

Transcript of initial interview with Mr. Joseph J. Flynn



President & CEO of Auxilio Inc.



OTCQB: AUXO

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Joseph J. Flynn - President & CEO. Joseph J. Flynn is the co-founder and President & CEO of Auxilio. Under Flynn's leadership and strategic direction, the company has experienced continued and successful growth since its inception in 2004. He is an accomplished business leader in the IT, media and market research industries with over 20 years of international and domestic business management experience with some of the world's largest global companies such as; the Nielsen Corporation and Advanstar Communications. Mr. Flynn is fluent in Spanish, French and Portuguese and is a graduate of the Catholic University of America in Washington DC with a Bachelor of Arts in International Affairs.

Smallcaps Investment Research: A warm welcome everyone to a new interview on Smallcaps Investment Research. We're thrilled to have Mr. Joe Flynn, the President & CEO of Auxilio Inc. with us today. Auxilio provides solutions and services that mitigate risk, reduce costs and provide operational efficiency to the healthcare industry in the United States. The Company is listed on the OTCQB market with ticker symbol AUXO. Thank you for joining us Joe, welcome.

Joe Flynn: Thank you for inviting me.

As this is our initial interview, could you give us an introduction of Auxilio, its history and its activities?

Absolutely. Auxilio was started in 2004. The Company was started by myself and my original partner Etienne Weidemann, as well as the help of a boutique investment group out of Salt Lake City, called Cambria Capital. Auxilio has been public since its inception.

The Company was created with the idea that the way in which business is done in hospitals in the United States continues to be very paper intensive, basically, an inefficient and costly process.

So we saw an opportunity to create an outsourced IT management services firm that would take over the burden of managing the cost of paper production, and also the management of all the different vendors related to this process. Our solution reduces costs, and removes some of the pressure from very overburdened information technology staff at hospitals.

It caught fire pretty quickly after we launched the concept, as we were able to contract a number of hospitals in Southern California, as well as in Northern California.

Then about a year and a half later, we contracted with a very large health system on the east coast, called Barnabas Health. This group has a lot of the hospitals in the state of New Jersey and is actually the second largest employer in that state. Those were the early days.

Since then, the Company went from about four hospitals and \$800,000 in revenue in 2004, to almost 320 hospitals and around \$60 million in revenue today.

We believe there are still significant growth opportunities for Auxilio, knowing that there are more than 6,700 individual acute care facilities or hospitals, and thousands of independent clinics.

Even though some of those hospitals are too small for us. We measure hospitals by number of beds. And our target is hospitals with 200 beds and above. So if you narrow that down, there are probably about 4,000 potential targets for us, still a tremendous upside opportunity.

Great information. Auxilio generates revenue from a number of sources. Let's discuss them one by one in more detail. First, the Company's core business unit provides Managed Print Services. How does that work exactly, and can you maybe give us an example of the cost savings that you managed to produce for a particular customer?

When we start with a new potential customer, we first determine the utilization fee. Our customers only pay us a per document produced fee. Inside that fee, let's say 3.5 cents per document, are all the costs related to the production of that document.

So for example, if a hospital produces 10 million documents per month, which is a fairly large hospital, then our monthly fee would be about \$350,000 a month.

In order to determine the exact savings that we can offer a customer, we first have to find out the hospital's current cost. We analyze all the volumes of all the machines producing paper, producing copies. We also analyze the accounts payable in areas that are related to this, such as the toner ink, the labor, the lease cost, equipment purchases, any kind of processing fees, leasing fees, etc.

That way, we identify the total monthly paper volume and cost for the hospital. We divide those two and find that it's costing a hospital maybe \$0.04 per produced page. From there we determine our fee. We really like to target about 25% gross margins for Auxilio over the life of the contract, and about 20% savings for our customers.

To give you an example, the health system that I mentioned before, Barnabas Health, has been a customer of ours since 2005. During that time span, we've saved them around \$8 million. When we started, the health system produced about 18 million documents a month, now it's down to about 13 million.

And that's really based on the efforts we made in driving out volumes and rightsizing the amount of equipment that they buy. Often times, the reason we exist is because the health systems are really at the mercy of equipment vendors like Xerox, Konica Minolta, or Canon. Those companies are only interested in selling as much equipment as they can. As a result, the hospitals end up buying a lot more equipment than they actually need.

So our goal is to go in, wrap our heads around the expense, guarantee its savings

upfront, but continue to drive expenses down while maintaining our margin throughout. If we can save our customers money, then they're obviously very happy. That's also the reason why we've had a very strong renewal rate. So far, about 90% of our customers have renewed our services since we started the Company.

Auxilio also has a Data Security Group, called Redspin. What services does this unit provide and to whom?

Online security has become a major issue because both criminal organizations and state sponsored groups have hackers that are trolling the internet to grab valuable information. Interestingly enough, healthcare information is extremely valuable because it provides an enormous amount of data on the life of an individual.

Over the course of the last three or four years, we started to see that regulations around securing patient information has become a very serious issue. In fact, the U.S. government has a regulation known as HIPPA, which is the **Health Information Privacy and Protection Act**. This essentially forces healthcare providers to ensure that private health information is absolutely safeguarded from being exposed to the public.

Exactly for this reason Auxilio entered the security business. Our customers were coming to us with concerns about the print environment being extremely exposed to network hackers because all these devices are on the network. Further, these hospitals are producing millions of pieces of paper a month. Most of that information has patient health information on it.

Consequently, we acquired Redspin just over a year ago to help us identify the vulnerabilities in the networks and the vulnerabilities in the hospitals. Redspin basically provides paid for assessments on the vulnerabilities of hospital networks, it does HIPPA risk assessments, penetration testing and security assessments and it provides consulting about how to remediate those problems.

By acquiring Redspin we learned a lot about this industry and we are extremely excited about the opportunities to expand in this area. In order to expand, there are a number of companies with which we can partner or possibly even acquire.

Cyber security is obviously a hot topic, and very critical in hospitals, which are handling millions of patients' medical records. Can you give us an idea of the scale of the current problem?

The scale is endless. Almost on a weekly basis a hospital system gets breached by hackers. I would venture to say that the product market alone in healthcare is probably north of \$4 or \$5 billion. And the services market is even becoming larger. The demand on the IT budgets of hospitals is really growing exponentially.

Just recently here in California a prestigious hospital called the Hollywood Presbyterian was not only breached, but actually held ransom by hackers. The hackers, a Chinese group, hacked into the hospital's computer systems, held the entire network hostage and demanded a fee. The medical center ended up paying the fee and none of the information was released into the public.

Hollywood Presbyterian is not a very big place, so imagine if hackers get into a really large hospital, such as Johns Hopkins, Beth Israel Deaconess, or the Mayo Clinic.

In addition, at most of these big healthcare facilities not only patient information is at stake, but also intellectual property, as they are tied into university institutions where they're doing an enormous amount of research around medical devices or critical diseases. This is highly valuable intellectual property that needs to be protected.

And so we believe that by gaining that expertise and growing that expertise around this area really puts us in a strong position to grow this business going forward.

In June you announced a partnership with HealthWare Systems. The first

product that resulted from this cooperation is called iPLATFORM. Would you describe the product and its benefits for your customers, and what do you expect from it in terms of sales?

Because most hospitals are not for profit, they are many years behind other industries from an IT investment standpoint. There's really an enormous amount of inefficiency in the workflow on how things are done.

We found a small Company, called HealthWare, that had developed a number of very interesting software based platforms and modules that significantly increase the efficiency in basic workflows, specifically in hospitals.

For example, the admissions process in hospitals is still very paper based and essentially very inefficient which causes problems for the hospital in a number of ways. First, if they can't move patients through the hospital fast enough, then they can't get revenue. Second, once patients are admitted, they get sent from one department to another, all over the facility. Consequently, hospitals have no idea where all these people are.

So if they don't have a tracking system and an admission system that's essentially paperless and automated, then it's very manual and hack hazardous.

HealthWare has developed some incredibly interesting and effective solutions. We've private labeled their solutions under what we call iPLATFORM. These solutions help the patient enter in a tracking process, allowing hospitals to move patients through the system more rapidly. iPLATFORM also streamlines interdepartmental workflows, by centralizing the patient data from separate systems and combining them into a single electronic shared patient folder accessible to multiple systems. The hospital can configure these modules and integrate them into their existing platforms.

Although we just started offering the product, we're seeing a large demand for this in our

customer base, especially the larger health systems. Right now we have a number of pilot projects running which can turn into very large sales.

We're excited about this, we're at early stage discussions with our customers about this. And we see this as a big upside opportunity.

Let's move over to the Company's financials. Although revenue was slightly down in the second quarter, which ended June 30, 2016, earnings were up considerably. What were the main drivers for this strong improvement?

Towards the end of last year, we closed a number of very large health systems. The past quarters, we implemented no less than 85 hospitals. The most new hospital implementations we did in one year previous to this was about 35. So it's clear this was an enormous undertaking for us.

After we signed agreements with so many health systems, we pulled back a little on adding new ones because we wanted to make sure that we didn't mess up the implementation.

As those implementations take place, our costs rise and our margins decline. Once we've added those new businesses and those accounts come into maturity, our margins drive northwards again. That probably explains why we saw pretty strong margin improvements in the past quarter.

Now that the implementations are as good as over, we're again looking at a fairly large pipeline of new deals. And so we see 2017 as a growth year. I hope that the new accounts are brought on with higher margins going forward.

That's very good news. Can you also shed some light on your outlook for the Company's financials in the next few quarters?

We have a culture of not providing any specific guidance on our financial performance. The markets that we serve have long sales cycles. Because most

hospitals are not for profit, their management is very consensus driven. Sometimes, negotiating a contract takes 3 to 4 months. That's one of the reasons why we're hesitant to give guidance, as it's very difficult for us to know when exactly a new deal will close.

I can tell you though that we continue to remain very optimistic on both our long and short term prospects. We're looking to really take advantage of the opportunities in the document management space, the new relationship with HealthWare, and the continued opportunities in new customers in the security business.

I can confirm that we just had our first major cross sale. One of our MPS healthcare systems in North Carolina, signed up to take a very large deal with Redspin.

Terrific. Also the Company's balance sheet looks very solid with almost \$4.5 million in cash and only \$1 million in long-term debt.

We manage our growth well. Once we became profitable, we determined that we wanted to stay there and stop diluting our shareholders.

Good to know is that we have a banking relationship. So if we wanted to expand or make another acquisition, most of that can be done through debt. Most of my peers at my side in the public markets don't have that luxury. So we feel very fortunate.

And would you give us some more details about the Company's current stock repurchase program?

We continue to weigh the balance between stock repurchase and a very accretive acquisition. Thanks to our growth and position in the market place, we are presented with interesting acquisition opportunities almost on a weekly basis.

And can you tell us a little bit about yourself and the other key executives of the Company?

Auxilio has great team. I manage the Company with three other executives. I went to the Catholic University of America in Washington D.C. I graduated from there in 1987 with a double degree in Foreign Language Education and International Relations.

After I graduated, I got into the international technology media business and I was involved in organizing some of the largest technology trade shows. At that time there were a lot of American technology companies that were expanding overseas.

A few years later, as I got tired of working for other people, I wanted to start my own thing. That's when I met the Cambria Capital Group. We put our heads together to decide what markets we wanted to go after. And the rest, as they say, is history.

My CFO, Paul Anthony has been with Auxilio almost since the beginning. Paul worked for Coopers & Lybrand and then was the corporate controller for a company that was acquired by IBM. After that acquisition, I was able to recruit him. Paul is doing a great job. We never had to restate our earnings, we never had any SEC investigations or anything like that. We have a very clean slate and I attest a lot of that to Paul's abilities.

Our EVP of operations is a gentleman by name of Sean Hughes. Sean actually was employed with Catholic Healthcare East, our largest customer in 2010. Sean there was the number 2 IT person, he was the assistant CIO. He has an excellent background in IT services, in contract negotiations and vendor negotiations which is really what he does for us.

And Simon Vermooten is our EVP of Managed Print Services. After a short stint in the hotel business, Simon worked for a number of large document management firms, including Lexmark and IKON. Simon puts together all our deals.

And finally, on the Redspin side, we have Dan Berger who is the President of Redspin.

When we acquired the business, Dan came with Redspin. He has a long background in the IT services business.

What's your outlook for Auxilio for the next 12 to 18 months?

I think we'll see continued growth and focus on margin improvements. In addition, I foresee a continued focus on acquisition opportunities to really round out our service offerings. There are a lot of interesting small private companies out there. We obviously want to be very prudent in those decisions.

And before we go, what would you say are the 2 or 3 most compelling reasons for a long term investor to consider Auxilio today?

I would say that we believe that we're in the sweet spot of the healthcare industry in the United States, which is the healthcare provider industry that is woefully understaffed and woefully underinvested in key areas. And those key areas are risk mitigation or security, cost savings, and operational efficiency.

From a standpoint of our offering, we offer cost savings in the document management space, we offer risk mitigation with Redspin, and we offer operational efficiency with iPLATFORM. We feel that these are all areas for which there is high demand, predictable revenues, and increasing margins.

We feel that we're in an excellent position and we think we're going to put ourselves in an even better position if we make the right decisions related to acquisitions and or partnerships.

Fantastic. Joe, it's been a pleasure speaking with you. Thank you for helping us gain insight into Auxilio and I look forward to speaking with you again soon.

My pleasure, thank you.

Interview Feedback

We welcome your questions and feedback regarding this interview at:

<http://www.smallcaps.us/auxilio-ceo-joe-flynn-discusses-outstanding-growth-opportunities-in-us-healthcare-industry>

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