Zacks Small-Cap Research

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DecisionPoint Systems (DPSI-OTCBB)

DPSI: Zacks Company Report – NEUTRAL Revenues on the Upswing But Obstacles Remain

Current Recommendation	**Neutral**
Prior Recommendation	Outperform
Date of Last Change	05/07/2014
Current Price (05/06/14)	$0.55
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 become 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	**$1.10**
52-Week Low	**$0.41**
One-Year Return (%)	**-50.00**
Beta	**0.27**
Average Daily Volume (sh)	**18,925**
Shares Outstanding (mil)	**13**
Market Capitalization ($mil)	**$7**
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 (%)	**142.5**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2014 Estimate	**-1.7**
P/E using 2015 Estimate	**-2.0**
Zacks Rank	**2**

Risk Level	**High**
Type of Stock	**Small-Value**
Industry	**Comp-Software**
Zacks Rank in Industry	**9 of 78**

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 E	18 E	23 E	68 E
2015					73 E

Earnings per Share
(EPS is operating earnings before non recurring items)

	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	-$0.05 E	-$0.06 E	-$0.05 E	-$0.20 E
2015					-$0.19 E

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EARNINGS REPORT

DecisionPoint Systems reported a good first quarter aided by strong sales and even stronger expense control. Revenues in the March 31, 2014 quarter were $16.7 million versus $13.8 million the year before, up 21%. This was also up sequential from the disappointing fourth quarter of $14.6 million, which is typically the strongest quarter of the year for technology companies. This quarter comes on the heals of a disappointing Q4 2013, where revenues fell short and earnings losses were high. Some of the business from that quarter slipped into Q1 making the first quarter unusually strong. Some of the improvement in revenues was revenues that slipped out of the fourth quarter and into the first. We are heartened by the improvement but are hesitant to extrapolate a recovery from one data point given the company's high debt.

Gross margin was 21.4% versus 20.5% a year ago and 19.6% in December. More importantly the company reduced expenses by laying off a third of the workforce as it integrated its acquisitions and removed redundancies as well as right-sized the business. It is now down to 93 employees of whom 20 are salesmen and 20 engineers. This is expected to take $3.3 million per year out of operating expenses. Expenses declined to $3.7 million for the quarter versus $4.4 million in Q4 and $5 million a year ago. In that $4.4 million in Q4, there were some one-time expenses for severance and banking and legal fees for raising capital.

Going forward management expects expenses to remain at $3.7 to $4 million per quarter, fluctuating based on sales commissions paid dependent on revenue levels.
The company paid $207,000 in interest expense for the quarter. This is for the line of credit and other bank debt and separate from that paid on the preferred stock as well as the principle paid on a bank loan.

Net income was a loss of $113,000 versus a loss of $2.1 million a year ago. This resulted in GAAP EPS loss of $0.04 versus a loss of $0.27 a year ago for common stockholders. Certainly the cost structure is much improved.

Most importantly the company was EBITDA positive. It reported a positive $565,000 and on an adjusted basis (adding stock based compensation and a one-time restructuring charge of $142,000) came in a positive $731,000.

For Q2, the company believes that is may again have an up quarter versus the year ago that came in at $14.7 million. It hopes to be cash flow positive and near breakeven.

We have come to expect lumpy quarters and have difficultly projecting any further. The company itself has little visibility as evidenced by the earnings disappointments reported through out last year. We believe the company is now in show-me mode to investors.

Our primary concern right now debt restricting and getting the company in a sustainable state. The current ratio is now 0.6X instead of 2X the quick is also 0.6X instead of 1X. There is $5 million in current debt and another $1.8 million in long-term debt or 22% of assets. To pay the interest ($127,000 per quarter) and preferred dividends ($250,000 per quarter) takes $1.5 million a year and the company reported EBIDTA of $565,000 for the quarter (times four that is $2.26). Additionally there is the matter of the $1.3 million of current debt that is not part of the line of credit that must be paid or extended. The company is paying $90,000 per month in principle on that debt, or $1.1 million this year. Clearly the company needs to increase cash flow during the course of 2014, hopefully through improved sales.

Given lack of profits plus the heavy debt burden, we are hesitant to recommend the stock despite its very low enterprise valuation and its much-improved first quarter. Adding to this scenario is the industry disruption of DecisionPoint's main suppliers Motorola and Zebra merging that could cause problems through out the year. Not only does Zebra expect the process to take all of 2014, but also merging

technology companies and sales forces is never pretty and is always unpredictable. Should DecisionPoint show a few quarters of up revenues, breakeven cash flow, restructured capitalization and traction in new products its valuation could appreciate to more in line with the industry. Until then it is speculative investment particular given the going concern opinion given by the auditors.

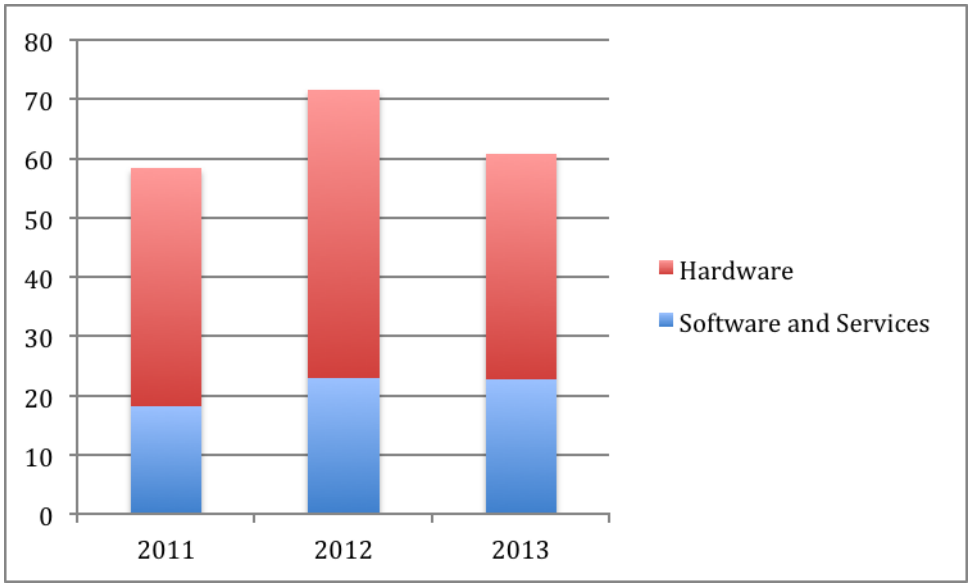
For the next quarter ending June 30, 2014 we are expecting another up revenue quarter as management has indicated that sales appear strong near term. We are hopeful for a cash flow positive quarter and traction in sales. For June we expect sales of $17.1 million versus $14.7 million a year ago up 16%. EPS to common shareholders may be slightly down from Q1 at a loss of $0.05 versus a loss of $0.04 as we do not expect to have the gain on fair market value adjustment of warrant liability in this quarter or going forward.

For the year we are expecting the company could recover revenues to $68 million in sales and a reduction in the loss to $0.20 per share. Some debt should be paid down by then and there could be some conversion of the preferred to stock once again reducing interest expense for common stockholders.

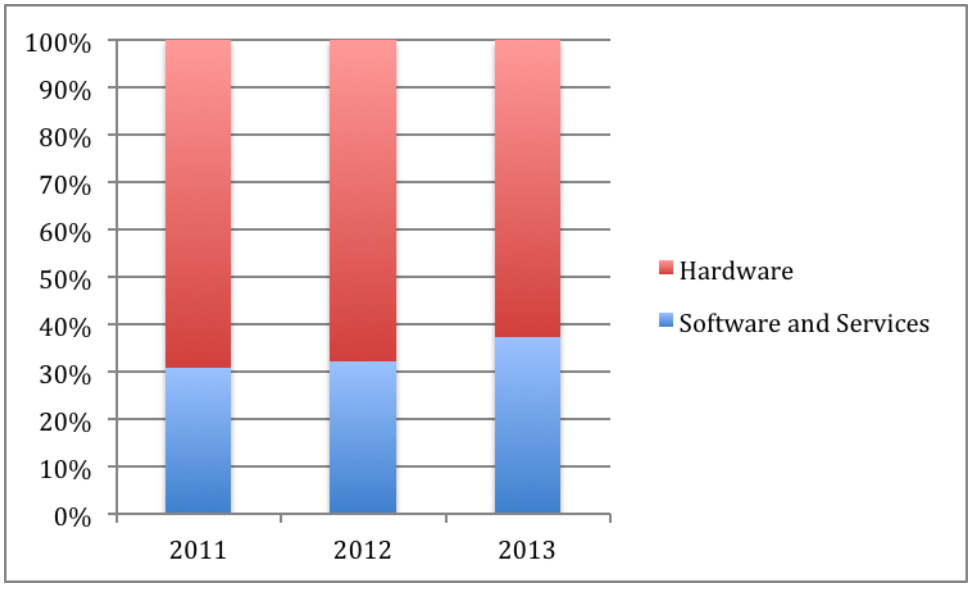
SUMMARY AND RISKS

- DecisionPoint Systems is a systems integrator focusing on the high growth market of wireless solutions for industry and retail.
- The company, created though an ESOP plan that went public through a shell in 2011, has had erratic revenues and a lack of profitability over the past few years. It says it is working its way through its debt and making progress to profitability. 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.
- 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.
- 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.

Sales Breakdown: By Product



Sales Breakdown: As a Percent of Sales



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 0.7 times enterprise value to trailing revenues. Using that metric, DPSI would be worth $44.5 million enterprise value. Adding back the cash ($0.6 million) and subtracting the debt ($6.8) gives us a market cap of $38.3 million. Using fully diluted 30.5 million shares gives us a share price of $1.25.

This discount can be attributed to the heavy debt carried by DecisionPoint versus Agilysys, which has no debt and $96 million in cash, as well as a bigger customer base, product line and resources. We believe that once DecisionPoint gets its financial house in order and shows sustained sales improvements it could appreciate closer to the $1.25.

PROJECTED INCOME STATEMENT & BALANCE SHEET

BALANCE SHEET

	March 31, 2014	December 31, 2013	Percent Change
ASSETS			
Current assets			
Cash	$ 612	$ 641	-4.5%
Accounts receivable, net	9,581	10,504	-8.8%
Due from related party	182	188	-3.2%
Inventory, net	1,487	1,533	-3.0%
Deferred costs	3,984	3,809	4.6%
Deferred tax assets	47	49	-4.1%
Prepaid expenses and other current assets	263	188	39.9%
Total current assets	16,156	16,912	-4.5%
Property and equipment, net	141	136	3.7%
Other assets, net	156	165	-5.5%
Deferred costs, net of current portion	1,682	1,807	-6.9%
Goodwill	8,315	8,395	-1.0%
Intangible assets, net	3,391	3,907	-13.2%
Total assets	$ 29,841	$ 31,322	-4.7%
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities			
Accounts payable	$ 9,302	$ 9,774	-4.8%
Accrued expenses and other current liabilities	3,095	2,976	4.0%
Lines of credit	3,701	3,883	-4.7%
Current portion of debt	1,252	1,474	-15.1%
Due to related parties	149	77	93.5%
Accrued earn out consideration	308	319	-3.4%
Warrant liability	552	803	-31.3%
Unearned revenue	7,614	7,481	1.8%
Total current liabilities	25,973	26,787	-3.0%
Long term liabilities			
Unearned revenue, net of current portion	2,337	2,481	-5.8%
Debt, net of current portion and discount	1,829	1,961	-6.7%
Accrued earn out consideration, net of current portion	144	149	-3.4%
Deferred tax liabilities	718	740	-3.0%
Other long term liabilities	73	77	-5.2%
Total liabilities	31,074	32,195	-3.5%
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	12,276	12,193	0.7%
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%
Additional paid-in capital	17,219	17,231	-0.1%
Treasury stock, 153,883 shares of common stock	(205)	(205)	0.0%
Accumulated deficit	(29,918)	(29,475)	1.5%
Unearned ESOP shares	(593)	(629)	-5.7%
Accumulated other comprehensive income	(25)	(1)	2400.0%
Total stockholders' equity	(1,233)	(873)	41.2%
Total liabilities	$ 29,841	$ 31,322	-4.7%
Total Debt	[illegible]782	[illegible]318	-7.3%

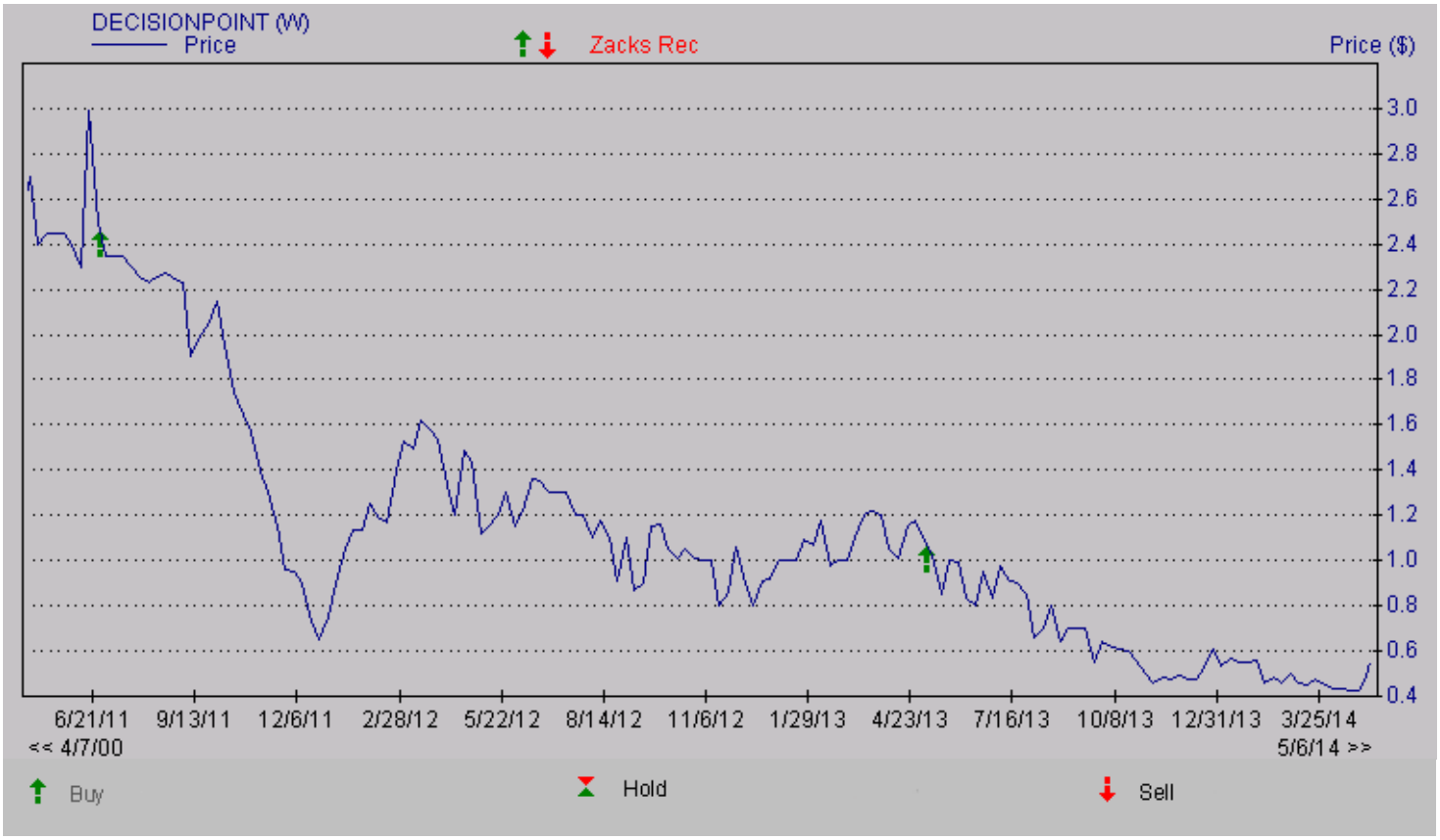
INCOME STATEMENT

Decision Point
5-May-14

	March Q1 13	June Q2 13	Sept Q3 13	Dec Q4 13	March Q1 14A	June Q2 14E	Sept Q3 14E	Dec Q4 14E	2011	2012	2013	2014E	2015E
REVENUE													
Net Revenue	13.8	14.7	17.6	14.6	16.7	17.1	17.0	17.2	58.4	71.5	60.7	68.0	73.0
Yr-to-yr Gr.	-23%	-17%	-5%	-16%	21%	16%	-3%	18%		23%	-15%	12%	7%
OPERATING EXPENSES													
Cost of goods sold	10.9	11.2	14.1	11.7	13.1	13.4	13.3	13.4	46.4	56.5	48.0	53.2	57.7
Gross Margin	2.8	3.6	3.5	2.9	3.6	3.7	3.7	3.8	12.0	15.0	12.7	14.8	15.3
% of Sales	20.5%	24.2%	19.7%	19.6%	21.4%	21.6%	21.8%	22.3%	20.5%	21.0%	21.0%	21.8%	21.0%
SG&A	5.0	4.5	4.5	4.4	3.7	3.8	4.0	4.0	13.6	18.2	18.3	15.5	15.9
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)	(0.9)	(0.2)	(1.5)	(0.1)	(0.1)	(0.3)	(0.2)	(1.6)	(3.1)	(4.8)	(0.7)	(0.6)
Interest expense	0.2	0.3	0.2	0.2	0.2	0.1	0.1	0.1	1.2	1.0	1.0	0.6	0.4
Fair mkt value adj of warrant liabilit	0.0	0.0	(0.2)	(0.1)	(0.3)	0.0	0.0	0.0	2.7	0.0	(0.3)	(0.3)	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)	(0.3)	(0.4)	(0.3)	(5.1)	(4.0)	(5.4)	(1.1)	(0.9)
Taxes	(0.3)	(0.0)	(0.1)	0.267	0.0	0.0	0.0	0.0	0.1	(0.1)	(0.2)	0.1	0.1
Tax Rate	13.5%	2.6%	40.2%	-17.1%	-24.2%	-8.6%	-5.1%	-7.5%	-2.0%	3.1%	3.7%	-8.1%	-10.8%
Net Income before preferred	(2.104)	(1.1)	(0.2)	(1.8)	(0.1)	(0.3)	(0.5)	(0.3)	(5.2)	(3.9)	(5.2)	(1.2)	(1.0)
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)	(0.6)	(0.7)	(0.6)	(5.7)	(4.8)	(7.8)	(2.5)	(2.3)
GAAP EPS	**($0.27)**	**($0.15)**	**($0.04)**	**($0.32)**	**($0.04)**	**($0.05)**	**($0.06)**	**($0.05)**	**($0.94)**	**($0.61)**	**($0.80)**	**($0.20)**	**($0.19)**
Primary shares	8.6	8.7	10.0	11.8	12.3	12.3	12.3	12.3	6.0	7.9	9.8	12.3	12.4
Non-GAAP EPS					$0.00	-$0.01	-$0.01	-$0.01	-$0.17	-$0.13	-$0.17	-$0.04	-$0.03
Fully diluted					30.5	30.5	30.5	30.5	30.5	30.5	30.5	30.5	30.5

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