Zacks Small-Cap Research

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DecisionPoint Systems (DPSI-OTCBB)

DPSI: Weak Q1 Reported; New Litigation Complicates the Turnaround Plan

Current Recommendation	**Hold**
Prior Recommendation	Buy
Date of Last Change	05/08/2014
Current Price (05/14/15)	$0.20
Target Price	**$0.50**

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	**$0.50**
52-Week Low	**$0.18**
One-Year Return (%)	**-60.0**
Beta	**0.87**
Average Daily Volume (sh)	**24,923**
Shares Outstanding (mil)	**13**
Market Capitalization ($mil)	**$3**
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	**4.0**
Zacks Rank	**2**

Risk Level	**High**
Type of Stock	**N/A**
Industry	**Computer-Software**
Zacks Rank in Industry	**15 of 74**

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	11 A	17 E	17 E	19 E	64 E
2016					67 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	-$0.05 A	-$0.00 E	$0.00 E	$0.03 E	-$0.01 E
2016					$0.05 E

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EARNINGS REPORT

We have previously noted that DecisionPoint has consistently inconsistent results and the Q1 just reported continues that trend. Coming off an encouraging Q4, Q1 disappointed with sales down 30% year over year and down 32% sequentially. Comparisons were expected to be tough. Last year's first quarter was exceptionally strong as some sales slipped from Q4 to Q1 that year. Seasonality and the weather played a part in Q1 softness but the biggest news was the defection of five salespeople (25% of the sales force) during the quarter to a competitor. This not only disrupted selling, but also caused DecisionPoint to file lawsuits for "unfair competition and solicitation, breaches of confidentiality and loyalty, and other improper activities". It is still unknown if these sales people took clients with them; the company gave no further information as they are in the midst of the litigation process. It spent $340,000 on legal expense in the quarter, and plans to spend more in coming quarters. In order to preserve cash, the company also announced that it would pay its first quarter preferred dividend in kind (PIK), and may do it again in Q2, as it fights this legal battle.

Although the company did not break out sales, it indicated that both hardware and software were both down an equal amount from last year, while professional services, a higher margin revenues source, held steady.

While gross margin stayed at 22%, SG&A expenses were down again this quarter. The company spent $313,000 less this quarter than in Q4 and this includes the extra $340,000 in legal costs. Granted commissions are the largest variable and sales were down 30%, so this number was reduced because of that. Of the five salespeople that left, two have been already replaced.

Taxes, which are typically erratic, were at a 3.5% rate and were a subtraction from losses.

Reported GAAP EPS was a loss of $0.08 versus a loss of $0.04 a year ago. Non-GAAP EPS was a loss of $0.05 versus last year's non-GAAP loss of $0.04. This missed our estimate of a loss of $0.03 per share. Certainly we were looking for much higher revenues and expenses.

Balance Sheet

The company had $2.1 million in operating cash flow in the quarter, primarily from collecting accounts receivable from the strong fourth quarter, which reduced some debt, but the company is still cash constrained. Total debt was reduced from $8.2 million to $5.4 million. Working capital is still negative at $8.5 million, worse than last quarter. The current ratio sunk to 0.6X, and the quick to 0.6X, far from the recommended 2X and 1X. We believe that unless sales pick up significantly, legal costs and operating needs may again keep the company from paying a cash dividend on the preferred.

Q2 2015

Q2, a seasonally better quarter, should have higher revenues. However this year the monkey wrench is the reduction in the sales force and the risk these defectors take accounts with them. There is no telling what the short or long-term outcome could be at this point. We are keeping our estimates in place in the hopes business returns to normal quickly, but it is highly possible that $16.5 million in revenues could be a stretch. The company also continues on its search for a CEO and hopes to have a hire in the next few weeks.

2015

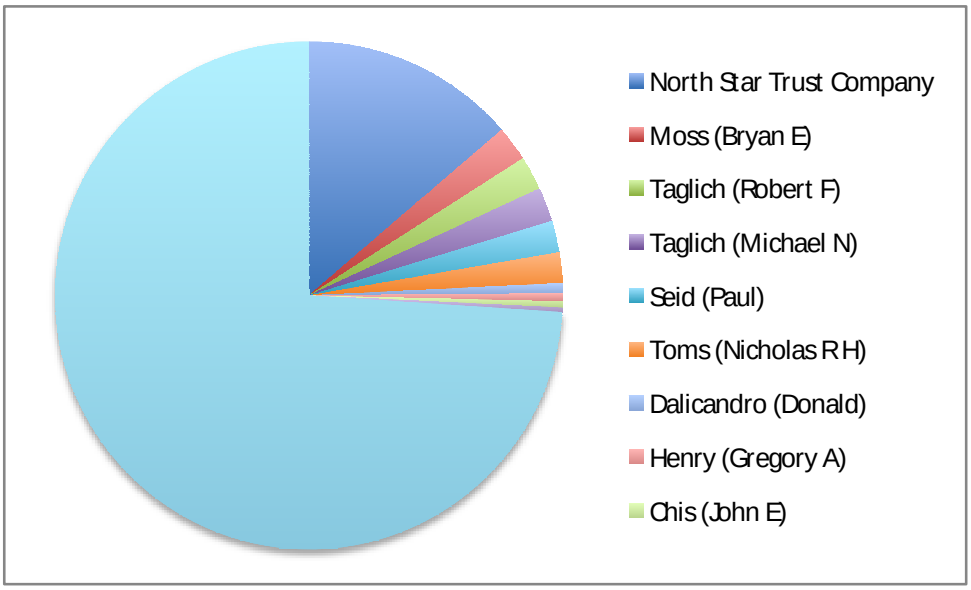
We are keeping cutting our annual revenue estimate for the year to $64 million to reflect the weak first quarter. This is now flat with a year ago. We are also shaving our non-GAAP EPS estimate to a loss of $0.01.

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 there is some clarity on what is the scope and ramification of the lawsuits.

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.
- The company recent lost 25% of its sales force to a competitor and has initiated litigation against them and the competitor.
- Though adjusted EBITDA was positive again this quarter, 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 $60 million. Using that metric, DPSI would be worth $84 million enterprise value. Adding back the cash ($0.8 million) and subtracting the debt ($8.5 million) gives us a market cap of $76 million. Using fully diluted 31.4 million shares gives us a share price of $2.43.

The discount can be attributed to the heavy preferred debt carried by DecisionPoint versus Agilysys, a growing company which has no debt and $74 million in cash, 57% gross margins (more than twice DPSI's), 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 (when they are not being paid in kind) 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.

BALANCE SHEET

	March 31, 2015	Dec 31, 2014	Percent Change
ASSETS			
Current assets			
Cash	$ 818	$ 1,616	-49.4%
Accounts receivable, net	5,782	11,497	-49.7%
Due from related party	-	-	
Inventory, net	1,573	2,035	-22.7%
Deferred costs	3,020	3,177	-4.9%
Deferred tax assets	13	21	-38.1%
Prepaid expenses and other current assets	209	81	158.0%
Total current assets	11,415	18,427	-38.1%
Property and equipment, net	168	145	15.9%
Other assets, net	116	124	-6.5%
Deferred costs, net of current portion	1,235	1,314	-6.0%
Goodwill	8,023	8,202	-2.2%
Intangible assets, net	1,660	2,045	-18.8%
Total assets	$ 22,617	$ 30,257	-25.3%
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities			
Accounts payable	$ 7,352	$ 10,000	-26.5%
Accrued expenses and other current liabilities	2,150	2,755	-22.0%
Lines of credit	**3,453**	**5,811**	-40.6%
Current portion of debt	**614**	**813**	-24.5%
Due to related parties	107	73	46.6%
Accrued earn out consideration	-	-	
Unearned revenue	6,266	6,918	-9.4%
Total current liabilities	19,942	26,370	-24.4%
Long term liabilities			
Unearned revenue, net of current portion	1,860	2,015	-7.7%
Debt, net of current portion and discount	**1,373**	**1,580**	-13.1%
Accrued earn out consideration, net of current portion	-	165	-100.0%
Deferred tax liabilities	431	460	-6.3%
Warrant liability	597	519	15.0%
Other long term liabilities	206	61	237.7%
Total liabilities	24,409	31,170	-21.7%
STOCKHOLDERS' EQUITY			
Cumulative Convertible Preferred stock	12,849	12,822	0.2%
Common stock	13	13	0.0%
Additional paid-in capital	17,257	17,252	0.0%
Treasury stock, 153,883 shares of common stock	(205)	(205)	0.0%
Accumulated deficit	(31,259)	(30,292)	3.2%
Unearned ESOP shares	(446)	(484)	-7.9%
Accumulated other comprehensive income	(1)	(19)	-94.7%
Total stockholders' equity	(1,792)	(913)	96.3%
	$ 22,617	$ 30,257	-25.3%
Total Debt	**5,440**	**8,204**	-33.7%
Net cash	$ (2,635)	$ (4,195)	-37.2%
Current Ratio	0.57	0.70	-18.1%
Quick Ratio	0.49	0.62	-20.6%
Tangible Net Worth	$ (11,475)	$ (11,160)	2.8%
Working capital	(8,527)	(7,943)	7.4%

INCOME STATEMENT

	March Q1 14	June Q2 14	Sept Q3 14	Dec Q4 14	March Q1 15	June Q2 15E	Sept Q3 15E	Dec Q4 15E	2013	2014	2015E	2016E
REVENUE												
Net Revenue	16.7	16.5	14.1	17.2	11.7	16.5	17.0	18.7	60.7	64.5	63.9	67.1
Yr-to-yr Gr.	21%	12%	-20%	17%	-30%	0%	20%	9%	-15%	6%	-1%	5%
OPERATING EXPENSES												
Cost of goods sold	13.1	12.7	11.1	13.4	9.2	12.8	13.2	14.4	48.0	50.4	49.5	51.0
Gross Margin	3.6	3.8	3.0	3.8	2.6	3.7	3.8	4.3	12.7	14.2	14.4	16.1
% of Sales	21.4%	22.9%	21.4%	22.1%	22.0%	22.5%	22.6%	22.8%	21.0%	22.0%	22.5%	24.0%
SG&A	3.7	3.4	3.0	3.170	2.857	3.200	3.250	3.300	18.3	13.3	12.6	13.9
Adjustment to earn-out	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	(0.1)	0.4	(0.0)	0.714	(0.275)	0.513	0.592	0.964	(4.8)	0.9	1.8	2.2
Operating Margin	-1%	2%	0%	4%	-2%	3%	3%	5%	-8%	1%	3%	3%
Interest expense	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	1.0	0.9	0.7	0.7
Fair mkt value adj of warrant lia	(0.3)	0.1	(0.1)	(0.0)	0.1	0.0	0.0	0.0	(0.3)	(0.3)	0.1	0.0
Other Income	(0.0)	(0.0)	(0.0)	0.0	0.1	0.0	0.0	0.0	(0.0)	0.0	0.1	0.1
Pretax Income	(0.1)	0.1	(0.2)	0.5	(0.6)	0.3	0.4	0.8	(5.4)	0.3	0.9	1.4
Taxes	0.0	0.1	0.4	(0.7)	(0.0)	0.0	0.0	0.0	(0.2)	(0.2)	0.0	0.1
Tax Rate	-24.2%	123.5%	-239.2%	-142%	3.5%	3.5%	3.5%	3.5%	3.7%	-60.2%	3.5%	5.0%
Net Income before preferred	(0.1)	(0.0)	(0.6)	1.2	(0.6)	0.3	0.4	0.8	(5.2)	0.5	0.9	1.4
Preferred dividends	(0.3)	(0.3)	(0.3)	(0.3)	(0.4)	(0.4)	(0.4)	(0.4)	(2.6)	(1.3)	(1.5)	(1.5)
Net to common shareholders	(0.4)	(0.4)	(0.9)	0.9	(1.0)	(0.1)	0.0	0.4	(7.8)	(0.8)	(0.665)	(0.177)
GAAP EPS	**($0.04)**	**($0.03)**	**($0.07)**	**$0.07**	**($0.08)**	**($0.01)**	**$0.00**	**$0.03**	**($0.80)**	**($0.07)**	**($0.05)**	**($0.01)**
Primary shares	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	**($0.04)**	**($0.02)**	**($0.07)**	**$0.06**	**($0.05)**	**($0.00)**	**$0.00**	**$0.03**	**($0.65)**	**($0.13)**	**($0.01)**	**($0.00)**
Primary	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	**($0.01)**	**($0.01)**	**($0.03)**	**$0.03**	**($0.02)**	**($0.00)**	**$0.00**	**$0.01**	**($0.13)**	**($0.01)**	**($0.00)**	**$0.05**
Fully diluted	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	0.474	0.899	0.459	0.872	0.333				(1.664)	2.689		

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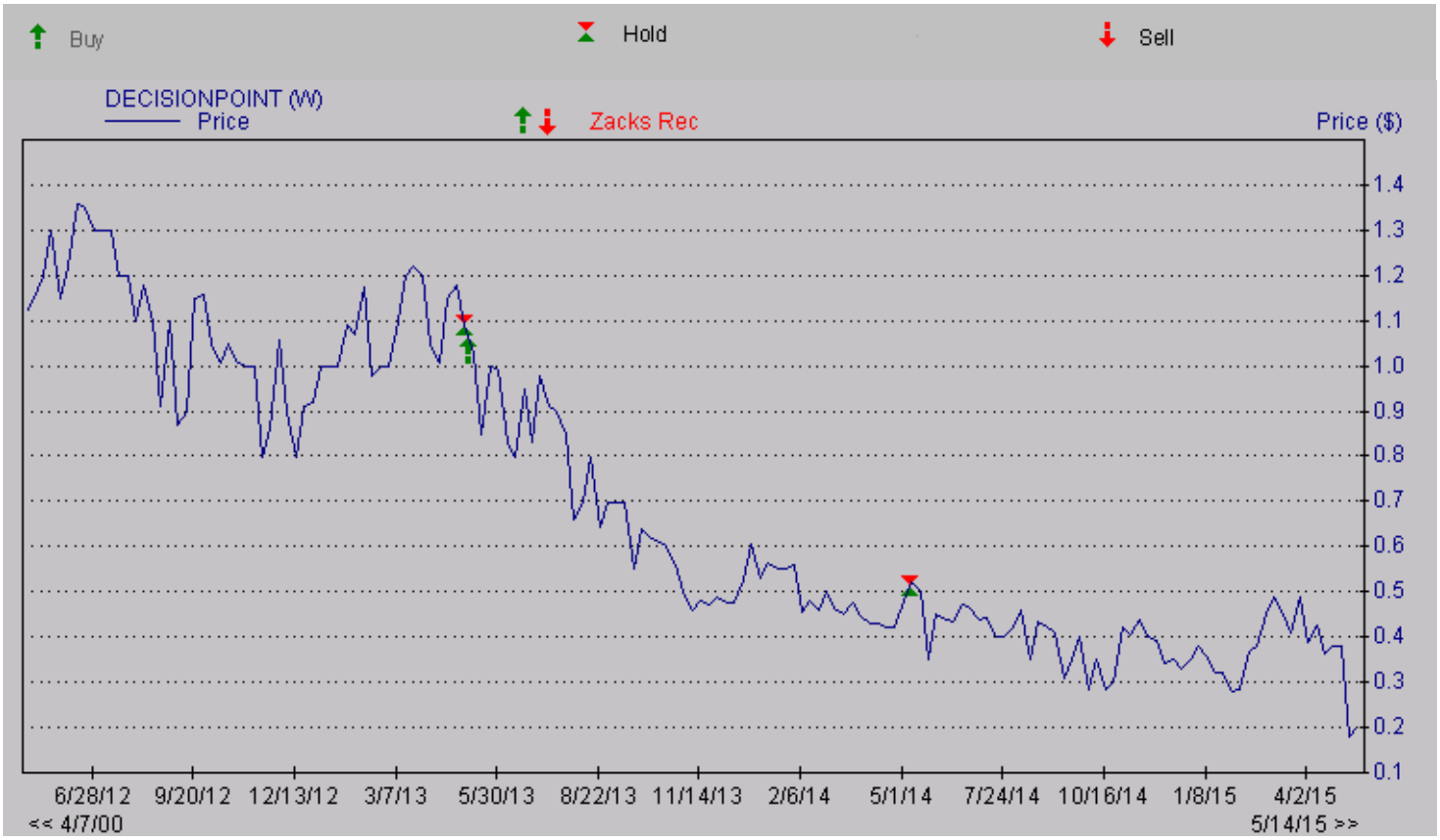

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