4m)	**($1.3m)**	($1.5m)	($1.7m)	**($3.1m)**	($1.3m)	($0.9m)	**($2.1m)**	($0.5m)	($0.0m)	**($0.5m)**	$0.4m	$0.9m	**$1.3m**	$1.7m	$2.8m	**$4.5m**
Cashflow																				
Operating cashflow	*AUD*	**($4.1m)**	($0.7m)	($0.3m)	**($1.0m)**	($1.3m)	($0.7m)	**($2.0m)**	($1.3m)	($0.5m)	**($1.8m)**	($0.6m)	$0.2m	**($0.4m)**	($0.4m)	$1.7m	**$1.4m**	$0.8m	$3.4m	**$4.2m**
Free cashflow	*AUD*	**($4.6m)**	($0.9m)	($0.5m)	**($1.5m)**	($1.3m)	($0.8m)	**($2.1m)**	($1.3m)	($0.5m)	**($1.8m)**	($0.6m)	$0.2m	**($0.4m)**	($0.4m)	$1.7m	**$1.4m**	$0.8m	$3.4m	**$4.2m**
Balance sheet																				
Cash balance	*AUD*	**$5.0m**	$4.0m	$3.5m	**$3.5m**	$2.2m	$1.4m	**$1.4m**	$3.0m	$2.5m	**$2.5m**	$1.8m	$2.1m	**$2.1m**	$1.7m	$3.4m	**$3.4m**	$4.2m	$7.6m	**$7.6m**
Contributed equity	*AUD*	**$21.1m**	$21.1m	$21.1m	**$21.1m**	$21.1m	$21.1m	**$21.1m**	$24.0m	$24.0m	**$24.0m**	$24.0m	$24.0m	**$24.0m**	$24.0m	$24.0m	**$24.0m**	$24.0m	$24.0m	**$24.0m**
Financial ratios																				
Growth rates																				
ARR growth - AUD (YoY)	*%*	**118%**	98%	25%	**25%**	(24%)	6%	**6%**	74%	62%	**62%**	57%	52%	**52%**	52%	50%	**50%**	51%	50%	**50%**
ARR growth - USD (YoY)	*%*	**119%**	92%	17%	**17%**	(29%)	2%	**2%**	73%	78%	**78%**	71%	51%	**51%**	52%	50%	**50%**	51%	50%	**50%**
User growth (YoY)	*%*	**75%**	143%	56%	**56%**	(41%)	(16%)	**(16%)**	37%	49%	**49%**	51%	40%	**40%**	40%	40%	**40%**	43%	45%	**45%**
Revenue growth (YoY)	*%*	**94%**	65%	135%	**104%**	25%	(30%)	**(10%)**	37%	62%	**50%**	57%	60%	**59%**	52%	51%	**51%**	51%	50%	**50%**
Margins																				
Gross profit margin	*%*	**77%**	79%	75%	**77%**	68%	60%	**64%**	64%	66%	**65%**	66%	66%	**66%**	66%	66%	**66%**	66%	66%	**66%**
Underlying EBITDA margin	*%*	**(74%)**	(41%)	(6%)	**(19%)**	(47%)	(54%)	**(50%)**	(28%)	(20%)	**(24%)**	(10%)	(0%)	**(5%)**	5%	10%	**8%**	15%	20%	**18%**
Underlying NPAT margin	*%*	**(85%)**	(45%)	(13%)	**(25%)**	(63%)	(72%)	**(67%)**	(40%)	(23%)	**(31%)**	(10%)	(0%)	**(5%)**	5%	10%	**8%**	15%	20%	**18%**

Source: Company data & Shaw and Partners

4.1 Average recurring revenue (ARR) and statutory revenue

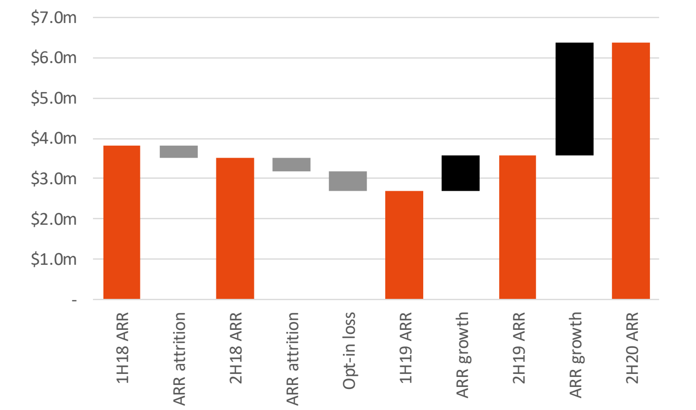
- DSE's ARR is determined by the number of Users across its product suite and is billed on a monthly subscription basis. DSE's 318 Partners are responsible for product provisioning, billing and support, and have a symbiotic relationship with DSE who assist with enablement including training, marketing and innovation.
- DSE is currently delivering AU$8.5m in ARR (at Dec-20), which is primarily made up of revenues from SME Users. On a constant currency basis (USD), DSE is currently generating US$6.4m in ARR (at Dec-20) which represents 77.8% YoY growth.
  - We note ARR comparisons on a constant currency basis or USD basis provide a more accurate representation of underlying performance, given >70% of revenue is derived from North America and therefore is collected in USD.
  - We assume an AUD/USD rate of $0.75 across our entire forecast spectrum.
  - We note that DSE reports on a December year-end basis.
- We forecast ARR reaching AU$12.9m, AU$19.4m and AU$29.0m in FY21e - FY23e respectively, representing YoY growth of 52.1%, 50.4% and 50.0% respectively.
- Our forecasts are underwritten on growth in SME Users given strong adoption across DSE's product suite, in particular Office 365 backup, G Suite Gmail backup and email archiving. We also assume marginal growth in ARPU as DSE's product suite is broadened and delivers incremental functionality improvements to end Users.
- We anticipate DSE to add larger enterprise solutions ("Enterprise") from 2H22e and as a result build in a level of ARR in our assumptions. Underpinning our estimates are ARPUs slightly lower than SME ARPU given likely discounting for larger Enterprise. We assume that Enterprise are businesses with >5,000 employees or Users.
- Additionally, our forecasts assume (albeit not discretely) a level of adoption from government cloud products, which we expect to launch during FY21e.

Figure 20: Annual recurring revenue (ARR) – AUD



Source: Company data & Shaw and Partners

Figure 21: Annual recurring revenue (ARR) waterfall – USD



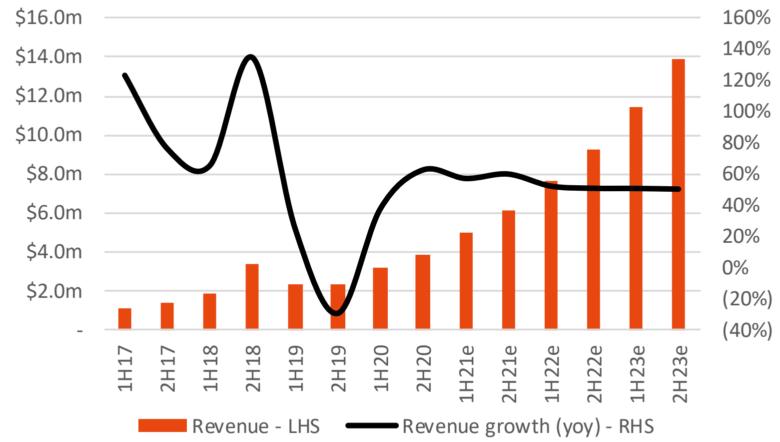
Source: Company data & Shaw and Partners estimates

- We note a level of attrition in ARR resulting from an event that occurred in October 2018 – see further discussion in **Section 4.3**.
- Peak ARR reported by DSE was AU$8.2m, alongside ARPU of AU$0.92 and 750k Users. After moderation of metrics following the decommissioning event in October 2018, we note stabilisation in June 2019 to ARR of AU$3.9m, ARPU of AU$1.28 and 0.25m Users.
- We see DSE as on track to continue its upward growth trajectory. We note QoQ growth across all key metrics for the past 6 quarters from Jun-19 to Dec-20, including ARR, ARPU, Users and Partners.
- With a renewed focus on Office 365 backup, email archiving and backup and G Suite backup, as well as growth opportunities in Enterprise, we see DSE as well placed to deliver an accelerating ARR profile.

Revenues

- Our assumption on revenues recognised from ARR is broadly in line with historical trends and results in revenues of AU$11.1m, AU$16.9m, AU$25.4m across FY21e – FY23e respectively.
- Our forecasts infer sales revenue growth of 58.6% in FY21e, 51.3% in FY22e and acceleration to 50.4% in FY23e.

Figure 22: Sales revenue and growth

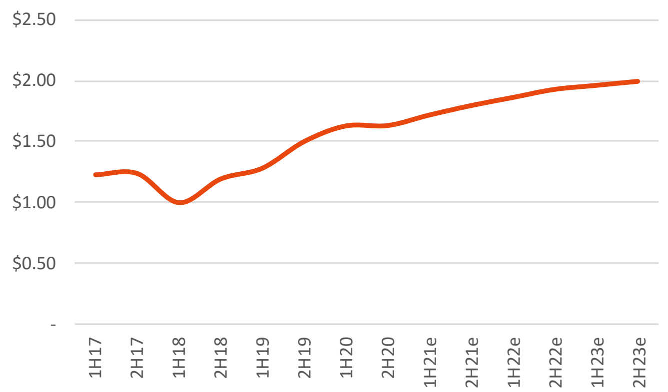


Source: Company data & Shaw and Partners

4.2 Average revenue per user (ARPU)

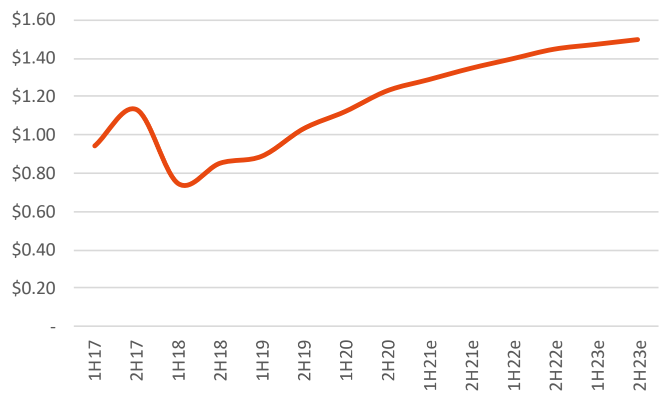
- In line with company reporting, we express ARPU on a monthly basis throughout this report, unless otherwise states.
- We understand that DSE have a range of ARPU profiles between ~AU$1.00 to ~AU$2.60 per user, depending on the mix of product and modalities subscribed. The net result is a current ARPU of AU$1.64 (at December 2020).
- ARPU has trended positively over the past two years growing from AU$1.20 to AU$1.64, up 25.8% and 8.8% YoY at December 2019 and December 2020 respectively. ARPU acceleration has occurred as a result of higher ARPU product mix, predominantly Office 365 backup which is a relatively recently launched and feature rich product.
- We forecast ARPU rising to AU$1.80 in FY21e (+10.1% YoY), AU$1.93 in FY22e (+7.4% YoY) and AU$2.00 in FY23e (+3.4% YoY) which is underwritten by our assumption of greater upsell from products such as email archiving, as well as the introduction of new data protection and other products.
- Our ARPU assumes a slightly lower ARPU for Enterprise users which sees some moderation in ARPU growth. We anticipate Enterprise Users from 2H22e, however present our forecasts on a blended basis.

Figure 23: Average revenue per user (ARPU) - AUD



Source: Company data & Shaw and Partners

Figure 24: Average revenue per user (ARPU) - USD

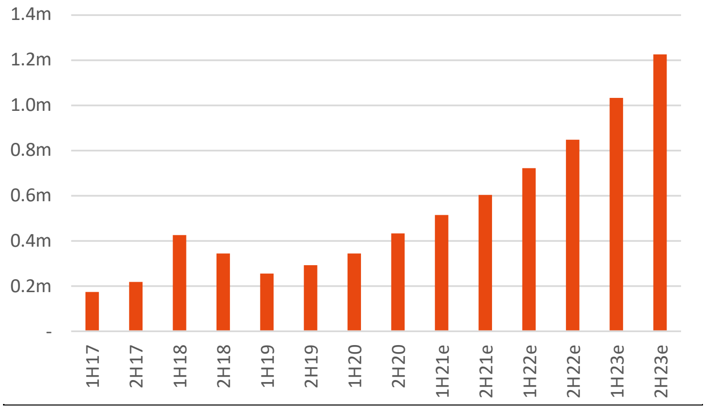


Source: Company data & Shaw and Partners

4.3 Users

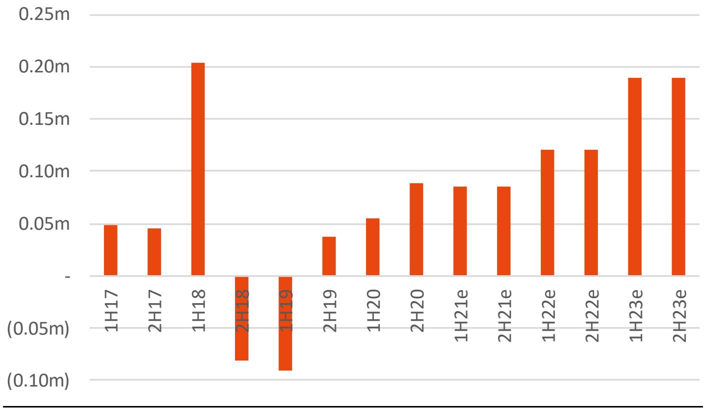
- We anticipate Users to grow from 0.43m at FY20 to 0.60m (+40.0% YoY) and 0.84m (+40.0% YoY) in FY21e and FY22e respectively.
- We assume 5% in annualised churn in Users, which is materially based upon churn from SME businesses discontinuing operations as opposed to switching backup providers. DSE's typical end user is currently a SME with an average of 25 Users or seats.
- In terms of Enterprise contribution (which we define as businesses with >5,000 employees or Users), we assume a material net benefit from 2H22e onwards which is built into our blended User forecast.

Figure 25: Number of Users



Source: Company data & Shaw and Partners

Figure 26: Net add rate in Users



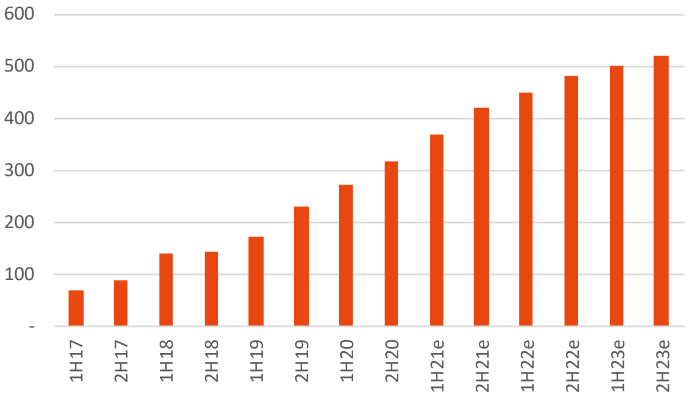
Source: Company data & Shaw and Partners

- We note the fall in Users (and therefore ARR) of 420k in October 2018 as a result of a LATAM-based partner deactivating email backup across its user base.
  - The cause of Users falling away was due to an opt-in campaign which was discontinued. This involved the Partner onboarding 500k Users with a monthly opt-in notice, however 420k users were decommissioned as they were deemed to not be actively utilising email backup services. A net 80k Users were retained.
  - Whilst we view this as somewhat of a misstep in reporting and disclosure by DSE, our understanding is that future events of a similar nature will not occur, as opt-in Users and ARR would be reported separately from core Users.
  - On the contrary, we view opt-in arrangements as an opportunity for significant user onboarding and would not discourage reliance on the practice, on the proviso that the company separately split out any such arrangements.
  - Our understanding and assumptions at the time of writing this report are that there are no widescale or outstanding opt-in arrangements across DSE's user base.

4.4 Channel Partners

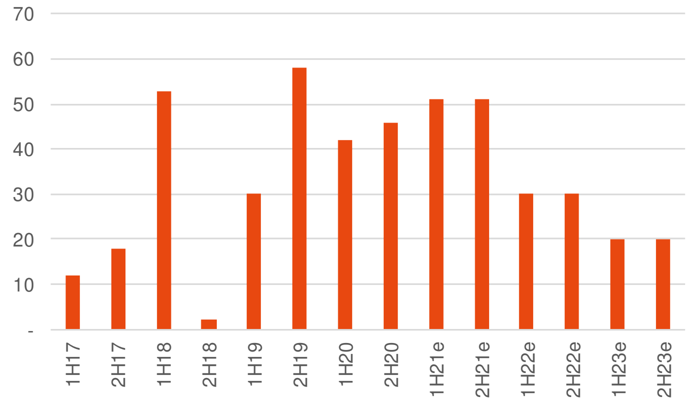
- DSE's business model is symbiotic in nature and relies upon signing on Channel Partners to resell products and services to SMEs. Distribution of DSE's products and solutions is undertaken predominantly through Channel Partners or resellers who typically earn a margin of ~20% - 30% on sales.
- DSE utilises Partners for distribution, whilst focussing its own resources on training, marketing, technical support, development and product enhancements.
- The company had 318 Partners as at FY20 (+38.3% YoY), with Shaw forecasting a further increase of 102 Partners to 420 in FY21e.
- We assume 3% in annualised churn, which is in line with the Partner churn disclosed by DSE at FY20.

Figure 27: Number of Partners



Source: Company data & Shaw and Partners

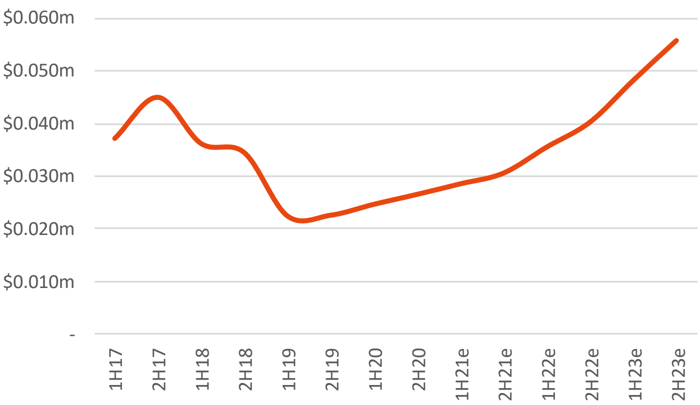
Figure 28: Net add rate in Partners



Source: Company data & Shaw and Partners

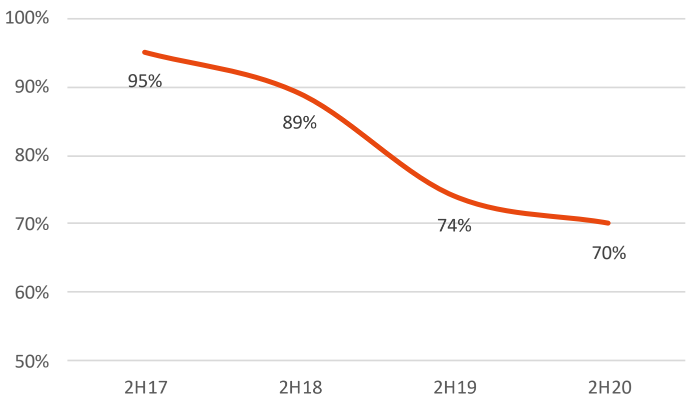
- Whilst Partner reach is important in terms of awareness and distribution, it is important to sign high quality Partners with an ability to create scale in DSE's User base.
- We focus on average ARR per partner, which rose to AU$27k at FY20. We expect this to rise as higher quality Partners increase distribution and number of paying Users, however, also anticipate an increase in Partners distributing DSE products and services.
- Importantly Partner revenue concentration has fallen to more reasonable levels. Concentration across the top 10 Partners was 95% in FY17, which we view as relatively risky in the context of the revenue sustainability, especially as we envisage a likely skew towards the top few Partners.
- Concentration in the top 10 Partners has fallen 25% from 95% in FY17 to 70% in FY20 as DSE continues to diversify and de-risk its partner base.
- We expect a continuation of this trend as the business continues to scale, offer additional products and services and expands its global footprint.

Figure 29: Average ARR per partner (AUD)



Source: Company data & Shaw and Partners

Figure 30: Top 10 Partner revenue concentration



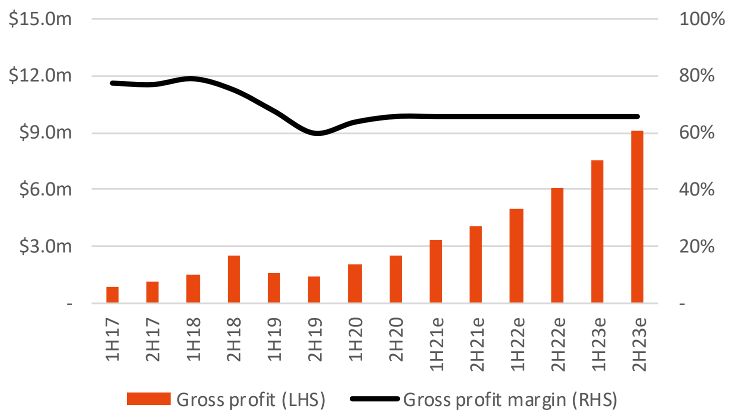
Source: Company data & Shaw and Partners

4.5 Operating performance

Gross profit and gross profit margins

- Gross margins on sales were 65.9% in FY20, showing improvement of 5.9% from FY19 as cost of sales declined in line with greater scale and improved purchasing from data centres providers.
- We note that DSE predominantly use Amazon Web Services (AWS) for their hosting arrangements.
- Gross margins peaked at 79.2% in FY18 as a result of a larger product mix in web hosting, however, have compressed as backup services have gained traction. Backup requires larger amounts of data storage and therefore partly eroded gross margins.
- We assume that gross margins are close to their long-term ceiling and therefore apply flat margins across our forecast spectrum. We view this as somewhat conservative, as DSE may gain access to further discounting as it achieves greater scale and adoption.

Figure 31: Gross profit and gross profit margins

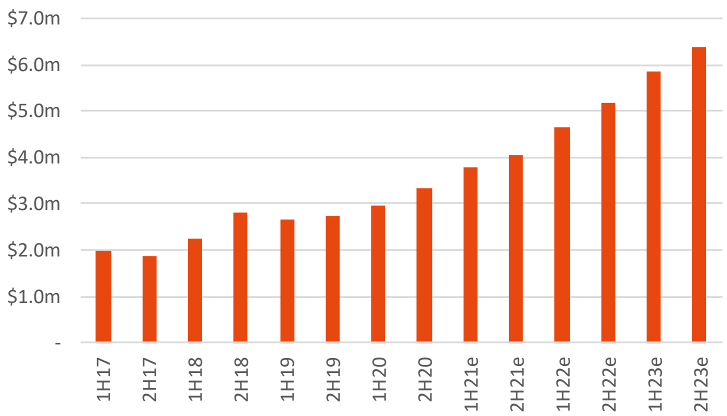


Source: Company data & Shaw and Partners

Operating expenses and EBITDA

- DSE's operating expense base has risen from $5.4m in FY19 to $6.3m in FY20, largely due to increases in employee expenses. Despite stabilisation in gross margins, we see DSE delivering operating leverage through a sticky and scalable operating expense base as ARR and revenues accelerate.
- Nonetheless, we expect incremental increases in the expense base of $1.6m to $7.9m in FY21e and a further $1.9m increase in FY22e to $9.8m.

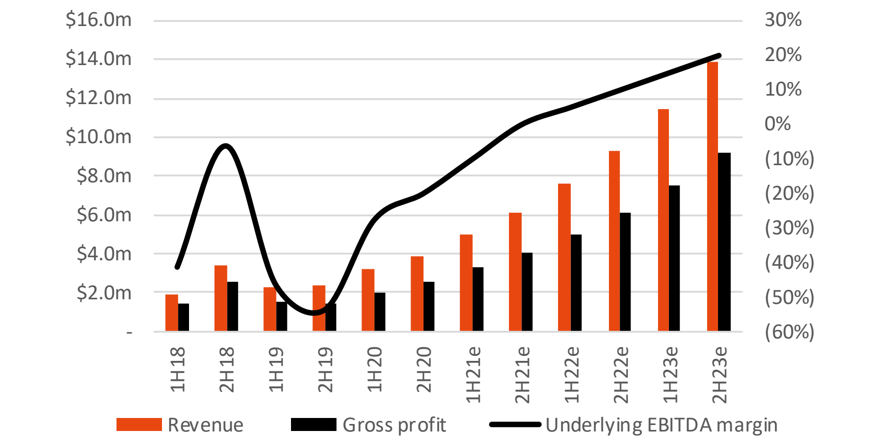
Figure 32: Operating expenses



Source: Company data & Shaw and Partners

- DSE has recorded underlying EBITDA losses since listing. Its latest result for FY20 was a loss of $0.8m on gross profit of $4.6m. We estimate DSE to reach approximately underlying EBITDA break even in 2H21e, before making underlying EBITDA profit from FY22e at $1.3m.
- Whilst growth is typically the core focus for early stage SaaS businesses, at some stage the focus must be shifted to profitability. DSE is showing signs of favourable unit economics that support the attainment of profits (at both the EBITDA and NPAT levels).
- We forecast further uplift in underlying EBITDA margins to 17.6% in FY23e as a result of synergies from scaled hosting costs and uptake of DSE's broader product suite.
- At scale, we anticipate DSE to produce healthy EBITDA margins of >50%, which is likely to be available on significant levels of ARR levels with lower growth. The business is likely to be highly profitable with strong and attractive incremental margins at scale.
- We also note that DSE now expenses its development costs, and has a nil balance for intangible assets, which we view as a more transparent approach to financial reporting.

Figure 33: Revenue, margins and underlying EBITDA

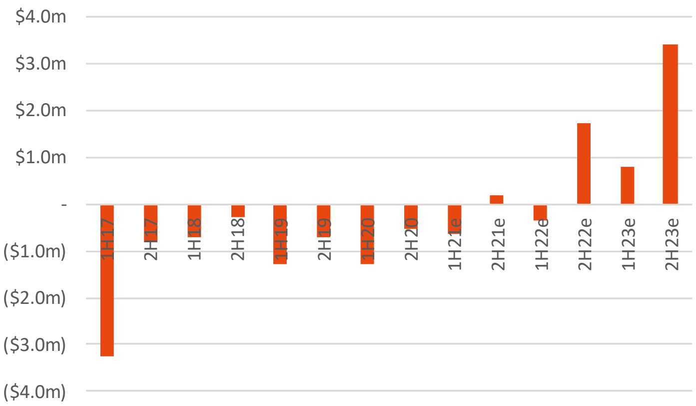


Source: Company data & Shaw and Partners

4.6 Balance sheet and cashflow

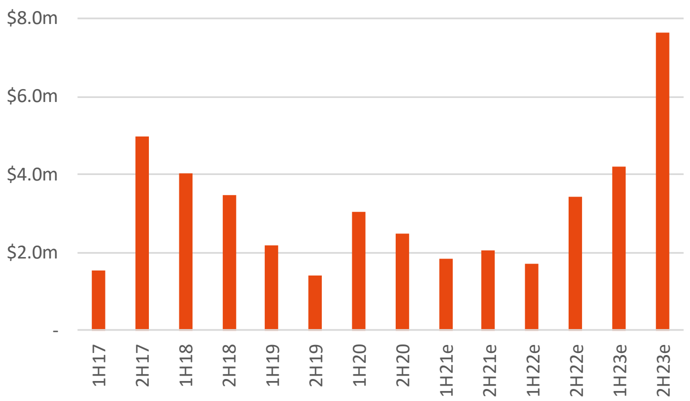
- We forecast DSE reaching positive operating and net cash flows from 2H21e, however note some levels of seasonality with a skew to higher cash flows in second half (DSE reports on a December year-end basis).
- After FY21e, we view the business reaching a favourable position with significant ARR which will sustain a considerable level of free cashflow for reinvestment into development, new product lines, user or Partner acquisition and potentially accretive acquisition opportunities.
- At December 2020, DSE had $2.5m cash on hand. With cash burn of $0.5m in 2H20 and a path to greater profitability, we do not envisage a need to raise capital in the short term. We do however note that DSE is on an aggressive expansion path in terms of user and Partner acquisition and is investing heavily in its infrastructure and functionality, therefore the possibility of a capital raising remains.

Figure 34: Operating cashflow



Source: Company data & Shaw and Partners

Figure 35: Cash balance



Source: Company data & Shaw and Partners

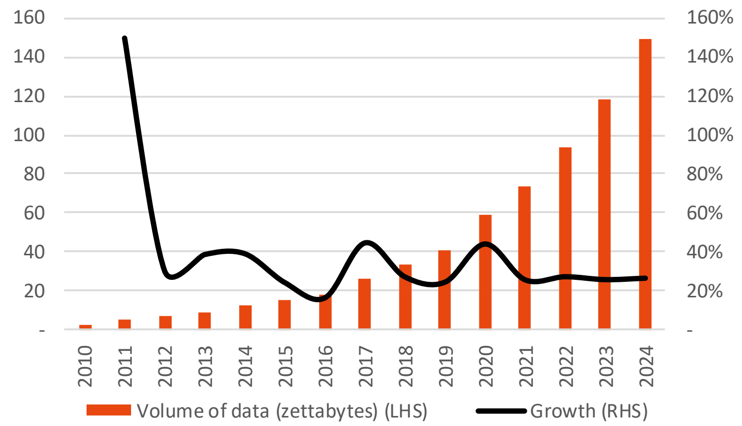
SECTION 5: INDUSTRY, MARKET AND COMPETITION

- DSE operates in the backup-as-a-service (BaaS) space via predominantly channel sales to small medium enterprises (SMEs) in multiple geographies across the world. DSE's products and solutions are currently deployed across 136 countries.
- The company's largest markets and focus include North America, Europe and APAC. North America represents the fastest growing market for DSE and is dominating the opportunity for the company.

5.1 The Backup-as-a-Service (BaaS) market

- BaaS offers a cost effective and low touch solution for organisations that are focussing on hyper growth and scale in their operations.
- The cloud backup and recovery software market has risen significantly from US$6bn in 2017 and is forecast to grow at a 24% CAGR to US$22.2bn by 2025 (*source: Allied Market Research*).
- Proliferation of work-from-home (WFH) and the digital workplace has resulted in an exponential rise in demand for predominantly SaaS-based service offerings.
- The sheer quantum of data being produced has also created a need to store, backup and protect sensitive information, especially in an environment where regulation and consumer protections are paramount.

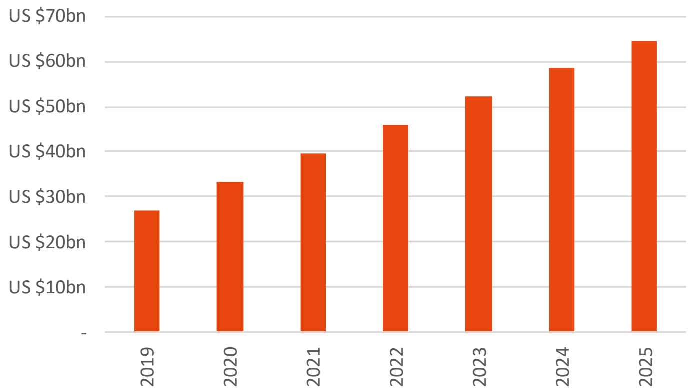
Figure 36: Volume of global data created, captured and consumed



Source: Statista

- With WFH employees often relying on their own devices as opposed to company managed devices, the efficacy and reliability of security is typically compromised.
- WFH employees are being targeted by phishing schemes due to their potentially limited capacity to identify and combat attacks. In this context, BaaS services provide an added layer of protection.
- SMEs are typically resource constrained, and lack sufficient in-house IT resources and expertise. With increasingly complex IT systems and competition, SMEs are becoming more dependent upon cloud-based applications to remain competitive and agile, which are typically provisioned by MSPs.

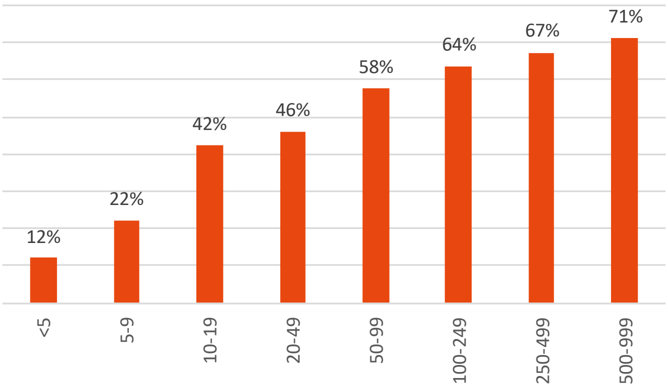
Figure 37: Managed Security Service Provider (MSSP) market



Source: Mordor Intelligence

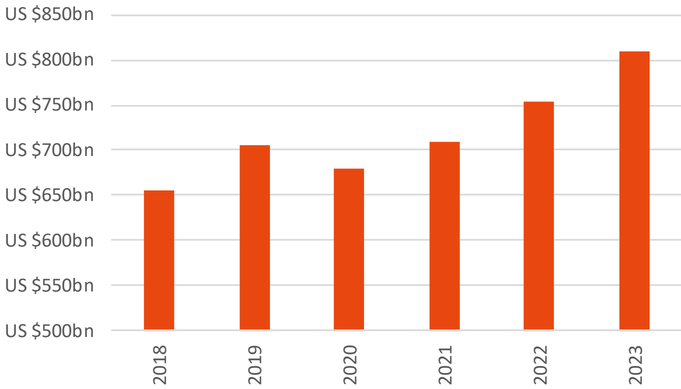
- Technologies previously deemed essential to large enterprise are now becoming the norm for SMEs and are typically being provisioned through MSPs. The typical revenue model sees MSPs receive a margin for distributing IT products and services, and are seen as an extension of, or entire IT department for many SMEs.
- As data protection needs rise, traditional on-premise backup solutions are increasingly difficult for SMEs to implement, with BaaS proving to be a superior alternative in several cases.

Figure 38: SMEs investing in Cloud solutions by number of employees



Source: International Data Corporation (IDC)

Figure 39: SME IT spending



Source: International Data Corporation (IDC)

5.2 Competitive landscape in the Backup-as-a-Service (BaaS) market

- The competitive landscape in the cloud backup and recovery software market is vast, with the market forecast to grow at a 24% CAGR to $22.2bn by 2025 (*source: Allied Market Research*).
- The market is relatively fragmented, with a number of software solutions providers marketing their products globally, predominantly through the use of Channel Partners or resellers.
- We note a high level of industry consolidation, M&A activity and potential IPO activity for a number of BaaS providers in the broader global market.
- DSE's solutions and products are award winning (refer to **Figure 17**), with differentiation or superiority to competing products across functionality, ease of use, pricing, customer service and user experience. DSE continues to invest ahead of growth and is constantly looking at ways to innovate and stay ahead of the curve.
- The following table presents a brief summary of some of DSE's competitors across its key market.

Figure 40: Competitive landscape in the cloud backup market

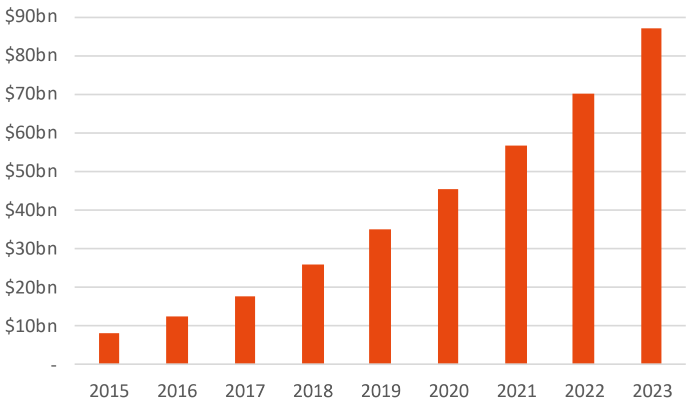
Company	Status	Users	Revenue (USD)	Valuation / MCap (USD)
Dropsuite	**Publicly listed (ASX)**	**430,000**	**$5.5m**	**$80m**
Acronis	Private - raised US$147m at >US$1bn valuation (Sep 2019)	5,500,000	na	>$1bn
AvePoint	Private - rumoured CY 1Q21 SPAC	7,000,000	$148m	$2bn
CloudAlly (a zix company)	Acquired by Zix Corp (NYSE)	250,000	$8m	$30m
Commvault	Private - US based	na	$711m	$3.2bn
datto	Publicly listed (NYSE)	1,000,000	$507m	$4.2bn
Own{backup}	Private - raised US$167.5m at US$1.4bn valuation (Jan 2021)	3,000	$50m	$1.4bn
skykick	Private - US based	na	$37m	na
Veeam	Acquired by Insight Partners (venture capital)	400,000	$1bn	$5bn
Veritas	Private - US based	50,000	$2bn+	na

Source: Company data, Crunchbase, Owler, Shaw and Partners, various other sources

5.3 The ever-expanding Cloud market

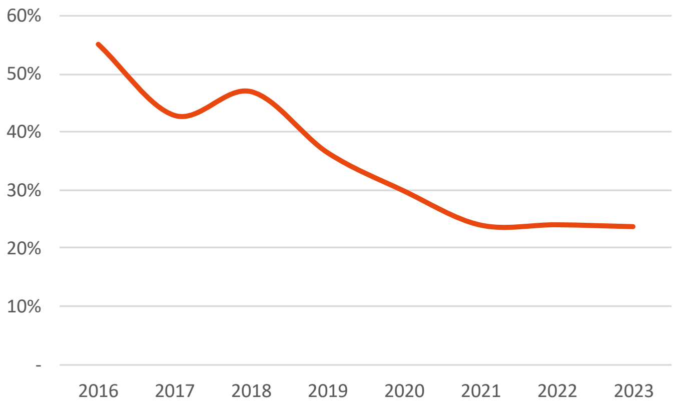
- DSE offers services via intermediaries which include some of the largest telecommunications and carrier businesses globally. These services are productised and offered via the public cloud and over Amazon Web Services (AWS) infrastructure.
- AWS is the market leader in providing infrastructure cloud services globally with over US$40bn in annual revenue and is forecast to continue growing >20% per annum. AWS infrastructure is global in nature and market leading.

Figure 41: Amazon Web Services revenue



Source: Amazon Web Services

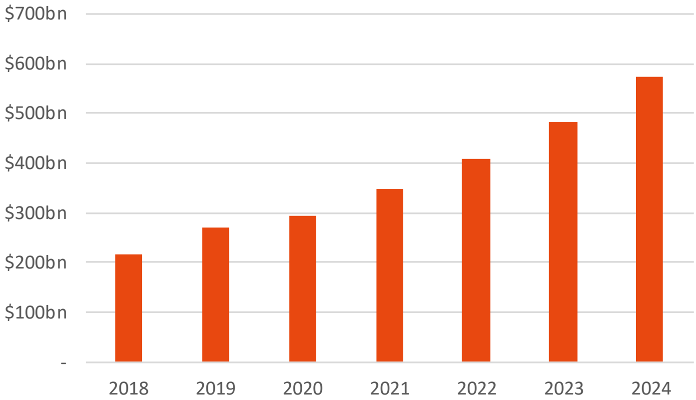
Figure 42: Annual growth rate in Amazon Web Services revenue



Source: Amazon Web Services

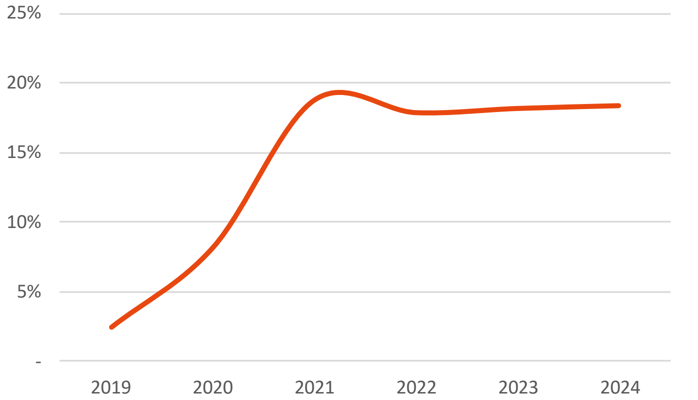
- DSE products are offered over the public cloud, which makes the product suitable for global markets and businesses.
- At a high level, public cloud is offsite hosting by a specialist provider, such as Amazon (AWS), Microsoft (Azure) or Google (GCP), within data centres that are extendable, global and generally pay as you go in nature.

Figure 43: Global public cloud market



Source: Gartner 2020

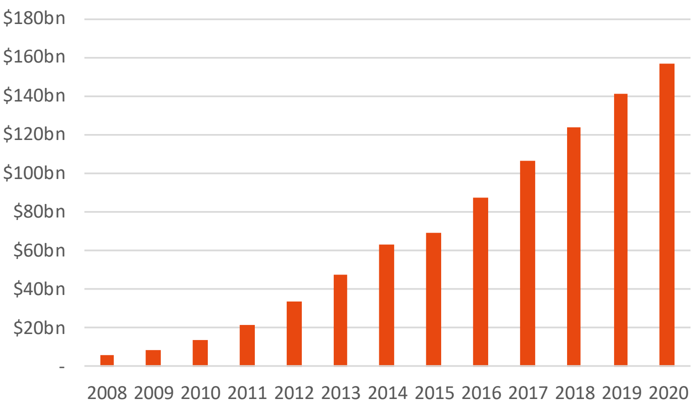
Figure 44: YoY growth rate in global public cloud market



Source: Gartner 2020

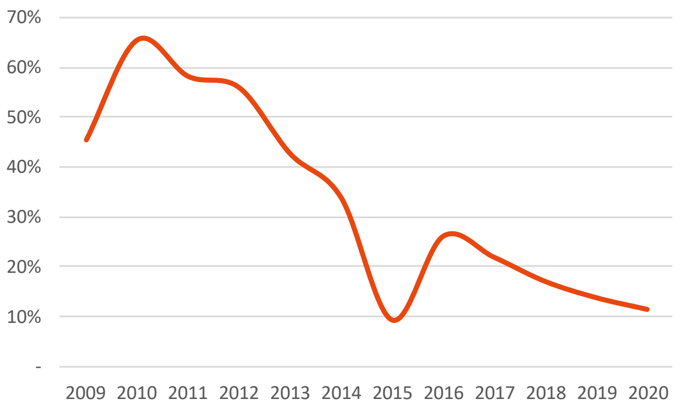
- In our view, public cloud has significant benefits over private cloud and on-premise solutions. These benefits include consumption being operating like in nature from a costs point of view, to being available globally with exponential extendibility. Our view is supported by industry data that indicates that in more mature regions globally public cloud is outpacing private cloud growth materially and taking share.
- Public cloud globally is a market of ~US$300bn in size and is predicted by Gartner to deliver an ~18% CAGR over the next 5 years. This equates to a significant opportunity for a range of products and services that range from infrastructure services to software as a service providers.
- In general, DSE products sit within the application services segment of the public cloud market which equates to ~43% of industry revenues, which is a ~US$129bn market.
- Over time we forecast that there will continue to be a shift towards operating expense and recurring revenue business models. This includes monthly and yearly billing and continues a shift away from capex like consumption for many businesses globally. We expect this trend is likely to continue and accelerate.
- We expect DSE growth rates to surpass industry growth rates over the next 10 years by a significant margin, albeit with growth off a smaller base.

Figure 45: Global SaaS market



Source: Gartner 2020

Figure 46: YoY growth rate in global SaaS market

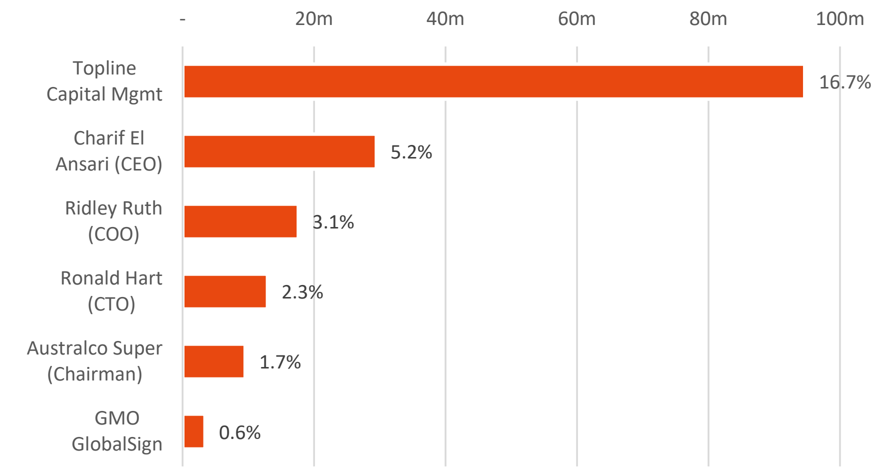


Source: Gartner 2020

SECTION 6: SHARE STRUCTURE AND SHAREHOLDERS

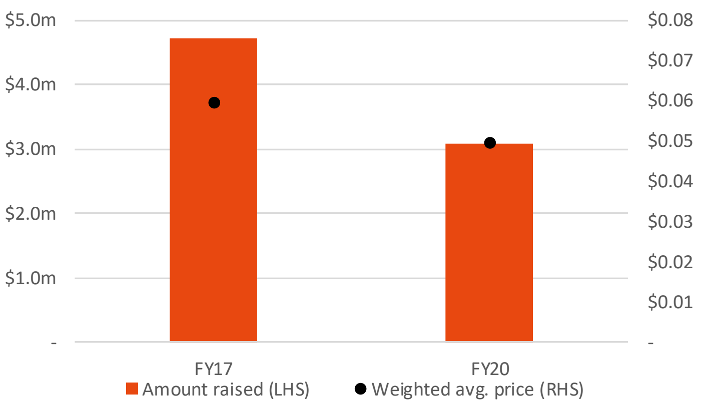
- DSE was originally founded in 2012 and listed on the ASX in 2016 by means of reverse takeover (RTO) via Excalibur Mining, raising $5.3m through the issuance of 5.3m shares at $0.10 per share.
- Since 2016, DSE has been mostly funded through equity, having raised $5.7m in FY17 and $3.1m in FY20. DSE currently has ~565m fully paid ordinary shares and ~39.0m performance rights on issue.
- Charif El-Ansari (CEO) owns 29.5m ordinary shares or 5.2% of the register, and also has performance rights in the company. The current COO, CTO and Chairman also own a combined 7.1% of the share register.
- We note relatively limited institutional ownership outside of the largest shareholder, Topline Capital Management, a US based fund manager.

Figure 47: Number and percentage of outstanding shares



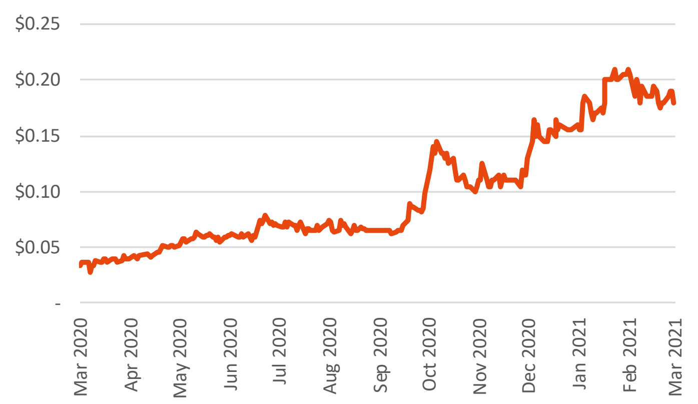
Source: Company data, FactSet

Figure 48: Total equity issued since IPO



Source: Company data, FactSet

Figure 49: Share price



Source: Company data, FactSet

SECTION 7: BOARD AND MANAGEMENT

7.1 Board

Theo Hnarakis, Non-Executive Chairman
Theo brings a wealth of experience scaling Australian ASX-listed technology businesses as Melbourne IT's Managing Director for more than a decade, along with senior roles at News Corp., Boral Group, PMP Communications Group. Currently, Theo is the Non-Executive Chairman of DSE and a Non-Executive Director at FarmGate MSU.

Charif El-Ansari, Managing Director/CEO
Charif is the former Head of Sales and Business Development at Google Asia. He is a well-respected technology industry veteran with over 15 years of experience in various management positions at Google and Dell that required a strong entrepreneurial drive. Charif has held sales, marketing, operations and business development roles in the US and Asia.

Bruce Tonkin, Non-Executive Director
Bruce is a respected authority on Internet business and technical infrastructure issues, and COO of .au Domain Administration Ltd (auDA). He has held senior roles at Melbourne IT (CTO 17+ years), ICANN (Board director 9+ years), and Monash University. Currently, Bruce is a Non-Executive Director at DSE.

7.2 Management

Charif El-Ansari, Managing Director/CEO
See above.

Ridley Ruth, COO
Ridley brings 20 years of industry knowledge to DSE. Previously, he was as Vice President Sales and later General Manager of StopTheHacker, a leading website security company (acquired by CloudFlare). Ridley has prior experience in sales, marketing, business development, website security and forensic data duplication.

Ron Hart, CTO
Ron brings 25 years of software engineering experience to the team with over 9 years of providing technical leadership to start-up companies. He specializes in high volume, high reliability solutions with a quick-to-market approach, leveraging open-source technologies and an agile development process.

SECTION 8: KEY RISKS

Risks to our investment thesis include although are not limited to:

Technological change
We see DSE's application as purpose built and technologically competitive with other products in market. However, this may not always be the case due to technological changes. These changes may lead to a requirement for DSE to redevelop its products in order to meet dynamic user requirements.

Competition
Whilst DSE's product is one of several available in its key markets, new competition or intensified competition from existing operators may result in margin erosion, or even a loss of existing Partners or Users.

Growth aspirations
DSE has global ambitions and has attained a level of penetration amongst users in the North America, Europe and APAC. The company has ambitions to continue to grow materially and deliver a step change in growth. There is no guarantee that DSE has the team in place or skills to navigate its growth aspirations.

Cash burn
DSE has historically delivered negative cash flows and is forecast to reach positive cash flows in the near future. There is risk that positive cashflow is not achieved in line with forecast, and companies that have negative cash flows typically exhibit greater volatility and there is no guarantee that DSE will be able to continue financing the business or that the group will reach profitability.

Churn, stickiness and LTV
DSE is still at the inception of growth and its User base. Currently the group exhibits relatively low churn at a User and Partner level and has an expanding User base. There is no guarantee that these users will continue with the group. Higher churn may in turn decrease the total LTV of DSE, which may impact valuation considering DSE is likely being valued on its ARR and a consistent growth trajectory.

Revenues and cashflows
DSE delivers products and services predominantly to SMEs globally. DSE may from time to time see delays to cash flows or potential differences to revenue recognition from ARR stemming from various revenue profiles of its income streams. This is likely to be magnified through periods of extreme user growth.

International operations
The company offers products and services via the cloud, but services these operations through sales and support across multiple countries across several geographic regions. As such DSE is subject to an elevated level of currency, execution and cost risk.

Small cap illiquidity and volatility
As a small cap company, DSE exhibits higher levels of volatility and lower liquidity than the broader market in general. This beta is magnified during periods of market upheaval, such as the current Covid environment.

Data breach
DSE utilises cloud-based storage for the majority of its data. We note DSE may experience hacking or stolen information that could adversely affect the operations and reputation of the group.

Key board and management risk
DSE's CEO is a founder of the business and a large shareholder in the group. Failure to retain and grow executive talent may adversely impact the group's growth. Moreover, this risk is elevated for businesses experiencing material growth over a short time horizon, such as DSE.

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

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