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Zacks Small-Cap Research

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Zynex Inc (ZYXI-OTC)

ZYXI: Q3 2011 Results. Another Top-Line Beat.

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	01/06/2011
Current Price (11/03/11)	$0.79
Target Price	**$1.40**

OUTLOOK

Q3 revenue, similar to Q2, came in meaningfully better than our estimates. However, this again did not translate to a beat on EPS as a result of operating expenses not falling as fast as we anticipated. SG&A continues to impact EPS growth. Operating expense control will to be the key for management to hit their 2011 EPS guidance and accelerate EPS growth for the long-term.

Despite concerns, which are baked into our valuation, we think the shares continue to trade on the cheap side.

We model EPS of $0.06 in 2011. We are maintaining our Outperform rating and price target of $1.40.

SUMMARY DATA

52-Week High	**$1.02**
52-Week Low	**$0.30**
One-Year Return (%)	**46.04**
Beta	**0.23**
Average Daily Volume (sh)	**4,991**
Shares Outstanding (mil)	**31**
Market Capitalization ($mil)	**$24**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**1**
Insider Ownership (%)	**N/A**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**63.8**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**79.0**
P/E using 2011 Estimate	**13.2**
P/E using 2012 Estimate	**6.1**
Zacks Rank	**N/A**

Risk Level	**Above Avg.,**
Type of Stock	**Small-Blend**
Industry	**Med Products**

Above Avg.,
Small-Blend
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ZACKS ESTIMATES

Revenue
(in '000 of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2010	4,875 A	5,742 A	6,657 A	6,810 A	24,084 A
2011	6,633 A	8,395 A	9,427 A	9,395 E	33,849 E
2012					39,067 E
2013					45,075 E

Earnings per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2010	$0.00 A	$0.00 A	$0.01 A	$0.00 A	$0.01 A
2011	-$0.00 A	$0.02 A	$0.02 A	$0.03 E	$0.06 E
2012					$0.13 E
2013					$0.16 E

Zacks Projected EPS Growth Rate - Next 4 Years % 20

WHAT’S NEW

Q3 2011 Financial Results: *Another Beat on the Top Line (but not on the bottom)...*

Revenue

Zynex reported financial results for the third quarter ending September 30, 2011 on November 3rd. Revenue of $9.4 million beat our $8.9 million estimate by just over 6%.

Total revenue consisted of $2.5 million (+22% y-o-y) in rentals and $7.0 million (+50% y-o-y) in product sales. Rental revenue, in particular, continues to come in stronger than our estimates and as a result, we have made upward revisions to this line in our model for the remainder of 2011 as well as later years.

	Actual Q3 2010	Actual Q3 2011	Y-o-Y Change	Zacks Est Q3 2011	Actual +/- Zacks est.
Consumables	$2,305	$3,434	49.0%	$3,398	1.1%
Equipment Sales	$2,320	$3,511	51.3%	$3,310	6.1%
Total Product Sales	$4,625	$6,945	50.2%	$6,708	3.5%
Rental Revenue	$2,032	$2,482	22.1%	$2,170	14.4%
	$6,657	**$9,427**	**41.6%**	**$8,878**	**6.2%**

Gross Margin

Gross margin was 79.5%, in-line with our 79.8% estimate. Gross margin has shown sequential improvement every quarter since Q4 2010, despite revenue from higher-margin rentals falling as a percentage of total sales over that same period. The improvement in gross margin is a result of an impressive 850 basis point widening in product sales margin (from 70.3% in Q4 2010 to 78.8% in Q3 2011). Management indicated on the call the GM could again benefit as a result of the recent launch on NexWave, the company's newest addition to their electrotherapy business, sales of which are expected to carry a relatively high margin.

Net Income / EPS

Net income and EPS were $591k and $0.02, largely in-line with our $772k and $0.02 estimates. Similar to Q2, although revenue came in ahead of our estimate, this did not translate into a beat on the bottom line - also similar to Q2, the reason was mostly due to lower than expected leverage from SG&A expenses.

Elevated SG&A has been a thorn in Zynex's side for some time, although they have recently made great strides in reducing this as a percentage of sales (i.e. - increasing operating leverage). SG&A as a percentage of revenue has fallen from 80.3% in Q1 2011 to 67.8% in the most recent quarter and was 71.5% through the first nine months of 2011, down from 72.3% over the same period in 2010. Our initial (and current) investment thesis with Zynex is that we expect to see ever greater operating leverage going forward, and which translates into more revenue flowing to the bottom line. Management continues to work to whittle away at operating expenses, the fruits of which we expect to be a significant contributor to EPS growth.

Cash

Zynex exited Q3 with $761k in cash, approximately flat from Q2 ($783k). Cash from operating activities was an inflow of $216k. Investing activities used $384k. Total drawn on the credit line was $3.38 million at the end of Q3, up slightly from $3.20 million at Q2. Management noted on the call that they have already secured a new credit line from a different lender and will be terminating the existing loan during Q4. The new credit line has similar terms.

BUSINESS UPDATE / GUIDANCE

- **Blood Monitoring Device Development:** In April 2011 Zynex announced they had signed an agreement with OmniaVincit, LLC to conduct the first clinical evaluation of the company's blood volume monitoring device which is being developed in Zynex's new Monitoring division. Trials are expected to commence in Q4 2011. Our model does not currently incorporate any revenue contribution from Zynex's new Monitoring and Diagnostics businesses.

- **International Sales:** International sales were not disclosed but management noted that they remain insignificant, although growing. Zynex will continue to place a greater emphasis on expanding its international presence through signing new distribution contracts.

- **NexWave Launch:** NexWave, Zynex's newest addition to their electrotherapy business, received FDA 510(k) clearance and launched. Management indicated on the call that it has received a warm reception from customers.

- **Shareholder Lawsuit / Anthem:** Zynex filed an 8-K on September 23, 2011 reporting that they came to terms with Anthem Blue Cross Blue Shield relative to a dispute between the two companies over refund requests. As a reminder, in April 2010 Zynex received a refund request from Anthem in the amount of $1.3 million. Zynex estimated at the time that they had about $1.5 million worth of rebillings that were not properly reimbursed by Anthem - which would more than offset Anthem's claim. The 8-K notes that, per a settlement agreement, Zynex will pay Anthem $226k and all claims will be resolved. Zynex will make an initial $60k payment and will pay the balance over the next 12 months. We view this settlement as good news for Zynex and removes an issue that had been hanging over the company since the initial claim was filed by Anthem.

- **NeuroDyne:** In August Zynex announced that they signed a letter of intent to acquire NeuroDyne Medical Corp, a privately-held Cambridge, MA based manufacturer of medical devices for electromyography (sEMD) and autonomic nervous system monitoring. NeuroDyne's suite of products appear to complementary to Zynex's and are used for a variety of purposes including spinal imaging (via sEMD) and neuromuscular rehabilitation. NeuroDyne's website notes their world-wide customer base is 3,000 strong and includes notable names such as the U.S. Air Force, Mayo Clinic and J&J, among several others. While terms of the proposed deal or NeuroDyne's financial history have not been disclosed, we view this as a potentially positive step towards Zynex's quest to further grow revenue and profitability. Zynex is currently in the due diligence process - no timeline was given on if or when the deal might close.

- **ActivaTek Inc:** On October 31st Zynex announced that it signed an agreement with ActivaTek, Inc. to sell their lontophoresis products via Zynex's U.S. sales force. Lontophoresis is a non-invasive medication delivery system using a small electrical charge applied to a patch which is affixed to the skin. Zynex will begin selling the products immediately.

- **2011 Guidance:** Management narrowed the range of their previously issued revenue and EPS guidance for 2011. Previous revenue and EPS guidance of $32MM - $34MM and $0.08 - $0.10 was more specifically narrowed to $33MM - $34MM and $0.08 - $0.09.

OUR 2011 OUTLOOK

We now look for Zynex to post revenue of $33.9 million in 2011, up from $33.2 million prior to Q3 results. Although we now expect a slightly stronger Q4 (in revenue and net income) than what we modeled prior to Q3 results, our full-year EPS estimate has moved from $0.07 to $0.06, reflecting a rounding difference in Q3 EPS (we modeled Q3 EPS of $0.0248, actual Q3 EPS was $0.0195). Our full-year EPS estimate could prove conservative (and is clearly very conservative relative to guidance) if management successfully trims SG&A expense at a faster rate than we model, gross margins widen further than what we estimate (we expect another 100 basis point improvement from Q3) or revenue comes in above management's guidance.

Valuation

Based on our model we now look for EPS to grow at a four-year CAGR of about 20% through 2013. We use a PE/G ratio of 1.1x to value Zynex. This represents a 20% discount to the approximate 1.4x PE/G that the industry currently trades at. Our discount reflects certain concerns and risks that we have outlined in our initiation report on Zynex (2/14/2011). We cited the lingering Anthem lawsuit as a significant concern - since this has since been resolved we have haircut our PE/G discount from 33% to the current 20%. Resolution of other concerns and/or mitigation of risks would likely warrant an even lower PE/G discount and, therefore, a higher price target. Meaningful progress with commercialization of Zynex's pipeline, including their blood monitoring device, could provide some upside relative to our current revenue and EPS estimates. Actual EPS falling short of our estimates and/or adverse consequences related to risks/concerns could prompt us to lower our valuation for Zynex.

Applying the 1.1x PE/G and estimated four-year EPS CAGR of 20% to our 2011 EPS estimate of $0.06, results in a value of $1.32 / share - we round this to $1.40 - as such our price target remains unchanged.

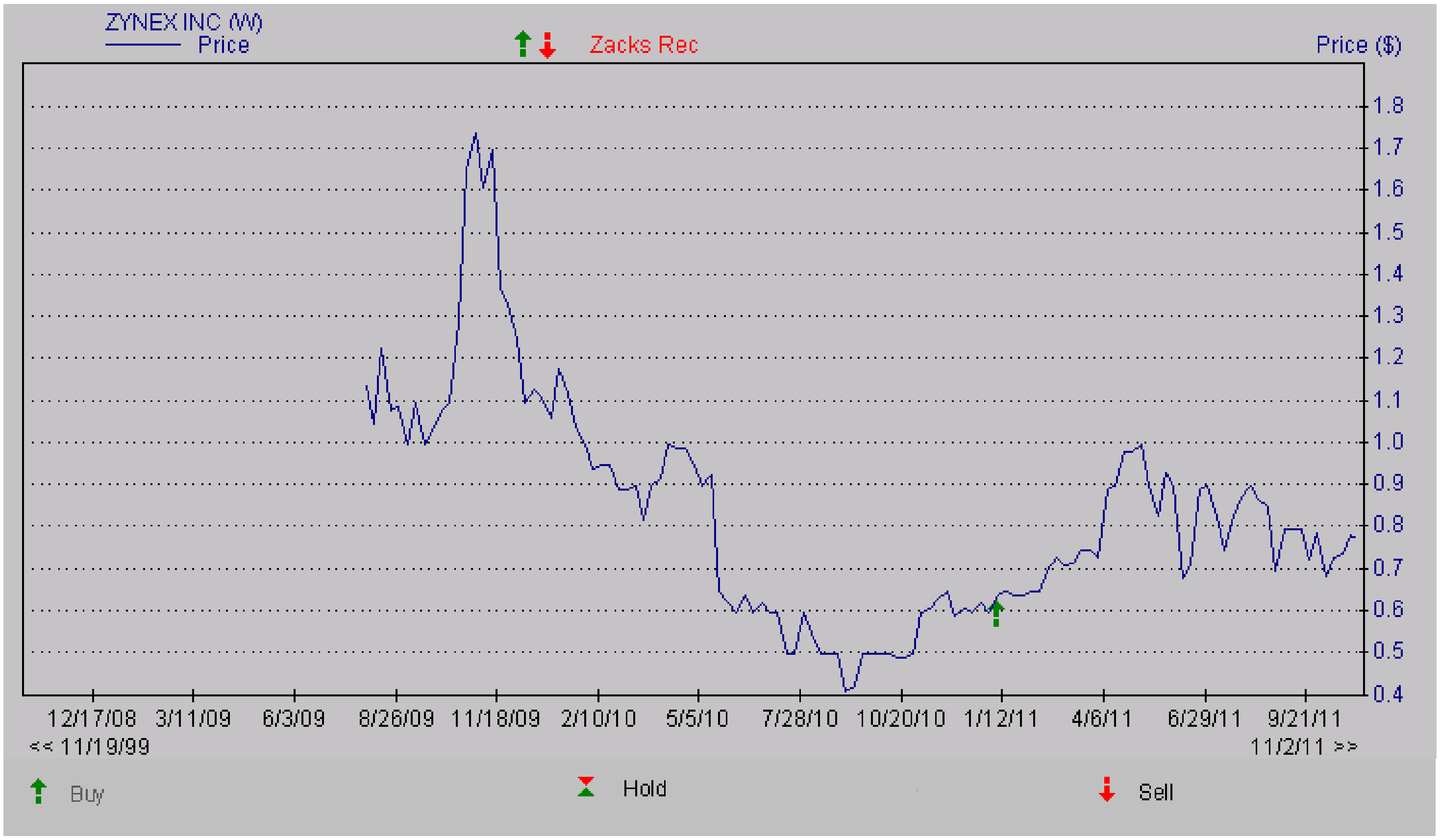
FINANCIAL MODEL

Zynex Inc.

	2010 A	Q1A	Q2A	Q3A	Q4E	2011 E	2012 E	2013 E	2014 E
Rental revenue	$8,532.5	$2,448.0	$2,447.0	$2,482.0	$2,328.0	$9,705.0	$8,275.0	$7,850.0	$7,635.0
YOY Growth	*-19.0%*	*7.8%*	*4.8%*	*22.1%*	*22.9%*	*13.7%*	*-14.7%*	*-5.1%*	*-2.7%*
Consumable sales	$9,101.0	$2,659.0	$3,106.0	$3,434.0	$3,448.7	$12,647.7	$14,650.2	$16,903.2	$17,691.0
YOY Growth	*44.7%*	*33.7%*	*38.0%*	*49.0%*	*34.9%*	*39.0%*	*15.8%*	*15.4%*	*4.7%*
Equipment sales	$6,450.6	$1,526.0	$2,842.0	$3,511.0	$3,618.0	$11,497.0	$16,142.0	$20,322.0	$21,850.0
YOY Growth	*247.6%*	*148.0%*	*146.0%*	*51.3%*	*53.3%*	*78.2%*	*40.4%*	*25.9%*	*7.5%*
Product sales revenue	$15,551.6	$4,185.0	$5,948.0	$6,945.0	$7,066.7	$24,144.7	$30,792.2	$37,225.2	$39,541.0
YOY Growth	*90.9%*	*60.7%*	*74.6%*	*50.2%*	*43.7%*	*55.3%*	*27.5%*	*20.9%*	*6.2%*
Total Revenues	$24,084.1	$6,633.0	$8,395.0	$9,427.0	$9,394.7	$33,849.7	$39,067.2	$45,075.2	$47,176.0
YOY Growth	*28.9%*	*36.1%*	*46.2%*	*41.6%*	*38.0%*	*40.5%*	*15.4%*	*15.4%*	*4.7%*
Rental COGS	$802.1	$334.0	$392.0	$465.0	$349.2	$1,540.2	$1,282.6	$1,216.8	$1,183.4
Rental margin	*90.6%*	*86.4%*	*84.0%*	*81.3%*	*85.0%*	*84.1%*	*84.5%*	*84.5%*	*84.5%*
Sales COGS	$4,399.8	$1,110.0	$1,335.0	$1,470.0	$1,484.0	$5,399.0	$6,774.3	$8,189.5	$8,699.0
Sales margin	*71.7%*	*73.5%*	*77.6%*	*78.8%*	*79.0%*	*77.6%*	*78.0%*	*78.0%*	*78.0%*
Cost of Revenues	$5,201.9	$1,444.0	$1,727.0	$1,935.0	$1,833.2	$6,939.2	$8,056.9	$9,406.3	$9,882.4
Gross Income	$18,882.1	$5,189.0	$6,668.0	$7,492.0	$7,561.5	$26,910.5	$31,010.3	$35,668.9	$37,293.6
Gross Margin	*78.4%*	*78.2%*	*79.4%*	*79.5%*	*80.5%*	*79.5%*	*79.4%*	*79.1%*	*79.1%*
SG&A	$17,321.6	$5,328.0	$5,769.0	$6,389.0	$6,012.6	$23,498.6	$24,612.3	$27,495.9	$27,598.0
% SG&A	*71.9%*	*80.3%*	*68.7%*	*67.8%*	*64.0%*	*69.4%*	*63.0%*	*61.0%*	*58.5%*
Operating Income	$1,560.5	($139.0)	$899.0	$1,103.0	$1,548.9	$3,411.9	$6,398.0	$8,173.0	$9,695.6
Operating Margin	*6.5%*	*-2.1%*	*10.7%*	*11.7%*	*16.5%*	*10.1%*	*16.4%*	*18.1%*	*20.6%*
Interest income, net	($209.2)	($58.0)	($79.0)	($87.0)	($88.0)	($312.0)	$25.0	$40.0	$80.0
Other income	($16.4)	$0.0	$2.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Gain on value of derivative liab	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Pre-Tax Income	$1,334.9	($197.0)	$822.0	$1,016.0	$1,460.9	$3,099.9	$6,423.0	$8,213.0	$9,775.6
Taxes	$985.0	($87.0)	$338.0	$425.0	$525.9	$1,201.9	$2,344.4	$2,997.8	$3,568.1
Tax Rate	*73.8%*	*N/A*	*41.1%*	*41.8%*	*36.0%*	*38.8%*	*36.5%*	*36.5%*	*36.5%*
Net Income	$349.9	($110.0)	$484.0	$591.0	$935.0	$1,898.0	$4,078.6	$5,215.3	$6,207.5
YOY Growth	*-85.3%*	*N/A*	*1538.7%*	*60.6%*	*4820.9%*	*442.4%*	*114.9%*	*27.9%*	*19.0%*
Net Margin	*1.5%*	*-1.7%*	*5.8%*	*6.3%*	*10.0%*	*5.6%*	*10.4%*	*11.6%*	*13.2%*
EPS	$0.01	($0.00)	$0.02	$0.02	$0.03	$0.06	$0.13	$0.16	$0.19
YOY Growth	*85.5%*	*N/A*	*1521.6%*	*58.8%*	*4810.9%*	*438.6%*	*111.6%*	*26.3%*	*18.3%*
Diluted Shares O/S	30,705	30,631	31,025	31,013	31,015	30,921	31,400	31,800	32,000

Source: Zacks Investment Research *Brian Marckx, CFA*

HISTORICAL ZACKS RECOMMENDATIONS



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