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

Smith Micro Software, Inc. (NASDAQ: SMSI)

May 5, 2022

Buy: Q1 Review. Reiterate Buy and \$8.30 Target.

James McIlree, CFA

561-237-2709

jmcilree@dawsonjames.com

Q1 results were in line with our estimates and our expectation that revenue growth will accelerate in the second half is unchanged. We continue to forecast significant top-line growth in 2023 and improving margins which we think will drive multiple expansion. We reiterate our Buy recommendation and \$8.30 price target.

Q1 revenue of \$12.7 million was a bit ahead of our \$12.3 million estimate and the EBITDA loss of \$3.9 million was slightly lower than our \$3.8 million estimate. The transition to SafePath 7 is underway at T-Mobile and the company is increasing spending in order to migrate Verizon and AT&T to SafePath 7 by year-end. As marketing for SafePath 7 at T-Mobile begins, revenue growth is expected to respond beginning Q3. We expect sequential revenue growth thereafter as T-Mobile, then Verizon and AT&T begin deployment of SafePath to their customer bases.

We believe there is significant upside to our estimates for next year and beyond. In Q1 2020 Smith generated \$7.8 million in revenue from SafePath, mostly from Sprint, when Sprint had 26.3 million postpaid subscribers. Smith is now serving T-Mobile, Verizon and AT&T with a combined 230 million postpaid subscribers. At the Q1 2020 take-rate, this implies quarterly SafePath revenue potential of almost \$70 million, or annual revenue over \$250 million.

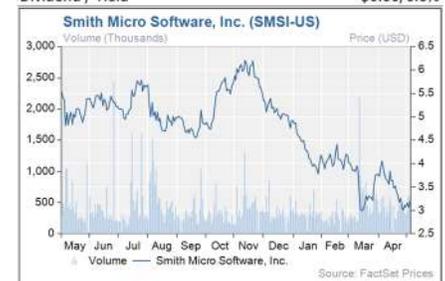
The biggest question is when this acceleration begins. We have modeled the Family Safety business, which includes T-Mobile, AT&T and Verizon, to begin accelerating in Q3, but at a pace that is about equal to the prior acceleration of Sprint alone. Given Smith now serves all three of the largest domestic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

Spending is increasing to migrate Verizon and AT&T from the platform Smith acquired from Avast and this will pressure opex for the next couple of quarters. Also, operating duplicate platforms while this migration is underway will pressure gross margin. The opex and gross margin impacts are somewhat higher than we had previously forecast, and we have adjusted our estimates accordingly. This will also pressure the company's cash balance and we expect it to utilize its credit facility later this year.

Valuation: Our price target of \$8.30 is based on an EV/Sales multiple of 5.5x on our 2023 revenue estimate of \$71.4 million. Shares of a comp group of other software and software-as-a-service vendors have traded as high as 8x FTM sales (based on FactSet estimates) and the high end of the range is currently 5.5x. We believe a multiple at the high end of the comp range is appropriate 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		\$3.19		
Price Target		\$8.30		
Estimates	F2021A	F2022E	F2023E	
Revenues (\$000s)	\$ 58,422	\$ 52,410 E	\$ 79,410	
1Q March	\$ 11,381	\$ 12,735 A	\$ 16,315	
2Q June	\$ 15,919	\$ 12,325 E	\$ 18,815	
3Q September	\$ 16,443	\$ 13,125 E	\$ 21,015	
4Q December	\$ 14,679	\$ 14,225 E	\$ 23,265	
	F2021A	F2022E	F2023E	
EBITDA (\$000s)	\$ (1,305)	\$ (15,676)E	\$ 6,590	
1Q March	\$ 887	\$ (3,916)A	\$ (1,276)	
2Q June	\$ 25	\$ (4,792)E	\$ 1,518	
3Q September	\$ 121	\$ (4,093)E	\$ 3,665	
4Q December	\$ (2,338)	\$ (2,874)E	\$ 6,208	
EV/Sales	2.9 x	3.2 x	2.1 x	
EV/EBITDA	NM	(10.8)	25.6 x	
Stock Data				
52-Week Range	\$2.84	-	\$6.52	
Shares Outstanding (mil.)	54.3			
Market Capitalization (mil.)	\$173			
Enterprise Value (mil.)	\$169			
Debt to Capital	1%			
Cash (mil.)	\$10			
Cash/Share	\$0.18			
Average Three Months Trading Volume (K)	208			
Insider Ownership	12.9%			
Institutional Ownership	28.5%			
Short interest (mil.)	4.2%			
Dividend / Yield	\$0.00/0.0%			



Actual v estimates

Revenue of \$12.7 million was a bit higher than our \$12.3 million forecast. Family Safety revenue of \$10.4 million was slightly lower than our \$10.5 million estimates while CommSuite and ViewSpot revenue of \$1.4 million and \$900 thousand, respectively, were slightly higher than our \$1 million and \$750 thousand estimates. Gross margin was slightly lower than expected and cash operating expenses slightly higher resulting in an EBITDA loss of \$3.9 million versus our \$3.8 million estimate.

Q1 22			
\$ in 000's except per share	Actual	Estimates	Delta
Revenue	\$ 12,735	\$ 12,275	4%
COGS	3,637	3,437	
Gross Profit	9,098	8,838	3%
	71%	72%	
SG&A	2,985	3,200	
R&D	7,402	7,137	
G&A	4,045	5,489	
Amort. of Intangible Asset	1,645		
Opex	16,077	15,826	2%
Operating Income	\$ (6,979)	\$ (6,988)	0%
Interest Income	0	9	
Other Income (Expense)	0	25	
Pretax Income	(6,983)	(6,954)	0%
Taxes	19	25	
Net Income	(7,002)	(6,979)	
Basic Shares	54,501	53,834	
Diluted Shares	54,501	53,834	
Basic EPS	\$ (0.13)	\$ (0.13)	
Diluted EPS	\$ (0.13)	\$ (0.13)	1%
Operating Income	(6,979)	(6,988)	
Depreciation & Amortization	1,998	1,924	
Stock Comp	1,065	1,226	
Other	0	0	
EBITDA	\$ (3,916)	\$ (3,838)	-2%
Margin	-30.7%	-31.3%	

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

We believe 2022 will be a transition year for Smith as 1) subscribers move off the old Sprint network and onto the T-Mobile network, 2) the new variable pricing contract with T-Mobile's Circle customers commences, and 3) 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. 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 to 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 \$4.4 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 completed soon. Quarter-to-quarter comparisons could improve depending on success at Dish.

Smith is the sole provider of family location and safety services to the three largest U.S. wireless carriers serving 230 million postpaid phone customers. The revenue potential is far in excess of current run rates. Before Sprint was acquired by T-Mobile, in Q1 2020, Smith generated \$7.85 million SafePath revenue, mostly from Sprint. At the time, Sprint had 26 million postpaid phone subscribers. Applying that same ratio of revenue to subs to the much expanded 230 million postpaid subs now being served by Smith yields quarterly revenue potential of almost \$70 million, or more than 6x the \$10.4 million generated in Q1 2022. 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 Q1 Smith reported cash of \$9.8 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 mostly the same but the increased cost to ensure the migration of the Verizon and AT&T customer base to SafePath 7 has resulted in lower EPS and EBITDA estimates. This turns around in 2023 as duplicative costs are eliminated and excess costs to accommodate the migration are no longer needed.

	2022E		2023E	
	Old	New	Old	New
Revenue (\$M)	\$ 52.6	\$ 52.4	\$ 79.4	\$ 79.4
Non-GAAP EPS	\$ (0.25)	\$ (0.32)	\$ 0.03	\$ 0.10
EBITDA (\$M)	\$ (12.5)	\$ (15.7)	\$ 7.6	\$ 6.6

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

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	\$ 44.3	\$ 71.4
CommSuite	\$ 18.2	\$ 13.7	\$ 4.4	\$ 4.0
ViewSpot	\$ 4.2	\$ 3.5	\$ 3.6	\$ 3.9
Other	\$ 0.9	\$ 0.2	\$ 0.1	\$ 0.1
Total	\$ 51.3	\$ 59.8	\$ 52.4	\$ 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 of 5.5x our 2023 revenue estimate of \$71.4 million. Shares of a comp group of other software and software-as-a-service vendors have traded as high as 8x FTM sales (based on FactSet estimates) and the high end of the range is currently 5.5x. We believe a multiple at the high end of the comp range is appropriate 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
ECOM	Channeladvisor Corporation	\$ 14.62	\$ 339.0	\$ 190.3	1.8	\$ 37.0	9.2
EXTR	Extreme Networks, Inc.	\$ 10.30	\$ 1,482.7	\$ 1,195.5	1.2	\$ 157.7	9.4
PHUN	Phunware, Inc.	\$ 2.08	\$ 152.1	\$ 27.66	5.5	\$ (10.02)	(15.2)
QUMU	Qumu Corporation	\$ 1.40	\$ 10.1	\$ 24.2	0.4	\$ (8.9)	(1.1)
RNWK	RealNetworks, Inc.	\$ 0.51	\$ (0.7)	\$ 62.06	(0.0)	\$ (13.40)	NM
CRM	salesforce.com, inc.	\$ 185.48	\$ 180,405.4	\$ 33,556.7	5.4	\$ 9,870.1	18.3
UPLD	Upland Software, Inc.	\$ 15.48	\$ 795.3	\$ 323.1	2.5	\$ 101.1	7.9
VERI	Veritone, Inc.	\$ 10.86	\$ 321.8	\$ 195.4	1.6	\$ 26.9	12.0
VMW	VMware, Inc. Class A	\$ 109.85	\$ 56,010.1	\$ 14,019.8	4.0	\$ 4,889.6	11.5
SMSI	Smith Micro Software, Inc.	\$ 3.19	\$ 168.9	\$ 61.6	2.7	\$ (8.1)	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 22A	Q2 22E	Q3 22E	Q4 22E	FY2022E	FY2023E
Revenue	\$ 43,346	\$ 51,300	\$ 58,422	\$ 12,735	\$ 12,325	\$ 13,125	\$ 14,225	\$ 52,410	\$ 79,410
COGS	3,927	5,190	12,698	3,637	3,574	3,675	3,556	14,443	14,706
Gross Profit	39,419	46,110	45,724	9,098	8,751	9,450	10,669	37,968	64,704
	91%	89.9%	78.3%	71.4%	71.0%	72.0%	75.0%	72.4%	81.5%
SG&A	7,148	9,090	11,581	2,985	3,085	3,085	3,085	12,240	13,158
R&D	11,119	17,759	26,197	7,402	7,702	7,702	7,702	30,508	32,796
G&A	9,921	12,801	17,920	4,045	4,145	4,145	4,145	16,480	17,716
Amort. of Intangible asset	932	2,920	8,100	1,645	1,555	1,555	1,555	6,311	5,874
Restructuring/Other	194	19	12,864	0	0	0	0	0	0
Opex	29,314	42,589	76,662	16,077	16,487	16,487	16,487	65,539	69,544
Operating Income	\$ 10,105	\$ 3,521	\$ (30,938)	\$ (6,979)	\$ (7,737)	\$ (7,037)	\$ (5,819)	\$ (27,572)	\$ (4,840)
Interest Income	228	96	34	0	0	0	0	0	0
Interest Expense	0	0	(2)	(4)	(4)	(4)	(4)	(16)	0
Other Income (Expense)	469	708	78	0	0	0	0	0	100
Pretax Income	10,802	4,325	(30,828)	(6,983)	(7,741)	(7,041)	(5,823)	(27,588)	(4,740)
Taxes	80	160	215	19	25	25	25	94	100
Net Income	10,722	4,165	(31,043)	(7,002)	(7,766)	(7,066)	(5,848)	(27,682)	(4,840)
Preferred Dividends	(120)	0	0	0	0	0	0	0	0
Net to Common	\$ 10,602	\$ 4,165	\$ (31,043)	\$ (7,002)	\$ (7,766)	\$ (7,066)	\$ (5,848)	\$ (27,682)	\$ (4,840)
Basic Shares	34,490	40,808	51,232	54,501	53,878	53,920	53,960	54,065	54,099
Diluted Shares	36,968	42,764	51,232	54,501	53,878	55,920	55,960	54,065	54,099
Basic EPS	\$ 0.31	\$ 0.10	\$ (0.61)	\$ (0.13)	\$ (0.14)	\$ (0.13)	\$ (0.11)	\$ (0.51)	\$ (0.09)
Diluted EPS	\$ 0.29	\$ 0.10	\$ (0.61)	\$ (0.13)	\$ (0.14)	\$ (0.13)	\$ (0.10)	\$ (0.51)	\$ (0.09)
Operating Income	10,105	3,521	(30,938)	(6,979)	(7,737)	(7,037)	(5,819)	(27,572)	(4,840)
Depreciation & Amort.	1,341	3,582	9,338	1,998	1,879	1,879	1,879	7,636	7,170
Stock Comp	1,494	3,064	4,848	1,065	1,065	1,065	1,065	4,260	4,260
Other	194	927	15,447	0	0	0	0	0	0
EBITDA	\$ 13,134	\$ 11,094	\$ (1,305)	\$ (3,916)	\$ (4,792)	\$ (4,093)	\$ (2,874)	\$ (15,676)	\$ 6,590
Margin	30.3%	21.6%	-2.2%	-30.7%	-38.9%	-31.2%	-20.2%	-29.9%	8.3%

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

Exhibit 2. Balance Sheet and Cash Flow Statement

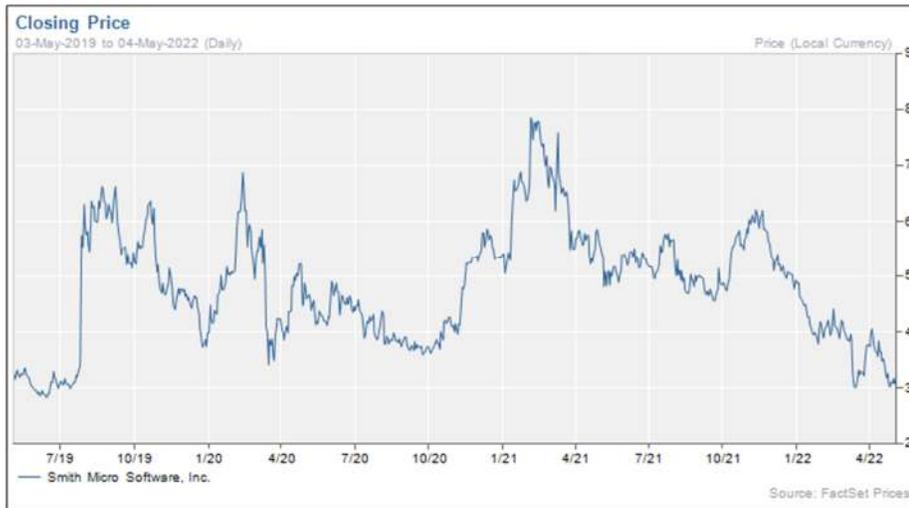
(\$ in 000's)	FY2019	FY2020	FY2021	FY2022E	FY2023E
Cash	28,268	25,754	16,078	5,013	7,513
A/R	10,894	12,347	10,590	10,133	16,572
Prepaid Expenses & Other	802	1,189	1,988	2,454	4,014
Current Assets	\$ 39,964	\$ 39,290	\$ 28,656	\$ 17,600	\$ 28,099
Equipment & Improvements	2,109	2,170	2,698	2,185	1,889
Right-of-use asset	6,464	5,785	5,710	5,372	5,372
Deferred Tax Assets	94	0	0	0	0
Other	234	694	620	616	616
Intangible Assets	4,535	12,698	42,631	36,321	30,447
Goodwill	7,797	12,266	35,041	35,041	35,041
Total Assets	\$ 61,197	\$ 72,903	\$ 115,356	\$ 97,135	\$ 101,464
A/P	2,050	2,282	3,301	3,516	5,751
Accrued Payroll & Benefits	2,107	2,867	4,055	4,497	7,355
Operating Lease	1,221	1,433	1,400	1,401	1,401
Other Accrued Liab.	244	216	436	806	1,319
Deferred Revenue	98	1,572	176	50	82
Current Liabilities	\$ 5,720	\$ 8,370	\$ 9,368	\$ 10,271	\$ 15,908
Lease Liabilities	5,774	4,805	4,467	4,072	4,072
NP	0	0	0	5,000	0
Deferred Rent	885	887	844	888	1,452
Other LT Liabilities	134	125	117	131	214
Equity	\$ 48,684	\$ 58,716	\$ 100,560	\$ 76,774	\$ 79,818
Total Liabilities & Equity	\$ 61,197	\$ 72,903	\$ 115,356	\$ 97,135	\$ 101,464

	FY2019	FY2020	FY2021	FY2022E	FY2023E
Net Income	10,722	4,165	(31,043)	(27,682)	(1,315)
Depreciation & Amortization	1,341	3,582	9,338	7,636	7,170
Stock Comp	1,494	3,064	4,848	4,260	4,260
Working Capital & Other	(3,569)	(2,887)	3,941	54	(1,715)
Operating CF	\$ 9,988	\$ 7,924	\$ (12,916)	\$ (15,732)	\$ 8,400
Capx	(1,659)	(1,323)	(830)	(813)	(1,000)
Acquisitions	(3,974)	(13,500)	(56,865)	0	0
Other	370	142	192	12	0
Investing Activities	\$ (5,263)	\$ (14,681)	\$ (57,503)	\$ (801)	\$ (1,000)
Equity	11,503	4,214	60,743	75	100
Debt	0	0	0	5,000	(5,000)
Other	(119)	29	0	393	0
Financing	\$ 11,384	\$ 4,243	\$ 60,743	\$ 5,468	\$ (4,900)
Change in Cash	\$ 16,109	\$ (2,514)	\$ (9,676)	\$ (11,065)	\$ 2,500

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
 Update – Buy – May 5, 2022 – Price Target \$8.30

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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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Current as of 26-Apr-22

	Company Coverage		Investment Banking	
Ratings Distribution	# of Companies	% of Total	# of Companies	% of Totals
Market Outperform (Buy)	32	74%	4	13%
Market Perform (Neutral)	11	26%	0	0%
Market Underperform (Sell)	0	0%	0	0%
Total	43	100%	4	9%

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