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Research Note

Investors should consider this report as only a single factor in making their investment decision.

Pareteum Corporation

Speculative Buy

John Nobile
March 18, 2019

TEUM $5.21 — (NASDAQ)

	2017A	2018A	2019E	2020E
Revenues (millions)	$13.5	$32.4	$110.0	$180.0
Earnings (loss) per share	$(0.84)	$(0.20)	$(0.00)	$0.20

52-Week range	$5.29 – $1.45	Fiscal year ends:	December
Common shares out as of 11/13/18	97.8 million	Revenue per share (TTM)	$0.50
Approximate float	88.1 million	Price/Sales (TTM)	10.4X
Market capitalization	$510 million	Price/Sales (FY2020)E	3.3X
Book value/share	$1.35	Price/Earnings (TTM)	NMF
Price/ book value	3.9X	Price/Earnings (FY2020)E	26.1X

Pareteum Corporation, headquartered in New York, NY, is a cloud communications platform company. Cloud communications involves the integration of multiple communication methods and services that can be accessed over the Internet and are handled and hosted by a third-party (such as Pareteum) through the cloud.

Key investment considerations:

Reiterating Speculative Buy rating and raising our twelve-month price target to $10.00 per share from $7.50 based on our strong revenue growth forecast to 2020.

Pareteum's 36-month contractual backlog is up more than five-fold to $800 million as of mid-March 2019 from $147 million at December 31, 2017. Pareteum's backlog (with a conversion rate averaging over 100% over the past twelve months) and the synergies (through cross selling, market expansion, and cost savings) created by the acquisitions of Artilium (October 2018) and iPass (February 2019) should support our 2020 revenue growth forecast.

We project strong revenue growth should result in EBITDA of $42 million in 2020, up from $11.2 million in 2019.

For 2019, we project revenue more than tripling to $110 million and a net loss of $530,000 or break-even per share. We previously forecasted revenue of $113 million and net income of $17.1 million or $0.15 per share. Our revised forecast primarily reflects the integration of the company's two acquisitions.

For 2020, we project a 63.6% increase in revenue to $180 million and net income of 23.4 million or $0.20 per share. We anticipate gross profit increasing by 58.2% to $104.4 million from our projected $66 million in 2019, offset in part by gross margin compression to 58% from 60% in 2019. The decrease in gross margins reflects a full year of lower iPass margins.

The company reported (on 3/12/19) 4Q18 revenue more than tripled to $14.3 million from $4 million. The loss per share (includes currency translation changes) was $(0.06) versus a loss of $(0.31) per share in 4Q17. Included in 4Q18 was $(0.05) per share of restructuring and acquisition costs. We estimated revenue of $13.2 million and EPS of $0.01.

****Please view our disclosures on pages 9 - 11.***

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Recommendation and Valuation

We are reiterating our Speculative Buy rating on Pareteum Corporation and raising our twelve-month price target to $10.00 per share from $7.50 based on our strong revenue growth forecast to 2020.

Our rating should be supported by worldwide spending on public cloud services and infrastructure, which is forecasted to achieve a five-year compound annual growth rate (CAGR) of 21.9% with public cloud services spending totaling $277 billion by 2021. One of the industries projected to grow the fastest is the telecommunications industry with a 23.3% CAGR to 2021. Software as a Service (such that Pareteum offers) is projected to be the largest cloud computing category, capturing nearly two thirds of all public cloud spending in 2018.

Pareteum's 36-month contractual backlog is up more than five-fold to $800 million as of mid-March 2019 from $147 million at December 31, 2017. Pareteum's backlog (with a conversion rate averaging over 100% over the past twelve months) and the synergies (through cross selling, market expansion, and cost savings) created by the acquisitions of Artilium (October 2018) and iPass (February 2019) should support our 2020 revenue growth forecast.

We project strong revenue growth should result in EBITDA of $42 million in 2020, up from $11.2 million in 2019.

TEUM trades at a TTM multiple of 10.4X sales while industry (telecommunications software and services) peers trade at a trailing multiple of 1.6X sales. We believe Pareteum's premium compared to the industry is due to its substantial growth prospects. We project sales growth of over 60% for TEUM in 2020 compared to 6.6% for the industry. We applied a multiple of 8.5X (unchanged) to our FY20 sales per share projection of $1.57, discounted for execution risk, to derive a year-ahead value of approximately $10.00 per share.

Recent Developments

New Contracts Worth $17 Million in Early March – In March 2019, Pareteum announced ten new customers have executed three-year contracts during early March 2019, valued at $17 million. These new customer transactions span Europe, Africa, US and Asia, and include software communications platform service offerings from the company's recent acquisitions of iPass and Artilium.

New $50 Million Credit Facility – On February 26, 2019, Pareteum entered into a credit agreement with Post Road Administrative Finance, LLC and its affiliate Post Road Special Opportunity Fund I LLP. Pursuant to the agreement, Post Road will provide the company with a secured loan of up to $50 million, with an initial loan of $25 million and additional loans in increments of $5 million as requested by the company within the next 18 months. The loan bears interest at an annual rate of 8.5% plus the Eurodollar rate. All amounts owed under the credit agreement are due on February 26, 2022.

Concurrent with entering into this credit agreement, the existing loan agreement with iPass and Fortress Credit Corp. was terminated.

4Q and FY 2018 Financial Results

4Q18 – Revenue more than tripled to $14.3 million from $4 million. The net loss (includes currency translation changes) was $5.5 million or $(0.06) per share versus a loss of $8.7 million or $(0.31) per share in 4Q17. Included in the net loss for 4Q18 was $5.2 million or $(0.05) per share of restructuring and acquisition costs. We estimated revenue of $13.2 million and net income of $540,000 or $0.01 per share.

Gross profit increased to $9.1 million from $2.9 million despite gross margins decreasing to 63.4% from 72.5%. Product development costs increased to $846,000 from $424,000, SG&A expenses increased to $6.1 million from $5.1 million. Depreciation and amortization costs increased to $2.5 million from $1.4 million. Other expense decreased to $97,000 from $3.3 million.

FY 2018 – Revenue more than doubled to $32.4 million from $13.5 million. The net loss (includes currency translation changes) was $13 million or $(0.20) per share versus a loss of $13.7 million or $(0.84) per share in the year-ago period. Included in the net loss for 2018 was $7.3 million or $(0.10) per share of restructuring and acquisition costs versus $966,000 or $(0.02) per share of costs in 2017.

Gross profit increased to $22.1 million from $9.9 million with gross margins decreasing to 68.1% from 72.8%. Product development costs increased to $3.1 million from $1.5 million and SG&A expenses increased to $21 million from $11.7 million. Depreciation and amortization costs increased to $5.4 million from $4.5 million. TEUM reported other income of $1.9 million versus $103,000 in 2017.

Liquidity – As of December 31, 2018, Pareteum had $6.5 million cash (of which $431,000 is restricted), a current ratio of 1.2X, long-term liabilities of $9 million, and shareholder's equity of $132.1 million.

For the year ended December 31, 2018, the company burned $8.2 million cash from operations, $11.5 million cash from investing, and generated $12.3 million cash from financing activities. Cash decreased by $7.3 million to $6.5 million at December 31, 2018.

Projections

2019 – We project revenue more than tripling to $110 million and a net loss of $530,000 or break-even per share. We previously forecasted revenue of $113 million and net income of $17.1 million or $0.15 per share. Our revised forecast primarily reflects the integration of the company's two acquisitions.

We anticipate gross profit tripling to $66 million from $22.1 million, offset in part by gross margin compression to 60% from 68.1% in 2018. The decrease in gross margins reflects a full year of lower blended margins with Artilium and iPass.

We project SG&A expenses more than doubling to $44 million or 40% of sales due primarily to the inclusion of iPass. Product development costs should grow $7.9 million to $11 million to support sales growth and expand business opportunities from the Artilium and iPass acquisitions. Depreciation and amortization expense should increase to $10.8 million from $5.4 million due primarily to greater depreciable fixed assets. We project a swing to operating income of $200,000 versus an operating loss of $14.6 million as the increase in revenue more than offsets the growth in operating expenses. We project operating margins of 0.2% compared to (45.1)%.

Interest expense should increase to $1 million from $450,000 due to the debt acquired from the Artilium acquisition. We project a tax benefit of $70,000.

2020 – We project a 63.6% increase in revenue to $180 million and net income of 23.4 million or $0.20 per share.

We anticipate gross profit increasing by 58.2% to $104.4 million from our projected $66 million in 2019, offset in part by gross margin compression to 58% from 60% in 2019. The decrease in gross margins reflects a full year of lower iPass margins.

We project SG&A expenses increasing 13.6% to $50 million or 27.8% of sales due to a full year inclusion of iPass and increased compensation costs. Product development costs should grow $1.6 million to $12.6 million as the company continues to expand its business opportunities. Depreciation and amortization expense is projected at $10.8 million. We project operating income of $31 million versus $200,000 as the increase in revenue more than offsets the growth in operating expenses. We project operating margins of 17.2% compared to 0.2%.

We project no interest expense as the company's positive cash flow should allow for the payoff of debt. We project the company paying $7.8 million in taxes for a tax rate of 25%.

Risks

In our view, these are the principal risks underlying the stock.

Economic – The economic climate, especially in Europe, may have an adverse effect in the markets in which Pareteum operates. Many of the company's customers' business is consumer driven, and to the extent there is a decline in consumer spending, Pareteum's customers could experience a reduction in the demand for their services.

International markets – Pareteum has significant international operations in Europe, and to a lesser extent in the US, Middle East and elsewhere. There can be no assurance that the company will be able to obtain the permits and operating licenses required for it to operate

Technological obsolescence - The telecommunications industry is subject to rapid and significant changes in technology, frequent new service introductions and evolving industry standards. If Pareteum fails to adapt successfully to technological advances, it could lose customers.

Integration of acquisitions - Strategic acquisitions are a part of the company's growth strategy. Acquisitions of businesses and customer lists involve operational risks, including the possibility that an acquisition may not ultimately provide the benefits originally anticipated by management.

Foreign currency exchange rates - Because most of Pareteum's business is conducted outside the US, fluctuations in foreign currency exchange rates versus the US dollar could adversely affect its financial results.

Competition – Pareteum is substantially smaller than its major competitors, whose marketing and pricing decisions, and relative size advantage, could adversely affect the company's ability to attract and retain customers and are likely to continue to cause significant pricing pressures that could adversely affect Pareteum's financial results.

Customer dependency - For the year ended December 31, 2017, Pareteum had one significant customer which accounted for 88% of its revenue. The loss or reduction in services to this significant customer could have an adverse impact on the company's business and financial condition.

Regulations – Pareteum operates in a heavily regulated industry. As a provider of communications technology, the company is subject to varying degrees of regulation in each of the jurisdictions in which it provides services. There can be no assurance that future regulatory changes will not have a material adverse effect on the company or that regulators will not raise issues with regard to Pareteum's compliance with applicable regulations.

Liquidity risk - Shares of Pareteum Corporation have risks common to those of the microcap segment of the market. Often these risks cause microcap stocks to trade at discounts to their peers. The most common of these risks is liquidity risk, which is typically caused by small trading floats and very low trading volume and can lead to large spreads and high volatility in stock price. There are 88.1 million shares in the float and the average daily volume is approximately 2.3 million shares.

Miscellaneous risk - The company's financial results and equity values are subject to other risks and uncertainties including competition, operations, financial markets, regulatory risk, and/or other events. These risks may cause actual results to differ from expected results.

Consolidated Balance Sheets
(in thousands $)

	2017A	2018A
Cash and cash equivalents	13,538	6,052
Restricted cash	200	431
Receivables	2,058	15,362
Prepaid expenses	900	2,084
Total current assets	16,696	23,929
Other assets	91	137,113
Note receivable	595	-
Net property and equipment	4,714	-
Long term investments	3,230	-
Total assets	**25,326**	**161,042**
Accounts payable and customer deposits	1,979	-
Obligations under capital leases	-	-
Net billings in excess of revenues	243	-
Accrued expenses and other payables	5,250	-
Convertible promissory note	66	-
Loans payable	-	-
Total current liabilities	7,538	20,006
Derivative liabilites	1,598	-
Other long term liabilites	151	-
Convertible promissory note	618	-
Senior loan	-	-
Net billings in excess of revenues	-	-
Total liabilities	**9,905**	**28,977**
Total stockholders' equity*	**15,421**	**132,065**
Total liabilities & stockholders' equity	**25,326**	**161,042**

Source: Company filings and Taglich Brothers' estimates

Income Statements for the Fiscal Years Ended
(in thousands $)

	2016A	2017A	2018A	2019E	2020E
Revenue	12,856	13,548	32,436	110,000	180,000
Cost of revenue (excluding D&A)	3,659	3,684	10,331	44,000	75,600
Gross profit	9,197	9,864	22,105	66,000	104,400
Product development	3,544	1,480	3,093	11,000	12,600
Sales, general and administrative	13,049	11,672	20,970	44,000	50,000
Depreciation and amortization	4,247	4,533	5,427	10,800	10,800
Impairment, sale of assets, restructuring	7,260	966	7,259	-	-
Operating income (loss)	(18,903)	(8,787)	(14,644)	200	31,000
Interest income	112	172	136	200	200
Interest expense	(7,270)	(5,063)	(450)	(1,000)	-
Other income (expense)	(4,643)	103	1,943	-	-
Income (loss) before taxes	(30,704)	(13,575)	(13,119)	(600)	31,200
Income tax (benefit)	38	107	(144)	(70)	7,800
Net income (loss)	(30,742)	(13,682)	(12,975)	(530)	23,400
EPS	(4.56)	(0.84)	(0.20)	(0.00)	0.20
Shares Outstanding	6,739	16,338	64,549	113,750	115,000
EBITDA	(19,187)	(3,979)	(7,242)	11,200	42,000
Margin Analysis					
Gross margin	71.5%	72.8%	68.1%	60.0%	58.0%
Product development	27.6%	10.9%	9.5%	10.0%	7.0%
SG&A	101.5%	86.2%	64.7%	40.0%	27.8%
Operating margin	(147.0)%	(64.9)%	(45.1)%	0.2%	17.2%
Year / Year Growth					
Total Revenues		5.4%	139.4%	239.1%	63.6%
Net Income		NMF	NMF	NMF	NMF
EPS		NMF	NMF	NMF	NMF

Source: Company filings and Taglich Brothers' estimates

Quarterly Income Statements 2018A - 2020E
(in thousands $)

	3/18A	6/18A	9/18A	12/18A	2018A	3/19E	6/19E	9/19E	12/19E	2019E	3/20E	6/20E	9/20E	12/20E	2020E
Revenue	4,113	6,003	8,008	14,312	32,436	19,000	25,000	31,000	35,000	110,000	39,000	43,000	47,000	51,000	180,000
Cost of revenue (excluding D&A)	1,195	1,780	2,129	5,227	10,331	7,600	10,000	12,400	14,000	44,000	16,380	18,060	19,740	21,420	75,600
Gross profit	2,918	4,223	5,879	9,085	22,105	11,400	15,000	18,600	21,000	66,000	22,620	24,940	27,260	29,580	104,400
Product development	727	754	766	846	3,093	2,750	2,750	2,750	2,750	11,000	3,150	3,150	3,150	3,150	12,600
Sales, general and administrative	2,986	2,867	8,970	6,147	20,970	10,250	10,750	11,250	11,750	44,000	11,750	12,250	12,750	13,250	50,000
Depreciation and amortization	965	994	999	2,469	5,427	2,700	2,700	2,700	2,700	10,800	2,700	2,700	2,700	2,700	10,800
Impairment, sale of assets, restructuring	74	5	1,995	5,185	7,259	-	-	-	-	-	-	-	-	-	-
Operating income (loss)	(1,834)	(397)	(6,851)	(5,562)	(14,644)	(4,300)	(1,200)	1,900	3,800	200	5,020	6,840	8,660	10,480	31,000
Interest income	43	43	50	-	136	50	50	50	50	200	50	50	50	50	200
Interest expense	(93)	(130)	(227)	-	(450)	(400)	(300)	(200)	(100)	(1,000)	-	-	-	-	-
Other income (expense)	(146)	2,159	27	(97)	1,943	-	-	-	-	-	-	-	-	-	-
Income (loss) before taxes	(2,030)	1,675	(7,001)	(5,659)	(13,119)	(4,650)	(1,450)	1,750	3,750	(600)	5,070	6,890	8,710	10,530	31,200
Income tax (benefit)	-	19	19	(182)	(144)	(600)	(190)	230	490	(70)	1,270	1,720	2,180	2,630	7,800
Net income (loss)	(2,030)	1,656	(7,020)	(5,477)	(12,975)	(4,050)	(1,260)	1,520	3,260	(530)	3,800	5,170	6,530	7,900	23,400
EPS	(0.04)	0.03	(0.12)	(0.06)	(0.20)	(0.04)	(0.01)	0.01	0.03	(0.00)	0.03	0.04	0.06	0.07	0.20
Shares Outstanding	50,062	64,741	59,315	104,489	64,549	110,000	115,000	115,000	115,000	113,750	115,000	115,000	115,000	115,000	115,000
EBITDA	(972)	2,799	(5,775)	(3,190)	(7,242)	(1,550)	1,550	4,650	6,550	11,200	7,770	9,590	11,410	13,230	42,000
Margin Analysis															
Gross margin	70.9%	70.3%	73.4%	62.5%	68.1%	60.0%	60.0%	60.0%	60.0%	60.0%	58.0%	58.0%	58.0%	58.0%	58.0%
Product development	17.7%	12.6%	9.6%	5.9%	9.5%	14.5%	11.0%	8.9%	7.9%	10.0%	8.1%	7.3%	6.7%	6.2%	7.0%
SG&A	72.6%	47.8%	112.0%	42.9%	64.7%	53.9%	43.0%	36.3%	33.6%	40.0%	30.1%	28.5%	27.1%	26.0%	27.8%
Operating margin	(44.6)%	(6.6)%	(85.6)%	(38.9)%	(45.1)%	(22.6)%	(4.8)%	6.1%	10.9%	0.2%	12.9%	15.9%	18.4%	20.5%	17.2%
Year / Year Growth															
Total Revenues	47.2%	85.3%	128.9%	256.5%	139.4%	361.9%	316.5%	287.1%	144.6%	239.1%	105.3%	72.0%	51.6%	45.7%	63.6%
Net Income	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF
EPS	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF

Source: Company filings and Taglich Brothers' estimates

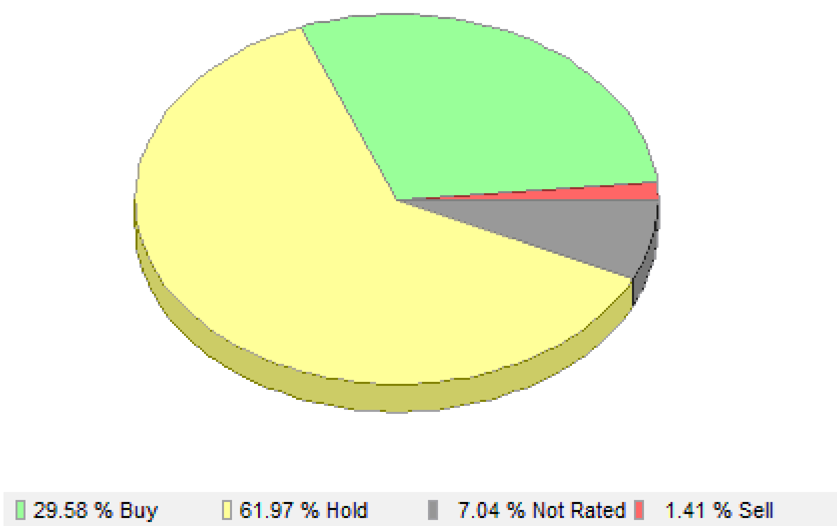
Statement of Cash Flows for the Periods Ended
(in thousands $)

	2017A	2018A
Net cash provided by (used in) operations	**(1,410)**	**(8,178)**
Net cash provided by (used in) investing	**(538)**	**(11,456)**
Net cash provided by (used in) financing	**2,047**	**12,300**
Effect of currency exchange rates	(196)	80
Net change in cash	**(97)**	**(7,254)**
Cash - beginning of period	**13,835**	**13,738**
Cash - end of period	**13,738**	**6,484**

Source: Company filings and Taglich Brothers' estimates

Price Chart

Taglich Brothers' Current Ratings Distribution



Investment Banking Services for Companies Covered in the Past 12 Months

Rating	#	%
Buy	**2**	**8**
Hold		
Sell		
Not Rated	**2**	**50**

Important Disclosures

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I, John Nobile, the research analyst of this report, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities and issuers; and that no part of my compensation was, is, or will be, directly, or indirectly, related to the specific recommendations or views contained in this report.

Public companies mentioned in this report:

Meaning of Ratings

Buy – The growth prospects, degree of investment risk, and valuation make the stock attractive relative to the general market or comparable stocks.

Speculative Buy – Long term prospects of the company are promising but investment risk is significantly higher than it is in our BUY-rated stocks. Risk-reward considerations justify purchase mainly by high risk-tolerant accounts. In the short run, the stock may be subject to high volatility and could continue to trade at a discount to its market.

Neutral – Based on our outlook the stock is adequately valued. If investment risks are within acceptable parameters, this equity could remain a holding if already owned.

Sell – Based on our outlook the stock is significantly overvalued. A weak company or sector outlook and a high degree of investment risk make it likely that the stock will underperform relative to the general market.

Dropping Coverage – Research coverage discontinued due to the acquisition of the company, termination of research services, non-payment for such services, diminished investor interest, or departure of the analyst.

Some notable Risks within the Microcap Market

Stocks in the Microcap segment of the market have many risks that are not as prevalent in Large-cap, Blue Chips or even Small-cap stocks. Often it is these risks that cause Microcap stocks to trade at discounts to their peers. The most common of these risks is liquidity risk, which is typically caused by small trading floats and very low trading volume which can lead to large spreads and high volatility in stock price. In addition, Microcaps tend to have significant company specific risks that contribute to lower valuations. Investors need to be aware of the higher probability of financial default and higher degree of financial distress inherent in the microcap segment of the market.

From time to time our analysts may choose to withhold or suspend a rating on a company. We continue to publish informational reports on such companies; however, they have no ratings or price targets. In general, we will not rate any company that has too much business or financial uncertainty for our analysts to form an investment conclusion, or that is currently in the process of being acquired.