Zacks Small-Cap Research

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Auxilio Inc. (AUXO-OTCQB)

AUXO: Q2 Breaks even as the Company Invests in New Businesses

OUTPERFORM

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	08/21/2011
Current Price (08/13/14)	$1.15
Target Price	**$2.00**

OUTLOOK

AUXILIO manages and reduces printing costs for hospitals and facilities by providing on-site staff and vendor management. It is the only vender neutral provider. Its services are in high demand as clients' budgets are squeezed and health care profitability is reduced. The company is rolling other IT services to sell its client base to increase the company TAM as well as increase margins. Its recent acquisition of Delphiis adds a new product, security services, to aid in HIPPA compliance.

SUMMARY DATA

52-Week High	**$1.72**
52-Week Low	**$0.90**
One-Year Return (%)	**27.78**
Beta	**1.67**
Average Daily Volume (sh)	**11,218**
Shares Outstanding (mil)	**21**
Market Capitalization ($mil)	**$24**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**0**
Insider Ownership (%)	**30**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**28.5**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**21.5**
P/E using 2014 Estimate	**14.3**
P/E using 2015 Estimate	**10.7**
Zacks Rank	**3**

Risk Level	**Above Average**
Type of Stock	**Small-Growth**
Industry	**Outsourcing**
Zacks Rank in Industry	**7 of 16**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2012	7 A	11 A	9 A	10 A	36 A
2013	10 A	10 A	11 A	11 A	43 A
2014	10 A	10 A	12 E	15 E	48 E
2015					54 E

Earnings per Share
(Non-GAAP Diluted EPS before non-recurring items)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2012	-$0.07 A	-$0.01 A	-$0.03 A	$0.00 A	-$0.12 A
2013	$0.01 A	$0.02 A	$0.05 A	$0.04 A	$0.11 A
2014	$0.01 A	$0.00 A	$0.03 E	$0.05 E	$0.10 E
2015					$0.14 E

Zacks Projected EPS Growth Rate - Next 5 Years % **15**

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WHAT'S NEW

Q2 Earnings Breakeven as the Company Invests in New Businesses

On August 14, 2014, AUXILIO, Inc. (AUXO) reported revenues and earnings of $10.4 million and breakeven EPS versus our estimate of $12.7 million and non-GAAP fully diluted EPS of $0.03. The company faulted some consolidation among its customers, and bad weather in the North East that decreased print volumes. While this sounds odd, the company bills on a lagging three-month basis so that the March quarter activities are reflected in the June quarter revenues.

This was also the last quarter without the acquisition of Delphiis that closed July 8th 2014. The company has now had only three weeks as a combined business and has spent that time acquainting current customers with the new service offerings, starting on the largest first. Although it has not yet finished the audit to put the company on GAAP accounting, management believes that 2013 revenues were between $750,000 and $900,000. This September quarter the company will begin recognizing revenues from this acquisition.

Revenues were $10.4 million versus $9.8 million last year, up 6%. Hardware was $0.6 million this year versus $0.8 million last. Gross margin was 16.6% down from 16.8% last year due to contract mix.

Operating expenses went up $200,000 as the company brought on new senior management and begun to invest in new businesses and increase staffing sales and marketing for these businesses.

Operating income fell to $92,000 from $205,000 last year or 0.9% from 2.1% last year as the company invests in new businesses. After paying no taxes, this loss resulted in breakeven on a non-GAAP EPS basis versus $0.01 in 2013.

After the quarter ended, the company's $1.55 million convertible note, paying 8%, was converted to an equivalent number of shares, reducing interest expense by $124,000 per year going forward. This amount, plus the 930,000 shares that were issued for the purchase of Delphiis, will increase the primary share count. All told, next quarter we are expecting the shares outstanding to be 23.4 million.

The company now has no long-term debt and $3.75 million in net cash after paying out $1 million in cash in July for the Delphiis acquisition. Cash flow for the quarter was $64,000. This cash plus a $2 million line of credit should be ample for the company's needs.

Importantly, in the quarter the company renewed contracts with two large customers: California Pacific Medical Center and St. Joseph's in Yonkers, New York.

Earnings Forecast

We are adjusting estimates for the next two quarters to reflect the higher share count due to the conversion of the note, and reducing full year revenues to reflect the shortfall in revenues this quarter that will not be made up for in subsequent quarters. For Q3 2014, we are now looking for non-GAAP fully diluted EPS of $0.03 versus $0.05 last year. We still think $12 million in sales is possible.

For the 2014-year, we are reducing revenues to $48 million and non-GAAP EPS to $0.10. 2015 is being reduced to $54 and $0.14. While we believe the company's new service offerings will ultimately be successful, given the client base decision-making processes, this could take longer than originally anticipated.

INVESTMENT THESIS

- Auxilio is a services company with over 86% recurring revenue and should command a higher earnings multiple due to a high degree of visibility.
- It is a smaller player in a market at least ten times its size and as the only non-vendor specific provider in the health care marketplace. It should be able to capture market share due to its focus on customer cost savings rather than hardware sales.
- The company is a pure-play on the need for health care providers to cut costs as well as comply with new IT and privacy regulations.
- On a non-GAAP basis the company is trading at 8.2Xs our expected 2014 non-GAAP EPS of $0.14.
- If the company executes by capturing market share and successfully add new revenue streams, we believe the company could ultimately trade at 15Xs 2015 fully diluted non-GAAP EPS of $0.14 or $2.00 by next year.

PROJECTED INCOME STATEMENT

	March	June	Sept	Dec		March	June	Sept	Dec						
	Q1 13	Q2 13	Q3 13	Q4 13		Q1 14A	Q2 14A	Q3 14E	Q4 14E		2011	2012	2013	2014E	2015E
REVENUE															
Net Revenue	$10.1	$9.8	$10.8	$12.3		$10.2	$10.4	$12.3	$15.1		$21.8	$35.6	$43.0	$48.00	$53.8
Yr-to-yr Gr.	54.3%	-8.6%	23.1%	28%		2%	6%	14%	23%		42%	63%	21%	12%	12%
OPERATING EXPENSES															
Cost of goods sold	8.5	8.2	8.6	10.0		8.5	8.7	9.9	12.1		19.1	31.0	$35.3	39.2	43.0
Gross Margin	1.6	1.6	2.2	2.2		1.7	1.7	2.4	3.0		2.7	4.6	7.7	8.8	10.8
% of Sales	15.6%	16.8%	20.6%	18.2%		17.0%	16.6%	19.5%	19.8%		12.4%	13.0%	17.9%	18.4%	20.0%
S&M	0.7	0.5	0.5	0.46		0.5	0.6	0.6	0.7		1.8	2.6	2.1	2.4	2.8
G&A	1.0	0.9	0.9	0.96		1.2	1.0	1.0	1.1		3.4	3.7	3.8	4.3	5.0
Tot Operating Exp.	1.7	1.4	1.4	1.41		1.7	1.6	1.6	1.8		5.2	6.3	5.9	6.7	7.8
Operating Income	(0.1)	0.2	0.9	0.8		0.0	0.1	0.8	1.2		(2.5)	(1.6)	1.8	2.1	3.0
Net Interest	(0.1)	(0.1)	($0.1)	(0.1)		(0.1)	(0.1)	0.0	0.0		(0.1)	(0.5)	(0.4)	(0.2)	0.0
Other income	0.0	0.0	$0.1	0.0		0.0	0.0	0.0	0.0		0.1	(0.3)	0.1	0.1	0.1
Pretax Income	(0.2)	0.1	$0.8	0.7		(0.1)	(0.0)	0.8	1.2		(2.5)	(2.4)	1.4	2.0	3.0
Taxes	(0.0)	0.0	0.0	0.1		0.0	0.0	0.0	0.0		0.0	0.0	0.1	0.0	0.3
Tax Rate	2.4%	0.0%	2.6%	8.6%		-2.3%	0.0%	0.0%	0.0%		(0.0)	-0.3%	5.5%	0.0%	10.0%
Net Income	(0.2)	0.1	0.8	0.7		(0.1)	(0.0)	0.8	1.2		(2.5)	(2.4)	1.3	2.0	2.7
EPS-Basic	($0.01)	$0.00	$0.04	$0.03		($0.00)	($0.00)	$0.03	$0.05		($0.13)	($0.12)	$0.07	$0.09	$0.12
EPS-Fully dil.	($0.01)	$0.00	$0.04	$0.03		($0.01)	($0.00)	$0.03	$0.05		($0.13)	($0.12)	$0.06	$0.09	$0.11
Non-GAAP	$0.01	$0.00	$0.05	$0.05		$0.01	$0.00	$0.03	$0.05			($0.08)	$0.13	$0.10	$0.14
Non-GAAP Diluted	$0.01	$0.01	$0.05	$0.04		$0.01	$0.00	$0.03	$0.05			($0.08)	$0.11	$0.10	$0.14
Share Out	20.1	20.2	20.2	20.6		20.7	20.9	23.4	23.4		19.4	19.6	20.3	22.1	22.2
Fully diluted shares	20.1	21.0	21.1	22.8		22.3	21.1	23.4	23.4		19.4	19.6	22.8	22.5	23.7

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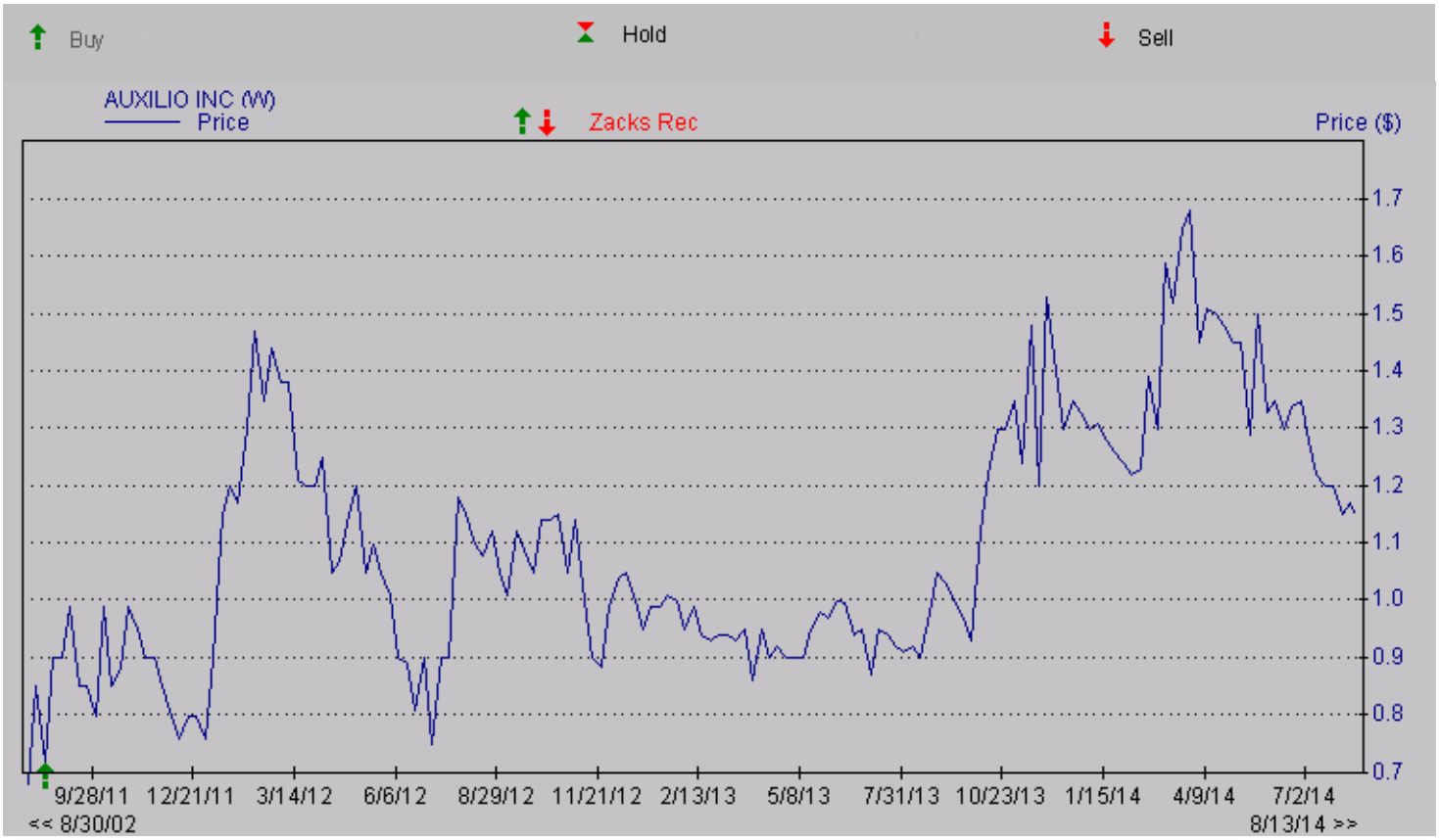

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