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Zacks Small-Cap Research

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Zynex Inc (ZYXI-OTC)

ZYXI: Q3 Results Largely In-Line. Maintaining Outlook / Recommendation

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	01/06/2011
Current Price (11/07/12)	$0.75
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.

Maintaining Outperform rating and price target.

SUMMARY DATA

52-Week High	**$1.01**
52-Week Low	**$0.55**
One-Year Return (%)	**-0.37**
Beta	**0.40**
Average Daily Volume (sh)	**5,212**
Shares Outstanding (mil)	**31**
Market Capitalization ($mil)	**$23**
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 (%)	**39.2**
Earnings Per Share (%)	**21.0**
Dividend (%)	**N/A**
P/E using TTM EPS	**15.0**
P/E using 2012 Estimate	**12.5**
P/E using 2013 Estimate	**7.5**
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	10,102 A	10,436 E	39,508 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	$0.01 A	$0.02 E	$0.06 E
2013					$0.10 E
2014					$0.12 E

Zacks Projected EPS Growth Rate - Next 5 Years % **8**

Q3 2012 Financial Results: *Largely In-line with our estimates…*

Zynex reported financial results for third quarter ending September 30, 2012 on November 7th. Revenue growth continued, albeit it at a slower pace than the first six months of the year, with sales coming in very much in-line with our estimate. Revenue of $10.1 million was up 7% from Q3 2011 and was only slightly lower (1.7%) than our $10.3 million estimate. Rental revenue, while continuing to contract, fell less than we anticipated. Rental revenue was $2.3 million, down 8% y-o-y but better than our $2.0 million (-18%) estimate. Meanwhile sales of equipment and consumables posted growth of 8% and 17%, respectively, which were both lower than our estimates. It's worth noting, however, that consumables sales have been very strong throughout the year, reflecting the ever larger equipment installed base.

Total revenue growth remains mostly tied to expansion of the sales force and feeding consumables to a growing installed based. Management again noted that revenue from the Zynex NeuroDiagnostics business, which includes the recently acquired NeuroDyne product line, continues to grow, although remains relatively small comparatively. 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. Zynex also launched a new product during Q3 called InWave which recently received FDA 501(k) clearance. InWave is used for female urinary incontinence, a worldwide market management estimates at ~$160 million. The product is currently still in the midst of being rolled out to Zynex's entire ~200 person sales force and is expected to be a meaningful contributor to revenue going forward.

Revenue

Total revenue consisted of $2.3 million (-8% y-o-y) in rentals and $7.8 million (+13% y-o-y) in product sales. Both the equipment and consumables portion of product sales came in softer than our estimate but, as noted above, consumables growth continues to be very strong.

	Actual Q3 2011	Actual Q3 2012	Y-o-Y Change	Zacks Est Q3 2012	Actual +/- Zacks est.
Consumables	$3,434	$4,018	17.0%	$4,124	-2.6%
Equipment Sales	$3,511	$3,803	8.3%	$4,115	-7.6%
Total Product Sales	$6,945	$7,821	12.6%	$8,239	-5.1%
Rental Revenue	$2,482	$2,281	-8.1%	$2,040	11.8%
	$9,427	**$10,102**	**7.2%**	**$10,279**	**-1.7%**

Gross Margin

Gross margin at 78.1% dipped from the 82.2% reported in Q2 and was below our 80.8% estimate. GM tends to jump around from quarter-to-quarter but 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 Q3 2012 compared to 36% in Q3 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 nine months 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 $358k and $0.01 compared to our $552k and $0.02 estimates. The difference due to a slight miss on revenue and the lower than modeled GM. Meanwhile, SG&A as a % of sales was 71%, just about dead-on with out 70.8% 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. But management has indicated that they expect to see some more operating leverage in these expenses as revenue continues to grow - which we've incorporated into our modeled assumptions for 2013 and beyond.

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. 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 Q3 with $843k in cash and equivalents, up from $623k at the end of Q2. Cash used in operating and investing activities were $158k and $464k, respectively. Total drawn on the credit line was $6.1 million, leaving $900k in borrowing capacity at the end of Q3. Management indicated on the call that cash from operating activities should show some improvement going forward and believes the current credit line and cash balance will 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 noted that this had 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. Presumably, as these cash collections begin to flow more regularly this should benefit Zynex's cash flow from operations.

Guidance

Management had previously issued 2012 revenue and EPS guidance of $38MM - $40MM and $0.06 - $0.08. With Q3 earnings, management narrowed the range of this guidance to revenue and EPS of $39MM - $40MM and $0.06 - $0.07. Our Q4 revenue and EPS estimates remain materially unchanged but with the $0.01 EPS miss in Q3, our full-year 2012 EPS estimate has moved $0.07 to $0.06. We look for full-year revenue of $39.5MM, implying annual growth of 16%.

OUTLOOK: *Largely unchanged since our last update…*

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.

Management addressed this potential issue on the Q3 call and noted that they have not experienced any adverse effects from the recent CMS action but also noted that they have plans relative to budgeting if and when this might become problematic.

We look for revenue of $39.5 million in 2012, growing to $50.3 million in 2015, largely unchanged from our last update. 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 model EPS to grow at a five-year CAGR of about 8.4% through 2014. Industry PE/G ratio currently sits at 2.1x. 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. Applying this to our 2013 EPS estimate of $0.10 values ZYXI at about $1.35/share. We are maintaining our Outperform rating and $1.35/share price target.

FINANCIAL MODEL

Zynex Inc.

	2011 A	Q1A	Q2A	Q3A	Q4E	2012 E	2013 E	2014 E	2015 E
Rental revenue	$9,892.0	$2,062.0	$2,437.0	$2,281.0	$2,320.0	$9,100.0	$8,395.0	$8,165.0	$8,120.0
YOY Growth	15.9%	-15.8%	-0.4%	-8.1%	-7.8%	-8.0%	-7.7%	-2.7%	-0.6%
Consumable sales	$12,976.2	$3,824.0	$4,010.4	$4,018.0	$4,260.8	$16,113.2	$17,760.0	$19,053.0	$20,704.6
YOY Growth	42.6%	43.8%	29.1%	17.0%	12.8%	24.2%	10.2%	7.3%	8.7%
Equipment sales	$11,279.8	$3,058.0	$3,578.6	$3,803.0	$3,855.0	$14,294.6	$17,532.0	$19,448.0	$21,458.0
YOY Growth	74.9%	100.4%	25.9%	8.3%	13.4%	26.7%	22.6%	10.9%	10.3%
Product sales revenue	$24,256.0	$6,882.0	$7,589.0	$7,821.0	$8,115.8	$30,407.8	$35,292.0	$38,501.0	$42,162.6
YOY Growth	56.0%	64.4%	27.6%	12.6%	13.1%	25.4%	16.1%	9.1%	9.5%
Total Revenues	$34,148.0	$8,944.0	$10,026.0	$10,102.0	$10,435.8	$39,507.8	$43,687.0	$46,666.0	$50,282.6
YOY Growth	41.8%	34.8%	19.4%	7.2%	7.7%	15.7%	10.6%	6.8%	7.8%
Cost of Revenues	$7,371.0	$1,813.0	$1,786.0	$2,216.0	$2,073.2	$7,888.2	$8,472.3	$8,950.6	$9,603.4
Gross Income	$26,777.0	$7,131.0	$8,240.0	$7,886.0	$8,362.6	$31,619.6	$35,214.6	$37,715.3	$40,679.2
Gross Margin	78.4%	79.7%	82.2%	78.1%	80.1%	80.0%	80.6%	80.8%	80.9%
SG&A	$23,676.0	$6,645.0	$7,308.0	$7,174.0	$7,325.9	$28,452.9	$29,925.6	$31,499.5	$33,437.9
% SG&A	69.3%	74.3%	72.9%	71.0%	70.2%	72.0%	68.5%	67.5%	66.5%
Operating Income	$3,101.0	$486.0	$932.0	$712.0	$1,036.7	$3,166.7	$5,289.1	$6,215.8	$7,241.3
Operating Margin	9.1%	5.4%	9.3%	7.0%	9.9%	8.0%	12.1%	13.3%	14.4%
Interest income, net	($459.0)	($93.0)	($81.0)	($119.0)	($108.0)	($401.0)	($100.0)	$25.0	$50.0
Other income	$0.0	$0.0	($7.0)	($6.0)	$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	$587.0	$928.7	$2,765.7	$5,189.1	$6,240.8	$7,291.3
Taxes	$1,080.0	$73.0	$371.0	$229.0	$362.2	$1,035.2	$2,075.6	$2,496.3	$2,916.5
Tax Rate	40.9%	18.6%	44.0%	39.0%	39.0%	37.4%	40.0%	40.0%	40.0%
Net Income	$1,562.0	$320.0	$473.0	$358.0	$566.5	$1,730.5	$3,113.4	$3,744.5	$4,374.8
YOY Growth	346.4%	-390.9%	-2.3%	-39.4%	-5.7%	10.8%	79.9%	20.3%	16.8%
Net Margin	4.6%	3.6%	4.7%	3.5%	5.4%	4.4%	7.1%	8.0%	8.7%
EPS	$0.05	$0.01	$0.02	$0.01	$0.02	$0.06	$0.10	$0.12	$0.14
YOY Growth	342.4%	-387.1%	-3.0%	-40.0%	-6.2%	9.8%	77.6%	19.1%	16.1%
Diluted Shares O/S	30,978	31,037	31,249	31,317	31,385	31,247	31,650	31,950	32,150

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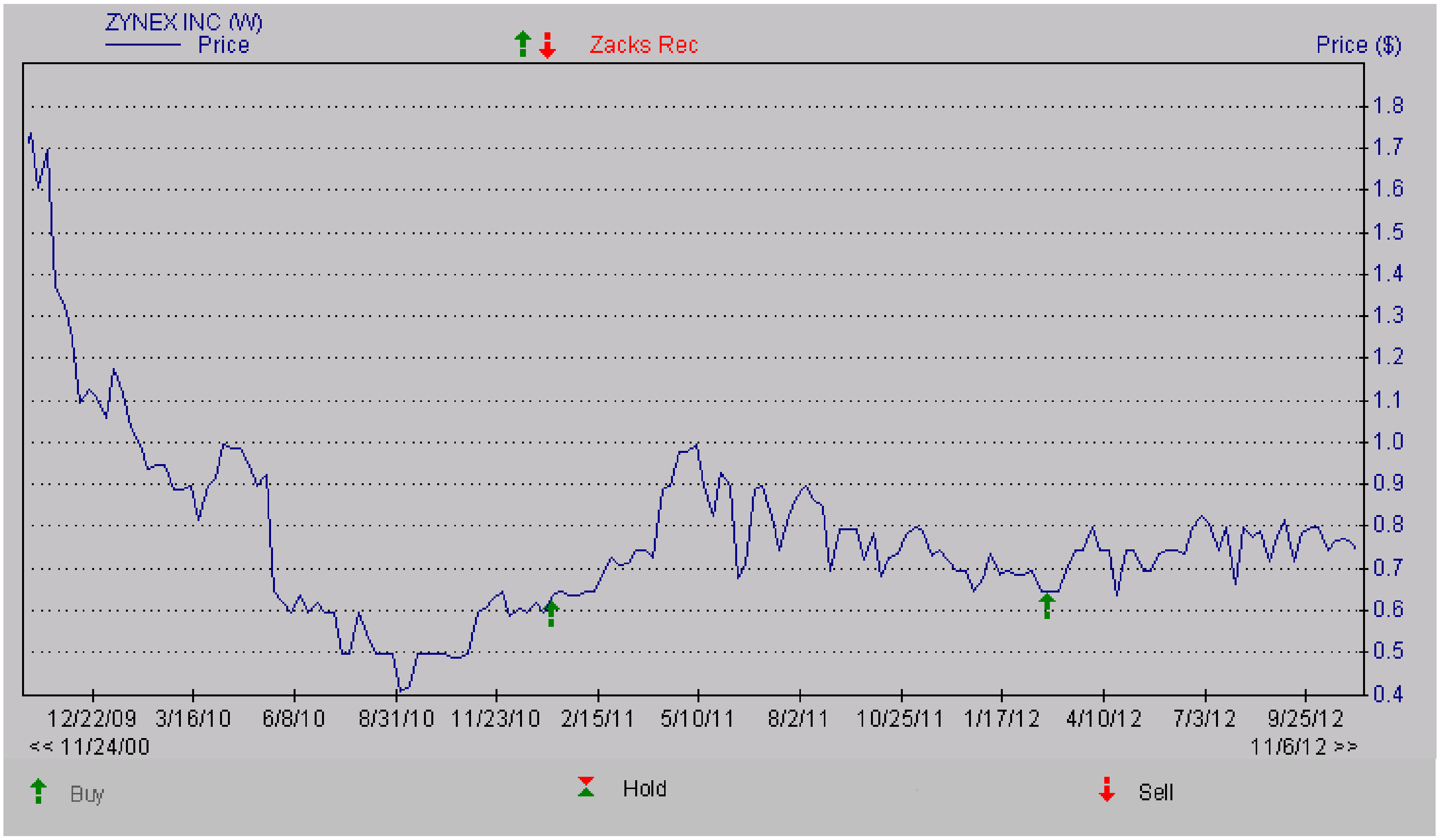
HISTORICAL ZACKS RECOMMENDATIONS



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