PETRA CAPITAL

21 July 2023

Dropsuite Limited (DSE) BUY Share Price: A$0.29

Keeping the faith Target Price: A$0.31

Following another solid quarter, we remain favourably disposed to DSE's strategic intent within a high growth and global market. Reiterate Buy with new $0.31ps TP.

2Q23 broadly in line with expectations

- DSE reported a reasonably solid 2Q23 result, with the key feature being the ARR of A$30.4m, +8% on pcp in AUD terms and +9% on pcp in USD terms. On a year-on-year basis, DSE is growing at ~2x system growth.
- The ARR growth was predicated on continued growth in both ARPU (+2% on pcp in AUD terms) and net users (+6% on pcp), with the latter being achieved despite the deactivation of a major legacy hosting partner.
- Consistent with management's expectations, DSE's GP margin stayed within its target range at 69% (and was above our 68% estimate), while Op. CF continued to be positive at $0.34m, down from $0.40m in pcp.

Positive outlook commentary remains intact

- Notwithstanding a more modest quarter of growth and the recent launch of Microsoft's Syntex (which is an AI-powered tool that incl. a backup solution for Microsoft 365), DSE's strategic intent and outlook are unchanged.
- While Syntex is undoubtedly a threat, we believe DSE's (i) TAM is large, and growing, and (ii) market leading position with MSPs can be retained via its commitment to product quality/innovation and independence.

Modest earnings forecasts revisions

- We have lowered our EPS estimate for both FY23 and FY24 by 1%, with our FY25 estimate unchanged. The key drivers are (i) lower revenues, driven by lower user growth and ARPU, and (ii) higher GP margin.

Reiterate Buy and lift TP to $0.31ps (from $0.29ps)

- We believe DSE has the products, business model and capital to exceed system growth (~25% p.a.) within its target market (data back-up and archiving) over the next several years.
- Given DSE's ability to leverage its strong balance sheet to supplement what we expect to be a strong multi-year organic growth profile with M&A, we reiterate our Buy rating with a new TP of $0.31ps (previously $0.29ps).
- While our DCF valuation is unchanged at $0.29ps, we have transitioned to a valuation blend comprising our DCF valuation and EV/sales valuation of $0.33ps (using an ascribed FY24 multiple of 5x).
- Consistent with DSE's partner-led business model and growth strategy, the key share price catalysts include (i) continued growth in ARR in excess of reinvestments, (ii) product innovation, and (iii) strategic M&A.

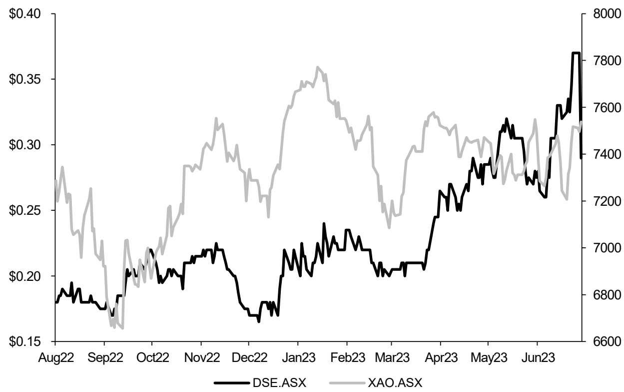
Company Data

Shares – ordinary (M)	692.7
Dilution (M)	16.8
Total (fully diluted) (M)	709.5
Market capitalisation ($M)	197.4
12-month low/high ($)	0.16 - 0.39
Average monthly turnover ($M)	19.8
GICS Industry	Software

Financial Summary (fully diluted/normalised)

Year End December	2021A	2022A	2023F	2024F	2025F
Revenue (A$m)	11.7	20.7	30.9	41.7	51.7
Costs (A$m)	11.7	19.4	28.8	38.7	46.1
EBITDA (A$m)	0.0	1.3	2.1	3.0	5.7
NPAT (A$m)	0.0	1.5	1.7	2.4	4.4
EPS (¢)	0.0	0.2	0.2	0.3	0.6
EPS Growth (%)	98.7	>100.0	14.5	37.4	84.9
PER (x)	nm	137.3	118.7	85.4	46.2
FCF (A$m)	0.2	0.9	1.4	1.7	4.3
FCF per share (cps)	0.0	0.1	0.2	0.2	0.6
Price to FCF (x)	912.1	234.3	141.4	115.8	48.0
EV (A$m)	162.8	177.0	178.5	177.1	175.4
EV/EBITDA	nm	141.5	85.3	59.7	30.8
Payout ratio (%)	0.0	0.0	0.0	0.0	0.0
Dividend (¢)	0.0	0.0	0.0	0.0	0.0
Net Yield (%)	0.0	0.0	0.0	0.0	0.0
Franking (%)	0.0	0.0	0.0	0.0	0.0

DSE – performance over one year



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James Lennon
+61 2 9239 9618

Analysis

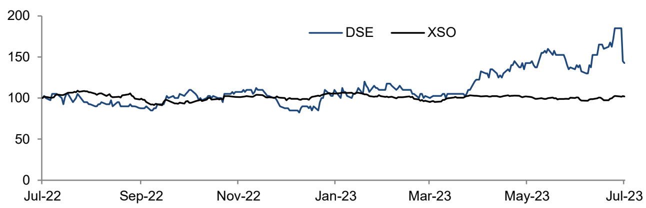
Dropsuite

Year End December

MARKET DATA

Recommendation		Buy
Price	**A$**	**0.29**
Price target (12-month)	**A$**	**0.31**
52 week high / low	A$	0.16 - 0.39
Market capitalisation	**A$m**	**197.4**
Shares on issue (basic)	no.	692.7
Performance rights	no.	16.8
Other equity	no.	0.0
Shares on issue (diluted)	no.	709.5

12-MONTH SHARE PRICE PERFORMANCE

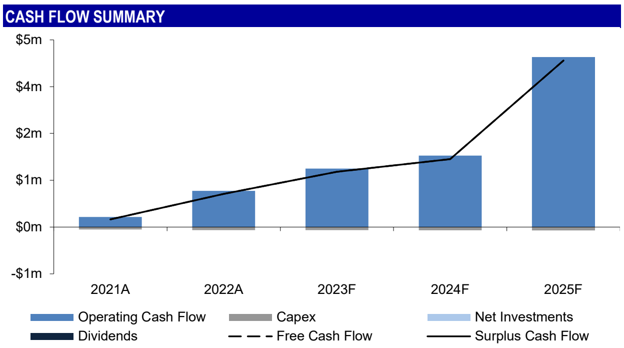


INVESTMENT FUNDAMENTALS		2021A	2022A	2023F	2024F	2025F
Underlying net profit	$m	(0.0)	1.5	1.7	2.4	4.4
Reported net profit	**$m**	**(0.0)**	**1.5**	**1.7**	**2.4**	**4.4**
Reported EPS (diluted)	¢	(0.0)	0.2	0.2	0.3	0.6
Normalised EPS (diluted)	**¢**	**(0.0)**	**0.2**	**0.2**	**0.3**	**0.6**
....Growth	%	98.7	>100.0	14.5	37.4	84.9
Normalised diluted PER	**x**	**nm**	**137.3**	**118.7**	**85.4**	**46.2**
Adjusted Op. CF per share	¢	0.0	0.1	0.2	0.3	0.6
Adjusted FCF per share	¢	0.0	0.1	0.2	0.2	0.6
Price to free cash flow per share	**x**	**912.1**	**234.3**	**141.4**	**115.8**	**48.0**
Free cash flow yield	%	**0.1**	**0.4**	**0.7**	**0.9**	**2.1**
Dividend per share	**¢**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Payout ratio	%	0.0	0.0	0.0	0.0	0.0
Yield	%	0.0	0.0	0.0	0.0	0.0
Franking	%	0.0	0.0	0.0	0.0	0.0
Enterprise value	**$m**	**162.8**	**177.0**	**178.5**	**177.1**	**175.4**
EV/EBITDA	x	nm	141.5	85.3	59.7	30.8
EV/EBIT	x	nm	148.6	88.6	61.4	31.3
Price to book (NAV)	x	8.9	8.1	7.3	6.5	5.4
Price to NTA	x	8.9	8.1	7.3	6.5	5.4

KEY RATIOS		2021A	2022A	2023F	2024F	2025F
EBITDA margin	%	0.0	6.0	6.8	7.1	11.0
EBIT margin	%	(0.3)	5.8	6.5	6.9	10.8
Underlying net profit margin	%	(0.3)	7.0	5.5	5.7	8.6
Return on average equity	%	16.1	17.5	17.6	17.2	16.4
Return on average assets	%	17.0	18.7	18.9	18.8	18.0
Net tangible assets per share	¢	3.2	3.5	3.9	4.4	5.3
Net debt /(cash)	$m	(21.6)	(22.3)	(25.1)	(28.7)	(35.1)
Interest cover (EBIT / net interest)	x	n/a	n/a	n/a	n/a	n/a
Leverage (net debt / EBITDA)	x	n/a	n/a	n/a	n/a	n/a
Gearing (net debt / net debt plus equity)	%	n/a	n/a	n/a	n/a	n/a

DUPONT ANALYSIS		2021A	2022A	2023F	2024F	2025F
Net Profit Margin	%	11.3	13.5	15.1	16.7	17.9
Asset Turnover	x	1.2	1.1	1.0	0.9	0.8
Return on Assets	%	13.4	14.6	14.8	14.7	14.2
Financial Leverage	x	1.2	1.2	1.2	1.2	1.2
Return on Equity	**%**	**16.1**	**17.5**	**17.6**	**17.2**	**16.4**

CASH FLOW SUMMARY



PROFIT AND LOSS		2021A	2022A	2023F	2024F	2025F
Total revenue	$m	11.7	20.7	30.9	41.7	51.7
EBITDA	**$m**	**0.0**	**1.3**	**2.1**	**3.0**	**5.7**
Depreciation & amortisation	$m	0.0	0.1	0.1	0.1	0.1
EBIT	$m	(0.0)	1.2	2.0	2.9	5.6
Net interest	$m	(0.0)	(0.3)	(0.2)	(0.3)	(0.3)
Non-operating income	$m	0.0	0.0	0.0	0.0	0.0
Pretax Profit	$m	(0.0)	1.5	2.3	3.2	5.9
Tax expense	$m	0.0	0.0	0.6	0.8	1.5
Minorities	$m	0.0	0.0	0.0	0.0	0.0
Reported NPAT	**$m**	**(0.0)**	**1.5**	**1.7**	**2.4**	**4.4**
Significant items	$m	0.0	0.0	0.0	0.0	0.0
Underlying NPAT	$m	(0.0)	1.5	1.7	2.4	4.4

GROWTH PROFILE		2021A	2022A	2023F	2024F	2025F
Operating revenue	%	64.6	76.8	49.4	34.8	24.1
EBITDA	%	>100.0	>100.0	67.2	41.8	91.7
EBIT	%	98.4	>100.0	69.2	43.1	94.1
Operating NPAT	%	98.5	>100.0	16.5	40.0	87.7
Normalised EPS	%	98.7	>100.0	14.5	37.4	84.9
DPS	%	0.0	0.0	0.0	0.0	0.0

BALANCE SHEET		2021A	2022A	2023F	2024F	2025F
Cash	$m	21.6	22.3	25.1	28.7	35.1
Receivables	$m	2.2	4.1	6.2	8.3	10.3
Inventory	$m	0.0	0.0	0.0	0.0	0.0
Other	$m	0.2	0.4	0.4	0.4	0.4
Current	$m	24.0	26.8	31.7	37.4	45.8
Prop, plant & equip	$m	0.0	0.1	0.1	0.1	0.1
Goodwill	$m	0.0	0.0	0.0	0.0	0.0
Other	$m	0.1	0.1	0.1	0.1	0.1
Non current	$m	0.1	0.1	0.1	0.2	0.2
Total assets	**$m**	**24.1**	**26.9**	**31.8**	**37.6**	**46.0**
Accounts Payable	$m	2.0	2.5	3.9	5.2	6.5
Borrowings	$m	0.0	0.0	0.0	0.0	0.0
Other	$m	0.2	0.2	0.7	0.9	1.5
Total liabilities	**$m**	**2.2**	**2.7**	**4.5**	**6.1**	**7.9**
Net assets	$m	21.9	24.2	27.3	31.5	38.1
Equity	$m	21.9	24.2	27.3	31.5	38.1
Minorities	$m	0.0	0.0	0.0	0.0	0.0
Shareholder's equity	**$m**	**21.9**	**24.2**	**27.3**	**31.5**	**38.1**
Shares on issue	m	681.9	689.9	701.9	716.0	723.5

CASH FLOW		2021A	2022A	2023F	2024F	2025F
EBITDA	$m	0.0	1.3	2.1	3.0	5.7
Change in working capital	$m	(0.0)	(1.4)	(0.7)	(0.8)	(0.8)
Net interest	$m	0.0	0.2	0.2	0.3	0.3
Tax paid	$m	0.0	0.0	(0.1)	(0.6)	(0.9)
Other	$m	0.3	0.9	0.0	0.0	0.0
Operating cash flow	**$m**	**0.3**	**0.9**	**1.5**	**1.8**	**4.4**
Capital expenditure	$m	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)
Acquisitions/divestment/other	$m	0.0	0.0	0.0	0.0	0.0
Investing cash flow	**$m**	**(0.1)**	**(0.1)**	**(0.1)**	**(0.1)**	**(0.1)**
Free cash flow	**$m**	**0.2**	**0.9**	**1.4**	**1.7**	**4.3**
Equity	$m	18.9	0.0	1.4	1.8	2.1
Increase / (decrease) in borrowings	$m	0.0	0.0	0.0	0.0	0.0
Dividend/other	$m	0.0	0.0	0.0	0.0	0.0
Financing cash flow	**$m**	**18.9**	**0.0**	**1.4**	**1.8**	**2.1**
Net cash flow	**$m**	**19.1**	**0.9**	**2.8**	**3.6**	**6.4**

Source: Petra Capital

21 July 2023

Petra Capital

Level 17, 14 Martin Place, Sydney NSW 2000
Level 5, 1 Collins Street, Melbourne VIC 3000

ABN 95 110 952 782
ACN 110 952 782
AFSL 317 944

Director:	George Marias	+61 (0)2 9239 9601	gmarias@petracapital.com.au
Research (Resources):	Brett McKay	+61 (0)2 9239 9605	bmckay@petracapital.com.au
Research (Resources):	Hugh Stackpool	+61 (0)2 9239 9625	hstackpool@petracapital.com.au
Research (Resources):	David Brennan	+61 (0)2 9239 9630	dbrennan@petracapital.com.au
Research (Resources):	Andrew Harrington	+61 (0)2 9239 9614	aharrington@petracapital.com.au
Research (Resources):	Kieran Barratt	+61 (0)2 9239 9610	kbarratt@petracapital.com.au
Research (Resources):	Colin McLelland	+61 (0)2 9239 9639	cmclelland@petracapital.com.au
Research (Industrials):	Liam Cummins	+61 (0)2 9239 9607	lcummins@petracapital.com.au
Research (Industrials):	James Lennon	+61 (0)2 9239 9618	jlennon@petracapital.com.au
Research (Industrials):	Sam Haddad	+61 (0)2 9239 9633	shaddad@petracapital.com.au
Research (Industrials):	Ken Wagner	+61 (0)2 9239 9642	kwagner@petracapital.com.au
Research (Industrials):	Daniel Ireland	+61 (0)2 9239 9647	direland@petracapital.com.au
Research (Industrials):	Mark Yarwood	+61 (0)2 9239 9646	myarwood@petracapital.com.au
Research (Healthcare):	Tanushree Jain	+61 (0)2 9239 9649	tjain@petracapital.com.au
Sales:	Frank Barila	+61 (0)2 9239 9603	fbarila@petracapital.com.au
Sales:	Vincent Pisani	+61 (0)2 9239 9617	vpisani@petracapital.com.au
Sales:	Peter Veldhuizen	+61 (0)2 9239 9609	pveldhuizen@petracapital.com.au
Sales:	Neil Watson	+61 (0)2 9239 9602	nwatson@petracapital.com.au
Sales:	Leigh Gardner	+61 (0)400 740 842	lgardner@petracapital.com.au
Sales:	Vince Barila	+61 (0)2 9239 9627	vbarila@petracapital.com.au
Sales:	Colin Redmond	+61 (0)2 9239 9613	credmond@petracapital.com.au
Sales:	Richard Macphillamy	+61 (0)2 9239 9604	rmacphillamy@petracapital.com.au
Sales:	Paul Doherty	+61 (0)407 194 549	pdoherty@petracapital.com.au
Sales:	Tyrone Lara	+61 (0)2 9239 9608	tlara@petracapital.com.au
Sales:	Vince Musumeci	+61 (0)2 9239 9606	vmusumeci@petracapital.com.au
Sales:	Andrew Richards	+61 (0)2 9239 9638	arichards@petracapital.com.au
Sales:	Rob Dobson	+61 (0)2 9239 9628	rdobson@petracapital.com.au
Sales:	Denise Wong	+61 (0)2 9239 9650	dwong@petracapital.com.au
Corporate (ECM):	Verity Barritt	+61 (0)2 9239 9622	vbarritt@petracapital.com.au
Corporate (ECM):	Maureen Baker	+61 (0)438 571 970	mbaker@petracapital.com.au
Corporate (ECM):	Louise Kissell	+61 (0)2 9239 9645	lkissell@petracapital.com.au
Administration:	Suzanne Graham	+61 (0)2 9239 9624	sgraham@petracapital.com.au
Administration:	Belinda Teichmann	+61 (0)2 9239 9636	bteichmann@petracapital.com.au
Administration:	Joanne Condopoulos	+61 (0)2 9239 9635	jcondopoulos@petracapital.com.au
Administration:	Victoria Smith	+61 (0)2 9239 9616	vsmith@petracapital.com.au
Administration:	Larissa Falvo	+61 (0)2 9239 9611	lfalvo@petracapital.com.au
Administration:	Grace Saxby	+61 (0)2 9239 9621	gsaxby@petracapital.com.au
Legal & Compliance:	Danielle Smith	+61 (0)2 9239 9612	dsmith@petracapital.com.au
Financials:	Tony Christelis	+61 (0)2 9239 9615	tchristelis@petracapital.com.au

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