

Zynex Inc

(ZYXI-OTC)

ZYXI: Q2 2011 Results. Big Beat on Revenue. EPS In-Line.

Current Recommendation	Outperform
Prior Recommendation	N/A
Date of Last Change	01/06/2011
Current Price (08/03/11)	\$0.87
Target Price	\$1.40

OUTLOOK

Q2 revenue came in much better than our estimate although elevated SG&A continues to impact EPS growth. Operating expense control will to be the key for management to hit their 2011 EPS guidance. Management expects revenue growth to outpace that of SG&A in 2H 2011 which should benefit income and EPS.

Despite a variety of concerns, which are baked into our valuation, we think the shares trade on the cheap side.

We model EPS of \$0.07 in 2011. We are maintaining our Outperform rating and price target of \$1.40.

SUMMARY DATA

52-Week High	\$1.02		
52-Week Low	\$0.30		
One-Year Return (%)	56.14		
Beta	0.19		
Average Daily Volume (sh)	12,621		

Shares Outstanding (mil)	31		
Market Capitalization (\$mil)	\$27		
Short Interest Ratio (days)	N/A		
Institutional Ownership (%)	0		
Insider Ownership (%)	69		

Annual Cash Dividend	\$0.00		
Dividend Yield (%)	0.00		

5-Yr. Historical Growth Rates			
Sales (%)	69.3		
Earnings Per Share (%)	N/A		
Dividend (%)	N/A		

P/E using TTM EPS	87.0		
P/E using 2011 Estimate	12.4		
P/E using 2012 Estimate	7.9		

Zacks Rank	N/A		
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**Above Avg.,
Small-Blend
Med Products**

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ZACKS ESTIMATES**Revenue**
(in '000 of \$)

	Q1	Q2	Q3	Q4	Year
	(Mar)	(Jun)	(Sep)	(Dec)	(Dec)
2010	4,875 A	5,742 A	6,657 A	6,810 A	24,084 A
2011	6,633 A	8,395 A	8,878 E	9,296 E	33,201 E
2012					38,297 E
2013					44,362 E

Earnings per Share

	Q1	Q2	Q3	Q4	Year
	(Mar)	(Jun)	(Sep)	(Dec)	(Dec)
2010	\$0.00 A	\$0.00 A	\$0.01 A	\$0.00 A	\$0.01 A
2011	-\$0.00 A	\$0.02 A	\$0.02 E	\$0.03 E	\$0.07 E
2012					\$0.11 E
2013					\$0.15 E

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

WHAT'S NEW

Q2 2011 Financial Results: *Big Beat on the Top Line. Revenue Guidance Raised...*

Revenue

Zynex reported financial results for the second quarter ending June 30, 2011 on August 3, 2011. Revenue of \$8.4 million crushed our \$7.2 million estimate by almost 17% and represented growth of 46% y-o-y and 27% sequentially.

The \$8.4 million in total revenue consisted of \$2.5MM (+5%) in rental revenue and \$5.9 million (+75%) in product sales. Rental and product revenue both handily beat our estimates.

	<u>Actual</u> <u>Q2 2010</u>	<u>Actual</u> <u>Q2 2011</u>	<u>Y-o-Y</u> <u>Change</u>	<u>Zacks Est</u> <u>Q2 2011</u>	<u>Actual +/-</u> <u>Zacks est.</u>
Consumables	\$2,251	\$3,106	38.0%	\$2,866	8.4%
Equipment Sales	\$1,155	\$2,842	146.1%	\$2,368	20.0%
Total Product Sales	\$3,406	\$5,948	74.6%	\$5,234	13.6%
Rental Revenue	\$2,335	\$2,447	4.8%	\$1,975	23.9%
	\$5,741	\$8,395	46.2%	\$7,209	16.5%

Gross Margin

Gross margin was 79.4%, also better than our estimate of 76.7%. Similar to Q1 2011 results, gross margin benefitted from a combination of a higher than modeled percentage of sales coming from rentals (which carry a higher margin compared to product sales) along with product margins remaining stronger than we expected (77.6% A vs. 72.0% E).

Net Income / EPS

Net income and EPS were \$484k and \$0.02, very much in-line with our \$572k and \$0.02 estimates. Despite revenue coming in ~17% ahead of our estimate and gross margin significantly better than where we had it modeled, this did not translate into a beat on the bottom line. The reason was lower than expected leverage from SG&A expenses which came in at 68.7% of revenue compared to our 63.1% estimate.

Zynex continues to add sales reps which has directly benefitted revenue growth but is also largely the reason for growth in SG&A. It appears that the company is making headway with growing revenues faster than SG&A expenses, however, as SG&A as a percentage of revenue is down from 76.5% in the year-earlier period (i.e. - Q2 2010) as well as the 80.3% from Q1 2010 (although Q1 is typically relatively soft from a revenue standpoint due to insurance deductibles not yet being met). Management noted on the call that they expect revenue growth to outpace that of SG&A expenses for the remainder of the year. We continue expect to see more leverage from SG&A in future periods as newly hired sales reps become more productive/efficient. As we have noted in the past, it is critical that this happens in order to maximize EPS growth. While the company will continue to add sales personnel through at least the end of the current year, the dilution from less productive, newly hired reps should have less of a financial impact as the overall size of the sales force increases. Zynex also recently added headcount in billing/collections which should be scalable with growth in revenue.

Cash

Zynex exited Q2 with \$783k in cash and equivalents, up slightly from \$646k at the end of Q1. The increase in the cash balance was a result of additional draws on the credit line as cash from operations was an outflow of \$345k. Total balance on the credit line was \$3.2 million as of June 30, 2011. While the Q1 2011 10-Q (3/31/2011) notes that borrowing under the facility was capped at \$3.5 million and an EBITDA covenant was tripped, management indicated on the call that they have been working with their lender and do not anticipate any liquidity issues.

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. Zynex hopes to use data from the evaluation for the design of clinical trials for the device. Our model does not currently incorporate any revenue contribution from Zynex's new Monitoring and Diagnostics businesses.
- **Expanding Sales Force:** Management noted that they expect to continue to add more sales reps throughout the year as they expand their domestic footprint.
- **International Sales:** International sales 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.
- **NexWave Launch:** NexWave, Zynex's newest addition to their electrotherapy business, was expected to launch around mid-year 2011. Management noted on the call that they are still awaiting FDA clearance and hope to have the product on the market by current year-end.
- **Shareholder Lawsuit / Anthem:** In May 2010 Zynex filed a motion to dismiss the shareholder lawsuit (see our initiation report on ZYXI for background on the lawsuit). Zynex's Q1 2010 10-Q notes that on March 31, 2011 the U.S. District Court of Colorado entered an order denying Zynex's motion to dismiss the shareholder lawsuit.

Management noted on the Q2 call that there was nothing new to report 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:** Concurrent with the Q2 2011 results, management increased its revenue guidance for the full year 2011. Previous guidance of \$30MM - \$32MM was raised to \$32MM - \$34MM. EPS guidance was moved to \$0.08 - \$0.10, from \$0.08 - \$0.11 prior to Q2 results.

OUR 2011 OUTLOOK

We now look for Zynex to post revenue of \$33.2 million in 2011, up from \$29.6 million prior to Q2 results. Our EPS estimate remains at \$0.07 which assumes only modest sequential improvement in SG&A expense as a percentage of revenue. Our EPS estimate could prove conservative if management successfully trims SG&A expense at a faster rate than we model, gross margins continue to widen from the Q2 level or revenue comes in at the high end of management's guidance.

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 1.1x to value Zynex. This represents a 33% discount to the approximate 1.6x PE/G that the industry currently trades at. Our discount reflects the various concerns and risks that we have outlined in our initiation report on Zynex (2/14/2011). 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. 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.

We continue to value Zynex at \$1.40 per share.

FINANCIAL MODEL

Zynex Inc.

	2010 A	Q1A	Q2A	Q3E	Q4E	2011 E	2012 E	2013 E	2014 E
Rental revenue	\$8,532.5	\$2,448.0	\$2,447.0	\$2,170.0	\$2,120.0	\$9,185.0	\$7,600.0	\$7,230.0	\$7,065.0
<i>YOY Growth</i>	-19.0%	7.8%	4.8%	6.8%	11.9%	7.6%	-17.3%	-4.9%	-2.3%
Consumable sales	\$9,101.0	\$2,659.0	\$3,106.0	\$3,397.6	\$3,557.6	\$12,720.2	\$14,656.8	\$16,978.1	\$17,772.3
<i>YOY Growth</i>	44.7%	33.7%	38.0%	47.4%	39.2%	39.8%	15.2%	15.8%	4.7%
Equipment sales	\$6,450.6	\$1,526.0	\$2,842.0	\$3,310.0	\$3,618.0	\$11,296.0	\$16,040.0	\$20,154.0	\$21,600.0
<i>YOY Growth</i>	247.6%	148.0%	146.0%	42.7%	53.3%	75.1%	42.0%	25.6%	7.2%
Product sales revenue	\$15,551.6	\$4,185.0	\$5,948.0	\$6,707.6	\$7,175.6	\$24,016.2	\$30,696.8	\$37,132.1	\$39,372.3
<i>YOY Growth</i>	90.9%	60.7%	74.6%	45.0%	46.0%	54.4%	27.8%	21.0%	6.0%
Total Revenues	\$24,084.1	\$6,633.0	\$8,395.0	\$8,877.6	\$9,295.6	\$33,201.2	\$38,296.8	\$44,362.1	\$46,437.3
<i>YOY Growth</i>	28.9%	36.1%	46.2%	33.4%	36.5%	37.9%	15.3%	15.8%	4.7%
Rental COGS	\$802.1	\$334.0	\$392.0	\$260.4	\$233.2	\$1,219.6	\$988.0	\$939.9	\$918.5
<i>Rental margin</i>	90.6%	86.4%	84.0%	88.0%	89.0%	86.7%	87.0%	87.0%	87.0%
Sales COGS	\$4,399.8	\$1,110.0	\$1,335.0	\$1,529.3	\$1,650.4	\$5,624.7	\$7,520.7	\$9,097.4	\$9,646.2
<i>Sales margin</i>	71.7%	73.5%	77.6%	77.2%	77.0%	76.6%	75.5%	75.5%	75.5%
Cost of Revenues	\$5,201.9	\$1,444.0	\$1,727.0	\$1,789.7	\$1,883.6	\$6,844.3	\$8,508.7	\$10,037.3	\$10,564.7
Gross Income	\$18,882.1	\$5,189.0	\$6,668.0	\$7,087.9	\$7,412.0	\$26,356.8	\$29,788.1	\$34,324.8	\$35,872.6
<i>Gross Margin</i>	78.4%	78.2%	79.4%	79.8%	79.7%	79.4%	77.8%	77.4%	77.2%
SG&A	\$17,321.6	\$5,328.0	\$5,769.0	\$5,770.4	\$5,949.2	\$22,816.6	\$24,127.0	\$27,060.9	\$27,165.8
<i>% SG&A</i>	71.9%	80.3%	68.7%	65.0%	64.0%	68.7%	63.0%	61.0%	58.5%
Operating Income	\$1,560.5	(\$139.0)	\$899.0	\$1,317.4	\$1,462.8	\$3,540.2	\$5,661.1	\$7,264.0	\$8,706.8
<i>Operating Margin</i>	6.5%	-2.1%	10.7%	14.8%	15.7%	10.7%	14.8%	16.4%	18.7%
Interest income, net	(\$209.2)	(\$58.0)	(\$79.0)	(\$112.0)	(\$100.0)	(\$349.0)	\$25.0	\$40.0	\$80.0
Other income	(\$16.4)	\$0.0	\$2.0	\$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	(\$197.0)	\$822.0	\$1,205.4	\$1,362.8	\$3,191.2	\$5,686.1	\$7,304.0	\$8,786.8
Taxes	\$985.0	(\$87.0)	\$338.0	\$434.0	\$490.6	\$1,175.6	\$2,075.4	\$2,665.9	\$3,207.2
<i>Tax Rate</i>	73.8%	N/A	41.1%	36.0%	36.0%	36.8%	36.5%	36.5%	36.5%
Net Income	\$349.9	(\$110.0)	\$484.0	\$771.5	\$872.2	\$2,015.7	\$3,610.7	\$4,638.0	\$5,579.6
<i>YOY Growth</i>	-85.3%	N/A	1538.7%	109.6%	4490.6%	476.0%	79.1%	28.5%	20.3%
<i>Net Margin</i>	1.5%	-1.7%	5.8%	8.7%	9.4%	6.1%	9.4%	10.5%	12.0%
EPS	\$0.01	(\$0.00)	\$0.02	\$0.02	\$0.03	\$0.07	\$0.11	\$0.15	\$0.17
<i>YOY Growth</i>	85.5%	N/A	1521.6%	107.1%	4468.7%	471.4%	76.6%	26.8%	19.6%
Diluted Shares O/S	30,705	30,631	31,025	31,050	31,100	30,952	31,400	31,800	32,000

Source: Zacks Investment Research

Brian Marckx, CFA

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