

# Dropsuite Ltd (DSE)

Rating: Buy | Risk: High | Price Target: \$0.34

30 April 2023

## 1Q highlights impressive execution across all fronts. Reiterate Buy.

### Key Information

Current Price (\$ps)	0.27
12m Target Price (\$ps)	0.34
52 Week Range (\$ps)	0.15 - 0.27
Target Price Upside (%)	25.9%
TSR (%)	25.9%
Reporting Currency	AUD
Market Cap (\$m)	190.4
Sector	Information Technology
ASX 200 Weight (%)	0.01%

### Fundamentals

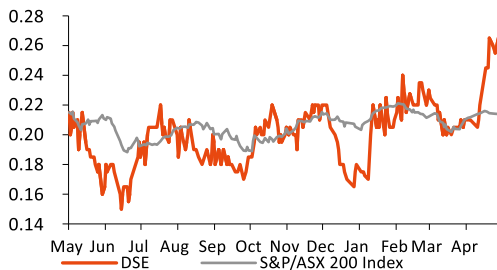
YE 30 Jun (AUD)	FY22A	FY23E	FY24E	FY25E
Sales (\$m)	20.7	29.3	37.2	44.1
NPAT (\$m)	1.5	2.1	2.9	3.9
EPS (cps)	0.2	0.3	0.4	0.5
EPS Growth (%)	638.7%	42.7%	36.2%	29.2%
DPS (cps) (AUD)	0.0	0.0	0.0	0.0
Franking (%)	0%	0%	0%	0%

### Ratios

YE 30 Jun	FY22A	FY23E	FY24E	FY25E
P/E (x)	92.9	90.2	66.2	51.3
EV/EBITDA (x)	131.7	86.1	54.5	38.1
Div Yield (%)	0.0%	0.0%	0.0%	0.0%
Payout Ratio (%)	0.0%	0.0%	0.0%	0.0%

### Price Performance

YE 30 Jun	1 Mth	2 Mth	3 Mth	1 Yr
Relative (%)	24.9%	19.3%	31.1%	27.3%
Absolute (%)	28.6%	20.0%	28.6%	25.6%
Benchmark (%)	3.7%	0.7%	(2.5%)	(1.7%)



Price performance indexed to 100

Source: FactSet

### Major Shareholders

Topline Capital Management LLC (Investme)	26.1%
Glory Wealth Group Ltd.	7.1%
FEARO TRACY ANNE	5.4%

### Event

DSE released its 1Q trading and cashflow in mid-April and we hosted a briefing with management last Friday. The three things that stood out to us were: 1) ARR growth continues to be strong with no evidence of any macro slowdown; 2) Gross margins are tracking ahead of expectation and the FY23 target (~66%) looks likely to be exceeded; and 3) that DSE continues to execute flawlessly across scaling, its go-to-market and new product innovation. DSE represents a rare combo of both strong growth (+50% YoY) whilst being profitable and cashflow positive. It is advancing high-conviction M&A opportunities and is well funded with a cash balance of \$22.7m and no debt. DSE is a top pick. Reiterate Buy.

### Highlights

- 1Q key metrics** – ARR \$28.2m grew +66% YoY and +11% sequentially. In US\$ terms this was 50% and 10% respectively. Users grew +40% YoY (and surpassed 1m users for the first time) and ARPU +7% in US\$. DSE added +33 direct partners and +191 Indirect, suggesting new business trends remain strong. Gross margins delivered at 69%, ahead of implied FY23 targets (~66%). Receipts of \$6.1m grew +65% YoY. Payments delivered at \$6m (vs \$5.3m prior quarter) delivering another free cashflow positive quarter. DSE closed 1Q with cash balance of \$22.7m and no debt.
- Highlights** – 1) 1Q ARR grew +66% YoY well above our +32% FY expectations for FY23. Key drivers were all strong including, partner adds, user growth and ARPU. While there is still 3 quarters to go, we see no evidence of any macro slowdown here. DSE's dual leverage to both cyber security spend and the growing MSP channel appear to be working strongly in its favour. We have upgraded our FY23/24/25 revenue forecasts by 6-7%. 2) Gross margins at 69% were above expectations, highlighting the ongoing focus on managing its cloud costs. DSE's implied FY23 target (~66%) now looks likely to be exceeded. 3) Partner growth continued to be strong and we understand mix trends are favourable with DSE seeing an increasing proportion of larger partners signing (in the 200-500 user range). This is encouraging and a strong validation of its products, value proposition and go-to-market strategy. 4) whilst DSE is investing to support growth, this is being done in a measured and efficient way. Payments grew +16% QoQ but typically 1Q sees higher annual outgoings. If we exclude these (~\$300k) then QoQ growth was more like 8% vs the 11% sequential growth in ARR. 5) Lastly, DSE launched Quickbooks Online (QBO) backup in the quarter, with monetisation expected from April, and we understand the launch of Government Cloud will follow shortly thereafter. This should provide a further tailwind to top line growth in the 2H FY23.
- Outlook** – DSE reiterated its key outlook statements including its expectation to deliver ARR growth, strong sales pipeline, remaining profitable and cashflow positive, driving product innovation and investing in its bench strength and advancing high conviction M&A. Post the 1Q, we have upgraded FY23/FY24/FY25 revenue forecasts by 6-7%

### Recommendation

We reiterate our Buy rating and increase our PT to 34c (30c prior). The key driver of PT increase has been higher forecast cashflows. On our forecasts, DSE is currently trading on an FY23 EV/Revenue multiple of 5.7x while our PT implies 7.4x.

Jules Cooper | Senior Analyst

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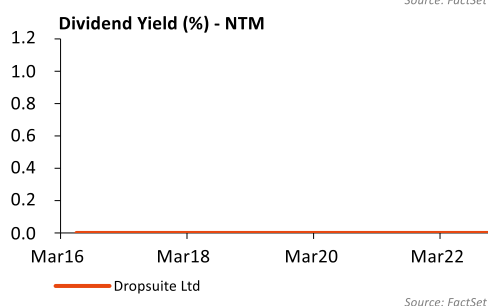
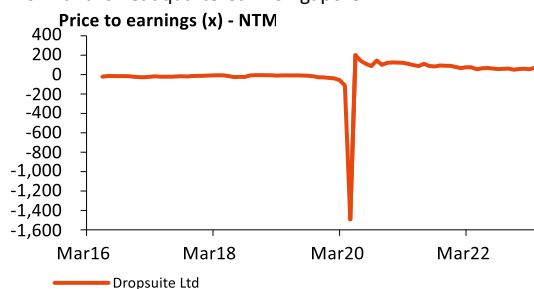
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# Dropsuite Ltd Information Technology Software & Services FactSet: DSE-AU / Bloomberg: DSE AU

Key Items	Data
Recommendation	BUY
Risk	HIGH
Price (\$ps)	0.27
Target Price (\$ps)	0.34
52 Week Range (\$ps)	0.15 - 0.27
Shares on Issue (m)	705.3
Market Cap (\$m)	190.4
Enterprise Value (\$m)	166.6
TSR (%)	25.9%

Valuation NPV	Data
Beta	1.10
Cost of Equity (%)	9.1%
Cost of Debt (net) (%)	0.0%
Risk Free Rate (%)	3.0%
Terminal Growth (%)	3.5%
WACC (%)	9.1%
Valuation (\$m)	218.5
Valuation per share (cps) (AUD)	0.31

Dropsuite (DSE) is a leading partner-centric, data backup, archiving and compliance vendor for small and medium sized businesses globally. Its suite of backup solutions cover websites, email, servers and productivity suites including Microsoft 365 and Google Workplace. DSE was founded in 2011 and is headquartered in Singapore.



## Financial Year End: 30 June

Investment Summary (AUD)	FY21A	FY22A	FY23E	FY24E	FY25E
EPS (Reported) (cps)	(0.0)	0.2	0.3	0.4	0.5
EPS (Underlying) (cps)	0.0	0.2	0.3	0.4	0.5
EPS (Underlying) Growth (%)	107.8%	638.7%	42.7%	36.2%	29.2%
PE (Underlying) (x)	nm	92.9	90.2	66.2	51.3
EV / EBIT (x)	953.4	138.2	90.6	57.1	39.7
EV / EBITDA (x)	786.8	131.7	86.1	54.5	38.1
DPS (cps) (AUD)	0.0	0.0	0.0	0.0	0.0
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Franking (%)	0%	0%	0%	0%	0%
Payout Ratio (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Free Cash Flow Yield (%)	0.3%	0.6%	0.8%	1.8%	2.4%
Profit and Loss (AUD) (m)	FY21A	FY22A	FY23E	FY24E	FY25E
Sales	11.7	20.7	29.3	37.2	44.1
Sales Growth (%)	64.6%	76.8%	41.7%	26.7%	18.7%
EBITDA	0.2	1.3	1.9	3.0	4.2
EBITDA Margin (%)	1.8%	6.2%	6.6%	8.1%	9.4%
Depreciation & Amortisation	0.0	(0.1)	(0.1)	(0.1)	(0.2)
EBIT	0.2	1.2	1.8	2.9	4.0
EBIT Margin (%)	1.5%	5.9%	6.3%	7.7%	9.0%
Net Interest	0.0	0.3	1.0	1.0	1.1
Pretax Profit	0.2	1.5	2.8	3.9	5.1
Tax	0.0	0.0	(0.7)	(0.9)	(1.2)
Tax Rate (%)	0.0%	0.0%	(24.0%)	(24.0%)	(24.0%)
Minorities	0.0	0.0	0.0	0.0	0.0
NPAT Underlying	0.2	1.5	2.1	2.9	3.9
Significant Items	(0.2)	0.0	0.0	0.0	0.0
NPAT Reported	0.0	1.5	2.1	2.9	3.9
Cashflow (AUD) (m)	FY21A	FY22A	FY23E	FY24E	FY25E
EBIT	0.2	1.2	1.8	2.9	4.0
Tax Paid	0.0	0.0	(0.7)	(0.9)	(1.2)
Net Interest	0.0	0.2	1.0	1.0	1.1
Change in Working Capital	0.1	(1.5)	(1.8)	(0.9)	(0.8)
Depreciation & Amortisation	0.0	0.1	0.1	0.1	0.2
Other	0.0	0.9	1.2	1.5	1.7
Operating Cashflow	0.3	0.9	1.6	3.7	5.0
Capex	(0.1)	(0.1)	(0.1)	(0.2)	(0.2)
Acquisitions and Investments	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Investing Cashflow	(0.1)	(0.1)	(0.1)	(0.2)	(0.2)
Free Cashflow	0.4	0.9	1.5	3.6	4.8
Equity Raised / Bought Back	18.9	0.0	0.0	0.0	0.0
Dividends Paid	0.0	0.0	0.0	0.0	0.0
Change in Debt	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Financing Cashflow	18.9	0.0	0.0	0.0	0.0
Net Change in Cash	19.1	0.9	1.5	3.6	4.8
Balance Sheet (AUD) (m)	FY21A	FY22A	FY23E	FY24E	FY25E
Cash	21.6	22.3	23.8	27.4	32.2
Accounts Receivable	2.2	4.1	7.0	8.8	10.5
Other Current Assets	0.2	0.4	0.4	0.4	0.4
PPE	0.0	0.1	0.1	0.1	0.2
Goodwill & Intangibles	0.0	0.0	0.0	0.0	0.0
Investments	0.0	0.0	0.0	0.0	0.0
Other Non Current Assets	0.1	0.1	0.1	0.1	0.1
Total Assets	24.1	26.9	31.3	36.8	43.3
Accounts Payable	2.0	2.5	3.5	4.5	5.3
Short Term Debt	0.0	0.0	0.0	0.0	0.0
Long Term Debt	0.0	0.0	0.0	0.0	0.0
Income Taxes Payable	0.0	0.0	0.0	0.0	0.0
Other	0.2	0.2	0.3	0.3	0.4
Total Liabilities	2.2	2.7	3.8	4.8	5.7
Total Shareholder Equity	21.9	24.2	27.6	32.0	37.6
Ratios	FY21A	FY22A	FY23E	FY24E	FY25E
ROE (%)	1.5%	6.4%	8.2%	9.9%	11.1%
Gearing (%)	(7,309.8%)	(1,178.7%)	(638.8%)	(592.4%)	(594.6%)
Net Debt / EBITDA (x)	(100.7)	(17.5)	(12.3)	(9.2)	(7.8)

## 1Q23 cashflow

Figure 1: 1Q23 cashflow

	1Q21	2Q21	3Q21	4Q21	FY21	1Q22	2Q22	3Q22	4Q22	FY22	1Q23
Receipts from customers	2.3	2.4	2.9	3.4	11.0	3.7	4.3	5.2	5.6	18.8	6.1
YoY growth	84%	65%	69%	102%	80%	63%	81%	81%	63%	71%	65%
Payments to employees and supplier	-2.3	-2.4	-2.8	-3.2	-10.7	-4.0	-4.0	-4.6	-5.3	-17.8	-6.0
R&D											
Product manufacturing and op	-0.8	-0.9	-1.1	-1.4	-4.1	-1.6	-1.8	-2.1	-2.2	-7.7	-2.1
Advertising and marketing	0.0	-0.1	-0.1	-0.3	-0.6	-0.2	-0.2	-0.2	-0.4	-1.1	-0.3
Leased assets											
Staff costs	-1.2	-1.2	-1.3	-1.4	-5.0	-1.7	-1.7	-2.0	-2.3	-7.8	-3.2
Admin and corporate costs	-0.3	-0.3	-0.3	-0.1	-1.0	-0.4	-0.2	-0.3	-0.3	-1.2	-0.4
Interest recd	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.2	0.1
Interest paid	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Tax paid	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other						-0.3				-0.3	0.0
Net cash used in operating activities	0.0	0.0	0.1	0.2	0.3	-0.5	0.4	0.6	0.4	0.9	0.3
PP&E	0.0	0.0	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	-0.1	0.0
Intellectual property	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Lease liabilities (included in financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross operating free cashflow	0.0	0.0	0.1	0.2	0.2	-0.3	0.4	0.5	0.3	0.9	0.1
Total cash opex	-2.3	-2.4	-2.8	-3.2	-10.8	-4.0	-4.0	-4.6	-5.3	-17.9	-6.0
Other											
Share issue	0.0	0.0	18.9	0.0	18.9	0.0	0.0	0.0	0.0	0.0	0.0
Convertible notes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Options	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Transaction costs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Investing activities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Opening cash	2.5	2.4	2.4	21.4	2.5	21.6	21.1	21.6	22.2	21.6	22.3
Operating	0.0	0.0	0.1	0.2	0.2	-0.3	0.4	0.5	0.3	0.9	0.1
Financing	0.0	0.0	18.9	0.0	18.9	0.0	0.0	0.0	0.0	0.0	0.0
Investing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Unallocated	0.0	0.0	0.0	0.0	0.0	-0.3	0.1	0.2	-0.2	-0.2	0.3
Closing cash balance	2.4	2.4	21.4	21.6	21.6	21.1	21.6	22.2	22.3	22.3	22.7

Source: Company reports, Shaw and Partners analysis

## Forecast changes

Post the 1Q result, we have upgraded FY23/24/25 revenue by 6-7%

Figure 2: Forecast changes

Changes to Estimates A\$m	Old 2023	New 2023	Delta	Old 2024	New 2024	Delta	Old 2025	New 2025	Delta
Revenue	27.6	29.3	6%	34.7	37.2	7%	41.3	44.1	7%
Opex	-25.5	-26.2	3%	-31.6	-32.6	3%	-37.1	-38.2	3%
Op EBITDA	2.2	3.1	46%	3.0	4.5	50%	4.2	5.9	40%
SBP	-1.2	-1.2	0%	-1.5	-1.5	0%	-1.7	-1.7	0%
EBITDA	0.9	1.9	105%	1.5	3.0	100%	2.5	4.2	68%
PBT	1.8	2.8	55%	2.4	3.9	64%	3.4	5.1	51%
NPAT	1.4	2.1	55%	1.8	2.9	64%	2.6	3.9	51%
Operating cashflow	1.1	1.6	54%	2.7	3.7	40%	3.7	5.0	34%
Capex	-0.1	-0.1	0%	-0.2	-0.2	0%	-0.2	-0.2	0%
Free cashflow	0.9	1.5	61%	2.5	3.6	43%	3.5	4.8	36%
Net cash (debt)	23.3	23.8	2%	25.8	27.4	6%	29.3	32.2	10%
Total cash costs	-25.5	-26.2	3%	-31.6	-32.6	3%	-37.1	-38.2	3%
Cash EBITDA (ex SBP)	2.2	3.1	46%	3.0	4.5	50%	4.2	5.9	40%

Source: Shaw and Partners analysis

## Risks to rating and price target

### Top line growth does not deliver

We think our forecasts have been framed conservatively and that the risk lies to the upside through FY25. However, a tougher macro environment could impact demand for email backup and archiving solutions, sold to SMBs via MSPs. Further, our medium-term revenue growth relies on the successful launch of new products at higher ARPU. Lastly, DSE is growing fast and scaling rapidly, which brings its own unique set of challenges. Any of these factors could result in DSE not delivering the forecast growth we expect, which may impact operating leverage, efficiency optics and sentiment.

### Loss of a material partner

As a partner-centric software vendor, DSE sells its solutions via hundreds of direct resellers and thousands of indirect MSPs. However, we think it is likely that within DSE's top 10 partners, that some could be generating revenues in excess of a couple of million. The loss of any material partner, could result in DSE not delivering the forecast growth we expect, which may impact operating leverage, efficiency optics and sentiment.

### Broader "Tech" rotation risks may impact sentiment

In 2022, small-cap software fell -26% lagging the ASX Small Ords (-21%) and the US peer group (-35%), as inflation, rising rates, geopolitical disruption and recession risks all impacted. Whilst valuations have corrected and software's fundamentals generally remain strong, there is potential for a macro slowdown to impact demand in the short-term. This may impact perceptions of software's relative growth and quality attributes, which could continue to negatively impact sentiment and delay any potential re-rating.

## Rating Classification

<b>Buy</b>	Expected to outperform the overall market
<b>Hold</b>	Expected to perform in line with the overall market
<b>Sell</b>	Expected to underperform the overall market
<b>Not Rated</b>	Shaw has issued a factual note on the company but does not have a recommendation

## Risk Rating

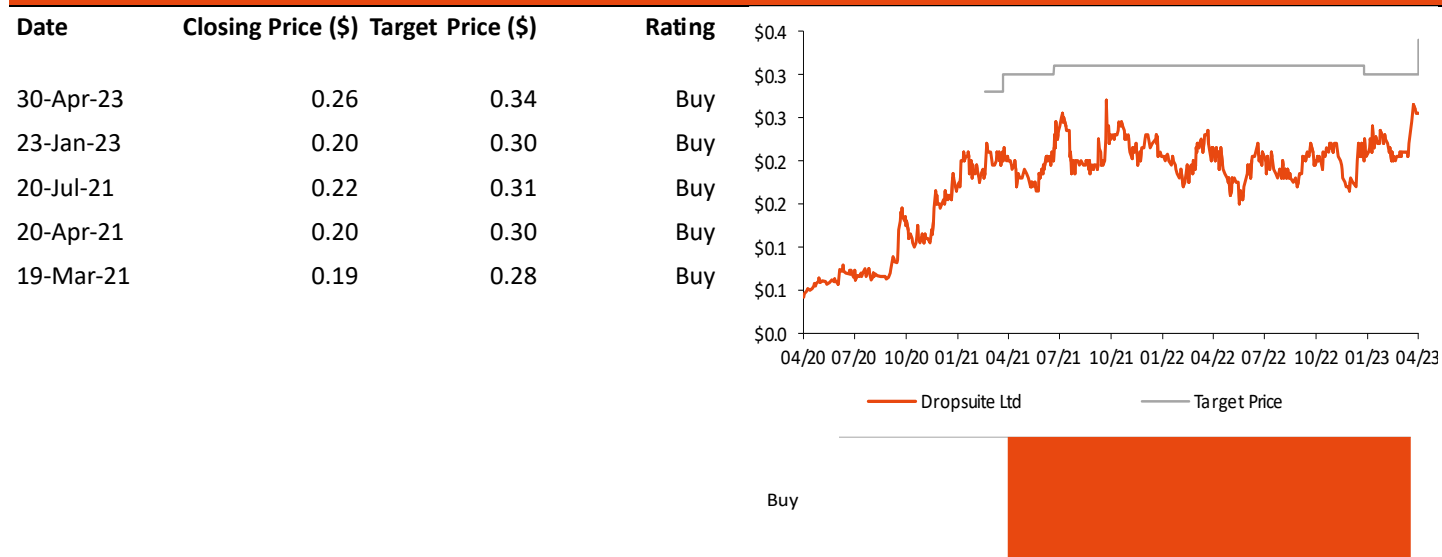
<b>High</b>	Higher risk than the overall market – investors should be aware this stock may be speculative
<b>Medium</b>	Risk broadly in line with the overall market
<b>Low</b>	Lower risk than the overall market

**RISK STATEMENT:** Where a company is designated as 'High' risk, this means that the analyst has determined that the risk profile for this company is significantly higher than for the market as a whole, and so may not suit all investors. Clients should make an assessment as to whether this stock and its potential price volatility is compatible with their financial objectives. Clients should discuss this stock with their Shaw adviser before making any investment decision.

### Distribution of Investment Ratings

Rating	Count	Recommendation Universe
Buy	100	90%
Hold	10	9%
Sell	1	1%

### History of Investment Rating and Target Price - Dropsuite Ltd



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2 Chifley Square	120 Collins Street	111 Eagle Street	91 King William Street	54 Marcus Clarke Street	108 St Georges Terrace	2 Quamby Place
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