Zacks Small-Cap Research

December 17, 2013

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InterCloud Systems Inc. (ICLD-NASDAQ)

ICLD: Adding IPC- OUTPERFORM

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	12/16/2013
Current Price (12/16/13)	$9.97
Target Price	**$15.00**

OUTLOOK

InterCloud Systems, Inc. is a global single source provider of value added services for both corporate enterprises and service providers. The firm is made up of six operating subsidiaries that have molded the firm into a significant player in cloud and managed services as well as telecom infrastructure. In the first full year of operation the firm is poised to record revenues north of $60 million. The growth of the cloud and the outsourcing of services by telecom providers will act as a tail wind for the firm. Another cloud services subsidiary (IPC) was recently signed that will add approximately $25 million to the top-line. While we like growth story, investors should be aware that some risks exist with regard to dilution as well as the execution risk of bringing all the firms together under one roof.

SUMMARY DATA

52-Week High	**$14.58**
52-Week Low	**$2.31**
One-Year Return (%)	**N/A**
Beta	**N/A**
Average Daily Volume (sh)	**1,469,232**
Shares Outstanding (mil)	**7**
Market Capitalization ($mil)	**$64**
Short Interest Ratio (days)	**0.02**
Institutional Ownership (%)	**0**
Insider Ownership (%)	**N/A**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**N/A**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2013 Estimate	**N/A**
Zacks Rank	**3**

Risk Level	**High**
Type of Stock	**Growth**
Industry	**Software/Services**

ZACKS ESTIMATES

Revenue

(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013	$12.40 A	$14.36 A	$16.16 A	$17.25 E	60.17 E
2014					72.00 E
2015					85.00 E

Earnings per Share

(EPS is operating earnings before non recurring items)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013	-$0.50 E	-$1.33 A	$0.12 A	$0.13 E	-$1.58 A
2014					$0.50 E
2015					$0.64 E

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WHATS NEW

On December 13th 2013 InterCloud announced the execution of a definitive agreement to acquire Integration Partners-NY Corporation ("IPC-NY"). IPC-NY is a managed service provider offering its enterprise and service provider clients an end-to-end portfolio of IT solutions including voice, data, optical and unified communications services. IPC-NY consults, designs, builds, implements, and services IT networks for enterprise and service provider networks. The synergies with InterCloud will allow its clients to transition from existing IT networks to open architecture Cloud based solutions. *IPC-NY has enterprise and service provider customers and will* help distribute the Company's cloud platform to its new and existing customers. IPC-NY is expected to have 2013 gross revenues of approximately $25 million and 2013 net income of approximately $3.5 million. The Company expects to close the acquisition of IPC-NY no later than December 31, 2013.

In order to finance this acquisition, the Company completed the sale of $11.625 million aggregate principal amount of 12% convertible debentures.

InterCloud Systems Sees Significant Revenue Growth & Margin Expansion

On November 14, 2013, InterCloud Systems Inc. reported financial results for its third quarter and nine months, ended September 30, 2013.

Third quarter ended, year over year revenues rocketed $13.207 million to $16.158 million from $2.950 million for the comparable quarter of 2012. Sequentially, revenues improved by nearly 13 percent or $1.802 million from $14.356 million for the second quarter fiscal 2013.

The year over year increases in revenues resulted primarily from the company’s inclusion of revenues from its acquisitions as well as organic growth.

Gross profit for the quarter was $5.498 million resulting in gross margin of 34.0 percent. This compares to gross profit of $4.249 million and gross margin of 29.6 percent for the second quarter fiscal 2013 and gross profit of $1.221 million and gross margin of 41.4 percent during the quarter ended September 30, 2012. The difference in gross margin was a result of the acquisitions completed in 2012 and April 2013.

Operating expenses increased to $3.437 million for the third quarter, up $1.546 million from the comparable three months of 2012. Operating expenses were $3.712 million for the second quarter 2013.

Operating income for the three months ended September 30, 2013 was $2.061 million compared to an operating loss of $669,132 million for the third quarter 2012. Operating income for the three months ended June 30, 2013 was $537,251.

Net income attributable to common shareholders increased year over year by $2.144 million to net income of $1.297 million for the third quarter. This compares to a net loss attributable to common shareholders of $847,737 for three months ended September 30, 2012. During the three months ended June 30, 2013, net loss attributable to common shareholders was $1.314 million.

Based on a weighted average number of diluted shares of 6.852 million, diluted net income per share resulted in net income of $0.12 per share for the third quarter of fiscal 2013. This compared to a basic and diluted net loss per share of $2.16 based on a weighted average number of basic and diluted shares of 392,860 during the three months ended September 30, 2012.

As of September 30, 2013, the Company had $3.361 million in cash and cash equivalents and total current assets of $18.652 million. This compares to $2.277 million in cash and cash equivalents and $16.033 million in current assets as of June 30, 2013.

Offering

On November 5, 2013 InterCloud announced that it has closed its previously announced underwritten public offering of 1,250,000 shares of its common stock at a price to the public of $4.00 per share and warrants to purchase up to an aggregate of 625,000 shares of common stock, with an exercise price of $5.00 per share. In addition, the underwriter exercised its over-allotment option to purchase an additional 93,750 warrants to purchase an additional 93,750 shares of common stock. InterCloud received gross proceeds from the offering, before deducting underwriting discounts and commissions and other estimated offering expenses payable by InterCloud, of approximately $5 million. InterCloud will use the net proceeds from the offering for working capital and general corporate purposes.

KEY POINTS

- The firm is made up of six acquisitions that will likely mold the firm into a significant player in the cloud and managed services universe.
- The trend of outsourcing by telecom providers will likely continue and will significantly benefit InterCloud.
- There appears to be no other significant player that offers the array of services of InterCloud.
- Cisco Global Cloud Index expects Global cloud traffic to account for nearly two-thirds of total data center traffic by 2016
- According to IDC By 2020, a significant portion of the Digital Universe will be centrally hosted, managed, or stored in public or private repositories that today we call ‘cloud services.’ And even if a byte in the Digital Universe does not ‘live in the cloud’ permanently, it will, all likelihood, pass through the cloud at some point in its life.

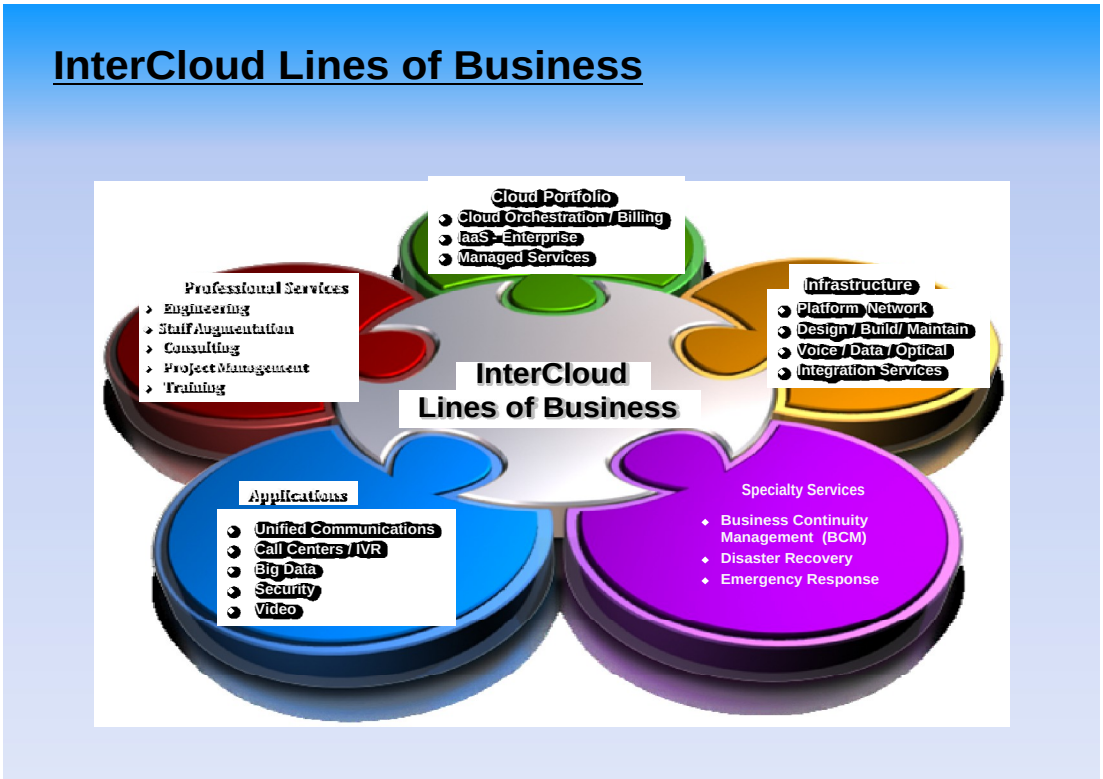
OVERVIEW

InterCloud Systems (ICLD) provides a multitude of value-added products and services to corporations and service providers. The firm is a primary source for Cloud-Based Services, Professional Consulting to support telecommunications business and infrastructure solutions for voice and data platforms. InterCloud engineers, installs and maintains progressive networks of Fiber Optic, Ethernet and Wireless networks on an international scale. The organization has offerings such as:

- Infrastructure as a service
- Platform as a service
- Software as a service
- Voice, Data, Optical solutions
- Unified communications
- Managed Firewall
- Managed VPN

ICLD has been growing through an enlarged customer base and the precipitous growth of the cloud based services market. The expansion of the market has been advantageous for InterCloud because it has grown their quarterly revenue, which has allowed them to acquire complementary companies. The firms range from wire line installation, fiber optics engineering and utility contractors. These present subsidiaries enable ICLD to execute various strategies across a dynamic array of professional services. As well as, source diverse revenue channels and lower expenses by having labor as an in house service as opposed to contracted.

InterCloud Subsidiaries include: ADEX Corporation, AW Solutions, Inc. Rives-Monteiro Engineering, TNS & Tropical Communications.



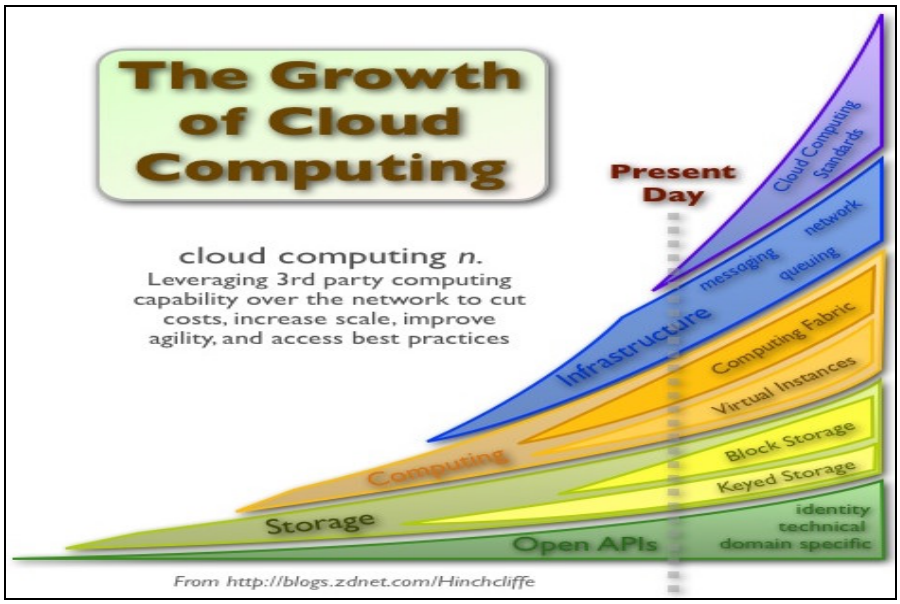
Cloud Computing Tailwind

Cloud Computing is the use of computing resources that are delivered as a service over a network. Cloud computing entrusts remote services with a user's data, software and computation and is offered by providers according to three fundamental models including infrastructure as a service (IaaS), platform as a service (PaaS), and software as a service (SaaS) where IaaS is the most basic and each higher model abstracts from the details of the lower models. **(Source: infoworld, Cisco)**

IaaS providers offer computers - physical or virtual machines - and other resources while SaaS or "on-demand software" providers supply access to application software and databases where the software and associated data are centrally hosted on the cloud. PaaS providers offer a computing platform and a "solution stack" as a service or a set of software subsystems or components needed to deliver a fully functional solution.

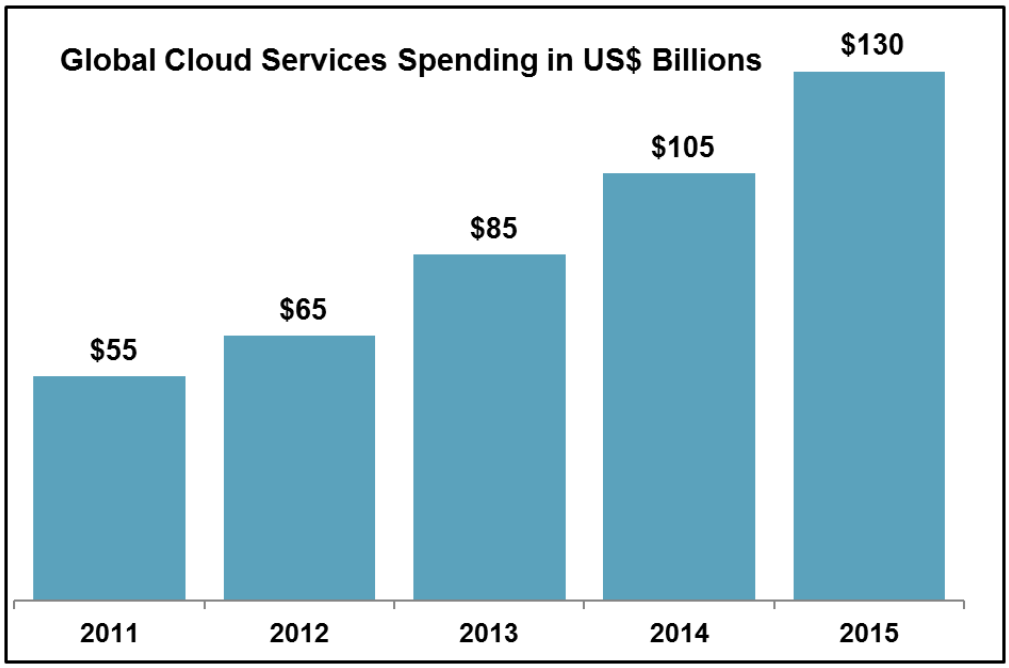
Additional types of Cloud Computing include API as a service (APIaaS); Backend as a service (BaaS); Data as a service (DaaS); Database as a service (DBaaS); Desktop as a service (DaaS); Integrated development environment as a service (IDEaaS); Integration platform as a service (IPaaS); Network as a

service (NaaS); Security as a service (SECaaS); Storage as a service (STaaS) and Test environment as a service (TEaaS).



It is believed the Cloud Computing name comes from the use of a cloud-shaped symbol as an abstraction denoting networks in diagrams of computing and communications systems. Still, the fast-growing, high-tech smartphone services industry has contributed to strong growth and job creation in cloud computing in the past and is expected to continue its rapidly increasing trend in the future.

IDC reports that enterprise cloud application revenues reached $22.9B in 2011 and expects it to reach $67.3B by 2016, attaining a CAGR of 24%. Furthermore, IDC anticipates that $1 of every $5 will be spent on cloud-based software and infrastructure by 2106.Similarly, Cisco Global Cloud Index expects Global cloud traffic to account for nearly two-thirds of total data center traffic by 2016 while total data center traffic is anticipated to grow from 39% in 2011 to 64% in 2016. Likewise, Cisco predicts that by 2016, three out of five data center workloads will be processed in the cloud.



Equally, Gartner is predicting Infrastructure-as-a-Service (IaaS), cloud management & security devices, and Platform-as-a-Service (PaaS) to grow from $7.6B in 2011 to $35.5B in 2016, at a CAGR of 36%.

Finally, Software as a Service (SaaS) and cloud-based business application services are anticipated to grow from $13.4 billion in 2011 to $32.2 billion in 2016, a five-year CAGR of 19.1%.

Cloud Services Platform
On May 28, 2013 InterCloud announced the formal launch of its InterCloudVm cloud services platform The InterCloudVm is an enterprise grade platform, designed to offer both medium and large customers customizable infrastructure and applications that meet their stringent security and performance level needs without the associated capital expenditures. The platform allows customers and their users to securely access their applications via a private, hybrid, or public cloud and is highly elastic, rapidly scalable and offers ease of use to IT administrators.

Containing three modules, Infrastructure as a Service (Iaas), Platform as a Service (Paas) and Software as a Service (Saas), the platform supports a wide range of industry standard operating systems under an single umbrella, capable of running mail, webservers, database servers, mobile platform development, multimedia, voice communication servers and enterprise applications such as ERP, CRM, SCM, HRM, among others. Intercloud offers professional services to its customers in order to assist them in cloud implementations and ongoing management of their applications.

Typical Client Case Study

InterCloud Cloud service IAAS (Infrastructure as a service):

Server Consolidation with reduced CAPEX Model
Project Name: Integration and consolidation of Server Farm: Major Retail

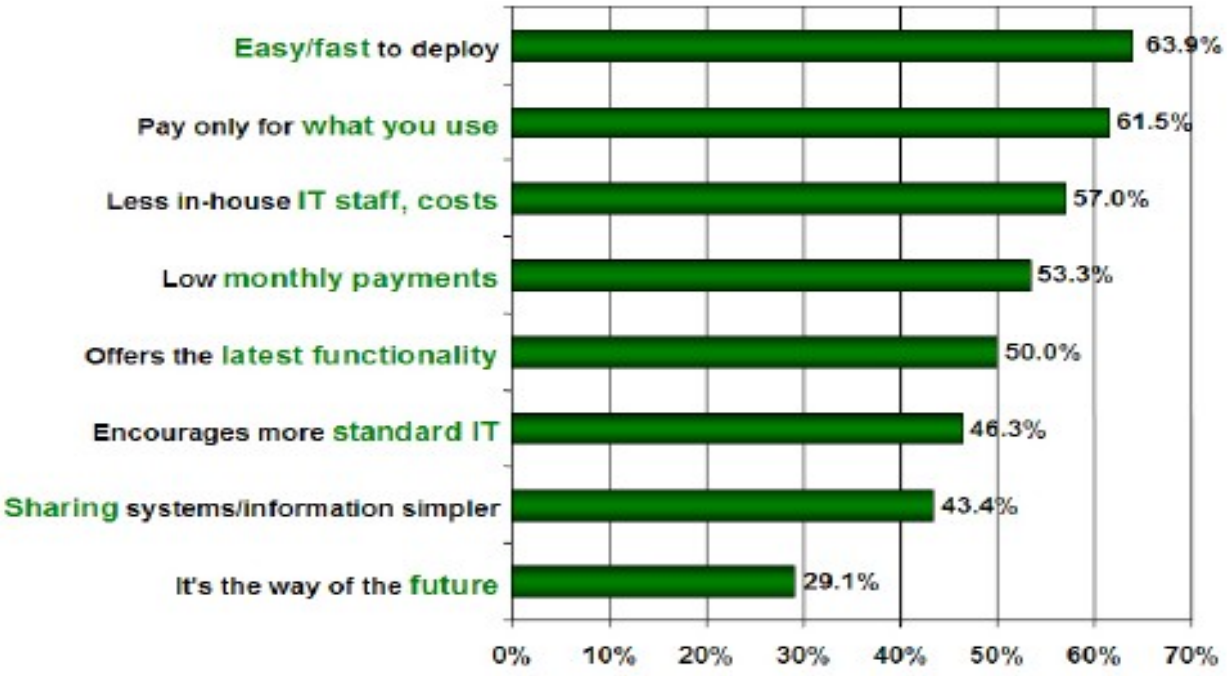
Project Description: Major retailer first invested in Asian Subsidiary in January 2004, subsequently making it a fully owned subsidiary in March 2009. In fiscal 2011, the company generated combined sales of about 60 billion yen from 373 stores located

primarily in Japan and the United States. As part of expansion this retailer has been acquiring top brands and currently own 8 well know clothing brands. To integrate and consolidate the IT organizations of these acquisitions, the company's brand was selected as first brand to be deployed and consolidated using InterCloud services.

Benefit to Client: The Retailer uses high end applications for garment designing that requires collaboration from designers globally. This requires the computer resources to be highly scalable. Physical compute assets create downtime when you scale up and under utilization during scaled down period. Using InterCloud IAAS platform the client was able to meet their highly elastic resource requirement for current and future Infrastructure. The client also is currently in the process of moving their POS platform to a centralized IAAS platform with InterCloud. This will save the client millions of dollars in CC processing fees.

Technology/Skill Sets: Microsoft SQL, Cloud Stack, XEN, Cisco Networking, Private Cloud over Dedicated circuit.

Enterprise CIO's are more often demanding dynamically scalable and virtualized resources to support their business. (Source: Infosys Technologies Limited– Rahavan Subramanian.) This Infosys survey of CIO's show the many reasons CIO's incur resources.

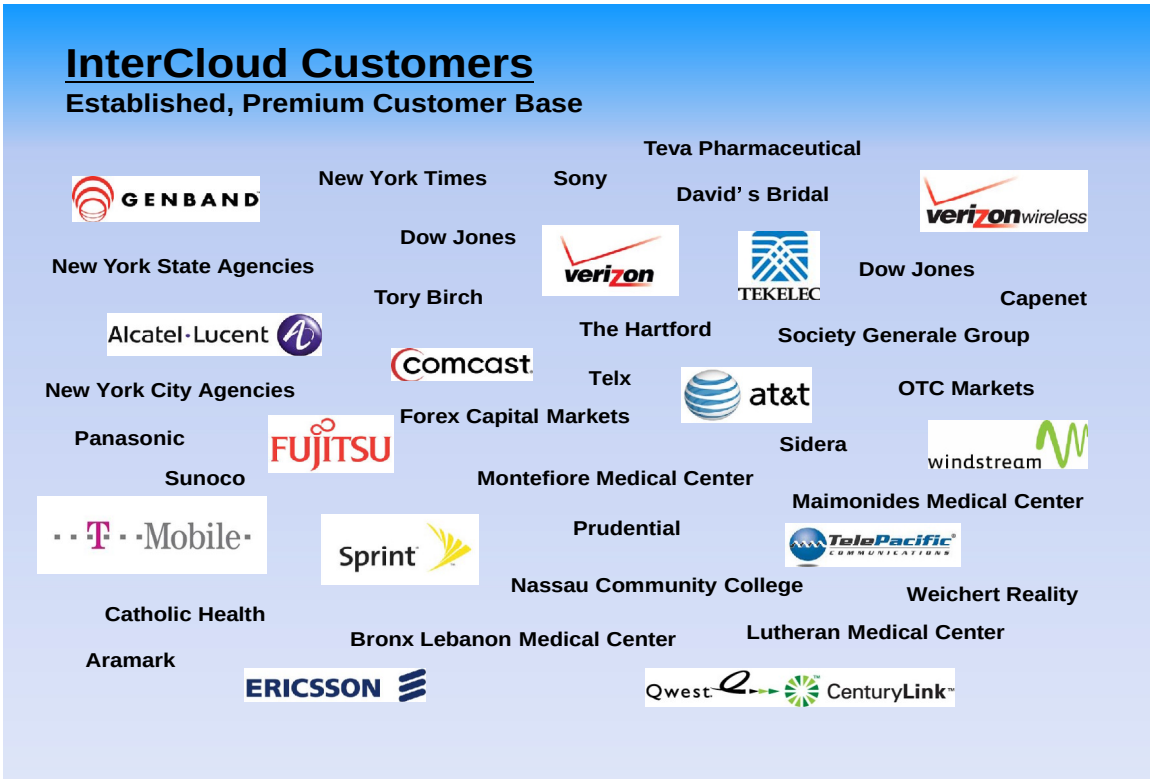


Telecom Service Outsourcing continues

As telecom service providers continue to operate in a low single-digit revenue and capped capex environment, they will be forced to outsource more and more tasks until only customer care, sales, marketing, and branding become their core business. Outsourcing is the only avenue left for them to cut operating expenses and beef up their margins, so we expect the outsourcing market to continue to grow. (Source Infonetics)

- Worldwide, telecom service providers paid network equipment vendors $50.4 billion in 2009 for outsourced services
- Infonetics Research forecasts this segment of the outsourced services market to grow to $73.2 billion by 2014
- The biggest revenue-generating tasks that equipment manufacturers provide for telecom service providers are network maintenance, network build, network planning and design, and application service delivery
- Much of the growth in outsourced services is coming from EMEA (Europe, Middle East, Africa) and Asia Pacific

  Intercloud's blue chip customer portfolio is impressive and will serve to diversify revenue.



The firm acts as an end-to-end solution provider of cloud and managed service based platforms, professional services, applications and infrastructure to both the telecommunications industry and corporate enterprises. It operate three divisions.

- ***Cloud and Managed Services.*** *InterCloud's services offerings include platform as a service (PaaS), infrastructure as a service (IaaS), database as a service (DbaaS), and software as a service (SaaS). The Company's experience in system integration and solutions centric services helps its customers to quickly migrate and adopt cloud based services. Managed services offerings include network management, 24x7x365 monitoring, security monitoring, storage and backup services. Cloud-based and managed services, which include both hardware solutions and professional services, enable corporate enterprises to integrate their applications and migrate various services into a web-hosted environment, as well as extend the ability of telecommunications and broadband service providers to provide cloud-based services.*

- ***Applications and Infrastructure.*** *InterCloud provides an array of applications and services, including unified communications, interactive voice response (IVR) and SIP based call centers. , as well as structured cabling and other field installations throughout North America and internationally. The Company will design, engineer, install and maintain various types of WiFi and wide-area networks, distributed antenna systems (DAS), and small cell distribution networks for incumbent local exchange carriers (ILECs), telecommunications original equipment manufacturers (OEMs), cable broadband multiple system operators (MSOs) and enterprise customers large end-users. Service and applications teams support the deployment of new networks and technologies, as well as expand and maintain existing networks. They also design, install and maintain sell hardware solutions for the leading OEMs that support voice, data and optical networks.*

- ***Professional Services.*** *InterCloud provides consulting and professional staffing solutions to the service provider and enterprise market in support of all facets of the telecommunications business, including project management, network implementation, network installation, network upgrades, rebuilds, maintenance and consulting services. The Company leverages a recruiting database, which includes more than 70,000 professionals, for the rapid deployment of professional services. On a weekly basis, Intercloud deploy's hundreds of professionals in support of network infrastructure deployments worldwide. Skilled recruiters assist telecommunications companies, cable broadband MSOs and enterprise clients throughout the project lifecycle of network deployments and maintenance.*

From a margin standpoint the division expected to grow the fastest (Cloud and Managed Services) has the highest corporate margin ranging from 45-50%. Applications and infrastructure is next with a margin range of 30-33% and Professional Services is the lowest margin business at 19-21%. Looking at expected growth rates margin expansion should be a part of the story.

	% Current Revenue	Growth Rate	Gross Margin Range
Professional Services	48%	Slower	19-21%
Applications/Infrastructure	35%	Moderate	30-33%
Cloud & Managed Services	18%	High	45-50%

During the three month period ended September 30, 2012, substantially all of the company's revenue was derived from specialty contracting services, while for the three month period ended September 30, 2013, 42% of revenues were derived from specialty contracting services, 51% were derived from telecommunication staffing services and 7% were derived from environmental remediation services.

INDUSTRY OUTLOOK

The Software and Services Industry outlook over the next year is positive with strength in cloud computing and mobility offsetting the fiscal cliff turmoil that clouded 2013's outlook. CompTIA's consensus forecast projects a growth rate of 3 percent for the global IT industry in 2013, with upside potential of 5.2 percent. The U.S. forecast is slightly lower – 2.9 percent with upside potential of 4.9 percent.

IT industry executives view the IT services (3.4 percent growth forecast, 5.6 percent upside) and software segments (3 percent forecast, 5 percent upside) as holding the most promise in 2013. Hardware sales – with many categories experiencing high unit growth, but downward pressure on prices – are expected to grow by just 1.8 percent (3.6 percent upside).

Reaching the upside of the forecast range will require macroeconomic stability, steady business confidence and healthy customers. There is good reason to believe the IT industry will hit the upside of growth projections, but there is still enough uncertainty to warrant caution."

CompTIA sees 2013 as another transitional year, where incremental advances in a number of areas make their marks on the IT industry and the broader economy.

INDUSTRY POSITION

The business of providing infrastructure and managed services to telecommunications companies and enterprise clients is highly fragmented and the business is characterized by a large number of participants, including several large companies as well as a significant number of small, privately held, local competitors.

Current and potential larger competitors include ePlus, Arrow Electronics, Inc., Black Box Corporation Dimension Data, Dycom Industries, Inc., Goodman Networks, Inc., TeleTech Holdings, Inc., , Unitek Global Services, Inc. and Synacor.

The firm competes on the basis of

- Price
- Quality
- Reputation
- Range of Services offered
- Geographic Area

RECENT NEWS

Improving the Balance Sheet

On December 2nd 2013 the company announced it is using proceeds received as a result of investors exercising warrants issued in its recent public offering, and with the consent of its senior lender, InterCloud has been able to redeem and cancel $3 million worth of its Series F Preferred Stock.

The redemption also eliminates the potential conversion of the shares of Series F Preferred Stock into over 300,000 shares of common stock, based upon current price levels. Series F Preferred Stock was issued in lieu of cash consideration to the sellers of TNS, Inc. subsidiary as part of the purchase price for that entity, which was acquired in September 2012. TNS, Inc. revenues for the twelve month period following its acquisition by InterCloud have increased by approximately 60%, from $3.1 million to $4.9 million, with a corresponding increase in net income of $0.8 million to $1.0 million, from $0.2 million for the twelve month period ended September 30, 2012.

Divestiture

On November 26th 2013 the company announced that its wholly-owned subsidiary ADEX Corporation completed its divestment of its wholly-owned subsidiary Environmental Remediation and Financial Services LLC ("ERFS"), effective as of October 1, 2013. The divestiture enables InterCloud to further focus its business on IT and telecom markets.

The effect of the divesture will be to cancel and eliminate from the Company's balance sheet over $6.0 million of liabilities, including $4.2 million of Series I Preferred Stock; an earn-out liability estimated at $2.1 million; and current liabilities of approximately $146,000.

New Contracts

On November 21st 2013 InterCloud announced that its Professional Services Group was recently awarded over $2.5 million in new professional services contracts, from new and existing clients.

The project services are for national tier 1 and tier 2 carriers' network expansions and include: site audits; site mappings; engineering and design; and structural design and analysis. InterCloud expects to commence work on these additional projects in the fourth quarter.

VALUATION

With its blue chip portfolio of telecom clients, the new firm will act as an end-to-end solution provider of cloud and managed service based platforms, professional services, applications and infrastructure to both the telecommunications industry and corporate enterprises. The firm should enjoy a tailwind from the strength of cloud services as well as from the fact that Telecom service outsourcing will continue. It is reasonable for investors to expect some margin expansion as the higher margin businesses (Cloud and Managed Services) will likely grow at a faster rate than some lower margin business.

Despite a solid outlook for core growth as well as acquisition growth, investors face three risks in the shares of InterCloud. First, the firm faces the task of integrating all of the firms acquired into one firm. Second, the investor faces dilution risk. For example the firm will be issuing shares for its pending acquisition of Telco in the neighborhood of $3.9 million dollars in the fourth quarter of 2013. Finally, as of September 30, 2013 the company had a capital deficit of $7.4 million. In two separate capital structure moves (divestiture and pay down of Series F) management proved it is serious about addressing these risks.

If we look at the company's price to sales ratio we get a reasonable 1.08x compared to similar companies with similar sales that trade between 1.75x and 2.00x. If we take next year's sales projections and divide by fully diluted shares outstanding then apply a conservative multiple of 1.40x and discount that by 12% we arrive at a price target of $15.00.

RISKS

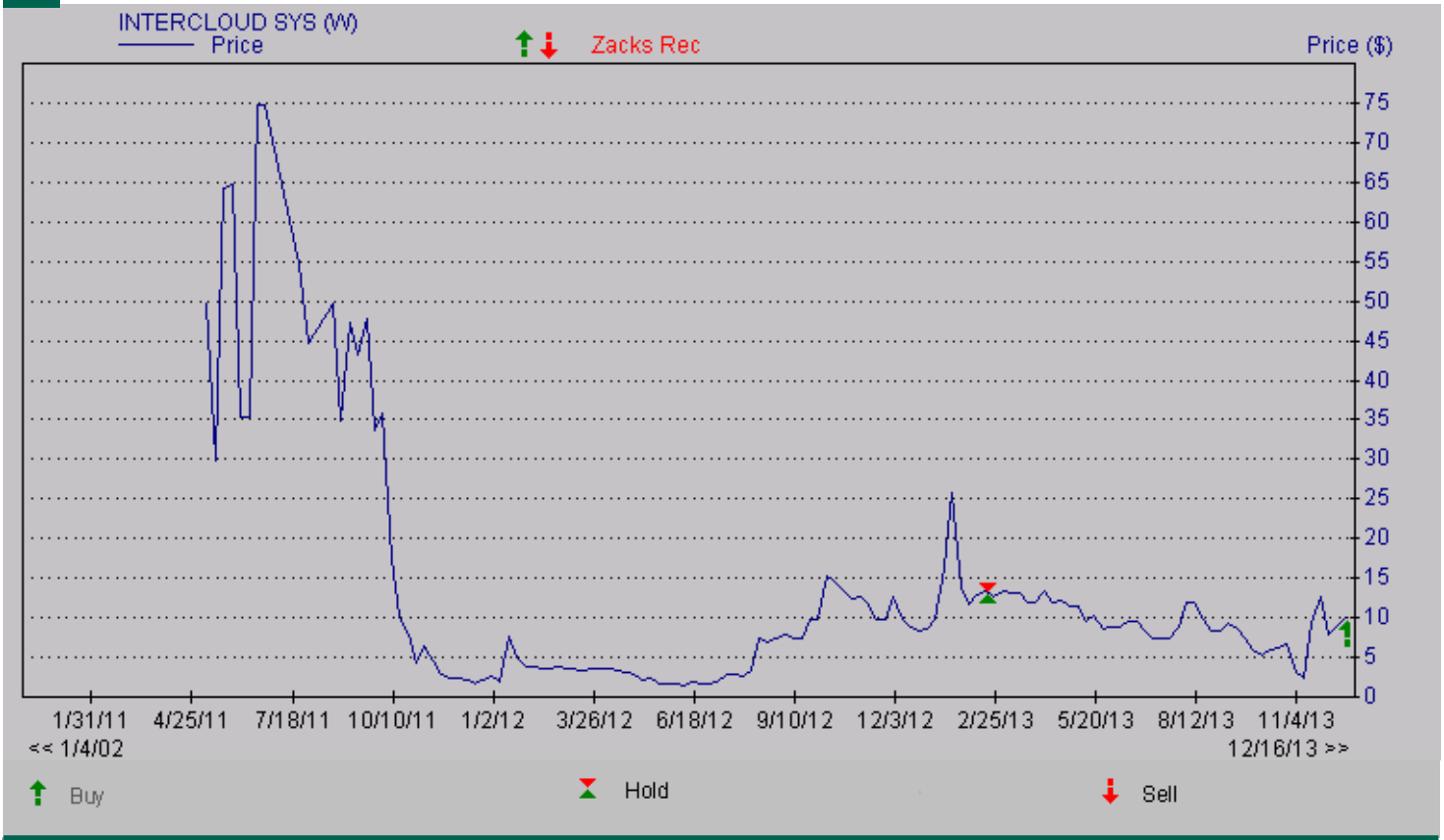
- The firm competes directly and indirectly with well healed larger firms that have more flexibility.
- InterCloud faces the challenge of integrating the acquired company's into one firm.
- New offerings to continue its acquisitions as well as any future equity financing will dilute the current shareholders.
- As of September 30th 2013 the company had a capital deficit of $7.4 million.

PROJECTED INCOME STATEMENT

INCOME STATEMENT ($ Millions)	Mar-13 Q1 13	Jun-12 Q2 13 E	Sep-13 Q3 13	Dec-13 Q4 13 E	FY 2013 E
REVENUE					
Net Revenue	**12.40**	**14.36**	**16.16**	**17.25**	**60.17**
Sequential Growth		*16%*	*13%*	*7%*	
OPERATING EXPENSES					
Cost of Revenues	8.77	10.11	10.66	10.95	40.5
% of Revenue	*70.7%*	*70.4%*	*66.0%*	*63.5%*	
Gross Profit -	**3.6**	**4.2**	**5.5**	**6.3**	**19.7**
Proforma Gross Margin	*29.3%*	*29.6%*	*34.0%*	*36.5%*	*32.7%*
R&D + Engg	0.00	0.00	0.00	0.00	0.0
% of Revenue	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
SG&A	2.94	3.45	3.77	3.90	14.06
% of Revenue	*23.7%*	*24.0%*	*23.3%*	*22.6%*	*23.4%*
GW Amort, Restructuring, other	*0.09*	*0.27*	*(0.34)*	*0.25*	*0.27*
% of Revenue					
Total Operating Expenses	3.03	3.71	3.44	4.15	14.33
% of Revenue	*24.4%*	*25.9%*	*21.3%*	*24.1%*	*24%*
Operating Income -	**0.6**	**0.5**	**2.1**	**2.2**	**5.4**
Operating Margin	*4.9%*	*3.7%*	*12.8%*	*12.5%*	*9%*
NON-OPERATING ITEMS					
Non operating Income/Expense	-1	-2	-1	-1	-4
% of Revenue	*-10.39%*	*-11.41%*	*-3.61%*	*-3.19%*	*-6.75%*
Tax Provision	-0.221	-0.049	0.013	0.012	-0.245
Pref Divs	*$ 0.59*	*$ 0.26*	*$ 0.17*	*$ 0.17*	*$ 1.19*
Net Income -	**-1.05**	**-1.31**	**1.30**	**1.42**	**0.4**
Net Income Margin	*-8.5%*	*-9.2%*	*8.0%*	*8.2%*	*1%*
EARNINGS PER SHARE					
EPS - Basic	-$0.50	-$1.33	$0.26	$0.21	-$1.36
EPS - Diluted	-$0.50	-$1.33	$0.12	$0.13	-$1.58

Ken Nagy, CFA Zacks Investment Research 11/15/2012

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