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Stock Rating
Overweight

Industry View
In-Line

Sagent Pharmaceuticals

Clear Signs of Progress in 3Q

3Q generally supports our positive thesis with solid gross margin improvement from 2Q's trough and 28% sequential revenue growth from new launches, providing additional validation of Sagent's business model of new launches, and product breadth, creating mix-driven margin expansion.

New product story positive. New launches for levofloxacin and gemcitabine combined with the on-going launch of shortage product paclitaxel suggest solid commercial and pipeline momentum. Levofloxcin trends remain strong and paclitaxel provides a tailwind for 4Q and into year-end. Moreover, the ANDA pipeline continues to shape up well for 2012 (16 approved but not launched).

GM margin progress encouraging: Incremental gross profit of ~46% shows clear progress on GM after 2Q's challenges. This is consistent with our thesis that new product launches will improve mix and drive GM expansion over time. Recent shortage list approvals levofloxacin, paclitaxel, and vecuronium should support this trend with the mid-teens GM FY guidance achievable to conservative.

Drug shortage and regulatory environment positive tailwinds. Management commentary suggests some positive but very early signs from the FDA. However, quantifying the exact impact is challenging for now.

Operating spending was slightly greater than our estimate (by ~$1.5MM). We agree with aggressive, opportunistic product development spend especially in the still early stages of Sagent's evolution. However, middle of the income statement leverage is key to the model, meaning this will be important to monitor.

3Q was generally in-line was MSe with revenue of $41MM vs MSe of $43 but GM was +300bps at 16.8% vs. MSe of 13.5%. Operating expenses were generally as expected at ~$10.5MM vs. $9.9MM MSe, yielding a loss per share of $0.17 vs. $0.20 MSe. We are making no major changes to our model.

Key Ratios and Statistics

Reuters: SGNT.O Bloomberg: SGNT US
Medical Technology / United States of America

Price target	**$29.00**
Shr price, close (Nov 4, 2011)	$24.01
Mkt cap, curr (mm)	$669
52-Week Range	$29.23-13.50

Fiscal Year ending	12/10	12/11e	12/12e	12/13e
ModelWare EPS ($)	**ND**	**(0.91)**	**0.34**	**1.22**
Prior ModelWare EPS ($)	**-**	**(1.11)**	**0.35**	**1.21**
P/E	**ND**	**NM**	**69.7**	**19.7**
Consensus EPS ($)§	**-**	**(0.85)**	**0.46**	**1.80**
Div yld (%)	ND	0.0	0.0	0.0

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).
§ = Consensus data is provided by Thomson Reuters Estimates.
e = Morgan Stanley Research estimates

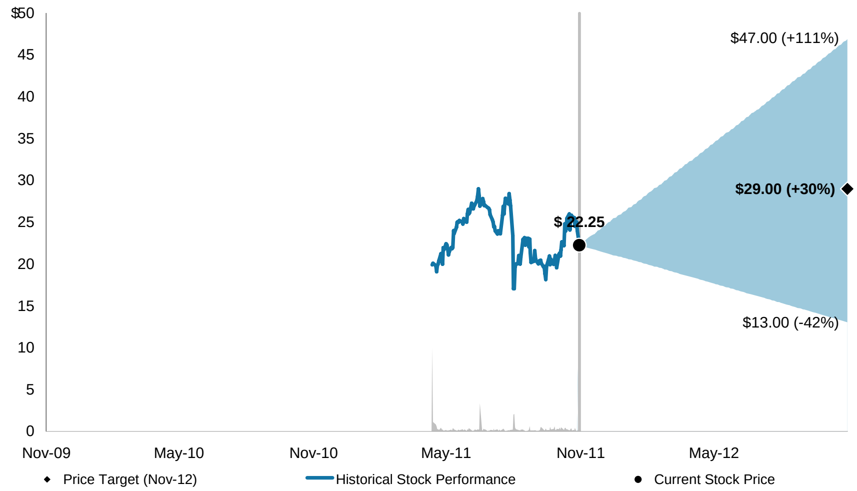
Quarterly ModelWare EPS

Quarter	2010	2011e Prior	2011e Current	2012e Prior	2012e Current
Q1	(3.89)	-	(2.09)a	0.09	0.09
Q2	ND	-	(0.37)a	0.09	0.08
Q3	ND	-	(0.09)a	0.09	0.08
Q4	ND	(0.15)	(0.11)	0.08	0.08

e = Morgan Stanley Research estimates, **a** = Actual company reported data

Risk-Reward Snapshot: Sagent Pharmaceuticals (SGNT, OW, $29)

Risk-Reward View: Pipeline Approvals and Margin Expansion Drive Positive View



Source: Thomson Reuters, Morgan Stanley Research

Price Target $29		**3.5x 2012 EV/Revenue and 10.5x 2013 EV/EBITDA which is a premium to peers** given Sagent's higher growth and margin expansion potential.
Bull Case $47	Blended valuation	**Generic blockbusters abound creating upside to margins.** Sagent receives approval for nearly every major product likely to be in the pipeline including taxotere, oxaliplatin, and vancomycin with upside to share expectations (average of 14% vs. 9% in base case) as Sagent emerges as a major injectables player. Revenue upside falls to operating profit at high rates with greater margin expansion. Success merits a premium multiple.
Base Case $29	Blended valuation	**Strong new product approval cadence drives margin expansion,** Revenue CAGR of 66% through 2013 driven by new product approvals across oncology, anti-infectives and critical care. Important high margin product approvals come through on time allowing GM to expand to 30% from 12.2% in 2010. Sagent model is validated as these approvals flow through at high margin with OM reaching 17.5% by 2013.
Bear Case $13	Blended valuation	**Sagent's novel model sees margin challenges**. Here the pace of new product approvals and particularly the larger, important opportunities proves harder to come by capping gross and operating margins. Alternatively, Sagent could require greater spending levels despite new approvals so that margin expansion disappoints. Revenue CAGR of 54% through 2013 with operating margins of 9.5% by 2013 vs. 18% in our base case.

Why Overweight?

- **Revenue growth potential.** We see a clear path to sustainable >20% revenue growth for the next three years as Sagent's pipeline matures off a low base. >100% growth in 2010
- **Margin expansion potential** mounting approvals on a non-vertically integrated cost structure allow incremental revenue to flow to the bottom line at high margins.
- **Room for new players** the generics space is competitive but chronic shortages and Sagent's strong management team leave us positive on share gain opportunity

Key Value Drivers

- Pipeline approvals
- New additions to the pipeline
- Lack of vertical integration creates margin expansion potential
- Lean middle of the income statement
- High contribution margins of the generic injectables model
- Successful launches of heparin, topotecan and others prove the company's capability.

Key Risks

- Maintaining product quality with worldwide supply chain while controlling spending
- Competition from larger players and new entrants
- FDA approval timing of important, high margin products
- Management continuity
- Pricing pressure

Potential Catalysts

- New product approvals
- Quarterly results

Investment Case

A Closer Look at 3Q

Belying the stock's reaction, there was plenty to like in 3Q that provides additional validation of Sagent's business model and our positive thesis on the stock. Expectations were elevated into the quarter given positive IMS trends and a strong levofloxacin launch that suggested upside to consensus. That said, revenue was solid with 28% Q/Q and 94% Y/Y growth as new product momentum took hold (gemcitabine, levofloxacin, and Zosyn). Moreover, solid pipeline commentary suggests these trend look sustainable.

Pricing environment remains challenging. Management commentary suggests the base pricing environment remains very challenging and is running ahead of expectations. Heparin, gemcitabine, and Zoysn all highlight this trend. This will be a key trend to watch going forward. In the near term, Sagent's modest gross profit base means new launches can more than offset this trend and drive the margin story. However, the pricing reality only works to magnify the importance of pipeline progress and new launches and news was generally positive in 3Q.

Specific product and launch updates include:

- **Heparin**: still a positive contributor but pricing pressure in this market is significant. While there appears to be lots finger pointing about the source of heavy discounting, we suspect that it is simply a reflection of an increasing number of competitors. Management commentary suggests pricing pressure will continue and long term margin expectations on this product likely need to come down. The Hikma (covered by Peter Verdult) launch in coming quarters is worth watching.

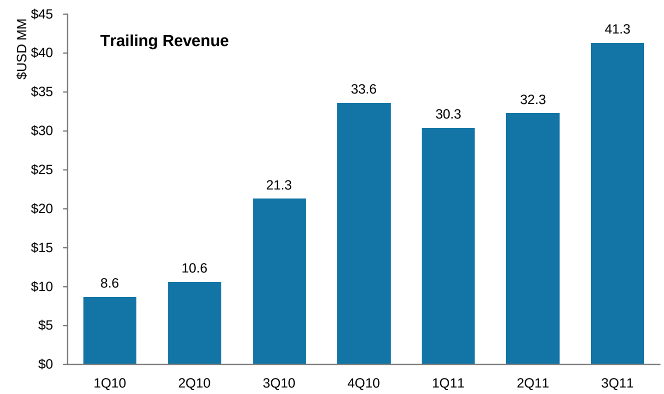
- **Gemcitabine**: Pricing pressure in this market is extreme and Hospira's solution launch will only intensify these trends. For the time being, Sagent's small distributor focused strategy appears to be working well.

- **Zosyn**: Pfizer's aggressive pricing policy is continuing, but commentary suggests this has stabilized. We continue to have relatively low expectations for this product.

- **Levofloxacin**: limited competition has helped to make this a strong launch and revenue should increase again in 4Q. However, competition will come eventually, meaning new pipeline approvals will be key for 2012. In addition, Hospira's commentary that Rocky Mount and Austin, TX issues are slowing approval could prove to Sagent's gain.

Exhibit 1

New Product Launches Accelerate Revenue Growth



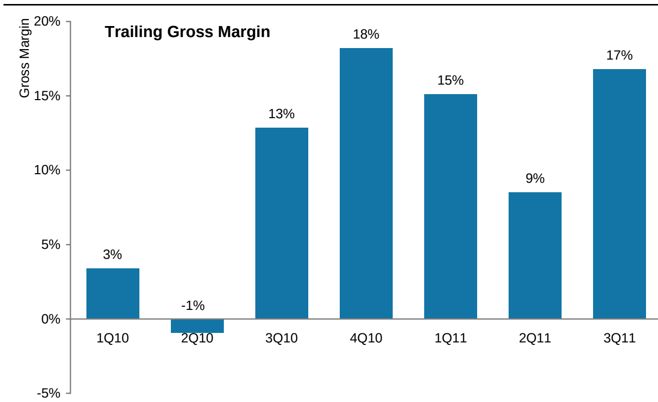
Source: Company data, Morgan Stanley Research

GM takes a step forward. Exiting 2Q11, GM was the major concern for Sagent with a launch delay and pricing pressure driving a GM of just 8.5%. 3Q saw GM recover strongly to 16.8% or 828 bps Q/Q on positive mix from new launches with levofloxacin being the greatest contributor.

<u>Most important, incremental GM was ~46%, sequentially showing the underlying power of the business model</u> as new launches take hold particularly in competitively advantaged markets like levofloxacin. Our estimates for 4Q imply only an incremental GM of 21% largely due to the paclitaxel launch.

Exhibit 2

Gross Margins recover from 2Q



Source: Company data, Morgan Stanley Research

Commentary from management that GM should rise again sequentially in 4Q means that guidance for full year mid-teens GM is within reach. In fact, holding GM flat Q/Q put full year GM at 14.7%, which is already in the guidance range. The launch of paclitaxel with pricing power should make for another solid quarter of GM expansion in 4Q.

Operating spending slightly ahead but no major changes. Operating spending was slightly ahead of expectations on both product development ($3.5 MM vs $2.8 MM) and SG&A ($6.7MM vs $5.8MM). Middle of the income statement leverage is key to Sagent's business model to offset structurally lower GM. Thus, finding a sustainable level of opex to support the pipeline and selling effort is a second key expense dynamic. Management commentary suggests the SG&A should stabilize around current levels of $6.3MM to $6.7MM. We expect product development expense to fluctuate as products, progress and partnership deals close.

Pipeline update bodes well for 2012

Progress on the KSP joint venture Chengdu, China facility. The facility completed validation testing and is now considered operational by management. The first product submission was made to the FDA during the quarter, with another 2+ expected by year end. With all Chengdu submitted products on the critical drug shortage list, accelerated FDA timelines could support a 1H12 inspection, a potentially interesting early test of pull through from President Obama's recent executive order.

Taking a conservative approach on paclitaxel launch. Sagent's launch strategy is taking shape with management electing to attempt to hold price at least during this phase of limited competition. By not aggressively pursuing market share and offering the drug at a premium price, the company should be able to capture near term margin during the shortage period. This should offer greater NPV as the long term competition is inevitable, but we are interested to see how well this strategy works practically. For our model, we are assuming $5.7 MM in sequential revenue growth of which taxol could account for ~50% or more depending on how well the launch goes. Presumably paclitaxel should provide a revenue and margin bridge to pipeline launches in 2012 (particularly Strides).

Pipeline progressing well. There are 59 ANDAs on file or pending commercial launch, covering 32 products, which adjusted for approvals is flat to up Q/Q. Additionally, the earlier stage pipeline continues to develop well; there are 27 active R&D projects vs 26 in 2Q. There are 16 approved ANDAs compared to 6 in 2Q, as the pipeline age mix should support a sustainable rate of approvals.

Of the 16 approved products, 8 are from the Sagent Strides Joint venture. An on-going facility transfer will delay launch until 1H12 as expected. Management commentary put the average market size of the 8 products in the ~$30MM range, suggesting a reasonable opportunity for 2012.

Exhibit 3

Pipeline Still Solid, Largely Unchanged

	12/31/08	12/31/09	10/31/10	12/31/10	03/31/11	06/30/11	09/30/11
On File:							
Total Products	*ND*	*ND*	38	38	39	42	32
ANDAs	38	63	68	68	69	75	59
Age of Filings:							
Average On File (months)	*ND*	*ND*	*19*	*21*	*ND*	*ND*	*ND*
<12 months	*ND*	*ND*	21	19	*ND*	*ND*	*ND*
12-24 months	*ND*	*ND*	24	23	*ND*	*ND*	*ND*
>24 months	*ND*	*ND*	16	26	*ND*	*ND*	*ND*
Initial Development							
Total Products	*ND*	*ND*	41	51	32	26	27
ANDAs	*ND*	*ND*	*ND*	*ND*	52	25	30
Approved Not Launched							
Total Products	*ND*	*ND*	7	8	6	6	16
ANDAs	*ND*	*ND*	9	9	9	*ND*	*ND*

Source: Company data, Morgan Stanley Research

Morgan Stanley is acting as a financial advisor to Pfizer Inc. ("Pfizer") in relation to its review of strategic alternatives for its Nutrition business. Pfizer will pay fees to Morgan Stanley for its services, including transaction fees that will be subject to the consummation of any resulting transaction. Please refer to the notes at the end of the report.

Exhibit 4

Changes to Model

Last Updated August 10, 2011

	2011	2012	2013	2014	2015	2016	Revision
Total Revenues							
Current	$151	$245	$339	$423	$494	$552	adjusting model for modestly greater base pricing pressure
% Growth (y/y)		*63%*	*38%*	*25%*	*17%*	*12%*	
Prior	$155	$249	$343	$426	$497	$556	
% Growth (y/y)		*61%*	*38%*	*24%*	*17%*	*12%*	
Gross Profit							
Current	$22	$61	$102	$139	$173	$193	no major changes
% Gross Margin	*15%*	*25%*	*30%*	*33.0%*	*35%*	*35%*	
Prior	$20	$62	$103	$141	$174	$195	
% Gross Margin	*13%*	*25%*	*30%*	*33.0%*	*35%*	*35%*	
SG&A							
Current	$25	$26	$27	$27	$28	$30	no major changes
% of Sales	*16%*	*11%*	*8%*	*6.5%*	*6%*	*6%*	
Prior	$23	$24	$26	$28	$29	$31	
% of Sales	*15%*	*10%*	*8%*	*6.5%*	*6%*	*6%*	
Product Development							
Current	$11	$13	$15	$18	$20	$22	no major changes
% of Sales	*7%*	*5%*	*5%*	*4%*	*4%*	*4%*	
Prior	$10	$15	$17	$19	$21	$22	
% of Sales	*7%*	*6%*	*5%*	*5%*	*4%*	*4%*	
EPS, diluted							
Current	($0.91)	$0.34	$1.22	$1.94	$2.51	$2.79	
% Growth (y/y)		*-138%*	*254%*	*59%*	*29%*	*11%*	
Prior	($1.11)	$0.35	$1.21	$1.90	$2.47	$2.77	
% Growth (y/y)		*-131%*	*251%*	*57%*	*30%*	*12%*	
Diluted Shares Outstanding							
Current	20	30	31	32	32	33	
Prior	20	31	31	32	33	33	
Free Cash Flow							
Current	($22)	($4)	$20	$45	$67	$79	
Prior	($27)	($3)	$20	$44	$67	$80	

Source: Company data, Morgan Stanley Research

Exhibit 5

Variance

	Current Quarter				Y/Y		
($ in millions, except EPS)	3Q11E	3Q11A	A vs E (%)	Cons Est 3Q11	2Q10A	% Change	Comments
Total Revenues	**$43**	**$41**	**(4%)**	**$42**	**$11**	**291%**	
COGS	$37	**34**	(8%)	$34	$11	222%	
Gross Profit	**$6**	**$7**	**20%**	$8	**($0)**		
Operating Expenses:							
Product Development	$2.8	$3.5	24%		$3	6%	
SG&A	$5.8	$6.7	15%		$4	54%	
Total Operating Expenses*	**$8.6**	**$10.1**	**18%**		**$8**	**33%**	
Operating Income (Loss)	**($4)**	**($4)**	**(12%)**		**($8)**		
Interest Income (Expense)	$1.4	**($1.1)**	(178%)		$0		
Net Income (Loss)	**($6)**	**($4.7)**	**(14%)**		**($7)**		
Shares Outstanding	28	28	(2%)		ND		
EPS, Diluted	**($0.20)**	**($0.17)**		**($0.11)**	**N/A**		
Margin Analysis							
Gross Margin	13.5%	16.8%	330 bps	**18.1%**	-0.9%	1,770 bps	
Product Development	6.5%	8.4%	190 bps		31.0%	(2,260 bps)	
SG&A	13.5%	16.2%	270 bps		41.2%	(2,500 bps)	
Operating Income	-9.5%	-8.7%	80 bps	0%	-73.2%	6,440 bps	
Net Income	-12.9%	-11.5%	140 bps	**0%**	-70.0%	5,860 bps	

***Includes JV Equity**

Source: Company data, Morgan Stanley Research

Exhibit 6

Income Statement

	2007A	2008A	2009A	2010A	2011E Mar-11	2011E Jun-11	2011E Sep-11	2011E Dec-11	2011E	2012E	2013E	2014E	2015E	2016E
Total Revenue	**$0.1**	**$12.0**	**$29.2**	**$74.1**	**$30.3**	**$32.3**	**$41.3**	**$47.0**	**$150.9**	**$245.3**	**$338.9**	**$422.7**	**$493.9**	**$552.4**
% Growth (y/y)	*1%*	*11906%*	*144%*	*153%*	*251%*	*205%*	*94%*	*40%*	*104%*	*63%*	*38%*	*25%*	*17%*	*12%*
Total Cost of Goods Sold	0.0650	12	29	65	26	30	34	39	128	184	237	283	321	359
gross margin	*35.0%*	*0.6%*	*1.6%*	*12.2%*	*15.1%*	*8.5%*	*16.8%*	*17.3%*	*14.9%*	*25.0%*	*30.0%*	*33.0%*	*35.0%*	*35.0%*
Gross Profit	**$0.0**	**$0.1**	**$0.5**	**$9.0**	**$4.6**	**$2.7**	**$6.9**	**$8.1**	**$22.4**	**$61.3**	**$101.7**	**$139.5**	**$172.9**	**$193.3**
Operating Expenses														
Product Development	2.5	18.7	11.9	11.2	2.4	2.4	3.5	2.8	11.0	12.9	15.3	18.0	19.8	22.1
% of revenue	*NM*	*156.1%*	*40.6%*	*15.2%*	*7.8%*	*7.4%*	*8.4%*	*6.0%*	*7.3%*	*5.3%*	*4.5%*	*4.3%*	*4.0%*	*4.0%*
SG&A	10.6	11.0	12.1	18.9	5.0	6.5	6.7	6.5	24.6	25.8	27.1	27.5	28.4	30.4
% of revenue	*NM*	*91.6%*	*41.3%*	*25.6%*	*16.4%*	*20.1%*	*16.2%*	*13.8%*	*11.0%*	*10.5%*	*8.0%*	*6.5%*	*5.8%*	*5.5%*
Total Operating Expenses	$13.9	$30.8	$25.4	$31.6	$8.0	$9.4	$10.5	$9.8	$37.7	$41.6	$42.4	$45.4	$48.2	$52.5
EBIT (non-GAAP)	**($13.8)**	**($30.8)**	**($25.0)**	**($22.6)**	**($3.4)**	**($6.6)**	**($3.6)**	**($1.7)**	**($15.3)**	**$19.7**	**$59.3**	**$94.1**	**$124.7**	**$140.9**
Other (Income) Expense, Net	(0.6)	0.8	7.0	2	1	2	(1)	1	3	4.1	3.0	2.6	3.9	3.8
Pretax Income	**(13.2)**	**(31.6)**	**(32.0)**	**(24.5)**	**(4.4)**	**(8.2)**	**(4.7)**	**(3.1)**	**(18.2)**	**15.6**	**56.3**	**91.4**	**120.8**	**137.0**
Income Tax Expense (benefit)	-	-	-	-	-	-	-	-	-	5.1	18.6	30.2	39.9	45.2
Income Tax Rate	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*5%*	*5%*	*NM*	*33%*	*33%*	*33%*	*33%*	*33%*
Net Income	**($13.2)**	**($31.6)**	**($32.0)**	**($24)**	**($4.4)**	**($8.2)**	**($4.7)**	**($3.1)**	**($18)**	**$10.5**	**$37.7**	**$61.3**	**$80.9**	**$91.8**
One Time Items - Post Tax	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Net Income Reported	**($13.2)**	**($31.6)**	**($32.0)**	**($24.5)**	**($4.4)**	**($8.2)**	**($4.7)**	**($3.1)**	**($18.2)**	**$10.5**	**$37.7**	**$61.3**	**$80.9**	**$91.8**
Basic EPS					**($2.09)**	**($0.37)**	**($0.17)**	**($0.11)**	**($0.91)**	**$0.37**	**$1.30**	**$2.08**	**$2.69**	**$2.99**
Diluted EPS (fully taxed)					**($2.09)**	**($0.37)**	**($0.17)**	**($0.11)**	**($0.91)**	**$0.34**	**$1.22**	**$1.94**	**$2.51**	**$2.79**
Basic Shares Outstanding	ND	ND	ND	ND	2.1	22.1	27.9	28.0	20.0	28.4	28.9	29.5	30.1	30.7
Diluted Shares Outstanding	ND	ND	ND	ND	2.1	22.1	27.9	28.0	20.0	30.4	31.0	31.6	32.2	32.9
Margins/Expense Analysis:														
Gross Margin														
Total Gross Margin	*35.0%*	***0.6%***	***2%***	***12.2%***	***15.1%***	***8.5%***	***16.8%***	***17.3%***	***14.9%***	***25.0%***	***30.0%***	***33.0%***	***35.0%***	***35.0%***
R&D	*2540.0%*	*156.1%*	*40.6%*	*15.2%*	*7.8%*	*7.4%*	*8.4%*	*6.0%*	*7.3%*	*5.3%*	*4.5%*	*4.3%*	*4.0%*	*4.0%*
SG&A	*10630.0%*	*91.6%*	*41.3%*	*25.6%*	*16.4%*	*20.1%*	*16.2%*	*13.8%*	*16.3%*	*10.5%*	*8.0%*	*6.5%*	*5.8%*	*5.5%*
EBIT		*-256.1%*	*-85.4%*	*-30.5%*	*-11.3%*	*-20.5%*	*-8.7%*	*-3.5%*	*-10.2%*	*8.0%*	*17.5%*	*22.3%*	*25.3%*	*25.5%*
Net Income		*-262.8%*	*-109.5%*	*-33.1%*	*-14.4%*	*-25.4%*	*-11.5%*	*-6.7%*	*-12.1%*	*4.3%*	*11.1%*	*14.5%*	*16.4%*	*16.6%*
Incremental EBIT		*-142.1%*	*33.6%*	*5.3%*	*17.0%*	*5.1%*	*3.3%*	*5.7%*	*9.5%*	*37.1%*	*42.3%*	*41.5%*	*43.1%*	*27.6%*
Operating Expense	*13868.0%*	*256.7%*	*86.9%*	*42.7%*	*26.4%*	*29.1%*	*25.6%*	*20.9%*	*25.0%*	*17.0%*	*12.5%*	*10.8%*	*9.8%*	*9.5%*
Growth Analysis:														
Total revenue		*11906%*	*144%*	*153%*	*251%*	*205%*	*94%*	*40%*	*104%*	*63%*	*38%*	*25%*	*17%*	*12%*
EBIT		*122%*	*NA*	*NA*	*NA*	*NA*	*NA*	*NA*	*NA*	*NA*	*201%*	*59%*	*33%*	*13%*
EPS		*NA*	*NA*	*NA*	*NA*	*NA*	*NA*	*NA*	*NA*	*NA*	*254%*	*59%*	*29%*	*11%*

Source: Company data, Morgan Stanley Research

Exhibit 7

Balance Sheet

	2008A	2009A	2010A	2011E	2012E	2013E	2014E	2015E	2016E
Assets									
Cash and Investments	25.7	8.0	34.6	133.4	124.9	136.4	179.0	245.8	324.6
Accounts Receivables, Net	0.2	6.9	18.9	16.8	27.3	37.7	47.0	54.9	61.4
Inventories	6.5	18.985	30.6	40.1	57.5	74.1	88.5	100.3	112.2
Prepaid Expenses & Other Current Assets	0.2	8.4	5.3	6.3	7.0	7.1	7.6	8.1	8.8
Due from related party and other	0.0	0.5	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Note receivable	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Deferred income taxes	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Current Assets	**32.7**	**42.96**	**90.4**	**197.7**	**217.6**	**256.3**	**323.1**	**410.1**	**508.0**
Restricted cash and cash equivalents	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Net Property, Plant & Equipment	0.9	0.7	0.8	2.5	3.2	5.7	8.3	10.9	13.6
Investment in joint ventures	12.2	19.5	24.5	20.0	17.1	17.2	17.2	17.3	17.3
Deferred financing costs	0.0	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Intangible assets, net	5.2	1.7	2.6	2.6	2.6	2.6	2.6	2.6	2.6
Total Assets	**51.1**	**65.1**	**118.6**	**223.1**	**240.9**	**282.1**	**351.6**	**441.2**	**541.9**
Liabilities									
Accounts Payable	9.0	17.3	24.4	25.7	36.8	47.5	56.6	64.2	71.8
Accrued Liabilities	3.9	4.9	11.0	11.0	11.0	11.0	11.0	11.0	11.0
Preferred stock w arrants	0.0	0.0	1.4	1.4	1.4	1.4	1.4	1.4	1.4
Notes payable	0.0	4.5	20.7	20.7	20.7	20.7	20.7	20.7	20.7
Total Current Liabilities	**13.0**	**26.8**	**57.6**	**58.9**	**70.0**	**80.6**	**89.8**	**97.4**	**105.0**
Deferred Income Taxes	0.0	sv	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Long-term Debt	0.0	0.0	0.0	25.0	20.2	12.0	10.0	10.0	10.0
Total Liabilities	**13.0**	**26.8**	**57.6**	**83.9**	**90.2**	**92.7**	**99.8**	**107.4**	**115.0**
Preferred stock (Series A)	83.0	113.0	113.0	0.0	0.0	0.0	0.0	0.0	0.0
Preferred stock (Series B)	0.0	0.0	44.8	0.0	0.0	0.0	0.0	0.0	0.0
Total preferred stock (Series A & B)	**83.0**	**113.0**	**157.8**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Common stock	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Preferred stock (non-series)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Additional paid-in capital	0.5	1.1	2.3	256.5	257.5	258.6	259.7	260.8	262.0
Accumulated deficit	(45.4)	(75.9)	(100.4)	(118.6)	(108.2)	(70.5)	(9.2)	71.7	163.5
Accumulated Other Comprehensive Income	0.0	0.0	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Treasury at Cost	0.0	0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Shareholders' Equity	**(44.9)**	**(74.8)**	**(96.8)**	**139.2**	**150.7**	**189.4**	**251.8**	**333.9**	**426.9**
Total Liabilities & Shareholders' Equity	**51.0**	**65.0**	**118.6**	**223.1**	**240.9**	**282.1**	**351.6**	**441.2**	**541.9**

Source: Company data, Morgan Stanley Research

Exhibit 8

Cash Flow Statement

	2007A	2008A	2009A	2010A	2011E	2012E	2013E	2014E	2015E	2016E
From Operating Activity										
Net Income (loss)	**(13.2)**	**(30.5)**	**(30.5)**	**(24.5)**	**(18.2)**	**10.5**	**37.7**	**61.3**	**80.9**	**91.8**
Depreciation	0.1	0.2	0.3	0.2	0.3	0.4	0.4	0.5	0.6	0.6
Amortization	0.5	1.8	4.0	1.0	1.0	2.0	0.3	0.1	0.1	0.1
Stock-based compensation, net of tax	0.0	0.3	0.6	0.9	0.9	1.0	1.0	1.1	1.2	1.2
Restricted stock repurchase liability	(0.2)	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Equity in net loss of unconsolidated JVs	0.7	1.1	1.5	1.5	4.6	3.0	0.0	0.0	0.0	0.0
Change in fair value of preferred stock w arrants	0.0	0.0	0.0	0.8	0.0	0.0	0.0	0.0	0.0	0.0
Net Change in Working Capital	**2.1**	**2.2**	**(18.6)**	**(7.8)**	**(7.2)**	**(17.4)**	**(16.5)**	**(15.0)**	**(12.6)**	**(11.5)**
Accounts Receivable	(0.1)	(0.1)	(6.7)	(12.1)	2.2	(10.5)	(10.4)	(9.3)	(7.9)	(6.5)
Inventories	(0.7)	(5.7)	(12.5)	(11.6)	(9.6)	(17.3)	(16.6)	(14.4)	(11.8)	(11.9)
Prepaid Expenses/Other Current Assets	(0.5)	0.3	(8.1)	3.1	(1.0)	(0.7)	(0.1)	(0.5)	(0.5)	(0.7)
Due from related party	0.0	0.0	(0.5)	(0.4)	0.0	0.0	0.0	0.0	0.0	0.0
Note receivable	(0.3)	0.3	(0.1)	-	0.0	0.0	0.0	0.0	0.0	0.0
Accounts Payable	3.2	7.9	9.3	13.2	1.2	11.1	10.7	9.2	7.6	7.6
Deferred revenue	0.5	(0.5)	0.0	-	0.0	0.0	0.0	0.0	0.0	0.0
Cash From Operations	**(10.0)**	**(24.9)**	**(42.8)**	**(27.8)**	**(18.6)**	**(0.6)**	**23.0**	**48.0**	**70.2**	**82.2**
From Investing Activity										
Capital expenditures	(0.6)	(0.5)	(0.1)	(0.3)	(3.0)	(3.1)	(3.2)	(3.2)	(3.3)	(3.4)
Funding of restricted cash, net	(0.2)	0.3	(0.3)	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Investments in unconsolidated JVs	(4.8)	(7.5)	(8.8)	(5.2)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)
Purchase of product licensing rights	(0.3)	(1.4)	(0.2)	(0.4)	0.0	0.0	0.0	0.0	0.0	0.0
Purchase of product development rights	(2.6)	(3.2)	(0.1)	(1.5)	0.0	0.0	0.0	0.0	0.0	0.0
Net from Investing	**(8.5)**	**(12.4)**	**(9.4)**	**(7.276)**	**(3.1)**	**(3.2)**	**(3.3)**	**(3.3)**	**(3.4)**	**(3.4)**
From Financing Activity										
Additions to notes payable	0.0	0.0	4.5	16.2	25.0	(4.8)	(8.2)	(2.0)	0.0	0.0
Payment of deferred financing costs	0.0	0.0	(0.3)	(0.1)	0.0	0.0	0.0	0.0	0.0	0.0
Proceeds from issuance of preferred stock (Series A anc	49.0	30.0	30.0	45.4	0.0	0.0	0.0	0.0	0.0	0.0
Proceeds from issuance of preferred stock (non-Series A	0.0	0.0	0.0	-	0.0	0.0	0.0	0.0	0.0	0.0
Proceeds from issuance of common stock	0.0	0.0	0.1	0.2	95.5	0.0	0.0	0.0	0.0	0.0
Net from Financing	**49.0**	**30.0**	**34.3**	**61.7**	**120.5**	**(4.8)**	**(8.2)**	**(2.0)**	**0.0**	**0.0**
Effect of exchange rate change	0.0	0.0	0.0	-	0.0	0.0	0.0	0.0	0.0	0.0
Net Cash Flow	**30.6**	**(7.2)**	**(17.9)**	**26.645**	**98.8**	**(8.6)**	**11.5**	**42.7**	**66.8**	**78.8**
Cash at Beginning of Year	2.3	32.9	25.7	7.7	34.4	133.2	124.7	136.2	178.8	245.6
Cash at End of Year	**32.9**	**25.7**	**7.7**	**34.4**	**133.2**	**124.7**	**136.2**	**178.8**	**245.6**	**324.4**

Source: Company data, Morgan Stanley Research

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(as of October 31, 2011)

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Underweight/Sell	**418**	**15%**	**115**	**11%**	**28%**
Total	**2,828**		**1018**		

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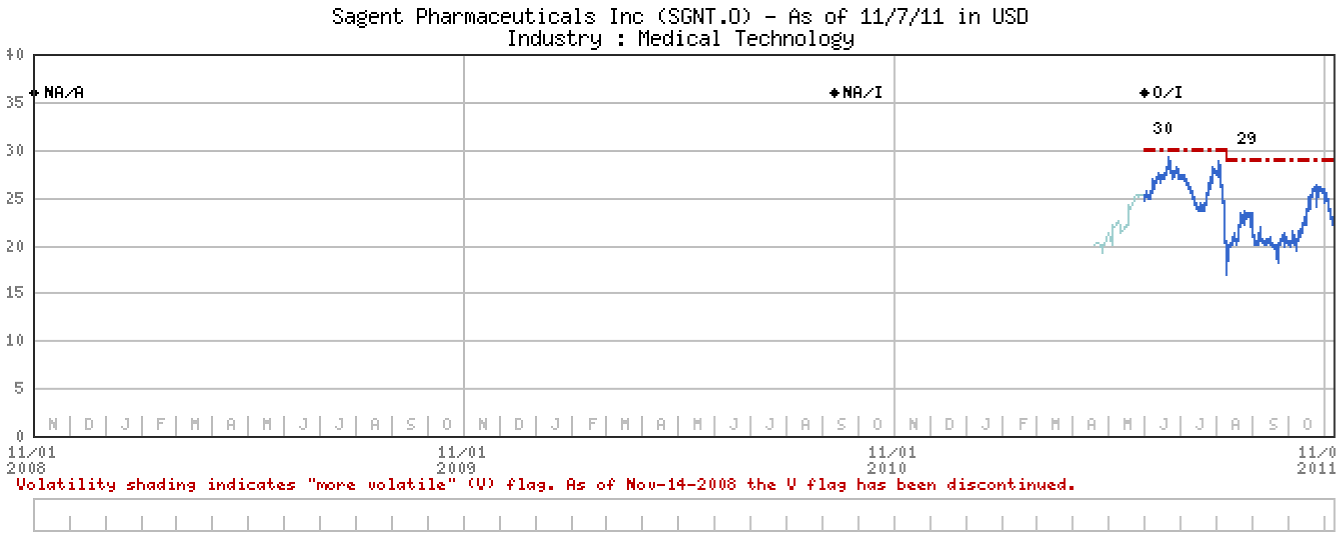

Stock Rating History: 11/1/08 : NA/A; 9/10/10 : NA/I; 5/31/11 : O/I

Price Target History: 5/31/11 : 30; 8/10/11 : 29

Source: Morgan Stanley Research   Date Format : MM/DD/YY   Price Target -·   No Price Target Assigned (NA)
Stock Price (Not Covered by Current Analyst)   Stock Price (Covered by Current Analyst)
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Industry Coverage:Medical Technology

Company (Ticker)	Rating (as of)	Price* (11/07/2011)
Steve Beuchaw		
Accuray Inc (ARAY.O)	E (09/27/2011)	$4.04
Align Technology Inc (ALGN.O)	U (09/12/2011)	$22.98
Dentsply International Inc. (XRAY.O)	E (09/12/2011)	$36.17
Sirona Dental Systems Inc. (SIRO.O)	O (09/12/2011)	$46.81
Varian Medical Systems, Inc (VAR.N)	E (09/12/2011)	$58.18
David R. Lewis		
Abbott Laboratories (ABT.N)	O (09/04/2008)	$53.63
Abiomed (ABMD.O)	E (02/06/2009)	$18.74
Baxter International (BAX.N)	O (09/04/2008)	$54.48
Becton Dickinson (BDX.N)	E (07/31/2009)	$74.43
Boston Scientific (BSX.N)	E (09/10/2010)	$5.79
C.R. Bard (BCR.N)	E (01/03/2011)	$88.11
CareFusion Corp. (CFN.N)	O (05/20/2010)	$25.31
Covidien (COV.N)	O (07/15/2010)	$46.52
Edwards Lifesciences (EW.N)	E (09/04/2008)	$76.21
Grifols (GRFS.O)	O (09/12/2011)	$6
Haemonetics Corporation (HAE.N)	U (01/03/2011)	$59.22
Hansen Medical, Inc. (HNSN.O)	U (01/08/2009)	$2.26
Hill-Rom Holdings Inc. (HRC.N)	O (09/12/2011)	$33.66
Hologic, Inc. (HOLX.O)	E (05/05/2009)	$16.23
Integra LifeSciences (IART.O)	E (09/10/2010)	$30.4
Intuitive Surgical Inc. (ISRG.O)	E (10/02/2007)	$432.37
Johnson & Johnson (JNJ.N)	E (08/10/2010)	$64
MAKO Surgical Corp. (MAKO.O)	E (07/11/2011)	$35.39
Medtronic Inc. (MDT.N)	E (09/04/2008)	$35.05
St. Jude Medical (STJ.N)	E (10/10/2011)	$38.9
Stericycle Inc. (SRCL.O)	E (04/06/2011)	$81.48
Stryker Corporation (SYK.N)	O (01/08/2010)	$49.06
Teleflex Inc. (TFX.N)	E (09/12/2011)	$59.83
Zimmer Holdings, Inc. (ZMH.N)	E (07/16/2009)	$52.86
Marshall Urist, M.D., Ph.D.		
Hospira (HSP.N)	E (07/16/2009)	$31.98
Sagent Pharmaceuticals Inc (SGNT.O)	O (05/31/2011)	$22.25

Stock Ratings are subject to change. Please see latest research for each company.
* Historical prices are not split adjusted.