

Nevro

Let the Launch Begin: Senza Approved, Raising PT to \$54

We're reiterating our OW rating and raising our Y/E price target on NVRO from \$46 to \$54. Friday's FDA approval sets the stage for the most compelling new product launch in the field of neurostimulation to treat chronic pain in more than a decade. Despite three well established, much larger competitors, we expect Nevro to capture at least 10% of the US pain stim market by 2017 and 18-19% by 2019. This is what's embedded in our forecast today, and for several reasons we view this as conservative, but naturally it will come down to execution. Internationally, Nevro has already captured >20% of the rechargeable market (40% of EU market, as opposed to 90% of the US) prior to the December presentation of its US pivotal trial data (demonstrating superiority in both back and leg pain) and its forthcoming publication in JAMA. This will be a closely followed US launch and we are bullish on Senza's prospects.

- **Nevro will be hosting a conference call Monday morning at 8:30am ET.** On the back of Friday night's approval, management is moving up the release of its 1Q results to Monday morning. So, on the call the company will discuss its 1Q OUS performance with its US plans now that FDA approval is in hand. The dial-in number for the 8:30am ET call is (877) 201-0168; Conference ID: 41475428
- **Our model calls for Nevro to capture 5% of the US market in 2016, rising to 18-19% by 2019.** This implies that domestic revenues climb from \$64M in 2016 to \$271M over this same period, or a CAGR of 62%. To put this ramp in some context, when Boston Scientific entered the US SCS market in 2004 with what we would regard as a less differentiated product offering (rechargeable IPGs vs. primary cell), it proceeded to capture 27% share in four years.
- **If we use Nevro's international experience as a guide, our US market share assumptions could prove conservative.** We estimate that the international SCS market in 2014 was ~\$375M, of which ~\$150M (40%) were rechargeable devices, similar to Senza. Within this rechargeable segment, Nevro achieved 20-25% market share, but if you only consider the markets where Senza is sold, then Nevro's share may be 30% or higher. In European rechargeable markets where Senza is sold (namely the UK, Germany, Netherlands, and Ireland), Nevro's share is closer to 30%, and in Australia, where the market is ~90% rechargeable, like the US, Senza's share is significantly higher.

Nevro Corp. (NVRO; NVRO US)

FYE Dec	2013A	2014A	2015E	2015E	2016E	2016E	2017E	2017E	2018E
			(Prev)	(Curr)	(Prev)	(Curr)	(Prev)	(Curr)	
EPS - Recurring (\$)									
Q1 (Mar)	-	(0.43)	(0.58)	(0.57)	-	-	-	-	-
Q2 (Jun)	-	(0.46)	(0.78)	(0.90)	-	-	-	-	-
Q3 (Sep)	-	(0.48)	(0.72)	(0.72)	-	-	-	-	-
Q4 (Dec)	-	(0.33)	(0.62)	(0.62)	-	-	-	-	-
FY	(1.60)	(1.66)	(2.70)	(2.80)	(2.50)	(2.62)	(1.35)	(1.46)	0.00
Revenue FY (\$ mn)	24	33	55	56	107	107	179	180	256

Source: Company data, Bloomberg, J.P. Morgan estimates.

See page 5 for analyst certification and important disclosures.

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Overweight

NVRO, NVRO US

Price: \$45.36

▲ **Price Target: \$54.00**
Previous: \$46.00

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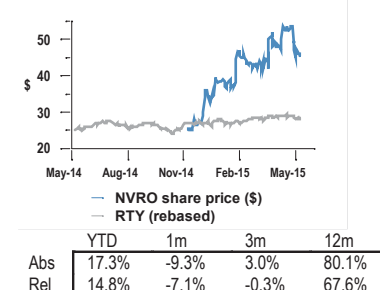
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Price Performance



Company Data

Price (\$)	45.36
Date Of Price	08 May 15
52-week Range (\$)	55.05-18.00
Market Cap (\$ mn)	1,126.29
Fiscal Year End	Dec
Shares O/S (mn)	25
Price Target (\$)	54.00
Price Target End Date	31-Dec-15

- **Senza has the strongest clinical profile of any SCS.** Senza is indicated as an aid in the management of chronic intractable pain of the trunk and/or limbs, including unilateral or bilateral pain associated with failed back surgery syndrome, intractable low back pain and leg pain. The label includes the results of the SENZAUS pivotal trial, the largest prospective randomized SCS trial ever conducted and the only head-to-head comparison in the field. The study enrolled 241 patients across 11 sites and compared Senza HF10 therapy to Boston Scientific's Precision Plus traditional SCS system on a 1:1 basis. On an intent-to-treat (ITT) basis, which includes all randomized patients, the Senza arm demonstrated a 75.7% response rate ($\geq 50\%$ reduction in back pain) compared to control at just 37.7%. This was both noninferior ($p < 0.001$) and superior ($p < 0.001$) on a post-hoc basis. Given the lack of available SCS clinical data, we believe that even on a post-hoc basis Senza's superior results will resonate strongly with clinicians.
- **Longer-term, we see HF10 as a platform technology.** Nevro is in the early stages of evaluating Senza in a number of other indications. The first and most immediate of these is in treating pain in pre-spinal surgery patients (i.e. "virgin back"), which is not currently reimbursed by payers due to a lack of clinical evidence. Chronic intractable neck and upper extremity pain is another promising pipeline opportunity, in addition to chronic migraine. Senza's lack of paresthesia is essential for SCS treatment in these patient populations, as the tingling sensation in or near a patient's head would likely be a non-starter that would limit commercial adoption.

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10 May 2015

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Investment Thesis, Valuation and Risks

Nevro (*Overweight; Price Target: \$54.00*)

Investment Thesis

Nevro develops implantable spinal cord stimulators (SCS) for the treatment of chronic back, leg, and other types of pain. We expect the company's Senza device to revolutionize the established SCS market through its differentiated high-frequency stimulation therapy (HF10), unparalleled clinical evidence, and the ability to successfully treat patients with back pain—a population historically poorly served by SCS therapy. While Senza is only approved internationally today, we expect a US launch by early 2016 to drive significant revenue growth over the next few years, making Nevro one of the best growth stories in small-cap MedTech, in our view.

Valuation

We're reiterating our OW rating and raising our YE price target on NVRO from \$46 to \$54. Our December 2015 price target of \$54 values Nevro at 7.0x our 2018 revenue forecast discounted back two years at a rate of 20%. This represents a premium to its immediate peer group of high-growth MedTech names, which we feel is justified given (1) a 2014-19E sales CAGR that is 2x higher (61% vs. 29%); (2) clinically superior head-to-head data vs. the competition in an established market with broad reimbursement; and (3) the potential to drive market expansion in an underpenetrated multi-billion dollar opportunity.

Risks to Rating and Price Target

Risks to our Overweight rating and \$54 price target include: (1) the SCS market is highly concentrated with entrenched competitors that are larger than Nevro; (2) Senza faces clinical and regulatory risk ahead of US approval; (3) Nevro has yet to launch commercially in the US; (4) Nevro's intellectual property could face legal challenges; and (5) Nevro has a history of losses and is expected to require additional capital.

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Nevro: Summary of Financials

Income Statement - Annual	FY14A	FY15E	FY16E	FY17E	Income Statement - Quarterly	1Q15E	2Q15E	3Q15E	4Q15E
Revenues	33	56	107	180	Revenues	7	10	16	23
Cost of products sold	(11)	(19)	(32)	(48)	Cost of products sold	(2)	(3)	(6)	(8)
Gross profit	-	-	-	-	Gross profit	-	-	-	-
SG&A	(30)	(80)	(110)	(134)	SG&A	(13)	(21)	(22)	(24)
R&D	(20)	(25)	(28)	(30)	R&D	(6)	(7)	(6)	(6)
Operating income	(28)	(69)	(63)	(33)	Operating income	(14)	(22)	(18)	(16)
EBITDA	(28)	(69)	(62)	(32)	EBITDA	(14)	(22)	(18)	(16)
Net interest (income) / expense	(0)	(3)	(5)	(5)	Net interest (income) / expense	(0)	(1)	(1)	(1)
Other income / (expense)	(2)	0	0	0	Other income / (expense)	0	0	0	0
Income taxes	(0)	(0)	(0)	(1)	Income taxes	(0)	(0)	(0)	(0)
Net income - GAAP	(31)	(73)	(68)	(38)	Net income - GAAP	(14)	(22)	(20)	(17)
Net income - recurring	(31)	(73)	(68)	(38)	Net income - recurring	(14)	(22)	(20)	(17)
Diluted shares outstanding	19	26	26	26	Diluted shares outstanding	25	25	27	27
EPS - excluding non-recurring	(1.66)	(2.80)	(2.62)	(1.46)	EPS - excluding non-recurring	(0.57)	(0.90)	(0.72)	(0.62)
EPS - recurring	(1.66)	(2.80)	(2.62)	(1.46)	EPS - recurring	(0.57)	(0.90)	(0.72)	(0.62)
Balance Sheet and Cash Flow Data	FY14A	FY15E	FY16E	FY17E	Ratio Analysis	FY14A	FY15E	FY16E	FY17E
Cash and cash equivalents	25	82	112	224	Sales growth	38.6%	72.0%	90.6%	68.2%
Accounts receivable	7	8	8	8	EBIT growth	12.5%	144.7%	(9.2%)	(47.9%)
Inventories	15	19	25	25	EPS growth - recurring	3.5%	69.1%	(6.7%)	(44.1%)
Other current assets	3	3	3	4	Gross margin	-	-	-	-
Current assets	201	188	187	279	EBIT margin	(86.5%)	(114.6%)	(53.9%)	(14.5%)
PP&E	1	1	1	1	EBITDA margin	(86.2%)	(114.6%)	(53.3%)	(14.0%)
Total assets	202	190	189	281	Tax rate	(1.6%)	(0.4%)	(0.6%)	(1.3%)
Total debt	20	20	40	50	Net margin	(94.2%)	(130.2%)	(64.0%)	(21.3%)
Total liabilities	30	31	52	62	Net Debt / EBITDA	20.6%	97.7%	128.2%	694.6%
Shareholders' equity	172	158	137	219	Net Debt / Capital (book)	(3.5%)	(65.6%)	(114.2%)	(391.2%)
Net income (including charges)	(31)	(14)	(22)	(20)	Return on assets (ROA)	(15.2%)	(37.2%)	(36.1%)	(16.3%)
D&A	0	0	0	0	Return on equity (ROE)	(17.8%)	(44.1%)	(46.3%)	(21.6%)
Change in working capital	(4)	(5)	(6)	1	Enterprise value / sales	34.4	19.0	9.9	5.3
Other	3	0	1	1	Enterprise value / EBITDA	NM	NM	NM	NM
Cash flow from operations	(31)	(19)	(28)	(18)	Free cash flow yield	(3.8%)	(1.3%)	(1.9%)	(1.1%)
Capex	(1)	(0)	(0)	(0)					
Free cash flow	(32)	(15)	(23)	(13)					
Cash flow from investing activities	(108)	76	38	19					
Cash flow from financing activities	152	0	20	110					
Dividends	-	-	-	-					
Dividend yield	-	-	-	-					

Source: Company reports and J.P. Morgan estimates.

Note: \$ in millions (except per -share data). Fiscal year ends Dec

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10 May 2015

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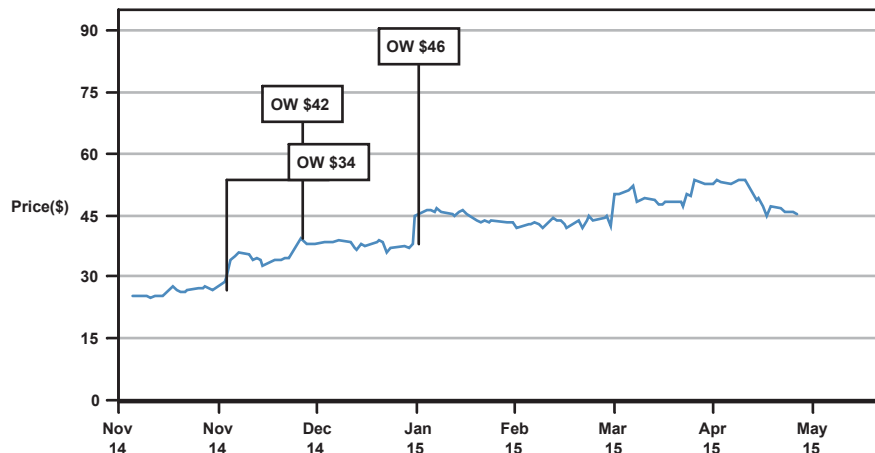
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Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
Initiated coverage Dec 01, 2014.

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10 May 2015

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