

23 October 2024

Company Update

Dropsuite Ltd

Software and Services

Rating
BUY
unchanged

Price Target
A\$4.50
unchanged

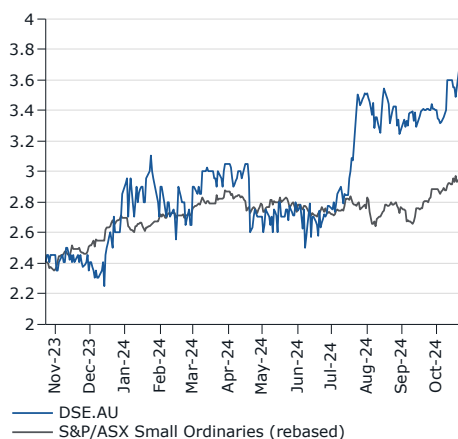
DSE-ASX

Price
A\$3.77

Market Data

52-Week Range (A\$) :	2.20 - 3.77
Market Cap (A\$M) :	256.1
Shares Out. (M) :	69.8
Dividend /Shr (A\$) :	0.00
Dividend Yield (%) :	0.0
Enterprise Value (A\$M) :	230.6
Cash (A\$M) :	25.5
Long-Term Debt (A\$) :	0.0

FYE Dec	2023A	2024E	2025E	2026E
Sales (A\$M)	29.9	39.9	51.4	63.0
Gross Profit (A\$M)	20.5	27.3	35.2	43.1
EBITDA (A\$M)	2.6	2.9	5.0	7.4
EBIT (A\$M)	2.6	2.8	4.9	7.4
Net Income Adj (A\$M)	2.6	2.8	4.9	7.4
Net Debt (Cash) (A\$M)	(25)	(27)	(32)	(40)
EV/Sales (x)	7.8	5.7	4.4	3.4



Priced as of close of business 22 October 2024

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

Owen Humphries | Analyst | Canaccord Genuity (Australia) Ltd. | ohumphries@cgf.com | +61.2.9263.2702
Annabelle Holden | Analyst | Canaccord Genuity (Australia) Ltd. | AHolden@cgf.com | 61.2.9263.2792

Another record quarter; +34% cc ARRg at +8% FCF margins

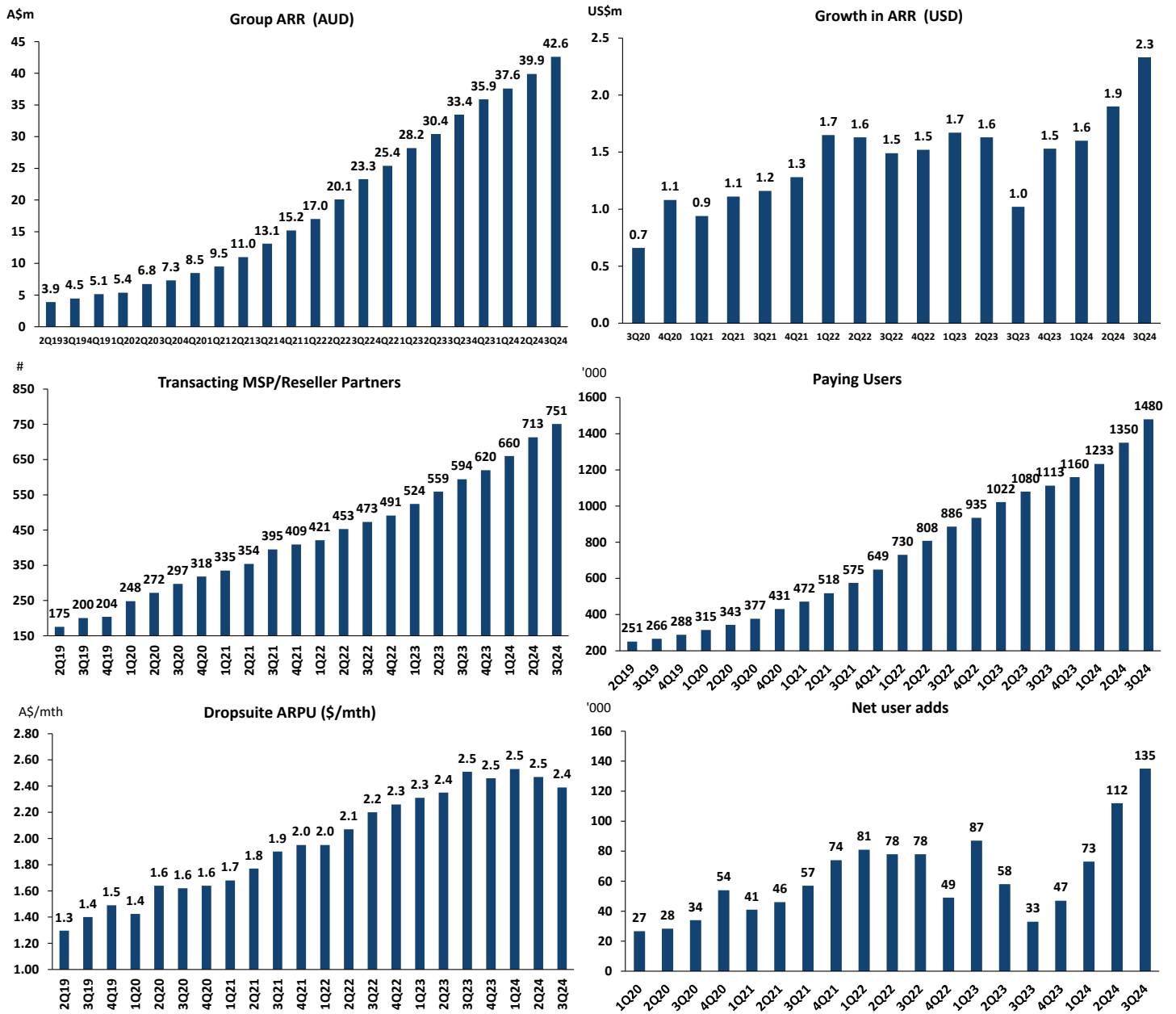
- **DSE reported another record incremental growth quarter with ARR increasing +7% qoq (+9% cc) and +27% yoy (+34% cc) to \$43m (CGe \$43m, US\$29m).** The incremental quarterly ARR add of US\$2.3m (CGe US\$2m) was a record and an illustration of the underlying business momentum and network effects of as its MSP network expands.
- The +27% yoy ARR growth was driven by +34% user growth, +1% ARPU growth offset by -5% FX. Run-rating DSE's incremental 3Q24 ARR (US\$2.3m) and FX cross-rate of 0.67x sees DSE ARR increase to A\$65m in FY25, and provides a larger reinvestment opportunity (\$15m gross profit growth). A focus for investors has been the somewhat flat ARR increase qoq since 1Q22, however the last four quarters strong momentum.
- **The company added a record 135k users (+34% yoy) with the step up bringing the total users to 1.48m.** DSE product is sold through the MSP channel with a typical lag as they proliferate this product into their SME customer base. Therefore, growth in its reseller/partner network provides a lead into future ARR growth. The company added 38 new direct and 270 indirect transacting MSPs during the period with >5k indirect partners representing an industry penetration of just ~4% (FY20 <1%).
- **APRU of A\$2.39** increased +1% pcp on a cc basis, however -5% pcp on FX adj. basis and impacted by a mix shift from PartnerServ, BYOS and non-for-profit partners.
- **Gross margins of 69% was** stable on the prior quarters. Long term upside relates to moving to private cloud and could see gross profit margins >80% increasing DSE operating leverage to growth.
- **FCF remains positive at +\$0.7m** (2Q24 +\$0.5m, 3Q23 +\$1.3m) and inline with guidance. DSE closed the quarter with **\$26m cash** and management continue to reiterate their pursuit of "high conviction M&A opportunities" at the right valuation, noting elevated multiples in the private space have persisted.
- The quarterly illustrates a resilient and predictable growth profile as DSE gains market share in a structurally growing industry. **Looking forward 12 months, on DSE's current trajectory (US\$2.3m inc. add), we believe the market will be looking forward one year to a business generating an ARR >\$65m and a scaled quality SaaS player on the ASX.** We expect the share price to be driven by strong organic growth (complimented by strategic M&A) and ultimately a multiple re-rating (FY26 <3x EV/ARR, US peers >6x). We retain our BUY recommendation; however, we leave our forecasts unchanged.

Figure 1: Dropsuite (DSE-AU): Financial summary

						Share Price Market Cap					\$ 3.77
											\$ 256.1
Dropsuite (DSE)											
Profit & Loss (\$m)	2022A	2023A	2024F	2025F	2026F	Valuation ratios	2022A	2023A	2024F	2025F	2026F
ARR	25.4	34.3	45.6	58.1	71.1	EPS (cps)	2.2	1.2	1.9	3.2	4.3
Sales Revenue	21.0	29.9	39.9	51.4	63.0	Enterprise Value (\$m)	234	232	229	224	217
COGS	-7.1	-9.4	-12.6	-16.2	-19.8	EV/ARR	9.2	6.8	5.0	3.9	3.0
Gross Profit	13.9	20.5	27.3	35.2	43.1	EV/Revenue	11.2	7.8	5.7	4.4	3.4
Opex	-11.8	-17.8	-24.5	-30.2	-35.7	EV/Gross Profit	16.9	11.3	8.4	6.4	5.0
EBITDA	2.1	2.6	2.9	5.0	7.4	EV/GPAPA (gp after S&M)	16.9	11.3	8.4	6.4	5.0
D & A	-0.1	-0.1	-0.1	-0.1	-0.1	EV / EBITDA (x)	nmf	nmf	nmf	44.9	29.2
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)	10.6	9.4	8.5	7.5	6.1
- 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 charts



Source: Company reports, Canaccord Genuity estimates

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Investment Recommendation

Date and time of first dissemination: October 22, 2024, 19:12 ET

Date and time of production: October 22, 2024, 19:12 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 10/22/24)

Rating	Coverage Universe		IB Clients
	#	%	%
Buy	614	66.88%	24.43%
Hold	133	14.49%	9.77%
Sell	14	1.53%	7.14%
Speculative Buy	148	16.12%	52.03%
	918*	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.

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

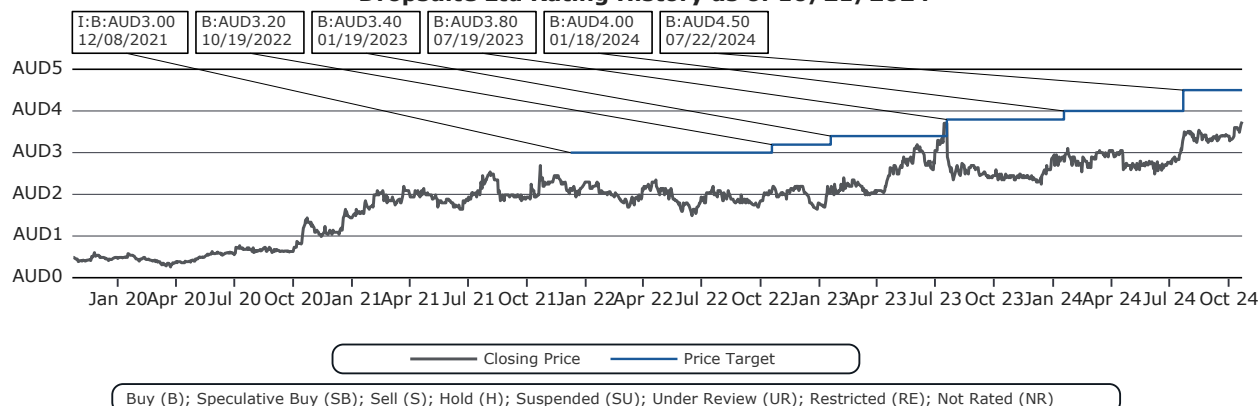
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Dropsuite Ltd Rating History as of 10/21/2024



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