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## Nevro Corp

## Fundamentals are Very Much Intact

Stock Rating

Overweight

Industry View

In-Line

Price Target

\$105.00

The Nevro thesis advanced on multiple levels despite some inevitable expectation noise. Disclosures on the call indicates that the company is investing at a faster pace with better profitability and is expanding earlier into key markets. Remain Overweight.

**Nevro posted a solid beat and raise amid elevated expectations.** Revenues beat consensus by 6% (\$61mn vs. \$57.5mn) and likely would have matched our street high number (\$63mn) adjusting for one-time Australia disruption. The miss vs. MSe street high was split between the US and ex. US geographies at ~\$1mn a piece. It is important to note that we have seen SMID cap implanter's US sales slow across our coverage (280 bps, comp-adjusted) during 3Q, which we attribute to outsized US seasonality this summer. The ex. US miss, as previously stated, was transient Australia weakness tied to disruption with two large implanters. For those investors focused on the "unofficial forecasts" these two factors would likely have placed results 2-4% higher. We continue to believe Senza offers superior results and remains on a path to take outsized share and expand the market. Importantly, there were several positive market developments on the call that we describe below and subsequently we would be buyers on expectation driven weakness.

**Expectations have created a lot of noise among SMID cap growth stories this earnings season, but we do not see a fundamental change at Nevro, and in fact multiple uncertainties and key opportunities advanced on the call.** Among them was progress within (i) reimbursement and (ii) sale forces expansion rep. On reimbursement, Cigna reversed its prior decision to designate HF therapy as investigational and experimental, and now is fully covered. which should work to assuage fears that began with certain Blues plans earlier in the year. On salesforce, the company is hiring more aggressively than we previously expected, surpassing its initial expectation of 60 reps in 2016 by already hiring 65 through 3Q. Management expects to hire more reps in 4Q and while this will put some temporary pressure on revenue per rep, the company reaffirmed its expectation for \$1.3-\$1.5mn per rep after 12-15 months a time frame they accelerated on last quarters call. We see this investment as logical given our diligence. Recall, Nevro has <50% of the account coverage of peers and is not competing in paddle leads (1/3 of US market), suggesting the company's adjusted share is already well beyond 30%. In fact many of our physician conversations suggest share levels

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## Nevro Corp ( NVRO.N, NVRO US )

Medical Technology / United States of America

|                                 |                   |               |               |               |
|---------------------------------|-------------------|---------------|---------------|---------------|
| <b>Stock Rating</b>             | <b>Overweight</b> |               |               |               |
| <b>Industry View</b>            | <b>In-Line</b>    |               |               |               |
| <b>Price target</b>             | <b>\$105.00</b>   |               |               |               |
| Shr price, close (Nov 7, 2016)  | \$89.12           |               |               |               |
| Mkt cap, curr (mm)              | \$2,856           |               |               |               |
| 52-Week Range                   | \$106.79-45.15    |               |               |               |
| <b>Fiscal Year Ending</b>       | <b>12/15</b>      | <b>12/16e</b> | <b>12/17e</b> | <b>12/18e</b> |
| <b>ModelWare EPS (\$)</b>       | (2.54)            | (1.14)        | (0.01)        | 1.31          |
| <b>Prior ModelWare EPS (\$)</b> | -                 | (1.20)        | 0.21          | 1.42          |
| <b>P/E</b>                      | NM                | NM            | NM            | 68.0          |
| <b>Consensus EPS (\$)</b>       | (2.60)            | (1.42)        | (0.69)        | 0.59          |
| <b>Div yld (%)</b>              | -                 | -             | -             | -             |

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework

\$ = Consensus data is provided by Thomson Reuters Estimates  
e = Morgan Stanley Research estimates

## QUARTERLY MODELWARE EPS (\$)

| Quarter | 2015   | 2016e Prior | 2016e Current | 2017e Prior | 2017e Current |
|---------|--------|-------------|---------------|-------------|---------------|
| Q1      | (0.57) | -           | (0.33)a       | (0.21)      | (0.27)        |
| Q2      | (0.77) | -           | (0.31)a       | (0.00)      | (0.05)        |
| Q3      | (0.70) | (0.29)      | (0.14)        | 0.13        | 0.08          |
| Q4      | (0.51) | (0.27)      | (0.36)        | 0.25        | 0.19          |

e = Morgan Stanley Research estimates, a = Actual Company reported data

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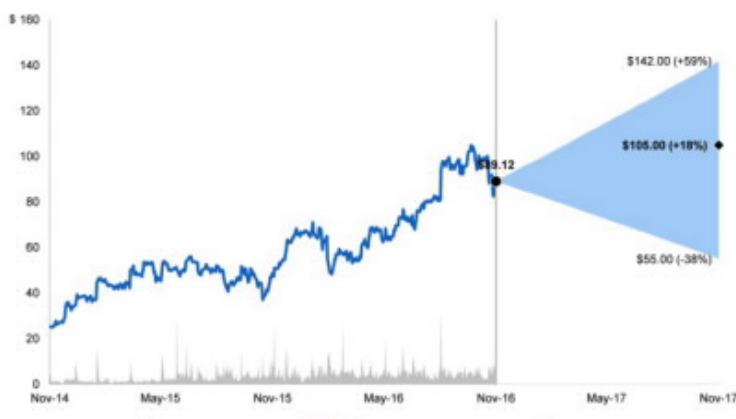
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close to 50%. Management is investing to capitalize on market expansion, geographic coverage and existing region penetration. The company began to express this view at [our conference](#) and we see it as an offensive, not defensive, signal.

**Two very important disclosures on TAM expansion on the call.** As we have [previously discussed](#), Nevro's total addressable market (TAM) could see multiple cycles of significant expansion. Paddle leads is the most near-term opportunity and management has submitted its design change to the FDA and is ramping manufacturing to prepare for the launch. Nevro is on track for a 1H17 launch, which would provide access to 30% of the SCS market where Nevro currently does not have access. Beyond paddle leads, TAM should expand (i) into back pain which could double the US SCS market size from \$1.2bn to \$2.4bn, (ii) into the non-surgical cohort which could be a +\$1bn market, and (iii) into chronic upper extremity pain. Management gave additional information on chronic upper extremity pain, as upper limb and neck pain data will be presented at NANS in January which is much earlier than expected, as we've previously talked about upper extremity as a 2020+ opportunity. Details are scant but our sense is the data may provide greater evidence for commercial penetration into upper limb (which is on label) or form the basis of a large US IDE for neck pain (which is not). Either way, this is at least 6-12 months earlier than expected. Less details were given on non-surgical, but it remains a significant opportunity and we do expect clinical advancement in 2017.

**Thoughts on 4Q guidance and what it means for 2017.** We previewed that investors expecting a guidance raise on this call as large as the 2Q raise would be disappointed given larger numbers and a desire to manage expectations into '17. Implied 4Q guidance implies 2-10% sequential growth, and our sense is that this reflects conservatism and not underlying fundamentals as the company transitions to 2017 and level sets certain consensus outliers. Our numbers are coming down modestly in 2017 mostly reflecting a modification to our revenue per rep assumptions (down to \$1.28mn from \$1.38mn). Our estimates for 2018 and beyond remain largely unchanged.

**Margin progression beginning to alleviate our earlier concerns.** Nevro's gross margins reached 68.4% in the quarter, ramping up over the past couple of quarters from 60% levels in 2015. We expect more step function improvement into 2017 on higher volumes. Unit economics remain very underappreciated as the company continues to demonstrate it can scale the business, invest faster and narrow the burn rate. We are not making any material changes to our expense assumptions into 2017, but considering cash on hand of \$300mn, Nevro has the capacity and business model to invest materially to expand both share and the addressable market into 2017. We model break-even in 2H17, but we do not believe that profitability should be a focus for investors near-term as revenue growth is the driver off shareholder value.

**Risk Reward****Faster Launch and Higher US Spinal Cord Stimulation Market Share Drive Upside Potential**

Source: Morgan Stanley Research, Thomson Reuters

**Price Target \$105**

Our price target of \$105 is derived from a discounted cash flow valuation. Assuming terminal share of 30%, margins of 40%, and a 8.5% WACC yield EV of \$2.9bn. Adjusting for \$150mn of net cash puts equity value at \$3.1bn. Diluted share count of 31.7mn yields a share price at \$97 today, or \$105 one year from now.

**Bull \$142****10x 2017 EV/Sales**

**A new market leader?** An faster US launch drives increasing investor enthusiasm. Market share in the US reaches ~25% by 2017 (vs. 13-14% in our base case), increasing visibility on ultimate share of 40%+ and margins above 40%. Value as a potential strategic asset increases.

**Base \$105****DCF-based; 8.5x 2017 EV/Sales**

**Painlessly disruptive.** Nevro captures ~20% of the US SCS market by the end of 2017 following a May 2015 Senza launch. Nevro appears on track to reach 30-40% share over time, in line with the European experience and our survey work.

**Bear \$55****6x 2017 EV/Sales**

**Tough traction.** A more effective competitive response limits uptake as the SCS market proves more sensitive to marketing than clinical data. US market share reaches only 15% by 2017 and tops out in the mid teens; valuation contracts.

**Investment Thesis**

- Nevro's entry into the \$1.5 billion market for spinal cord stimulation (SCS) is a potentially disruptive event.
- Nevro's clinical data is compelling and of a quality rarely seen in medical devices today.
- Our clinical diligence and proprietary AlphaWise survey of 60 physicians conducted in October 2015, suggest Nevro could take 30% or more of the SCS market over time, higher than consensus expects.
- Large and capable competitors will not stand still, but Nevro may have caught them off guard and has a clear data and timing advantage.

**Key Value Drivers**

- WW SCS market share is a critical value driver. Five pts of share is worth ~\$18 of value.
- Surgical back pain can drive \$15 of value.

**Potential Catalysts**

- Visibility on US launch progress [Ongoing]
- Industry consolidation
- Updates on Nevro and competitor studies [Ongoing]
- Details on transitional APC pass-through payment status [1Q16]

**Risks to Achieving Price Target**

- Larger and stronger competitors are accelerating product development to mount a competitive response.
- Current rep/physician relationships are stronger than we anticipated
- Nevro is confident in its IP position, but patent litigation may be a key risk over time.

# Analysis

Exhibit 1: Nevro: P&L Reconciliation

| (\$ in millions, except EPS) | Current Quarter |          |             |            |            | Cons. Est. | 3Q15A    | Y/Y % Change |
|------------------------------|-----------------|----------|-------------|------------|------------|------------|----------|--------------|
|                              | 3Q16E           | 3Q16A    | A vs E (\$) | A vs E (%) | EPS Impact |            |          |              |
| Total Revenues               | \$62.9          | \$60.9   | -\$2.0      | -3%        | \$0.01     | \$7.6      | \$15     | 295.5%       |
| COGS                         | 20.8            | 19.2     | -1.5        | -7%        | (\$0.05)   | 19.7       | \$6      | 222%         |
| Gross Profit                 | 42.2            | 41.7     | -0.5        | -1%        | (\$0.02)   | 37.9       | \$9      | 342%         |
| Operating Expenses:          |                 |          |             |            |            |            |          |              |
| SG&A                         | 40.0            | 35.6     | -4.4        | -11%       | \$0.15     | --         | \$22     | 63%          |
| R&D                          | 10.0            | 7.9      | -2.1        | -21%       | \$0.07     | --         | \$5      | 51%          |
| Total Operating Expenses     | 50.0            | 43.6     | -6.4        | -13%       | \$0.23     | 48.2       | \$27     | 60%          |
| Operating Income (Loss)      | (7.8)           | (1.9)    | 6.0         | -76%       | \$0.21     | (10.3)     | (\$18)   | -89%         |
| Interest Income (Expense)    | 0.1             | (1.8)    | -1.9        | --         | (\$0.07)   | --         | -\$1     | --           |
| Other Income (Expense)       | (0.6)           | 0.3      | 0.8         | --         | \$0.03     | --         | -\$1     | --           |
| Total Non-Op (Expense)       | (0.6)           | 0.0      | 0.6         | --         | \$0.02     | (0.9)      | -\$1     | --           |
| Pretax Income                | (8.3)           | (3.4)    | 4.9         | -59%       | \$0.17     | (11.3)     | (\$19)   | -82%         |
| Income Taxes                 | 0.0             | (0.4)    | -0.4        | --         | \$0.04     | 0.5        | (\$0)    | 67%          |
| Net Income (Loss)            | (8.3)           | (3.9)    | 4.5         | -53%       | \$0.16     | (11.8)     | (\$19)   | -80%         |
| Diluted Shares Outstanding   | 26.4            | 28.5     | 0.1         | 0%         | \$0.00     | 29.5       | 28       |              |
| EPS, Diluted                 | (\$0.29)        | (\$0.14) | \$0.16      | -54%       |            | (\$0.40)   | (\$0.70) |              |
| <b>Margin Analysis</b>       |                 |          |             |            |            |            |          |              |
| Gross Profit                 | 67.0%           | 68.4%    |             | 140 bps    |            | 65.8%      | 61.3%    | 720 bps      |
| SG&A                         | 64%             | 58%      |             | -510 bps   |            | --         | 142.2%   | -8370 bps    |
| R&D                          | 16%             | 13%      |             | -290 bps   |            | --         | 34.1%    | -2110 bps    |
| Operating Income             | -12%            | -3%      |             | 940 bps    |            | -18.0%     | -115.0%  | 11190 bps    |
| Pre-tax Income               | -13%            | -6%      |             | 760 bps    |            | -19.6%     | -124.6%  | 11890 bps    |
| Tax Rate                     | 0%              | 13%      |             | 1300 bps   |            | -4.5%      | 1.4%     | 1160 bps     |
| Net Income                   | -13%            | -6%      |             | 690 bps    |            | -20.5%     | -126.3%  | 11990 bps    |

Source: Morgan Stanley Research; Company Data

Exhibit 2: Nevro: Income Statement

| (\$ in millions, except per share data) |         |         |          |          |          |          |          |          |          |          |           |        |        |
|---|---------|---------|----------|----------|----------|----------|----------|----------|----------|----------|-----------|--------|--------|
|   | 2012A   | 2013A   | 2014A    | 2015A    | 2016E    |          |          |          | 2017E    | 2018E    | 2019E     | 2020E  |        |
|   |         |         |          |          | Mar-16   | Jun-16   | Sep-16   | Dec-16   |          |          |           |        |        |
| Revenue                                 | 18.2    | 23.5    | 32.6     | 69.6     | 41.7     | 55.4     | 60.9     | 66.5     | 224.4    | 328.1    | 439.2     | 525.2  | 601.6  |
| COGS                                    | 7.5     | 9.5     | 11.3     | 28.1     | 15.7     | 18.8     | 19.2     | 21.3     | 75.0     | 101.4    | 123.0     | 136.6  | 150.4  |
| Gross profit                            | 10.6    | 14.0    | 21.3     | 41.5     | 26.0     | 36.6     | 41.7     | 45.2     | 149.4    | 226.7    | 316.3     | 388.7  | 451.2  |
| R&D                                     | 15.7    | 20.3    | 19.8     | 21.4     | 6.4      | 8.2      | 7.9      | 10.0     | 32.5     | 40.0     | 42.4      | 44.9   | 47.6   |
| SG&A                                    | 14.1    | 18.8    | 29.8     | 82.5     | 28.6     | 34.3     | 35.6     | 45.0     | 143.6    | 180.0    | 207.0     | 229.8  | 248.2  |
| Total operating expenses                | 29.8    | 39.2    | 49.6     | 103.9    | 35.0     | 42.5     | 43.6     | 55.0     | 176.0    | 220.0    | 249.4     | 274.7  | 295.8  |
| Operating income (loss)                 | (19.1)  | (25.2)  | (28.3)   | (62.4)   | (9.0)    | (5.9)    | (1.9)    | (9.8)    | (26.6)   | 6.7      | 66.9      | 114.0  | 155.4  |
| Interest and other income               | 0.1     | 0.2     | (0.0)    | (2.2)    | (0.4)    | (0.7)    | (1.8)    | 0.0      | (2.9)    | 0.1      | 0.1       | 0.2    | 0.3    |
| Other income (expense)                  | 0.2     | (0.7)   | (1.9)    | (1.7)    | 0.5      | (1.9)    | 0.3      | (0.6)    | (1.7)    | (2.3)    | (2.3)     | (2.0)  | 0.0    |
| Total other income (expense)            | 0.3     | (0.5)   | (1.9)    | (3.9)    | 0.1      | (2.6)    | (1.6)    | (0.5)    | (4.6)    | (2.1)    | (2.1)     | (1.7)  | 0.4    |
| Pretax income                           | (18.8)  | (25.7)  | (30.2)   | (66.3)   | (9.0)    | (8.5)    | (3.4)    | (10.3)   | (31.2)   | 4.6      | 64.7      | 112.2  | 155.8  |
| Tax (expense) benefit                   | (0.2)   | (0.4)   | (0.5)    | (1.2)    | (0.3)    | (0.3)    | (0.4)    | -        | (1.0)    | (4.8)    | (22.7)    | (39.3) | (54.5) |
| Tax rate                                | -0.9%   | -1.4%   | -1.6%    | -1.8%    | -3.7%    | -3.0%    | -13.0%   | 0.0%     | -3.3%    | 105.3%   | 35.0%     | 35.0%  | 35.0%  |
| Net income (loss)                       | (19.0)  | (26.0)  | (30.7)   | (67.4)   | (9.3)    | (8.8)    | (3.9)    | (10.3)   | (32.3)   | (0.2)    | 42.1      | 72.9   | 101.2  |
| Basic shares                            | 11.9    | 21.0    | 16.0     | 26.6     | 28.2     | 28.4     | 28.5     | 28.6     | 28.4     | 28.6     | 28.7      | 28.8   | 28.9   |
| Diluted shares                          | 11.9    | 21.0    | 16.0     | 26.6     | 28.2     | 28.4     | 28.5     | 28.6     | 28.4     | 30.3     | 32.1      | 32.2   | 32.3   |
| Diluted EPS                             |         |         | (\$1.92) | (\$2.54) | (\$0.33) | (\$0.31) | (\$0.14) | (\$0.36) | (\$1.14) | (\$0.01) | \$1.31    | \$2.26 | \$3.13 |
| <b>Margin/expense analysis:</b>         |         |         |          |          |          |          |          |          |          |          |           |        |        |
| Gross margin                            | 58.5%   | 59.7%   | 65.4%    | 59.6%    | 62.4%    | 66.0%    | 68.4%    | 68.0%    | 66.6%    | 69.1%    | 72.0%     | 74.0%  | 75.0%  |
| R&D                                     | 86.3%   | 86.6%   | 60.9%    | 30.7%    | 15.3%    | 14.7%    | 13.0%    | 15.0%    | 14.5%    | 12.2%    | 9.7%      | 8.6%   | 7.9%   |
| SG&A                                    | 77.7%   | 80.1%   | 91.4%    | 118.5%   | 68.8%    | 61.9%    | 58.5%    | 67.7%    | 64.0%    | 54.9%    | 47.1%     | 43.7%  | 41.3%  |
| EBIT                                    | -105.4% | -107.0% | -86.9%   | -89.6%   | -21.6%   | -10.7%   | -3.1%    | -14.8%   | -11.9%   | 2.0%     | 15.2%     | 21.7%  | 25.8%  |
| EBITDA                                  | -105.2% | -106.8% | -86.6%   | -88.7%   | -20.7%   | -10.0%   | -3.1%    | -14.7%   | -11.5%   | 2.1%     | 15.2%     | 21.7%  | 25.8%  |
| Pretax income                           | -103.6% | -109.2% | -92.7%   | -95.2%   | -21.5%   | -15.4%   | -5.6%    | -15.5%   | -13.9%   | 1.4%     | 14.7%     | 21.4%  | 25.9%  |
| Net margin                              | -104.5% | -110.7% | -94.2%   | -96.9%   | -22.3%   | -15.8%   | -6.4%    | -15.5%   | -14.4%   | -0.1%    | 9.6%      | 13.9%  | 16.8%  |
| <b>Growth rate analysis:</b>            |         |         |          |          |          |          |          |          |          |          |           |        |        |
| Revenue                                 |         | 29.5%   | 38.6%    | 113.7%   | 331.1%   | 385.2%   | 295.5%   | 100.6%   | 222.4%   | 46.2%    | 33.9%     | 19.8%  | 14.5%  |
| COGS                                    |         | 25.9%   | 19.1%    | 149.3%   | 304.4%   | 242.1%   | 222.3%   | 66.5%    | 166.7%   | 35.2%    | 21.2%     | 11.0%  | 10.1%  |
| Gross profit                            |         | 32.0%   | 51.8%    | 94.8%    | 348.9%   | 518.6%   | 341.9%   | 122.0%   | 260.2%   | 51.7%    | 39.5%     | 22.9%  | 16.1%  |
| R&D                                     |         | 29.9%   | -2.6%    | 7.9%     | 27.3%    | 55.2%    | 51.0%    | 70.2%    | 51.8%    | 23.3%    | 6.0%      | 6.0%   | 6.0%   |
| SG&A                                    |         | 33.6%   | 58.1%    | 177.0%   | 118.1%   | 73.1%    | 62.8%    | 62.9%    | 74.1%    | 25.4%    | 15.0%     | 11.0%  | 8.0%   |
| EBIT                                    |         | 31.5%   | 12.5%    | 120.3%   | -26.9%   | -69.1%   | -89.4%   | -25.3%   | -57.3%   |          |           | 70.4%  | 36.4%  |
| EBITDA                                  |         | 31.5%   | 12.4%    | 118.9%   | -29.9%   | -71.0%   | -89.4%   | -23.5%   | -58.2%   |          |           | 70.4%  | 36.3%  |
| Pretax income                           |         | 36.4%   | 17.7%    | 119.4%   | -35.7%   | -56.5%   | -82.1%   | -24.0%   | -52.9%   |          |           | 73.4%  | 38.8%  |
| Net income                              |         | 37.2%   | 17.9%    | 119.8%   | -33.9%   | -55.5%   | -80.0%   | -27.2%   | -52.1%   |          |           | 73.4%  | 38.8%  |
| Share count, diluted                    |         |         |          | 66.5%    | 13.5%    | 11.0%    | 2.4%     | 2.0%     | 7.0%     | 6.6%     | 5.9%      | 0.4%   | 0.4%   |
| EPS                                     |         |         |          | 32.0%    | -41.8%   | -59.9%   | -80.5%   | -28.6%   | -55.2%   | -99.3%   | -16469.2% | 72.7%  | 38.3%  |

Source: Morgan Stanley Research, Company Data

Exhibit 3: Nevro: Revenue Model

| \$ in millions            |        |       |       |        |        |        |        |        |        |       |       |       |       |
|---------------------------|--------|-------|-------|--------|--------|--------|--------|--------|--------|-------|-------|-------|-------|
|                           | 2012A  | 2013A | 2014A | 2015A  | 2016E  |        |        |        | 2017E  | 2018E | 2019E | 2020E |       |
|                           |        |       |       |        | Mar-16 | Jun-16 | Sep-16 | Dec-16 |        |       |       |       |       |
| <b>Global SCS Revenue</b> |        |       |       |        |        |        |        |        |        |       |       |       |       |
| Revenue                   | 18.2   | 23.5  | 32.6  | 69.5   | 41.7   | 55.4   | 60.9   | 66.5   | 224.5  | 328.1 | 439.2 | 525.2 | 601.6 |
| % y/y growth              | 139.7% | 29.0% | 38.6% | 113.4% | 331.6% | 388.0% | 295.5% | 100.8% | 222.9% | 46.2% | 33.9% | 19.6% | 14.5% |
| % CC growth               | 139.7% | 29.0% | 41.8% | 137.3% | 336.3% | 390.0% | 296.4% | 101.1% | 224.2% | 46.2% | 33.9% | 19.6% | 14.5% |
| % FX                      | 0.0%   | 0.0%  | -3.2% | -23.9% | -4.7%  | -2.0%  | -0.9%  | -0.3%  | -1.3%  | 0.0%  | 0.0%  | 0.0%  | 0.0%  |
| Est. market share         |        |       |       | 4.5%   | 10.1%  | 12.7%  | 13.8%  | 14.2%  | 12.8%  | 17.2% | 21.2% | 23.6% | 25.4% |
| <b>US SCS Revenue</b>     |        |       |       |        |        |        |        |        |        |       |       |       |       |
| Average reps              |        |       |       | 66.1   | 106.5  | 126.5  | 152.5  | 169.5  | 138.8  | 204.0 | 256.0 | 298.0 | 336.0 |
| % y/y growth              |        |       |       |        |        |        |        |        |        | 47.0% | 25.5% | 16.4% | 12.8% |
| Rep change q/q            |        |       |       | 100.0  | 13.0   | 27.0   | 25.0   | 9.0    | 74.0   | 60.0  | 44.0  | 40.0  | 36.0  |
| Annualized rev / rep      |        |       |       | 0.37   | 1.11   | 1.28   | 1.24   | 1.20   | 1.21   | 1.28  | 1.43  | 1.50  | 1.54  |
| % y/y growth              |        |       |       |        |        |        |        |        |        | 5.7%  | 11.4% | 5.0%  | 3.0%  |
| Revenue                   |        |       |       | 24.4   | 29.5   | 40.6   | 47.2   | 50.9   | 168.2  | 261.3 | 365.3 | 446.4 | 518.3 |
| % y/y growth              |        |       |       |        |        |        |        |        |        | 55.4% | 39.8% | 22.2% | 16.1% |
| Est. market share         |        |       |       | 2.0%   | 9.1%   | 11.8%  | 13.2%  | 13.6%  | 12.0%  | 17.1% | 21.9% | 24.9% | 27.1% |
| <b>OUS SCS Revenue</b>    |        |       |       |        |        |        |        |        |        |       |       |       |       |
| Average reps              |        | 32.3  | 40.0  | 47.0   | 51.5   | 55.0   | 58.5   | 60.5   | 56.4   | 62.0  | 63.5  | 64.5  | 65.5  |
| % y/y growth              |        |       | 24.0% | 17.5%  | 14.4%  | 18.3%  | 23.2%  | 23.5%  | 19.9%  | 10.0% | 2.4%  | 1.6%  | 1.6%  |
| Rep change q/q            |        | 8.0   | 8.0   | 6.0    | 3.0    | 4.0    | 3.0    | 1.0    | 11.0   | 2.0   | 1.0   | 1.0   | 1.0   |
| Annualized rev / rep      |        | 0.73  | 0.81  | 0.96   | 0.95   | 1.08   | 0.94   | 1.03   | 1.00   | 1.08  | 1.16  | 1.22  | 1.27  |
| % y/y growth              |        |       | 11.8% | 18.0%  | 10.3%  | 10.7%  | 2.1%   | -5.0%  | 3.9%   | 7.9%  | 8.0%  | 5.0%  | 4.0%  |
| Revenue                   | 18.2   | 23.5  | 32.6  | 45.2   | 12.2   | 14.8   | 13.7   | 15.6   | 56.3   | 66.8  | 73.9  | 78.8  | 83.3  |
| % y/y growth              | 139.7% | 29.0% | 38.6% | 38.6%  | 26.3%  | 31.0%  | 25.7%  | 17.3%  | 24.7%  | 18.7% | 10.6% | 6.7%  | 5.6%  |
| % CC growth               | 139.7% | 29.0% | 41.8% | 62.5%  | 31.0%  | 33.0%  | 27.0%  | 18.1%  | 26.7%  | 18.7% | 10.6% | 6.7%  | 5.6%  |
| % FX                      | 0.0%   | 0.0%  | -3.2% | -23.9% | -4.7%  | -2.0%  | -1.3%  | -0.8%  | -2.1%  | 0.0%  | 0.0%  | 0.0%  | 0.0%  |
| Est. market share         | 5.8%   | 6.8%  | 8.9%  | 13.2%  | 13.9%  | 15.9%  | 16.2%  | 16.8%  | 15.7%  | 17.4% | 18.1% | 18.3% | 18.3% |

Source: Morgan Stanley Research; Company Data

## Exhibit 4: Nevro: Balance Sheet

(\$ in millions, except per share data)

|                                      | 2013A       | 2013A       | 2014A        | 2015A        | 2016E        | 2017E        | 2018E        | 2019E        | 2020E        |
|--------------------------------------|-------------|-------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| <b>ASSETS</b>                        |             |             |              |              |              |              |              |              |              |
| <b>Current assets</b>                |             |             |              |              |              |              |              |              |              |
| Cash and cash equivalents            | 5.6         | 12.4        | 25.3         | 87.0         | 73.9         | 57.2         | 76.9         | 110.3        | 206.8        |
| Short-term investments               | 25.0        | 44.1        | 101.5        | 106.6        | 199.8        | 199.8        | 199.8        | 199.8        | 199.8        |
| Accounts receivable - net            | 5.9         | 6.6         | 6.6          | 22.5         | 40.3         | 66.5         | 85.6         | 101.3        | 115.1        |
| Inventories                          | 9.6         | 10.1        | 14.9         | 62.4         | 87.6         | 92.0         | 101.5        | 101.3        | 97.4         |
| Prepaid expenses and other           | 2.8         | 1.5         | 2.9          | 4.0          | 9.1          | 9.1          | 10.3         | 11.3         | 12.2         |
| <b>Total current assets</b>          | <b>48.8</b> | <b>74.6</b> | <b>201.1</b> | <b>282.6</b> | <b>410.7</b> | <b>426.6</b> | <b>474.1</b> | <b>524.1</b> | <b>631.3</b> |
| <b>Non-current assets</b>            |             |             |              |              |              |              |              |              |              |
| PP&E, net                            | 0.1         | 0.1         | 0.6          | 5.8          | 6.8          | 6.8          | 6.8          | 6.8          | 6.8          |
| Other                                | 0.1         | 0.2         | 0.4          | 1.9          | 2.2          | 2.2          | 2.2          | 2.2          | 2.2          |
| Restricted Cash                      | 0.1         | 0.3         | 0.3          | 0.9          | 0.9          | 0.9          | 0.9          | 0.9          | 0.9          |
| <b>Total non-current assets</b>      | <b>0.3</b>  | <b>0.6</b>  | <b>1.4</b>   | <b>8.6</b>   | <b>9.9</b>   | <b>9.9</b>   | <b>9.9</b>   | <b>9.9</b>   | <b>9.9</b>   |
| <b>Total assets</b>                  | <b>49.1</b> | <b>75.4</b> | <b>202.5</b> | <b>291.2</b> | <b>420.6</b> | <b>436.5</b> | <b>484.0</b> | <b>534.0</b> | <b>641.2</b> |
| <b>LIABILITIES</b>                   |             |             |              |              |              |              |              |              |              |
| <b>Current liabilities</b>           |             |             |              |              |              |              |              |              |              |
| Accounts payable                     | 2.0         | 3.2         | 4.5          | 21.9         | 35.1         | 36.3         | 36.9         | 30.4         | 33.2         |
| Accrued liabilities                  | 2.9         | 4.5         | 6.3          | 14.4         | 22.3         | 22.3         | 25.3         | 27.9         | 30.0         |
| Other current liabilities            | 0.5         | 0.2         | 0.1          | 0.1          | 0.2          | 0.2          | 0.2          | 0.2          | 0.2          |
| <b>Total current liabilities</b>     | <b>5.2</b>  | <b>7.9</b>  | <b>10.8</b>  | <b>36.4</b>  | <b>57.6</b>  | <b>60.9</b>  | <b>62.4</b>  | <b>58.5</b>  | <b>63.4</b>  |
| <b>Non-current liabilities</b>       |             |             |              |              |              |              |              |              |              |
| Loans from banks and others          | -           | -           | 19.5         | 19.7         | 134.8        | 134.8        | 134.8        | 114.8        | 114.8        |
| Other long-term liabilities          | 0.2         | 0.1         | 0.1          | 0.5          | 0.6          | 0.6          | 0.6          | 0.6          | 0.6          |
| <b>Total non-current liabilities</b> | <b>0.2</b>  | <b>0.1</b>  | <b>19.6</b>  | <b>20.2</b>  | <b>135.4</b> | <b>135.4</b> | <b>135.4</b> | <b>115.4</b> | <b>115.4</b> |
| <b>Total liabilities</b>             | <b>5.4</b>  | <b>8.0</b>  | <b>30.4</b>  | <b>56.6</b>  | <b>193.0</b> | <b>196.2</b> | <b>197.8</b> | <b>173.9</b> | <b>178.8</b> |
| <b>EQUITY</b>                        |             |             |              |              |              |              |              |              |              |
| Convertible preferred stock          | 105.4       | 133.2       | -            | -            | -            | -            | -            | -            | -            |
| Common stock                         | 9.0         | 9.0         | 9.0          | 9.0          | 9.0          | 9.0          | 9.0          | 9.0          | 9.0          |
| Additional paid-in capital           | 3.2         | 5.3         | 290.9        | 424.1        | 454.7        | 455.7        | 456.7        | 457.7        | 458.7        |
| Accumulated OCI                      | 0.0         | 0.0         | 0.1          | (0.2)        | (0.3)        | (0.3)        | (0.3)        | (0.3)        | (0.3)        |
| Accumulated deficit                  | (65.0)      | (91.2)      | (122.0)      | (188.4)      | (221.7)      | (217.1)      | (170.1)      | (97.2)       | 4.1          |
| <b>Total equity</b>                  | <b>43.6</b> | <b>67.4</b> | <b>172.1</b> | <b>234.6</b> | <b>237.7</b> | <b>239.3</b> | <b>286.3</b> | <b>360.2</b> | <b>462.5</b> |
| <b>Total liabilities and equity</b>  | <b>49.1</b> | <b>75.4</b> | <b>202.5</b> | <b>291.2</b> | <b>420.6</b> | <b>436.5</b> | <b>484.0</b> | <b>534.0</b> | <b>641.2</b> |
| <b>Working capital</b>               |             |             |              |              |              |              |              |              |              |
| Days sales outstanding               | 117.8       | 132.6       | 61.9         | 61.9         | 62.0         | 65.0         | 65.0         | 65.0         | 65.0         |
| Days inventory                       | 463.7       | 389.0       | 447.6        | 444.8        | 375.0        | 300.0        | 275.0        | 250.0        | 220.0        |
| Days payable                         | 94.6        | 122.4       | 134.4        | 156.0        | 150.0        | 125.0        | 100.0        | 75.0         | 75.0         |
| Cash conversion cycle                | 486.9       | 389.2       | 375.2        | 350.8        | 287.0        | 240.0        | 240.0        | 240.0        | 210.0        |

Source: Morgan Stanley Research; Company Data

## Exhibit 5: Nevro: Cash Flow Analysis

(\$ in millions, except per share data)

|  | 2013A         | 2013A         | 2014A          | 2015A          | 2016E         | 2017E         | 2018E         | 2019E         | 2020E        |
|--|---------------|---------------|----------------|----------------|---------------|---------------|---------------|---------------|--------------|
| <b>Cash Flows from operating activities</b>            |               |               |                |                |               |               |               |               |              |
| <b>Net income (loss)</b>                               | <b>(19.6)</b> | <b>(26.6)</b> | <b>(30.7)</b>  | <b>(67.4)</b>  | <b>(32.3)</b> | <b>(9.2)</b>  | <b>42.1</b>   | <b>72.9</b>   | <b>101.2</b> |
| Depreciation and amortization                          | 0.0           | 0.0           | 0.1            | 0.6            | 0.8           | 0.1           | 0.1           | 0.1           | 0.1          |
| Stock-based compensation expense                       | 1.1           | 1.6           | 2.0            | 7.3            | 7.0           | 1.0           | 1.0           | 1.0           | 1.0          |
| Deferred taxes   | -             | -             | -              | -              | -             | 4.8           | 4.9           | -             | -            |
| Amortization of premium/discount on short-term investm | 0.5           | 0.5           | 0.1            | (0.5)          | (0.2)         | -             | -             | -             | -            |
| Noncash research and development expense               | -             | -             | 0.5            | -              | -             | -             | -             | -             | -            |
| Noncash interest expense                               | -             | -             | 0.0            | 0.2            | 0.4           | -             | -             | -             | -            |
| Provision for doubtful accounts                        | -             | -             | (0.2)          | 0.1            | 0.3           | -             | -             | -             | -            |
| Write-down of inventory / Other                        | -             | 1.1           | 0.8            | 2.8            | 2.8           | -             | -             | -             | -            |
| <b>Changes in working capital</b>                      | <b>(5.2)</b>  | <b>1.7</b>    | <b>(3.8)</b>   | <b>(43.6)</b>  | <b>(36.4)</b> | <b>(22.3)</b> | <b>(28.3)</b> | <b>(29.6)</b> | <b>(5.8)</b> |
| <b>Net cash provided by operating activities</b>       | <b>(22.5)</b> | <b>(21.1)</b> | <b>(31.1)</b>  | <b>(106.4)</b> | <b>(67.6)</b> | <b>(16.7)</b> | <b>19.8</b>   | <b>53.5</b>   | <b>95.5</b>  |
| <b>Cash flows from investing activities</b>            |               |               |                |                |               |               |               |               |              |
| Purchases of short-term investments                    | (40.4)        | (70.4)        | (199.3)        | (190.0)        | (234.2)       | -             | -             | -             | -            |
| Proceeds from maturity of short-term investments       | 55.7          | 50.9          | 51.6           | 235.3          | 131.6         | -             | -             | -             | -            |
| Restricted cash  | (0.1)         | (0.2)         | -              | (0.6)          | -             | -             | -             | -             | -            |
| Purchase of property and equipment                     | (0.0)         | (0.1)         | (0.6)          | (0.5)          | (1.7)         | (0.1)         | (0.1)         | (0.1)         | (0.1)        |
| <b>Net cash provided by investing activities</b>       | <b>15.3</b>   | <b>(19.8)</b> | <b>(108.1)</b> | <b>39.7</b>    | <b>(94.4)</b> | <b>(0.1)</b>  | <b>(0.1)</b>  | <b>(0.1)</b>  | <b>(0.1)</b> |
| <b>Cash Flows from Financing Activities</b>            |               |               |                |                |               |               |               |               |              |
| Proceeds from issuance of convertible preferred stock  | -             | 47.7          | -              | -              | -             | -             | -             | -             | -            |
| Proceeds from issuance of common stock                 | 1.5           | 0.1           | 132.6          | 122.8          | 36.6          | -             | -             | -             | -            |
| Payment of deferred offering costs                     | -             | -             | -              | -              | -             | -             | -             | -             | -            |
| Debt issuance (paydown)                                | -             | -             | 19.5           | -              | 102.4         | -             | -             | (20.0)        | -            |
| <b>Net cash provided by financing activities</b>       | <b>1.5</b>    | <b>47.8</b>   | <b>152.1</b>   | <b>122.8</b>   | <b>139.2</b>  | <b>-</b>      | <b>-</b>      | <b>(20.6)</b> | <b>-</b>     |
| <b>Exchange differences</b>                            | <b>-</b>      | <b>-</b>      | <b>-</b>       | <b>(0.3)</b>   | <b>(0.4)</b>  | <b>-</b>      | <b>-</b>      | <b>-</b>      | <b>-</b>     |
| <b>Change in cash and cash equivalents</b>             | <b>(5.7)</b>  | <b>6.6</b>    | <b>12.9</b>    | <b>61.7</b>    | <b>(12.7)</b> | <b>(16.7)</b> | <b>19.7</b>   | <b>33.4</b>   | <b>95.5</b>  |
| Cash at the beginning of the period                    | 11.3          | 9.6           | 12.4           | 25.3           | 87.0          | 73.9          | 57.2          | 76.9          | 110.3        |
| Cash at the end of the period                          | 5.6           | 12.4          | 25.3           | 87.0           | 73.9          | 57.2          | 76.9          | 110.3         | 206.8        |

Source: Morgan Stanley Research; Company Data



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(as of October 31, 2016)



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| STOCK RATING<br>CATEGORY | COVERAGE UNIVERSE |               | INVESTMENT BANKING CLIENTS (IBC) |                   |                            | OTHER MATERIAL<br>INVESTMENT SERVICES<br>CLIENTS (MISC) |                                |
|--------------------------|-------------------|---------------|----------------------------------|-------------------|----------------------------|---|--------------------------------|
|                          | COUNT             | % OF<br>TOTAL | COUNT                            | % OF<br>TOTAL IBC | % OF<br>RATING<br>CATEGORY | COUNT   | % OF<br>TOTAL<br>OTHER<br>MISC |
| <b>Overweight/Buy</b>    | <b>1142</b>       | <b>35%</b>    | <b>264</b>                       | <b>40%</b>        | <b>23%</b>                 | <b>566</b>  | <b>36%</b>                     |
| <b>Equal-weight/Hold</b> | <b>1431</b>       | <b>43%</b>    | <b>303</b>                       | <b>46%</b>        | <b>21%</b>                 | <b>713</b>  | <b>45%</b>                     |
| <b>Not-Rated/Hold</b>    | <b>69</b>         | <b>2%</b>     | <b>7</b>                         | <b>1%</b>         | <b>10%</b>                 | <b>9</b>  | <b>1%</b>                      |
| <b>Underweight/Sell</b>  | <b>665</b>        | <b>20%</b>    | <b>81</b>                        | <b>12%</b>        | <b>12%</b>                 | <b>288</b>  | <b>18%</b>                     |
| <b>TOTAL</b>             | <b>3,307</b>      |               | <b>655</b>                       |                   |                            | <b>1576</b>   |                                |

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months.

### Analyst Stock Ratings

Overweight (O). The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Equal-weight (E). The stock's total return is expected to be in line with the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Not-Rated (NR). Currently the analyst does not have adequate conviction about the stock's total return relative to the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Underweight (U). The stock's total return is expected to be below the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

### Analyst Industry Views

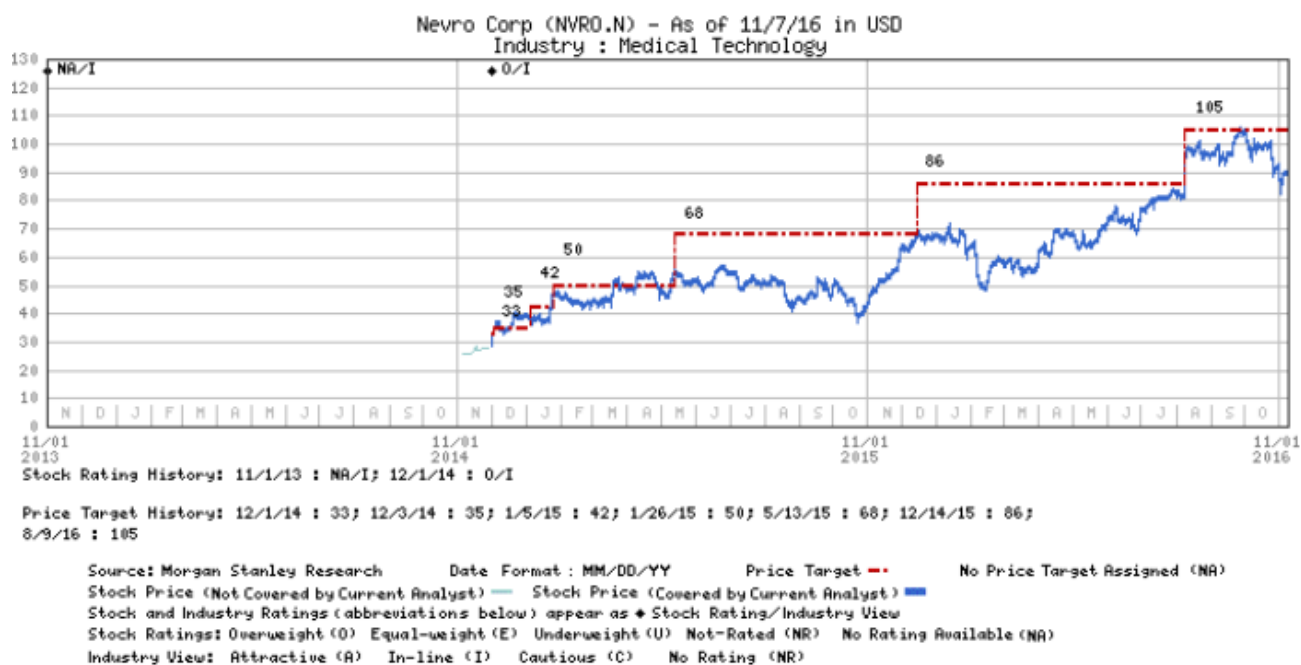
Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index or MSCI sub-regional index or MSCI AC Asia Pacific ex Japan Index.

### Stock Price, Price Target and Rating History (See Rating Definitions)



Effective January 13, 2014, the stocks covered by Morgan Stanley Asia Pacific will be rated relative to the analyst's industry (or industry team's) coverage.

Effective January 13, 2014, the industry view benchmarks for Morgan Stanley Asia Pacific are as follows: relevant MSCI country index or MSCI sub-regional index or MSCI AC Asia Pacific ex Japan Index.

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## INDUSTRY COVERAGE: Medical Technology

| COMPANY (TICKER)                   | RATING (AS OF) | PRICE* (11/07/2016) |
|------------------------------------|----------------|---------------------|
| <b>David R. Lewis</b>              |                |                     |
| Abbott Laboratories (ABT.N)        | E (01/04/2016) | \$39.86             |
| Abiomed (ABMD.O)                   | E (02/06/2009) | \$107.34            |
| Baxter International (BAX.N)       | U (05/06/2016) | \$47.62             |
| Becton Dickinson (BDX.N)           | E (01/04/2016) | \$177.89            |
| Boston Scientific (BSX.N)          | O (10/16/2015) | \$22.04             |
| C.R. Bard (BCR.N)                  | E (01/05/2015) | \$220.62            |
| DexCom Inc (DXCM.O)                | O (11/02/2015) | \$63.00             |
| Edwards Lifesciences (EW.N)        | O (07/06/2015) | \$91.34             |
| Grifols (GRFS.O)                   | U (01/04/2016) | \$14.99             |
| Haemonetics Corporation (HAE.N)    | E (05/01/2012) | \$36.84             |
| Halyard Health (HYH.N)             | U (10/12/2015) | \$34.58             |
| Hill-Rom Holdings Inc. (HRC.N)     | O (06/16/2016) | \$59.43             |
| Hologic, Inc. (HOLX.O)             | E (01/06/2014) | \$38.68             |
| Insulet Corp. (PODD.O)             | E (11/02/2015) | \$35.81             |
| Integra LifeSciences (IART.O)      | E (11/11/2013) | \$78.41             |
| Intuitive Surgical Inc. (ISRG.O)   | O (01/04/2016) | \$678.43            |
| Johnson & Johnson (JNJ.N)          | E (08/10/2010) | \$116.66            |
| Medtronic PLC (MDT.N)              | O (06/17/2014) | \$83.95             |
| Nevro Corp (NVRO.N)                | O (12/01/2014) | \$89.12             |
| St. Jude Medical (STJ.N)           | E (05/02/2016) | \$78.96             |
| Stryker Corporation (SYK.N)        | O (01/08/2010) | \$119.68            |
| Teleflex Inc. (TFX.N)              | E (01/05/2015) | \$146.32            |
| Zimmer Biomet Holdings Inc (ZBH.N) | O (01/05/2015) | \$104.45            |
| <b>Jonathan L. Demchick</b>        |                |                     |
| Globus Medical Inc (GMED.N)        | E (07/27/2016) | \$22.56             |
| NuVasive Inc (NUVA.O)              | E (09/14/2015) | \$59.69             |
| <b>Steve Beachaw</b>               |                |                     |
| Align Technology Inc (ALGN.O)      | O (04/21/2015) | \$87.86             |
| Dentsply Sirona Inc (XRAY.O)       | O (11/01/2016) | \$61.12             |

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\* Historical prices are not split adjusted.