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Smith Micro Software, Inc. (NASDAQ: SMSI)

May 6, 2021

Buy: Q1 Results; Increase Price Target to \$11.40

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We reiterate our Buy recommendation of Smith Micro Software and increase our price target to \$11.40 per share from \$11.10 per share. With the acquisitions of its two major competitors, Smith is an undisputed market-share leader in family safety services for the wireless market. The recently completed purchase of the Family Safety Mobile business from Avast reduces customer concentration, adds important intellectual property, provides a base for expansion into international markets, and sets up the potential for product line expansion, particularly into home and IoT services.

Q1 revenue and EBITDA exceeded our expectations. Revenue of \$11.4 million was higher than our \$11.0 estimate and EBITDA of \$887 thousand was better than our \$681 thousand estimate.

We have raised our revenue estimates for this year and next. For this year, we are now expecting revenue of \$60.6 million versus our prior estimate of \$60.4 million, and for 2022, our estimated revenue is increased to \$82.4 million from \$79.7 million. The higher revenue estimate for 2022 results in an increased price target, using the same EV/sales multiple of 7.1x.

We expect the key growth driver to be the Family Safety business, which comprises the SafePath platform and the Family Safety business acquired from Avast. Revenue from the Avast acquisition should begin this quarter, and the company is optimistic it can accelerate revenue with the platform's major customer, Verizon. SafePath 7.0 will launch at T-Mobile in the coming weeks or months, and this should accelerate growth at that customer. We also expect the launch to stave off the decline recently experienced by customers migrating from the Sprint network to the T-Mobile network as those customers will now have the option of continuing their family safety plan on the T-Mobile network.

We have adjusted our gross margin estimates downward to reflect a greater than expected contribution from the acquired Avast business and higher than expected costs for SafePath 7.0. However, we expect gross margins to improve beginning Q3 and ultimately approach or achieve the 90% level seen in 2019 and 2020.

Valuation: Our price target of \$11.40 is based on an EV/Sales multiple of 7.1x our 2022 revenue estimate of \$82.4 million. Shares of a comp group of other software and software-as-a-service vendors trade between 1.9x and 9.3x FTM sales (based on FactSet estimates). We have chosen a target multiple towards the higher end of the range because of Smith's dominance in its sector and a robust outlook.

Risks: Risks to achieving our price target include declines in the CommSuite product line, disruptions from the T-Mobile acquisition of Sprint, integration of the Family Safety business, continuing impacts of the COVID pandemic and customer concentration.

Current Price	\$5.36		
Price Target	\$11.40		
Estimates	F2020A	F2021E	F2022E
Revenues (\$000s)	\$ 51,300	\$ 60,634 E	\$ 82,356
1Q March	\$ 13,322	\$11,381 A	\$ 18,320
2Q June	\$ 12,933	\$ 15,094 E	\$ 19,611
3Q September	\$ 12,629	\$ 16,465 E	\$ 21,300
4Q December	\$ 12,416	\$ 17,694 E	\$ 23,125
	F2020A	F2021E	F2022E
EBITDA (\$000s)	\$ 11,093	\$ 2,095 E	\$ 15,828
1Q March	\$ 4,153	\$ 887 A	\$ 1,735
2Q June	\$ 3,204	\$ (995) E	\$ 2,966
3Q September	\$ 2,030	\$ 548 E	\$ 4,663
4Q December	\$ 1,706	\$ 1,656 E	\$ 6,464
EPS-GAAP	\$ 0.10	\$ (0.31)	\$ (0.05)
EPS-PF	\$ 0.26	\$ 0.02	\$ 0.27
Stock Data			
52-Week Range	\$3.50	-	\$8.05
Shares Outstanding (mil.)	53.2		
Market Capitalization (mil.)	\$285		
Enterprise Value (mil.)	\$262		
Debt to Capital	8%		
Book Value/Share	\$1.42		
Price/Book	3.8x		
Average Three Months Trading Volume (K)	1,274		
Insider Ownership	14.6%		
Institutional Ownership	21.3%		
Short interest (mil.)	2.6%		
Dividend / Yield	\$0.00/0.0%		



Q1 Results

Q1 revenue and EBITDA exceeded our expectations. Revenue of \$11.4 million was higher than our \$11.0 estimate and EBITDA of \$887 thousand was better than our \$681 thousand estimate. Gross margin was lower than forecast as costs were higher to launch SafePath 7.0. Opex was higher than we modeled by \$2.3 million. \$1.5 million of this delta was driven by the accelerated amortization of intangible assets related to the modification of a customer contract. This modification also resulted in a \$600 thousand benefit to revenue.

Q1 21			
\$ in 000's except per share	Actual	Estimates	Delta
Revenue	\$ 11,381	\$ 11,016	3%
COGS	1,545	1,212	
Gross Profit	9,836	9,804	0%
	86%	89%	
SG&A	4,232	2,781	
R&D	5,183	5,000	
G&A	3,658	3,060	
Opex	13,073	10,847	21%
Operating Income	\$ (3,237)	\$ (1,043)	-210%
Interest Income	8	129	
Other Income (Expense)	4	0	
Pretax Income	(3,225)	(915)	-252%
Taxes	0	25	
Net Income	(3,225)	(940)	
Basic Shares	43,368	46,516	
Diluted Shares	45,892	46,516	
Basic EPS	\$ (0.07)	\$ (0.02)	
Diluted EPS	\$ (0.07)	\$ (0.02)	-250%
Stock Comp	1,016	812	
Amortization	2,298	715	
Other	611	0	
Non-GAAP Net Income	700	587	
Non-GAAP EPS	\$ 0.02	\$ 0.01	
Operating Income	(3,237)	(1,043)	
Depreciation & Amortization	2,497	906	
Stock Comp	1,016	812	
Other	611	6	
EBITDA	\$ 887	\$ 681	30%
Margin	7.8%	6.2%	

Source: Smith Micro Software, Inc. and Dawson James Securities estimates.

Outlook

We have modeled SafePath at T-Mobile to decline in the first half of this year and resume growth in the second half. This is partly driven by the waning impacts of the pandemic but mostly from the introduction of SafePath 7.0 to the combined Sprint/T-Mobile customer base. CommSuite is modeled to decline this year and next, but to date, Smith has done an excellent job staving off the expected decline.

Revenue. \$ in M	2020A	2021E	2022E
Family Safety *	\$ 28.0	\$ 40.9	\$ 65.1
CommSuite	\$ 18.2	\$ 14.9	\$ 12.1
ViewSpot	\$ 4.2	\$ 4.7	\$ 5.1
Other	\$ 0.9	\$ 0.1	\$ 0.1
Total	\$ 51.3	\$ 60.6	\$ 82.4

*The Family Safety segment includes SafePath and the Avast Family Safety business

Source: Smith Micro Software, Inc. and Dawson James Securities estimates.

We assume continued growth in 2022. This is partly due to the assumed elimination of the pandemic on the economy as well as the Fed's loose monetary policy driving robust economic growth. There are three new customers for SafePath launching this year that should provide a meaningful revenue contribution in 2022.

The integration of the Family Safety business acquired from Avast presents some managerial and modeling challenges. The Avast Family Safety Mobile business in 2020 generated \$36.6 million in revenue from five mobile operators. Smith estimates recurring revenue this year of \$18 to \$19 million. Recurring revenue excludes any contribution from Sprint, which has been migrating to SafePath, and AT&T. EBITDA for the Family Safety business was about \$6 million in 2020. This excludes a \$1.2 million restructuring expense and was down sharply from \$13 million in 2019. The decline reflects a drop in revenues from \$44 million in 2019 to \$37 million in 2020, while expenses, excluding the restructuring charge, were mostly fixed.

Much of the decline in the Family Safety business was due to the loss of the Sprint contract to Smith Micro. Combining the Family Safety revenue with the SafePath revenue, the pro forma combined revenue (excluding ViewSpot and CommSuite) in 2019 was \$62 million and in 2020 \$65 million. This is 5% growth in a year impacted by the pandemic.

One of the major challenges for Smith Micro will be expense control as the legacy contracts acquired from Avast expire. In our model, we have included only recurring revenue beginning in Q2 and have assumed some reduction in the expense run rate due to the restructuring actions taken prior to the acquisition as well as assumed expense reduction as revenue from legacy customers wanes. However, expenses are typically stickier than revenue, so it is possible we have been too optimistic on our expenses. We believe if this is the case, it will be offset by our omission of legacy revenue this year, which will be greater than what we have included in our estimates. That is, greater than zero.

For this year, we assume more than \$15 million in revenue from the Family Safety acquisition for the almost three quarters of the year it is owned by Smith. For now, we are assuming a minimal incremental EBITDA contribution. As pointed out above, we have assumed some expense reduction of the Family Safety business from the 2020 levels and zero contribution from legacy contracts. A non-zero revenue contribution from legacy should provide some revenue and EBITDA upside to our estimates.

We expect 2022 to be a growth year as the pandemic is put behind us and the Fed's loose monetary policy drives robust growth.

We have increased our revenue estimates for this year and next but lowered our EPS and EBITDA estimates. The lower estimated gross margin is the primary cause of the reduced EPS and EBITDA estimates. We also believe we have been conservative in our modeling of expenses and believe there could be upside to our EPS and EBITDA estimates if the company controls expenses more aggressively than we forecast.

	2021E		2022E	
	Old	New	Old	New
Revenue (\$M)	\$ 60.4	\$ 60.6	\$ 79.7	\$ 82.4
Non-GAAP EPS	\$ 0.10	\$ 0.02	\$ 0.31	\$ 0.27
EBITDA (\$M)	\$ 5.7	\$ 2.1	\$ 17.1	\$ 15.8

Source: Dawson James Securities estimates.

Valuation

Our price target of \$11.40 is based on an EV/Sales multiple of 7.1x our 2022 revenue estimate of \$79.7 million. Shares of a comp group of other software and software-as-a-service vendors trade between 1.9x and 9.3x FTM sales (based on FactSet estimates). We have chosen a target multiple towards the higher end of the range because of Smith's dominance in its sector and a robust outlook.

	Company Name	Price	EV (\$M)	Rev. Est.-FTM (\$M)	EV/ FTM Sales	EBITDA Est. FTM (\$M)	EV/ FTM EBITDA
PTC	PTC Inc.	\$ 130.90	\$ 16,568.5	\$ 1,780.9	9.3	\$ 564.8	29.3
PHUN	Phunware, Inc.	\$ 1.46	\$ 112.7	\$ 13.00	8.7	\$ (8.19)	(13.8)
CRM	salesforce.com, inc.	\$ 215.40	\$ 194,465.8	\$ 25,777.7	7.5	\$ 7,607.0	25.6
VERI	Veritone, Inc.	\$ 19.58	\$ 539.5	\$ 85.4	6.3	\$ (21.9)	(24.7)
UPLD	Upland Software, Inc.	\$ 46.61	\$ 1,708.0	\$ 308.9	5.5	\$ 99.7	17.1
VMW	VMware, Inc. Class A	\$ 160.04	\$ 68,595.4	\$ 12,740.8	5.4	\$ 4,423.1	15.5
ECOM	Channeladvisor Corporation	\$ 21.22	\$ 545.1	\$ 155.6	3.5	\$ 33.3	16.4
EGAN	eGain Corporation	\$ 9.40	\$ 243.3	\$ 79.8	3.0	\$ 2.8	86.0
SEAC	SeaChange International, Inc.	\$ 1.07	\$ 54.0	\$ 25.2	2.1	\$ (12.9)	(4.2)
QUMU	Qumu Corporation	\$ 5.44	\$ 69.9	\$ 36.8	1.9	\$ (10.3)	(6.8)
SMSI	Smith Micro Software, Inc.	\$ 5.36	\$ 261.7	\$ 68.1	3.8	\$ 6.8	38.5

Source: FactSet and Dawson James Securities estimates.

Risk Analysis

Risks to achieving our price target include declines in the CommSuite product line, disruptions from the T-Mobile acquisition of Sprint, integration of the Family Safety business, continuing impacts of the COVID pandemic and customer concentration.

Exhibit 1. Income Statement

\$ in 000's	FY2018	FY2019	FY2020	Q1 21A	Q2 21E	Q3 21E	Q4 21 E	FY2021E	FY2022E
Revenue	\$ 26,285	\$ 43,346	\$ 51,300	\$ 11,381	\$ 15,094	\$ 16,465	\$ 17,694	\$ 60,634	\$ 82,356
COGS	4,332	3,926	5,190	1,545	2,670	2,799	2,920	9,934	11,910
Gross Profit	21,953	39,420	46,110	9,836	12,424	13,666	14,774	50,700	70,446
	84%	91%	89.9%	86.4%	82.3%	83.0%	83.5%	83.6%	85.5%
SG&A	5,784	7,517	10,704	4,232	5,925	5,625	5,625	21,406	23,668
R&D	8,602	11,682	19,076	5,183	7,256	7,256	7,256	26,952	29,025
G&A	8,607	9,922	12,795	3,658	5,121	5,121	4,871	18,772	20,459
Restructuring	173	194	15	0	0	0	0	0	0
Opex	23,166	29,315	42,590	13,073	18,302	18,002	17,752	67,130	73,152
Operating Income	\$ (1,213)	\$ 10,105	\$ 3,520	\$ (3,237)	\$ (5,878)	\$ (4,336)	\$ (2,978)	\$ (16,429)	\$ (2,706)
Interest Income	0	229	97	8	223	77	80	388	321
Interest Expense	(471)	0	0	0	0	0	0	0	0
Change in Warrant Liability	(812)	0	0	0	0	0	0	0	0
Other Income (Expense)	(232)	468	709	4	0	0	0	4	0
Pretax Income	(2,728)	10,802	4,326	(3,225)	(5,655)	(4,259)	(2,898)	(16,037)	(2,385)
Taxes	12	80	161	0	25	25	25	75	100
Net Income	(2,740)	10,722	4,165	(3,225)	(5,680)	(4,284)	(2,923)	(16,112)	(2,485)
Preferred Dividends	(404)	(120)	0	0	0	0	0	0	0
Net to Common	\$ (3,144)	\$ 10,602	\$ 4,165	\$ (3,225)	\$ (5,680)	\$ (4,284)	\$ (2,923)	\$ (16,112)	\$ (2,485)
Basic Shares	22,322	34,490	40,806	43,368	52,468	53,248	53,348	50,608	53,699
Diluted Shares	22,322	36,968	42,901	45,892	52,468	53,248	53,348	51,239	53,699
Basic EPS	\$ (0.12)	\$ 0.31	\$ 0.10	\$ (0.07)	\$ (0.11)	\$ (0.08)	\$ (0.05)	\$ (0.32)	\$ (0.05)
Diluted EPS	\$ (0.12)	\$ 0.29	\$ 0.10	\$ (0.07)	\$ (0.11)	\$ (0.08)	\$ (0.05)	\$ (0.31)	\$ (0.05)
Stock Comp	935	1,494	3,063	1,016	1,524	1,524	1,524	5,588	6,096
Amortization	249	932	2,920	2,298	3,023	3,023	2,773	11,117	11,092
Other	1,893	(212)	918	611	0	0	0	611	0
Non-GAAP Net Income	(67)	12,816	11,066	700	(1,133)	263	1,374	1,204	14,703
Non-GAAP EPS	\$ (0.00)	\$ 0.35	\$ 0.26	\$ 0.02	\$ (0.02)	\$ 0.00	\$ 0.03	\$ 0.02	\$ 0.27
Operating Income	(1,213)	10,105	3,520	(3,237)	(5,878)	(4,336)	(2,978)	(16,429)	(2,706)
Depreciation & Amort.	779	1,341	3,582	2,497	3,360	3,360	3,110	12,326	12,438
Stock Comp	935	1,494	3,064	1,016	1,524	1,524	1,524	5,588	6,096
Other	173	194	927	611	0	0	0	611	0
EBITDA	\$ 674	\$ 13,134	\$ 11,093	\$ 887	\$ (995)	\$ 548	\$ 1,656	\$ 2,095	\$ 15,828
Margin	2.6%	30.3%	21.6%	7.8%	-6.6%	3.3%	9.4%	3.5%	19.2%
	FY2018	FY2019	FY2020	Q1 21A	Q2 21E	Q3 21E	Q4 21 E	FY2021E	FY2022E
Revenue	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
COGS	16.5%	9.1%	10.1%	13.6%	17.7%	17.0%	16.5%	16.4%	14.5%
Gross Profit	83.5%	90.9%	89.9%	86.4%	82.3%	83.0%	83.5%	83.6%	85.5%
SG&A	22.0%	17.3%	20.9%	37.2%	39.3%	34.2%	31.8%	35.3%	28.7%
R&D	32.7%	27.0%	37.2%	45.5%	48.1%	44.1%	41.0%	44.4%	35.2%
G&A	32.7%	22.9%	24.9%	32.1%	33.9%	31.1%	27.5%	31.0%	24.8%
Opex	88.1%	67.6%	83.0%	114.9%	121.3%	109.3%	100.3%	110.7%	88.8%
Operating Income	-4.6%	23.3%	6.9%	-28.4%	-38.9%	-26.3%	-16.8%	-27.1%	-3.3%
Interest Income	0.0%	0.5%	0.2%	0.1%	1.5%	0.5%	0.5%	0.6%	0.4%
Interest Expense	-1.8%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Pretax Income	-10.4%	24.9%	8.4%	-28.3%	-37.5%	-25.9%	-16.4%	-26.4%	-2.9%
Tax Rate	-0.4%	0.7%	3.7%	0.0%	-0.4%	-0.6%	-0.9%	-0.5%	-4.2%
Net Income	-10.4%	24.7%	8.1%	-28.3%	-37.6%	-26.0%	-16.5%	-26.6%	-3.0%
Y/Y									
Revenue	14.4%	64.9%	18.4%	-14.6%	16.7%	30.4%	42.5%	18.2%	35.8%
Opex	-1.7%	26.5%	45.3%	28.3%	77.9%	62.1%	61.3%	57.6%	9.0%
Operating Income	78.6%	933.1%	-65.2%	-265.2%	-526.9%	Lge	Lge	-566.7%	-83.5%
Net Income	58.9%	491.3%	-61.2%	-257.7%	-511.9%	Lge	-603.9%	-486.8%	84.6%

Source: Smith Micro Software, Inc. and Dawson James Securities estimates

Exhibit 2. Balance Sheet and Cash Flow Statement

(\$ in 000's)	FY2018	FY2019	FY2020	FY2021E	FY2022E
Cash	12,159	28,268	25,754	34,573	50,118
A/R	7,130	10,894	12,347	16,482	21,541
Prepaid Expenses & Other	795	802	1,189	1,412	1,845
Current Assets	\$ 20,084	\$ 39,964	\$ 39,290	\$ 52,467	\$ 73,504
Equipment & Improvements	865	2,109	2,170	2,361	1,190
Right-of-use asset	0	6,464	5,785	5,690	5,690
Deferred Tax Assets	191	94	0	0	0
Other	140	234	694	679	679
Intangible Assets	238	4,535	12,698	35,081	23,989
Goodwill	3,685	7,797	12,266	45,359	45,359
Total Assets	\$ 25,203	\$ 61,197	\$ 72,903	\$ 141,637	\$ 150,411
A/P	1,160	2,050	2,282	3,190	4,169
Accrued Payroll & Benefits	1,745	2,107	2,867	6,851	8,953
Operating Lease	0	1,221	1,433	1,427	1,427
Other Accrued Liab.	450	244	216	3,512	4,590
Deferred Revenue	28	98	1,572	1,436	1,877
Current Liabilities	\$ 3,383	\$ 5,720	\$ 8,370	\$ 16,415	\$ 21,016
Lease Liabilities	0	5,774	4,805	4,627	4,627
Deferred Rent	723	885	887	1,314	1,717
Other LT Liabilities	534	134	125	194	254
Equity	\$ 20,563	\$ 48,684	\$ 58,716	\$ 119,086	\$ 122,797
Total Liabilities & Equity	\$ 25,203	\$ 61,197	\$ 72,903	\$ 141,637	\$ 150,411
	FY2018	FY2019	FY2020	FY2021E	FY2022E
Net Income	(2,740)	10,722	4,165	(16,112)	(2,485)
Depreciation & Amortization	779	1,341	3,582	12,326	12,438
Stock Comp	935	1,494	3,064	5,588	6,096
Working Capital & Other	(1,848)	(3,569)	(2,887)	3,281	(429)
Operating CF	\$ (2,874)	\$ 9,988	\$ 7,924	\$ 5,083	\$ 15,620
Capx	(173)	(1,659)	(1,323)	(321)	(175)
Acquisitions	0	(3,974)	(13,500)	(56,000)	0
Other	0	370	142	11	0
Investing Activities	\$ (173)	\$ (5,263)	\$ (14,681)	\$ (56,310)	\$ (175)
Equity	17,605	11,503	4,214	60,013	100
Debt	(4,200)	0	0	0	0
Other	(404)	(119)	29	34	0
Financing	\$ 13,001	\$ 11,384	\$ 4,243	\$ 60,047	\$ 100
Change in Cash	\$ 9,954	\$ 16,109	\$ (2,514)	\$ 8,819	\$ 15,545

Source: Smith Micro Software, Inc. and Dawson James Securities estimates

Important Disclosures:

Price Chart:



Price target and ratings changes over the past three years:

Initiated – Buy – May 4, 2021 – Price Target \$11.10

Price Target Change – Buy – May 6, 2021 – Price Target changed from \$11.10 to \$11.40

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- 1) **Buy:** The analyst believes the price of the stock will appreciate and produce a total return of at least 20% over the next 12-18 months.
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As of: 5-May-21

	Company Coverage		Investment Banking	
Ratings Distribution	# of Companies	% of Total	# of Companies	% of Totals
Market Outperform (Buy)	23	70%	5	22%
Market Perform (Neutral)	10	30%	0	0%
Market Underperform (Sell)	0	0%	0	0%
Total	33	100%	5	15%

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