BEHIND THE NUMBERS
Quality of Earnings Analysis
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DocuSign, Inc. (DOCU)
Earnings Quality Update

We are raising our earnings quality rating of DOCU from 3- to 3+ (Minor Concern).

For an explanation of the EQ Review Rating scale, please refer to the end of this report.

Summary

DOCU's 3Q24 adjusted EPS of $0.79 beat by 16 cents. The beat looks real as the low-quality items are much lower than 16 cents. We again are impressed to see positive GAAP EPS of 19 cents. DOCU did raise guidance on all metrics after the 3Q results. The company is still hurting from a weak real estate market, but that market is now growing again and helping DOCU. We raised the rating as there are better trends in some metrics, but keeping the 3 rating as DOCU boosted stock compensation as a percentage of sales. We see several areas worth watching:

- Stock compensation jumped to 23.2% of sales. We view this as negative given that DOCU reduced headcount recently. (Headcount rose sequentially to 6,945 from 6,748 but remains down last year's peak of 8,061). DOCU attributes some of the higher stock compensation to hiring and bonuses. But, its long-term target is 20% of sales. Because DOCU adds stock compensation back to adjusted EPS, this helped 3Q24 results by 1.2 cents.

	23-Oct	23-Jul	23-Apr	23-Jan	22-Oct	22-Jul	22-Apr	22-Jan	21-Oct
Sales	$700.4	$687.7	$661.4	$659.6	$645.5	$622.2	$588.7	$580.8	$545.5
Stock Comp	$159.4	$151.7	$139.8	$145.9	$135.2	$141.2	$110.7	$118.0	$109.4
Taxes on Exercise	$2.9	$4.0	$4.2	$1.9	$2.5	$3.4	$5.1	$4.2	$10.1
Total	$162.3	$155.7	$144.0	$147.9	$137.7	$144.6	$115.8	$122.2	$119.5
% of Sales	23.2%	22.6%	21.8%	22.4%	21.3%	23.2%	19.7%	21.0%	21.9%

- Interest income remained high at $17.7 million in 3Q, but the sequential growth disappeared compared to 2Q's $17.5 million. This was still 6.8 cents of EPS.

- Adding back acquired intangibles was another 1.8 cents in adjusted EPS, which was expected.

- Adjusted Selling and Marketing costs declined by $17.1 million y/y. The lower headcount was $8.4 million of that and was expected. Another $6.9 million came from cutting advertising and may not be sustainable if DOCU shifts back to growth and it already cut advertising in 1Q and 2Q of this year. The $6.9 million is worth 2.7 cents in EPS.

- On the positive side, DOCU held R&D at the higher levels posted in 2Q. This is also where stock compensation makes a large impact. Cash R&D is higher, but is not growing as quickly:

	23-Oct	23-Jul	23-Apr	23-Jan	22-Oct	22-Jul	22-Apr
Sales	$700.4	$687.7	$661.4	$659.6	$645.5	$622.2	$588.7
R&D	$136.6	$136.0	$115.4	$125.9	$115.9	$126.5	$112.2
Cash R&D	$87.5	$89.0	$77.5	$83.7	$79.4	$84.3	$78.5
R&D % Sales	19.5%	19.8%	17.4%	19.1%	18.0%	20.3%	19.1%
Cash R&D %	12.5%	12.9%	11.7%	12.7%	12.3%	13.5%	13.3%

- DOCU capitalizes and defers acquisition costs for new business (largely sales commissions and set-up fees). This is a frequent help to EPS as well. It bounced up in 3Q, which was worth 5.4 cents, or 0.9 cents y/y. The positive of this is it shows new business is being signed up. Keep in mind there is some seasonality to this item. Also, the 5.4 cents in EPS here is normally 3 cents when it is $7-9 million.

	23-Oct	23-Jul	23-Apr	23-Jan	22-Oct	22-Jul	22-Apr	22-Jan	21-Oct
New Acq Costs	$54.1	$46.0	$43.2	$52.8	$45.9	$63.2	$19.1	$44.6	$41.1
Amortization	$40.2	$38.2	$35.8	$35.5	$34.2	$53.9	$12.2	$30.9	$28.8
Net Difference	$14.0	$7.8	$7.4	$17.3	$11.7	$9.3	$6.9	$13.7	$12.3

- The renewal rate continued to normalize. This was a concern last year as some renewals stretched into the following quarter and pushed up receivables. This quarter not only saw

DSOs drop but lower receivables helped spur a big change in cash flow. Cash from operations was $264.2 million in 3Q24 vs. $52.5 million in 3Q23. Of the $211.7 million swing, receivables were $136.2 million of it:

DSOs	4Q	3Q	2Q	1Q	A/R	4Q	3Q	2Q	1Q
fiscal 24		47.4	55.5	55.0			$360	$415	$409
fiscal 23	72.1	60.2	50.2	45.5		$517	$423	$340	$201
fiscal 22	69.9	51.5	51.2	47.8		$441	$306	$285	$250

- Earnings were pressured by a larger loss in professional services again. Adjusted for stock compensation, the loss was $3.0 million in 3Q24 vs. $1.6 million in income in 3Q23. This was a 1.6-cent headwind.

Explanation of EQ Rating Scale

6- (Exceptionally Strong)- Indicates uncommonly conservative accounting policies to the point that revenue and earnings are essentially understated relative to the company's peers. Higher possibility of reporting positive earnings surprises

5 (Strong)- Indicates the company has no areas of concern with its reported results and we see very little risk of the company disappointing due to recent results being overstated from aggressive reporting in recent periods.

4 (Acceptable)- Indicates the company may have exhibited a minor “red flag”, but the severity of the issue is not yet a concern. Minimal risk of an earnings disappointment resulting from previous earnings or cash flow overstatement

3 (Minor Concern)- Indicates the company has exhibited either a larger number of or more serious warning signs than companies receiving a 4. The likelihood of an immediate earnings or cash flow disappointment is not considered to be high, but the signs mentioned deserve a higher degree of attention in the future.

2 (Weak) Indicates the company’s recently reported results have benefitted materially from aggressive accounting. Follow up work should be performed to determine the nature and extent of the problem. There is a possibility that upcoming results could disappoint as the impact of unsustainable benefits disappears.

1 (Strong Concern)- Indicates that the company’s recent results are significantly overstated and that we view a disappointment in upcoming quarters is highly likely

In addition to the numerical rating, the EQ Review Rating also include either a minus or plus sign. A minus sign indicates that our analysis shows the overall earnings quality of the company has worsened since the last review and there is a possibility the numerical rating will fall should the problem continue into upcoming quarters. Likewise, a positive sign indicates that the overall earnings quality is improving, and the company may see an upgrade in its numerical rating should the trend continue.

Key Points to Understand About the EQ Score

The EQ Review Rating is much more than a blind, quantitative scoring method. While we utilize proprietary adjustments, ratios, and methods developed over decades of earnings quality analysis, the foundation of all of our analysis is reading recent SEC filings, press releases, conference call transcripts and in some cases, conversations with managements.

The EQ Review Rating is not comparable to a traditional buy/sell rating. The Rating is intended to specifically convey the extent to which reported earnings may be over/understated. Fundamental factors such as forecasts for future growth, increasing competition, and valuation are not reflected in the rating. Therefore, a high score does not in itself indicate a company is a buy but rather indicates that recent results are a good indication of the underlying earnings and cash generation capacity of the company. A low score (1-2) will likely result in us performing a more thorough review of fundamental factors to determine if the company warrants a full-blown sell recommendation.

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