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Smith Micro Software, Inc. (NASDAQ: SMSI)

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Buy: Verizon Terminates Family Safety Agreement.

We have lowered our price target on Smith Micro Software to $3.50 (from $8.30) after the company disclosed one of its Tier 1 customers, we believe it is Verizon, is terminating its family safety solutions agreement. We maintain our Buy recommendation.

Current Price			**$1.59**
Price Target			**$3.50**
Estimates	F2021A	F2022E	F2023E
Revenues ($M's)	$ 58.4	$ 48.1 E	$ 56.0
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	$ 17.1
	F2021A	F2022E	F2023E
EBITDA ($M's)	$ (1.3)	$ (18.2)E	$ 2.7
1Q March	$ 0.9	$ (3.9)A	$ (3.0)
2Q June	$ 0.0	$ (4.9)A	$ (0.9)
3Q September	$ 0.1	$ (5.2)A	$ 1.1
4Q December	$ (2.3)	$ (4.2)E	$ 3.2
EV/Sales	1.5 x	1.8 x	1.5 x
EV/EBITDA	NM	(4.7)	31.2 x
Stock Data			
52-Week Range	$1.31	-	$4.25
Shares Outstanding (mil.)			56.4
Market Capitalization (mil.)			$90
Enterprise Value (mil.)			$85
Debt to Capital			15%
Cash (mil.)			$0
Cash/Share			$0.00
Average Three Months Trading Volume (K)			97
Insider Ownership			11.9%
Institutional Ownership			14.8%
Short interest (mil.)			2.8%
Dividend / Yield			$0.00/0.0%

Smith Micro announced one of its Tier 1 customers, which accounted for about $4.1 million in quarterly revenue, has decided to terminate its family safety solutions agreement. The termination, which begins in 2024, will result in lower top-line growth next year and a lower total potential market than we had estimated previously. While our revenue estimate for this year is down slightly, we have increased our EBITDA estimate to $2.7 million from a $1.1 million loss. We estimate the company had been spending $1.5 to $2.0 million per quarter on features this customer had requested before migrating to the SP7 platform. We expect this spending to cease immediately and result in improved EBITDA.

For 2024, we have modeled a reduction in Q1 revenue to $13 million, down from $17.1 million in Q4 this year due to the absence of revenues from the customer terminating the agreement. We continue to expect revenue from the company's remaining Tier 1 customers (AT&T and T-Mobile) to grow and model full-year 2024 revenue of $63.4 million. We had not published an estimate for 2024 prior to this report, but we had expected all customers to expand in 2024, so revenues exceeding $80 million before the termination was likely.

The termination of the agreement will result in a requirement that Smith supports the legacy platform for the terminating customer (which we believe is Verizon) until the agreement ends. This will temper the gross margin improvement we had modeled in the second half and lower our gross margin estimate for this year and next, although we expect gross margin to achieve 80% by the end of next year.

Another challenge for the company is the $15 million convertible note that begins to amortize April 1. $5 million of principal is due per quarter for the next three quarters. The company can pay the amount due in cash or stock. If the company elects to pay in stock, the conversion price is the lower of 1) the initial fixed conversion price of $3.35 per share or 2) the greater of A) a 10% discount to the 3-lowest prices of the prior 20 days or B) $0.62. Principal payments in stock at the initial fixed price would require 1.5 million shares; at current prices, it would require 3.1 million shares. We expect the company will try to modify the agreement which would likely result in additional costs.

Valuation: Our price target of $3.50 is based on an EV/Sales multiple of 3.1x on our 2024 revenue estimate of $63.4 million. Our target multiple is lower than our prior target multiple 5.5x and reflects the greater risk created by the termination and our revenue estimate is also lower.

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.

The relationship with Smith's two other Tier 1 carriers, AT&T and T-Mobile is unchanged. Late last year, Smith Micro announced it has executed a new contract with a Tier 1 domestic wireless carrier (we believe it is AT&T) to provide a digital family safety platform. With a new contract in place, we expect marketing activities to increase and subscriber additions to impact the financial results in the beginning of this year. Marketing efforts at T-Mobile have begun at modest levels and we expect these to accelerate.

Even with the loss of Verizon, the company will benefit from improved gross margins and lower opex. 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. 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 are nearing their 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.

Past the loss of Verizon, Smith will 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 will serve two of the three major domestic carriers, whose combined post-paid subscriber base is 5x the number of post-paid subscribers served by Sprint. This suggests an annual revenue opportunity of $150 million.

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. For the two remaining carrier customers this is a potential market of $180 million to $300 million 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.

We believe Verizon will attempt to develop its own family safety platform, and it is unlikely to offer it as a competitive solution leaving Smith as the dominant provider of family location and safety services to the U.S. wireless carrier market. We expect the SafePath platform can expand into the home and international markets that are at least equal in size to the domestic market.

Outlook

Our revenue estimate for 2023 reflects the roll-out of SafePath 7 to AT&T and T-Mobile and stable revenues at Verizon. T-Mobile has already begun marketing this year and we expect AT&T this year as well. 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 this 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% by year-end 2024. EBITDA and EBITDA margin should grow as revenue scales, and we expect EBITDA margin to exceed 20% in 2024.

Valuation

Our price target of $3.50 is based on an EV/Sales multiple of 3.1x on our 2024 revenue estimate of $63.4 million. This multiple is a discount to the peer group with a median multiple of 4.3x.

		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	$ 322.32	$ 15.81	20.4	$145,280.2	$ 19,729.8	7.4x	$ 9,560.6	15.2 x
ASAN	Asana, Inc. Class A	14.75	(0.77)	NM	2,827.6	661.7	4.3x	(148.6)	NM
TEAM	Atlassian Corp Class A	164.62	1.89	87.3	41,464.3	4,024.8	10.3x	756.9	54.8 x
DOCU	DocuSign, Inc.	59.76	2.23	26.8	11,753.9	2,704.0	4.3x	648.1	18.1 x
DBX	Dropbox, Inc. Class A	20.49	1.72	11.9	8,148.8	2,498.6	3.3x	905.4	9.0 x
HUBS	HubSpot, Inc.	388.58	4.44	87.6	18,465.5	2,128.3	8.7x	338.6	54.5 x
NTNX	Nutanix, Inc. Class A	28.09	0.37	75.3	6,573.5	1,938.4	3.4x	182.7	36.0 x
ONTF	ON24, Inc.	9.65	(0.11)	NM	130.8	193.3	0.7x	(2.0)	NM
RNG	RingCentral, Inc. Class A	33.95	3.19	10.6	4,919.2	2,233.2	2.2x	524.8	9.4 x
SMAR	Smartsheet, Inc. Class A	43.41	(0.05)	NM	5,291.9	978.8	5.4x	10.0	528.0 x
TWLO	Twilio, Inc. Class A	63.77	1.31	48.5	8,802.3	4,425.0	2.0x	586.4	15.0 x
WDAY	Workday, Inc. Class A	184.93	4.72	39.2	44,821.9	7,350.3	6.1x	1,956.8	22.9 x
ZM	Zoom Video Communications, Inc. Class A	73.72	3.67	20.1	16,536.6	4,622.0	3.6x	1,572.0	10.5 x
	Median			33.0			4.3x		18.1 x
SMSI	Smith Micro Software, Inc.	$ 1.59	$ 0.01	242.1	$ 133.5	$ 57.2	2.3x	$ 4.7	28.7 x

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	FY2024E
Revenue	$ 43,346	$ 51,300	$ 58,422	$ 12,735	$ 12,674	$ 11,699	$ 11,000	$ 48,108	$ 56,000	$ 63,440
COGS	3,927	5,190	12,698	3,637	3,617	3,629	3,410	14,293	14,582	13,749
Gross Profit	39,419	46,110	45,724	9,098	9,057	8,070	7,590	33,815	41,418	49,691
	91%	89.9%	78.3%	71.4%	71.5%	69.0%	69.0%	70.3%	74.0%	78.3%
SG&A	7,148	9,090	11,581	2,985	3,720	2,986	2,520	12,211	7,993	6,993
R&D	11,119	17,759	26,197	7,402	8,213	7,523	7,057	30,195	23,785	22,000
G&A	9,921	12,801	17,920	4,045	4,026	4,133	3,667	15,871	12,581	11,581
Amort. of Intangible asset	932	2,920	8,100	1,645	1,577	1,545	1,545	6,312	5,874	5,874
Restructuring/Other	194	19	12,864	0	0	0	0	0	0	0
Opex	29,314	42,589	76,662	16,077	17,536	16,187	14,790	64,590	50,233	46,448
Operating Income	$ 10,105	$ 3,521	$ (30,938)	$ (6,979)	$ (8,479)	$ (8,117)	$ (7,200)	$ (30,775)	$ (8,815)	$ 3,242
Interest Income	228	96	34	0	2	0	0	2	0	0
Interest Expense	0	0	(2)	(4)	0	(696)	(225)	(925)	(563)	(563)
Change in Warrant Liability	0	0	0	0	0	1,557	0	1,557	0	0
Other Income (Expense)	469	708	78	0	15	(29)	(29)	(43)	100	100
Pretax Income	10,802	4,325	(30,828)	(6,983)	(8,462)	(7,285)	(7,454)	(30,184)	(9,277)	2,780
Taxes	80	160	215	19	31	27	25	102	100	100
Net Income	10,722	4,165	(31,043)	(7,002)	(8,493)	(7,312)	(7,479)	(30,286)	(9,377)	2,680
Preferred Dividends	(120)	0	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)	$ (9,377)	$ 2,680
Basic Shares	34,490	40,808	51,232	54,501	55,183	55,722	58,615	56,005	60,112	64,841
Diluted Shares	36,968	42,764	51,232	54,501	55,183	55,722	60,615	56,005	60,112	64,841
Basic EPS	$ 0.31	$ 0.10	$ (0.61)	$ (0.13)	$ (0.15)	$ (0.13)	$ (0.13)	$ (0.54)	$ (0.16)	$ 0.04
Diluted EPS	$ 0.29	$ 0.10	$ (0.61)	$ (0.13)	$ (0.15)	$ (0.13)	$ (0.12)	$ (0.54)	$ (0.16)	$ 0.04
Stock Comp	1,494	3,063	4,848	1,065	1,689	1,095	1,095	4,944	4,380	4,380
Amortization	932	2,920	8,100	1,645	1,577	1,545	1,545	6,312	5,874	5,874
Other	(212)	918	15,852	0	0	(484)	0	(484)	0	0
Non-GAAP Net Income	12,816	11,066	(2,243)	(4,292)	(5,227)	(5,156)	(4,839)	(19,514)	877	12,934
Non-GAAP EPS	$ 0.35	$ 0.26	$ (0.04)	$ (0.08)	$ (0.09)	$ (0.09)	$ (0.08)	$ (0.35)	$ 0.01	$ 0.20
Operating Income	10,105	3,521	(30,938)	(6,979)	(8,479)	(8,117)	(7,200)	(30,775)	(8,815)	3,242
Depreciation & Amort.	1,341	3,582	9,338	1,998	1,904	1,849	1,869	7,620	7,170	7,170
Stock Comp	1,494	3,064	4,848	1,065	1,689	1,095	1,095	4,944	4,380	4,380
Other	194	927	15,447	0	0	0	0	0	0	0
EBITDA	$ 13,134	$ 11,094	$ (1,305)	$ (3,916)	$ (4,886)	$ (5,173)	$ (4,236)	$ (18,211)	$ 2,735	$ 14,792
Margin	30.3%	21.6%	-2.2%	-30.7%	-38.6%	-44.2%	-38.5%	-37.9%	4.9%	23.3%

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

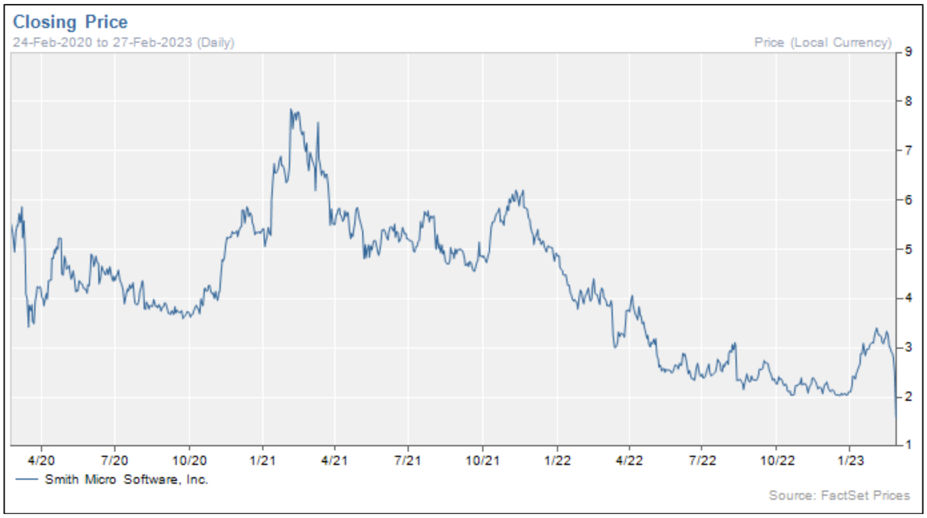
Exhibit 2. Balance Sheet and Cash Flow Statement

($ in 000's)	FY2019	FY2020	FY2021	FY2022E	FY2023E	FY2024E
Cash	28,268	25,754	16,078	14,283	12,818	22,557
A/R	10,894	12,347	10,590	9,041	13,137	15,139
Prepaid Expenses & Other	802	1,189	1,988	1,022	1,591	1,834
Current Assets	$ 39,964	$ 39,290	$ 28,656	$ 24,346	$ 27,546	$ 39,529
Equipment & Improvements	2,109	2,170	2,698	1,693	1,397	1,101
Right-of-use asset	6,464	5,785	5,710	4,709	4,709	4,709
Deferred Tax Assets	94	0	0	0	0	0
Other	234	694	620	547	547	547
Intangible Assets	4,535	12,698	42,631	36,320	30,446	24,572
Goodwill	7,797	12,266	35,041	35,041	35,041	35,041
Total Assets	**$ 61,197**	**$ 72,903**	**$ 115,356**	**$ 102,656**	**$ 99,686**	**$ 105,499**
A/P	2,050	2,282	3,301	3,408	5,306	6,115
Accrued Payroll & Benefits	2,107	2,867	4,055	3,142	4,892	5,638
Operating Lease	1,221	1,433	1,400	1,402	1,402	1,402
Other Accrued Liab.	244	216	436	904	1,407	1,621
Deferred Revenue	98	1,572	176	0	0	0
Convertible Note payable	0	0	0	6,035	0	0
Current Liabilities	$ 5,720	$ 8,370	$ 9,368	$ 14,891	$ 13,007	$ 14,776
Cv. Notes due 2023	0	0	0	4,173	0	0
Warrant Liability	0	0	0	4,721	0	0
Lease Liabilities	5,774	4,805	4,467	3,237	3,237	3,237
Other LT Liabilities	134	125	117	110	171	197
Equity	$ 48,684	$ 58,716	$ 100,560	$ 75,524	$ 83,270	$ 87,289
Total Liabilities & Equity	**$ 61,197**	**$ 72,903**	**$ 115,356**	**$ 102,656**	**$ 99,686**	**$ 105,499**
	FY2019	FY2020	FY2021	FY2022E	FY2023E	FY2024E
Net Income	10,722	4,165	(31,043)	(30,287)	(11,733)	(461)
Depreciation & Amortization	1,341	3,582	9,338	7,620	7,170	7,170
Stock Comp	1,494	3,064	4,848	4,944	4,380	4,380
Working Capital & Other	(3,569)	(2,887)	3,941	(1,248)	(453)	(450)
Operating CF	**$ 9,988**	**$ 7,924**	**$ (12,916)**	**$ (18,971)**	**$ (636)**	**$ 10,639**
Capx	(1,659)	(1,323)	(830)	(335)	(1,000)	(1,000)
Acquisitions	(3,974)	(13,500)	(56,865)	0	0	0
Other	370	142	192	94	0	0
Investing Activities	**$ (5,263)**	**$ (14,681)**	**$ (57,503)**	**$ (241)**	**$ (1,000)**	**$ (1,000)**
Equity	11,503	4,214	60,743	1,798	100	100
Debt	0	0	0	15,584	71	0
Other	(119)	29	0	35	0	0
Financing	**$ 11,384**	**$ 4,243**	**$ 60,743**	**$ 17,417**	**$ 171**	**$ 100**
Change in Cash	**$ 16,109**	**$ (2,514)**	**$ (9,676)**	**$ (1,795)**	**$ (1,465)**	**$ 9,739**

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
Update – Buy – January 18, 2023 – Price Target $8.30
Price Target Change – Buy – February 28, 2023 – Price Target changed from $8.30 to $3.50

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Current as of 22-Feb-23

	Company Coverage		**Investment Banking**	
Ratings Distribution	# of Companies	% of Total	# of Companies	% of Totals
Market Outperform (Buy)	23	68%	1	4%
Market Perform (Neutral)	11	32%	2	18%
Market Underperform (Sell)	0	0%	0	0%
Total	34	100%	3	9%

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