Zacks Small-Cap Research

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Lisa Thompson
312-265-9154
lthompson@zacks.com

scr.zacks.com

10 S. Riverside Plaza, Chicago, IL 60606

Auxilio Inc. (AUXO-OTCQB)

AUXO: Slow Start to the Year Creates Buying Opportunity
OUTPERFORM

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 and 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. It signed its first customer in this area this quarter.

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	08/21/2011
Current Price (05/13/14)	$1.35
Six- Month Target Price	**$2.00**

SUMMARY DATA

52-Week High	**$1.72**
52-Week Low	**$0.87**
One-Year Return (%)	**50.85**
Beta	**1.64**
Average Daily Volume (sh)	**20,368**
Shares Outstanding (mil)	**21**
Market Capitalization ($mil)	**$28**
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 (%)	**24.7**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**12.3**
P/E using 2014 Estimate	**10.4**
P/E using 2015 Estimate	**8.4**
Zacks Rank	**3**

Risk Level	**High**
Type of Stock	**Small-Growth**
Industry	**Outsourcing**
Zacks Rank in Industry	**8 of 17**

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

Weak Hardware Sales Results in Flat Revenues Providing A Buying Opportunity

On May 14, 2014, AUXILIO, Inc., the California-based Managed Print Services (MPS) company for the health care industry, reported flat revenues versus a year ago. Sales in Q1 were almost even at $10.2 million versus $10.1 million a year ago. This is somewhat of a disappointment versus the 28% revenue growth we saw in the fourth quarter of last year and the 23% in Q3. However this was the result of selling less hardware in the quarter, recurring revenues were still up 10%. Due to the timing of large contracts it is difficult to predict revenues on a quarterly basis but the company still stands pat on its thinking on business on an annual basis.

Gross margins however increased in the quarter to 17% versus 15.6% the year before primarily because of the reduction in hardware as a percent of sales. Sequential this was down from 18.2% in Q4. The company is targeting a long-term gross margin of 20-25%.

Total operating expenses declined year over year. While the reported number was $35,000 less than last year, this year included $100,000 in non-recurring severance expense making it truly a $135,000 reduction. This improvement was helped primarily by the termination of a channel partner agreement last year.

As a result, non-GAAP income from operations, excluding stock based compensation, during the quarter was $254,000 plus the $100,000 one-time expense or $354,000 or a positive $0.01 per share versus our estimate of $0.02. This compared to a positive non-GAAP $0.02 EPS for 2012. On a GAAP basis the company reported breakeven this year versus a loss of $0.01 last year.

The company was slightly cash flow positive and added slightly to its cash balance.

Progress in Q1 2014

The company also announced the signing of three major contracts this quarter. One with New Hanover Hospital in Wilmington, NC, one with USCD and a renewal with a major customer, Sutter West Bay. Sutter Bay was not one of the major four clients in 2013, but with the addition of Sutter Bay East, it will be a top four in the 2014 year. Since only nine were signed in all of 2013, the company is on track to add more new business this year than last. Previously, the company indicated that is already had contracts signed to get the company to a total of $42 million in recurring revenue versus the $37.1 million it generated in 2013. If we add the same $6 million in additional hardware revenues sold last year to that $42 we could reach $48 million for 2014 without any further growth for the rest of the year.

An important event in the quarter for the company was its first contract for IT services consulting a new venture that expands its addressable market. The deal was signed with a New England hospital and is small generating perhaps between $200,000 and $1 million for the year. More importantly is that the company has some evidence that its strategy of branching beyond managed print services could bear fruit quickly and gain some traction among its current customer base. Investors should track this progress at it could provide some big upside for the company.

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 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.

INDUSTRY OUTLOOK

Auxilio is still a small player in the managed print services business as shown on the Gartner chart below where it is not large enough to meet the criteria for inclusion. As seen below all of the large players are copier manufacturers except ARC that concentrates on the construction business. This leaves Auxilio as a partner that has no incentive to sell excess equipment or to prefer one choice to the others.

Gartner 2013 Managed Print Services Magic Quadrant



VALUATION

Auxilio is a traditional services company with a high degree of recurring revenues and as such should be afforded a PE in line with its growth rate. We believe the company can grow revenues at 20% and earnings much faster than that as it is has a scalable business model and has just moved to sustainable profitability in 2013. It should be able to improve margins for the next few years as it grows into it long term goals. Versus other public companies that provide managed print services, such as ARC and CDW, we see that they trade at a PE multiple over their growth rates. Using 2014 EPS for AUXO, versus these companies the stock should trade between On a PE basis we believe the company should trade at 15Xs its 2015 EPS or approximately $2.00 within the next six months.

Public Comps Performance and Valuation Data ($ in millions)

	Cal 2014E Revenue	LTM EBIDA Margin	5-Yr Future CAGR	Cal '14 P/E	P/E/G	EV/2014E Sales
ARC	$418	15.9%	13.3%	25.8	1.9	1.2
CDW	$11,550	6.6%	12.6%	13.5	1.1	0.7
NUAN	$2,096	10.2%	0.8%	12.7	NM	3.0
Average	$4,688	10.9%	8.9%	17.4	1.9	1.6
Median	$2,096	10.2%	12.6%	13.5	1.1	1.2

RISKS

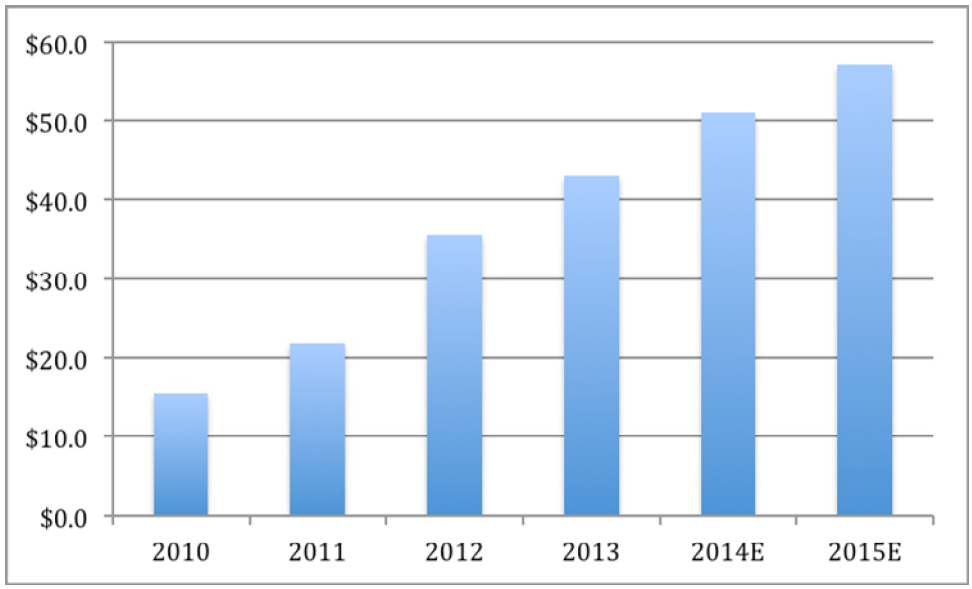
- The greatest risk in Auxilio is its reliance of over half its revenue on four or five large customers. The loss of any of them could cause great damage to the stock price.
- Auxilio has very low trading volume that could make it difficult to get in and out of the stock.
- The health care industry is in flux and there could be an increase in the sales cycle as hospitals focus on other aspects of their business
- The new electronic medical record mandate could cut into the production of paper documents

PROJECTED INCOME STATEMENT

For 2014 we are forecasting Auxilio to generate $51 million in revenues versus $43 million in 2013 given long term contracts already booked, growth in its sales force, and its increased ability to penetrate larger customers given its now-proven track record. With increased margins due to operating efficiencies, we believe the company can grow earnings even faster. Moving from just 4% operating margins today to 6% next year could increase operating earnings over 50%. Given a slightly higher state tax rate and lower interest expense due to the maturing of convertible notes, we believe non-GAAP EPS could go from $0.09 to $0.13 in 2014. The company still has $15.5 million in federal tax loss carry-forward and $8.5 million in state tax loss carry-forward that should keep them at virtually zero taxes except for certain states.

In 2015 we expect the company to grow another 15% or faster as it adds additional IT services to its product offerings and continues its market penetration. Revenues could reach $57 million and non-GAAP EPS of $0.16.

Auxilio Revenues (in millions)



	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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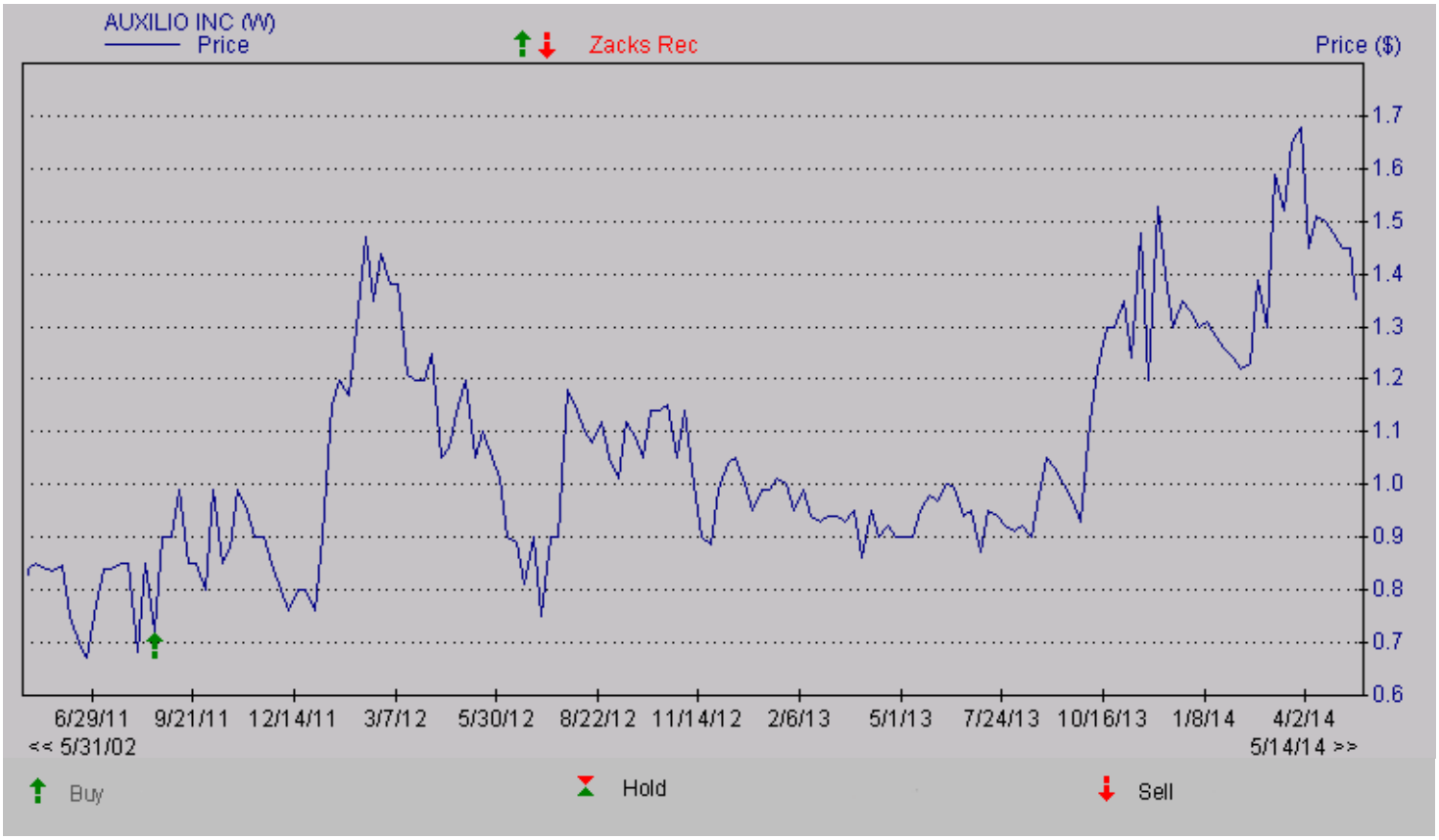

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