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## Vuzix Corporation (NASDAQ: VUZI)

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### Buy: Waveguide Volume PO from Fortune 50 Customer.

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Vuzix announced a volume purchase order for a custom designed waveguide from a U.S.-based Fortune 50 software and hardware technology customer. The company is looking to its OEM waveguide and display business as a significant source of growth. We reiterate our Buy recommendation and \$15 price target.

Vuzix announced a volume purchase order for a custom designed waveguide from a U.S.-based Fortune 50 software and hardware technology customer. There are seven U.S. based technology hardware and software companies, Alphabet, Microsoft, Meta, Dell, Intel and IBM, in the Fortune 50. Apple, Microsoft, Alphabet and Meta have expressed interest in the head mounted display market for many years and given the [challenges of developing and manufacturing waveguides and display engines](#) that are small, inexpensive, and lightweight, any of these are potential customers for Vuzix.

Terms of the agreement were not disclosed, but the order is for a head-mounted display product development program. We believe these programs begin small, typically between \$500K to \$2 million, and if successful can turn into something much more substantial.

Vuzix is also 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 company is also working with five major defense contractors on waveguide-based products and expects to add more customers before year-end and 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. We estimate typical production contracts 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 display. Importantly, its 10-year non-compete agreement in the U.S. military market expired in mid-June giving it the freedom to be more aggressive in this space.

**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                           | \$6.94      |             |            |
| 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          | 22.3 x      | 10.8 x     |
| EV/EBITDA                               | NM          | (16.2) x    | (19.3) x   |
| <b>Stock Data</b>                       |             |             |            |
| 52-Week Range                           | \$3.88      | -           | \$16.20    |
| Shares Outstanding (mil.)               | 63.7        |             |            |
| Market Capitalization (mil.)            | \$442       |             |            |
| Enterprise Value (mil.)                 | \$329       |             |            |
| Debt to Capital                         | 0%          |             |            |
| Cash & Equivalents (mil.)               | \$113.3     |             |            |
| Cash/Sh.                                | \$1.78      |             |            |
| Average Three Months Trading Volume (K) | 1,080       |             |            |
| Insider Ownership                       | 7.4%        |             |            |
| Institutional Ownership                 | 46.4%       |             |            |
| Short interest (mil.)                   | 25.6%       |             |            |
| Dividend / Yield                        | \$0.00/0.0% |             |            |



The company has expanded its product offering with its license and share purchase agreements with Atomistic. We believe this is 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.

### **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**

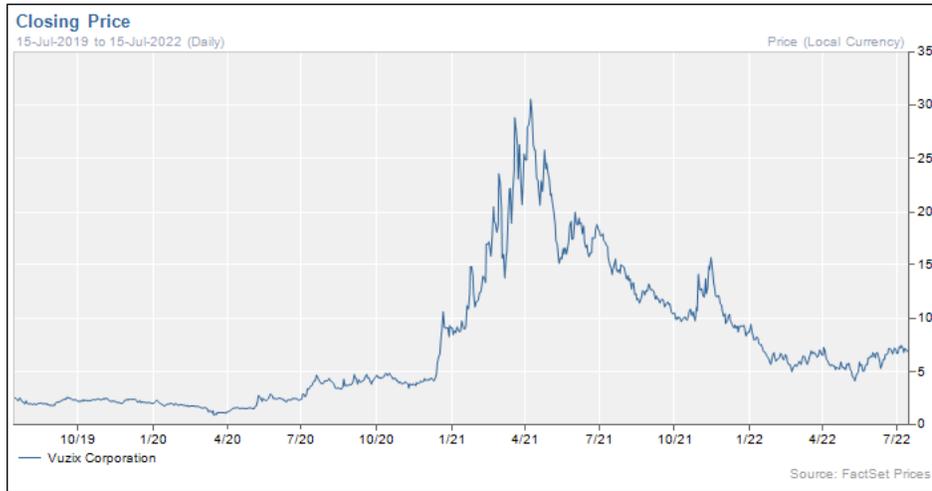
(\$ in 000's)

|                                       | 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>          |
| <b>Current Assets</b>                 | <b>\$ 19,074</b>     | <b>\$ 45,055</b>     | <b>\$ 137,150</b>     | <b>\$ 96,267</b>      | <b>\$ 67,126</b>      |
| 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                 |
| <b>Total Assets</b>                   | <b>\$ 28,446</b>     | <b>\$ 52,471</b>     | <b>\$ 148,467</b>     | <b>\$ 127,845</b>     | <b>\$ 133,923</b>     |
| 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>            |
| <b>Current Liabilities</b>            | <b>\$ 2,635</b>      | <b>\$ 3,095</b>      | <b>\$ 4,156</b>       | <b>\$ 5,966</b>       | <b>\$ 5,966</b>       |
| Operating Lease Right of use          | 1,571                | 1,073                | 583                   | 454                   | 454                   |
| <b>Equity</b>                         | <b><u>24,240</u></b> | <b><u>48,303</u></b> | <b><u>143,728</u></b> | <b><u>121,425</u></b> | <b><u>127,503</u></b> |
| <b>Total Liabilities &amp; Equity</b> | <b>\$ 28,446</b>     | <b>\$ 52,471</b>     | <b>\$ 148,467</b>     | <b>\$ 127,845</b>     | <b>\$ 133,923</b>     |
|                                       |                      |                      |                       |                       |                       |
|                                       | 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>          |
| <b>Operating Cash Flow</b>            | <b>\$ (22,355)</b>   | <b>\$ (13,964)</b>   | <b>\$ (26,980)</b>    | <b>\$ (26,217)</b>    | <b>\$ (14,071)</b>    |
| 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>       |
| <b>Investing Activities</b>           | <b>\$ (3,158)</b>    | <b>\$ (1,486)</b>    | <b>\$ (4,852)</b>     | <b>\$ (22,467)</b>    | <b>\$ (14,500)</b>    |
| 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>              |
| <b>Financing Activities</b>           | <b>\$ 18,855</b>     | <b>\$ 40,913</b>     | <b>\$ 115,967</b>     | <b>\$ 1,578</b>       | <b>\$ 2,400</b>       |
| <b>Change in Cash</b>                 | <b>\$ (6,658)</b>    | <b>\$ 25,463</b>     | <b>\$ 84,134</b>      | <b>\$ (47,106)</b>    | <b>\$ (26,171)</b>    |

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
- Update – Buy – July 6, 2022 – Price Target \$15.00
- Update – Buy – July 18, 2022 – Price Target \$15.00

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Current as of 13-Jul-22

|                             | <b>Company Coverage</b> |             | <b>Investment Banking</b> |             |
|-----------------------------|-------------------------|-------------|---------------------------|-------------|
| <b>Ratings Distribution</b> | # of Companies          | % of Total  | # of Companies            | % of Totals |
| Market Outperform (Buy)     | 30                      | 70%         | 4                         | 13%         |
| Market Perform (Neutral)    | 13                      | 30%         | 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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