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Zacks Small-Cap Research

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Zynex Inc (ZYXI-OTC)

ZYXI: Fiscal 2010 Results.

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 $0.09 in 2011. We are maintaining our Outperform rating and price target of $1.40.

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	01/06/2011
Current Price (03/11/11)	$0.72
Target Price	**$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	**72.0**
P/E using 2011 Estimate	**8.0**
P/E using 2012 Estimate	**6.0**
Zacks Rank	**N/A**

Above Avg., Small-Blend Med Products

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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	7,007 E	7,226 E	7,587 E	8,139 E	29,958 E
2012					36,014 E
2013					40,898 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	$0.02 E	$0.02 E	$0.03 E	$0.03 E	$0.09 E
2012					$0.12 E
2013					$0.14 E

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

WHAT'S NEW

FY 2010 Financial Results…

Revenue

Zynex reported financial results for the twelve months ending December 31, 2010 on March 10, 2011. Fourth quarter revenue of $6.81 million was 5% below our $7.17 million estimate and was up 25.8% and 2.3% from the fourth quarter 2009 and the third quarter 2010 (i.e. – sequentially), respectively. The $6.81 million in total revenue consisted of $1.89 million (-30.8% y-o-y) in rental revenue and $4.92 million (+83.8% y-o-y) in product sales revenue.

Product revenue, broken out between sales of equipment and sales of consumables, came in about 8% lower than our estimate while rental revenue beat our number by 2%.

	Actual Q4 2009	Actual Q4 2010	Y-o-Y Change	Zacks Est Q4 2010	Actual +/- Zacks est.
Consumables	$2,096	$2,556	+ 22%	$2,370	+ 8%
Equipment Sales	$578	$2,360	+ 308%	$2,952	- 20%
Total Product Sales	$2,674	$4,916	+ 84%	$5,322	- 8%
Rental Revenue	$2,737	$1,894	- 31%	$1,849	+ 2%
	$5,411	**$6,810**	**+ 26%**	**$7,171**	**- 5%**

For the full year 2010 revenue came in at $24.09 million, an increase of 29% from fiscal 2009. Rental revenue fell 19% to $8.53 million while product sales increased 91% to $15.55 million.

The consumables portion of product revenue posted 45% growth for the full year while equipment sales were up by almost 250%.

	Actual FY 2009	Actual FY 2010	Y-o-Y Change
Consumables	$6,291	$9,101	+ 45%
Equipment Sales	$1,856	$6,451	+ 248%
Total Product Sales	$8,147	$15,552	+ 91%
Rental Revenue	$10,534	$8,532	- 19%
	$18,681	**$24,084**	**+ 29%**

EPS

EPS came in at $0.00 in Q4 2010 on net income of $19k, down from $0.01 and $264k in Q4 2009 and were shy of our $0.02 and $641k estimate. The difference compared to our estimate was from a combination of the lower than estimated total revenue number, SG&A expense at 65.8% of sales (versus 61.5% E) and an effective income tax rate of 97%, all partially offset by a stronger than estimated gross margin (77.1% A vs. 76.4% E).

Management noted in the earnings press release that income tax penalties and interest was the cause of the spike in the tax rate in the quarter. The company mentioned that they are working to reduce any further penalties and "does not expect to incur tax penalties and interest at these amounts in the future."

For the full year 2010 EPS was $0.01 on net income of $350k, compared to $0.08 and $2,382k for fiscal 2009. The 29% revenue growth in 2010 was offset by higher lease facility expense (related to the new headquarters building), headcount additions (mostly related to sales), a $200k one-time charge taken in Q3 2010 related to the CFO transition and drop in GM from 79.7% in 2009 to 78.4% in 2010 (mostly related to the slide in rental revenue).

Cash
Zynex exited 2010 with $602k in cash and equivalents roughly flat from the end of Q3 2010 and down slightly from $863k at the end of 2009. Cash used in operations was $665k in 2010 but, stripping out changes in working capital, operating cash flow was positive $2,747k.

BUSINESS UPDATE / GUIDANCE

Following the earnings press release management held a webcast and in it provided a brief business update.

- **New Business Units:** While no additional details were provided regarding the products under development in the two new business units (Zynex Monitoring Solutions and Zynex Medical), management mentioned that they have been pleased with progress – and specifically with their blood volume monitoring device. Depending on progress including the to-be-planned clinical trials and eventual FDA marketing clearance, management hopes to see some contribution from new products under these businesses beginning sometime in 2012. As we noted in our initial report on Zynex, our model does not include any contribution from products from these new business units.

- **New Electrotherapy Product:** Zynex's newest addition to its electrotherapy product line-up, called NexWave, is expected to launch later in 2011.

- **Shareholder Lawsuit / Anthem:** Management noted that they are still waiting for an answer from the courts regarding their motion to dismiss the shareholder lawsuit. Zynex filed the motion in May 2010. Zynex did not have any updates 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 expects revenue of $30 million - $32 million and EPS between $0.08 - $0.11. Management did not mention whether this guidance includes any provision for any potential future income tax penalties.

OUR 2011 OUTLOOK

While our initial investment thesis on Zynex remains intact, we have made some revisions to our model following the Q4 2010 results based on some revenue trends that may have emerged. In order to ask questions during the brief Q&A portion of Zynex's earnings webcast conference call you had to type your questions into the webcast interface. The cumbersomeness of the process meant we were left without answers to a number of our "outlook"-themed questions. Notwithstanding the difficulty, we commend management for holding the call and for continuing to provide some financial guidance.

Revenue
We look for Zynex to post revenue of $29.96 million in revenue in 2011, compared to our pre-Q4 2010 estimate of $31.10 million. We now look for product sales revenue of $22.7 million, representing growth of about 76%. This is revised down from $23.7 million as we have trimmed growth of equipment sales (to $11.0MM or +70% from $13.3MM or +89%). At the same time, we have upwardly revised our consumables revenue estimate from $10.4MM to $11.8MM (+16% to +29%). We have also revised our rental revenue estimate from $7.4MM (y-o-y decrease of 12%) to $7.2MM (y-o-y decrease of 15%).

EPS
We now look for EPS of $0.09 in 2011, revised down from $0.10 prior to the FY2010 results. Our EPS estimate assumes Zynex does not incur any significant income tax penalties during the year.

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.

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 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 24% in 2011 (compared to guidance of 25% - 33%) and 20% 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.

We initiated coverage of Zynex in February of this year. We value Zynex at $1.40 per share

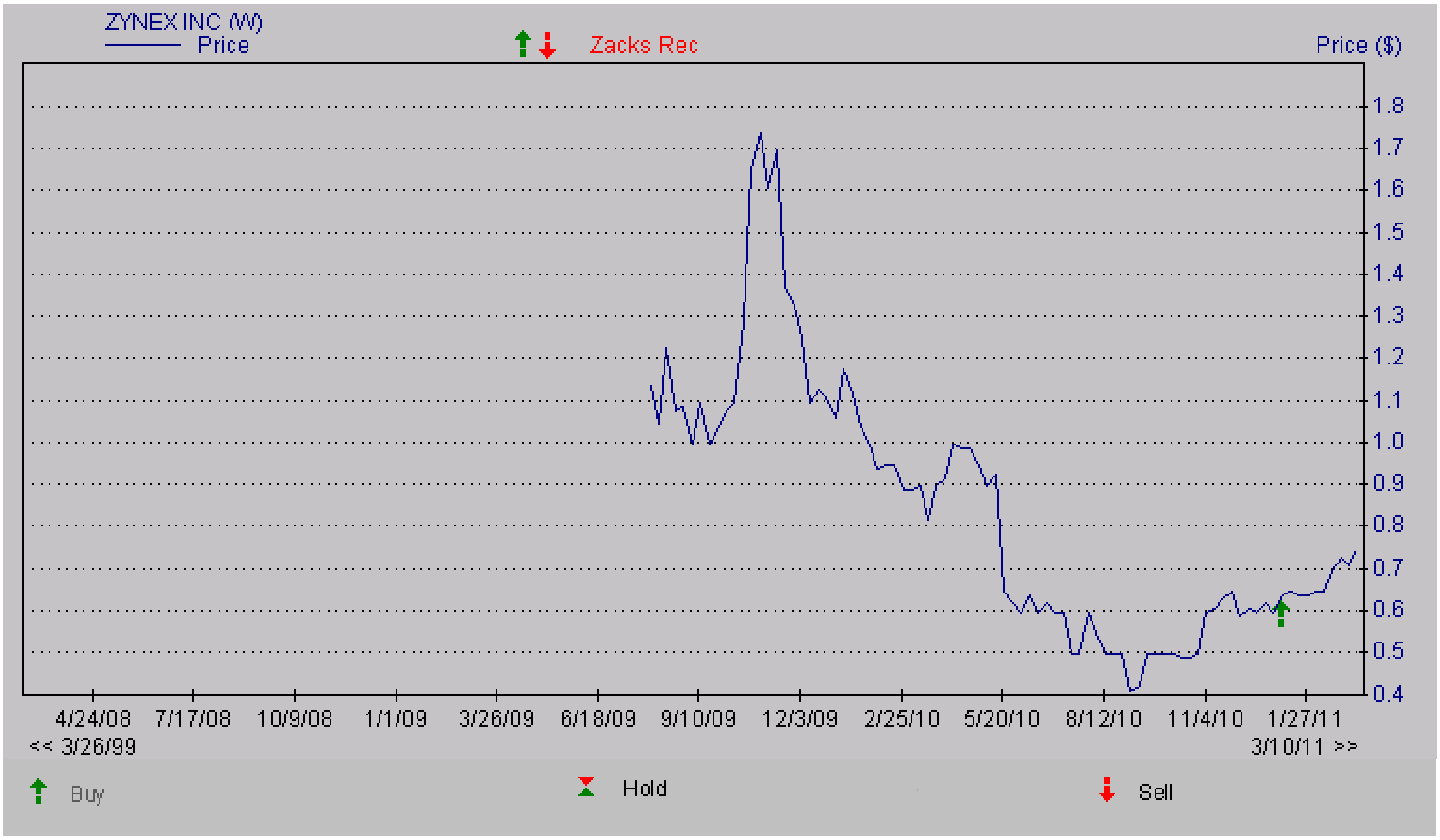
FINANCIAL MODEL

Zynex Inc.

	2010 A	Q1E	Q2E	Q3E	Q4E	2011 E	2012 E	2013 E	2014 E
Rental revenue	$8,532.5	$1,831.0	$1,835.0	$1,781.0	$1,772.0	$7,219.0	$6,521.0	$6,295.0	$6,150.0
YOY Growth	*-19.0%*	*-19.4%*	*-21.4%*	*-12.4%*	*-6.4%*	*-15.4%*	*-9.7%*	*-3.5%*	*-2.3%*
Consumable sales	$9,101.0	$2,781.0	$2,873.0	$2,960.6	$3,145.6	$11,760.2	$13,505.4	$15,336.6	$15,897.0
YOY Growth	*44.7%*	*39.8%*	*27.6%*	*28.4%*	*23.1%*	*29.2%*	*14.8%*	*13.6%*	*3.7%*
Equipment sales	$6,450.6	$2,395.0	$2,518.0	$2,845.0	$3,221.0	$10,979.0	$15,988.0	$19,266.0	$20,345.0
YOY Growth	*247.6%*	*289.2%*	*118.0%*	*22.6%*	*36.5%*	*70.2%*	*45.6%*	*20.5%*	*5.6%*
Product sales revenue	$15,551.6	$5,176.0	$5,391.0	$5,805.6	$6,366.6	$22,739.2	$29,493.4	$34,602.6	$36,242.0
YOY Growth	*90.9%*	*98.7%*	*58.3%*	*25.5%*	*29.5%*	*46.2%*	*29.7%*	*17.3%*	*4.7%*
Total Revenues	$24,084.1	$7,007.0	$7,226.0	$7,586.6	$8,138.6	$29,958.2	$36,014.4	$40,897.6	$42,392.0
YOY Growth	*28.9%*	*43.7%*	*25.9%*	*14.0%*	*19.5%*	*24.4%*	*20.2%*	*13.6%*	*3.7%*
Rental COGS	$802.1	$212.4	$201.9	$151.4	$141.8	$707.4	$652.1	$629.5	$615.0
Rental margin	*90.6%*	*88.4%*	*89.0%*	*91.5%*	*92.0%*	*90.2%*	*90.0%*	*90.0%*	*90.0%*
Sales COGS	$4,399.8	$1,470.0	$1,563.4	$1,619.8	$1,910.0	$6,563.1	$8,553.1	$10,034.8	$10,510.2
Sales margin	*71.7%*	*71.6%*	*71.0%*	*72.1%*	*70.0%*	*71.1%*	*71.0%*	*71.0%*	*71.0%*
Cost of Revenues	$5,201.9	$1,682.4	$1,765.2	$1,771.2	$2,051.7	$7,270.5	$9,205.2	$10,664.3	$11,125.2
Gross Income	$18,882.1	$5,324.6	$5,460.7	$5,815.5	$6,086.9	$22,687.7	$26,809.2	$30,233.3	$31,266.8
Gross Margin	*78.4%*					*75.7%*	*74.4%*	*73.9%*	*73.8%*
SG&A	$17,321.6	$4,456.5	$4,559.6	$4,521.6	$4,818.0	$18,355.7	$21,068.4	$23,311.6	$23,951.5
% SG&A	*71.9%*	*63.6%*	*63.1%*	*59.6%*	*59.2%*	*61.3%*	*58.5%*	*57.0%*	*56.5%*
Operating Income	$1,560.5	$868.2	$901.2	$1,293.8	$1,268.8	$4,332.0	$5,740.8	$6,921.7	$7,315.3
Operating Margin	*6.5%*	*12.4%*	*12.5%*	*17.1%*	*15.6%*	*14.5%*	*15.9%*	*16.9%*	*17.3%*
Interest income, net	($209.2)	($30.0)	($22.5)	($14.5)	($7.0)	($74.0)	$100.0	$200.0	$300.0
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	$838.2	$878.7	$1,279.3	$1,261.8	$4,258.0	$5,840.8	$7,121.7	$7,615.3
Taxes	$985.0	$310.1	$325.1	$473.4	$466.9	$1,575.4	$2,161.1	$2,635.0	$2,817.7
Tax Rate	*73.8%*	*37.0%*	*37.0%*	*37.0%*	*37.0%*	*37.0%*	*37.0%*	*37.0%*	*37.0%*
Net Income	$349.9	$528.0	$553.6	$806.0	$794.9	$2,682.5	$3,679.7	$4,486.7	$4,797.7
YOY Growth	*-85.3%*	*N/A*	*1774.2%*	*119.0%*	*4083.9%*	*666.5%*	*37.2%*	*21.9%*	*6.9%*
Net Margin	*1.5%*	*7.5%*	*7.7%*	*10.6%*	*9.8%*	*9.0%*	*10.2%*	*11.0%*	*11.3%*
EPS	$0.01	$0.02	$0.02	$0.03	$0.03	$0.09	$0.12	$0.14	$0.15
YOY Growth	*85.5%*	*N/A*	*1745.5%*	*114.7%*	*4037.4%*	*653.9%*	*35.5%*	*20.4%*	*6.3%*
Diluted Shares O/S	30,705	31,120	31,180	31,280	31,300	31,220	31,600	32,000	32,200

Source: Zacks Investment Research *Brian Marckx, CFA*

HISTORICAL ZACKS RECOMMENDATIONS



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