# THE DEVIL'S ADVOCATE REPORT

October 2, 2020

## DocuSign, Inc.

*(SELL)*

| | | | |
|---|---|---|---|
| **Price:** | $222.26 | **Ticker:** | DOCU |
| **52-Week Range:** | $59.77-$290.23 | **Dividend:** | Zero |
| **Shares Outstanding:** | 203 million | **Yield:** | Zero |
| **Market Capitalization:** | $45.1 billion | | |

*Data As of October 2, 2020*

*Exclusive Marketers of*
*The Devil's Advocate Report*

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**Investment Thesis**

DocuSign, Inc., with a $45 billion market capitalization, is a fast-growing company that provides electronic signature solutions that enable businesses to digitally prepare, execute, and act on agreements. In a way, DocuSign is similar to Peloton, Inc., a recent object of this report, in that DocuSign's growth rates have been temporarily boosted by the pandemic and its valuation multiples have increased to the point at which many years of rapid expansion will be required to justify the current valuation.

In-person meetings have not been possible, or at least severely minimized, because of the pandemic and, as a result, people and companies have had to rely more on digital solutions, such as those provided by DocuSign. Some were prepared for this transition while others were not. Businesses that were not had to change their procedures and embrace technologies such as those provided by DocuSign and, in the process, much of the growth experienced by the company in 2020 might otherwise have materialized in 2021 or 2022. The potential downside of that is that future expansion will now be more difficult to realize from the considerably higher revenue base that now exists. Since investors seem to anticipate an extrapolation of these trends, DocuSign needs to sign up greater and greater absolute numbers of customers just to maintain the current percentage growth rates. For example, while the company expanded its customer base by 40% in the most recent quarter, to 750,000, in order to keep that growth rate for three more years, it would need to end that period (July 31, 2023) with 2.1 million customers, or almost a tripling of its current customer base.

The company had revenues of $342 million in the quarter ended July 2020, and that represented 45% year-over-year growth, which is the most rapid year-over-year improvement since 2016. Because of that, the company is trading at more than 33x run-rate *revenues*. To put that into perspective, the S&P 500 trades at less than 30x *earnings*. Yet, while it has been operating for 17 years, DocuSign has never reported a GAAP profit. Instead, it generated $233 million in GAAP losses over the past year. However, on a non-GAAP basis, it reports a slight profit, mainly because of the liberal use of stock-based compensation. In the most recent quarter alone, the company issued nearly $70 million in stock-based compensation, which represented 20% of revenues. Such stock issuance has resulted in dilution for existing shareholders of around 4-9% per year since the April 2018 IPO.

The expectations that the company can continue to expand at recent rates should prove very difficult to meet, but keeping its growth rates high is essential to sustain the extreme valuation multiples. There is significant competition in the e-signature market and future revenue growth is far from certain. DocuSign's main competitor is Adobe, which dominates the PDF market. Adobe, unlike DocuSign, does not offer a free version of its e-signature service, known as Adobe Sign, and perhaps that is the main reason DocuSign has gotten



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ahead of Adobe in terms of name recognition and overall user-base. That, in turn, has made it easier for DocuSign to attract paying corporations.

But Adobe could offer a free version too, if it decides to pay more attention to a segment that relatively suddenly has resulted in a $45 billion market capitalization for DocuSign, for essentially providing just one of the many service that Adobe offers. Thus, should it decide to focus more on its Adobe Sign business, DocuSign's business could be significantly impaired, both from market share losses and a potential price war. Besides Adobe, more than a dozen companies are now providing e-signature services at various price points. Some focus on certain industries, such as real estate, insurance or banking, others focus on certain geographical areas. Consequently, while the industry could expand 20-25% per year for the next five years, as some market research firms estimate, that does not necessarily mean that DocuSign will expand at the same rate, and it does not necessarily imply that there will be profitable growth.

Based on Wall Street's consensus estimates, DocuSign can sustain its 40%+ revenue growth over the next few quarters, yet, only a 31% expansion is estimated for FY2021 (which starts February 1st). Assuming that the company is entering FY2021 with a growth rate of around 40% but only averages 31%, it logically follows that even Wall Street expects the company's growth rate to moderate to the low-to-mid 20% range towards the end of FY2021.

If it can be accepted that the current period represents temporarily above-normal growth rates, and that considerably lower expansion can be expected in the period after the pandemic has ended, then DocuSign will most likely not trade at 30x revenues but perhaps 10x. That would not be unprecedented, since DocuSign traded at approximately 10x revenues in the second half of 2018—even though it was expanding at a 35% rate at that time, which is probably more than it will be able to do in a year or two. Thus, should Wall Street's growth projections materialize, DocuSign could be valued at around $18 billion, or 10x the consensus FY2021 revenues, which indicates a share price of $89. And that assumes no dilution. If dilution remains at around 5% per year, then DocuSign has to expand revenues 5% just to overcome the new share issuance, each and every year.

On the other hand, if DocuSign's growth rates moderate to around 20% by the end of next year, even if the company can sustain its 33x Price/Sales ratio, the stock would only gain 20%, minus the dilution of around 5%, or around 15% per year. Alternatively, should DocuSign grow revenues by 20% and have 5% dilution but only be valued at 28x revenues, then the shares would be unchanged. Consequently, with what appears to be considerable downside and just modest upside, shares of DocuSign are recommended for sale and short-sale.



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## Company Overview

*Background*

DocuSign was founded in Seattle in 2003, and had its first sales in 2005 when zipForm (now zipLogix) integrated DocuSign into its virtual real estate forms. Mock trials featuring licensed attorneys and real judges highlighted the admissibility of DocuSign contracts in court based on encrypted audit logs of signature events as well as the impossibility of changing contracts.

The company moved its headquarters to San Francisco, California, in 2010, the same year it added support for iPhones, iPads and phone-based authentication. Around that time, DocuSign began referring to its service as "eSignature Transaction Management". By the end of 2010, the company handled 73 percent of the Software-as-a-Service (SaaS)-based electronic signature market, with 80 million signatures processed.

In April 2012, DocuSign signed an agreement with PayPal that allowed users to capture signatures and payments in a single transaction with DocuSign Payment. Similar partnerships with Salesforce.com, and Google Drive preceded the PayPal agreement. In July 2012, Business Insider reported that approximately 90% of Fortune 500 companies had signed up to use DocuSign.

It is noteworthy that despite its 17-year operating history and its deep penetration of the Fortune 500 companies achieved already eight years ago, the company has never been profitable on GAAP-basis, and reported cumulative GAAP losses of $687 million in the last three fiscal years alone.

DocuSign came public in April 2018 and priced its IPO at $29 per share. It raised $629 million by selling 21.7 million shares. Following the IPO, it had 156.6 million shares outstanding, plus 37.0 million "anti-dilutive" securities for a total of 193.6 million shares. As of July 31, 2020, it had 185.2 million shares outstanding and 24.5 million anti-dilutive" securities for a total of 209.7 million shares. Thus, in just over two years, the dilution has been either 18.3% or 9.2%, depending on which of these two numbers one uses.

DocuSign indicates that the anti-dilutive securities should be labeled such since, if they were exercised, the resulting higher share count would result in a lower loss per share than what would otherwise have been the case. On the other hand, the stock options and convertible notes are well in the money. In either case, since the company is profitable on a non-GAAP basis, a method that the company reports regularly, ~~so~~ these securities would be considered dilutive on that basis and should, therefore, be incorporated in the fully diluted share count. To that end, DocuSign used 203 million diluted shares as the denominator when it presented the Q2-FY2021 non-GAAP EPS (which was positive) in the most recently reported earnings release, but used only 185 million shares when calculating the GAAP EPS (which was negative).



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In July 2018, DocuSign acquired SpringCM, a contract lifecycle management software management and workflow platform provider, for $220 million. At the time, SpringCM had 1st half 2018 revenues of $15.4 million, or around $31 million annualized. This represented approximately 5% of the company's revenues at the time. Therefore, both DocuSign's FY2019 and FY2020 included a slight revenue boost from this acquisition. Also, DocuSign paid around 7x run-rate revenues for SpringCM, which at the time had almost identical profit margins as DocuSign (net loss approximately equal to revenues). At its April 2018 IPO, DocuSign was itself valued at around 7x run-rate revenues.

In July 2020, the company acquired Liveoak Technologies for approximately $48 million. Liveoak is focused on video identity verification —the ability to perform remote agreements via video conferencing, which gives DocuSign a footing into employing video conferencing as a way to create a detailed audit trail. In addition, the acquisition allows DocuSign to offer online notarization. Therefore, the company announced a new service known as DocuSign Notary.

Finally, in March 2019, DocuSign announced the DocuSign Agreement Cloud, a suite of new products aimed at digitizing and automating the entire agreement process.

Current Operations

DocuSign's main product is secure electronic signature (eSignature or e-signature), which seeks to replace traditional paper-based signatures. That, combined with its digital transaction management services, eliminates the need to send paper documents. Since e-signatures can be done from anywhere in the world on a smartphone or iPad, it certainly provides a convenience factor in addition to the fact that it is quicker to sign and return a digital document such as a contract, consent form or deed.

The company also facilitates a secure exchange of electronic contracts and authorized documents. DocuSign's other services include electronic authentication of various entities, individuals, and documents, as well as the management of user identity, and workflow automation. Since there is a free version, individuals who sign the documents do not have to pay, but DocuSign makes money from the counterparties who initiate the contracts. The company has nearly 750,000 customers and hundreds of millions of users worldwide.

DocuSign's customers range from large global enterprises to sole proprietorships. Examples of the uses for the company's technology include contracts for sales, employment offers for human resources, non-disclosure agreements for legal, among many others. The company has an average contract duration of 14 months based on the number of contracts, and 17 months if based on dollar value.

DocuSign is one of the main pandemic beneficiaries, since remote working has become a business-need and not just an emergency response as it was initially. The pandemic has



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accelerated the digital transformation, not just in the United States but internationally as well. The company generated around 19.5% of its revenues from international markets and it has 28% of its full-time employees located outside of the US.

DocuSign estimates that its total addressable market (TAM) is $25 billion, and with around $1.4 billion in revenues expected for the current fiscal year, it has penetrated almost 6% of that market. Furthermore, the recently acquired (Liveoak) notary business adds another $1 billion to the addressable market opportunity. That said, Liveoak had almost no revenues[1] at the time of the acquisition.

The company's fee-based plans are as follows:

The Personal plan allows a single user to send up to five documents each month to collect signatures, which makes it suitable for individual contractors and small-scale employers. It offers basic features, like a specified number of fields to collect basic information, reusable templates, basic workflows that automatically move the documents from one party to the other based on submission status, support for multiple languages, and integration with various online storage solutions like Google Drive and DropBox. The plan starts at $120 annually ($10 per month).

- The Standard plan additionally offers functionality to set and send automated reminders, and personal branding across a range of documents. Standard plan starts at $300 annually per user ($25 per month).

- The Business Pro plan offers additional features that are intended for large organizations. They include two-factor text message authentication, in-person signatures on client devices, bulk sending of forms and documents, and even the collection of any necessary payments like those for submitting a form fee or paying for an invoice. Annual charges for Business Pro plan start at $480 per user ($40 per month).

DocuSign also offers bespoke custom solutions. In addition to all the features available in the Business Pro plan, these solutions incorporate other functions that allow integration with various CRM solutions and with existing or new APIs, admin-level access for user management, and enterprise level support.

Though DocuSign is mostly known for its e-signature services, the company also generates revenue from a few other products and services:

- The DocuSign Agreement Cloud is the company's cloud software suite for automating and connecting the agreement process. It includes DocuSign eSignature,

[1] $1.6 million on an annualized basis, as estimated by data provider Rocket Reach



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but also several other applications for automating pre- and post-signature processes—for example, automatically generating an agreement from data in other systems, supporting negotiation workflow, collecting payment after signatures, and using artificial intelligence (AI) to analyze a collection of agreements for risks and opportunities. Finally, the Agreement Cloud includes hundreds of integrations to other systems, like Google, Microsoft, Oracle, Salesforce, SAP, and Workday, so agreement processes can integrate with larger business processes and data. The DocuSign Agreement Cloud has more than 585,000 customers. Different pricing structures apply to different Agreement Cloud products.

- DocuSign Payments allows for the collection of payments and signatures in one step, thereby reducing cost overhead. With integration to Stripe, PayPal, and Authorize.Net, DocuSign Payments attempts to capitalize on the convenience of collecting signatures and payments at the same time, which could be complementary services for insurance premiums, membership agreements, rentals, and donations, among other services. This service is currently available in the U.S., UK, Canada, and Australia, and supports payments through credit card, debit card, ACH payments, Apple Pay, and Android Pay. In addition to the subscription charges for Business Pro plans that include Payment solutions, a customer needs to pay the payment gateway fees for each transaction, which vary in the range of up to 3% in addition to other fixed costs.

- DocuSign also offers mobile apps that allow salespersons to meet with a customer, put up a proposal, and receive the signed contract on a mobile device. The DocuSign mobile SDK can be used by developers and programmers to integrate DocuSign offerings into their own apps.

Electronic Signatures

In the U.S., the main law governing electronic signatures is the Electronic Signatures in Global and National Commerce (ESIGN) act of 2000. There is also the Uniform Electronic Transactions Act (UETA), which has been adopted by 47 states. Those laws require the following criteria to be met to make an electronic signature legally binding:

- Intent to sign
- Consent to do business electronically
- Received UETA Consumer Consent Disclosures
- Affirmatively agreed to use electronic records for the transaction
- Has not withdrawn such consent
- Association of signature with the record
- System used to capture the transaction must keep an associated record that reflects the process by which the signature was created or generate a textual or graphic statement (which is added to the signed record) proving that it was executed with an electronic signature.



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- Record retention
- Electronic signature records be capable of retention and accurate reproduction for reference by all parties or persons entitled to retain the contract or record.
- Opt-out clause
- Signed copy of fully executed agreement

Also, there is a difference between an electronic and digital signature, even though the terms are often used interchangeably. An Electronic Signature is the equivalent of a hand-written signature. It can be a client typing their name in a text box, checking an "I accept" checkbox, or some other process that records a person's agreement to be bound by a contract. In the past, contracts would need to be printed out, signed, and stored. This could take days/weeks; but, with electronic signatures, it can be completed in minutes. A Digital Signature is more akin to having a notary public stamp a document assuring that the signatures are valid and that the document has not been tampered with. Consequently, the electronic signature captures the person's intent to enter into the agreement, and the digital signature is used to secure the data and verify the authenticity of the signed document.

Digital signatures are typically used in Adobe PDF documents by individuals and organizations to prove who verified the document on a specific date/time and that the document has not been modified since being signed. Based on the requirements and work flow associated with signing a contract, there can be one or more signatures on a single PDF document. The actual digital signature is a section of non-visible, hashed & encrypted metadata embedded in the document using a certificate. In addition to the actual digital signature, an optional visible representation of the signature can also be included in the PDF document. The visible portion of the signature can include an image of the signature and/or a description of the signing certificate.

## Profitability Lacking

In the most recently reported quarter, revenues expanded 45.2% compared to the same period last year, to $342.2 million, while billings increased 61% year-over-year to $405.7 million. This indicates potential near-term revenue acceleration since the two growth metrics tend to converge over time:



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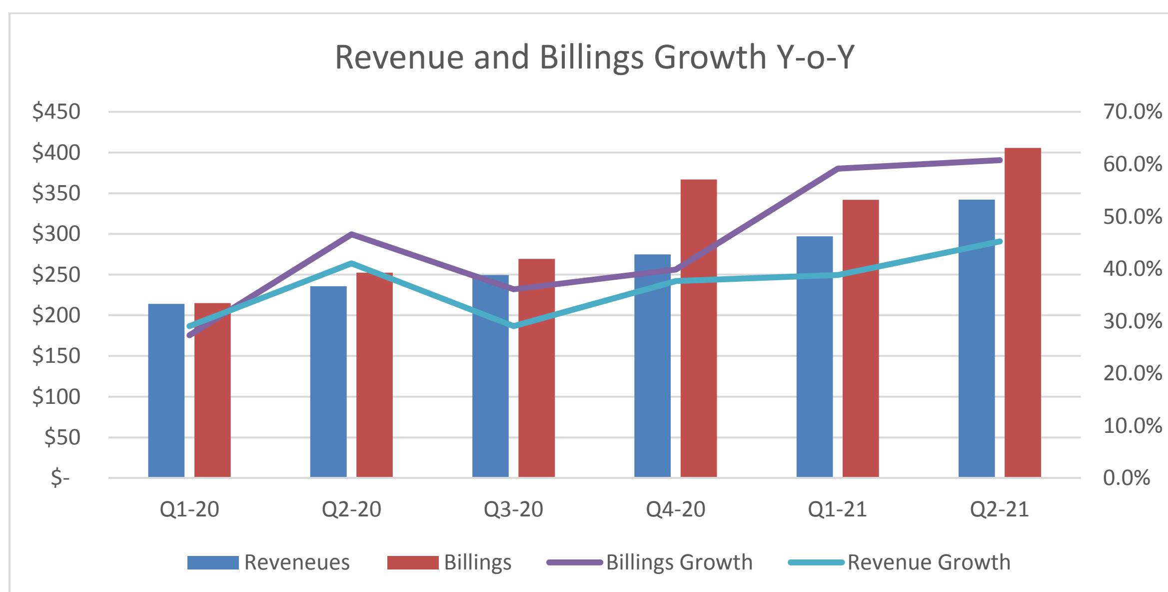


Both revenue and billing growth were at record levels in the most recent quarter. Like most other software companies, DocuSign signs multi-year deals up front and does not recognize it all as revenue right away, so the company's billings (current-quarter revenue plus the sequential change in deferred revenue) is perhaps a more accurate indicator of the company's growth. These customers are highly unlikely to go back to paper documents after implementing a working digital strategy. The issue for DocuSign is signing up the increasing number of customers required to maintain the current growth rates, but a potentially more important issue is to do this in a manner that actually produces profits and not just revenue.

Considering that DocuSign is a 17-year-old company with a market capitalization of around $45 billion, it is rather extraordinary that it has never earned a GAAP profit, even though its revenues have expanded rapidly for many years:

| (in millions) | 1H 2021 | FV2020 | FY2019 | FY2018 | FY2017 | FY2016 |
|---|---|---|---|---|---|---|
| **Revenue** | $639.2 | $974.0 | $701.0 | $518.5 | $381.5 | $250.5 |
| **Gross Profit** | 474.58 | 730.74 | 508.55 | 400.23 | 278.98 | 176.63 |
| ***Gross Margin*** | *74.2%* | *75.0%* | *72.5%* | *77.2%* | *73.1%* | *70.5%* |
| **Loss from Ops** | (100.5) | (193.5) | (426.3) | (51.7) | (115.8) | (119.3) |
| **Operating Margin** | *-15.7%* | *-19.9%* | *-60.8%* | *-10.0%* | *-30.4%* | *-47.6%* |
| **Net Loss** | $(112.4) | $(208.4) | $(426.5) | $(52.3) | $(115.4) | $(122.6) |
| ***Net Margin*** | *-17.6%* | *-21.4%* | *-60.8%* | *-10.1%* | *-30.3%* | *-48.9%* |

(US GAAP. Source: DocuSign's SEC filing.)

There is no discernable trend in its gross margin, and while operating and net margins have improved, this has not been a steady progression towards profitability—even though



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revenues almost quadrupled between FY2016 and FY2020. This indicates perhaps that the company has to spend excessively on operating expenses, which exceeded gross profits by approximately $42 million in both the first quarter of FY2021 as well as the same period last year:

| (in millions) | Q1- 2021 | Q1-2020 |
|---|---|---|
| **Revenue** | $ 297.09 | $ 213.96 |
| **Cost of Revenue** | 74.03 | 52.02 |
| **Gross Profit** | 223.06 | 161.94 |
| **Gross Margin** | 75.1% | 75.7% |
| **Operating Expenses** | | |
| **Sales & Marketing** | 171.97 | 129.94 |
| **R&D** | 54.23 | 37.18 |
| **General & Admin.** | 38.81 | 37.26 |
| **Total Op. Exp.** | 265.02 | 204.38 |
| **Loss from Ops** | $ (41.96) | $ (42.44) |

By the second quarter of FY2020, which is the most recently reported, the company's loss from operations narrowed slightly compared to the same period in the prior year, but deteriorated by almost $17 million sequentially to a loss of almost $59 million:

| (in millions) | Q2- 2021 | Q2-2020 |
|---|---|---|
| **Revenue** | $ 342.21 | $ 235.61 |
| **Cost of Revenue** | 90.61 | 61.18 |
| **Gross Profit** | 251.60 | 174.44 |
| **Gross Margin** | 73.5% | 74.0% |
| **Operating Expenses** | | |
| **Sales & Marketing** | 194.99 | 150.89 |
| **R&D** | 63.79 | 47.52 |
| **General & Admin.** | 51.45 | 40.76 |
| **Total Op. Exp.** | 310.23 | 239.16 |
| **Loss from Ops** | $ (58.63) | $ (64.72) |

This sequential deterioration occurred even though revenues were 15.2% higher. Therefore, it is difficult to forecast when DocuSign can breakeven on a GAAP basis, since there no obvious relationship exists between its revenue growth and GAAP profitability.

DocuSign guided to third quarter revenues of $360.0 million, which would represent 44.3% growth compared to the same period last year, but only 5% sequential growth (compared to the most recent quarter, in which revenues grew 15% sequentially). That said, for full-year



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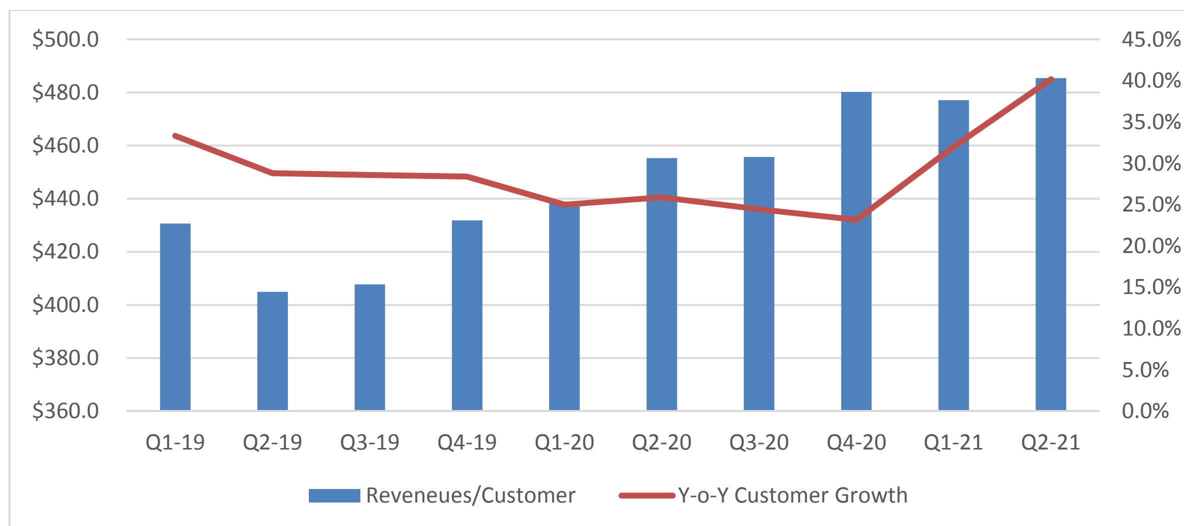
2021 (ending January 31st), the company is expecting billings to expand approximately 48% y-o-y. If that materializes, the second half of FY2021 would represent a dramatic slowdown in billings growth rates from the 60% average rate in the first half, particularly since management has guided to an expansion of 42% in the current (third) quarter. Consequently, that implies that the growth rate for the fourth quarter of 2021 billings are expected to moderate quite dramatically to around 37%. Considering that billings are a very strong forward indicator, investors could be disappointed, should this slowdown materialize.

Using the simplistic measure of average revenue per customer, this has been relatively stable at around $400-$480 per customer, per quarter, and while year-over-year customer growth had declined from more than 33% in early FY2019 to just 23% in the fourth quarter of FY2020, the pandemic accelerated the year-over-year customer growth to just over 40% in the most recently reported quarter:




DocuSign ended the first quarter of FY2019 with 400,000 customers and had 750,000 as of the end of the second quarter of FY2021. Thus, if DocuSign is to keep the recent growth rate at the same level for the next three years, it would have to end the second quarter of FY2024 with 2.07 million users. The law of large numbers indicates that it will be increasingly difficult to sign up a greater number of new customers each year so perhaps it would be easier to expand revenues by extracting an increasing amount of revenue per customer. Although, as the chart above indicates, that measure has been relatively flat during the past three quarters, perhaps partly because competition is preventing DocuSign from raising prices.



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**Substantial Competition Due to Low Barriers to Entry**

Of the competitors in this market, DocuSign is the best capitalized and has the highest brand recognition, with the exception of Adobe, which has 10x the revenues. That company already dominates the PDF (portable document format) business, with products such as the Adobe Reader and Adobe Acrobat Pro, but it also has a substantial Document Cloud business, which competes directly with DocuSign. Adobe's Document Cloud segment had revenues of $375 million in the most recently reported quarter, or slightly more than DocuSign's total revenue[2]. Even so, Adobe has probably under-invested in the signature business in recent years, since its growth rates have been around half of DocuSign's in recent periods. Even so, given that company's dominance in the PDF market —more than 250 billion PDFs were opened in Adobe products last year[3], it could leverage its large user base to take market share.

Adobe Sign, which is the name of the service, is a result of Adobe's 2011 acquisition of a company known as EchoSign, for around $400 million. EchoSign had around three million customers at that time. DocuSign, by comparison, had six million users at the end of 2010 and 13 million at the end of 2011, so with perhaps 9 million users in mid-2011 it was approximately three times larger than EchoSign. Because of Adobe's dominance of the PDF market, its EchoSign/Adobe Sign service emerged as the main competitor to DocuSign.

Much like DocuSign's software, Adobe's allows users to securely insert their e-signatures in contracts and documents, and essentially any device can be used for this, including smartphones, laptops or tablets. It enables sending, tracking and signing documents, integrates with Salesforce, Box, and other apps. However, Adobe's product is more expensive and it does not offer a free version, as DocuSign does, which has limited the adoption rate of the Adobe product. While both companies recognize that their e-signing services are almost exclusively a corporate solution and that individual consumers will not want to pay to e-sign documents, it appears DocuSign has realized that it can enhance its name recognition and adoption by becoming widely-used among non-paying consumers and then use that position as leverage to sign up corporations.

Consumers, who might have to sign a handful of contracts per year, can do so free of charge with the DocuSign app on their smartphones or tablets, but the similar service from Adobe costs $9.99 per month. Thus, a consumer would have to pay $120 per year with Adobe, to sign a handful of contracts/documents, or do it for free on using the DocuSign app. However, should Adobe decide to offer a free version to compete more directly with DocuSign's free product, and perhaps include Adobe Sign in its ubiquitous Adobe Acrobat reader, DocuSign's business would probably be severely impacted.

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[2] While Adobe's Document Cloud revenues are greater than DocuSign's, this is not a perfect apples-to-apples comparison and there is no doubt that DocuSign has more paying customers and users than Adobe.
[3] https://www.adobe.com/content/dam/cc/en/fast-facts/pdfs/fast-facts.pdf



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In addition to Adobe, DocuSign's other competitors include:

- HelloSign, which was acquired by Dropbox (DBX) in January 2019 for $230 million. HelloSign is an electronic signature solution that enables users to decide where each of the participants will sign as well as assigning the order in which the document is to be signed. HelloSign has a user-friendly interface, with several API (application programming interface) integration options and provides notifications of document status. While it offers a free trial period, users are only allowed to send three documents, which might be too limited an experience for some potential customers to persuade them to even try it. HelloSign has a relatively modest market share, with around $50 million of annual revenues.

- Authentisign is a e-sign service provided by Instanet Solutions and it has been used in the real estate industry for many years. Since it is browser-based, Authentisign lets the user enter a secure website where they can upload, electronically sign and send their documents for signing to parties involved. Documents are stored on its servers for increased security. Authentisign is mainly used by realtors and brokers because it can fully integrate itself with real estate forms and contracts. Service plans start at around $69 per year, which is considerably less expensive that DocuSign.

- OneSpan (NASDAQ:OSPN) offers a very similar service to DocuSign, now known as OneSpan Sign (formerly eSignLive). It provides e-signature technology to different companies, and focuses on banks and insurance companies. Customers can send and receive legally binding signatures that contain a user's particular information. The signature solution is available in the cloud or on premise, as well as on iOS and Android apps. It offers multiple authentication options, remote and in-person signing as well as eNotary services. Licensing costs start at $20 per month, per user.

- SignX, a Chinese company with more than two million monthly users, has a simple user interface. SignX includes editing, security, and tracking features, and is also priced lower than DocuSign. It sends notification every time a document is opened, offers tamper proof technology and bulk sends. SignX offers a free version, with which users can send five documents, while the unlimited service starts at $7.00 per month, per user, which is meaningfully cheaper than the $10 per month, per user, starting price for DocuSign's similar service. The enterprise version starts at $154 per year ($13 per month).

- Nitro Cloud, based in Australia, is another DocuSign competitor that facilitates the collection of legally binding signatures on important documents. The company was founded in 2005 and has 1.8 million licensed users and 10,400 business customers. Any Internet-enabled device can sign and send documents, and those documents can



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be integrated with cloud storage. The service can also create PDF files. Pricing starts at $4.99 per month, per user, but the company also sells perpetual licenses for $159.99 per user. Unlike most of the other services, Nitro does not support the Android operating system, nor is there a Mac version.

- SIGNiX, which is not to be confused with the aforementioned SignX, is a service that was acquired by Sungard in 2006. Sungard was later acquired by Fidelity National Information Services. It offers similar services as DocuSign but charges more, at $25 per month per user, relative to the $10 per month for DocuSign. SIGNiX is well established in highly regulated industries such as real estate, wealth management, financial institutions, healthcare and government services, and also includes notary services. Because of its partnership with zipLogix, Signix's solutions is now used by more than 340,000 real estate agents.

- SignNow, which was acquired by Barracuda Networks in 2013, was ranked the #1 software application for Enterprise businesses in a side-by-side comparison done by Fit Small Business in 2017. It is used to sign, send and manage documents by millions of people and it. The service is somewhat cheaper than DocuSign's, at $8.00 per month, per user. SignNow is also available for free on iPhone, iPad, and Android devices, which lets users upload documents from their smartphone's e-mail, camera, or Dropbox account and tap to insert their signature.

Besides those mentioned above, there are a few additional participants such as iText, RightSign, Ascetia, Gemalto, Entrust Datacard, Secured Signing, Identrust, Kofax and PandaDoc that are also competing for market share. Consequently, there are a few dozen companies with relatively interchangeable services, all competing for the same customers. Ultimately, unless there is significant consolidation, competition on the basis of price should become more prevalent, which could make it more difficult for these companies to increase market share while at the same time earning an actual return on capital.

## GAAP vs Non-GAAP Profitability

Unlike many cloud-focused software companies, DocuSign is profitable—at least on a non-GAAP basis. For example, in the most recently reported quarter, the second quarter of FY2021, the company generated a non-GAAP profit of $0.17 per share. That said, it also lost $0.35 per share on a GAAP basis. While its non-GAAP EPS has improved steadily over the last two years, the GAAP EPS has been consistently negative with no discernable improvement in the trend line:




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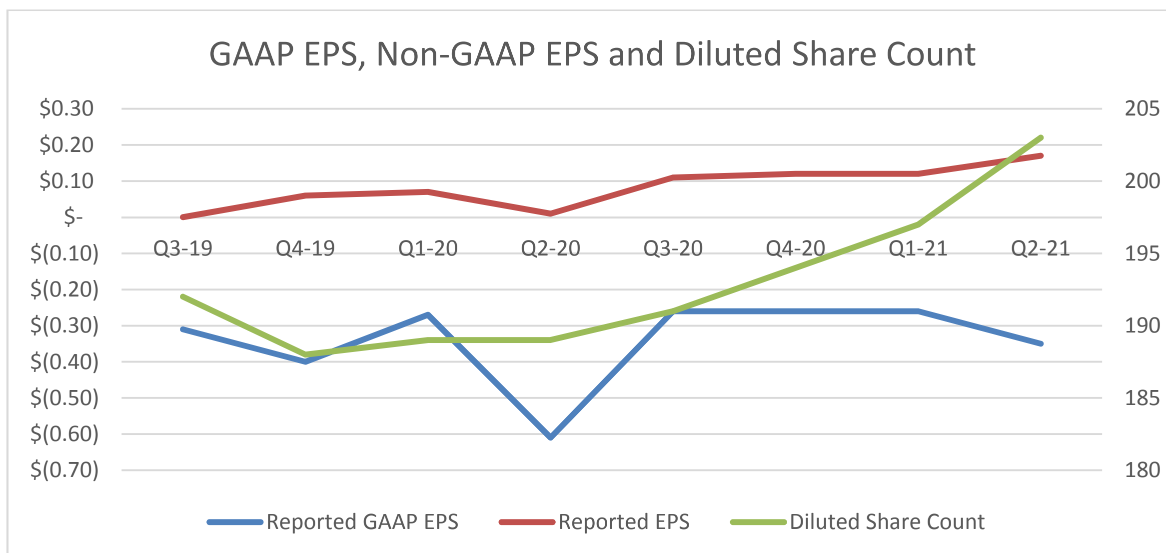
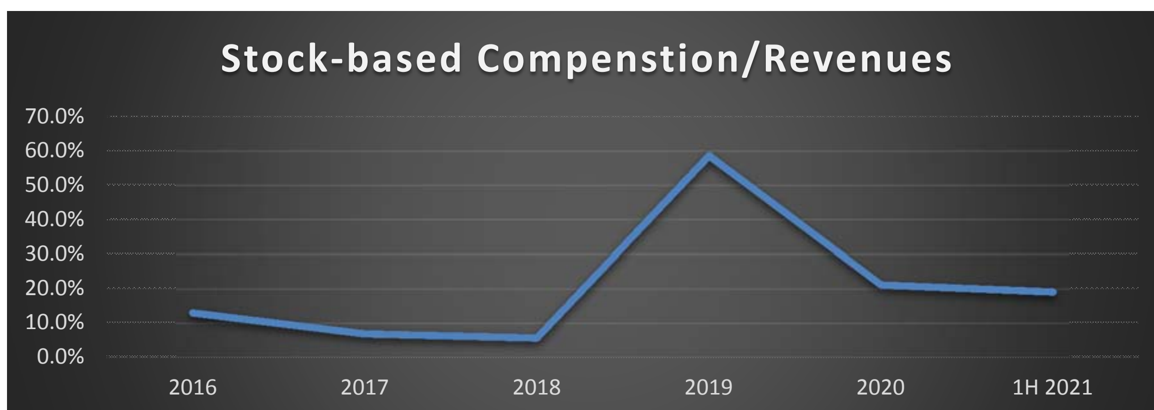



However, one trend line that has been decidedly upward-sloping is the one for the number of diluted shares outstanding, which has increased by 8% since year-end FY2019.

The main difference between GAAP and non-GAAP earnings is stock-based compensation. The company has issued shares as follows:

| | |
|---|---|
| **FY2018** | 6,261,000 |
| **FY2019** | 13,917,000 |
| **FY2020** | 11,951,000 |
| **FY2021YTD** | 3,636,000 |

In terms of the value of the stock-based compensation, when issued, this measure has averaged around 20% of revenues after the initial post-IPO boom, which took the ratio to 60% of FY2019 revenues:



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In total, 35.8 million shares have been issued to insiders in the past four fiscal years. The FY2021 figure represents the first half, so if that doubles and reaches 7.27 million shares for the full year, that would be a decline compared to the prior two years. That, of course, is related to the fact that the share price is considerably higher now. For example, the average price in calendar year 2019 was just $57, so the 11.9 million shares issued in FY2020 (which essentially overlaps calendar 2019 since it ended January 31, 2020), were valued at around $678 million at the time of issuance, whereas the 7.27 million shares that might be issued in FY2021 at $220 each, that would represent $1.6 billion. In aggregate, the 35.8 million shares issued since FY2018 are now valued at $7.9 billion. That, perhaps, is closer to its true cost of doing business than the $3.6 billion in total expenses (gross and operating) the company has recorded since the beginning of FY2018.

Alternatively, the stock it has issued to insiders, at a current value of $7.9 billion, is equal to 3x the cumulative revenues of $2.67 billion it has generated since the start of FY2018. One of the many problems with this development is that stock-based compensation works well as long as the share price is increasing. However, should the share price reach a plateau and be stagnant for an extended period of time, employees and insiders will become less willing to accept share grants and options in lieu of cash. Yet, if the company actually had to pay these expenses in cash, if could not claim to be profitable, even on a non-GAAP basis, and its free cash flow would be much diminished.

Consequently, the true profitability of the underlying business could be revealed only subsequent to a period devoid of share price appreciation, and it is likely that the virtuous cycle that has existed up until this point, with higher share prices leading to higher share-based rewards for insiders leading to greater non-GAAP profits, would then be reversed.

## Valuation

Compared to Historical Valuation

DocuSign came public in April 2018 at an IPO price of $29, or a market capitalization of $4.54 billion, that corresponded to approximately 7x its run-rate revenues ($166 million in the first quarter of FY2019). After its IPO, the shares traded at around $40 for the rest of the year, implying a market value of $7.6 billion, which towards the end calendar 2018 corresponded to a valuation of around 10x run-rate revenues of approximately $760 million[4].

Presently, with 203 million diluted shares outstanding, DocuSign has a market capitalization of approximately $45 billion, relative to its consensus FY2021 revenue of $1.38 billion, which indicates a forward multiple of 33x sales. Historically, a stock trading over an EV/S multiple of 10x was considered expensive and only a select few fast-growing companies

[4] Based on the average of Q3-Q4 of FY2019



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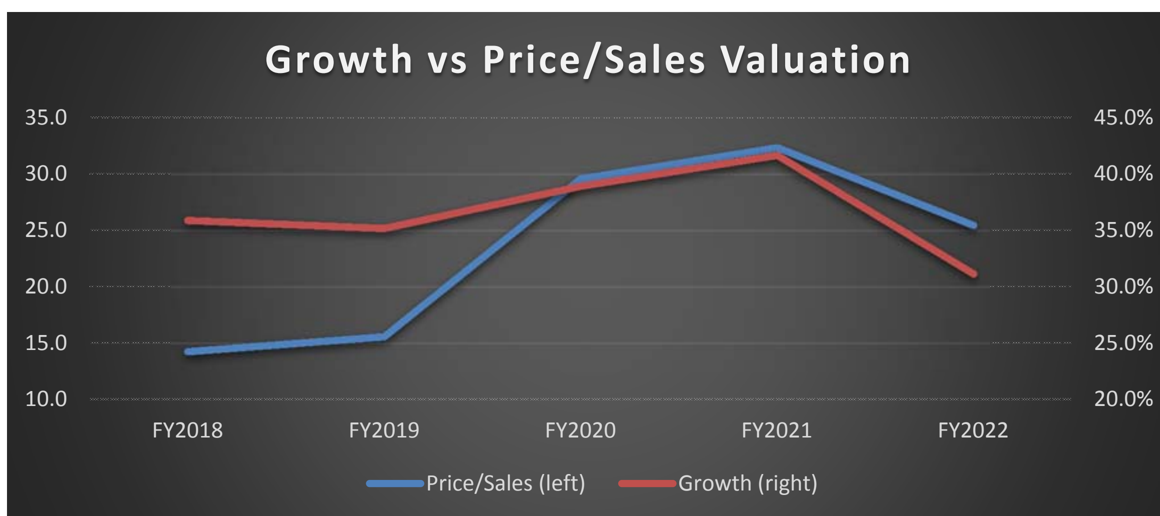
were able to maintain higher valuation multiples than that. DocuSign, while expanding revenues at a pace of around 35% in the past three years, was able to improve its growth rate to 45% in the most recent quarter, although that was mainly caused by the pandemic-induced work-from-home boom.

By next year, Wall Street's consensus forecast indicates just 31% growth, which would be DocuSign's lowest expansion rate for at least five years. Still, the valuation is presently at an all-time high:




Consequently, the fact that revenues have been pulled forward into FY2021 does not alter the expectation for revenue growth to revert back into the low-30% range in the next fiscal year. That fiscal year begins in just four months and the anticipated moderation in its rate of expansion could soon be priced in by the market. A further cause for concern is that the average analyst estimate for revenue growth beyond FY2022 only appears to be in the 15% to 20% range.

While the company is now expected to generate 41.7% revenue growth in the current fiscal year (slightly helped by acquisitions), it also trades at 33x such revenues, as the chart above indicates. Consequently, investors today are paying approximately 4.5x as much, per unit of revenues, than they did in the IPO 2.5 years ago—even though the growth rates were slightly higher then compared to what they are expected to be in the next year. If DocuSign were to meet Wall Street's forecast for FY2022 revenues of $1.81 billion but the market places the same Price/Sales multiple of 10x as it did two years ago, the shares would trade at $89.

Compared to Adobe

Adobe Inc. is a more mature technology company that is well-entrenched in the PDF/electronic signature business. Adobe expanded revenues 23.7% in FY2018 and 29.8% in FY2019, but is only expected to grow 14.6% in FY2020 and 15.4% in FY2021, the



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pandemic and work-at-home situation notwithstanding. Still, it is valued at 40x next year's expected earnings, or 17x the revenues expected in the current year. DocuSign is trading at 200x next year's expected (non-GAAP) earnings and 26x its consensus FY2022 revenues. In addition, this should be considered from the perspective that Adobe's share price has advanced 70% in the past year, even though its growth rates are moderating. Thus, one year ago, Adobe was trading at exactly 10x the revenues it was expected to generate in FY2020 and, at the time, its growth rates had been 24%-30% in the prior two years. Consequently, it is not inconceivable that if sentiment normalizes, and the pandemic-beneficiaries return to pre-pandemic valuations, that DocuSign could revert to a valuation of 10x revenues and growth rates of 24-30%. If that is applied to its consensus FY2022 revenues of $1.81billion, a valuation of $18.1 billion, or $89 per share, is indicated.

Compared to Dropbox's Acquisition of HelloSign

Dropbox spent $230 million to purchase HelloSign last year. At the time of the acquisition, that company had 80,000 users and estimated revenues of $20-$30 million, growing around 50% per year[5]. Unlike DocuSign, Dropbox's shares are unchanged in the past year. Still, if DocuSign were valued at the 7-11x trailing revenues at which HelloSign was acquired, a valuation of around $10 billion (using the mid-point) is indicated. Of course, HelloSign was acquired pre-pandemic, so the multiple used in that transaction could be considered normalized relative to the current situation.

Compared to OneSpan

While DropBox and Adobe have competing products, those companies are generating the bulk of their revenues from other products, but OneSpan is more focused on document management, including e-signatures. OneSpan has an $800 million market capitalization, $100 million in net cash, and $234 million in revenues forecasted for 2020[6]. Consequently, it trades at an enterprise value-to-sales ratio of just 3.0x, as compared to 31x for DocuSign. It also trades at 37x the earnings projected for next year[4]. Those earnings, if they materialize, would indicate a 120% y-o-y expansion, while the revenues are only projected to grow 14%. OneSpan has also generated free cash flow of $37 million in the last four quarters, with only $4 million of that derived from stock-based compensation. Again, the corresponding figures for DocuSign are $61 million of free cash flow in the past four quarters, but that includes a $199 million contribution from stock-based compensation. On a valuation basis, OneSpan trades at 19x its free cash flow while DocuSign trades at 733x. Thus, OneSpan appears to be a slower-growing company, but more profitable both on a net profit margin as well as free cash flow margin basis, and its valuation multiples are just a fraction of the multiples the market places on DocuSign.

[5] Estimates from J.P. Morgan

[6] Based on Wall Street's consensus



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**Investment Summary**

While DocuSign's technology is disruptive and has transformed industries such as real estate and banking by eliminating paper-based processes and replacing them with far more convenient and efficient e-sign tools, after the 260% increase in the company's share price in the past year, it appears that many years of continued growth and flawless execution are already priced into the DocuSign valuation. There is no doubt that the pandemic has pulled forward revenues from corporations that were hesitant about embracing electronic signatures but became forced to do so due to the lockdown. Therefore, the pandemic provided a substantial boost for DocuSign, but resulted in growth rates that are unsustainable.

A far larger and profitable company, Adobe, has an essentially identical product that still represents only an ancillary business for it, but Adobe could decide to compete more seriously with DocuSign; it has not competed on price on the one side of the business (the retail consumer) for which DocuSign provides free entry. There are at least a half-dozen other competitors with essentially similar offerings. Although first-to-market and branding advantages have value in the tech service marketplace, this is not a technologically differentiated product, nor is it an enterprise type of system that has high switching costs. A decision to compete for market share/on cost by competitors, particularly Adobe, could dramatically impede the DocuSign growth rate and/or exacerbate its loss position.

DocuSign is currently valued at 33x the revenues expected in the current fiscal year. To put this into perspective, the shares are trading at a multiple of *revenue* that is higher than the S&P 500's multiple of *earnings*—despite the fact that DocuSign has yet to generate any GAAP earnings.

While DocuSign has been one of the main beneficiaries of pandemic-related lockdowns, the stock market appears to value the company as if this trend will continue indefinitely. More likely, DocuSign's rate of expansion will moderate in the next year as the pandemic subsides, and the lower growth of revenues in dollar terms will be compared to the now considerably higher revenue base. This is reflected in Wall Street's consensus revenue growth, which indicates a 45% expansion in the current quarter, but just 31% for the next fiscal year. To reconcile those estimates, y-o-y expansion would have to decline to approximately 20% towards the end of the next fiscal year. Should that materialize, the shares will most likely not trade at 33x revenue but perhaps closer to 10x. That is also the valuation DocuSign traded at for most of 2018, which was the year it came public, and it expanded at a rate of around 35% at that time. At 10x next year's consensus revenue forecast of $1.8 billion, the shares would trade at $89.

Alternatively, should the company continue to trade at 33x revenues but only expand revenues by 20%, then the share price will increase perhaps 15% per year, after accounting for dilution due to stock-based compensation. Since the downside appears to be considerably greater than the upside, shares of DocuSign are recommended for sale and short-sale




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**DOCUSIGN, INC.**
**CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)**

| (in thousands, except per share data) | July 31, 2020 | January 31, 2020 |
|---|---|---|
| **Assets** | | |
| Current assets | | |
| Cash and cash equivalents | $ 404,262 | $ 241,203 |
| Investments—current | 269,777 | 414,939 |
| Restricted cash | 280 | 280 |
| Accounts receivable | 224,502 | 237,841 |
| Contract assets—current | 17,044 | 12,502 |
| Prepaid expenses and other current assets | 52,158 | 37,125 |
| Total current assets | 968,023 | 943,890 |
| Investments—noncurrent | 66,265 | 239,729 |
| Property and equipment, net | 150,646 | 128,293 |
| Operating lease right-of-use assets | 168,313 | 149,833 |
| Goodwill | 349,254 | 194,882 |
| Intangible assets, net | 135,825 | 56,500 |
| Deferred contract acquisition costs—noncurrent | 198,325 | 153,333 |
| Other assets—noncurrent | 16,659 | 24,678 |
| **Total assets** | $ 2,053,310 | $ 1,891,138 |
| **Liabilities and Stockholders' Equity** | | |
| Current liabilities | | |
| Accounts payable | $ 33,053 | $ 28,144 |
| Accrued expenses and other current liabilities | 54,916 | 54,344 |
| Accrued compensation | 111,623 | 83,189 |
| Contract liabilities—current | 624,031 | 507,560 |
| Operating lease liabilities—current | 30,415 | 20,728 |
| Total current liabilities | 854,038 | 693,965 |
| Convertible senior notes, net | 479,105 | 465,321 |
| Contract liabilities—noncurrent | 11,837 | 11,478 |
| Operating lease liabilities—noncurrent | 177,862 | 162,432 |
| Deferred tax liability—noncurrent | 8,740 | 4,920 |
| Other liabilities—noncurrent | 19,837 | 6,695 |
| Total liabilities | 1,551,419 | 1,344,811 |
| Commitments and contingencies | | |
| Stockholders' equity | | |
| Common stock | 19 | 18 |
| Additional paid-in capital | 1,749,323 | 1,685,167 |
| Accumulated other comprehensive income (loss) | 2,098 | (1,673) |
| Accumulated deficit | (1,249,549) | (1,137,185) |
| Total stockholders' equity | 501,891 | 546,327 |
| **Total liabilities and stockholders' equity** | $ 2,053,310 | $ 1,891,138 |



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**DOCUSIGN, INC.**
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS (Unaudited)**

| | Three Months Ended July 31, | | Six Months Ended July 31, | |
|---|---|---|---|---|
| **(in thousands, except per share data)** | **2020** | **2019** | **2020** | **2019** |
| **Revenue:** | | | | |
| Subscription | $ 323,643 | $ 220,811 | $ 604,565 | $ 422,269 |
| Professional services and other | 18,566 | 14,801 | 34,661 | 27,305 |
| Total revenue | 342,209 | 235,612 | 639,226 | 449,574 |
| **Cost of revenue:** | | | | |
| Subscription | 64,730 | 39,472 | 116,740 | 72,591 |
| Professional services and other | 25,885 | 21,704 | 47,907 | 40,604 |
| Total cost of revenue | 90,615 | 61,176 | 164,647 | 113,195 |
| **Gross profit** | 251,594 | 174,436 | 474,579 | 336,379 |
| **Operating expenses:** | | | | |
| Sales and marketing | 194,992 | 150,886 | 366,785 | 280,822 |
| Research and development | 63,791 | 47,517 | 118,025 | 84,700 |
| General and administrative | 51,446 | 40,755 | 90,257 | 78,016 |
| Total operating expenses | 310,229 | 239,158 | 575,067 | 443,538 |
| **Loss from operations** | (58,635) | (64,722) | (100,488) | (107,159) |
| Interest expense | (7,684) | (7,273) | (15,244) | (14,429) |
| Interest income and other income, net | 2,601 | 4,531 | 6,343 | 9,748 |
| **Loss before provision for income taxes** | (63,718) | (67,464) | (109,389) | (111,840) |
| Provision for income taxes | 842 | 1,168 | 2,975 | 2,514 |
| **Net loss** | $ (64,560) | $ (68,632) | $ (112,364) | $ (114,354) |
| **Net loss per share** | $ (0.35) | $ (0.39) | $ (0.61) | $ (0.66) |
| **Weighted-average number of shares** | 184,862 | 175,389 | 183,930 | 173,773 |



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