

Zynex Inc

(ZYXI-OTC)

**ZYXI: Q4: Revenue In-Line, Nice
Reduction in SG&A But GM Softer...**

Current Recommendation	Outperform
Prior Recommendation	N/A
Date of Last Change	01/06/2011
Current Price (03/14/13)	\$0.55
Target Price	\$2.00

OUTLOOK

Revenue growth has been very strong. We model +10% in 2013, coming off an impressive +42% in 2011 and another 16% in 2012. Sales growth coming from continued expansion of the sales force. ZYXI is also diversifying revenue sources through new product launches and new medical billing and consulting segment. Key to maximize EPS is controlling op expenses, which has been an issue for Zynex - but which showed meaningful improvement in Q4 2012 and which the company noted should continue to improve. ZYXI generated positive operating cash flow in 2012 and aims to do so again in 2013.

Recent CMS decision on TENS reimbursement poses risk.

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

SUMMARY DATA

52-Week High	\$1.01
52-Week Low	\$0.51
One-Year Return (%)	-26.43
Beta	0.49
Average Daily Volume (sh)	7,735

**Above Avg.,
Small-Blend
Med Products**

Shares Outstanding (mil)	31
Market Capitalization (\$mil)	\$17
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 (%)	34.0
Earnings Per Share (%)	26.0
Dividend (%)	N/A

P/E using TTM EPS	11.0
P/E using 2013 Estimate	7.9
P/E using 2014 Estimate	5.0

Zacks Rank	N/A
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ZACKS ESTIMATES**Revenue**
(in '000 of \$)

	Q1	Q2	Q3	Q4	Year
	(Mar)	(Jun)	(Sep)	(Dec)	(Dec)
2012	8,944 A	10,026 A	10,102 A	10,594 A	39,666 A
2013	9,959 E	11,076 E	11,181 E	11,446 E	43,662 E
2014					46,666 E
2015					50,283 E

Earnings per Share

	Q1	Q2	Q3	Q4	Year
	(Mar)	(Jun)	(Sep)	(Dec)	(Dec)
2012	\$0.01 A	\$0.02 A	\$0.01 A	\$0.01 A	\$0.05 A
2013	\$0.01 E	\$0.02 E	\$0.02 E	\$0.02 E	\$0.07 E
2014					\$0.11 E
2015					\$0.13 E

Zacks Projected EPS Growth Rate - Next 5 Years % **21**

Q4 2012 Financial Results: Revenue In-Line, Nice Reduction in SG&A But GM Softer...

Zynex reported financial results for the fourth quarter ending December 31, 2012 on March 14th. Revenue growth continued, remained at about the same level as the 2nd and 3rd quarters of the year, and came in just about dead-on with our estimate. Q4 also saw a nice reduction in SG&A as a % of revenue - which management noted is expected to be a theme reflected in 2013 as well. Despite the almost double-digit revenue growth and reduction in operating expenses, all of this benefit did not flow through to net income and EPS due to a meaningful contraction in gross margin (with both sales and rental margins coming in).

Revenue of \$10.6 million was up 9% from Q4 2011 and was in-line with our \$10.4 million estimate. Rental revenue was \$2.1 million, down 15% yoy and below our \$2.3 million (-8%) estimate. Meanwhile sales of equipment and consumables posted approximate growth of 13% and 23%, respectively. Consumables sales continue to benefit from the ever larger and growing installed base.

Total revenue growth remains mostly tied to expansion of the sales force and feeding consumables to a growing installed base. Zynex expects to continue building their sales force - both from sales consultants and direct hires - to facilitate sales growth. The company has recently diversified its potential revenue sources, however, including new product launches and new business lines - the former including InWave for the treatment of female incontinence and the latter including a medical billing segment (called Zynex Billing and Consulting) which the company formed in Q4 2012 and which aims to leverage the company's expertise in that area to engage private medical practices and generate additional revenue for the company. And while the vast majority of revenue continues to come from electrical stimulation devices and related consumables from the Zynex Medical segment, management remains focused on bringing new products to market which includes a blood monitoring device that is currently in clinical testing but which Zynex believes could potentially launch sometime in 2013 or 2014.

InWave



zynexmed.com

Revenue

Total revenue consisted of \$2.1 million (-15% y-o-y) in rentals and \$8.5 million (+18% y-o-y) in product sales. The equipment portion of product sales was in-line with our estimate while the consumables portion handily beat (+9%) our number.

	<u>Actual</u> <u>Q4 2011</u>	<u>Actual</u> <u>Q4 2012</u>	<u>Y-o-Y</u> <u>Change</u>	<u>Zacks Est</u> <u>Q4 2012</u>	<u>Actual +/-</u> <u>Zacks est.</u>
Consumables	\$3,777	\$4,627	22.5%	\$4,261	8.6%
Equipment Sales	\$3,401	\$3,830	12.6%	\$3,855	-0.6%
Total Product Sales	\$7,178	\$8,457	17.8%	\$8,116	4.2%
Rental Revenue	\$2,515	\$2,137	-15.0%	\$2,320	-7.9%
	\$9,693	\$10,594	9.3%	\$10,436	1.5%

Gross Margin

Gross margin at 72.1% was relatively very soft, the lowest of any quarter since Q4 2009 and significantly lower than our 80.1% estimate. Both the sales margin and rental margin were relatively weak in Q4. For the full year 2012 GM was 77.9%, down slightly from 78.4% in 2011. Zynex did not provide much detail on gross margin on the call. While we think the Billing and Consulting business may provide greater margins, there may not be much in the way

of revenue contribution from this business in the current year. We also note that Zynex may see some impact from the recently implemented 2.3% medical device tax - although management noted on the call that this should not be overly significant. While we continue to model GM in 2013 and beyond at above 75%, we have lowered our GM estimates slightly as we think ZYXI may see a slight headwind.

Net Income / EPS

Net income and EPS were \$397k and \$0.01 compared to our \$567k and \$0.02 estimates. The difference due entirely to the weaker than expected gross margin.

Despite somewhat disappointing GM, one very meaningful highlight in Q4 was that SG&A as a % of sales improved considerably and was relatively low at just 66.4%. As we've consistently noted in the past, elevated SG&A expense has really constrained much EPS growth despite fairly rapidly growing revenue over the last several years. Management noted on the call that in Q4 they began implementing operational improvements which has had the effect of wringing out some SG&A related expenses - in addition, the company expects the combination of continued operational efficiencies and normal leverage from growing revenue to continue to benefit operating margin in 2013 and beyond. We currently model SG&A as a % of sales to improve from the 71% in 2012 to 68.5% in 2013.

Cash

Zynex exited Q4 with \$823k in cash and equivalents, roughly flat from the end of Q3. Cash from operating activities was an inflow of \$321k in Q4, ex-changes in working capital this was an inflow of \$926k. For the full year 2012 cash flow from operating activities was an outflow of \$879k but ex-changes in working capital (which included \$1.7MM increase in A/R and \$2.1MM increase in inventory) and it was an inflow of \$3.3 million. We model the company to again generate positive operating cash flow in 2013. Management reiterated their expectations 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.

Cash used in investing activities was \$139k in Q4 and \$1.6MM for the full year - mostly relating to the purchase of equipment and inventory for rentals.

Guidance

Management issued initial revenue and EPS guidance for the full year 2013. They look for revenue and EPS to come in the ranges of \$41MM - \$44MM and \$0.06 - \$0.09 (compared to 2012 actuals of \$39.7MM and \$0.05). We currently model 2013 revenue and EPS of \$43.7MM (+10%) and \$0.07.

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 might 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.

And as we noted above, our model now also incorporates a consideration of some impact to margins from the 2.3% medical device tax.

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 or any contribution from the new Billing and Consulting business - both of which could provide some upside to our model - particularly in the out-years. While our model does not incorporate any revenue contribution from the blood

monitoring device 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. We will also incorporate a contribution from the new Billing and Consulting business if and when it's appropriate.

VALUATION

We model EPS to grow at a five-year CAGR of about 21% through 2015. Industry PE/G ratio currently sits at 1.7x. 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 \$0.07 values ZYXI at about \$2.00/share. We are maintaining our Outperform rating.

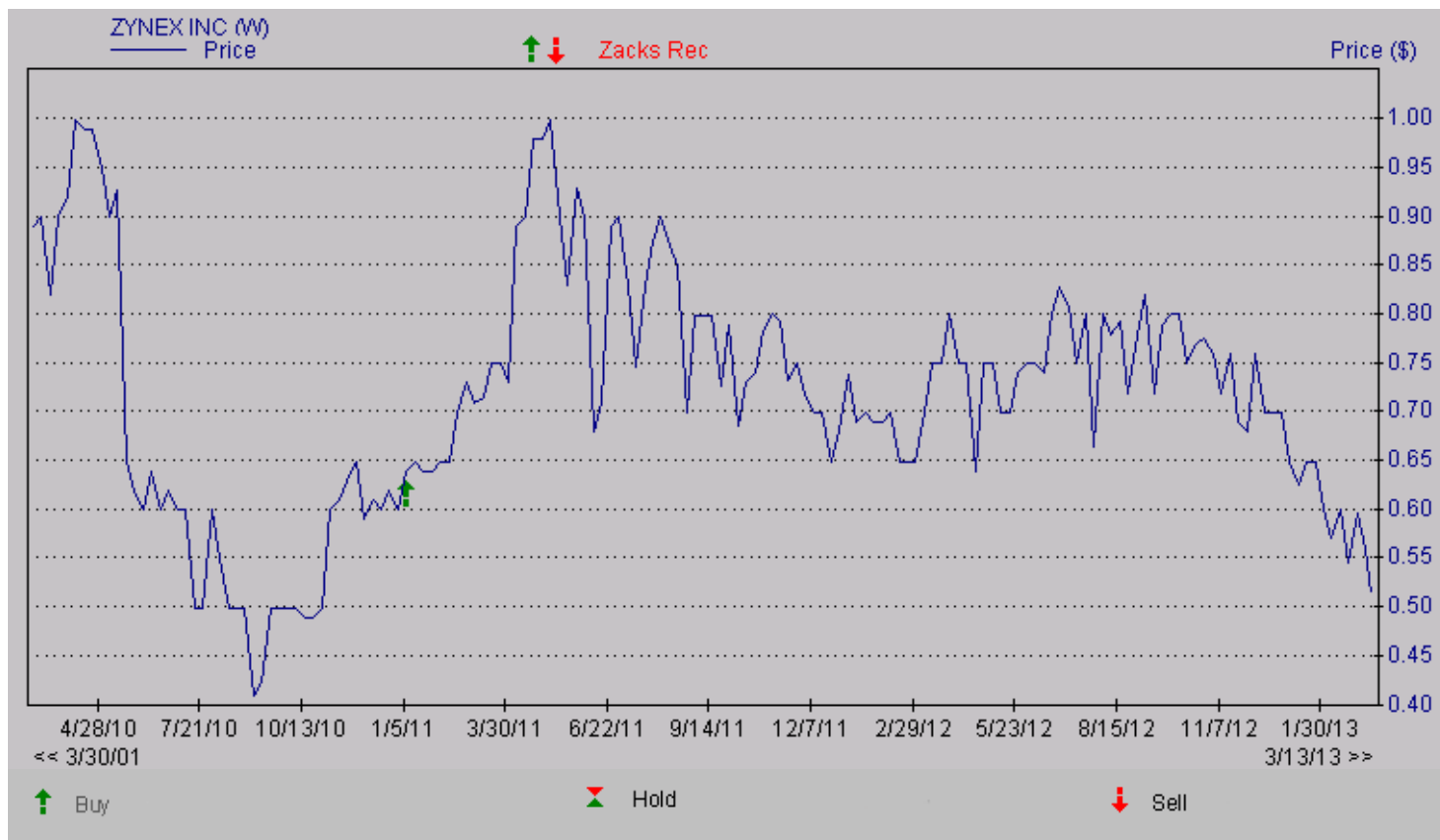
FINANCIAL MODEL

Zynex Inc.

	2012 A	Q1E	Q2E	Q3E	Q4E	2013 E	2014 E	2015 E	2016 E
Rental revenue	\$8,917.0	\$1,970.0	\$2,100.0	\$2,045.0	\$1,904.0	\$8,019.0	\$8,165.0	\$8,120.0	\$8,241.0
<i>YOY Growth</i>	-9.9%	-4.5%	-13.8%	-10.3%	-10.9%	-10.1%	1.8%	-0.6%	1.5%
Consumable sales	\$16,479.4	\$4,218.9	\$4,591.4	\$4,607.7	\$4,848.8	\$18,266.7	\$19,053.0	\$20,704.6	\$22,598.6
<i>YOY Growth</i>	27.0%	10.3%	14.5%	14.7%	4.8%	10.8%	4.3%	8.7%	9.1%
Equipment sales	\$14,269.6	\$3,770.0	\$4,385.0	\$4,528.0	\$4,693.0	\$17,376.0	\$19,448.0	\$21,458.0	\$23,588.0
<i>YOY Growth</i>	26.5%	23.3%	22.5%	19.1%	22.5%	21.8%	11.9%	10.3%	9.9%
Product sales revenue	\$30,749.0	\$7,988.9	\$8,976.4	\$9,135.7	\$9,541.8	\$35,642.7	\$38,501.0	\$42,162.6	\$46,186.6
<i>YOY Growth</i>	26.8%	16.1%	18.3%	16.8%	12.8%	15.9%	8.0%	9.5%	9.5%
Total Revenues	\$39,666.0	\$9,958.9	\$11,076.4	\$11,180.7	\$11,445.8	\$43,661.7	\$46,666.0	\$50,282.6	\$54,427.6
<i>YOY Growth</i>	16.2%	11.3%	10.5%	10.7%	8.0%	10.1%	6.9%	7.8%	8.2%
Cost of Revenues	\$8,770.0	\$2,262.7	\$2,217.3	\$2,651.2	\$3,109.9	\$10,241.2	\$10,105.7	\$10,741.8	\$11,252.1
Gross Income	\$30,896.0	\$7,696.2	\$8,859.1	\$8,529.5	\$8,335.8	\$33,420.6	\$36,560.3	\$39,540.8	\$43,175.5
<i>Gross Margin</i>	77.9%	77.3%	80.0%	76.3%	72.8%	76.5%	78.3%	78.6%	79.3%
SG&A	\$28,159.0	\$7,040.9	\$7,687.0	\$7,703.5	\$7,428.3	\$29,859.8	\$31,406.2	\$33,287.1	\$35,813.4
<i>% SG&A</i>	71.0%	70.7%	69.4%	68.9%	64.9%	68.5%	67.3%	66.2%	65.8%
Operating Income	\$2,737.0	\$655.2	\$1,172.1	\$826.0	\$907.5	\$3,560.8	\$5,154.1	\$6,253.8	\$7,362.1
<i>Operating Margin</i>	6.9%	6.6%	10.6%	7.4%	7.9%	8.2%	11.0%	12.4%	13.5%
Interest income, net	(\$432.0)	(\$118.5)	(\$118.5)	(\$108.5)	(\$103.5)	(\$449.0)	\$25.0	\$50.0	\$50.0
Other income	\$31.0	\$8.0	\$8.0	\$8.0	\$8.0	\$32.0	\$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	\$2,336.0	\$544.7	\$1,061.6	\$725.5	\$812.0	\$3,143.8	\$5,179.1	\$6,303.8	\$7,412.1
Taxes	\$788.0	\$190.7	\$371.6	\$253.9	\$284.2	\$1,100.3	\$1,812.7	\$2,206.3	\$2,594.2
<i>Tax Rate</i>	33.7%	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%
Net Income	\$1,548.0	\$354.1	\$690.1	\$471.6	\$527.8	\$2,043.5	\$3,366.4	\$4,097.4	\$4,817.9
<i>YOY Growth</i>	-0.9%	10.6%	45.9%	31.7%	33.0%	32.0%	64.7%	21.7%	17.6%
<i>Net Margin</i>	3.9%	3.6%	6.2%	4.2%	4.6%	4.7%	7.2%	8.1%	8.9%
EPS	\$0.05	\$0.01	\$0.02	\$0.02	\$0.02	\$0.07	\$0.11	\$0.13	\$0.15
<i>YOY Growth</i>	-1.7%	9.8%	45.5%	31.5%	32.4%	31.5%	61.7%	21.0%	16.0%
Diluted Shares O/S	31,222	31,290	31,330	31,380	31,405	31,351	31,950	32,150	32,600

Brian Marckx, CFA

HISTORICAL ZACKS RECOMMENDATIONS



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