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Zacks Small-Cap Research

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Zynex Inc (ZYXI-OTC)

ZYXI: Q1 2011 Results. SG&A Impacts EPS.

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	01/06/2011
Current Price (05/05/11)	$1.00
Target Price	**$1.40**

OUTLOOK

The shares are up just over 50% since we initiated on ZYXI in February 2011 but we think some upside remains. Operating expense control will be critical in order for management to hit their 2011 EPS guidance. 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 value remains in the shares.

We model EPS of $0.07 in 2011. We are maintaining our Outperform rating and price target of $1.40.

SUMMARY DATA

52-Week High	**$1.00**
52-Week Low	**$0.38**
One-Year Return (%)	**-16.67**
Beta	**-0.26**
Average Daily Volume (sh)	**19,623**
Shares Outstanding (mil)	**31**
Market Capitalization ($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 (%)	**76.4**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**100.0**
P/E using 2011 Estimate	**14.2**
P/E using 2012 Estimate	**9.0**
Zacks Rank	**N/A**

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

ZACKS ESTIMATES

Revenue
(in '000 of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2010	4,875 A	5,742 A	6,657 A	6,810 A	24,084 A
2011	6,633 A	7,209 E	7,587 E	8,139 E	29,568 E
2012					34,458 E
2013					40,059 E

Earnings per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2010	$0.00 A	$0.00 A	$0.01 A	$0.00 A	$0.01 A
2011	-$0.00 A	$0.02 E	$0.03 E	$0.03 E	$0.07 E
2012					$0.11 E
2013					$0.14 E

Zacks Projected EPS Growth Rate - Next 4 Years % 17

WHAT'S NEW

Q1 2011 Financial Results…

Revenue

Zynex reported financial results for the three month period ending March 31, 2011 on May 5, 2011. First quarter revenue of $6.63 million was 5% below our $7.01 million estimate and was up 36% from the first quarter 2010. Sales fell about 3% sequentially from Q4 2010 but, as management explained on the call, Q1 equipment revenue is typically soft as a result of insurance deductibles being reset at year end and not yet met early in the new year.

The $6.63 million in total revenue consisted of $2.49 million (+8% y-o-y) in rental revenue and $4.19 million (+148% y-o-y) in product sales. Rental revenue handily beat our $1.83 million estimate while product revenue came in significantly lower than our $5.18 million number. We clearly underestimated the insurance-related seasonality in the industry.

	Actual Q1 2010	Actual Q1 2011	Y-o-Y Change	Zacks Est Q1 2011	Actual +/- Zacks est.
Consumables	$1,989	$2,659	33.7%	$2,781	-4.4%
Equipment Sales	$615	$1,526	148.1%	$2,395	-36.3%
Total Product Sales	$2,604	$4,185	60.7%	$5,176	-19.1%
Rental Revenue	$2,271	$2,448	7.8%	$1,831	33.7%
	$4,875	**$6,633**	**36.1%**	**$7,007**	**-5.3%**

Gross Margin

Gross margin came in at 78.2%, better than our 76% estimate. The better gross margin was due to a combination of a higher than modeled percentage of revenue coming from rentals (which carry a higher margin than product sales) along with product margins coming in very strong (73.5% versus 71.6% estimate).

Net Income / EPS

Net income and EPS were ($110k) and ($0.00) compared to our $528k and $0.02 estimates. The difference compared to our estimates was due to the lower revenue figure and significantly higher than modeled SG&A expenses, slightly offset by the higher gross margin.

SG&A expense was $5.33 million. We were looking for this to come in at about $4.4 million. Management noted a charge of roughly $100k was taken in the quarter related to the retirement of the VP of Billing (announced earlier in the year). Management attributed the majority of the significant increase (+19% sequentially) in SG&A expense in the quarter to recruitment of additional sales reps and build out of the billing and collections departments in anticipation of greater demand. As we noted in our initiation report on Zynex (2/14/2011), management will have to be diligent in controlling SG&A expense in order to maximize earnings. Management noted on the Q1 call that they are prepared to adjust expenses to the level of revenue growth and expect growth in revenue to outstrip that of operating expenses for the remainder of the year.

Cash

Zynex exited the first quarter 2011 with $646k in cash and equivalents, up slightly from $602k at the end of fiscal 2010. Cash used in operations was $646k. Zynex drew $1.05 million on their revolver during the most recent quarter. Total borrowed under the line of credit stood at $2.3 million at March 31, 2011. The revolver is capped at $3.5 million but certain covenants can restrict total borrowing availability (based on collateral coverage, etc.) - this amount was $2.6 million at 12/31/2010. Zynex did not disclose the amount available for borrowing at the end of Q1 2011 but we assume that cash needs can be met through operating cash flow (and possibly borrowing - assuming availability remains).

BUSINESS UPDATE / GUIDANCE

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

- **Expanding Sales Force:** Management noted that 18 sales reps were added during Q1 and they continue to expect to bring on additional reps throughout the year as they expand their domestic footprint.

- **International Sales:** Zynex expects to place a greater emphasis on expanding its international presence through signing new distribution contracts.

- **NexWave Launch:** NexWave, Zynex's newest addition to their electrotherapy business, is expected to launch around mid-year 2011.

- **Shareholder Lawsuit / Anthem:** Management did not provide an update to the shareholder lawsuit and noted that there was nothing material to report relative to the $1.3 million refund claim made by Anthem Blue Cross Blue Shield in April 2010. As a reminder, Zynex believes they have $1.5 million in "rebillings" that were not properly reimbursed by Anthem, more than offsetting the insurers claim.

- **2011 Guidance:** Management reiterated its previously issued guidance of revenue of $30 million - $32 million and EPS between $0.08 - $0.11.

OUR 2011 OUTLOOK

While our initial investment thesis on Zynex remains intact, we have made some revisions to our model following the Q1 2011 results.

Revenue
We look for Zynex to post revenue of $29.6 million in 2011, compared to our pre-Q1 2011 estimate of $30 million. We look for product sales and rental revenue of $21.6 million and $8.0 million, representing growth of about 39% and (7%), respectively.

EPS
We now look for EPS of $0.07 in 2011, revised down from $0.09 prior to the Q1 2011 results. Our revision reflects the $0.02 lower than modeled EPS figure in Q1 (i.e. - our quarterly EPS estimates for the remainder of 2011 remain intact). We note that we have made only very minor adjustments to our SG&A expense estimates (despite this coming in significantly higher than modeled in Q1) and have slightly tweaked our gross margins upwards. We believe Zynex may need to find areas to trim operating expenses in order to hit their EPS guidance of $0.08 - $0.11.

VALUATION / RECOMMENDATION

Zynex's stock was seriously punished with the April 2009 restatement announcement and, despite revenue growth of almost 60% in 2009 and 29% in 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. In April 2011 Zynex announced an agreement with clinical research services company, OmniaVincit, LLC to conduct the first clinical evaluation of the company's blood volume monitoring device. Zynex hopes to use data from the evaluation for the design of clinical trials for the device.

Despite our concerns and the hangovers from the lawsuit/restatement and ongoing insurance claims, we think Zynex's stock still 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 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 75% over the last four full fiscal years (from $2.6 million in 2006 to $24.1 million in 2010). We think it's reasonable that revenue can grow another 23% in 2011 (compared to guidance of 25% - 33%) 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). If, however, management is unable to rein-in operating expenses relative to revenue, EPS will continue to languish.

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 in our initiation report on Zynex (2/14/2011). 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.

We initiated coverage of Zynex in February of this year. The shares are up just over 50% since we started covering the company but we think there remains some upside in the stock. We continue to value Zynex at $1.40 per share.

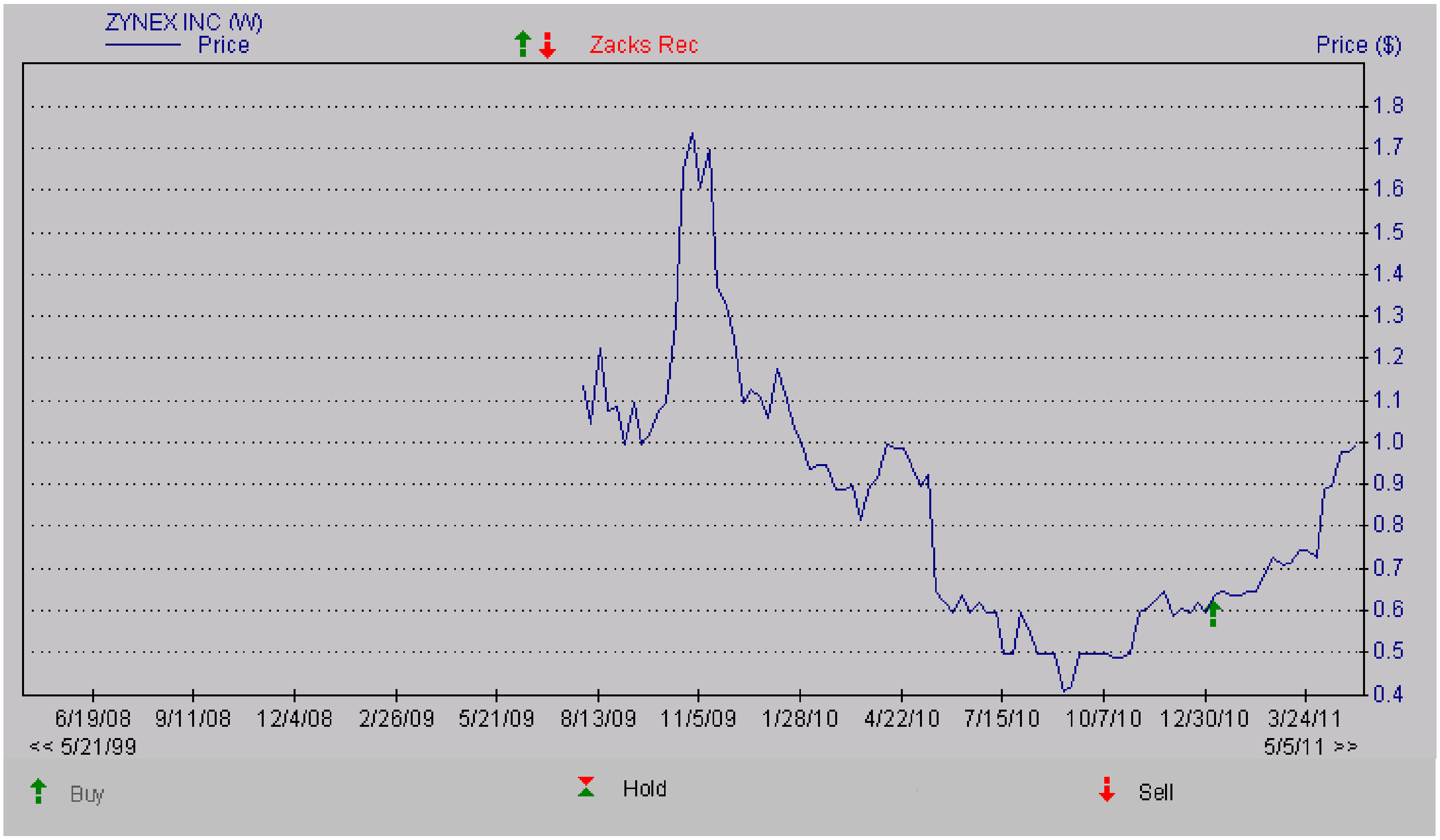
FINANCIAL MODEL

Zynex Inc.

	2010 A	Q1A	Q2E	Q3E	Q4E	2011 E	2012 E	2013 E	2014 E
Rental revenue	$8,532.5	$2,448.0	$1,975.0	$1,781.0	$1,772.0	$7,976.0	$6,621.0	$6,295.0	$6,150.0
YOY Growth	*-19.0%*	*7.8%*	*-15.4%*	*-12.4%*	*-6.4%*	*-6.5%*	*-17.0%*	*-4.9%*	*-2.3%*
Consumable sales	$9,101.0	$2,659.0	$2,866.4	$2,960.6	$3,145.6	$11,631.6	$12,921.6	$15,022.2	$15,682.8
YOY Growth	*44.7%*	*33.7%*	*27.3%*	*28.4%*	*23.1%*	*27.8%*	*11.1%*	*16.3%*	*4.4%*
Equipment sales	$6,450.6	$1,526.0	$2,368.0	$2,845.0	$3,221.0	$9,960.0	$14,915.0	$18,742.0	$19,988.0
YOY Growth	*247.6%*	*148.0%*	*105.0%*	*22.6%*	*36.5%*	*54.4%*	*49.7%*	*25.7%*	*6.6%*
Product sales revenue	$15,551.6	$4,185.0	$5,234.4	$5,805.6	$6,366.6	$21,591.6	$27,836.6	$33,764.2	$35,670.8
YOY Growth	*90.9%*	*60.7%*	*53.7%*	*25.5%*	*29.5%*	*38.8%*	*28.9%*	*21.3%*	*5.6%*
Total Revenues	$24,084.1	$6,633.0	$7,209.4	$7,586.6	$8,138.6	$29,567.6	$34,457.6	$40,059.2	$41,820.8
YOY Growth	*28.9%*	*36.1%*	*25.6%*	*14.0%*	*19.5%*	*22.8%*	*16.5%*	*16.3%*	*4.4%*
Rental COGS	$802.1	$334.0	$217.3	$147.8	$124.0	$823.1	$662.1	$629.5	$615.0
Rental margin	*90.6%*	*86.4%*	*89.0%*	*91.7%*	*93.0%*	*89.7%*	*90.0%*	*90.0%*	*90.0%*
Sales COGS	$4,399.8	$1,110.0	$1,465.6	$1,619.8	$1,910.0	$6,105.4	$7,933.4	$9,622.8	$10,166.2
Sales margin	*71.7%*	*73.5%*	*72.0%*	*72.1%*	*70.0%*	*71.7%*	*71.5%*	*71.5%*	*71.5%*
Cost of Revenues	$5,201.9	$1,444.0	$1,682.9	$1,767.6	$2,034.0	$6,928.5	$8,595.5	$10,252.3	$10,781.2
Gross Income	$18,882.1	$5,189.0	$5,526.5	$5,819.0	$6,104.6	$22,639.1	$25,862.1	$29,806.9	$31,039.6
Gross Margin	*78.4%*	*78.2%*	*76.7%*	*76.7%*	*75.0%*	*76.6%*	*75.1%*	*74.4%*	*74.2%*
SG&A	$17,321.6	$5,328.0	$4,549.1	$4,521.6	$4,818.0	$19,216.8	$20,157.7	$22,833.7	$23,628.8
% SG&A	*71.9%*	*80.3%*	*63.1%*	*59.6%*	*59.2%*	*65.0%*	*58.5%*	*57.0%*	*56.5%*
Operating Income	$1,560.5	($139.0)	$977.4	$1,297.4	$1,286.5	$3,422.3	$5,704.4	$6,973.2	$7,410.9
Operating Margin	*6.5%*	*-2.1%*	*13.6%*	*17.1%*	*15.8%*	*11.6%*	*16.6%*	*17.4%*	*17.7%*
Interest income, net	($209.2)	($58.0)	($70.0)	($50.0)	($45.0)	($223.0)	$25.0	$40.0	$80.0
Other income	($16.4)	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Gain on value of derivative liab	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Pre-Tax Income	$1,334.9	($197.0)	$907.4	$1,247.4	$1,241.5	$3,199.3	$5,729.4	$7,013.2	$7,490.9
Taxes	$985.0	($87.0)	$335.7	$461.5	$459.4	$1,183.7	$2,119.9	$2,594.9	$2,771.6
Tax Rate	*73.8%*	*N/A*	*37.0%*	*37.0%*	*37.0%*	*37.0%*	*37.0%*	*37.0%*	*37.0%*
Net Income	$349.9	($110.0)	$571.7	$785.9	$782.2	$2,015.6	$3,609.5	$4,418.3	$4,719.2
YOY Growth	*-85.3%*	*N/A*	*1835.4%*	*113.6%*	*4016.6%*	*476.0%*	*79.1%*	*22.4%*	*6.8%*
Net Margin	*1.5%*	*-1.7%*	*7.9%*	*10.4%*	*9.6%*	*6.8%*	*10.5%*	*11.0%*	*11.3%*
EPS	$0.01	($0.00)	$0.02	$0.03	$0.03	$0.07	$0.11	$0.14	$0.15
YOY Growth	*85.5%*	*N/A*	*1819.4%*	*110.6%*	*3990.5%*	*471.2%*	*76.6%*	*20.9%*	*6.1%*
Diluted Shares O/S	30,705	30,631	30,960	31,100	31,150	30,960	31,400	31,800	32,000

Source: Zacks Investment Research *Brian Marckx, CFA*

HISTORICAL ZACKS RECOMMENDATIONS



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