

# Dropsuite Ltd (DSE)

Rating: Buy | Risk: High | Price Target: \$4.10

22 July 2024

**A strong 2Q result reinforces both the opportunity and the execution. Reiterate Buy.**

## Key Information

Current Price (\$ps)	3.40
12m Target Price (\$ps)	4.10
52 Week Range (\$ps)	2.25 - 3.40
Target Price Upside (%)	20.6%
TSR (%)	20.6%
Reporting Currency	AUD
Market Cap (\$m)	243.1
Sector	Information Technology
Avg Daily Volume (m)	0.1
ASX 200 Weight (%)	0.01%

## Fundamentals

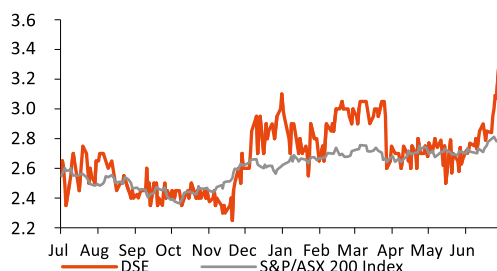
YE 30 Jun (AUD)	FY23A	FY24E	FY25E	FY26E
Sales (\$m)	30.6	40.1	48.4	56.6
NPAT (\$m)	1.6	1.9	1.7	2.1
EPS (cps)	1.9	2.6	2.3	2.9
EPS Growth (%)	5.4%	38.4%	(12.7%)	23.8%
DPS (cps) (AUD)	0.0	0.0	0.0	0.0
Franking (%)	0%	0%	0%	0%

## Ratios

YE 30 Jun	FY23A	FY24E	FY25E	FY26E
P/E (x)	nm	nm	nm	nm
EV/EBITDA (x)	198.0	340.7	235.2	99.6
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 (%)	25.5%	22.0%	24.1%	12.4%
Absolute (%)	27.8%	23.6%	28.3%	21.4%
Benchmark (%)	2.3%	1.6%	4.2%	9.0%



Price performance indexed to 100

Source: FactSet

## Major Shareholders

Topline Capital Partners LP	31.0%
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## Event

DSE has released a 2Q update that was better than expected. US\$ ARR delivered at US\$26.5m vs the ~\$26m we forecast. If DSE can maintain its 2Q ARR added run-rate into the 2H, then we see potential for FY24 ARR growth to exceed the 30% we currently forecast. On the profitability/cashflow side, the 1H looks to be tracking slightly better than the guide which could flow through to modestly stronger full year profitability and cashflow than we currently forecast (we model FY24 cash EBITDA of \$2.8m vs \$2.7m delivered in FY23). Even after the +11% move today, DSE is only trading on an FY25 EV/Revenue multiple of 4.5x which we think is attractive given: 1) its strong top line growth and leverage to secular tailwinds like cyber security and data protection; 2) that it is profitable and demonstrating it can successfully generate a return on incremental investment; and 3) that it has a strong balance sheet that could support M&A. DSE is a top pick. Reiterate Buy.

## Highlights

- Key metrics** – US\$ ARR of US\$26.5m grew 29% YoY and was slightly ahead of our forecast (~\$26m). Incremental ARR added in 2Q was +\$1.9m and compares to +\$1.6m added in 1Q and an average +\$1.5m/quarter added in FY23. In A\$ terms, ARR grew +31% YoY, benefitting from currency moves. Gross margins delivered at 69%, in-line with 1Q (69%) and continues to track above full year guidance (~68%). Gross free cash flow delivered at +\$300k in 2Q, comprising receipts of \$9.3m (+40%) and total cash costs of \$9.0m (+38% YoY). DSE closed 2Q24 with net cash of \$25.1m and no debt.
- Our take** – 1) Incremental US\$ ARR added increased to +\$1.9m in 2Q and was a record for the business. This is an encouraging surprise and demonstrates that DSE is successfully generating a return on recent investment (2Q cash costs of \$9m compare to an average \$6.8m/quarter in FY23). If DSE can maintain this +\$1.9m ARR added run-rate in the 2H, then we see potential for US\$ ARR growth to be closer to 32% YoY vs the 30% we currently forecast. 2) DSE added a record number of both Direct (+53 vs trailing 4 quarter average of +34) and Indirect (+295 vs similar +227 compare) partners in 2Q. This is encouraging as: 1) it highlights DSE's partner base is far from mature. We remind investors that prior to it being acquired, Datto reported 18,500 MSP partners or 4x the number of partners DSE has today (+4600); and 2) Given DSE's attractive net revenue retention (NRR over 125%) new partners provides a tailwind over future periods as SMB end customers are onboarded and DSE successfully cross-sells their higher value SKUs and new products. 3) Combined 1Q and 2Q receipts growth (+43% YoY) has now exceeded payments growth (+42%). DSE's FY24 outlook looks to "maintain profitability and cashflow inline with FY23", which suggests the reverse or full-year cost growth slightly exceeding revenue growth. While we appreciate FY24/FY25 are conscious reinvestment years (and the SAM opportunity warrants that), the 1H does look to be tracking slightly better than the guide, which could flow through to modestly stronger full-year profitability and cashflow than we currently forecast (we model FY24 cash EBITDA of \$2.8 vs \$2.7m delivered in FY23). To be clear, while the beat (if any) would only be minor, it may optically be well received by investors. Longer term, we see significant potential for DSE to expand margins and note peers like Datto was generating EBITDA margins >20% in FY21 before it was acquired.
- Outlook / Forecasts** – DSE reiterated that it remains: 1) well positioned to deliver strong ARR growth; and 2) expects to maintain cashflow and profitability broadly in-line with FY23 levels; and 3) continues to pursue high conviction M&A. We have not made any changes to our FY24 forecasts. We forecast FY24 US\$ ARR growth of 30%, gross margins of 68% and cash EBITDA of \$2.8m (vs \$2.7m in FY23).

## Recommendation

We reiterate our Buy rating and \$4.10 PT. DSE is currently trading on an FY25 EV/Revenue multiple of 4.5x. Our PT implies 6.1x.

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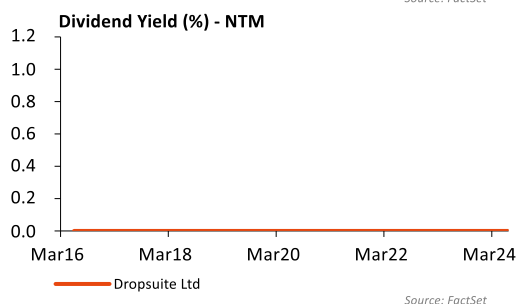
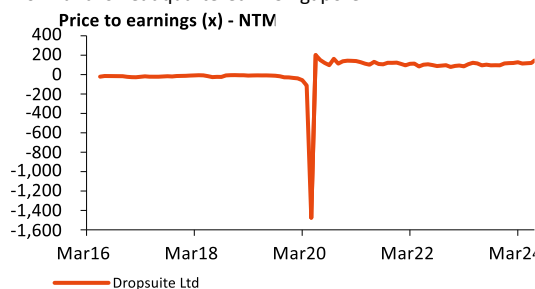
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**Dropsuite Ltd**  
**Information Technology**  
**Software & Services**  
**FactSet: DSE-AU / Bloomberg: DSE AU**

Key Items	Data
Recommendation	BUY
Risk	HIGH
Price (\$ps)	3.40
Target Price (\$ps)	4.10
52 Week Range (\$ps)	2.25 - 3.40
Shares on Issue (m)	71.5
Market Cap (\$m)	243.1
Enterprise Value (\$m)	215.3
TSR (%)	20.6%

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)	273.1
Valuation per share (cps) (AUD)	3.82

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)	FY22A	FY23A	FY24E	FY25E	FY26E
EPS (Reported) (cps)	1.8	1.9	2.6	2.3	2.9
EPS (Underlying) (cps)	1.8	1.9	2.6	2.3	2.9
EPS (Underlying) Growth (%)	539.9%	5.4%	38.4%	(12.7%)	23.8%
PE (Underlying) (x)	nm	nm	nm	nm	nm
EV / EBIT (x)	181.5	249.0	1,040.7	462.7	129.1
EV / EBITDA (x)	173.0	198.0	340.7	235.2	99.6
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 (%)	0.6%	0.8%	1.4%	1.5%	1.8%
Profit and Loss (AUD) (m)	FY22A	FY23A	FY24E	FY25E	FY26E
Sales	20.7	30.6	40.1	48.4	56.6
Sales Growth (%)	76.8%	48.0%	30.8%	20.8%	17.0%
EBITDA	1.3	1.1	0.6	0.9	2.1
EBITDA Margin (%)	6.2%	3.6%	1.6%	1.9%	3.7%
Depreciation & Amortisation	(0.1)	(0.2)	(0.4)	(0.4)	(0.5)
EBIT	1.2	0.9	0.2	0.5	1.6
EBIT Margin (%)	5.9%	2.9%	0.5%	0.9%	2.8%
Net Interest	0.3	0.7	1.7	1.8	2.0
Pretax Profit	1.5	1.6	1.9	2.3	3.6
Tax	0.0	0.0	0.0	(0.6)	(1.4)
Tax Rate (%)	0.0%	0.0%	0.0%	(25.9%)	(40.5%)
Minorities	0.0	0.0	0.0	0.0	0.0
NPAT Underlying	1.5	1.6	1.9	1.7	2.1
Significant Items	0.0	0.0	0.0	0.0	0.0
NPAT Reported	1.5	1.6	1.9	1.7	2.1
Cashflow (AUD) (m)	FY22A	FY23A	FY24E	FY25E	FY26E
EBIT	1.2	0.9	0.2	0.5	1.6
Tax Paid	0.0	0.0	0.0	(0.6)	(1.4)
Net Interest	0.2	0.7	1.7	1.8	2.0
Change in Working Capital	(1.5)	(0.9)	(0.8)	(0.7)	(0.7)
Depreciation & Amortisation	0.1	0.2	0.4	0.4	0.5
Other	0.9	1.4	2.2	2.6	3.0
Operating Cashflow	0.9	2.3	3.7	4.1	4.9
Capex	(0.1)	(0.1)	(0.2)	(0.2)	(0.3)
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)	(0.2)	(0.2)	(0.3)
Free Cashflow	0.9	2.1	3.5	3.8	4.6
Equity Raised / Bought Back	0.0	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	0.0	0.0	0.0	0.0	0.0
Net Change in Cash	0.9	2.1	3.5	3.8	4.6
Balance Sheet (AUD) (m)	FY22A	FY23A	FY24E	FY25E	FY26E
Cash	22.3	24.3	27.8	31.7	36.3
Accounts Receivable	4.1	5.9	7.7	9.3	10.8
Other Current Assets	0.4	0.7	0.7	0.7	0.7
PPE	0.1	0.1	0.1	0.2	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	0.2	0.0	(0.3)	(0.5)
Total Assets	26.9	31.2	36.2	41.5	47.5
Accounts Payable	2.5	3.2	4.1	5.0	5.9
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	0.6	0.6	0.6	0.7
Total Liabilities	2.7	3.8	4.8	5.7	6.5
Total Shareholder Equity	24.2	27.4	31.5	35.8	40.9
Ratios	FY22A	FY23A	FY24E	FY25E	FY26E
ROE (%)	6.4%	6.1%	6.5%	5.0%	5.5%
Gearing (%)	(1,178.7%)	(784.5%)	(759.8%)	(761.8%)	(782.6%)
Net Debt / EBITDA (x)	(17.5)	(22.0)	(44.0)	(35.2)	(17.5)

## 2Q24 key metrics

Figure 1: Quarterly key metrics

	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23	1Q24	2Q24
ARR (A\$m)	17.0	20.1	23.3	25.4	28.2	30.4	33.4	34.3	37.6	39.9
ARR (US\$m)	12.5	14.1	15.6	17.2	18.8	20.5	21.5	23.0	24.6	26.5
ARR added (US\$m)	1.7	1.6	1.5	1.5	1.7	1.7	1.0	1.5	1.6	1.9
Gross margin	63%	64%	64%	70%	69%	69%	68%	70%	69%	69%
Receipts (A\$m)	3.7	4.3	5.2	5.6	6.1	6.7	8.1	7.7	8.9	9.3
Payments (A\$m)	-4.0	-4.0	-4.6	-5.3	-6.0	-6.5	-6.9	-7.7	-8.8	-9.0
Gross FCF (A\$m)	-0.3	0.4	0.5	0.3	0.1	0.1	1.2	0.0	0.2	0.3
Direct partners	421	453	473	491	524	559	594	620	660	713
Indirect partners	1967	2200	3000	3243	3434	3684	3893	4124	4344	4639
Users	730000	808000	886000	935000	1020000	1080000	1113000	1160000	1240000	1350000
ARPU (A\$)	1.95	2.07	2.2	2.26	2.31	2.35	2.57	2.46	2.53	2.47
ARPU (US\$)	1.43	1.45	1.47	1.53	1.54	1.58	1.62	1.65	1.66	1.64

Source: Company reports, 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 and modestly increasing 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. It is likely that within DSE's top 10 partners, some could be generating revenues more than 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.

### Competition risks

DSE operates in a growing and attractive market. If other back-up vendors were to aggressively invest in or price their products, to gain market share, then this could result in DSE not delivering the forecast growth we expect, which may impact operating leverage, efficiency optics and sentiment.

### Broader 'Tech' sentiment may be impacted by macro slowdown

In 2023, small-cap ASX software stocks rallied +35% materially outperforming the Small Ords (-1%). This is the complete reverse of 2022. Sentiment has lifted as the rates peak comes into focus and software's fundamentals have generally remained strong. However, as we move deeper into the macro slowdown, there is potential for short term demand impacts to become more pronounced. This could impact Tech sentiment more broadly.

## 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

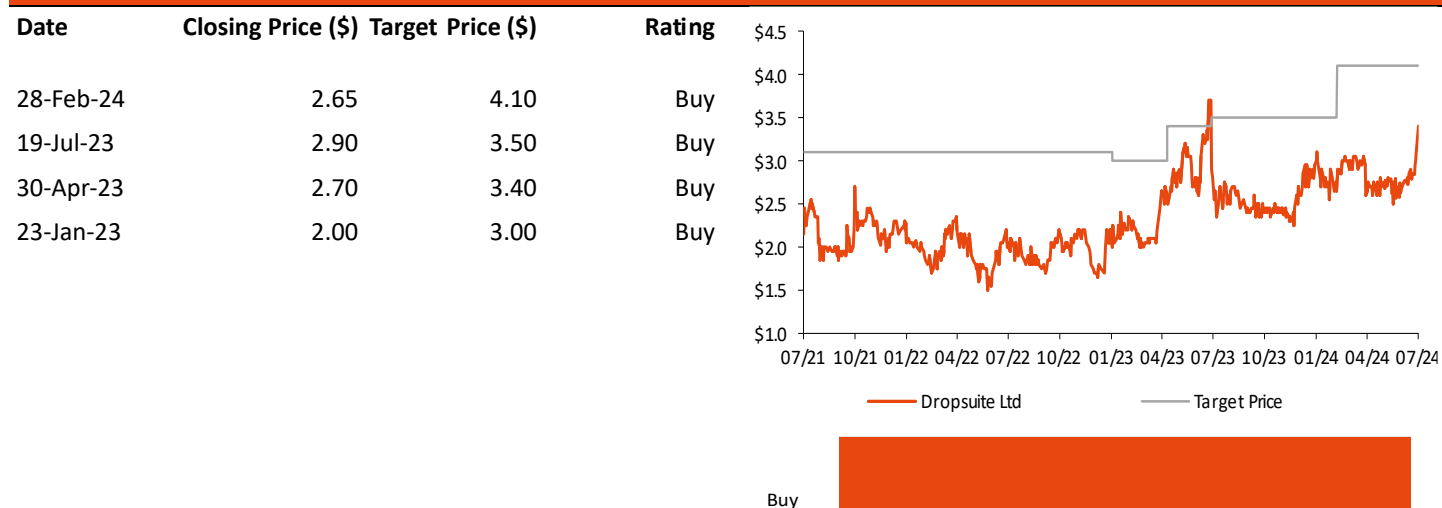
<b>High</b>	Higher risk than the overall market – investors should be aware this stock may be speculative
<b>Medium</b>	Risk broadly in line with the overall market
<b>Low</b>	Lower risk than the overall market

**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	72	90%
Hold	7	9%
Sell	1	1%

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



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