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Vuzix Corporation (NASDAQ: VUZI)

March 2, 2023

Buy: Q4 Review.

Q4 revenue was less than expected as certain customers pushed deployments into the current quarter. We have modeled quarter-to-quarter improvement in sales this year based on broader deployments at customers who have been piloting the company's smart glasses. We also expect OEM orders from defense and commercial customers to begin in the second half.

Q4 revenue of \$2.9 million was short of our \$3.5 million estimate and the EBITDA loss of \$7.3 million exceeded our estimate of a \$5.5 million loss. Gross margin was lower than expected and includes a \$290K inventory write-down and operating expenses were higher than modeled. The company experienced delays in deployments but has seen a surge in deliveries in the first two months of this quarter. Our revenue estimate for this year is unchanged.

Commercial opportunities could be catalyzed by Apple's long-awaited entry into the market with an AR/VR headset. Vuzix offers an ultralite smartglass system for the OEM market that utilizes the company's proprietary waveguide solution and custom microdisplay engine. A consumer smartglass solution is being pursued by many of the major tech companies including Meta, Apple and Alphabet. We expect a robust market will emerge over the coming years and Vuzix is positioning itself to serve that space.

In the defense market, 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 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).

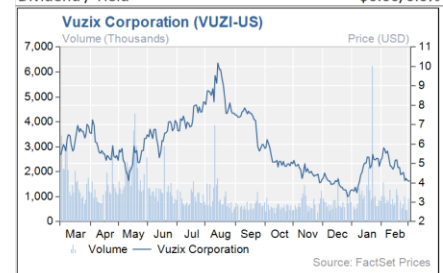
Risk Analysis Risks to achieving our price target include continuing negative impacts of the COVID-19 pandemic on the overall economy, changes to business practices in the medium and long-term due to the COVID-19 pandemic, potential competition from Apple and Facebook, increased competition from Google and RealWear, ability to deliver new products on time and manufacturing costs as sales ramp.

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Current Price				\$4.10
Price Target				\$15.00
Estimates	F2022A	F2023E	F2024E	
Revenues (\$M's)	\$ 11.8	\$ 20.5 E	\$ 25.5	
1Q March	\$ 2.5	\$ 4.6 E	\$ 5.6	
2Q June	\$ 3.0	\$ 5.1 E	\$ 6.1	
3Q September	\$ 3.4	\$ 5.6 E	\$ 6.6	
4Q December	\$ 2.9	\$ 5.1 E	\$ 7.1	
	F2022A	F2023E	F2024E	
EBITDA (\$M's)	\$ (23.9)	\$ (20.5)E	\$ (20.3)	
1Q March	\$ (5.6)	\$ (5.4)E	\$ (5.5)	
2Q June	\$ (5.8)	\$ (5.1)E	\$ (5.2)	
3Q September	\$ (5.4)	\$ (4.8)E	\$ (4.9)	
4Q December	\$ (7.3)	\$ (5.1)E	\$ (4.6)	
EV/Sales	NM	9.2 x	7.4 x	
EV/EBITDA	NM	(9.2) x	(9.3) x	
Stock Data				
52-Week Range	\$3.27	-	\$10.49	
Shares Outstanding (mil.)				63.7
Market Capitalization (mil.)				\$261
Enterprise Value (mil.)				\$189
Debt to Capital				0%
Cash & Equivalents (mil.)				\$72.6
Cash/Sh.				\$1.14
Average Three Months Trading Volume (K)				922
Insider Ownership				7.2%
Institutional Ownership				45.5%
Short interest (mil.)				22.8%
Dividend / Yield				\$0.00/0.0%


Please find Important Disclosures beginning on Page 6.

Q4 Actual v Estimates

Q4 22	Actual	Estimates	Delta	% Delta
Total Sales	\$ 2,898	\$ 3,500	\$ (602)	-17%
Total COGS	3,024	2,512	512	20%
Total Gross Profit	(126)	988	(1,114)	-113%
R&D	3,136	3,441	(305)	-9%
Sales & Marketing	2,183	1,981	202	10%
G&A	5,731	5,250	481	9%
D&A	640	449	191	43%
Operating Expense	11,725	11,120	605	5%
Operating Income	\$ (11,851)	\$ (10,132)	(1,719)	-17%
Interest & Other	1,093	488	605	
Pretax Income	\$ (10,758)	\$ (9,643)	\$ (1,115)	
Income Taxes	0	0		
Net Income	\$ (10,758)	\$ (9,643)	\$ (1,115)	
Preferred Dividends	0	0		
Net to Common	\$ (10,758)	\$ (9,643)	\$ (1,115)	-12%
Diluted Shares	63,740	63,740		
EPS	\$ (0.17)	\$ (0.15)	\$ (0.02)	-12%
Operating Income	\$ (11,851)	\$ (10,132)		
D&A	762	732		
Stock Comp	3,759	3,881		
Other				
EBITDA	\$ (7,330)	\$ (5,519)		

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.

Meta investing billions and billions shows it will take time and dollars to make the market.

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 \$10, 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 deliver new products on time and manufacturing costs as sales ramp.

Exhibit 1. Income Statement
(\$ in 000's except per share data)

	2020	2021	2022 A	Q1 23 E	Q2 23 E	Q3 23 E	Q4 23 E	2023 E	2024 E
Total Sales	\$ 11,581	\$ 13,165	\$ 11,836	\$ 4,625	\$ 5,125	\$ 5,625	\$ 5,125	\$ 20,500	\$ 25,500
Total COGS	10,984	11,596	10,353	3,397	3,597	3,797	3,597	14,387	16,387
Total Gross Profit	598	1,568	1,483	1,228	1,528	1,828	1,528	6,113	9,113
R&D	7,568	11,675	12,677	3,371	3,371	3,371	3,371	13,485	14,159
Sales & Marketing	4,040	6,119	8,078	2,175	2,175	2,175	2,175	8,701	9,136
G&A	6,915	22,503	21,039	5,184	5,184	5,184	5,184	20,738	21,165
D&A	1,129	988	1,789	449	449	449	449	1,794	0
Other	74	133	133	0	0	0	0	0	0
Operating Expense	19,725	41,418	43,716	11,179	11,179	11,179	11,179	44,718	44,460
Operating Income	\$ (19,127)	\$ (39,849)	\$ (42,233)	\$ (9,951)	\$ (9,651)	\$ (9,351)	\$ (9,651)	\$ (38,605)	\$ (35,348)
Interest & Other	1,175	(397)	1,469	(19)	(19)	(19)	(19)	(76)	(76)
Pretax Income	\$ (17,952)	\$ (40,246)	\$ (40,764)	\$ (9,970)	\$ (9,670)	\$ (9,370)	\$ (9,670)	\$ (38,681)	\$ (35,424)
Income Taxes	0	0	0	0	0	0	0	0	0
Net Income	\$ (17,952)	\$ (40,246)	\$ (40,764)	\$ (9,970)	\$ (9,670)	\$ (9,370)	\$ (9,670)	\$ (38,681)	\$ (35,424)
Preferred Dividends	(2,056)	0	0	0	0	0	0	0	0
Net to Common	\$ (20,008)	\$ (40,246)	\$ (40,764)	\$ (9,970)	\$ (9,670)	\$ (9,370)	\$ (9,670)	\$ (38,681)	\$ (35,424)
Diluted Shares	38,110	61,125	63,738	63,474	63,748	64,455	65,836	64,378	68,791
EPS	\$ (0.53)	\$ (0.66)	\$ (0.64)	\$ (0.16)	\$ (0.15)	\$ (0.15)	\$ (0.15)	\$ (0.60)	\$ (0.51)
Operating Income	\$ (19,127)	\$ (39,849)	\$ (42,233)	\$ (9,951)	\$ (9,651)	\$ (9,351)	\$ (9,651)	\$ (38,605)	\$ (35,348)
D&A	2,642	2,310	2,588	762	762	762	762	3,049	0
Stock Comp	2,806	17,303	15,776	3,759	3,759	3,759	3,759	15,037	15,037
EBITDA	\$ (13,680)	\$ (20,237)	\$ (23,870)	\$ (5,430)	\$ (5,130)	\$ (4,830)	\$ (5,130)	\$ (20,520)	\$ (20,311)

Source: Vuzix Corporation and Dawson James Securities estimates

Exhibit 2. Balance Sheet and Cash Flow Statement

(\$ in 000's)

	2020	2021	2022 A	2023 E	2024 E
Cash	36,070	120,204	72,564	28,425	16,120
A/R	1,389	2,242	3,559	3,370	4,685
Note Receivable	0	0	0	0	0
Revenue in excess of billings	0	0	269	269	269
Employee Retention Credit Rec.	0	0	467	467	467
Inventory	6,101	12,152	11,268	11,510	14,070
Prepaid Expenses & Other	<u>1,496</u>	<u>2,552</u>	<u>3,115</u>	<u>5,508</u>	<u>7,657</u>
Current Assets	\$ 45,055	\$ 137,150	\$ 91,241	\$ 49,548	\$ 43,268
Tooling & Equipment	2,837	5,190	3,879	3,830	3,781
Operating Lease Right of use	1,517	1,117	956	956	956
Patents & Trademarks	1,593	1,988	2,220	2,220	2,220
Licenses, net	194	1,390	30,159	64,409	64,409
Intangible Assets & Other	1,275	1,631	3,858	3,758	3,658
Total Assets	\$ 52,471	\$ 148,467	\$ 132,313	\$ 124,721	\$ 118,292
Accounts Payable	1,517	2,055	1,212	2,143	2,979
Unearned Revenue	41	28	29	51	71
Accrued Expenses	983	1,419	1,671	2,954	4,107
Licensing Fees Commitment	0	0	11,500	0	0
Taxes Payable	110	120	215	380	529
Operating Lease Right of use	<u>444</u>	<u>534</u>	<u>651</u>	<u>651</u>	<u>651</u>
Current Liabilities	\$ 3,095	\$ 4,156	\$ 15,277	\$ 6,180	\$ 8,337
Operating Lease Right of use	1,073	583	305	305	305
Licensing Fees Commitment	0	0	0	0	0
Equity	<u>48,303</u>	<u>143,728</u>	<u>116,730</u>	<u>118,236</u>	<u>109,649</u>
Total Liabilities & Equity	\$ 52,471	\$ 148,467	\$ 132,313	\$ 124,721	\$ 118,292
	2020	2021	2022 A	2023 E	2024 E
Net Income	\$ (17,952)	\$ (40,377)	\$ (40,764)	\$ (38,681)	\$ (35,424)
D&A	2,642	2,310	2,588	3,049	3,049
Stock Comp	2,806	17,303	15,776	15,037	15,037
Other	41	784	323	100	100
Working Capital	<u>(1,501)</u>	<u>(6,999)</u>	<u>(2,444)</u>	<u>(11,544)</u>	<u>(3,867)</u>
Operating Cash Flow	\$ (13,964)	\$ (26,980)	\$ (24,521)	\$ (32,039)	\$ (21,105)
CapEx	(497)	(3,809)	(1,724)	(3,000)	(3,000)
Acquisition	0	0	(18,823)	0	0
Other	<u>(989)</u>	<u>(1,043)</u>	<u>(624)</u>	<u>(11,500)</u>	<u>0</u>
Investing Activities	\$ (1,486)	\$ (4,852)	\$ (21,171)	\$ (14,500)	\$ (3,000)
Equity	39,357	127,112	(1,948)	2,400	11,800
Debt	1,556	0	0	0	0
Other	0	(1,144)	0	0	0
Preferred	<u>0</u>	<u>(10,000)</u>	<u>0</u>	<u>0</u>	<u>0</u>
Financing Activities	\$ 40,913	\$ 115,967	\$ (1,948)	\$ 2,400	\$ 11,800
Change in Cash	\$ 25,463	\$ 84,134	\$ (47,640)	\$ (44,139)	\$ (12,305)

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
- Update – Buy – November 2, 2022 – Price Target \$15.00
- Update – Buy – November 10, 2022 – Price Target \$15.00
- Update – Buy – November 17, 2022 – Price Target \$15.00
- Update – Buy – January 11, 2023 – Price Target \$15.00
- Update – Buy – March 2, 2023 – Price Target \$15.00

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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	3%
Market Perform (Neutral)	11	32%	2	6%
Market Underperform (Sell)	0	0%	0	0%
Total	34	100%	3	9%

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