Research Update

Zynex, Inc.

Rating: Neutral

Juan Noble

October 13, 2014

ZYXI $0.14 (ZYXI: OTC)

	2012A	2013A	*2014E*	*2015E*
Total revenues (in millions)	$40.0	$21.7	***$11.7***	***$14.4***
Earnings (loss) per share	$0.05	($0.23)	***($0.25)***	***($0.07)***

52 - Week range	$0.51 – $ 0.11	Fiscal year ends:	December
Shares outstanding as of Oct. 6, 2014	31.3 million	Revenue/share (ttm)	$0.42
Approximate float	13 million	Price/Sales (ttm)	0.3X
Market Capitalization	$4.4 million	Price/Sales (2015)E	0.4X
Tangible Book value as of June 30, 2014	NA	Price/Earnings (ttm)	NA
Price/Book	NA	Price/Earnings (2015)E	NA

Zynex, Inc., based in Lone Tree, Colorado, manufactures a line of electrotherapy devices that relieve pain while reducing reliance on drugs, and speeds rehabilitation and recovery of i mobility. The company also produces diagnostic devices and distributes electrotherapy systems manufactured by others. A substantial portion of revenue is recurring – device rentals and the sale of electrodes and batteries sent to patients using rented or purchased units.

Key Investment Considerations:

Reiterating Neutral investment rating.

Revenue gains have slowed, reflecting a drop in demand stemming from broad reductions in Medicare reimbursements for medical devices, Medicare's curtailment of reimbursement for TENS use for relief of chronic lower back pain, and physician uncertainty over the impact of the Patient Protection and Affordable Care Act (PPACA).

ZYXI has rationalized its product line and sharply reduced operating expenses. Sales should stabilize then regain modest growth momentum by the end of 2014.

The outlook through 2015 should remain difficult due to reduced demand and more restrictive insurance reimbursement. We project some recovery in demand which should reverse the decline in revenue and narrow losses by 2015 but the process of regaining profitability could be a lengthy one.

For 2014 we project a loss of ($0.25) per share, including ($0.09) per share due to inventory write-offs, on revenue of $11.7 million. Previously we projected a 2014 loss of ($0.11) per share loss on revenue of $13.8 million. Our 2015 loss of ($0.07) per share is unchanged but we have lowered our revenue estimate to $14.4 million from $15.7 million.

In 2Q14 *(results released Sept. 25, 2014)* ***Zynex lost ($0.18) per share on revenue of $1.3 million. Revenue for the quarter was reduced by around $1.6 million due to a bank credit squeeze that prevented the company from purchasing more inventory. Excluding the effect of 2Q inventory write-offs, the company lost ($0.09) share. We projected a 2Q loss of ($0.03) per share on revenue of $3.5 million.***

See disclosures on pages 14 - 16

Investment Recommendation

Reiterating Neutral investment rating.

ZYXI is trading at 0.3X trailing revenue vs. 8X for medical device stocks with market valuations of less than $250 million. The deep discount from the sector multiple arguably stems from ZYXI's stalled revenue growth, significant losses, and a shrunken market for the company's products. Prospects for a substantive recovery of growth momentum are still uncertain.

The stock price has fallen sharply during the past year but to the extent that Zynex can regain profitability by recovering sales growth and controlling its costs, the stock's valuation could improve. The company's revenue may have already bottomed out so gains in the quarters ahead might lift the stock price off its recent lows.

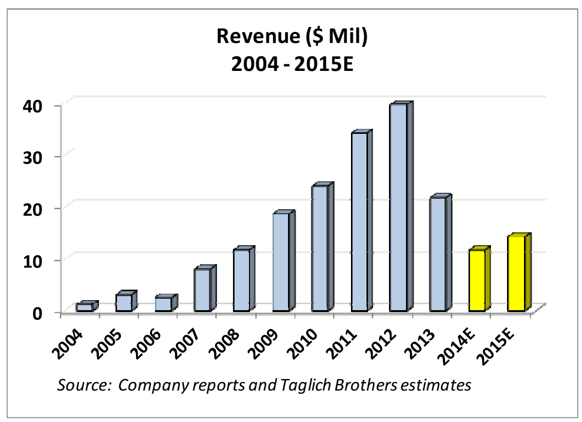
Recent Developments

<u>*New CFO*</u> Brian Alleman, chief financial officer since July 2014. Career highlights: 2009–present, managing director, Alleman & Associates, LLC, strategic business advisory firm providing executive services. 2010–2011 CEO, Fulcrum Patent Solutions LLC. 2008–2010 CFO, TAEUS International Corporation. 2002–2009 partner, Tatum LLC. 2005–2008 CFO, Simtek Corporation. 1993-2002 COO and CFO, Centuri Corporation. 1986-1989 Partner, Arthur Young. 1978-1986 Manager, Arthur Andersen. BS Accounting, 1978, Seton Hall University.

Overview

Zynex, Inc., headquartered in Lone Tree, Colorado, was founded in 1996 and became a publicly held company in 2004 through a reverse merger with a shell company. Zynex operated as a wholesaler of European-made electrotherapy devices until its first medical device was cleared by the Food and Drug Administration (FDA) in 1999. In 2003 Zynex's full line of electrotherapy devices and a stroke rehabilitation device were cleared by the FDA. In 2008 some of its major products were cleared for marketing in Europe.

Zynex manufactures a line of neuromodulator devices that reduce reliance on drugs and promotes rehabilitation and increased mobility. Zynex's non-invasive transcutaneous electrical nerve stimulation systems have been used to treat pain ranging from mild persistent problems such as sore muscles to acute postoperative pain.

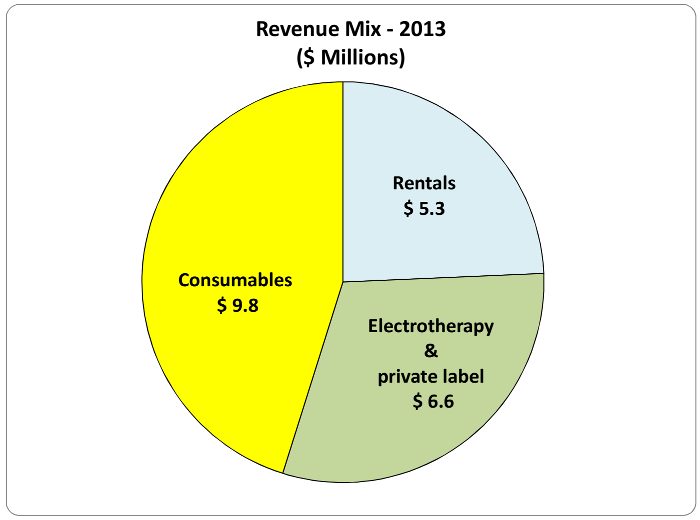


The company's neuromuscular electrical stimulation (NMES) systems are used mainly by physical therapists to treat victims of trauma, stroke, or incidents that degrade muscle function, enabling stroke or spinal injury victims to regain lost mobility, functionality, speech, and memory. Revenue increased sharply, growing threefold in the three years through 2012 but plummeted in the wake of tighter reimbursement restrictions in 2013.

Revenue growth stalled abruptly on curtailment of Medicare reimbursement for TENS in treating chronic lower back pain, and uncertainty over the impact of the Patient Protection and Affordable Care Act (PPACA). In 2013, hardware sales and rental revenue fell sharply. The company aims to regain growth momentum partly through the sale of diagnostic devices unaffected by significant reimbursement cuts and the launch of a line of topical and transdermal pain creams for the treatment of inflammation, peripheral neuropathy, headaches and other ailments. But in light of Zynex's current sales mix, the recovery process could be a lengthy one.

In addition to its own products, Zynex distributes private labeled electrical stimulation devices, electrodes and batteries produced by other US manufacturers. A substantial portion of revenue is recurring. Rentals and electrodes and batteries sold to patients using either rental or purchased units account for three-quarters of revenue.

Zynex's products are either purchased or rented on a monthly basis, mainly by patients, healthcare providers and distributors. Health insurers that cover patients generally determine, based on the anticipated time the device will be used, if devices will be rented or purchased. More than half of the company's revenue consists of sales to patients covered by private health insurance plans. Patients also include Medicare and Medicaid beneficiaries. Returned rental units are refurbished and made available for future rentals. Rental margins and margins on consumables, typically around 80%, range significantly higher than the 50% margins on device sales.



In the US, which accounts for most of its sales, the company sells its medical devices through a sales force that includes independent sales representatives. Overseas, Zynex has distributors in Canada, Australia, Southeast Asia, the United Arab Emirates, the Netherlands, and Germany. An international sales manager oversees distributors covering Asia and the Middle East.

Strategy

Zynex is reevaluating the strategy for Zynex Medical, its largest business. The company has rationalized its product line, narrowing it down essentially to NexWave, a TENS pain therapy device, InWave, an incontinence therapy device, and NeuroMove, a stroke rehabilitation device. The rest of the product line, which formerly included other TENS systems and neurodiagnostic devices, has been discontinued. All inventory relating to discontinued products was written off in 2Q14. To diversify away from electrotherapy products, which are based largely on aging technology and tend to be priced as commodities, Zynex started compounding and selling topical and transdermal pain creams in early 2014. Pain creams contributed $368,000 to 1H14 revenue.

To attenuate the impact of a sharp decline in revenue, Zynex reduced its staff, cutting annual employee costs by $7 million, and renegotiated its lease, potentially reducing annual rent expense by $1 million.

Most of the company's technology – TENS was developed 30 years ago – is not patent protected. To keep its product knowledge proprietary, Zynex internally develops software for all of its products. All products are tested in-house to ensure quality and patient safety, and reduce the cost of warranty expenses.

Outlook

With the aging of the population, the prevalence of age-related disease – cancer, cardiovascular disorders, stroke, diabetes, and degenerative spinal disorders – is expected to rise significantly, increasing the demand for pharmaceutical- and device-based therapy. Technological advances in device design, as seen earlier in cardiac rhythm management, coronary revascularization devices, spinal implants, orthopedic prostheses, and neuromodulation systems, should also drive the growth in demand.
Gains could potentially be offset in part by more stringent regulatory 510(k) review mandated by the Food and Drug Administration Reform Act of 2012, and pressure on pricing and industry profits as the PPACA goes into

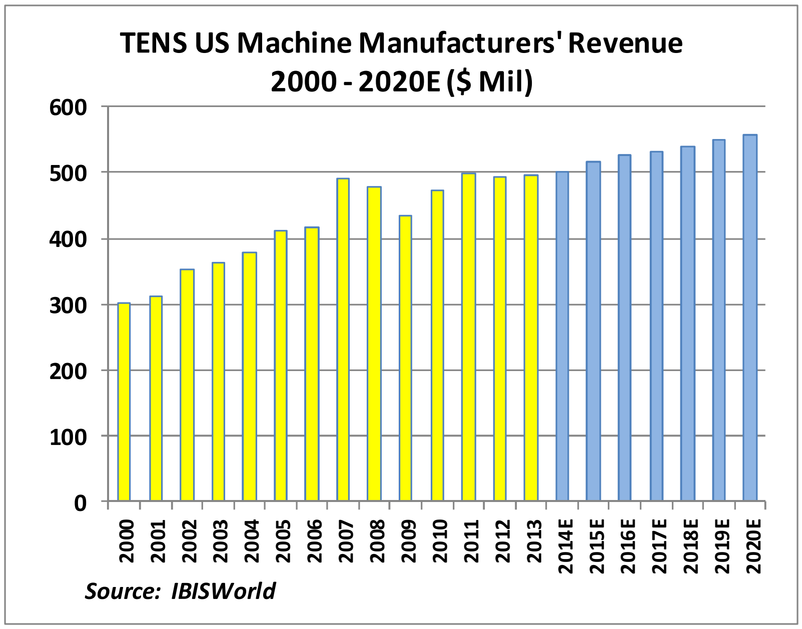
effect. Sections of the law that require all medical device manufacturers to pay 2.3% of the sales price of a device may be repealed or amended in budget negotiations.

The more immediate threat to Zynex's growth outlook stems from the curtailment of Medicare reimbursement. A June 2013 decision memorandum from CMS determined that "TENS is not reasonable and necessary for the treatment of CLBP under section 1862(a)(1)(A) of the Social Security Act." That decision directly affects TENS device manufacturers. High-end neuromodulation device manufacturers such as Medtronic and St. Jude Medical (see Competition) have not experienced as severe an impact as Zynex has. But the EMPI business of DJO Global, a large TENS manufacturer, has suffered more significant revenue declines that either Medtronic or St. Jude Medical.

In April 2013 Medicare payments for services to physicians were reduced by 2% as part of the automatic spending cuts in Federal spending mandated by the Budget Control Act of 2011. These cuts were temporarily deferred in December 2013 and planned Medicare cuts for 2014 were deferred by Congress in March 2014. In June 2013 CMS announced its proposal to reduce reimbursements for home healthcare by 3.5% annually from 2014 to 2017.

<u>Neromodulation Devices</u> This $2.6 billion segment of the US medical device market encompasses a wide range of devices that intervene in neural pathways to reduce pain and disorders stemming from illness and trauma that have impaired the central nervous system in some fashion. The neuromodulation segment includes electrotherapeutic devices, which apply an electrical impulse to an affected part of the anatomy.

TENS systems are distinct from neuromdulation systems which deliver therapeutic effect via devices implanted in the brain or major nerve systems. TENS devices and the other systems sold by ZYNEX are transdermal delivery systems.



The US TENS market grew an average of 7.1% a year between 2000 and 2007. The industry's average annual growth from 2007 through 2013 was essentially flat, a rate that masks declines in 2008 and 2009. By IBISWorld's estimates, the US market for TENS in 2014 will total $502 million. Broad reductions in Medicare coverage for durable medical equipment (which include medical devices) and new limitations on Medicare reimbursement for chronic lower back pain are likely to curtail usage of TENS devices, particularly in the home health market. By IBISWorld estimates, the US TENS market will grow less than 2% a year through 2020.

Competition

Zynex's competitors include large broad-line medical device manufacturers with substantial neurostimulation businesses, including Medtronic, which reported a 5% rise in nine-month (ending January 2014) neuromodulation revenue to $1.4 billion. St. Jude Medical's 2013 neuromodulation revenue was $426 million, essentially flat compared to 2012.

DJO Global's Recovery Science business reported 2013 revenue of $313 million, down 6% from 2022. In 2012 the Recovery Science business' revenue dropped 7.5% due in part to changes in reimbursement for certain products in DJO's EMPI business. EMPI's product line consists in large part of TENS devices.

Aside from the larger competitors in this industry segment, there are more than 60 US manufacturers of electrotherapy devices, most of which carry a wide variety of products sold to the physical therapy market. IBISWorld's TENS market data imply an average annual revenue of around $8 million per TENS manufacturer.

Competition is based on price, which is important to patients, clinicians and insurers. As all TENS devices perform the same function, based on largely dated technology, and are produced by a large number of manufacturers, they increasingly trade as commodities. Differentiating technology can also be an advantage. Despite limited potential for innovation in TENS devices, manufacturers try to differentiate their products. TENS systems are commonly differentiated by being bundled with another pain management modality, just as Zynex combines TENS with NMS and IF. Product innovations may make systems easier for untrained patients to use at home, or be mainly cosmetic, but in a commoditized market, novel features can underlie a slight competitive edge even if they do not enhance functionality.

2014 Second Quarter and Six-Month Results

In 2Q14, Zynex incurred a loss of $5.6 million, or ($0.18) per share, on revenue of $1.3 million. Excluding the effect of a $2.7 million write-off of discontinued product inventory, ZYXI lost ($0.09) per share in 2Q. Insufficient funding to finance inventory reduced 2Q sales, mainly of batteries and electrodes, by $1.6 million. We projected a loss of ($0.03) per share on revenue of $3.5 million.

2Q revenue dropped 75% to $1.3 million due to a drop in customer orders. The decline in revenue was led, in dollar terms, by an 80% decline in consumables sales, which reflected revenue lost due to insufficient financing for inventory. Rental revenue also fell sharply, dropping 64% to $589,000.

Gross profit for 2Q, excluding inventory write-

	Quarter ending June 30:			'14 vs. '13	**Six Mos. ending June 30:**		
($ Thousands)	**2014A**	***2014E***	**2013A**	%+/-	**2014**	**2013**	**%+/-**
Revenue							
Rental	589	*986*	1,643	(64%)	1,324	3,322	(60%)
Sales	760	*2,519*	3,829	(80%)	3,192	9,818	(67%)
Total revenue	1,349	*3,505*	5,472	(75%)	4,516	13,140	(66%)
Cost of revenue							
Rental	268	*286*	398	(33%)	403	699	(42%)
Sales	903	*856*	1,485	(39%)	1,765	3,375	(48%)
Inventory write-off	2,655				2,655		
Total	3,826	1,142	1,883	103%	4,823	4,074	18%
Gross profit	(2,477)	*2,362*	3,589	(169%)	(307)	9,066	(103%)
SG&A expenses	2,947	*3,740*	6,153	(52%)	6,403	11,986	(47%)
Operating income (loss)	(5,424)	(1,378)	(2,564)	NM	(6,710)	(2,920)	NM
Interest expense	(144)	*(85)*	(214)	(33%)	(302)	(344)	(12%)
Other income (expense)	9		78	NM	9	72	NM
Pretax income	(5,559)	*(1,462)*	(2,700)	NM	(7,003)	(3,192)	NM
Income tax		*585*	973	NM		1,155	NM
Income before minority int	(5,559)	*(877)*	(1,727)		(7,003)	(2,037)	
Minority interest in earnings	6	*10*	11	NM	20	17	
Net income	(5,553)	*(867)*	(1,716)	NM	(6,983)	(2,020)	NM
Average shares outstanding	31,171	*33,250*	31,148		31,171	31,148	
Earnings (loss) per share	(0.18)	*(0.03)*	(0.06)	NM	(0.22)	(0.06)	NM
Margin Analysis							
Gross margin	NA	67.4%	65.6%		(6.8%)	69.0%	
Rental	45.5%	29.0%	24.2%		30.4%	21.0%	
Sales	118.8%	34.0%	38.8%		55.3%	34.4%	
SG&A	218.5%	106.7%	112.4%		141.8%	91.2%	

Source: Company reports and Taglich Brothers estimates

offs, fell 95% to $178,000 as revenue declined and the gross margin (excluding inventory write-offs) narrowed to 13% from 65.6% due mainly to reduced overhead coverage.

Operating expenses dropped 52% to $2.9 million due to staff reductions, lower sales commissions, reduced rent, and lower professional fees and travel expenses. The operating loss for 2Q widened to $5.4 million from $2.6 million, a consequence of the manufacturing loss and an increase in operating expenses.

Interest expense dropped 33% to $144,000 due to lower average borrowings, offset in part by a 300 basis point interest rate increase stemming from noncompliance with loan covenants.

In the first half of 2014, ZYXI lost $7 million, or ($0.22) per share, on revenue of $4.5 million. Excluding a $2.7 million 2Q inventory write-off, the company incurred a six-month loss of ($0.14) per share, vs. a 1H13 loss of ($0.06) loss per share on revenue of $13.1 million. 1H14 revenue dropped 66% due to a decline in orders exacerbated by an inability to fund inventory; stock outs reduced six-month revenue by $1.6 million.

Six-month gross profit, excluding the effect of a $2.7 million inventory write-off, dropped 74% to $2.3 million, a consequence of the decline in revenue and gross margin compression to 52% from 69% stemming from reduced overhead coverage. Including inventory write-offs, the company incurred a six-month manufacturing loss of $307,000.

SG&A expenses dropped 47% to $6.4 million, reflecting reductions in staff, lower commissions and rent, and a drop in professional fees, office and travel expenses. The operating loss for 1H14 widened to $6.7 million from $2.9 million, a consequence of the manufacturing loss and the increase in operating expenses.

Interest expense dropped 12% to $302,000 due to lower average borrowings, offset in part by a 300 basis point interest rate increase stemming from noncompliance with loan covenants.

Finances In 2Q14 Zynex burned cash of $3.5 million but reduced working capital by $4.2 million mainly by a reduction in receivables and an increase in deferred revenue. Cash of $734,000 from operations and proceeds from the sale of equipment covered repayment on the revolving line of credit, increasing cash by $122,000 to $311,000 at the end of the quarter.

For the first half of 2014, the company burned cash of $4.4 million but reduced working capital by $5.1 million mainly through reductions in receivables, inventory and income taxes receivable, and an increased in deferred revenue. Cash from operations of $731,000, proceeds from the sale of equipment and changes in rental assets offset repayment of bank loans and capital lease obligations, increasing cash by $12,000 as of June 30, 2014.

Credit Facility Zynex has an asset-backed revolving credit facility with Triumph Community Bank that matures on December 19, 2014. The Triumph agreement contains certain customary restrictive and financial covenants for asset-backed credit facilities. As of June 30, 2014, $4.9 million was outstanding under the loan agreement. As the company was in default and under demand for accelerated payments, no further borrowing was available.

Borrowings bear interest at the default interest rate. As of June 30, 2014, the effective interest rate was 11.18% (6.75% interest rate plus 3% additional default interest rate and 1.43% fees). The loan agreement requires monthly interest payments in arrears on the first date of each month.

As of June 30, 2014, Zynex was not in compliance with the minimum debt service coverage ratio requirement for the quarter ended March 31, 2014 and certain other alleged defaults. The bank notified Zynex that it would no longer make additional loans and was exercising its default remedies, including, among others, accelerating the repayment of all outstanding obligations under the loan agreement and collecting the company's bank deposits to apply towards the outstanding obligations.

Zynex and the bank are negotiating the terms of an accelerated repayment of the amounts outstanding under the agreement and the bank has continued to make additional loans to the company. However, the bank could potentially discontinue such additional loans and/or may not agree on a repayment plan acceptable to the company. If the bank insists on immediate repayment, the company could be forced into insolvency proceedings.

Projections

Operations Revenue is well below ZYXI's 2012 peak of almost $40 million; in 2Q14, the company's run rate was approximately $11 million, excluding the effect of sales lost due to insufficient financing. Our projections reflect expectations for some recovery of demand as revenue stabilizes, possibly in 3Q14.

For 2014 we project a loss of $8.2 million, or ($0.25) per share, on revenue of $11.7 million. Excluding the effect of inventory write-offs, we estimate a 2014 loss of $5.6 million, or ($0.17) per share. Previously, we projected a 2014 loss of $3.7 million, or ($0.11) per share, on revenue of $13.8 million. Our revenue projection was revised to reflect 2Q14 results and a 3Q14 recovery of most of the 2Q revenue lost due to insufficient borrowing capacity to finance inventory purchases. Revenue will drop an estimated 46% and the gross profit will fall to $4.5 million ($7.2 million excluding inventory write-offs).

Operating expenses should decrease 38% to $13.2 million due to further reductions in sales commissions, the full-year impact of a $7 million reduction in annual personnel expenses, and a reduction in rent. Excluding the effect of inventory write-off, the operating loss for the year should narrow to $6 million from $7.6 million. So long as collections and inventory turnover do not deteriorate, average borrowings should drop, enabling Zynex to cut its interest expense 22% to $474,000. The net loss for the year will widen to $8.2 million from $7.3 million, a consequence mainly of the 2Q inventory write-off.

For 2015 we project a loss of $2.2 million, or ($0.07) per share, on revenue of $14.4 million. Our loss projection is largely unchanged but we have reduced our revenue estimate from $15.7 million. A modest recovery in demand should increase revenue by an estimated 4% but gross margins are likely to remain largely flat as tight pricing flexibility forces the company to restrain prices in order to regain volume growth momentum.

Operating expenses drop 2% to $12.9 million, reflecting the limits of the ability to take more costs out of the business. The operating loss will narrow to an estimated $3.3 million from $6 million.

Finances We project 2014 cash burn of $4.9 million, offset by a $5 reduction in working capital as receivables and inventory decrease significantly due to the drop in revenue, partly offset by reductions in payables and accruals. Cash of $94,000 from operations and cash gains from the sale equipment and changes in rental inventory will fall short of repayments on bank loans and capital lease payments, reducing cash by $115,000 to $208,000 at the end of 2014.

For 2015, we project cash burn of $854,000 and an $820,000 increase in working capital due to an increase in receivables. Proceeds from additional borrowing should cover cash of $1.7 million used in operations, capital expenditures and payments on capital leases, increasing cash by $146,000 to $354,000 at the end of 2015.

Zynex's Electrical Nerve Stimulation Technology and its Product Line

Zynex's principal products include pain management, rehabilitation and incontinence therapy devices, some of them bundled in combination systems. Single-use supplies such as electrodes and batteries account for a sizable proportion of revenue.

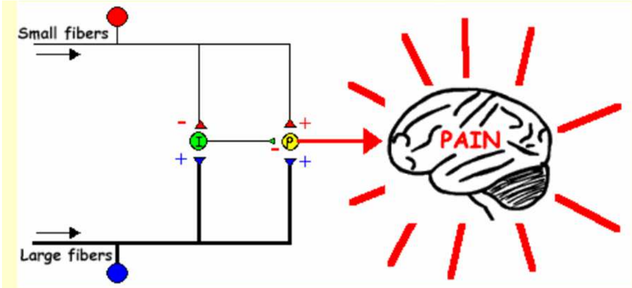
Source: Physiomed

Electrotherapy devices are generally small, portable (hand-held in many cases), and relatively inexpensive. The TENS unit illustrated at right (not a Zynex product) is fairly typical. There are TENS systems that retail on the Internet for as little as $30.

Pain Management Electrical stimulation systems, also known as neurostimulation devices, range from Medtronic's PrimeAdvanced® and Restore™ implantables to the ubiquitous TENS (transcutaneous electrical nerve stimulation) system. TENS reduces pain by electrically stimulating nerve fibers that interfere with pain signals and by stimulating the production of pain-relieving endomorphins. Common pain relief applications for TENS include back and neck, RSD (complex regional pain syndrome), arthritis, shoulder pain, neuropathies, and other acute and chronic pain.

TENS therapy is delivered through a small, external portable battery-powered generator from which electrical impulses are coursed through electrodes placed on the skin, either directly over the painful area or at certain points along the nerve pathway.

The mechanism of action of TENS is explained by the gate-control theory (Melzack and Wall, 1965), illustrated at the right, as follows: in the absence of stimuli, both large and small nerve fibers are quiet and the inhibitory interneuron (I) blocks the signal in the projection neuron (P) that connects to the brain. The "gate is closed", so there is no pain sensed.



I = "Inhibitory Interneuron"; P = "Projection Neuron"
- = inhibition (blocking); + = excitation (activation)
Source: Eric H. Chudler

With non-painful stimuli, mainly the large nerve fibers are activated. Activation of the large nerve fibers also activates the projection neuron (P), but it also activates the inhibitory interneuron (I) which then blocks the signal in the projection neuron (P) that connects to the brain. The gate remains closed so there is no pain sensed.

With pain stimulation, small nerve fibers become active, activating the projection neurons (P) and blocking the inhibitory interneuron (I). Because activity of the inhibitory interneuron is blocked, it cannot block the output of the projection neuron that connects with the brain. So the gate is "open", and the brain senses pain. TENS aims to stimulate the large diameter nerve fibers, closing the gate and reducing pain.

The sensation produced by the electrical stimulation appears to "override" the pain messages and may stimulate the body to produce its own natural morphine-like substance, which minimizes pain.

Since it was developed more than 30 years ago TENS has been used to treat almost every type of pain, from mild persistent problems such as sore muscles to acute postoperative pain. Its most common use, however, has been in the treatment of chronic low-back pain, an application in which the American Academy of Neurology now says TENS is ineffective. Whether TENS suppresses or overrides pain signals, stimulates production of natural pain relieving chemicals, or is merely a placebo effect, it has provided pain relief in many cases. Its broad acceptance is based in part on its benign side effects profile. TENS is non-addictive, non-sedative, and can be used indefinitely without the problems associated with prolonged use of some pain medications.

Rehabilitation Neuromuscular electrical stimulation (NMES) systems deliver electrical impulses to the surface over targeted muscles through electrodes. These electrical impulses cause muscles to contract as a form of exercise or physical therapy. NMES is used mainly by physical therapist to treat victims of trauma, stroke, or incidents that degrade muscle function. NEMS is also to diagnose the performance of nerves and muscles, and measure improvement after treatment.

NEMS is used in cases of chronic neuromuscular disorders such as cerebral palsy, spina bifida, club foot and some nonprogressive myopathies. It is also applied to healthy muscle to strengthen or maintain muscle mass during periods of enforced inactivity, increase range of motion, improve voluntary muscle control, and temporarily reduce spasticity.

Risks

In our view, these are the principal risks underlying the stock:

Regulatory/Legal Zynex's devices must be cleared for US marketing by the FDA, mostly through the 510(k) review process, a relatively low regulatory hurdle that requires the company to demonstrate that a product under review is substantially equivalent to a similar device on the market (predicate device) before 1976. Devices sold in in the European Union (EU) must be CE (Conformite Europeenne) marked, showing that it meets EU health, safety, and environmental requirements.

The Patient Protection and Affordable Care Act (PPACA) of 2010, which must be fully implemented by 2019, contains provisions that will increase pressure on pricing and require medical device manufacturers to pay fees on their sales. Adverse proposals by the Medicare system could cripple near-term growth.

Intervening Technnology Zynex's technology is protected by trademarks and trade secrets, rather than patents. While the company keeps it software proprietary by developing and maintaining it internally, competitors could potentially develop more effective devices.

Reimbursement Applications for reimbursement are subject to disputes which can result in carriers' requests for refunds of previously paid claims. Refunds are frequently offset after review of the billings in question, and the sums refunded have been largely immaterial. Potential for refunds underlies some revenue uncertainty. Potential for refunds underlies some revenue uncertainty. One private health insurance carrier accounted for 7% of net accounts receivable as of December 31, 2013. If this carrier proved to be especially problematical, reimbursements might be lost or delayed.

Liquidity ZYXI may be unable to obtain additional borrowing sufficient to finance its working capital. Our projections for 2014 and 2015 reflect bank loans that exceed the line's current limits. If the company is unable to negotiate higher borrowing capacity, revenue growth recovery may not be achieved.

Interest Rates When the Federal Reserve raises interest rates, the company's borrowing costs would increase. Higher interest rates are also likely to dampen stock market performance.

Competition The market for electrotherapy devices is fragmented and highly competitive. TENS and interferential current technologies have been on the market for more than 30 years and these devices increasingly tend to trade as commodities with limited pricing flexibility.

Concentration of stock ownership Thomas Sandgaard owns 58% of ZYXI shares. This concentration of ownership gives him disproportionate influence over management actions, potentially leading to decisions that may not be in the best interest of the stockholders at large.

Microcap Concerns Shares of ZYXI have risks common to the stocks of other microcap (which we define as market capitalizations of $250 million or less) companies. These risks often underlie stock price discounts from the valuations of larger-capitalization stocks. Liquidity risk, typically caused by small trading floats and very low trading volume, can lead to large spreads and high volatility in stock price. The company has approximately 13 million shares in the float. Average daily volume is 20,600 shares.

Miscellaneous Risks The company's financial results and equity values are subject to other risks and uncertainties known and unknown, including but not limited to competition, operations, financial markets, regulatory risk, and/or other events. These risks may cause actual results to differ from expected results.

Balance Sheets
($ 000)
2011A –2015E

	2011A	2012A	2013A	2Q14A	2014E	2015E
ASSETS						
Current assets						
Cash + equivalents	789	823	323	311	208	354
Accts receivable	10,984	12,224	7,033	4,982	4,230	5,183
Inventory	4,556	6,160	5,002	2,583	1,653	1,582
Prepaid expenses	293	243	346	173	152	187
Deferred tax asset	1,384	1,855	72	72	72	72
Income tax receivable				371		
Other	42	57	928	35	50	50
Total	18,048	21,362	13,704	8,527	6,364	7,428
Fixed assets (net)	3,422	3,851	2,891	2,051	1,839	1,421
Deposits	170	171	400	11	15	15
Deferred financing fees	145	98	48			
Intangibles		203	178	154	144	124
Goodwill		251				
TOTAL ASSETS	21,785	25,936	17,221	10,743	8,363	8,988
LIABILITIES AND EQUITY						
Current liabilities						
Line of credit	3,289	5,906	5,820	4,876	5,500	7,500
Notes & other obligations - curr	131	144	92	35	35	35
Accts pay	2,189	2,057	2,743	3,000	2,209	2,307
Accruals	2,276	1,430	926	504	442	442
Income taxes payable	1,567	2,164	96	91		
Deferred rent	296	371	7			
Deferred revenue				1,296		
Contingencies - curr		21		4		
Total	9,748	12,093	9,684	9,806	8,187	10,284
Notes & other obligations (less curr)	258	114	150	121	93	37
Deferred rent	1,156	785	2,454	2,832	2,800	2,800
Deferred tax liability	483	786	72	72	72	72
Warranty liability		20	13	12	12	12
Contingencies - less curr		83				
Shareholders' equity	10,140	12,055	4,848	(2,100)	(2,800)	(4,216)
TOTAL LIABILITIES AND EQUITY	21,785	25,936	17,221	10,743	8,363	8,989

Source: Company reports and Taglich Brothers estimates

Annual Income Statements
($ 000)
2011A –2015E

	2011A	2012A	2013A	2014E	2015E
Revenue					
Rental	9,892	8,917	5,270	3,086	3,225
Sales	24,256	30,749	16,414	8,627	11,129
Total	34,148	39,666	21,684	11,713	14,354
Cost of revenue					
Rental	1,842	1,283	1,373	932	962
Sales	5,529	7,487	6,767	3,613	3,784
Inventory write-off				2,655	
Total	7,371	8,770	8,140	7,200	4,746
Gross profit	26,777	30,896	13,544	4,513	9,608
SG&A expenses	23,676	28,159	21,144	13,150	12,934
Operating income (loss)	3,101	2,737	(7,600)	(8,637)	(3,326)
Interest income	1	3			
Interest expense	(460)	(435)	(607)	(474)	(430)
Other income (expense)	2	31	77	9	
Pretax income (loss)	2,644	2,336	(8,130)	(9,102)	(3,756)
Income tax (benefit)	(1,080)	(788)	790	839	1,503
Net income before minority int			(7,340)	(8,262)	(2,254)
Minority interest in earnings			39	40	40
Net income (loss)	1,564	1,548	(7,301)	(8,222)	(2,214)
Average shares outstanding	30,978	31,222	31,152	32,398	33,375
Earnings (loss) per share	0.05	0.05	(0.23)	(0.25)	(0.07)
Margin Analysis					
Gross margin - total	78.4%	77.9%	62.5%	38.5%	66.9%
Rental	81.4%	85.6%	73.9%	69.8%	70.2%
Sales	77.2%	75.7%	58.8%	58.1%	66.0%
SG&A	69.3%	71.0%	97.5%	112.3%	90.1%
Operating income	9.1%	6.9%	NA	NA	NA
Pretax income	7.7%	5.9%	NA	NA	NA
Net income	4.6%	3.9%	NA	NA	NA

Source: Company reports and Taglich Brothers estimates

Quarterly Income Statements
($ Thousands)
2013A - 2015E

	1Q13A	2Q13A	3Q13A	4Q13A	**2013A**	1Q14A	2Q14A	3Q14E	4Q14E	**2014E**	1Q15E	2Q15E	3Q15E	4Q15E	**2015E**
Revenue															
Rental	1,679	1,643	1,284	664	**5,270**	735	589	899	863	**3,086**	772	560	944	950	**3,225**
Sales	5,989	3,829	3,907	2,689	**6,624**	2,432	760	3,149	2,286	**8,627**	2,481	2,714	3,306	2,628	**11,129**
Total revenue	7,668	5,472	5,191	3,353	**11,894**	3,167	1,349	4,048	3,149	**11,713**	3,252	3,274	4,250	3,578	**14,354**
Cost of revenue															
Rental	301	398	257	417	**1,373**	135	268	279	250	**932**	232	162	293	275	**962**
Sales	1,890	1,485	1,289	2,103	**6,767**	862	903	1,071	777	**3,613**	843	923	1,124	894	**3,784**
Inventory write-off							2,655			**2,655**					
Total	2,191	1,883	1,546	2,520	**8,140**	997	3,826	1,349	1,027	**7,200**	1,075	1,085	1,417	1,169	**4,746**
Gross profit	5,477	3,589	3,645	833	**3,754**	2,170	(2,477)	2,698	2,121	**4,513**	2,177	2,189	2,833	2,409	**9,608**
SG&A expenses	5,833	6,153	4,713	4,389	**7,580**	3,456	2,947	3,441	3,306	**13,150**	3,283	3,242	3,268	3,141	**12,934**
Operating income (loss)	(356)	(2,564)	(1,068)	(3,556)	**(3,826)**	(1,286)	(5,424)	(742)	(1,185)	**(8,637)**	(1,106)	(1,053)	(435)	(732)	**(3,326)**
Interest expense	(130)	(214)	(136)	(127)	**(607)**	(158)	(144)	(83)	(88)	**(474)**	(94)	(106)	(113)	(117)	**(430)**
Other income (expense)	(6)	78		5	**77**		9			**9**					
Pretax income	(492)	(2,700)	(1,204)	(3,678)	**(4,356)**	(1,444)	(5,559)	(825)	(1,273)	**(9,102)**	(1,200)	(1,159)	(549)	(849)	**(3,756)**
Income tax (benefit)	182	973	455	(820)	**790**			330	509	**839**	480	464	219	340	**1,503**
Net income before minority interest	(310)	(1,727)	(749)	(4,498)	**(3,566)**	(1,444)	(5,559)	(495)	(764)	**(8,262)**	(720)	(695)	(329)	(510)	**(2,254)**
Minority interest in earnings	6	11	11	11	**39**	14	6	10	10	**40**	10	10	10	10	**40**
Net income (loss)	(304)	(1,716)	(738)	(4,487)	**(3,527)**	(1,430)	(5,553)	(485)	(754)	**(8,222)**	(710)	(685)	(319)	(500)	**(2,214)**
Average shares outstanding	31,148	31,148	31,148	31,163	**31,152**	31,171	31,171	33,500	33,750	**32,398**	33,000	33,250	33,500	33,750	**33,375**
Earnings (loss) per share	(0.01)	(0.06)	(0.02)	(0.14)	**(0.11)**	(0.05)	(0.18)	(0.01)	(0.02)	**(0.25)**	(0.02)	(0.02)	(0.01)	(0.01)	**(0.07)**
Margin Analysis															
Gross margin	71.4%	65.6%	70.2%	24.8%	**31.6%**	68.5%	(183.6%)	66.7%	67.4%	**38.5%**	66.9%	66.9%	66.7%	67.3%	**66.9%**
Rental	17.9%	24.2%	20.0%	62.8%	**26.1%**	18.4%	45.5%	31.0%	29.0%	**30.2%**	30.0%	29.0%	31.0%	29.0%	**29.8%**
Sales	31.6%	38.8%	33.0%	78.2%	**102.2%**	35.4%	118.8%	34.0%	34.0%	**41.9%**	34.0%	34.0%	34.0%	34.0%	**34.0%**
SG&A	76.1%	112.4%	90.8%	130.9%	**63.7%**	109.1%	218.5%	85.0%	105.0%	**112.3%**	100.9%	99.0%	76.9%	87.8%	**90.1%**

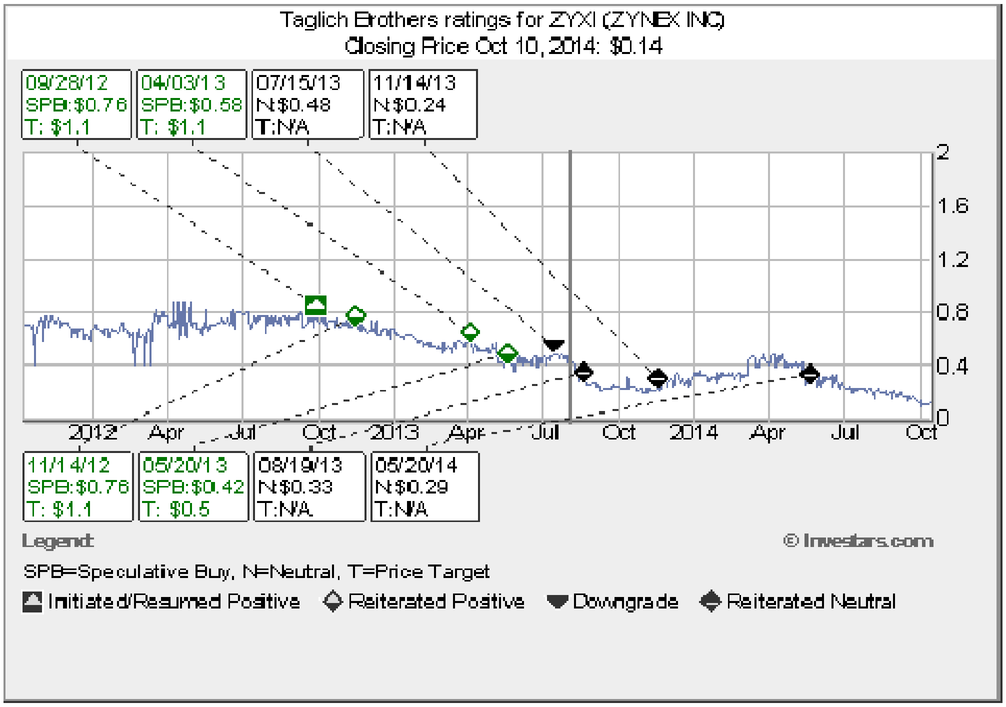
Source: Company reports and Taglich Brothers estimates

Annual Cash Flow Statements
($ 000)
2011A –2015E

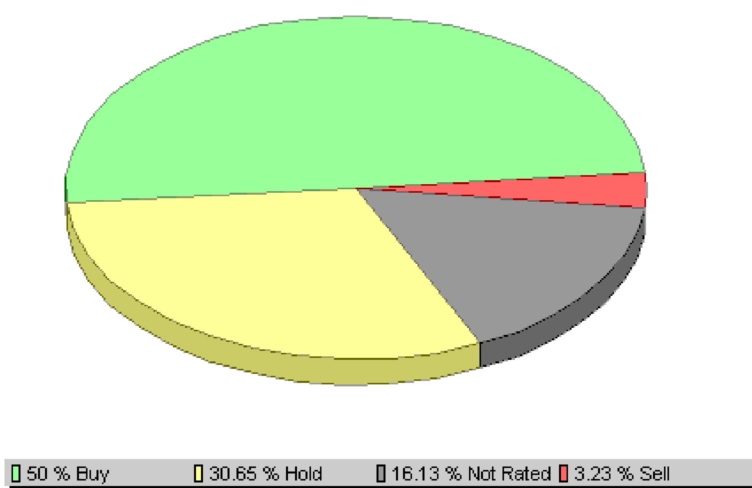
	2011A	2012A	2013A	2Q14A	2014E	2015E
Operating activities				(quarter only)		
Net Income	1,564	1,548	(7,340)	(5,559)	(8,222)	(2,214)
Depreciation/ amortization	806	864	708	149	584	600
Accretion of contingency consideration		(31)	(94)			
Provision for losses - accts rec	1,190	485	469	(835)	(577)	500
Amortization of intangibles		48	131	4	35	20
Impairment of goodwill			251			
Impairment of intangibles			160			
Amortization - financing fees	91	50	50	35	118	140
Stock based compensation - employees	267	166	133	24	105	100
Stock based compensation for services	79	20				
Provision for obsolete inventory	149	573	97	(14)		
Write-off of field inventory			1,340	2,669	2,669	
Deferred rent	(221)	(296)	1,299		357	
Deferred tax benefit	(295)	(168)	1,069			
Cash burn/throwoff	3,630	3,259	(1,727)	(3,527)	(4,931)	(854)
Changes in working capital	(3,992)	(4,138)	1,345	4,241	5,025	(820)
Net cash from operations	(362)	(879)	(382)	734	94	(1,674)
Investing activities						
Cash paid for domain name		(18)				
Payment on contingency			(3)	(4)	(4)	
Capital expenditures/(sales of equip)			(644)	153	92	(100)
Cash paid for acquisition		(245)				
Change in rental equip/inventory	(1,267)	(1,321)	764	20	190	80
Net - investing activities	(1,267)	(1,584)	117	169	278	(20)
Financing activities						
Bank loan proceeds (repayments) - net	2,019	2,617	(86)	(732)	(320)	2,000
Deferred financing fees	(147)	(2)				
Payments - capital lease obligations	(104)	(131)	(149)	(49)	(167)	(160)
Proceeds - issuance of stock	48	13				
Net cash from financing	1,816	2,497	(235)	(781)	(487)	1,840
Net change in cash	187	34	(500)	122	(115)	146
Cash - beginning	602	789	823	189	323	208
Cash - ending	789	823	323	311	208	354

Source: Company reports and Taglich Brothers estimates

Price Chart



Taglich Brothers Current Ratings Distribution



Investment Banking Services for Companies Covered in the Past 12 Months

Rating	#	%
Buy	2	8
Hold	1	20
Sell		
Not Rated		

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Public companies mentioned in this report

Medtronic	(NYSE: MDT)	St. Jude Medical	(NYSE: STJ)

Meaning of Ratings

Buy – The growth prospects, degree of investment risk, and valuation make the stock attractive relative to the general market or comparable stocks.

Speculative Buy – Long term prospects of the company are promising but investment risk is significantly higher than it is in our BUY-rated stocks. Risk-reward considerations justify purchase mainly by high risk-tolerant accounts. In the short run, the stock may be subject to high volatility and could continue to trade at a discount to its market.

Neutral – Based on our outlook the stock is adequately valued. If investment risks are within acceptable parameters, this equity could remain a holding if already owned.

Sell – Based on our outlook the stock is significantly overvalued. A weak company or sector outlook and a high degree of investment risk make it likely that the stock will underperform relative to the general market.

Dropping Coverage – Research coverage discontinued due to the acquisition of the company, termination of research services, non-payment for such services, diminished investor interest, or departure of the analyst.

Some notable Risks within the Microcap Market

Stocks in the Microcap segment of the market have many risks that are not as prevalent in Large-cap, Blue Chips or even Small-cap stocks. Often it is these risks that cause Microcap stocks to trade at discounts to their peers. The most common of these risks is liquidity risk, which is typically caused by small trading floats and very low trading volume which can lead to large spreads and high volatility in stock price. In addition, Microcaps tend to have significant company specific risks that contribute to lower valuations. Investors need to be aware of the higher probability of financial default and higher degree of financial distress inherent in the microcap segment of the market.

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