EQUITY RESEARCH

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May 5, 2022

SolarWinds Corporation

Positive results in an uneven macro; Q1/22 review

Our view: SolarWinds reported solid Q1 results with revenue, EPS, and EBITDA ahead of consensus. CY/22 revenue/adj-EBITDA was maintained while CY/22 EPS was guided down. Management noted the early success of their hybrid observavility solution and migration journey to SaaS. Overall, we remain optimistic about their LT growth but remain cautious in the near term due to uneven macros. Maintain our SP rating and lower our PT to $14.

Key points:

All you need to know: SolarWinds delivered a good quarter with revenue/ adj-EBITDA ahead of expectations at $176.9M/$68.6M vs. consensus of $174.6M/$63.6M. Total ARR remained relatively flat as +30% y/y subscription ARR growth (accounting for ~23% of total ARR), was offset by a -6% decrease in maintenance ARR (~77% of the total). Q2/22 guidance fell below expectations on all metrics with a revenue shortfall of ~$7M vs. consensus in which management called out as a ~$4M of shortfall due to FX headwinds and the remaining attributed to the trajectory of maintenance revenue, which tends to pick up in the back-end of the year. Looking into CY/22, management maintained revenue and EBITDA guidance but lowered EPS guidance due to a higher interest and tax forecast. Given the uneven macros, we believe there is the potential for continued FX headwinds throughout the year which could put additional pressure on metrics. That said, management feels confident that they can land within the range and will assess the impact as the upcoming quarters unfold. On a positive note, the renewal rate came out to 91% this quarter with the TTM renewal at 88%, trending closer to historical norms of low-to-mid 90s prior to the breach. Also, management noted no material impact (~$600K per quarter at most) from the Russia-Ukraine crisis. Overall, we like the LT opportunity but remain mindful of near-term macro headwinds. Maintain SP and lower PT to $14 as we watch for clean execution.

Key growth drivers: Management highlighted some key drivers in their business including: 1) renewal rates trending back to historical norms which reflects the increasing stickiness of their customer base; 2) the ability to capitalize on customer migration to subscription arrangements, which will likely have a positive impact on growth through CY/24. Management also noted that they were able to convert some of their largest customers from maintenance to subscription giving them more confidence in this transition; 3) The evolution of their platform with the hybrid observability solution, expected to launch in April as management highlighted positive customer feedback through their early access program.

Mixed CY/22 guidance: CY/22 midpoint revenue/adj-EBITDA was maintained at $740M/$303.4M, in-line with expectations while EPS was guided down to $0.92 at the midpoint vs. prior guidance of $1.045. While the revenue and adjusted EBITDA outlook is reassuring, we believe execution from here will be key.

Sector Perform

NYSE: SWI; USD 11.71

Price Target USD 14.00 ↓ 16.00

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
10.00	11.71	14.00	21.00
↓ 15%		↑ 20%	↑ 79%

*Implied Total Returns

Key Statistics

Shares O/S (MM):	159.0	Market Cap (MM):	1,861
Dividend:	0.00	Yield:	0.0%
		Avg. Daily Volume:	529,277

RBC Estimates

FY Dec	2020A	2021A	2022E	2023E
Revenue	716.8	718.6	740.0	773.1
Prev.	711.7			773.0
EPS, Ops Diluted	1.36	1.19	0.92	1.03
Prev.	1.34	1.20	1.05	1.13
P/E	8.6x	9.8x	12.7x	11.4x
EBITDA, Adj	353.4	301.4	303.4	328.0
Prev.	351.0	303.3	305.0	328.2

Revenue	**Q1**	**Q2**	**Q3**	**Q4**
2021	173.9A	176.9A	181.3A	186.7A
2022	176.9A	175.5E	190.2E	197.4E
Prev.	174.5E	181.5E	188.5E	195.5E
2023	184.0E	187.4E	197.5E	204.2E
Prev.	183.4E	189.4E	196.4E	203.7E
EPS, Ops Diluted				
2021	0.28A	0.25A	0.37A	0.30A
2022	0.24A	0.20E	0.23E	0.25E
Prev.	0.22E	0.26E	0.27E	0.29E
2023	0.24E	0.25E	0.26E	0.28E
Prev.	0.27E	0.27E	0.29E	0.30E

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

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For Required Conflicts Disclosures, see page 9
RBC Capital Markets appreciates your consideration in the 2022 Institutional Investor All-America and All-Canada Research Team survey.

Exhibit 1 - Results vs. RBC estimates

Revenue, EPS, and Margins	Mar-22A actual	est.	Delta	Y/Y	Q/Q
Total revenue	176.9	174.5	2.4	1.7%	-5.3%
Gross margin	90.3%	91.0%	-70 bps	-144 bps	-42 bps
Sales and marketing	55.3	55.0	0.3	8.0%	-1.9%
as % of revenue	31.3%	31.5%	-23 bps	183 bps	108 bps
General and administrative	18.5	19.2	-0.8	14.6%	2.9%
as % of revenue	10.4%	11.0%	-57 bps	118 bps	82 bps
Research and development	20.8	23.1	-2.3	-7.6%	0.9%
as % of revenue	11.8%	13.2%	-148 bps	-118 bps	72 bps
Operating income	65.2	61.5	3.6	-6.6%	-12.5%
Operating margin	36.8%	35.2%	159 bps	-326 bps	-304 bps
Other income	-16.3	-16.1	-0.2	5.0%	1.4%
Taxes	11.3	10.0	1.3	NA	2.0%
Tax rate	23.1%	22.0%	111 bps	18 bps	415 bps
EPS	$0.24	$0.22	$0.01	-11.6%	-21.0%
Shares	159.8	160.5	-0.7	1.7%	0.6%
Balance Sheet and Cash Flow					
DSO	50	40	10	3	4
Deferred revenue	364.5	359.0	5.4	-1.1%	0.5%
Billings	178.7	170.9	7.8	5.5%	-10.0%
CFO	40.3	32.2	8.1	152.2%	11.4%
CFO per share	$0.25	$0.20	$0.05	147.9%	10.8%
CAPEX	-1.2	-4.4	3.2	-65.2%	-48.3%
Free cash flow	39.1	27.8	11.3	210.7%	15.4%
Free cash flow per share	$0.24	$0.17	$0.07	205.4%	14.8%

$ in million except per share data

Source: Company reports and RBC Capital Markets estimates

Q2/22 Guidance

- Total revenue of $174M million to $177M million, or $175.5 million at the midpoint ((-2)-0% y/y growth). This compares to the prior RBC estimate of $174.6 million and prior consensus of $181.5 million.
- Adjusted EBITDA margin of 37-38%, which reflects an EBITDA range of $65.3 million to $66.4 million, or $65.8 million at the midpoint. This compares to the prior RBC estimate of $74M million and prior consensus of $73.2 million.
- EPS of $0.20. This compares to the prior RBC estimate and prior consensus of $0.26.
- Weighted average outstanding diluted shares of 161.6 million.

CY/22 Guidance

- Total revenue of $730 million to $750 million, or $740 million at the midpoint (2-4% y/y growth). This compares to prior guidance of $730.0 million to $750.0 million, or $740.0 million at the midpoint, the prior RBC estimate at $740 million and prior consensus of $740.9 million.

- Adjusted EBITDA margin of 41%, which reflects an EBITDA range of $299.3 million to $307.5 million, or $303.4 million at the midpoint. This compares to prior guidance of 41%, which reflects an EBITDA range of $299.3 million to $307.5 million, or $303.4 million at the midpoint with the prior RBC estimate at $305 million and prior consensus at $303.4 million.

- EPS of $0.88 to $0.95, or $0.92 at the midpoint. This compares to the prior RBC estimate and prior consensus of $1.05.

- Weighted average outstanding diluted shares of 162.6 million vs. previous guidance of 162.6 million.

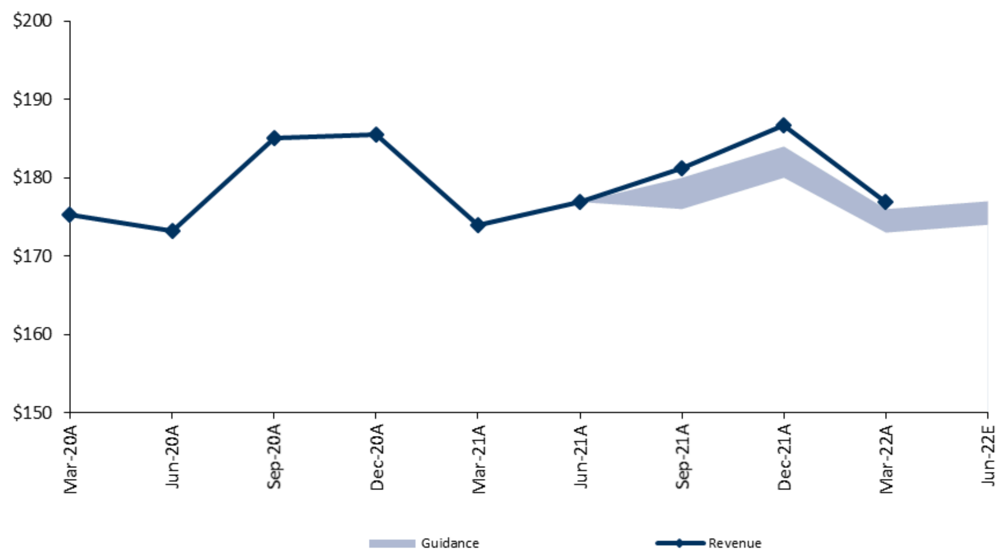
Exhibit 2 - Revised vs. prior estimates

					Mar-22A		Jun-22E		2022E		2023E	
Revenue, EPS, and Margins	Mar-21A	Jun-21A	Sep-21A	Dec-21A	actual	est.	new	prior	new	prior	new	prior
Total revenue	173.9	176.9	181.3	186.7	176.9	174.5	175.5	181.5	740.0	740.0	773.1	773.0
Gross margin	91.7%	91.9%	90.9%	90.7%	90.3%	91.0%	89.0%	92.0%	89.3%	91.8%	90.0%	92.0%
Sales and marketing	51.2	52.3	52.3	56.4	55.3	55.0	56.2	54.1	235.5	222.9	239.7	230.6
as % of revenue	29.4%	29.6%	28.9%	30.2%	31.3%	31.5%	32.0%	29.8%	31.8%	30.1%	31.0%	29.8%
General and administrative	16.1	15.8	18.1	18.0	18.5	19.2	19.0	19.6	79.3	80.3	87.5	87.5
as % of revenue	9.3%	8.9%	10.0%	9.6%	10.4%	11.0%	10.8%	10.8%	10.7%	10.9%	11.3%	11.3%
Research and development	22.5	22.7	22.8	20.6	20.8	23.1	22.6	23.4	92.4	95.0	97.4	97.4
as % of revenue	12.9%	12.8%	12.6%	11.0%	11.8%	13.2%	12.9%	12.9%	12.5%	12.8%	12.6%	12.6%
Operating income	69.7	71.8	71.6	74.5	65.2	61.5	58.4	69.9	253.7	280.8	271.2	295.7
Operating margin	40.1%	40.6%	39.5%	39.9%	36.8%	35.2%	33.3%	38.5%	34.3%	37.9%	35.1%	38.2%
Other income	-15.5	-19.1	-15.6	-16.1	-16.3	-16.1	-16.3	-16.1	-62.9	-62.2	-56.0	-56.0
Taxes	12.4	13.2	-3.7	11.1	11.3	10.0	9.3	11.8	42.5	48.1	45.2	52.7
Tax rate	22.9%	25.1%	-6.6%	19.0%	23.1%	22.0%	22.0%	22.0%	22.3%	22.0%	0.0%	0.0%
EPS	$0.27	$0.25	$0.37	$0.30	$0.24	$0.22	$0.20	$0.26	$0.92	$1.05	$1.03	$1.13
Shares	157.1	157.9	160.3	159.0	159.8	160.5	161.1	161.8	161.9	162.6	165.3	166.0
Balance Sheet and Cash Flow												
DSO	47	50	40	46	50	40	38	38				
Deferred revenue	368.4	360.2	350.8	362.7	364.5	359.0	357.2	351.9	358.7	353.4	352.9	347.6
Billings	169.3	168.7	171.8	198.6	178.7	170.9	168.2	174.3	736.0	730.7	767.3	767.2
CFO	16.0	56.1	9.9	36.1	40.3	32.2	62.9	60.3	191.8	202.8	265.7	246.9
CFO per share	$0.10	$0.36	$0.06	$0.23	$0.25	$0.20	$0.39	$0.37	$1.18	$1.24	$1.61	$1.49
CAPEX	-3.4	-12.3	8.7	-2.3	-1.2	-4.4	-4.4	-4.5	-15.3	-18.5	-19.3	-19.3
Free cash flow	12.6	43.8	18.6	33.9	39.1	27.8	58.5	55.8	176.6	184.3	246.4	227.6
Free cash flow per share	$0.08	$0.28	$0.12	$0.21	$0.24	$0.17	$0.36	$0.34	$1.09	$1.13	$1.49	$1.37

$ in million except per share data

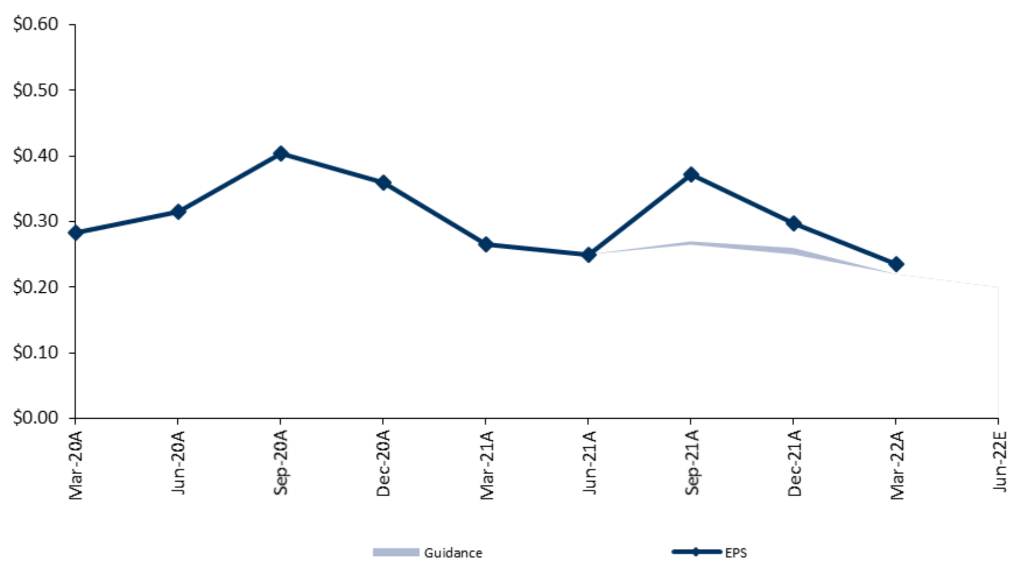
Source: Company reports and RBC Capital Markets estimates

Exhibit 3 - Quarterly revenue vs. guidance (M)



Source: Company reports

Exhibit 4 - Quarterly EPS vs. guidance



Source: Company reports

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Ticker: SWI		Dec-21A				Dec-22E				Dec-23E						
($M) unless noted	Mar-21A	Jun-21A	Sep-21A	Dec-21A	Mar-22A	Jun-22E	Sep-22E	Dec-22E	Mar-23E	Jun-23E	Sep-23E	Dec-23E	2020A	2021A	2022E	2023E
INCOME STATEMENT																
Subscription revenue	28.3	29.3	32.3	34.4	38.7	36.0	39.0	42.0	43.0	44.0	45.0	47.0	104.5	124.3	155.7	179.0
Maintenance revenue	120.7	120.8	119.7	118.5	115.5	113.5	118.0	119.0	114.0	114.4	119.0	120.1	468.3	479.7	466.0	467.5
Total recurring revenue	149.0	150.1	152.0	152.9	154.2	149.5	157.0	161.0	157.0	158.4	164.0	167.1	572.8	604.0	621.7	646.5
License revenue	24.9	26.7	29.2	33.8	22.6	26.0	33.2	36.4	27.0	29.0	33.5	37.1	144.0	114.7	118.3	126.6
Total revenue	173.9	176.9	181.3	186.7	176.9	175.5	190.2	197.4	184.0	187.4	197.5	204.2	716.8	718.7	740.0	773.1
Total cost of revenue	14.4	14.3	16.5	17.3	17.2	19.3	20.9	21.7	18.4	18.7	19.8	20.4	52.1	62.5	79.1	77.3
Gross profit	159.6	162.6	164.8	169.4	159.7	156.2	169.3	175.7	165.6	168.6	177.8	183.8	664.6	656.2	660.9	695.8
Sales and marketing	51.2	52.3	52.3	56.4	55.3	56.2	60.9	63.2	57.0	58.1	61.2	63.3	197.9	212.2	235.5	239.7
Research and development	22.5	22.7	22.8	20.6	20.8	22.6	24.2	24.8	23.2	23.6	24.9	25.7	72.7	88.6	92.4	97.4
General and administrative	16.1	15.8	18.1	18.0	18.5	19.0	20.5	21.4	21.1	21.4	22.2	22.7	57.1	68.0	79.3	87.5
Operating expenses	89.8	90.8	93.2	94.9	94.6	97.8	105.5	109.4	101.3	103.1	108.3	111.8	327.7	368.7	407.3	424.6
Operating income	69.7	71.8	71.6	74.5	65.2	58.4	63.7	66.3	64.3	65.5	69.4	72.0	337.0	287.5	253.7	271.2
Other income	(15.5)	(19.1)	(15.6)	(16.1)	(16.3)	(16.3)	(16.3)	(14.0)	(14.0)	(14.0)	(14.0)	(14.0)	(76.4)	(66.4)	(62.9)	(56.0)
Pretax income	54.2	52.7	56.0	58.4	48.9	42.1	47.4	52.3	50.3	51.5	55.4	58.0	263.0	221.3	190.8	215.2
Taxes	12.4	13.2	(3.7)	11.1	11.3	9.3	10.4	11.5	10.6	10.8	11.6	12.2	47.9	33.0	42.5	45.2
Net income	41.8	39.5	59.7	47.3	37.6	32.9	37.0	40.8	39.7	40.7	43.8	45.8	215.0	188.2	148.3	170.0
Earnings per share	$0.27	$0.25	$0.37	$0.30	$0.24	$0.20	$0.23	$0.25	$0.24	$0.25	$0.26	$0.28	$1.36	$1.19	$0.92	$1.03
Diluted shares outstanding	157.1	157.9	160.3	159.0	159.8	161.1	162.6	164.1	164.6	165.1	165.6	166.1	157.8	158.6	161.9	165.3
KEY METRICS																
DSO	47	50	40	46	50	38	38	40	40	38	38	40				
Cash	880.4	410.6	708.9	732.1	751.2	806.6	810.3	879.4	930.7	1,010.6	1,024.4	1,113.3	270.7	732.1	879.4	1,113.3
Cash per share	$5.60	$2.60	$4.42	$4.61	$4.70	$5.01	$4.98	$5.36	$5.65	$6.12	$6.19	$6.70	$1.72	$4.62	$5.43	$6.73
Debt	1,981.1	1,970.1	1,966.2	1,963.9	1,956.8	1,956.8	1,956.8	1,956.8	1,956.8	1,956.8	1,956.8	1,956.8	2,017.0	1,963.9	1,956.8	1,956.8
Net cash	(1,100.8)	(1,559.5)	(1,257.3)	(1,231.8)	(1,205.6)	(1,150.2)	(1,146.5)	(1,077.4)	(1,026.1)	(946.2)	(932.4)	(843.5)	(1,746.3)	(1,231.8)	(1,077.4)	(843.5)
Net cash per share	($7.01)	($9.88)	($7.84)	($7.75)	($7.54)	($7.14)	($7.05)	($6.57)	($6.23)	($5.73)	($5.63)	($5.08)	($11.07)	($7.77)	($6.65)	($5.10)
Deferred revenue	368.4	360.2	350.8	362.7	364.5	357.2	348.3	358.7	355.1	348.0	339.3	352.9	373.1	362.7	358.7	352.9
Billings	169.3	168.7	171.8	198.6	178.7	168.2	181.3	207.9	180.4	180.3	188.8	217.8	746.5	708.3	736.0	767.3
Subscription billings	25.5	22.0	22.7	45.2	40.1	28.7	30.1	52.4	39.4	36.9	36.3	60.6	128.8	115.4	52.4	60.6
Unlevered free cash flow	27.9	43.5	19.8	23.4	55.2	62.3	18.4	106.3	59.3	92.6	27.5	117.5	305.5	114.6	242.2	296.8
Adjusted EBITDA	73.0	74.8	75.3	78.4	68.8	65.8	79.6	89.2	77.3	78.9	84.3	87.5	353.4	301.4	303.4	328.0
Adjusted EBITDA Margin	41.9%	42.3%	41.5%	42.0%	38.9%	37.5%	41.8%	45.2%	42.0%	42.1%	42.7%	42.9%	49.3%	41.9%	41.0%	42.4%
PERCENT OF REVENUE																
Subscription revenue	16.3%	16.6%	17.8%	18.4%	21.9%	20.5%	20.5%	21.3%	23.4%	23.5%	22.8%	23.0%	14.6%	17.3%	21.0%	23.2%
Maintenance revenue	69.4%	68.3%	66.1%	63.5%	65.3%	64.7%	62.0%	60.3%	62.0%	61.0%	60.3%	58.8%	65.3%	66.7%	63.0%	60.5%
Total recurring revenue	85.7%	84.8%	83.9%	81.9%	87.2%	85.2%	82.5%	81.5%	85.3%	84.5%	83.0%	81.8%	79.9%	84.0%	84.0%	83.6%
License revenue	14.3%	15.1%	16.1%	18.1%	12.8%	14.8%	17.5%	18.5%	14.7%	15.5%	17.0%	18.2%	20.1%	16.0%	16.0%	16.4%
Gross margin	91.7%	91.9%	90.9%	90.7%	90.3%	89.0%	89.0%	89.0%	90.0%	90.0%	90.0%	90.0%	92.7%	91.3%	89.3%	90.0%
Sales and marketing	29.4%	29.6%	28.9%	30.2%	31.3%	32.0%	32.0%	32.0%	31.0%	31.0%	31.0%	31.0%	27.6%	29.5%	31.8%	31.0%
Research and development	12.9%	12.8%	12.6%	11.0%	11.8%	12.9%	12.7%	12.6%	12.6%	12.6%	12.6%	12.6%	10.1%	12.3%	12.5%	12.6%
General and administrative	9.3%	8.9%	10.0%	9.6%	10.4%	10.8%	10.8%	10.8%	11.5%	11.4%	11.3%	11.1%	8.0%	9.5%	10.7%	11.3%
Operating margin	40.1%	40.6%	39.5%	39.9%	36.8%	33.3%	33.5%	33.6%	34.9%	35.0%	35.1%	35.3%	47.0%	40.0%	34.3%	35.1%
Net margin	24.0%	22.3%	32.9%	25.3%	21.2%	18.7%	19.5%	20.7%	21.6%	21.7%	22.2%	22.4%	30.0%	26.2%	20.0%	22.0%
Adjusted EBITDA	41.9%	42.3%	41.5%	42.0%	38.9%	37.5%	41.8%	45.2%	42.0%	42.1%	42.7%	42.9%	49.3%	41.9%	41.0%	42.4%
GROWTH Y/Y																
Subscription revenue	19.5%	18.1%	20.2%	18.2%	36.8%	22.9%	20.8%	22.2%	11.0%	22.2%	15.4%	11.9%	-68.0%	19.0%	25.3%	14.9%
Maintenance revenue	6.0%	6.0%	0.9%	-2.8%	-4.3%	-6.0%	-1.5%	0.4%	-1.3%	0.8%	0.8%	0.9%	4.9%	2.4%	-2.9%	0.3%
Total recurring revenue	8.4%	8.2%	4.5%	1.2%	3.5%	-0.4%	3.3%	5.3%	1.8%	5.9%	4.5%	3.8%	-25.9%	5.5%	2.9%	4.0%
License revenue	-32.3%	-20.0%	-25.6%	-2.0%	-9.0%	-2.8%	13.6%	7.7%	19.3%	11.5%	0.9%	1.8%	-12.9%	-20.4%	3.1%	7.0%
Total revenue	-0.8%	2.1%	-2.1%	0.6%	1.7%	-0.8%	4.9%	5.7%	4.0%	6.8%	3.8%	3.4%	-23.6%	0.3%	3.0%	4.5%
Operating income	-6.9%	-12.8%	-24.4%	-14.7%	-6.6%	-18.7%	-11.0%	-10.9%	-1.4%	12.1%	8.9%	8.6%	-22.7%	-14.7%	-11.8%	6.9%
EPS	-6.3%	-20.7%	-7.8%	-17.2%	-11.6%	-18.4%	-38.8%	-16.4%	2.7%	20.8%	16.1%	10.9%	NA	-12.9%	-22.8%	12.3%
Deferred revenue	3.6%	4.0%	-2.0%	-2.8%	-1.1%	-0.8%	-0.7%	-1.1%	-2.6%	-2.6%	-2.6%	-1.6%	8.6%	-2.8%	-1.1%	-1.6%
Billings	-9.7%	2.8%	-12.7%	-1.0%	5.5%	-0.3%	5.5%	4.7%	1.0%	7.2%	4.2%	4.8%	-24.3%	-5.1%	3.9%	4.2%
Subscription billings	-26.5%	40.0%	-37.1%	6.7%	57.3%	30.2%	32.5%	16.0%	-1.6%	28.5%	20.7%	15.5%	-65.0%	-10.4%	-54.6%	15.5%
Unlevered free cash flow	-60.6%	-38.4%	-74.6%	-72.8%	97.9%	43.0%	-6.7%	NM	7.3%	48.7%	48.9%	10.6%	-17.8%	-62.5%	111.3%	22.5%
Adjusted EBITDA	-15.2%	-4.0%	-23.2%	-14.2%	-5.7%	-12.1%	5.7%	13.9%	12.3%	20.0%	6.0%	-1.9%	-22.1%	-14.7%	0.7%	8.1%
GROWTH Q/Q																
Subscription revenue	-2.7%	3.5%	10.2%	6.5%	12.7%	-7.1%	8.3%	7.7%	2.4%	2.3%	2.3%	4.4%				
Maintenance revenue	-1.0%	0.1%	-0.9%	-1.0%	-2.5%	-1.7%	4.0%	0.8%	-4.2%	0.3%	4.0%	0.9%				
Total recurring revenue	-1.3%	0.8%	1.3%	0.6%	0.9%	-3.1%	5.0%	2.5%	-2.5%	0.9%	3.5%	1.9%				
License revenue	-28.0%	7.5%	9.3%	15.7%	-33.1%	14.9%	27.7%	9.8%	-25.9%	7.4%	15.5%	10.7%				
Total revenue	-6.3%	1.7%	2.5%	3.0%	-5.3%	-0.8%	8.4%	3.8%	-6.8%	1.8%	5.4%	3.4%				
Operating income	-20.1%	3.0%	-0.3%	4.0%	-12.5%	-10.3%	9.1%	4.1%	-3.1%	2.0%	5.9%	3.7%				
Deferred revenue	-1.2%	-2.2%	-2.6%	3.4%	0.5%	-2.0%	-2.5%	3.0%	-1.0%	-2.0%	-2.5%	4.0%				
Billings	-15.6%	-0.3%	1.9%	15.6%	-10.0%	-5.9%	7.8%	14.7%	-13.2%	-0.1%	4.7%	15.4%				
Subscription billings	-39.9%	-13.4%	3.0%	99.2%	-11.4%	-28.3%	4.7%	74.4%	-24.9%	-6.4%	-1.6%	66.9%				
Unlevered free cash flow	-67.6%	56.0%	-54.6%	18.6%	135.7%	12.7%	-70.4%	NM	-44.2%	56.2%	-70.3%	NM				
Adjusted EBITDA	-20.1%	2.6%	0.6%	4.1%	-12.2%	-4.3%	20.9%	12.2%	-13.4%	2.2%	6.8%	3.8%				

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. Maintenance revenue likely dips in CY/22 and while new business and renewals are temporarily depressed, we think some business that paused rather than left could eventually return.
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 11% and 9%, respectively, which is relatively less than peers.

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?

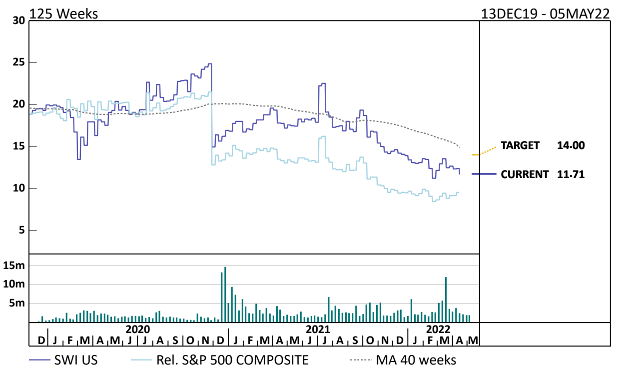
SolarWinds does not have a publicly disclosed ESG program. That said, the company has an employee-driven charitable arm called Geeks that Give, which supports local communities through monetary, material or in-kind donations to charitable organizations. The program supports efforts in the following areas: Healthy Neighbors, Healthy Minds and Healthy Spaces.

What is diversity like at board / management level?

Management: 11% female, 89% male. Board of directors: 9% female, 91% 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 $14 using an 10.5x multiple on our CY/23 EBITDA estimate of $328M, 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 $21 is based on EBITDA growth of 4% in CY/22E and 11% 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 13x CY/23E EV/EBITDA, or a slight premium to our base-case scenario.

Downside scenario

Our downside scenario of $10 is based on a 2% EBITDA decline in CY/22E and an increase of 5% 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 9x 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 cyber attack.

Matthew Hedberg (612) 313-1293; matthew.hedberg@rbccm.com

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Ratings

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Risk Rating

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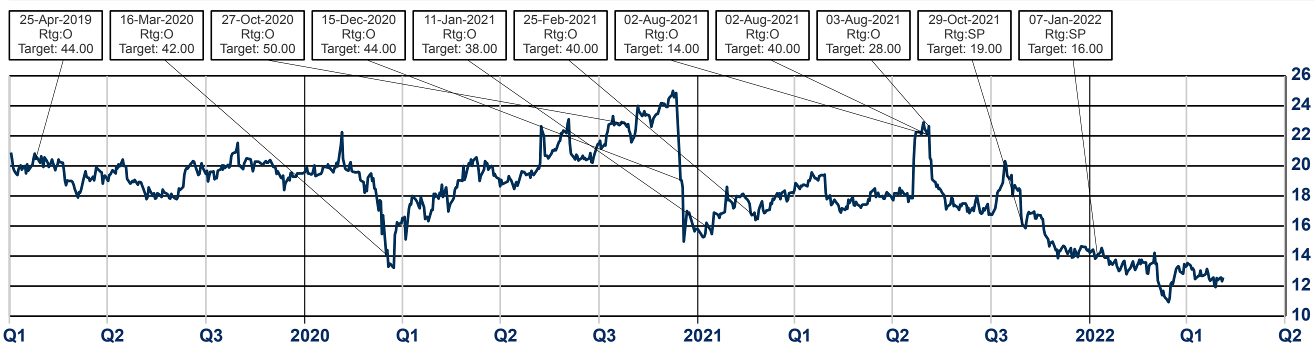
Distribution of ratings
RBC Capital Markets, Equity Research
As of 31-Mar-2022

			Investment Banking Serv./Past 12 Mos.	
Rating	**Count**	**Percent**	**Count**	**Percent**
BUY [Outperform]	**841**	**57.68**	**330**	**39.24**
HOLD [Sector Perform]	**569**	**39.03**	**172**	**30.23**
SELL [Underperform]	**48**	**3.29**	**3**	**6.25**

Rating and price target history for: SolarWinds Corporation, SWI US as of 04-May-2022 (in USD)



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SolarWinds Corporation

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