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Zacks Small-Cap Research

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Zynex Inc (ZYXI-OTC)

ZYXI: 35% Revenue Growth in Q1. 2012 Guidance Affirmed

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	01/06/2011
Current Price (05/12/12)	$0.70
Target Price	**$1.50**

OUTLOOK

Q1 revenue was up 35% y-o-y and beat our estimate handily. Management affirmed previously issued guidance for 2012. We continue to model ~16% revenue growth in 2012 and EPS of $0.08, up from $0.05 in 2011.

Zynex 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.

We are maintaining our $1.50/share price target and Outperform rating.

SUMMARY DATA

52-Week High	**$1.01**
52-Week Low	**$0.55**
One-Year Return (%)	**46.04**
Beta	**0.23**
Average Daily Volume (sh)	**8,415**
Shares Outstanding (mil)	**31**
Market Capitalization ($mil)	**$22**
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 (%)	**44.8**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**14.0**
P/E using 2012 Estimate	**8.8**
P/E using 2013 Estimate	**5.8**
Zacks Rank	**N/A**

Above Avg.,
Small-Blend
Med Products

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	8,944 A	9,539 E	10,382 E	10,914 E	39,726 E
2013					45,737 E
2014					47,878 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	$0.01 A	$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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Q1 2012 Financial Results: *Big Beat on Revenue...*

Revenue
Zynex reported financial results for the first quarter ending March 31, 2012 on May 8th. Coming off revenue growth of 42% for the full-year 2011, Zynex started out 2012 with a bang. Revenue of $8.9 million was up 35% from Q1 2011 and well ahead of our $7.7 million (+16%) estimate on very strong sales of both equipment and consumables. Revenue growth continues to be mainly driven by rapidly expanding the sales force and tapping new geographic territories throughout the U.S.

Total revenue consisted of $2.1 million (-16% y-o-y) in rentals and $6.9 million (+65% y-o-y) in product sales. While rentals came in slightly softer than our number, both components (equipment and consumables) of the product category were well ahead of our estimates.

We continue to model strong growth in products sales coming from further expansion in the sales force, incremental contribution from the recent NeuroDyne acquisition, the recurring revenue stream from consumables (over an ever larger installed base), and introduction of new products in the Zynex Medical (i.e. - electrotherapy) business. As we've noted in the past, we do not currently model any contribution from Zynex's pipeline, namely their blood volume monitoring device. Depending on if and when the device launches and its ultimate commercial success, this could provide some upside to our estimates, especially relative to the out-years in our model.

	Actual Q1 2011	Actual Q1 2012	Y-o-Y Change	Zacks Est Q1 2012	Actual +/- Zacks est.
Consumables	$2,659	$3,846	44.6%	$3,098	24.1%
Equipment Sales	$1,526	$3,041	99.3%	$2,344	29.7%
Total Product Sales	$4,185	$6,887	64.6%	$5,442	26.6%
Rental Revenue	$2,448	$2,057	-16.0%	$2,280	-9.8%
	$6,633	**$8,944**	**34.8%**	**$7,722**	**15.8%**

Gross Margin
Gross margin was very strong at 79.7% and significantly wider than our 76.4% estimate. Management attributed the strength in the GM to growth in revenue from consumables as well as greater sales of next-generation TENS device which has lower input costs compared to earlier TENS products. GM does jump around from quarter to quarter, however, and can be highly dependent on the mix of products sold and the percentage of total revenue coming from rentals. We continue to model gross margin to remain near, to slightly below the level for the full-year 2011 (78.4%) 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 $320k and $0.01, ahead of our $62k and $0.00 estimates. The difference, mostly attributable to the big beat on the top-line, also aided by a lower than modeled income tax rate. Meanwhile, SG&A as a percentage of sales, which can have a big influence on net income and EPS, was pretty much dead-on with our estimate (74.3% A vs 74.0% E).

We continue to model an incremental improvement in SG&A as a percentage of sales for the full year 2012 compared to 2011. This, along with modeled strong revenue growth, are the main impetus for our estimated EPS of $0.08 in 2012, up from $0.05 in 2011. As a reminder, management has been successful in trimming expenses and cut SG&A as a percentage of sales from 71.9% in 2010 to 69.3% in 2011. If Zynex can continue to grow revenues, maintain gross margin at the 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 Q1 with $742k in cash, roughly flat from the end of Q4 2011. Cash used in operating and investing activities were $770k and $340 ($145k of which is related to the purchase of NeuroDyne), respectively. Total drawn on the credit line was $4.4MM, up from $3.3MM at the end of Q4 2011.

Late last year Zynex replaced their legacy credit facility with one with a higher borrowing limit and a more favorable rate. The facility matures in December 2014 and has a maximum borrowing capacity of $7MM. Actual borrowing availability is also dependent on compliance with financial covenants and A/R balance (which secures the loan). Assuming Zynex can borrow the full $7MM, there was approximately $2.6MM availability left at the end of Q1. Management noted on the call that they expect cash on the balance sheet and borrowing availability under this loan to be sufficient to fund operations until at least the end of the current year.

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 noted on the Q1 call that they expect to build on the studies done in 2011 to conduct further trials in 2012. Management believes that if everything goes right, the device could possibly be on the U.S. market by sometime in 2013. As we've noted previously, while our model does not incorporate any revenue contribution from this product as few details have been revealed about the device or the related development/trials, we will update our model when we are more comfortable with the chances of eventual regulatory approval and commercialization of this product as well as other products under development.

- **International Sales:** International sales remain insignificant although Zynex continues 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.

- **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 noted 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 acquired 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. Zynex is currently in process of integrating NeuroDyne's operations with Zynex's Colorado headquarters (which should afford some cost synergies). NeuroDyne's CEO remains 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 Iontophoresis 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:** Zynex has 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. Final court approval is scheduled for September. Derivative lawsuits have also been settled and are expected to get final court approval next month. Zynex expects settlement of the lawsuits to be fully funded by insurance. We view settlement of lawsuits as a significant positive.

- **2012 Guidance:** Management reiterated previously issued 2012 guidance of revenue in the range of $38MM - $40MM and EPS in the range of $0.06 - $0.08. We have made some minor tweaks to our model following Q1 results although our revenue and EPS estimates for 2012 (and beyond) are not materially changed. We still look for 2012 revenue of approximately $39.7MM (+16%) and EPS of $0.08, both on the high side of management's guidance.

VALUATION

Our $1.50 / share price target and Outperform rating remain intact. 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, a slight discount to the 1.8x PE/G that the industry currently trades at. 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.

FINANCIAL MODEL

Zynex Inc.

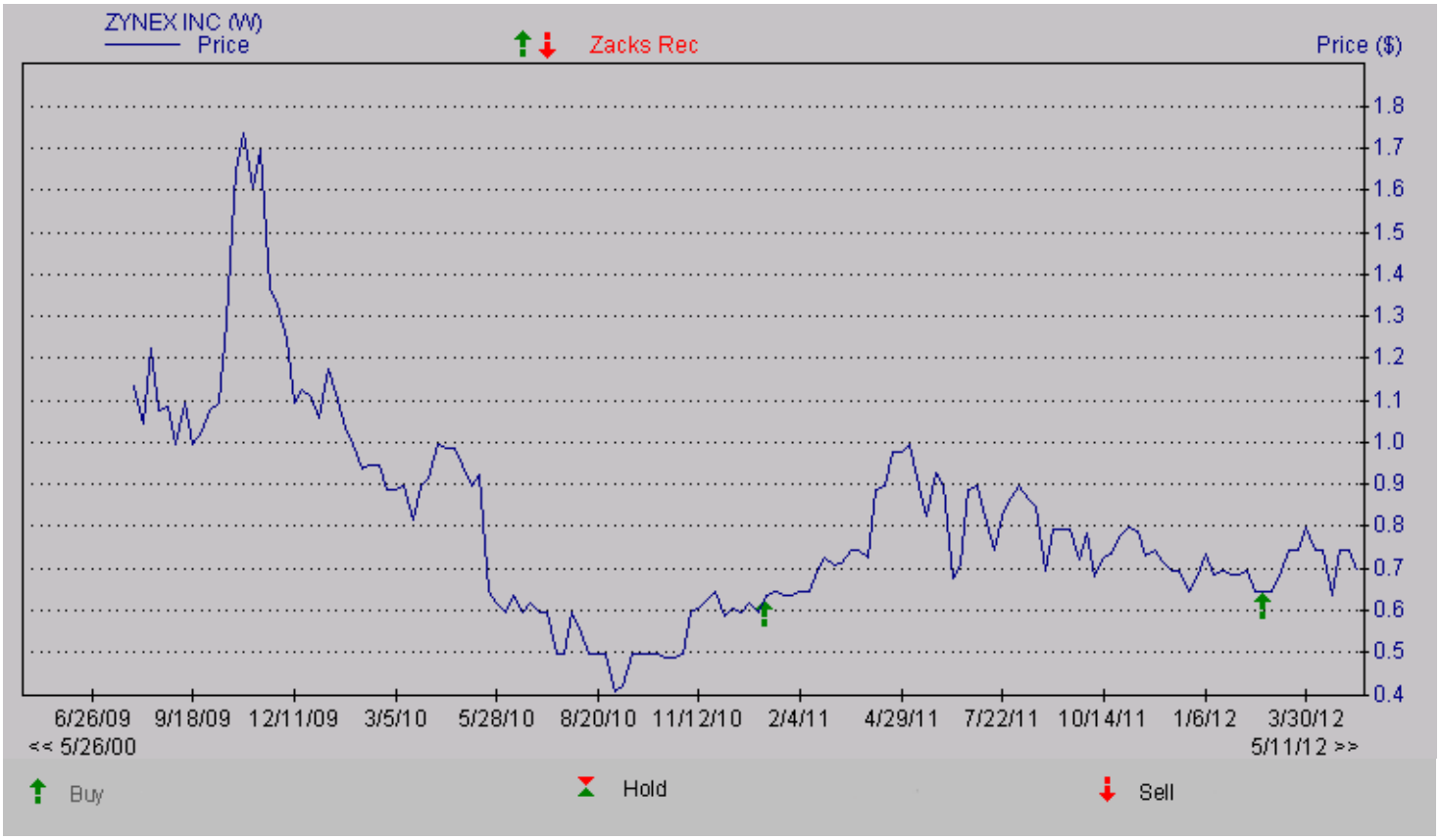
	2011 A	Q1A	Q2E	Q3E	Q4E	2012 E	2013 E	2014 E	2015 E
Rental revenue	$9,892.0	$2,057.0	$2,148.0	$2,040.0	$1,902.0	$8,147.0	$7,735.0	$7,530.0	$7,480.0
YOY Growth	*15.9%*	*-16.0%*	*-12.2%*	*-17.8%*	*-24.4%*	*-17.6%*	*-5.1%*	*-2.7%*	*-0.7%*
Consumable sales	$12,976.2	$3,846.0	$3,614.3	$3,913.2	$4,135.2	$15,508.6	$17,771.8	$18,592.8	$19,974.1
YOY Growth	*42.6%*	*44.6%*	*16.4%*	*14.0%*	*9.5%*	*19.5%*	*14.6%*	*4.6%*	*7.4%*
Equipment sales	$11,279.8	$3,041.0	$3,777.0	$4,375.0	$4,877.0	$16,070.0	$20,230.0	$21,750.0	$24,000.0
YOY Growth	*74.9%*	*99.3%*	*32.9%*	*24.6%*	*43.4%*	*42.5%*	*25.9%*	*7.5%*	*10.3%*
Product sales revenue	$24,256.0	$6,887.0	$7,391.3	$8,288.2	$9,012.2	$31,578.6	$38,001.8	$40,342.8	$43,974.1
YOY Growth	*56.0%*	*64.6%*	*24.3%*	*19.3%*	*25.6%*	*30.2%*	*20.3%*	*6.2%*	*9.0%*
Total Revenues	$34,148.0	$8,944.0	$9,539.3	$10,328.2	$10,914.2	$39,725.6	$45,736.8	$47,872.8	$51,454.1
YOY Growth	*41.8%*	*34.8%*	*13.6%*	*9.6%*	*12.6%*	*16.3%*	*15.1%*	*4.7%*	*7.5%*
Cost of Revenues	$7,371.0	$1,813.0	$2,086.6	$2,298.0	$2,455.2	$8,652.8	$10,171.4	$10,671.9	$11,497.8
Gross Income	$26,777.0	$7,131.0	$7,452.6	$8,030.2	$8,459.0	$31,072.8	$35,565.4	$37,200.9	$39,956.2
Gross Margin	*78.4%*	*79.7%*	*78.1%*	*77.8%*	*77.5%*	*78.2%*	*77.8%*	*77.7%*	*77.7%*
SG&A	$23,676.0	$6,645.0	$6,391.3	$6,775.3	$6,930.5	$26,742.1	$28,814.2	$29,681.1	$30,872.4
% SG&A	*69.3%*	*74.3%*	*67.0%*	*65.6%*	*63.5%*	*67.3%*	*63.0%*	*62.0%*	*60.0%*
Operating Income	$3,101.0	$486.0	$1,061.3	$1,254.9	$1,528.5	$4,330.7	$6,751.2	$7,519.8	$9,083.8
Operating Margin	*9.1%*	*5.4%*	*11.1%*	*12.2%*	*14.0%*	*10.9%*	*14.8%*	*15.7%*	*17.7%*
Interest income, net	($459.0)	($93.0)	($110.0)	($118.0)	($124.0)	($426.0)	($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	$393.0	$951.3	$1,136.9	$1,404.5	$3,904.7	$6,651.2	$7,544.8	$9,133.8
Taxes	$1,080.0	$73.0	$390.0	$466.1	$575.8	$1,505.0	$2,727.0	$3,093.4	$3,744.9
Tax Rate	*40.9%*	*18.6%*	*41.0%*	*41.0%*	*41.0%*	*38.5%*	*41.0%*	*41.0%*	*41.0%*
Net Income	$1,562.0	$320.0	$561.3	$670.8	$828.6	$2,399.7	$3,924.2	$4,451.4	$5,388.9
YOY Growth	*346.4%*	*-390.9%*	*16.0%*	*13.5%*	*37.9%*	*53.6%*	*63.5%*	*13.4%*	*21.1%*
Net Margin	*4.6%*	*3.6%*	*5.9%*	*6.5%*	*7.6%*	*6.0%*	*8.6%*	*9.3%*	*10.5%*
EPS	$0.05	$0.01	$0.02	$0.02	$0.03	$0.08	$0.12	$0.14	$0.17
YOY Growth	*342.4%*	*-387.1%*	*14.4%*	*11.4%*	*35.7%*	*51.3%*	*61.0%*	*12.7%*	*20.5%*
Diluted Shares O/S	30,978	31,037	31,450	31,600	31,750	31,459	31,950	32,150	32,300

Source: Zacks Investment Research

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