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Smith Micro Software, Inc. (NASDAQ: SMSI)

August 12, 2022

Buy: Q2 In Line. Quarter Billion Revenue Opportunity in Sight.

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Q2 results were in line with our estimates. The integration of the three platforms Smith has been maintaining since the acquisitions of Circle and Avast is near completion and will lead to substantially higher gross margin and substantially lower operating expenses. The company raised \$18 million which should be more than adequate to reach free cash flow. We reiterate our Buy recommendation and \$8.30 price target.

Q2 revenue was \$12.7 million versus our \$12.3 million estimate. Gross margin was in line and the EBITDA loss of \$4.9 million was near our \$4.8 million estimate.

Since the acquisition of Circle in 2020 and the Family Safety Business of Avast in 2021 Smith has been maintaining duplicate networks and incurring significant development costs to create and migrate subscribers to the SafePath platform. That effort is nearing completion and should result in gross margin returning to the 80%-90% range over the coming 18 months from 71% in Q2. Additionally, beginning this quarter operating expenses will fall sharply and by the middle of the second half of next year operating expenses will decline \$3 million per quarter, about 20% of current cash opex.

We have moderated our expected ramp in SafePath customers for the rest of this year and into the first half of next year as Smith and its customers work on the roll-out plans and marketing plans of SafePath to their subscribers. This pushes the hockey stick in revenue towards the back half of next year and results in additional cash needs for the company.

Smith announced an \$18 million capital raise. The company issued 1.1 million of common shares, with an equal number of 5-year warrants, at a \$2.65 strike price for \$3 million. It also issued \$15 million of 6% convertible notes maturing at the end of 2023. The notes convert at \$3.35 per share and 2.2 million 5-year warrants with a \$3.35 strike price were also issued in conjunction with the convertible notes. We estimate this will be more than adequate to fund the company until it reaches cash flow break-even, which we forecast occurs in the second half of 2023.

The company estimates it can reach 9 to 15 million accounts by 2025 and we estimate this is a revenue opportunity ranging from \$270 million to \$900 million annually for Smith.

Valuation: Our price target of \$8.30 is based on an EV/Sales multiple of 5.5x on a run-rate revenue estimate of \$90 million, which should be achieved when SafePath is available and marketed to the subscribers of the three largest domestic wireless carriers. This multiple is consistent with a peer group and far below the 10x multiple of some in the group.

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	\$3.04		
Price Target	\$8.30		
Estimates	F2021A	F2022E	F2023E
Revenues (\$000s)	\$ 58,422	\$ 49,833 E	\$ 63,988
1Q March	\$ 11,381	\$ 12,735 A	\$ 12,707
2Q June	\$ 15,919	\$ 12,674 A	\$ 14,427
3Q September	\$ 16,443	\$ 12,357 E	\$ 16,927
4Q December	\$ 14,679	\$ 12,067 E	\$ 19,927
	F2021A	F2022E	F2023E
EBITDA (\$000s)	\$ (1,305)	\$ (19,478)E	\$ (10,842)
1Q March	\$ 887	\$ (3,916)A	\$ (2,060)
2Q June	\$ 25	\$ (4,886)A	\$ (274)
3Q September	\$ 121	\$ (5,358)E	\$ 2,847
4Q December	\$ (2,338)	\$ (5,318)E	\$ 5,461
EV/Sales	2.9 x	3.4 x	2.7 x
EV/EBITDA	NM	(8.8)	(15.7)
Stock Data			
52-Week Range	\$2.30	-	\$6.52
Shares Outstanding (mil.)			56.3
Market Capitalization (mil.)			\$171
Enterprise Value (mil.)			\$171
Debt to Capital			18%
Cash (mil.)			\$22
Cash/Share			\$0.40
Average Three Months Trading Volume (K)			569
Insider Ownership			13.1%
Institutional Ownership			25.9%
Short interest (mil.)			4.6%
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 \$10.2 million was slightly lower than our \$10.4 million estimates while CommSuite and ViewSpot revenue of \$1.4 million and \$1.1 million, respectively, were slightly higher than our \$1 million and \$900 thousand estimates. Gross margin was as expected and cash operating expenses slightly higher resulting in an EBITDA loss of \$4.9 million versus our \$4.8 million estimate.

Q2 22			
\$ in 000's except per share	Actual	Estimates	Delta
Revenue	\$ 12,674	\$ 12,325	3%
COGS	3,617	3,574	
Gross Profit	9,057	8,751	3%
	71%	71%	
SG&A	3,720	3,085	
R&D	8,213	7,702	
G&A	4,026	4,145	
Amort. of Intangible asset	1,577	1,555	
Opex	17,536	16,487	6%
Operating Income	\$ (8,479)	\$ (7,737)	-10%
Interest Income	2	0	
Other Income (Expense)	15	0	
Pretax Income	(8,462)	(7,741)	-9%
Taxes	31	25	
Net Income	(8,493)	(7,766)	
Basic Shares	55,183	54,707	
Diluted Shares	55,183	54,707	
Basic EPS	\$ (0.15)	\$ (0.14)	
Diluted EPS	\$ (0.15)	\$ (0.14)	-8%
Operating Income	(8,479)	(7,737)	
Depreciation & Amortization	1,904	1,879	
Stock Comp	1,689	1,065	
Other	0	0	
EBITDA	(4,886)	(4,792)	-2%
Margin	-38.6%	-38.9%	

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

The company is nearing the end of a multi-year migration effort to consolidate all subscribers on one platform. This will have two major benefits for margins. First, gross margin should improve from the current 71% level to the 80%-90% range the company achieved in 2018-2020. On current revenue, this is a \$5 million annual improvement in free cash generation. Second, the development costs that have been incurred to migrate customers from the legacy platforms is nearing its end and will result in a \$12 million annual reduction in cash operating expenses. Combined, this is an almost \$20 million annual improvement in free cash generation.

The other major benefit will be a resumption of revenue growth. With all development and migration work complete we expect Smith and its carrier customers to begin actively marketing the family safety services to its customer base. This is a large opportunity for Smith and the carriers. Before Sprint's acquisition by T-Mobile, Smith was generating \$30 to \$35 million in annualized revenue from Sprint, the smallest of the then major carriers. Since then, Smith has consolidated the industry and now serves the three major domestic carriers, whose combined post-paid subscriber base is 7x the number of post-paid subscribers served by Sprint. This suggests a revenue opportunity of at least \$200 to \$250 million annually.

Smith estimates the number of multi-line accounts served by each of the three carriers at between 15 and 20 million and the number of accounts that could be served by Smith at between 3 and 5 million per carrier. This equals 9 to 15 million accounts each paying on average \$10 per month, or a revenue contribution to the carriers of between \$1.1 and \$1.8 billion annually. Smith's contract terms with its carrier customers are proprietary but we estimate Smith takes between 25% and 50% of the total revenue. At 25%, this is a revenue opportunity of \$270 million to \$450 million annually. This is consistent with revenue opportunity estimate derived by comparing Smith's revenue from Sprint and applying that to the much larger base now served.

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. As stated above, we believe this is a \$270 million to \$450 million opportunity far in excess of current run rates. And in our view, even this potential is too low since SafePath is a platform that can expand into the home. And that is just the domestic market. We believe the international market is at least equal in size.

The \$18 million capital raise gives Smith the cash it needs to complete the migration to a unified platform. We have modeled the company issuing shares to pay the \$15 million note due in 2023.

Outlook

Our revenue estimate for this year has changed to reflect the push in the roll-out of SafePath 7 to the carriers. The company expects T-Mobile and AT&T to begin marketing this year and Verizon next year. Assuming lags between marketing and subscription as well as trial periods common to the industry, we expect modest SafePath Q/Q revenue growth through the first half of next year and a more aggressive growth rate in the second half.

	2022E		2023E	
	Old	New	Old	New
Revenue (\$M)	\$ 52.4	\$ 49.8	\$ 79.4	\$ 64.0
PF EPS	\$ (0.31)	\$ (0.38)	\$ 0.10	\$ (0.21)
EBITDA (\$M)	\$ (15.7)	\$ (19.5)	\$ 6.6	\$ (10.8)

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 achieve 80% by the end 2023 and expand further into 2024. EBITDA and EBITDA margin should grow as revenue scales, and we expect EBITDA margin exceeding 20% exiting 2023.

Valuation

Our price target of \$8.30 is based on an EV/Sales multiple of 5.5x on a run-rate revenue estimate of \$90 million, which should be achieved when SafePath is available and marketed to the subscribers of the three largest domestic wireless carriers. This multiple is consistent with a peer group and far below the 10x multiple of some in the group.

		FTM EPS	P/E	TEV	FTM Sales	EV/	FTM	EV/
				(in M's)	(in M's)	Sales	EBITDA	EBITDA
							(in M's)	
ADBE	Adobe Incorporated	\$ 15.22	28.6	\$204,530.2	\$ 19,433.8	10.5x	\$ 9,505.5	21.5 x
ASAN	Asana, Inc. Class A	(1.17)	NM	5,170.8	622.4	8.3x	(240.5)	NM
TEAM	Atlassian Corp. Plc Class A	1.79	154.1	72,351.3	3,708.0	19.5x	682.6	106.0 x
CTXS	Citrix Systems, Inc.	5.51	18.6	15,622.6	3,342.7	4.7x	1,235.1	12.6 x
DOCU	DocuSign, Inc.	1.85	39.2	14,978.1	2,620.6	5.7x	516.9	29.0 x
DBX	Dropbox, Inc. Class A	1.66	14.8	9,765.6	2,405.1	4.1x	884.2	11.0 x
HUBS	HubSpot, Inc.	2.83	135.8	18,997.2	1,939.5	9.8x	246.1	77.2 x
NTNX	Nutanix, Inc. Class A	(0.50)	NM	3,989.7	1,658.9	2.4x	(12.7)	NM
ONTF	ON24, Inc.	(0.42)	NM	162.2	198.3	0.8x	(18.2)	NM
RNG	RingCentral, Inc. Class A	2.26	22.5	6,611.9	2,273.8	2.9x	370.7	17.8 x
SMAR	Smartsheet, Inc. Class A	(0.51)	NM	4,571.9	880.5	5.2x	(46.7)	NM
TWLO	Twilio, Inc. Class A	(0.18)	NM	12,653.1	4,501.9	2.8x	294.6	43.0 x
WDAY	Workday, Inc. Class A	3.94	42.2	41,636.1	6,822.8	6.1x	1,744.1	23.9 x
ZM	Zoom Video Communications, Inc. Class A	3.92	27.5	27,789.3	4,855.1	5.7x	1,679.4	16.5 x
	Median		28.6			5.5x		22.7 x
SMSI	Smith Micro Software, Inc.	\$ (0.26)	NM	\$ 167.2	\$ 58.5	2.9x	\$ (14.2)	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 22A	Q3 22E	Q4 22E	FY2022E	FY2023E
Revenue	\$ 43,346	\$ 51,300	\$ 58,422	\$ 12,735	\$ 12,674	\$ 12,357	\$ 12,067	\$ 49,833	\$ 63,988
COGS	3,927	5,190	12,698	3,637	3,617	3,769	3,439	14,462	14,796
Gross Profit	39,419	46,110	45,724	9,098	9,057	8,588	8,628	35,371	49,192
	91%	89.9%	78.3%	71.4%	71.5%	69.5%	71.5%	71.0%	76.9%
SG&A	7,148	9,090	11,581	2,985	3,720	3,720	3,720	14,145	15,889
R&D	11,119	17,759	26,197	7,402	8,213	8,213	8,213	32,041	34,993
G&A	9,921	12,801	17,920	4,045	4,026	4,026	4,026	16,123	17,204
Amort. of Intangible asset	932	2,920	8,100	1,645	1,577	1,577	1,577	6,376	5,874
Restructuring/Other	194	19	12,864	0	0	0	0	0	0
Asset Impairment									
Opex	29,314	42,589	76,662	16,077	17,536	17,536	17,536	68,685	73,960
Operating Income	\$ 10,105	\$ 3,521	\$ (30,938)	\$ (6,979)	\$ (8,479)	\$ (8,948)	\$ (8,908)	\$ (33,314)	\$ (24,768)
Interest Income	228	96	34	0	2	2	2	6	8
Interest Expense	0	0	(2)	(4)	0	(113)	(225)	(342)	(563)
Other Income (Expense)	469	708	78	0	15	15	15	45	100
Pretax Income	10,802	4,325	(30,828)	(6,983)	(8,462)	(9,043)	(9,116)	(33,604)	(25,222)
Taxes	80	160	215	19	31	25	25	100	100
Net Income	10,722	4,165	(31,043)	(7,002)	(8,493)	(9,068)	(9,141)	(33,704)	(25,322)
Preferred Dividends	(120)	0	0	0	0	0	0	0	0
Net to Common	\$ 10,602	\$ 4,165	\$ (31,043)	\$ (7,002)	\$ (8,493)	\$ (9,068)	\$ (9,141)	\$ (33,704)	\$ (25,322)
Basic Shares	34,490	40,808	51,232	54,501	55,183	57,854	58,195	56,433	59,721
Diluted Shares	36,968	42,764	51,232	54,501	55,183	59,854	60,195	56,433	59,721
Basic EPS	\$ 0.31	\$ 0.10	\$ (0.61)	\$ (0.13)	\$ (0.15)	\$ (0.16)	\$ (0.16)	\$ (0.60)	\$ (0.42)
Diluted EPS	\$ 0.29	\$ 0.10	\$ (0.61)	\$ (0.13)	\$ (0.15)	\$ (0.15)	\$ (0.15)	\$ (0.60)	\$ (0.42)
Stock Comp	1,494	3,063	4,848	1,065	1,689	1,689	1,689	6,132	6,756
Amortization	932	2,920	8,100	1,645	1,577	1,577	1,577	6,376	5,874
Other	(212)	918	15,852	0	0	0	0	0	0
Non-GAAP Net Income	12,816	11,066	(2,243)	(4,292)	(5,227)	(5,802)	(5,875)	(21,196)	(12,692)
Non-GAAP EPS	\$ 0.35	\$ 0.26	\$ (0.04)	\$ (0.08)	\$ (0.09)	\$ (0.10)	\$ (0.10)	\$ (0.38)	\$ (0.21)
Operating Income	10,105	3,521	(30,938)	(6,979)	(8,479)	(8,948)	(8,908)	(33,314)	(24,768)
Depreciation & Amort.	1,341	3,582	9,338	1,998	1,904	1,901	1,901	7,704	7,170
Stock Comp	1,494	3,064	4,848	1,065	1,689	1,689	1,689	6,132	6,756
Other	194	927	15,447	0	0	0	0	0	0
EBITDA	\$ 13,134	\$ 11,094	\$ (1,305)	\$ (3,916)	\$ (4,886)	\$ (5,358)	\$ (5,318)	\$ (19,478)	\$ (10,842)
Margin	30.3%	21.6%	-2.2%	-30.7%	-38.6%	-43.4%	-44.1%	-39.1%	-16.9%

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

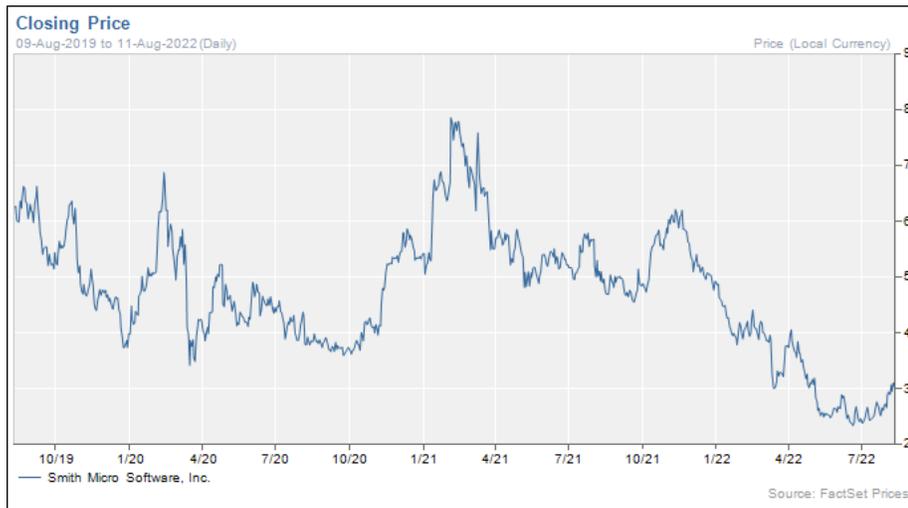
Exhibit 2. Balance Sheet and Cash Flow Statement

(\$ in 000's)	FY2019	FY2020	FY2021	FY2022E	FY2023E
Cash	28,268	25,754	16,078	12,292	15,314
A/R	10,894	12,347	10,590	9,918	15,286
Prepaid Expenses & Other	802	1,189	1,988	2,394	3,953
Current Assets	\$ 39,964	\$ 39,290	\$ 28,656	\$ 24,603	\$ 34,553
Equipment & Improvements	2,109	2,170	2,698	1,981	1,685
Right-of-use asset	6,464	5,785	5,710	4,291	4,291
Deferred Tax Assets	94	0	0	0	0
Other	234	694	620	541	541
Intangible Assets	4,535	12,698	42,631	36,256	30,382
Goodwill	7,797	12,266	35,041	35,041	35,041
Total Assets	\$ 61,197	\$ 72,903	\$ 115,356	\$ 102,713	\$ 106,493
A/P	2,050	2,282	3,301	3,593	5,934
Accrued Payroll & Benefits	2,107	2,867	4,055	3,579	5,910
Operating Lease	1,221	1,433	1,400	1,400	1,400
Other Accrued Liab.	244	216	436	1,168	1,929
Deferred Revenue	98	1,572	176	0	0
Current Liabilities	\$ 5,720	\$ 8,370	\$ 9,368	\$ 9,740	\$ 15,173
Lease Liabilities	5,774	4,805	4,467	3,640	3,640
Cv. Notes due 2023	0	0	0	15,000	0
Deferred Rent	885	887	844	0	0
Other LT Liabilities	134	125	117	111	184
Equity	\$ 48,684	\$ 58,716	\$ 100,560	\$ 74,222	\$ 87,496
Total Liabilities & Equity	\$ 61,197	\$ 72,903	\$ 115,356	\$ 102,713	\$ 106,493
	FY2019	FY2020	FY2021	FY2022E	FY2023E
Net Income	10,722	4,165	(31,043)	(33,705)	(8,507)
Depreciation & Amortization	1,341	3,582	9,338	7,704	7,170
Stock Comp	1,494	3,064	4,848	6,132	6,756
Working Capital & Other	(3,569)	(2,887)	3,941	(1,448)	(1,422)
Operating CF	\$ 9,988	\$ 7,924	\$ (12,916)	\$ (21,317)	\$ 3,997
Capx	(1,659)	(1,323)	(830)	(612)	(1,000)
Acquisitions	(3,974)	(13,500)	(56,865)	0	0
Other	370	142	192	83	0
Investing Activities	\$ (5,263)	\$ (14,681)	\$ (57,503)	\$ (529)	\$ (1,000)
Equity	11,503	4,214	60,743	2,125	15,025
Debt	0	0	0	15,900	(15,000)
Other	(119)	29	0	35	0
Financing	\$ 11,384	\$ 4,243	\$ 60,743	\$ 18,060	\$ 25
Change in Cash	\$ 16,109	\$ (2,514)	\$ (9,676)	\$ (3,786)	\$ 3,022

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
- Update – Buy – August 12, 2022 – Price Target \$8.30

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- 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 8-Aug-22

	Company Coverage		Investment Banking	
Ratings Distribution	# of Companies	% of Total	# of Companies	% of Totals
Market Outperform (Buy)	29	66%	4	14%
Market Perform (Neutral)	14	32%	0	0%
Market Underperform (Sell)	1	2%	0	0%
Total	44	100%	4	9%

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