

DecisionPoint Systems, Inc.  
Form 10-Q  
November 14, 2013

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2013

Or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

DECISIONPOINT SYSTEMS, INC.  
(Exact name of registrant as specified in its charter)

Delaware  
(State of Incorporation)

000-54200  
(Commission File Number)

37-1644635  
(IRS Employer Identification No.)

8697 Research Drive Irvine CA, 92618-4204  
(Address of principal executive offices) (Zip code)

(949) 465-0065  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirement for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting

Edgar Filing: DecisionPoint Systems, Inc. - Form 10-Q

company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

The number of shares of common stock, par value \$0.001 per share of DecisionPoint Systems, Inc. outstanding as of the close of business on October 31, 2013, were 12,144,096.

Table of Contents

DECISIONPOINT SYSTEMS, INC.

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

	Page
<u>Item 1.</u>	
<u>Condensed Consolidated Financial Statements (unaudited)</u>	
<u>Condensed Consolidated Balance Sheets as of September 30, 2013 and December 31, 2012</u>	3
<u>Condensed Consolidated Statements of Operations and Comprehensive Loss for the Three and Nine Months Ended September 30, 2013 and 2012</u>	4
<u>Condensed Consolidated Statement of Stockholders' Equity (Deficit) for the Nine Months Ended September 30, 2013</u>	5
<u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2013 and 2012</u>	6
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	7
<u>Item 2.</u>	
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	24
<u>Item 3.</u>	
<u>Quantitative and Qualitative Disclosures About Market Risk</u>	40
<u>Item 4.</u>	
<u>Controls and Procedures</u>	40

PART II. OTHER INFORMATION

<u>Item 1.</u>	<u>Legal Proceedings</u>	
<u>Item 1a.</u>	<u>Risk Factors</u>	41
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	41
<u>Item 3.</u>	<u>Defaults Upon Senior Securities</u>	41
<u>Item 4.</u>	<u>Mine Safety Disclosures</u>	41
<u>Item 5.</u>	<u>Other Information</u>	41
<u>Item 6.</u>	<u>Exhibits</u>	41
<u>Signatures</u>		42

Table of Contents

## PART I FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

DECISIONPOINT SYSTEMS, INC.  
 Unaudited Condensed Consolidated Balance Sheets  
 (In thousands, except share and per share data)

	September 30, 2013	December 31, 2012
<b>ASSETS</b>		
Current assets		
Cash	\$270	\$1,103
Accounts receivable, net	12,685	12,287
Due from related party	195	202
Inventory, net	918	811
Deferred costs	3,773	3,955
Deferred tax assets	47	48
Prepaid expenses and other current assets	919	302
Total current assets	18,807	18,708
Property and equipment, net		
Other assets, net	139	179
Deferred costs, net of current portion	151	205
Goodwill	1,810	2,124
Intangible assets, net	8,485	8,571
Total assets	4,472	6,023
	\$33,864	\$35,810
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities		
Accounts payable	\$13,036	\$11,080
Accrued expenses and other current liabilities	3,040	2,895
Lines of credit	4,247	3,430
Current portion of debt	1,963	1,800
Due to related parties	160	1
Accrued earn out consideration	331	1,186
Warrant liability	933	-
Unearned revenue	6,639	7,409
Total current liabilities	30,349	27,801
Long term liabilities		
Unearned revenue, net of current portion	2,472	2,883
Debt, net of current portion and discount	2,099	2,922
Accrued earn out consideration, net of current portion	154	159
Deferred tax liabilities	1,038	1,078
Other long term liabilities	76	80
Total liabilities	36,188	34,923

Commitments and contingencies and subsequent event	-	-
<b>STOCKHOLDERS' EQUITY</b>		
Cumulative Convertible Preferred stock, \$0.001 par value, 10,000,000 shares authorized, 1,105,155 shares issued and outstanding, including cumulative and imputed preferred dividends of \$586 and \$361, and with a liquidation preference of \$8,983 and \$8,758 at September 30, 2013 and December 31, 2012, respectively	7,609	7,370
Common stock, \$0.001 par value, 100,000,000 shares authorized, 12,297,979 issued and 12,144,096 outstanding as of September 30, 2013, and 9,300,439 issued and 9,146,556 outstanding as of December 31, 2012	12	9
Additional paid-in capital	16,621	16,132
Treasury stock, 153,883 shares of common stock	(205 )	(205 )
Accumulated deficit	(25,720 )	(21,674 )
Unearned ESOP shares	(664 )	(767 )
Accumulated other comprehensive income	23	22
Total stockholders' (deficit) equity	(2,324 )	887
Total liabilities and stockholders' equity	\$33,864	\$35,810

See accompanying notes to unaudited condensed consolidated financial statements

Table of Contents

DECISIONPOINT SYSTEMS, INC.  
 Unaudited Condensed Consolidated Statements of Operations and Comprehensive Loss  
 (In thousands, except share and per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net sales	\$17,575	\$18,567	\$46,067	\$54,144
Cost of sales	14,113	14,445	36,216	42,559
Gross profit	3,462	4,122	9,851	11,585
Selling, general and administrative expense	4,485	4,741	13,981	13,370
Adjustment to earn-out obligations	(820 )	-	(820 )	-
Operating loss	(203 )	(619 )	(3,310 )	(1,785 )
Other expense:				
Interest expense	241	350	723	698
Other income, net	(168 )	(19 )	(182 )	(80 )
Total other expense	73	331	541	618
Net loss before income taxes	(276 )	(950 )	(3,851 )	(2,403 )
Provision (benefit) for income taxes	(109 )	64	(466 )	132
Net loss	(167 )	(1,014 )	(3,385 )	(2,535 )
Cumulative and imputed preferred stock dividends	(223 )	(249 )	(661 )	(710 )
Net loss attributable to common shareholders	\$(390 )	\$(1,263 )	\$(4,046 )	\$(3,245 )
Net loss per share -				
Basic and diluted	\$(0.04 )	\$(0.15 )	\$(0.44 )	\$(0.42 )
Weighted average shares outstanding -				
Basic and diluted	10,019,109	8,182,103	9,117,969	7,698,635
Comprehensive loss	\$(166 )	\$(992 )	\$(3,383 )	\$(2,507 )

See accompanying notes to unaudited condensed consolidated financial statements



Table of Contents

DECISIONPOINT SYSTEMS, INC.  
 Unaudited Consolidated Statements of Stockholders' Equity (Deficit)  
 (In thousands)

	Convertible Preferred stock		Common stock		Additional paid-in capital	Treasury stock	Accumulated deficit	Unearned ESOP shares	Accumulated other comprehensive income	Total stockholders' equity (deficit)
	Shares	Amount	Shares	Amount						
Balance at December 31, 2012	1,105	\$ 7,370	9,300	\$ 9	\$ 16,132	\$ (205 )	\$ (21,674 )	\$ (767 )	\$ 22	\$ 887
Net loss	-	-	-	-	-	-	(3,385 )	-	-	(3,385 )
Foreign currency translation adjustment	-	-	-	-	-	-	-	-	1	1
Common stock issued to employee as part of a specified portion of their regular annual cash bonus	-	-	71	-	83	-	-	-	-	83
Common stock issued in private placement, net of costs	-	-	2,927	3	400	-	-	-	-	403
Employee stock-based compensation	-	-	-	-	6	-	-	-	-	6
Accrued dividends on preferred stock	-	239	-	-	-	-	(661 )	-	-	(422 )
Principal payment from ESOP	-	-	-	-	-	-	-	103	-	103
Balance at September 30, 2013	1,105	\$ 7,609	12,298	\$ 12	\$ 16,621	\$ (205 )	\$ (25,720 )	\$ (664 )	\$ 23	\$ (2,324 )

See accompanying notes to unaudited condensed consolidated financial statements





Table of Contents

DECISIONPOINT SYSTEMS, INC.  
 Unaudited Condensed Consolidated Statements of Cash Flows  
 (In thousands)

	Nine Months ended September 30,	
	2013	2012
Cash flows from operating activities:		
Net loss	\$(3,385 )	\$(2,535 )
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and amortization	1,497	992
Amortization of deferred financing costs and note discount	140	160
Employee stock-based compensation	6	50
Non-employee stock-based compensation	-	341
Non-cash interest income	-	(24 )
Acquisition earn-out adjustment	(820 )	-
Change in fair value of warrants	(166 )	-
ESOP compensation expense	104	98
Deferred taxes, net	(5 )	28
Allowance for doubtful accounts	56	13
Loss on disposal of property and equipment	13	-
Changes in operating assets and liabilities:		
Accounts receivable	(468 )	3,899
Due from related party	-	(357 )
Inventory, net	(107 )	(184 )
Deferred costs	496	(583 )
Prepaid expenses and other current assets	(578 )	179
Other assets, net	5	(11 )
Accounts payable	1,961	(572 )
Accrued expenses and other current liabilities	106	178
Due to related parties	158	(791 )
Unearned revenue	(1,163 )	(186 )
Net cash (used in) provided by operating activities	(2,150 )	695
Cash flows from investing activities		
Cash paid for acquisitions	-	(5,051 )
Purchases of property and equipment	(33 )	(50 )
Net cash used in investing activities	(33 )	(5,101 )
Cash flows from financing activities		
(Repayments) borrowings from lines of credit, net	817	718
Proceeds from issuance of term debt	1,000	4,033
Cash received in reverse recapitalization, net of expenses	-	1,500
Repayment of debt	(1,552 )	(962 )
Paid financing costs	(119 )	(296 )
Dividends paid	(296 )	(482 )
Common stock issued in private placement, net of costs	1,502	-

Edgar Filing: DecisionPoint Systems, Inc. - Form 10-Q

Net cash provided by financing activities	1,352	4,511
Effect on cash of foreign currency translation	(2 )	(79 )
Net (decrease) increase in cash	(833 )	26
Cash at beginning of period	1,103	366
Cash at end of period	\$270	\$392

Supplemental disclosures of cash flow information:

Interest paid	\$705	\$858
Income taxes paid	234	56

Supplemental disclosure of non-cash financing activities:

Accrued and imputed dividends on preferred stock	\$661	\$261
Warrants issued in connection with common stock private placement	1,099	-

See accompanying notes to unaudited condensed consolidated financial statements

Table of Contents

DECISIONPOINT SYSTEMS, INC.  
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

NOTE 1 - DESCRIPTION OF BUSINESS

Description of Business

DecisionPoint Systems, Inc. (“DecisionPoint”, “Company”), through its subsidiaries is a provider of Enterprise Mobility Systems. Enterprise Mobility Solutions are those computer systems that give an enterprise the ability to connect to people, control assets, and transact business from any location by using mobile computers, tablet computers, and smartphones to securely connect the mobile worker to the back office software systems that run the enterprise. Technologies that support Enterprise Mobility Solutions include national wireless carrier networks, Wi-Fi, local area networks, mobile computers, smartphones and tablets, mobile software applications, middleware and device security and management software. The Company also provides professional services, proprietary and third party software and software customization as an integral part of its customized solutions for its customers. The proprietary suite of software products utilizes the latest technologies to empower the mobile worker in many areas including merchandising, sales and delivery, field service, logistics and transportation, and warehouse management.

NOTE 2 - BASIS OF PRESENTATION, LIQUIDITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. The unaudited condensed consolidated financial statements have been prepared on the same basis as the annual consolidated financial statements. In the opinion of the Company’s management, the accompanying unaudited condensed consolidated financial statements contain all of the adjustments (consisting of normal recurring accruals and adjustments) necessary to present fairly the consolidated financial position, results of operations and cash flows of the Company at the dates and for the periods indicated. The interim results for the periods ended September 30, 2013, are not necessarily indicative of results for the full 2013 fiscal year or any other future interim periods.

The accompanying unaudited condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, DecisionPoint Systems International and Apex Systems Integrators, Inc. (“Apex”). DecisionPoint Systems International has two wholly-owned subsidiaries, DecisionPoint Systems Group, Inc. (“DPS Group”) and CMAC, Inc. (“CMAC”). Apex was acquired on June 4, 2012, and as such, the operating results of Apex have been consolidated into the Company’s consolidated results of operations beginning on June 5, 2012. In addition, on July 31, 2012, the Company consummated an asset purchase agreement (“Asset Purchase Agreement”) with MacroSolve, Inc. Pursuant to the Asset Purchase Agreement, the Company purchased the business (including substantially all the related assets) of the seller’s Illume Mobile division (“Illume Mobile”) and is a division of the Company. The Company currently operates in one business segment.

The preparation of unaudited condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the recorded amounts reported therein. Certain accounting policies involve judgments and uncertainties to such an extent that there is reasonable likelihood that materially

different amounts could have been reported under different conditions, or if different assumptions had been used. The Company evaluates its estimates and assumptions on a regular basis. The Company uses historical experience and various other assumptions that are believed to be reasonable under the circumstances to form the basis for making judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ materially from these estimates and assumptions used in preparation of the unaudited condensed consolidated financial statements.

These unaudited condensed consolidated financial statements have been prepared by management and should be read in conjunction with the audited consolidated financial statements of DecisionPoint Systems, Inc. and notes thereto for the year ended December 31, 2012, included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 28, 2013.

Table of Contents

Liquidity

In the quarter ended September 30, 2013, the Company experienced a decrease in revenue of \$1.0 million compared to the quarter ended September 30, 2012, and a \$2.9 million increase in revenue compared to the previous sequential quarter ended June 30, 2013. In the nine months ended September 30, 2013, the Company incurred approximately \$1.3 million in increased expenses due to professional fees relating to capital raising activities, including the registration of common shares as a result of the Series D Preferred Stock offering completed in December 2012 and the private placement of common stock completed in August 2013 and associated audit fees, and other matters such as employee termination costs. The Company experienced a net loss of \$0.2 million and \$3.4 million for the three and nine month periods ended September 30, 2013. In addition, the Company has a substantial working capital deficit totaling \$(11.5) million at September 30, 2013. Although a portion of this deficit is associated with deferred costs and unearned revenues and term debt that has been classified current due to expected future covenant violations (see further discussion at Note 8), the liabilities of the Company that are expected to be satisfied in the foreseeable future in cash exceed the operating assets that are expected to be satisfied in cash.

To address this, the Company has plans to seek additional capital through sales of our securities. There is no assurance additional funding will be available on terms acceptable to us, or at all. If the Company raises additional funds by selling additional shares of our capital stock, or securities convertible into shares of our capital stock, the ownership interest of our existing shareholders will be diluted. The Company is also reducing non-essential expenses and completing the integration of our acquisitions of Apex and Illume Mobile, which is expected to result in further cost savings. Such expense reduction measures include, but are not limited to, consolidation of administrative personnel, consolidation of information technology environments, reduction of outsourced consulting expertise and replacing certain service providers with lower cost providers. The result of these activities has reduced the expense structure of the consolidated business, however this reduction has not been material to date and we do not anticipate it becoming material in the foreseeable future.

On August 15, 2013, the Company entered into a Securities Purchase Agreement (the "Purchase Agreement") with multiple accredited investors for the sale of common stock for gross proceeds of \$1,756,400 (including \$100,000 from management and existing shareholders of the Company) for 2,927,333 shares of common stock. The effective price of the offering was \$0.60 per share of common stock. An initial closing for \$1,556,400 was held on August 15, 2013. The final closing for \$200,000 was held on August 21, 2013. Additionally, pursuant to the Purchase Agreement, the Company issued 1,463,667 warrants to multiple accredited investors at an exercise price of \$1.00 per share. Further, the Company issued 292,733 warrants to the placement agent at an exercise price of \$0.60 per share. The warrants received liability accounting treatment under existing accounting standards. The Company received net proceeds of approximately \$1.5 million from the offering, after deducting the placement agent's fees of 10% and other offering expenses. (see Note 9 – Stockholders' Equity and Note 3 – Warrant Liability).

In November 2013, the Company entered into definitive subscription agreements ("Series E Purchase Agreement") with accredited investors for the sales of \$3,835,000 in gross proceeds for 383,500 shares of Series E Convertible Preferred Stock ("Series E Preferred Shares") for a purchase price of \$10.00 per share. The initial Conversion Price is \$0.50, subject to adjustment in the event of stock splits, stock dividends and similar transactions, and in the event of subsequent equity sales at a lower price per share, subject to certain exceptions. The Company received net proceeds of approximately \$3.4 million (net of the fair value of placement agent warrants) from the initial closing, after deducting the placement agent's fees of 8% and other offering expenses. The Company issued to the Placement Agent five-year warrants to purchase 767,000 shares of our common stock (equal to 10% of the number of shares of common stock underlying the Series E Preferred Shares sold under the Series E Purchase Agreement) at an exercise price of \$0.55 per share, in connection with the Series E Purchase Agreement initial closing. The Company expects to close a second round of Series E Preferred Shares with gross proceeds of \$300,000-\$700,000 shortly thereafter. (see Note 13 – Subsequent Event).

During 2012 and 2013, all principal payments on the Company's term debt were made within payment terms. The Company was not in compliance with certain financial covenants under the agreements with Royal Bank of Canada ("RBC Credit Agreement") and BDC, Inc. ("BDC Credit Agreement") as of December 31, 2012, March 31, 2013 and June 30, 2013. The Company has received waivers for non-compliance for past covenant violations. On August 22, 2013, the BDC Credit Agreement was amended and certain financial covenants were modified. Pursuant to the amended loan agreement, the Company is required to maintain, for the duration of the investment, a term debt to equity ratio not exceeding 1.1:1 (measured annually); and an adjusted current ratio of 0.40:1 (measured annually) and revised annually 120 days after each year end. We were in compliance with all of our BDC financial covenants as of September 30, 2013. We expect to continue to meet the requirements of our BDC financial covenants over the short and long term. On August 16, 2013 the RBC Credit Agreement was amended and certain financial covenants were modified. Pursuant to the amended credit agreement and commencing with the fiscal year ending December 31, 2013, the Company is required to maintain a fixed coverage ratio, calculated on a consolidated basis of not less than 1.15:1 with a step-up to 1.25:1 as of March 31, 2014, tested on a rolling four quarter basis thereafter and a ratio of funded debt to EBITDA, calculated on an annual consolidated basis of not greater than 3.0:1, tested on a rolling four quarter basis thereafter. As part of the revised financial covenants, covenant testing was waived by RBC for September 30, 2013. The Company does not believe that it will be in compliance with the reset covenants at December 31, 2013. Although management of the Company believes it is improbable that RBC will exercise their rights up to, and including, acceleration of the outstanding debt, there can be no assurance RBC will not exercise their rights pursuant to the provisions of the debt obligation. Accordingly, the Company has classified this debt obligation as current at September 30, 2013 (see Note 8 – Term Debt).

## Table of Contents

At October 31, 2013, the outstanding balance on the line of credit with Silicon Valley Bank (“SVB”) is \$3.7 million, down from \$4.1 million at September 30, 2013, and the availability under the line of credit has decreased to \$1.6 million (see Note 7 – Lines of Credit). The Company relies on the line of credit to fund daily operating activities maintaining very little cash on hand. As of December 31, 2012, the Company was in compliance with all of its financial covenants with SVB. As of May 31, 2013 and June 30, 2013, the Company was not in compliance with the Tangible Net Worth financial covenant as defined in the amended SVB Loan Agreement. SVB agreed to temporarily forbear exercising their rights and remedies under the facility until August 28, 2013 and agreed to waive the existing covenant violations if a gross capital raise of \$1.5 million was completed by such date. The Company completed the capital raise and was able to achieve compliance with the forbearance agreement prior to August 28, 2013. Except for any capital raises through August 28, 2013, the minimum Tangible Net Worth requirement of a \$(9.7) million deficit will be further reduced by one half of any funds raised through sales of common stock (as only 50% of additional capital raises are given credit in the Tangible Net Worth calculation). As of September 30, 2013, the Company was in compliance with the Tangible Net Worth financial covenant and had available a \$0.3 million cushion over the requirement. In November 2013, the Company entered into a definitive subscription agreement with accredited investors for the sale of Series E Preferred Stock, raising \$3.8 million in gross proceeds (See Note 13). Given the effect of the capital raise (\$3.8 million in gross proceeds, net of \$400,000 in costs) closed to date in November, the Company believes that at the time of this filing it is compliant with the terms and provisions of its SVB lending agreement and expects to continue to meet the requirements of our SVB financial covenants over the short and long term. The Company is in currently discussions with SVB regarding the Tangible Net Worth covenant and a reduction of the 50% of additional capital raised to 25% of capital raised in November 2013. Should the Company continue to incur losses in a manner consistent with its recent historical financial performance, the Company will violate this covenant without additional net capital raises in amounts that are approximately twice the amount of the losses incurred.

In the near term, the Company’s successful restructuring of its operations and reduction of operating costs and/or its ability to raise additional capital at acceptable terms is critical to its ability to continue to operate for the foreseeable future. If the Company continues to incur operating losses and/or does not raise sufficient additional capital, material adverse events may occur including, but not limited to, 1) a reduction in the nature and scope of the Company’s operations, 2) the Company’s inability to fully implement its current business plan and/or 3) continued defaults under the various loan agreements. A covenant default would give the bank the right to demand immediate payment of all outstanding amounts which the Company would not be able to repay out of normal operations. There are no assurances that the Company will successfully implement its plans with respect to these liquidity matters. The unaudited condensed consolidated financial statements do not reflect any adjustment that may be required resulting from the adverse outcome relating to this uncertainty.

### Summary of Significant Accounting Policies

There have been no material changes to the Company's significant accounting policies during the nine months ended September 30, 2013. See Footnote 2 of the Company's consolidated financial statements included in the Company's 2012 Annual Report on Form 10-K filed on March 28, 2013, for a comprehensive description of the Company's significant accounting policies.

**Concentration of Credit Risk** - The Company derived approximately 9.8% and 13.3% of revenues from one customer, and 21.1% and 26.2% of revenues from the top three customers in the nine months ended September 30, 2013 and 2012, respectively. Additionally there was one customer which comprised 15.5% of accounts receivable at September 30, 2013. Customer mix can shift significantly from year to year, but a concentration of the business with a few large customers is typical in any given year. A decline in revenues could occur if a customer which has been a significant factor in one financial reporting period gives significantly less business in the following period.



The Company's contracts with these customers and other customers do not include any specific purchase requirements or other requirements outside of the normal course of business. The majority of customer contracts are on an annual basis for service support while on a purchase order basis for hardware purchases. Typical hardware sales are submitted on an estimated order basis with subsequent follow on orders for specific quantities. These sales are ultimately subject to the time that the units are installed at each of the customer locations as per their requirements. Service contracts are purchased on an annual basis generally and are the performance responsibility of the actual service provider as opposed to the Company. Termination provisions are generally standard clauses based upon non-performance, but a customer can cancel with a certain reasonable notice period anywhere from 30 to 90 days. General industry standards for contracts provide ordinary terms and conditions, while actual work and performance aspects are usually dictated by a Statement of Work which outlines what is being ordered, product specifications, delivery, installation and pricing.

Translation of Foreign Currencies - The Company's functional currency is the U.S. dollar. The financial statements of the Company's foreign subsidiary is measured using the local currency, in this case the Canadian dollar (CDN\$), as its functional currency and is translated to U.S. dollars for reporting purposes. Assets and liabilities of the subsidiary are translated at exchange rates as of the balance sheet dates. Revenues and expenses of the subsidiary are translated at the rates of exchange in effect during the year.

Comprehensive Loss - Comprehensive loss is comprised of net loss and other comprehensive loss. The only component of comprehensive loss is the foreign currency translation adjustments, which were nominal in amount. There was no tax effect allocated to any component of other comprehensive loss during the periods presented.

Table of Contents

Fair Value Measurement - Financial assets and liabilities are measured at fair value, which is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The following is a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value:

- Level 1 — Quoted prices in active markets for identical assets or liabilities.
- Level 2 — Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The following table presents the Company's warrant liability measured at fair value on a recurring basis as of September 30, 2013 and December 31, 2012, aggregated by the level in the fair-value hierarchy within which those measurements fall (in thousands):

	Balance	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Balance at December 31, 2012	\$-	-	-	\$ -
Balance at September 30, 2013	\$933	-	-	\$ 933

The following table presents the activity for liabilities measured at estimated fair value using unobservable inputs (Level 3) from December 31, 2012 through September 30, 2013 (in thousands):

	Level 3
Balance at December 31, 2012	\$-
Fair value of derivative warrants issued in connection with share purchase agreement (see Note 3)	1,099
Adjustments to fair value (reflected in other income)	(166)
Balance at September 30, 2013	\$933

Reclassifications - Certain reclassifications have been made to prior years to conform to current period financial statement presentation with no effect on our previously reported consolidated financial position, results of operations, or cash flows.

NOTE 3 – WARRANT LIABILITY

The Company has determined that certain warrants the Company has issued contain provisions that protect the holders from future issuances of the Company's Common Stock at prices below such warrants' then in effect respective exercise prices (see Note 9). These provisions could result in modification of the warrants then in effect exercise price. The Company evaluated the following guidance ASC 480-10 Distinguishing Liabilities from Equity and ASC 815-40 Contracts in an Entity's Own Equity. Pursuant to this guidance, the Company's management concluded these instruments do not meet the criteria for classification as equity treatment and must be recorded as a liability as a result of the terms in the warrants that provide for price protection in the event of a future issuance. The Company recognized these Warrants as liabilities at their fair value and re-measures them at fair value on each reporting date. ASC 820 Fair Value Measurement provides requirements for disclosure of liabilities that are measured at fair value on a recurring basis in periods subsequent to the initial recognition (see Note 2).

Table of Contents

The Company uses Level 3 inputs for its valuation methodology for the warrant derivative liabilities. The estimated fair values were determined using a Monte Carlo option pricing model based on various assumptions. The Company's derivative liabilities are adjusted to reflect estimated fair value at each period end, with any decrease or increase in the estimated fair value being recorded in other income or expense accordingly, as adjustments to the fair value of derivative liabilities. Various factors are considered in the pricing models the Company uses to value the warrants, including the Company's current stock price, the remaining life of the warrants, the volatility of the Company's stock price, and the risk-free interest rate. In addition, as of the valuation dates, management assessed the probabilities of future financing assumptions in the Monte Carlo valuation models. Future changes in these factors will have a significant impact on the computed fair value of the warrant liability. As such, the Company expects future changes in the fair value of the warrants to continue to vary from quarter to quarter.

The Company revalues the warrants as of the end of each reporting period. The estimated fair value of the outstanding warrant liabilities was approximately \$0.9 million and \$0.0 million, as of September 30, 2013 and December 31, 2012, respectively. The change in fair value of the derivative liabilities for the three and nine months ended September 30, 2013 was approximately \$166,000 and is included in other income in the unaudited condensed consolidated statement of operations and comprehensive loss.

The derivative warrant liabilities were valued at the closing dates of the Purchase Agreement (see Note 9 (c)) and the end of each reporting period using a Monte Carlo valuation model with the following assumptions:

Investor Warrants	Placement Agent Warrants		Investor Warrants		
	September	August	September	August	August
	30, 2013	21, 2013	30, 2013	21, 2013	15, 2013
Closing price per share of common stock	\$0.63	\$0.84	\$0.63	\$0.84	\$0.69
Exercise price per share (range)	0.60	0.60	1.00	1.00	1.00
Expected volatility	132.1	% 134.9	% 132.1	% 134.9	% 134.1
Risk-free interest rate	1.4	% 1.6	% 1.4	% 1.6	% 1.6
Dividend yield	-	-	-	-	-
Remaining expected term of underlying securities (years)	4.9	5.0	4.9	5.0	5.0

## NOTE 4 – LOSS PER COMMON SHARE

Basic loss per share is computed by dividing the loss available to common shareholders by the weighted-average number of common shares outstanding. Diluted loss per share is computed similarly to basic loss per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares had been issued and if the additional common shares were dilutive. The weighted-average basic and diluted shares for each of the nine months ended September 30, 2013 and 2012 exclude approximately 0.5 million of ESOP shares that have not been committed to be released.

For periods presented in which there is a net loss, potentially dilutive securities are excluded from the computation of fully diluted net loss per share as their effect is anti-dilutive. All potentially dilutive securities are anti-dilutive due to the net loss incurred by the Company in the periods presented.



Table of Contents

Potential dilutive securities consist of (in thousands):

	Nine Months Ended September 30,	
	2013	2012
Convertible preferred stock - Series A	270	270
Convertible preferred stock - Series B	131	131
Convertible preferred stock - Series C	-	1,415
Convertible preferred stock - Series D	7,824	-
Warrants to purchase common stock	2,737	277
Options to purchase common stock	544	642
Total potentially dilutive securities	11,506	2,735

## NOTE 5 – BUSINESS COMBINATIONS

## Illume Mobile

On July 31, 2012 (“Illume Closing Date”), the Company consummated an asset purchase agreement (“Asset Purchase Agreement”) with MacroSolve, Inc. Pursuant to the Asset Purchase Agreement, the Company purchased the business (including substantially all the related assets) of the seller’s Illume Mobile division (“Illume Mobile”), based in Tulsa, Oklahoma. Founded in 1996, Illume Mobile is a mobile business solutions provider that serves mobile products and platforms. Illume Mobile’s initial core business is the development and integration of business applications for mobile environments. The Company accounted for the transaction using the purchase method of accounting and the operating results for Illume Mobile have been consolidated into the Company’s results of operations beginning on August 1, 2012.

In consideration for the business of Illume Mobile, the Company paid \$1,000,000, of which \$250,000 was paid in cash and \$750,000 was paid in the form of 617,284 shares of the Company’s common stock. The Company valued the shares issued in conjunction with the acquisition at \$697,531.

Pursuant to the Asset Purchase Agreement, the Company was required to make an additional payment (“Earn Out Payment”) to the seller of up to \$500,000 of which 50% will be paid in cash, and 50% will be paid in shares of the common stock of the Company. The value of the shares will be based on the closing price of the Company’s common stock on the one year anniversary of the Illume Closing Date, July 31, 2013. The fair value of the Earn Out Payment was calculated to be approximately \$107,000 at the Closing Date. At September 30, 2013, the calculated Earn Out Payment due under the Asset Purchase Agreement was zero. Accordingly, there is \$0 accrued for the Earn Out Payment included in accrued earn out consideration in the unaudited condensed consolidated financial statements. The adjustment was recorded as a separate component of operating expenses in the unaudited condensed consolidated statement of operations and comprehensive loss as of September 30, 2013.

## Apex

On June 4, 2012 (“Closing Date”), pursuant to a Stock Purchase Agreement (“Purchase Agreement”), the Company acquired all of the issued and outstanding shares of Apex, a corporation organized under the laws of the Province of Ontario, Canada. Apex is a provider of wireless mobile work force software solutions. Its suite of products utilizes

the latest technologies to empower the mobile worker in many areas including merchandising, sales and delivery; field service; logistics and transportation; and, warehouse management. Its clients are North American companies that are household names whose products and services are used daily to feed, transport, entertain and care for people throughout the world.

In consideration for the shares of Apex, the Company paid CDN\$5,000,000 (US\$4,801,000 at the Closing Date) (“Closing Amount”) in cash. The Company was required to pay up to an undiscounted amount of CDN\$3,500,000 (US\$3,360,700 at the Closing Date) in consideration for Apex achieving certain levels of adjusted earnings before interest, depreciation, taxes and amortization (“EBITDA”), as defined by the Purchase Agreement, in the period ended July 2013. The fair value of the earn out was calculated to be approximately CDN\$1,076,000 (US\$1,033,000 at the Closing Date). At September 30, 2013, the calculated Earn Out Payment due under the Purchase Agreement was CDN\$341,000 (US\$331,000). The seller has disputed the Company’s calculation (see Note 12). Accordingly, there is CDN\$341,000 (US\$331,000) recorded as potential additional purchase consideration in the unaudited condensed consolidated financial statements. The adjustment of CDN\$735,000 (US\$713,000) was recorded as a separate component of operating expenses in the unaudited condensed consolidated statement of operations and comprehensive loss as of September 30, 2013. The Company accounted for the transaction using the purchase method of accounting and the operating results for Apex have been consolidated into the Company’s results of operations beginning on June 5, 2012. The Company funded the purchase of Apex through borrowings as further explained below.

Table of Contents

As part of the Purchase Agreement, the Company is obligated to pay bonus consideration to the CEO of Apex. Such bonus is considered additional contingent purchase consideration as the Company is obligated to pay the bonus regardless of whether or not the CEO's employment is retained. The fair value of the bonus was calculated to be approximately CDN\$160,000 (US\$153,000 at the Closing Date). At September 30, 2013 there is CDN\$160,000 (US\$154,000) recorded in accrued earn out consideration in the Company's unaudited condensed consolidated balance sheets.

## Pro Forma Financial Information (unaudited):

The following summarizes the Company's unaudited consolidated results of operations for the three and nine months ended September 30, 2012 as if the Apex and Illume Mobile acquisitions had occurred on January 1, 2012: (in thousands except per share data):

	Three Months Ended September 30, 2012		Nine Months Ended September 30, 2012	
	As Reported	Pro Forma	As Reported	Pro Forma
Net sales	\$18,567	\$18,669	\$54,144	\$56,346
Net loss attributable to common shareholders	(1,263 )	(1,445 )	(3,245 )	(5,311 )
Net loss per share - basic and diluted	(0.15 )	(0.18 )	(0.42 )	(0.69 )

Included in the pro forma combined results of operations are the following adjustments for Apex: (i) amortization of intangible assets for the three and nine months ended September 30, 2012 of \$0 and \$572,000, respectively (ii) a net increase in interest expense for the three and nine months ended September 30, 2012 of \$0 and \$291,000, respectively.

Included in the pro forma combined results of operations are the following adjustments for Illume Mobile: (i) amortization of intangible assets for the three and nine months ended September 30, 2012 of \$18,000 and \$125,000, respectively. Net loss per share assumes the 325,000 shares issued in connection with the Apex acquisition and the 617,284 shares issued in connection with the Illume Mobile acquisition are outstanding for the period presented.

The historical financial information of Apex has been extracted for the periods required from the historical financial statements of Apex Systems Integrators, Inc. which were prepared in accordance with U.S. generally accepted accounting principles. The historical financial information of Illume Mobile has been derived from using internally generated management reports for the periods required.

The unaudited pro forma financial information is not intended to represent or be indicative of the Company's consolidated results of operations that would have been reported had the Apex and Illume Mobile acquisitions been completed as of the beginning of the period presented, nor should it be taken as indicative of the Company's future consolidated results of operations.

The combined amounts of Apex and Illume Mobile's revenue and net loss since the respective acquisition dates included in the Company's unaudited condensed consolidated statement of operations for the three and nine months ended September 30, 2013 were \$0.7 million, (\$0.1) million and \$2.6 million, (\$1.8) million, respectively, and for the three and nine months ended September 30, 2012 were \$0.6 million, (\$0.7) million and \$0.7 million, (\$1.2) million, respectively.



NOTE 6 – GOODWILL AND INTANGIBLE ASSETS

The following summarizes the transaction affecting goodwill through September 30, 2013 (in thousands):

Balance at December 31, 2012	\$8,571
Effect of currency translation on Apex	(86 )
Balance at September 30, 2013	\$8,485

Table of Contents

As of September 30, 2013 and December 31, 2012, the Company's intangible assets and accumulated amortization consist of the following (in thousands):

	September 30, 2013			December 31, 2012		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Customer relationships	\$3,319	\$ (1,498 )	\$1,821	\$3,373	\$ (966 )	\$2,407
Contractor and resume databases	675	(371 )	304	675	(270 )	405
Tradename	878	(324 )	554	893	(193 )	700
Internal use software	2,892	(1,137 )	1,755	2,978	(545 )	2,433
Covenant not to compete	105	(67 )	38	105	(27 )	78
	\$7,869	\$ (3,397 )	\$4,472	\$8,024	\$ (2,001 )	\$6,023

The effect of foreign currency translation on the goodwill and intangible assets for the nine months ended September 30, 2013 is approximately (\$86,000) and (\$120,000), respectively.

## NOTE 7 – LINES OF CREDIT

The Company has a \$10.0 million revolving line of credit with Silicon Valley Bank (“SVB”) which provides for borrowings based upon eligible accounts receivable, as defined in the Loan Agreement (“SVB Loan Agreement”). Under the SVB Loan Agreement as amended, SVB has also provided the Company with a term loan as discussed at Note 8. The SVB Loan Agreement is secured by substantially all the assets of the Company and matures in February 2015. As of September 30, 2013, the outstanding balance on the line of credit is approximately \$4.1 million and the interest rate is 7.0%. The line of credit has a certain financial covenant and other non-financial covenants. As of December 31, 2012, the Company was in compliance with all of its financial covenants with SVB. As of May 31, 2013 and June 30, 2013, the Company was not in compliance with the Tangible Net Worth covenant as defined in the amended SVB Loan Agreement. On August 16, 2013, the Company and SVB signed an agreement (“Forbearance Agreement”) where SVB agreed to temporarily forbear from exercising their rights and remedies under the facility until August 28, 2013 and agreed to waive the existing covenant violations, subject to the Company's completion of a capital raise. The Company completed the capital raise and was able to achieve compliance with the forbearance agreement prior to August 28, 2013. Except for any capital raises through August 28, 2013, the minimum Tangible Net Worth requirement of a \$(9.7) million deficit will be further reduced by one half of any funds raised through sales of common stock (as only 50% of additional capital raises are given credit in the Tangible Net Worth calculation). As of September 30, 2013, the Company was in compliance with the Tangible Net Worth financial covenant and had available a \$0.3 million cushion over the requirement. In November 2013, the Company entered into a definitive subscription agreement with accredited investors for the sale of Series E Preferred Stock, raising \$3.8 million in gross proceeds (See Note 13). Given the effect of the capital raise (\$3.8 million in gross proceeds, net of \$400,000 in costs) closed to date in November, the Company believes that at the time of this filing it is compliant with the terms and provisions of its SVB lending agreement and expects to continue to meet the requirements of our SVB financial covenants over the short and long term. The Company is in currently discussions with SVB regarding the Tangible Net Worth covenant and a reduction of the 50% of additional capital raised to 25% of capital raised in November 2013. Should the Company continue to incur losses in a manner consistent with its recent historical financial performance, the Company will violate this covenant without additional net capital raises in amounts that are approximately twice the amount of the losses incurred.

Availability under the line of credit was approximately \$4.3 million as of September 30, 2013 and \$1.6 million as of October 31, 2013. The line of credit allows the Company to cause the issuance of letters of credit on account of the Company to a maximum of the borrowing base as defined in the Loan Agreement. No letters of credit were outstanding as of September 30, 2013 or December 31, 2012.

On February 27, 2013, the SVB Loan Agreement was amended to provide for 1) an extension of the termination date of the line of credit to February 28, 2015, 2) the modification of the line of credit borrowing base, advance rate and financial covenants, 3) the inclusion of an additional \$1.0 million term loan (See further discussion at Note 8, 5) a modification of the rate of interest of the line of credit to 3.75% above SVB's prime rate and 5) other various terms and provisions.

The Company is party to a credit agreement, dated June 4, 2012 (the "RBC Credit Agreement") with Royal Bank of Canada ("RBC"). Under the RBC Credit Agreement, the revolving demand facility allows for borrowings up to CDN\$200,000 based upon eligible accounts receivable. Interest is based on the Royal Bank Prime ("RBP") plus 1.5% and is payable on demand. As of September 30, 2013, the outstanding balance on the line of credit was \$180,000 and the interest rate is 4.5%. The RBC Credit Agreement is secured by the assets of Apex. The revolving demand facility has certain financial covenants and other non-financial covenants. As of June 30, 2013 and December 31, 2012, Apex was not in compliance with the Fixed Charge Coverage ratio covenant as defined in the RBC Credit Agreement. At June 30, 2013, Apex was not in compliance with the Maximum Funded Debt to EBITDA ratio covenant as defined in the RBC Credit Agreement. In March 2013 and May 2013, the Company received waivers for non-compliance of these covenants at December 31, 2012, March 31, 2013 and June 30, 2013. The covenants were reset by RBC on August 16, 2013. The Company does not believe that it will be in compliance with the reset covenants at December 31, 2013. See further discussion regarding this condition at Note 8.

Table of Contents

For the nine months ended September 30, 2013 and 2012, the Company's interest expense for the lines of credit, including amortization of deferred financing costs, was approximately \$262,000 and \$251,000, respectively.

RBC and SVB are party to a subordination agreement, pursuant to which RBC agreed to subordinate any security interest in assets of the Company granted in connection with the RBC Credit Agreement to SVB's security interest in assets of the Company.

Under the RBC Credit Agreement, the lender provided Apex with a term loan as discussed at Note 8.

## NOTE 8 – TERM DEBT

Term debt as of September 30, 2013, consists of the following (in thousands):

	Balance December 31, 2012	Additions	Payments	Amortization of Note Discount	Effect of Currency Translation	Balance September 30, 2013
RBC term loan	\$2,090	\$-	\$(608 )	\$ -	\$(68 )	\$1,414
Note discount	(38 )	-	-	18	\$1	(19 )
BDC term loan	1,705	-	-	-	(56 )	1,649
Note discount	(31 )	-	-	5	1	(25 )
SVB term loan	1,000	-	(750 )	-	-	250
Note discount	(4 )	-	-	4	-	-
SVB term loan-2	-	1,000	(194 )	-	-	806
Note discount	-	(19 )	-	6	-	(13 )
<b>Total debt</b>	<b>\$4,722</b>	<b>\$981</b>	<b>\$(1,552 )</b>	<b>\$ 33</b>	<b>\$(122 )</b>	<b>4,062</b>
Less contractual current portion						(1,377 )
Less RBC debt long term classified as current						(586 )
<b>Debt, net of current portion</b>						<b>\$2,099</b>

RBC Term Loan -- On June 4, 2012, Apex entered into the RBC Credit Agreement with RBC pursuant to which RBC made available certain credit facilities in the aggregate amount of up to CDN\$2,750,000, including a term facility ("RBC Term Loan") in the amount of CDN \$2,500,000 (US\$2,401,000 at the Closing Date). The RBC Term Loan accrues interest at Royal Bank Prime ("RBP") plus 4% (7% at December 31, 2012). Principal and interest is payable over a three year period at a fixed principal amount of CDN \$70,000 a month beginning in July 2012 and continuing through June 2015. Apex paid approximately \$120,000 in financing costs, which has been recorded as deferred financing costs or note discount in the accompanying unaudited condensed consolidated balance sheet as of September 30, 2013, and is being amortized to interest expense over the term of the loan.

In addition, the RBC Term Loan calls for mandatory repayments based on 20% of Apex's free cash flow as defined in the RBC Credit Agreement, before discretionary bonuses based on the annual year end audited financial statements of Apex, beginning with the fiscal year ended December 31, 2012, and payable within 30 days of the delivery of the annual audited financial statements, and continuing every six months through December 31, 2014. This amount is estimated to be \$0 at September 30, 2013 and December 31, 2012.

The RBC Term Loan has certain financial covenants and other non-financial covenants. As of June 30, 2013 and December 31, 2012, Apex was not in compliance with the Fixed Charge Coverage ratio covenant as defined in the RBC Credit Agreement. At June 30, 2013, Apex was not in compliance with the Maximum Funded Debt to EBITDA ratio covenant as defined in the RBC Credit Agreement. In March 2013, May 2013 and August 2013, the Company received waivers for non-compliance of these covenants at December 31, 2012, March 31, 2013 and June 30, 2013. On August 16, 2013 the RBC Credit Agreement was amended and certain financial covenants were modified. Pursuant to the amended credit agreement and commencing with the fiscal year ending December 31, 2013, the Company is required to maintain a fixed coverage ratio, calculated on a consolidated basis of not less than 1.15:1 with a step-up to 1.25:1 as of March 31, 2014, tested on a rolling four quarter basis thereafter and a ratio of funded debt to EBITDA, calculated on an annual consolidated basis of not greater than 3.0:1, tested on a rolling four quarter basis thereafter. As part of the revised financial covenants, covenant testing was waived by RBC for September 30, 2013. The Company does not believe that it will be in compliance with the reset covenants at December 31, 2013. Although the Company believes it is improbable RBC will exercise their rights up to, and including, acceleration of the outstanding debt, there can be no assurance that RBC will not exercise their rights pursuant to the provisions of the debt obligation. Accordingly, the Company has classified the term debt obligation as current at September 30, 2013.

Table of Contents

BDC Term Loan -- On June 4, 2012, Apex also entered into a loan agreement (the “BDC Loan Agreement”) with BDC Capital, Inc. (“BDC”), pursuant to which BDC made available to Apex a term credit facility (“BDC Term Loan”) in the aggregate amount of CDN \$1,700,000 (USD \$1,632,000 at the Closing Date). The BDC Term Loan initially accrued interest at the rate of 12% per annum, and matures on June 23, 2016, with an available one year extension for a fee of 2%, payable at the time of extension. On April 29, 2013, the BDC Term Loan was amended to accrue interest at the rate of 12.5% per annum. In addition to the interest payable, consecutive quarterly payments of CDN\$20,000 as additional interest are due beginning on June 23, 2012, and subject to compliance with bank covenants, Apex will make a mandatory annual principal payment in the form of a cash flow sweep which will be equal to 50% of the Excess Available Funds (as defined by the BDC Loan Agreement) before discretionary bonuses based on the annual year end audited financial statements of Apex. The maximum annual cash flow sweep in any year will be CDN\$425,000. As of December 31, 2012 and at September 30, 2013, the Company estimates that the cash sweep will be approximately \$0. Such payments will be applied to reduce the outstanding principal payment due on the maturity date. In the event that Apex’s annual audited financial statements are not received within 120 days of its fiscal year end, the full CDN\$425,000 becomes due and payable on the next payment date. Apex paid approximately \$70,000 in financing costs which has been recorded as deferred financing costs in the accompanying unaudited consolidated balance sheet as of September 30, 2013, and is being amortized to interest expense over the term of the loan.

The terms of the BDC loan agreement also provide for a fee to BDC in the event of the occurrence of any of the following:

- (a) if 50% or more of any company comprising Apex or the Company (consolidated assets or shares) is sold or merged with an unrelated entity; or
- (b) if there is a change of control of Apex and/or the Company prior to the Maturity Date or any extended maturity date of the BDC Term Loan,

In the event of (a) or (b) above, Apex will pay to BDC a bonus in an amount equal to 2% of the aggregate value of Apex and the Company determined as at the closing date of such transaction, which bonus shall become due and payable at the time of the closing of such transaction. Notwithstanding any prepayment of the BDC Term Loan, the bonus and Apex’s obligation to pay same to the BDC will remain in full force and effect until the maturity date or any amended or extended maturity date agreed by the BDC such that in the event of any sale, initial public offering or similar transaction, Apex’s obligation to pay the bonus amount to the BDC will survive such prepayment.

The BDC Loan Agreement contains certain financial and non-financial covenants. As of June 30, 2013 and December 31, 2012, Apex was not in compliance with the minimum working capital financial covenant. In March 2013, May 2013 and August 2013, the Company received waivers for non-compliance of these covenants at December 31, 2012, March 31, 2013 and June 30, 2013. On August 22, 2013, the BDC Term Loan was amended and certain financial covenants were modified. Pursuant to the amended loan agreement, the Company is required to maintain, for the duration of the investment, a term debt to equity ratio not exceeding 1.1:1 (measured annually); and an adjusted current ratio of 0.40:1 (measured annually) and revised yearly 120 days after each year end. We were in compliance with all of our BDC financial covenants as of September 30, 2013. We expect to continue to meet the requirements of our BDC financial covenants over the short and long term.

In the event either or both of the RBC Loan Agreement or the BDC Loan Agreement were deemed to be in default, RBC or BDC, as applicable, could, among other things (subject to the rights of SVB as the Company’s senior lender), terminate the facilities, demand immediate repayment of any outstanding amounts, and foreclose on our assets. Any such action would require us to curtail or cease operations, as the Company does not currently have alternative sources of financing.

SVB Term Loan - On December 31, 2010, pursuant to an Assumption and Amendment to Loan and Security Agreement ("Amended SVB Loan Agreement"), the Company borrowed \$3.0 million (the "SVB Term Loan") from Silicon Valley Bank ("SVB"). The SVB Term Loan was due in 36 equal monthly installments of principal plus interest beginning on February 1, 2011. The SVB Term Loan is secured by substantially all of the assets of the Company except for the assets of Apex. On May 20, 2011, pursuant to a Consent and Amendment to Loan and Security Agreement ("Amendment"), the maturity date was amended to April 30, 2012, with the remaining principal due on that date to be paid as a balloon payment. On September 27, 2011, the agreement was amended and certain covenants were replaced or modified resulting in the Company being in full compliance at September 30, 2011. The principal amount outstanding under the SVB Term Loan accrues interest at a fixed rate equal to 9% per annum. In addition, a final payment equal to 2% of the aggregate amount of the Term Loan is due on the earlier of the maturity date or the date the Term Loan is prepaid. This final payment of \$60,000 has been recorded as a discount to the SVB Term Loan, which is being amortized to interest expense through December 2013, using the effective interest method.

Table of Contents

The Amended SVB Loan Agreement includes various customary covenants, limitations and events of default. Financial covenants, among others, include liquidity and fixed charge coverage ratios, minimum tangible net worth requirements and limitations on indebtedness. As of December 31, 2012, the Company was in compliance with all of its financial covenants with SVB. As of May 31, 2013 and June 30, 2013, the Company was not in compliance with the Tangible Net Worth covenant as defined in the Amended SVB Loan Agreement. On August 16, 2013, the Company and SVB signed an agreement (“Forbearance Agreement”) where SVB agreed to temporarily forbear from exercising their rights and remedies under the facility until August 28, 2013 and agreed to waive the existing covenant violations if a gross capital raise of \$1.5 million is completed by such date. The Company completed the capital raise and was able to achieve compliance with the forbearance agreement prior to August 28, 2013. As of September 30, 2013, the Company was in compliance with the Tangible Net Worth financial covenant and had available a \$0.3 million cushion over the requirement. In November 2013, the Company entered into a definitive subscription agreement with accredited investors for the sale of Series E Preferred Stock, raising \$3.8 million in gross proceeds (See Note 13). Given the effect of the capital raise (\$3.8 million in gross proceeds, net of \$400,000 in costs) closed to date in November, the Company believes that at the time of this filing it is compliant with the terms and provisions of its SVB lending agreement and expects to continue to meet the requirements of our SVB financial covenants over the short and long term. The Company is in currently discussions with SVB regarding the Tangible Net Worth covenant and a reduction of the 50% of additional capital raised to 25% of capital raised in November 2013. See further discussion regarding this matter at Note 7.

On September 27, 2011, pursuant to a Limited Waiver and Amendment to Loan and Security Agreement, the Loan Agreement was amended.

On February 27, 2013, the Company entered into an amended the Loan and Security Agreement which provided an additional term loan of \$1,000,000. The new term loan is due in 36 monthly installments of principal plus accrued interest beginning on April 1, 2013. The additional term loan accrues interest at 7.5% per annum.

For the nine months ended September 30, 2013 and 2012, the Company’s interest expense on the term debt, including amortization of deferred financing costs, was approximately \$439,000 and \$331,000, respectively.

In the event either or both RBC Loan Agreement and/or the BDC Loan Agreement were deemed to be in default, then the Amended SVB Loan agreement would be in default, which could, among other things, terminate the facility and term loan, demand immediate repayment of any outstanding amounts, and foreclose on our assets. Any such action would require us to curtail or cease operations, as the Company does not currently have alternative sources of financing.

**NOTE 9 – STOCKHOLDERS’ EQUITY**

The Company is authorized to issue two classes of stock designated as common stock and preferred stock. As of September 30, 2013, the Company is authorized to issue 110,000,000 total shares of stock. Of that amount, 100,000,000 shares are common stock, each having a par value of \$0.001. The remaining 10,000,000 shares are preferred stock, each having a par value of \$0.001, of which 500,000 shares are designated as Series A Preferred Stock, of which 269,608 are issued and outstanding, 500,000 shares are designated as Series B Preferred Stock, of which 131,347 are issued and outstanding, 5,000,000 shares are designated as Series C Preferred Stock, of which 0 shares are issued and outstanding and, 4,000,000 shares are designated as Series D Preferred Stock, of which 704,200 shares are issued and outstanding.



Table of Contents

## (a) Cumulative Convertible Preferred Stock

A summary of preferred stock outstanding as of September 30, 2013 is as follows (in thousands, except share data):

## Description

Series A Preferred, \$0.001 par value per share, 500,000 shares designated, 269,608 shares issued and outstanding, liquidation preference of \$975 plus cumulative dividends of \$344	\$1,319
Series B Preferred, \$0.001 par value per share, 500,000 shares designated, 131,347 shares issued and outstanding, liquidation preference of \$380 plus cumulative dividends of \$85	465
Series D Preferred, \$0.001 par value per share, 4,000,000 shares designated, 704,200 shares issued and outstanding, liquidation preference of \$7,042 (net of \$1,374 in issuance costs) plus imputed dividends of \$157	5,825
<b>Total convertible preferred stock</b>	<b>\$7,609</b>

## Series A Preferred Stock and Series B Preferred Stock

The holders of the Series A and Series B Preferred Stock shall be entitled to receive, when, as, and if declared by the Board of Directors, dividends at an annual rate of 8% of the stated value. The stated value of the Series A Preferred is \$4.00 per share and the stated value of the Series B Preferred is \$3.20 per share. Dividends shall be cumulative and shall accrue on each share of the outstanding preferred stock from the date of its issue.

The holders of the Series A and Series B Preferred Stock have no voting rights except on matters affecting their rights or preferences. Subject to the rights of the Series D Preferred Stock, upon any liquidation, dissolution or winding-up of the Company, the holders of the Series A (subject to the rights of the Series B Preferred) and Series B Preferred Stock shall be entitled to receive an amount equal to the stated value per share of \$4.00 and \$3.20, respectively, plus any accrued and unpaid dividends before any payments shall be made to the holders of any common stock or hereinafter issued preferred stock. The Series A Preferred Stock has preference over the Series B Preferred Stock in liquidation.

Each share of Series A Preferred Stock is convertible, at the option of the holder, at a conversion price of \$4.00 per share. Each share of Series B Preferred Stock is convertible, at the option of the holder, at a conversion price of \$3.20 per share.

## Series C Preferred Stock

On December 20, 2012, the Company redeemed all issued and outstanding shares of Series C Preferred Stock using the proceeds generated from the sale of the Series D Preferred Stock.

## Series D Preferred Stock

The Series D Preferred Stock has a Stated Value of \$10.00 per share, votes on an as-converted basis with the common stock, and is convertible, at the option of the holder, into such number of shares of our common stock equal to the number of shares of Series D Preferred Stock to be converted, multiplied by the Stated Value, divided by the Conversion Price in effect at the time of the conversion. The initial Conversion Price is \$1.00, subject to adjustment in

the event of stock splits, stock dividends and similar transactions, and in the event of subsequent equity sales at a lower price per share, subject to certain exceptions. As a result of the subsequent sales of common stock on August 15, 2013 and August 21, 2013 (see Note 9(b)), the Conversion Price of the Series D Preferred Stock was reduced to \$0.90. The Series D Preferred Stock entitles the holder to cumulative dividends, payable quarterly, at an annual rate of (i) 8% of the Stated Value during the three year period commencing on the date of issue, and (ii) 12% of the Stated Value commencing three years after the date of issue. We may, at the Company's option, pay dividends in PIK Shares, in which event the applicable dividend rate will be 12% and the number of such PIK Shares issuable will be equal to the aggregate dividend payable divided by the lesser of (x) the then effective Conversion Price or (y) the average volume weighted average price of the Company's common stock for the five prior consecutive trading days. On October 15, 2013, the Company paid a cash dividend of \$142,000 on the Series D preferred Stock for the period from July 1, 2013 to September 30, 2013.

Upon any liquidation, dissolution or winding-up of our Company, holders of Series D Preferred Stock will be entitled to receive, for each share of Series D Preferred Stock, an amount equal to the Stated Value of \$10.00 per share plus any accrued but unpaid dividends thereon before any distribution or payment may be made to the holders of any common stock, Series A Preferred Stock, Series B Preferred Stock, or subsequently issued preferred stock.

Table of Contents

In addition, commencing on the trading day on which the closing price of the common stock is greater than \$2.00 for thirty consecutive trading days with a minimum average daily trading volume of at least 5,000 shares for such period, and at any time thereafter, the Company may, in its sole discretion, effect the conversion of all of the outstanding shares of Series D Preferred Stock to common stock (subject to the condition that, all of the shares issuable upon such conversion may be re-sold without limitation under an effective registration statement or pursuant to Rule 144 under the Securities Act).

The Series D Preferred Stock holders also were granted registration rights which required the Company to file a registration statement with the SEC within 60 days of the final closing date (December 31, 2012), and to have the registration statement declared effective within 90 days thereafter. The initial registration statement was filed on February 12, 2013. Failure of the registration statement to be declared effective by May 12, 2013, resulted in a partial liquidated damage equal to 0.1% of the purchase price paid by each investor to become payable on each monthly anniversary until the registration statement was declared effective. On July 30, 2013, the registration statement was declared effective by the U.S. Securities and Exchange Commission. On October 15, 2013, the Company paid liquidated damages of \$18,000.

Pursuant to the Series D Certificate of Designation, commencing two years from the termination or expiration of the offering of the Series D Preferred Stock (which termination occurred on December 31, 2012), and at any time thereafter, the Company in its sole discretion may redeem all of the outstanding shares of Series D Preferred Stock at a purchase price of \$10.00 per share plus any accrued but unpaid dividends.

(b) Common Stock

For the nine months ended September 30, 2013

On August 15, 2013, the Company entered into a Purchase Agreement with multiple accredited investors relating to the issuance and sale of Common Stock in a private offering. On August 15, 2013, the initial closing date (the "Initial Closing") of the Purchase Agreement, we sold (i) an aggregate of 2,594,000 shares of our Common Stock for \$0.60 per share and (ii) Common Stock Purchase Warrants (the "Investor Warrants") for the purchase of an aggregate of 1,297,000 shares for aggregate gross proceeds of \$1,556,400. The Investor Warrants have a five-year term, an exercise price of \$1.00 and contain certain provisions for anti-dilution and price adjustments in the event of a future offering.

On August 21, 2013, the final closing date (the "Final Closing") of the Purchase Agreement, we sold (i) an aggregate of 333,333 shares of our Common Stock for \$0.60 per share and (ii) 166,667 Investor Warrants for aggregate gross proceeds of \$200,000.

For a period commencing on the Initial Closing and terminating on a date which is 24 months from the Initial Closing, in the event the Company issues or grants any shares of Common Stock or securities convertible, exchangeable or exercisable for shares of Common Stock pursuant to which shares of Common Stock may be acquired at a price less than \$0.60 per share, then the Company shall promptly issue additional shares of Common Stock to the investors under the Purchase Agreement in an amount sufficient that the subscription price paid, when divided by the total number of shares issued (shares purchased under the Purchase Agreement plus the additional shares issued under this provision), will result in an actual price paid by the Subscriber per share of Common Stock equal to such lower price.

If the Company at any time while the Investor Warrants are outstanding, shall sell or grant an option to purchase, or sell or grant any right to reprice, or otherwise dispose of or issue any common stock or securities convertible, exchangeable or exercisable for shares of common stock (as, at an effective price per share less than the exercise price of the Investor Warrants then in effect, the exercise price of the Investor Warrants will be reduced to equal to such

lower price

Pursuant to the terms in the Purchase Agreement, on September 23, 2013, the Company filed a Registration Statement on Form S-1 (the "Form S-1") for the registration of the 2,927,333 shares of Common Stock and the 1,463,667 shares issuable upon exercise of the Investor Warrants sold under the Purchase Agreement. On October 4, 2013, the Form S-1 was declared effective by the SEC.

The Company paid the placement agent \$175,600 in commissions (equal to 10% of the gross proceeds), and issued to the placement agent five-year warrants (the "Placement Agent Warrants") to purchase 292,733 shares of our common stock (equal to 10% of the number of shares of common stock sold under the Purchase Agreement). The Placement Agent Warrants have a five-year term, an exercise price of \$0.60 and contain provisions for anti-dilution and price adjustments in the event of a future offering.

If the Company at any time while the Placement Agent Warrants are outstanding, shall sell or grant an option to purchase, or sell or grant any right to reprice, or otherwise dispose of or issue any common stock or securities convertible, exchangeable or exercisable for shares of common stock, at an effective price per share less than the exercise price of the Placement Agent Warrants then in effect, the exercise price of the Placement Agent Warrants will be reduced to equal to such lower price.

Table of Contents

The Company recorded the Investor Warrants and Placement Agent Warrants as a liability (see further disclosure at Note 3). Accordingly, the net proceeds raised (\$1.7 million in gross offering proceeds, net of \$0.2 million in cost), were allocated to the fair value of the warrant liability of \$1.1 million and the remainder was recorded as equity (\$0.4 million).

On April 26, 2013, the Company issued 70,207 shares of its common stock to 3 employees as part of a specified portion of their regular annual cash bonus.

For the year ended December 31, 2012

On June 4, 2012, the Company issued 325,000 shares of its common stock as consideration for acquisition related expenses in conjunction with the Apex transaction. The shares were valued at \$341,000 and were recorded as part of selling, general and administrative expenses in the consolidated statement of operations and comprehensive loss as of December 31, 2012. (Note 5)

On July 31, 2012, pursuant to the Asset Purchase Agreement with MacroSolve, the Company issued 617,284 shares of its common stock to purchase the business of Illume Mobile, a division of MacroSolve. The shares were valued at \$698,000 and were recorded as part of the purchase price. (Note 5)

On November 15, 2012, the Company entered into an agreement (the “Sigma Agreement”) with Sigma Opportunity Fund II, LLC (“Sigma Opportunity Fund”) and Sigma Capital Advisors, LLC (“Sigma Advisors”). Pursuant to the Sigma Agreement, the Company issued to the holders of the Series C Preferred Stock an aggregate of 175,364 shares of common stock as an anti-dilution adjustment.

(c) Warrants

For the nine months ended September 30, 2013

During the nine months ended September 30, 2013, the Company issued 1,463,667 Investor Warrants and 292,733 Placement Agent Warrants as discussed above. The exercise price of the Investor Warrants and the Placement Agent Warrants will be adjusted in the event of future issuances of the Company’s Common Stock at prices below the exercise price then in effect (“down-round” protection). The Company evaluated the following guidance ASC 480-10 Distinguishing Liabilities from Equity and ASC 815-40 Contracts in an Entity’s Own Equity. Based on this guidance, the Company’s management concluded these instruments are to be accounted for as liabilities instead of equity due to the down-round protection feature available on the exercise price of the Warrants. The Company recognized these Warrants as liabilities at their fair value and will re-measure them at fair value on each reporting date. ASC 820 Fair Value Measurement provides requirements for disclosure of liabilities that are measured at fair value on a recurring basis in periods subsequent to the initial recognition (see Note 2). Fair values for warrants are determined using the Monte-Carlo Simulation Model valuation technique. The Monte-Carlo Simulation Model valuation model provides for dynamic assumptions regarding volatility and risk-free interest rates within the total period to expected conversion. In addition, management assessed the probabilities of future financing assumptions.

As of August 15, 2013 and August 21, 2013, the dates of issuance, we recorded the warrant liability at \$1,099,000. At September 30, 2013, the warrants were re-valued with a fair value of \$933,000 with the difference of \$166,000 recorded to other income in the unaudited condensed consolidated statement of operations and comprehensive loss.

The following table summarizes information about the Company’s outstanding common stock warrants as of September 30, 2013:

Edgar Filing: DecisionPoint Systems, Inc. - Form 10-Q

	Date		Strike	Total Warrants Outstanding and Exercisable	Total Exercise Price	Weighted Average Exercise Price
	Issued	Expiration	Price			
Senior Subordinated Notes	Dec-09	Dec-14	\$ 3.62	138,260	\$ 500,000	
Senior Subordinated Notes	Dec-09	Dec-14	4.34	138,260	600,000	
Placement Agent Preferred Stock - Class D	Dec-12	Dec-17	1.10	704,200	774,620	
Common Stock Investor Warrants	Aug-13	Aug-18	1.00	1,297,000	1,297,000	
Common Stock Investor Warrants	Aug-13	Aug-18	1.00	166,667	166,667	
Placement Agent Warrants - Common Stock	Aug-13	Aug-18	0.60	292,733	175,640	
				2,737,120	\$ 3,513,927	\$1.28

Table of Contents

## NOTE 10 – ESOP PLAN

The Company has an Employee Stock Ownership Plan (the “ESOP”) which covers all non-union employees. The Company’s contribution expense for the nine months ended September 30, 2013, was \$134,000 representing approximately \$104,000 for the ESOP principal payment and \$30,000 for the ESOP interest. ESOP shares are allocated to individual employee accounts as the loan obligation of the ESOP to the Company is reduced. These amounts were previously calculated on an annual basis by an outside, independent financial advisor. Compensation costs relating to shares released are based on the fair value of shares at the time they are committed to be released. The unreleased shares are not considered outstanding in the computation of earnings per common share. ESOP compensation expense consisting of both cash contributions and shares committed to be released for the nine months ended September 30, 2013 was approximately \$78,000. The fair value of the shares was \$0.94 per share, based on the average of the daily market closing share price.

## NOTE 11 - STOCK OPTION PLAN

In December 2010, the Company established the 2010 Stock Option Plan (the “Plan”). The Plan authorizes the issuance of 1,000,000 shares of common stock. Pursuant to the terms of the Merger Agreement, the Company assumed all of Old DecisionPoint’s obligations under their outstanding stock option plans.

The Plan is administered by the Board of Directors, or a committee appointed by the Board of Directors, which determines recipients and types of awards to be granted, including the number of shares subject to the awards, the exercise price and the vesting schedule. The term of stock options granted under the Plans cannot exceed ten years. Options shall not have an exercise price less than 100% of the fair market value of the Company’s common stock on the grant date, and generally vest over a period of five years. If the individual possesses more than 10% of the combined voting power of all classes of stock of the Company, the exercise price shall not be less than 110% of the fair market of a share of common stock on the date of grant.

A summary of the status of the Plans as of September 30, 2013, and information with respect to the changes in options outstanding is as follows:

	Options Available for Grant	Options Outstanding	Weighted - Average Exercise Price	Aggregate Intrinsic Value
December 31, 2012	455,495	544,505	\$1.82	\$-
Granted	-	-	-	-
Exercised	-	-	-	-
Forfeited	-	-	-	-
September 30, 2013	455,495	544,505	\$1.82	\$-
Exercisable options at September 30, 2013		446,374	\$1.75	\$-

The following table summarizes information about stock options outstanding as of September 30, 2013:

Range of	Options Outstanding		Options Exercisable	
	Weighted-Average Remaining	Weighted-Average	Weighted-Average Remaining	Weighted-Average

Edgar Filing: DecisionPoint Systems, Inc. - Form 10-Q

Exercise Prices	Number Outstanding	Contractual Life (Years)	Exercise Price	Number Exercisable	Contractual Life (Years)	Exercise Price
1.33 - \$2.03	365,620	1.58	\$1.65	355,461	1.53	\$1.64
2.06 - \$4.34	178,885	7.60	2.16	90,913	7.54	2.16
Total	544,505	3.56	\$1.82	446,374	2.76	\$1.75

No awards were exercised during the nine months ended September 30, 2013 and 2012, respectively. The total fair value of awards vested for the nine months ended September 30, 2013 and 2012 was \$40,000 and \$73,000, respectively.



Table of Contents

Stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the required service period, which is generally equal to the vesting period. There were no stock option grants during the nine months ended September 30, 2013 and 2012.

Due to the limited time that the Company's common stock has been publicly traded, management estimates expected volatility based on the average expected volatilities of a sampling of five companies with similar attributes to the Company, including: industry, size and financial leverage. The expected term of the awards represents the period of time that the awards are expected to be outstanding. Management considered expectations for the future to estimate employee exercise and post-vest termination behavior. The Company does not intend to pay dividends in the foreseeable future, and therefore has assumed a dividend yield of zero. The risk-free interest rate is the yield on zero-coupon U.S. Treasury securities for a period that is commensurate with the expected term of the awards.

Employee stock-based compensation costs for the nine months ended September 30, 2013 and 2012, was \$31,000 and \$50,000, respectively, and is included in selling, general and administrative expense in the accompanying unaudited condensed consolidated statements of operations. As of September 30, 2013, total unrecognized estimated employee compensation cost related to stock options granted prior to that date was \$109,000 which is expected to be recognized over a weighted-average vesting period of 2.69 years.

NOTE 12 – COMMITMENTS AND CONTINGENCIES

Leases - The Company leases its facilities and certain equipment under various operating leases which expire at various dates through fiscal 2018 and require us to pay a portion of the related operating expenses such as maintenance, property taxes, and insurance. There have been no material changes to our lease arrangements during the nine months ended September 30, 2013. Please refer to Note 14 to the audited consolidated financial statements for the year ended December 31, 2012, included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 28, 2013.

Rent expense for the nine months ended September 30, 2013 and 2012, was \$511,000 and \$353,000, respectively.

Apex Earn Out Obligations - If EBITDA (as uniquely defined in the agreement), of Apex for the twelve months ending July 31, 2013 ("2013 EBITDA"), is equal to or less than CDN\$2,000,000, Apex shall pay an amount, to its former owners, equal to the product of the 2013 EBITDA multiplied by four less CDN\$5,000,000 ("2013 EBITDA Basic Earn-Out Amount"), up to a maximum of CDN\$3,000,000. An amount equal to 22.22% of the 2013 EBITDA Basic Earn-Out Amount shall be paid in cash and the balance shall be paid by Apex issuing a subordinated convertible note (the "Note") (see Note 5).

Under the terms of the Note, Apex will pay the principal sum due on the Note in eight quarterly payments beginning on January 31, 2014 ("Installment Dates"). Interest from and after August 1, 2013, shall be paid in arrears on the last day of each calendar quarter commencing on January 31, 2014. The interest rate shall be determined as follows:

- (i) 9% per annum, calculated and compounded quarterly before November 1, 2014; and
- (ii) 11% per annum, calculated and compounded quarterly after October 31, 2014;
- (iii) except, however, that, if, during the term of the Note, the Company raises Net Equity Capital (as defined in the Note) in an amount greater than CDN\$5,000,000 and this Note is not repaid in full within 30 days from the date that the Company receives such Net Equity Capital, the interest rate otherwise provided in the Note shall be 15% per annum from the end of such 30-day period to the first anniversary thereof and 20% per annum thereafter to

the date of payment in full.

The Note is convertible, only on each Installment Date, at the option of the Note holder, into shares of our common stock at a conversion price that is equal to the greater of the market price of our common stock on the day prior to the conversion, or \$1.00. The shares issuable under the Note will be restricted but will have certain piggy back registration rights as set forth in the Purchase Agreement.

If the 2013 EBITDA is greater than CDN\$2,000,000, Apex shall pay an amount, to its former owners, (the “2013 EBITDA Additional Earn-Out Amount”) by which the dollar-for-dollar 2013 EBITDA exceeds CDN\$2,000,000, up to a maximum of CDN\$500,000. The 2013 EBITDA Additional Earn-Out shall be paid by the issuance of shares of the Company’s common stock. The number of shares to be issued shall be determined by the amount due divided by the 30 day average daily closing price of the shares of the Company’s common stock in the month of July 2013. The shares issued will be restricted but will have certain piggy back registration rights as set forth in the Purchase Agreement.

Table of Contents

The fair value of the earn out was calculated to be approximately CDN\$1,076,000 (US\$1,033,000 at the Closing Date). At September 30, 2013, the calculated Earn Out Payment due under the Purchase Agreement was CDN\$341,000 (US\$331,000). Accordingly, there is CDN\$341,000 (US\$331,000) recorded as potential additional purchase consideration in the unaudited condensed consolidated financial statements. The adjustment of CDN\$735,000 (US\$713,000) was recorded as a separate component of operating expenses in the unaudited condensed consolidated statement of operations and comprehensive loss as of September 30, 2013. On October 31, 2013 the Sellers disputed the Company's calculation of the Earn Out Payment due and has stated the payment should be \$1.6 million. Per the terms of the Purchase Agreement, the seller and the Company have ten business days to reconcile any differences in the calculation of the Earn Out Payment. The ten business days concludes on November 14, 2013. If a reconciliation cannot be completed in that time period, the Company and the seller will refer the matter to a mutually agreed upon accounting firm to conclude the accuracy of the Earn Out Payment. The accounting firm will have 45 calendar days to review the seller and the Company's calculation of the Earn Out Payment, which will conclude on December 31, 2013.

The Company also entered into an employment agreement with Donald Dalicandro, the Former Chief Executive Officer of Apex, as a result of the Apex acquisition. Under the employment agreement, the Company further agreed Mr. Dalicandro would be appointed to the Company's board of directors effective June 4, 2012, and would not be removed from the Company's board of directors during the Earn-Out Period (as defined in the employment agreement) and the Bonus Period (as defined in the employment agreement) except by death, bankruptcy, incapacity or voluntary resignation. The agreement calls for annual bonus upon achieving certain results of operation at Apex for the 12 months ending July 31, 2013, 2014, and 2015. Such bonuses are considered additional contingent purchase consideration as the Company is obligated to pay the bonus regardless of whether or not his employment is retained (see Note 5).

As part of the Purchase Agreement, we are obligated to pay bonus consideration to the CEO of Apex. Such bonus is considered additional contingent purchase consideration as we are obligated to pay the bonus regardless of whether or not the CEO's employment is retained. The fair value of the bonus was calculated to be approximately CDN\$160,000 (US\$153,000 at the Closing Date). At September 30, 2013 there is CDN\$160,000 (US\$154,000) recorded in accrued earn out consideration in the Company's unaudited condensed consolidated balance sheets.

Apex Escrow Obligation - As part of the Apex Purchase Agreement, from the Closing Date up until the expiry of the bonus period, the Company is obligated to escrow 25% of any Equity Capital raised in excess of \$500,000. The funds in the escrow are to be used to pay the 2013 EBITDA Basic Earn-Out and the 2013 EBITDA Additional Earn-Out and the additional bonus consideration. In December 2012, the Company raised \$7,042,000 as part of the Series D Purchase Agreement. These funds have not been placed into escrow pending agreement between the Company and the sellers of Apex regarding the financial institution that will escrow the funds, the amount of funds that are to be placed in escrow and the terms of the escrow agreement itself.

Contingencies - The Company is not a party to any material pending legal proceedings other than ordinary routine litigation incidental to the business; the outcome of which the Company believes will not have a material adverse effect on the business, financial condition, cash flows or results of operations. These matters are subject to inherent uncertainties and management's view of these matters may change in the future.

The Company is subject to the possibility of various loss contingencies, including claims, suits and complaints, arising in the ordinary course of business. The Company considers the likelihood of loss or impairment of an asset or the incurrance of a liability, as well as its ability to reasonably estimate the amount of loss, in determining loss contingencies. An estimated loss contingency is accrued when it is probable that an asset has been impaired or a liability has been incurred and the amount of loss can be reasonably estimated. The Company regularly evaluates current information available to it to determine whether such accruals should be adjusted and whether new accruals

are required.

Under the Company's bylaws, directors and officers have certain rights to indemnification by the Company against certain liabilities that may arise by reason of their status or service as directors or officers. The Company maintains director and officer insurance, which covers certain liabilities arising from the obligation to indemnify directors and officers and former directors in certain circumstances. No material indemnification liabilities were accrued at September 30, 2013.

The Company is party to employment agreements with certain of its key executive officers as of September 30, 2013. The agreements do not provide for any material, out of ordinary course of business provisions or benefits.

Included in the key executive officer agreements is an employment agreement with its Chief Operating Officer. Pursuant to the agreement, the officer is entitled to an annual bonus calculated pursuant to terms set forth in the agreement. The agreement also contains a severance provision providing up to twelve months of salary in certain situations.

#### NOTE 13 – SUBSEQUENT EVENT

In November 2013, the Company entered into definitive subscription agreements (“Series E Purchase Agreement”) with accredited investors for the sales of \$3,835,000 in gross proceeds for 383,500 shares of Series E Convertible Preferred Stock (“Series E Preferred Shares”) for a purchase price of \$10.00 per share. The initial Conversion Price is \$0.50, subject to adjustment in the event of stock splits, stock dividends and similar transactions, and in the event of subsequent equity sales at a lower price per share, subject to certain exceptions. The Company received net proceeds of approximately \$3.4 million (net of the fair value of placement agent warrants) from the initial closing, after deducting the placement agent's fees of 8% and other offering expenses. The Company paid the Placement Agent \$306,800 in commissions (equal to 8% of the gross proceeds), and issued to the Placement Agent five-year warrants to purchase 767,000 shares of our common stock (equal to 10% of the number of shares of common stock underlying the Series E Preferred Shares sold under the Series E Purchase Agreement) at an exercise price of \$0.55 per share, in connection with the Series E Purchase Agreement initial closing. The Company expects to close a second round of Series E Preferred Shares with gross proceeds of \$300,000-\$700,000 shortly thereafter.

The Series D Preferred Stock's initial Conversion Price was \$1.00, subject to adjustment in the event of stock splits, stock dividends and similar transactions, and in the event of subsequent equity sales at a lower price per share, subject to certain exceptions. As a result of the issuance of Common Stock in connection with the August 15, 2013 private placement (see Note 9(b)), the Conversion Price of the Series D Preferred Stock was reduced to \$0.90. As a result of the sale of Series E Preferred Shares described above, the Conversion Price of the Series D Preferred Stock was further reduced to \$0.75 per share on November 12, 2013. The Company expects a second closing of Series E Preferred shortly after November 12, 2013 of approximately \$300,000- \$700,000. If the second closing is for \$700,000 the revised conversion price would be reduced to \$0.73 per share. The Series D Preferred Stock contained certain anti-dilution provisions whereby the subsequent sale of Series E Preferred Shares may potentially create an imputed dividend that would impact EPS.

On August 15, 2013, the Company entered into a Purchase Agreement with multiple accredited investors relating to the issuance and sale of Common Stock in a private offering (see Note 9(b)). For a period commencing on the Initial Closing and terminating on a date which is 24 months from the Initial Closing, in the event the Company issues or grants any shares of Common Stock or securities convertible, exchangeable or exercisable for shares of Common Stock pursuant to which shares of Common Stock may be acquired at a price less than \$0.60 per share, then the Company shall promptly issue additional shares of Common Stock to the investors under the Purchase Agreement in an amount sufficient that the subscription price paid, when divided by the total number of shares issued (shares purchased under the Purchase Agreement plus the additional shares issued under this provision), will result in an actual price paid by the Subscriber per share of Common Stock equal to such lower price. As a result of the sale of

Series E Preferred Shares described above, the Company is required to issue up to 585,467 additional common shares to the subscribers in the private offering,

The conversion price of the Investor Warrants issued in connection with the August 15, 2013 private placement was \$1.00 per share. If the Company at any time while the Investor Warrants are outstanding, shall sell or grant an option to purchase, or sell or grant any right to reprice, or otherwise dispose of or issue any common stock or securities convertible, exchangeable or exercisable for shares of common stock (as, at an effective price per share less than the exercise price of the Investor Warrants then in effect, the exercise price of the Investor Warrants will be reduced to equal to such lower price. As a result of the sale of Series E Preferred Shares described above, the conversion price of the Investor Warrants was reduced to \$0.50 per share on November 12, 2013.

The conversion price of the Placement Agent Warrants issued in connection with the August 15, 2013 private placement was \$0.60 per share. If the Company at any time while the Placement Agent Warrants are outstanding, shall sell or grant an option to purchase, or sell or grant any right to reprice, or otherwise dispose of or issue any common stock or securities convertible, exchangeable or exercisable for shares of common stock (as, at an effective price per share less than the exercise price of the Placement Agent Warrants then in effect, the exercise price of the Placement Agent Warrants will be reduced to equal to such lower price. As a result of the sale of Series E Preferred Shares described above, the conversion price of the Placement Agent Warrants was reduced to \$0.50 per share on November 12, 2013.

Table of Contents

ITEM 2.MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward Looking Statements

Some of the statements contained in this Form 10-Q that are not historical facts are "forward-looking statements" which can be identified by the use of terminology such as "estimates," "projects," "plans," "believes," "expects," "anticipates," "intends," or the negative or other variations, or by discussions of strategy that involve risks and uncertainties. We urge you to be cautious of the forward-looking statements, that such statements, which are contained in this Form 10-Q, reflect our current beliefs with respect to future events and involve known and unknown risks, uncertainties and other factors affecting our operations, market growth, services, products and licenses. No assurances can be given regarding the achievement of future results, as actual results may differ materially as a result of the risks we face, and actual events may differ from the assumptions underlying the statements that have been made regarding anticipated events. Factors that may cause actual results, our performance or achievements, or industry results, to differ materially from those contemplated by such forward-looking statements include, without limitation:

- Our ability to raise capital when needed and on acceptable terms and conditions;
- Our ability to manage the growth of our business through internal growth and acquisitions;
- The intensity of competition;
- General economic conditions and,
- Our ability to attract and retain management, and to integrate and maintain technical information and management information systems.

All written and oral forward-looking statements made in connection with this Form 10-Q are attributable to us or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. Given the uncertainties that surround such statements, you are cautioned not to place undue reliance on such forward-looking statements. Except as may be required under applicable securities laws, we undertake no obligation to publicly update or revise any forward-looking statements whether as a result more information, future events or occurrences.

Overview

DecisionPoint enables our clients to “move decisions closer to the customer” by “empowering the mobile worker”. We define the mobile worker as those individuals that are on the front line in direct contact with customers. These workers include field repair technicians, sales associates, couriers, public safety employees and millions of other workers that deliver goods and or services throughout the country. Whether they are blue or white collar, mobile workers have many characteristics in common. Mobile workers need information, access to corporate resources, decision support tools and the ability to capture and report information back to the organization.

DecisionPoint empowers these mobile workers through the implementation of various mobile technologies including specialized mobile business applications, wireless networks, mobile computers (for example, rugged, tablets, and smartphones) and a comprehensive suite of consulting, integration, deployment and support services.

Mobile computing capabilities and usage continue to grow. With choice comes complexity so helping our customers navigate the myriad of options is what we do best. The right choice may be an off-the-shelf application or a custom business application to fit a very specific business process. DecisionPoint has the specialized resources and support structure to address the needs of mobile applications in the retail, transportation, field workforce sales/service and the warehousing market segments. We continue to invest in building out our capabilities to support these markets and business needs. For example, in July 2012, we invested in the expansion of our custom software development capabilities through the acquisition of Illume Mobile in Tulsa, OK, which specializes in the custom development of

specialized mobile business applications for Apple, Android and Windows Mobile devices. Additionally, through the acquisition of Illume Mobile we acquired a cloud-based, horizontal software application “ContentSentral” which manages and distributes multiple types of corporate content (for example, PDF, video, images, and spreadsheets) on mobile tablets used by field workers. We also dramatically increased our software products expertise with the acquisition in June 2012 of APEX in Canada. The APEXWare™ software suite significantly expanded our field sales/service software offerings. APEXWare™ is a purpose-built mobile application suite ideally suited to the automation of field sales/service and warehouse workers. Additionally, we continue to expand our deployment and MobileCare support offerings. In 2012 we moved our headquarters location to a larger facility in Irvine, CA in order to accommodate the expansion of our express depot and technical support organizations. We also continue to invest in our “MobileCare EMM” enterprise mobility management offering. In 2008, we recognized the need for customers to outsource their mobile device management (“MDM”) needs, thus we invested in building out a MDM practice that offers these services under a comprehensive managed service model. We have extended this offering from our historically ruggedized mobile computer customer base to address the growth of consumer devices in the enterprise and support the Bring Your Own Device (BYOD) and Bring Your Own Application (BYOA) movement.

## Table of Contents

Recognizing that we cannot build every business application, we have developed an ‘ecosystem’ of partners which support our custom and off-the-shelf solutions. These partners include suppliers of mobile devices (Apple, Intermec, Motorola, among others), wireless carriers (AT&T, Sprint, T-Mobile, Verizon), mobile peripheral manufacturers (Zebra Technologies Corporation, Datamax - O’Neil), in addition to a host of specialized independent software vendors such as AirWatch, VeriFone GlobalBay, XRS and Wavelink.

We are focused on several commercial enterprise markets. These include retail, field sales/service, warehousing and distribution and transportation. With the continued growth of the mobile internet, we expect to see growth in our current markets in addition to the emergence of new markets. In order to identify these new markets we recently created a new internal organization whose sole purpose is to identify and nurture new market opportunities. We expect our customers to continue to embrace and deploy new technology to better enhance their own customers’ experiences and improve their own operations while lowering their operating costs. Our expertise and understanding of our customers’ operations and business operations in general, coupled with our expertise and understanding of mobile technology equipment and software offerings enables us to identify new trends and opportunities and provide these new solutions to our existing and potential customers.

At DecisionPoint, we deliver to our customers the ability to make better, faster and more accurate business decisions by implementing industry-specific, enterprise wireless and mobile computing systems for their front-line mobile workers, inside and outside of the traditional workplace. It is these systems that provide the information to improve the hundreds of individual business decisions made each day. Historically, critical information has remained locked away in the organization’s enterprise computing systems, accessible only when employees were at their desks. Our solutions unlock this information and deliver it to employees when needed regardless of their location. As a result, our customers are able to move their business decision points closer to their customers which we believe in turn improves customer service levels, reduces cost and accelerates business growth.

We have several offices throughout North America which allows us to serve our multi-location clients and their mobile workforces. We provide depot services through our West and East coast facilities. Additionally, we are always keenly aware of potential acquisition candidates that can provide complementary products and service offerings to our customer base.

### Business Combinations

#### Illume Mobile Acquisition

On July 31, 2012 (“Illume Closing Date”), we consummated an asset purchase agreement (“Asset Purchase Agreement”) with MacroSolve, Inc. Pursuant to the Asset Purchase Agreement, we purchased the business (including substantially all the related assets) of the seller’s Illume Mobile division (“Illume Mobile”), based in Tulsa, Oklahoma.

Founded in 1996, Illume Mobile is a mobile business solutions provider that services mobile products and platforms. Illume Mobile’s initial core business is the development and integration of business applications for mobile environments. Today, Illume Mobile serves the mobile application development needs of a wide range of customers, from Fortune 500s to small and medium-sized businesses. It delivers advanced, mobile apps for many device platforms including iPad, iPhone and Android with functionality including 3D animation, mobile video, augmented reality, GPS, and more. Illume Mobile seeks to leverage its combination of creativity, technical savvy, years of mobile experience, and market insight to enable customers to envision their mobile applications and bring them to reality, providing the most value in the shortest amount of time.

#### Apex Systems Integrators Acquisition



On June 4, 2012 (“Closing Date”), pursuant to a Stock Purchase Agreement (“Purchase Agreement”), we acquired all of the issued and outstanding shares of Apex Systems Integrators Inc. (“Apex”), a corporation organized under the laws of the Province of Ontario, Canada. Apex is a provider of wireless mobile work force software solutions. Its suite of products utilizes the latest technologies to empower the mobile worker in many areas including merchandising, sales and delivery; field service; logistics and transportation; and, warehouse management. Its clients are North American companies that are household names whose products and services are used daily to feed, transport, entertain and care for people throughout the world.

The operating results of Illume Mobile have been included in our results of operations beginning August 1, 2012 and operating results of Apex have been included in our results of operations beginning June 5, 2012.

Pro Forma Disclosure of Financial Information (unaudited)

The following table summarizes our unaudited consolidated results of operations for the nine months ended September 30, 2012 as if the Apex and Illume acquisitions had occurred on January 1, 2012 (in thousands except per share data):

Table of Contents

	Three Months Ended September 30, 2012		Nine Months Ended September 30, 2012	
	As Reported	Pro Forma	As Reported	Pro Forma
Net sales	\$18,567	\$18,669	\$54,144	\$56,346
Net loss attributable to common shareholders	(1,263 )	(1,445 )	(3,245 )	(5,311 )
Net loss per share - basic and diluted	(0.15 )	(0.18 )	(0.42 )	(0.69 )

Included in the pro forma combined results of operations are the following adjustments for Apex: (i) amortization of intangible assets for the three and nine months ended September 30, 2012 of \$0 and \$572,000, respectively (ii) a net increase in interest expense for the three and nine months ended September 30, 2012 of \$0 and \$291,000, respectively.

Included in the pro forma combined results of operations are the following adjustments for Illume Mobile: (i) amortization of intangible assets for the three and nine months ended September 30, 2012 of \$18,000 and \$125,000, respectively. Net loss per share assumes the 325,000 shares issued in connection with the Apex acquisition and the 617,284 shares issued in connection with the Illume Mobile acquisition are outstanding for each period presented (see Note 5 – “Business Combinations” in the accompanying Notes to the Unaudited Condensed Consolidated Financial Statements).

The historical financial information of Apex has been extracted for the periods required from the historical financial statements of Apex Systems Integrators, Inc. which were prepared in accordance with U.S. generally accepted accounting principles. The historical financial information of Illume Mobile has been derived from using internally generated management reports for the periods required.

The unaudited pro forma financial information is not intended to represent or be indicative of our consolidated results of operations that would have been reported had the Apex and Illume Mobile acquisitions been completed as of the beginning of the period presented, nor should it be taken as indicative of our future consolidated results of operations.

#### Recent Business Developments

During the third quarter of 2013, we focused on improving customer service levels and increasing our ability to leverage consumer class mobile devices and cloud services to support our enterprise applications. We released a new customer ordering portal that enables our enterprise customers to easily order additional products using electronic payment methods thus reducing the paperwork and time associated with generating repetitive purchase orders. We also consolidated our east and west coast depot facilities into a single facility in our Irvine, CA location. This consolidation enables us to gain the economies of scale created by a single location while also allowing us to extend the service hours of our east coast customers. Lastly, we relocated our Oklahoma, software development center to a historic building that is located in the heart of downtown Tulsa. The space was designed by DecisionPoint to meet the needs of our customers and employees.

With the continued expansion of consumer class tablet computers and smart phones into the enterprise, we released the 2.7 version of ContentSentral, our mobile content management solution. Some of the enhancements in this release include improvements to the user interface, extended support for additional file types and enhanced email and printing capabilities. We are also increasing our support of Android devices. In addition to extending APEXWare FS to the Motorola Android product line we have also become a Samsung partner and joined the Samsung APP Exchange. Furthering our efforts to support cloud computing and the SaaS software deployment model, DecisionPoint was selected to be part of the Amazon Web Service (AWS) Partner Network as an APN Consulting Partner. APN

Consulting Partners are professional service firms that help customers design, architect, migrate or build new applications on AWS. Consulting Partners are given access to a range of resources and training to better help customers deploy, run and manage applications in the AWS cloud.

#### Company History

DecisionPoint Systems, Inc., formerly known as Comamtech, Inc. (the "Company", "DecisionPoint", "we", "our" or "us"), was incorporated on August 16, 2010, in Canada under the laws of the Ontario Business Corporations Act ("OCBA"). On June 15, 2011, we entered into a Plan of Merger ("Merger Agreement") among the Company, its wholly-owned subsidiary, 2259736 Ontario Inc., incorporated under the laws of the Province of Ontario, Canada ("Purchaser") and DecisionPoint Systems, Inc. ("Old DecisionPoint"). Pursuant to the Merger Agreement, under Section 182 of the OCBA, on June 15, 2011 ("Effective Date"), Old DecisionPoint merged ("Merger") into the Purchaser and became a wholly-owned subsidiary of the Company. Prior to the Merger, Comamtech was a "shell company" (as such term is defined in Rule 12b-2 under the Securities Exchange Act of 1934, as amended ("Exchange Act")). In connection with the Merger, we changed our name to DecisionPoint Systems, Inc., and the Purchaser changed its name to DecisionPoint Systems International, Inc. ("DecisionPoint Systems International"). On June 15, 2011, both companies were reincorporated in the State of Delaware. Since the Merger, the business conducted by us has been the business conducted by Old DecisionPoint prior to the Merger.

Table of Contents

The accompanying unaudited condensed consolidated financial statements present the previously issued shares of Comamtech common stock as having been issued pursuant to the Merger on June 15, 2011, in exchange for the net assets of Comamtech totaling approximately \$3.9 million as consideration received. The shares of common stock of the Company issued to Old DecisionPoint's stockholders in the Merger are presented as having been outstanding since the original issuance of the shares. Further, the exchange ratio has been retroactively applied to all shares, weighted-average share, loss per share, and stock option and warrant disclosures.

We have two wholly-owned subsidiaries, Apex and DecisionPoint Systems International. Apex was acquired on June 4, 2012. DecisionPoint Systems International has two wholly-owned subsidiaries, DecisionPoint Systems Group Inc. ("DPS Group") and CMAC, Inc. DecisionPoint Systems International acquired CMAC on December 31, 2010. CMAC was founded and incorporated in March 1996, and is a logistics consulting and systems integration provider focused on delivering operational and technical supply chain solutions, headquartered in Alpharetta, Georgia.

DPS Group has two wholly-owned subsidiaries, DecisionPoint Systems CA, Inc. and DecisionPoint Systems CT, Inc. DecisionPoint Systems CA, Inc., formerly known as Creative Concepts Software, Inc. was founded in 1995 and is a leading provider of Enterprise Mobility Solutions. Enterprise Mobility Solutions are those computer systems that give an enterprise the ability to connect to people, control assets, and transact business from any location by using mobile computers, tablet computers, and smartphones to securely connect the mobile worker to the back office software systems that run the enterprise. Technologies that support Enterprise Mobility Solutions include national wireless carrier networks, Wi-Fi, local area networks, mobile computers, smartphones and tablets, mobile software applications, middleware and device security and management software. DecisionPoint Systems CT, Inc. formerly known as Sentinel Business Systems, Inc. was founded in 1976, and has developed over time a family of powerful enterprise data collection software solutions, products and services. The combined company is a data collection systems integrator that sells and installs mobile devices, software, and related bar coding equipment, radio frequency identification systems technology and provides custom solutions and other professional services.

## Results of Operations

For comparison purposes, all dollar amounts have been rounded to nearest million while all percentages are actual. Due to rounding, totals in the tables presented may not sum to the total presented in the table.

	Three Months Ended		Increase (Decrease)	Nine Months Ended		Increase (Decrease)
	September 30, 2013	September 30, 2012		September 30, 2013	September 30, 2012	
Total revenue	\$ 17.6	\$ 18.6	(5.3 %)	\$ 46.1	\$ 54.1	(14.9 %)
Gross profit	3.5	4.1	(16.0 %)	9.9	11.6	(15.0 %)
Total operating expenses	3.7	4.7	(22.7 %)	13.2	13.4	(1.6 %)
Loss from operations	(0.2 )	(0.6 )	(67.2 %)	(3.3 )	(1.8 )	85.4 %
Loss before provision for income taxes	(0.3 )	(1.0 )	(71.0 %)	(3.9 )	(2.4 )	60.2 %

Table of Contents

## Total Revenue

Revenues for the three and nine months ended September 30, 2013 and 2012 is summarized below:

	Three Months Ended			Nine Months Ended		
	September 30, 2013	2012	Increase (Decrease)	September 30, 2013	2012	Increase (Decrease)
Hardware	\$ 11.9	\$ 12.1	(2.3 %)	\$ 28.7	\$ 36.8	(21.9 %)
Professional services	4.3	4.7	(7.4 %)	12.7	12.6	0.8 %
Software	0.9	1.4	(32.9 %)	3.5	3.2	6.9 %
Other	0.5	0.4	20.8 %	1.2	1.6	(21.8 %)
	\$ 17.6	\$ 18.6	(5.3 %)	\$ 46.1	\$ 54.1	(14.9 %)

Revenues were \$17.6 million for the three months ended September 30, 2013, compared to \$18.6 million for the same period ended September 30, 2012, a decrease of \$1.0 million or 5.3%. The decrease in revenue was partially offset due to the inclusion of the operating results of our Apex and Illume Mobile acquisitions in mid-2012. Revenues for Apex were \$0.5 million for the three months ended September 30, 2013, compared to \$0.4 million for the same period ended September 30, 2012. Revenues for Illume Mobile were \$0.2 million in the three months ended September 30, 2013 compared to \$0.2 million for the same period ended September 30, 2012. Excluding the impact of Apex and Illume Mobile acquisitions in mid-2012, revenues decreased by \$1.2 million, or 6.6% over the same quarter in the prior year with the largest decrease occurring in software where sales decreased by 32.9%.

Revenues were \$46.1 million for the nine months ended September 30, 2013, compared to \$54.1 million for the same period ended September 30, 2012, a decrease of \$8.0 million or 14.9%. The decrease in revenue was partially offset due to the inclusion of the operating results of our Apex and Illume Mobile acquisitions in mid-2012. Revenues for Apex were \$1.9 million for the nine months ended September 30, 2013, compared to \$0.5 million for the same period ended September 30, 2012. Revenues for Illume Mobile were \$0.7 million in the nine months ended September 30, 2013, compared to \$0.2 million for the same period ended September 30, 2012. Excluding the impact of Apex and Illume Mobile acquisitions in mid-2012, revenues decreased by \$10.0 million, or 18.7% over the same period in the prior year with the largest decrease occurring in hardware sales where sales decreased by 21.9%.

The improved economic conditions in the U.S. which had begun in the first half of 2010, and continued improvement throughout 2011 and 2012 had a positive effect on our sales in those years. Prior to 2010, major retail chains had deferred new technology implementation and delayed systems' refresh. Conversely, the economic environment in 2012 stabilized whereupon we benefitted from renewed interest and more importantly, fundamental need to implement new cost saving technology. In the first nine months of 2013, we did not have the same level of customers with new technology implementation and systems' refresh. As a result, the hardware revenues for the three and nine months ended September 30, 2013 declined by 2.3% and 21.9%, respectively, which was due to the decrease in system upgrades of mobile computing at the retail level. The slight increase in professional services for the nine months ended September 30, 2013 compared to the same period in 2012 of 0.8%, related to deployment and staging services to support our customers' prior technology upgrades. For the three months ended September 30, 2013, we did not have the same level of customers in professional services which resulted in a decrease of \$0.4 million, or 7.4% over the same period in the prior year. Our increase in software revenues for the nine months ended September 30, 2013 compared to the same period in 2012 is attributable to contributions of software revenues from the Apex and Illume Mobile acquisitions. The slight decrease in other revenues for the nine months ended September 30, 2013 compared to the same period in the prior year relates to a reallocation of our corporate resources away from the lower

volume for consumables and towards the professional services business.

Cost of Sales

Cost of sales for the three and nine months ended September 30, 2013 and 2012 is summarized below:

	Three Months Ended			Nine Months Ended		
	September 30, 2013	September 30, 2012	Increase (Decrease)	September 30, 2013	September 30, 2012	Increase (Decrease)
Hardware	\$ 9.8	\$ 10.0	(2.4 %)	\$ 23.4	\$ 30.5	(23.4 %)
Professional services	2.9	3.0	(2.0 %)	8.6	8.4	2.2 %
Software	1.1	1.2	(8.7 %)	3.4	2.7	27.0 %
Other	0.3	0.2	30.8 %	0.9	1.0	(11.4 %)
	\$ 14.1	\$ 14.4	(2.3 %)	\$ 36.2	\$ 42.6	(14.9 %)

Table of Contents

The types of expenses included in the cost of sales line are hardware costs, third party licenses, costs associated with third party professional services, salaries and benefits for project managers and software engineers, freight, consumables and accessories.

Cost of sales were \$36.2 million for the nine months ended September 30, 2013, compared to \$42.6 million for the same period ended September 30, 2012, a decrease of \$6.4 million or 14.9%. The decrease in cost of sales for hardware of 23.4% for the nine months ended September 30, 2013 compared to the same period in 2012 was slightly higher than the hardware revenue decrease due to a fewer large orders which usually have reduced pricing. The increase in cost of sales for professional services from the nine months ended September 30, 2013 to the nine months ended September 30, 2012 was 2.2% compared to the revenue growth rate of 0.8%. The increase in cost of sales for software of 27.0% for the nine months ended September 30, 2013 compared to the same period in 2012 was slightly higher due to the impact of software intangible asset amortization. The decrease in other cost of sales was related to the decrease in other revenues.

**Gross Profit**

Our gross profit was \$3.5 million for the three months ended September 30, 2013, compared to \$4.1 million for the same period ended September 30, 2012, a decrease of \$0.6 million or 16.0%. Our gross margin percentage decreased by 250 basis points to 19.7% in 2013, from 22.2% in the comparable period of 2012.

Our gross profit was \$9.9 million for the nine months ended September 30, 2013, compared to \$11.6 million for the same period ended September 30, 2012, a decrease of \$1.7 million or 15.0%. Our gross margin percentage was 21.4% for the nine months ended September 30, 2013, compared to 21.4% for the comparable period of 2012.

The decrease in gross margin percentage for the three months ended September 30, 2013 was due to a few large orders which usually have reduced pricing. For the nine months ended September 30, 2013, our gross margin was comparable with the same period ended September 30, 2012. We have continued implementation of increased cost control for the products and services which we resell, and our professional service costs were positively impacted by our better utilization associated with greater recognized revenue from these services in the current three and nine months and therefore, we realized higher margins on those services. Additionally, the benefits of increased cost control were partially offset due to amortization of intangible software assets, offset by the lower volume of hardware sales which carry a lower gross margin, combined with a higher proportion of sales from professional services.

**Selling, General and Administrative Expenses**

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2013	2012	Increase (Decrease)	2013	2012	Increase (Decrease)
Selling, general and administrative expenses	\$ 4.5	\$ 4.7	(5.4%)	\$ 14.0	\$ 13.4	4.6 %
As a percentage of sales	25.5 %	25.5 %	(0.0%)	30.3 %	24.7 %	5.7 %
Adjustment to earn-out obligations	\$ (0.8 )	\$ -		\$ (0.8 )	\$ -	

Selling, general and administrative expenses were \$4.5 million for the three months ended September 30, 2013, compared to \$4.7 million for the same period in the prior year. This represents a decrease of \$0.2 million, or 5.4%. The decrease was primarily due to reduced legal and other professional fees.

Selling, general and administrative expenses were \$14.0 million for the nine months ended September 30, 2013, compared to \$13.4 million for the same period in the prior year. This represents an increase of \$0.6 million, or 4.6%. The increase was primarily due to the increase in sales salary related expenses of \$0.6 million which, in part relates to the expansion of the sales force in the U.S. tasked with bringing the APEXWare™ product to the U.S. market offset partially by reduced legal and other professional fees.



Table of Contents

The adjustment recorded for the earn-out obligations were \$0.8 million for the three and nine months ended September 30, 2013. The adjustment for Apex was \$0.7 million and \$0.1 million for Illume Mobile.

	Three Months Ended			Nine Months Ended		
	September 30,		Increase	September 30,		Increase
	2013	2012	(Decrease)	2013	2012	(Decrease)
Depreciation and amortization						
In cost of sales	\$ 0.2	\$ 0.2	(8.9 %)	\$ 0.6	\$ 0.3	110.4 %
In operating expenses	0.3	0.3	(16.5 %)	0.9	0.7	26.5 %
Total depreciation and amortization	\$ 0.5	\$ 0.6	(13.5 %)	\$ 1.5	\$ 1.0	51.2 %
As a percentage of sales	2.8%	3.1 %		3.2 %	1.8 %	

In addition to the differences above, selling, general and administrative costs were lower for the nine months ended September 30, 2013 due to amortization of intangible assets as a result of the Apex and Illume acquisitions in 2012.

## Interest Expense

Interest expense, which is related to our line of credit, subordinated debt, was \$0.2 million for the three months ended September 30, 2013, compared to \$0.3 million for the same period in the prior year.

Interest expense, which is related to our line of credit, subordinated debt, was \$0.7 million for the nine months ended September 30, 2013, compared to \$0.7 million for the same period in the prior year.

The \$0.1 million decrease in interest expense for the three months ended September 30, 2013 compared to the same period in the prior year was the result of decreased general debt obligations offset by an amendment to BDC Loan Agreement on April 29, 2013 to accrue interest at the rate of 12.5% per annum and the amendment to the Loan and Security Agreement with SVB entered in to on February 27, 2013 which provided an additional term loan of \$1 million at a rate of 7.5%. Due to these additional borrowings, interest expense was slightly less during the three months ended September 30, 2013.

## Liquidity and Capital Resources

## Cash and Cash Flow

Although we have historically experienced losses, a material part of those losses were from non-cash transactions (refer to the accompanying unaudited Condensed Consolidated Statements of Cash Flows.) In connection with these losses, we have accumulated substantial net operating loss carry-forwards to off-set future taxable income. In order to maintain normal operations for the foreseeable future, we must continue to have access to our line of credit, become profitable and/or access additional equity capital. There can be no assurance that we will become profitable or that we can continue to raise additional funds required to continue our normal operations. The accompanying consolidated financial statements do not include any adjustments that would be required should we not be successful with these activities.

Funds generated by operating activities and our credit facilities continue to be our most significant sources of liquidity. For the nine months ended September 30, 2013, our revenue decreased approximately 14.9%, compared to the nine months ended September 30, 2012, partially due to the lower level of retail customers' system refreshes and system implementations. Excluding the impact of Apex and Illume Mobile Earn-Out adjustment, we also had an increased level of selling, general and administrative expenses in the first nine months of 2013 compared to the same period in 2012 due to inclusion of the results from Apex and Illume Mobile along with increased selling expenses, professional expenses and investor relations expenses related to being a public company along with an increase in amortization expense of intangible assets, all resulted in higher operating loss for the first nine months of 2013.

We believe that our strategic shift to higher margin field mobility solutions with additional APEXWare™ software and professional service revenues will improve our results as economic conditions continue to improve.

In the quarter ended September 30, 2013, we experienced a decrease in revenue of \$1.0 million compared to the quarter ended September 30, 2012, and a \$2.9 million increase in revenue compared to the previous sequential quarter ended June 30, 2013. In the nine months ended September 30, 2013, we incurred approximately \$1.3 million in increased expenses due to professional fees relating to capital raising activities, the registration of common shares as a result of the Series D Preferred Stock offering and associated audit fees, and other matters such as employee termination costs. We experienced a net loss of \$0.2 million and \$3.4 million for the three and nine month periods ended September 30, 2013, which were far in excess of the internal forecast maintained by the management team. In addition, we have a substantial working capital deficit totaling \$(11.5) million at September 30, 2013. Although a portion of this deficit is associated with deferred costs and unearned revenues and term debt that has been classified current due to expected future covenant violations (see Note 8 – “Term Debt” in the accompanying Notes to the Unaudited Condensed Consolidated Financial Statements), our liabilities that are expected to be satisfied in the foreseeable future in cash far exceed the operating assets that are expected to be satisfied in cash. As a result, the availability under our credit line has contracted significantly and our overall liquidity has become significantly constrained.

Table of Contents

To address this, we have plans to seek additional capital through sales of our securities. There is no assurance additional funding will be available on terms acceptable to us, or at all. If we raise additional funds by selling additional shares of our capital stock, or securities convertible into shares of our capital stock, the ownership interest of our existing shareholders may be diluted. We are also reducing non-essential expenses and completing the integration of our acquisitions of Apex and Illume Mobile, which is expected to result in further cost savings. Such expense reduction measures include, but are not limited to, consolidation of administrative personnel, consolidation of information technology environments, reduction of outsourced consulting expertise and replacing certain service providers with lower cost providers. The result of these activities has reduced the expense structure of the consolidated business, however this reduction has not been material to date and we do not anticipate it becoming material in the foreseeable future.

On August 15, 2013, we entered into a securities purchase agreement (the “Purchase Agreement”) with accredited investors for the sale of common stock for gross proceeds of \$1,756,400 (including \$100,000 from management and existing shareholders of the Company) for 2,927,333 shares of common stock. The effective price of the offering was \$0.60 per share of common stock. An initial closing for \$1,556,400 was held on August 15, 2013. The final closing for \$200,000 was held on August 21, 2013. Additionally, pursuant to the Purchase Agreement, the Company issued 1,463,667 warrants to accredited investors at an exercise price of \$1.00 per share. Further, the Company issued 292,833 warrants to the placement agent at an exercise price of \$0.60 per share. The warrants received liability accounting treatment under existing technical standards. We received net proceeds of approximately \$1.5 million from the offering, after deducting the placement agent’s fees of 10% and other offering expenses. (see Note 9 – “Stockholders’ Equity” and Note 3 – “Warrant Liability” in the accompanying Notes to the Unaudited Condensed Consolidated Financial Statements).

In November 2013, the Company entered into definitive subscription agreements (“Series E Purchase Agreement”) with accredited investors for the sales of \$3,835,000 in gross proceeds for 383,500 shares of Series E Convertible Preferred Stock (“Series E Preferred Shares”) for a purchase price of \$10.00 per share. The initial Conversion Price is \$0.50, subject to adjustment in the event of stock splits, stock dividends and similar transactions, and in the event of subsequent equity sales at a lower price per share, subject to certain exceptions. The Company received net proceeds of approximately \$3.4 million (net of the fair value of placement agent warrants) from the initial closing, after deducting the placement agent’s fees of 8% and other offering expenses. The Company issued to the Placement Agent five-year warrants to purchase 767,000 shares of our common stock (equal to 10% of the number of shares of common stock underlying the Series E Preferred Shares sold under the Series E Purchase Agreement) at an exercise price of \$0.55 per share, in connection with the Series E Purchase Agreement initial closing. The Company expects to close a second round of Series E Preferred Shares with gross proceeds of \$300,000-\$700,000 shortly thereafter (see Note 13 – “Subsequent Event” in the accompanying Notes to the Unaudited Condensed Consolidated Financial Statements).

During 2012 and 2013, all principal payments on our term debt were made within payment terms. We were not in compliance with certain financial covenants under the agreements with Royal Bank of Canada (“RBC Credit Agreement”) and BDC, Inc. (“BDC Credit Agreement”) as of December 31, 2012, March 31, 2013 and June 30, 2013. We have received waivers for non-compliance for past covenant violations. On August 22, 2013, the BDC Credit Agreement was amended and certain financial covenants were modified. Pursuant to the amended loan agreement, we are required to maintain, for the duration of the investment, a term debt to equity ratio not exceeding 1.1:1 (measured annually); and an adjusted current ratio of 0.40:1 (measured annually) and revised yearly 120 days after each year end. We were in compliance with all of our BDC financial covenants as of September 30, 2013. We expect to continue to meet the requirements of our BDC financial covenants over the short and long term. On August 16, 2013 the RBC Credit Agreement was amended and certain financial covenants were modified. Pursuant to the amended credit agreement and commencing with the fiscal year ending December 31, 2013, we are required to maintain a fixed coverage ratio, calculated on a consolidated basis of not less than 1.15:1 with a step-up to 1.25:1 as of March 31, 2014, tested on a rolling four quarter basis thereafter and a ratio of funded debt to EBITDA, calculated on

an annual consolidated basis of not greater than 3.0:1, tested on a rolling four quarter basis thereafter. As part of the revised financial covenants, covenant testing was waived by RBC for September 30, 2013. We do not believe that we will be in compliance with the reset covenants at December 31, 2013. Although we believe it is improbable that RBC will exercise their rights up to, and including, acceleration of the outstanding debt, there can be no assurance RBC will not exercise their rights pursuant to the provisions of the debt obligation. Accordingly, we have classified this debt obligation as current at September 30, 2013 (see Note 8 – “Term Debt” in the accompanying Notes to the Unaudited Condensed Consolidated Financial Statements).

At October 31, 2013, the outstanding balance on the line of credit with Silicon Valley Bank (“SVB”) is \$3.7 million, down from \$4.1 million at September 30, 2013, and the availability under the line of credit has decreased to \$1.6 million (see Note 7 – Lines of Credit). We rely on the line of credit to fund daily operating activities maintaining very little cash on hand. As of December 31, 2012, we were in compliance with all of our financial covenants with SVB. As of May 31, 2013 and June 30, 2013, we were not in compliance with the Tangible Net Worth financial covenant as defined in the amended SVB Loan Agreement. SVB has agreed to temporarily forbear from exercising their rights and remedies under the facility until August 28, 2013 and has agreed to waive the existing covenant violations if a gross capital raise of \$1.5 million is completed by such date. We completed the capital raise and were able to achieve compliance with the forbearance agreement prior to August 28, 2013. Except for any capital raises through August 28, 2013, the minimum Tangible Net Worth requirement of a \$(9.7) million deficit will be further reduced by one half of any funds raised through sales of common stock (as only 50% of additional capital raises are given credit in the Tangible Net Worth calculation). As of September 30, 2013, we were in compliance with the Tangible Net Worth financial covenant and had available a \$0.3 million cushion over the requirement. In November 2013, the Company entered into a definitive subscription agreement with accredited investors for the sale of Series E Preferred Stock, raising \$3.8 million in gross proceeds (See Note 13). Given the effect of the capital raise (\$3.8 million in gross proceeds, net of \$400,000 in costs) closed to date in November, we believe that at the time of this filing we are in compliant with the terms and provisions of its SVB lending agreement and expect to continue to meet the requirements of our SVB financial covenants over the short and long term. The Company is in currently discussions with SVB regarding the Tangible Net Worth covenant and a reduction of the 50% of additional capital raised to 25% of capital raised in November 2013. Should we continue to incur losses in a manner consistent with its recent historical financial performance, we will violate this covenant without additional net capital raises in amounts that are approximately twice the amount of the losses incurred.

## Table of Contents

In the near term, our successful restructuring of our operations and reduction of operating costs and/or our ability to raise additional capital at acceptable terms is critical to our ability to continue to operate for the foreseeable future. If we continue to incur operating losses and/or do not raise sufficient additional capital, material adverse events may occur including, but not limited to, 1) a reduction in the nature and scope of the Company's operations, 2) the Company's inability to fully implement its current business plan and/or 3) continued defaults under the various loan agreements. A covenant default would give the bank the right to demand immediate payment of all outstanding amounts which we would not be able to repay out of normal operations. There are no assurances that we will successfully implement our plans with respect to these liquidity matters. The unaudited condensed consolidated financial statements do not reflect any adjustment that may be required resulting from the adverse outcome relating to this uncertainty.

As a matter of course, we do not maintain significant cash balances on hand since we are financed by a line of credit. Typically, we use any excess cash to repay the then outstanding line of credit balance. As long as we continue to generate revenues and meet our financial covenants, we are permitted to draw down on our line of credit to fund our normal working capital needs. As of September 30, 2013, the outstanding balance on our SVB line of credit was approximately \$4.1 million and the interest rate is 7.0%. As of September 30, 2013, there was \$4.3 million available under the line of credit. As of October 31, 2013, the outstanding balance under the line of credit was \$3.7 million and there was \$1.3 million available under the line of credit. On February 27, 2013, we obtained an additional \$1.0 million term loan from SVB (see below under "2013 Financing" for terms of the line of credit and the term loan.)

In connection with our Preferred Series D Private Placement in December 2012, 25% of the net proceeds are to be restricted for the Apex payment of the contingent consideration and the additional bonus consideration (see below under "2012 Financing.") These funds have not been placed into escrow pending agreement between the Company and former owners of Apex regarding the financial institution that will escrow the funds, the amount of funds to be escrowed and the terms of the escrow agreement itself.

In the last four complete years of operations from 2009 through 2012, we have not experienced any significant effects of inflation on our product and service pricing, revenues or our income from continuing operations.

As of September 30, 2013 and December 31, 2012, we had cash of approximately \$0.3 million and \$1.1 million, respectively. We have used, and plan to use, such cash for general corporate purposes, including working capital.

As of September 30, 2013, we had negative working capital of \$11.5 million and total stockholders' deficit of (\$2.3) million. As of December 31, 2012, we had negative working capital of \$9.1 million and total stockholders' equity of \$0.9 million. We experienced a net loss of \$0.2 million and \$3.4 million for the three and nine month periods ended September 30, 2013. Although a portion of this deficit is associated with deferred costs and unearned revenues and term debt that has been classified current due to expected future covenant violations (see further discussion at Note 8 – "Term Debt" in the accompanying Notes to the Unaudited Condensed Consolidated Financial Statements), the liabilities of the Company that are expected to be satisfied in the foreseeable future in cash exceed the operating assets that are expected to be satisfied in cash.

### 2013 Financing, Common Stock Private Placement and Preferred Series E Private Placement

#### Silicon Valley Bank Financing

On February 27, 2013, we and Silicon Valley Bank ("SVB"), entered into an Amendment (the "Amendment") to Loan and Security Agreement, which amended the terms of the Loan and Security Agreement dated as of December 15, 2006 (as amended, the "Loan Agreement"). Pursuant to the Amendment, SVB made a new term loan to us on February 27, 2013, of \$1,000,000 ("Term Loan II"). Repayment of Term Loan II, together with accrued interest thereon, is due in 36

monthly installments commencing on the first day of the month following the month in which the funding date of Term Loan II occurred.

## Table of Contents

Pursuant to the Amendment, the Loan Agreement was amended to provide that the revolving credit line thereunder will accrue interest at an annual rate equal to 3.75 percentage points above the Prime Rate, which may be further reduced to 3.25 percentage points above the Prime Rate after we achieve two consecutive fiscal quarters (beginning with any fiscal quarter ending on or after March 31, 2013) of profitability. In addition, the maturity date of the revolving credit line under the Loan Agreement was extended to February 28, 2015, the principal amount outstanding under the Term Loan under the Loan Agreement will accrue interest at a fixed annual rate equal to 9.0%, the principal amount outstanding under the Term Loan II will accrue interest at a fixed annual rate equal to 7.5%, and we agreed to pay an anniversary fee of \$100,000 on February 28, 2014.

The Loan Agreement includes customary covenants, limitations and events of default. Financial covenants which may materially impact our liquidity include minimum liquidity and fixed charge coverage ratios (1.5 to 1), minimum tangible net worth requirements (\$9.7 million) and limitations on indebtedness. Additionally, the Loan Agreement has customary cross-default covenants which will cause us to be in default if we are in default in other loan agreements. As of December 31, 2012, we were in compliance with all of our financial covenants with SVB. As of May 31, 2013 and June 30, 2013, we were not on compliance with the Tangible Net Worth financial covenant as defined in the amended SVB Loan Agreement.

On August 16, 2013, we signed an agreement with SVB (“Forbearance Agreement”) where SVB has agreed to temporarily forbear from exercising their rights and remedies under the facility until August 28, 2013 and has agreed to waive the existing covenant violations if a gross capital raise of \$1.5 million is completed by such date. We completed the capital raise and were able to achieve compliance with the Forbearance Agreement prior to August 28, 2013. Accordingly, we believe that at the time of this filing it is compliance with the terms and provisions of its SVB lending agreements. Except for any capital raises through August 28, 2013, the minimum Tangible Net Worth requirement of a \$(9.7) million deficit will be further reduced by one half of any funds raised through sales of common stock (as only 50% of additional capital raises are given credit in the Tangible Net Worth calculation). As of September 30, 2013, we were in compliance with the Tangible Net Worth financial covenant and had available a \$0.3 million cushion over the requirement. In November 2013, the Company entered into a definitive subscription agreement with accredited investors for the sale of Series E Preferred Stock, raising \$3.8 million in gross proceeds (See Note 13). Given the effect of the capital raise (\$3.8 million in gross proceeds, net of \$400,000 in costs) closed to date in November, we believe that at the time of this filing it is compliant with the terms and provisions of its SVB lending agreement and expect to continue to meet the requirements of our SVB financial covenants over the short and long term. The Company is in currently discussions with SVB regarding the Tangible Net Worth covenant and a reduction of the 50% of additional capital raised to 25% of capital raised in November 2013. Should we continue to incur losses in a manner consistent with its recent historical financial performance, we will violate this covenant without additional net capital raises in amounts that are approximately twice the amount of the losses incurred.

### Common Stock Private Placement

On August 15, 2013, we entered into a Securities Purchase Agreement (the “Purchase Agreement”) with multiple accredited investors relating to the issuance and sale of Common Stock in a private offering. On August 15, 2013, the initial closing date (the “Initial Closing”) of the Purchase Agreement, we sold (i) an aggregate of 2,594,000 shares of our Common Stock for \$0.60 per share and (ii) Common Stock Purchase Warrants (the “Investor Warrants”) for the purchase of an aggregate of 1,297,000 shares for aggregate gross proceeds of \$1,556,400. The Investor Warrants have a five-year term, an exercise price of \$1.00 and contain certain provisions for anti-dilution and price adjustments in the event of a future offering.

On August 21, 2013, the final closing date (the “Final Closing”) of the Purchase Agreement, we sold (i) an aggregate of 333,333 shares of our Common Stock for \$0.60 per share and (ii) 166,667 Investor Warrants for aggregate gross proceeds of \$200,000.

For a period commencing on the Initial Closing and terminating on a date which is 24 months from the Initial Closing, in the event we issue or grant any shares of Common Stock or securities convertible, exchangeable or exercisable for shares of Common Stock pursuant to which shares of Common Stock may be acquired at a price less than \$0.60 per share, then we shall promptly issue additional shares of Common Stock to the investors under the Purchase Agreement in an amount sufficient that the subscription price paid, when divided by the total number of shares issued (shares purchased under the Purchase Agreement plus the additional shares issued under this provision), will result in an actual price paid by the investor per share of Common Stock equal to such lower price.

If we at any time while the Investor Warrants are outstanding, shall sell or grant an option to purchase, or sell or grant any right to reprice, or otherwise dispose of or issue any common stock or securities convertible, exchangeable or exercisable for shares of common stock, at an effective price per share less than the exercise price of the Investor Warrants then in effect, the exercise price of the Investor Warrants will be reduced to equal to such lower price.

Pursuant to the terms in the Purchase Agreement, on September 23, 2013, the Company filed a Registration Statement on Form S-1 (the "Form S-1") for the registration of the 2,927,333 shares of Common Stock and the 1,463,667 shares issuable upon exercise of the Investor Warrants sold under the Purchase Agreement. On October 4, 2013, the Form S-1 was declared effective by the SEC.



## Table of Contents

We paid the placement agent \$175,600 in commissions (equal to 10% of the gross proceeds), and issued to the Placement Agent five-year warrants (the “Placement Agent Warrants”) to purchase 292,733 shares of our common stock (equal to 10% of the number of shares of common stock sold under the Purchase Agreement). The Placement Agent Warrants have a five-year term, an exercise price of \$0.60 and contain provisions for anti-dilution and price adjustments in the event of a future offering.

If we at any time while the Placement Agent Warrants are outstanding, shall sell or grant an option to purchase, or sell or grant any right to reprice, or otherwise dispose of or issue any common stock or securities convertible, exchangeable or exercisable for shares of common stock, at an effective price per share less than the exercise price of the Placement Agent Warrants, the exercise price of the Placement Agent Warrants then in effect will be reduced to equal to such lower price.

We recorded the Investor Warrants and Placement Agent Warrants as a liability (see further disclosure at Note 3 – “Warrant Liability” in the accompanying Notes to the Unaudited Condensed Consolidated Financial Statements). Accordingly, the net proceeds raised (\$1.7 million in gross offering proceeds, net of \$0.2 million in cost) were allocated to the fair value of the warrant liability of \$1.1 million and the remainder was recorded as equity (\$0.4 million).

### Preferred Series E Private Placement

In November 2013, the Company entered into definitive subscription agreements (“Series E Purchase Agreement”) with accredited investors for the sales of \$3,835,000 in gross proceeds for 383,500 shares of Series E Convertible Preferred Stock (“Series E Preferred Shares”) for a purchase price of \$10.00 per share. The initial Conversion Price is \$0.50, subject to adjustment in the event of stock splits, stock dividends and similar transactions, and in the event of subsequent equity sales at a lower price per share, subject to certain exceptions. The Company received net proceeds of approximately \$3.4 million (net of the fair value of placement agent warrants) from the initial closing, after deducting the placement agent’s fees of 8% and other offering expenses. The Company paid the Placement Agent \$306,800 in commissions (equal to 8% of the gross proceeds), and issued to the Placement Agent five-year warrants to purchase 767,000 shares of our common stock (equal to 10% of the number of shares of common stock underlying the Series E Preferred Shares sold under the Series E Purchase Agreement) at an exercise price of \$0.55 per share, in connection with the Series E Purchase Agreement initial closing. The Company expects to close a second round of Series E Preferred Shares with gross proceeds of \$300,000-\$700,000 shortly thereafter (see Note 13 – “Subsequent Event” in the accompanying Notes to the Unaudited Condensed Consolidated Financial Statements).

### 2012 Financing and Preferred Series D Private Placement

#### Royal Bank of Canada and BDC Capital, Inc. Financing

On June 4, 2012, Apex entered into a Credit Agreement (“RBC Credit Agreement”) with Royal Bank of Canada (“RBC”), pursuant to which RBC made available certain credit facilities in the aggregate amount of up to CDN\$2,750,000 (US\$2,641,000 at the Closing Date), including a revolving demand facility with an authorized limit of CDN\$200,000 (US\$192,000 at the Closing Date). The RBC Term Loan accrues interest at RBP plus 4% (7% at December 31, 2012). Principal and interest is payable over a three year period at a fixed principal amount of CDN\$69,444 a month beginning in July 2012 and continuing through June 2015. Apex paid approximately \$120,000 in financing costs, which has been recorded as deferred financing costs and is being amortized to interest expense over the term of the loan.

In addition, the RBC Term Loan calls for mandatory repayments based on 20% of Apex’s free cash flow as defined in the RBC Credit Agreement, before discretionary bonuses based on the annual year end audited financial statements of

Apex, beginning with the fiscal year ended December 31, 2012, and payable within 30 days of the delivery of the annual audited financial statements, and continuing every six months through December 31, 2014. As of September 30, 2013 and December 31, 2012, the Company estimates that the mandatory repayment based on 20% of Apex's free cash flow will be \$0.

Table of Contents

The RBC Term Loan has certain financial covenants and other non-financial covenants. As of June 30, 2013 and December 31, 2012, Apex was not in compliance with the Fixed Charge Coverage ratio (as defined by the RBC Credit Agreement). Under the RBC Credit Agreement, violation of this covenant is an Event of Default which grants RBC the right to demand immediate payment of outstanding balances. In March 2013, May 2013 and August 2013, we received waivers for non-compliance of these covenants at December 31, 2012, March 31, 2013 and June 30, 2013. On August 16, 2013 the RBC Credit Agreement was amended and certain financial covenants were modified. Pursuant to the amended credit agreement and commencing with the fiscal year ending December 31, 2013, We are required to maintain a fixed coverage ratio, calculated on a consolidated basis of not less than 1.15:1 with a step-up to 1.25:1 as of March 31, 2014, tested on a rolling four quarter basis thereafter and a ratio of funded debt to EBITDA, calculated on an annual consolidated basis of not greater than 3.0:1, tested on a rolling four quarter basis thereafter. As part of the revised financial covenants, covenant testing was waived for September 30, 2013. We do not believe that we will be in compliance with the reset covenants at December 31, 2013. Although we believe it is improbable RBC will exercise their rights up to, and including, acceleration of the outstanding debt, there can be no assurance that RBC will not exercise their rights pursuant to the provisions of the debt obligation. Accordingly, we have classified the term debt obligation as current at September 30, 2013.

On June 4, 2012, Apex also entered into the BDC Loan Agreement with BDC Capital Inc. (“BDC”), a wholly-owned subsidiary of Business Development Bank of Canada, pursuant to which BDC made available to Apex a term credit facility (“BDC Credit Facility”) in the aggregate amount of CDN \$1,700,000 (USD \$1,632,340 at the Closing Date). The BDC Term Loan initially accrued interest at the rate of 12% per annum, and matures on June 23, 2016, with an available one year extension for a fee of 2%, payable at the time of extension. On April 29, 2013, the BDC Term Loan was amended to accrue interest at the rate of 12.5% per annum. In addition to the interest payable, consecutive quarterly payments of CDN\$20,000 as additional interest are due beginning on June 23, 2012, and subject to compliance with bank covenants, Apex will make a mandatory annual principal payment in the form of a cash flow sweep which will be equal to 50% of the Excess Available Funds (as defined by the BDC Loan Agreement) before discretionary bonuses based on the annual year end audited financial statements of Apex. The maximum annual cash flow sweep in any year will be CDN\$425,000. As of December 31, 2012 and at September 30, 2013, the Company estimated the cash sweep will be approximately \$0. Such payments will be applied to reduce the outstanding principal payment due on the maturity date. In the event that Apex’s annual audited financial statements are not received within 120 days of its fiscal year end, the full CDN\$425,000 becomes due and payable on the next payment date. Apex paid approximately \$70,000 in financing costs which has been recorded as deferred financing costs and is being amortized to interest expense over the term of the loan.

The BDC Loan Agreement contains certain financial and non-financial covenants which may materially impact our liquidity, including minimum working capital requirements, tangible net worth requirements and limitations on additional indebtedness. Under the BDC Loan Agreement, violation of this covenant is an Event of Default which grants BDC the right to demand immediate payment of outstanding balances. In March 2013, May 2013 and August 2013, we received waivers for non-compliance of these covenants at December 31, 2012, March 31, 2013 and June 30, 2013. On August 22, 2013, the BDC Term Loan was amended and certain financial covenants were modified. Pursuant to the amended loan agreement, the Company is required to maintain, for the duration of the investment, a term debt to equity ratio not exceeding 1.1:1 (measured annually); and an adjusted current ratio of 0.40:1 (measured annually) and revised yearly 120 days after each year end. We were in compliance with all of our BDC financial covenants as of September 30, 2013. Currently, we expect to continue to meet the requirements of our BDC financial covenants over the short and long term.

In connection with the BDC Loan Agreement, BDC executed a subordination agreement in favor of Silicon Valley Bank, pursuant to which BDC agreed to subordinate any security interest in assets of the Company granted in connection with the BDC Loan Agreement to Silicon Valley Bank’s existing security interest in assets of the

Company. The subordination agreement contains cross-default provisions which may materially impact our liquidity.

In the event either or both of the RBC Loan Agreement or the BDC Loan Agreement were deemed to be in default, RBC or BDC, as applicable, could, among other things (subject to the rights of SVB as the Company's senior lender), terminate the facilities, demand immediate repayment of any outstanding amounts, and foreclose on our assets. Any such action would require us to curtail or cease operations. The Company does not have alternative sources of financing.

#### Preferred Series D Private Placement

On December 20, 2012, we entered into and closed a securities purchase agreement (the "Series D Purchase Agreement") with accredited investors (the "Investors"), pursuant to which we sold an aggregate of 633,600 shares of Series D Convertible Preferred Stock (the "Series D Preferred Shares") for a purchase price of \$10.00 per share, for aggregate gross proceeds of \$6,336,000 (the "Series D First Closing").

Table of Contents

We retained Taglich Brothers, Inc. (the “Placement Agent”) as the placement agent for the Series D First Closing. We paid the Placement Agent \$506,880 in commissions (equal to 8% of the gross proceeds), and issued to the Placement Agent five-year warrants (the “Placement Agent Warrants”) to purchase 633,600 shares of our common stock (equal to 10% of the number of shares of common stock underlying the Series D Preferred Shares sold under the Purchase Agreement) at an exercise price of \$1.10 per share, in connection with the Series D First Closing. The Investors included certain of our officers, directors and employees, who purchased an aggregate of 20,700 Series D Preferred Shares. We used \$4.7 million of the proceeds from the Series D Closing to redeem all of our outstanding shares of Series C Preferred Stock.

On December 31, 2012, we sold an additional 70,600 shares of Series D Preferred Stock for a purchase price of \$10.00 per share, for aggregate gross proceeds of \$706,000 (the “Series D Second Closing”, and together with the Series D First Closing, the “Series D Closings”) pursuant to the Series D Purchase Agreement for an aggregate of 704,200 shares of Series D Preferred Stock sold. The Placement Agent acted as the placement agent for the Series D Second Closing as well. We paid the Placement Agent \$56,480 in commissions (equal to 8% of the gross proceeds), and issued to the Placement Agent Placement Agent Warrants to purchase 70,600 shares of common stock (equal to 10% of the number of shares of common stock underlying the Series D Preferred Shares sold under the Series D Purchase Agreement) at an exercise price of \$1.10 per share, in connection with the Series D Second Closing for an aggregate of 704,200 such Placement Agent Warrants. The Investors included one of our officers who purchased an aggregate of 2,500 Series D Preferred Shares.

Our proceeds from the Series D Closings, before deducting placement agent fees and other expenses, were approximately \$7.0 million. We used \$4.7 million for redemption of all of our outstanding shares of Series C Preferred Stock. Approximately \$1.0 million was used to pay fees and expenses of the offering, and \$1.3 million are funds available for general corporate purposes. Pursuant to the Stock Purchase Agreement, we are required to place 25% of net offering proceeds, as defined, in an escrow account to satisfy our payment obligations of certain earn-out provisions. These funds have not been placed into escrow pending agreement between the Company and the sellers under the stock purchase agreement regarding the financial institution that will escrow the funds, the amount of funds that are to be placed in escrow and the escrow agreement itself.

In connection with the Series D First Closing, on December 20, 2012, we filed a Certificate of Designation of Series D Preferred Stock (the “Series D Certificate of Designation”) with the Secretary of State of Delaware. Pursuant to the Series D Certificate of Designation, we designated 4,000,000 shares of our preferred stock as Series D Preferred Stock. The Series D Preferred Stock has a Stated Value of \$10.00 per share, votes on an as-converted basis with the common stock, and is convertible, at the option of the holder, into such number of shares of our common stock equal to the number of shares of Series D Preferred Stock to be converted, multiplied by the Stated Value, divided by the Conversion Price in effect at the time of the conversion. The initial Conversion Price is \$1.00, subject to adjustment in the event of stock splits, stock dividends and similar transactions, and in the event of subsequent equity sales at a lower price per share, subject to certain exceptions. As a result of the private placement closed on August 15, 2013 and August 21, 2013 (see Note 9(b)), the Conversion Price of the Series D Preferred Stock was reduced to \$0.90. The Series D Preferred Stock entitles the holder to cumulative dividends, payable quarterly, at an annual rate of (i) 8% of the Stated Value during the three year period commencing on the date of issue, and (ii) 12% of the Stated Value commencing three years after the date of issue. We may, at our option, pay dividends in PIK Shares, in which event the applicable dividend rate will be 12% and the number of such PIK Shares issuable will be equal to the aggregate dividend payable divided by the lesser of (x) the then effective Conversion Price or (y) the average volume weighted average price of the Company’s common stock for the five prior consecutive trading days.

Upon any liquidation, dissolution or winding-up of our Company, holders of Series D Preferred Stock will be entitled to receive, for each share of Series D Preferred Stock, an amount equal to the Stated Value of \$10.00 per share plus any accrued but unpaid dividends thereon before any distribution or payment may be made to the holders of any

common stock, Series A Preferred Stock, Series B Preferred Stock, or subsequently issued preferred stock.

In addition, commencing on the trading day on which the closing price of the common stock is greater than \$2.00 for thirty consecutive trading days with a minimum average daily trading volume of at least 5,000 shares for such period, and at any time thereafter, we may, in our sole discretion, effect the conversion of all of the outstanding shares of Series D Preferred Stock to common stock (subject to the condition that, all of the shares issuable upon such conversion may be re-sold without limitation under an effective registration statement or pursuant to Rule 144 under the Securities Act).

The Series D Preferred Stock holders also were granted registration rights which required the Company to file a registration statement with the SEC within 60 days of the final closing date (December 31, 2012), and to have the registration statement declared effective within 90 days thereafter. The initial registration statement was filed on February 12, 2013. Failure of the registration statement to be declared effective by May 12, 2013, resulted in a partial liquidated damage equal to 0.1% of the purchase price paid by each investor to become payable on each monthly anniversary until the registration statement was declared effective. On July 30, 2013, the registration statement was declared effective by the U.S. Securities and Exchange Commission. On October 15, 2013, the Company paid liquidated damages of \$18,000.

Table of Contents

## Cash Flows from Operating, Investing and Financing Activities

Information about our cash flows, by category, is presented in the accompanying unaudited Condensed Consolidated Statements of Cash Flows. The following table summarizes our cash inflows (outflows) for the nine months ended September 30, 2013 and 2012 (in millions):

	Nine Months Ended		Increase/(Decrease)		
	September 30, 2013	2012			
Operating activities	\$(2.2 )	\$0.7	\$(2.8 )	(409.4	%)
Investing activities	(0.0 )	(5.1 )	(5.1 )	(99.4	%)
Financing activities	1.4	4.5	(3.2 )	(70.0	%)

Cash provided by operating activities during the first nine months of 2013 decreased by \$2.8 million over the prior year. The decrease in cash from operations was primarily driven by a decrease in gross profit of \$1.7 million resulting in an increase in net loss in the first nine months of 2013 of \$0.9 million. Additionally, the changes in net working capital and other balance sheet changes contributed to a \$2.5 million increase in cash used in operating activities, offset from a \$4.4 million decrease in accounts receivable due to timing of receivable collections.

During the nine months ended September 30, 2013, net cash used in operating activities was \$2.2 million. Our net loss was \$3.5 million in the first nine months of 2013, a portion of which was the result of non-cash transactions during the year. Specifically, we had a \$0.8 million of other non-cash transactions including, but not limited to depreciation and amortization, employee stock-based compensation and ESOP compensation expense.

For the nine months ended September 30, 2012, net cash provided by operating activities was \$0.7 million. Our net loss was \$2.5 million during the first nine months of 2012, most of which was the result of non-cash transactions during the quarter. Specifically, we had a \$1.2 million non-cash expense such as depreciation and amortization, employee and non-employee stock-based compensation, and deferred taxes.

Net cash used in investing activities was negligible during the nine months ended September 30, 2013. Net cash used in investing activities was \$5.1 million for the nine months ended September 30, 2012 and primarily related to the cash payment for the acquisition of Apex System Integrators, Inc. in June 2012.

During the nine months ended September 30, 2013, net cash provided by financing activities was \$1.4 million, primarily due to \$1.0 million in proceeds from the bank term loan, net of \$1.6 million in payments for term loans, a net \$0.8 million in borrowings under our lines of credit, payment of \$0.3 million for the Series D Preferred Stock dividend and \$1.5 million in net proceeds from a common stock private placement.

During the nine months ended September 30, 2012, net cash provided by financing activities was \$4.5 million, primarily due to the \$4.0 million due to the issuance of term loan, \$0.7 million in borrowings under our line of credit, \$1.0 million in debt repayments, payment of \$0.5 million for the Series C Preferred Stock dividend, \$0.3 million of financing costs and \$1.5 million received in reverse recapitalization.

## Critical Accounting Policies

Our consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America, which requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and

expenses during the reporting periods. Critical accounting policies are those that require the application of management's most difficult, subjective, or complex judgments, often because of the need to make estimates about the effect of matters that are inherently uncertain and that may change in subsequent periods. In preparing the consolidated financial statements, management has utilized available information, including our past history, industry standards and the current economic environment, among other factors, in forming its estimates and judgments, giving due consideration to materiality. Actual results may differ from these estimates. In addition, other companies may utilize different estimates, which may impact the comparability of our results of operations to those of companies in similar businesses. We believe that the following critical accounting policies involve a high degree of judgment and estimation:



## Table of Contents

### Accounts Receivable and Allowance for Doubtful Accounts

We have policies and procedures for reviewing and granting credit to all customer accounts, including:

- Credit reviews of all new customer accounts,
- Ongoing credit evaluations of current customers,
- Credit limits and payment terms based on available credit information,
- Adjustments to credit limits based upon payment history and the customer's current credit worthiness, and
- An active collection effort by regional credit functions, reporting directly to the corporate financial officers.

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. These allowances are highly judgmental and require assumptions based on both recent trends of certain customers estimated to be a greater credit risk, as well as historical trends of the entire customer pool. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. To mitigate this credit risk we perform periodic credit evaluations of our customers.

### Inventory

Inventory is stated at the lower of cost or market. Cost is determined under the first-in, first-out (FIFO) method. We periodically review our inventory and make provisions as necessary for estimated obsolete and slow-moving goods. We mark down inventory by an amount equal to the difference between cost of inventory and the estimated market value based upon assumptions about future demands, selling prices and market conditions. The creation of such provisions results in a write-down of inventory to net realizable value and a charge to cost of sales.

### Goodwill and Long-Lived Assets

Goodwill represents the excess purchase price paid over the fair value of the net assets of acquired companies. Goodwill is subject to impairment testing as necessary, (at least once annually at December 31) if changes in circumstances or the occurrence of certain events indicate potential impairment. In assessing the recoverability of our goodwill, identified intangibles, and other long-lived assets, significant assumptions regarding the estimated future cash flows and other factors to determine the fair value of the respective assets must be made, as well as the related estimated useful lives. The fair value of goodwill and long-lived assets is estimated using a discounted cash flow valuation model and observed earnings and revenue trading multiples of identified peer companies. If these estimates or their related assumptions change in the future as a result of changes in strategy or market conditions, we may be required to record impairment charges for these assets in the period such determination was made.

### Intangible Assets

We make judgments about the recoverability of purchased finite-lived intangible assets whenever events or changes in circumstances indicate that impairment may exist. Recoverability of finite-lived intangible assets is measured by comparing the carrying amount of the asset to the future undiscounted cash flows that the asset is expected to generate. If it is determined that an individual asset is impaired, the amount of any impairment is measured as the difference between the carrying value and the fair value of the impaired asset.

The assumptions and estimates used to determine future values and remaining useful lives of our intangible are complex and subjective. They can be affected by various factors, including external factors such as industry and

economic trends, and internal factors such as changes in our business strategy and our forecasts.

#### Comprehensive Loss

Comprehensive loss consists of net loss and accumulated other comprehensive loss, which includes certain changes in equity that are excluded from net income. Comprehensive loss for the nine months ended September 30, 2013 is equal to the net loss plus other comprehensive loss totaling \$23,000 (relating to exchange translation adjustments arising from the consolidation of our Canadian Apex subsidiary). Comprehensive loss for the comparable nine months ended September 30, 2012 is \$5,000.

#### Fair Value Measurement

Financial assets and liabilities are measured at fair value, which is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The following is a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value:

## Table of Contents

- Level 1 — Quoted prices in active markets for identical assets or liabilities.
- Level 2 — Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

## Income Taxes

We account for income taxes in accordance with the Financial Accounting Standards Board (“FASB”) guidance, which requires deferred tax assets and liabilities, be recognized using enacted tax rates to measure the effect of temporary differences between book and tax bases on recorded assets and liabilities. FASB guidance also requires that deferred tax assets be reduced by a valuation allowance, if it is more likely than not some portion or all of the deferred tax assets will not be recognized.

We evaluate on an annual basis its ability to realize deferred tax assets by assessing its valuation allowance and by adjusting the amount of such allowance, if necessary. The factors used to assess the likelihood of realization are forecasts of future taxable income and available tax planning strategies that could be implemented to realize the net deferred tax assets.

In accordance with FASB guidance on accounting for uncertainty in income taxes, we evaluate tax positions to determine whether the benefits of tax positions are more likely than not of being sustained upon audit based on the technical merits of the tax position. For tax positions that are more likely than not of being sustained upon audit, we recognize the largest amount of the benefit that is greater than 50% likely of being realized upon ultimate settlement. For tax positions that are not more likely than not of being sustained upon audit, we do not recognize any portion of the benefit. If the more likely than not threshold is not met in the period for which a tax position is taken, we may subsequently recognize the benefit of that tax position if the tax matter is effectively settled, the statute of limitations expires, or if the more likely than not threshold is met in a subsequent period.

## Translation of Foreign Currencies

The Company's functional currency is the U.S. dollar. The financial statements of the Company's foreign subsidiary is measured using the local currency, in this case the Canadian dollar (CDN\$), as its functional currency and is translated to U.S. dollars for reporting purposes. Assets and liabilities of the subsidiary are translated at exchange rates as of the balance sheet dates. Revenues and expenses of the subsidiary are translated at the rates of exchange in effect during the year.

## Revenue recognition

Revenues are generated through product sales, warranty and maintenance agreements, software customization, and professional services. Product sales are recognized when the following criteria are met (1) there is persuasive evidence that an arrangement exists; (2) delivery has occurred and title has passed to the customer, which generally happens at the point of shipment provided that no significant obligations remain; (3) the price is fixed and determinable; and (4) collectability is reasonably assured. We generate revenues from the sale of extended warranties on wireless and mobile hardware and systems. Revenue related to extended warranty and service contracts is recorded as unearned revenue and is recognized over the life of the contract and we may be liable to refund a customer for amounts paid in certain circumstances. This has not been an issue for us historically.

We also generate revenue from software customization and professional services on either a fee-for-service or fixed fee basis. Revenue from software customization and professional services that is contracted as fee-for-service, also referred to as per-diem billing, is recognized in the period in which the services are performed or delivered. Adjustments to contract price and estimated labor costs are made periodically, and losses expected to be incurred on contracts in progress are charged to operations in the period such losses are determined.

We enter into revenue arrangements that contain multiple deliverables. Judgment is required to properly identify the accounting units of the multiple deliverable transactions and to determine the manner in which revenue should be allocated among the accounting units. Moreover, judgment is used in interpreting the commercial terms and determining when all criteria of revenue recognition have been met for each deliverable in order for revenue recognition to occur in the appropriate accounting period. While changes in the allocation of the arrangement consideration between the units of accounting will not affect the amount of total revenue recognized for a particular sales arrangement, any material changes in these allocations could impact the timing of revenue recognition, which could affect the Company's results of operations. When we enter into an arrangement that includes multiple elements, the allocation of value to each element is derived based on management's best estimate of selling price when vendor specific objective evidence or third party evidence is unavailable.

## Table of Contents

Revenue from software licenses is recognized when all of the software revenue recognition criteria are met and, if applicable, when vendor specific objective evidence, or VSOE, exists to allocate the total license fee to each element of multiple-element software arrangements, including post-contract customer support. Post-contract support is recognized ratably over the support period. When a contract contains multiple elements wherein the only undelivered element is post-contract customer support and VSOE of the fair value of post-contract customer support does not exist, revenue from the entire arrangement is recognized ratably over the support period. Software royalty revenue is recognized in arrears on a quarterly basis, based upon reports received from licensees during the period, unless collectability is not reasonably assured, in which case revenue is recognized when payment is received from the licensee.

### Stock-based compensation

We record the fair value of stock-based payments as an expense in our consolidated financial statements. We determine the fair value of stock options using the Black-Scholes option-pricing model. This valuation model requires us to make assumptions and judgments about the variables used in the calculation. These variables and assumptions include the weighted-average period of time that the options granted are expected to be outstanding, the volatility of our common stock, the risk-free interest rate and the estimated rate of forfeitures of unvested stock options. Additional information on the variables and assumptions used in our stock-based compensation are described in Note 10 of the accompanying notes to our unaudited condensed consolidated financial statements.

### Off-Balance Sheet Arrangements

There were no off-balance sheet arrangements as of September 30, 2013.

### Inflation

We do not believe that inflation has had a material impact on our business or operating results during the periods presented.

## ITEMQUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

3.

Not required for smaller reporting companies.

## ITEMCONTROLS AND PROCEDURES

4.

Our independent accounting firm has not, nor is required, to perform any procedures to assess the effectiveness of management remediation efforts.

### Evaluation of Disclosure Controls and Procedures.

Our management, with the participation of our Chief Executive Officer (principal executive officer) and our Chief Financial Officer (principal financial officer), evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15 under the Securities Exchange Act of 1934 (the "Exchange Act")) as of the end of the period covered by this Quarterly Report on Form 10-Q. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and

procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Based on our evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures are designed at a reasonable assurance level and are effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

#### Changes in Internal Controls.

There were no changes in our internal controls over financial reporting during the fiscal quarter ended September 30, 2013, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II-OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, we may become involved in various lawsuits and legal proceedings, which arise in the ordinary course of business. However, litigation is subject to inherent uncertainties, and an adverse result in these or other matters may arise from time to time that may harm its business. We are not currently party to any material legal proceedings.

ITEM 1A. RISK FACTORS

There have been no material changes from the risk factors disclosed in the “Risk Factors” section of our Form 10-K as filed with the SEC on March 28, 2013.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

Exhibit Number	Description of Exhibit
<u>10.1</u>	<u>Loan Amendment with Business Development Bank of Canada</u>
<u>10.2</u>	<u>Loan Amendment with Royal Bank of Canada</u>
<u>31.1</u>	<u>Certification of the Principal Executive Officer pursuant to Exchange Act Rule 13a-14(a)</u>
<u>31.2</u>	<u>Certification of the Principal Financial Officer pursuant to Exchange Act Rule 13a-14(a)</u>
<u>32.1</u>	<u>Certification of the Principal Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002</u>
<u>32.2</u>	

Certification of the Principal Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002

EX-101.INS XBRL INSTANCE DOCUMENT

EX-101.SCH XBRL TAXONOMY EXTENSION SCHEMA DOCUMENT

EX-101.CAL XBRL TAXONOMY EXTENSION CALCULATION LINKBASE

EX-101.DEF XBRL TAXONOMY EXTENSION DEFINITION LINKBASE

EX-101.LAB XBRL TAXONOMY EXTENSION LABELS LINKBASE

EX-101.PRE XBRL TAXONOMY EXTENSION PRESENTATION LINKBASE



Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DecisionPoint Systems, Inc.

Date: November 14, 2013

By: /s/ Nicholas R. Toms  
Nicholas R. Toms  
Chief Executive Officer (Principal Executive Officer)

Date: November 14, 2013

By: /s/ Michael Roe  
Michael Roe  
VP of Finance (Principal Financial Officer)