

22 July 2024

Raising Target Price

# Dropsuite Ltd

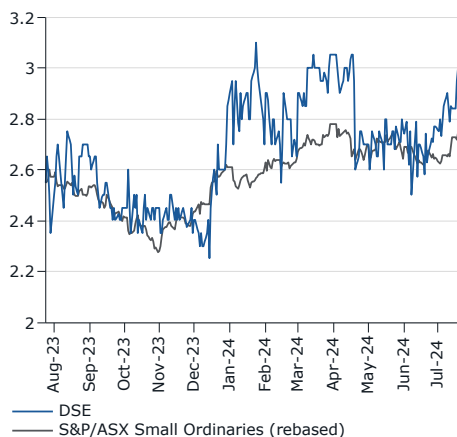
## Software and Services

Rating <b>BUY</b> unchanged	Price Target <b>A\$4.50</b> ↑ from A\$4.00
DSE-ASX	Price <b>A\$3.40</b>

### Market Data

52-Week Range (A\$) :	2.20 - 3.90
Market Cap (A\$M) :	231.0
Shares Out. (M) :	67.9
Dividend /Shr (A\$) :	0.00
Dividend Yield (%) :	0.0
Enterprise Value (A\$M) :	206.5
Cash (A\$M) :	24.5
Long-Term Debt (A\$) :	0.0

FYE Dec	2023A	2024E	2025E	2026E
Sales (A\$M)	29.9	39.9↑	51.4↑	63.0↑
Previous	-	39.8	51.1	62.2
Gross Profit (A\$M)	20.5	27.3	35.2	43.1
EBITDA (A\$M)	2.6	2.9↑	5.0↑	7.4↑
Previous	-	2.8	4.8	6.9
EBIT (A\$M)	2.6	2.8↑	4.9↑	7.4↑
Previous	-	2.7	4.7	6.8
Net Income Adj (A\$M)	2.6	2.8↑	4.9↑	7.4↑
Previous	-	2.7	4.7	6.8
Net Debt (Cash) (A\$M)	(25)	(27)	(32)	(40)↓
Previous	-	-	-	(39)
EV/Sales (x)	6.9	5.1	3.9	3.0



Priced as of close of business 22 July 2024

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

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## Breakout quarter; records across key business metrics

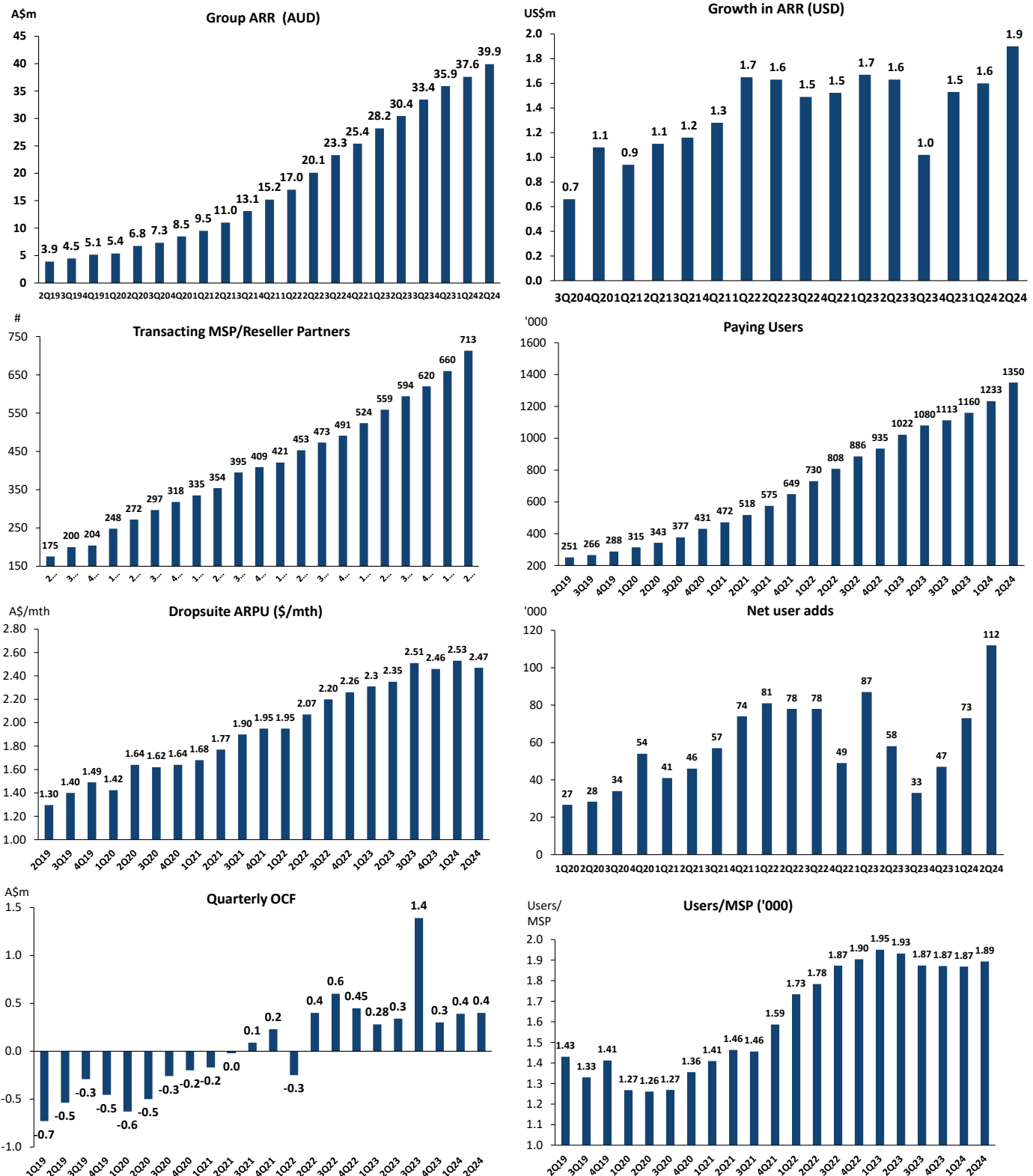
- DSE reported what we consider a breakout quarter, with investments committed over the previous two years resulting in (1) record quarterly net users growth (112k), (2) record direct/indirect partner adds (53x/275x), (3) reduction in MSP churn to a historically low <3% that generated a record incremental ARR improvement of US \$1.9m to US\$26.5m/A\$39.9m (+31%).
- ARR increased +6% qoq (cc +8%) and +31% pcp to A\$39.9m (CGe \$39.5m, US\$26.5m).** The incremental quarterly ARR add of US\$1.9m (CGe US\$1.7m) was a record and we believe an illustration of underlying business momentum, notably across all regions. +31% ARR growth was driven by +25% user growth, +4% ARPU growth and +2% FX benefit vs pcp. Run-rating DSE's incremental 2Q24 ARR (US \$1.9m), we see FY24E ARR growth of A\$11.4m representing a cash gross profit growth of \$8m providing increased reinvestment capability.
- Record net user additions of 112k** (1Q24 73k, 4Q23 47k, 3Q23 33k) was the highlight and +30% higher than its previous peak (1Q23 87k). DSE reported 1.35m paying users (pcp 1.08m) with churn reducing to historically low levels of <3%. ARPU of A\$2.47/US\$1.64 per month was broadly in line with prior quarters (1Q24 A\$2.53) and impacted by the release of a new SKU for non-for-profit organisation at discounted rates. We note DSE product remains priced at a premium to industry peers given its enhanced UX, service and feature set.
- The company **onboarded a record 53 direct partners** (~710, CGe 25) and 295 indirect transacting MSPs (~4.5k), which we consider a lead for future revenue growth. On the conference call management noted a "large whitespace that exists within existing MSP customer base" (i.e., its backbook) and when coupled with record growth in its frontbook (new indirect partner adds) should see its user growth maintain >100k/qtr over the medium term.
- Gross profit margins of 69%** (CGe 1H24 69%) is consistent with expectations; we see long-term upside potential as the company moves to the private cloud (CGe >80%). **FCF of +\$0.4m** (1Q24 \$0.4m, 4Q23 \$0.3m) was in line, and we forecast +7% FCF margins in FY24. DSE closed the quarter with **net cash of \$25m**, stable on the prior quarter. Management reiterated it expects to pursue "high conviction M&A opportunities" and invest in R&D/S&M that will see DSE maintain cashflow and profitability broadly in line with FY23 levels (i.e. EBITDA ~\$3m; FCF ~\$2m). **We are buoyed by the strong exit run rate of user adds, which should translate to an acceleration in ARR growth in 2H24.**
- The CrowdStrike cyber issues that impacted 8.5m MFST users over the weekend should also provide a tailwind to the sector as companies review their cybersecurity protocols and the importance of an independent backup solution. We note 85% of SMEs do not currently back up their data, which we believe will be materially lower in the long term.
- We forecast the stock is **on track to be a rule-40 company in FY24**, and observing US SaaS metrics on a larger sample size would see DSE trade to 6x CY25E EV/revenue, equating to a \$5ps valuation, in our view. We therefore expect an ongoing multiple re-rating in the stock, coupled with strong organic growth that will be complemented by strategic M&A. **We increase our price target to \$4.50ps** (previously \$4.00ps, pre share consolidation) following the roll-forward of our valuation and increase in our medium-term growth rate.

**Figure 1: DSE financial summary**

Dropsuite (DSE)						Share Price Market Cap					\$ 3.40 \$ 231.0
Profit & Loss (\$m)	2022A	2023A	2024F	2025F	2026F	Valuation ratios	2022A	2023A	2024F	2025F	2026F
						EPS (cps)	2.2	1.2	1.9	3.2	4.3
ARR	25.4	34.3	45.6	58.1	71.1						
Sales Revenue	21.0	29.9	39.9	51.4	63.0	Enterprise Value (\$m)	209	206	204	199	191
COGS	-7.1	-9.4	-12.6	-16.2	-19.8	EV/ARR	8.2	6.0	4.5	3.4	2.7
Gross Profit	13.9	20.5	27.3	35.2	43.1	EV/Revenue	10.0	6.9	5.1	3.9	3.0
Opex	-11.8	-17.8	-24.5	-30.2	-35.7	EV/Gross Profit	15.0	10.1	7.4	5.6	4.4
EBITDA	2.1	2.6	2.9	5.0	7.4	EV/GPAPA (gp after S&M)	15.0	10.1	7.4	5.6	4.4
D & A	-0.1	-0.1	-0.1	-0.1	-0.1	EV / EBITDA (x)	nmf	nmf	nmf	39.9	25.8
EBIT	2.1	2.6	2.8	4.9	7.4	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	2.1	2.6	2.8	4.9	7.4	Payout ratio (%)	0%	0%	0%	0%	0%
Tax expense	0.0	0.0	0.0	0.0	0.0						
NPAT (Normalised)	2.1	2.6	2.8	4.9	7.4	Dupont Analysis	2022A	2023A	2024F	2025F	2026F
Significant items	-0.6	0.0	0.0	0.0	0.0	Net Profit Margin	7.0%	8.6%	7.1%	9.6%	11.7%
NPAT (Reported)	1.5	2.6	2.8	4.9	7.4	Asset Turnover	0.8	1.0	1.2	1.3	1.4
						ROA (%)	5.4%	8.3%	8.4%	12.8%	16.0%
Gross Profit Margin (%)	66.2%	68.5%	68.5%	68.5%	68.5%	Financial Leverage	1.1	1.1	1.1	1.1	1.1
EBITDA Margin (%)	10.1%	8.8%	7.2%	9.7%	11.8%	ROE (%)	6.1%	9.4%	9.4%	14.0%	17.4%
EBIT Margin (%)	9.8%	8.6%	7.1%	9.6%	11.7%						
NPAT Margin (%)	7.0%	8.6%	7.1%	9.6%	11.7%	Balance Sheet ratios	2022A	2023A	2024F	2025F	2026F
						Net Debt (cash)	-22.3	-24.5	-27.3	-32.2	-39.6
Cash Flow (\$m)	2022A	2023A	2024F	2025F	2026F	NTA per share (\$)	0.4	0.4	0.4	0.5	0.6
Operating EBITDA	2.1	2.6	2.9	5.0	7.4	Price / NTA (x)	9.6	8.5	7.7	6.8	5.5
- Interest & Tax Paid	0.2	0.0	0.0	0.0	0.0	Shares on issue (m)	67.9	67.9	67.9	69.8	69.8
+/- change in Work. Cap.	-1.4	-0.5	0.0	0.0	0.0	EFPOWA (m)	67.9	67.9	67.9	69.8	68.9
- other	0.0	0.0	0.0	0.0	0.0						
Operating Cashflow	0.9	2.1	2.9	5.0	7.4	Assumptions	2022A	2023A	2024F	2025F	2026F
- Other Capex	-0.1	-0.1	-0.1	-0.1	-0.1	Revenue growth	79.0%	42.5%	33.7%	28.7%	22.5%
- Intangibles/other	0.0	0.0	0.0	0.0	0.0	Gross profit margin	66.2%	68.5%	68.5%	68.5%	68.5%
- Acquisitions	0.0	0.0	0.0	0.0	0.0	Opex growth	64.3%	71.3%	36.9%	42.6%	37.2%
Free Cashflow	0.9	2.0	2.8	4.9	7.3						
- Ord Dividends	0.0	0.0	0.0	0.0	0.0	Users ('000)	935	1160	1485	1783	2057
- Equity /other	0.0	0.0	0.0	0.0	0.0	MSP (#)	491	620	763	863	963
Net Cashflow	0.9	2.0	2.8	4.9	7.3	ARPU (A\$)	2.3	2.5	2.6	2.7	2.9
Cash at beginning of period	21.6	22.5	24.5	27.3	32.2	ARR (A\$m)	25.4	34.3	45.6	58.1	71.1
+/- borrowings / other	0.0	0.0	0.0	0.0	0.0						
Cash at end of period	22.5	24.5	27.3	32.2	39.6	Interim Analysis	2H22A	1H23A	2H23A	1H24E	2H24E
						Revenues	12.1	14.1	15.8	18.6	21.4
Balance Sheet	2022A	2023A	2024F	2025F	2026F	Gross profit	8.3	9.7	10.7	12.7	14.6
Cash	22.3	24.5	27.3	32.2	39.6	EBIT	1.6	1.0	1.5	1.3	1.5
Debtors	4.1	5.4	5.4	5.4	5.4	EBIT margin (%)	13.2%	7.3%	9.7%	7.0%	7.2%
Inventory	0.0	0.0	0.0	0.0	0.0	DPS	1.0	3.0	3.0	5.0	6.0
PPE	0.1	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	0.5	0.8	0.8	0.8	0.8	Board of Directors	shareholding	%			
Total Assets	26.9	30.8	33.6	38.6	45.9	Theodore Hnarakis (NEC)	11.8	17.3%			
Deferred Revenue	0.1	0.1	0.1	0.1	0.1	Charif Elansari (CEO)	29.5	43.4%			
Trade Creditors	2.5	3.3	3.3	3.3	3.3	Dr Bruce Tonkin (NED)	1.5	2.2%			
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	2.8	3.5	3.5	3.5	3.5						
NET ASSETS	24.2	27.3	30.1	35.0	42.4						

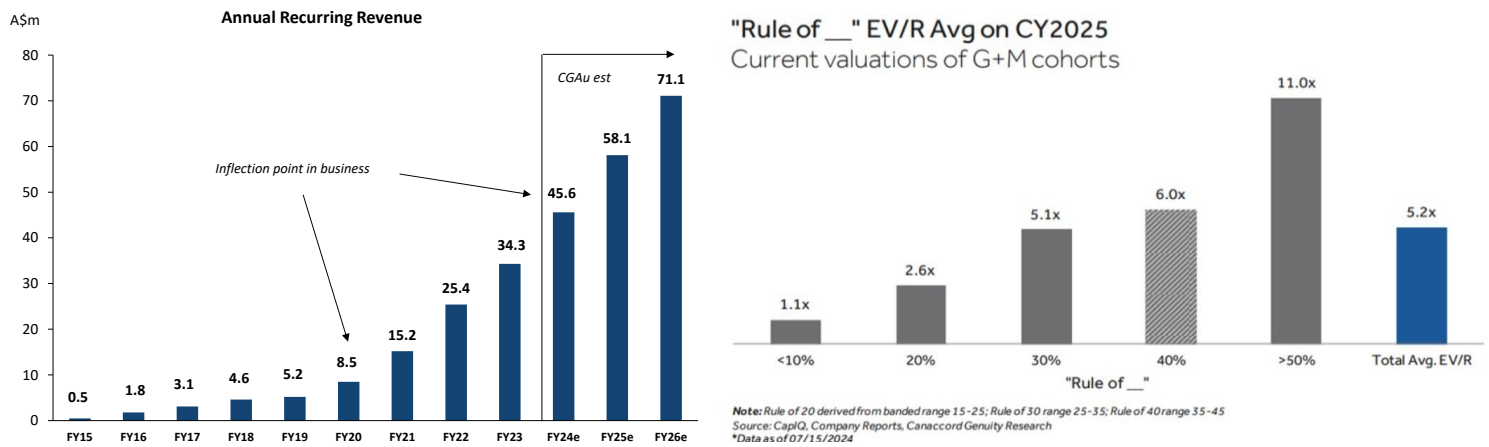
Source: Company reports, Canaccord Genuity estimates

**Figure 2: Key growth drivers**



Source: Company Reports, Canaccord Genuity estimates

**Figure 3: Projected growth justifies larger multiple, in our view**



Source: Company Reports, Canaccord Genuity estimates

# Appendix: Important Disclosures

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## Investment Recommendation

Date and time of first dissemination: July 22, 2024, 05:34 ET

Date and time of production: July 22, 2024, 05:34 ET

## Target Price / Valuation Methodology:

Dropsuite Ltd - DSE

DCF methodology (\$0.30ps, Ke 13%,  $\beta$  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 07/22/24)

Rating	Coverage Universe		IB Clients
	#	%	%
Buy	609	66.85%	22.66%
Hold	132	14.49%	11.36%
Sell	12	1.32%	8.33%
Speculative Buy	149	16.36%	49.66%
	911*	100.0%	

\*Total includes stocks that are Under Review

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**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.

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

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

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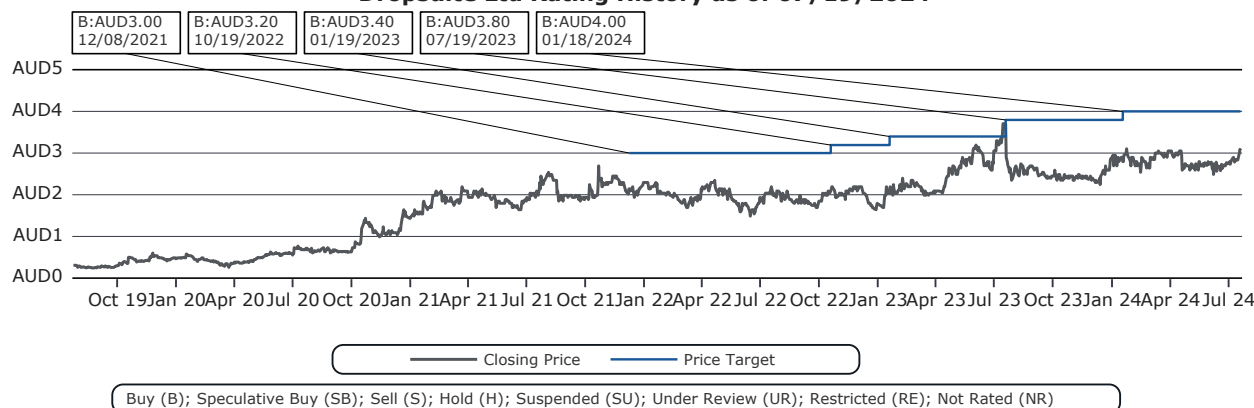
## 12-Month Recommendation History (as of date same as the Global Stock Ratings table)

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### Dropsuite Ltd Rating History as of 07/19/2024



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