Zacks Small-Cap Research

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

scr.zacks.com

10 S. Riverside Plaza, Chicago, IL 60606

DecisionPoint Systems (DPSI-OTCBB)

DPSI: Zacks Company Report – Q4 is 1st Profitable Quarter in Years; Will it Continue?

Current Recommendation	**Neutral**
Prior Recommendation	Outperform
Date of Last Change	05/08/2014
Current Price (03/20/15)	$0.41
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. If the company pays down its debt through positive cash flow, and maintains profitability, equity shareholders could see an improvement in valuation.

SUMMARY DATA

52-Week High	**$0.55**
52-Week Low	**$0.26**
One-Year Return (%)	**-14.03**
Beta	**0.86**
Average Daily Volume (sh)	**11,153**
Shares Outstanding (mil)	**13**
Market Capitalization ($mil)	**$5**
Short Interest Ratio (days)	**18.02**
Institutional Ownership (%)	**0**
Insider Ownership (%)	**15**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**157.4**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**NM**
P/E using 2015 Estimate	**NM**
P/E using 2016 Estimate	**8.2**
Zacks Rank	**3**

Risk Level	**High**
Type of Stock	**Small-Value**
Industry	**Computer-Software**
Zacks Rank in Industry	**22 of 73**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013	14 A	15 A	18 A	15 A	61 A
2014	17 A	17 A	14 A	17 A	65 A
2015	16 E	17 E	17 E	19 E	68 E
2016					71 E

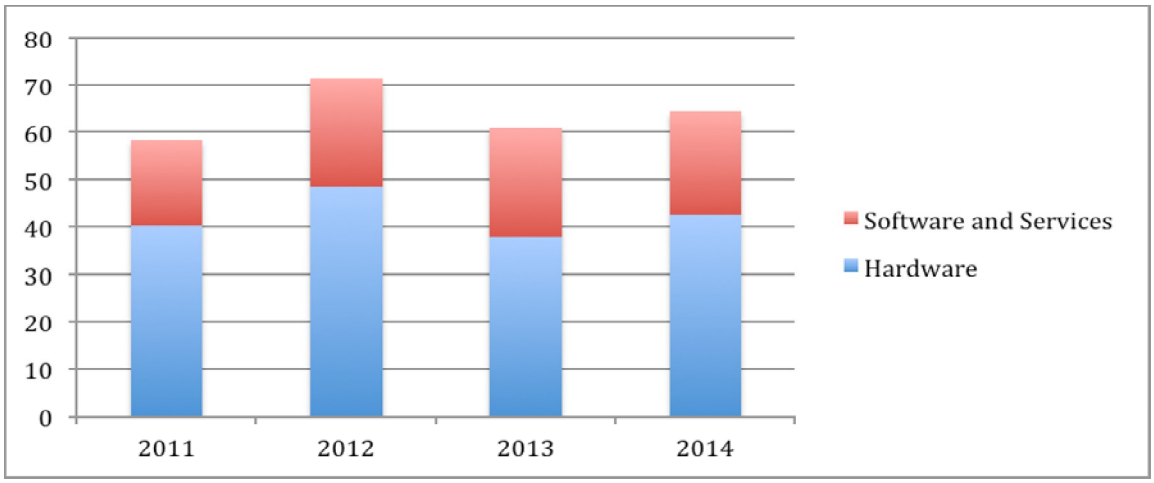
Earnings per Share
(Fully diluted GAAP EPS before non-recurring)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013	-$0.22 A	-$0.15 A	-$0.09 A	-$0.11 A	-$0.65 A
2014	-$0.04 A	-$0.03 A	-$0.07 A	$0.03 A	-$0.07 A
2015	-$0.03 E	$0.00 E	$0.00 E	$0.01 E	$0.01 E
2016					$0.05 E

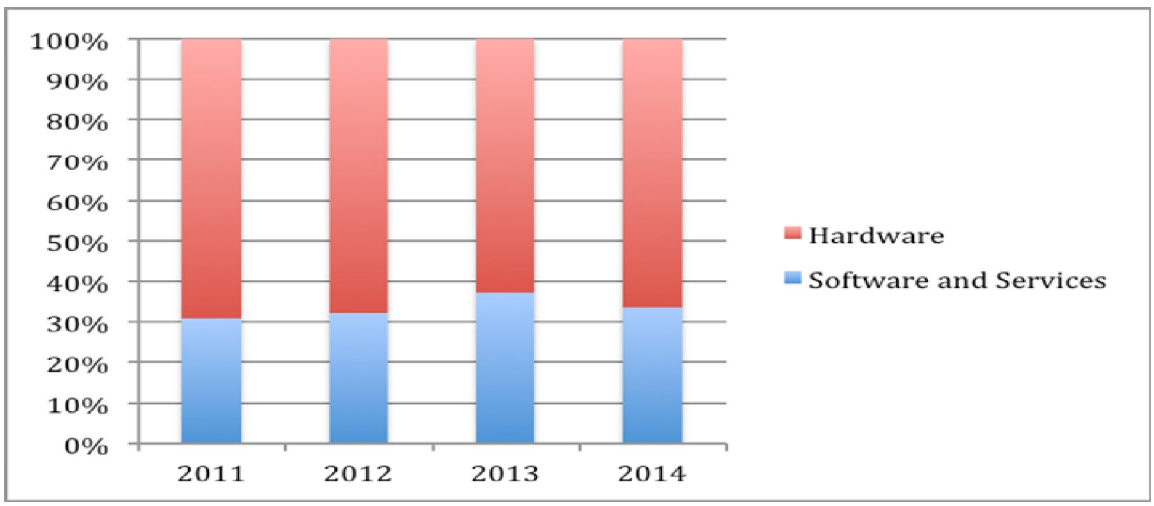
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EARNINGS REPORT

Q4 showed continued progress in improving the profitability of DecisionPoint. The company reported its first profit in years, although only for the quarter. Non-GAAP EPS calculated on a fully diluted basis was $0.03 versus last year's non-GAAP loss of $0.11 (on a primary basis). This beat our estimate of $0.01 per share. Most significant in the difference was the company's reversal of taxes of $716,000 while we were looking for a return of $400,000 combined with higher than expected revenues. Revenues were $17.2 versus $14.6, up 17% and above our estimate of $15.6 million. Revenues for the year ended at $64.5 million up 5% after the decline in revenues in 2013 as shown below.



Most encouraging was the company's ability to reduce SG&A be an astounding $5 million a year while decreasing losses. Some of this was due to not having to raise money, and some was reduced payroll, but importantly this work having been done gives the company a much lower breakeven point going forward. The next job will be for the company to increase sales and raise margins. Last year it appeared that the company had been on a course to decrease the percent of sales coming from the low margin hardware, but that did not happen in 2014. Should DecisionPoint be able to increase its percentage of software and services it could increase gross margin. On application development services, margins are 30-40%. Combined with even higher margin software sales, gross margins, which were 22% in the quarter and the year, could be much higher.



The company recently signed two large application development contracts and sees good prospects in this line of business. One contract was with a large retailer than has been a long time customer and the other was with a new customer in the oil and gas industry. The company continues to find its niche serving the more mobile industries primarily: retailers, fleets, on-site field service, mobile sales, dealers and warehouses.

Balance Sheet

While the company has improved its breakeven, the balance sheet is not much improved. It did shift some debt from long term to short term, but overall debt, or debt plus line of credit, went from $7.3 in 2013 to $8.2 million in 2014. The increased debt is however at lower interest rates, reducing interest payments going forward. Net cash, or cash minus line of credit is now a negative $4.2 million versus $3.2 million. Working capital is a negative $8 million, but better $1.1 million better than last year. The current ratio remains at 0.7X, and the quick is at 0.6X, far from the recommended 2X and 1X.

Q1 2015

For the March 31, 2014 quarter, we are expecting revenues to be down sequentially as seasonally it is the weaker quarter of the year. This, combined with the exceptionally harsh winter (as customers are primarily mobile industries), will hurt year over year comparisons as well. Since we expect less revenue in Q1 than Q4, and see expenses higher (as Q1 has one-time costs such as audit fees), and there won't be any income tax benefit, income should be sequentially down.

We are forecasting revenues of $15.8 million, down 5% year over year, and non-GAAP EPS of a loss of $0.03 (using primary shares.)

2015

We are keeping our revenue estimate for the year at $68 million in sales, up 5% as well as our non-GAAP EPS estimate of $0.01.

We are maintaining a neutral on the stock until was see some consistent revenue growth that indicates that the company has a path to sustained profitability, and we get past the weak Q1. Despite having renegotiated its bank loan, and being in compliance with its bank covenants for the first time in years, the auditors have maintained the going concern opinion. With its uneven quarters, the company has little reserve to maintain itself with a few weak quarters and really needs more cash and less debt. While getting the preferred shareholders to convert would improve finances, it may be difficult to get the preferred shareholders to convert to common given the attractive 8% and 10% yields of the Series D and E. The Series E is convertible at $0.50 forced conversion is at $1.00. The Series D is convertible at $0.71 and forced is at $1.40. Should the companies prospects and stock price improve, we believe management would try to persuade the majority preferred holders, who also control the board, to convert and improve the profitability of the company and the prospects for common stockholders.

SUMMARY AND RISKS

- DecisionPoint Systems is a systems integrator focusing on the high growth market of wireless solutions for industry and retail, and industry going through rapid changes.

- The company has had erratic revenues and a lack of profitability over the past few years.

- Though adjusted EBITDA positive this quarter, it had negative cash flow and it still has not reach breakeven but we expect that could happen in the next few quarters as it has lowered its breakeven considerably. Even it reaches breakeven or profits for one quarter, investors may not believe profits to be sustainable given the company's non-linear revenues and lack of sales growth.

- The company is high risk having done multiple capital raises to sustain operations and have diluted holders. It was issued a going concern opinion in the December 31, 2013, which it still has on its 2014 audit.

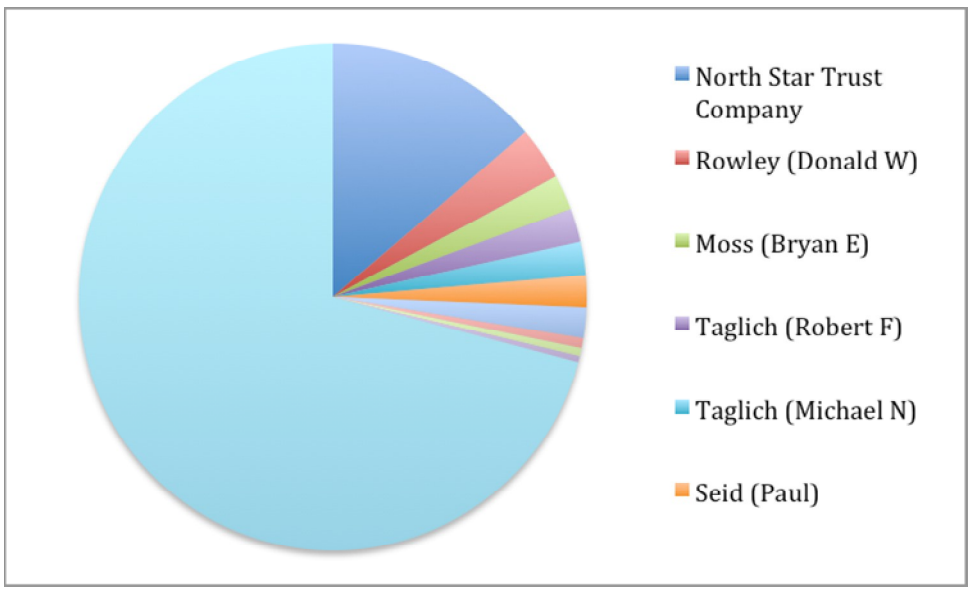
- The company has a highly unusual capital structure for a technology company with a variety of series of convertible preferred stock. These owners must be paid before net income to common stockholders and after servicing debt there has been even greater losses for common holders.

- 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.

- The company was served a Wells notice from the SEC that has not yet been resolved.

OWNERSHIP OF COMMON STOCK



VALUATION

DecisionPoint Systems is undervalued compared to other less troubled peer companies. As a VAR it has a different business model than software and services companies, and it is difficult to find true public 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 1.4 times enterprise value to trailing revenues. DPSI's trailing 12-month revenues are $64.5 million. Using that metric, DPSI would be worth $90 million enterprise value. Adding back the cash ($1.6 million) and subtracting the debt ($8.2 million) gives us a market cap of $83.7 million. Using fully diluted 31.4 million shares gives us a share price of $2.66.

This discount can be attributed to the heavy debt carried by DecisionPoint versus Agilysys, which has no debt and $74 million in cash, 57% gross margins, 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.

CASH FLOW

In Thousands	12 Months Ended Dec. 31, 2014	Dec. 31, 2013	% Change
Cash flows from operating activities:			
Net income (loss)	524	(5218)	-110%
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Depreciation and amortization	1754	1967	-11%
Amortization of deferred financing costs and note discount	153	181	-15%
Employee and Director stock-based compensation	119	76	57%
Acquisition earn-out adjustment		(820)	
Change in fair value of warrants	284	296	-4%
Loss on disposal of property and equipment	5	13	-62%
ESOP compensation expense	47	138	-66%
Allowance for doubtful accounts	(46)	142	-132%
Deferred taxes, net	(197)	(271)	-27%
Changes in operating assets and liabilities, net of assets and liabilities acquired:			
Accounts receivable, net	(976)	1615	-160%
Due from related parties	181		
Inventory, net	(502)	(723)	-31%
Deferred costs	1123	462	143%
Prepaid expenses and other current assets	106	126	-16%
Other assets, net	11	(18)	-161%
Accounts payable	314	(1296)	-124%
Accrued expenses and other current liabilities	6	(103)	-106%
Due to related parties	(84)	76	-211%
Unearned revenue	(983)	(284)	246%
Net cash (used in) provided by operating activities	1185	(4233)	-128%
Cash flows from investing activities			
Capital expenditures	(63)	(45)	40%
Net cash used in investing activities	(63)	(45)	40%
Cash flows from financing activities			
(Repayments) borrowings from lines of credit, net	1931	459	321%
Proceeds from the issuance of term debt		1000	
Repayment of debt	(1153)	(2082)	-45%
Issuance of convertible series E preferred stock		4090	
Paid financing costs associated with convertible preferred stock offering		(597)	
Dividends paid	(748)	(423)	77%
Paid financing costs	(100)	(119)	-16%
Payments for contingent acquisition liability	(84)		
Common stock issued in private placement, net of costs		403	
Warrants classified as a liability in connection with common stock private placement		1099	
Net cash provided by (used in) financing activities	(154)	3830	-104%
Effect on cash of foreign currency translation	7	(14)	-150%
Net increase (decrease) in cash	975	(462)	-311%
Cash at beginning of year	641	1103	-42%
Cash at end of year	1616	641	152%
Supplemental disclosure of cash flow information:			
Interest paid	803	1019	-21%
Income taxes paid	89	258	-66%
Supplemental disclosure of non-cash financing activities:			
Accrued and imputed dividends on preferred stock	340	265	28%
Imputed dividends as contingent beneficial converion on series D preferred stock		1343	
Accrued PIK dividends on series D and Series E preferred stock		289	
Warrants issued in connection with common stock private placement		1099	
Warrants issued in connection with convertible series E preferred stock		278	
Settlement of earn-out obligation with convertible note payable	291		
Payment of accrued dividends through issuance of PIK shares	289		

BALANCE SHEET

	Dec 31, 2014	Dec. 31, 2013	Percent Change
ASSETS			
Current assets			
Cash	$ 1,616	$ 641	152.1%
Accounts receivable, net	11,497	10,504	9.5%
Due from related party	-	188	-100.0%
Inventory, net	2,035	1,533	32.7%
Deferred costs	3,177	3,809	-16.6%
Deferred tax assets	21	49	-57.1%
Prepaid expenses and other current assets	81	188	-56.9%
Total current assets	18,427	16,912	9.0%
Property and equipment, net	145	136	6.6%
Other assets, net	124	165	-24.8%
Deferred costs, net of current portion	1,314	1,807	-27.3%
Goodwill	8,202	8,395	-2.3%
Intangible assets, net	2,045	3,907	-47.7%
Total assets	$ 30,257	$ 31,322	-3.4%
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities			
Accounts payable	$ 10,000	$ 9,774	2.3%
Accrued expenses and other current liabilities	2,755	2,976	-7.4%
Lines of credit	**5,811**	**3,883**	49.7%
Current portion of debt	**813**	**1,474**	-44.8%
Due to related parties	73	77	-5.2%
Accrued earn out consideration	-	319	-100.0%
Unearned revenue	6,918	7,481	-7.5%
Total current liabilities	26,370	25,984	1.5%
Long term liabilities			
Unearned revenue, net of current portion	2,015	2,481	-18.8%
Debt, net of current portion and discount	**1,580**	**1,961**	-19.4%
Accrued earn out consideration, net of current portion	165	149	10.7%
Deferred tax liabilities	460	740	-37.8%
Warrant liability	519	803	-35.4%
Other long term liabilities	61	77	-20.8%
Total liabilities	31,170	32,195	-3.2%
STOCKHOLDERS' EQUITY			
Cumulative Convertible Preferred stock	12,822	12,193	5.2%
Common stock	13	13	0.0%
Additional paid-in capital	17,252	17,231	0.1%
Treasury stock, 153,883 shares of common stock	(205)	(205)	0.0%
Accumulated deficit	(30,292)	(29,475)	2.8%
Unearned ESOP shares	(484)	(629)	-23.1%
Accumulated other comprehensive income	(19)	(1)	1800.0%
Total stockholders' equity	(913)	(873)	4.6%
	$ 30,257	$ 31,322	-3.4%
Total Debt	**8,204**	**7,318**	12.1%
Net cash	$ (4,195)	$ (3,242)	29.4%
Cash Minus Debt Minus Preferred	$ (17,017)	$ (15,435)	10.2%
Current Ratio	0.70	0.65	7.4%
Quick Ratio	0.62	0.59	5.0%
Tangible Net Worth	$ (11,160)	$ (13,175)	-15.3%
Working capital	(7,943)	(9,072)	-12.4%

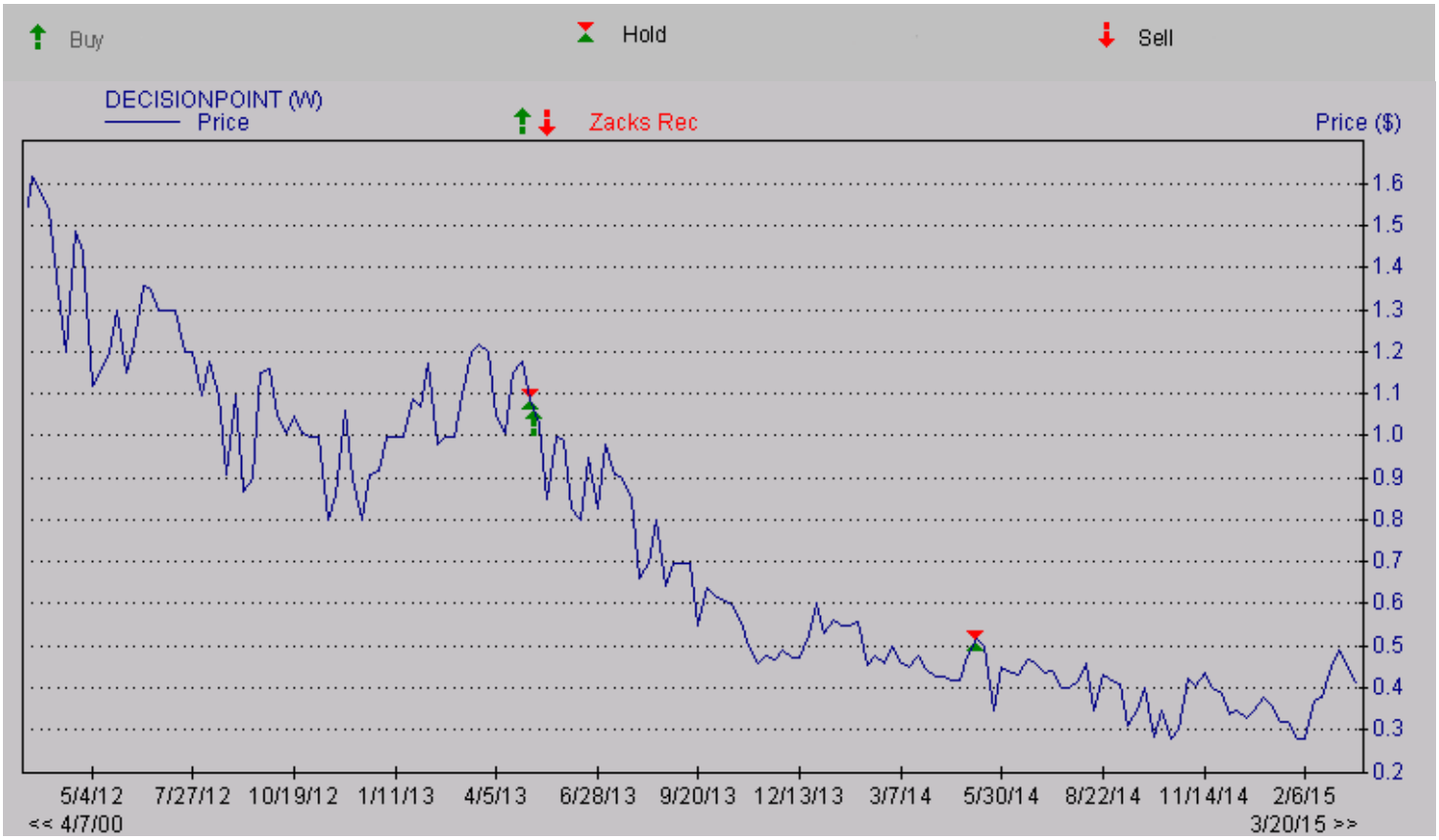
INCOME STATEMENT

Decision Point

	Dec Q4 13	March Q1 14	June Q2 14	Sept Q3 14	Dec Q4 14	March Q1 15E	June Q2 15E	Sept Q3 15E	Dec Q4 15E	2013	2014	2015E	2016E
REVENUE													
Net Revenue	14.6	16.7	16.5	14.1	17.2	15.8	16.5	17.0	18.7	60.7	64.5	68.0	71.4
Yr-to-yr Gr.	-16%	21%	12%	-20%	17%	-5%	0%	20%	9%	-15%	6%	5%	5%
OPERATING EXPENSES													
Cost of goods sold	11.7	13.1	12.7	11.1	13.4	12.3	12.8	13.2	14.4	48.0	50.4	52.6	54.3
Gross Margin	2.9	3.6	3.8	3.0	3.8	3.5	3.7	3.8	4.3	12.7	14.2	15.4	17.1
% of Sales	19.7%	21.4%	22.9%	21.4%	22.1%	22.4%	22.5%	22.6%	22.8%	21.0%	22.0%	22.6%	24.0%
SG&A	4.4	3.7	3.4	3.0	3.170	3.400	3.200	3.250	3.300	18.3	13.3	13.2	15.0
Adjustment to earn-out	0.0	0.0	0.0	0.0	-0.086	0.000	0.000	0.000	0.000	(0.8)	(0.1)	0.0	0.0
Operating Income	(1.5)	(0.1)	0.4	(0.0)	0.714	0.139	0.513	0.592	0.964	(4.8)	0.9	2.2	2.1
Operating Margin	-10%	-1%	2%	0%	4%	1%	3%	3%	5%	-8%	1%	3%	3%
Interest expense	0.2	0.2	0.2	0.229	0.209	0.209	0.209	0.209	0.209	1.0	0.9	0.8	0.7
Fair mkt value adj of warrant lia	(0.1)	(0.251)	0.084	(0.088)	(0.030)	0.000	0.000	0.000	0.000	(0.3)	(0.3)	0.0	0.0
Other Income	0.0	(0.008)	(0.021)	(0.017)	0.031	0.000	0.000	0.000	0.000	(0.0)	0.0	0.0	0.0
Pretax Income	(1.6)	(0.091)	0.081	(0.166)	0.504	(0.070)	0.304	0.383	0.755	(5.4)	0.3	1.4	1.4
Taxes	0.267	0.0	0.1	0.4	(0.716)	0.000	0.000	0.000	0.000	(0.199)	(0.197)	0.0	0.1
Tax Rate	-17.2%	-24.2%	123.5%	-239.2%	-1.421	0.0%	0.0%	0.0%	0.0%	3.7%	-60.2%	0.0%	5.0%
Net Income before preferred	(1.8)	(0.113)	(0.019)	(0.563)	1.220	(0.070)	0.304	0.383	0.755	(5.2)	0.5	1.4	1.3
Preferred dividends	(1.9)	(0.329)	(0.334)	(0.334)	(0.339)	(0.339)	(0.339)	(0.339)	(0.339)	(2.6)	(1.3)	(1.4)	(1.4)
Net to common shareholders	(3.7)	(0.442)	(0.353)	(0.897)	0.881	(0.409)	(0.036)	0.044	0.416	(7.8)	(0.8)	0.015	(0.030)
GAAP EPS	**($0.37)**	**($0.04)**	**($0.03)**	**($0.07)**	**$0.07**	**($0.03)**	**($0.00)**	**$0.00**	**$0.03**	**($0.80)**	**($0.07)**	**$0.00**	**($0.00)**
Primary shares	10.1	12.3	12.3	12.4	12.4	12.4	12.4	12.4	12.4	9.8	12.4	12.4	12.4
Non-GAAP EPS	**($0.11)**	**($0.04)**	**($0.02)**	**($0.07)**	**$0.06**	**($0.03)**	**$0.00**	**$0.01**	**$0.04**	**($0.65)**	**($0.13)**	**$0.01**	**$0.01**
Primary	10.1	12.3	12.3	12.4	12.4	12.4	12.4	12.4	12.4	9.8	12.4	12.4	12.4
										24%	26%	0%	0%
Non-GAAP Dil EPS	**($0.03)**	**($0.01)**	**($0.01)**	**($0.03)**	**$0.03**	**($0.01)**	**$0.00**	**$0.00**	**$0.01**	**($0.13)**	**($0.01)**	**$0.01**	**$0.05**
Fully diluted	33.0	30.5	31.5	31.5	31.4	31.4	31.4	31.4	31.4	30.5	31.2	31.4	31.5
Adjusted EBITDA	(0.452)	0.474	0.899	0.459	0.872					(1.664)	2.689		

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