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Vuzix Corporation (NASDAQ: VUZI)

August 10, 2022

Buy: Q2 Review.

Q2 Revenue and EBITDA were better than expected. The company remains in a strong position to benefit from deployment of smart glasses in enterprise, industrial, defense and consumer applications. We reiterate our Buy recommendation and \$15 price target.

Q2 revenue of \$3.0 million was better than our \$2.5 million estimate and exceeded consensus estimates as well. The EBITDA loss of \$5.5 million was better than our \$5.8 million loss estimate. At the end of the quarter the company had over \$100 million in cash, runway for 5-years at the current burn rate.

Gross profit was a bit lower than expected, with product costs higher due to discounts on higher-volume sales, the foreign exchange impact of non-U.S. dollar denominated sales and higher overhead allocation. Operating expenses were lower than forecast and the result was better than expected EBITDA.

We have Q3 looking similar to Q2 and increased quarter-over-quarter sales in Q4 and 2023. The company has multiple large-scale deployments possible in the logistics and health care markets. Announcements could come in the second half. Vuzix is pursuing multiple opportunities in the defense market, particularly in heads-up and helmet-mounted display. The company has development deals with a handful of major defense contractors on waveguide-based products. Lead times can be extended, 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. Vuzix is also working with multiple customers on supplying waveguides for the consumer market. There is significant upside to our sales projections from these waveguide projects.

The company has unique expertise in waveguide design and manufacturing, and is 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.

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				\$8.19
Price Target				\$15.00
Estimates	F2021A	F2022E	F2023E	
Revenues (\$000s)	\$ 13,165	\$ 12,644 E	\$ 20,500	
1Q March	\$ 3,915	\$ 2,503 A	\$ 4,625	
2Q June	\$ 2,917	\$ 3,008 A	\$ 5,125	
3Q September	\$ 3,019	\$ 3,008 E	\$ 5,125	
4Q December	\$ 3,314	\$ 4,125 E	\$ 5,625	
	F2021A	F2022E	F2023E	
EBITDA (\$000s)	\$ (20,368)	\$(20,368)E	\$(20,725)	
1Q March	\$ (3,890)	\$(3,890)A	\$(5,381)	
2Q June	\$ (4,602)	\$(4,602)A	\$(5,181)	
3Q September	\$ (5,708)	\$(5,708)E	\$(5,181)	
4Q December	\$ (6,167)	\$(6,167)E	\$(4,981)	
EV/Sales	NM	33.6 x	20.7 x	
EV/EBITDA	NM	(20.8) x	(20.5) x	
Stock Data				
52-Week Range	\$3.88	-	\$16.20	
Shares Outstanding (mil.)				64.0
Market Capitalization (mil.)				\$524
Enterprise Value (mil.)				\$424
Debt to Capital				0%
Cash & Equivalents (mil.)				\$100.6
Cash/Sh.				\$1.57
Average Three Months Trading Volume (K)				1,411
Insider Ownership				7.4%
Institutional Ownership				48.0%
Short interest (mil.)				25.8%
Dividend / Yield				\$0.00/0.0%



Actual v Estimates

Q2 22	Actual	Estimates	Delta	% Delta
Total Sales	\$ 3,008	\$ 2,500	\$ 508	20%
Total COGS	2,582	1,862	720	39%
Total Gross Profit	426	638	(212)	-33%
R&D	2,996	3,103	(107)	-3%
Sales & Marketing	1,851	2,023	(173)	-9%
G&A	5,040	5,717	(677)	-12%
D&A	540	449	92	20%
Operating Expense	10,427	11,293	(866)	-8%
Operating Income	\$ (10,001)	\$ (10,655)	654	6%
Interest & Other	(21)	(92)	71	
Pretax Income	\$ (10,022)	\$ (10,747)	\$ 725	
Income Taxes	0	0		
Net Income	\$ (10,022)	\$ (10,747)	\$ 725	
Preferred Dividends	0	0		
Net to Common	\$ (10,022)	\$ (10,747)	\$ 725	7%
Diluted Shares	63,740	63,668		
EPS	\$ (0.16)	\$ (0.17)	\$ 0.01	7%
Operating Income	\$ (10,001)	\$ (10,655)		
D&A	611	483		
Stock Comp	3,881	4,320		
Other				
EBITDA	\$ (5,509)	\$ (5,852)	\$ 343	6%

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

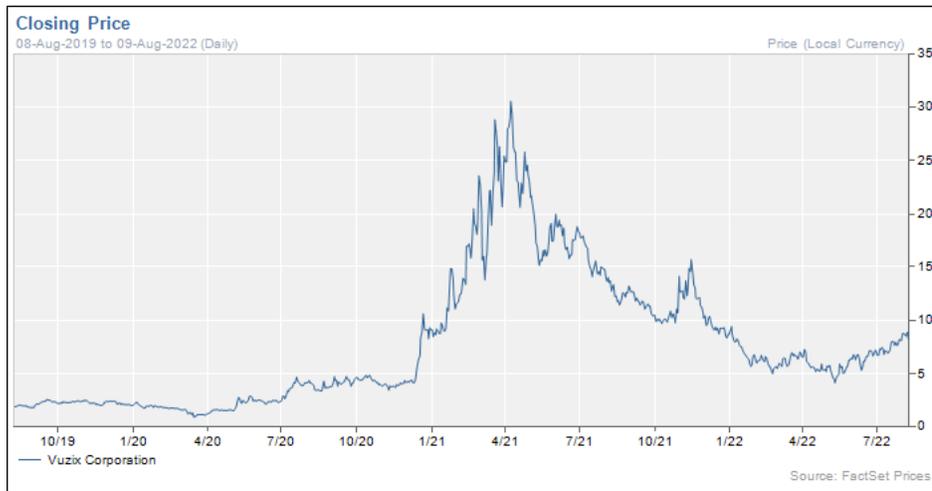
(\$ in 000's except per share data)

	2019	2020	2021	Q1 22 A	Q2 22 A	Q3 22 E	Q4 22 E	2022 E	2023 E
Total Sales	\$ 5,997	\$ 11,581	\$ 13,165	\$ 2,503	\$ 3,008	\$ 3,008	\$ 4,125	\$ 12,644	\$ 20,500
Total COGS	11,079	9,654	10,714	1,864	2,582	2,566	3,233	10,245	15,333
Total Gross Profit	(4,408)	1,928	2,451	639	426	442	892	2,398	5,167
R&D	8,901	7,568	11,675	3,103	2,996	2,996	2,996	12,092	12,883
Sales & Marketing	4,216	4,040	6,119	2,023	1,851	1,851	1,851	7,575	8,701
G&A	6,600	6,915	22,503	5,454	5,040	5,250	5,250	20,994	20,481
D&A	2,442	2,458	1,870	423	540	449	449	1,860	1,794
Other	0	74	264	50	0	0	0	50	0
Operating Expense	22,158	21,055	42,431	11,053	10,427	10,545	10,545	42,571	43,859
Operating Income	\$ (26,566)	\$ (19,127)	\$ (39,980)	\$ (10,414)	\$ (10,001)	\$ (10,104)	\$ (9,654)	\$ (40,172)	\$ (38,692)
Interest & Other	90	1,175	(397)	(92)	(21)	(21)	(21)	(154)	(76)
Pretax Income	\$ (26,476)	\$ (17,952)	\$ (40,377)	\$ (10,506)	\$ (10,022)	\$ (10,124)	\$ (9,674)	\$ (40,326)	\$ (38,768)
Income Taxes	0	0	0	0	0	0	0	0	0
Net Income	\$ (26,476)	\$ (17,952)	\$ (40,377)	\$ (10,506)	\$ (10,022)	\$ (10,124)	\$ (9,674)	\$ (40,326)	\$ (38,768)
Preferred Dividends	(1,932)	(2,056)	0	0	0	0	0	0	0
Net to Common	\$ (28,408)	\$ (20,008)	\$ (40,377)	\$ (10,506)	\$ (10,022)	\$ (10,124)	\$ (9,674)	\$ (40,326)	\$ (38,768)
Diluted Shares	30,348	38,110	61,125	63,695	63,740	63,829	64,112	63,844	65,445
EPS	\$ (0.94)	\$ (0.53)	\$ (0.66)	\$ (0.16)	\$ (0.16)	\$ (0.16)	\$ (0.15)	\$ (0.63)	\$ (0.59)
Operating Income	\$ (26,566)	\$ (19,127)	\$ (39,980)	\$ (10,414)	\$ (10,001)	\$ (10,104)	\$ (9,654)	\$ (40,172)	\$ (38,692)
D&A	2,542	2,642	2,310	483	611	611	611	2,316	2,443
Stock Comp	1,498	2,806	17,303	4,320	3,881	3,881	3,881	15,963	15,524
EBITDA	\$ (22,526)	\$ (13,680)	\$ (20,368)	\$ (5,611)	\$ (5,509)	\$ (5,612)	\$ (5,162)	\$ (21,894)	\$ (20,725)

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
- Update – Buy – August 3, 2022 – Price Target \$15.00
- Update – Buy – August 10, 2022 – Price Target \$15.00

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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;
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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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