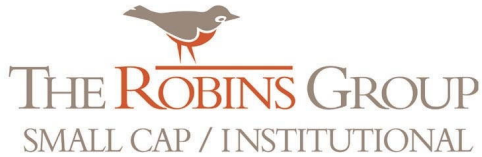


AUGUST 19, 2009



The Research Early Bird

UPDATE REPORT

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

INDUSTRY: SPECIALTY RETAIL

**RATING: STRONG BUY**

**RISK: HIGH**

**DISCLOSURES: 5A, 6A, 6D, 9**

SEE LAST PAGE FOR IMPORTANT DISCLOSURES

CLOSING PRICE 08/18/09	TRAILING P/E (TTM)	SHARES OUT (MILS.)	MARKET CAP (MILS.)	3-5 YEAR REV. GROWTH	PRICE TARGET
\$5.48	37.5	22.6	\$123.8	N/A	\$9.00

ANNUAL DATA – DEC YEAR END			
	2008A	2009E	2010E
EPS	\$0.11	\$ 0.25	\$ 0.50
P/E	49.8	21.9	11.0
REVENUE (MIL.)	\$19.8	\$43.9	\$83.7
P/S	6.3	2.8	1.5

EARNINGS					
	Q1	Q2	Q3	Q4	ANNUAL
2010E	N/A	N/A	N/A	N/A	\$ 0.50
2009E	\$ 0.05	\$ 0.05	\$ 0.06	\$ 0.09	\$ 0.25
2008A	\$ (0.01)	\$ 0.01	\$ 0.05	\$ 0.06	\$ 0.11
2007A	\$ (0.02)	\$ 0.00	\$ 0.00	\$ (0.03)	\$ (0.05)

**HIGH QUALITY, HIGH IMAGE, HIGH PRICE OR THE CALL THAT SHOULDN'T HAVE HAPPENED**

**Too Much for One Call:** The one good thing we can say about ZAGG's second quarter report and conference call is that it's completed, reported and the conference call has ended. For concluding such a great operating period, it was a really poor dénouement. We now can look forward to the future and the best news is that ZAGG's operating performance (the evidence, if you will) for the second quarter should leave no doubt in investors' minds that the SLC mouse continues to roar with growth (even in an economic climate that has neutered many other Specialty Retailers or SmartPhone industry adjunct players); that management provided those who listened to the fundamental layers of new opportunities that were added this past period plenty of excitement for the future; and lastly, management still has to work on their overall delivery and formulation of guidance. There is nothing new in this last point.

We are maintaining our "Strong Buy" rating. The emotional spill-over of Thursday's overly enthusiastic and somewhat misguided presentation will be overshadowed by the fundamental strength in the business. Although guidance indicates that the remainder of 2009's operating trajectory appears to be on a flat course, like last year management will add more and more color to the reality of the situation as results come in and opportunities turn into realities. New observers are unaware that the Company improved their guidance three times more during the remainder of the operating year and before QIV2008 and Year-end results were reported. I can see the same modus operandi at play for 2009.

In reviewing the opportunities mentioned in the call that should benefit the future and add to growth, there are enumerable avenues that should keep the momentum rolling. Here are the major bullet points laid-out, then we will dissect each in far more detail later on:

- Despite the fumbled "forecast," revenues continued on a tear during the second quarter with ZAGG's top-line rising 236% to \$9.215 million. After-tax profits popped almost 6-times to \$1.194 with after-tax, fully-diluted EPS equaling \$0.05, increasing 5-times from year-ago levels.
- Sales were bolstered by continued support from Best Buy Stores which continue to champion ZAGG's InvisibleSHIELD product for cellphones but is now considering adding to its "Mobile Stores" more skus that are other SmartPhone accessories as well.

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- In addition, ZAGG was able to add both Target Stores, which launched the InvisibleSHIELD with an “end-cap” display, and 300 MediaMart stores in Germany.
- During the call, Mr. Shu Ueyama was introduced to the audience as the newest member to the ZAGG board of directors. He brings with him tremendous branding knowledge and success in the mobile electronics arena as well as the beginning of a JV for the introduction and sale of ZAGG’s products into Japan. We believe this is a very important step for expanding the Company’s reach into what is the second largest consumer electronics market just after the USA.
- The Company announced that it had added a third, major US based retailer—RadioShack. This new channel will start retailing the InvisibleSHIELD for a MP3 player and two SmartPhones though its 4,000 corporate stores. Like Best Buy, this retailer holds considerable promise because of its substantial distribution reach and, like BBY, can grow its sku count to a multiple of the current offering.
- There was an array of new products announced on the call—many of which are just brand extension accessories that may add at best 5% to 10% to total sales. The concept of ZAGG.skins was also introduced. This is not only a line extension but a way to market personalized, higher-margined InvisibleSHIELDS to teens/brand fanatics or customized InvisibleSHIELDS into the corporate market with Company logos. It really represents a whole new use and approach to the marketplace for the InvisibleSHIELD.
- There was further explanation and an update on AppSpace.com

**Increasing Opportunities Galore:** When one tries to dissect the quarterly call and project the impact on future quarters, it’s as if there is almost too much to discern, let alone tabulate into the model to help project the growing numbers. Starting with those factors that should have the most immediate impact, let’s start with the growing factors that are adding to sales.....

1. SmartPhone sales are still just ripping the “cover-off-the-ball,” and those of us buying one (touch-screen, app-playing and all) we are wanting to be a little more careful with the device and protect its appearance. Our understanding is that as good as it is for Apple’s iPhone, the Palm Pre is doing almost as well...at least according to the sales numbers ZAGG sees from BBY. That said, there are at least 20 more models coming out between now and the Christmas cut-off (think mid-October) so that the shelves can be loaded with the latest gadget. Anyway you cut it; this is just fantastic for ZAGG! More gadgets, more sales of the InvisibleSHIELD.
2. BestBuy can’t get enough of ZAGG and InvisibleSHIELD. REMEMBER, they started with only three skus in May, 2008 (just like RadioShack is now). They are at 35 skus, and appear to be going to 50 to 60 InvisibleSHIELD skus in the near future. When discussing the opportunity with ZAGG management the impression is that BestBuy is even considering adding other ZAGG accessory skus and broadening the offering beyond the skins. We know that some of the “scare” provided in the call was that a late quarter sale, between \$500,000 and \$1,000,000 goosed the last period’s top-line and may serve as channel fill as well as detract from QIII’09. (But, as you read further, there is plenty to add this quarter.) MORE IMPORTANTLY regarding BestBuy, it has created a ZAGG branded “store front” in its “Store within a Store” to promote the ZAGG brand and line. Think about it - Apple and ZAGG have their own corporate identity-branded areas inside a BBY store (ZAGG and Apple are on par with one-another and that should shock you enough.) The point here is that ZAGG’s products are becoming very important to the whole “mobile store” concept. AND, BBY has decided to add an installation counter for the InvisibleSHIELD,

just like Christmas package wrapping service, so that buyers stay longer in the store, are more satisfied with the purchase, spend more money, etc.

3. New retail opportunities are abounding. Target stores found the InvisibleSHIELD to be as successful as they hoped and are moving the InvisibleSHIELD skus from an end-cap display to the plan-o-gram pegs on the aisles. Carphone Warehouse is finally working to move the InvisibleSHIELD skus from its successful sales base in the UK to Europe - this has the potential of adding another 1,400 stores. We mentioned Media Mart—purported to be the largest consumer electronics retailer in Europe—in the above paragraphs and the 300 stores in Germany that carry the InvisibleSHIELD. There are another 1,700 stores throughout the remainder of Europe that can also carry the product lending to further substantial growth. That brings us to RadioShack! As we also noted above, BestBuy started just over a year-ago with only three skus and a real disbelief that InvisibleSHIELD would ever make any difference in their stores. They were proven wrong and it is now a major sales accessory item. With RadioShack, the upper management can always be pointed to BBY as the example of success but the store salespeople and managers need to be informed as to how it can help them add incremental margin. This September, there is in Dallas, ZAGG's first meet-'n-greet summit with store reps and managers: it is a forum where ZAGG will be able to have a BBY display and illustrate what they are doing for the other retailers and show the RadioShack salespeople, which historically have been known for helping with hands-on assistance, why the InvisibleSHIELD can be beneficial to consumers and add incremental sales and margin to the stores. It is the same building process that the ZAGG went through with BBY. The hope is that the next level of adoption will be accepted before Christmas ordering occurs.
4. The mall cart operation, which many observers write-off as a vestigial undertaking, still generates 7% of sales despite all the other activities that goes on within ZAGG and continues to show remarkable acceptance and growth. During the call, it was announced that ZAGG now has 67 Carts in operation and 78 signed agreements (this number is the same as the one I heard a couple of weeks ago.) They are certainly going to meet their goal (possibly exceed it) of having 80 units in the field by the holiday season.

### Coming Opportunities:

1. **Japan ties and BOD member:** What more can you say when you have signed one of the best known consumer electronics businessmen in all of Japan, and the outside world, to your board of directors. It also says something about having a joint venture with him as well. I am venturing a guess(!!!) that the shares sold by Pedersen (the 800,000 at a premium and the warrants) were to Ueyama to initiate the JV as well. This is a pure guess, but to give the businessman not only incentive on the local front but upside on the share price in front of all the growth that ZAGG might experience from real progress in Japan (a market that could match the USA), it certainly makes sense to focus and inspire the new teammate to produce. I think very good things are coming from this new arrangement.
2. **New products** mean a number of things for ZAGG. Probably the biggest disappointment I had in the call was the explanation and description of the new releases. Yes, there are going to be some advances and new colors made with the *Z.buds*, but then the Company is re-releasing the "Rockstick" (a portable speaker system for MP3 players) in its second generation form as the *Zrock* which is great for college dorm rooms, etc. The *Zrock* produces great sound from any iPod; for the iPhone it will act as a speakerphone while charging it - the perfect desktop station for your iPhone. Other new devices and accessories that ZAGG is also releasing later this year includes the *Z.spark*, a power pack charging unit

for devices; and *Z.foam* and *Z.wipes* are for the more healthy minded—they are antimicrobial products that kill germs so that they aren't passed from one-another or to remove make-up from mobile phones, respectively. The Company is also beginning to sell a ZAGG line of branded “rags and digs” clothing and personal accessories. As we mentioned above, these products are brand name extensions. Of course it is hoped that something will catch fire and take-off with kids as a fashion statement or hot item. In reality, management is really hoping that they generate a few percentage points of incremental sales and certainly better margin contribution to gross.

3. **ZaggSkins™** should be a real winner. Here the Company is taking its InvisibleSHIELD and adding printed designs, logos or brands to the SHIELD so that whatever device now sports the InvisibleSHIELD can be personalized to its owners tastes. As kids (many, many years ago), we would use ink and *Elmers* glue to make designs on our cloth-bound, 3-ring, notebooks and high school *PeeChees*. Today with the hard plastic covers, it's difficult to personalize laptops, SmartPhones, Games, etc. without damaging the case or operating hardware. With ZaggSkins, kids can buy their own designs, or have pre-made brands printed on the InvisibleSHIELDS that they purchase and install right on their devices.

This is absolutely a clever extension for the Company since it should not only extend their market beyond their customer base but even entice many in their focus demographic who typically don't buy InvisibleSHIELDS. For example, it's perfect for youngsters between ten (possibly the lower limit to cellphone users) and sixteen-year-olds... (kid's that don't care as much for taking care of their possessions.) Additionally, it targets the corporate market and a branding opportunity—a new untapped arena—where so many other branding opportunities to bring top-of-mind awareness have become outrageously expensive. Just think, if you are a consulting team entering a new or existing client account, you now can unveil “Schmedly” branded laptops, Blackberry's, etc. not HP, Dell or RIMM devices. Even the super thrifty, who might not want to spend that extra \$20 bucks for an InvisibleSHIELD just might buy it for a gift or gag now.

The new ZAGGskins are to be introduced to the Market by the fourth quarter of this year. Product unveiling and introductions have already been tested with many of ZAGG's BigBox partners and the feedback was enthusiastic. Many of the simple, more common designs will be available via the major retailers and the created designs, comic characters, sports logos, brands, etc., will have to be ordered and fulfilled via the internet. Pricing is suggested to be similar to that of the InvisibleSHIELD but because of the internet orientation of much of the volume, it appears that the Company's margin may actually be boosted by ZAGGskin's introduction. One last point, since the new “skin” is not totally clear and bubbles won't form as easily underneath the film, it can be dry applied meaning easier application.

4. **AppSpace.com** is probably the most underestimated and greatly discounted new asset that ZAGG has under development. Observers all compare AppSpace to Apple's iTunes site and believe that it will compete directly with the “Granddaddy” blockbuster, yet they forget that one of the major reasons that all the other SmartPhone are getting into the business is to also compete in the app space as well.

**AppSpace** exists to benefit from the “enemies” and voids that Apple and the iTunes site have made: There are plenty of non-iPhone SmartPhones that can use Apps and a directory of new Apps as they come available. There are enumerable app developers that are tired of being disregarded for their work. Tie that to a search engine mechanism that is more and more helpful at suggesting new apps that may be desirable and one of the largest databases of new SmartPhone owners, the Company should have something more than just another pipedream. There is one more factor that should add to the Site's

success, ZAGG is working to both make AppSpace a retail site that generates revenues and one that can point customers to the ZAGG website.

By fourth quarter, we think that there will be enough of the skeleton of the operating site up and functioning and the community building that the perspective on the creation will change. In the meantime, we have come to learn that the cost of creating the new endeavor has not cost the Company an arm and a leg. Many were pleased by the “restrained” operating cost ZAGG demonstrated during the second quarter operating period. When it comes to energized college graduates focused on “creating good, not wealth,” incredible amounts of work can be achieved for a relatively small investment. To date, there is nothing to be ashamed from the graphics and operation of the site.

### **New Guidance and Our Estimate:**

As we suspected but much earlier than anticipated, management issued up-graded guidance to show improving operating results more representative of the real work occurring in Salt Lake City. They must have worked all weekend to think of ways to undo the damage...one of which was to repeal the commitment toward the ZAGG Foundation (a straw argument if there ever was one). But in total, a press release with a more succinct synopsis of the points to be made in the call, a summary of the growth initiatives, an announcement of the “closure” of the Foundation and guidance of \$38 million in revenues and \$0.22 in earnings, all worked to set the share price a little more at ease during trading. Unfortunately, a combination of continued commitment to hard work (actually a hallmark of management), more operating milestones, and greater market accomplishments should help get the shares back on track and to our new target range of \$8 to \$10 within the next six to 12 months.

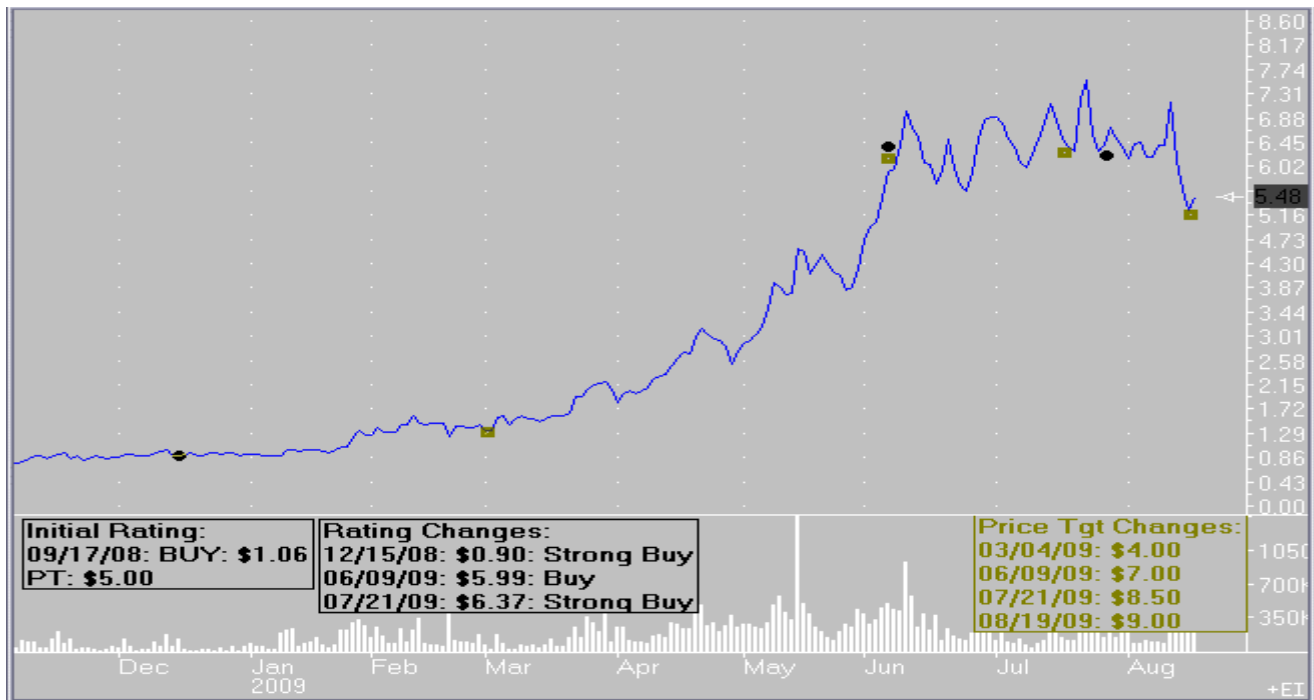
Once again, ZAGG’s top-team is using the “under-promise, over-perform” approach<sup>1</sup> to guidance, which is great. As in 2008, I suspect it will be upped two to three times as the year progresses.

My feeling is that as BestBuy, RadioShack, Target, MediaMart, the Carts, the new products and even CarPhone Warehouse get rolling into the holiday season with the flow of new SmartPhones should all help to forward sales as the year concludes. This should show up in a very strong fourth quarter. We are still holding out for a 2009 that has revenues that exceed \$42.5 million and \$0.25 in earnings. This number could be low if RadioShack and MediaMart really adopt the products faster than we’ve modeled. This is also true, which we think will be the case, if ZAGGskins sell-through more rapidly than we’ve modeled.

From a price action standpoint, the improvement in earnings for the remainder of 2009 and the forecasts that should come for 2010 plus the move of the shares to the NASDAQ, which we believe will be during the month of September, should help restore the share to their old highs (hence our more aggressive rating). Longer-term, we believe that the shares will see the low teens in 2010 when preliminary earnings of \$0.40 to \$0.50 will appear during the next month for 2010. We are still encouraged that a Company that is experiencing such organic growth in an otherwise very weak, non-consumer market has no coverage from a major brokerage house. This means that the story is still not well known and has more “following” or shelf-life to go before it is truly discovered and understood by the market.

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<sup>1</sup> If we could only get management to stop using the “under-promise, over-perform, then embarrassing brag about it on the conference call” modus operandi, the shares may have risen to \$10 even right after the call last Thursday even with the overall market hick-up! They have the first half (the important half) of the formula for operating a successful company down pat! They just have to learn to bridle their enthusiasm which when you meet them is truly an honest expression of their excitement. However, Wall Street just isn’t impressed by it.



**ZAGG**

\$ in thousands, except EPS

	Year 2008	% MRGN	QI 2009	% MRGN	QII 2009	% MRGN	QIII 2009	% MRGN	QIV 2009	% MRGN	Year 2009	% MRGN	Year 2010	% MRGN
			Actual		Actual		Estimate		Estimate		Estimate		Estimate	
Sales	\$19,792	100.00%	\$8,091	100.00%	\$9,215	100.00%	\$11,895	100.00%	\$14,675	100.00%	\$43,876	100.00%	\$83,655	100.00%
Cost of goods sold	\$6,594	33.32%	\$2,895	36.35%	\$3,700	40.15%	\$4,776	40.15%	\$5,797	39.50%	\$17,167	39.13%	\$30,225	36.13%
Gross Margins	\$13,198	66.68%	\$5,196	63.65%	\$5,515	59.85%	\$7,119	59.85%	\$8,878	60.50%	\$26,709	60.87%	\$53,430	63.87%
S,G and A	\$6,843	34.57%	\$2,137	26.41%	\$2,259	24.51%	\$2,995	25.18%	\$3,550	24.19%	\$10,941	24.94%	\$20,555	24.57%
Advertising	\$3,976	20.09%	\$1,455	17.98%	\$1,393	15.12%	\$1,885	15.85%	\$1,885	12.84%	\$6,618	15.08%	\$13,635	16.30%
Other	\$0	0.00%	\$0	0.00%	\$0	0.00%	\$0	0.00%	\$0	0.00%	\$0	0.00%	\$0	0.00%
Operating costs	\$10,819	54.66%	\$3,592	44.40%	\$3,652	39.63%	\$4,880	41.03%	\$5,435	37.04%	\$17,559	40.02%	\$34,190	40.87%
Income from Ops	\$2,379	12.02%	\$1,604	19.82%	\$1,863	20.22%	\$2,239	18.82%	\$3,443	23.46%	\$9,150	20.85%	\$19,240	23.00%
Interest & other	\$221	1.12%	\$39	0.48%	\$50	0.54%	\$65	0.55%	\$75	0.51%	\$229	0.52%	\$665	0.79%
Pre-tax other	\$2,600	13.14%	\$1,643	20.31%	\$1,913	20.76%	\$2,304	19.37%	\$3,518	23.98%	\$9,379	21.38%	\$19,905	23.79%
Taxes	\$501	19.27%	\$615	37.43%	\$719	37.58%	\$864	37.50%	\$1,319	37.50%	\$3,517	37.51%	\$7,415	37.25%
Income	\$2,099	10.61%	\$1,028	12.71%	\$1,194	12.96%	\$1,440	12.11%	\$2,199	14.98%	\$5,861	13.36%	\$12,490	14.93%
EPS	\$0.11	na	\$0.05	na	\$0.05	na	\$0.06	na	\$0.09	na	\$0.25	na	\$0.50	na
Shares Out	18,929		19,186		22,614		23,550		24,050		22,350		25175	
			% Δ Prev QTR Sales		% Δ Prev QTR Sales		% Δ Prev QTR Sales		% Δ Prev QTR Sales		% Δ Sales		% Δ Sales	
			10.02%		13.89%		29.08%		23.37%		121.69%		90.66%	
	% Δ Sales		% Δ Sales		% Δ Sales		% Δ Sales		% Δ Sales		% Δ Gross MRG.		% Δ Gross MRG.	
	285.43%		184.39%		236.44%		73.55%		99.55%		102.37%		100.05%	
			% Δ Gross MRG.		% Δ Gross MRG.		% Δ Gross MRG.		% Δ Gross MRG.		% Δ Op. MRG.		% Δ Op. MRG.	
			151.38%		172.08%		60.45%		90.24%		284.60%		110.28%	
			% Δ Op. MRG.		% Δ Op. MRG.		% Δ Op. MRG.		% Δ Op. MRG.		% Δ Pre-tax MRG.		% Δ Pre-tax MRG.	
			-803.51%		840.91%		63.44%		231.41%		260.7%		112.2%	
			% Δ Pre-tax MRG.		% Δ Pre-tax MRG.		% Δ Pre-tax MRG.		% Δ Pre-tax MRG.					
			-1002.7%		588.1%		62.4%		224.3%					

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Rating	% of covered companies with this rating	% For which IB services have been provided	Rating Description
<b>Strong Buy</b>	45.5%	20.0%	Immediate purchase is recommended. We anticipate at least 35% annual, risk-adjusted appreciation potential.
<b>Buy</b>	27.3%	16.7%	Purchase is recommended. The security is expected to outperform the general market over the next 12-18 months.
<b>Neutral</b>	18.2%	0.0%	The share price has moved above the specific 'Buy' range and appreciation potential is less than or equal to the market.
<b>Sell</b>	4.5%	0.0%	The stock has reached the target price and/or conditions have changed sufficiently to alter the outlook for the stock.
<b>N/R</b>	4.5%	0.0%	No investment rating has been assigned at the present time.

NOTE: TRG changed its institutional ratings scale on 10/4/04. Previously, TRG used Buy, Hold, Sell

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- High** The security is more volatile than the market and/or the company is more leveraged than its peer group.
- Moderate** 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.
- Low** The security is less volatile than the market and/or the company is less leveraged than its peer group.

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