



Capital
Markets

November 2, 2023

SolarWinds Corporation

Getting some sun despite the macro winds; Q3/23 review

Our view: SolarWinds reported strong results relative to expectations with outperformance across the board and CY/23 guidance raised. The subscription transition continues to track well as management noted that a larger percentage of new deals are being sold as subscriptions. Key highlights include solid profitability gains, an uptick in TTM renewal rates, and a pressured but stable environment. Overall, we are impressed by the pace and execution of this subscription transition in an uncertain macro backdrop. Maintain SP and \$13 PT.

Key points:

All you need to know: SolarWinds delivered strong results ahead of expectations and guidance with revenue growth of +6% y/y to \$189.6M vs. consensus of \$183.7M. This reflects the highest quarterly revenue growth since Q1/20. We'd also highlight that the subscription mix continues to expand with subscription revenue growth of +39% y/y to \$59M accounting for 31% of total revenue vs. 29% q/q. Profitability was also strong with adjusted EBITDA and EPS at \$85.1M and \$0.23 which reflects a 44.9% EBITDA margin vs consensus of \$75.4M and \$0.18, respectively. Total ARR growth was +8% y/y to \$668M as the mix-shift to subscription ARR also continues to accelerate with +34% growth (vs. 33% y/y in Q2/23) to \$213M, now 32% of the mix vs. 30% q/q. Thinking about the progress of their subscription transition, the first phase was to convert maintenance customers to subscription as management highlighted that they continue to convert maintenance customers at a higher than 1:1 ratio and a larger percentage of new deals are now being sold as subscriptions. The second phase of this transition began with the launch of their observability SaaS solution with good traction into year-end. Federal demand also remains strong though management noted that there was some deal slippage at the end of the quarter which closed in the first few weeks of Q4/23. Overall, we are impressed with the pace of the transition and appreciate the execution.

Additional highlights: 1) TTM maintenance renewal rate of 95%, up from 94% q/q, which we were pleased to see; 2) \$100K TTM revenue customers are now 955 (+8% y/y) or +22 sequential adds compared to +3 q/q adds last year and -12 q/q adds in Q2/23; 3) the pipeline remains solid across all geographies and continues to expand; 4) continued macro pressures, particularly in Europe, though broader trends seem relatively stable; 5) SME market remains resilient with more pressure on enterprises; and 6) regarding the recent SEC fraud allegations against the CISO, management feels confident regarding their facts as we will monitor this over time.

Looking ahead: CY/23 midpoint revenue guidance was raised to \$751M from \$744M previously, pointing to +4% revenue growth. On the profitability side, the midpoint adjusted EBITDA/EPS guide was raised to \$323M/\$0.84 vs. \$310.5M/\$0.775 previously, pointing to a 43% margin. At this point, management views CY/24 similar to how they've modeled CY/23.

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Sector Perform

NYSE: SWI; USD 10.33

Price Target USD 13.00

| WHAT'S INSIDE | |
|---|---|
| <input type="checkbox"/> Rating/Risk Change | <input type="checkbox"/> Price Target Change |
| <input type="checkbox"/> In-Depth Report | <input checked="" type="checkbox"/> Est. Change |
| <input type="checkbox"/> Preview | <input checked="" type="checkbox"/> News Analysis |

Scenario Analysis*

| Downside Scenario | Current Price | Price Target | Upside Scenario |
|-------------------|---------------|--------------|-----------------|
| 8.00 | 10.33 | 13.00 | 17.00 |
| ↓ 23% | | ↑ 26% | ↑ 65% |

*Implied Total Returns

Key Statistics

| | | | |
|------------------|-------|--------------------|---------|
| Shares O/S (MM): | 159.0 | Market Cap (MM): | 1,642 |
| Dividend: | 0.00 | Yield: | 0.0% |
| | | Avg. Daily Volume: | 518,324 |

RBC Estimates

| FY Dec | 2022A | 2023E | 2024E | 2025E |
|-------------------------|-----------|-----------|-----------|-----------|
| Revenue | 719.4 | 750.6 | 773.0 | 815.0 |
| Prev. | | 744.0 | | |
| EPS, Ops Diluted | 0.83 | 0.84 | 0.93 | 1.03 |
| Prev. | | 0.77 | 0.89 | |
| P/E | 12.4x | 12.3x | 11.1x | 10.0x |
| EBITDA, Adj | 280.4 | 322.9 | 340.2 | 366.6 |
| Prev. | | 310.2 | 330.0 | |
| Revenue | Q1 | Q2 | Q3 | Q4 |
| 2022 | 176.9A | 176.0A | 179.4A | 187.1A |
| 2023 | 186.0A | 185.0A | 189.6A | 190.0E |
| Prev. | | | 184.0E | 189.0E |
| 2024 | 189.0E | 190.5E | 194.0E | 199.5E |
| Prev. | 190.0E | 191.5E | | 197.5E |
| EPS, Ops Diluted | | | | |
| 2022 | 0.24A | 0.21A | 0.20A | 0.19A |
| 2023 | 0.20A | 0.21A | 0.23A | 0.21E |
| Prev. | | | 0.18E | 0.18E |
| 2024 | 0.21E | 0.22E | 0.24E | 0.26E |
| Prev. | 0.20E | | 0.23E | 0.24E |

All values in USD unless otherwise noted.

Priced as of prior trading day's market close, EST (unless otherwise noted).



Exhibit 1 - Results vs. RBC estimates

| Revenue, EPS, and Margins | Sep-23A | | Delta | Y/Y | Q/Q |
|------------------------------------|---------|--------|----------|----------|----------|
| | actual | est. | | | |
| Total revenue | 189.6 | 184.0 | 5.6 | 5.7% | 2.5% |
| Gross margin | 90.8% | 90.0% | 80 bps | -24 bps | 52 bps |
| Sales and marketing | 52.0 | 58.5 | -6.5 | -12.3% | -3.0% |
| as % of revenue | 27.4% | 31.8% | -438 bps | -561 bps | -155 bps |
| General and administrative | 16.7 | 19.1 | -2.4 | 0.1% | -7.9% |
| as % of revenue | 8.8% | 10.4% | -157 bps | -49 bps | -100 bps |
| Research and development | 22.3 | 21.2 | 1.1 | 13.9% | 7.7% |
| as % of revenue | 11.7% | 11.5% | 24 bps | 84 bps | 57 bps |
| Operating income | 81.2 | 66.8 | 14.4 | 19.7% | 8.8% |
| Operating margin | 42.8% | 36.3% | 651 bps | 502 bps | 250 bps |
| Other income | -29.4 | -26.4 | -3.0 | 24.4% | 0.0% |
| Taxes | 13.7 | 10.5 | 3.2 | NA | 23.6% |
| Tax rate | 26.5% | 26.0% | 51 bps | -188 bps | 194 bps |
| EPS | \$0.23 | \$0.18 | \$0.05 | 17.3% | 11.7% |
| Shares | 165.3 | 167.4 | -2.1 | 2.6% | -0.1% |
| Balance Sheet and Cash Flow | | | | | |
| DSO | 43 | 38 | 5 | -3 | 3 |
| Deferred revenue | 369.7 | 366.8 | 2.8 | 5.6% | -1.2% |
| Billings | 184.9 | 176.5 | 8.4 | 3.1% | 6.4% |
| CFO | 68.4 | 34.7 | 33.7 | 170.6% | 39.7% |
| CFO per share | \$0.41 | \$0.21 | \$0.21 | 163.8% | 39.8% |
| CAPEX | -1.6 | -4.6 | 3.0 | -20.8% | 54.4% |
| Free cash flow | 66.8 | 30.1 | 36.7 | 187.4% | 39.4% |
| Free cash flow per share | \$0.40 | \$0.18 | \$0.22 | 180.1% | 39.5% |

\$ in million except per share data

Source: Company reports and RBC Capital Markets estimates

Management call-back notes

- Management noted that they assumed a consistent macro environment as they focus on maintaining operation discipline along with a prudent guide. At this point, management views CY/24 similar to how they've modeled out CY/23.
- Thinking about margin progression, management highlighted that the top-line performance will flow through to the bottom-line as they continue to optimize costs and selectively hire in lower cost regions.
- On federal, management noted that some deals slipped at the end of Q3/23 though have closed in the first few days in Q4/23.
- Broadly, management noted macros have deteriorated in Europe. That said, despite the uncertain macro backdrop, the pipeline remains solid across all geographies and continues to expand.
- As momentum continues to build for the subscription transition, management is first focused on the North American region, follow by EMEA, and lastly in APJ in CY/24.
- With the disruption in the observability after a series of acquisitions in the recent years, management describes their role within the landscape as a platform that helps customers consolidate tools and reduce complexity. As such, management noted that



net-new business isn't typically greenfield as those customers have previously owned certain types of observability solutions.

Q4/23 guidance

- Total revenue of \$188.5 million to \$192.5 million, or \$190.5 million at the midpoint, which points to +2% y/y midpoint growth. This compares to the prior RBC estimate of \$189.0 million and prior consensus of \$189.7 million.
- Adjusted EBITDA of \$80.5 million to \$82.5 million, or \$81.5 million at the midpoint, which points to a ~42.7% margin. This compares to the prior RBC estimate of \$78.4 million and prior consensus of \$78.5 million.
- EPS of \$0.20 to \$0.22, or \$0.21 at the midpoint. This compares to the prior RBC estimate of \$0.18 and prior consensus of \$0.19.
- Weighted average outstanding diluted shares of \$167.4 million.

CY/23 guidance

- Total revenue of \$749 million to \$753 million, or \$751 million at the midpoint, which points to +4% y/y midpoint growth. This compares prior guidance of \$740 million to \$748 million, or \$744 million at the midpoint, prior RBC estimate at \$744.0 million and prior consensus of \$744.4 million.
- Adjusted EBITDA of \$322 million to \$324 million, or \$323 million at the midpoint, which points to a ~43% margin. This compares prior guidance of \$308 million to \$313 million, or \$310.5 million at the midpoint, prior RBC estimate and prior consensus at \$310.2 million.
- EPS of \$0.83 to \$0.85, or \$0.84 at the midpoint. This compares to guidance to the \$0.76 to \$0.79, or \$0.775 at the midpoint, prior RBC estimate at \$0.77 and prior consensus of \$0.78.
- Weighted average outstanding diluted shares of \$166.4 million.

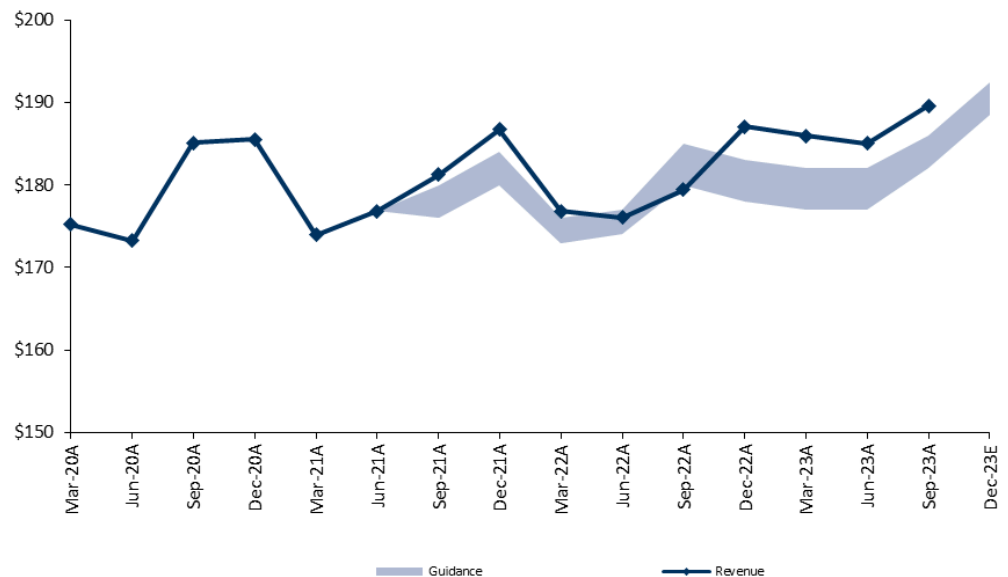


Exhibit 2 - Revised vs. prior estimates

| | 2022 | | 2023 | | 2023E | | 2023E | | 2023E | | 2024E | |
|-------------------------------------|---------|---------|---------|---------|---------|---------|--------|--------|--------|--------|--------|--------|
| | Sep-22A | Dec-22A | Mar-23A | Jun-23A | Sep-23A | Dec-23E | 2023E | 2023E | 2023E | 2023E | 2024E | 2024E |
| Revenue, EPS, and Margins | Sep-22A | Dec-22A | Mar-23A | Jun-23A | actual | est. | new | prior | new | prior | new | prior |
| Total revenue | 179.4 | 187.1 | 186.0 | 185.0 | 189.6 | 184.0 | 190.0 | 189.0 | 750.6 | 744.0 | 773.0 | 773.0 |
| Gross margin | 91.0% | 90.6% | 90.6% | 90.3% | 90.8% | 90.0% | 90.0% | 90.0% | 90.4% | 90.2% | 90.3% | 90.0% |
| Sales and marketing | 59.3 | 61.5 | 57.8 | 53.6 | 52.0 | 58.5 | 55.1 | 59.5 | 218.5 | 229.5 | 221.8 | 234.4 |
| as % of revenue | 33.0% | 32.9% | 31.1% | 29.0% | 27.4% | 31.8% | 29.0% | 31.5% | 29.1% | 30.8% | 28.7% | 30.3% |
| General and administrative | 16.7 | 19.4 | 17.5 | 18.2 | 16.7 | 19.1 | 18.1 | 19.8 | 70.4 | 74.6 | 71.7 | 74.6 |
| as % of revenue | 9.3% | 10.4% | 9.4% | 9.8% | 8.8% | 10.4% | 9.5% | 10.5% | 9.4% | 10.0% | 9.3% | 9.7% |
| Research and development | 19.5 | 21.4 | 20.5 | 20.7 | 22.3 | 21.2 | 22.8 | 21.9 | 86.3 | 84.3 | 87.3 | 85.0 |
| as % of revenue | 10.9% | 11.4% | 11.0% | 11.2% | 11.7% | 11.5% | 12.0% | 11.6% | 11.5% | 11.3% | 11.3% | 11.0% |
| Operating income | 67.8 | 67.3 | 72.7 | 74.6 | 81.2 | 66.8 | 75.1 | 68.8 | 303.5 | 282.9 | 316.8 | 301.7 |
| Operating margin | 37.8% | 36.0% | 39.1% | 40.3% | 42.8% | 36.3% | 39.5% | 36.4% | 40.4% | 38.0% | 41.0% | 39.0% |
| Other income | -23.7 | -27.0 | -28.7 | -29.4 | -29.4 | -26.4 | -28.4 | -26.4 | -116.0 | -111.0 | -105.7 | -94.7 |
| Taxes | 12.5 | 10.1 | 11.1 | 11.1 | 13.7 | 10.5 | 12.1 | 11.0 | 48.1 | 43.7 | 54.9 | 53.8 |
| Tax rate | 28.4% | 25.1% | 25.3% | 24.6% | 26.5% | 26.0% | 26.0% | 26.0% | 25.6% | 25.4% | 0.0% | 0.0% |
| EPS | \$0.20 | \$0.19 | \$0.20 | \$0.21 | \$0.23 | \$0.18 | \$0.21 | \$0.18 | \$0.84 | \$0.77 | \$0.93 | \$0.89 |
| Shares | 161.1 | 161.7 | 162.8 | 165.4 | 165.3 | 167.4 | 167.3 | 170.4 | 166.2 | 166.5 | 168.5 | 171.6 |
| Balance Sheet and Cash Flow | | | | | | | | | | | | |
| DSO | 46 | 48 | 52 | 41 | 43 | 38 | 40 | 40 | | | | |
| Deferred revenue | 349.9 | 376.5 | 385.6 | 374.3 | 369.7 | 366.8 | 377.0 | 374.2 | 377.0 | 374.2 | 349.3 | 346.7 |
| Billings | 179.3 | 213.6 | 195.1 | 173.8 | 184.9 | 176.5 | 197.4 | 196.3 | 751.2 | 741.7 | 745.3 | 745.5 |
| CFO | 25.3 | 47.8 | 0.8 | 49.0 | 68.4 | 34.7 | 81.1 | 86.2 | 199.3 | 170.6 | 204.6 | 194.6 |
| CFO per share | \$0.16 | \$0.30 | \$0.00 | \$0.30 | \$0.41 | \$0.21 | \$0.48 | \$0.51 | \$1.20 | \$1.01 | \$1.21 | \$1.13 |
| CAPEX | -2.0 | -1.9 | -0.3 | -1.0 | -1.6 | -4.6 | -4.8 | -4.7 | -7.8 | -10.7 | -19.3 | -19.3 |
| Free cash flow | 23.2 | 45.9 | 0.5 | 47.9 | 66.8 | 30.1 | 76.3 | 81.5 | 191.5 | 159.9 | 185.3 | 175.3 |
| Free cash flow per share | \$0.14 | \$0.28 | \$0.00 | \$0.29 | \$0.40 | \$0.18 | \$0.46 | \$0.48 | \$1.15 | \$0.96 | \$1.10 | \$1.02 |
| \$ in million except per share data | | | | | | | | | | | | |

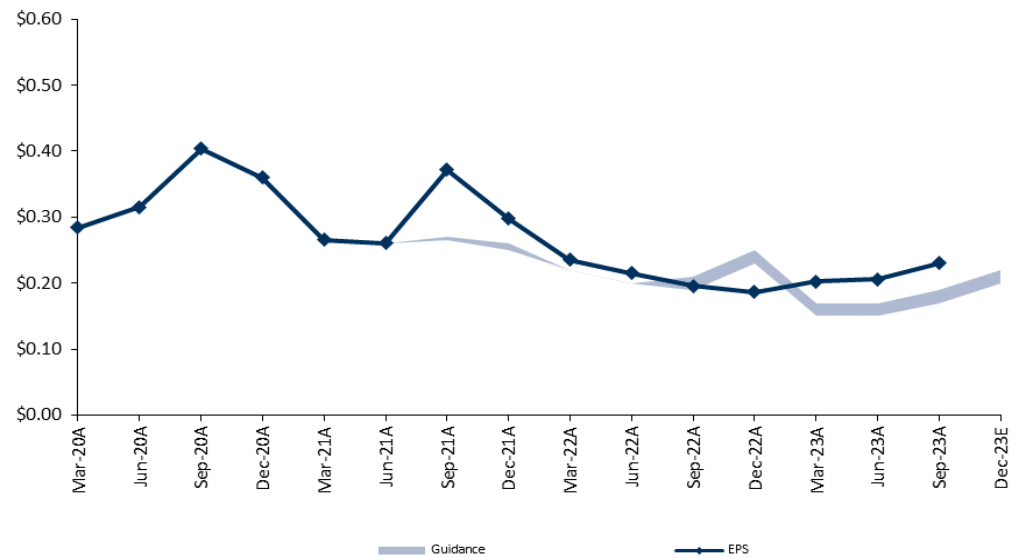
Source: Company reports and RBC Capital Markets estimates

Exhibit 3 - Quarterly revenue vs. guidance (M)



Source: Company reports

Exhibit 4 - Quarterly EPS vs. guidance



Source: Company reports



| Ticker: SWI (\$M) unless noted | Dec-23E | | | | Dec-24E | | | | Dec-25E | | | | 2022A | 2023E | 2024E | 2025E |
|-----------------------------------|-----------|-----------|-----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|-----------|----------|----------|----------|
| | Mar-23A | Jun-23A | Sep-23A | Dec-23E | Mar-24E | Jun-24E | Sep-24E | Dec-24E | Mar-25E | Jun-25E | Sep-25E | Dec-25E | | | | |
| INCOME STATEMENT | | | | | | | | | | | | | | | | |
| Subscription revenue | 54.4 | 53.4 | 58.8 | 60.5 | 63.0 | 65.0 | 70.0 | 76.0 | 77.0 | 79.0 | 84.0 | 90.0 | 167.7 | 227.0 | 274.0 | 330.0 |
| Maintenance revenue | 114.5 | 116.1 | 116.4 | 114.5 | 111.0 | 111.0 | 110.5 | 110.5 | 109.0 | 109.0 | 108.0 | 107.0 | 458.9 | 461.4 | 443.0 | 433.0 |
| Total recurring revenue | 168.8 | 169.4 | 175.2 | 175.0 | 174.0 | 176.0 | 180.5 | 186.5 | 186.0 | 188.0 | 192.0 | 197.0 | 626.6 | 688.5 | 717.0 | 763.0 |
| License revenue | 17.1 | 15.6 | 14.4 | 15.0 | 15.0 | 14.5 | 13.5 | 13.0 | 13.0 | 13.0 | 13.0 | 13.0 | 92.8 | 62.1 | 56.0 | 52.0 |
| Total revenue | 186.0 | 185.0 | 189.6 | 190.0 | 189.0 | 190.5 | 194.0 | 199.5 | 199.0 | 201.0 | 205.0 | 210.0 | 719.4 | 750.6 | 773.0 | 815.0 |
| Total cost of revenue | 17.5 | 18.0 | 17.4 | 19.0 | 18.9 | 19.1 | 18.4 | 19.0 | 18.9 | 19.1 | 19.5 | 20.0 | 65.6 | 71.9 | 75.3 | 77.4 |
| Gross profit | 168.5 | 167.1 | 172.2 | 171.0 | 170.1 | 171.5 | 175.6 | 180.5 | 180.1 | 181.9 | 185.5 | 190.1 | 653.8 | 678.7 | 697.7 | 737.6 |
| Sales and marketing | 57.8 | 53.6 | 52.0 | 55.1 | 54.8 | 54.7 | 55.5 | 56.9 | 57.3 | 57.9 | 58.4 | 59.4 | 234.9 | 218.5 | 221.8 | 233.1 |
| Research and development | 20.5 | 20.7 | 22.3 | 22.8 | 21.7 | 21.7 | 21.7 | 22.1 | 20.9 | 21.7 | 22.6 | 23.5 | 81.1 | 86.3 | 87.3 | 88.7 |
| General and administrative | 17.5 | 18.2 | 16.7 | 18.1 | 17.0 | 17.5 | 18.2 | 19.0 | 17.9 | 18.1 | 18.5 | 18.9 | 74.2 | 70.4 | 71.7 | 73.4 |
| Operating expenses | 95.8 | 92.5 | 91.0 | 96.0 | 93.6 | 93.9 | 95.4 | 98.0 | 96.1 | 97.7 | 99.4 | 101.9 | 390.2 | 375.2 | 380.9 | 395.1 |
| Operating income | 72.7 | 74.6 | 81.2 | 75.1 | 76.5 | 77.5 | 80.1 | 82.6 | 84.0 | 84.2 | 86.1 | 88.2 | 263.6 | 303.5 | 316.8 | 342.5 |
| Other income | (28.7) | (29.4) | (29.4) | (28.4) | (28.7) | (27.7) | (25.7) | (23.7) | (28.7) | (27.7) | (25.7) | (23.7) | (84.7) | (116.0) | (105.7) | (105.7) |
| Pretax income | 44.0 | 45.2 | 51.7 | 46.6 | 47.9 | 49.9 | 54.5 | 58.9 | 55.3 | 56.5 | 60.4 | 64.5 | 178.9 | 187.5 | 181.1 | 236.8 |
| Taxes | 11.1 | 11.1 | 13.7 | 12.1 | 12.4 | 13.0 | 14.2 | 15.3 | 14.4 | 14.7 | 15.7 | 16.8 | 45.1 | 48.1 | 54.9 | 61.6 |
| Net income | 32.9 | 34.1 | 38.0 | 34.5 | 35.4 | 36.9 | 40.3 | 43.6 | 40.9 | 41.8 | 44.7 | 47.8 | 133.8 | 139.5 | 156.2 | 175.2 |
| Earnings per share | \$0.20 | \$0.21 | \$0.23 | \$0.21 | \$0.21 | \$0.22 | \$0.24 | \$0.26 | \$0.24 | \$0.25 | \$0.26 | \$0.28 | \$0.83 | \$0.84 | \$0.93 | \$1.03 |
| Diluted shares outstanding | 162.8 | 165.4 | 165.3 | 167.3 | 167.8 | 168.3 | 168.8 | 169.3 | 169.8 | 170.3 | 170.8 | 171.3 | 160.8 | 166.2 | 168.5 | 170.5 |
| KEY METRICS | | | | | | | | | | | | | | | | |
| DSO | 52 | 41 | 43 | 40 | 40 | 38 | 38 | 40 | 40 | 38 | 38 | 40 | | | | |
| Cash | 140.7 | 178.2 | 235.2 | 308.0 | 311.8 | 364.5 | 410.3 | 479.1 | 489.7 | 538.3 | 585.2 | 660.2 | 148.9 | 308.0 | 479.1 | 660.2 |
| Cash per share | \$0.86 | \$1.08 | \$1.42 | \$1.84 | \$1.86 | \$2.17 | \$2.43 | \$2.83 | \$2.88 | \$3.16 | \$3.43 | \$3.85 | \$0.93 | \$1.85 | \$2.84 | \$3.87 |
| Debt | 1,266.9 | 1,246.0 | 1,246.4 | 1,246.4 | 1,246.4 | 1,246.4 | 1,246.4 | 1,246.4 | 1,246.4 | 1,246.4 | 1,246.4 | 1,246.4 | 1,267.0 | 1,246.4 | 1,246.4 | 1,246.4 |
| Net cash | (1,126.1) | (1,067.8) | (1,011.2) | (938.4) | (934.6) | (881.9) | (836.0) | (767.2) | (756.7) | (708.0) | (661.2) | (586.1) | (1,118.1) | (938.4) | (767.2) | (586.1) |
| Net cash per share | (\$6.92) | (\$6.46) | (\$6.12) | (\$5.61) | (\$5.57) | (\$5.24) | (\$4.95) | (\$4.53) | (\$4.46) | (\$4.16) | (\$3.87) | (\$3.42) | (\$6.95) | (\$5.65) | (\$4.55) | (\$3.44) |
| Deferred revenue | 385.6 | 374.3 | 369.7 | 377.0 | 365.7 | 358.4 | 345.9 | 349.3 | 338.9 | 332.1 | 320.5 | 323.7 | 376.5 | 377.0 | 349.3 | 323.7 |
| Billings | 195.1 | 173.8 | 184.9 | 197.4 | 177.7 | 183.2 | 181.5 | 203.0 | 188.5 | 194.2 | 193.4 | 213.2 | 733.2 | 751.2 | 745.3 | 789.3 |
| Subscription billings | 60.4 | 42.1 | 54.5 | 67.9 | 51.7 | 57.7 | 57.5 | 79.5 | 66.5 | 72.2 | 72.4 | 93.2 | 73.9 | 67.9 | 79.5 | 93.2 |
| Unlevered free cash flow | 41.0 | 66.0 | 64.1 | 83.0 | 25.8 | 74.4 | 68.0 | 91.4 | 31.0 | 71.4 | 69.5 | 98.1 | 223.7 | 254.0 | 259.6 | 270.0 |
| Adjusted EBITDA | 77.4 | 79.1 | 85.1 | 81.3 | 81.3 | 82.5 | 86.4 | 90.2 | 88.6 | 89.6 | 92.4 | 95.9 | 280.4 | 322.9 | 340.2 | 366.6 |
| Adjusted EBITDA Margin | 41.6% | 42.8% | 44.9% | 42.8% | 43.0% | 43.3% | 44.5% | 45.2% | 44.5% | 44.6% | 45.1% | 45.7% | 39.0% | 43.0% | 44.0% | 45.0% |
| PERCENT OF REVENUE | | | | | | | | | | | | | | | | |
| Subscription revenue | 29.2% | 28.9% | 31.0% | 31.8% | 33.3% | 34.1% | 36.1% | 38.1% | 38.7% | 39.3% | 41.0% | 42.9% | 23.3% | 30.2% | 35.4% | 40.5% |
| Maintenance revenue | 61.6% | 62.7% | 61.4% | 61.4% | 58.7% | 58.3% | 57.0% | 55.4% | 54.8% | 54.2% | 52.7% | 51.0% | 63.8% | 61.5% | 57.3% | 53.1% |
| Total recurring revenue | 90.8% | 91.6% | 92.4% | 92.1% | 92.1% | 92.4% | 93.0% | 93.5% | 93.5% | 93.5% | 93.7% | 93.8% | 87.1% | 91.7% | 92.8% | 93.6% |
| License revenue | 9.2% | 8.4% | 7.6% | 7.9% | 7.9% | 7.6% | 7.0% | 6.5% | 6.5% | 6.5% | 6.3% | 6.2% | 12.9% | 8.3% | 7.2% | 6.4% |
| Gross margin | 90.6% | 90.3% | 90.8% | 90.0% | 90.0% | 90.0% | 90.5% | 90.5% | 90.5% | 90.5% | 90.5% | 90.5% | 90.9% | 90.4% | 90.3% | 90.5% |
| Sales and marketing | 31.1% | 29.0% | 27.4% | 29.0% | 29.0% | 28.7% | 28.6% | 28.5% | 28.8% | 28.8% | 28.5% | 28.3% | 32.6% | 29.1% | 28.7% | 28.6% |
| Research and development | 11.0% | 11.2% | 11.7% | 12.0% | 11.5% | 11.4% | 11.2% | 11.1% | 10.5% | 10.8% | 11.0% | 11.2% | 11.3% | 11.5% | 11.3% | 10.9% |
| General and administrative | 9.4% | 9.8% | 8.8% | 9.5% | 9.0% | 9.2% | 9.4% | 9.5% | 9.0% | 9.0% | 9.0% | 9.0% | 10.3% | 9.4% | 9.3% | 9.0% |
| Operating margin | 39.1% | 40.3% | 42.8% | 39.5% | 40.5% | 40.7% | 41.3% | 41.4% | 42.2% | 41.9% | 42.0% | 42.0% | 36.6% | 40.4% | 41.0% | 42.0% |
| Net margin | 17.7% | 18.4% | 20.1% | 18.2% | 18.7% | 19.4% | 20.8% | 21.9% | 20.6% | 20.8% | 21.8% | 22.7% | 18.6% | 18.6% | 20.2% | 21.5% |
| Adjusted EBITDA | 41.6% | 42.8% | 44.9% | 42.8% | 43.0% | 43.3% | 44.5% | 45.2% | 44.5% | 44.6% | 45.1% | 45.7% | 39.0% | 43.0% | 44.0% | 45.0% |
| GROWTH Y/Y | | | | | | | | | | | | | | | | |
| Subscription revenue | 40.3% | 44.4% | 39.1% | 21.7% | 15.9% | 21.7% | 19.1% | 25.6% | 22.2% | 21.5% | 20.0% | 18.4% | 34.6% | 35.4% | 20.7% | 20.4% |
| Maintenance revenue | -0.9% | 1.8% | 1.8% | -0.5% | -3.0% | -4.4% | -5.1% | -3.5% | -1.8% | -1.8% | -2.3% | -3.2% | -4.3% | 0.6% | -4.0% | -2.3% |
| Total recurring revenue | 9.5% | 12.3% | 11.8% | 6.2% | 3.1% | 3.9% | 3.0% | 6.6% | 6.9% | 6.8% | 6.4% | 5.6% | 3.7% | 9.9% | 4.1% | 6.4% |
| License revenue | -24.2% | -37.8% | -36.7% | -32.8% | -12.5% | -7.0% | -6.3% | -13.3% | -13.3% | -10.3% | -3.7% | 0.0% | -19.0% | -33.0% | -9.9% | -7.1% |
| Total revenue | 5.1% | 5.1% | 5.7% | 1.6% | 1.6% | 3.0% | 2.3% | 5.0% | 5.3% | 5.5% | 5.7% | 5.3% | 0.1% | 4.3% | 3.0% | 5.4% |
| Operating income | 11.5% | 17.7% | 19.7% | 11.5% | 5.3% | 3.9% | -1.3% | 10.1% | 9.7% | 8.6% | 7.5% | 6.8% | -8.7% | 15.1% | 4.4% | 8.1% |
| EPS | -14.0% | -4.0% | 17.3% | 10.5% | 4.5% | 6.5% | 3.8% | 24.9% | 14.2% | 12.1% | 9.7% | 8.2% | NA | 1.4% | 9.8% | 10.9% |
| Deferred revenue | 5.8% | 7.0% | 5.6% | 0.1% | -5.1% | -4.2% | -6.4% | -7.3% | -7.3% | -7.3% | -7.3% | -7.3% | 3.8% | 0.1% | -7.3% | -7.3% |
| Billings | 9.2% | 7.6% | 3.1% | -7.6% | -8.9% | 5.4% | -1.9% | 2.8% | 6.1% | 6.0% | 6.6% | 5.0% | 3.5% | 2.5% | -0.8% | 5.9% |
| Subscription billings | 50.8% | 82.5% | 34.6% | -8.1% | -14.4% | 37.0% | 5.4% | 17.0% | 28.7% | 25.2% | 26.0% | 17.3% | -36.2% | -8.1% | 17.0% | 17.3% |
| Unlevered free cash flow | -25.8% | 28.0% | 35.6% | 19.1% | -37.1% | 12.7% | 6.1% | 10.2% | 20.2% | -4.0% | 2.3% | 7.3% | 92.0% | 13.5% | 2.2% | 4.0% |
| Adjusted EBITDA | 12.5% | 18.4% | 21.0% | 9.1% | 5.0% | 4.2% | 1.5% | 10.9% | 9.0% | 8.7% | 7.0% | 6.4% | -7.5% | 15.1% | 5.4% | 7.7% |
| GROWTH Q/Q | | | | | | | | | | | | | | | | |
| Subscription revenue | 9.4% | -1.8% | 10.1% | 3.0% | 4.1% | 3.2% | 7.7% | 8.6% | 1.3% | 2.6% | 6.3% | 7.1% | | | | |
| Maintenance revenue | -0.5% | 1.4% | 0.3% | -1.6% | -3.1% | 0.0% | -0.5% | 0.0% | -1.4% | 0.0% | -0.9% | -0.9% | | | | |
| Total recurring revenue | 2.5% | 0.4% | 3.4% | -0.1% | -0.6% | 1.1% | 2.6% | 3.3% | -0.3% | 1.1% | 2.1% | 2.6% | | | | |
| License revenue | -23.2% | -9.1% | -7.6% | 4.1% | 0.0% | -3.3% | -6.9% | -3.7% | 0.0% | 0.0% | 0.0% | 0.0% | | | | |
| Total revenue | -0.6% | -0.5% | 2.5% | 0.2% | -0.5% | 0.8% | 1.8% | 2.8% | -0.3% | 1.0% | 2.0% | 2.4% | | | | |
| Operating income | 8.0% | 2.6% | 8.8% | -7.5% | 2.0% | 1.3% | 3.3% | 3.1% | 1.7% | 0.3% | 2.2% | 2.4% | | | | |
| Deferred revenue | 2.4% | -2.9% | -1.2% | 2.0% | -3.0% | -2.0% | -3.5% | 1.0% | -3.0% | -2.0% | -3.5% | 1.0% | | | | |
| Billings | -8.7% | -10.9% | 6.4% | 6.7% | -10.0% | 3.1% | -0.9% | 11.9% | -7.1% | 3.0% | -0.4% | 10.3% | | | | |
| Subscription billings | -18.2% | -30.3% | 29.5% | 24.5% | -23.9% | 11.6% | -0.4% | 38.3% | -16.3% | 8.6% | 0.2% | 28.8% | | | | |
| Unlevered free cash flow | -18.2% | 61.1% | -2.9% | 29.5% | -68.9% | 188.6% | -8.6% | 34.5% | -66.1% | 130.4% | -2.6% | 41.1% | | | | |
| Adjusted EBITDA | 3.8% | 2.3% | 7.5% | -4.4% | 0.0% | 1.5% | 4.7% | 4.4% | -1.7% | 1.2% | 3.1% | 3.8% | | | | |

Source: Company Reports and RBC Capital Markets estimates



Key fundamental questions

Our view

Are we past the disruption from the SUNBURST breach?

At this point, the company has had several stabilizing quarters and the initial impact was less than many had feared. While there likely remains a near-term negative impact to the core IT business, the number of customers noted as impacted has been significantly less than what was originally disclosed. TTM maintenance renewal rates are now stable in the low 90s, similar to historical levels.

What has been the impact on the business around COVID?

The company believes that COVID has validated the increased need for MSPs to keep SMBs afloat and has noted that MSPs logged into offerings 2x more during COVID than pre-COVID. MSPs have become increasingly important partners for customers on their cloud migration and digital transformation journeys.

What can cause revenue acceleration post the N-able spin?

Our investment thesis centers on an increasingly higher mix of subscription revenue as well as stabilizing demand trends post the 2020 hack. We think if the company is successful in these two areas, revenue has the potential to accelerate along with sustaining industry-best margins.



Key ESG questions

This section is intended to highlight key ESG discussion points relevant to this company, as well as our views on the outlook. Both the questions we highlight and our responses will evolve over time as the dialogue between management, analysts and investors continues to advance. We welcome any feedback on the topics.

Our view

What are the most material ESG issues facing this company?

Data privacy and security: As the threat landscape continues to evolve and increasingly sophisticated breaches come to light, adequate security controls at all levels of the software life cycle have become necessary to continue to retain and expand the customer base. SolarWinds was targeted by a sophisticated cyber-espionage attack (SUNBURST) in December 2020, which affected many customers, including several federal agencies. Since then, the company has tightened its security posture, including deploying Falcon Endpoint Protection across its endpoints among other steps taken. The company launched a Secure by Design initiative, with a focus on securing the supply chain and its software development build environment. Additionally, the company follows the NIST Cybersecurity framework and its data centers have the following attestations and certifications: SOC2 Type II and SSAE16. **Diversity and Inclusion:** SolarWinds has limited disclosures on its diversity and inclusion initiatives and composition of its workforce. The proportion of women in management and board of directors is 33% and 17%, respectively. **Energy consumption:** While the software industry is not a particularly energy-intensive industry, its biggest source of energy consumption comes from the data centers, which account for ~1% of global electricity use. SolarWinds currently has ~30 co-location centers, which enable relatively more efficient server utilization and energy consumption than on-premise data centers.

Does the company integrate ESG considerations into its strategy?

SolarWinds does not have a publicly disclosed ESG program. That said, the company has an employee-driven charitable arm called Geeks that Give, which supports local communities through monetary, material or in-kind donations to charitable organizations. The program supports efforts in the following areas: Healthy Neighbors, Healthy Minds and Healthy Spaces. Additionally, following the breach in December 2020, there has been a greater focus on data privacy and security through its Secure By Design initiative.

What is diversity like at board / management level?

Management: 33% female, 67% male. Board of directors: 17% female, 83% male.



Target/Upside/Downside Scenarios

SolarWinds Corporation



Source: Bloomberg and RBC Capital Markets estimates for Target

Valuation

We calculate our base-case price target of \$13 using a 9.3x multiple on our CY/24 EBITDA estimate of \$340M, in line with the estimated historical stand-alone average multiple. Our price target and multiple reflect peer multiple compression and balance an increasing subscription mix with an uncertain macro outlook and unknown impacts from the Sunburst hack. Our price target supports a Sector Perform rating.

Upside scenario

Our upside scenario of \$17 is based on EBITDA growth of 8% in CY/24E, or 300 bps above our base-case estimate in each year. To reach this level of growth, we believe there would need to be some combination of higher cross-selling, better new customer additions, and a stable to better macro environment. We believe upside to EBITDA could point to 10.5x CY/23E EV/EBITDA, or a slight premium to our base-case scenario.

Downside scenario

Our downside scenario of \$8 is based on an increase of 2% in CY/24E, or 300 bps below our base-case estimate in each year. To reach this level of growth, we believe there would need to be a fall-off in tech spending, less success expanding into new customers, and lower renewal rates. We believe downside to EBITDA could point to 7x CY/23E EV/EBITDA, which would be a slight discount to our base-case scenario.

Investment summary

High-level overview of SolarWinds

SolarWinds is a provider of IT infrastructure management software to monitor and manage networks, systems and applications across on-premise, cloud and hybrid IT environments without the need for customization or professional services. Products are designed for IT professionals and built on a common technology platform that enables products to be purchased individually, scaled as needed, or as part of a larger suite. Products have been developed organically and through strategic acquisitions, with a number of recent acquisitions to expand core IT, MSP and Cloud offerings.

Our investment thesis centers on an increasingly higher mix of subscription revenue as well as stabilizing demand trends post the 2020 hack following the spin of the MSP business, N-able. We believe as long as these trends persist, the percentage of recurring revenue should continue to track higher, which should drive consistent to increasing revenue growth rates and increasing operating margins, albeit modestly given the leading margin profile.

Potential catalysts

1) Increased subscription traction; 2) cross- and up-sell into a large and growing base of customers; 3) incremental margin gains; 4) international expansion; 5) potential M&A to further extend the portfolio of products.

Risks to rating and price target

1) Licenses still account for ~20% of revenue and could prove volatile; 2) potential variance in subscription and maintenance expansion and renewal rates; 3) competition and technology change; 4) macroeconomic challenges including but not limited to the impact of COVID-19; 5) Silver Lake and Thoma Bravo own a majority of shares and have a controlling interest over stockholders; and 6) the 2020 cyberattack.



Company description

SolarWinds is a provider of IT infrastructure management software to monitor and manage networks, systems and applications across on-premise, cloud and hybrid IT environments without the need for customization or professional services. Products are designed for IT professionals and built on a common technology platform that enables products to be purchased individually, scaled as needed, or as part of a larger suite. Products have been developed organically and through strategic acquisitions, with a number of recent acquisitions to expand core IT and cloud offerings.

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Ratings

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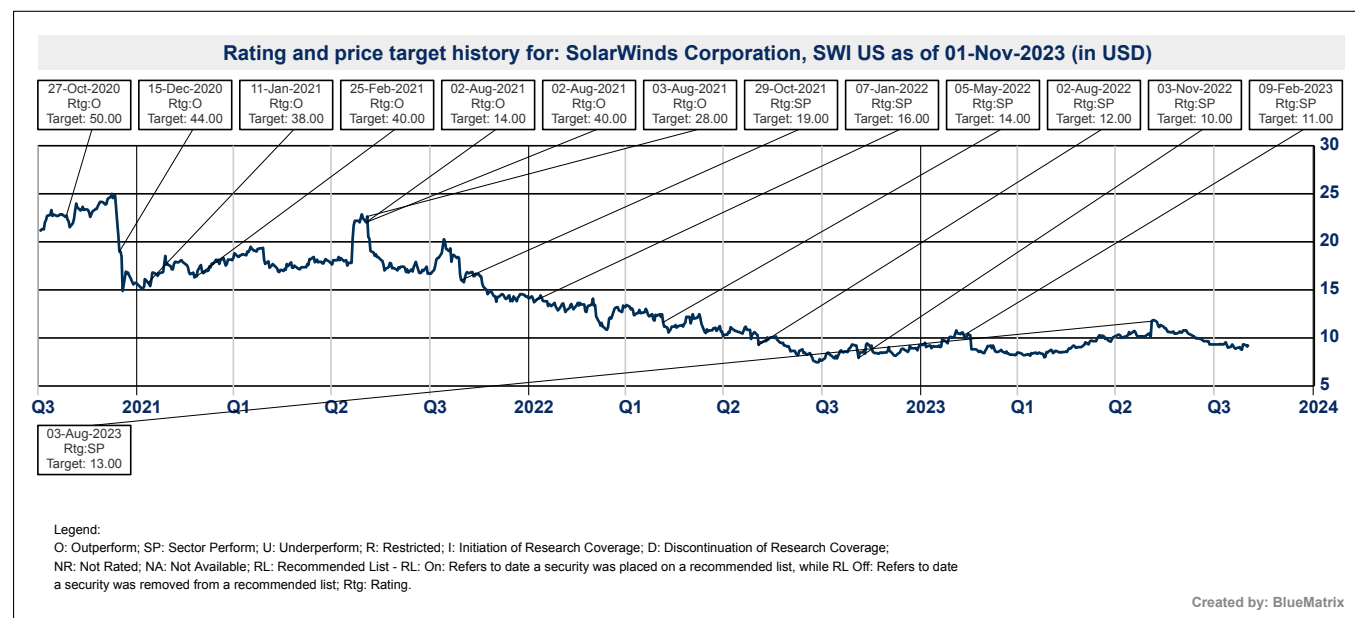
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| RBC Capital Markets, Equity Research | | | | |
| As of 30-Sep-2023 | | | | |
| Rating | Count | Percent | Investment Banking | |
| | | | Serv./Past 12 Mos. | |
| Rating | Count | Percent | Count | Percent |
| | | | Count | Percent |
| BUY [Outperform] | 820 | 55.97 | 250 | 30.49 |
| HOLD [Sector Perform] | 590 | 40.27 | 148 | 25.08 |
| SELL [Underperform] | 55 | 3.75 | 5 | 9.09 |



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SolarWinds Corporation

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