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Zynex Inc (ZYXI-OTC)

ZYXI: Initiating on ZYXI. Too Cheap Despite Risks.

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	01/06/2011
Current Price (02/14/11)	$0.65
Six- Month Target Price	**$1.40**

OUTLOOK

Despite impressive revenue growth, the stock has done virtually nothing since the April 2009 restatement announcement. We think revenue grows at a 17% 4-year CAGR through 2013 from the electrotherapy business alone. The outstanding lawsuit and insurance claims will likely continue to punish valuation. Despite a variety of concerns, which are baked into our valuation, we think the shares trade much too cheap.

We model EPS of $0.10 in 2011. We are initiating coverage of ZYXI with an Outperform rating and price target of $1.40.

SUMMARY DATA

52-Week High	**$1.00**
52-Week Low	**$0.38**
One-Year Return (%)	**-31.58**
Beta	**0.09**
Average Daily Volume (sh)	**34,800**
Shares Outstanding (mil)	**31**
Market Capitalization ($mil)	**$20**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**N/A**
Insider Ownership (%)	**69**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**76.4**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**32.5**
P/E using 2011 Estimate	**6.5**
P/E using 2012 Estimate	**5.4**
Zacks Rank	**N/A**

Risk Level	**High,**
Type of Stock	**Small-Blend**
Industry	**Med Products**

ZACKS ESTIMATES

Revenue
(in '000 of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2009	4,232 A	4,347 A	4,691 A	5,411 A	18,681 A
2010	4,875 A	5,742 A	6,657 A	7,171 E	24,445 E
2011					31,097 E
2012					36,360 E

Earnings per Share
(EPS is operating earnings before non recurring items)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2009	$0.03 A	$0.02 A	$0.02 A	$0.01 A	$0.08 A
2010	$0.00 A	$0.00 A	$0.01 A	$0.02 E	$0.03 E
2011					$0.10 E
2012					$0.12 E

Zacks Projected EPS Growth Rate - Next 4 Years % **17**

INITIATING COVERAGE

Zynex's stock was seriously punished with the April 2009 restatement announcement and, despite revenue growth of almost 60% in 2009 and 30% through the first nine months of 2010, has yet to fully recover. Until there is resolution on what we would characterize as "significant" lingering concerns (most notably the outstanding lawsuit and ongoing refund claims by Anthem), we believe Zynex's stock will continue to trade at a significant discount. Complete insider control and thin float also generally penalizes valuation – as Zynex's CEO owns 60% of the outstanding shares, we also expect this to continue to weigh on the share price.

We are also concerned about the current absence of a definitive and significant catalyst to propel long-term revenue growth. Zynex's recent strategy of recruiting competitors' sales reps may not be sustainable for more than a few more years, especially if larger competitors increase commissions to their reps in order to stem their sales force attrition and the resultant market share losses to Zynex. The new businesses (Monitoring and NeuroDiagnostics) may indeed evolve into very meaningful contributors to and drivers of long-term revenue growth. But until there are more specifics on the products expected to be developed through these businesses and plans relative to R&D strategies and efforts, it is impossible to comfortably gauge the viability of management's expectations for these units or their potential financial contribution.

Despite our concerns and the hangovers from the lawsuit/restatement and ongoing insurance claims, we think Zynex's stock trades cheaper than what is warranted given the potential to continue to post significant sales (and EPS) growth over the next few years. While our model is largely predicated on the faith in management's somewhat general financial guidance (for FY 2010 and 2011), the company has demonstrated that their relatively simple strategy of expanding the size of their sales force has been successful enough to grow revenue at a CAGR of 94% over the last three full fiscal years (from $2.6 million in 2006 to $18.7 million in 2009 and is at a $23.0 million run-rate for 2010 through the first nine months). We think it's reasonable that revenue can grow another 27% in 2011 (compared to guidance of 30% - 40%) and 17% in 2012 and EPS growth can accelerate as long as management contains the growth in operating expenses (which there should be ample opportunity to do).

Valuation

Based on our model we look for EPS to grow at a four-year CAGR of about 17% through 2013. We use a PE/G ratio of 0.8x to value Zynex. This represents a 20% discount to the 1.0x that is generally considered "fair value" and a 33% discount to the approximate 1.2x PE/G that the medical equipment industry currently trades at. Our discount reflects the various concerns and risks that we have outlined throughout this report. Resolution of some of these concerns and/or mitigation of risks would likely warrant a lower PE/G discount and, therefore, a higher price target. Actual EPS falling short of our estimates and/or adverse consequences related to risks/concerns could prompt us to lower our valuation for Zynex.

As it stands now, we value Zynex at $1.40 per share (calculated using four-year PE/G of 0.8x and 2011 EPS estimate of $0.10). ZYXI currently trades at $0.65. We are initiating coverage of Zynex with an Outperform rating and $1.40 price target.

BUSINESS

Zynex Inc. is involved in the design and sale of FDA-approved non-invasive electrotherapy products for the treatment of pain management and the rehabilitation of stroke and spinal cord injury patients (the majority of Zynex's current revenue is derived from their pain management products, produced through one of the company's three wholly-owned subsidiaries). International operations are currently insignificant but are a major component of the company's vision for long-term growth. In February 2010 Zynex announced the creation of two new business units; Zynex Monitoring Solutions ("Monitoring"), engaged in the development of products for cardiac monitoring and Zynex NeuroDiagnostics ("NeuroDiagnostics"), engaged in the development of products for neurological diagnosis. These two new businesses represent the other major pieces of the company's future growth strategy.

Zynex Medical, founded by Thomas Sandgaard in 1996, was initially involved in the marketing of European-made electrotherapy devices. Zynex Medical ("Medical") is the operating company of parent Zynex Inc. ("Zynex"), which acquired Medical in 2004. Zynex is based in Lone Tree, Colorado. As of December 31, 2009 the company had 97 employees but we believe Zynex has grown significantly since by adding sales reps and billing personnel to help fuel further growth.

Zynex conducts insignificant research and development (although this may evolve with the expansion of the new businesses) and holds no patents (a patent application for NeuroMove was filed but subsequently withdrawn) on their products. Zynex has, however, filed patents within its new business units. Zynex believes their competitive advantage essentially lies in their ability to outsell their competitors, provide superior service to patients and leverage their existing billing and collections department, in a market which they estimate at approximately $550 million annually. The market is dominated by two companies which hold roughly 80% share, with the remainder split among various significantly smaller manufacturers including Zynex (Zynex holds about 4% share of the market).

Zynex's business model hinges on their sales representatives establishing and fostering relationships with physicians who then prescribe the company's products to their patients. Zynex has grown net revenue from $2.6 million in 2006 to $18.7 million in 2009. This helped Zynex land at 8th in growth among all medical equipment companies in *Deloitte's Technology Fast 500* list for revenue growth for the years 2005 to 2009. This 94% CAGR from 2006 to 2009 was largely fueled by the rapid expansion of the company's sales force, initially sparked by a $1 million PIPE financing in January 2004 (and follow-on $600k PIPE in 2006). Zynex believes the majority of this revenue growth has come from share gains against larger competitors. Revenue is up another 30% through the first nine months of 2010, a rate management has indicated they believe is sustainable through at least 2011 from continuing their strategy of increasing the size of their sales force. Zynex also hopes to grow their international presence and in December 2010 announced that they filled a newly created position of International Area Sales Manager for Asia and the Middle East.

The top-line growth has not translated into consistent EPS growth, however, as gross margins (while still impressive) have shown a fairly regular slide since 2006 and operating expenses spiked in 2010. Controlling the growth in operating expenses will become ever more important as we expect gross margins to continue to narrow due to an ongoing slide in higher margin rental revenue.

Zynex hopes the two newly created businesses (Monitoring and NeuroDiagnostics) will provide opportunities to accelerate longer-term growth. The company announced that they have initiated development on products in both these units, including a device to monitor the amount of blood loss during surgery, which management has high hopes for. Zynex believes products currently under development in NeuroDiagnostics will reach commercialization relatively quickly as the products are being developed using an existing technology platform (used in Medical). The company also recently hired a seasoned industry veteran to lead the NeuroDiagnostics division. New product development, on the scale that management has indicated may be involved with these new businesses, is a significant change from Zynex's historically relatively meager R&D operations and may require the company to tap additional financing. Zynex has also indicated that, further in the future, they may look to acquire complementary technology in order to help facilitate the build-out of these businesses. However, as both of these units are still in their infancy and the company has released very few details relative to the products under development or plans for scale-up in R&D capabilities, we have virtually no visibility on their ultimate potential or the feasibility of management's expectations.

A class-action lawsuit filed after Zynex restated their financial statements for the first nine months of fiscal 2008 accuse the CEO and former CFO of intentionally inflating revenue (and therefore earnings). The stock price nosedived after the April 2009 restatement announcement and has yet to fully recover.

Another overhang on the stock has been refund requests from Anthem Blue Cross Blue Shield, a large insurer that accounts for 23% of Zynex's revenue. Due to the nature of the industry, Zynex often receives refund requests from insurance providers. Zynex settled one of the claims for refund from Anthem during Q3 2008 (which included paying Anthem $680k) but in April 2010 received a second request totaling $1.3 million. The request remains outstanding and Zynex believes they have $1.5 million in "rebillings" that were not properly reimbursed by Anthem, more than offsetting the insurers claim.

PRODUCTS

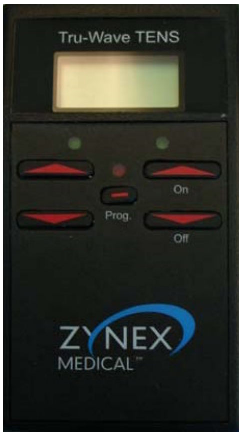
All of Zynex's products are considered Class II devices by the FDA. Regulatory clearance for all of the company's currently marketed devices was gained through the 510(k) pathway which only requires that a product show safety and efficacy that is "substantially equivalent" to a currently marketed device. All of Zynex's products use non-proprietary technology and hold no patent protection.

The majority of Zynex's revenue is currently derived from their pain management products which require a doctor's prescription. The benefits of electrotherapy for pain management have been documented with clinical studies (although skeptics remain) which has benefitted uptake for this type of treatment.

Transcutaneous electrical nerve stimulation (TENS) is the use of electrical current for therapeutic purposes. While TENS can refer to the use of electricity for any clinical purpose, it has become synonymous mostly with the treatment of pain. The modern TENS devices evolved from technology developed by companies such as Medtronic in the 1970's. Modern TENS equipment are small, portable devices intended for home use. They deliver an electrical current through the skin via electrodes (usually either 2 or 4) which are attached to a battery-powered device. TENS is currently used to reduce acute pain as a result of surgery, trauma and osteoarthritis as well as chronic pain such as back and knee pain.

While perception in the medical community relative to the efficacy of TENS remains somewhat mixed, there is evidence that TENS can reduce pain through the activation of opioid receptors (feel-good receptors) and blocking pain through exciting analgesia producing receptors. Not all the evidence supports these claims, however, especially when it is indication-dependent. One recent report from the Bone and Joint Decade 2000 – 2010 Task Force concluded that TENS provided no significant relief for neck pain. An article in the January 2010 edition of *Neurology* recommended against the use of TENS for chronic low back pain. Despite the lack of consensus on the utility of TENS, most insurance companies typically do provide reimbursement for these devices for use in pain management.

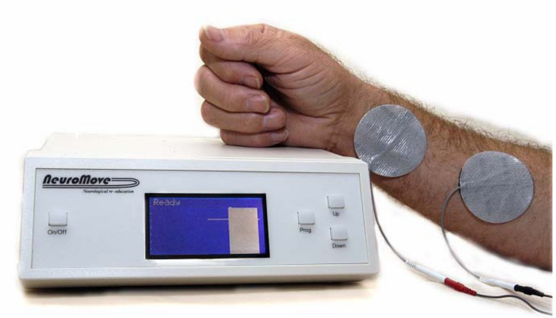
TENS Devices
Zynex manufactures and markets three devices for pain management therapy; TruWave, TruWave+, IF8000 and IF8100. In addition, the company markets ValuTENS, private-label TENS device. Zynex's description of the devices, from the company's 10-K: "TruWave is a "traditional" TENS type unit that delivers pain-alleviating electrotherapy, whereas the IF8000 is a more sophisticated unit with deeper pain alleviating and neuromuscular training settings." According to Zynex, the IF8100 "is an easier to use, fixed-program version of the IF8000." Inferential current (IF) used in the IF8000 and IF8100 devices allow it to provide therapy deeper into the muscle tissue relative to TENS therapy.

TruWave	TruWave +	IF-8100
		
Zynex Inc.	Zynex Inc.	Zynex Inc.

NeuroMove
NeuroMove, which launched in 2003, is marketed to the stroke and spinal cord injury market. The device uses electrical stimulation to help patients with impaired mobility regain movement and functionality. According to Zynex, NeuroMove uses the relatively new science of neuroplasticity, in which the healthy parts of the brain learn to carry out functions that were normally handled by now damaged parts of the brain. To do this, "NeuroMove technology monitors muscle activity and detects brain signals that indicate-- even without any visible movement-- the brain's effort to move a specific muscle or area of the body. Once the effort is detected, the NeuroMove induces actual movement through electrical stimulation, thus providing effective feedback to initiate relearning in the healthy part of the brain." Zynex cites independent clinical studies that were published in peer-reviewed journals as evidence of the efficacy of the NeuroMove.

Although the product has been on the market for seven years, Zynex notes in their public filings that it represents only a small portion of their total revenue. Medicare does not reimburse for NeuroMove, which likely also means most private insurance will not cover the device. Zynex also notes in their public filings that, "The stroke and SCI markets have demonstrated that many patients and their caregivers will privately pay for the NeuroMove." While this may be the case, until insurance reimbursement becomes widely available for the device, sales of NeruoMove are unlikely to show any significant growth, in our opinion.

NeuroMove



Zynex Inc

NMES Devices
Neuromuscular electrical stimulation (NMES) is similar to TENS, but uses higher electrical intensity in order to cause the muscle to contract. NMES therapy is used to combat muscle atrophy, increase strength and range of motion and to promote blood flow. Medicare and private insurance reimbursement are generally available for NMES for these indications.

Zynex's E-Wave device is used specifically for NMES. In addition, the IF8000 and IF8100 can be programmed for NMES.

E-Wave

Zynex Inc

Other Products
In addition to the ValuTENS product mentioned previously, Zynex resells cervical and lumbar traction devices, a lumbar support product and an electrical stimulation device for the treatment of incontinence.

Recurring Consumable Products
Zynex's private label consumable products make up approximately 35% - 40% of the company's total revenue. Consumables consist of batteries for the various devices as well as the electrodes that serve as the contact point to the user's skin. Consumables also represent a large portion of Zynex's recurring revenue as it is common for customers to purchase these on a regular basis during the course of treatment with one of the electrotherapy devices.

BUSINESS MODEL

Zynex's impressive revenue growth over the last few years is a direct result of the significant expansion of their sales force. Based on our due diligence, we do not believe Zynex's current product line-up holds any significant advantages (in efficacy, functionality, ease of use, or otherwise) over the major manufacturers of competing devices. There is also no indication that Zynex's recent market share gains are necessarily a result of superior customer service. By default, we believe Zynex's business model largely hinges on their sales, billing and collection efforts. Insurance billing and collections processes can be esoteric and somewhat specialized in nature which we believe affords a meaningful barrier to entry and should provide Zynex with considerable insulation from less established competitors. We are, however, not certain that Zynex's distribution network and insurance billing/collections acumen can be effective enough to take share from larger competitors over the long run.

In an effort to expand their geographical footprint, Zynex recruits industry-experienced contract sales representatives. These reps bring along their existing accounts which means Zynex immediately gains control of that market share. As a result of Zynex's relatively small size, this strategy has been very effective in growing revenue.

Zynex also employs a large billing and collections department which currently accounts for the largest portion of SG&A expense. The company has also been adding headcount in billing and collections and cited this as one of the reasons for moving into their new 75,000 square foot building in early 2010 from the 17,000 square foot space that they previously occupied. The lease on the new facility is also significantly more expensive than the prior lease (we estimate annual expense on the new lease will run about $1,400k while the old lease we estimate was about $200k per year). The combination of greater payroll and benefit costs (presumably as a direct result of adding support personnel in billing and collections) along with the more expensive building lease has been the major reason for the spike in SG&A expenses so far in 2010 compared to the first nine months of 2009.

PIPELINE

NexWave is the most recent addition to Zynex's electrotherapy product line-up. NexWave has multi-functionality and is capable of delivering electrical stimulation for TENS, IF and NMES. Prototypes of the product were unveiled at the company's June national sales meeting. Zynex expected that the product roll-out would commence in late 2010.

NexWave

Zynex Inc.

Most of Zynex's new product development and engineering efforts are expected to be concentrated within the new Monitoring and NeuroDiagnostics businesses which were created in early 2010. Zynex mentions in their 2009 annual report that they do not expect any revenue from these businesses for at least the next two years – the November 2010 hiring of an industry veteran may help accelerate this timeline, however. As we previously noted, Zynex has released only very general information relative to the products that they expect to pursue through these businesses so we have virtually no visibility relative to the potential that they may hold. Zynex has also had virtually no product development operations (R&D expense was only \$3k and \$20k in 2009 and 2008, respectively), with R&D comprised mostly of making minor improvements to their existing products. So this foray into product development is a significant shift for Zynex and will potentially require substantial investments in, and scale-up of, their R&D capabilities.

Per Zynex's press releases, NeuroDiagnostics is charged with utilizing NeuroMove's electromyography (EMG) technology for the "development and marketing of neurological diagnosis devices to hospitals and clinics worldwide. Our goal is for Zynex NeuroDiagnostic to become a primary worldwide neurological device provider for monitoring EMG, EEG, sleep pattern, auditory and nerve conductivity applications. We believe that this subsidiary will significantly contribute to our long-term growth and provide a platform for potential strategic acquisitions within the neurology monitoring industry."

In late November Zynex announced that they hired James Miller as President of the NeuroDiagnostics business. According to the company's press release, Mr. Miller has over 30 years experience in the healthcare industry including holding executive positions with Boston Scientific and Johnson & Johnson.

Zynex announced in September 2010 that its new Monitoring division is working on the development of a device to monitor the amount of blood loss during surgery and the detection of internal bleeding in the recovery room. In the press release Thomas Sandgaard notes that the early design and prototyping efforts are showing promise. The Monitoring business expects to add staff and resources "in order to launch an exciting line of products as soon as possible."

Blood Volume Monitor

Zynex Inc.

MARKETS

Zynex estimates the total domestic electrotherapy market to be approximately $550 million and growing at 5% annually. The “defined” markets for Zynex’s products are pain management and stroke/spinal cord injury. In addition there is a much more general population that does not necessarily have an acute condition but may benefit from electrotherapy. People suffering from muscular atrophy or with generally lower blood circulation that may benefit from NMES therapy could fall into this category. Physicians have relatively broad discretion so diagnosis of specific conditions is not a requirement to prescribing electrotherapy which makes this “undefined” market somewhat ambiguous. As a result we will confine our discussion of Zynex’s target markets to the pain management and stroke/spinal cord injury populations as well as their international operations.

Pain Management

The 2007 total global market for pain management was estimated at approximately $46 billion by Business Insights. Analgesics were estimated to account for 43%, or about $20 billion, of this market and had demonstrated recent growth of just over 15%. TENS can often times be used in place of or as an adjunct to pain medication, which can have dangerous side effects including sleeplessness and respiratory depression.

The abuse and over-prescribing of opioids, the strongest class of pain drugs, has by many accounts, reached epidemic proportions. Prescription opioids are now the second most common drug of choice of addicts admitted to drug rehabilitation clinics. Statistics show that prescription drug abuse costs the U.S. over $484 billion every year and are now the second leading cause of accidental death behind car accidents. A recent study by the Substance Abuse and Mental Health Services Administration (SAMHS) showed that visits to hospitals’ ER departments as a result of prescription drug abuse doubled from 2005 to 2009 (from 627k visits in 2005 to 1.2 million visits in 2009). ER visits due to prescription drugs has exceeded those related to illegal drugs for the third straight year. According to SAMHS, the number of people seeking treatment for prescription opioids spiked 400 percent from 1998 to 2008.

As a result of the enormous and growing problem with opioid abuse, certain state and federal governments have recently proposed stricter regulations against their use and availability. In July 2010 an advisory panel to the FDA shot down a proposal by the agency which outlined recommendations on how to reduce the inappropriate prescribing, misuse and abuse of extended-release opioids. The advisory committee cited that the proposed Risk Evaluation and Mitigation Strategy did not go far enough to stop abuse of painkillers. And in Washington State, legislatures are expected to pass a law that puts significantly greater onus on the physician to help curb prescription drug dependence. This includes advising certain patients to seek alternative treatments, including physical therapy (which could potentially include the use of TENS).

While it’s difficult to determine whether TENS uptake has benefited from the growing problem with prescription drug abuse, it may provide a catalyst to expand the overall market for electrotherapy. TENS is a relatively inexpensive therapy that has shown to benefit (at least some) patients with acute and chronic pain without the potentially serious side effects of opioids. Recently increased government oversight and new legislation and regulations aimed at curbing further growth of prescription pain drug abuse could result in greater acceptance and use of alternative therapies, including TENS.

Stroke and Spinal Cord Injury
Estimates put the size of the combined domestic stroke and spinal cord injury markets at roughly 7 million people and growing at approximately 8% per year. Those that may benefit from EMG therapy such as that provided by NeuroMove is likely to be significantly less than this, however, and may be confined to those with already relatively high levels of functionality. Most of the clinical studies that concluded EMG therapy may be useful in helping these patients regain movement included only patients with higher functionality. Nonetheless, growth of EMG therapy in the stroke and spinal cord population is likely to be constrained more by insurance reimbursement policy than from size of the target population.

International
International revenue has been insignificant, although Zynex has recently taken steps towards expanding their overseas business. In late 2008 they received CE Marking for TruWave, IF8000 and IF8001, providing regulatory clearance for sale of these products in Europe. Zynex has mentioned that they have “engaged” distributors in Canada, Australia, Philippines, Malaysia, Vietnam, UAE, Holland, and Germany.

In December 2010 Zynex announced the appointment of James Leffel as International Area Sales Manager, responsible for establishing distribution relationships in Asia and the Middle East. Just prior to moving into his current role, Mr. Leffel spent two years in Zynex’s shareholder communications department. He started his career with Zynex in 2005 as a sales representative for the NeuroMove product which he held for three years.

MANUFACTURING

Zynex outsources all of its manufacturing and assembly to domestic contractors. In-house product handling is mostly limited to testing and light refurbishing of returned units which are then re-rented.

SALES / MARKETING

Zynex uses independent contractor sales representatives to market the majority of their products to physicians and physical therapists. In addition, they employ in-house sales people to market the NeuroMove directly to the end-user and physicians who specialize in stroke and spinal cord injury rehabilitation. Zynex believes one of their competitive advantage is their ability cultivate relationships with physicians and outsell their competitors.

The typical sales process starts with Zynex’s sales representative talking to a physician, the physician writing a prescription for one of Zynex’s products (which must include justification for use of an electrotherapy device for the patients’ particular diagnosis) and then the sales rep verifying with the home office that the patient has insurance coverage. At that point the product is typically shipped to the patients’ home where a Zynex contractor then comes and demonstrates how to use the device. Zynex’s billing department bills the insurance company directly for the product, supplies and cost of demonstration.

In late 2009 Zynex began adding additional contract sales reps. This helped push revenue up 30% through the first nine months of 2010, a rate management has indicated they believe is sustainable through at least 2011 from continuing their strategy of increasing the size of their footprint.

Sales and Rentals
Zynex’s devices can be rented or purchased. The decision to rent or purchase is typically guided by a doctor’s prescription which has influence over the level of reimbursement provided by third-party payers. While coverage guidelines can differ among private third-party payers, in general, they use Medicare as a guide to set coverage policy. Medicare requires that TENS units be used for a trial/rental period (usually 1 – 3 months and diagnosis-dependent) before consideration will be given to covering purchase. If the physician believes the patient can

continue to benefit from TENS treatment (and therefore, recommends purchase of the unit) beyond the rental period, he must complete a Certificate of Medical Necessity form (CMN) and have records of the how long the patient used the TENS unit, duration of treatment and outcome in order to meet Medicare's purchase coverage criteria. Revenue from Medicare only accounts for approximately 6% of Zynex's sales and some variability in coverage policies from private insurers means these strict criteria to determine rental/purchase coverage may not be exactly applicable to all of Zynex's customers. But we think it provides a general guideline to understand how third-party payers may base their rental versus purchase decisions as it relates to Zynex's electrotherapy products. And while insurance accounts for the majority of Zynex's revenue, some of the rental fees and device purchases are made directly by the patient.

Long-term rentals can be highly profitable – and some of these rentals are eventually converted to a sale. Based on our research, we estimate that approximately three months of rental revenue is roughly equal to revenue from sale of one TENS device. Zynex consistently reports gross margins from rentals of 85% - 90% (compared to product sales gross margins of 70% - 75%). Unfortunately rental revenue looks like it may have peaked in the fourth quarter 2009 at $2.7 million and has experienced a fairly consistent decline since. Zynex attributes the decline to a "decrease in rental reimbursement amounts by significant third party payer" and "units in rental reaching their maximum rental allowed by third party payers." The company noted in their Q3 2010 10-Q that they expect the trend of more products being sold rather than rented to continue. As we explain in our "Outlook" section, this will undoubtedly squeeze the company's overall gross margin going forward.

REIMBURSEMENT

While most insurance companies cover TENS, some private insurers moved to restrict coverage of these devices during the 1990's. While coverage guidelines can differ among third party payers, in general TENS is often covered for chronic intractable back pain (lumbar, cervical or thoracic), post-traumatic acute pain and post-surgical pain. Many insurance companies (including Medicare) require that a CMN form be included with the request for reimbursement. There is no indication that insurers will further restrict coverage of TENS, but with the debate relative to its effectiveness still alive, this remains an ever-present risk. However, an argument could also be made that TENS can reduce overall healthcare costs, which could be a boon to expanding coverage for electrotherapy, especially with the implementation of "Obamacare" and its focus on reducing healthcare expenditures.

Based on our due diligence, it appears that TENS units are typically reimbursed through health insurance while worker's compensation and auto insurance often reimburse for Zynex's interferential current (IF) devices.

Due to the nature of the industry and the reimbursement environment in which the company operates, estimates are required to record net revenues and accounts receivable at the expected net realizable values. Zynex writes off a significant portion of gross revenue to provider discounts – which basically represents the difference between what Zynex bills and what insurance companies ultimately pay. Provider discounts can be a result of terms negotiated through contracts or insurance companies essentially disagreeing with the amount billed. While provider discounts are common in the industry, Zynex's are atypically high from what we have seen with medical device companies in general.

Zynex's relatively large provider discounts are not necessarily problematic - especially if they are largely a result of negotiated contracts, although this is not disclosed one way or the other in their filings. They can become problematic, however, if insurance companies feel that they are being excessively overbilled which could result in ongoing disputes between the two parties and potentially sour relationships with third party payers. This can be particularly detrimental in the case of Zynex as two insurance companies account for over one-third of the company's revenue. While we have no particular insight into the state of the relationships between Zynex and the various insurance companies that they deal with, we have some concern that Anthem has filed two large back-to-back claims for refunds. The first claim covered periods prior to July 31, 2008 and resulted in Zynex paying Anthem $680k and also forgiving unpaid claims of $330k. The second claim for $1.3 million is still outstanding and covers the period October 1, 2008 through March 12, 2010. Zynex believes that they have $1.5 million in re-billings that will offset the latest claim.

Accrual accounting also requires that these provider discounts be estimated for the period that they are recorded in. Inaccurately estimating and/or disclosing the extent of provider discounts resulted in the over-reporting of revenue during the first three quarters of 2008. This is what the class-action lawsuit against the company is based on. However, as we explain in our "Revenue Recognition" section below, we believe cash collections since the restatement period accurately reflect what Zynex has been reporting in net revenue and accounts receivable since the restatement period.

REVENUE RECOGNITION / DOUBTFUL ACCOUNTS

On April 9, 2009 Zynex announced that it would restate their financial statements for the first three quarters of 2008. A class-action lawsuit was subsequently brought by shareholders of Zynex common stock (as of May 21, 2008 – March 31, 2009). This suit essentially alleges that the CEO and former CFO intentionally reported inflated revenue figures (which basically accuses them of booking accounts receivable and revenue that they knew was likely not collectible) covering the restatement period. Revenue through the first nine months of 2008 was restated from $12,292k to $7,828k (36% haircut). Accounts receivable as of 9/30/2008 was restated from $9,433k to $4,970k. The heart of the lawsuit focus on the validity of estimates for allowances for provider discounts and doubtful accounts. These are integral components of the company's revenue recognition policy which we have copied below from Zynex's 2009 10-K.

Revenue Recognition And Allowances For Provider Discounts And Collectability: The Company recognizes revenue when each of the following four conditions are met: 1) a contract or sales arrangement exists; 2) products have been shipped and title has transferred or rental services have been rendered; 3) the price of the products or services is fixed or determinable; and 4) collectibility is reasonably assured. Accordingly, the Company recognizes revenue, both rental and sales, when products have been dispensed to the patient and the patient's having insurance has been verified. For medical products that are sold from inventories consigned at clinic locations, the Company recognizes revenue when it receives notice that the product has been prescribed and dispensed to the patient and the patient's having insurance has been verified or for certain matters, preauthorization has been obtained from the insurance company, when required. Revenue from the rental of products is normally on a month-to-month basis and is recognized ratably over the products' rental period. Products on rental contracts are placed in property and equipment and depreciated over their estimated useful life. All revenue is recognized at amounts estimated to be paid by customers or third party providers using the Company's established rates, net of estimated provider discounts. The Company recognizes revenue from distributors when it ships its products fulfilling an order and title has transferred.

A significant portion of the Company's revenues are derived, and the related receivables are due, from insurance companies or other third party payors. The nature of these receivables within this industry has typically resulted in long collection cycles. The process of determining what products will be reimbursed by third party providers and the amounts that they will reimburse is complex and depends on conditions and procedures that vary among providers and may change from time to time. The Company maintains an allowance for provider discounts and records additions to the allowance to account for the risk of nonpayment. Provider discounts result from reimbursements from insurance or other third party payors that are less than amounts claimed, where the amount claimed by the Company exceeds the insurance or other payor's usual, customary and reasonable reimbursement rate, amounts subject to insureds' deductibles, and when there is a benefit denial. The Company determines the amount of the allowance, and adjusts the allowance at the end of each reporting period, based on a number of factors, including historical rates of collection, the aging of the receivables, trends in the historical rates of collection and current relationships and experience with insurance companies or other third party payors. If the rates of collection of past-due receivables recorded for previous fiscal periods changes, or if there is a trend in the rates of collection on those receivables, the Company may be required to change the rate at which it provides for additions to the allowance. A change in the rates of the Company's collections can result from a number of factors, including experience and training of billing personnel, changes in the reimbursement policies or practices of payors, or changes in industry rates of reimbursement. Accordingly, the provision for provider discounts recorded in the income statement as a reduction of revenue has fluctuated and may continue to fluctuate significantly from quarter to quarter.

Due to the nature of the industry and the reimbursement environment in which the Company operates, estimates are required to record net revenues and accounts receivable at their net realizable values. Inherent in these estimates is the risk that they will have to be revised or updated as additional information becomes available. Specifically, the complexity of third party billing arrangements and the uncertainty of reimbursement amounts for certain products or services from payors may result in adjustments to amounts originally recorded. Due to continuing changes in the health care industry and third party reimbursement, it is possible that management's estimates could change in the near term, which could have an impact on results of operations and cash flows. Any differences between estimated settlements and final determinations are reflected as a reduction to revenue in the period known.

In addition to the allowance for provider discounts, the Company provides an allowance for uncollectible accounts receivable. These uncollectible accounts receivable are a result of non-payment from patients who have been direct billed for co-payments or deductibles; lack of appropriate insurance coverage; and disallowances of charges by third party payors. If there were a change to a material insurance provider contract or policies or application of them by a provider, or a decline in the economic condition of providers, or a significant turnover of Company personnel, the current amount of the allowance for uncollectible accounts receivable may not be adequate and may result in an increase of these levels in the future.

Our comments….

While we have no visibility into the validity of the lawsuit, we have no reason to believe that there will be restatements of the reported financials filed after the third quarter 2008 through the most recent reporting period. Cash flow (which works as a fairly reliable litmus test) since the restatement appears to be fairly consistent with what might be expected compared to reported net income. While drawn-out collection periods (~18+ months), which are typical in the industry, can create significant short-term variability between revenue and operating cash flow, these differences should be smoothed out over several quarters. Cash from operations totaled $2,043k compared to net income of $2,671k for the eight quarters following the restatement (through 9/30/2010). Revenue is also growing significantly faster than accounts receivable – another indication that reported revenue has not overstated collectability. Revenue grew 69% ($7,828k to $13,270k) through the first nine months of 2009 compared to the same period in 2008 (using restated figures), while accounts receivable increased by only 22% ($4,970k to $6,093k). Through the first nine months 2010, revenue is up 30% ($13,270k to $17,274k) y-o-y, with A/R up only 9% ($6,093 to $6,628k).

COMPETITION

Medtronic was one of the pioneers in the development of transcutaneous electrical nerve stimulation in the 1970's. Don Maurer, part of the engineering and scientific team at Medtronic, founded Empi Inc. in the late 1970's and purchased Medtronics' TENS business a few years later. Empi, headquartered in St. Paul, MN, is now part of DJO Incorporated, a large provider of rehabilitation and orthopedic devices as well as surgical implant products. The Empi business consolidated into DOJ's "Domestic Rehabilitation" which also includes bracing and support products. This division generated $641 million in sales in 2009 - with an estimated 30% - 55% related to Empi. Empi sells their products both domestically and internationally. Empi's relatively vast pain-management product line-up include handheld TENS devices, a multiple electrotherapy device called *Infinity Plus*, and *EasyWear Low Back Conductive Wrap*, a wearable electrotherapy wrap.

The second largest player in the industry is RS Medical. Founded in 1990, RS Medical sells a wide variety of electrotherapy devices and support products such as knee braces. The company is estimated to hold about 20% share of the electrotherapy market. The company's website notes that their products are, "supported by the most comprehensive physician and patient services in the industry. An employee sales force of approximately 250 Account Managers serves physicians in more than 195 major metropolitan markets." RS Medical claims that there *RS-4i* device is the "most commonly prescribed electrical stimulator in medicine today."

Both of these companies have sales forces and financial resources that are significantly larger than Zynex's as well as brand names that are likely much more recognizable. To our knowledge there are no studies that compare efficacy or patient preference (based on difference in features of the products, ease-of-use, etc) of the various electrotherapy devices offered from the different manufacturers.

RS Medical's *RS-4i*

rsmedical.com

Empi's *Infinity Plus*

empi.com

Empi's *EasyWear*

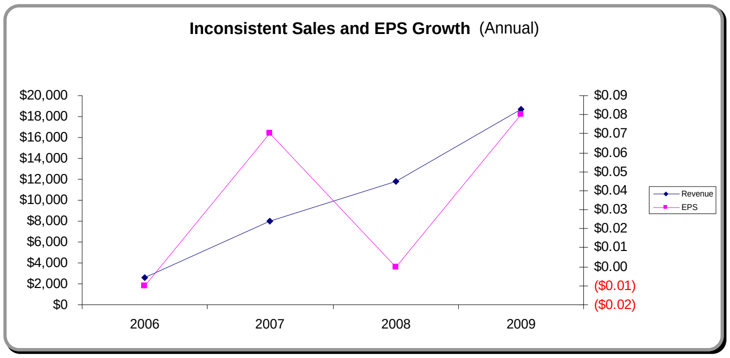
empi.com

In addition to Empi and RS Medical there are a multitude of smaller companies that sell products that compete directly with Zynex. Some of these companies use a sales force and sell directly to physicians and physical therapists. Others strictly sell through the internet. We found advertised prices for internet-only sales as low as $55.00 for a dual-channel (4-lead) TENS unit. We reiterate, however, that there is no reliable information relative to potential differences in efficacy or patient-preference between the various electrotherapy devices on the market. So lower prices may not necessarily offer a significant competitive advantage, especially since most people prescribed electrotherapy treatment will have the cost of the device covered through insurance. In addition, the brick-and-mortar businesses (i.e. – Zynex, Empi, RS Medical) have established distribution channels and billing/collections departments which do provide significant tangible competitive advantages over these e-sellers.

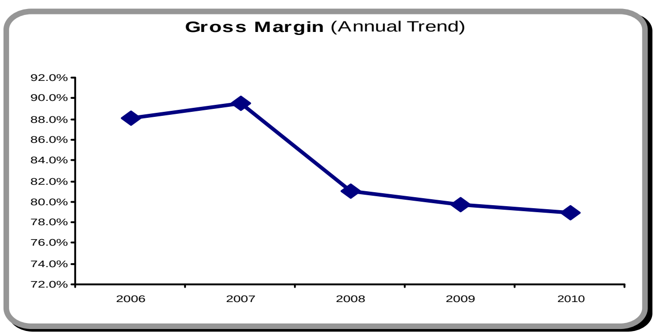
FINANCIALS

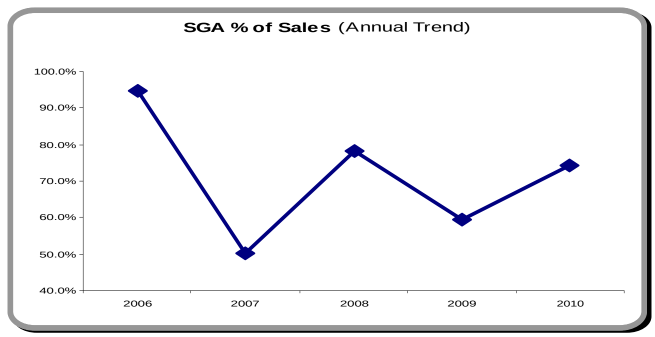
HIGHLIGHTS

Annual Results
Zynex has had an impressive run in revenue growth since 2006. Revenue grew at an annual rate of 94% from 2006 through 2009. Revenue is up another 30% through the first nine months of 2010. As previously noted, this revenue growth is the result of significant expansion of the sales force. Zynex has struggled to turn this revenue growth into accelerating EPS, however. EPS of $0.07 in 2007 fell to $0.00 in 2008 before rebounding to $0.08 in 2009.



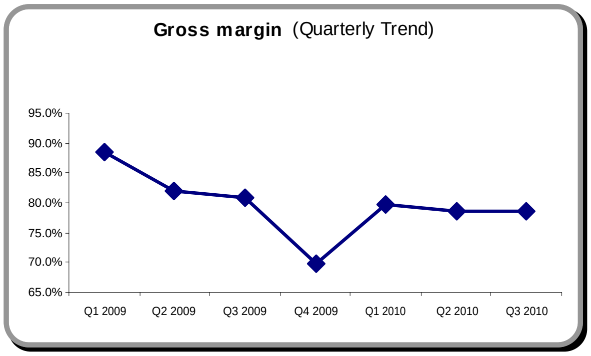
The inconsistency in EPS growth is due to a combination of narrowing gross margins and variability in SG&A expenses as a percent of sales since 2006. Gross margin peaked at 89.5% in 2007, before falling to 81% in 2008 and 79.7% in 2009. This highlights the importance of controlling SG&A expense growth in order for Zynex to be able to realize consistent EPS growth in the future (especially since we expect gross margins to continue to contract).

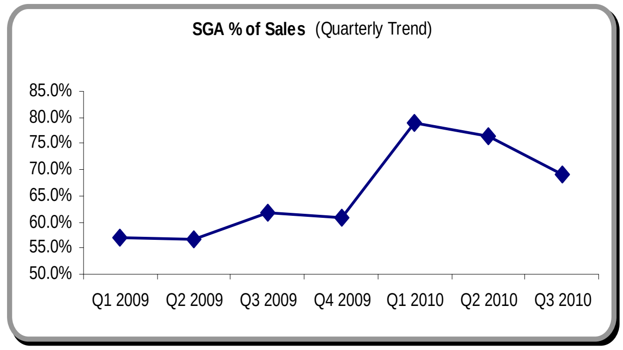




Recent Results
EPS through the first nine months of 2010 was $0.00, compared to $0.07 in the same period 2009. Similar to what the annual trend shows, the slide in EPS in 2010 is due to the combination of tighter gross margins and higher operating expenses as a percent of revenue.

Gross margins have fallen from 83.8% during the first nine months of 2009 to 78.9% in the same period 2010, mostly as a result of higher-margin rental revenue falling from $7,797k (59% of sales) to $6,639k (38% of sales). Gross margins have fallen every quarter of 2010 from 79.6% in Q1 to 78.7% in Q2 to 78.6% in Q3. We expect further gross margin contraction as rental revenue continues to fall.





Meanwhile, operating expenses are up 65% through the first three quarters of 2010 compared to the same period 2009 – versus revenue growth of 30%. We believe there are a few things going on with operating expenses that are important to recognize. Zynex breaks our SG&A into three major categories in their filings; sales & commissions, payroll & benefits, and facility costs (i.e. – building lease). Sales & commissions expense remained stable at 22% of sales through the first nine months of 2010 compared to the same period in 2009, while both payroll/benefits and facility costs are both up as a percent of sales.

As sales/commissions are mostly a variable expense, this is not likely to show significant improvement in the future. Payroll/benefits spiked from $3.4 million (25% of sales) in the first nine months of 2009 to $5.7 million (33% of sales) in the same period 2010. Facility costs went from $183k to $1.4 million over the same periods as a result of the new building lease. Facility costs are almost completely leverageable and will remain relatively stable throughout the 69-month term of the lease which will directly benefit earnings as long as revenue continues to grow. Similarly, payroll/benefits should also grow significantly slower than revenue now that Zynex has beefed up their support staff which should also push down SG&A as a percent of sales with continued revenue growth.

And while operating expenses as a percent of sales are significantly higher in the first nine months of 2010 compared to the same period in 2009, Zynex is starting to see some significant improvement to this on a sequential basis. SG&A has shown consistent sequential improvement for each quarter of 2010, falling from 79% of sales in Q1 to 77% in Q2 to 69% in Q3 – and pro forma for the $200k in one-time expenses related to the replacement of the CFO, SG&A as a percent of sales in Q3 2010 was 66%. This is still a far cry from the 59.3% for all of 2009 but it is moving in the right direction. As gross margins continue to contract from the fall in high margin rental revenue, Zynex will have to be diligent in on squeezing leverage out of the fixed and semi-fixed costs in SG&A.

FINANCIAL CONDITION

Zynex used $825k in cash for operations through the first nine months of 2010. Cash generated (used) in operations during each quarter of this year was; ($651k) in Q1, ($900k) in Q2 and $726k in Q3. Ex-changes in working capital and Zynex generated $1,747k in cash from operations through the first nine months of 2010.

Cash balance stood at $593k at 9/30/2010. Zynex has additional liquidity provided by a bank revolver, capped at $3.5 million but availability is limited by certain covenants. The revolver has a first lien on all of Zynex's assets and bears interest using what sounds to be a complicated calculation plus an additional 4% above LIBOR. It was charging 14% interest at of the end of Q3 - extraordinarily expensive, especially given that LIBOR has been hovering around historical lows and, even fully drawn, the loan would be covered almost 2x by A/R alone. We are not sure if this is this rate is indicative of the underwriters' current opinion (we note the terms were negotiated prior to April 2010 when Zynex's credit profile may have been weaker than current) of Zynex's credit worthiness but we hope that Zynex has an opportunity to renegotiate this rate in the near future.

Zynex tripped the "cash velocity" covenant in the revolver indenture. We assume this has been renegotiated through and amendment.

Based on our model we believe Zynex will generate positive operating cash flow for the foreseeable future. We do note however, that it is likely that there will be spikes in working capital due to inventory builds and growth in accounts receivable commensurate with growth in sales of the electrotherapy business (i.e. – base business). Availability under the revolver along with ongoing cash generation looks like it should be more than sufficient to cover even somewhat significant short-term spikes in working capital.

Zynex has historically had only modest expenditure needs, although this could potentially change with the evolution of the two new business units. Depending on what management has in mind relative to building out these new businesses, Zynex may need to supplement operating cash flow with some additional outside financing – although it's much too early to know whether there will be a need for financing.

OUTLOOK

As is the case with forecasting the future of any company, our "Outlook" for Zynex is based on a number of assumptions relative to revenue, expenses and earnings. Important is that it also assumes that Zynex's growth or even their status as a going-concern is not derailed by certain ongoing issues that are awaiting resolution and/or other concerns that we currently have. These could have a significant adverse impact on the future and success of Zynex so we believe it is prudent to consider our "Outlook" in the context of certain risks that are involved with an investment in Zynex's stock.

Our concerns….

- Outstanding lawsuit - The aforementioned class action lawsuit names Zynex as well as the CEO and former CFO as defendants. Zynex is awaiting a ruling on their motion to dismiss which they filed in May 2010. The lawsuit contends that the CEO and former CFO intentionally inflated earnings and revenue for their own gain (benefitting from resultant increases in Zynex's stock price). Some very serious allegations are made in the complaint including that, "no less than seven former Zynex employees have come forward to describe, in great detail, the improper and (sometimes) illegal methods employed by the Defendants to improperly drive orders and recognize excessive revenue…" We have no visibility on the likely outcome of this lawsuit or the validity of the claims being made but until there is more clarity on both, they will remain a significant concern as they could seriously negatively affect Zynex's future. In the meantime, these will almost certainly continue to hang over Zynex's head and limit upside in the stock price.

- Claims by Anthem – Anthem accounts for 23% of Zynex's revenue and recently filed a second claim seeking a large ($1.3 million) refund from the company. Zynex claims they have re-billings to Anthem that should more than offset this amount. Again, we have no visibility on the likely outcome of this so our model does not include any direct negative impact (i.e. – payment from Zynex to Anthem) for this claim. There is also a possibility that there could be more claims in the future and that claims from Anthem could damage Zynex's relationship with the insurer, thereby potentially putting at risk the large ongoing revenue stream from Anthem.

- Sustainability of the business model – Zynex lacks a true competitive advantage (relative to larger competitors) in our opinion. There is nothing that leads us to believe that Zynex's product portfolio, customer service or distribution are any better than their larger competitors' as a whole. Zynex's growth has been a direct result of hiring competitors' sales reps with existing books of business. We are concerned that this business model may not provide outsized revenue growth beyond just a couple of more years as larger competition likely has the muscle to stem market share losses to Zynex.

- New businesses – Management expects long-term growth to be largely fueled by Monitoring and NeuroDiagnostics. There has been only very limited details released relative to the plans for these businesses or products under development so it's impossible to gauge their potential financial contribution. These new businesses would also presumably require a significant foray into R&D, an area all but absent with Zynex's current operations.

- Expense control – Management will need to diligent about watching operating expenses in order to maximize earnings. With little to no revenue currently flowing to the bottom-line, operating expense control is also critical to stimulate investor interest in Zynex's stock. The new headquarters building is over four times as large as Zynex's prior space and comes with an even relatively more expensive lease. Management noted that they had outgrown the smaller building and needed more space in order to accommodate their faster growth. However, if revenue growth stalls now, the negative impact to earnings will be magnified.

- Reimbursement - While there's no indication that insurers will further restrict coverage of TENS, with the debate relative to its effectiveness still alive, this remains an ever-present risk.

- Liquidity – Terms of the revolver appear to be highly in favor of the lender and, based on the interest rate and apparent tight covenants, Zynex may have been raked over the coals (notwithstanding the overall tight lending environment and potentially weaker credit profile when Zynex negotiated terms of the loan in Q1 2010). While we do not believe there is significant risk of this credit line being pulled, liquidity will remain somewhat of a concern until terms of the revolver are renegotiated.

- Insider Control - Zynex's CEO owns approximately 60% of the company's outstanding common stock and therefore essentially has complete control over all decision-making (at the management and director levels). The relatively low float also makes the stock that much less liquid.

Our outlook….

As there is essentially nothing other than expansion of the company's sales force driving revenue, there are no concrete fundamentals for us to use to forecast Zynex's future sales. The growing epidemic of prescription drug abuse could potentially expand the overall market for TENS use, although we do not believe this has been, or will be, a significant catalyst for Zynex's revenue growth. And while Zynex expects the majority of longer-term growth to be fueled by the new businesses, until more details are revealed about products under development in Monitoring and NeuroDiagnostics, we feel there is no utility in making blind guesses about any potential revenue contribution from these businesses. As a result, our revenue growth outlook for Zynex is largely based on the general guidance that management has offered in press releases and presentations (which relates only to the company's current electrotherapy, or "base", business) that is predicated on continued growth in the size of the sales staff. Relative to forecasting cost of goods sold and operating expenses, our model incorporates some trends that have emerged and how we think these may evolve or change over the next several years.

Zynex's Q3 2010 revenue came in at $6.7 million, at the high-end of management's previously issued guidance of between $6.2 million and $6.8 million. Zynex's November 2010 third quarter earnings announcement also included revenue guidance of $24.0 million - $25.0 million for the full-year 2010. For Q4 2010, we model revenue of $7.17 million, representing y-o-y growth of about 33%. We expect high-margin rental revenue to continue to slide, and with it, overall gross margin. However, we think Zynex can continue to gain significant leverage from fixed SG&A costs in the coming quarter. The net result, we expect to be EPS of $0.02 in Q4 2010, up from $0.01 in Q4 2009 (y-o-y) as well as in Q3 2010 (sequentially).

Our Q4 forecast implies full-year 2010 revenue and EPS of $24.5 million (implying 31% y-o-y growth) and $0.03, compared to $18.7 million and $0.08 in 2009.

Management indicated in a September 2010 presentation that they think they can deliver 30% - 40% revenue growth in 2011 from their electrotherapy business (i.e. – no contribution from new businesses). We more conservatively model revenue to grow 27% in 2011 to $31.1 million. We assume the trend of contracting rental revenue continues but for greater operating leverage to more than offset the tightening gross margins, resulting in operating margins widening from about 8% in 2010 to 16% in 2011. We look for EPS of $0.10 in 2011.

We believe Zynex may have difficulty in maintaining 20%+ revenue growth from their electrotherapy business for more than just the next couple of years. Recruiting sales reps from competitors has been very successful in growing revenue over the last few years, but it becomes ever more challenging to grow from a larger revenue base, especially without a significantly leverageable business model or exploitable competitive advantages. As such, we model revenue growth to fall to 17% in 2012 (to $36.4 million) and 13% in 2013 (to $41.2 million). Assuming Zynex can continue to squeeze efficiencies from SG&A, we think EPS could grow to $0.12 in 2012 and $0.14 in 2013. Upside to our revenue and EPS estimates could come with meaningful contributions from product launches in the new Monitoring and NeuroDiagnostics businesses.

VALUATION / RECOMMENDATION

Zynex's stock was seriously punished with the April 2009 restatement announcement and, despite revenue growth of almost 60% in 2009 and 30% through the first nine months of 2010, has yet to fully recover. Until there is resolution on what we would characterize as "significant" lingering concerns (most notably the outstanding lawsuit and ongoing refund claims by Anthem), we believe Zynex's stock will continue to trade at a significant discount. Complete insider control and thin float also generally penalizes valuation – as Zynex's CEO owns 60% of the outstanding shares, we also expect this to continue to weigh on the share price.

We are also concerned about the current absence of a definitive and significant catalyst to propel long-term revenue growth. Zynex's recent strategy of recruiting competitors' sales reps may not be sustainable for more than a few more years, especially if larger competitors increase commissions to their reps in order to stem their sales force attrition and the resultant market share losses to Zynex. The new businesses (Monitoring and NeuroDiagnostics) may indeed evolve into very meaningful contributors to and drivers of long-term revenue growth. But until there are more specifics on the products expected to be developed through these businesses and plans relative to R&D strategies and efforts, it is impossible to comfortably gauge the viability of management's expectations for these units or their potential financial contribution.

Despite our concerns and the hangovers from the lawsuit/restatement and ongoing insurance claims, we think Zynex's stock trades cheaper than what is warranted given the potential to continue to post significant sales (and EPS) growth over the next few years. While our model is largely predicated on the faith in management's somewhat general financial guidance (for FY 2010 and 2011), the company has demonstrated that their relatively simple strategy of expanding the size of their sales force has been successful enough to grow revenue at a CAGR of 94% over the last three full fiscal years (from $2.6 million in 2006 to $18.7 million in 2009 and is at a $23.0 million run-rate for 2010 through the first nine months). We think it's reasonable that revenue can grow another 27% in 2011 (compared to guidance of 30% - 40%) and 17% in 2012 and EPS growth can accelerate as long as management contains the growth in operating expenses (which there should be ample opportunity to do).

Valuation
Based on our model we look for EPS to grow at a four-year CAGR of about 17% through 2013. We use a PE/G ratio of 0.8x to value Zynex. This represents a 20% discount to the 1.0x that is generally considered "fair value" and a 33% discount to the approximate 1.2x PE/G that the industry currently trades at. Our discount reflects the various concerns and risks that we have outlined throughout this report. Resolution of some of these concerns and/or mitigation of risks would likely warrant a lower PE/G discount and, therefore, a higher price target. Actual EPS falling short of our estimates and/or adverse consequences related to risks/concerns could prompt us to lower our valuation for Zynex.

As it stands now, we value Zynex at $1.40 per share (calculated using four-year PE/G of 0.8x and 2011 EPS estimate of $0.10). ZYXI currently trades at $0.65. We are initiating coverage of Zynex with an Outperform rating and $1.40 price target.

KEY MANAGEMENT PROFILES (from public filings)

Thomas Sandgaard
President, CEO, Chairman
Mr. Sandgaard founded the Company in 1996 after a successful European based career in the semiconductor, telecommunications and medical equipment industries with ITT, Siemens and Philips Telecom. Mr. Sandgaard held middle and senior management positions in the areas of international sales and distribution, technology transfers, mergers and acquisitions and marketing. Mr. Sandgaard holds a degree in electronics engineering from Odense Teknikum, Denmark and an MBA from the Copenhagen Business School. Mr. Sandgaard founded the Company's business and has been a director since the business was acquired by the Company. Valued Skills: Mr. Sandgaard has an in-depth knowledge of the industry, the history and the operations of the Company. Mr. Sandgaard has a long-standing commitment to the Company and is the driving force as to the Company and its strategies.

Anthony Scalese
CFO
Anthony Scalese was appointed Chief Financial Officer of the Company, effective September 7, 2010. Mr. Scalese has served as Chief Financial Officer of Qualmark Corporation, a global manufacturer of durability testing equipment, since 2003. Mr. Scalese joined Qualmark in February 2000 as Corporate Controller and previously worked for Coram Healthcare (now Apria Healthcare) as well as Foundation Health Systems (now Healthnet). Mr. Sclaese is a Certified Public Accountant licensed in Colorado. Mr. Scalese received a Masters in Business Administration from the University of Colorado and a Bachelor of Science in Business Administration from Colorado State University.

FINANCIAL STATEMENTS

INCOME STATEMENT

Zynex Inc.

	2009 A	Q1A	Q2A	Q3A	Q4E	2010 E	2011 E	2012 E	2013 E
Rental revenue	$10,534.4	$2,271.1	$2,335.4	$2,032.0	$1,849.0	$8,487.5	$7,442.0	$6,720.0	$6,500.0
YOY Growth	*32.7%*	*-14.3%*	*-10.2%*	*-20.3%*	*-32.4%*	*-19.4%*	*-12.3%*	*-9.7%*	*-3.3%*
Consumable sales	$6,291.0	$1,989.0	$2,251.0	$2,305.0	$2,370.0	$8,915.0	$10,370.0	$12,120.0	$13,720.0
YOY Growth	*80.1%*	*72.1%*	*64.9%*	*37.7%*	*13.1%*	*41.7%*	*16.3%*	*16.9%*	*13.2%*
Equipment sales	$1,855.9	$615.3	$1,155.3	$2,320.0	$2,952.0	$7,042.6	$13,285.0	$17,520.0	$20,945.0
YOY Growth	*457.5%*	*44.2%*	*202.6%*	*394.7%*	*410.5%*	*279.5%*	*88.6%*	*1416.5%*	*802.8%*
Product sales revenue	$8,146.8	$2,604.3	$3,406.3	$4,625.0	$5,322.0	$15,957.6	$23,655.0	$29,640.0	$34,665.0
YOY Growth	*113.0%*	*64.6%*	*95.0%*	*115.8%*	*99.0%*	*95.9%*	*48.2%*	*25.3%*	*17.0%*
Total Revenues	$18,681.2	$4,875.4	$5,741.7	$6,657.0	$7,171.0	$24,445.1	$31,097.0	$36,360.0	$41,165.0
YOY Growth	*58.8%*	*15.2%*	*32.1%*	*41.9%*	*32.5%*	*30.9%*	*27.2%*	*16.9%*	*13.2%*
Rental COGS	$1,564.1	$275.3	$257.8	$169.0	$212.6	$914.7	$893.0	$806.4	$780.0
Rental margin	*85.2%*	*87.9%*	*89.0%*	*91.7%*	*88.5%*	*89.2%*	*88.0%*	*88.0%*	*88.0%*
Sales COGS	$2,229.2	$720.5	$964.3	$1,257.0	$1,479.5	$4,421.4	$6,623.4	$8,299.2	$9,706.2
Sales margin	*72.6%*	*72.3%*	*71.7%*	*72.8%*	*72.2%*	*72.3%*	*72.0%*	*72.0%*	*72.0%*
Cost of Revenues	$3,793.3	$995.8	$1,222.2	$1,426.0	$1,692.2	$5,336.1	$7,516.4	$9,105.6	$10,486.2
Gross Income	$14,887.9	$3,879.6	$4,519.5	$5,231.0	$5,478.8	$19,109.0	$23,580.6	$27,254.4	$30,678.8
Gross Margin	*79.7%*	*79.6%*	*78.7%*	*78.6%*	*76.4%*	*78.2%*	*75.8%*	*75.0%*	*74.5%*
SG&A	$11,074.1	$3,847.0	$4,389.6	$4,606.0	$4,413.4	$17,256.0	$18,492.4	$21,152.6	$23,517.5
% SG&A	*59.3%*	*78.9%*	*76.5%*	*69.2%*	*61.5%*	*70.6%*	*59.5%*	*58.2%*	*57.1%*
Operating Income	$3,813.8	$32.6	$129.9	$625.0	$1,065.4	$1,852.9	$5,088.2	$6,101.8	$7,161.4
Operating Margin	*20.4%*	*0.7%*	*2.3%*	*9.4%*	*14.9%*	*7.6%*	*16.4%*	*16.8%*	*17.4%*
Interest income, net	($160.9)	($78.6)	($49.6)	($43.0)	($48.0)	($219.2)	($52.0)	$100.0	$200.0
Other income	($1.2)	($17.6)	$1.2	$0.0	$0.0	($16.4)	$0.0	$0.0	$0.0
Gain on value of derivative liab	$171.5	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Pre-Tax Income	$3,823.3	($63.6)	$81.5	$582.0	$1,017.4	$1,617.4	$5,036.2	$6,201.8	$7,361.4
Taxes	$1,441.0	$3.0	$52.0	$214.0	$376.4	$645.4	$1,863.4	$2,294.7	$2,723.7
Tax Rate	*37.7%*	*-4.7%*	*63.8%*	*36.8%*	*37.0%*	*39.9%*	*37.0%*	*37.0%*	*37.0%*
Net Income	$2,382.3	($66.6)	29.5	368.0	641.0	$971.9	$3,172.8	$3,907.1	$4,637.7
YOY Growth	*-2047.2%*	*107.0%*	*95.8%*	*-19.8%*	*142.9%*	*59.2%*	*226.4%*	*23.1%*	*18.7%*
Net Margin	*12.8%*	*-1.4%*	*0.5%*	*5.5%*	*8.9%*	*4.0%*	*10.2%*	*10.7%*	*11.3%*
EPS	$0.08	($0.00)	$0.00	$0.01	$0.02	$0.03	$0.10	$0.12	$0.14
YOY Growth	*-2064.8%*	*107.0%*	*95.9%*	*-20.8%*	*140.4%*	*59.6%*	*220.6%*	*21.6%*	*17.2%*
Diluted Shares O/S	30,374	30,497	30,703	30,667	30,700	30,642	31,200	31,600	32,000

Source: Zacks Investment Research *Brian Marckx, CFA*

BALANCE SHEET Zynex Inc.

	September 30, 2010	December 31, 2009
Assets		
Current assets:		
Cash	$593	$863
Accounts receivable, net	$6,628	$5,039
Inventory	$3,425	$2,034
Prepaid expenses	$39	$139
Deferred tax asset	$1,248	$864
Other current asset	$76	$77
Total current assets	$12,009	$9,016
Property and equipment, net	$2,654	$2,718
Deposits	$174	$166
Deferred financing fees, net	$100	$30
Total Assets	**$14,937**	**$11,930**
Liabilities and Shareholders' Equity		
Current liabilities:		
Line of credit	$972	$0
Current portion of capital leases and other oblig.	$71	$95
Accounts payable	$1,485	$1,127
Income taxes payable	$541	$905
Accrued payroll and payroll taxes	$651	$426
Other accrued liabilities	$894	$788
Total current liabilities	$4,614	$3,341
Long-term liabilities:		
Capital leases and other oblig., less current portion	$261	$20
Deferred rent liability	$1,390	$544
Deferred tax liability	$592	$239
Total Liabilities	**$6,857**	**$4,144**
Shareholders' equity:		
Preferred stock	$0	$0
Common stock	$31	$30
Additional paid-in capital	$4,620	$4,357
Retained earnings	$3,429	$3,099
Total shareholders' equity	**$8,080**	**$7,486**
Total Liabilities and Shareholders' Equity	**$14,937**	**$11,630**

Source: Zynex Inc. / Zacks Investment Research *Brian Marckx, CFA*

CASH FLOW STATEMENT **Zynex Inc.**

	Nine Months Ending September 30, 2010	2009
Cash Flows From Operating Activities:		
Net income	$330	$2,118
Depreciation	$591	$499
Provision for provider discounts	$55,221	$39,004
Provision for losses in A/R (uncollectibility)	$3,286	$2,369
Amortization of financing fees	$31	$21
Gain on value of derivative liability	$0	($172)
Change in reserve for obsolete inventory	($2)	$152
Deferred rent expense	$846	$0
Net loss on disposal of equipment	$18	$0
Issuance of common stock for consulting svcs	$61	$75
Employee stock based compensation	$203	$113
Deferred tax benefit	($331)	($172)
Changes in operating assets and liabilities:		
Accounts receivable	($60,096)	($41,851)
Inventories	($1,389)	($88)
Prepaid expenses	$100	$53
Other current assets	($19)	($108)
Accounts payable	$358	($306)
Accrued liabilities	$331	($451)
Income taxes payable	($364)	$506
Net cash provided by operating activities	($825)	$1,762
Cash Flows From Investing Activities:		
Proceeds received in lease termination	$108	$0
Purchases of equipment	($271)	($818)
Net cash used in investing activities	($163)	($818)
Cash Flows From Financing Activities:		
Decrease in bank overdraft	$0	($113)
Net borrowings from (payments on) line of credit	$972	($682)
Deferred financing fees	($90)	$0
Payments on notes payable and capital leases	($164)	($29)
Repayments of loans from stockholder	$0	($25)
Issuance of common stock	$0	$144
Net cash provided by financing activities	$718	($705)
Net increase in cash	($270)	$239
Cash at beginning of year	$863	$0
Cash and cash equivalents at end of year	**$593**	**$239**

Source: Zynex Inc. / Zacks Investment Research Brian Marckx, CFA

HISTORICAL ZACKS RECOMMENDATIONS

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