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Smith Micro Software, Inc. (NASDAQ: SMSI)

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Buy: Q3 Results. T-Mobile Signed. CommSuite Decline.

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Q3 results were less than expected and the expected recovery in growth has been pushed to the right. However, Smith now dominates the domestic wireless carrier family safety business and is positioned for rapid growth in the second half of next year and beyond. We reiterate our buy recommendation and \$11.40 price target.

Smith's purchase of its two major competitors, Circle in 2020 and Avast's Family Safety business this year, positions it as the dominant supplier of family safety products to the three major wireless carriers in the U.S.: Verizon, T-Mobile and AT&T. 2021 has been a transition year for Smith with T-Mobile's purchase of Sprint causing an interruption of growth of Smith's Family Safety product and AT&T's recent decision to re-sign with Smith. Verizon is also expected to accelerate its marketing of its family safety product next year. The impact of these changes is expected to occur in the second half of next year about 6 months later than we previously forecast.

We are lowering our 2022 estimates to reflect a reduction in expected revenue from the CommSuite product and delays in finalizing a commercial agreement with T-Mobile for Smith's SafePath product. The finalization of the commercial agreement with T-Mobile occurred this month, while our model reflected completion in Q3. The increase in Family Safety subscribers at T-Mobile is now expected to have a meaningful impact in the second half of 2022. We had forecast a decline in CommSuite revenue, but the decline has accelerated and as the subscriber migration from the legacy Sprint network to the T-Mobile network accelerated; so too has the revenue decline of CommSuite. CommSuite is expected to be end-of-life at T-Mobile in the second half of next year.

The primary focus for the coming quarters for Smith will be assisting the three domestic carriers in their roll-out plans and migrating the service to the SafePath platform by the end of next year. Success in these two endeavors will then free up resources to pursue additional business in the rest of the world and seek additional acquisition opportunities that fit into Smith's unique skill set serving the wireless carrier market.

We expect modest revenue growth in 2022 due to the CommSuite decline and SafePath delays mentioned above. However, we expect a second half acceleration in revenue to continue into 2023 and significant revenue and EBITDA growth as all three domestic carriers market their family safety products, based on Smith's SafePath platform, to their combined subscriber base.

Valuation: Our price target of \$11.40 is based on the midpoint of EV/Sales multiple range of 7x to 7.5x and the midpoint of our Q4 2022 revenue run-rate and our 2023E revenue. Shares of a comp group of other software and software-as-a-service vendors trade between 0.7x and 10.6x 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	\$5.95		
Price Target	\$11.40		
Estimates	F2020A	F2021E	F2022E
Revenues (\$000s)	\$ 51,300	\$ 58,917 E	\$ 63,030
1Q March	\$ 13,322	\$ 11,381 A	\$ 14,527
2Q June	\$ 12,933	\$ 15,919 A	\$ 14,424
3Q September	\$ 12,629	\$ 16,443 A	\$ 16,093
4Q December	\$ 12,416	\$ 15,174 E	\$ 17,986
	F2020A	F2021E	F2022E
EBITDA (\$000s)	\$ 11,093	\$ 215 E	\$ (956)
1Q March	\$ 4,153	\$ 887 A	\$ (1,604)
2Q June	\$ 3,204	\$ 25 A	\$ (1,463)
3Q September	\$ 2,030	\$ 121 A	\$ 141
4Q December	\$ 1,706	\$ (818) E	\$ 1,970
EPS-GAAP	\$ 0.10	\$ (0.63)	\$ (0.34)
EPS-PF	\$ 0.26	\$ (0.02)	\$ (0.06)
Stock Data			
52-Week Range	\$4.42	-	\$8.05
Shares Outstanding (mil.)	53.5		
Market Capitalization (mil.)	\$319		
Enterprise Value (mil.)	\$299		
Debt to Capital	0%		
Book Value/Share	\$1.95		
Price/Book	3.1x		
Average Three Months Trading Volume (K)	788		
Insider Ownership	13.0%		
Institutional Ownership	36.3%		
Short interest (mil.)	4.5%		
Dividend / Yield	\$0.00/0.0%		



Smith is now the sole provider of family location and safety services to the three largest U.S. wireless carriers serving 224 million postpaid phone customers. The revenue potential is far in excess of current run rates. Before Sprint was acquired by T-Mobile, we estimate Smith generated about \$7 million from Sprint in Q1 2020 from SafePath. At the time, Sprint had 26 million postpaid phone subscribers. Applying that same ratio of revenue to subs to the much expanded 224 million postpaid subs now being served by Smith yields quarterly revenue potential of \$60 million, or 5x the \$12 million generated in Q3 2021. And in our view, even this potential is too low since SafePath is a platform that has expanded the services available and the Sprint business in early 2020 was growing, until the pandemic and the acquisition by T-Mobile interrupted that growth. And that is just the domestic market. We believe the international market is at least equal in size.

At the end of Q3 Smith reported cash of \$32 million but subsequent to quarter-end paid about \$13 million as a earn-out to Avast due to the re-signing of AT&T. We expect operating cash flow to turn solidly positive in the second half of next year and significant free cash flow generation in 2023. This will allow the company to continue adding to its product portfolio with acquisitions and/or accelerated R&D.

Q3 Results

Revenue of \$16.4 million was 4% less than expected, as both Family Safety and CommSuite revenue fell short of our estimates. Gross margin was lower than we forecast as the impact of the acquired Avast business continued to weigh on costs. It will likely take a couple of quarters to rationalize costs, and this is reflected in our estimates. Operating expenses were higher than we forecast and include a \$12.9 million charge for the earn-out payment to Avast. We expect operating expense to grow modestly over the coming quarters.

Actual v Estimates

Q3 21			
\$ in 000's except per share	Actual	Estimates	Delta
Revenue	\$ 16,443	\$ 17,075	-4%
COGS	3,692	3,586	
Gross Profit	12,751	13,490	-5%
	78%	79%	
SG&A	5,046	4,853	
R&D	8,159	7,972	
G&A	5,143	4,401	
Restructuring/Other	12,864	0	
Opex	31,212	17,226	
Operating Income	\$ (18,461)	\$ (3,736)	
Interest Income	1	75	
Pretax Income	(18,462)	(3,662)	
Taxes	145	25	
Net Income	(18,607)	(3,687)	
Basic Shares	53,939	53,248	
Diluted Shares	53,939	53,248	
Basic EPS	\$ (0.34)	\$ (0.07)	
Diluted EPS	\$ (0.34)	\$ (0.07)	
Stock Comp	1,327	1,279	
Amortization	3,015	2,714	
Other	14,009	100	
Non-GAAP Net Income	(256)	407	
Non-GAAP EPS	\$ (0.00)	\$ 0.01	
Operating Income	(18,461)	(3,736)	
Depreciation & Amortization	3,391	3,053	
Stock Comp	1,327	1,279	
Other	13,864	100	
EBITDA	\$ 121	\$ 696	-83%
Margin	0.7%	4.1%	

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

Outlook

Our revenue estimate for this year and next is lower to reflect the decline in CommSuite and the delays in signing T-Mobile. Our revenue estimate for 2022 is back-end loaded, as the company's customers spend the next few months preparing for more aggressive marketing of their family safety offerings with the impact felt in the latter half of the year.

EBITDA and margins will follow revenue growth. Gross margin is modeled to improve throughout next year and is estimated to reach 90% again in 2023. EBITDA and EBITDA margin will grow as revenue scales, and we expect EBITDA margin exceeding 30% exiting 2023. The company last achieved that EBITDA margin level in the second half of 2019.

Revenue. \$ in M	2020A	2021E	2022E	2023E
Family Safety *	\$ 28.0	\$ 42.4	\$ 54.5	\$ 84.0
CommSuite	\$ 18.2	\$ 13.8	\$ 4.5	\$ 4.0
ViewSpot	\$ 4.2	\$ 3.6	\$ 3.9	\$ 4.3
Other	\$ 0.9	\$ 0.1	\$ 0.1	\$ 0.1
Total	\$ 51.3	\$ 59.9	\$ 63.0	\$ 92.4

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

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

Valuation

Our price target of \$11.40 is based on the midpoint of EV/Sales multiple range of 7x to 7.5x and the midpoint of our Q4 2022 revenue run-rate and our 2023 revenue. Shares of a comp group of other software and software-as-a-service vendors trade between 0.7x and 10.6x 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
CRM	salesforce.com, inc.	\$ 299.67	\$ 309,327.1	\$ 29,097.3	10.6	\$ 8,402.3	36.8
PTC	PTC Inc.	\$ 120.18	\$ 15,619.0	\$ 1,926.0	8.1	\$ 703.2	22.2
VMW	VMware, Inc. Class A	\$ 124.95	\$ 93,814.8	\$ 13,291.5	7.1	\$ 4,696.0	20.0
VERI	Veritone, Inc.	\$ 31.85	\$ 936.8	\$ 163.3	5.7	\$ 5.0	185.5
ECOM	Channeladvisor Corporation	\$ 27.02	\$ 693.0	\$ 177.7	3.9	\$ 36.1	19.2
UPLD	Upland Software, Inc.	\$ 24.36	\$ 1,142.9	\$ 308.5	3.7	\$ 98.2	11.6
EGAN	eGain Corporation	\$ 11.68	\$ 286.2	\$ 92.2	3.1	\$ 1.5	185.9
EXTR	Extreme Networks, Inc.	\$ 11.16	\$ 1,657.4	\$ 1,136.3	1.5	\$ 147.5	11.2
SEAC	SeaChange International, Inc.	\$ 0.90	\$ 29.0	\$ 27.4	1.1	\$ (9.5)	(3.1)
QUMU	Qumu Corporation	\$ 2.32	\$ 24.1	\$ 25.3	0.9	\$ (13.1)	(1.8)
RNWK	RealNetworks, Inc.	\$ 1.35	\$ 43.0	\$ 59.30	0.7	\$ (14.20)	(3.0)
SMSI	Smith Micro Software, Inc.	\$ 5.99	\$ 294.4	\$ 62.5	4.7	\$ (0.8)	NM

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.

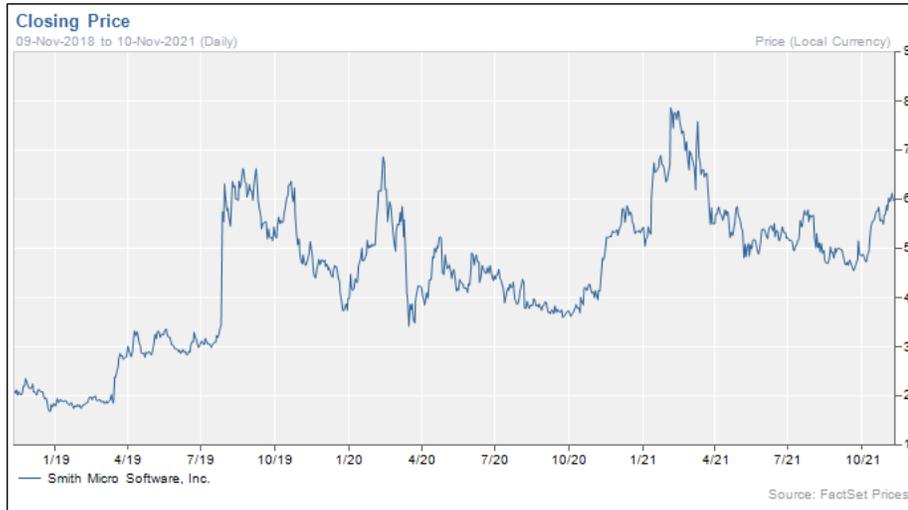
Exhibit 1. Income Statement

\$ in 000's	FY2018	FY2019	FY2020	Q1 21A	Q2 21A	Q3 21A	Q4 21 E	FY2021E	FY2022E	FY2023E
Revenue	\$ 26,285	\$ 43,346	\$ 51,300	\$ 11,381	\$ 15,919	\$ 16,443	\$ 15,174	\$ 58,917	\$ 63,030	\$ 92,446
COGS	4,332	3,926	5,190	1,545	3,358	3,692	3,035	11,630	10,182	9,868
Gross Profit	21,953	39,420	46,110	9,836	12,561	12,751	12,139	47,287	52,848	82,578
SG&A	5,784	7,517	10,704	4,232	4,853	5,046	5,046	19,177	21,191	22,780
R&D	8,602	11,682	19,076	5,183	7,972	8,159	8,159	29,473	32,636	35,084
G&A	8,607	9,922	12,795	3,658	4,946	5,143	4,184	17,931	17,701	19,029
Restructuring/Other	173	194	15	0	0	12,864	0	12,864	0	0
Opex	23,166	29,315	42,590	13,073	17,771	31,212	17,389	79,445	71,528	76,892
Operating Income	\$ (1,213)	\$ 10,105	\$ 3,520	\$ (3,237)	\$ (5,210)	\$ (18,461)	\$ (5,249)	\$ (32,157)	\$ (18,680)	\$ 5,686
Interest Income	0	229	97	8	16	1	81	106	324	324
Interest Expense	(471)	0	0	0	0	(2)	0	(2)	0	0
Change in Warrant Liability	(812)	0	0	0	0	0	0	0	0	0
Other Income (Expense)	(232)	468	709	4	5	0	0	9	0	0
Pretax Income	(2,728)	10,802	4,326	(3,225)	(5,189)	(18,462)	(5,169)	(32,045)	(18,356)	6,010
Taxes	12	80	161	0	14	145	25	184	100	100
Net Income	(2,740)	10,722	4,165	(3,225)	(5,203)	(18,607)	(5,194)	(32,229)	(18,456)	5,910
Preferred Dividends	(404)	(120)	0	0	0	0	0	0	0	0
Net to Common	\$ (3,144)	\$ 10,602	\$ 4,165	\$ (3,225)	\$ (5,203)	\$ (18,607)	\$ (5,194)	\$ (32,229)	\$ (18,456)	\$ 5,910
Basic Shares	22,322	34,490	40,806	43,368	53,017	53,939	53,348	50,918	53,898	54,099
Diluted Shares	22,322	36,968	42,901	45,892	53,017	53,939	53,348	51,549	53,898	54,099
Basic EPS	\$ (0.12)	\$ 0.31	\$ 0.10	\$ (0.07)	\$ (0.10)	\$ (0.34)	\$ (0.10)	\$ (0.63)	\$ (0.34)	\$ 0.11
Diluted EPS	\$ (0.12)	\$ 0.29	\$ 0.10	\$ (0.07)	\$ (0.10)	\$ (0.34)	\$ (0.10)	\$ (0.63)	\$ (0.34)	\$ 0.11
Stock Comp	935	1,494	3,063	1,016	1,279	1,327	1,327	4,949	5,308	0
Amortization	249	932	2,920	2,298	2,645	3,015	2,464	10,422	9,858	9,858
Other	1,893	(212)	918	611	972	14,009	0	15,592	0	0
Non-GAAP Net Income	(67)	12,816	11,066	700	(307)	(256)	(1,402)	(1,265)	(3,290)	15,767
Non-GAAP EPS	\$ (0.00)	\$ 0.35	\$ 0.26	\$ 0.02	\$ (0.01)	\$ (0.00)	\$ (0.03)	\$ (0.02)	\$ (0.06)	\$ 0.29
Operating Income	(1,213)	10,105	3,520	(3,237)	(5,210)	(18,461)	(5,249)	(32,157)	(18,680)	5,686
Depreciation & Amort.	779	1,341	3,582	2,497	2,984	3,391	3,104	11,976	12,416	12,416
Stock Comp	935	1,494	3,064	1,016	1,279	1,327	1,327	4,949	5,308	5,308
Other	173	194	927	611	972	13,864	0	15,447	0	0
EBITDA	\$ 674	\$ 13,134	\$ 11,093	\$ 887	\$ 25	\$ 121	\$ (818)	\$ 215	\$ (956)	\$ 23,410
Margin	2.6%	30.3%	21.6%	7.8%	0.2%	0.7%	-5.4%	0.4%	-1.5%	25.3%

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
- Update – Buy – July 21, 2021 – Price Target \$11.40
- Update – Buy – August 5, 2021 – Price Target \$11.40
- Update – Buy – November 11, 2021 – Price Target \$11.40

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Ratings Distribution	# of Companies	% of Total	# of Companies	% of Totals
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Market Perform (Neutral)	11	31%	0	0%
Market Underperform (Sell)	0	0%	0	0%
Total	36	100%	4	11%

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