

Brekford Corp. (NasdaqOTCBB/BFDI)

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BUY **Strong momentum heading into 2012**

Brekford provides traffic enforcement camera and vehicle upfitting services

Investment Highlights

1) Brekford held their annual shareholder meeting earlier this month and Company management presented the highlights of the past year as well as insights into coming years. Highlights for 2011 included the awarding of multi-year Speed Enforcement Programs in seven cities or towns covering four counties in Maryland (although two of these had been awarded late last year), all of which have been successfully initiated and at least one contract has already been expanded to include the installation of more cameras. Altogether, Brekford has installed eighteen speed enforcement cameras in 2011, its first year of operating this new growth initiative, and expects to have thirty-five speed cameras operating by the end of 2012, plus installing and operating the Company's first twelve red light cameras. Highlights for its core business area include a \$4 million award to install rugged computers in vehicles operated by quasi-governmental utility companies, as part of a twelve-month contract.

2) On the financial front, Brekford has reported very strong financial results for the first nine months of the year. For the nine month period, the Company has posted revenues of \$14.3 million, up nearly 50% year-over-year, with net income of \$939,000 or \$0.02 per share, as compared with break-even results for the same period last year. In the most recent Q3/2011 quarter, Brekford recorded revenues of \$5.3 million, more than twice those of Q3/2010, and net income of \$494,000 or \$0.01 per share versus \$35,000 or \$0.00 per share in the prior year period. Revenue growth this year has been fueled by the new automated traffic enforcement program (ATEG) as well as sales from electronic ticketing systems. The higher sales volumes this year have improved overall gross margins and more than compensated for higher overhead costs, leading to increased net income so far in 2011 for Brekford. Our estimates for Q3/2011 had been revenues of \$5.7 million and net income of \$420,000, or also \$0.01 per share. At the end of September, Brekford had a little over \$2.2 million in cash and equivalents, up from \$1.5 million at the start of the year, offset by

Current Price **\$0.69**

Price Target **\$1.00**

Estimates	F2009A	F2010A	F2011E
Revenue (\$Mill)	\$14,557	\$11,609	\$20,573
1Q March	3,379	3,361	4,105 A
2Q June	3,638	3,519	4,860 A
3Q September	3,890	2,655	5,328 A
4Q December	3,650	2,074	6,280 E
Prev. Rev. Estimate (\$Mill)			\$21,090
EPS			
EPS	\$0.01	\$0.00	\$0.04
1Q March		0.00	0.00 A
2Q June		0.00	0.01 A
3Q September		0.00	0.01 A
4Q December		(0.00)	0.01 E
Previous EPS Estimate			\$0.03
P/E (x)	N/A	N/A	19.1
EBITDA/Share			
EBITDA/Share	\$0.02	\$0.01	\$0.05
EV/EBITDA (x)	40.4	102.3	13.1

Stock Data	
52-Week Range	\$0.10-\$0.70
Shares Outstanding (mill)	40.7
Market Capitalization (mill)	\$28.1
Enterprise Value (mill)	\$26.6
Debt to Capital (9/11)	17.9%
Book Value/Share (9/11)	\$0.08
Price/Book	8.8 X
Average Trading Volume (10-day)	28,400
Insider Ownership	62.7%
Institutional Ownership	0.0%
Short interest	N/A
Dividend / Yield	\$0.00/0.0%



Price target and ratings changes over the past 3 years:
Initiated - July 22, 2011 - BUY - Target \$1.00

\$700,000 in notes payable on the balance sheet in both periods. Operating cash flow for Brekford for the first nine months of 2011 was \$1.1 million, which helped increase cash balances for the Company and was also employed in adding to property, plant and equipment in order to support growth in operations.

3) In addition to a recap of highlights for 2011, Brekford management also provided guidance for the Company for 2011 as a whole, 2012 and beyond in regards to financial and operating metrics. Brekford's forecast mostly relates to growth in the new ATEG segment, including projected growth in installed traffic cameras from 18 in 2011 to 47 in 2012, which included 35 speed cameras and 12 red light cameras (there are no red light cameras installed currently). The Company also provided revenue forecasts by segment for 2011 and 2012 in their annual meeting presentation. Considering Company guidance and results for the year-to-date, we are adjusting our estimates for Q4/2011 for Brekford only slightly, to revenues of \$6.28 million (from \$6.35 million previously) and to net income of \$610,000 (from \$590,000 before), or \$0.01 per share in both cases. Similarly in 2012, we are adjusting our estimates for Brekford just slightly, to revenues of \$27.67 million (from \$28.75 million), representing 34% year-over-year growth, and to \$0.08 per share in earnings (from \$0.07 per share previously). Revenue growth in 2012 for Brekford is estimated to accrue principally in the new automated traffic enforcement segment, more than doubling to \$13.5 million from \$6.4 million in 2011 while sales in the other three areas (e-ticketing, mobile technology, and vehicle upfitting) hold steady next year. A recent selection to provide school zone speed cameras for the City of Hagerstown, Maryland (approximately 75 miles west of Baltimore), the Company's largest contract and largest client to date, will go a long way toward meeting Brekford's growth goals by itself. However, we also expect the Company to sign additional contracts in Maryland next year and perhaps even enter into new states, such as Florida, which are beginning to implement new speed camera enforcement programs.

Conclusion/Stock Valuation

Brekford shares have seen excellent price appreciation this year, fueled by solid earnings reports and high growth in the new traffic enforcement area. However, we believe that forecasted continued growth, positive news flow on new contracts especially in the spring and summer heading into the new school year as more communities adopt automated traffic enforcement programs, and growing investor interest in BFDI shares as trading volume and liquidity increase will help maintain these shares' positive momentum into 2012. Thus, we are maintaining our Buy rating on BFDI shares and 12-18 month price target of \$1.00 per share, or 12.5X next year's estimated calendar earnings per share of \$0.08 and 1.4X estimated revenues for calendar 2012. Our targeted valuation metrics for BFDI are similar to those of comparable companies such as corrections services providers The GEO Group (NYSE/GEO/Buy) and Corrections Corporation of America (NYSE/CXW/Not Rated) and one company in the rugged mobile computer market, Socket Mobile (Nasdaq/SCKT/Not Rated).

Risk Factors

We believe an investment in Brekford involves the following risks:

- **Limited History of Profitability** – Although Brekford has reported profitable results for the first three quarters of this year as well as the prior two fiscal years, and is also forecast to be profitable for the remainder of this year and next, prior to 2009 the Company operated at a loss. In addition, until the first quarter of this year Brekford had reported declining revenues, and the Company is undertaking a major new growth vehicle with its automated traffic enforcement group. Should growth in this new division occur more rapidly than anticipated or require more resources than planned, the Company could begin to show operating losses, requiring the need to raise additional equity capital or long-term debt.

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- **Reliance on new business segment** — Revenues from Brekford's legacy business have been declining for several years due primarily to budgetary constraints experienced by many municipal governments, and the Company is relying on revenues from its new ATEG segment to fuel growth. Should growth in this new division be slower than planned or experience growing pains, Brekford's current strategy could prove to be less positive than foreseen, requiring the Company to potentially reduce expenses or seek out new growth initiatives.
 - **Risk of Share Dilution** – Brekford currently has several large convertible notes and various warrants and options outstanding , which if converted and exercised could potentially mean the issuance of an additional 5-10 million shares, representing potential share dilution of 12%-25% if all underlying warrants and options are exercised. These exercising, however, would bring in additional equity capital to the Company.
 - **Competitive Markets** – The Company competes in the law enforcement vehicle upfitting market and especially the automated traffic enforcement market with a number of larger competitors with greater resources and broader geographic reach. Brekford, however, has been able to differentiate itself in these competitive markets to date through its technological expertise or higher levels of service, and we anticipate that these historical characteristics will continue into the future.
 - **Common stock restrictions** – Brekford shares currently trade on the Nasdaq Over-the-counter bulletin board with certain restrictions and limited trading volume that are associated with this smaller, less-established stock exchange. However, recent growth and positive financial results have improved liquidity in these shares, making it easier for potential investors to build positions.

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Brekford Corp.
Consolidated Statements of Operations
(In \$000s)

FYE December	2007	2008	2009	1Q10	2Q10	3Q10	4Q10	2010	1Q11	2Q11	3Q11	4Q11E	2011E	2012E
				Mar	June	Sept	Dec		Mar	June	Sept	Dec		
Net revenue	\$19,764	\$13,502	\$14,557	\$3,361	\$3,519	\$2,655	\$2,074	\$11,609	\$4,105	\$4,860	\$5,328	\$6,280	\$20,573	\$27,678
Cost of revenue	16,175	11,506	11,918	2,930	3,038	2,172	1,558	9,698	3,351	3,814	4,062	4,620	15,846	20,200
Gross Profit	3,589	1,995	2,639	431	481	483	516	1,911	753	1,046	1,267	1,660	4,727	7,478
Operating Expenses:														
Salaries and related expenses	3,763	1,281	1,057	168	265	226	301	960	263	334	283	470	1,349	1,970
Selling, general & administrative expenses	1,678	2,254	945	184	190	206	255	834	349	355	416	500	1,619	2,400
Total operating expenses	5,441	3,535	2,003	353	455	431	556	1,794	611	688	698	970	2,968	4,370
Income (loss) from operations	(1,852)	(1,540)	636	78	26	51	(39)	116	142	358	568	690	1,759	3,108
Other Income (expense)														
Interest expense	(54)	(12)	(35)	(58)	(22)	(22)	(26)	(127)	(28)	(27)	(39)	(60)	(154)	(20)
Interest income	77	39	20	6	4	6	3	19	0	1	0	1	3	32
Other expenses	(1,931)	32	37	0	0	0	0	0	(2)	0	(36)	(20)	(58)	(20)
Income (loss) before tax	(3,760)	(1,481)	658	26	9	35	(62)	8	113	332	494	611	1,550	3,100
Provision for income taxes	0	0	80	0	0	0	0	0	0	0	0	0	0	0
Net income (loss)	(3,760)	(1,481)	578	26	9	35	(62)	8	113	332	494	611	1,550	3,100
Basic income per share	(\$0.06)	(\$0.02)	\$0.01	\$0.00	\$0.00	\$0.00	(\$0.00)	\$0.00	\$0.00	\$0.01	\$0.01	\$0.01	\$0.04	\$0.08
Diluted income per share	(\$0.06)	(\$0.02)	\$0.01	\$0.00	\$0.00	\$0.00	(\$0.00)	\$0.00	\$0.00	\$0.01	\$0.01	\$0.01	\$0.04	\$0.08
Basic shares outstanding	60,334	63,567	53,589	39,706	40,064	40,081	39,921	39,921	40,487	40,629	40,744	40,850	40,678	41,000
Diluted shares outstanding	60,334	63,567	55,014	49,706	40,064	40,081	39,921	39,921	40,487	41,308	44,812	45,000	42,902	41,000
Key ratios:														
Revenue growth		-31.7%	7.8%					-20.3%	22.1%	38.1%	100.7%	202.8%	77.2%	34.5%
Gross margin	18.2%	14.8%	18.1%	12.8%	13.7%	18.2%	24.9%	16.5%	18.4%	21.5%	23.8%	26.5%	23.0%	27.0%
Salaries/Revenues	19.0%	16.7%	6.5%	5.5%	5.4%	8.5%	14.5%	8.3%	6.4%	6.9%	5.3%	7.5%	6.6%	7.1%
Depreciation, amort, non-cash comp	\$3,859	(\$156)	\$233	\$49	\$58	\$17	\$21	\$146	\$55	\$173	\$118	\$120	\$466	\$500
Operating margin	-9%	-11%	4%	2.3%	0.7%	1.9%	-1.9%	1.0%	3.5%	7.4%	10.7%	11.0%	8.6%	11.2%
Cash Flow/share	\$0.00	(\$0.03)	\$0.01	\$0.00	\$0.00	\$0.00	(\$0.00)	\$0.00	\$0.00	\$0.01	\$0.01	\$0.02	\$0.05	\$0.09
EBITDA/share	\$0.03	(\$0.03)	\$0.02	\$0.00	\$0.00	\$0.00	(\$0.00)	\$0.01	\$0.00	\$0.01	\$0.01	\$0.02	\$0.05	\$0.09

Balance Sheets
Quarterly Earnings Comparisons

Assets:	(\$000s)	
	12/31/10	9/30/11
Cash and equivalents	\$1,534	\$2,237
Accounts receivable, net	1,753	3,406
Prepaid and Other	24	16
Inventories	199	253
Total current	3,511	5,913
Property & equipment, net	1,012	1,547
Other non-current	28	33
TOTAL ASSETS	\$4,551	\$7,492

Revenues (in 000's)

	March	June	Sept	Dec	Total
2009	3,379	3,638	3,890	3,650	14,557
2010	3,361	3,519	2,655	2,074	11,609
2011E	4,105	4,860	5,328	6,280	20,573

Earnings per Share

	2009	2010	2011E
2009	0.00	0.00	0.00
2010	0.00	\$0.00	0.00
2011E	0.00	\$0.01	0.01

Liabilities:	2010	2011
Accounts payable	\$802	\$1,101
Accrued expenses	48	3
Deferred revenue	56	261
Due to municipalities	0	1,073
Other	240	465
Total current	1,147	2,904
Notes payable - stockholders	700	700
Other	440	683
Total liabilities	2,287	4,286
Stockholders' equity	2,263	3,206
TOTAL LIAB & EQ	\$4,551	\$7,492

Revenue breakdown

	2009	2010	Q1/11A	Q2/11A	Q3/11A	Q4/11E	2011E	2012E
Sales by Type (\$000s)								
E-Ticketing systems	\$640	\$860	\$320	\$370	\$430	\$500	\$1,620	\$1,400
Mobile Tech & Video Solutions	10,470	6,610	1,850	1,900	2,100	2,350	8,200	8,300
360° Vehicle Upfitting Solutions	3,450	4,040	835	900	1,200	1,468	4,403	4,460
Automated traffic Enforcement								
Red Light cameras								
# Cameras		0	0	0	1	2	2	12
Revenue/Camera		10	10	10	10	10	40	42
Total - Red Light		\$0	\$0	\$0	\$10	\$20	\$30	\$498
Speed cameras								
# Cameras		2	6	10	14	18	18	35
Revenue/Camera		50	183	169	114	108	574	372
Total - Speed		\$100	\$1,100	\$1,690	\$1,589	\$1,942	\$6,321	\$13,020
Total - Traffic enforcement		\$0	\$100	\$1,100	\$1,690	\$1,599	\$1,962	\$13,518
Total	\$14,560	\$11,610	\$4,105	\$4,860	\$5,329	\$6,280	\$20,574	\$27,678

Source: Dawson James Securities, Inc. estimates; Company documents

Important Disclosures:

Price Chart:



Price target and ratings changes over the past 3 years:
Initiated – July 22, 2011 – Price Target \$1.00

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	Company Coverage		Investment Banking	
Ratings Distribution	# of Companies	% of Total	# of Companies	% of Totals
Buy	15	63%	5	33%
Neutral	8	33%	5	63%
Sell	1	4%	0	0%
Total	24	100%	10	42%

Information about valuation methods and risks can be found in the “STOCK VALUATION” and “RISK FACTORS” sections of this report.

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