Zacks Small-Cap Research

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DecisionPoint Systems (DPSI-OTCBB)

DPSI: Zacks Company Report – NEUTRAL
Q3 Down Revenues Overshadow Progress

Current Recommendation	**Neutral**
Prior Recommendation	Outperform
Date of Last Change	05/08/2014
Current Price (11/10/14)	$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. 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	**$0.60**
52-Week Low	**$0.26**
One-Year Return (%)	**-9.82**
Beta	**0.66**
Average Daily Volume (sh)	**4,599**
Shares Outstanding (mil)	**13**
Market Capitalization ($mil)	**$5**
Short Interest Ratio (days)	**18.02**
Institutional Ownership (%)	**1**
Insider Ownership (%)	**15**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**165.8**
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	**3**

Risk Level	**High**
Type of Stock	**Small-Value**
Industry	**Comp-Software**
Zacks Rank in Industry	**26 of 74**

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	14 A	16 E	63 E
2015					68 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	-$0.07 A	$0.02 E	-$0.12 E
2015					-$0.08 E

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EARNINGS REPORT

Q3 was surely a transition quarter for DecisionPoint as **it welcomed an almost entirely new board, appointed an interim CEO, and lowered its breakeven point** to a more manageable level of approximately $16 million in revenues. Despite operational and management changes, **the company disappointed for the quarter by reporting $14.1 million in revenues versus $17.6 million a year ago (down 20%)** and our estimate of $17 million. The seasonal pick up we were looking for did not materialize and some sales slipped into the fourth quarter. Evidence of this is shown in a 29% decrease in accounts receivable for the quarter as old sales were collected and new sales were not booked. On the plus side, the company reduced its SG&A by another $500,000 and lowered its breakeven.

Gross margin was 21.4% versus 19.7% a year ago, and 22.7% in Q2 due to hardware/software product mix. Expenses dropped again from Q2 due in part to a board that is being paid lower fees and general cost cutting. Versus last year, expenses are now $1.5 million lower per quarter. Going into the budget for next year the company hopes to be able to do some marketing to new customers as that has been ignored for some time due to cost constraints. We expect expenses to go up next year accordingly.

With lower sequential revenues, the company moved back to a slight operating loss although it remained EBITDA positive. A strange quirk in tax laws (FIN18) caused by losses in Canada and profits in the US required the company to allocate $400,000 to taxes this quarter, which is expects to reverse in the fourth quarter. These taxes were the main culprit in making the company miss EPS estimates and resulted in a loss before preferred interest of $563,000. After paying interest on preferred stock, the loss to common shareholders rose to $897,000: a half million higher than Q2. The primary shares outstanding increased 23% year over year, while the fully diluted share count increased 66% to 35.7 million shares. This resulted in GAAP EPS loss of $0.07 versus a loss of $0.04 a year ago. Adjusted EBITDA was once again positive at $459,000; the company paid $229,000 in interest. Cash flow was a negative $129,000. At stock prices higher than $1-1.35, the convertible preferred stock can be forced to convert which would greatly improve profitability.

For the December 31, 2014 quarter, we are expecting up revenues both sequentially and year over year due to easy comparisons. We expect sales of $15.6 million versus $14.6 million a year ago up 7%. GAAP EPS to common shareholders should be a positive number with up revenues and a reversal of taxes expected in Q4. If it is GAAP profitable before preferred dividends, it will have to use diluted share count of 35.7 million rather than the 12.4 million primary shares it has been using. Using the fully diluted share count the company is trading at a market cap of $14.6 million and an enterprise value of $32.5 million.

We are lowering our revenue estimate for the year to $63 million in sales, and increasing the loss to $0.12. 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, 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 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 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.

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 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 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 1.8 times enterprise value to trailing revenues. DPSI's trailing 12-month revenues are $62 million. Using that metric, DPSI would be worth $112 million enterprise value. Adding back the cash ($1.5 million) and subtracting the debt plus preferred stock ($19.3) gives us a market cap of $94 million. Using fully diluted 35.7 million shares gives us a share price of $2.63.

This discount can be attributed to the heavy debt carried by DecisionPoint versus Agilysys, which has no debt and $77 million in cash, 63% 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.

PROJECTED INCOME STATEMENT & BALANCE SHEET

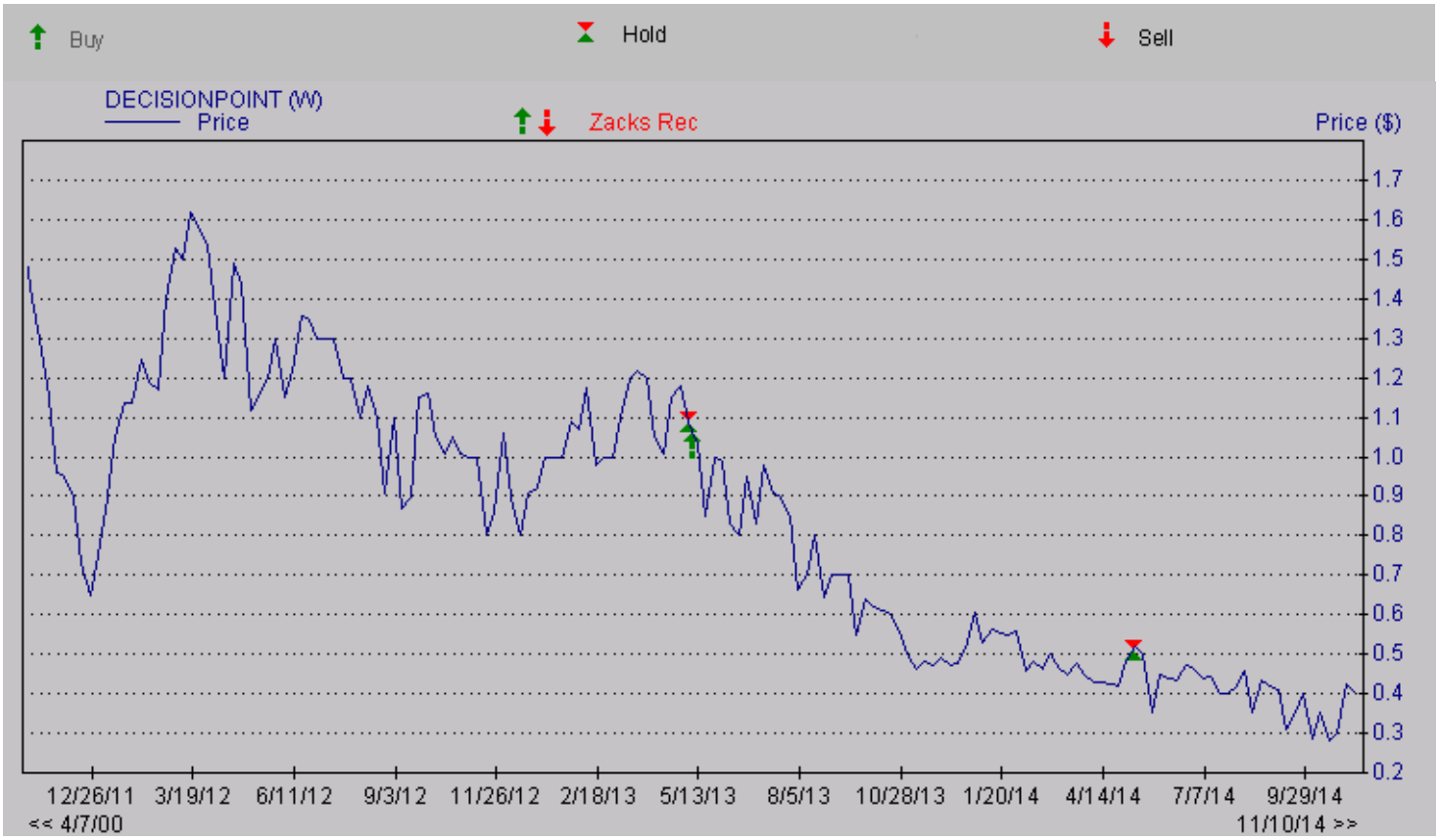
Cash	$ 1,471	$ 1,420	3.6%	$
Accounts receivable, net	6,860	9,649	-28.9%	10,
Due from related party	-	-		
Inventory, net	642	681	-5.7%	1,
Deferred costs	3,667	4,055	-9.6%	3,
Deferred tax assets	47	49	-4.1%	
Prepaid expenses and other current assets	463	52	790.4%	
Total current assets	13,150	15,906	-17.3%	16,
y and equipment, net	137	145	-5.5%	
ssets, net	131	141	-7.1%	
d costs, net of current portion	1,406	1,615	-12.9%	1,
ill	8,295	8,401	-1.3%	8,
ble assets, net	2,523	3,029	-16.7%	3,
Total assets	$ 25,642	$ 29,237	-12.3%	$ 31,
ITIES AND STOCKHOLDERS' EQUITY				
t liabilities				
Accounts payable	$ 7,910	$ 8,443	-6.3%	$ 9,
Accrued expenses and other current liabilities	3,658	2,897	26.3%	2,
Lines of credit	**4,046**	**4,642**	-12.8%	**3,**
Current portion of debt	**878**	**1,095**	-19.8%	**1,**
Due to related parties	152	114	33.3%	
Accrued earn out consideration	90	291	-69.1%	
Warrant liability	549	637	-13.8%	
Unearned revenue	5,824	7,263	-19.8%	7,
Total current liabilities	23,107	25,382	-9.0%	26,
erm liabilities				
Unearned revenue, net of current portion	2,037	2,313	-11.9%	2,
Debt, net of current portion and discount	**1,655**	**1,805**	-8.3%	**1,**
Accrued earn out consideration, net of current portion	-	94	-100.0%	
Deferred tax liabilities	703	732	-4.0%	
Other long term liabilities	66	73	-9.6%	
Total liabilities	27,568	30,398	-9.3%	32,
CHOLDERS' 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	12,735	12,649	0.7%	12,
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	17,248	17,235	0.1%	17,
Treasury stock, 153,883 shares of common stock	(205)	(205)	0.0%	(
Accumulated deficit	(31,173)	(30,271)	3.0%	(29,
Unearned ESOP shares	(520)	(557)	-6.6%	(
Accumulated other comprehensive income	(24)	(25)	-4.0%	
Total stockholders' equity	(1,926)	(1,161)	65.9%	(
	$ 25,642	$ 29,237	-12.3%	$ 31,
Total Debt	**$ 3,579**	**$ 4,542**	-12.8%	**$ 4,**
Total Debt plus Preferred	**$ 19,314**	**$ 20,191**	-4.3%	**$ 19,**
Cash Minus Debt	$ (5,108)	$ (6,122)	-16.6%	$ (6,
Cash Minus Debt Minus Preferred	$ (17,843)	$ (18,771)	-4.9%	$ (18,
Current Ratio	0.57	0.63	-9.2%	
Quick Ratio	0.54	0.60	-9.8%	

INCOME STATEMENT

	Dec Q4 12	March Q1 13	June Q2 13	Sept Q3 13	Dec Q4 13	March Q1 14A	June Q2 14A	Sept Q3 14A	Dec Q4 14E	2011	2012	2013	2014E	2015E
REVENUE														
Net Revenue	17.4	13.8	14.7	17.6	14.6	16.7	16.5	14.1	15.6	58.4	71.5	60.7	63.0	68.0
Yr-to-yr Gr.		-23%	-17%	-5%	-16%	21%	12%	-20%	7%		23%	-15%	4%	8%
OPERATING EXPENSES														
Cost of goods sold	13.7	10.9	11.2	14.1	11.7	13.1	12.7	11.1	12.3	46.4	56.5	48.0	49.2	53.7
Gross Margin	3.7	2.8	3.6	3.5	2.9	3.6	3.8	3.0	3.4	12.0	15.0	12.7	13.8	14.3
% of Sales	21.2%	20.5%	24.2%	19.7%	19.7%	21.4%	22.9%	21.4%	21.6%	20.5%	21.0%	21.0%	21.8%	21.0%
SG&A	5.0	5.0	4.5	4.5	4.4	3.7	3.4	3.0	3.0	13.6	18.2	18.3	13.2	13.0
Adjustment to earn-out	0.0	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	(1.4)	(2.2)	(0.898)	(0.2)	(1.5)	(0.1)	0.4	(0.0)	0.4	(1.6)	(3.1)	(4.8)	0.6	1.3
Interest expense	0.0	0.2	0.3	0.2	0.2	0.2	0.2	0.2	0.2	1.2	1.0	1.0	0.9	0.9
Fair mkt value adj of warrant liabil	0.0	0.0	0.0	(0.2)	(0.1)	(0.3)	0.1	(0.1)	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)	0.0	(0.4)	(0.1)	(0.0)	0.0	(0.0)
Pretax Income	(1.4)	(2.4)	(1.1)	(0.3)	(1.6)	(0.1)	0.081	-0.166	0.1	(5.1)	(4.0)	(5.4)	(0.0)	0.4
Taxes	0.3	(0.3)	(0.0)	(0.1)	0.267	0.0	0.1	0.4	(0.4)	0.1	(0.1)	(0.2)	0.1	0.1
Tax Rate	-18.9%	13.5%	2.6%	39.5%	-17.2%	-24.2%	123.5%	-239.2%	-293.2%	-2.0%	3.1%	3.7%	-614.3%	23.8%
Net Income before preferred	(1.6)	(2.104)	(1.1)	(0.2)	(1.8)	(0.1)	(0.019)	(0.563)	0.523	(5.2)	(3.9)	(5.2)	(0.1)	0.3
Preferred dividends		(0.2)	(0.2)	(0.2)	(1.9)	(0.3)	(0.334)	(0.334)	(0.334)	(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)	(0.897)	0.2	(5.7)	(4.8)	(7.8)	(1.5)	(1.0)
GAAP EPS	**($0.11)**	**($0.27)**	**($0.15)**	**($0.04)**	**($0.37)**	**($0.04)**	**($0.03)**	**($0.07)**	**$0.02**	**($0.94)**	**($0.61)**	**($0.80)**	**($0.12)**	**($0.08)**
Primary shares	15.0	8.6	8.7	10.0	10.1	12.3	12.3	12.4	12.4	6.0	7.9	9.8	12.4	12.4
								23%						
Non-GAAP EPS	**$0.00**	**($0.13)**	**($0.08)**	**($0.02)**	**($0.11)**	**($0.01)**	**($0.01)**	**($0.03)**	**$0.01**	**($0.17)**	**($0.13)**	**($0.17)**	**($0.00)**	**$0.01**
Fully diluted	24.0	17.6	17.7	21.5	33.0	30.5	31.5	35.7	35.7	30.5	30.5	30.5	33.4	36.0

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