

Pareteum Corp. (Nasdaq/TEUM)

BUY
Current Price: \$2.29 / Target: \$5.00

Pareteum provides cloud software to enable communications services and applications.

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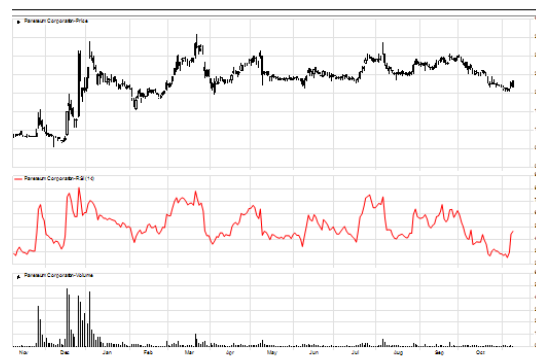
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Strong 3Q With Over 100% Organic Growth

- Pareteum posted another strong quarter with both revenue and connections up by over 100%.
- The key to the company's success is that it provides a service that is heavily in demand as it serves the needs of both telecom carriers and enterprise customers as they seek to manage numerous wireless devices over a wide range of networks.
- Because Pareteum is a SaaS – software as a service – company, offering a software service over the internet, it has the ability to scale dramatically without a major increase in operating expense, as it is doing.
- Its acquisition of Artilium closed just after the quarter ended, and that company is a close match with a similar product set and complementary customers.
- For the quarter, revenue came in at just over \$8.0 mm, up 129%. Connections were up 128%.
- EBITDA came in at \$1.8 mm, roughly tripling. Many of the company's SaaS comps do not presently generate positive EBITDA.
- Despite the strong results, TEUM shares just do not trade like the high growth SaaS company Pareteum is. Some of that may be due to the company's small market cap, but as a believer that fundamentals eventually drive stock prices, we see tremendous upside in the stock.
- Our \$5 price target is unchanged and represents just a 4.5x multiple on our now higher 2020 revenue estimate. Comps trade at 13.9x trailing estimates. So there should be upside well beyond our target.

Estimates	2018E	2019E	2020E
Revenue(\$000s)	\$31,862	\$73,943	\$107,024
1Q March	4,113 A	16,157	23,871
2Q June	6,003 A	17,608	25,667
3Q September	8,008 A	19,371	27,861
4Q December	13,738	20,808	29,625
EPS	\$0.06	\$0.09	\$0.26
1Q March	(0.04) A	0.02	0.04
2Q June	0.03 A	0.03	0.06
3Q September	(0.07) A	0.03	0.07
4Q December	0.01	0.03	0.08
P/E (x)	N/A	N/A	8.8X
EBITDA	\$3,374	\$14,206	\$31,050
EV/EBITDA (x)	36.6X	8.7X	4.0X
Stock Data			
52-Week Range	\$0.54 - \$3.59		
Shares Outstanding (mil.)	55.7		
Market Capitalization (mil.)	\$125.2		
Enterprise Value (mil.)	\$123.5		
Debt to Capital	2.9%		
Book Value/Share	\$0.46		
Price/Book	4.9 X		
Average Trading Volume (3-month) Mill	1.3		
Insider Ownership	10.5%		
Institutional Ownership	14.0%		
Short interest	12.2%		



Price target and ratings changes over the past 3 years:

Update - Buy - April 4, 2018 - \$2.10 Target

Update - Buy - September 22, 2018 - \$3.10 Target

Update - Buy - October 25, 2018 - \$5.00 Target

Strong Quarter but Best May be Yet to Come with Artilium Now Closed

Last night, Pareteum reported third quarter results and hosted its management earnings call. Revenue was better than expected, guidance was raised and the forward-looking key performance indicators (KPIs) were positive. We reiterate our Buy rating and \$5 price target. The strong results did not include the acquisition of Artilium which closed just after the quarter ended, so growth should accelerate.

Revenue came in at just over \$8 mm, which the company had pre-announced a few weeks ago. This represented 129% year over year and 33% sequential growth. The number of devices managed by Pareteum software increased by 128% to 2.9 mm. Since unit growth essentially matched revenue growth, ARPU was flat year over year at \$2.76 but higher than the first two quarters of the year. On a forward-looking basis, the company ended the quarter with \$403 mm in backlog, up 329% versus the year ago period. In short, Pareteum's service closely fits the needs of telecom carriers and enterprise customers around the globe, and because it is offering a software-based service, it is fully scalable to meet demand without a commensurate increase in operating costs. As we discussed in our last note dated October 25th, Artilium, which the company acquired October 1, is a very close match in terms of services offered, with a complementary customer set.

Now that the company is scaling up, profitability is surging too. EBITDA tripled with a respectable 22% margin. Again, we see further upside due to the scalability of the SaaS model. There was a sizable one-time stock compensation payment made in the quarter, pushing GAAP net income negative, but we are focused on EBITDA.

Our updated model is attached at the end of this report and factors in Artilium as of October 1. Given the better than expected performance of Pareteum in the quarter, we raise our 4Q revenue estimate from \$12.7 mm to \$13.7 mm. Our EBITDA forecast goes from \$2.5 mm to \$3.4 mm.

On its earnings call, management noted the sharp disparity between the trading valuation of its share price and other SaaS companies. The sector is a favorite of institutional investors presently, largely because of the scalability and margin benefits one gets by providing a virtual service over an internet platform.

Our comp table is presented on the next page and we would point out several notable data points. First, TEUM shares trade at 11.8x trailing revenue, which is only a modest discount to comps. However, if we plug in our 2020 revenue estimate, given the company's rapid organic growth and addition of Artilium, this ratio drops to just 1.9x. Even at our \$5 price target, this would represent a multiple of 4.5x. While the company's market cap is smaller than its peers, our projected revenue number is comparable to peers. Only one company, LogMeIn, trades near our target multiple, while the average multiple is 13.9x. Twilio, which is a hedge fund favorite presently, trades at 23.9x. Management noted on its call that it believes that it can get the share price to \$25. We believe that the comps demonstrate that such a sharp increase in the stock price is consistent with SaaS trading multiples.

SaaS Comps Trade at 13.9x Trailing Revenue, Implying Significant Upside for TEUM

Company Name	Fiscal Period	Price	Shares Outstanding	Market Value	Enterprise Value	Sales	EBIT	EBITDA	Enterprise Value/ Sales
Pareteum	06/30/2018	\$2.29	99.0	226.7	208.0	17.6	(7.4)	(2.6)	11.8x
TEUM @ 2020E	12/31/20	\$2.29	99.0	226.7	208.0	107.0	27.1	31.1	1.9x
TEUM @ target on 2020E	12/31/20	\$5.00	99.0	495.0	476.4	107.0	27.1	31.1	4.5x
Alteryx, Inc. Class A	12/31/2017	\$58.64	29.9	3,629.7	3,467.4	131.6	(17.1)	(13.6)	26.3x
Appian Corporation Class A	12/31/2017	\$28.21	28.1	1,796.2	1,688.9	176.7	(31.8)	(30.9)	9.6x
Apptio, Inc. Class A	12/31/2017	\$26.63	45.1	1,201.1	1,055.8	188.5	(26.2)	(20.1)	5.6x
Bandwidth Inc. Class A	12/31/2017	\$49.24	12.7	969.8	906.3	163.0	14.7	20.4	5.6x
Cloudera, Inc.	01/31/2018	\$14.71	153.0	2,251.3	1,872.9	367.4	(390.3)	(378.2)	5.1x
LogMeIn, Inc.	12/31/2017	\$88.05	51.2	4,504.8	4,537.2	989.8	48.0	269.3	4.6x
Okta, Inc. Class A	01/31/2018	\$62.60	97.1	6,834.9	6,562.4	260.0	(116.4)	(91.8)	25.2x
Shopify, Inc. Class A	12/31/2017	\$148.19	94.1	15,836.3	14,258.1	673.3	(52.6)	(29.2)	21.2x
Talend SA Sponsored ADR	12/31/2017	\$62.90	29.9	1,833.1	1,741.0	149.8	(29.0)	(26.9)	11.6x
Twilio, Inc. Class A	12/31/2017	\$96.19	79.0	9,905.6	9,534.0	399.0	(65.8)	(47.0)	23.9x
Yext, Inc.	01/31/2018	\$20.00	98.6	1,971.7	1,846.9	170.2	(66.6)	(61.5)	10.9x
Zendesk, Inc.	12/31/2017	\$57.64	107.0	6,169.9	6,171.2	430.5	(114.4)	(82.6)	14.3x

Average
13.9x

Source: Company reports and Dawson James estimates

Pareteum Income Forecast

Dollars in thousands, except per share
Fiscal years ended December 31

	2018E					2019E					2020E				
	1Q	2Q	3Q	4Q	Year	1Q	2Q	3Q	4Q	Year	1Q	2Q	3Q	4Q	Year
	March	June	September	December		March	June	September	December		March	June	September	December	
Pareteum revenue	4,112,570	6,003,180	8,008,000	9,471,964	27,595,714	10,929,340	12,380,158	13,824,447	15,262,237	52,396,183	17,074,877	18,871,203	20,651,363	22,415,500	79,012,943
YoY growth	47.1%	85.3%	128.9%	135.9%	103.7%	165.8%	106.2%	72.6%	61.1%	89.9%	56.2%	52.4%	49.4%	46.9%	50.8%
Seq growth	2.4%	46.0%	33.4%	18.3%		15.4%	13.3%	11.7%	10.4%		11.9%	10.5%	9.4%	8.5%	
Artium revenue				4,266,197	4,266,197	5,227,552	5,227,552	5,546,056	5,546,056	21,547,217	6,795,818	6,795,818	7,209,873	7,209,873	28,011,382
YoY growth									30.0%	405.1%	30.0%	30.0%	30.0%	30.0%	30.0%
Seq growth						22.5%	0.0%	6.1%	0.0%		22.5%	0.0%	6.1%	0.0%	
Revenue	4,112,570	6,003,180	8,008,000	13,738,161	31,861,911	16,156,892	17,607,710	19,370,504	20,808,294	73,943,400	23,870,695	25,667,021	27,861,236	29,625,374	107,024,325
YoY growth	47.1%	85.3%	128.9%	242.2%	135.2%	292.9%	193.3%	141.9%	51.5%	132.1%	47.7%	45.8%	43.8%	42.4%	44.7%
Seq growth	2.4%	46.0%	33.4%	71.6%	231.9%	17.6%	9.0%	10.0%	7.4%	355.4%	14.7%	7.5%	8.5%	6.3%	361.3%
Cost of revenue	1,194,523	1,779,882	2,129,000	3,984,067	9,087,472	4,685,499	5,106,236	5,617,446	6,034,405	21,443,586	6,922,502	7,443,436	8,079,758	8,591,358	31,037,054
As a percent of revenue	29.0%	29.6%	26.6%	29.0%	28.5%	29.0%	29.0%	29.0%	29.0%	29.0%	29.0%	29.0%	29.0%	29.0%	29.0%
Product development	726,845	753,931	766,000	1,785,961	4,032,737	2,100,396	2,289,002	2,518,165	2,705,078	9,612,642	3,103,190	3,336,713	3,621,961	3,851,299	13,913,162
As a percent of revenue	17.7%	12.6%	9.6%	13.0%	12.7%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%
Sales and marketing	688,998	652,442	843,000	1,373,816	3,558,256	1,615,689	1,760,771	1,937,050	2,080,829	7,394,340	2,387,069	2,566,702	2,786,124	2,962,537	10,702,433
As a percent of revenue	16.8%	10.9%	10.5%	10.0%	11.2%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
General and administrative	2,296,852	2,214,070	2,490,000	4,808,356	11,809,278	5,170,205	5,282,313	5,423,741	5,410,156	21,286,416	5,728,967	5,133,404	5,015,022	4,443,806	20,321,199
As a percent of revenue	55.8%	36.9%	31.1%	35.0%	37.1%	32.0%	30.0%	28.0%	26.0%	28.8%	24.0%	20.0%	18.0%	15.0%	19.0%
EBITDA	(794,648)	602,855	1,780,000	1,785,961	3,374,168	2,585,103	3,169,388	3,874,101	4,577,825	14,206,416	5,728,967	7,186,766	8,358,371	9,776,373	31,050,477
EBITDA margin	-19.3%	10.0%	22.2%	13.0%	10.6%	16.0%	18.0%	20.0%	22.0%	19.2%	24.0%	28.0%	30.0%	33.0%	29.0%
Restructuring charges	73,600	5,592	1,995,000	-	2,074,192	-	-	-	-	-	-	-	-	-	-
Depreciation and amortization	965,290	994,318	999,000	1,000,000	3,958,608	1,000,000	1,000,000	1,000,000	1,000,000	4,000,000	1,000,000	1,000,000	1,000,000	1,000,000	4,000,000
Stock based compensation	-	-	5,638,000	-	5,638,000	-	-	-	-	-	-	-	-	-	-
Impairment - assets	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Impairment - goodwill	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Loss on sale of assets	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Operating income	(1,833,538)	(397,055)	(6,852,000)	785,961	2,979,368	1,585,103	2,169,388	2,874,101	3,577,825	10,206,416	4,728,967	6,186,766	7,358,371	8,776,373	27,050,477
Operating margin	-44.6%	-6.6%	-85.6%	5.7%	9.4%	9.8%	12.3%	14.8%	17.2%	13.8%	19.8%	24.1%	26.4%	29.6%	25.3%
Interest income	42,672	43,193	-	40,000	125,865	40,000	40,000	40,000	40,000	160,000	40,000	40,000	40,000	40,000	160,000
Interest expense	(63,458)	(99,708)	-	(100,000)	(263,166)	(100,000)	(100,000)	(100,000)	(100,000)	(400,000)	(100,000)	(100,000)	(100,000)	(100,000)	(400,000)
Interest expense related to debt discount	(29,566)	(30,272)	-	(30,000)	(89,838)	(30,000)	(30,000)	(30,000)	(30,000)	(120,000)	(30,000)	(30,000)	(30,000)	(30,000)	(120,000)
Changes in derivative liability	(313,733)	1,597,647	-	-	1,283,914	-	-	-	-	-	-	-	-	-	-
Amortization of debt discount	(6,142)	-	-	-	(6,142)	-	-	-	-	-	-	-	-	-	-
Other income	69,546	567,710	(150,000)	-	487,256	-	-	-	-	-	-	-	-	-	-
Amortization of deferred financing costs	-	(6,209)	-	-	(6,209)	-	-	-	-	-	-	-	-	-	-
Pretax Income	(2,134,219)	1,675,306	(7,002,000)	695,961	4,511,048	1,495,103	2,079,388	2,784,101	3,487,825	9,846,416	4,638,967	6,096,766	7,268,371	8,686,373	26,690,477
Taxes	(418)	18,842	20,000	-	38,424	-	-	-	-	-	-	-	-	-	-
Net income to common	(2,133,801)	1,656,464	(7,022,000)	695,961	4,472,624	1,495,103	2,079,388	2,784,101	3,487,825	9,846,416	4,638,967	6,096,766	7,268,371	8,686,373	26,690,477
Net income margin	-51.9%	27.6%	-87.7%	5.1%	14.0%	9.3%	11.8%	14.4%	16.8%	13.3%	19.4%	23.8%	26.1%	29.3%	24.9%
Diluted shares outstanding	50,062,434	64,741,232	104,437,636	104,437,636	80,919,735	104,437,636	104,437,636	104,437,636	104,437,636	104,437,636	104,437,636	104,437,636	104,437,636	104,437,636	104,437,636
Seq change	50,062,434	14,678,798	39,696,404	-	-	-	-	-	-	-	-	-	-	-	-
EPS diluted - continuing	(\$0.04)	\$0.03	(\$0.07)	\$0.01	\$0.06	\$0.01	\$0.02	\$0.03	\$0.03	\$0.09	\$0.04	\$0.06	\$0.07	\$0.08	\$0.26

Source: Company reports and Dawson James estimates

Important Disclosures:



Source: FactSet Data Systems

Price target and ratings changes over the past 3 years:

Update - Buy - April 4, 2018 - \$2.10 Target

Update - Buy - September 22, 2018 - \$3.10 Target

Update - Buy - October 25, 2018 - \$5.00 Target

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Valuation:

We value TEUM shares at 4.5x our 2020 revenue estimate, or a two thirds discount to the 13.9x comps trade at on their trailing results.

Risk Factors:

1. The first risk factor to consider after a company has completed such a sizable merger is integration risk. We think this is mitigated by the fact that the two companies enjoyed a 24-week strategic alliance (courtship) period before announcing their merger. However, problems with systems integration of critical systems such as billing or customer support could delay revenue, increase churn and result in lower cash flow.
2. Pareteum is still a relatively small company, competing with most of its telecom network and technology suppliers. While this frenemy arrangement is common in the industry, should one or more larger partners decide it no longer wants to partner, this could negatively impact the company.
3. Cyber threats are always a risk and especially so for a company whose whole business is based on software in the cloud. Should a malicious actor be able to breach the company's software at some point and disrupt its services or compromise customer confidential information, its business would likely suffer.

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- 2) **Neutral:** the analyst believes the price of the stock is fairly valued for the next 12-18 months;
- 3) **Sell:** the analyst believes the price of the stock will decline by at least 20% over the next 12-18 months and should be sold.

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