

# Dropsuite Ltd (DSE)

Rating: Buy | Risk: High | Price Target: \$4.80

23 October 2024

## 3Q delivers clear evidence of acceleration, driving FY24/FY25 upgrades. Reiterate Buy.

### Key Information

Current Price (\$ps)	3.67
12m Target Price (\$ps)	4.80
52 Week Range (\$ps)	2.25 - 3.67
Target Price Upside (%)	30.8%
TSR (%)	30.8%
Reporting Currency	AUD
Market Cap (\$m)	264.4
Sector	Information Technology
Avg Daily Volume (m)	0.0
ASX 200 Weight (%)	0.01%

### Fundamentals

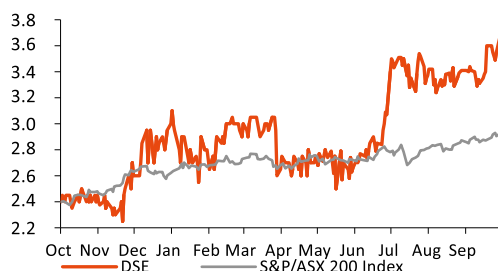
YE 30 Jun (AUD)	FY23A	FY24E	FY25E	FY26E
Sales (\$m)	30.6	40.8	52.2	63.4
NPAT (\$m)	1.6	1.4	2.1	2.1
EPS (cps)	2.2	2.0	2.9	2.9
EPS Growth (%)	5.8%	(9.6%)	45.0%	(1.6%)
DPS (cps) (AUD)	0.0	0.0	0.0	0.0
Franking (%)	0%	0%	0%	0%

### Ratios

YE 30 Jun	FY23A	FY24E	FY25E	FY26E
P/E (x)	nm	nm	nm	nm
EV/EBITDA (x)	217.3	265.8	110.1	79.9
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 (%)	6.3%	4.9%	2.7%	28.9%
Absolute (%)	7.9%	8.9%	7.9%	49.8%
Benchmark (%)	1.6%	4.0%	5.2%	20.9%



Price performance indexed to 100

Source: FactSet

### Major Shareholders

Topline Capital Management LLC	30.8%
EL ANSARI CHARIF /DROPSUITE/	4.9%
Wilson Asset Management (International)	1.7%

### Event

DSE has released a 3Q trading update that was better than expected. We now have clear evidence of ARR accelerating post investment over the last year. Management are doing better than what they said they would, and remain firmly committed to “healthy, profitable ARR growth” as they scale into a large global opportunity. This is bullish and long duration investors should take notice, given DSE is: 1) organically growing ARR at over 30%, supported by a combination of solid execution and industry tailwinds (cyber, data regulations, growth in MSP channel etc); 2) is profitable and cash positive today and peers suggest attractive terminal margins are achievable at scale; and 3) has a strong balance sheet and remains disciplined on M&A. DSE remains a top pick. Reiterate Buy.

### Highlights

- **Key metrics** – US\$ ARR of US\$28.8m grew 34% YoY and delivered a +4ppt growth improvement vs 2Q (+29%). Incremental ARR added in 3Q was +\$2.3m (vs \$1.9m in 2Q) and now clearly demonstrating an inflection. In A\$ terms, ARR grew only +27% YoY, impacted by currency. Gross margins delivered at 69%, in-line with recent quarters. Gross free cash flow delivered at positive \$500k in 3Q vs \$300k in 2Q. Cash costs of \$9.2m increased by only +\$100k sequentially. DSE closed 3Q with \$25.5m of cash and no debt.
- **Our take – 1) Clear evidence of ARR acceleration post investment.** DSE delivered a 4ppt improvement in ARR growth in 3Q, which is the first YoY percentage improvement since 1Q22. While 2Q hinted at it, 3Q now clearly demonstrates an inflection has been reached. DSE increased headcount by ~35% over the last year to strategically support its growth opportunity. This is now clearly being reflected in accelerating ARR growth demonstrating an attractive return on that investment. **2) Upgrading FY24 and FY25 ARR growth.** We now forecast US\$ ARR growth of 34% in FY24 vs 30% prior. This implies ARR added of +\$2m in 4Q, modestly below the 3Q add (\$2.3m) but in-line with the average year-to-date. This could be conservative, as 4Q is typically seasonally stronger and the tailwinds from PartnerServ are expected to continue “over coming quarters”. With percentage growth now accelerating, our prior FY25 forecasts looked way to low. We now forecast US\$ ARR growth of 26% in FY25, implying a -9ppt decel vs FY24 but with a broadly similar dollar add vs FY24 (+\$12m). Again, we feel this could be conservative, as the 3Q run-rate supports +\$14m of ARR added or +30% growth. **3) Still in an investment phase, but the pace of cost growth slowed in 3Q.** We are very aware that DSE has signalled that 2024 and 2025 will be reinvestment years. However, sequentially in 3Q headcount and employee cash costs were largely unchanged. Our forecasts imply a return to investment in 4Q, and we now forecast 26% growth in cash costs in FY25, in-line with our forecast for ARR growth (and a similar scenario to FY24). For those investors looking for a ‘north star’ on DSE’s future profitability, it is worth highlighting that when Datto was listed it was achieving gross margins of 78% (vs DSE’s 69% currently) and cash EBITDA margins of 28-29% (vs DSE’s likely 7-8% in FY24). We see plenty of scope for operating leverage over the longer-term.
- **Outlook / Forecast** – DSE reiterated its FY24 outlook, including: 1) that it is well positioned to deliver strong ARR growth; 2) expects to maintain cashflow and profitability broadly in-line with FY23 levels; and 3) continues to pursue high conviction M&A. Post this update, we have increased our FY24/25/26 revenue forecasts by between 1-12% and cash costs by 1-11%. Specifically, we now forecast FY24 and FY25 cash EBITDA of \$3m and \$4.7m respectively (vs \$2.7m delivered in FY23).

### Recommendation

We increase our PT to \$4.80 (was \$4.10) and reiterate our Buy rating. The key driver of our PT upgrade is higher cashflow forecasts. DSE is trading on an FY25 EV/Revenue multiple of 4.8x. Our PT implies 6.2x.

Jules Cooper | Senior Analyst

+61 3 9268 1177

Jules.Cooper@shawandpartners.com.au

Jack Daley | Equities Research Associate

+61 3 9268 1141

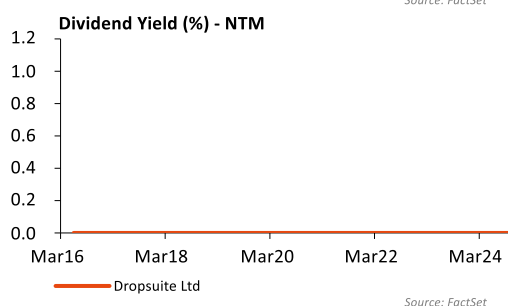
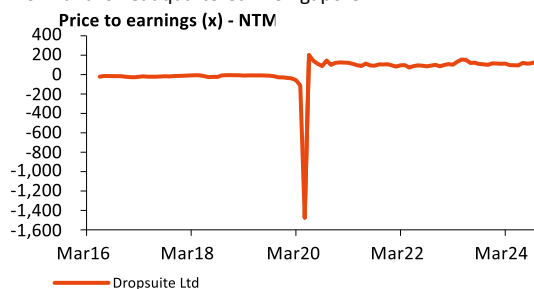
Jack.Daley@shawandpartners.com.au

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

Key Items	Data
Recommendation	BUY
Risk	HIGH
Price (\$ps)	3.67
Target Price (\$ps)	4.80
52 Week Range (\$ps)	2.25 - 3.67
Shares on Issue (m)	72.1
Market Cap (\$m)	264.4
Enterprise Value (\$m)	237.2
TSR (%)	30.8%

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)	317.7
Valuation per share (cps) (AUD)	4.41

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)	2.1	2.2	2.0	2.9	2.9
EPS (Underlying) (cps)	2.1	2.2	2.0	2.9	2.9
EPS (Underlying) Growth (%)	639.9%	5.8%	(9.6%)	45.0%	(1.6%)
PE (Underlying) (x)	93.0	nm	nm	nm	nm
EV / EBIT (x)	199.1	273.2	401.5	129.5	91.2
EV / EBITDA (x)	189.7	217.3	265.8	110.1	79.9
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%	1.0%	1.1%	1.4%	1.6%
Profit and Loss (AUD) (m)	FY22A	FY23A	FY24E	FY25E	FY26E
Sales	20.7	30.6	40.8	52.2	63.4
Sales Growth (%)	77.0%	48.1%	33.2%	28.0%	21.5%
EBITDA	1.3	1.1	0.9	2.1	2.9
EBITDA Margin (%)	6.2%	3.6%	2.2%	4.1%	4.5%
Depreciation & Amortisation	(0.1)	(0.2)	(0.3)	(0.3)	(0.4)
EBIT	1.2	0.9	0.6	1.8	2.5
EBIT Margin (%)	5.9%	2.9%	1.4%	3.5%	4.0%
Net Interest	0.3	0.7	0.9	1.0	1.1
Pretax Profit	1.5	1.6	1.4	2.8	3.6
Tax	0.0	0.0	0.0	(0.6)	(1.5)
Tax Rate (%)	0.0%	0.0%	0.0%	(23.2%)	(41.2%)
Minorities	0.0	0.0	0.0	0.0	0.0
NPAT Underlying	1.5	1.6	1.4	2.1	2.1
Significant Items	0.0	0.0	0.0	0.0	0.0
NPAT Reported	1.5	1.6	1.4	2.1	2.1
Cashflow (AUD) (m)	FY22A	FY23A	FY24E	FY25E	FY26E
EBIT	1.2	0.9	0.6	1.8	2.5
Tax Paid	0.0	0.0	0.0	(0.6)	(1.5)
Net Interest	0.2	0.7	0.8	1.0	1.1
Change in Working Capital	(1.5)	(0.9)	(0.8)	(1.0)	(1.0)
Depreciation & Amortisation	0.1	0.2	0.3	0.3	0.4
Other	0.9	1.4	2.1	2.6	3.2
Operating Cashflow	0.9	2.3	3.1	4.1	4.7
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	2.9	3.9	4.4
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	2.9	3.9	4.4
Balance Sheet (AUD) (m)	FY22A	FY23A	FY24E	FY25E	FY26E
Cash	22.3	24.3	27.2	31.1	35.5
Accounts Receivable	4.1	5.9	7.8	10.0	12.1
Other Current Assets	0.4	0.7	0.8	0.8	0.8
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	0.1	0.0	(0.1)
Total Assets	26.9	31.2	36.1	42.0	48.5
Accounts Payable	2.5	3.2	4.2	5.4	6.6
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	0.7	0.7
Total Liabilities	2.7	3.8	4.9	6.1	7.3
Total Shareholder Equity	24.2	27.4	31.2	36.0	41.3
Ratios	FY22A	FY23A	FY24E	FY25E	FY26E
ROE (%)	6.4%	6.1%	4.9%	6.4%	5.5%
Gearing (%)	(1,178.7%)	(784.5%)	(680.8%)	(639.0%)	(620.8%)
Net Debt / EBITDA (x)	(17.5)	(22.0)	(30.5)	(14.7)	(12.4)

### Key metrics

Figure 1: Quarterly key metrics

	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23	1Q24	2Q24	3Q24
ARR (A\$m)	17.0	20.1	23.3	25.4	28.2	30.4	33.4	34.3	37.6	39.9	42.6
ARR (US\$m)	12.5	14.1	15.6	17.2	18.8	20.5	21.5	23.0	24.6	26.5	28.8
Gross margin	63%	64%	64%	70%	69%	69%	68%	70%	69%	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	9.7
Payments (A\$m)	-4.0	-4.0	-4.6	-5.3	-6.0	-6.5	-6.9	-7.7	-8.8	-9.1	-9.2
Gross FCF (A\$m)	-0.3	0.4	0.5	0.3	0.1	0.1	1.2	0.0	0.2	0.3	0.5
Partners	421	453	473	491	524	559	594	620	660	700	738
Users	730000	808000	886000	935000	1020000	1080000	1113000	1160000	1240000	1350000	1485000
ARPU (A\$)	1.95	2.07	2.2	2.26	2.31	2.35	2.57	2.46	2.53	2.47	2.39
ARPU (US\$)	1.43	1.45	1.47	1.53	1.54	1.58	1.62	1.65	1.66	1.64	1.62

Source: Company reports, Shaw and Partners analysis

### Forecast changes

Figure 2: Forecast changes

Changes to Estimates A\$m	Old 2024	New 2024	Delta	Old 2025	New 2025	Delta	Old 2026	New 2026	Delta
Revenue	40.2	40.8	1%	48.4	52.2	8%	56.7	63.4	12%
Opex	-37.6	-37.8	1%	-45.0	-47.5	6%	-51.7	-57.4	11%
Op EBITDA	2.7	3.0	12%	3.4	4.7	39%	5.0	6.0	22%
SBP	-2.1	-2.1	0%	-2.5	-2.6	5%	-2.8	-3.2	13%
EBITDA	0.6	0.9	59%	0.9	2.1	127%	2.2	2.9	32%
PBT	1.1	1.4	30%	1.6	2.8	76%	2.9	3.6	25%
NPAT	1.1	1.4	30%	1.1	2.1	96%	1.6	2.1	30%
Operating cashflow	2.8	3.1	10%	3.2	4.1	29%	4.1	4.7	15%
Capex	-0.2	-0.2	0%	-0.2	-0.2	5%	-0.2	-0.3	13%
Free cashflow	2.6	2.9	11%	3.0	3.9	30%	3.8	4.4	16%
Net cash (debt)	26.9	27.2	1%	29.9	31.1	4%	33.8	35.5	5%
Total cash costs	-37.6	-37.8	1%	-45.0	-47.5	6%	-51.7	-57.4	11%
Cash EBITDA (ex SBP)	2.7	3.0	12%	3.4	4.7	39%	5.0	6.0	22%

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 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

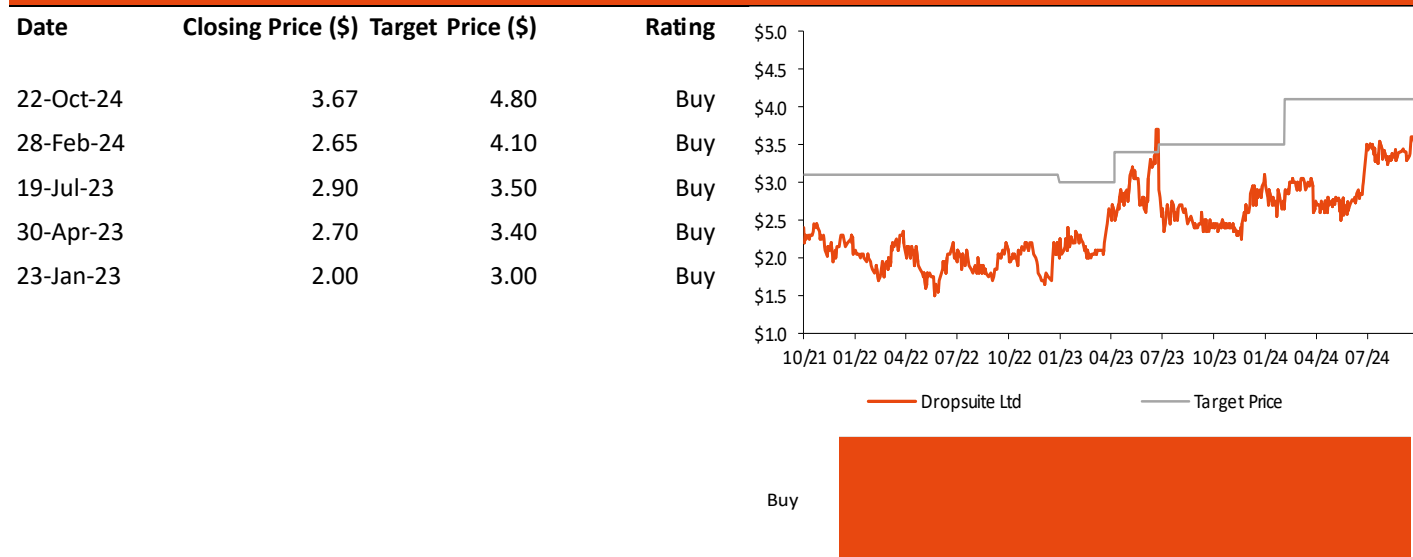
<b>High</b>	Higher risk than the overall market – investors should be aware this stock may be speculative
<b>Medium</b>	Risk broadly in line with the overall market
<b>Low</b>	Lower risk than the overall market

**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	76	96%
Hold	3	4%
Sell	0	0%

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



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Sydney   Head Office	Melbourne	Brisbane	Adelaide	Canberra	Perth	Noosa
Level 7, Chifley Tower	Level 36	Level 28	Level 25	Level 9	Level 47	Suite 11a Q Place
2 Chifley Square	120 Collins Street	111 Eagle Street	91 King William Street	5 Constitution Avenue	108 St Georges Terrace	2 Quamby Place
Sydney NSW 2000	Melbourne VIC 3000	Brisbane QLD 4000	Adelaide SA 5000	Canberra ACT 2601	Perth WA 6000	Noosa Heads QLD 4567
Telephone: +61 2 9238 1238	Telephone: +61 3 9268 1000	Telephone: +61 7 3036 2500	Telephone: +61 8 7109 6000	Telephone: +61 2 6113 5300	Telephone: +61 8 9263 5200	Telephone: +61 7 3036 2570
Toll Free: 1800 636 625	Toll Free: 1800 150 009	Toll Free: 1800 463 972	Toll Free: 1800 636 625	Toll Free: 1800 636 625	Toll Free: 1800 198 003	Toll Free: 1800 271 201