



## Quadrant 4 Systems Corporation (OTCQB: QFOR)

January 28, 2014  
Target Price: \$7.00  
Recent Price: \$0.71

### Undervalued Social Media, Mobility, Analytics and Cloud (SMAC) Company Projected to Triple Revenue with over 650% Increase in EBITDA from 2013-2015

#### Company Overview

Quadrant 4 Systems Corporation is an IT software company that develops and implements mission-critical cloud-based enterprise systems for both Fortune 500 companies and smaller enterprises. Operating in several countries, Q4 services over 150 companies in North America. The Company is a leading provider of Health Exchange platforms (QHIX) and a proprietary set of SMAC (social media, mobility, analytics and cloud computing) technology solutions to enterprise clients in the Financial Services, Health Care, Retail and Manufacturing sectors.

#### Market Data

Fiscal Year	December 31
Industry	IT Services
Market Cap	\$59.3M
Price/Earnings (ttm)	N/A
Price/Book (mrq)	7.2x
Price/Sales (ttm)	1.7x
EV/EBITDA (ttm)	13.7x
ROE (ttm)	N/A
Institutional Ownership	10.4%
Shares Outstanding	83.6M
Float	55.2M
Avg. Daily Vol. (3 mos.)	257,070
As of January 27, 2014	

#### Income Snapshot

	TTM
Revenue	\$34.8M
Gross Profit	\$9.6M
Gross Margin	27.6%

#### Balance Sheet Snapshot

	ProForma
Cash	\$1.0M
Debt	\$7.1M

#### Investment Highlights

**Focused on Social Media, Mobile, Analytics and Cloud (SMAC) technologies; four technologies that are shaping the future. SMAC projected to be worth \$5T by 2020.** QFOR is at the forefront of the next major advancement in tech. Social Media, Mobile, Analytics, and Cloud are four areas of tech that QFOR has identified as fundamental attributes of modern business strategy, but which are not being utilized properly. New SMAC-based products (examples are QFOR's healthcare exchange and RetailSphere platforms) are projected to substantially increase revenue growth, margins, and EBITDA, leading to our 2015 projections of \$128 million in revenue, 48.4% gross margins and \$35.1 million in EBITDA. According to Cognizant, SMAC will represent \$5 trillion in spending by 2020. The Company's strategy is to develop SMAC technologies and then apply these to specific industry verticals. Initially, QFOR will be targeting three multibillion dollar verticals: healthcare, retail, and financial services, with the initial focus on the healthcare market.

**QFOR's healthcare exchange platform (QHIX) projected to reach an annual revenue run rate of \$48 million by end of 2014.** QHIX currently has 50,000 members and four exchange partners in implementation, and the Company believes it can enroll up to five million lives within 36 months. With a total market size of over 100 million lives, this would represent approximately 5% market penetration. QFOR has been investing heavily in SMAC innovation and adoption of proprietary technologies for healthcare. This gives the Company a huge advantage of a very clean and scalable QHIX platform which is necessary for implementation of new business models evolving out of the recent disruptions in healthcare. Other competitors' solutions have evolved incrementally over time and may face legacy issues in terms of adoption to requirements of the new business models we are expecting to see from healthcare reform. With advantages such as flexibility for employers and ease of use for members, QHIX is poised to become a leading private healthcare exchange platform.



QFOR has a multi-pronged strategy to deploy the platform through strategic partnerships across the Health Insurance and Benefit Administration segments. Being a technology company and a neutral player, we believe QFOR is well positioned to partner with insurance carriers and health plan providers to implement customized private health exchange solutions. Carriers and plan administrators are looking to aggregate additional health and non-health related products under one platform. In addition to working directly with the carriers and health plans, the Company is establishing relationships with broker networks in various states to implement private health exchanges for large global agencies and help them consolidate the distribution channels. The third element of QFOR's go-to market strategy involves forming alliances with Third Party Administrators (TPAs) and Human Resource (HR) solution providers. WageWorks (NYSE: WAGE), on its November 5, 2013 conference call, announced that it was entering into a strategic relationship with QFOR. WAGE currently has 2.8 million lives (source: WAGE 2012 10-K). WAGE is a leading provider of pretax benefit solutions including enrollment services and administration of flexible spending accounts for small and medium employer groups of employees ranging from 50 – 500. With the integration of QFOR's technology platform and enrollment technology, WAGE can expand its core product portfolio of pre-tax benefit administration through to a full private health exchange solution. Partnering with WAGE provides market validation of QFOR's healthcare exchange platform and access to additional products as well as new market segments. QFOR also has established several other partnerships for rolling out its private health exchange platforms in several states. QFOR's exchange partners will have a readily available and complete suite of products ranging from member engagement portals and financial back office functions without the cost of integrating another company's products.

**Benefitfocus (NasdaqGM: BNFT), a private healthcare exchange provider with negative EBITDA, is trading at a P/S of 16.6x.** Many companies that offer healthcare benefits or would like to offer healthcare benefits have begun searching for private healthcare exchanges like QHIX. The influx of major names, including Walgreens, IBM, Sears, Darden, and Time Warner, moving to private exchanges has spurred premium valuations for exchange providers. Benefitfocus, a cloud-based private exchange platform with negative EBITDA, is trading at a P/S of 16.6x. Benefitfocus' private exchange platform, HR InTouch Marketplace, has been available since late-April 2012. While BNFT has a large user base (20 million+), it's only a small portion of the overall market opportunity, which is estimated at 100 million subscribers. Another important observation relative to BNFT is a large portion of BNFT's business is based on enrollment and benefit communications services. BNFT's technology has evolved over the last 10 years incrementally and may face some legacy issue in terms of adoption to requirements of the new business models we are expecting to see from healthcare reforms. Taking into account the size of the market, the amount of development QFOR has put into its own health exchange, QFOR's positive EBITDA, and QFOR's complementary business lines, we believe the valuation gap between the two companies is wholly unwarranted. Given the amount of R&D used to develop QHIX, Chairman and CFO Dhru Desai states that they have a two-year lead on any other competitor in the marketplace and with the Company's history and track record of innovation and adopting SMAC technologies for industry applications they will continue to maintain this lead.



## Peer Comparison

Name	Ticker	Price	Market Cap	P/B (mrq)	P/S (ttm)	Fwd. P/S	EV/EBITDA (ttm)	Revenue (ttm)	Fwd. Rev. YoY Growth
XHIBIT CORP	XBTC	1.35	145.58	11.12	5.93	N/A	N/A	45.13	N/A
DATAWATCH CORP	DWCH	29.82	254.35	4.60	6.55	6.24	N/A	30.30	40.09%
CALLIDUS SOFTWARE INC	CALD	14.29	649.22	196.51	6.13	5.13	N/A	107.38	16.74%
CORNERSTONE ONDEMAND INC	CSOD	54.47	2830.00	50.69	16.74	10.95	N/A	166.70	56.97%
JIVE SOFTWARE INC	JIVE	9.12	631.47	7.99	4.23	3.56	N/A	138.98	29.87%
BENEFITFOCUS INC	BNFT	65.62	1610.00	58.78	16.60	12.59	N/A	96.70	26.07%
WAGeworks INC	WAGE	59.01	2040.00	7.48	9.06	8.84	56.57	210.90	25.11%
<b>Average</b>			<b>1165.80</b>	<b>48.17</b>	<b>9.32</b>	<b>7.89</b>	<b>56.57</b>	<b>113.73</b>	<b>32.47%</b>
<b>Median</b>			<b>649.22</b>	<b>11.12</b>	<b>6.55</b>	<b>7.54</b>	<b>56.57</b>	<b>107.38</b>	<b>27.97%</b>
QUADRANT 4 SYSTEMS CORP	QFOR	0.71	59.30	7.24	1.71	0.93	15.00	34.79	67.39%

As of January 27, 2014

Source: Bloomberg, RedChip Estimates

## Valuation Conclusion

We are valuing QFOR using a P/S multiple of 6.0x, which is a 24% discount to the average forward P/S multiple of other cloud computing software companies. Given robust revenue, EBITDA, and net income growth over the next few years, we believe this multiple is conservative. We apply this multiple to our FY15 estimated revenue per share projection of \$1.34. Assigning a 10% discount rate to this total over 1.5 years we derive a target price of \$7.00.

SMAC is expected to become the next big innovation in tech, and we believe that QFOR deserves to be valued comparatively to other fast-growing cloud companies. We believe the Company's healthcare exchange will be the main growth driver in 2014 and 2015. Assuming the low-end of projected revenue per user (\$2 per month or \$24 per year) and conservative user assumptions (average lives of 700,000 in 2014 and 2.5 million in 2015), we project QFOR Health to generate revenue of \$16.8 million in 2014 and \$60.0 million in 2015 at 65% gross margins.

We also conservatively project RetailSphere to generate \$5 million and \$15 million in revenue in 2014 and 2015, respectively. This assumes an average yearly sales price per retail chain of \$200,000, and total customers of 25 retail chains in 2014 and 75 retail chains in 2015. Our projections for the consulting, solutions, and cloud segments of QFOR are in line with management (\$46 million in combined revenue in 2014, \$53 million in combined revenue in 2015). Our projections do not currently account for a financial services industry SMAC product, which management anticipates bringing to market in late 2014-early 2015. This adds additional upside to our projections. As QFOR's SMAC products make up a larger proportion of revenue, we expect gross margins to accelerate rapidly (37.9% in 2014, 48.4% in 2015). We expect general and administration expenses to more than double in both 2014 and 2015; however, we expect this to increase at a slower rate than a typical cloud-based company, as QFOR has already cultivated relationships with many blue-chip clients, thus lowering the amount of expenses needed for sales and marketing.



	2010	2011	2012	2013E	2014E	2015E
Revenue	15,233,596	29,141,433	26,561,723	40,000,000	67,800,000	128,000,000
COGS	12,883,772	22,265,260	20,185,244	30,000,000	42,130,000	66,000,000
<b>Gross Profit</b>	<b>2,349,824</b>	<b>6,876,173</b>	<b>6,376,479</b>	<b>10,000,000</b>	<b>25,670,000</b>	<b>62,000,000</b>
Gross %	15.4%	23.6%	24.0%	25.0%	37.9%	48.4%
General & Administration	(900,119)	(2,262,420)	(3,389,246)	(5,500,000)	(11,526,000)	(26,880,000)
Amortization	(1,502,549)	(3,132,666)	(6,985,242)	(5,000,000)	(5,000,000)	(5,000,000)
Interest Expense	(2,225,566)	(1,629,743)	(1,833,018)	(2,120,000)	(1,331,001)	(1,331,001)
Derivative Gain		0	154,165	0	0	0
<b>Net Income before Income Taxes</b>	<b>(2,278,410)</b>	<b>(148,656)</b>	<b>(5,676,862)</b>	<b>(2,620,000)</b>	<b>7,812,999</b>	<b>28,788,999</b>
Income Taxes	0	0	0	0	1,953,250	7,197,250
<b>Net Income</b>	<b>(2,278,410)</b>	<b>(148,656)</b>	<b>(5,676,862)</b>	<b>(2,620,000)</b>	<b>5,859,749</b>	<b>21,591,749</b>
<b>Net Income per Common Share</b>	<b>(0.09)</b>	<b>(0.00)</b>	<b>(0.11)</b>	<b>(0.04)</b>	<b>0.07</b>	<b>0.23</b>
Weighted Average Common Shares	24,845,602	47,754,470	52,498,492	62,586,716	89,566,297	95,579,636
<b>EBITDA</b>	<b>1,449,705</b>	<b>4,613,753</b>	<b>2,987,233</b>	<b>4,500,000</b>	<b>14,144,000</b>	<b>35,120,000</b>

We believe that the greatest risks to our projections come from sales of the QFOR healthcare exchange ramping up at a slower than expected rate and from general and administrative expenses accelerating faster than anticipated, which would lead to lower EBITDA and net income.

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