Zacks Small-Cap Research

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Auxilio Inc. (AUXO-OTCQB)

AUXO: Acquisition of Delphiis Widens Product Offering to Security Service and HIPAA Compliance
OUTPERFORM

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	08/21/2011
Current Price (07/08/14)	$1.29
Six- Month 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	**$0.87**
One-Year Return (%)	**43.33**
Beta	**1.60**
Average Daily Volume (sh)	**9,802**
Shares Outstanding (mil)	**21**
Market Capitalization ($mil)	**$27**
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	**4**

Risk Level	**High**
Type of Stock	**Small-Growth**
Industry	**Outsourcing**
Zacks Rank in Industry	**14 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	13 E	13 E	13 E	51 E
2015					57 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	$0.02E	$0.03 E	$0.05 E	$0.13 E
2015					$0.16 E

Zacks Projected EPS Growth Rate - Next 5 Years % **18**

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WHAT'S NEW

Auxilio buys Delphiis to Add Security Services and Aid HIPAA Compliance

On July 7, 2014, AUXILIO, Inc., the California-based Managed Print Services (MPS) company for the health care industry, announced the acquisition of Delphiis for $2.7 million in cash and stock (plus the potential for additional earn outs based on performance.) This is comprised of 930,000 shares and $1 million in cash initially with additional payments to be made as revenue goals are met. The deal closed as of July 7, 2014 and the two companies, physically close to each other are already combined. Due to the fact that Delphiis was using cash accounting, Auxilio is still adjusting numbers to a GAAP basis and will give more information on the impact the acquisition will have on Auxilio revenues and expenses when it releases numbers for the September quarter. As a result **we are not adjusting numbers until the June quarter is reported**. We do know the company is cash flow positive, is small, and employed only five full time people. We do not expect the acquisition to materially impact numbers current although it could help to increase growth rates long term as it increases the company's total addressable market.

Delphiis, located in Orange County, CA was founded in 2011 and is focused on selling enterprise security services. It already has a few large West Coast university hospital customers and generates some revenue. Its security solution is sold in three parts: as a consultant, as a SaaS software platform and as managed services. The company's products are higher margin than Auxilio's, possibly a 40% gross margin versus Auxilio's end margin of 35%.

Since there is no overlap in the customer base, there is an excellent opportunity to cross sell. If Auxilio could sell to Delphiis' customers it could add over $12 million in revenue, while if Delphiis could penetrate the 100 hospitals in Auxilio's client base, the company could add over $15 million in revenues. Combined this potential $27 million is significant given the estimated $51 million in total sales we expect for Auxilio in 2014. Auxilio will have to add sales support to pursue this business however.

Delphiis' founder Mike Gentile, is a well-known security expert will be joining Auxilio, and his renowned should be a big plus for the company. He is the author of two books: The Ciso Handbook: The Practical Guide to Securing Your Company, and Ciso Soft Skills: Securing Organizations Impaired by Employee Politics, Apathy and Intolerant Perspectives. Additionally, Delphiis will benefit by having the clout of being a transparent public company with stability to show potential clients who may have been hesitant to do business with a small private startup.

In addition to general security, Delphiis' product offering is a solution to a hospital's concern about complying with the Health Information Portability and Accountability Act of 1996 (HIPAA) standards and preventing breaches of information that can incur heavy fines, as well as detrimental press. Fines for breaching HIPAA laws can be upwards of $1.5 million per occurrence and costs the industry $5.6 billion annually. The synergy the acquisition brings is not only can the two companies' sales force target hospitals efficiently, but it has been shown that as much as 27% of breaches are paper based, not digital, which is Auxilio's forte.

Fines can be significant for non-compliance as shown on the following chart. The record fine to date was $4.8 million dollars levied against New York and Presbyterian Hospital and Columbia University "following their submission of a joint breach report, dated September 27, 2010, regarding the disclosure of the ePHI of 6,800 individuals, including patient status, vital signs, medications, and laboratory results."

HIPAA Violation	Minimum Penalty	Maximum Penalty
Individual did not know (and by exercising reasonable diligence would not have known) that he/she violated HIPAA	$100 per violation, with an annual maximum of $25,000 for repeat violations (Note: maximum that can be imposed by State Attorneys General regardless of the type of violation)	$50,000 per violation, with an annual maximum of $1.5 million
HIPAA violation due to reasonable cause and not due to willful neglect	$1,000 per violation, with an annual maximum of $100,000 for repeat violations	$50,000 per violation, with an annual maximum of $1.5 million
HIPAA violation due to willful neglect but violation is corrected within the required time period	$10,000 per violation, with an annual maximum of $250,000 for repeat violations	$50,000 per violation, with an annual maximum of $1.5 million
HIPAA violation is due to willful neglect and is not corrected	$50,000 per violation, with an annual maximum of $1.5 million	$50,000 per violation, with an annual maximum of $1.5 million

Additionally, entities can face criminal penalties if they "knowingly" obtain or disclose information. They can face a fine of up to $50,000, as well as imprisonment up to one year. Offenses committed under false pretenses allow penalties to be increased to a $100,000 fine, with up to five years in prison. Finally, offenses committed with the intent to sell, transfer, or use individually identifiable health information for commercial advantage, personal gain or malicious harm permit fines of $250,000, and imprisonment for up to ten years.

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 10Xs our expected 2014 non-GAAP EPS of $0.13 with earnings growth over 18%
- Given the earnings and revenue growth, a valuations of its peers, we believe the company should trade at least 15Xs 2014 fully diluted non-GAAP EPS of $0.13 or $2.00.

	March	June	Sept	Dec	March	June	Sept	Dec					
	Q1 13	Q2 13	Q3 13	Q4 13	Q1 14A	Q2 14E	Q3 14E	Q4 14E	2011	2012	2013	2014E	2015E
REVENUE													
Net Revenue	$10.1	$9.8	$10.8	$12.3	$10.2	$12.7	$12.9	$15.2	$21.8	$35.6	$43.0	$51.00	$57.1
Yr-to-yr Gr.	54.3%	-8.6%	23.1%	28%	2%	30%	19%	23%	42%	63%	21%	19%	12%
OPERATING EXPENSES													
Cost of goods sold	8.5	8.2	8.6	10.0	8.5	10.5	10.5	12.3	19.1	31.0	$35.3	41.8	46.2
Gross Margin	1.6	1.6	2.2	2.2	1.7	2.2	2.4	2.9	2.7	4.6	7.7	9.2	10.9
% of Sales	15.6%	16.8%	20.6%	18.2%	17.0%	17.3%	18.6%	18.9%	12.4%	13.0%	17.9%	18.0%	19.1%
S&M	0.7	0.5	0.5	0.46	0.5	0.6	0.6	0.6	1.8	2.6	2.1	2.3	2.7
G&A	1.0	0.9	0.9	0.96	1.2	1.0	1.1	1.1	3.4	3.7	3.8	4.4	5.1
Tot Operating Exp.	1.7	1.4	1.4	1.41	1.7	1.6	1.7	1.7	5.2	6.3	5.9	6.7	7.8
Operating Income	(0.1)	0.2	0.9	0.8	0.0	0.6	0.7	1.2	(2.5)	(1.6)	1.8	2.5	3.1
Net Interest	(0.1)	(0.1)	($0.1)	(0.1)	(0.1)	0.0	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)	0.6	0.7	1.2	(2.5)	(2.4)	1.4	2.2	3.1
Taxes	(0.0)	0.0	0.0	0.1	0.0	0.1	0.1	0.1	0.0	0.0	0.1	0.2	0.3
Tax Rate	2.4%	0.0%	2.6%	8.6%	-2.3%	10.0%	10.0%	10.0%	(0.0)	-0.3%	5.5%	10.0%	10.0%
Net Income	(0.2)	0.1	0.8	0.7	(0.1)	0.5	0.6	1.1	(2.5)	(2.4)	1.3	2.0	2.8
EPS-Basic	($0.01)	$0.00	$0.04	$0.03	($0.00)	$0.02	$0.03	$0.05	($0.13)	($0.12)	$0.07	$0.10	$0.14
EPS-Fully dil.	($0.01)	$0.00	$0.04	$0.03	($0.01)	$0.02	$0.03	$0.05	($0.13)	($0.12)	$0.06	$0.08	$0.12
Non-GAAP	$0.01	$0.02	$0.05	$0.05	$0.01	$0.03	$0.04	$0.06		($0.08)	$0.13	$0.14	$0.16
Non-GAAP Diluted	$0.01	$0.02	$0.05	$0.04	$0.01	$0.03	$0.04	$0.05		($0.08)	$0.11	$0.13	$0.16
Share Out	20.1	20.2	20.2	20.6	20.7	20.7	20.8	20.9	19.4	19.6	20.3	20.3	20.4
Fully diluted shares	20.1	21.0	21.1	22.8	22.3	23.2	23.2	23.5	19.4	19.6	22.8	23.7	23.8
Yr-to-yr Gr.									0.8%	1.1%	16.6%	3.7%	0.4%

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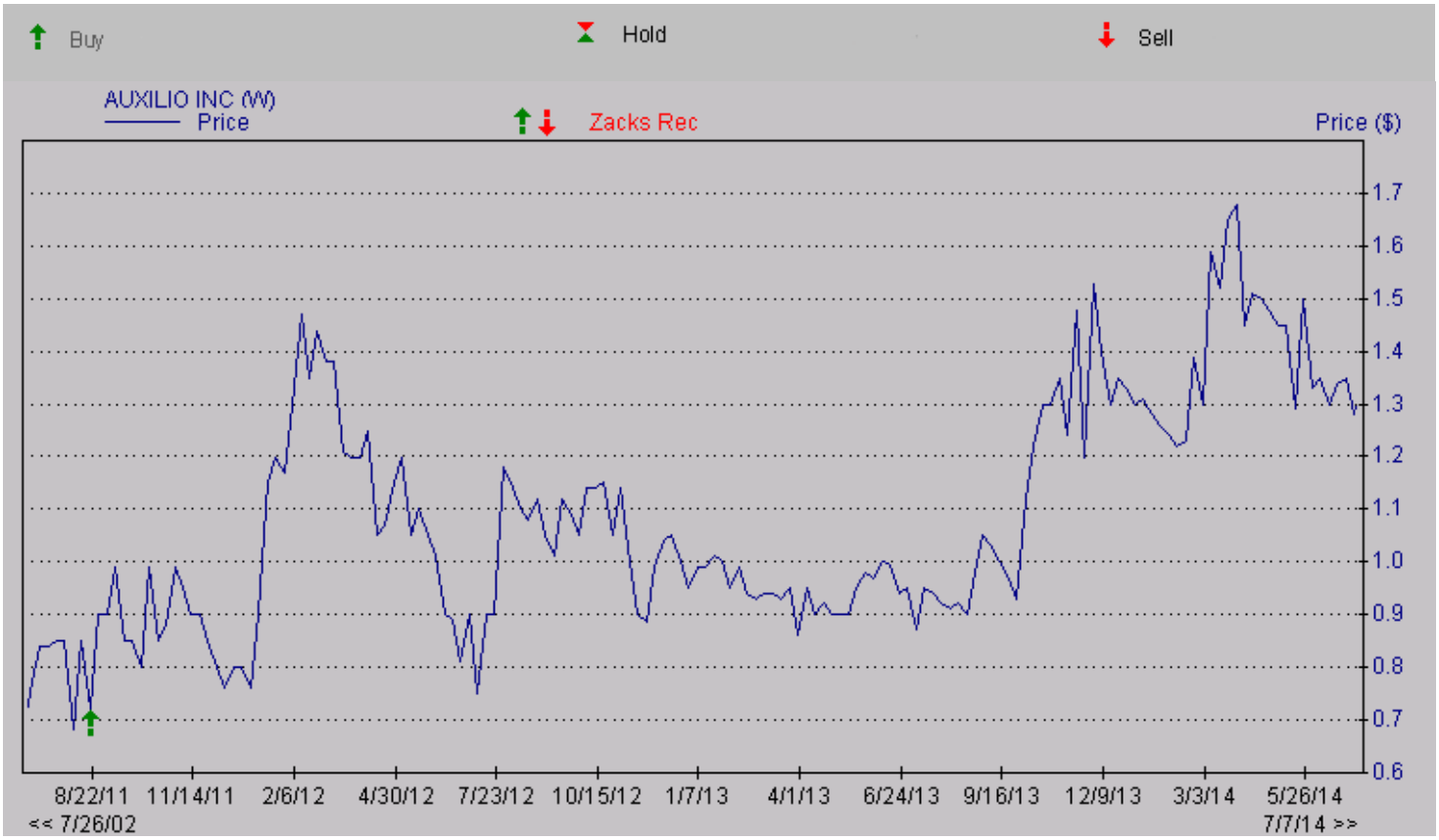

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