Zacks Small-Cap Research

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SMTP Inc. (SMTP-NASDAQ)

SMTP: Announces Secondary to Raise Cash and Accelerate Marketing, Cutting Earnings Forecast

Current Recommendation	**Buy**
Prior Recommendation	Buy
Date of Last Change	10/14/2014
Current Price (08/04/15)	$5.66
Target Price	**$15.00**

OUTLOOK

SMTP is a small growing SaaS provider of email delivery services that bought two other email services companies last year to add marketing automation and a front-end for email creation and tracking offerings. The smaller one, SharpSpring, is now the driver of the company and is proving to be competitive with MKTO and HUBS. This newly announced $9 million secondary will added needed working capital to accelerate marketing and increase the float.

SUMMARY DATA

52-Week High	**$6.66**
52-Week Low	**$4.52**
One-Year Return (%)	**-5.2**
Beta	**-8.1**
Average Daily Volume (sh)	**15,717**
Shares Outstanding (mil)	**6**
Market Capitalization ($mil)	**$33**
Short Interest Ratio (days)	**0.52**
Institutional Ownership (%)	**9**
Insider Ownership (%)	**53**
Annual Cash Dividend	**0**
Dividend Yield (%)	**0**
5-Yr. Historical Growth Rates	
Sales (%)	**23.6**
Earnings Per Share (%)	**N/A**
Dividend (%)	**NM**
P/E using TTM EPS	**21.6**
P/E using 2015 Estimate	**NM**
P/E using 2016 Estimate	**16.8**
Zacks Rank	**3**

Risk Level	**Above Average**
Type of Stock	**Small-Blend**
Industry	**Internet-Services**
Zacks Rank in Industry	**9 of 43**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013	1.4 A	1.4 A	1.5 A	1.5 A	5.8 A
2014	1.5 A	1.5 A	1.6 A	2.9 A	7.5 A
2015	3.3 A	3.6 A	3.8 E	4.3 E	15.0 E
2016					18.0 E

Earnings per Share
(EPS is fully diluted non-GAAP earnings)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013	$0.15 A	$0.14 A	$0.17 A	$0.14 A	$0.60 A
2014	$0.09 A	$0.06 A	$0.09 A	-$0.02 A	$0.21 A
2015	-$0.03 A	$0.00 A	-$0.05 E	-$0.06 E	-$0.15 E
2016					-$0.15 E

Zacks Projected EPS Growth Rate - Next 5 Years 25% **25**

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WHAT'S NEW

Secondary Will Raise Cash to Accelerate Marketing, Return to Losses

As some investors had feared, the company announced a secondary today to raise $9 million in cash, half for the company, and half for an early investor who is liquidating part of his position. The $4.5 million the company is raising will be used to pay off the acquisitions, correct a working capital starved balance sheet, and increase spending on marketing and sales. This will allow the company to spend much more than previously planned to spur sales and as a result we are cutting earnings estimates significantly. Originally the company had planned to stay cash flow positive but has instead decided to raise cash and reinvest in the business due to the high ROI it has been receiving from marketing and sales.

While keeping revenues the same, we are cutting earnings significantly from a non GAAP EPS estimate of $0.03 in 2015 to a loss of $0.15. Assuming the company takes the same strategy in 2016, we expect losses to continue. Since its main competitors HubSpot and Marketo deficit spend to the tune of negative 30-35% EBITDA, there is pressure to keep up on some level. In a market growing 60% per year, any investment should be easy to turn into profits in short order.

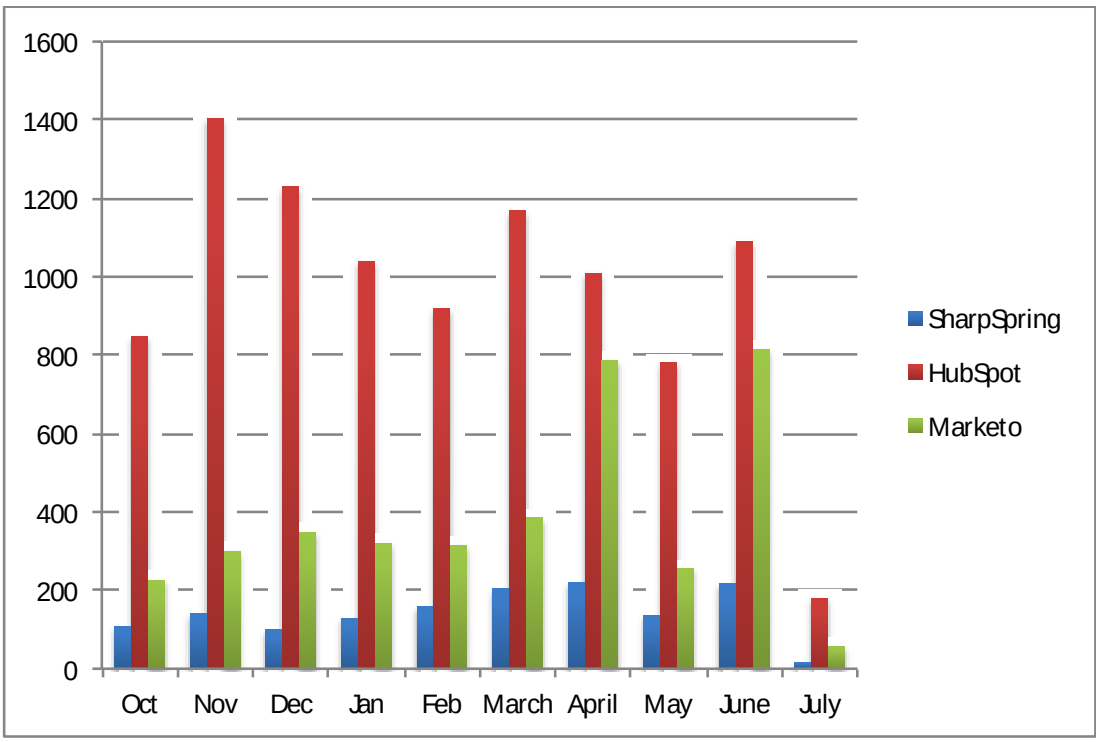
The sale of the stock by the majority holder and early investor Semyon Dukach will increase needed float and remove fear of an overhang of his stock should he have decided to sell in open market transactions. Semyon Dukach, bought SMTP's predecessor company EMUmail in 1999 and has been the majority holder ever since and was the CEO of the company up until 2012. He is currently the managing director of Techstars in Boston. He said he decided to leave his "position as CEO of SMTP and focus full time on angel investing activities and mentoring young entrepreneurs." Mr. Dukach currently owns 2,657,213 shares or 41.6% of the company and is Chairman of the Board. At the current stock price he would plan to sell approximately 700,000 shares or 11% of the outstanding. We believe this would be a great help to float and alleviate any concern about a stock overhang were he to sell it in the open market.

Q2 Reported as Expected, SharpSpring Ahead of Plan

Additionally, the company reported Q2 earnings that came in very close to forecasted. Revenues were $3.6 million versus $1.5 million in 2014, up 143%. For the first time, the company broke out SharpSpring revenues, which were $1 million for the quarter versus $700,000 in Q1 2015. Since SharpSpring is now expected to reach its goal of a $5 million run rate by year-end to earn its earn-out, the company expensed $1.7 million in change in earn-out liability. For the next three quarters we are now expecting the expense will be $250,000 per quarter, with a stub in the June quarter next year of approximately $50,000.The company also announced that SharpSpring added 182 new customers in Q2, which equated to a $1.3 million in annual recurring revenue, versus $1 million in Q1. At the end of Q2, it had over 550 total SharpSpring customers, about 90% of which are marketing agencies.

In the chart that follows, we can see SharpSpring adoption versus the two big public companies HubSpot and Marketo according to data collected by Datanyze.

Chart 1. Datanyze Net Customer Migration



Gross margin was 74.3% versus 76.3% last year reflecting the start up costs of bringing on new customers.

Operating expenses were $3.3 million in Q2 and almost identical to the number in Q1.

GAAP EPS came in at a loss of $0.32 versus $0.03 profit last year, and non-GAAP EPS was breakeven versus a non-GAAP profit of $0.08 in 2014, on target with our estimates.

2015

For the full year 2015, we are keeping our revenue estimate the same at $15 million, which would be revenue growth of 105%, but lowering earnings in accordance with the company's expectation to have EBITDA be within a "few hundred thousand of breakeven" as it spends heavily on marketing and sales. We are adjusting our GAAP EPS to a loss of $0.83. Non-GAAP estimates are being reduced to a loss of $0.15.

2016

In 2016, we are also reducing EPS to reflect higher spending. GAAP EPS is now expected to be a loss of $0.43 and non-GAAP EPS at a positive $0.15.

INVESTMENT THESIS

- Its recent acquisitions of SharpSpring and GraphicMail should more than triple the companies' addressable market opportunity, make it much more competitive against larger players. It also expands its geographic reach internationally where it has had limited exposure.

- SharpSpring is less expensive, more fully featured direct competitor to Marketo and HubSpot and is now driving the company. As investors become more aware of this and compare valuations we believe the stock could appreciate based on the comparison to this highly valued companies. Marketo trades at 5.3x enterprise value to sales and HubSpot 7.3xs.

- With these acquisitions and internal growth, the company may be able to more than double revenues to $15 million in sales. Should the company achieve these numbers we believe the stock would be worth considerably more in the next twelve months.

- The company is trading at 2.0 times enterprise value to sales, well below its peers, which trade at an average enterprise value of 5.8 times sales. We are reiterating our BUY, but have increased our target price slightly to of $13 due to the increase in the valuations of comparable companies and having raised our revenue forecast. This is 130% above the current stock price.

INDUSTRY

SMTP competes in a $2 billion opportunity for email marketing spending worldwide that is growing 60% a year. It has ample new opportunity as it brings its products over seas and sells to a wide range of companies. It is now poised to address companies large and small and has increased GraphicMail's ability to send only a 100,000 emails a month to SMTP industrial strength capability of 100 million emails a month. It has a full service solution for all aspects of email marketing.

VALUATION

SMTP can be valued against other public SaaS companies. Many of the highly valued SaaS companies are not yet profitable, so we use valuation based on a multiple of sales. As shown on the chart below company valuations range from a low of 1.2 times enterprise value to forecasted 2015 revenues for the $240 million, money-losing Jive Software (JIVE), to a high of 12.6 times for $14 billion Workday, which provides a SaaS platform for human resource information systems (HRIS). The group yields an average of 6.3 times forecasted 2015 revenues and 7.5 times trailing twelve month, higher than last quarter. Using this current metric, if we plug in SMTP's estimated 2015 and trailing 12 month revenues, we can see the stock moving to $15 by next year if the revenue forecasts are reached. Given the company's current price of $5.89, that is 137% upside.

Company	Ticker	Revenue 2015E	Revenue LTM	EBIDTA Margin	Enterprise Value / Sales 2015E	Enterprise Value / Sales LTM	Included in Average?	Enterprise Value
Callidus Software	CALD	$168	$145	-3%	4.3x	5.0x	y	724
Salesforce	CRM	$6,550	$5,660	7%	7.6x	8.7x	y	49,510
Constant Contact	CTCT	$372	$354	14%	1.8x	1.9x	y	661
Ellie Mae	ELLI	$235	$184	21%	9.1x	11.7x	y	2,140
HubSpot	**HUBS**	**$167**	**$130**	**-34%**	**9.8x**	**12.5x**	**y**	**1,630**
Jive Software	JIVE	$198	$185	-17%	1.2x	1.3x	y	240
LogMeIn	LOGM	$266	$244	15%	5.9x	6.4x	y	1,560
Live Person	LPSN	$245	$222	2%	2.1x	2.3x	y	506
Marketo	**MKTO**	**$210**	**$178**	**-31%**	**5.6x**	**6.6x**	**y**	**1,170**
NetSuite	N	$744	$644	-10%	10.3x	11.9x	y	7,660
Realpage	RP	$464	$415	6%	3.3x	3.6x	y	1,510
Syncronoss Technologies	SNCR	$580	$492	28%	3.4x	4.0x	y	1,980
Solarwinds	SWI	$507	$467	34%	5.2x	5.6x	y	2,610
2U Inc.	TWOU	$147	$119	-18%	8.9x	11.1x	y	1,310
Textura	TXTR	$89	$68	-16%	7.6x	10.0x	y	681
Ultimate Software	ULTI	$617	$530	12%	8.1x	9.4x	y	5,000
Workday	WDAY	$1,140	$879	-20%	12.6x	16.3x	y	14,350
Average				**-0.5%**	**6.3x**	**7.5x**		**$5,485**

	Revenue 2015E	Revenue LTM	EBITDA Margin	Enterprise Value / Sales 2015E	Enterprise Value / Sales LTM	Valuation Range Low	Valuation Range High
SMTP	**$15.1**	**$11.4**	**-2.60%**	**6.3x**	**7.5x**	**$86**	**$94**
YoY growth							

Conclusion of Enterprise Value	**$90,223,595**
Market Value	**$92,380,095**
Shares Outstanding	6,155,858
Price per Share	**$15.01**

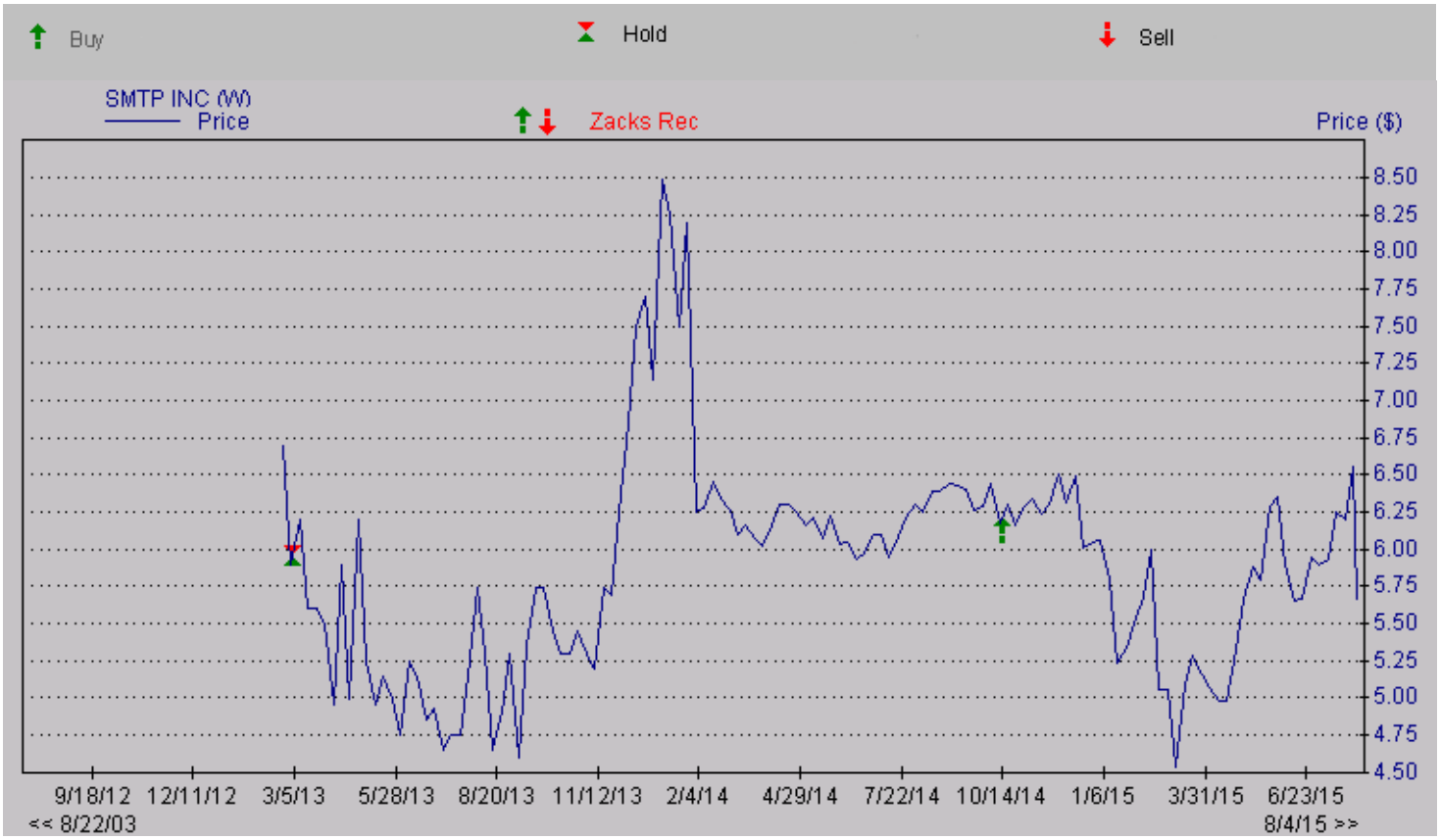
INCOME STATEMENT

	Q1 2014R	Q2 2014	Q3 2014	Q4 2014	Q1 2015	Q2 2015	Q3 2015E	Q4 2015E			
	31-Mar	30-Jun	30-Sep	31-Dec	31-Mar	30-Jun	30-Sep	31-Dec	2014	2015E	2016E
SMTP & GraphicMail	$1,490,054	$1,480,770	NA	$2,414,429	$2,585,502	$2,591,554	$2,525,000	$2,605,000		$10,307,056	$10,800,000
SharpSpring	0	0	NA	483,000	700,000	1,000,000	1,300,000	1,650,000		$4,650,000	7,200,000
Net revenue	**$1,490,054**	**$1,480,770**	**$1,631,244**	**$2,897,429**	**$3,285,502**	**$3,591,554**	**$3,825,000**	**$4,255,000**	**$7,499,497**	**$14,957,056**	**$18,000,000**
Yr-to-yr Growth	8.8%	6.1%	11.0%	90.6%	120.5%	142.5%	134.5%	46.9%	30.3%	99.4%	20.3%
Cost of services	327,230	351,153	340,649	696,581	790,966	924,283	960,000	1,044,000	$1,715,613	$3,719,249	4,000,000
Gross profit	1,162,824	1,129,617	1,290,595	2,200,848	2,494,536	2,667,271	2,865,000	3,211,000	5,783,884	11,237,807	14,000,000
Gross Margin	78.0%	76.3%	79.1%	76.0%	75.9%	74.3%	74.9%	75.5%	77.1%	75.1%	77.8%
Operating expenses:											
Sales and marketing	168,300	228,013	380,172	1,056,481	1,372,361	1,314,839	1,700,000	1,900,000	$1,832,966	$6,287,200	8,173,360
General and administrative	483,815	563,786	973,016	1,115,996	1,084,016	1,072,267	1,200,000	1,400,000	$3,136,613	$4,756,283	5,469,725
Research and development	118,622	101,387	141,923	441,495	471,214	537,151	570,000	600,000	$803,427	$2,178,365	2,722,956
Amortization expense	0		25,667	259,404	378,895	382,679	382,679	382,679	$285,071	$1,526,932	1,530,716
Total operating expenses	770,737	893,186	1,520,778	2,873,376	3,306,486	3,306,936	3,852,679	4,282,679	6,058,077	14,748,780	17,896,758
Operating income:	392,087	236,431	(230,183)	(672,528)	(811,950)	(639,665)	(987,679)	(1,071,679)	(274,193)	(3,510,973)	(3,896,758)
	26.3%	16.0%	-14.1%	-23.2%	-24.7%	-17.8%	-25.8%	-25.2%	-3.7%	-23.5%	-21.6%
Other income:											
Interest income	0	144	367		0	0	0	0	0	0	0
Total other income	0	144	367	(6,627)	(50,024)	(15,623)	(10,000)	(10,000)	(16,278)	(85,647)	0
Change in earnout liability	0	0	0	(682,000)	(704,000)	(1,667,332)	(250,000)	(250,000)	(682,000)	(2,871,332)	(300,000)
Loss on disposal of fixed assets	0	0	(10,172)	0	0	0	0	0	0	0	0
Income before income taxes	392,087	236,575	(239,988)	(1,361,155)	(1,565,974)	(2,322,620)	(1,247,679)	(1,331,679)	(972,471)	(6,467,952)	(3,896,758)
Provision for income tax	168,765	85,367	(142,160)	(243,230)	(395,946)	(455,969)	(274,489)	(292,969)	(131,258)	(1,419,374)	(779,352)
Tax rate	43.0%	36.1%	59%	18%	25.3%	19.6%	22.0%	22.0%	13.5%	21.9%	20.0%
Net income	$223,322	$151,208	(97,828)	(1,117,925)	(1,170,028)	(1,866,651)	(973,190)	(1,038,710)	(841,213)	(5,048,578)	(3,117,406)
Yr-to-yr Growth	-1.0%	-60.8%	-131%	-427%	-624%	-1334%	895%	-7%	-166.1%	500%	NM
Adj for Non-GAAP	$89,000	$198,431	533,000	1,029,925	1,019,000	$1,846,651	$649,259	$626,009	$1,858,000	4,140,920	2,070,537
Non-GAAP Income	$312,322	$392,639	435,172	(88,000)	(151,028)	20,000	(323,930)	(412,700)	$1,016,787	(907,659)	(1,046,869)
Yr-over-Yr	21%	27%	27%	-3%	-148%	-95%	-174%	369%	-45.0%	-189%	15%
Net income per share:											
Basic	$0.05	0.03	(0.02)	(0.21)	(0.21)	(0.32)	(0.15)	(0.15)	(0.17)	(0.83)	(0.43)
Diluted	$0.05	0.03	(0.02)	(0.21)	(0.21)	(0.32)	(0.15)	(0.15)	(0.17)	(0.82)	(0.43)
Non-GAAP	**$0.07**	**$0.08**	**$0.09**	**-$0.02**	**-$0.03**	**$0.00**	**-$0.05**	**-$0.06**	**$0.21**	**-$0.15**	**-$0.15**
Yr-to-yr Growth	-50.9%	-43.5%	-48.5%	-112.1%	-138%	-96%	-158%	273%	-65.7%	-171.7%	-1.6%
Shares											
Basic	4,239,363	5,016,461	5,020,005	5,370,813	5,457,000	5,871,445	6,399,417	6,745,571	4,913,903	6,118,358	7,174,142
Diluted	4,302,443	5,063,993	5,020,005	5,370,813	5,457,000	5,921,445	6,449,417	6,795,571	4,913,903	6,155,858	7,174,142
	34.7%	65.7%	59.9%	69.5%	26.8%	16.9%	28.5%	26.5%	60.1%	25.3%	16.5%
Adjusted EBITDA	$578,000	$440,000	360,000	(52,000)	(106,000)	36,000	(392,000)	(476,000)	1,326,000	(938,000)	(1,082,042)

BALANCE SHEET

	June 30, 2015	March 31, 2015	% Change
Assets			
Cash and cash equivalents	$1,817,552	$2,156,500	-16%
Accounts receivable	520,685	487,356	7%
Deferred income taxes	240,622	240,650	0%
Income taxes receivable	1,234,100	774,370	59%
Other current assets	318,298	233,042	37%
Total current assets	4,131,257	3,891,918	6%
Property and equipment, net	508,917	332,506	53%
Goodwill	8,913,786	8,893,611	0%
Intangibles	7,232,112	7,445,572	-3%
Deferred income taxes	612,941	612,941	0%
Deposits	13,434	28,512	-53%
Total assets	21,412,447	21,205,060	1%
Liabilities and Shareholders' Equity			
Accounts payable	305,527	355,781	-14%
Deferred revenue	921,522	993,652	-7%
Earn out liabilities	5,051,036		
Income taxes payable	13,897	13,904	0%
Accrued expenses and other current liabilities	272,376	227,593	20%
Deferred income taxes	6,084	5,749	6%
Total current liabilities	6,570,442	1,596,679	312%
Earn out liabilities	-	8,384,096	
Total liabilities	6,570,442	9,980,775	-34%
Shareholders' equity:			
Preferred stock			
Common stock	6,400	5,462	17%
Additional paid in capital	18,741,506	13,454,283	39%
Accumulated other comprehensive income	(45,028)	(241,238)	-81%
Accumulated deficit	(3,860,873)	(1,994,222)	94%
Total shareholders' equity	14,842,005	11,224,285	32%
Total liabilities and shareholders' equity	$21,412,447	$21,205,060	1%
Current Ratio	0.6	2.4	-74%
Working capital	(2,439,185)	2,295,239	-206%

HISTORICAL ZACKS RECOMMENDATIONS



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Hold/Neutral: The analyst expects that the company will perform in line with the broader U.S. equity market over the next one to two quarters.
Sell/Underperform: The analyst expects the company will underperform the broader U.S. Equity market over the next one to two quarters.

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