

Dropsuite Ltd

Software and Services

Rating BUY <i>unchanged</i>	Price Target A\$0.40 ↑ <i>from A\$0.38</i>
DSE-ASX	Price A\$0.28

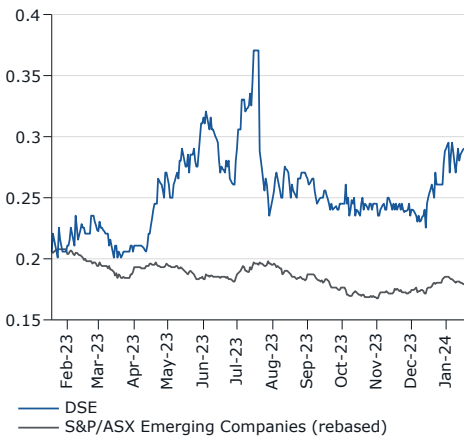
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4Q23 print points to an acceleration in FY24 user growth

Market Data

52-Week Range (A\$) :	0.16 - 0.39
Market Cap (A\$M) :	190.2
Shares Out. (M) :	679.3
Dividend /Shr (A\$) :	0.53
Dividend Yield (%) :	0.0
Enterprise Value (A\$M) :	165.7
Cash (A\$M) :	24.5
Long-Term Debt (A\$) :	0.0

FYE Dec	2022A	2023E	2024E	2025E
Sales (A\$M)	21.0	29.9↓	39.6↑	50.6
<i>Previous</i>	-	30.1	39.4	-
Gross Profit (A\$M)	13.9	20.5	27.1	34.7
EBITDA (A\$M)	2.1	2.6↓	3.4↓	5.4↓
<i>Previous</i>	-	2.8	5.8	9.0
EBIT (A\$M)	2.1	2.6↓	3.4↓	5.3↓
<i>Previous</i>	-	2.7	5.7	8.9
Net Income Adj (A\$M)	2.1	2.6↓	3.4↓	5.3↓
<i>Previous</i>	-	2.7	5.7	8.9
Net Debt (Cash) (A\$M)	(22)	(25)	(28)↑	(33)↑
<i>Previous</i>	-	-	(31)	(40)
EV/Sales (x)	8.0	5.5	4.1	3.1



Priced as of close of business 18 January 2024

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

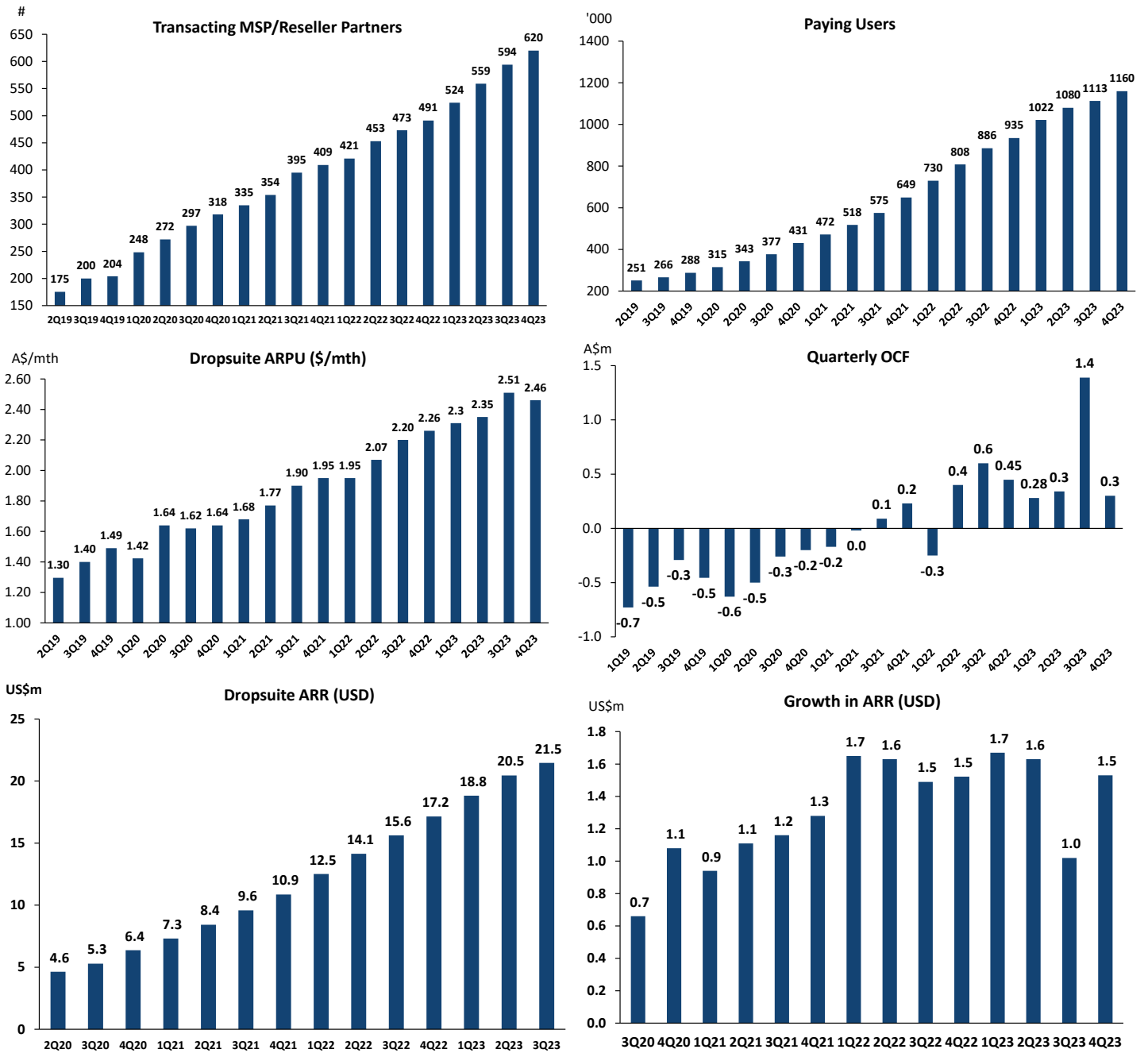
- **4Q23 ARR** increased +3% qoq [+7% cc] and +35% pcp to \$34.3m [CGe \$35.4m] with the incremental quarterly ARR increase of A\$0.9m (US\$1.5m) impacted by a stronger AUD and previously flagged elevated churn. The US\$1.5m ARR increase was in line with CGe (US\$1.4m).
- **Record gross user addition in the quarter to +93k** (3Q23 +86k, prev. record +86k) illustrating a strong sales funnel that likely accelerated through the quarter. User churn of -38k users relates to a legacy/non-core South American partner that has now deactivated, with 1Q24/FY24 likely to see an acceleration in net user growth. **Paying net users increased +47k to 1.16m**, representing +4% qoq and +24% yoy. During the period, DSE launched Partner Serv to assist MSPs migrate from competing products, with strong immediate results. The pipeline for this product remains strong and should further assist FY24 user growth.
- **ARPU** of A\$2.46 reduced -2% qoq but in USD terms increased +2% qoq and +8% yoy as the company benefited from upselling users to high value products (i.e., Archiving) coupled with lower contribution from a low ARPU legacy partner (ARPU \$0.70). We expect ARPU to revert to its steady growth into FY24, with a step up in net users, coupled with an increasing ARPU seeing an acceleration in group ARR throughout FY24.
- **Gross profit margins increased to 70% (3Q: 68%, pcp 70%)**, and we see further upside relating to moving to private cloud that could see gross profit margins >80%, increasing DSE's operating leverage to revenue growth.
- The company generated **4Q23 FCF of +\$0.3m**, bringing the full year to +\$2m and broadly in line with our forecasts. **Cash finished CY23 at \$24m** (CGe \$25m) with the company "pursuing high conviction M&A" while retaining profitability.
- The company provided guidance that it expects to "maintain cashflow and profitability broadly in line with FY23 levels", i.e., FCF of ~+\$2m with its growth in gross profit offset by strong expected acceleration in R&D/S&M investment (>+40%). Our earnings forecasts have been adjusted to reflect the accelerated investment which should yield results into 2H24.
- DSE **Managed Service Partnerships** increased to 620 (+26 partners) and +231 incremental indirect partners (CGe ~4k). The network effect from MSP partners is increasingly valuable as users expand and diversify use cases as a result of increasing data security and regulation.
- DSE's record gross adds quarterly illustrates continued execution as one of the fastest growing SaaS stocks on the ASX. Almost all of DSE's revenue comes from highly predictable, recognised subscriptions from its customers. Bond yields are down and growth stocks should come in favour as we enter a low growth environment. We estimate that **run-rating ~100k/qtr net users at its current ARPU would see the group add >US\$8m/A\$12m ARR and translates to a A\$9m gross profit uplift to reinvest**. Looking forward 12 months, we see DSE's EV/revenue multiple fall to <4x, despite having one of the highest efficiency/quality scores on the ASX (FY23 revg + FCF margin of +50%).
- **We maintain a conviction BUY** and expect the stock to benefit from (1) acceleration in net user growth into FY24 as DSE cycles legacy user churn (4Q23 47k, CGe 1Q24 >100k); (2) an enhanced ARPU from recently launched (Gov Cloud, Quickbooks, Partner Serv) and new product initiatives; (3) an accelerated S&M/R&D investment profile in FY23/FY24 (>40% cost growth); and (4) strategic M&A in complementary products. Our valuation increases slightly to \$0.40ps (previously \$0.38ps), reflecting the roll forward of our DCF valuation.

Figure 1: Dropsuite (DSE-ASX)

						Share Price \$ 0.28 Market Cap \$ 190.2					
Dropsuite (DSE)											
Profit & Loss (\$m)	2021A	2022A	2023F	2024F	2025F	Valuation ratios	2021A	2022A	2023F	2024F	2025F
ARR	15.2	25.4	34.3	45.3	58.3	EPS (cps)	0.0	0.2	0.1	0.2	0.3
Sales Revenue	11.7	21.0	29.9	39.6	50.6	Enterprise Value (\$m)	169	168	166	162	157
COGS	-4.2	-7.1	-9.4	-12.5	-15.9	EV/ARR	11.1	6.6	4.8	3.6	2.7
Gross Profit	7.5	13.9	20.5	27.1	34.7	EV/Revenue	14.4	8.0	5.5	4.1	3.1
Opex	-7.2	-11.8	-17.8	-23.7	-29.2	EV/Gross Profit	22.3	12.1	8.1	6.0	4.5
EBITDA	0.4	2.1	2.6	3.4	5.4	EV/GPAPA (gp after S&M)	22.3	12.1	8.1	6.0	4.5
D & A	0.0	-0.1	-0.1	-0.1	-0.1	EV / EBITDA (x)	nmf	nmf	nmf	nmf	nmf
EBIT	0.4	2.1	2.6	3.4	5.3	P/E (x)	nmf	nmf	nmf	nmf	nmf
Net Interest Expense	0.0	0.0	0.0	0.0	0.0	DPS (cps)	0.0	0.0	0.0	0.0	0.0
NPBT	0.4	2.1	2.6	3.4	5.3	Payout ratio (%)	0%	0%	0%	0%	0%
Tax expense	0.0	0.0	0.0	0.0	0.0						
NPAT (Normalised)	0.4	2.1	2.6	3.4	5.3	Dupont Analysis	2021A	2022A	2023F	2024F	2025F
Significant items	-0.4	-0.6	0.0	0.0	0.0	Net Profit Margin	-0.3%	7.0%	8.6%	8.5%	10.6%
NPAT (Reported)	0.0	1.5	2.6	3.4	5.3	Asset Turnover	0.5	0.8	1.0	1.2	1.3
						ROA (%)	-0.1%	5.4%	8.3%	9.8%	13.5%
Gross Profit Margin (%)	64.5%	66.2%	68.5%	68.5%	68.5%	Financial Leverage	1.1	1.1	1.1	1.1	1.1
EBITDA Margin (%)	3.3%	10.1%	8.8%	8.7%	10.7%	ROE (%)	-0.1%	6.1%	9.4%	11.0%	14.8%
EBIT Margin (%)	3.0%	9.8%	8.6%	8.5%	10.6%						
NPAT Margin (%)	-0.3%	7.0%	8.6%	8.5%	10.6%	Balance Sheet ratios	2021A	2022A	2023F	2024F	2025F
						Net Debt (cash)	-21.6	-22.3	-24.5	-27.8	-33.2
Cash Flow (\$m)	2021A	2022A	2023F	2024F	2025F	NTA per share (\$)	0.0	0.0	0.0	0.0	0.1
Operating EBITDA	0.4	2.1	2.6	3.4	5.4	Price / NTA (x)	7.9	7.9	7.0	6.2	5.3
- Interest & Tax Paid	0.0	0.2	0.0	0.0	0.0	Shares on issue (m)	679.3	679.3	679.3	679.3	679.3
+/- change in Work. Cap.	-0.1	-1.4	-0.5	0.0	0.0	EFPOWA (m)	616.7	679.3	679.3	679.3	679.3
- other	0.0	0.0	0.0	0.0	0.0						
Operating Cashflow	0.3	0.9	2.1	3.4	5.4	Assumptions	2021A	2022A	2023F	2024F	2025F
- Other Capex	-0.1	-0.1	-0.1	-0.1	-0.1	Revenue growth	64.7%	79.0%	42.5%	32.4%	27.9%
- Intangibles/other	0.0	0.0	0.0	0.0	0.0	Gross profit margin	64.5%	66.2%	68.5%	68.5%	68.5%
- Acquisitions	0.0	0.0	0.0	0.0	0.0	Opex growth	13.6%	64.3%	71.3%	36.9%	38.0%
Free Cashflow	0.2	0.9	2.0	3.3	5.3						
- Ord Dividends	0.0	0.0	0.0	0.0	0.0	Users ('000)	649.0	935.0	1160.0	1446.5	1754.7
- Equity /other	18.9	0.0	0.0	0.0	0.0	MSP (#)	409	491	620	720	820
Net Cashflow	19.1	0.9	2.0	3.3	5.3	ARPU (A\$)	2.0	2.3	2.5	2.6	2.8
Cash at beginning of period	2.4	21.6	22.5	24.5	27.8	ARR (A\$m)	15.2	25.4	34.3	45.3	58.3
+/- borrowings / other	0.0	0.0	0.0	0.0	0.0						
Cash at end of period	21.5	22.5	24.5	27.8	33.2	Interim Analysis	1H21A	2H21A	1H22A	2H22A	1H23E
						Revenues	5.0	6.8	8.9	12.1	14.1
Balance Sheet	2021A	2022A	2023F	2024F	2025F	Gross profit	3.3	4.2	5.6	8.3	9.7
Cash	21.6	22.3	24.5	27.8	33.2	EBIT	0.0	0.3	0.5	1.6	1.0
Debtors	2.2	4.1	5.4	5.4	5.4	EBIT margin (%)	0.5%	4.9%	5.5%	13.2%	7.3%
Inventory	0.0	0.0	0.0	0.0	0.0	DPS	0.0	0.0	0.0	1.0	3.0
PPE	0.0	0.1	0.1	0.1	0.1						
Intangibles	0.0	0.0	0.0	0.0	0.0	Board of Directors / Substantial Shareholders					
Other assets	0.3	0.5	0.8	0.8	0.8	Board of Directors		Shareholding		%	
Total Assets	24.1	26.9	30.8	34.2	39.5	Theodore Hnarakis (NEC)		11.8		1.7%	
Deferred Revenue	0.1	0.1	0.1	0.1	0.1	Charif Elansari (CEO)		29.5		4.3%	
Trade Creditors	2.0	2.5	3.3	3.3	3.3	Dr Bruce Tonkin (NED)		1.5		0.2%	
Unearned income	0.0	0.0	0.0	0.0	0.0	Eric Martorano (NED)		0.0		0.0%	
Other Liabilities	0.1	0.1	0.1	0.1	0.1						
Total Liabilities	2.3	2.8	3.5	3.5	3.5						
NET ASSETS	21.8	24.2	27.3	30.7	36.0						

Source: Company reports, Canaccord Genuity estimates

Figure 2: Key charts



Source: Company reports, Canaccord Genuity estimates

Figure 3: P&L, BS and CF summary

Profit & Loss		FY19A	FY20A	1H21A	2H21A	FY21A	1H22A	2H22A	FY22A	1H23	2H23E	FY23E	1H24E	2H24E	FY24E
Partners	#	204	318	335	409	409	453	491	491	559	620	620	670	720	720
New partners added	#		114	17	74	91	44	38	82	68	61	129	50	50	100
Users	'000	288	431	518	649	649	808	935	935	1080	1160	1160	1293	1446	1446
User Growth	'000		143.0	87.0	131.0	218.0	159.0	127.0	286.0	145.0	80.0	225.0	132.5	153.9	286.5
Users/partner	'000	1,412	1,355	1,546	1,587	1,587	1,784	1,904	1,904	1,932	1,871	1,871	1,929	2,009	2,009
ARPU	A\$/mth	1.49	1.64	1.77	1.95	1.95	2.07	2.26	2.26	2.35	2.46	2.46	2.53	2.61	2.61
ARR	A\$m	5.1	8.5	11.0	15.2	15.2	20.1	25.4	25.4	30.4	34.3	34.3	39.3	45.3	45.3
ARR growth	A\$m		3.3	2.5	4.2	6.7	4.9	5.3	10.2	5.0	3.9	8.9	5.0	6.0	11.0
Group Revenue	A\$m	4.7	7.1	5.0	6.8	11.7	8.9	12.1	21.0	14.1	15.8	29.9	18.4	21.2	39.6
COGS	A\$m	1.7	2.5	1.6	2.5	4.2	3.3	3.7	7.1	4.4	5.0	9.4	5.8	6.7	12.5
Gross Profit	A\$m	3.0	4.6	3.3	4.2	7.5	5.6	8.3	13.9	9.7	10.7	20.5	12.6	14.5	27.1
Gross profit margin	%	64%	65%	67%	62%	64%	62%	69%	66%	69%	68%	68%	68%	68%	68%
Total Opex	A\$m	5.4	6.3	3.3	3.9	7.2	5.1	6.7	11.8	8.7	9.2	17.8	11.0	12.7	23.7
EBITDA	A\$m	-2.3	-1.7	0.0	0.4	0.4	0.5	1.6	2.1	1.1	1.6	2.6	1.6	1.8	3.4
Depreciation and Amortisation	A\$m	-0.8	-0.5	0.0	0.0	0.0	0.0	0.0	-0.1	0.0	0.0	-0.1	0.0	0.0	-0.1
EBIT	A\$m	-3.2	-2.2	0.0	0.3	0.4	0.5	1.6	2.1	1.0	1.5	2.6	1.6	1.8	3.4
Net Interest	A\$m	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
NPBT	A\$m	-3.1	-2.1	0.0	0.3	0.4	0.5	1.6	2.1	1.0	1.5	2.6	1.6	1.8	3.4
Tax Expense	A\$m	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
NPAT (normalised)	A\$m	-3.1	-2.1	-0.1	0.0	0.0	0.3	1.6	1.5	0.8	1.5	2.6	1.6	1.8	3.4
Balance Sheet		FY19A	FY20A	1H21A	2H21A	FY21A	1H22A	2H22A	FY22A	1H23	2H23E	FY23E	1H24E	2H24E	FY24E
Cash	A\$m	1.4	2.5	2.4	21.6	21.6	21.6	22.3	22.3	23.0	24.0	24.5	26.0	27.8	27.8
Receivables	A\$m	0.8	1.4	1.8	1.8	2.2	3.0	4.1	4.1	5.4	5.4	5.4	5.4	5.4	5.4
PPE	A\$m	0.0	0.2	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Intangibles	A\$m	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	A\$m	0.1	0.2	0.3	0.3	0.3	0.4	0.5	0.5	0.8	0.8	0.8	0.8	0.8	0.8
Assets	A\$m	2.9	4.3	4.5	23.8	24.1	25.0	26.9	26.9	29.3	30.3	30.8	32.4	34.1	34.2
Payables	A\$m	0.9	1.3	1.6	1.6	2.0	2.3	2.5	2.5	3.3	3.3	3.3	3.3	3.3	3.3
Provisions	A\$m	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest bearing liabilities	A\$m	0.1	0.1	0.2	0.2	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other	A\$m	0.1	0.1	0.1	0.1	0.1	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Liabilities	A\$m	1.1	1.4	1.8	1.8	2.2	2.6	2.7	2.7	3.4	3.4	3.4	3.4	3.4	3.4
Equity	A\$m	1.8	2.5	2.7	22.0	21.9	22.5	24.2	24.2	25.8	27.6	27.6	29.1	30.9	30.9
ROE	%	-174.9%	-84.4%	-5.3%	0.4%	-0.1%	1.4%	6.6%	6.1%	3.2%	5.6%	9.3%	5.3%	5.8%	10.9%
Financial leverage ratio	x	1.6	1.7	1.7	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Cash Flow Statement		FY19A	FY20A	1H21A	2H21A	FY21A	1H22A	2H22A	FY22A	1H23	2H23E	FY23E	1H24E	2H24E	FY24E
EBITDA	A\$m	-2.3	-1.7	0.0	0.4	0.4	0.5	1.6	2.1	1.1	1.6	2.6	1.6	1.8	3.4
Working Capital	A\$m	0.5	-0.2	-0.1	0.0	-0.1	-0.6	-0.8	-1.4	-0.7	-0.5	-0.5	0.0	0.0	0.0
Net Interest paid	A\$m	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.2	0.3	0.0	0.0	0.0	0.0	0.0
Income taxes paid	A\$m	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net operating cash flows	A\$m	-1.8	-1.8	-0.1	0.4	0.3	-0.1	1.0	0.9	0.6	1.1	2.1	1.6	1.8	3.4
PPE	A\$m	-0.1	0.0	0.0	0.0	-0.1	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Development costs	A\$m	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other/Acquisitions	A\$m	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net investing cash flows	A\$m	0.0	0.0	0.0	0.0	-0.1	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Proceeds from issue of securities	A\$m	0.0	2.9	0.0	18.9	18.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net borrowings	A\$m	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net financing cash flows	A\$m	0.0	2.9	0.0	18.9	18.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net change	A\$m	-1.8	1.1	-0.1	19.2	19.1	-0.1	1.0	0.9	0.5	1.0	2.0	1.5	1.8	3.3
Cash at beginning of period	A\$m	3.2	1.3	2.5	2.4	2.5	21.6	21.5	21.6	22.4	23.0	22.5	24.5	26.0	24.5
Cash at end of period	A\$m	1.4	2.4	2.4	21.6	21.6	21.5	22.5	22.5	23.0	24.0	24.5	26.0	27.8	27.8

Source: Company Reports, Canaccord Genuity estimates

Appendix: Important Disclosures

Analyst Certification

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Investment Recommendation

Date and time of first dissemination: January 18, 2024, 03:04 ET

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Target Price / Valuation Methodology:

Dropsuite Ltd - DSE

DCF methodology (\$0.30ps, Ke 13%, β 1.5x, ERP 5.5%): Our terminal value incorporates a long-term cash EBIT margin of 35% (gross profit margin 65%, steady state S&M expense 5%, capex/G&A 25%) on our FY26E ARR expectations of \$46m (+25% CAGR).

Risks to achieving Target Price / Valuation:

Dropsuite Ltd - DSE

SMB spending headwinds

DSE's MSP partners sell directly to SMEs, and any change in SMB spending levels, or propensity to spend on cloud technology, could create headwinds for DSE. Further COVID-19 waves/restrictions, or a broader economic recession impacting spending patterns will be a headwind for DSE.

M&A risks

DSE holds a strong balance sheet and been open with investors about the potential for bolt-on acquisitions. While we do not anticipate transformation deals, DSE has not been acquisitive in the past and thus this new strategy poses a risk to investors.

Reputational harm

A successful cyberattack could have a negative impact on DSE's reputation and its ability to sign on new partners. While DSE has never had a breach and states its data encryption and storage capability is military grade, any breach would be a major business risk.

Competitive markets

DSE operates in the competitive data management and back-up space with larger well-funded competitive with diverse products. DSE differentiates itself in the market by purely focusing in on MSPs, and longer term we believe the data back-up space could become more competitive.

Inability to sign new MSP partners

DSE has materially increasing its distribution partners over the last three years. If DSE's product or prices become less competitive it may struggle to onboard new MSPs and this could impact its revenue profile.

Revenue concentration

66% of DSE revenues are sourced from its top 10 distribution partners. The high level of concentration risk and potential for these to churn poses a risk to our revenue and earnings forecasts.

Distribution of Ratings:

Global Stock Ratings (as of 01/18/24)

Rating	Coverage Universe		IB Clients
	#	%	%
Buy	600	65.29%	22.83%
Hold	137	14.91%	10.95%
Sell	14	1.52%	7.14%
Speculative Buy	158	17.19%	50.63%
	919*	100.0%	

*Total includes stocks that are Under Review

Canaccord Genuity Ratings System

BUY: The stock is expected to generate returns greater than 10% during the next 12 months.

HOLD: The stock is expected to generate returns from -10% to 10% during the next 12 months.

SELL: The stock is expected to generate returns less than -10% during the next 12 months.

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

Given the inherent volatility of some stocks under coverage, price targets for some stocks may imply target returns that vary temporarily from the ratings criteria above.

*As of January 1, 2024, the Ratings History Chart will reflect the new Canaccord Genuity Ratings System as defined above.

Risk Qualifier

SPECULATIVE: The stock bears significantly above-average risk and volatility. Investments in the stock may result in material loss.

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

A list of all the recommendations on any issuer under coverage that was disseminated during the preceding 12-month period may be obtained at the following website (provided as a hyperlink if this report is being read electronically) <http://disclosures-mar.canaccordgenuity.com/EN/Pages/default.aspx>

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Dropsuite Ltd Rating History as of 01/17/2024



Past performance

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