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Zacks Small-Cap Research

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Zynex Inc (ZYXI-OTC)

ZYXI: Q1: Big Bite to Revenue and Margins…

OUTLOOK

Both revenue and gross margins hit a big speed bump in Q1. For the first time in recent history management noted that they trimmed their sales force (as opposed to growing it which had been the game plan up until now). Recent healthcare reform measures and changes to reimbursement are what we believe are impacting recent financial results. We think ZYXI now has a more determined focus on diversifying revenue sources and reducing exposure to third-party reimbursement. New product launches, a new medical billing and consulting segment, and collaborations may now be where the growth opportunities exist. Another key to maximize EPS is controlling op expenses, which has been an issue for Zynex. ZYXI generated positive operating cash flow in 2012 and aims to do so again in 2013.
Longer-term upside to our model could come from pipeline and new services business, which we have yet to model.

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	01/06/2011
Current Price (05/07/13)	$0.50
Target Price	**$1.20**

SUMMARY DATA

52-Week High	**$1.01**
52-Week Low	**$0.42**
One-Year Return (%)	**-14.19**
Beta	**0.54**
Average Daily Volume (sh)	**10,325**
Shares Outstanding (mil)	**31**
Market Capitalization ($mil)	**$16**
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 (%)	**30.3**
Earnings Per Share (%)	**25.2**
Dividend (%)	**N/A**
P/E using TTM EPS	**9.6**
P/E using 2013 Estimate	**16.0**
P/E using 2014 Estimate	**5.3**
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)
2012	8,944 A	10,026 A	10,102 A	10,594 A	39,666 A
2013	7,668 A	10,052 E	10,007 E	10,578 E	38,305 E
2014					40,908 E
2015					44,759 E

Earnings per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2012	$0.01 A	$0.02 A	$0.01 A	$0.01 A	$0.05 A
2013	-$0.01 A	$0.02 E	$0.01 E	$0.01 E	$0.03 E
2014					$0.09 E
2015					$0.12 E

Zacks Projected EPS Growth Rate - Next 4 Years % **27**

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Q1 2013 Financial Results: *Big Bite to Revenue and Margins*

Zynex reported financial results for the first quarter ending March 31, 2013 on May 8th. In stark contrast to Q4 2012 where revenue growth continued, remained at about the same level as the previous two quarters, and came in just about dead-on with our respective estimate, Q1 2013 revenue was a significant disappointment relative to all those metrics. Management revised full-year revenue guidance downward, which now stands at $38 million - $42 million, revised from $41 million - $44 million which was provided with Q4 earnings.

The company cited some seasonality as well as uncertainty on the part of healthcare providers relative to recent healthcare reform measures as contributing the relatively weak (-14% yoy) revenue in Q1. Management also noted, however, that they believe these to be short-term issues and in the near future also expect to see a contribution from their newly formed Billing and Consulting business as well as the distribution agreement with NeuroVirtual which was penned in March. Management hopes that these ancillary segments, along with their blood volume monitoring device which Zynex believes could potentially launch in late 2013, will help diversify their revenue base and reduce dependence on insurance reimbursement.

And while SG&A expense, which has been an ongoing thorn in terms of growing the bottom-line, came down substantially (yoy as well as sequentially) on an absolute basis, as a percentage of revenue (76.1%) it was highest since Q1 2011. Management noted that they trimmed some headcount (underperforming direct sales reps) during the quarter which was done to help right-size the cost base relative to revenue. The relatively weak revenue also impacted gross margin, which at 71.4% was the lowest since Q4 2009.

InWave



Revenue of $7.7 million fell 14% yoy and was well below our $10.0 million estimate. Rental revenue was $1.7 million, down 19% yoy and below our $2.0 million (-15%) estimate. Equipment sales were also relatively weak, falling 32% yoy while consumables posted 2% growth. Consumables sales continue to benefit from the ever larger and growing installed base.

While revenue growth in the past was mostly tied to expansion of the sales force and feeding consumables to a growing installed base, ZYXI noted in the Q1 earnings release and conference call that they've started to shed some of their sales headcount due to seemingly reduced demand. This appears to be, at least in part, to recent healthcare reform initiatives including changes to reimbursement which may have had a negative impact on reimbursement (which, as we noted in recent updates, was a significant risk). While we expect the Zynex Medical electrotherapy business to continue to generate the bulk of revenue, we think management now has a more determined focus on diversifying revenue sources and on growing the top-line through other business lines, including from their NeuroDiagnostics business and newly formed Billing and Consulting segment.

Recent progress towards these efforts include new product launches and new business lines - the former including InWave for the treatment of female incontinence and the latter including a medical billing segment (called Zynex Billing and Consulting) which the company formed in Q4 2012 and which aims to leverage the company's expertise in that area to engage private medical practices and generate additional revenue for the company. Then in March 2013 ZYXI entered into an agreement with NeuroVirtual whereby Zynex will be the exclusive U.S. distributor of that company's electroencephalography and sleep diagnostic devices. The NeuroVirtual devices will be sold through Zynex's NeuroDiagnostics division, which management noted on the Q1 recently added about 12 sales reps.

Zynex also hopes to have their blood volume monitoring device, which management noted is still in clinical trials, on the market in late 2013.

Revenue

Total revenue consisted of $1.7 million (-19% y-o-y) in rentals and $6.0 million (-13% y-o-y) in product sales. The equipment portion of product sales was about $1.7 million (45%) lower than our estimate, which accounted for

about 74% of the difference between our estimated total revenue ($10.0 million) and actual total revenue ($7.7 million).

	Actual Q1 2012	Actual Q1 2013	Y-o-Y Change	Zacks Est Q1 2013	Actual +/- Zacks est.
Consumables	$3,824	$3,911	2.3%	$4,219	-7.3%
Equipment Sales	$3,058	$2,078	-32.0%	$3,770	-44.9%
Total Product Sales	$6,882	$5,989	-13.0%	$7,989	-25.0%
Rental Revenue	$2,062	$1,679	-18.6%	$1,970	-14.8%
	$8,944	**$7,668**	**-14.3%**	**$9,959**	**-23.0%**

Gross Margin
Gross margin at 71.4% was relatively very soft, the lowest of any quarter since Q4 2009 (69.8%) and significantly lower than our 77.3% estimate. While sales margin (82.1%) ticked up from Q4 (77.9%), it remained relatively soft compared to the average in 2012 (85.6%) while rental margin in Q1 (68.4%) was the lowest since Q4 2009 (61.1%). Zynex did not provide much detail on gross margin on the call but we think both changes in reimbursement along with the recently 2.3% medical device tax may have had some tightening effect on gross margin. While we think the Billing and Consulting business may provide greater margins, there may not be much in the way of revenue contribution from this business in the current year.

Net Income / EPS
Net income and EPS were ($304)k and ($0.01) compared to our $354k and $0.01 estimates. The difference a combination of the top-line miss, lower gross margin and higher SG&A as a percentage of sales.

Cash
Zynex exited Q1 with $681k in cash and equivalents, down from $823k at the end of 2012. Cash used in operating activities was $993k in Q1, ex-changes in working capital this was an inflow of $32k. We model the company to generate positive operating cash flow for the full-year 2013. Management reiterated their expectations on the call that cash from operating activities should show some improvement going forward and believes the current credit line and cash balance will be sufficient to fund operations.

Guidance
Management revised revenue and EPS downward from $41MM - $44MM and $0.06 - $0.09 to $38MM - $42MM and $0.04 - $0.08.

OUTLOOK: *Healthcare Reform / Reimbursement Changes Effecting Revenue and Margins…*

Our overall outlook remains largely unchanged although we have made some meaningful adjustments to our model, mostly reflecting continued tweaking of our assumptions relative to how recent trends extrapolate into the future. We also reiterate the additional risk that was introduced from the Centers for Medicare & Medicaid Services (CMS) deciding in June 2012 that, effective immediately, they would no longer provide reimbursement for TENS for chronic low back pain. Only a relatively small percentage of Zynex's (we estimate it's less than 10%) revenue comes from Medicare and CMS's recent decision relates only to chronic low back pain - both of which could help insulate the impact to Zynex. However, as Medicare reimbursement policies go, so often does private insurers. We think this, along with other recent healthcare reform and reimbursement changes, may be negatively impacting ZYXI's revenue and margins. The potential impact over the long-term is much less clear but we continue to think it's safe to assume that there is a significant chance that it may adversely effect revenue growth.

Our model continues to incorporate the assumption the electrotherapy business provides the bulk of revenue and we still do not incorporate any contribution from the aforementioned blood monitoring device or any contribution from the new Billing and Consulting business - both of which could provide some upside to our model - particularly in the out-years. While our model does not incorporate any revenue contribution from the blood monitoring device 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. We will also incorporate a contribution from the new Billing and Consulting business if and when it's appropriate.

VALUATION

We model EPS to grow at a four-year CAGR of about 27% through 2016. Industry PE/G ratio currently sits at 1.8x. We apply a 20% haircut to the industry PE/G to account for various risks, including the recent CMS decision on reimbursement for TENS for chronic low back pain. Applying this to our 2013 EPS estimate of $0.03 values ZYXI at about $1.20/share. We are maintaining our Outperform rating.

FINANCIAL MODEL

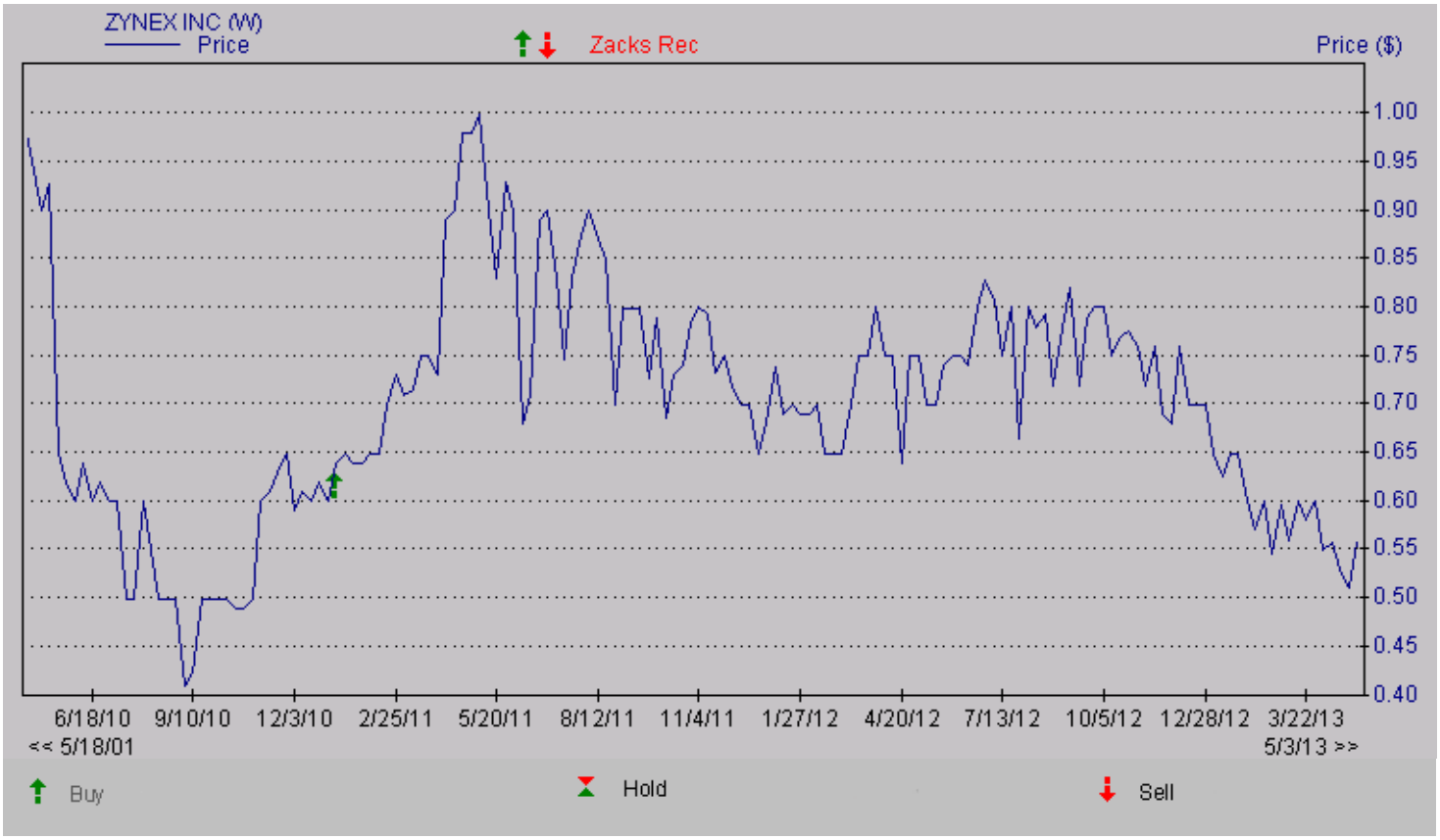
Zynex Inc.

	2012 A	Q1A	Q2E	Q3E	Q4E	2013 E	2014 E	2015 E	2016 E
Rental revenue	$8,917.0	$1,679.0	$2,000.0	$1,845.0	$1,804.0	$7,328.0	$7,318.0	$7,444.0	$7,512.0
YOY Growth	*-9.9%*	*-18.6%*	*-17.9%*	*-19.1%*	*-15.6%*	*-17.8%*	*-0.1%*	*1.7%*	*0.9%*
Consumable sales	$16,479.4	$3,911.0	$4,166.6	$4,124.0	$4,481.3	$16,682.9	$16,702.1	$18,430.3	$20,037.6
YOY Growth	*27.0%*	*2.3%*	*3.9%*	*2.6%*	*-3.1%*	*1.2%*	*0.1%*	*10.3%*	*8.7%*
Equipment sales	$14,269.6	$2,078.0	$3,885.0	$4,038.0	$4,293.0	$14,294.0	$16,888.0	$18,885.0	$20,710.0
YOY Growth	*26.5%*	*-32.0%*	*8.6%*	*6.2%*	*12.1%*	*0.2%*	*18.1%*	*11.8%*	*9.7%*
Product sales revenue	$30,749.0	$5,989.0	$8,051.6	$8,162.0	$8,774.3	$30,976.9	$33,590.1	$37,315.3	$40,747.6
YOY Growth	*26.8%*	*-13.0%*	*6.1%*	*4.4%*	*3.8%*	*0.7%*	*8.4%*	*11.1%*	*9.2%*
Total Revenues	$39,666.0	$7,668.0	$10,051.6	$10,007.0	$10,578.3	$38,304.9	$40,908.1	$44,759.3	$48,259.6
YOY Growth	*16.2%*	*-14.3%*	*0.3%*	*-0.9%*	*-0.1%*	*-3.4%*	*6.8%*	*9.4%*	*7.8%*
Cost of Revenues	$8,770.0	$2,191.0	$2,003.2	$2,370.9	$2,598.4	$9,163.6	$8,843.7	$9,542.6	$9,960.4
Gross Income	$30,896.0	$5,477.0	$8,048.3	$7,636.1	$7,979.9	$29,141.3	$32,064.4	$35,216.7	$38,299.2
Gross Margin	*77.9%*	*71.4%*	*80.1%*	*76.3%*	*75.4%*	*76.1%*	*78.4%*	*78.7%*	*79.4%*
SG&A	$28,159.0	$5,833.0	$7,136.6	$7,004.9	$7,394.2	$27,368.7	$27,531.2	$29,630.7	$31,754.8
% SG&A	*71.0%*	*76.1%*	*71.0%*	*70.0%*	*69.9%*	*68.5%*	*67.3%*	*66.2%*	*65.8%*
Operating Income	$2,737.0	($356.0)	$911.7	$631.2	$585.7	$1,772.6	$4,533.3	$5,586.0	$6,544.4
Operating Margin	*6.9%*	*-4.6%*	*9.1%*	*6.3%*	*5.5%*	*4.6%*	*11.1%*	*12.5%*	*13.6%*
Interest income, net	($432.0)	($130.0)	($118.5)	($108.5)	($103.5)	($460.5)	$25.0	$50.0	$50.0
Other income	$31.0	($6.0)	$8.0	$8.0	$8.0	$18.0	$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	$2,336.0	($492.0)	$801.2	$530.7	$490.2	$1,330.1	$4,558.3	$5,636.0	$6,594.4
Taxes	$788.0	($182.0)	$272.4	$180.4	$166.7	$437.5	$1,549.8	$1,916.3	$2,242.1
Tax Rate	*33.7%*	*39.0%*	*34.0%*	*34.0%*	*34.0%*	*32.9%*	*34.0%*	*34.0%*	*34.0%*
Net Income	$1,548.0	($304.0)	$528.8	$350.3	$323.5	$892.6	$3,008.4	$3,719.8	$4,352.3
YOY Growth	*-0.9%*	*-195.0%*	*11.8%*	*-2.2%*	*-18.5%*	*-42.3%*	*237.1%*	*23.6%*	*17.0%*
Net Margin	*3.9%*	*-4.0%*	*5.3%*	*3.5%*	*3.1%*	*2.3%*	*7.4%*	*8.3%*	*9.0%*
EPS	$0.05	($0.01)	$0.02	$0.01	$0.01	$0.03	$0.09	$0.12	$0.13
YOY Growth	*-1.7%*	*-194.7%*	*11.6%*	*-2.3%*	*-18.7%*	*-42.5%*	*230.1%*	*22.9%*	*15.4%*
Diluted Shares O/S	31,222	31,148	31,300	31,350	31,375	31,293	31,950	32,150	32,600

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