

Dropsuite Ltd

Software and Services

Rating BUY unchanged	Price Target A\$0.38 ↑ from A\$0.34
DSE-ASX	Price A\$0.28

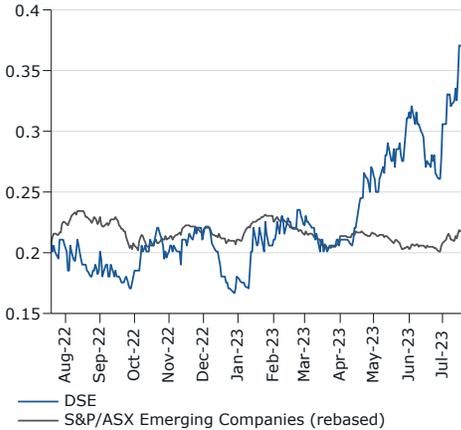
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2Q23 +51% ARR growth, +5% FCF margins; release overshadowed by MSFT backup product

Market Data

52-Week Range (A\$) :	0.15 - 0.25
Market Cap (A\$M) :	190.2
Shares Out. (M) :	679.3
Dividend /Shr (A\$) :	0.00
Dividend Yield (%) :	0.0
Enterprise Value (A\$M) :	167
Cash (A\$M) :	23.0
Long-Term Debt (A\$) :	0.0

FYE Dec	2022A	2023E	2024E	2025E
Sales (A\$M)	21.0	28.3↑	38.1↑	49.3↑
Previous	-	28.1	35.7	41.6
Gross Profit (A\$M)	13.9	18.9	25.5	33.0
EBITDA (A\$M)	2.1	2.8↑	5.7↑	10.9↑
Previous	-	2.7	4.1	5.8
EBIT (A\$M)	2.1	2.7	5.7↑	10.9↑
Previous	-	-	4.0	5.7
Net Income Adj (A\$M)	2.1	2.7	5.7↑	10.9↑
Previous	-	-	4.0	5.7
Net Debt (Cash) (A\$M)	(22)	(25)	(31)↓	(42)↓
Previous	-	-	(29)	(35)
EV/Sales (x)	8.0	5.8	4.2	3.0



2Q23 ARR increased +8% qoq (+6% net user/+2% price) and +51% pcp to \$30.4m (CGe \$29.6m). The incremental quarterly ARR add of \$2.2m is consistent with previous trend of >\$2m/qr. Annualising the 2Q23 incremental ARR would see an FY23E ARR of \$34.8m vs CGe of \$33.6m, implying upside to our forecasts.

The result was overshadowed by Microsoft's announcement, as part of its Inspire conference to deliver a new pay as you go (PAYG) back-up and restore service within its Syntex content management suite. The launch follows the announcement of its intent to launch a back-up product in November 2022 with Microsoft selecting 6x initial launch partners (AvePoint, Barracuda, Veeam, etc., i.e. DSE competitors). Microsoft historically has avoided any discussion around back-up products and utilised independent software vendors, such as DSE, to satisfy customer demand.

MSFT back-up solution

On the conference call, DSE expected limited direct impact on its growth ambitions, reiterating expectations for its growth rate to be 2x the industry in the medium term with an acceleration into 2H23. We believe the key reasons a vendor would not choose to use a Microsoft back-up products are:

- Lack of true independence, with end users putting all their eggs (data) in the one (Microsoft) basket. Depending on the regulatory and compliance environment it is likely users will require a separation of back-up data from operational data, particularly when logging in via the same admin access. DSE utilises AWS for its back-up with named launch partners utilising Azure for their back-up. Our understanding is Microsoft still recommends in its T&C to use a third-party back-up vendor provider.
- Limited experience with the delivery of back-up and restore services with Independent Vendors specialising in this area. This is particularly true around service levels and the need for urgent hands-on knowledge support in times of cyber disaster. MSFT product also doesn't initially appear to have a similar archiving (live back-up) solution, nor back-up teams/chat.
- Pricing targeted at enterprises with MSFT pricing at US\$8/user/mth, against DSE at US\$2/user/mth. This sits on top of the existing US\$12/user for an SME O365 licence. We are unsure how a PAYG usage base pricing will compare to DSE fixed price/mth.

A positive of the release is a belief by Microsoft that this is a big enough market to launch its own enterprise product that will likely build awareness of the broader back-up market. DSE product is targeted/tailored at SMEs where 85% of SMEs are yet to incorporate a back-up product.

DSE result

- **ARPU and user numbers continue to trend in a positive direction:** ARPU of US\$2.35 increased +2% qoq/+13% vs pcp, benefiting from a shift to higher ARPU product mix (i.e. upsell to archiving) and gross users increased +76k, bringing the total user count to 1.08m (pcp 0.8m). DSE noted that it expects an increase in S&M spend to "drive higher user numbers in future quarters".
- **DSE Managed Service Partnerships** increased to 559 direct partners (+35 partners) while also growing its indirect partners by 250, this included adding TD Synnex, a large global distributor (150k customers). The network effect from MSP partners is increasingly valuable, with channel checks illustrating a NPS score of 96 on key MSP accounts. Broader coverage of MSP partners through an increase in S&M, deeper proliferation within each MSP and upsell to higher priced APRU products (ABO back-up, archiving) should maintain an above trend growth in future periods.

Priced as of close of business 19 July 2023

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

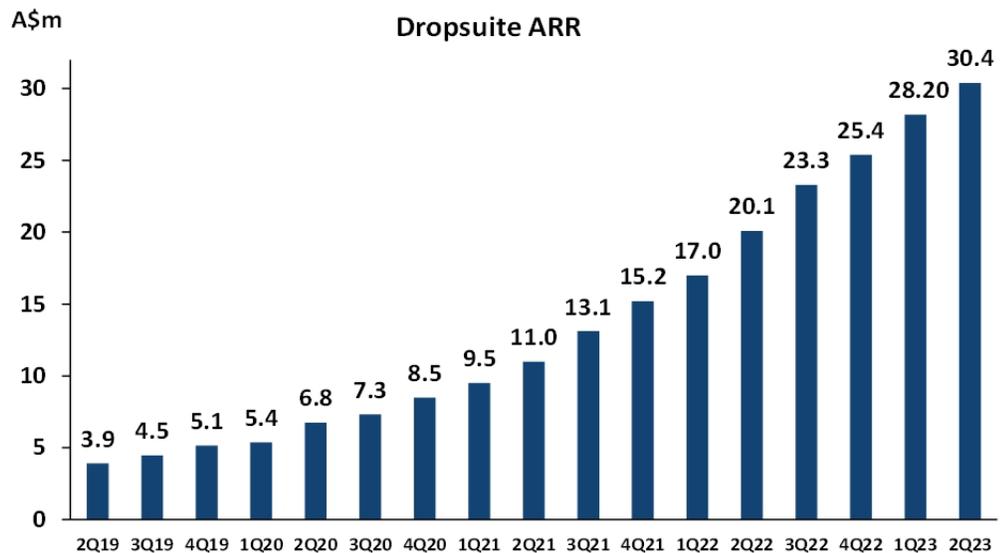
- **DSE reported strong gross margins of 69%**, stable on the prior quarter, following a period of rapid expansions (+500 bps on pcp). Long-term upside relates to moving to private cloud and could see gross profit margins >80%, increasing DSE's operating leverage to growth.
- DSE is sustainably OCF positive (fifth consecutive quarter), recording \$0.3m OCF in the quarter. Management has guided to reinvesting its incremental growth in gross profit (i.e. \$10m p.a. at ~50% growth rate) over the medium term into product enhancement and global S&M given the scale of the opportunity (132k MSP [DSE 2% market share], 85% SMEs not having a back-up product).
- Operationally, DSE continues to execute on product launches (key to ongoing ARPU growth). This includes monetisation of QBO back-up service and launch of GovCloud back-up/archiving which targets a new vertical (US public sector).
- **Guidance:** DSE has previously provided implicate forward guidance of "delivering 2x Industry growth till 2025" which infers ~+50% revenue CAGR (CGe +33% CAGR) providing upside risk to our and consensus forecasts. The company expects to maintain "its steady [growth] momentum" and as such we adjust our forecasts upwards.

Earnings revisions

Our FY23E, FY24E and FY25E ARR has been revised up +1%, +10% and +23%, respectively.

Our view

DSE's 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 with negligible churn. FY23 is turning into a breakout year for DSE, with elevated organic growth rates (+50%) enabling a higher reinvestment rate. New product launches (Quickbooks back-up, GovCloud) and targeted acquisitions (\$23m cash on hand) provides further pillar of growth. The launch of MSFT back-up product (and broader products in due course) will likely be an overhang on the stock for the short term given the uncertainty on the long-term growth rate of DSE. Maintaining an elevated growth rate will likely relieve this concern. We retain our BUY recommendation and slightly increase our valuation to \$0.38/share (previously \$0.34/share) following the revisions to our growth forecasts.



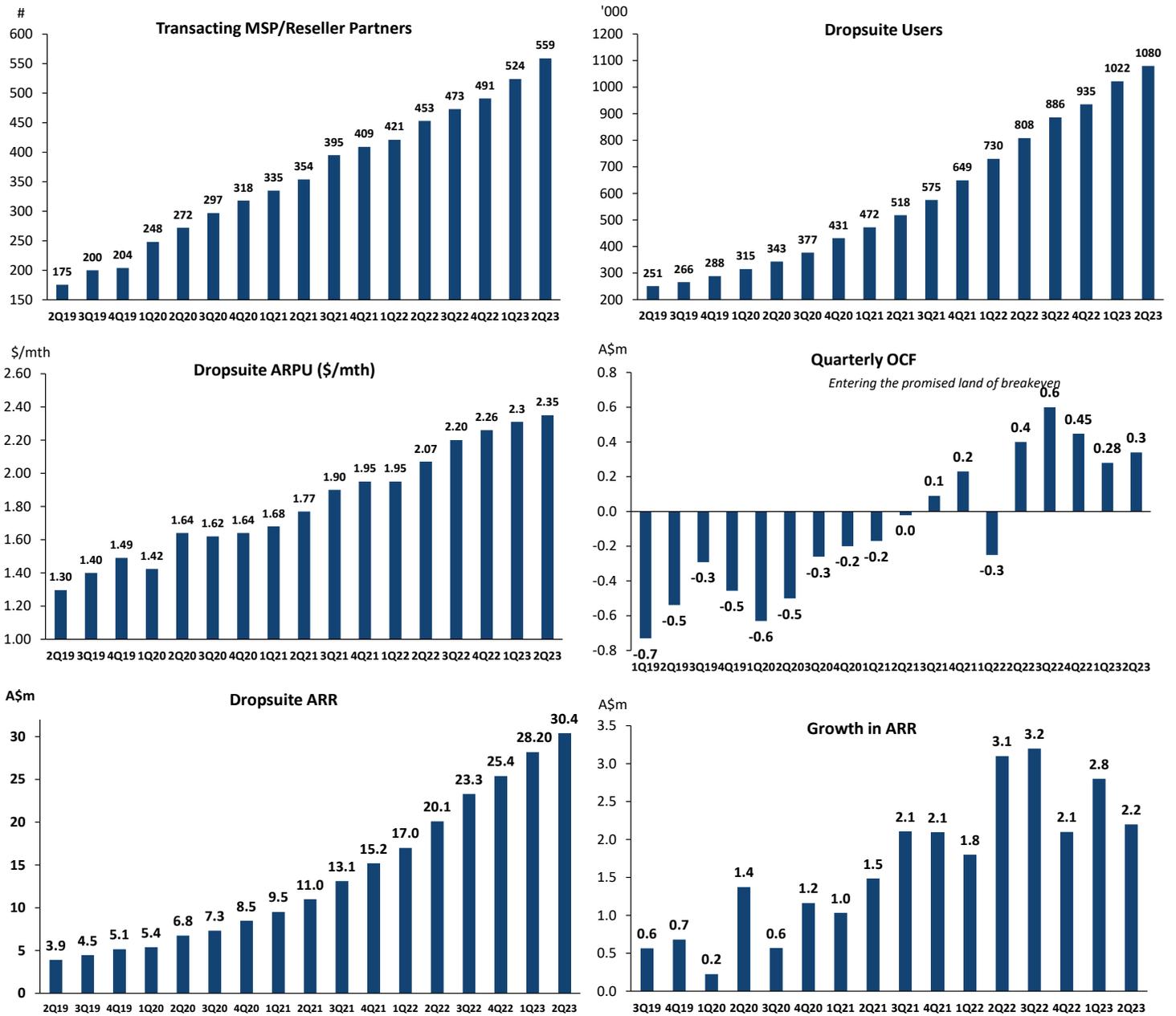
Source: Company reports

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

Profit & Loss		1H19A	2H19A	FY19A	1H20A	2H20A	FY20A	1H21A	2H21A	FY21A	1H22A	2H22A	FY22A	1H23E	2H23E	FY23E
Partners	#	175	204	204	272	318	318	335	409	409	453	491	491	541	591	591
New partners added	#		29		68	46	114	17	74	91	44	38	82	50	50	100
Users	'000	251	288	288	343	431	431	518	649	649	808	935	935	1060	1174	1174
User Growth	'000		37.1		55.0	88.0	143.0	87.0	131.0	218.0	159.0	127.0	286.0	124.7	114.1	238.8
Users/partner	'000	1,430	1,412	1,412	1,261	1,355	1,355	1,546	1,587	1,587	1,784	1,904	1,904	1,959	1,986	1,986
ARPU	A\$/mth	1.30	1.49	1.49	1.64	1.64	1.64	1.77	1.95	1.95	2.07	2.26	2.26	2.33	2.42	2.42
ARR	A\$m	3.9	5.1	5.1	6.8	8.5	8.5	11.0	15.2	15.2	20.1	25.4	25.4	28.9	34.1	34.1
ARR growth	A\$m		1.2		1.6	1.7	3.3	2.5	4.2	6.7	4.9	5.3	10.2	3.5	5.2	8.7
Group Revenue	A\$m	2.3	2.4	4.7	3.2	3.9	7.1	5.0	6.8	11.7	8.9	12.1	21.0	12.9	15.3	28.3
COGS	A\$m	0.7	0.9	1.7	1.1	1.3	2.5	1.6	2.5	4.2	3.3	3.7	7.1	4.3	5.1	9.3
Gross Profit	A\$m	1.6	1.5	3.0	2.1	2.6	4.6	3.3	4.2	7.5	5.6	8.3	13.9	8.7	10.3	18.9
Gross profit margin	%	68%	61%	64%	65%	66%	65%	67%	62%	64%	62%	69%	66%	67%	67%	67%
Total Opex	A\$m	2.7	2.7	5.4	3.0	3.3	6.3	3.3	3.9	7.2	5.1	6.7	11.8	7.5	8.6	16.1
EBITDA	A\$m	-1.1	-1.3	-2.3	-0.9	-0.8	-1.7	0.0	0.4	0.4	0.5	1.6	2.1	1.2	1.6	2.8
Depreciation and Amortisation	A\$m	-0.4	-0.4	-0.8	-0.4	-0.1	-0.5	0.0	0.0	0.0	0.0	0.0	-0.1	0.0	0.0	-0.1
EBIT	A\$m	-1.5	-1.7	-3.2	-1.3	-0.9	-2.2	0.0	0.3	0.4	0.5	1.6	2.1	1.1	1.6	2.7
Net Interest	A\$m	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
NPBT	A\$m	-1.5	-1.7	-3.1	-1.3	-0.9	-2.1	0.0	0.3	0.4	0.5	1.6	2.1	1.1	1.6	2.7
Tax Expense	A\$m	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
NPAT (normalised)	A\$m	-1.5	-1.7	-3.1	-1.3	-0.9	-2.1	-0.1	0.0	0.0	0.3	1.6	1.5	1.1	1.6	2.7
Balance Sheet		1H19A	2H19A	FY19A	1H20A	2H20A	FY20A	1H21A	2H21A	FY21A	1H22A	2H22A	FY22A	1H23E	2H23E	FY23E
Cash	A\$m	0.0	0.0	1.4	3.0	2.5	2.5	2.4	21.6	21.6	21.6	22.3	22.3	23.6	25.2	25.2
Receivables	A\$m	0.0	0.0	0.8	1.2	1.4	1.4	1.8	1.8	2.2	3.0	4.1	4.1	4.1	4.1	4.1
PPE	A\$m	0.0	0.0	0.0	0.0	0.2	0.2	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1
Intangibles	A\$m	0.0	0.0	0.5	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	A\$m	0.0	0.0	0.1	0.2	0.2	0.2	0.3	0.3	0.3	0.4	0.5	0.5	0.5	0.5	0.5
Assets	A\$m	0.0	0.0	2.9	4.5	4.3	4.3	4.5	23.8	24.1	25.0	26.9	26.9	28.2	29.8	29.8
Payables	A\$m	0.0	0.0	0.9	1.0	1.3	1.3	1.6	1.6	2.0	2.3	2.5	2.5	2.5	2.5	2.5
Provisions	A\$m	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest bearing liabilities	A\$m	0.0	0.0	0.1	0.1	0.1	0.1	0.2	0.2	0.1	0.2	0.1	0.1	0.1	0.1	0.1
Other	A\$m	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.0	0.0	0.0	0.0	0.0
Liabilities	A\$m	0.0	0.0	1.1	1.1	1.4	1.4	1.8	1.8	2.2	2.6	2.7	2.7	2.7	2.7	2.7
Equity	A\$m	0.0	0.0	1.8	3.4	2.5	2.5	2.7	22.0	21.9	22.5	24.2	24.2	25.4	27.0	27.0
ROE	%			-174.9%	-74.0%	-69.9%	-84.4%	-5.3%	0.4%	-0.1%	1.4%	6.6%	6.1%	4.4%	6.0%	10.1%
Financial leverage ratio	x			1.6	1.3	1.7	1.7	1.7	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Cash Flow Statement		1H19A	2H19A	FY19A	1H20A	2H20A	FY20A	1H21A	2H21A	FY21A	1H22A	2H22A	FY22A	1H23E	2H23E	FY23E
EBITDA	A\$m	-1.1	-1.3	-2.3	-0.9	-0.8	-1.7	0.0	0.4	0.4	0.5	1.6	2.1	1.2	1.6	2.8
Working Capital	A\$m	1.1	1.3	0.5	-0.4	0.3	-0.2	-0.1	0.0	-0.1	-0.6	-0.8	-1.4	0.0	0.0	0.0
Net Interest paid	A\$m	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.2	0.0	0.0	0.0
Income taxes paid	A\$m	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net operating cash flows	A\$m	0.0	0.0	-1.8	-1.3	-0.5	-1.8	-0.1	0.4	0.3	-0.1	1.0	0.9	1.2	1.6	2.8
PPE	A\$m	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	-0.1	0.0	-0.1	-0.1	0.0	-0.1	-0.1
Development costs	A\$m	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other/Acquisitions	A\$m	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net investing cash flows	A\$m	0.0	-0.1	0.0	-0.1	-0.1	0.0	-0.1	-0.1							
Proceeds from issue of securities	A\$m	0.0	0.0	0.0	2.9	0.0	2.9	0.0	18.9	18.9	0.0	0.0	0.0	0.0	0.0	0.0
Net borrowings	A\$m	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net financing cash flows	A\$m	0.0	0.0	0.0	2.9	0.0	2.9	0.0	18.9	18.9	0.0	0.0	0.0	0.0	0.0	0.0
Net change	A\$m	0.0	0.0	-1.8	1.6	-0.5	1.1	-0.1	19.2	19.1	-0.1	1.0	0.9	1.1	1.6	2.7
Cash at beginning of period	A\$m	0.0	0.0	3.2	1.4	2.9	1.3	2.5	2.4	2.5	21.6	21.5	21.6	22.5	23.6	22.5
Cash at end of period	A\$m	0.0	0.0	1.4	3.0	2.4	2.4	2.4	21.6	21.6	21.5	22.5	22.5	23.6	25.2	25.2

Source: Company reports, Canaccord Genuity estimates

Figure 3: Key charts



Source: Company reports

Figure 4: Earnings revisions

	FY21A	FY22A	FY23E			FY24E			FY25E		
			prev.	Curr.	% chg	prev.	Curr.	% chg	prev.	Curr.	% chg
Operating Revenue	11.7	21.0	28.1	28.3	0%	35.7	38.1	7%	41.6	49.3	18%
COGS	-4.2	-7.1	-9.3	-9.3	0%	-11.8	-12.6	7%	-13.7	-16.3	18%
Gross profit	7.5	13.9	18.9	18.9	0%	23.9	25.5	7%	27.9	33.0	18%
<i>Gross profit margin</i>	<i>64%</i>	<i>66%</i>	<i>67%</i>	<i>67%</i>		<i>67%</i>	<i>67%</i>		<i>67%</i>	<i>67%</i>	
Opex	-7.2	-11.8	-16.1	-16.1	0%	-19.8	-19.8	0%	-22.1	-22.1	0%
EBITDA	0.4	2.11	2.7	2.8	3%	4.1	5.7	40%	5.8	10.9	89%
D&A	0.0	-0.1	-0.1	-0.1	0%	-0.1	-0.1	0%	-0.1	-0.1	0%
EBIT	0.4	2.1	2.7	2.7		4.0	5.7		5.71	10.85	
Net interest	0.0	0.0	0.0	0.0	-	0.0	0.0	-	0.0	0.0	-
NPBT	0.4	2.1	2.7	2.7		4.0	5.7		5.7	10.9	
Tax	0.0	0.0	0.0	0.0	-	0.0	0.0	-	0.0	0.0	-
NPAT normalised	0.4	2.1	2.7	2.7		4.0	5.7		5.7	10.9	

Source: Company reports, Canaccord Genuity estimates

Appendix: Important Disclosures

Analyst Certification

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Investment Recommendation

Date and time of first dissemination: July 19, 2023, 03:05 ET

Date and time of production: July 19, 2023, 03:05 ET

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 07/19/23)

Rating	Coverage Universe		IB Clients
	#	%	%
Buy	619	65.71%	21.97%
Hold	133	14.12%	6.77%
Sell	16	1.70%	6.25%
Speculative Buy	160	16.99%	46.88%
	942*	100.0%	

*Total includes stocks that are Under Review

Canaccord Genuity Ratings System

BUY: The stock is expected to generate risk-adjusted returns of over 10% during the next 12 months.

HOLD: The stock is expected to generate risk-adjusted returns of 0-10% during the next 12 months.

SELL: The stock is expected to generate negative risk-adjusted returns during the next 12 months.

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

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

Risk Qualifier

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

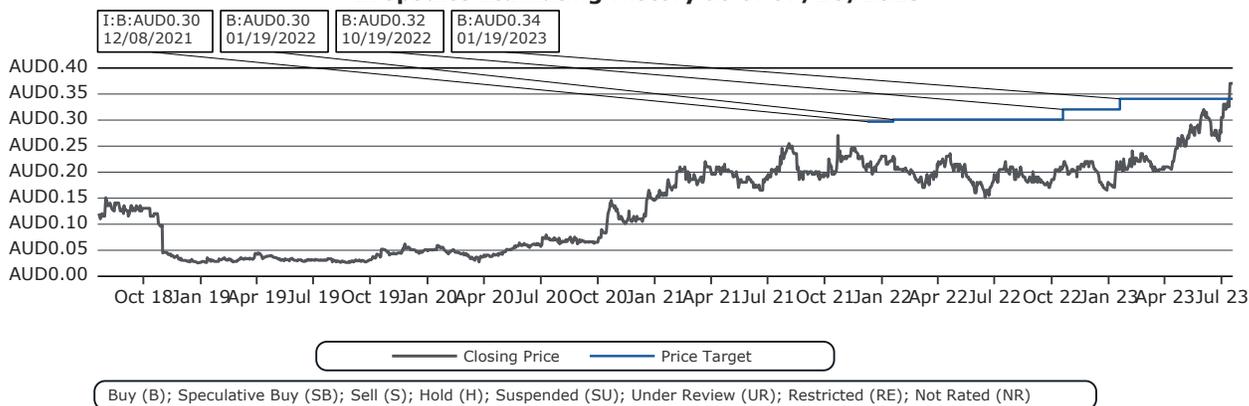
12-Month Recommendation History (as of date same as the Global Stock Ratings table)

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Dropsuite Ltd Rating History as of 07/18/2023



Past performance

In line with Article 44(4)(b), MiFID II Delegated Regulation, we disclose price performance for the preceding five years or the whole period for which the financial instrument has been offered or investment service provided where less than five years. Please note price history refers to actual past performance, and that past performance is not a reliable indicator of future price and/or performance.

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