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## Smith Micro Software, Inc. (NASDAQ: SMSI)

August 10, 2023

### Buy: Q2 Review. Expect Sequential Revenue Growth in Q3.

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We expect sequential revenue growth in Q3 and a return to positive EBITDA due to an aggressive cost-cutting program and higher gross margin as the multi-year effort to consolidate all customers on a common platform is complete. We think there is a significant upside to the shares, which are trading at a meaningful discount to the group median EV/Sales. We reiterate our Buy recommendation.

Q2 EBITDA exceeded our estimate on slightly lower than expected revenue. The company's aggressive cost-cutting program resulted in better than forecast gross margin and operating expenses. Cash opex was \$8.2 million, down \$3 million, or 27% from Q2 levels and down 42% from the year-ago quarter. We forecast positive EBITDA in Q3 from higher revenue, growing gross margin and continuation of the company's rapid, and aggressive cost-cutting program.

Revenue declined in Q2 from Q1 levels as the migration of Sprint's customer base to the T-Mobile platform resulted in lower revenue from both the Family Safety and CommSuite business. However, AT&T is expected to launch marketing of its Secure Family service on the SafePath platform this quarter and the Sprint migration to T-Mobile is largely complete. The company is guiding to a 4% to 8% sequential increase in revenue in Q3, the first Q/Q increase since Q3 2021.

Gross margin increased to 75% from 70% in Q1, even on lower revenue. The completion of the multi-year effort to merge the codes of acquired services onto the SafePath platform and an aggressive cost-cutting program were behind the margin improvement. Continued cost restraint and higher revenue in Q3 is expected to result in continued improvement in gross margin in Q3.

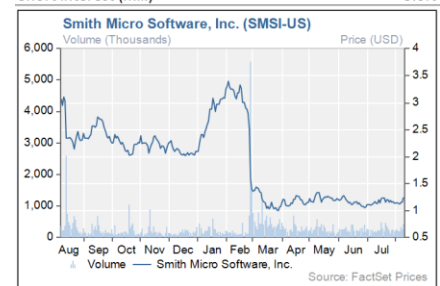
The company reached its goal of a \$4 million quarterly reduction in cash opex and expects another sequential drop of 2% to 5% in Q3 from Q2 levels. Much of these cuts are permanent and some will return when cash flow is consistently at a higher level.

Additional customer wins are expected in all three product segments over the coming quarters. This will likely impact revenue in the second-half of 2024 and combined with the increase in revenue from AT&T should result in Q/Q and Y/Y revenue growth in the second half of next year.

**Valuation:** Our price target of \$3.50 is based on an EV/Sales multiple of 4x on our Q4 2024 run rate revenue estimate of \$54 million. Our target multiple is a modest discount to the group median EV/Sales multiple of 4.2x.

**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	\$1.25		
Price Target	\$3.50		
Estimates	F2022A	F2023E	F2024E
<b>Revenues (\$M's)</b>	\$ 48.5	\$ 43.3 E	\$ 43.9
1Q March	\$ 12.7	\$ 10.9 A	\$ 8.4
2Q June	\$ 12.7	\$ 10.3 A	\$ 10.1
3Q September	\$ 11.7	\$ 10.8 E	\$ 11.7
4Q December	\$ 11.4	\$ 11.2 E	\$ 13.6
	F2022A	F2023E	F2024E
<b>EBITDA (\$M's)</b>	\$ (16.4)	\$ (2.8)E	\$ 2.8
1Q March	\$ (3.9)	\$ (3.4)A	\$ (1.4)
2Q June	\$ (4.2)	\$ (0.6)A	\$ 0.1
3Q September	\$ (4.9)	\$ 0.4 E	\$ 1.4
4Q December	\$ (3.6)	\$ 0.8 E	\$ 2.7
EV/Sales	1.8 x	2.0 x	2.0 x
EV/EBITDA	NM	NM	30.1 x
Stock Data			
52-Week Range	\$0.95	-	\$3.47
Shares Outstanding (mil.)	65.2		
Market Capitalization (mil.)	\$82		
Enterprise Value (mil.)	\$86		
Debt to Capital	13%		
Cash (mil.)	\$6		
Cash/Share	\$0.10		
Average Three Months Trading Volume (K)	349		
Insider Ownership	11.4%		
Institutional Ownership	14.0%		
Short interest (mil.)	3.0%		



Share count rose almost 5 million for debt and interest payments and we expect further share increases until the convertible note is paid off by the end of this year. The conversion ratio of the stock is based on market prices so positive news that drives the shares higher will reduce the number of shares required to pay this liability.

Q1 2024 revenue is expected to decline as the Verizon business ceases, but we expect sequential growth to resume in Q2. EBITDA for the year is expected to be positive but there is significant leverage to higher revenue levels as costs are mostly fixed. The company is pursuing additional family safety and ViewSpot customers, domestically and abroad, but we have not included new wins in our model.

At quarter end, the company had \$6.4 million in cash and the scale and pace of the cost-cutting puts the company in a solid position to meet its cash needs internally.

### Actual v Estimates

<b>Q2 23</b>			
<b>\$ in 000's except per share</b>	<b>Actual</b>	<b>Estimates</b>	<b>Delta</b>
Revenue	\$ 10,338	\$ 10,630	-3%
COGS	2,589	2,976	
Gross Profit	7,749	7,654	1%
SG&A	2,628	2,636	
R&D	3,705	4,111	
G&A	3,040	2,645	
Amort. of Intangible asset	1,620	1,686	
Opex	10,993	11,078	-1%
Operating Income	\$ (3,244)	\$ (3,424)	5%
Interest Income	0	0	
Other Income (Expense)	(811)	(667)	
Pretax Income	(5,663)	(4,278)	
Taxes	2	25	
Net Income	(5,665)	(4,303)	
Diluted Shares	62,453	65,843	
Diluted EPS	\$ (0.09)	\$ (0.07)	
Operating Income	(3,244)	(3,424)	
Depreciation & Amortization	1,633	1,946	
Stock Comp	1,030	945	
Other	84	0	
EBITDA	\$ (497)	\$ (533)	7%
Margin	-4.8%	-5.0%	

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

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. We expect AT&T growth to begin Q3 and this is likely to spur T-Mobile to follow. Assuming lags between marketing and subscription as well as trial periods common to the industry, we expect modest SafePath Q/Q revenue growth beginning Q3 and a more aggressive growth rate in 2024, adjusted for the absence of Verizon in Q1.

EBITDA and margins should follow revenue growth. Gross margin is modeled to improve through year-end and is estimated to achieve 80% by mid-year 2024. EBITDA and EBITDA margin should grow as revenue scales, and we expect EBITDA margin to approach 20% by the end of 2024.

### Estimates: Prior v Current

	2023E		2024E	
	Old	New	Old	New
Revenue (\$M)	\$ 43.5	\$ 43.3	\$ 43.6	\$ 43.9
Non-GAAP EPS	\$ (0.11)	\$ (0.08)	\$ (0.01)	\$ 0.02
EBITDA (\$M)	\$ (4.0)	\$ (2.8)	\$ 0.9	\$ 2.8

Source: Dawson James Securities estimates.

## Valuation

Our price target of \$3.50 is based on an EV/Sales multiple of 4x on our Q4 2024 run-rate revenue estimate of \$54 million. This multiple is a modest discount to the peer group with a median multiple of 4.2x.

		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	\$ 513.78	\$ 17.16	29.9	\$234,801.5	\$ 20,933.7	11.2x	\$ 10,090.2	23.3 x
ASAN	Asana, Inc. Class A	21.23	(0.41)	NM	4,439.2	705.7	6.3x	(72.7)	NM
TEAM	Atlassian Corp Class A	192.34	2.21	86.8	49,921.8	4,275.4	11.7x	849.2	58.8 x
DOCU	DocuSign, Inc.	50.70	2.62	19.3	9,926.6	2,822.2	3.5x	728.7	13.6 x
DBX	Dropbox, Inc. Class A	27.61	1.99	13.9	10,713.1	2,561.6	4.2x	1,000.1	10.7 x
HUBS	HubSpot, Inc.	488.07	5.98	81.7	23,483.7	2,391.8	9.8x	426.8	55.0 x
NTNX	Nutanix, Inc. Class A	29.58	0.78	37.8	6,949.9	2,103.4	3.3x	262.5	26.5 x
ONTF	ON24, Inc.	6.93	0.04	182.4	131.2	149.0	0.9x	(3.8)	NM
RNG	RingCentral, Inc. Class A	29.71	3.46	8.6	4,597.4	2,334.3	2.0x	547.8	8.4 x
SMAR	Smartsheet, Inc. Class A	40.00	0.54	74.7	5,010.6	1,048.4	4.8x	92.0	54.5 x
TWLO	Twilio, Inc. Class A	59.69	1.97	30.2	8,108.2	4,311.1	1.9x	717.7	11.3 x
WDAY	Workday, Inc. Class A	225.56	5.87	38.4	56,301.3	7,852.8	7.2x	2,158.8	26.1 x
ZM	Zoom Video Communications, Inc. Class A	66.55	4.35	15.3	14,581.8	4,596.1	3.2x	1,794.0	8.1 x
	Median			34.0			4.2x		23.3 x
SMSI	Smith Micro Software, Inc.	\$ 1.25	\$ (0.07)	NM	\$ 78.8	\$ 43.6	1.8x	\$ 0.6	128.7 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	2020	2021	2022	Q1 23 A	Q2 23 A	Q3 23 E	Q4 23 E	2023 E	2024 E
Revenue	\$ 51,300	\$ 58,422	\$ 48,513	\$ 10,930	\$ 10,338	\$ 10,825	\$ 11,205	\$ 43,298	\$ 43,858
COGS	5,190	12,698	14,210	3,282	2,589	2,652	2,689	11,212	9,311
Gross Profit	46,110	45,724	34,303	7,648	7,749	8,173	8,516	32,086	34,547
	89.9%	78.3%	70.7%	70.0%	75.0%	75.5%	76.0%	74.1%	78.8%
SG&A	9,090	11,581	12,887	3,554	2,628	2,536	2,536	11,254	10,334
R&D	17,759	26,197	29,870	5,868	3,705	3,575	3,575	16,724	14,569
G&A	12,801	17,920	16,161	3,475	3,040	2,934	2,934	12,382	11,954
Amort. of Intangible asset	2,920	8,100	6,312	1,686	1,620	1,620	1,620	6,546	5,874
Restructuring/Other	19	12,864	0	0	0	0	0	0	0
Opex	42,589	76,662	65,230	14,583	10,993	10,665	10,665	46,906	42,732
Operating Income	\$ 3,521	\$ (30,938)	\$ (30,927)	\$ (6,935)	\$ (3,244)	\$ (2,492)	\$ (2,149)	\$ (14,820)	\$ (8,185)
Interest Income	96	34	0	0	0	0	0	0	0
Interest Expense	0	(2)	(2,680)	(2,260)	(2,037)	(113)	(38)	(4,447)	(563)
Change in Warrant Liability	0	0	4,669	2,984	429	0	0	3,413	0
Other Income (Expense)	708	78	(115)	(667)	(811)	(811)	(811)	(3,100)	100
Pretax Income	4,325	(30,828)	(29,053)	(6,878)	(5,663)	(3,416)	(2,998)	(18,954)	(8,648)
Taxes	160	215	226	9	2	25	25	61	100
Net Income	4,165	(31,043)	(29,279)	(6,887)	(5,665)	(3,441)	(3,023)	(19,015)	(8,748)
Diluted Shares	42,764	51,232	55,422	61,646	62,453	70,181	71,425	67,959	75,527
Diluted EPS	\$ 0.10	\$ (0.61)	\$ (0.53)	\$ (0.11)	\$ (0.09)	\$ (0.05)	\$ (0.04)	\$ (0.28)	\$ (0.12)
Stock Comp	3,063	4,848	4,370	945	1,030	1,030	1,030	4,035	4,120
Amortization	2,920	8,100	6,312	1,700	1,633	1,620	1,620	6,546	5,874
Other	918	15,852	(201)	633	2,368	0	0	3,001	0
Non-GAAP Net Income	11,066	(2,243)	(18,798)	(3,609)	(634)	(791)	(373)	(5,433)	1,246
Non-GAAP EPS	\$ 0.26	\$ (0.04)	\$ (0.34)	\$ (0.06)	\$ (0.01)	\$ (0.01)	\$ (0.01)	\$ (0.08)	\$ 0.02
Operating Income	3,521	(30,938)	(30,927)	(6,935)	(3,244)	(2,492)	(2,149)	(14,820)	(8,185)
Depreciation & Amort.	3,582	9,338	7,556	1,700	1,633	1,880	1,880	7,093	6,914
Stock Comp	3,064	4,848	4,948	945	1,030	1,030	1,030	4,035	4,120
Other	927	15,447	2,015	690	84	0	0	774	0
EBITDA	\$ 11,094	\$ (1,305)	\$ (16,408)	\$ (3,600)	\$ (497)	\$ 418	\$ 761	\$ (2,918)	\$ 2,849
Margin	21.6%	-2.2%	-33.8%	-32.9%	-4.8%	3.9%	6.8%	-6.7%	6.5%

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

**Exhibit 2. Balance Sheet and Cash Flow Statement**

(\$ in 000's)	2020	2021	2022	2023 E	2024 E
Cash	25,754	16,078	14,026	11,932	12,574
A/R	12,347	10,590	10,501	8,596	10,428
Prepaid Expenses & Other	1,189	1,988	1,983	3,632	4,406
<b>Current Assets</b>	<b>\$ 39,290</b>	<b>\$ 28,656</b>	<b>\$ 26,510</b>	<b>\$ 24,160</b>	<b>\$ 27,407</b>
Equipment & Improvements	2,170	2,698	1,498	1,097	1,057
Right-of-use asset	5,785	5,710	3,722	3,033	3,033
Other	694	620	490	485	485
Intangible Assets	12,698	42,631	36,320	30,115	24,241
Goodwill	12,266	35,041	35,041	35,041	35,041
<b>Total Assets</b>	<b>\$ 72,903</b>	<b>\$ 115,356</b>	<b>\$ 103,581</b>	<b>\$ 93,931</b>	<b>\$ 91,264</b>
A/P	2,282	3,301	3,236	3,623	4,396
Accrued Payroll & Benefits	2,867	4,055	3,883	2,935	3,561
Operating Lease	1,433	1,400	1,441	1,454	1,454
Other Accrued Liab.	216	436	1,589	1,982	2,405
Deferred Revenue	1,572	176	0	0	0
Convertible Note payable	0	0	9,007	0	0
Derivative liabilities	0	0	1,575	0	0
<b>Current Liabilities</b>	<b>\$ 8,370</b>	<b>\$ 9,368</b>	<b>\$ 20,731</b>	<b>\$ 9,995</b>	<b>\$ 11,815</b>
Warrant Liability	0	0	3,317	0	0
Lease Liabilities	4,805	4,467	2,976	2,196	2,196
Other LT Liabilities	125	117	178	193	234
<b>Equity</b>	<b>\$ 58,716</b>	<b>\$ 100,560</b>	<b>\$ 76,379</b>	<b>\$ 81,547</b>	<b>\$ 77,019</b>
<b>Total Liabilities &amp; Equity</b>	<b>\$ 72,903</b>	<b>\$ 115,356</b>	<b>\$ 103,581</b>	<b>\$ 93,931</b>	<b>\$ 91,264</b>
	2020	2021	2022	2023 E	2024 E
Net Income	4,165	(31,043)	(29,279)	(19,015)	(8,748)
Depreciation & Amortization	3,582	9,338	7,556	7,092	6,914
Stock Comp	3,064	4,848	4,948	4,035	4,120
Working Capital & Other	(2,887)	3,941	(2,486)	3,424	(745)
<b>Operating CF</b>	<b>\$ 7,924</b>	<b>\$ (12,916)</b>	<b>\$ (19,261)</b>	<b>\$ (4,464)</b>	<b>\$ 1,542</b>
Capx	(1,323)	(830)	(49)	(497)	(1,000)
Acquisitions	(13,500)	(56,865)	0	0	0
Other	142	192	164	71	0
<b>Investing Activities</b>	<b>\$ (14,681)</b>	<b>\$ (57,503)</b>	<b>\$ 115</b>	<b>\$ (426)</b>	<b>\$ (1,000)</b>
Equity	4,214	60,743	3,000	50	100
Debt	0	0	14,036	2,746	0
Other	29	0	58	0	0
<b>Financing</b>	<b>\$ 4,243</b>	<b>\$ 60,743</b>	<b>\$ 17,094</b>	<b>\$ 2,796</b>	<b>\$ 100</b>
<b>Change in Cash</b>	<b>\$ (2,514)</b>	<b>\$ (9,676)</b>	<b>\$ (2,052)</b>	<b>\$ (2,094)</b>	<b>\$ 642</b>

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  
 Update – Buy – March 10, 2023 – Price Target \$3.50  
 Update – Buy – May 12, 2023 – Price Target \$3.50  
 Update – Buy – August 10, 2023 – Price Target \$3.50

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- 2) **Neutral:** The analyst believes the price of the stock is fairly valued for the next 12-18 months;
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Current as of 3-Aug-23

	<b>Company Coverage</b>		<b>Investment Banking</b>	
<b>Ratings Distribution</b>	# of Companies	% of Total	# of Companies	% of Totals
Market Outperform (Buy)	24	69%	3	8.60%
Market Perform (Neutral)	11	31%	3	8.60%
Market Underperform (Sell)	0	0%	0	0.00%
<b>Total</b>	<b>35</b>	<b>100%</b>	<b>6</b>	<b>17.20%</b>

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