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Vuzix Corporation (NASDAQ: VUZI)

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Buy: License and Share Purchase Deal with Atomistic

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Vuzix entered into a license and share purchase deal with Atomistic, valued at \$53 million. These agreements give Vuzix access and ultimate ownership of Atomistic's micro LED technology, a critical component in smart glasses. The deal ensures Vuzix's control of micro LED displays, mitigating supplier risk and enabling continued leadership in the field. We reiterate our Buy recommendation and \$15 price target.

The license and share purchase agreements with Atomistic are critically important to Vuzix's product roadmap, giving it control of this crucial technology in the smart glasses market. In 2019 the company entered into joint development agreement with Plessey, but this was voided by Plessey's subsequent agreement to license its AR technology and dedicate its entire LED manufacturing capacity to Facebook. In 2021 the company announced it was working with Jade Bird Display for micro LED display engines, but was subject to the same risk profile it had with Plessey. The deal with Atomistic puts Vuzix in control of this technology and greatly reduces risk of a supplier being called away. The import of micro LED display technology to the smart glasses market is demonstrated by Facebook's deal with Plessey and the recent purchase of Raxium by Google for a reported \$1 billion.

The license agreement gives Vuzix a right to Atomistic's micro LED and micro laser technology and Vuzix will fund development of a custom design and tooling of a backplane for micro displays. A share purchase agreement could result in ownership of Atomistic by Vuzix.

The development agreement calls for Vuzix to pay Atomistic \$30 million, \$18.5 million this year and \$11.5 million in 2023. Depending on achievement of six milestones, Vuzix will issue 1.75 million to 2.84 million shares, valued at \$22.75 million, for control of Atomistic.

Our revenue and EBITDA estimates do not change for this year or next since the development agreement is not expected to result in new product revenue this year or next and we have modeled the development payments as investments in licenses. However, this is a significant investment for the company and maintains its leadership in the market.

Pro forma for the \$30 million development agreement the balance sheet remains strong, with over \$83 million in cash, plenty to fund the cash needs of the company for three years based on the 2021 burn.

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.

Current Price	\$5.56		
Price Target	\$15.00		
Estimates	F2021A	F2022E	F2023E
Revenues (\$000s)	\$ 13,165	\$ 14,753 E	\$ 30,500
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
	F2021A	F2022E	F2023E
EBITDA (\$000s)	\$ (20,368)	\$(20,368)E	\$(17,064)
1Q March	\$ (3,890)	\$(3,890)A	\$(5,066)
2Q June	\$ (4,602)	\$(4,602)E	\$(3,466)
3Q September	\$ (5,708)	\$(5,708)E	\$(3,466)
4Q December	\$ (6,167)	\$(6,167)E	\$(5,066)
EV/Sales	NM	16.4 x	7.9 x
EV/EBITDA	NM	(11.9) x	(14.2) x
Stock Data			
52-Week Range	\$3.88	-	\$20.30
Shares Outstanding (mil.)	63.7		
Market Capitalization (mil.)	\$354		
Enterprise Value (mil.)	\$242		
Debt to Capital	0%		
Cash & Equivalents (mil.)	\$113.3		
Cash/Sh.	\$1.78		
Average Three Months Trading Volume (K)	2,150		
Insider Ownership	7.0%		
Institutional Ownership	45.0%		
Short interest (mil.)	27.2%		
Dividend / Yield	\$0.00/0.0%		



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

Exhibit 2. Balance Sheet and Cash Flow Statement

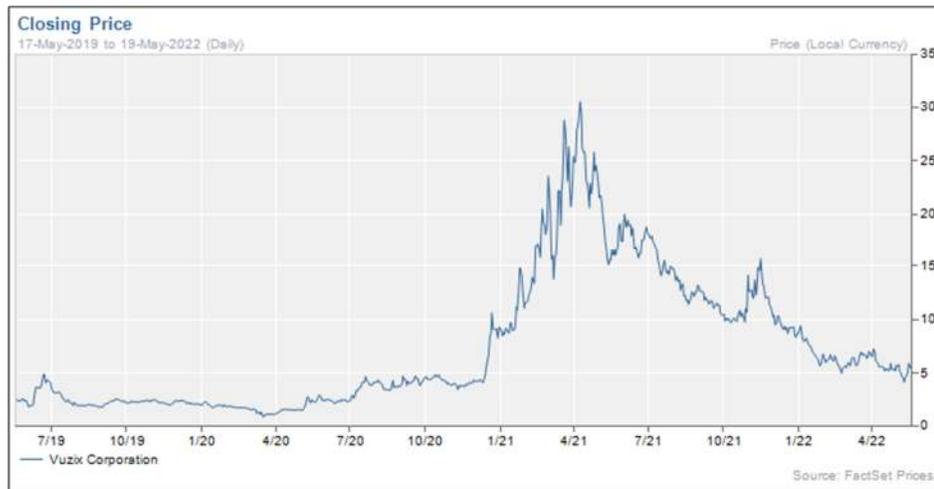
(\$ in 000's)

	2019	2020	2021	2022 E	2023 E
Cash	10,606	36,070	120,204	73,098	46,927
A/R	1,372	1,389	2,242	3,699	3,699
Note Receivable	250	0	0	0	0
Inventory	5,708	6,101	12,152	14,847	11,878
Prepaid Expenses & Other	<u>1,138</u>	<u>1,496</u>	<u>2,552</u>	<u>4,623</u>	<u>4,623</u>
Current Assets	\$ 19,074	\$ 45,055	\$ 137,150	\$ 96,267	\$ 67,126
Tooling & Equipment	4,328	2,837	5,190	7,343	8,411
Operating Lease Right of use	2,096	1,517	1,117	968	968
Patents & Trademarks	1,295	1,593	1,988	2,020	2,020
Licenses, net	314	194	1,390	19,833	54,083
Intangible Assets & Other	1,340	1,275	1,631	1,414	1,314
Total Assets	\$ 28,446	\$ 52,471	\$ 148,467	\$ 127,845	\$ 133,923
Accounts Payable	1,063	1,517	2,055	2,750	2,750
Operating Lease Right of use	525	444	534	514	514
Unearned Revenue	142	41	28	67	67
Accrued Expenses	886	983	1,419	2,533	2,533
Taxes Payable	<u>19</u>	<u>110</u>	<u>120</u>	<u>103</u>	<u>103</u>
Current Liabilities	\$ 2,635	\$ 3,095	\$ 4,156	\$ 5,966	\$ 5,966
Operating Lease Right of use	1,571	1,073	583	454	454
Equity	<u>24,240</u>	<u>48,303</u>	<u>143,728</u>	<u>121,425</u>	<u>127,503</u>
Total Liabilities & Equity	\$ 28,446	\$ 52,471	\$ 148,467	\$ 127,845	\$ 133,923
	2019	2020	2021	2022 E	2023 E
Net Income	\$ (26,476)	\$ (17,952)	\$ (40,377)	\$ (40,796)	\$ (36,351)
D&A	2,542	2,642	2,310	1,932	1,932
Stock Comp	1,498	2,806	17,303	17,279	17,279
Other	4,673	41	784	125	100
Working Capital	<u>(4,591)</u>	<u>(1,501)</u>	<u>(6,999)</u>	<u>(4,756)</u>	<u>2,969</u>
Operating Cash Flow	\$ (22,355)	\$ (13,964)	\$ (26,980)	\$ (26,217)	\$ (14,071)
CapEx	(1,899)	(497)	(3,809)	(3,808)	(3,000)
Other	<u>(1,259)</u>	<u>(989)</u>	<u>(1,043)</u>	<u>(18,659)</u>	<u>(11,500)</u>
Investing Activities	\$ (3,158)	\$ (1,486)	\$ (4,852)	\$ (22,467)	\$ (14,500)
Equity	18,855	39,357	127,112	1,578	2,400
Debt	0	1,556	0	0	0
Other	0	0	(1,144)	0	0
Preferred	<u>0</u>	<u>0</u>	<u>(10,000)</u>	<u>0</u>	<u>0</u>
Financing Activities	\$ 18,855	\$ 40,913	\$ 115,967	\$ 1,578	\$ 2,400
Change in Cash	\$ (6,658)	\$ 25,463	\$ 84,134	\$ (47,106)	\$ (26,171)

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

Update – Buy – May 19, 2022 – Price Target \$15.00

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Current as of 16-May-22

	Company Coverage		Investment Banking	
Ratings Distribution	# of Companies	% of Total	# of Companies	% of Totals
Market Outperform (Buy)	31	72%	4	13%
Market Perform (Neutral)	12	28%	0	0%
Market Underperform (Sell)	0	0%	0	0%
Total	43	100%	4	9%

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