EQUITY RESEARCH

Capital Markets

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SolarWinds Corporation

Solid consistency despite macro winds; Q2/23 review

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Our view: SolarWinds delivered strong results with a beat across the board and CY/23 guidance raise. The mix-shift to subscription continues to accelerate with +44% subscription revenue growth now accounting for 29% of the total revenue mix (21% in Q2/22) and +33% subscription ARR growth now 30% of the total ARR mix (24% in Q2/22). Macros remain consistent with last quarter though demand and the pipeline are healthy. Maintain SP and raise PT to $13 from $11 as the execution of the subscription transition is encouraging.

Key points:

All you need to know: Results were solid with revenue and adjusted EBITDA ahead of expectations and the high end of guidance at $185M/$79M, or +5% revenue growth and 43% margin vs. consensus of $179M/$71M. EPS also outperformed the high end of guidance at $0.21 vs. consensus of $0.17. Now a year into the subscription transition, we feel good about the progression of their subscription-first strategy which continues to gain momentum and provide a deeper layer of visibility with >90% recurring revenue. Specifically, subscription revenue grew +44% to $53M, now 29% of the revenue mix compared to 21% y/y and in line q/q. Total ARR also grew +6% y/y to $657M as the mix-shift to subscription ARR continues to accelerate with +33% growth (vs. 31% y/y in Q1/23) to $198M, now 30% of the mix vs. 29% q/q and 24% y/y. This shift has been driven by conversions from the maintenance base as management believes that they still have a long runway ahead. Thinking more broadly, macros have been pretty consistent with continued pressure on larger deals that are taking longer to close, though are being offset by the company's broad customer base. To that point, management noted that the pipeline is improving and demand remains healthy. Maintain SP and increase PT to $13 from $11 on increased estimates and improved execution.

Highlights beyond the macros: 1) TTM maintenance renewal rate of 94%, up 100 bps q/q. 2) +54 $100K TTM revenue customers added y/y to 933 (+6% y/y) but down 12 customers q/q from 945. Some factors resulting in this q/q decline include smaller deal sizes from the conversion to subscription, a very strong Q1/23 net add qtr and lumpy large deals. 3) Continued progress around AI capabilities that spans many use cases for its ITSM solutions. 4) While macros continue to impact EMEA, pipeline is growing at an accelerated pace. 5) Key near-term priorities include subscription adoption reflected in subscription revenue and ARR growth, expense discipline in a challenging macro, improving renewal rates and organic expansion of the company's platform.

Looking ahead: CY/23 midpoint revenue guidance was raised to $744M from $732.5M previously, pointing to +3% revenue growth. On the profitability side, the midpoint adjusted EBITDA/EPS guide was raised to $310.5M/$0.775 vs. $300M/$0.735 previously, pointing to 41.7% margin.

Sector Perform

NYSE: SWI; USD 10.16

Price Target USD 13.00 ↑ 11.00

WHAT'S INSIDE	
☐ Rating/Risk Change	☑ Price Target Change
☐ In-Depth Report	☑ Est. Change
☐ Preview	☑ News Analysis

Scenario Analysis*

Downside Scenario	Current Price	Price Target	Upside Scenario
8.00	10.16	13.00	15.00
↓ 21%		↑ 28%	↑ 48%

*Implied Total Returns

Key Statistics

Shares O/S (MM):	159.0	Market Cap (MM):	1,615
Dividend:	0.00	Yield:	0.0%
		Avg. Daily Volume:	322,632

RBC Estimates

FY Dec	2021A	2022A	2023E	2024E
Revenue	718.6	719.4	744.0	773.0
Prev.			731.5	753.1
EPS, Ops Diluted	1.20	0.83	0.77	0.89
Prev.			0.72	0.86
P/E	8.5x	12.2x	13.2x	11.4x
EBITDA, Adj	303.3	280.4	310.2	330.0
Prev.			299.1	315.4

Revenue	Q1	Q2	Q3	Q4
2022	176.9A	176.0A	179.4A	187.1A
2023	186.0A	185.0A	184.0E	189.0E
Prev.		178.5E	181.0E	186.0E
2024	190.0E	191.5E	194.0E	197.5E
Prev.	183.0E	185.6E	191.5E	193.0E
EPS, Ops Diluted				
2022	0.24A	0.21A	0.20A	0.19A
2023	0.20A	0.21A	0.18E	0.18E
Prev.		0.16E	0.17E	
2024	0.20E	0.22E	0.23E	0.24E
Prev.	0.19E	0.20E		

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

	Jun-23A				
Revenue, EPS, and Margins	actual	est.	Delta	Y/Y	Q/Q
Total revenue	185.0	178.5	6.5	5.1%	-0.5%
Gross margin	90.3%	90.0%	28 bps	-127 bps	-31 bps
Sales and marketing	53.6	58.0	-4.4	-8.9%	-7.3%
as % of revenue	29.0%	32.5%	-353 bps	-445 bps	-211 bps
General and administrative	18.2	17.9	0.3	-7.2%	4.2%
as % of revenue	9.8%	10.0%	-17 bps	-130 bps	44 bps
Research and development	20.7	20.5	0.1	6.7%	0.6%
as % of revenue	11.2%	11.5%	-33 bps	16 bps	12 bps
Operating income	74.6	64.3	10.3	17.7%	2.6%
Operating margin	40.3%	36.0%	431 bps	433 bps	123 bps
Other income	-29.4	-28.7	-0.8	66.5%	2.7%
Taxes	11.1	9.3	1.8	NA	-0.2%
Tax rate	24.6%	26.0%	-143 bps	8 bps	-71 bps
EPS	$0.21	$0.16	$0.05	-4.0%	2.0%
Shares	165.4	164.8	0.6	2.9%	1.6%
Balance Sheet and Cash Flow					
DSO	41	38	3	-2	-12
Deferred revenue	374.3	381.7	-7.4	7.0%	-2.9%
Billings	173.8	174.6	-0.9	7.6%	-10.9%
CFO	49.0	49.3	-0.3	18.9%	6028.7%
CFO per share	$0.30	$0.30	$0.00	15.5%	5931.8%
CAPEX	-1.0	-4.5	3.4	-55.6%	205.6%
Free cash flow	47.9	44.8	3.1	23.4%	10386.4%
Free cash flow per share	$0.29	$0.27	$0.02	19.9%	10220.8%

$ in million except per share data

Source: Company reports and RBC Capital Markets estimates

Management call-back notes

- SolarWinds has delivered consistent results despite a tougher macro as management attributed this to their high-volume and high-velocity business model that helped offset near-term headwinds.
- With the transition to a subscription-first model, there is also an additional layer of visibility as >90% of revenue is recurring.
- Management noted that the diversity of their customer base has also created defensibility against headwinds.
- Thinking about AI capabilities, management is not currently looking at Vector search, though may consider down the line.
- Momentum on the hybrid cloud platform is growing as management seeks to convert the maintenance base better than at a 1:1 ratio. There continues to be a large runway ahead to convert the maintenance base as management views this as a multi-year transition.
- From a modeling perspective, a lot of the work has been done in the first quarter to improve sales rep productivity. On the G&A side, the company has made more efficiencies around facilities.
- Overall, management remains focused on their subscription-first strategy, improvement of renewal rates, and strategic investments.

Q3/23 guidance

- Total revenue of $182 million to $186 million, or $184 million at the midpoint, which points to 3% y/y midpoint growth. This compares to the prior RBC estimate of $181.0 million and prior consensus of $182.2 million.
- Adjusted EBITDA of $74 million to $76.5 million, or $75.25 million at the midpoint, which points to a ~40.9 margin. This compares to the prior RBC estimate of $73.8 million and prior consensus of $75.1 million.
- EPS of $0.17 to $0.19, or $0.18 at the midpoint. This compares to the prior RBC estimate of $0.17 and prior consensus of $0.18.
- Weighted average outstanding diluted shares of 167.3 million.

CY/23 guidance

- Total revenue of $740 million to $748 million, or $744 million at the midpoint, which points to 3% y/y midpoint growth. This compares prior guidance of $725 million to $740 million, or $732.5 million at the midpoint, prior RBC estimate at $731.5 million and prior consensus of $734.3 million.
- Adjusted EBITDA of $308 million to $313 million, or $310.5 million at the midpoint, which points to a ~41.7% margin. This compares prior guidance of $295 million to $305 million, or $300 million at the midpoint, prior RBC estimate at $299.1 million and prior consensus at $299.3 million.
- EPS of $0.76 to $0.79, or $0.775 at the midpoint. This compares to prior guidance of $0.71 to $0.76, or $0.735 at the midpoint, prior RBC estimate at $0.72 and prior consensus of $0.73.
- Weighted average outstanding diluted shares of 166.5 million.

Exhibit 2 - Revised vs. prior estimates

					Jun-23A		Sep-23E		2023E		2024E	
Revenue, EPS, and Margins	Jun-22A	Sep-22A	Dec-22A	Mar-23A	actual	est.	new	prior	new	prior	new	prior
Total revenue	176.0	179.4	187.1	186.0	185.0	178.5	184.0	181.0	744.0	731.5	773.0	753.1
Gross margin	91.5%	91.0%	90.6%	90.6%	90.3%	90.0%	90.0%	90.0%	90.2%	90.2%	90.0%	90.0%
Sales and marketing	58.8	59.3	61.5	57.8	53.6	58.0	58.5	57.6	229.5	232.0	234.4	227.8
as % of revenue	33.4%	33.0%	32.9%	31.1%	29.0%	32.5%	31.8%	31.8%	30.8%	31.7%	30.3%	30.2%
General and administrative	19.6	16.7	19.4	17.5	18.2	17.9	19.1	17.2	74.6	70.2	74.6	72.4
as % of revenue	11.1%	9.3%	10.4%	9.4%	9.8%	10.0%	10.4%	9.5%	10.0%	9.6%	9.7%	9.6%
Research and development	19.4	19.5	21.4	20.5	20.7	20.5	21.2	20.3	84.3	81.8	85.0	83.6
as % of revenue	11.0%	10.9%	11.4%	11.0%	11.2%	11.5%	11.5%	11.2%	11.3%	11.2%	11.0%	11.1%
Operating income	63.3	67.8	67.3	72.7	74.6	64.3	66.8	67.9	282.9	275.5	301.7	294.0
Operating margin	36.0%	37.8%	36.0%	39.1%	40.3%	36.0%	36.3%	37.5%	38.0%	37.7%	39.0%	39.0%
Other income	-17.7	-23.7	-27.0	-28.7	-29.4	-28.7	-26.4	-28.7	-111.0	-114.7	-94.7	-94.7
Taxes	11.2	12.5	10.1	11.1	11.1	9.3	10.5	10.2	43.7	41.5	53.8	51.8
Tax rate	24.5%	28.4%	25.1%	25.3%	24.6%	26.0%	26.0%	26.0%	25.4%	25.8%	0.0%	0.0%
EPS	$0.21	$0.20	$0.19	$0.20	$0.21	$0.16	$0.18	$0.17	$0.77	$0.72	$0.89	$0.86
Shares	160.7	161.1	161.7	162.8	165.4	164.8	167.4	166.8	166.5	166.0	171.6	171.0
Balance Sheet and Cash Flow												
DSO	43	46	48	52	41	38	38	38				
Deferred revenue	350.0	349.9	376.5	385.6	374.3	381.7	366.8	374.1	374.2	381.6	346.7	368.2
Billings	161.6	179.3	213.6	195.1	173.8	174.6	176.5	173.4	741.7	736.6	745.5	739.7
CFO	41.2	25.3	47.8	0.8	49.0	49.3	34.7	40.7	170.6	180.0	194.6	210.2
CFO per share	$0.26	$0.16	$0.30	$0.00	$0.30	$0.30	$0.21	$0.24	$1.01	$1.07	$1.13	$1.23
CAPEX	-2.4	-2.0	-1.9	-0.3	-1.0	-4.5	-4.6	-4.5	-10.7	-14.0	-19.3	-18.8
Free cash flow	38.8	23.2	45.9	0.5	47.9	44.8	30.1	36.2	159.9	166.0	175.3	191.4
Free cash flow per share	$0.24	$0.14	$0.28	$0.00	$0.29	$0.27	$0.18	$0.22	$0.96	$1.00	$1.02	$1.12

$ in million except per share data

Source: Company reports and RBC Capital Markets estimates

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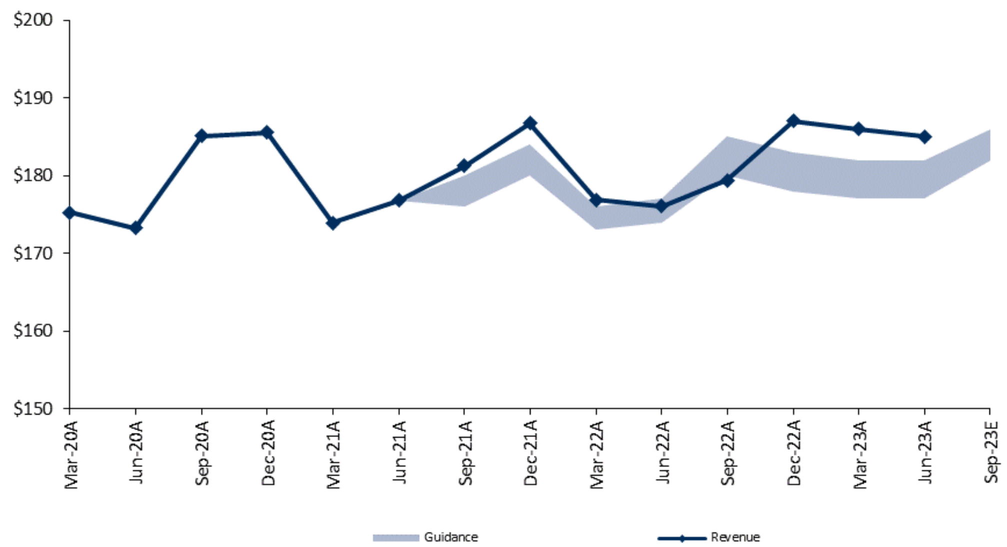
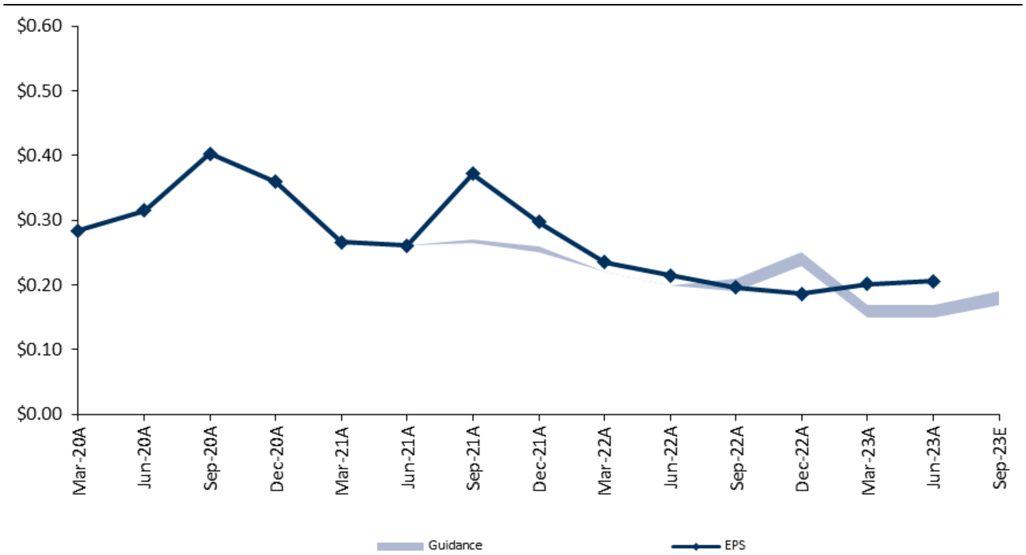
Exhibit 3 - Quarterly revenue vs. guidance (M)



Source: Company reports

Exhibit 4 - Quarterly EPS vs. guidance



Source: Company reports

Ticker: SWI		Dec-22A				Dec-23E				Dec-24E						
($M) unless noted	Mar-22A	Jun-22A	Sep-22A	Dec-22A	Mar-23A	Jun-23A	Sep-23E	Dec-23E	Mar-24E	Jun-24E	Sep-24E	Dec-24E	2021A	2022A	2023E	2024E
INCOME STATEMENT																
Subscription revenue	38.7	37.0	42.2	49.7	54.4	53.4	56.0	61.0	63.0	65.0	69.0	74.0	124.6	167.7	224.7	271.0
Maintenance revenue	115.5	114.0	114.4	115.1	114.5	116.1	113.0	113.0	112.0	112.0	111.0	110.0	479.4	458.9	456.5	445.0
Total recurring revenue	154.2	151.0	156.6	164.8	168.8	169.4	169.0	174.0	175.0	177.0	180.0	184.0	604.0	626.6	681.3	716.0
License revenue	22.6	25.1	22.8	22.3	17.1	15.6	15.0	15.0	15.0	14.5	14.0	13.5	114.6	92.8	62.7	57.0
Total revenue	176.9	176.0	179.4	187.1	186.0	185.0	184.0	189.0	190.0	191.5	194.0	197.5	718.6	719.4	744.0	773.0
Total cost of revenue	17.2	14.9	16.1	17.5	17.5	18.0	18.4	18.9	19.0	19.2	19.4	19.8	62.7	65.6	72.8	77.3
Gross profit	159.7	161.2	163.3	169.6	168.5	167.1	165.6	170.1	171.0	172.4	174.6	177.8	656.0	653.8	671.2	695.7
Sales and marketing	55.3	58.8	59.3	61.5	57.8	53.6	58.5	59.5	58.0	58.4	58.8	59.3	211.9	234.9	229.5	234.4
Research and development	20.8	19.4	19.5	21.4	20.5	20.7	21.2	21.9	20.9	21.1	21.3	21.7	88.3	81.1	84.3	85.0
General and administrative	18.5	19.6	16.7	19.4	17.5	18.2	19.1	19.8	18.2	18.4	18.8	19.2	67.2	74.2	74.6	74.6
Operating expenses	94.6	97.8	95.5	102.3	95.8	92.5	98.8	101.3	97.1	97.9	98.9	100.1	367.4	390.2	388.4	394.0
Operating income	65.2	63.3	67.8	67.3	72.7	74.6	66.8	68.8	73.9	74.5	75.7	77.6	288.6	263.6	282.9	301.7
Other income	(16.3)	(17.7)	(23.7)	(27.0)	(28.7)	(29.4)	(26.4)	(26.4)	(26.7)	(24.7)	(22.7)	(20.7)	(63.7)	(84.7)	(111.0)	(94.7)
Pretax income	48.9	45.7	44.1	40.3	44.0	45.2	40.4	42.4	47.2	49.8	53.0	56.9	225.0	178.9	171.9	207.0
Taxes	11.3	11.2	12.5	10.1	11.1	11.1	10.5	11.0	12.3	13.0	13.8	14.8	35.1	45.1	43.7	53.8
Net income	37.6	34.5	31.6	30.2	32.9	34.1	29.9	31.4	35.0	36.9	39.2	42.1	190.0	133.8	128.2	153.2
Earnings per share	$0.24	$0.21	$0.20	$0.19	$0.20	$0.21	$0.18	$0.18	$0.20	$0.22	$0.23	$0.24	$1.20	$0.83	$0.77	$0.89
Diluted shares outstanding	159.8	160.7	161.1	161.7	162.8	165.4	167.4	170.4	170.9	171.4	171.9	172.4	158.6	160.8	166.5	171.6
KEY METRICS																
DSO	50	43	46	48	52	41	38	40	40	38	38	40				
Cash	751.2	778.2	492.5	148.9	140.7	178.2	204.5	282.3	286.2	336.3	373.3	442.6	732.1	148.9	282.3	442.6
Cash per share	$4.70	$4.84	$3.06	$0.92	$0.86	$1.08	$1.22	$1.66	$1.67	$1.96	$2.17	$2.57	$4.62	$0.93	$1.70	$2.58
Debt	1,956.8	1,939.8	1,639.3	1,267.0	1,266.9	1,246.0	1,246.0	1,246.0	1,246.0	1,246.0	1,246.0	1,246.0	1,963.9	1,267.0	1,246.0	1,246.0
Net cash	(1,205.6)	(1,161.6)	(1,146.7)	(1,118.1)	(1,126.1)	(1,067.8)	(1,041.5)	(963.7)	(959.8)	(909.7)	(872.7)	(803.4)	(1,231.8)	(1,118.1)	(963.7)	(803.4)
Net cash per share	($7.54)	($7.23)	($7.12)	($6.91)	($6.92)	($6.46)	($6.22)	($5.66)	($5.62)	($5.31)	($5.08)	($4.66)	($7.77)	($6.95)	($5.79)	($4.68)
Deferred revenue	364.5	350.0	349.9	376.5	385.6	374.3	366.8	374.2	363.0	355.7	343.2	346.7	362.7	376.5	374.2	346.7
Billings	178.7	161.6	179.3	213.6	195.1	173.8	176.5	196.3	178.8	184.2	181.6	200.9	708.2	733.2	741.7	745.5
Subscription billings	40.1	23.1	40.5	73.9	60.4	42.1	48.5	68.3	51.8	57.7	56.6	77.4	115.7	73.9	68.3	77.4
Unlevered free cash flow	55.2	51.6	47.3	69.7	41.0	66.0	40.8	97.7	21.3	73.5	60.8	93.6	116.6	223.7	245.5	249.3
Adjusted EBITDA	68.8	66.8	70.3	74.5	77.4	79.1	75.2	78.4	76.1	79.8	83.5	87.8	303.3	280.4	310.2	327.1
Adjusted EBITDA Margin	38.9%	38.0%	39.2%	39.8%	41.6%	42.8%	40.9%	41.5%	40.0%	41.7%	43.0%	44.5%	42.2%	39.0%	41.7%	42.3%
PERCENT OF REVENUE																
Subscription revenue	21.9%	21.0%	23.6%	26.6%	29.2%	28.9%	30.4%	32.3%	33.2%	33.9%	35.6%	37.5%	17.3%	23.3%	30.2%	35.1%
Maintenance revenue	65.3%	64.7%	63.8%	61.5%	61.6%	62.7%	61.4%	59.8%	58.9%	58.5%	57.2%	55.7%	66.7%	63.8%	61.4%	57.6%
Total recurring revenue	87.2%	85.8%	87.3%	88.1%	90.8%	91.6%	91.8%	92.1%	92.1%	92.4%	92.8%	93.2%	84.1%	87.1%	91.6%	92.6%
License revenue	12.8%	14.2%	12.7%	11.9%	9.2%	8.4%	8.2%	7.9%	7.9%	7.6%	7.2%	6.8%	15.9%	12.9%	8.4%	7.4%
Gross margin	90.3%	91.5%	91.0%	90.6%	90.6%	90.3%	90.0%	90.0%	90.0%	90.0%	90.0%	90.0%	91.3%	90.9%	90.2%	90.0%
Sales and marketing	31.3%	33.4%	33.0%	32.9%	31.1%	29.0%	31.8%	31.5%	30.5%	30.5%	30.3%	30.0%	29.5%	32.6%	30.8%	30.3%
Research and development	11.8%	11.0%	10.9%	11.4%	11.0%	11.2%	11.5%	11.6%	11.0%	11.0%	11.0%	11.0%	12.3%	11.3%	11.3%	11.0%
General and administrative	10.4%	11.1%	9.3%	10.4%	9.4%	9.8%	10.4%	10.5%	9.6%	9.6%	9.7%	9.7%	9.4%	10.3%	10.0%	9.7%
Operating margin	36.8%	36.0%	37.8%	36.0%	39.1%	40.3%	36.3%	36.4%	38.9%	38.9%	39.0%	39.3%	40.2%	36.6%	38.0%	39.0%
Net margin	21.2%	19.6%	17.6%	16.1%	17.7%	18.4%	16.2%	16.6%	18.4%	19.3%	20.2%	21.3%	26.4%	18.6%	17.2%	19.8%
Adjusted EBITDA	38.9%	38.0%	39.2%	39.8%	41.6%	42.8%	40.9%	41.5%	40.0%	41.7%	43.0%	44.5%	42.2%	39.0%	41.7%	42.3%
GROWTH Y/Y																
Subscription revenue	36.8%	24.9%	30.8%	44.6%	40.3%	44.4%	32.6%	22.7%	15.9%	21.7%	23.2%	21.3%	19.3%	34.6%	34.0%	20.6%
Maintenance revenue	-4.3%	-5.4%	-4.5%	-2.9%	-0.9%	1.8%	-1.2%	-1.8%	-2.2%	-3.5%	-1.8%	-2.7%	2.4%	-4.3%	-0.5%	-2.5%
Total recurring revenue	3.5%	0.6%	3.0%	7.8%	9.5%	12.3%	7.9%	5.6%	3.7%	4.5%	6.5%	5.7%	5.5%	3.7%	8.7%	5.1%
License revenue	-9.0%	-6.0%	-22.1%	-34.0%	-24.2%	-37.8%	-34.1%	-32.8%	-12.5%	-7.0%	-6.7%	-10.0%	-20.4%	-19.0%	-32.4%	-9.1%
Total revenue	1.7%	-0.5%	-1.0%	0.2%	5.1%	5.1%	2.6%	1.0%	2.2%	3.5%	5.4%	4.5%	0.3%	0.1%	3.4%	3.9%
Operating income	-6.6%	-13.1%	-5.3%	-9.6%	11.5%	17.7%	-1.5%	2.2%	1.7%	-0.1%	13.3%	12.8%	-14.4%	-8.7%	7.3%	6.7%
EPS	-11.6%	-17.7%	-47.3%	-37.3%	-14.0%	-4.0%	-9.0%	-1.4%	1.3%	4.4%	27.8%	32.9%	NA	-30.4%	-7.4%	15.8%
Deferred revenue	0.5%	-3.5%	-0.3%	3.8%	5.8%	7.0%	4.8%	-0.6%	-5.9%	-5.0%	-6.4%	-7.3%	-2.8%	3.8%	-0.6%	-7.3%
Billings	9.3%	-8.6%	5.8%	7.6%	9.2%	7.6%	-1.6%	-8.1%	-8.4%	6.0%	2.9%	2.3%	-5.1%	3.5%	1.2%	0.5%
Subscription billings	106.0%	-22.1%	88.7%	63.4%	50.8%	82.5%	19.8%	-7.5%	-14.3%	37.1%	16.6%	13.3%	-10.2%	-36.2%	-7.5%	13.3%
Unlevered free cash flow	97.9%	-6.3%	NM	197.2%	-25.8%	28.0%	-13.6%	40.3%	-47.9%	11.3%	48.9%	-4.2%	-61.8%	92.0%	9.7%	1.5%
Adjusted EBITDA	-5.7%	-12.9%	-6.6%	-4.9%	12.5%	18.4%	7.0%	5.3%	-1.7%	0.8%	10.9%	12.0%	-14.2%	-7.5%	10.6%	5.5%
GROWTH Q/Q																
Subscription revenue	12.7%	-4.6%	14.2%	17.6%	9.4%	-1.8%	4.9%	8.9%	3.3%	3.2%	6.2%	7.2%				
Maintenance revenue	-2.5%	-1.3%	0.4%	0.6%	-0.5%	1.4%	-2.6%	0.0%	-0.9%	0.0%	-0.9%	-0.9%				
Total recurring revenue	0.9%	-2.1%	3.8%	5.2%	2.5%	0.4%	-0.3%	3.0%	0.6%	1.1%	1.7%	2.2%				
License revenue	-33.1%	10.9%	-9.2%	-2.0%	-23.2%	-9.1%	-3.8%	0.0%	0.0%	-3.3%	-3.4%	-3.6%				
Total revenue	-5.3%	-0.5%	1.9%	4.3%	-0.6%	-0.5%	-0.6%	2.7%	0.5%	0.8%	1.3%	1.8%				
Operating income	-12.5%	-2.8%	7.0%	-0.7%	8.0%	2.6%	-10.5%	3.0%	7.4%	0.8%	1.6%	2.6%				
Deferred revenue	0.5%	-4.0%	0.0%	7.6%	2.4%	-2.9%	-2.0%	2.0%	-3.0%	-2.0%	-3.5%	1.0%				
Billings	-10.0%	-9.6%	11.0%	19.1%	-8.7%	-10.9%	1.6%	11.2%	-8.9%	3.1%	-1.5%	10.7%				
Subscription billings	-11.4%	-42.4%	75.6%	82.4%	-18.2%	-30.3%	15.2%	40.9%	-24.2%	11.5%	-2.1%	36.9%				
Unlevered free cash flow	135.7%	-6.6%	-8.4%	47.4%	-41.2%	61.1%	-38.1%	139.3%	-78.2%	244.3%	-17.3%	54.1%				
Adjusted EBITDA	-12.2%	-2.9%	5.2%	5.9%	3.8%	2.3%	-5.0%	4.3%	-3.0%	4.9%	4.6%	5.2%				

Source: Company Reports and RBC Capital Markets estimates

Matthew Hedberg | 612-313-1293 | matthew.hedberg@rbccm.com

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.

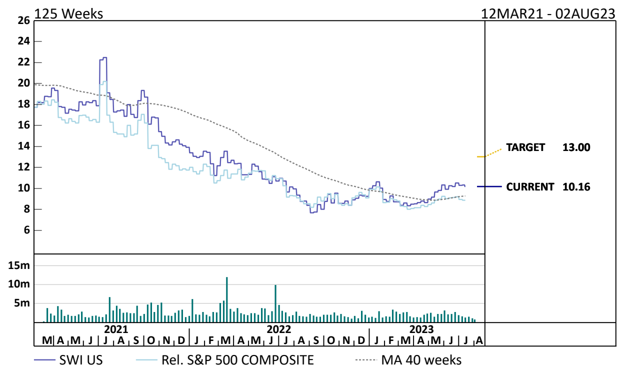
Key ESG questions

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 10.4x multiple on our CY/23 EBITDA estimate of $310M, 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 $15 is based on EBITDA growth of 14% in CY/23E, 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 11x 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 8% in CY/23E, 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 8x 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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Distribution of ratings
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As of 30-Jun-2023

			Investment Banking Serv./Past 12 Mos.	
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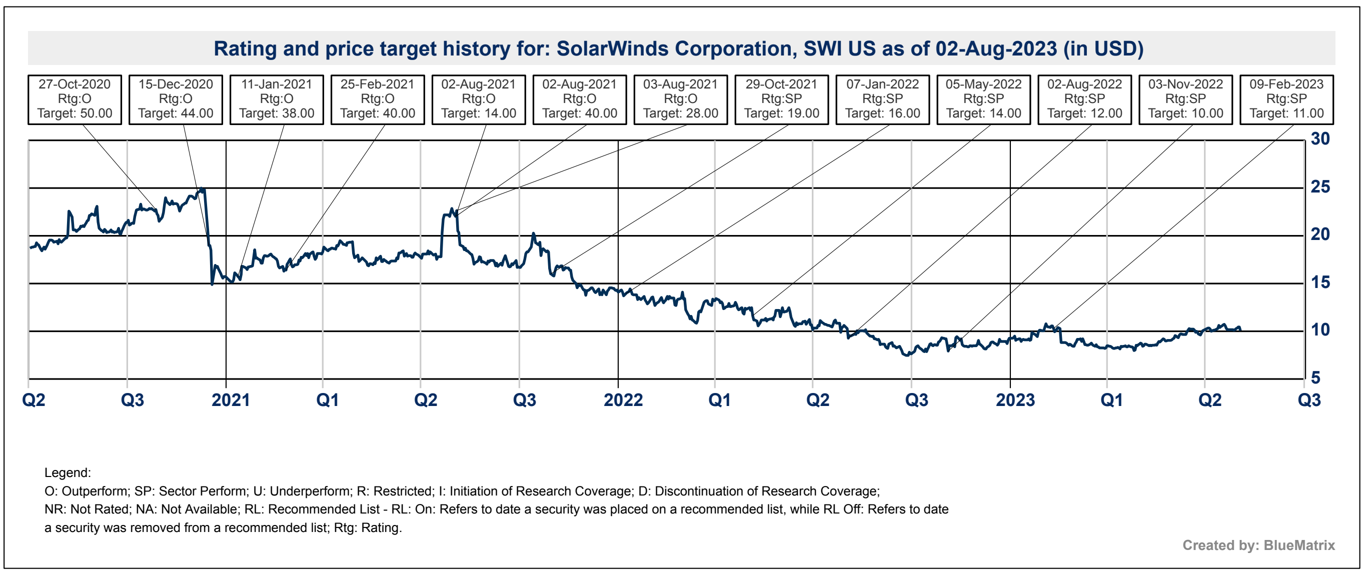
BUY [Outperform]	832	57.22	250	30.05
HOLD [Sector Perform]	573	39.41	138	24.08
SELL [Underperform]	49	3.37	3	6.12



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SolarWinds Corporation

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