

**ZAGG INC. (OTC BB: ZAGG)**

INDUSTRY: SPECIALTY RETAIL

DISCLOSURES: 1, 5, 10

**RATING: BUY**

**RISK: HIGH**

CLOSING PRICE 05/22/08	TRAILING P/E (TTM)	SHARES OUT (MILS.)	MARKET CAP (MILS.)	3-5 YEAR REV. GROWTH	PRICE TARGET
\$0.75	NM	18.9	\$14.2	N/A	\$2.50

ANNUAL DATA – DEC YEAR END			
	2007A	2008E	2009E
EPS	\$ (0.05)	\$(0.02)	N/A
P/E	N/M	N/M	N/A
REVENUE (MIL.)	\$5.1	\$13.2	N/A
P/S	2.8	1.1	N/A

EARNINGS					
	Q1	Q2	Q3	Q4	ANNUAL
2009E	N/A	N/A	N/A	N/A	N/A
2008E	\$ (0.01)	\$ (0.01)	\$(0.01)	\$ 0.01	\$ (0.02)
2007A	\$ (0.02)	\$ 0.00	\$ 0.00	\$(0.03)	\$(0.05)
2006A	\$ (0.01)	\$ 0.00	\$ 0.00	\$(0.02)	\$(0.02)

**ZAGG Enters Carphone Warehouse, Walmart.com; Beats Revenues Estimate**

Two big-box retailers have opened their doors to ZAGG in recent weeks:

- Carphone Warehouse (LSE: CPW – Not Rated), and
- Wal-Mart (NYSE: WMT – Not Rated).

**CPW, Europe’s Largest Cell Phone Retailer, Partners With Best Buy, Coming To U.S.**

Carphone Warehouse is the largest retailer of mobile phones in Europe, with 2,400 stores in 11 countries and £4 billion (US \$7.9 billion) in annual revenues. Half that revenue comes from providing telecoms, a business it has built up over the last five years. CPW is perceived as an innovator for offering not only gadgets and connection, but also independent advice and after-sales service. It is the exclusive U.K. distributor for the Apple (Nasdaq: AAPL – Not Rated) iPhone.

If you haven’t heard of the “Carphone Warehouse” brand, you soon will. CPW is poised on the brink of a sweeping expansion: on May 8, Best Buy Co. (NYSE: BBY – Not Rated) and CPW announced plans to enter into a joint venture. BBY will acquire 50% of CPW for £1.1 billion (US \$2.2 billion) in cash and open larger stores in Europe under the Best Buy brand. Starting in 2008, Carphone Warehouse also plans to enter the U.S. market, opening nearly 1,000 stores, some inside existing Best Buy stores and others standalones.

This opportunity is a considerable one. The companies estimate the size of the European market for consumer electronics at £89 billion (US \$176 billion). The iPhone launched in the U.K. in December and by mid-January, about 200,000 iPhones had been connected in the U.K.; this includes both devices sold at CPW and devices purchased directly from AAPL in its stores or on-line.

While this figure looks small in comparison with the 1.7 million iPhones shipped worldwide in 1Q08, the launch of APPL’s 3G iPhones in June is expected to boost sales. Many U.K. users have found the old 2G network slow for mobile Internet access. Also, AAPL is sticking to its target of 10 million iPhones sold worldwide in 2008.

CPW plans to test 3 ZAGG SKU's in 500 stores. The initial order will be about \$100,000, and CPW plans to order every two weeks. The long-term opportunity for ZAGG, then, is sizable, but in the short term CPW is sold out of the old iPhones in anticipation of the launch of 3G. ZAGG plans to ship by mid-June. Accordingly, we expect the lift to ZAGG's sales to be visible only in 3Q08.

**Definition**

3G is the third generation of mobile phone standards and technology, superseding 2G, the second generation. 3G networks have improved spectral efficiency and greater network capacity. They can transmit wide-area wireless voice calls, video calls, and broadband wireless data to mobile phones.

**InvisibleSHIELD Arrives At Wal-Mart**

As a first step, five ZAGG SKU's are available for purchase on the web site Walmart.com: full-body shields for the iPhone and the Microsoft (Nasdaq: MSFT – Not Rated) Zune, and three shields for various iPods. With 21.7 million unique visitors in March, 2008, according to Nielsen Online, Walmart.com is the fifth most heavily trafficked online retail shopping site.

The test may last one to three months. If successful, the product will then begin to move into WMT stores, of which there are over 4,000 in the U.S. (including Sam's Club warehouses) and 2,800 more internationally. WMT is the world's largest retailer, with \$375 billion in sales last year.

Like just about all WMT vendors, ZAGG has conceded on margin. The iPhone full-body shield will be sold for \$19.88 plus shipping and handling at Walmart.com, while ZAGG sells it on its own web site for \$24.95 plus shipping and handling. If the margin on the Web sales is 70%, then the margin on the WMT sales will be closer to 62%. Also, Walmart.com, not ZAGG, will benefit from the margin on the shipping and handling.

With WMT as a bellwether, interest from other retailers should increase.

**Building Out And Upgrading Sales Channels**

ZAGG's own web site, ZAGG.com, has been integrated with the old InvisibleSHIELD.com and updated. Traffic has been driven to it by search engine optimization strategies, viral marketing strategies, and pay-per-click advertising. Sales growth from this web site, which has the highest margins of all ZAGG's sales channels, has continued. However, we expect the rate of growth to slow when customers can also find ZAGG products on Walmart.com and on CPW's Web site.

ZAGG's penetration of APPL resellers is high: 85% of Mac resellers are already selling ZAGG products.

One driver of growth, iPhone sales, is very positive. Having underestimated gray-market demand in emerging markets, as we reported several months ago, AAPL is now hard-pressed to supply enough iPhones to meet demand.

“Significant progress” has been made with the Brighton Partners branding opportunity, but no further details are available except that the superhero character will be called “Zagg” and that he will support a group of superheroes called the Legion of Five, using high-tech gadgets. The *Hollywood Reporter* mentioned the project in April, and said that it includes a feature-length computer-generated-graphic film. We believe that the concept is being pitched to Walt Disney Co. (NYSE: DIS – Not Rated), where Stan Lee has done other projects.

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## 1Q08 Financial Results

As previously reported, ZAGG reported net sales for 1Q08 of \$2.8 million, a nearly fourfold increase from \$0.8 million in 1Q07 and a sequential increase of 35% from \$2.1 in net sales in 4Q07.

Net loss was (\$0.01) per share in the first quarter of 2008 compared to (\$0.02) per share in 1Q07. We had projected profitability this quarter, with \$0.01 in profit on \$1.8 million of revenues. We underestimated SG&A and marketing expense as the Invisible Shield ramped up international sales.

ZAGG's balance sheet remains healthy. Working capital is over \$2.2 million, and ZAGG has no long-term debt.

At March 31, 2008, ZAGG had a cash balance of \$1.2 million, down from \$2.1 million at December 31, 2007. \$450,000 of this change in cash reflects the short-term loan to Brighton Partners. The major operating expenses during the quarter were advertising (\$0.8 million) and SG&A (\$1.5 million). The other significant use of cash was a \$0.2 million buildup of inventories. These all are consistent with the picture of a rapidly growing company building a brand and preparing for higher sales.

## Valuation and Recommendation

Management reaffirmed its targets for 2008: to increase revenues to \$10 million and become profitable by the end of the year. President and CEO Robert G. Pedersen II expressed confidence that the company was on track toward this goal.

We think the \$10 million target may be modest if growth takes off in the big box stores, and what's more, if the big boxes take a big bite out of margin, ZAGG may need more than \$10 million to break even. Based on ZAGG's strong performance in 1Q08, we raise our 2008 revenues target to \$13 million, implying 5% sequential growth in each of the next two quarters and a 35% sequential jump in 4Q08, based on holiday sales and assuming ramp-up in the big boxes. This is conservative by comparison to ZAGG's growth in past quarters.

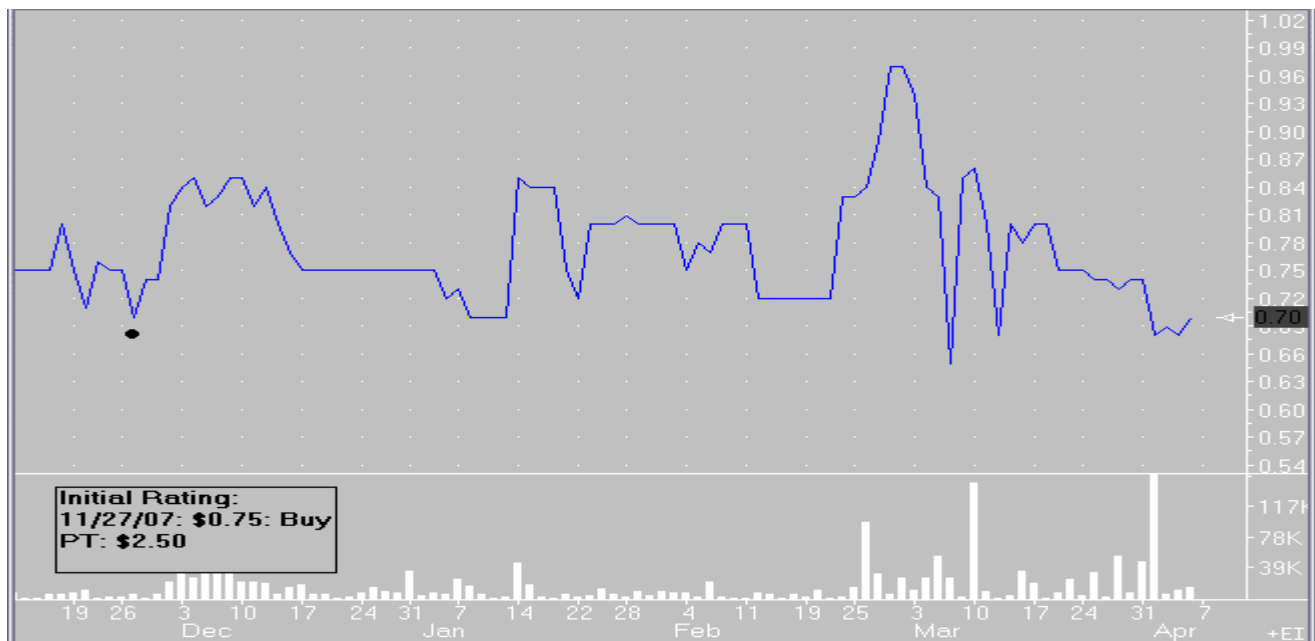
We project profitability in 4Q08. For the year 2008, we now project a loss of \$(0.02) rather than a profit. This reflects a higher contribution from lower-margin sales at the WMT Web site and potential margin pressure on sales through ZAGG's own Web site. We've also corrected for our underestimation of SG&A and marketing expense this quarter.

Potential upside could come from favorable currency effects when sales from Europe become significant.

Bearing in mind the small market cap of the business, unease in the market over all stocks -- particularly small-caps -- and the high concentration of management ownership (approximately 39% of the outstanding shares of common stock is owned and controlled by ZAGG's Chief Executive Officer and Chief Financial Officer), we believe the shares are attractive for investors looking for long-term capital appreciation and who have tolerance for higher-than-average risk.

We maintain our BUY rating and our price target of \$2.50.

ZAGG designs, manufactures, and distributes protective coverings for consumer electronic and hand-held devices under the brand name invisibleSHIELD. The patent-pending invisibleSHIELD is a protective, high-tech film covering, designed for iPods, laptops, cell phones, digital cameras, PDAs, watch faces, GPS systems, gaming devices, and other items. The invisibleSHIELD is made from a protective, film-like covering that was developed originally to protect the leading edges of rotary blades of military helicopters. The film also permits touch sensitivity, meaning it can be used on devices that have a touch-screen interface. The invisibleSHIELD film material is highly reliable and durable, since it was originally developed for use in a high friction, high velocity, aerospace context. Currently, ZAGG offers over 2,000 precision pre-cut designs with a lifetime replacement warranty through online channels, resellers, college bookstores, Mac Stores and mall kiosks.



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	QI'07		QII'07		QIII'07		QIV'07		Year, 07		QI'08		QII'08		QIII'08		QIV'08		Year, 08	
	3/31/2007	Δy/y	6/30/2007	Δy/y	9/30/2007	Δy/y	12/31/2007	Δy/y	12/31/2007	Δy/y	3/31/2008	Δy/y	6/30/2008	Δy/y	9/30/2008	Δy/y	12/31/2008	Δy/y	12/31/2008	Δy/y
Net Sales	793	51%	804	26%	1,437	76%	2,101	163%	5,136	85%	2,845	259%	2,988	272%	3,137	118%	4,235	102%	13,205	157%
Cost of Sales	187	15%	204	11%	299	55%	651	242%	1,341	84%	778	316%	896	339%	972	225%	1,313	102%	3,959	195%
Gross Profit	606	67%	600	32%	1,138	83%	1,450	138%	3,795	85%	2,068	241%	2,091	249%	2,165	90%	2,922	101%	9,246	144%
Expenses:																				
S, G & A	706	117%	555	58%	861	79%	1,076	38%	3,243	67%	1,505	113%	1,524	175%	1,525	77%	1,601	49%	6,154	90%
Advertising & Marketing	161	83%	79	7%	228	110%	477	376%	945	155%	790	391%	828	948%	869	282%	1,173	146%	3,660	287%
(Comp Expense due to stock*)	-	na	-	na	800	nm	45	nm	845	nm	-	-	-	-	-	-	-	-	-	-
Total Expenses	867	109%	634	49%	1,088	85%	1,599	81%	4,188	81%	2,295	165%	2,351	271%	2,394	120%	2,774	74%	9,814	134%
Income from operations	(261)	402%	(34)	-213%	50	45%	(993)	262%	(1,238)	373%	(227)	-13%	(260)	664%	(229)	-558%	148	-115%	(568)	nm
Total other income (expense)	(6)		(16)		17		34		29		46		7		10		12		75	
Net Income before taxes	(267)		(50)		67		(958)		(1,208)		(181)		(253)		(219)		160		(493)	
Income tax (expense) benefit	(3)		-		(0)		452		449		67		86		74		(56)		171	
Net Income	(270)		(50)		67		(507)		(760)		(114)		(167)		(145)		104		(321)	nm
Earnings (loss) per share	\$ (0.02)	nm	\$ (0.00)	nm	\$ 0.00	nm	\$ (0.03)	nm	\$ (0.05)	nm	\$ (0.01)	nm	\$ (0.01)	nm	\$ (0.01)	nm	\$ 0.01		\$ (0.02)	nm
Weighted shares outstanding	12,696		15,168		17,631		18,150		16,139		18,864		18,958		19,053		19,148		19,006	
Sequential revenues growth											35.4%		5%		5%		35%			
Gross margin	76.42%		74.63%		79.20%		69.03%		73.89%		72.67%		70.0%		69.0%		69.0%		67.25%	
Operation Mrgn	-32.91%		-4.23%		3.48%		-47.26%		-24.11%		-7.99%		-8.7%		-7.3%		3.5%		2.53%	
SG&A as % of sales	89.03%		69.03%		59.88%		51.22%		63.15%		52.89%		51.0%		48.6%		37.8%		46.60%	
Ad/Mrkt as %	20.30%		9.83%		15.84%		22.72%		18.40%		27.77%		27.7%		27.7%		27.7%		15.44%	
Tax Rate	1%		0%		0%		35.00%		-37%		34%		34.0%		34.0%		35.0%		35%	
Net Income Mrgn	-34.01%		-6.22%		4.63%		-24.12%		-14.80%		-4.01%		-5.6%		-4.6%		2.5%		-2.43%	

#### DISCLOSURES:

This report has been commissioned by Zagg, Inc. (the Company) as part of an on-going research and awareness program contracted between Catalyst Financial Resources, LLC (CFR), and the Company. CFR has been paid or promised payment for the production and editorial content of this report. The Company is paying CFR \$7,500 per month for 12 months and warrants for services rendered. However, the opinions, forecasts and price targets are based on our examination of company fundamentals, conversations with management, independent analysis of markets, economic conditions, and other publicly available information.

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<b>Accumulate</b>	Purchase of the stock is recommended for above average appreciation over the next 12 to 18 months, but the buyer may have an opportunity to acquire the stock within a 10% trading range.
<b>Hold</b>	Holding the stock is recommended because the share price has moved above the specific "Buy" range and, therefore, appreciation potential is less than or equal to the market.
<b>Sell</b>	The stock has reached the target price objective and/or conditions have changed sufficiently to alter the outlook for the stock.

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<b>Moderate</b>	The security has about the same volatility as the market and/or the company carries a level of leverage in line with its peer group.
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