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Smith Micro Software, Inc. (NASDAQ: SMSI)

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Buy: Debt Retired.

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Smith Micro has retired the \$15 million convertible note issued in August 2022. The company is again debt free. We expect sequential revenue growth to begin in Q2 and accelerate in the second half.

Growth this year will be driven by the expansion of AT&T's Secure Family service and potentially T-Mobile later in the year. We expect a modest contribution from the new carrier in Europe. The company is also introducing a new platform, SafePath Global, to target smaller carriers that do not have the resources to develop a customized SafePath implementation, and is also developing a SafePath Premium service targeted to families seeking even greater control of their digital lives.

The company is again debt-free with the repayment of the \$15 million convertible note issued in August of 2022. The loss of Verizon announced in early 2023 and the severe downturn in the microcap market last year resulted in upwards of 20 million shares issued to service the debt, far higher than anticipated at the time of issuance.

Smith recently announced a multiyear contract with a Tier 1 European Mobile Operator for SafePath. We expect this to have an initial modest impact in the second half of 2024 and meaningful revenue contribution in 2025. The signing of this contract is a significant accomplishment for the company and we expect meaningful revenue contribution in 2025.

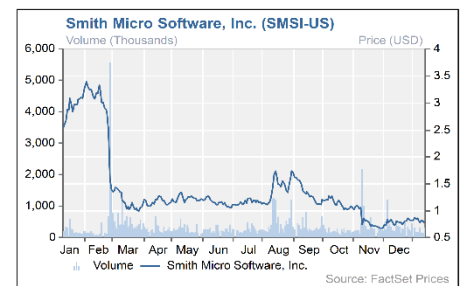
Smith estimates the number of multi-line accounts served by each of the three major domestic wireless carriers at between 15 and 20 million and the number of accounts that could be served by Smith at between 3 and 5 million per carrier. This equals 9 to 15 million accounts each paying on average \$8 to \$10 per month, or a revenue contribution to the carriers of between \$0.9 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 \$216 million to \$450 million annually. For the company's two carrier customers, this is a potential market of \$144 million to \$300 million annually.

Q4 was impacted by the cessation of Verizon, about 1 month earlier than we forecast. This will have a negative impact on gross margin as costs associated with that account will continue for a short period of time past the cessation of revenues. Those costs, and costs associated with the development and launch of AT&T's platform will be eliminated in the coming months and deployed to other areas such as SafePath Global and SafePath Premium. We expect gross margin to improve as those costs are eliminated and the business scales.

Valuation: Our price target of \$3.50 is based on an EV/Sales multiple of 5x on our Q4 2024 run rate revenue estimate of \$50 million. Our target multiple is a premium to the group median EV/Sales multiple of 4.7x, but far below the multiples of high-margin comps.

Risks: Risks to achieving our price target include declines in the CommSuite product line, scaling the business with its two major domestic customers, customer concentration, and expanding its customer base in Europe.

Current Price	\$0.77		
Price Target	\$3.50		
Estimates	F2022A	F2023E	F2024E
Revenues (\$M's)	\$ 48.5	\$ 41.1 E	\$ 40.4
1Q March	\$ 12.7	\$ 10.9 A	\$ 7.5
2Q June	\$ 12.7	\$ 10.3 A	\$ 9.3
3Q September	\$ 11.7	\$ 11.0 A	\$ 11.0
4Q December	\$ 11.4	\$ 8.8 E	\$ 12.5
EBITDA (\$M's)	F2022A	F2023E	F2024E
EBITDA (\$M's)	\$ (16.4)	\$ (4.6)E	\$ 0.4
1Q March	\$ (3.9)	\$ (3.6)A	\$ (2.1)
2Q June	\$ (4.2)	\$ (0.5)A	\$ (0.4)
3Q September	\$ (4.9)	\$ 0.7 A	\$ 1.0
4Q December	\$ (3.6)	\$ (1.2)E	\$ 1.9
EV/Sales	1.1 x	1.3 x	1.3 x
EV/EBITDA	NM	NM	122.5 x
Stock Data			
52-Week Range	\$0.65	-	\$3.47
Shares Outstanding (mil.)	70.4		
Market Capitalization (mil.)	\$54		
Enterprise Value (mil.)	\$53		
Debt to Capital	8%		
Cash (mil.)	\$8		
Cash/Share	\$0.11		
Average Three Months Trading Volume (K)	203		
Insider Ownership	10.3%		
Institutional Ownership	14.0%		
Short interest (mil.)	2.9%		



Outlook

Revenue is expected to decline Q/Q in Q4 2023 and Q1 of 2024. The Verizon account ceased at the end of November. This is over \$4 million in quarterly revenues and accounts for ~\$1.3 million in sales decline in Q4 and an additional almost \$2.5 million decline in Q1 of 2024. However, we expect this to be offset somewhat in Q1 by the ramping of marketing efforts at AT&T.

EBITDA and margins should follow revenue growth. Gross margin is modeled to improve through 2024 as revenue scales and is estimated to achieve 80% by the second half of 2024. EBITDA and EBITDA margin should grow as revenue scales, and we expect EBITDA margin to exceed 15% by the end of 2024.

Past the loss of Verizon, Smith will benefit from 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.

Revenue can grow rapidly when carriers market the product. For instance, revenues from Sprint increased from \$3.3 million to \$18 million in 12 months and increased again to \$28 million in the following 12 months before its acquisition by T-Mobile. It is reasonable to expect a similar trajectory with AT&T and T-Mobile assuming similar marketing support. But the two existing carrier customers have a postpaid subscriber base five times larger than Sprint when it was Smith's customer.

At quarter end, the company had \$8.0 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.

Valuation

Our price target of \$3.50 is based on an EV/Sales multiple of 5x on our Q4 2024 run rate revenue estimate of \$50 million. Our target multiple is about equal to the group median EV/Sales multiple of 5.1x, but far below the multiples of high-margin comps.

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		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	\$ 597.49	\$ 18.22	32.8	\$ 266,338.7	\$ 21,776.6	12.2x	\$ 10,655.4	25.0 x
ASAN	Asana, Inc. Class A	18.57	(0.20)	NM	4,031.9	715.5	5.6x	(36.1)	NM
TEAM	Atlassian Corp Class A	242.16	2.70	89.7	62,310.4	4,625.8	13.5x	1,016.2	61.3 x
DOCU	DocuSign, Inc.	61.35	2.89	21.3	10,687.9	2,899.0	3.7x	793.7	13.5 x
DBX	Dropbox, Inc. Class A	31.06	2.08	15.0	11,397.5	2,578.1	4.4x	1,037.5	11.0 x
HUBS	HubSpot, Inc.	570.33	6.69	85.3	27,872.9	2,542.0	11.0x	479.6	58.1 x
NTNX	Nutanix, Inc. Class A	49.11	1.08	45.6	11,615.4	2,273.1	5.1x	384.5	30.2 x
ONTF	ON24, Inc.	6.93	0.05	132.3	83.0	147.5	0.6x	0.6	140.3 x
RNG	RingCentral, Inc. Class A	33.11	3.53	9.4	4,722.3	2,414.8	2.0x	583.8	8.1 x
SMAR	Smartsheet, Inc. Class A	48.57	0.92	52.6	6,036.8	1,130.6	5.3x	136.1	44.4 x
TWLO	Twilio, Inc. Class A	71.81	2.52	28.5	10,238.1	4,449.8	2.3x	873.3	11.7 x
WDAY	Workday, Inc. Class A	278.97	6.54	42.6	69,184.7	8,388.6	8.2x	2,207.1	31.3 x
ZM	Zoom Video Communications, Inc. Class A	68.50	4.69	14.6	14,335.6	4,644.6	3.1x	1,866.2	7.7 x
	Median			37.7			5.1x		27.6 x
SMSI	Smith Micro Software, Inc.	\$ 0.77	\$ (0.16)	NM	\$ 56.7	\$ 40.4	1.4x	\$ 0.6	97.2 x

Source: FactSet and Dawson James Securities estimates.

Risk Analysis

Risks to achieving our price target include declines in the CommSuite product line, scaling the business with its two major domestic customers, customer concentration, and expanding its customer base in Europe.

Exhibit 1. Income Statement

\$ in 000's	2020	2021	2022	Q1 23 A	Q2 23 A	Q3 23 A	Q4 23 E	2023 E	2024 E
Revenue	\$ 51,300	\$ 58,422	\$ 48,513	\$ 10,930	\$ 10,338	\$ 11,001	\$ 8,805	\$ 41,074	\$ 40,380
COGS	5,190	12,698	14,210	3,282	2,589	2,528	2,421	10,820	8,849
Gross Profit	46,110	45,724	34,303	7,648	7,749	8,473	6,384	30,254	31,531
	89.9%	78.3%	70.7%	70.0%	75.0%	77.0%	72.5%	73.7%	78.1%
SG&A	9,090	11,581	12,887	3,554	2,628	2,449	2,481	11,112	10,111
R&D	17,759	26,197	29,870	5,868	3,705	3,704	3,755	17,032	15,302
G&A	12,801	17,920	16,161	3,475	3,040	2,934	2,967	12,416	12,090
Amort. of Intangible asset	2,920	8,100	6,312	1,686	1,620	1,567	1,567	6,440	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	10,654	10,770	47,000	43,377
Operating Income	\$ 3,521	\$ (30,938)	\$ (30,927)	\$ (6,935)	\$ (3,244)	\$ (2,181)	\$ (4,387)	\$ (16,747)	\$ (11,846)
Interest Income	96	34	0	0	0	0	0	0	0
Interest Expense	0	(2)	(2,680)	(2,260)	(2,037)	(1,443)	(38)	(5,778)	(563)
Change in Warrant Liability	0	0	4,669	2,984	429	73	0	3,486	0
Other Income (Expense)	708	78	(115)	(667)	(811)	(1,568)	(1,200)	(4,246)	100
Pretax Income	4,325	(30,828)	(29,053)	(6,878)	(5,663)	(5,119)	(5,624)	(23,284)	(12,308)
Taxes	160	215	226	9	2	14	25	50	100
Net Income	4,165	(31,043)	(29,279)	(6,887)	(5,665)	(5,133)	(5,649)	(23,334)	(12,408)
Diluted Shares	42,764	51,232	55,422	61,646	62,453	67,354	73,530	69,257	78,013
Diluted EPS	\$ 0.10	\$ (0.61)	\$ (0.53)	\$ (0.11)	\$ (0.09)	\$ (0.08)	\$ (0.08)	\$ (0.34)	\$ (0.16)
Stock Comp	3,063	4,848	4,370	945	1,030	1,339	1,341	4,657	5,364
Amortization	2,920	8,100	6,312	1,700	1,633	1,579	1,567	6,440	5,874
Other	918	15,852	(201)	633	2,368	2,853	1,200	7,054	1,200
Non-GAAP Net Income	11,066	(2,243)	(18,798)	(3,609)	(634)	638	(1,541)	(5,183)	30
Non-GAAP EPS	\$ 0.26	\$ (0.04)	\$ (0.34)	\$ (0.06)	\$ (0.01)	\$ 0.01	\$ (0.02)	\$ (0.07)	\$ 0.00
Operating Income	3,521	(30,938)	(30,927)	(6,935)	(3,244)	(2,181)	(4,387)	(16,747)	(11,846)
Depreciation & Amort.	3,582	9,338	7,556	1,700	1,633	1,580	1,827	6,740	6,914
Stock Comp	3,064	4,848	4,948	945	1,030	1,341	1,341	4,657	5,364
Other	927	15,447	2,015	690	84	0	0	774	0
EBITDA	\$ 11,094	\$ (1,305)	\$ (16,408)	\$ (3,600)	\$ (497)	\$ 740	\$ (1,219)	\$ (4,576)	\$ 432
Margin	21.6%	-2.2%	-33.8%	-32.9%	-4.8%	6.7%	-13.8%	-11.1%	1.1%

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

Exhibit 2. Balance Sheet and Cash Flow Statement

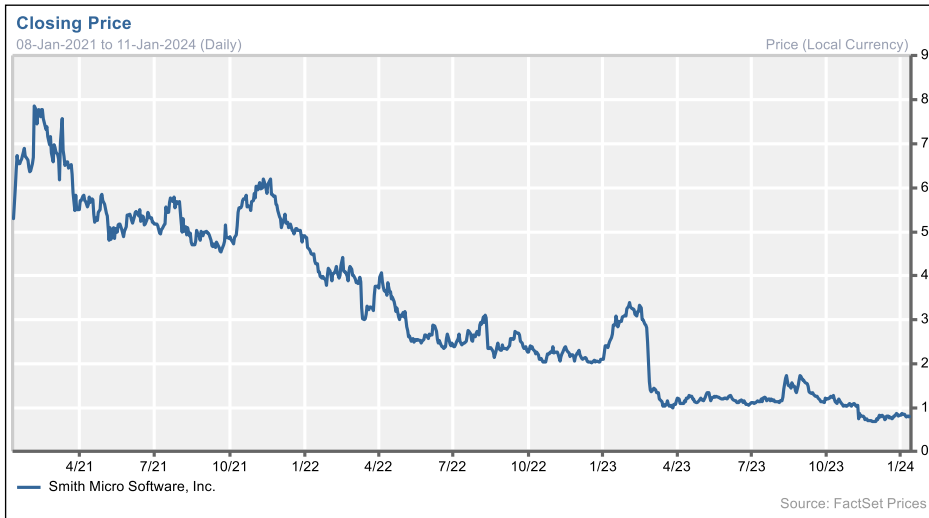
(\$ in 000's)	2020	2021	2022	2023 E	2024 E
Cash	25,754	16,078	14,026	9,814	7,606
A/R	12,347	10,590	10,501	6,755	9,581
Prepaid Expenses & Other	1,189	1,988	1,983	2,000	2,837
Current Assets	\$ 39,290	\$ 28,656	\$ 26,510	\$ 18,569	\$ 20,024
Equipment & Improvements	2,170	2,698	1,498	988	948
Right-of-use asset	5,785	5,710	3,722	2,686	2,686
Other	694	620	490	475	475
Intangible Assets	12,698	42,631	36,320	30,334	24,460
Goodwill	12,266	35,041	35,041	35,041	35,041
Total Assets	\$ 72,903	\$ 115,356	\$ 103,581	\$ 88,093	\$ 83,634
A/P	2,282	3,301	3,236	2,423	3,437
Accrued Payroll & Benefits	2,867	4,055	3,883	2,003	2,841
Operating Lease	1,433	1,400	1,441	1,434	1,434
Other Accrued Liab.	216	436	1,589	1,372	1,946
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
Current Liabilities	\$ 8,370	\$ 9,368	\$ 20,731	\$ 7,231	\$ 9,657
Warrant Liability	0	0	3,317	0	0
Lease Liabilities	4,805	4,467	2,976	1,787	1,787
Other LT Liabilities	125	117	178	142	202
Equity	\$ 58,716	\$ 100,560	\$ 76,379	\$ 78,932	\$ 71,988
Total Liabilities & Equity	\$ 72,903	\$ 115,356	\$ 103,581	\$ 88,093	\$ 83,634

	2020	2021	2022	2023 E	2024 E
Net Income	4,165	(31,043)	(29,279)	(23,334)	(12,408)
Depreciation & Amortization	3,582	9,338	7,556	6,739	6,914
Stock Comp	3,064	4,848	4,948	4,657	5,364
Working Capital & Other	(2,887)	3,941	(2,486)	6,501	(1,178)
Operating CF	\$ 7,924	\$ (12,916)	\$ (19,261)	\$ (5,437)	\$ (1,308)
Capx	(1,323)	(830)	(49)	(255)	(1,000)
Acquisitions	(13,500)	(56,865)	0	0	0
Other	142	192	164	71	0
Investing Activities	\$ (14,681)	\$ (57,503)	\$ 115	\$ (184)	\$ (1,000)
Equity	4,214	60,743	3,000	25	100
Debt	0	0	14,036	1,384	0
Other	29	0	58	0	0
Financing	\$ 4,243	\$ 60,743	\$ 17,094	\$ 1,409	\$ 100
Change in Cash	\$ (2,514)	\$ (9,676)	\$ (2,052)	\$ (4,212)	\$ (2,208)

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
- Update – Buy – August 31, 2023 – Price Target \$3.50
- Update – Buy – November 9, 2023 – Price Target \$3.50
- Update – Buy – December 6, 2023 – Price Target \$3.50
- Update – Buy – January 12, 2024 – Price Target \$3.50

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Current as of 14-Dec-23

	Company Coverage		Investment Banking	
Ratings Distribution	# of Companies	% of Total	# of Companies	% of Totals
Market Outperform (Buy)	21	61.76%	4	11.80%
Market Perform (Neutral)	13	38.24%	2	5.90%
Market Underperform (Sell)	0	0%	0	0.00%
Total	34	100%	6	17.70%

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