Zacks Small-Cap Research

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DecisionPoint Systems (DPSI-OTCBB)

DPSI: Zacks Company Report – NEUTRAL
Living on the Edge, But Making Progress

Current Recommendation	**Neutral**
Prior Recommendation	Outperform
Date of Last Change	05/08/2014
Current Price (08/08/14)	$0.46
Six- Month Target Price	**$0.55**

OUTLOOK

DecisionPoint is a systems integrator that sells wireless solutions to the healthcare, retail and warehouse markets to provide customers with real-time information and streamline operations. As more and more applications are becoming mobile, DecisionPoint could benefit by market growth as well as the decline in hardware and network prices for the end users. As the company pays down its debt through positive cash flow, and reaches profitability, equity shareholders could see an improvement in valuation.

SUMMARY DATA

52-Week High	**$0.85**
52-Week Low	**$0.34**
One-Year Return (%)	**-52.94**
Beta	**0.48**
Average Daily Volume (sh)	**9,600**
Shares Outstanding (mil)	**13**
Market Capitalization ($mil)	**$5**
Short Interest Ratio (days)	**18.02**
Institutional Ownership (%)	**0**
Insider Ownership (%)	**N/A**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**156.2**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**NM**
P/E using 2014 Estimate	**NM**
P/E using 2015 Estimate	**NM**
Zacks Rank	**1**

Risk Level	**High**
Type of Stock	**Small-Value**
Industry	**Comp-Software**
Zacks Rank in Industry	**2 of 76m**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2012	18 A	18 A	19 A	17 A	72 A
2013	14 A	15 A	18 A	15 A	61 A
2014	17 A	17 A	17 E	17 E	68 E
2015					73 E

Earnings per Share
(GAAP EPS)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2012	-$0.03 A	-$0.13 A	-$0.15 A	-$0.05 A	-$0.29 A
2013	-$0.22 A	-$0.15 A	-$0.09 A	-$0.31 A	-$0.80 A
2014	-$0.04 A	-$0.03 A	-$0.01 E	-$0.01 E	-$0.16 E
2015					-$0.08 E

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EARNINGS REPORT

In addition to living on the financial edge, DecisionPoint had a new problem this quarter. The SEC served a Wells notice on July 2, to both the company and the CEO Toms. As a result, since then Mr. Toms has been on administrative leave. While he is still being paid, his salary has been cut to $250,000 per year from $375,000, with an additional $125,000 payable based on meeting certain financial targets. While he is home, a consultant who has worked with the company since last year, with help from the CFO, and the sales manager (who are both on site), are doing his duties.

The notice concerns trading of DecisionPoint stock by a company 10% owned by Toms in 2009-2011. According to the SEC, the company was deficient is reporting these trades—although there was no such requirement to report them back in those days as an SB-2 filer. Thus the company is confident it has done nothing wrong, and its case will be quickly resolved. Mr. Toms, on the other hand, has to deal with allegations for his Wells notice separately and he will be paying his own legal bills. The company has insurance for this litigation, but must first fulfill a deductible before it can be used.

Second, there is a legal dispute with the board by major shareholders, the Taglich brothers, over having a public shareholder's meeting. In the past the company has held private ones and the Taglichs want a public one they can attend and voice opinions. The board wants to hold off until the Wells issues are resolved but the Taglichs think that is irrelevant and want one regardless of the Wells issue. We are hopeful these activists can steer the company to a more transparent process and perhaps suggest improvements to the make up of the board.

Amidst all this, the company reported its second quarter. While revenues fell short, EPS beat by $0.01 due to an unexpected $300,000 drop off in expenses. Revenues in the June 30, 2014 quarter were $16.5 million versus $14.7 million the year before, up 12%. This was slightly down sequential from the first quarter of $16.7 million.

Gross margin was 22.9% versus 24.2% a year ago. Last year's quarter had an unusually high percentage of software in it. We expect gross margins to continue to bounce around depending on the product mix in a particular quarter. Expenses dropped again from Q1 as the annual year-end audits and lawyers fees were not repeated in Q2. Versus last year, expenses dropped $1 million. The company now has 92 employees of which 20-22 are sales people, similar to Q1.

Management now expects expenses to remain closer to the $3.4 million per quarter despite previously indicating expenses could run $3.7 to $4 million per quarter just a few months ago.

The company actually showed an operating profit for the first time in years. GAAP operating income was $366,000 versus a loss of $898,000 last year. Once interest and taxes were paid, the result was a $19,000 loss. After paying interest on preferred stock, the loss rose to $353,000 to common shareholders. This resulted in GAAP EPS loss of $0.03 versus a loss of $0.15 a year ago.

EBITDA was once again positive at $858,000, but the company paid $456,000 in interest and $31,000 in taxes. Cash flow was then $371,000. Given the company's total debt plus preferred is $20.2 million paying down debt is not close. Fortunately the preferred is convertible, albeit at prices higher than $1-1.35.

For the next quarter ending September 30, 2014, we are expecting a flattish revenue quarter, but up sequentially as we enter the seasonally strong half of the year. For September we expect sales of $17.0 million versus $17.6 million a year ago down 3%. GAAP EPS to common shareholders could be a loss of $0.01 despite having similar net income to Q2. This is due purely to an odd accounting occurrence that will happen if the company makes just $19,000 more. If it does, it will go GAAP profitable before

preferred dividends and will have to use diluted share count of 31.5 million rather than the 12.3 million primary shares it has been using.

We are keeping our revenue estimate for the year at $68 million in sales, but reducing the loss to $0.09, as the slight increase in profitability will reduce the EPS loss due to a larger denominator. We are maintaining a neutral on the stock until was see some revenue growth that indicates that the company has a potential path to sustained profitability, and the going concern opinion is resolved by the renegotiation of the bank covenants.

SUMMARY AND RISKS

- DecisionPoint Systems is a systems integrator focusing on the high growth market of wireless solutions for industry and retail.
- The company has had erratic revenues and a lack of profitability over the past few years.
- Though cash flow positive this quarter, it still has not reach breakeven but we expect that could happen near term, though investors may not believe it to be sustainable with the company's non-linear revenues and lack of sales growth.
- The company is high risk having done two capital raises in 2013 to sustain operations and diluted holders and was issued a going concern opinion in the December 31, 2013 audit because of a breach in bank loan covenants that could allow the bank loans called at any time.
- The company has a highly usual capital structure for a technology company with a variety of series of convertible preferred stock. These owners must be paid before net income to common stockholders and after servicing debt there has been even greater losses for common holders.
- With the advent of low-priced cellular devices and service ubiquity, mobile software has become a high growth market that is of increasing strategic importance to companies. As such, it has attracted the interest of a number of larger companies as well as well-funded start-ups that could cause it difficult for DecisionPoint Systems to compete.
- Its precarious capital structure and lack of profitability may cause customers to shy away from doing business with the company as they may have concerns about it staying power and resources

OVERVIEW

INDUSTRY OUTLOOK - NEUTRAL

The outlook for the software industry is Neutral. The last few quarters have shown signs of demand stabilization and cost cutting initiatives. While areas like enterprise resource planning systems, supply chain management software, and customer relationship management software have been hit hard by weak IT spending, other niches have held up relatively well. These include gaming, video editing and security software. Government spending also has been supportive to the software industry.

With several important software categories reaching maturity, top-line growth for the industry is likely to remain below historical levels, even after the industry recovers. Nevertheless, long-term growth prospects are still modestly above average. In addition, several of the group's top companies possess stellar fundamentals, including high profit margins, pristine balance sheets and cash flow well in excess of capital requirements.

VALUATION

DecisionPoint Systems is undervalued compared to other peer companies. As a VAR it has a different business model than software and services companies and it is difficult to find true peers. One similar company is Agilysys (AGYS). It specializes in point-of-sale, property management, inventory and procurement, and mobile and wireless solutions that are designed to streamline operations, improve efficiency, and enhance the guest experience in the hospitality industry. It is trading at 1.9 times enterprise value to trailing revenues. DPSI's trailing 12-month revenues are $65.4 million. Using that metric, DPSI would be worth $122 million enterprise value. Adding back the cash ($1.4 million) and subtracting the debt plus preferred stock ($7.5) gives us a market cap of $117 million. Using fully diluted 31.5 million shares gives us a share price of $3.71.

This discount can be attributed to the heavy debt carried by DecisionPoint versus Agilysys, which has no debt and $88 million in cash, as well as a bigger customer base, product line and resources. We believe that if DecisionPoint gets its financial house in order, and shows sustained sales growth or margins, it could appreciate. The current structure of the company has most of the cash flow going to preferred shareholders leaving virtually nothing for common shareholders or to pay down debt. Until this is changed, either by improved profitability, conversion of the preferred or the sale of the company, we see limited benefit to common shareholders.

PROJECTED INCOME STATEMENT & BALANCE SHEET

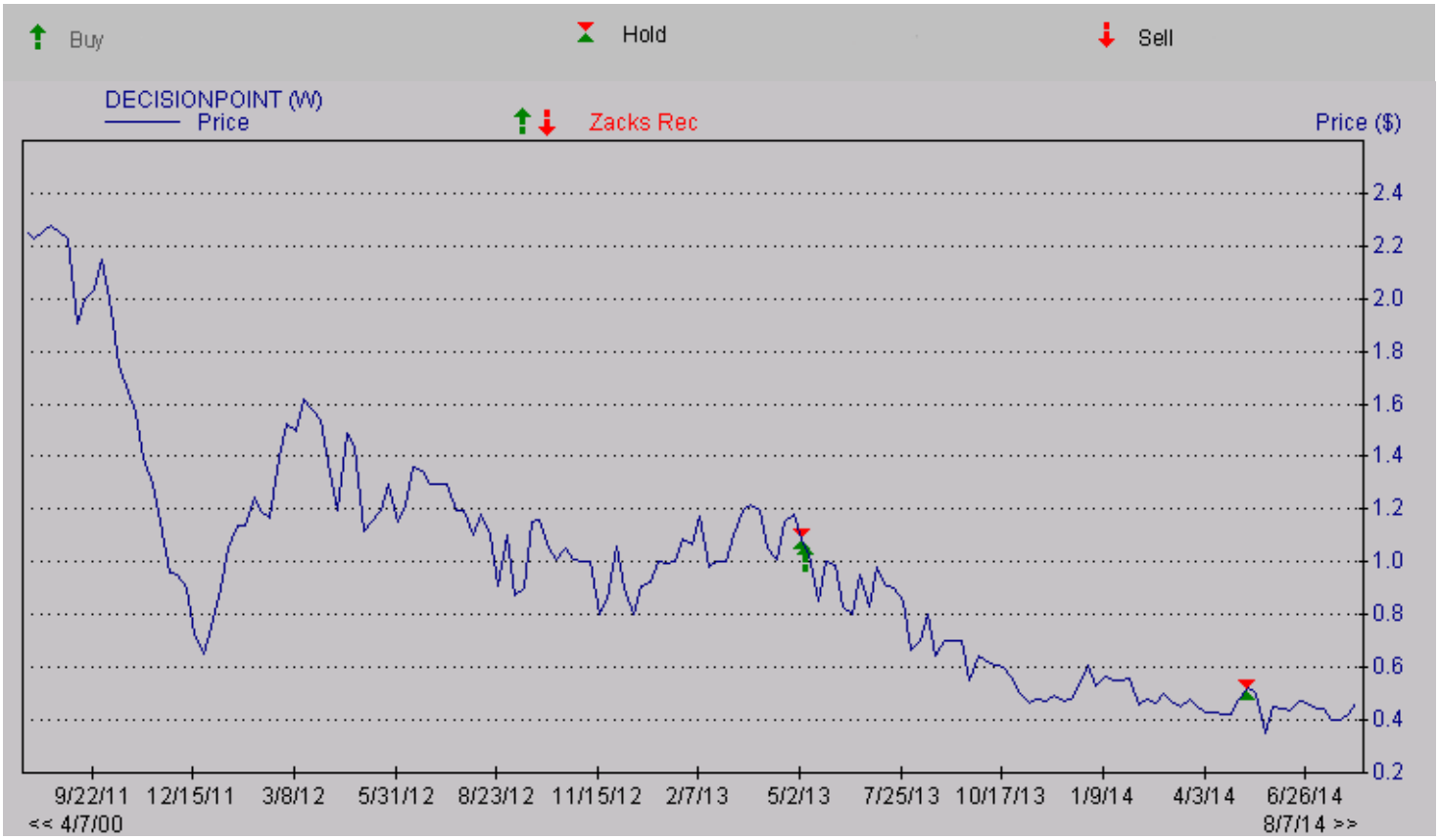
BALANCE SHEET	June 30, 2014	March 31, 2014	Percent Change	Dec. 31, 2013	Dec - June Percent Change
ASSETS					
Current assets					
Cash	$ 1,420	$ 612	132.0%	$ 641	121.5%
Accounts receivable, net	9,649	9,581	0.7%	10,504	-8.1%
Due from related party	-	182	-100.0%	188	-100.0%
Inventory, net	681	1,487	-54.2%	1,533	-55.6%
Deferred costs	4,055	3,984	1.8%	3,809	6.5%
Deferred tax assets	49	47	4.3%	49	0.0%
Prepaid expenses and other current assets	52	263	-80.2%	188	-72.3%
Total current assets	15,906	16,156	-1.5%	16,912	-5.9%
Property and equipment, net	145	141	2.8%	136	6.6%
Other assets, net	141	156	-9.6%	165	-14.5%
Deferred costs, net of current portion	1,615	1,682	-4.0%	1,807	-10.6%
Goodwill	8,401	8,315	1.0%	8,395	0.1%
Intangible assets, net	3,029	3,391	-10.7%	3,907	-22.5%
Total assets	$ 29,237	$ 29,841	-2.0%	$ 31,322	-6.7%
LIABILITIES AND STOCKHOLDERS' EQUITY					
Current liabilities					
Accounts payable	$ 8,443	$ 9,302	-9.2%	$ 9,774	-13.6%
Accrued expenses and other current liabilities	2,897	3,095	-6.4%	2,976	-2.7%
Lines of credit	**4,642**	**3,701**	**25.4%**	**3,883**	**19.5%**
Current portion of debt	**1,095**	**1,252**	**-12.5%**	**1,474**	**-25.7%**
Due to related parties	114	149	-23.5%	77	48.1%
Accrued earn out consideration	291	308	-5.5%	319	-8.8%
Warrant liability	637	552	15.4%	803	-20.7%
Unearned revenue	7,263	7,614	-4.6%	7,481	-2.9%
Total current liabilities	25,382	25,973	-2.3%	26,787	-5.2%
Long term liabilities					
Unearned revenue, net of current portion	2,313	2,337	-1.0%	2,481	-6.8%
Debt, net of current portion and discount	**1,805**	**1,829**	**-1.3%**	**1,961**	**-8.0%**
Accrued earn out consideration, net of current portion	94	144	-34.7%	149	-36.9%
Deferred tax liabilities	732	718	1.9%	740	-1.1%
Other long term liabilities	73	73	0.0%	77	-5.2%
Total liabilities	30,398	31,074	-2.2%	32,195	-5.6%
STOCKHOLDERS' EQUITY					
Cumulative Convertible Preferred stock, $0.001 par value, 10,000,000 shares authorized, 1,514,155 and 1,514,155 shares issued and outstanding, including cumulative and imputed preferred dividends of $2,037 and $1,956, and with a liquidation preference of $14,813 and $14,731 at March 31, 2014 and December 31, 2013, respectively	12,649	12,276	3.0%	12,193	3.7%
Common stock, $0.001 par value, 100,000,000 shares authorized, 12,883,446 issued and 12,729,563 outstanding as of March 31, 2014, and as of December 31, 2013	13	13	0.0%	13	0.0%
Additional paid-in capital	17,235	17,219	0.1%	17,231	0.0%
Treasury stock, 153,883 shares of common stock	(205)	(205)	0.0%	(205)	0.0%
Accumulated deficit	(30,271)	(29,918)	1.2%	(29,475)	2.7%
Unearned ESOP shares	(557)	(593)	-6.1%	(629)	-11.4%
Accumulated other comprehensive income	(25)	(25)	0.0%	(1)	2400.0%
Total stockholders' equity	(1,161)	(1,233)	-5.8%	(873)	33.0%
	$ 29,237	$ 29,841	-2.0%	$ 31,322	-6.7%
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Total Debt	**$ 6,542**	**$ 6,782**	11.2%	**$ 7,318**	3.1%
Total Debt plus Preferred	**$ 20,191**	**$ 19,058**	5.9%	**$ 19,511**	3.5%
Cash Minus Debt	$ (6,122)	$ (6,170)	-0.8%	$ (6,677)	-8.3%
Cash Minus Debt Minus Preferred	$ (18,771)	$ (18,446)	1.8%	$ (18,870)	-0.5%
Current Ratio	0.63	0.62		0.63	
Quick Ratio	0.60	0.56		0.57	

INCOME STATEMENT

	March Q1 13	June Q2 13	Sept Q3 13	Dec Q4 13	March Q1 14A	June Q2 14A	Sept Q3 14E	Dec Q4 14E	2011	2012	2013	2014E	2015E
REVENUE													
Net Revenue	13.8	14.7	17.6	14.6	16.7	16.5	17.0	17.3	58.4	71.5	60.7	67.5	73.0
Yr-to-yr Gr.	-23%	-17%	-5%	-16%	21%	12%	-3%	18%		23%	-15%	11%	8%
OPERATING EXPENSES													
Cost of goods sold	10.9	11.2	14.1	11.7	13.1	12.7	13.2	13.5	46.4	56.5	48.0	53.2	57.7
Gross Margin	2.8	3.6	3.5	2.9	3.6	3.8	3.8	3.8	12.0	15.0	12.7	14.3	15.3
% of Sales	20.5%	24.2%	19.7%	19.6%	21.4%	22.9%	22.4%	21.9%	20.5%	21.0%	21.0%	21.2%	21.0%
SG&A	5.0	4.5	4.5	4.4	3.7	3.4	3.5	3.5	13.6	18.2	18.3	14.2	14.5
Adjustment to earn-out	0.0	0.0	(0.8)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	(0.8)	0.0	0.0
Operating Income	(2.2)	(0.898)	(0.2)	(1.5)	(0.1)	0.4	0.3	0.2	(1.6)	(3.1)	(4.8)	0.1	0.8
Interest expense	0.2	0.3	0.2	0.2	0.2	0.2	0.2	0.2	1.2	1.0	1.0	0.8	0.4
Fair mkt value adj of warrant liabilit	0.0	0.0	(0.2)	(0.1)	(0.3)	0.1	0.0	0.0	2.7	0.0	(0.3)	(0.2)	0.0
Other Income	0.0	(0.0)	0.0	0.0	(0.0)	(0.0)	0.0	0.0	(0.4)	(0.1)	(0.0)	0.0	(0.0)
Pretax Income	(2.4)	(1.1)	(0.3)	(1.6)	(0.1)	0.081	0.1	0.1	(5.1)	(4.0)	(5.4)	(0.5)	0.4
Taxes	(0.3)	(0.0)	(0.1)	0.267	0.0	0.1	0.0	0.0	0.1	(0.1)	(0.2)	0.2	0.1
Tax Rate	13.5%	2.6%	40.2%	-17.1%	-24.2%	123.5%	23.4%	43.1%	-2.0%	3.1%	3.7%	-31.7%	25.8%
Net Income before preferred	(2.104)	(1.1)	(0.2)	(1.8)	(0.1)	(0.019)	0.1	0.0	(5.2)	(3.9)	(5.2)	(0.7)	0.3
Preferred dividends	(0.2)	(0.2)	(0.2)	(1.9)	(0.3)	(0.3)	(0.3)	(0.3)	(0.5)	(1.0)	(2.6)	(1.3)	(1.3)
Net to common shareholders	(2.3)	(1.3)	(0.4)	(3.7)	(0.4)	(0.353)	(0.3)	(0.3)	(5.7)	(4.8)	(7.8)	(2.0)	(1.0)
GAAP EPS	**($0.27)**	**($0.15)**	**($0.04)**	**($0.32)**	**($0.04)**	**($0.03)**	**($0.01)**	**($0.01)**	**($0.94)**	**($0.61)**	**($0.80)**	**($0.16)**	**($0.08)**
Primary shares	8.6	8.7	10.0	11.8	12.3	12.3	31.5	31.5	6.0	7.9	9.8	12.3	12.4
Non-GAAP EPS		**($0.08)**			-$0.01	-$0.01	-$0.01	-$0.01	-$0.17	-$0.13	-$0.17	-$0.02	$0.01
Fully diluted		17.7			30.5	31.5	31.5	31.5	30.5	30.5	30.5	30.5	30.5

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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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