



Covering the Undiscovered

ZAGG
(ZAGG)

ZAGG (ZAGG): How the Hell Did We Miss This?

<http://www.invisibleshield.com>

Current Price: \$.80

Price Target: \$2.25

Written and researched by Novid Rassouli

Edited and approved by Chris Lahiji

Intro

Many times when we find a company that has a fairly "hip" product, the valuation discount that we look for is non-existent. Investors pay huge premiums for growth due to the fact that everybody bandwagons without taking a moment to reflect on the nose bleed premiums they are paying for the next hot product. Fortunately for us, this is not the case with ZAGG, given that it is still fairly undiscovered.

ZAGG stands for Zealous About Great Gadgets. It was the very last company to present at ROTH's three-day conference in Dana Point. Over 400 companies presented. Attendance was very thin this late in the conference and only the diehards were still left listening to presentations.

Business Summary

ZAGG has a unique product coupled with a cheap valuation when factoring in future growth. Its flagship product is called the invisibleSHIELD, which is made from a polyurethane film. This very thin, pliable, flexible and durable clear plastic adheres to the surface and shape of the object it is applied to. ZAGG designs, manufactures, and distributes this invisible and seemingly invincible protective film for handheld gadgets. It currently offers over 2,000 precision pre-cut designs with a lifetime replacement warranty. Its distribution channels include their website, resellers, college bookstores, and mall kiosks. ZAGG has been primarily targeting cell phones as well as Apple products such as the iPod, iPhone, etc.

I am sure you are wondering exactly what I mean by "seemingly invincible protective film." If you go to invisibleshield.com you can see a video testing the strength of the film. This material was originally developed to protect military helicopters. The film would coat the leading edges of rotary blades to protect them from rocks and other debris that could chip the blades.

During his presentation at ROTH, Mr. Robert Pedersen II, the President and Chief Executive Officer of ZAGG, did a demonstration. He asked for a volunteer from the audience to assist him. Chris Lahiji was front and center in an instant. Mr. Pedersen grabbed one end of the protective film and asked Chris to hold the other end. He then attempted to break through the film by driving a pen through it. Unfortunately for the pen, the film is much stronger than it looks and the pen broke in half.

The beauty of this protective cover is that it is not only scratch resistant, but it is also precut to the exact design of your product so that all ports are left open. For instance, instead of taking your iPod out of the bulky case to charge it, you can just plug it straight into the charger as if there was no protective casing at all. Again, this protective cover is not limited to Apple products, you can protect laptops, PDAs, watch faces, gaming devices, digital cameras, mp3 players, almost anything you can think of that might need protecting. Mr. Pedersen had an iPhone as well as the new MacBook Air completely protected. He lifted them in the air and ran his keys across the products to demonstrate the effectiveness of the invisibleSHIELD. After he was done the products were still as immaculate as they were before the onslaught of his car key. The film also permits touch sensitivity, allowing you to cover the entire iPhone screen or laptop touch pad without interfering with their usage.

As far as protection is concerned, the company has a patent pending on the process of wrapping an entire gadget body in a transparent, durable and semi-permanent film. ZAGG also custom designs each cut-out for the film and currently has unique designs for over 2000 devices. All of the cut-out designs are developed internally and owned exclusively by the company.

Financials

Q3 2007 revenues increased 76% to \$1,437,408, up from \$816,022 in Q3 2006. Nine-month revenues increased 53% to \$3,034,714 compared to \$1,978,533 for the same period one year ago.

Q3 2007 net loss was \$733,428 compared to a gain of \$15,556 for Q3 2006. It should be noted that there was an \$800,000 item in regards to compensation expense (stock issuance). These are non-operating one time charges and, excluding this charge, ZAGG would have earned a net income of \$66,572, up from the \$15,556 earned in Q3 2006. Nine-month net loss was \$1,052,293 compared to a gain of \$16,717 for the same period a year prior. Again this figure includes the stock compensation as well as many of the added expenses of operating as a public company. Its expenses have increased due to the fact that management is positioning the company for aggressive growth in the near future.

When asked about future profitability, Mr. Pedersen stated that ZAGG would be profitable during all four quarters of 2008. This is a huge step in the right direction for

ZAGG. As long as it keeps costs under control and keeps growing revenues at the current pace, its bottom line will be strong in the coming quarters.

So far the company has been able to maintain gross margins of 75 to 80% and management is confident that even with the extensive expansion they have planned, margins will remain strong.

As far as working capital is concerned, they currently have \$2.5 million with a current ratio of 5 to 1. It is well positioned for building business far into the future.

Insiders own nearly 40% of the company. Mr. Pedersen owns the bulk of this percentage, holding 6,600,000 shares. The amount of shares he owns leaves investors feeling very confident in his future decisions. I also spoke with him at ROTH and his passion to grow sales and build the business was clearly displayed in his demeanor. He even explained how the current building they are working on in Salt Lake City, Utah is bursting at the seams given how much he is packing in. He said ZAGG will expand shortly but that he wants to continue to act in a cost conscious manner.

Catalysts

People go through phones these days as if they are disposable razors. I am talking blades, not the garbage phones Motorola makes. On top of that it seems like a new phone is introduced every week. Generally people who are willing to spend \$200-\$400 will invest \$25 to make sure their product remains pristine. ZAGG continues to configure the invisibleSHIELD product for use in newly developed consumer devices. ZAGG has a huge advantage in the market for new gadgets. Manufacturers of competing device cases need months to design and manufacture customized accessories for new devices. The invisibleSHIELD can be quickly configured and packaged as they enter the market, enabling consumers to purchase the product ahead of competing accessories for new electronic devices. I remember when I purchased the first generation iPod mini, I had to wait months to get a case to protect it. The new mini was known for being incredibly easy to scratch. I was constantly searching online to see if I could purchase it from a web based accessory company, unfortunately to no avail. This problem is solved through the speed in which ZAGG can get the invisibleSHIELD to the consumer.

ZAGG now has a following of over half a million customers who have purchased the invisibleSHIELD in a little over two years. ZAGG is starting to break into high margin accessory products. All of these satisfied customers now have confidence in the brand name and seeing the shield on other accessories will instill even more confidence in their purchases. Offering new products to already satisfied customers is a simple way of generating a healthy flow of high margin revenue that will fall to the bottom line.

Let me give you an idea of exactly how much selling power ZAGG has now that its name has a strong following. It brought out a new product called the Dash-Pad, made of a

special anti-slip material that sticks to the dashboard of your car without leaving a sticky residue. There are no magnets or adhesives. It contours to any dashboard and you can stick your cell phone or iPod to it so they will stay put while you are driving. When ZAGG brought this product onto QVC, they sold 3,000 units going for \$9.95 per unit in roughly five minutes, a staggering statistic. It constantly rolls out more accessories and will continue to do so. Accessories include ear buds, car chargers, and the RockStic, a portable speaker system designed to play songs from your mp3 player.

My friends who currently use ZAGG's invisibleSHIELD are gadget-philes who are always in the loop on anything having to do with electronics. From the newest products to the best protection on the market for their shiny new expensive electronic toys, they always seem to be informed. It's great that these "geeks", if I may, have become such big fans of the invisibleSHIELD, but Zagg needs to make the average consumer aware of its products.

This is where the wild card comes into play. ZAGG is currently in talks with big box retailers to gain a strong retail presence for the invisibleSHIELD. Up to this point, a high percentage of ZAGG's sales have been transacted online. The average customer picks up his electronics at a retail location as well as whatever protective case the retail location is selling and goes on his way, never even knowing that the invisibleSHIELD exists. This should all change shortly.

2008 will be a game-changing year for ZAGG with its introduction to the retail space. The growth spurt that would result from a strong retail presence in an Apple or Fry's would be enormous. It would give the product so much credibility and advertising to be on the shelves in Apple retail stores. We have seen how well retail stores have done for Apple thus far. Its entire philosophy stems from simplistic, sleek, cutting edge products. Products that exude innovation not only in functionality, but in form factor as well. Apple has had problems in the past with its products being vulnerable to scratches. As I mentioned earlier the first generation iPod mini had such a fragile face that after a couple months of use, it looked as though you had dragged it on the ground by the cord for a few miles. (http://blog.ted.com/images/ipodnano1744275_2.jpg) The invisibleSHIELD is quite a complimentary product for Apple. It enables customers to protect their products and keep them looking immaculate, without having to compromise the design, form or functionality of the product.

70% of ZAGG's sales are generated through its website. Its reseller sales network produces roughly 18%. Its mall cart retail initiative only comprises 12%. 2007 year-end revenues will be roughly \$4.5 million. Overall, this 12% retail presence is nominally a very small number, contributing only \$500,000 to the top line. As they move into retail locations and build strong alliances, this 12% number should balloon upward, putting revenues on track to double year over year.

I cannot stress enough how large this market is. A market that we believe is underserved given that most current options for protection are bulky, detracting from the elegance of the electronic devices. If they are not too bulky they generally don't provide enough

protection, leaving function buttons uncovered such as the iPod's wheel, which leaves the door open for future damage. The four largest areas that ZAGG can capitalize relate to the sales of: iPods, cell phones, digital cameras, and gaming systems. Here is a quote from their most recent 10K:

"According to industry sources, over 39,500,000 iPods were sold in Apple Corporation's most recent fiscal year, and over 21,000,000 were sold in the first quarter of its subsequent fiscal year. Over one billion cell phones were sold worldwide in 2006. Over 26,000,000 units of digital cameras were sold in 2005. Sony's PSP sold over 20,000,000 units as of August 2006 and Nintendo's DS Lite sold over 21,000,000 units during the same period."

If Zagg was to capture only 1% of the 39,500,000 iPods Apple sold, that would mean 395,000 iPods utilizing the invisibleSHIELD. If we take the \$24.95 for a full body coverage invisibleSHIELD, these iPods would generate roughly \$10 million in sales for ZAGG. More than doubling what they are on course to do for 2007. Again this does not include cell phones (immensely large market), digital cameras, and gaming. Hopefully this conveys exactly how much untapped growth potential remains on the table for ZAGG to capture.

As I mentioned earlier, the competitors who manufacture bulky cases take months to get their products to the market and have many other flaws that I have mentioned throughout this report when compared to the invisibleSHIELD. Other competitors include Best Skins Ever as well as NLU's BodyGuardz. Best Skins Ever offers a lower price point on their products. They do not offer the squeegee or soapy water to apply the shield. They also do not offer application services. NLU provides a thicker shield and it was late getting its products to the market. Another point of interest for NLU is that if ZAGG's pending patent is granted, NLU may have to withdraw its product. Again it should be noted that these companies are small and privately held. If investors are looking to play the protective film market, they will need to do it through ZAGG.

Conclusion

Mr. Pedersen could not stress his confidence in ZAGG's unique products enough. He urged everybody to look over the story and to not sit back idly and watch. Once the presentation was complete he gave his closing remarks and essentially said that the business will take off and anybody who does not take action now will look back and say, "I really should have listened to what that Robert Pedersen was saying." I couldn't agree with him more. After looking at the company in depth, the growth opportunity looks too good to pass up. I am confident that Mr. Pedersen will be able to lead ZAGG into the retail push forward, making them a household name and the "go to" protection product for all consumer electronics. Finally, a special thanks to Mr. Marc Robins for showing ZAGG to us. Without him, we would still be using saran wrap for phone protection.

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