

CS Disco, Inc.

Profitability inflection remains elusive; Reiterate Underperform, \$6 PO

Reiterate Rating: UNDERPERFORM | PO: 6.00 USD | Price: 7.32 USD

'24 rev guide implies reaccel, but lots to do to get there

Reiterate Underperform and \$6 PO, as 4Q23 results were above guidance, consistent with its [pre-announcement \(see our 5 Jan note\)](#), but its outlook suggests that a positive adj EBITDA inflection remains elusive until at least 2025. The business had a rough 2023, with multiple executive departures and meaningful pivot to try and achieve profitability. While the business was able to display impressive adj EBITDA margin expansion in 2023 (+14pts), it likely came at the detriment of future growth and platform enhancements. Thus, to reinvigorate both, the business is stepping up its investment profile, which we believe is the right thing to do for the long-term. However, it pushes out its positive margin inflection. We see an asymmetric risk/reward to the downside until there are concrete proof-points that its growth and product investment strategy is working.

Increases disclosures, can now see software revenue

For the first time, the company disclosed its software revenue component, which for 2023 was \$112mn (+2.7% y/y) and represented 81% of total revenue. While the added disclosure improves visibility into the revenue model, it also makes visible that the Review product could be a drag on total revenue growth. Nonetheless, we believe the additional revenue mix disclosure can help drive an improving narrative on LAW.

Positives: new metrics could provide visibility

1) Introduced new NRR metric, software NRR, which was 97%. Although not a good metric, being below 100%, we appreciate the increased model visibility and it was 5pts above total NRR which was 92%; 2) billings grew 9% to \$37.1mn, an acceleration from no growth last quarter; 3) was able to quickly fill the vacant Chief Revenue Officer seat with a seasoned veteran, who is a potential catalyst to drive better G2M execution.

Negatives: total customer count down for the first time

1) Total NRR declined 14pts y/y to 92%, and it could take many quarters for this metric to recover above 100%, which could be an overhang; 2) lost eight customers, bringing the total down to 1,441 (+9% y/y), and was the first quarter on record of a sequential decline in total customers; and 3) 1Q24 total revenue guidance implies negative sequential growth, which is a bad optic for a subscription software model.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	(0.80)	(0.38)	(0.28)	(0.27)	(0.22)
GAAP EPS	(1.21)	(0.70)	(0.83)	(0.80)	(0.78)
EPS Change (YoY)	-45.5%	52.5%	26.3%	3.6%	18.5%
Consensus EPS (Bloomberg)			(0.21)	(0.09)	0.14
DPS	0	0	0	0	0
Valuation (Dec)					
Free Cash Flow Yield*	-11.3%	-6.8%	-4.9%	-4.4%	-3.6%

* For full definitions of *IQmethod*SM measures, see page 5.

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Timestamp: 22 February 2024 10:32PM EST

22 February 2024

Equity

Key Changes

(US\$)	Previous	Current
2024E Rev (m)	148.9	148.4
2025E Rev (m)	168.1	162.5
2026E Rev (m)	NA	178.9
2024E EPS	-0.11	-0.28
2025E EPS	0.06	-0.27
2026E EPS	NA	-0.22

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Stock Data

Price	7.32 USD
Price Objective	6.00 USD
Date Established	9-Nov-2023
Investment Opinion	C-3-9
52-Week Range	5.07 USD - 10.77 USD
Mrkt Val (mn) / Shares Out (mn)	447 USD / 61.1
Free Float	38.9%
Average Daily Value (mn)	1.32 USD
BofA Ticker / Exchange	LAW / NYS
Bloomberg / Reuters	LAW US / LAW.N
ROE (2024E)	-9.8%
Net Dbt to Eqty (Dec-2023A)	-79.6%
ESGMeter TM	NLA

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".

NRR = net recurring revenue

G2M = go-to-market

ROI = return on investment

iQprofileSM CS Disco, Inc.

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	-16.6%	-9.0%	-7.5%	-8.0%	-7.2%
Return on Equity	-20.2%	-11.6%	-9.8%	-10.7%	-9.7%
Operating Margin	-35.5%	-22.1%	-15.2%	-12.5%	-10.0%
Free Cash Flow	(50)	(30)	(22)	(20)	(16)

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	NM	NM	NM	NM	NM
Asset Replacement Ratio	1.5x	1.2x	1.2x	1.2x	1.2x
Tax Rate	0.3%	1.1%	2.0%	2.0%	2.0%
Net Debt-to-Equity Ratio	-90.9%	-79.6%	-74.7%	-69.1%	-63.6%
Interest Cover	NM	NM	NM	NM	NM

Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	135	138	148	163	179
% Change	18.2%	2.1%	7.4%	9.6%	10.0%
Gross Profit	102	104	112	123	135
% Change	22.4%	2.2%	7.4%	9.6%	10.2%
EBITDA	(45)	(26)	(19)	(16)	(13)
% Change	-171.6%	41.8%	27.0%	13.7%	18.0%
Net Interest & Other Income	1	8	6	4	4
Net Income (Adjusted)	(50)	(25)	(19)	(19)	(16)
% Change	-144.8%	50.6%	23.3%	-0.3%	15.2%

Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	(70)	(41)	(50)	(50)	(50)
Depreciation & Amortization	3	4	4	4	4
Change in Working Capital	(4)	(8)	(8)	(5)	(4)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	26	20	36	36	40
Capital Expenditure	(4)	(5)	(4)	(5)	(5)
Free Cash Flow	-50	-30	-22	-20	-16
% Change	-103.6%	39.7%	27.3%	10.6%	17.5%
Share / Issue Repurchase	4	2	0	0	0
Cost of Dividends Paid	0	0	0	0	0
Change in Debt	0	0	0	0	0

Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	203	160	137	118	101
Trade Receivables	23	27	37	39	42
Other Current Assets	6	6	6	6	7
Property, Plant & Equipment	8	10	10	11	12
Other Non-Current Assets	17	30	26	28	30
Total Assets	256	232	217	202	193
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	23	23	25	24	26
Long-Term Debt	0	0	0	0	0
Other Non-Current Liabilities	10	8	7	7	7
Total Liabilities	33	31	33	32	33
Total Equity	224	200	184	170	159
Total Equity & Liabilities	256	232	217	202	193

* For full definitions of iQmethodSM measures, see page 5.

Company Sector

Server & Enterprise Software

Company Description

CS Disco develops applications and services primarily focused on the eDiscovery process, which corporate legal departments use for litigation and other legal matters. Users of the Disco platform can be corporate legal departments, law firms, and legal service providers.

Investment Rationale

We rate Disco Underperform. We believe that CS Disco has built a next-generation AI-powered eDiscovery application and accompanying services that enable corporate law departments and legal service providers to drive more efficient legal matter workflows. We believe Disco's TAM is large at \$19.3bn and is ripe to be disrupted. However, recent execution issues and a less visible revenue stream leads us to believe there are little catalysts until these overhangs are removed.

Stock Data

Average Daily Volume 181,004

Quarterly Earnings Estimates

	2023	2024
Q1	-0.20A	-0.10E
Q2	-0.11A	-0.09E
Q3	-0.06A	-0.06E
Q4	-0.01A	-0.04E

4Q23 Performance

- Total revenue of \$35.7mn was above our/Street's \$35.1mn/\$35.0mn estimates.
- Adjusted EBITDA of (\$957k) was above our/Street's (\$6.1mn)/(\$5.6mn) estimates.

FY24 Guidance

- Total revenue guidance of \$143.0-155.0mn is below our/Street's \$148.9/\$151.8mn estimates.
- Adjusted EBITDA guidance of (\$26mn)-(\$19mn) is below our/Street's (\$4.6mn)/(\$12mn).

Exhibit 1: Variance

Total revenue exceeded our estimate by 1.7%

4Q23A			
(in '000s)	Actual	BofA Estimate	Variance
Total Revenue	35,742	35,149	1.7%
Y/Y change %	9.9%	8.0%	182bps
Guidance			
Adjusted EBITDA	(957)	(6,081)	84.3%
Adjusted EBITDA margin	(2.7%)	(17.3%)	1462bps
Guidance			
EPS (Pro Forma)	(\$0.01)	(\$0.10)	1896.0%
Cash Flow from Operations	3,175	(4,915)	254.8%
OCF margin	8.9%	(14.0%)	2287bps
Free cash flow	1,892	(5,970)	415.5%
FCF margin	8.9%	(14.0%)	2287bps

Source: BofA Global Research estimates, company filings

BofA GLOBAL RESEARCH

Exhibit 2: Estimate revisions

We forecast total revenue for FY24 of \$148.4mn

(in '000s)	1Q24E			FY24E			FY25E			FY26E		
	New Estimate	Old Estimate	Change %	New Estimate	Old Estimate	Change %	New Estimate	Old Estimate	Change %	New Estimate	Old Estimate	Change %
Total Revenue	35,508	35,993	(1.3%)	148,362	168,054	(11.7%)	162,540	201,696	(19.4%)	178,871	N/A	N/A
Y/Y change %	7.2%	8.6%	(147bps)	7.4%	20.0%	(1258bps)	9.6%	20.0%	(1046bps)	10.0%	N/A	N/A
Guidance												
Adjusted EBITDA	(6,214)	(4,607)	(34.9%)	(18,913)	(6,460)	(192.8%)	(16,330)	6,992	(333.6%)	(13,391)	N/A	N/A
Adjusted EBITDA margin	(17.5%)	(12.8%)	(470bps)	(12.7%)	(3.8%)	(890bps)	(10.0%)	3.5%	(1351bps)	(7.5%)	N/A	N/A
Guidance												
EPS (Pro Forma)	(\$0.10)	(\$0.08)	(11.7%)	(\$0.28)	(\$0.15)	(47.6%)	(\$0.27)	\$0.05	(118.9%)	(\$0.22)	N/A	N/A
Cash Flow from Operations	(4,367)	(8,088)	85.2%	(17,651)	(8,975)	(49.2%)	(14,877)	2,648	(117.8%)	(10,938)	N/A	N/A
OCF margin	(12.3%)	(22.5%)	1017bps	(11.9%)	(5.3%)	(656bps)	(9.2%)	1.3%	(1047bps)	(6.1%)	N/A	N/A
Free cash flow	(5,432)	(9,167)	68.8%	(22,102)	(14,017)	(36.6%)	(19,753)	(3,403)	(82.8%)	(16,304)	N/A	N/A
FCF margin	(12.3%)	-22.5%	1017bps	(11.9%)	-5.3%	(656bps)	(9.2%)	1.3%	(1047bps)	(6.1%)	N/A	N/A

Source: BofA Global Research estimates, company filings

BofA GLOBAL RESEARCH



Price objective basis & risk

CS Disco, Inc. (LAW)

The \$6 PO is based on 1.7x our C24E revenue for good quarterly execution and better-than-expected expanding EBITDA margins. Our multiple represents an EV/revs/growth multiple of 0.8x, which compares to horizontal peers at 7.4x and 0.6x, warranted given higher execution risks and an unpredictable revenue stream.

Risks to our PO are 1) revenue growth is much better and more predictable than expected, 2) a visible path to profitability is much faster than expected, 3) Disco becomes the industry standard, lowering competitive threats, 4) execution is much better than expected, 5) demand and spend for legal-tech proves very resilient in a recessionary/inflationary environment.

Analyst Certification

I, Koji Ikeda, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Enterprise Software Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	8x8	EGHT	EGHT US	Michael J. Funk
	Adobe	ADBE	ADBE US	Brad Sills
	Alarm.com	ALRM	ALRM US	Michael J. Funk
	Amplitude, Inc.	AMPL	AMPL US	Koji Ikeda, CFA
	BILL	BILL	BILL US	Brad Sills
	CCC Intelligent Solutions	CCCS	CCCS US	Michael J. Funk
	Dynatrace	DT	DT US	Koji Ikeda, CFA
	Elastic NV	ESTC	ESTC US	Koji Ikeda, CFA
	GitLab Inc.	GTLB	GTLB US	Koji Ikeda, CFA
	Global-e Online Ltd.	GLBE	GLBE US	Koji Ikeda, CFA
	HubSpot	HUBS	HUBS US	Brad Sills
	Informatica Inc.	INFA	INFA US	Koji Ikeda, CFA
	Intapp Inc.	INTA	INTA US	Koji Ikeda, CFA
	Intuit	INTU	INTU US	Brad Sills
	JFrog Ltd	FROG	FROG US	Koji Ikeda, CFA
	MeridianLink, Inc.	MLNK	MLNK US	Koji Ikeda, CFA
	Microsoft Corporation	MSFT	MSFT US	Brad Sills
	MongoDB Inc	MDB	MDB US	Brad Sills
	nCino, Inc.	NCNO	NCNO US	Adam Bergere
	NICE Ltd.	NICE	NICE US	Michael J. Funk
	NICE Ltd.	NCSYF	NICE IT	Michael J. Funk
	PagerDuty	PD	PD US	Koji Ikeda, CFA
	PowerSchool Holdings, Inc.	PWSC	PWSC US	Koji Ikeda, CFA
	RingCentral	RNG	RNG US	Michael J. Funk
	Salesforce.com	CRM	CRM US	Brad Sills
	ServiceNow	NOW	NOW US	Brad Sills
	UiPath	PATH	PATH US	Brad Sills
	Unity	U	U US	Michael J. Funk
	Weave	WEAV	WEAV US	Michael J. Funk
	Workday Inc.	WDAY	WDAY US	Brad Sills
	Zeta Global	ZETA	ZETA US	Koji Ikeda, CFA
	ZoomInfo	ZI	ZI US	Koji Ikeda, CFA
NEUTRAL				
	Autodesk	ADSK	ADSK US	Michael J. Funk
	Bentley Systems	BSY	BSY US	Michael J. Funk
	BigCommerce Holdings, Inc.	BIGC	BIGC US	Koji Ikeda, CFA
	Coveo	YCVO	CVO CN	Koji Ikeda, CFA

US - Enterprise Software Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Datadog Inc	DDOG	DDOG US	Koji Ikeda, CFA
	DocuSign	DOCU	DOCU US	Brad Sills
	Freshworks, Inc.	FRSH	FRSH US	Adam Bergere
	HashiCorp	HCP	HCP US	Brad Sills
	Jamf	JAMF	JAMF US	Koji Ikeda, CFA
	Lightspeed Commerce Inc.	LSPD	LSPD US	Koji Ikeda, CFA
	Lightspeed Commerce Inc.	YLSPD	LSPD CN	Koji Ikeda, CFA
	Oracle Corporation	ORCL	ORCL US	Brad Sills
	Paycom	PAYC	PAYC US	Adam Bergere
	Paylocity	PCTY	PCTY US	Adam Bergere
	Shopify, Inc.	SHOP	SHOP US	Brad Sills
	Snowflake	SNOW	SNOW US	Brad Sills
	Veeva Systems, Inc.	VEEV	VEEV US	Brad Sills
	Zoom Video Communications	ZM	ZM US	Michael J. Funk

UNDERPERFORM

	AvidXchange, Inc.	AVDX	AVDX US	Brad Sills
	Blackbaud, Inc.	BLKB	BLKB US	Koji Ikeda, CFA
	BlackLine, Inc.	BL	BL US	Koji Ikeda, CFA
	C3.ai	AI	AI US	Brad Sills
	Confluent	CFLT	CFLT US	Brad Sills
	CS Disco, Inc.	LAW	LAW US	Koji Ikeda, CFA
	Dropbox	DBX	DBX US	Michael J. Funk
	Enfusion, Inc.	ENFN	ENFN US	Koji Ikeda, CFA
	Five9	FIVN	FIVN US	Michael J. Funk
	Guidewire Software, Inc.	GWRE	GWRE US	Michael J. Funk
	Twilio	TWLO	TWLO US	Michael J. Funk
	Vertex, Inc.	VERX	VERX US	Brad Sills

RSTR

	Splunk	SPLK	SPLK US	Brad Sills
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iQmethodSM Measures Definitions**Business Performance**

Return On Capital Employed

Return On Equity
Operating Margin
Earnings Growth
Free Cash Flow

Quality of Earnings

Cash Realization Ratio
Asset Replacement Ratio
Tax Rate
Net Debt-To-Equity Ratio
Interest Cover

Valuation Toolkit

Price / Earnings Ratio
Price / Book Value
Dividend Yield
Free Cash Flow Yield
Enterprise Value / Sales

EV / EBITDA

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income
Operating Profit
Expected 5 Year CAGR From Latest Actual
Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations
Capex
Tax Charge
Net Debt = Total Debt – Cash & Equivalents
EBIT

Numerator

Current Share Price
Current Share Price
Annualised Declared Cash Dividend
Cash Flow From Operations – Total Capex
EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities
Enterprise Value

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Amortization
Shareholders' Equity
Sales
N/A
N/A

Denominator

Net Income
Depreciation
Pre-Tax Income
Total Equity
Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)
Shareholders' Equity / Current Basic Shares
Current Share Price
Market Cap = Current Share Price × Current Basic Shares
Sales

Basic EBIT + Depreciation + Amortization

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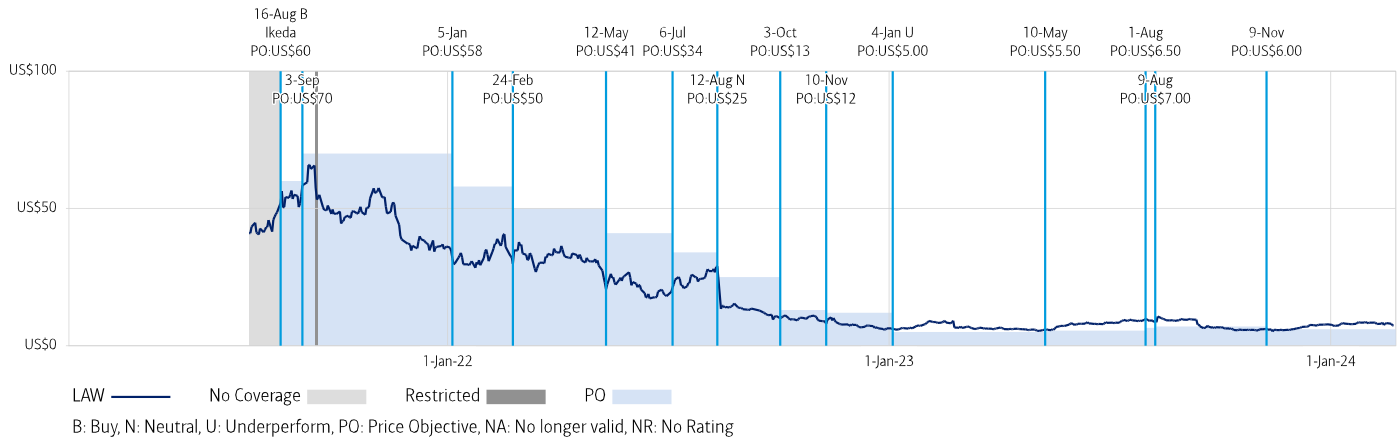
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Disclosures

Important Disclosures

Disco (LAW) Price Chart



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Equity Investment Rating Distribution: Technology Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	215	53.09%	Buy	111	51.63%
Hold	97	23.95%	Hold	45	46.39%
Sell	93	22.96%	Sell	24	25.81%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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