

Member FINRA/SIPC

Toll-Free: 866-928-0928 ♦ www.DawsonJames.com ♦ 101 North Federal Highway - Suite 600 ♦ Boca Raton, FL 33432

## Smith Micro Software, Inc. (NASDAQ: SMSI)

April 4, 2022

### Buy: Significant Growth Potential for SafePath.

**James McIlree, CFA**
**561-237-2709**
**jmcilree@dawsonjames.com**

*The launch of SafePath 7 at T-Mobile should result in an acceleration of revenue growth this year. We believe the company is in a position to post better than expected revenue growth as T-Mobile begins marketing SafePath to its customer base.*

We believe the launch of SafePath 7 at T-Mobile could result in a revenue trajectory for Smith Micro similar to what occurred in 2019 when Sprint's marketing of SafePath resulted in SafePath revenues rising from about \$1 million per quarter to over \$7 million per quarter over an 18-month time span. However, the magnitude could be twice as large since T-Mobile has double the number of subscribers as Sprint had. Plus, since the product is now proven and embraced by customers, we expect marketing to be more efficient and aggressive than it was a few years ago.

SafePath revenue for Smith grew from about \$1 million per quarter in Q3 2018 to \$7.8 million by Q1 2020. During this period Sprint was marketing SafePath to its customer base and revenues increased by \$1 to \$1.5 million per quarter. The acquisition of Sprint by T-Mobile put an end to this growth, but we believe we can see another acceleration in growth for SafePath from T-Mobile now that the carrier's customer bases have been consolidated, SafePath 7 launched and marketing of the service to the combined customers base (twice as large as Sprint standalone) begun.

The biggest question is when this acceleration begins. We have modeled the Family Safety business, which includes T-Mobile, AT&T and Verizon, to begin accelerating in Q3, but at a pace that is about equal to the prior acceleration of Sprint alone. Given Smith now serves all three of the largest domestic carriers, versus only the smallest of the major carriers, this trajectory could prove conservative.

**Valuation:** Our price target of \$8.30 is based on an EV/Sales multiple of 5.5x and our 2023 revenue estimate. Shares of a comp group of other software and software-as-a-service vendors trade as high 8x 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 growth outlook, after the SafePath and CommSuite transitions are complete.

**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	\$3.73		
Price Target	\$8.30		
<b>Estimates</b>	<b>F2021A</b>	<b>F2022E</b>	<b>F2023E</b>
Revenues (\$000s)	\$ 58,422	\$ 52,600 E	\$ 79,400
1Q March	\$ 11,381	\$ 12,275 E	\$ 16,850
2Q June	\$ 15,919	\$ 12,275 E	\$ 18,850
3Q September	\$ 16,443	\$ 13,275 E	\$ 20,850
4Q December	\$ 14,679	\$ 14,775 E	\$ 22,850
	<b>F2021A</b>	<b>F2022E</b>	<b>F2023E</b>
EBITDA (\$000s)	\$ (1,163)	\$ (12,462) E	\$ 7,568
1Q March	\$ 887	\$ (3,838) E	\$ (304)
2Q June	\$ 25	\$ (3,838) E	\$ 1,717
3Q September	\$ 121	\$ (3,155) E	\$ 3,279
4Q December	\$ (2,196)	\$ (1,632) E	\$ 4,879
EPS-GAAP	\$ 0.10	\$ (0.61)	\$ (0.46)
EPS-PF	\$ 0.26	\$ (0.04)	\$ (0.25)
<b>Stock Data</b>			
52-Week Range	\$2.84	-	\$6.52
Shares Outstanding (mil.)	54.3		
Market Capitalization (mil.)	\$203		
Enterprise Value (mil.)	\$187		
Debt to Capital	0%		
Cash (mil.)	\$16.1		
Cash/Share	\$0.30		
Average Three Months Trading Volume (K)	405		
Insider Ownership	13.2%		
Institutional Ownership	29.3%		
Short interest (mil.)	4.0%		
Dividend / Yield	\$0.00/0.0%		



We believe 2022 will be a transition year for Smith as subscribers continue to churn off the old Sprint network and onto the T-Mobile network, the new variable pricing contract with T-Mobile's Circle customers commences, and Verizon and AT&T migrate from the family safety platform acquired from Avast onto the SafePath 7 platform. During these transitions, Smith will face duplicate expenses of managing multiple networks, and this will likely pressure gross and EBITDA margins. While these changes have taken longer than anticipated, we remain encouraged by Smith's competitive position as the dominant supplier of family safety software to the domestic wireless market and its ability to grow this business into adjacent services and international markets.

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 the 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.

The estimated decline in CommSuite revenue will be a drag on year-over-year comparisons for the year. In 2020 CommSuite contributed \$18.2 million in revenue, falling to \$13.7 million in 2021 and an expected \$4 million in 2022. The migration of Sprint customers to the T-Mobile network resulted in service termination of the CommSuite subscription, and we expect that migration should be mostly completed in Q1 2022. Quarter-to-quarter comparisons could improve beginning Q2 depending on success at Dish. We had previously expected the multiple SafePath transitions to more than make up the loss at CommSuite, but that is not the case. As a result, total revenue likely will be down for the year and year-over-year topline growth is pushed to Q4.

Smith is 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 \$11.6 million generated in Q4 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 Q4 Smith reported cash of \$16 million. The company will remain a user of the cash for the next few quarters, until gross margin improves. Gross margin has been pressured by the expense of operating two networks, and until the transition of all carriers to the SafePath 7 network is complete, Smith will be burdened with these excess costs. We expect operating cash flow to turn solidly positive when the transition is complete and see 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.

## Outlook

Our revenue estimate for this year and next is lower to reflect the decline in CommSuite and the delays in the migration to SafePath 7. 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 should follow revenue growth. Gross margin is modeled to improve near year-end and is estimated to regain the historical 80-90% range again in 2023. EBITDA and EBITDA margin should grow as revenue scales, and we expect EBITDA margin exceeding 20% exiting 2023.

Revenue. \$ in M	2020A	2021A	2022E	2023E
Family Safety *	\$ 28.0	\$ 42.4	\$ 45.5	\$ 72.0
CommSuite	\$ 18.2	\$ 13.7	\$ 4.0	\$ 4.0
ViewSpot	\$ 4.2	\$ 3.5	\$ 3.0	\$ 3.3
Other	\$ 0.9	\$ 0.2	\$ 0.1	\$ 0.1
Total	\$ 51.3	\$ 59.8	\$ 52.6	\$ 79.4

\*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 \$8.30 is based on an EV/Sales multiple range of 5.5x and our 2023 revenue estimate. Shares of a comp group of other software and software-as-a-service vendors trade as high as 8x 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 growth outlook, after the SafePath and CommSuite transitions are complete.

	Company Name	Price	EV (\$M)	Rev. Est.-FTM (\$M)	EV/FTM Sales	EBITDA Est. FTM (\$M)	EV/FTM EBITDA
PHUN	Phunware, Inc.	\$ 2.60	\$ 202.5	\$ 25.67	7.9	\$ (10.02)	(20.2)
PTC	PTC Inc.	\$ 106.77	\$ 13,836.4	\$ 1,981.0	7.0	\$ 804.0	17.2
CRM	salesforce.com, inc.	\$ 212.25	\$ 213,956.5	\$ 32,088.2	6.7	\$ 9,870.1	21.7
VMW	VMware, Inc. Class A	\$ 114.21	\$ 58,203.8	\$ 13,755.2	4.2	\$ 4,865.7	12.0
EGAN	eGain Corporation	\$ 11.59	\$ 300.8	\$ 98.5	3.1	\$ 7.1	42.4
VERI	Veritone, Inc.	\$ 18.25	\$ 580.2	\$ 186.5	3.1	\$ 14.7	39.4
UPLD	Upland Software, Inc.	\$ 17.37	\$ 880.3	\$ 318.8	2.8	\$ 99.3	8.9
ECOM	Channeladvisor Corporation	\$ 16.32	\$ 401.7	\$ 183.8	2.2	\$ 37.0	10.8
EXTR	Extreme Networks, Inc.	\$ 12.27	\$ 1,772.5	\$ 1,184.4	1.5	\$ 166.1	10.7
SEAC	SeaChange International, Inc.	\$ 1.12	\$ 39.8	\$ 31.5	1.3	\$ (9.5)	(4.2)
QUMU	Qumu Corporation	\$ 1.80	\$ 17.2	\$ 23.9	0.7	\$ (10.3)	(1.7)
RNWK	RealNetworks, Inc.	\$ 0.56	\$ 2.0	\$ 58.70	0.0	\$ (13.40)	(0.2)
SMSI	Smith Micro Software, Inc.	\$ 3.73	\$ 186.6	\$ 59.5	3.1	\$ (7.3)	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**

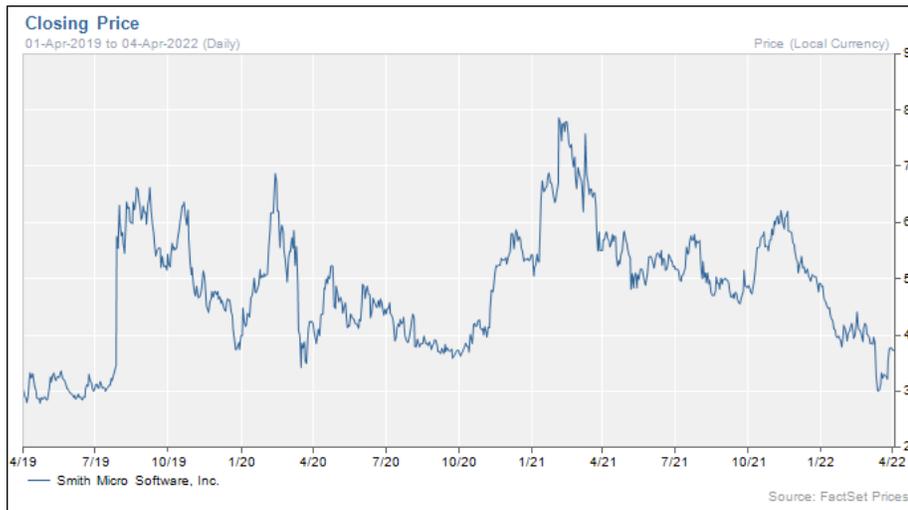
\$ in 000's	FY2019	FY2020	FY2021	Q1 22E	Q2 22E	Q3 22E	Q4 22E	FY2022E	FY2023E
Revenue	\$ 43,346	\$ 51,300	\$ 58,422	\$ 12,275	\$ 12,275	\$ 13,275	\$ 14,775	\$ 52,600	\$ 79,400
COGS	3,926	5,190	12,698	3,437	3,437	3,717	3,694	14,285	16,301
Gross Profit	39,420	46,110	45,724	8,838	8,838	9,558	11,081	38,315	63,099
SG&A	7,517	10,704	17,284	3,200	3,200	3,200	3,200	12,800	13,760
R&D	11,682	19,076	28,451	7,137	7,137	7,137	7,137	28,548	30,689
G&A	9,922	12,795	17,921	5,489	5,489	5,526	5,526	22,030	23,682
Restructuring/Other	194	15	13,006	0	0	0	0	0	0
Opex	29,315	42,590	76,662	15,826	15,826	15,863	15,863	63,378	68,131
Operating Income	\$ 10,105	\$ 3,520	\$ (30,938)	\$ (6,988)	\$ (6,988)	\$ (6,305)	\$ (4,782)	\$ (25,062)	\$ (5,032)
Interest Income	229	97	34	9	9	9	9	36	36
Interest Expense	0	0	(2)	0	0	0	0	0	0
Other Income (Expense)	468	709	78	25	25	25	25	100	100
Pretax Income	10,802	4,326	(30,828)	(6,954)	(6,954)	(6,271)	(4,748)	(24,926)	(4,896)
Taxes	80	161	215	25	25	25	25	100	100
Net Income	10,722	4,165	(31,043)	(6,979)	(6,979)	(6,296)	(4,773)	(25,026)	(4,996)
Preferred Dividends	(120)	0	0	0	0	0	0	0	0
Net to Common	\$ 10,602	\$ 4,165	\$ (31,043)	\$ (6,979)	\$ (6,979)	\$ (6,296)	\$ (4,773)	\$ (25,026)	\$ (4,996)
Basic Shares	34,490	40,806	51,232	53,834	53,878	53,920	53,960	53,898	54,099
Diluted Shares	36,968	42,901	51,232	53,834	53,878	55,920	55,960	53,898	54,099
Basic EPS	\$ 0.31	\$ 0.10	\$ (0.61)	\$ (0.13)	\$ (0.13)	\$ (0.12)	\$ (0.09)	\$ (0.46)	\$ (0.09)
Diluted EPS	\$ 0.29	\$ 0.10	\$ (0.61)	\$ (0.13)	\$ (0.13)	\$ (0.11)	\$ (0.09)	\$ (0.46)	\$ (0.09)
Operating Income	10,105	3,520	(30,938)	(6,988)	(6,988)	(6,305)	(4,782)	(25,062)	(5,032)
Depreciation & Amort.	1,341	3,582	9,338	1,924	1,924	1,924	1,924	7,696	7,696
Stock Comp	1,494	3,064	4,848	1,226	1,226	1,226	1,226	4,904	4,904
Other	194	927	15,589	0	0	0	0	0	0
EBITDA	\$ 13,134	\$ 11,093	\$ (1,163)	\$ (3,838)	\$ (3,838)	\$ (3,155)	\$ (1,632)	\$ (12,462)	\$ 7,568
Margin	30.3%	21.6%	-2.0%	-31.3%	-31.3%	-23.8%	-11.0%	-23.7%	9.5%

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  
 Price Target Change – Buy – March 11, 2022 – Price Target changed from \$11.40 to \$8.30  
 Update – Buy – April 4, 2022 – Price Target \$8.30

Dawson James Securities, Inc. (the "Firm") is a member of the Financial Industry Regulatory Authority ("FINRA") and the Securities Investor Protection Corporation ("SIPC").

The Firm does not make a market in the securities of the subject company(s). The Firm has not engaged in investment banking relationships with the subject company in the prior twelve months, as a manager or co-manager of a public offering and has not received compensation resulting from those relationships. The Firm may seek compensation for investment banking services in the future from the subject company(s). The Firm has not received any other compensation from the subject company(s) in the last 12 months for services unrelated to managing or co-managing of a public offering.

Neither the research analyst(s) whose name appears on this report nor any member of his (their) household is an officer, director, or advisory board member of these companies. However, Dawson James Securities does employ a Registered Representative who serves on the board of the company. This individual does not beneficially own 1% or more of any class of common equity securities of the subject company(s) of this report. The Firm and/or its directors and employees may own securities of the company(s) in this report and may increase or decrease holdings in the future. As of March 3, 2022, the Firm as a whole did not beneficially own 1% or more of any class of common equity securities of the subject company(s) of this report. The Firm, its officers, directors, analysts, or employees may affect transactions in and have long or short positions in the securities (or options or warrants related to those securities) of the company(s) subject to this report. The Firm may affect transactions as principal or agent in those securities.

Analysts receive no direct compensation in connection with the Firm's investment banking business. All Firm employees, including the analyst(s) responsible for preparing this report, may be eligible to receive non-product or service-specific monetary bonus compensation that is based upon various factors, including total revenues of the Firm and its affiliates as well as a portion of the proceeds from a broad pool of investment vehicles consisting of components of the compensation generated by investment banking activities, including but not limited to shares of stock and/or warrants, which may or may not include the securities referenced in this report.

Although the statements in this report have been obtained from and are based upon recognized statistical services, issuer reports or communications, or other sources that the Firm believes to be reliable, we cannot guarantee their accuracy. All opinions and estimates included in this report constitute the analyst's judgment as of the date of this report and are subject to change without notice.

**Information about valuation methods and risks can be found in the "Valuation" and "Risk Analysis" sections of this report.**

The securities of the company discussed in this report may be unsuitable for investors depending on their specific investment objectives and financial position. This report is offered for informational purposes only and does not constitute an offer or solicitation to buy or sell any securities discussed herein in any jurisdiction where such would be prohibited. Additional information is available upon request.

**Ratings Definitions:**

- 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;
- 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.

The following chart reflects the range of current research report ratings for all companies, followed by the analysts of the Firm. The chart also reflects the research report ratings relating to those companies for which the Firm has performed investment banking services.

Current as of... 15-Mar-22

	<b>Company Coverage</b>		<b>Investment Banking</b>	
<b>Ratings Distribution</b>	# of Companies	% of Total	# of Companies	% of Totals
Market Outperform (Buy)	31	74%	4	13%
Market Perform (Neutral)	11	26%	0	0%
Market Underperform (Sell)	0	0%	0	0%
<b>Total</b>	<b>42</b>	<b>100%</b>	<b>4</b>	<b>10%</b>

**Analyst Certification:**

The analyst(s) whose name appears on this research report certifies that 1) all of the views expressed in this report accurately reflect his (their) personal views about any and all of the subject securities or issuers discussed; and 2) no part of the research analyst's compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst in this research report; and 3) all Dawson James employees, including the analyst(s) responsible for preparing this research report, may be eligible to receive non-product or service-specific monetary bonus compensation that is based upon various factors, including total revenues of Dawson James and its affiliates as well as a portion of the proceeds from a broad pool of investment vehicles consisting of components of the compensation generated by investment banking activities, including but not limited to shares of stock and/or warrants, which may or may not include the securities referenced in this report.