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Smith Micro Software, Inc. (NASDAQ: SMSI)

November 10, 2022

Buy: Q3 Review.

Q3 results were generally in line with expectations, but a push to the right on acceleration of Family Safety plans has resulted in lower revenue estimates. Still, over the coming quarters, we expect higher gross margin and substantially lower operating expenses given the completion of the integration of the three separate platforms Smith has been maintaining since the acquisitions of Circle and Avast. We reiterate our Buy recommendation and \$8.30 price target.

Q3 results were generally in line with expectations with revenue of \$11.7 million down year-over-year and quarter-over-quarter driven by the attrition of SafePath customers off the Sprint network. Q4 should be the trough of this attrition and marketing efforts at T-Mobile are expected to begin soon, resulting in sequential revenue growth in Q1. We expect growth to accelerate as Verizon and AT&T begin their marketing efforts.

We had expected sequential growth to begin this quarter, but T-Mobile and AT&T have been pushed to the right. T-Mobile acceleration is expected next quarter based on marketing that is expected in the coming weeks. AT&T requires some additional development, and we expect launch in Q2 of next year.

With growth in revenue, gross margin should improve, a result of scale and the elimination of duplicative expenses with the elimination of support for multiple platforms. Operating expenses will come down sharply over the coming quarters. In Q3 cash opex was \$13.1 million, down from \$14.1 million in Q2. The company is targeting cash opex of \$11 million in Q2 of 2023. The combination of growing revenue, higher gross margin and lower opex is expected to bring sharp EBITDA improvement as the year progresses.

We believe the most significant operational risks for Smith are the take-up of SafePath over the coming quarters and further delays by the company's customers. In our model, we have assumed SafePath sequential growth begins in Q1 2023 at a modest pace and accelerates over the course of the year. We believe our estimates are reasonable, but a sharp economic contraction could jeopardize our forecast.

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 where multiples range as high as 8x.

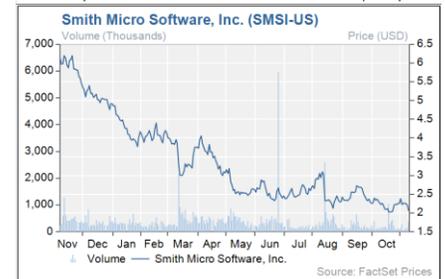
Risks: Risks to achieving our price target include declines in the CommSuite product line, disruptions from the T-Mobile acquisition of Sprint, integration of the Family Safety business, continuing impacts of the COVID pandemic and customer concentration.

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Current Price				\$2.07
Price Target				\$8.30
Estimates	F2021A	F2022E	F2023E	
Revenues (\$M's)	\$ 58.4	\$ 48.1	E \$ 57.0	
1Q March	\$ 11.4	\$ 12.7	A \$ 11.5	
2Q June	\$ 15.9	\$ 12.7	A \$ 12.7	
3Q September	\$ 16.4	\$ 11.7	A \$ 14.6	
4Q December	\$ 14.7	\$ 11.0	E \$ 18.1	
	F2021A	F2022E	F2023E	
EBITDA (\$M's)	\$ (1.3)	\$ (18.2)	E \$ (1.1)	
1Q March	\$ 0.9	\$ (3.9)	A \$ (3.0)	
2Q June	\$ 0.0	\$ (4.9)	A \$ (1.7)	
3Q September	\$ 0.1	\$ (5.2)	A \$ 0.4	
4Q December	\$ (2.3)	\$ (4.2)	E \$ 3.3	
EV/Sales	1.9 x	2.3 x	2.0 x	
EV/EBITDA	NM	(6.2)	(105.5)	
Stock Data				
52-Week Range	\$1.97	-	\$6.52	
Shares Outstanding (mil.)				56.4
Market Capitalization (mil.)				\$117
Enterprise Value (mil.)				\$113
Debt to Capital				15%
Cash (mil.)				\$0
Cash/Share				\$0.00
Average Three Months Trading Volume (K)				373
Insider Ownership				11.9%
Institutional Ownership				19.2%
Short interest (mil.)				3.1%
Dividend / Yield				\$0.00/0.0%



Actual v Estimates

Q3 22				
\$ in 000's except per share	Actual	Estimates	Delta	
Revenue	\$ 11,699	\$ 11,817	-1%	
COGS	3,629	3,604		
Gross Profit	8,070	8,213	-2%	
	69%	70%		
SG&A	2,986	3,720		
R&D	7,523	8,213		
G&A	4,133	4,026		
Amort. of Intangible asset	1,545	1,577		
Opex	16,187	17,536		
Operating Income	\$ (8,117)	\$ (9,323)		
Interest Income	0	2		
Other Income (Expense)	(29)	15		
Pretax Income	(7,285)	(9,419)		
Taxes	27	25		
Net Income	(7,312)	(9,444)		
Basic Shares	55,722	57,854		
Diluted Shares	55,722	59,854		
Basic EPS	\$ (0.13)	\$ (0.16)		
Diluted EPS	\$ (0.13)	\$ (0.16)		
Operating Income	(8,117)	(9,323)		
Depreciation & Amortization	1,849	1,901		
Stock Comp	1,095	1,689		
Other	0	0		
EBITDA	\$ (5,173)	\$ (5,733)	10%	
Margin	-44.2%	-48.5%		

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 the 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.

Outlook

Our revenue estimate for this year reflects the roll-out of SafePath 7 to the carriers in Q4. The company expects T-Mobile to begin marketing this year and AT&T 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.

EBITDA and margins should follow revenue growth. Gross margin is modeled to improve near year-end and is estimated to achieve 80% early 2024. EBITDA and EBITDA margin should grow as revenue scales, and we expect EBITDA margin to approach 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 where multiples range as high as 8x.

		Price	FTM EPS	P/E	TEV (in M's)	FTM Sales (in M's)	EV/ Sales	FTM EBITDA (in M's)	EV/ EBITDA
ADBE	Adobe Incorporated	\$ 298.87	\$ 15.24	19.6	\$139,355.8	\$ 19,325.1	7.2x	\$ 9,426.8	14.8 x
ASAN	Asana, Inc. Class A	16.03	(1.04)	NM	3,320.1	665.2	5.0x	(231.6)	NM
TEAM	Atlassian Corp Class A	122.29	1.54	79.6	31,420.1	3,783.5	8.3x	664.6	47.3 x
DOCU	DocuSign, Inc.	39.80	1.84	21.6	8,132.0	2,668.2	3.0x	535.6	15.2 x
DBX	Dropbox, Inc. Class A	21.19	1.71	12.4	8,654.5	2,440.1	3.5x	899.3	9.6 x
HUBS	HubSpot, Inc.	259.36	2.71	95.6	12,780.1	2,010.1	6.4x	245.8	52.0 x
NTNX	Nutanix, Inc. Class A	26.14	0.20	131.7	6,249.2	1,854.8	3.4x	141.3	44.2 x
ONTF	ON24, Inc.	6.99	(0.36)	NM	12.4	197.8	0.1x	(15.0)	NM
RNG	RingCentral, Inc. Class A	28.36	2.41	11.8	4,432.4	2,369.4	1.9x	405.2	10.9 x
SMAR	Smartsheet, Inc. Class A	25.93	(0.37)	NM	3,114.8	916.4	3.4x	(23.6)	NM
TWLO	Twilio, Inc. Class A	43.60	0.06	705.5	5,240.0	4,374.8	1.2x	336.3	15.6 x
WDAY	Workday, Inc. Class A	134.95	4.19	32.2	34,010.6	7,111.7	4.8x	1,853.1	18.4 x
ZM	Zoom Video Communications, Inc. Class A	71.84	3.60	20.0	17,880.7	4,667.3	3.8x	1,577.8	11.3 x
	Median			26.9			3.5x		15.4 x
SMSI	Smith Micro Software, Inc.	\$ 2.07	\$ (0.19)	NM	\$ 124.0	\$ 55.8	2.2x	\$ (3.5)	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 22A	Q4 22E	FY2022E	FY2023E
Revenue	\$ 43,346	\$ 51,300	\$ 58,422	\$ 12,735	\$ 12,674	\$ 11,699	\$ 11,000	\$ 48,108	\$ 57,000
COGS	3,927	5,190	12,698	3,637	3,617	3,629	3,410	14,293	14,318
Gross Profit	39,419	46,110	45,724	9,098	9,057	8,070	7,590	33,815	42,682
	91%	89.9%	78.3%	71.4%	71.5%	69.0%	69.0%	70.3%	74.9%
SG&A	7,148	9,090	11,581	2,985	3,720	2,986	2,520	12,211	8,896
R&D	11,119	17,759	26,197	7,402	8,213	7,523	7,057	30,195	27,044
G&A	9,921	12,801	17,920	4,045	4,026	4,133	3,667	15,871	13,484
Amort. of Intangible asset	932	2,920	8,100	1,645	1,577	1,545	1,545	6,312	5,874
Restructuring/Other	194	19	12,864	0	0	0	0	0	0
Opex	29,314	42,589	76,662	16,077	17,536	16,187	14,790	64,590	55,298
Operating Income	\$ 10,105	\$ 3,521	\$ (30,938)	\$ (6,979)	\$ (8,479)	\$ (8,117)	\$ (7,200)	\$ (30,775)	\$ (12,616)
Interest Income	228	96	34	0	2	0	0	2	0
Interest Expense	0	0	(2)	(4)	0	(696)	(225)	(925)	(563)
Change in Warrant Liability	0	0	0	0	0	1,557	0	1,557	0
Other Income (Expense)	469	708	78	0	15	(29)	(29)	(43)	100
Pretax Income	10,802	4,325	(30,828)	(6,983)	(8,462)	(7,285)	(7,454)	(30,184)	(13,079)
Taxes	80	160	215	19	31	27	25	102	100
Net Income	10,722	4,165	(31,043)	(7,002)	(8,493)	(7,312)	(7,479)	(30,286)	(13,179)
Preferred Dividends	(120)	0	0	0	0	0	0	0	0
Net to Common	\$ 10,602	\$ 4,165	\$ (31,043)	\$ (7,002)	\$ (8,493)	\$ (7,312)	\$ (7,479)	\$ (30,286)	\$ (13,179)
Basic Shares	34,490	40,808	51,232	54,501	55,183	55,722	58,258	55,916	59,829
Diluted Shares	36,968	42,764	51,232	54,501	55,183	55,722	60,258	55,916	59,829
Basic EPS	\$ 0.31	\$ 0.10	\$ (0.61)	\$ (0.13)	\$ (0.15)	\$ (0.13)	\$ (0.13)	\$ (0.54)	\$ (0.22)
Diluted EPS	\$ 0.29	\$ 0.10	\$ (0.61)	\$ (0.13)	\$ (0.15)	\$ (0.13)	\$ (0.12)	\$ (0.54)	\$ (0.22)
Stock Comp	1,494	3,063	4,848	1,065	1,689	1,095	1,095	4,944	4,380
Amortization	932	2,920	8,100	1,645	1,577	1,545	1,545	6,312	5,874
Other	(212)	918	15,852	0	0	(484)	0	(484)	0
Non-GAAP Net Income	12,816	11,066	(2,243)	(4,292)	(5,227)	(5,156)	(4,839)	(19,514)	(2,925)
Non-GAAP EPS	\$ 0.35	\$ 0.26	\$ (0.04)	\$ (0.08)	\$ (0.09)	\$ (0.09)	\$ (0.08)	\$ (0.35)	\$ (0.05)
Operating Income	10,105	3,521	(30,938)	(6,979)	(8,479)	(8,117)	(7,200)	(30,775)	(12,616)
Depreciation & Amort.	1,341	3,582	9,338	1,998	1,904	1,849	1,869	7,620	7,170
Stock Comp	1,494	3,064	4,848	1,065	1,689	1,095	1,095	4,944	4,380
Other	194	927	15,447	0	0	0	0	0	0
EBITDA	\$ 13,134	\$ 11,094	\$ (1,305)	\$ (3,916)	\$ (4,886)	\$ (5,173)	\$ (4,236)	\$ (18,211)	\$ (1,066)
Margin	30.3%	21.6%	-2.2%	-30.7%	-38.6%	-44.2%	-38.5%	-37.9%	-1.9%

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

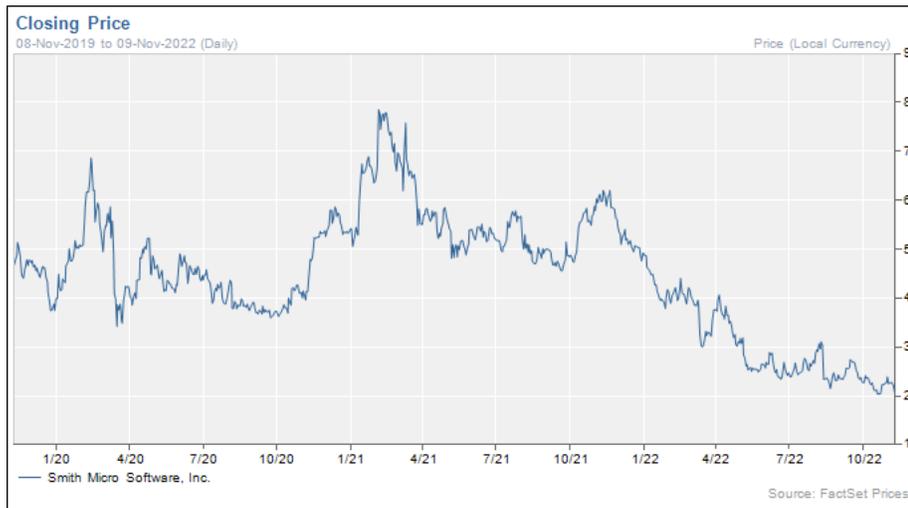
Exhibit 2. Balance Sheet and Cash Flow Statement

(\$ in 000's)	FY2019	FY2020	FY2021	FY2022E	FY2023E
Cash	28,268	25,754	16,078	14,283	11,200
A/R	10,894	12,347	10,590	9,041	13,904
Prepaid Expenses & Other	802	1,189	1,988	1,022	1,684
Current Assets	\$ 39,964	\$ 39,290	\$ 28,656	\$ 24,346	\$ 26,788
Equipment & Improvements	2,109	2,170	2,698	1,693	1,397
Right-of-use asset	6,464	5,785	5,710	4,709	4,709
Deferred Tax Assets	94	0	0	0	0
Other	234	694	620	547	547
Intangible Assets	4,535	12,698	42,631	36,320	30,446
Goodwill	7,797	12,266	35,041	35,041	35,041
Total Assets	\$ 61,197	\$ 72,903	\$ 115,356	\$ 102,656	\$ 98,928
A/P	2,050	2,282	3,301	3,408	5,616
Accrued Payroll & Benefits	2,107	2,867	4,055	3,142	5,178
Operating Lease	1,221	1,433	1,400	1,402	1,402
Other Accrued Liab.	244	216	436	904	1,489
Deferred Revenue	98	1,572	176	0	0
Convertible Note payable	0	0	0	6,035	0
Current Liabilities	\$ 5,720	\$ 8,370	\$ 9,368	\$ 14,891	\$ 13,685
Cv. Notes due 2023	0	0	0	4,173	0
Warrant Liability	0	0	0	4,721	0
Lease Liabilities	5,774	4,805	4,467	3,237	3,237
Other LT Liabilities	134	125	117	110	181
Equity	\$ 48,684	\$ 58,716	\$ 100,560	\$ 75,524	\$ 81,825
Total Liabilities & Equity	\$ 61,197	\$ 72,903	\$ 115,356	\$ 102,656	\$ 98,928
	FY2019	FY2020	FY2021	FY2022E	FY2023E
Net Income	10,722	4,165	(31,043)	(30,287)	(13,179)
Depreciation & Amortization	1,341	3,582	9,338	7,620	7,170
Stock Comp	1,494	3,064	4,848	4,944	4,380
Working Capital & Other	(3,569)	(2,887)	3,941	(1,248)	(625)
Operating CF	\$ 9,988	\$ 7,924	\$ (12,916)	\$ (18,971)	\$ (2,254)
Capx	(1,659)	(1,323)	(830)	(335)	(1,000)
Acquisitions	(3,974)	(13,500)	(56,865)	0	0
Other	370	142	192	94	0
Investing Activities	\$ (5,263)	\$ (14,681)	\$ (57,503)	\$ (241)	\$ (1,000)
Equity	11,503	4,214	60,743	1,798	100
Debt	0	0	0	15,584	71
Other	(119)	29	0	35	0
Financing	\$ 11,384	\$ 4,243	\$ 60,743	\$ 17,417	\$ 171
Change in Cash	\$ 16,109	\$ (2,514)	\$ (9,676)	\$ (1,795)	\$ (3,083)

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
 Update – Buy – October 10, 2022 – Price Target \$8.30
 Update – Buy – November 7, 2022 – Price Target \$8.30
 Update – Buy – November 10, 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 28-Oct-22

	Company Coverage		Investment Banking	
Ratings Distribution	# of Companies	% of Total	# of Companies	% of Totals
Market Outperform (Buy)	24	80%	3	13%
Market Perform (Neutral)	5	17%	1	20%
Market Underperform (Sell)	1	3%	0	0%
Total	30	100%	4	13%

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