Zacks Small-Cap Research

February 20, 2015

Lisa Thompson
312-265-9154
lthompson@zacks.com

scr.zacks.com

10 S. Riverside Plaza, Chicago, IL 60606

SMTP Inc. (SMTP-NASDAQ)

SMTP: Zacks Company Report – Dividend Eliminated, as Company Transforms to Growth Stock

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	10/14/2014
Current Price (02/19/15)	$4.91
Twelve Month Target Price	**$13.50**

OUTLOOK

SMTP is a small growing SaaS provider of email delivery services that bought two other email services companies this quarter to add marketing automation and a front-end for email creation and tracking. These acquisitions should be accretive, and double revenues next year, while improving profitability and increasing the total addressable market for the company. With an enterprise value to sales of less than 1.5 times 2015 estimated revenues, we rate the stock Outperform.

SUMMARY DATA

52-Week High	**$6.66**
52-Week Low	**$4.91**
One-Year Return (%)	**-13.51**
Beta	**-10.34**
Average Daily Volume (sh)	**7,215**
Shares Outstanding (mil)	**5**
Market Capitalization ($mil)	**$27**
Short Interest Ratio (days)	**0.30**
Institutional Ownership (%)	**9**
Insider Ownership (%)	**56**
Annual Cash Dividend	**0**
Dividend Yield (%)	**0**
5-Yr. Historical Growth Rates	
Sales (%)	**21.5**
Earnings Per Share (%)	**N/A**
Dividend (%)	**64.0**
P/E using TTM EPS	**12.9**
P/E using 2014 Estimate	**22.3**
P/E using 2015 Estimate	**12.6**
Zacks Rank	**3**

Risk Level	**Average**
Type of Stock	**Small-Blend**
Industry	**Internet-Services**
Zacks Rank in Industry	**12 of 41**

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	2.7 E	7.3 E
2015	3.1 E	3.3 E	3.7 E	4.5 E	14.6 E
2016					17.0 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	$0.03 E	$0.22 A
2015	$0.04 E	$0.08 E	$0.12 E	$0.15 E	$0.39 E
2016					$0.45 E

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

© Copyright 2015, Zacks Investment Research. All Rights Reserved.

WHAT'S NEW

Company Ends Dividend to Reinvest in Growth…

Today SMTP announced it would no longer pay a dividend as it plans to take cash from operations and reinvest in its business. This was somewhat unexpected; it was contrary to the assumption of many shareholders. However given the choice between dilution by a stock offering and ceasing the dividend it is the preferred solution to cash generation. It knocked the stock down 17% yesterday as dividend investors left the stock. The stock is now at a 52-week low.

…But Revenues from GraphicMail will be higher than expected

There was other news as the company pre-announced Q4 2014 revenues which were between $2.7-$2.8 million. While not adding to earnings at all, the company indicated that GraphicMail would contribute more to revenues than previously expected due to revenue recognition. Before its acquisition, GraphicMail had been recognizing revenue differently than SMTP does. For sales that were made by its reseller partners, GraphicMail had been booking revenues net, while its direct sales were booked as gross. SMTP will be recognizing all sales from that business as gross. This however will not change earnings, as costs will increase by the same amount. Most of the costs will be in cost of revenues and some will be in sales and marketing. We are adjusting our model accordingly.

For the fourth quarter, this will add another $300,000 in revenues than we had expected. Keep in mind this addition revenue is only for a partial quarter as the acquisition was completed on October 20th 2014. Revenues for the quarter are now expected to be between $2.7 and $2.8 million versus our estimate of $2.7 million. This is growth of approximately 80% versus last year. We are keeping EPS the same at a non-GAAP EPS of $0.06 versus $0.14 last year, down 55%. This should be the last quarter with one-time expenses, as any others for future actions should have been accrued for in Q4.

2015

Given the additional revenue to be recognized, we are raising revenues for 2015 by approximately $1 million to reflex the accounting change at GraphicMail, while keeping our earnings estimate the same. We will revisit our model in two weeks when the company reports the fourth quarter of 2014.

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, and lower the combined company's tax rate.

- With these acquisitions and internal growth, the company may be able to double revenues to $14 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 1.4 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 lowered our target price of $13.50 due to the decrease in the valuations of comparable companies. This is still 175% above the current stock price.

Recent Acquisitions

SharpSpring, a new start up, was purchased for $5 million in cash plus an earn-out of cash and stock. To qualify for its earn-out, SharpSpring must reach a $5 million run rate by the end of 2015, at which point it would receive an additional $10 million in cash and stock. The deal closed on **August 15, 2014**. It only launched its product this year, but as of August it was bringing in business at a $2 million annual run rate. SharpSpring's product is a marketing automation and call-tracking platform that is a direct challenger to Marketo in the small and medium business market. Marketing automation helps marketers track the web traffic of potential customers visiting its site and tracks phone contacts with customers and prospects. It is an excellent add-on service offering for SMTP's current customer base, as SMTP's deliverability services will allow SharpSpring to upsell to larger customers. SharpSpring also offers a customer relationship management module or a customer can bring their own system.

GraphicMail, is a ten-year-old integrated email solutions company based in Cape Town, South Africa, It operates in 25 countries and provides service in 13 languages. It employs about 50 people and has 9,000 direct customers who sell to 35,000 end users. It was purchased for $5.2 million in cash and stock with a possible $0.6 million earn out. It had $4 million in billings in 2013, and was profitable. SMTP believes it will be immediately accretive to earnings. GraphicMail has a robust front-end email platform that competes with products like MailChimp and Constant Contact, but needs help scaling for larger customers. SMTP on the other hand was looking for a front end but had the back end scaling capabilities. Together, the two should create an impressive offering for customers as well as expand the sales force and market reach for SMTP and SharpSpring. The GraphicMail acquisition, which was more complex due to its international operations, closed on **October 17, 2014**.

INDUSTRY

Until its recent acquisitions, SMTP competed only in the $800 million email delivery segment of the email marketing industry; this segment has an average compound growth rate of 9.9% according to Forrester Research as shown on the graph. With the acquisition of SharpSpring and GraphicMail, SMTP has increased its total addressable market (TAM) closer to the $2 billion opportunity for all aspects of email marketing spending.

VALUATION

SMTP can be valued against other public SaaS companies. Many of the highly valued SaaS companies are not yet profitable, so we are looking at valuation based on a multiple of sales. As shown on the chart below company valuations range from a low of 1.4 times enterprise value to forecasted 2015 revenues for the money-losing Jive Software (JIVE), to a high of 14 times for $16 billion Workday, which provides a SaaS platform for human resource information systems (HRIS). The group yields an average of 5.8 times forecasted 2015 revenues and 7.5 times trailing twelve month. The valuation of the group has moved

down somewhat since we last ran the comparables. Using this current metric, if we plug in SMTP's revenues, we can see the stock moving to $13.50 by next year if the revenue forecasts are reached.

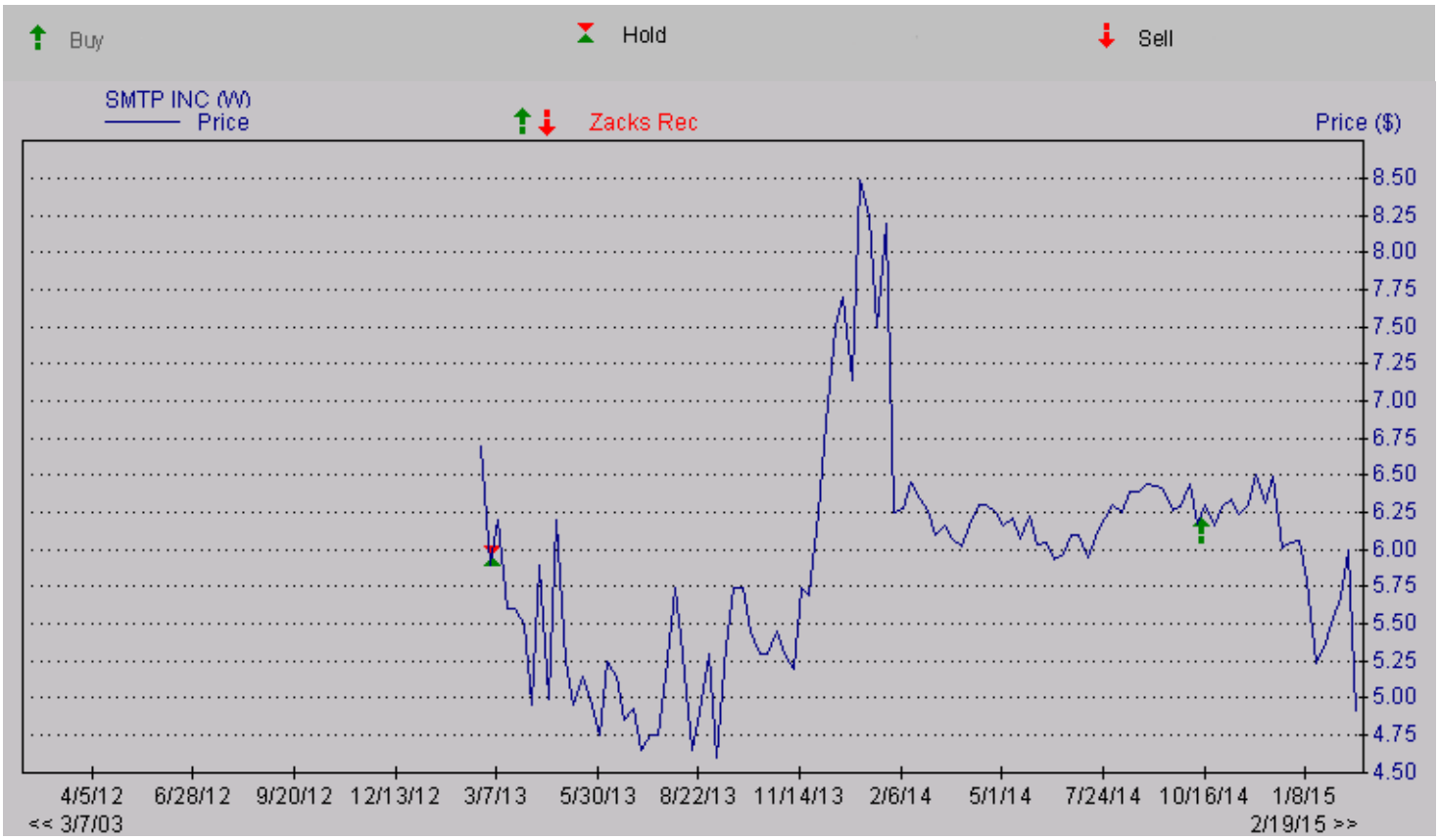
Company	Ticker	Revenue 2015E	Revenue LTM	EBIDTA Margin	Enterprise Value / Sales 2015E	Enterprise Value / Sales LTM	Included in Average?
Callidus Software	CALD	$165	$137	-1%	4.3x	5.2x	y
Concur Technologies*	CNQR	$854	$668	3%	9.7x	12.4x	n
Salesforce	CRM	$6,510	$5,070	2%	6.3x	8.1x	y
Constant Contact	CTCT	$388	$332	13%	3.1x	3.6x	y
Ellie Mae	ELLI	$206	$162	18%	6.7x	8.5x	y
HubSpot	HUBS	$161	$116	-19%	7.0x	9.7x	y
Jive Software	JIVE	$197	$179	-22%	1.4x	1.6x	y
LogMeIn	LOGM	$262	$222	9%	4.1x	4.8x	y
Live Person	LPSN	$266	$210	4%	2.0x	2.6x	y
Marketo	MKTO	$205	$150	-27%	5.1x	7.0x	y
NetSuite	N	$722	$556	-10%	10.6x	13.7x	y
Realpage	RP	$405	$396	9%	3.8x	3.9x	y
Syncronoss Technologies	SNCR	$570	$457	27%	3.1x	3.9x	y
Solarwinds	SWI	$522	$429	36%	6.9x	8.4x	y
2U Inc.	TWOU	$110	$104	-27%	5.6x	5.9x	y
Textura	TXTR	$89	$64	17%	6.8x	9.3x	y
Ultimate Software	ULTI	$617	$506	14%	7.4x	9.0x	y
Workday	WDAY	$1,130	$704	-21%	14.0x	22.5x	y
Average				**1%**	**5.8x**	**7.5x**	

	Revenue 2015E	Revenue LTM	EBITDA Margin	Enterprise Value / Sales 2015E	Enterprise Value / Sales LTM	Valuation Range Low	Valuation Range High
SMTP	**$14**	**$7**	**16.20%**	**5.8x**	**7.5x**	**$55**	**$81**
YoY growth							

Conclusion of Enterprise Value	**$67,799,138**
Market Value	**$73,674,463**
Shares Outstanding	5,473,993
Price per Share	**$13.46**

* acquired

HISTORICAL ZACKS RECOMMENDATIONS



DISCLOSURES

The following disclosures relate to relationships between Zacks Small-Cap Research ("Zacks SCR"), a division of Zacks Investment Research ("ZIR"), and the issuers covered by the Zacks SCR Analysts in the Small-Cap Universe.

ANALYST DISCLOSURES

I, Lisa Thompson, hereby certify that the view expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the recommendations or views expressed in this research report. I believe the information used for the creation of this report has been obtained from sources I considered to be reliable, but I can neither guarantee nor represent the completeness or accuracy of the information herewith. Such information and the opinions expressed are subject to change without notice.

INVESMENT BANKING, REFERRALS, AND FEES FOR SERVICE

Zacks SCR does not provide nor has received compensation for investment banking services on the securities covered in this report. Zacks SCR does not expect to receive compensation for investment banking services on the Small-Cap Universe. Zacks SCR may seek to provide referrals for a fee to investment banks. Zacks & Co., a separate legal entity from ZIR, is, among others, one of these investment banks. Referrals may include securities and issuers noted in this report. Zacks & Co. may have paid referral fees to Zacks SCR related to some of the securities and issuers noted in this report. From time to time, Zacks SCR pays investment banks, including Zacks & Co., a referral fee for research coverage.

Zacks SCR has received compensation for non-investment banking services on the Small-Cap Universe, and expects to receive additional compensation for non-investment banking services on the Small-Cap Universe, paid by issuers of securities covered by Zacks SCR Analysts. Non-investment banking services include investor relations services and software, financial database analysis, advertising services, brokerage services, advisory services, equity research, investment management, non-deal road shows, and attendance fees for conferences sponsored or co-sponsored by Zacks SCR. The fees for these services vary on a per client basis and are subject to the number of services contracted. Fees typically range between ten thousand and fifty thousand USD per annum.

POLICY DISCLOSURES

Zacks SCR Analysts are restricted from holding or trading securities placed on the ZIR, SCR, or Zacks & Co. restricted list, which may include issuers in the Small-Cap Universe. ZIR and Zacks SCR do not make a market in any security nor do they act as dealers in securities. Each Zacks SCR Analyst has full discretion on the rating and price target based on his or her own due diligence. Analysts are paid in part based on the overall profitability of Zacks SCR. Such profitability is derived from a variety of sources and includes payments received from issuers of securities covered by Zacks SCR for services described above. No part of analyst compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in any report or article.

ADDITIONAL INFORMATION

Additional information is available upon request. Zacks SCR reports are based on data obtained from sources we believe to be reliable, but are not guaranteed as to be accurate nor do we purport to be complete. Because of individual objectives, this report should not be construed as advice designed to meet the particular investment needs of any investor. Any opinions expressed by Zacks SCR Analysts are subject to change without notice. Reports are not to be construed as an offer or solicitation of an offer to buy or sell the securities herein mentioned.

ZACKS RATING & RECOMMENDATION

ZIR uses the following rating system for the 1124 companies whose securities it covers, including securities covered by Zacks SCR:
Buy/Outperform: The analyst expects that the subject company will outperform the broader U.S. equity market over the next one to two quarters.
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.

The current distribution is as follows: Buy/Outperform- 15.8%, Hold/Neutral- 78.0%, Sell/Underperform – 5.7%. Data is as of midnight on the business day immediately prior to this publication.