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## Vuzix Corporation (NASDAQ: VUZI)

May 11, 2022

### Buy: Q1 Review

*Q1 revenue was lower than expected as customers delayed purchases due to their supply-chain issues. We expect an acceleration in revenue in the second half and increased OEM activity to result in continued growth in 2023. We reiterate our Buy recommendation of Vuzix and \$15 price target.*

Q1 revenue was \$2.5 million versus our \$3.1 million estimate. We have lowered our 2022 revenue estimate to \$14.8 million (from \$20 million) to reflect the slower than expected start to the year. We expect deployments in the logistics and health care markets to be key drivers of enterprise deployments this year. We also expect the company will sign additional development contracts with aerospace/defense and consumer/enterprise focused customers setting up OEM production sales in 2023.

Vuzix has worked with five major defense contractors on waveguide-based products, a key investment area for the U.S and its allies. The company indicated it is set to add three more customers in the coming months and to begin development work that lasts into next year. The challenge has been the long-lead time involved in this type of work, but once deployment begins production runs can be long and very profitable. For instance, late last year the company delivered pre-production waveguide units for helmet-mounted display to a global Tier 1 aerospace and defense firm. We estimate a production contract could generate \$10 to \$15 million over a multi-year time frame. We believe Vuzix is pursuing multiple opportunities in the defense market, particularly in heads-up and helmet-mounted displays that would be at least as large as the Tier 1 deployment already mentioned. Importantly, its 10-year non-compete agreement in the U.S. military market expires in mid-June giving it the freedom to be more aggressive in this space.

Vuzix announced it will be expanding its waveguide capacity both in response to customer indications of interest and to make itself the number one choice of waveguides in the OEM market for industrial and consumer use. This investment is modest, a few million dollars, and will expand capacity, lower costs and enable a more robust feature set than the current product. We believe Vuzix can be one of the leading suppliers of waveguides and that this investment will enhance that capability.

The balance sheet is strong, with over \$113 million in cash, plenty to fund the cash needs of the company for almost five years based on the 2021 burn. The recently announced \$25 million share buyback weakens the balance sheet, reducing the runway by a year, and provides very little support for the stock, in our view.

**Price Target Methodology.** Our \$15 price target values the company's smart glasses and waveguide businesses at a significant discount to recent market transactions in the smart glasses space of \$775M to \$2B and \$500M to \$542M in the waveguide market (see page 2).

**Risk Analysis** Risks to achieving our price target include continuing negative impacts of the COVID-19 pandemic on the overall economy, changes to business practices in the medium and long-term due to the COVID-19 pandemic, potential competition from Apple and Facebook, increased competition from Google and RealWear, ability to deliver new products on time and manufacturing costs as sales ramp.

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Current Price				\$4.45
Price Target				\$15.00
<b>Estimates</b>	<b>F2021A</b>	<b>F2022E</b>	<b>F2023E</b>	
<b>Revenues (\$000s)</b>				
1Q March	\$ 3,915	\$ 2,503 A	\$ 5,625	
2Q June	\$ 2,917	\$ 2,500 E	\$ 9,625	
3Q September	\$ 3,019	\$ 4,125 E	\$ 9,625	
4Q December	\$ 3,314	\$ 5,625 E	\$ 5,625	
	<b>F2021A</b>	<b>F2022E</b>	<b>F2023E</b>	
<b>EBITDA (\$000s)</b>				
1Q March	\$ (20,368)	\$(20,368)E	\$(17,064)	
2Q June	\$ (3,890)	\$(3,890)A	\$(5,066)	
3Q September	\$ (4,602)	\$(4,602)E	\$(3,466)	
4Q December	\$ (5,708)	\$(5,708)E	\$(3,466)	
	\$ (6,167)	\$(6,167)E	\$(5,066)	
<b>EV/Sales</b>	NM	11.6 x	5.6 x	
<b>EV/EBITDA</b>	NM	(8.4) x	(10.0) x	
<b>Stock Data</b>				
52-Week Range	\$4.31	-	\$20.30	
Shares Outstanding (mil.)				63.7
Market Capitalization (mil.)				\$283
Enterprise Value (mil.)				\$171
Debt to Capital				0%
Cash & Equivalents (mil.)				\$113.3
Cash/Sh.				\$1.78
Average Three Months Trading Volume (K)				1,891
Insider Ownership				7.0%
Institutional Ownership				45.0%
Short interest (mil.)				27.2%
Dividend / Yield				\$0.00/0.0%



**Actual v Estimates.**

Q1 revenue was less than we forecast as customers delayed purchases due to issues with their supply chains and continued turmoil in the market. Gross margin was better than we forecast and operating expenses were lower than our estimates. This resulted in an EBITDA loss meaningfully better than we had modeled. We expect Q2 results to look similar to Q1.

**Q1 22 Actual v Estimates**

<b>Q1 22</b>	Actual	Estimates	Delta	% Delta
<i>(\$ in 000's)</i>				
Total Sales	\$ 2,503	\$ 3,127	\$ (624)	-20%
Total COGS	1,864	2,570	(706)	-27%
Total Gross Profit	639	557	82	15%
R&D	3,103	3,896	(792)	-20%
Sales & Marketing	2,023	1,645	379	23%
G&A	5,454	5,870	(416)	-7%
D&A	423	449	(26)	-6%
Operating Expense	11,053	11,859	(805)	-7%
Operating Income	\$ (10,414)	\$ (11,301)	887	8%
Interest & Other	(92)	(17)	(75)	
Pretax Income	\$ (10,506)	\$ (11,318)	\$ 812	
Income Taxes	0	0		
Net Income	\$ (10,506)	\$ (11,318)	\$ 812	
Preferred Dividends	0	0		
Net to Common	\$ (10,506)	\$ (11,318)	\$ 812	7%
Basic Shares	63,670	63,672		
Diluted Shares	63,695	63,672		
EPS	\$ (0.16)	\$ (0.18)	\$ 0.01	7%
Operating Income	\$ (10,414)	\$ (11,301)		
D&A	483	237		
Stock Comp	4,472	4,472		
Other				
EBITDA	\$ (5,459)	\$ (6,592)	\$ 1,134	17%

*Source Vuzix Corporation and Dawson James Securities estimates*

**Valuation**

Our price target is based on recent market transactions in the smart glasses and waveguide markets. These are two distinct markets, and Vuzix has important and meaningful positions in both of them.

In the smart glasses market, Pico Interactive was acquired by ByteDance (parent of TikTok) in August of 2021 for a [reported](#) \$775 million. In October of 2021, Magic Leap raised \$500 million at a [reported](#) \$2 billion valuation. The average of these two transactions is \$1.4 billion. Financial data for each is not available, but we believe revenue for Magic Leap is minimal.

In the waveguide market, DigiLens raised \$50 million in November 2021 at a [\\$500 million valuation](#) and in May of 2021 Snap purchased Wave Optics for cash and stock [totaling \\$541.8 million](#). The average of these transactions is \$521 million. Revenue is

not available for either of these companies but we believe they are minimal. Snap has [stated](#) revenue from Wave Optics was not material relative to its results.

Combining the average transaction value of \$1.4 billion for smart glasses with the \$521 million average transaction value for waveguides results in a combined target of \$1.9 billion, or \$30 per share after adjusting for the company's \$129 million cash balance. However, we have discounted this sharply, to \$15, to reflect the risk of competition by larger and better capitalized competitors, the time it may take to bring products to market, the risks COVID has for the growth of the economy and potential Federal Reserve actions to combat inflation.

**Risk Analysis**

Risks to achieving our price target include continuing negative impacts of the COVID-19 pandemic on the overall economy, changes to business practices in the medium and long-term due to the COVID-19 pandemic, potential competition from Apple and Facebook, increased competition from Google and RealWear, ability to delivery new products on time and manufacturing costs as sales ramp.

**Exhibit 1. Income Statement**

(\$ in 000's except per share data)

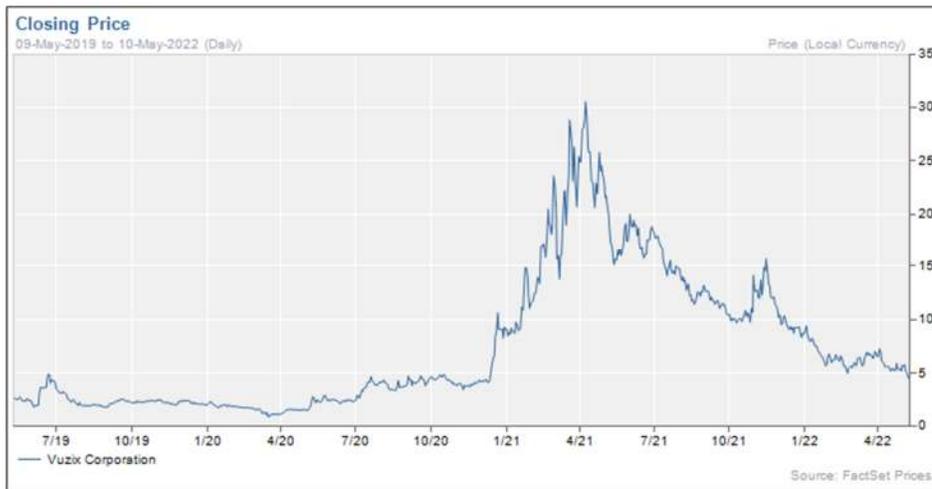
	2019	2020	2021	Q1 22 A	Q2 22 E	Q3 22 E	Q4 22 E	2022 E	2023 E
Total Sales	\$ 5,997	\$ 11,581	\$ 13,165	\$ 2,503	\$ 2,500	\$ 4,125	\$ 5,625	\$ 14,753	\$ 30,500
Total COGS	11,079	9,654	10,714	1,864	1,862	2,812	3,712	10,249	19,647
Total Gross Profit	(4,408)	1,928	2,451	639	638	1,313	1,913	4,504	10,853
R&D	8,901	7,568	11,675	3,103	3,103	3,103	3,103	12,414	13,345
Sales & Marketing	4,216	4,040	6,119	2,023	2,023	2,023	2,023	8,094	8,701
G&A	6,600	6,915	22,503	5,454	5,717	5,717	5,717	22,606	23,288
D&A	2,442	2,458	1,870	423	449	449	449	1,769	1,794
Other	0	74	264	50	0	0	0	50	0
Operating Expense	22,158	21,055	42,431	11,053	11,293	11,293	11,293	44,931	47,128
Operating Income	\$ (26,566)	\$ (19,127)	\$ (39,980)	\$ (10,414)	\$ (10,655)	\$ (9,980)	\$ (9,380)	\$ (40,428)	\$ (36,275)
Interest & Other	90	1,175	(397)	(92)	(92)	(92)	(92)	(368)	(76)
Pretax Income	\$ (26,476)	\$ (17,952)	\$ (40,377)	\$ (10,506)	\$ (10,747)	\$ (10,072)	\$ (9,472)	\$ (40,796)	\$ (36,351)
Income Taxes	0	0	0	0	0	0	0	0	0
Net Income	\$ (26,476)	\$ (17,952)	\$ (40,377)	\$ (10,506)	\$ (10,747)	\$ (10,072)	\$ (9,472)	\$ (40,796)	\$ (36,351)
Preferred Dividends	(1,932)	(2,056)	0	0	0	0	0	0	0
Net to Common	\$ (28,408)	\$ (20,008)	\$ (40,377)	\$ (10,506)	\$ (10,747)	\$ (10,072)	\$ (9,472)	\$ (40,796)	\$ (36,351)
Diluted Shares	30,348	38,110	61,125	63,695	63,668	63,827	64,146	63,834	64,942
EPS	\$ (0.94)	\$ (0.53)	\$ (0.66)	\$ (0.16)	\$ (0.17)	\$ (0.16)	\$ (0.15)	\$ (0.64)	\$ (0.56)
Operating Income	\$ (26,566)	\$ (19,127)	\$ (39,980)	\$ (10,414)	\$ (10,655)	\$ (9,980)	\$ (9,380)	\$ (40,428)	\$ (36,275)
D&A	2,542	2,642	2,310	483	483	483	483	1,932	1,932
Stock Comp	1,498	2,806	17,303	4,320	4,320	4,320	4,320	17,279	17,279
EBITDA	\$ (22,526)	\$ (13,680)	\$ (20,368)	\$ (5,611)	\$ (5,852)	\$ (5,177)	\$ (4,577)	\$ (21,216)	\$ (17,064)

Source: Vuzix Corporation and Dawson James Securities estimates



## **Important Disclosures:**

### **Price Chart:**



### **Price target and ratings changes over the past three years:**

Initiated – Buy – December 21, 2021 – Price Target \$15.00

Update – Buy – January 6, 2022 – Price Target \$15.00

Update – Buy – March 4, 2022 – Price Target \$15.00

Update – Buy – May 11, 2022 – Price Target \$15.00

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Current as of 26-Apr-22

	<b>Company Coverage</b>		<b>Investment Banking</b>	
<b>Ratings Distribution</b>	# 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%
<b>Total</b>	<b>43</b>	<b>100%</b>	<b>4</b>	<b>9%</b>

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