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Zacks Small-Cap Research

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Zynex Inc (ZYXI-OTC)

ZYXI: Q4 2011 Results / 2012 Guidance

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	01/06/2011
Current Price (03/19/12)	$0.75
Target Price	**$1.50**

OUTLOOK

Q4 results were largely in-line with our numbers. While 2012 EPS guidance is substantially lower than what we projected, revenue guidance is where we expected. Management has made good progress with expanding the sales force, leveraging SG&A and de-risking the business. Maintaining gross margin and continuing to leverage SG&A will be key to maximize the growing revenue that falls to the bottom line.

Based on progress with resolving certain outstanding issues/concerns, we have again reduced our valuation risk-discount. Our price target has moved from $1.40/share to $1.50/share. We are maintaining our Outperform rating.

SUMMARY DATA

52-Week High	**$1.02**	**Above Avg., Small-Blend Med Products**	**Above Avg., Small-Blend Med Products**
52-Week Low	**$0.55**		
One-Year Return (%)	**46.04**		
Beta	**0.23**		
Average Daily Volume (sh)	**6,875**		
Shares Outstanding (mil)	**31**		
Market Capitalization ($mil)	**$24**		
Short Interest Ratio (days)	**N/A**		
Institutional Ownership (%)	**1**		
Insider Ownership (%)	**N/A**		
Annual Cash Dividend	**$0.00**		
Dividend Yield (%)	**0.00**		
5-Yr. Historical Growth Rates			
Sales (%)	**63.8**		
Earnings Per Share (%)	**N/A**		
Dividend (%)	**N/A**		
P/E using TTM EPS	**15.0**		
P/E using 2012 Estimate	**9.4**		
P/E using 2013 Estimate	**6.3**		
Zacks Rank	**N/A**		

ZACKS ESTIMATES

Revenue
(in '000 of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2011	6,633 A	8,395 A	9,427 A	9,693 A	34,148 A
2012	7,722 E	10,082 E	10,670 E	11,256 E	39,730 E
2013					45,666 E
2014					47,766 E

Earnings per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2011	-$0.00 A	$0.02 A	$0.02 A	$0.02 A	$0.05 A
2012	$0.00 E	$0.02 E	$0.03 E	$0.03 E	$0.08 E
2013					$0.12 E
2014					$0.14 E

Zacks Projected EPS Growth Rate - Next 5 Years % **12**

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Q4 2011 Financial Results: *Largely In-Line with Our Numbers...*

Revenue
Zynex reported financial results for the fourth quarter ending December 31, 2011 on March 15th. Revenue of $9.7 million beat our $9.4 million estimate by just over 3%.

Total revenue consisted of $2.5 million (+33% y-o-y) in rentals and $7.2 million (+46% y-o-y) in product sales. Both categories' revenue came in stronger than our respective estimates, especially noteworthy was rentals beating our number by 8%.

	Actual Q4 2010	Actual Q4 2011	Y-o-Y Change	Zacks Est Q4 2011	Actual +/- Zacks est.
Consumables	$2,556	$3,777	47.8%	$3,449	9.5%
Equipment Sales	$2,360	$3,401	44.1%	$3,618	-6.0%
Total Product Sales	$4,916	$7,178	46.0%	$7,067	1.6%
Rental Revenue	$1,894	$2,515	32.8%	$2,328	8.0%
	$6,810	**$9,693**	**42.3%**	**$9,395**	**3.2%**

Gross Margin
Gross margin was 76.6%, compared to our 80.5% estimate. Gross margin had shown sequential improvement every quarter during 2011, save for Q4. Gross margin can jump around from quarter to quarter so the 290 basis point contraction from Q3 to Q4 is not necessarily indicative of a trend. Noteworthy is that gross margin for the full year 2011 remained constant at 78.4% from 2010. We currently model gross margin to remain near, to slightly below, this level going forward based on our assumption that lower margin product sales grow faster than the higher margin rentals business.

Net Income / EPS
Net income and EPS were $601k and $0.02, slightly below our $935k and $0.03 estimates - the difference due to the lower than modeled gross margin and higher interest expense, which were slightly offset by the higher revenue number. The spike in the interest expense line item relates to fees in connection with Zynex terminating their legacy credit facility - management replaced the credit line with one which has about twice the borrowing limit and a more favorable rate.

Noteworthy, and positive, is that SG&A as a percentage of sales in Q4 was right on with our 64% estimate. This is a metric that we have placed a lot of emphasis on and one that, as we noted since initiating on Zynex, is important that the company can wring leverage out of in order to grow their bottom line. ZYXI did a good job of doing exactly that throughout 2011, with SG&A as % of sales falling from 71.9% in 2010 to 69.3% in 2011. As gross margin remained constant at 78.4% in both 2010 and 2011, all of the benefit from this SGA leverage flowed through to operating margins (operating margin expanded from 6.5% in 2010 to 9.1% in 2011). If Zynex can continue to grow revenues, maintain gross margin at the 2010/2011 level (or at least only slightly below), and continue to gain leverage on SG&A (all of which are assumptions incorporated into our model), then net income and EPS should exhibit healthy growth.

Cash
Zynex exited Q4 with $789k in cash, approximately flat from Q3 ($761k). Cash from operating activities was an inflow of $413k. Investing activities used $144k. Total drawn on the credit line was $3.29 million at the end of Q4, basically flat from $3.38 million at Q3.

In December 2011 Zynex announced that they terminated their legacy credit facility and replaced it with a new credit line from Doral Healthcare Finance - which we view as a positive development. As we noted since initiating on Zynex, we had had some concerns relative to the company's liquidity position and pointed out that we would

view renegotiating terms of their credit line as a positive step. Zynex regularly bumped up against the $3.5 million maximum borrowing limit of their legacy line and had in the past tripped covenants. The effective borrowing rates on their previous credit lines were also less than favorable to the company (averaging ~ between 10% - 14%) . This Doral line has a maximum borrowing capacity of up to $7 million (twice the size of the legacy facility), three-year term and carries a rate of LIBOR or 3% (whichever is greater) plus a margin of 3.75%.

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. The device is being developed to monitor the amount of blood loss during surgery and for the detection of internal bleeding in the recovery room. Management noted on the Q4 call that initial studies have been completed and results looked encouraging. The company now has a working prototype and they will continue with development and testing. Management believes that if everything goes right, the device could possibly be on the U.S. market by sometime in 2013. Our model does not currently incorporate any revenue contribution from this product as few details have been revealed about the device or the related development/trials. As we have noted in the past, our model will be updated when we are more comfortable with the chances of eventual regulatory approval and commercialization of this product as well as other products under development.

- **International Sales:** International sales for Q4 were not disclosed but management noted that they remain insignificant, although growing. Zynex will continue to place a greater emphasis on expanding its international presence through signing new distribution contracts. In that regard, the company announced in February that they created a wholly-owned European subsidiary with a sole focus of selling into the European market. Zynex also expects to leverage NeuroDyne's international relationships to help grow their overseas business.

- **Shareholder Lawsuit / Anthem:** As we noted in our previous update, Zynex filed an 8-K on September 23, 2011 reporting that they came to terms with Anthem Blue Cross Blue Shield relative to a dispute between the two companies over refund requests. As a reminder, in April 2010 Zynex received a refund request from Anthem in the amount of $1.3 million. Zynex estimated at the time that they had about $1.5 million worth of rebillings that were not properly reimbursed by Anthem - which would more than offset Anthem's claim. The 8-K notes that, per a settlement agreement, Zynex will pay Anthem $226k and all claims will be resolved. Zynex made an initial $60k payment and will pay the balance over the next 12 months. We view this settlement as good news for Zynex and removes an issue that had been hanging over the company since the initial claim was filed by Anthem.

- **NeuroDyne:** In August 2011 Zynex announced that they signed a letter of intent to acquire NeuroDyne Medical Corp, a privately-held Cambridge, MA based manufacturer of medical devices for electromyography (sEMD) and autonomic nervous system monitoring. On March 12, 2012 Zynex announced that they closed the transaction. NeuroDyne's suite of products appear to be complementary to Zynex's and are used for a variety of purposes including spinal imaging (via sEMD) and neuromuscular rehabilitation. NeuroDyne's website notes their world-wide customer base is 3,000 strong and includes notable names such as the U.S. Air Force, Mayo Clinic and J&J, among several others. NeuroDyne's financial history was not disclosed and although we presume (based on the acquisition price) that NeuroDyne's revenue is relatively insignificant compared to Zynex's, we still view this as a potentially positive step towards Zynex's quest to further grow sales and profitability. Zynex will acquire NeuroDyne for $420k ($145k cash and $175k restricted shares due at closing, $100k due in 60 days) and NeuroDyne's owners will be entitled to receive earn-outs over seven years based on sales of the NeuroDyne products. On the Q4 call Zynex noted that all of NeuroDyne's operations would be transferred to Zynex's Colorado headquarters (implying cost synergies). NeuroDyne's CEO will remain on in the capacity of Vice-President of Technical Support for Zynex's NeuroDiagnostics division.

- **ActivaTek Inc:** On October 31st Zynex announced that it signed an agreement with ActivaTek, Inc. to sell their lontophoresis products via Zynex's U.S. sales force. Lontophoresis is a non-invasive medication delivery system using a small electrical charge applied to a patch which is affixed to the skin. Zynex began selling the products during Q4 and indicated on the call that the reception has been encouraging.

Management believes these Iontophoresis products could also be a meaningful contributor to revenue growth going forward.

- **Sales Rep Growth:** Management noted on the call that they now have approximately 200 reps selling their products in 38 states, up from about 100 one year ago. The company expects to continue to add to their sales force, which we believe will remain the main catalyst driving sales over the near-to-mid term.

- **Shareholder Lawsuit Settlement:** As a reminder, 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). The suit essentially alleged that the CEO and former CFO intentionally reported inflated revenue figures (which basically accused 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. We cited this lawsuit as a concern and one that would likely limit the upside in the shares until it was favorably resolved.

  In their Q3 10-Q Zynex announced that on November 11, 2011 an agreement was entered into to settle the lawsuit for a payment to the plaintiffs in the amount of $2.5 million. Zynex expects the settlement to be fully funded by insurance. We view settlement of this lawsuit as a significant positive.

- **2012 Guidance:** Management provided initial guidance for 2012 on the Q4 call. While revenue guidance is right in-line with our current (as well as prior to Q4 results announcement) estimate, EPS guidance came in well below what we were forecasting. Zynex's 2012 guidance is revenue between $38MM and $40MM and diluted EPS of between $0.06 and $0.08. Prior to Q4 results, we were looking for revenue and EPS of $39.1MM and $0.13. We now model revenue and EPS of $39.7MM and $0.08, both on the high side of management's guidance. The change in our EPS estimate reflects trimming of both gross margin and the extent of improvement in SG&A leverage (we still expect SG&A leverage to improve in 2012 and beyond, just not at the rate we had previously modeled).

VALUATION

We model EPS to grow at a five-year CAGR of about 12% through 2014. We use a PE/G ratio of 1.6x to value Zynex. This represents a 10% discount to the approximate 1.8x PE/G that the industry currently trades at. Our discount reflects the remaining concerns and risks that we have outlined in our initiation report on Zynex (2/14/2011). Our current 10% discount has been trimmed from the 33% we used when we initiated on Zynex and the 20% when we last published on the company (11/3/2011) which reflects what we believe is continued progress by management with de-risking. Several of our initial concerns have been mitigated, either completely or at least in large part, such as the Anthem lawsuit, the shareholder lawsuit, and the company's liquidity situation. Resolution of other concerns and/or mitigation of risks would likely warrant an even lower PE/G discount and, therefore, a higher price target. Meaningful progress with commercialization of Zynex's pipeline, including their blood monitoring device, could provide some upside relative to our current revenue and EPS estimates. Actual EPS falling short of our estimates and/or adverse consequences related to risks/concerns could prompt us to lower our valuation for Zynex.

Applying the 1.6x PE/G and estimated five-year EPS CAGR of 12% to our 2012 EPS estimate of $0.08, results in a value of approximately $1.50 / share. As such, our price target has moved up by $0.10 from $1.40 to $1.50.

FINANCIAL MODEL

Zynex Inc.

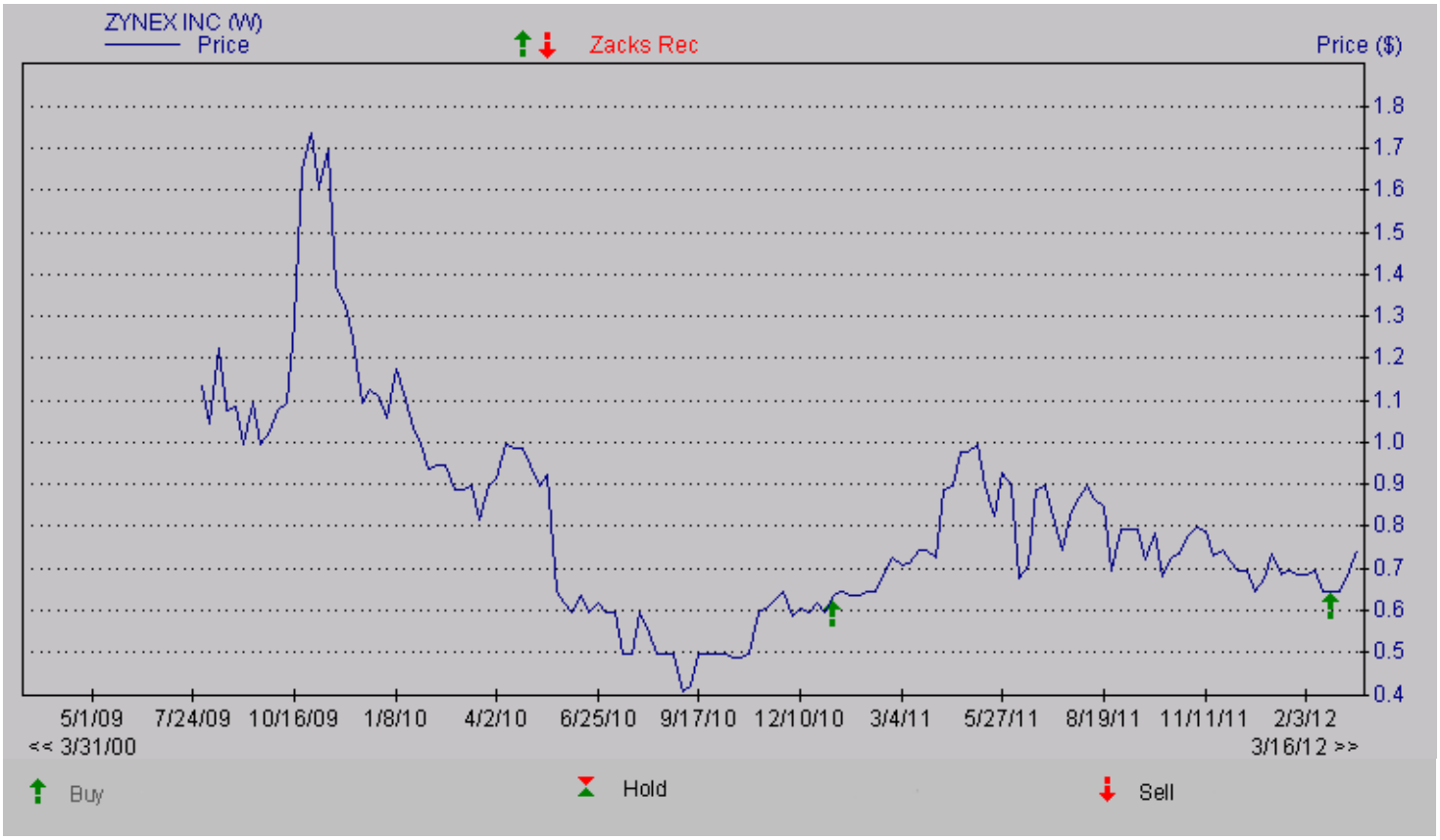
	2011 A	Q1E	Q2E	Q3E	Q4E	2012 E	2013 E	2014 E	2015 E
Rental revenue	$9,892.0	$2,280.0	$2,345.0	$2,040.0	$1,902.0	$8,567.0	$8,130.0	$7,911.0	$7,855.0
YOY Growth	*15.9%*	*-6.9%*	*-4.2%*	*-17.8%*	*-24.4%*	*-13.4%*	*-5.1%*	*-2.7%*	*-0.7%*
Consumable sales	$12,976.2	$3,098.1	$3,741.2	$3,916.7	$4,264.5	$15,020.5	$17,213.5	$18,005.4	$19,332.8
YOY Growth	*42.6%*	*16.5%*	*20.5%*	*14.1%*	*12.9%*	*15.8%*	*14.6%*	*4.6%*	*7.4%*
Equipment sales	$11,279.8	$2,344.0	$3,996.0	$4,713.0	$5,089.0	$16,142.0	$20,322.0	$21,850.0	$24,100.0
YOY Growth	*74.9%*	*53.6%*	*40.6%*	*34.2%*	*49.6%*	*43.1%*	*25.9%*	*7.5%*	*10.3%*
Product sales revenue	$24,256.0	$5,442.1	$7,737.2	$8,629.7	$9,353.5	$31,162.5	$37,535.5	$39,855.4	$43,432.8
YOY Growth	*56.0%*	*30.0%*	*30.1%*	*24.3%*	*30.3%*	*28.5%*	*20.5%*	*6.2%*	*9.0%*
Total Revenues	$34,148.0	$7,722.1	$10,082.2	$10,669.7	$11,255.5	$39,729.5	$45,665.5	$47,766.4	$51,287.8
YOY Growth	*41.8%*	*16.4%*	*20.1%*	*13.2%*	*16.1%*	*16.3%*	*14.9%*	*4.6%*	*7.4%*
Rental COGS	$1,842.0	$376.2	$398.7	$391.7	$418.4	$1,585.0	$1,504.1	$1,463.5	$1,453.2
Rental margin	*81.4%*	*83.5%*	*83.0%*	*80.8%*	*78.0%*	*81.5%*	*81.5%*	*81.5%*	*81.5%*
Sales COGS	$5,529.0	$1,447.6	$1,748.6	$1,846.8	$2,113.9	$7,156.9	$8,633.2	$9,166.7	$9,989.5
Sales margin	*77.2%*	*73.4%*	*77.4%*	*78.6%*	*77.4%*	*77.0%*	*77.0%*	*77.0%*	*77.0%*
Cost of Revenues	$7,371.0	$1,823.8	$2,147.3	$2,238.4	$2,532.3	$8,741.8	$10,137.2	$10,630.3	$11,442.7
Gross Income	$26,777.0	$5,898.3	$7,934.9	$8,431.3	$8,723.2	$30,987.7	$35,528.3	$37,136.1	$39,845.1
Gross Margin	*78.4%*	*76.4%*	*78.7%*	*79.0%*	*77.5%*	*78.0%*	*77.8%*	*77.7%*	*77.7%*
SG&A	$23,676.0	$5,714.3	$6,755.1	$6,999.3	$7,147.2	$26,616.0	$28,769.2	$29,615.2	$30,772.7
% SG&A	*69.3%*	*74.0%*	*67.0%*	*65.6%*	*63.5%*	*67.0%*	*63.0%*	*62.0%*	*60.0%*
Operating Income	$3,101.0	$183.9	$1,179.9	$1,431.9	$1,575.9	$4,371.7	$6,759.0	$7,521.0	$9,072.4
Operating Margin	*9.1%*	*2.4%*	*11.7%*	*13.4%*	*14.0%*	*11.0%*	*14.8%*	*15.7%*	*17.7%*
Interest income, net	($459.0)	($79.0)	($79.0)	($79.0)	($79.0)	($316.0)	($100.0)	$25.0	$50.0
Other income	$0.0	$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	$2,642.0	$104.9	$1,100.9	$1,352.9	$1,496.9	$4,055.7	$6,659.0	$7,546.0	$9,122.4
Taxes	$1,080.0	$43.0	$451.4	$554.7	$613.7	$1,662.8	$2,730.2	$3,093.8	$3,740.2
Tax Rate	*40.9%*	*41.0%*	*41.0%*	*41.0%*	*41.0%*	*41.0%*	*41.0%*	*41.0%*	*41.0%*
Net Income	$1,562.0	$61.9	$649.5	$798.2	$883.2	$2,392.9	$3,928.8	$4,452.1	$5,382.2
YOY Growth	*346.4%*	*-156.3%*	*34.2%*	*35.1%*	*47.0%*	*53.2%*	*64.2%*	*13.3%*	*20.9%*
Net Margin	*4.6%*	*0.8%*	*6.4%*	*7.5%*	*7.8%*	*6.0%*	*8.6%*	*9.3%*	*10.5%*
EPS	$0.05	$0.00	$0.02	$0.03	$0.03	$0.08	$0.12	$0.14	$0.17
YOY Growth	*342.4%*	*-154.9%*	*32.4%*	*32.6%*	*44.6%*	*50.4%*	*62.1%*	*12.6%*	*20.3%*
Diluted Shares O/S	30,978	31,400	31,450	31,600	31,750	31,550	31,950	32,150	32,300

Source: Zacks Investment Research

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