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Zacks Small-Cap Research

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Zynex Inc (ZYXI-OTC)

ZYXI: Q2 Strong Revenue and GM But SG&A Still High. CMS Decision Poses Risk.

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	01/06/2011
Current Price (08/07/12)	$0.80
Target Price	**$1.35**

OUTLOOK

Revenue growth has been very strong. We model +16% in 2012, coming off an impressive +42% in 2011. Sales growth coming from continued expansion of the sales force. Gross margin has also recently shown surprising strength. Key to maximize EPS is controlling op expenses, which has been an issue for Zynex. Recent CMS decision on TENS reimbursement also poses risk.

Longer-term upside to our model could come from pipeline, which we have yet to model.

We have moved our price target from $1.50/share to $1.35/share and are maintaining our Outperform rating.

SUMMARY DATA

52-Week High	**$1.01**
52-Week Low	**$0.55**
One-Year Return (%)	**-11.11**
Beta	**0.32**
Average Daily Volume (sh)	**6,112**
Shares Outstanding (mil)	**31**
Market Capitalization ($mil)	**$25**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**0**
Insider Ownership (%)	**N/A**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**44.8**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**16.0**
P/E using 2012 Estimate	**11.4**
P/E using 2013 Estimate	**7.3**
Zacks Rank	**N/A**

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

ZACKS ESTIMATES

Revenue
(in '000 of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2011	6,633 A	8,395 A	9,427 A	9,693 A	34,148 A
2012	8,944 A	10,026 A	10,278 E	10,314 E	39,564 E
2013					43,789 E
2014					46,880 E

Earnings per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2011	-$0.00 A	$0.02 A	$0.02 A	$0.02 A	$0.05 A
2012	$0.01 A	$0.02 A	$0.02 E	$0.02 E	$0.07 E
2013					$0.11 E
2014					$0.12 E

Zacks Projected EPS Growth Rate - Next 5 Years % 9

Q2 2012 Financial Results: *Strong Revenue and Gross Margin But Op Expenses Remain High…*

Zynex reported financial results for second quarter ending June 30, 2012 on August 7th. Revenue growth continues to impress and for the fifth consecutive quarter came in ahead or our estimate. Revenue of $10.0 million was up 19% from Q2 2011 and beat our $9.6 million estimate by about 5%. Sales of both equipment and consumables remained very strong while rental revenue was flat y-o-y. Revenue growth remains mostly tied to expansion of the sales force and feeding consumables to a growing installed based. Management noted that revenue from the Zynex NeuroDiagnostics business, which includes the recently acquired NeuroDyne product line, continues to grow, although remains relatively insignificant. The vast majority of revenue continues to come from electrical stimulation devices and related consumables from the Zynex Medical segment, although management remains focused on diversifying their product line including from a blood monitoring device that is currently in clinical testing but which Zynex believes could launch sometime next year. Management also noted on the call that they expect to introduce other new products during the current year.

Revenue

Total revenue consisted of $2.4 million (+0% y-o-y) in rentals and $7.6 million in product sales. While the equipment portion of product sales came in slightly softer than our estimate, rental revenue and consumables were 14% and 11% better than our numbers.

	Actual Q2 2011	Actual Q2 2012	Y-o-Y Change	Zacks Est Q2 2012	Actual +/- Zacks est.
Consumables	$3,106	$4,010	29.1%	$3,614	11.0%
Equipment Sales	$2,842	$3,579	25.9%	$3,777	-5.2%
Total Product Sales	$5,948	$7,589	27.6%	$7,391	2.7%
Rental Revenue	$2,447	$2,437	-0.4%	$2,148	13.5%
	$8,395	**$10,026**	**19.4%**	**$9,539**	**5.1%**

Gross Margin

Gross margin at 82.2% remained very strong, was well wider than our 78.1% estimate and broke through the 80% mark for the first time since Q3 2009. GM continues to benefit from a higher % of total sales coming from the high margin consumables segment as well as the next-generation TENS device which has lower input costs compared to earlier TENS products. Consumables accounted for 40% of total sales in Q2 2012 compared to 37% in Q2 2011 and 38% for the full year 2011. Gross margin should continue to benefit as consumables grows as a % of total revenue (we model consumables to account for 41% of revenue in 2012). We also note that the rentals margin has been in the high 80% through the first half of 2012, much stronger than in all of 2011 which has also clearly benefitted aggregate GM recently.

Net Income / EPS

Net income and EPS were $473k and $0.02 compared to our $561k and $0.02 estimates. The difference due to much higher than modeled SG&A expense more than offsetting the beat on the top-line and better GM. SG&A of $7.3 million or 73% of revenue was more than $900k higher than our $6.4 million (67% of estimated sales) estimate. Elevated SG&A expense, as we've noted in the past, continues to hinder the robust growth in sales translating into similar growth in EPS.

Part of the recent increase in SG&A as a % of sales is due to clinical trials expense related to the blood monitoring device (engineering and ops expenses runs through Zynex's SG&A) - although, based on the footnotes in the Q1 2012 10-Q, engineering and operations expense was fairly benign (Q2 10-Q is not yet filed). Zynex also recently beefed up its billing and reimbursement staff in anticipation of growing sales - which we hope will be leverageable as revenue grows, although we had already expected to see more in this regard at the current revenue levels. We think it's worth reiterating that, notwithstanding the recent improvement in GM and strong sales growth, unless Zynex can better control operating expenses, EPS growth will be constrained.

Cash
Zynex exited Q2 with $623k in cash and equivalents, down from $742k at the end of Q1. Cash used in operating and investing activities were $272k and $641k ($100k of investing was related to the purchase of NeuroDyne), respectively. Total drawn on the credit line was $5.2 million, leaving $1.8 million in borrowing capacity at the end of Q2. Management noted on the call that they expect the credit line to be sufficient to fund operations.

Zynex noted in the Q1 2012 10-Q that the recent Health and Human Services mandate requiring companies to implement the new HIPPA 5010 coding system and use newly created billing codes when billing for reimbursement has created some difficulty in Zynex (and other companies) receiving payment from third party payors. Zynex notes that this has slowed some cash collections but indicated on the Q2 call that this is more of an administrative issue that should be rectified and that they do not expect this to be an ongoing problem.

Guidance
Management reiterated previously issued 2012 guidance of revenue in the range of $38MM - $40MM and EPS in the range of $0.06 - $0.08. We have made some small adjustments to our 2012 estimates, with the majority related to tweaking down our Q4 revenue estimate (reflective of the risk posed by CMS decision - explained below), increasing our estimated SG&A expense but also increasing our estimated GM for 2H 2012.

Our 2012 revenue and EPS estimates have moved from $39.7 million and $0.08 prior to Q2 results to $39.6 million and $0.07 currently.

OUTLOOK: *Mostly unchanged but CMS decision could effect revenue growth…*

Our outlook remains largely unchanged although we have made some adjustments to our model, mostly reflecting continued tweaking of our assumptions relative to how recent trends extrapolate into the future. We also note that additional risk has been introduced from the Centers for Medicare & Medicaid Services (CMS) deciding in June 2012 that, effective immediately, they would no longer provide reimbursement for TENS for chronic low back pain. Exactly how much of an impact this may have on Zynex has obviously yet to be seen but we think it's safe to assume that there is a significant chance that it may adversely effect revenue growth. Only a relatively small percentage of Zynex's (we estimate it's less than 10%) revenue comes from Medicare and CMS's recent decision relates only to chronic low back pain - both of which could help insulate the impact to Zynex. However, as Medicare reimbursement policies go, so often does private insurers - if private insurers follow Medicare's lead, the company's TENS related revenue could be significantly effected. This will be something to keep an eye on.

We have trimmed our revenue estimates to account for the risk posed by CMS's decision. We now look for revenue of $39.6 million in 2012, growing to $50.6 million in 2015, reduced from $39.7 million in 2012 and $51.5 million. Our model continues to incorporate the assumption that expansion of the sales force is the main impetus for revenue growth and we still do not incorporate any contribution from the aforementioned blood monitoring device. As we've noted in the past, while our model does not incorporate any revenue contribution from this product as few details have been revealed about the device or the related development/trials, we will update our model when we are more comfortable with the chances of eventual regulatory approval and commercialization of this product as well as other products under development. Management referenced on the call that the device is still in clinical trials, will be entering additional trials in 2012, and could possibly launch in 2013.

VALUATION

We are moving our price target from $1.50/share to $1.35/share, reflecting the change in our 2012 EPS estimate from $0.08 to $0.07 and lowering our modeled five-year EPS growth rate through 2014 from 12% to just over 9%.

We now model EPS to grow at a five-year CAGR of about 9.4% through 2014. Industry PE/G ratio has moved up to 2.5x since our last update. We apply a 20% haircut to the industry PE/G to account for various risks, including the recent CMS decision on reimbursement for TENS for chronic low back pain. This values ZYXI at about $1.35/share. We are maintaining our Outperform rating.

FINANCIAL MODEL

Zynex Inc.

	2011 A	Q1A	Q2A	Q3E	Q4E	2012 E	2013 E	2014 E	2015 E
Rental revenue	$9,892.0	$2,062.0	$2,437.0	$2,040.0	$2,010.0	$8,549.0	$7,955.0	$7,740.0	$7,690.0
YOY Growth	*15.9%*	*-15.8%*	*-0.4%*	*-17.8%*	*-20.1%*	*-13.6%*	*-6.9%*	*-2.7%*	*-0.6%*
Consumable sales	$12,976.2	$3,824.0	$4,010.4	$4,123.9	$4,282.7	$16,241.0	$17,724.2	$19,140.6	$20,825.0
YOY Growth	*42.6%*	*43.8%*	*29.1%*	*20.1%*	*13.4%*	*25.2%*	*9.1%*	*8.0%*	*8.8%*
Equipment sales	$11,279.8	$3,058.0	$3,578.6	$4,115.0	$4,022.0	$14,773.6	$18,110.0	$20,000.0	$22,060.0
YOY Growth	*74.9%*	*100.4%*	*25.9%*	*17.2%*	*18.3%*	*31.0%*	*22.6%*	*10.4%*	*10.3%*
Product sales revenue	$24,256.0	$6,882.0	$7,589.0	$8,238.9	$8,304.7	$31,014.6	$35,834.2	$39,140.6	$42,885.0
YOY Growth	*56.0%*	*64.4%*	*27.6%*	*18.6%*	*15.7%*	*27.9%*	*15.5%*	*9.2%*	*9.6%*
Total Revenues	$34,148.0	$8,944.0	$10,026.0	$10,278.9	$10,314.7	$39,563.6	$43,789.2	$46,880.6	$50,575.0
YOY Growth	*41.8%*	*34.8%*	*19.4%*	*9.0%*	*6.4%*	*15.9%*	*10.7%*	*7.1%*	*7.9%*
Cost of Revenues	$7,371.0	$1,813.0	$1,786.0	$1,972.5	$2,090.2	$7,661.8	$8,638.8	$9,255.4	$9,967.3
Gross Income	$26,777.0	$7,131.0	$8,240.0	$8,306.3	$8,224.5	$31,901.8	$35,150.4	$37,625.2	$40,607.7
Gross Margin	*78.4%*	*79.7%*	*82.2%*	*80.8%*	*79.7%*	*80.6%*	*80.3%*	*80.3%*	*80.3%*
SG&A	$23,676.0	$6,645.0	$7,308.0	$7,277.4	$6,900.5	$28,131.0	$29,338.8	$30,941.2	$32,873.8
% SG&A	*69.3%*	*74.3%*	*72.9%*	*70.8%*	*66.9%*	*71.1%*	*67.0%*	*66.0%*	*65.0%*
Operating Income	$3,101.0	$486.0	$932.0	$1,028.9	$1,323.9	$3,770.8	$5,811.6	$6,684.0	$7,734.0
Operating Margin	*9.1%*	*5.4%*	*9.3%*	*10.0%*	*12.8%*	*9.5%*	*13.3%*	*14.3%*	*15.3%*
Interest income, net	($459.0)	($93.0)	($81.0)	($94.0)	($108.0)	($376.0)	($100.0)	$25.0	$50.0
Other income	$0.0	$0.0	($7.0)	$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	$2,642.0	$393.0	$844.0	$934.9	$1,215.9	$3,394.8	$5,711.6	$6,709.0	$7,784.0
Taxes	$1,080.0	$73.0	$371.0	$383.3	$498.5	$1,325.8	$2,341.8	$2,750.7	$3,191.4
Tax Rate	*40.9%*	*18.6%*	*44.0%*	*41.0%*	*41.0%*	*39.1%*	*41.0%*	*41.0%*	*41.0%*
Net Income	$1,562.0	$320.0	$473.0	$551.6	$717.4	$2,069.0	$3,369.9	$3,958.3	$4,592.6
YOY Growth	*346.4%*	*-390.9%*	*-2.3%*	*-6.7%*	*19.4%*	*32.5%*	*62.9%*	*17.5%*	*16.0%*
Net Margin	*4.6%*	*3.6%*	*4.7%*	*5.4%*	*7.0%*	*5.2%*	*7.7%*	*8.4%*	*9.1%*
EPS	$0.05	$0.01	$0.02	$0.02	$0.02	$0.07	$0.11	$0.12	$0.14
YOY Growth	*342.4%*	*-387.1%*	*-3.0%*	*-7.8%*	*18.2%*	*31.1%*	*59.6%*	*16.7%*	*15.5%*
Diluted Shares O/S	30,978	31,037	31,249	31,400	31,550	31,309	31,950	32,150	32,300

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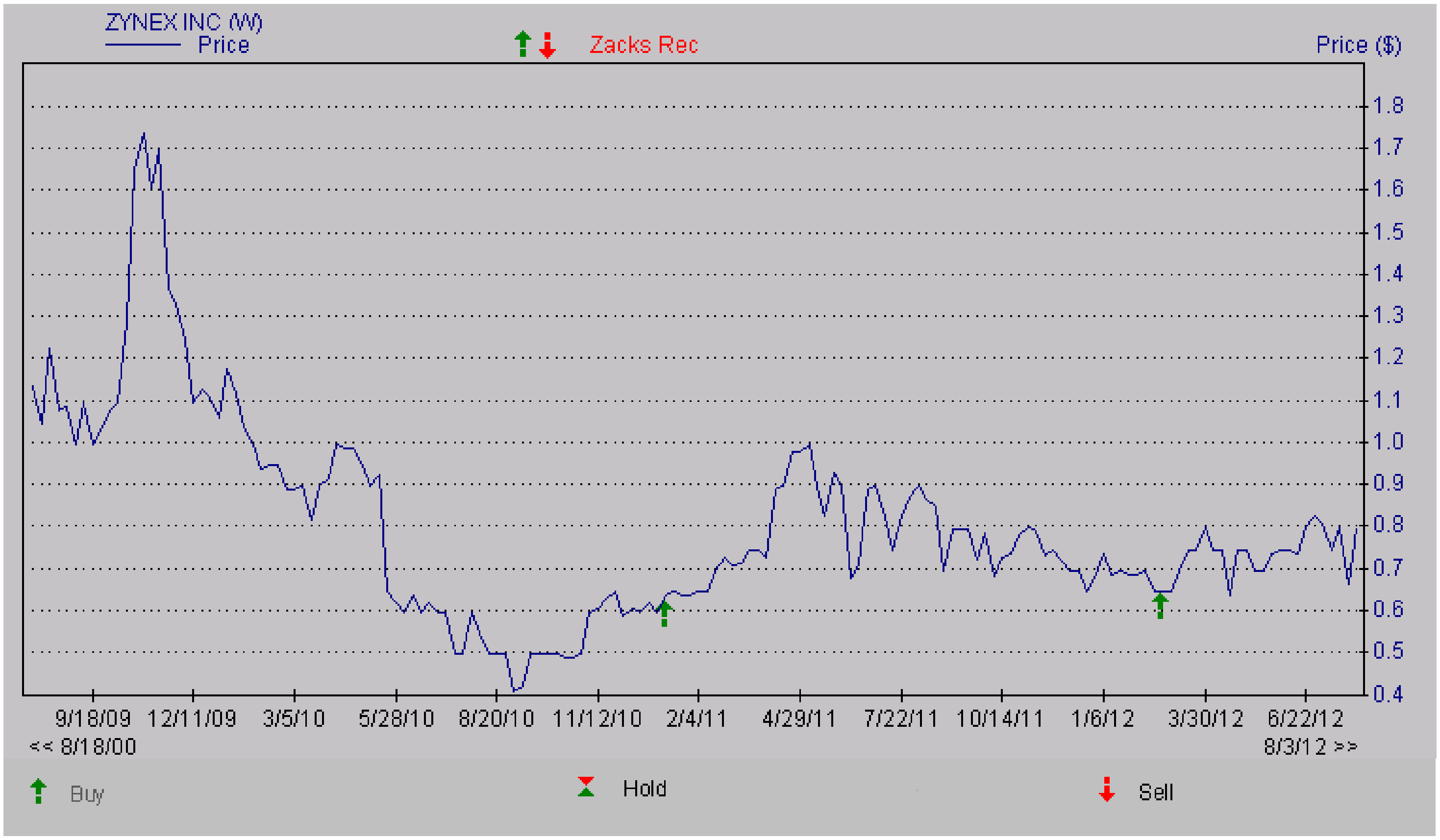
HISTORICAL ZACKS RECOMMENDATIONS



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