

Kythera Biopharmaceuticals

2Q/13 Wrap-Up, We Remain Confident Into ATX-101 Phase 3 Data

Kythera reported 2Q operating results after the close today, but more important, in our view, will be the upcoming topline data for the company's US/Canadian phase III trials for its primary asset, ATX-101 for the reduction of submental fat. We continue to believe ATX-101 represents a potential \$500+ million annual sales opportunity for Kythera and we have a high level of confidence in a successful phase III outcome for the company later this year based on positive and highly consistent results from US phase II and European phase III trials.

- **Phase III data approaching. Kythera continues to expect to report topline data for its phase III US and Canadian studies late in 3Q or early in 4Q.** This data represents the key gating factor for a filing, which we now expect in the first half of 2014. In addition, recall that while the two European pivotal studies are complete, Bayer, Kythera's partner, is waiting for the full safety data from the North American studies to include in the package. Along these lines, we also expect a European filing around yearend 2013.
- **Long-term data showing very durable response with ATX-101 and should help support value proposition of the drug.** Kythera is following patients from phase II studies who were responders to ATX-101 in an effort to assess longer-term safety and efficacy. Interim data thus far shows 90% of these patients had a sustained/improved response at two years, with more than 80% sustained/improved after three and four years with no long-term safety concerns. In our view, this durability of response should help support the value proposition for ATX-101 once approved.
- **ATX-101 could successfully address a significant unmet need in facial aesthetics.** There are currently no approved non-surgical options for the reduction of submental (under-chin) fat and Kythera will target this market with a non-invasive injectable therapy. We see a meaningful opportunity for ATX-101 to initially target the estimated 2 million unique patients in the US who currently receive a toxin and/or dermal filler with a longer-term opportunity to address the estimated 10 million individuals who would be physically and financially appropriate for the treatment. A survey we conducted last year confirmed a high level of interest in the product in both opportunities and also highlighted a number of off-label opportunities for ATX-101.

Overweight

KYTH, KYTH US

Price: \$26.96

▲ **Price Target: \$34.00**

Previous: \$30.00

Pharmaceuticals — Major & Specialty

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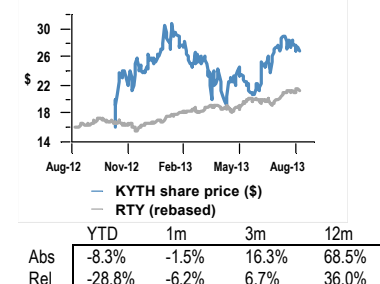
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Price Performance



Kythera Biopharmaceuticals, Inc. (KYTH;KYTH US)

FYE Dec	2011A	2012A	2013E	2013E	2014E	2014E	2015E	2015E
			(Prev)	(Curr)	(Prev)	(Curr)	(Prev)	(Curr)
EPS Adjusted (\$)								
Q1 (Mar)	(0.46)	(4.91)	(0.77)A	(0.77)A	-	-	-	-
Q2 (Jun)	(0.41)	3.21	(0.82)	(0.67)A	-	-	-	-
Q3 (Sep)	(1.66)	(11.41)	(0.84)	(0.78)	-	-	-	-
Q4 (Dec)	-	(1.04)	(0.69)	(0.78)	-	-	-	-
FY	(7.98)	(2.62)	(3.12)	(2.99)	(0.35)	(0.38)	(1.14)	(1.68)
Bloomberg EPS FY (\$)	-1.00	-4.04	-	-2.96	-	-1.24	-	-1.02

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

Company Data

Price (\$)	26.96
Date Of Price	06 Aug 13
52-week Range (\$)	31.93-14.07
Market Cap (\$ mn)	496.68
Fiscal Year End	Dec
Shares O/S (mn)	18
Price Target (\$)	34.00
Price Target End Date	31-Dec-14

See page 6 for analyst certification and important disclosures.

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Changes to Our Estimates

Figure 1: Changes to Kythera Revenue and EPS Estimates

Kythera Period	EPS			Revenue (\$ thousands)		
	Revised	Prior	Difference	Revised	Prior	Difference
3Q/13E	(\$0.78)	(\$0.84)	\$0.06	\$0	\$0	\$0
4Q/13E	(\$0.78)	(\$0.69)	(\$0.09)	\$0	\$0	\$0
2013E	(\$2.99)	(\$3.12)	\$0.13	\$0	\$0	\$0
2014E	(\$0.38)	(\$0.35)	(\$0.03)	\$39,000	\$39,000	\$0
2015E	(\$1.68)	(\$1.14)	(\$0.54)	\$20,552	\$34,253	(\$13,701)
2016E	\$0.44	\$0.54	(\$0.10)	\$80,636	\$79,916	\$720

Source: J.P. Morgan estimates.

Investment Thesis, Valuation and Risks

Kythera Biopharmaceuticals *(Overweight; Price Target: \$34.00)*

Investment Thesis

Maintain Overweight Rating. Kythera's primary pipeline asset, ATX-101, is in phase 3 development for the aesthetic reduction of submental fat and to us represents a \$500+ million annual sales opportunity. ATX-101 has shown positive and highly consistent results in US phase 2 and European phase 3 trials and we have a high level of confidence in the product's ongoing US phase 3 program.

Valuation

Establishing Dec-14 price target of \$34. Our prior Dec-13 price target was \$30. Our discounted cash flow (DCF) analysis leads us to a valuation of \$34/share for KYTH by the end of 2014, assuming the receipt of positive phase 3 data from the ongoing US trials and continued progress toward regulatory filings in the US and EU. We assume Kythera will launch ATX-101 in the US in 2015 and Bayer will launch in the EU around the same time. In addition, we expect Kythera's expense structure to continue to increase through 2030 on an absolute basis but consistently decline as a percentage of revenue through our estimate period.

We estimate a weighted average cost of capital (WACC) of 12%, which is consistent with our normal WACC estimates for companies of Kythera's size and development stage due to the risk of the company's business model relative to more established branded pharma companies with commercialized products. We also use a terminal decline of 30% past 2030 as the last patents covering ATX-101 expire in 2030. We use a long-term estimated tax rate of 38% in our analysis given Kythera's US/California domicile.

We have applied a 75% probability of success to ATX-101 gaining approval in the US and EU, which is consistent with probabilities of success for other products with initial positive phase 3 data and potential for filing in multiple jurisdictions.

Risks to Rating and Price Target

Risks to the downside include: 1) clinical risk from ongoing US phase 3 trials; 2) regulatory risk from FDA and EMA review of ATX-101 following submission; 3) commercial and partnership risk with ATX-101 potentially launching into the US and EU markets and 4) financing risk on any development delays for ATX-101.

Figure 2: Kythera Financial Model

\$ in millions

thousands USD	Fiscal year ends December 31						Mar 2013	Jun 2013	Sep 2013	Dec 2013	FY 2013E	FY 2014E	FY 2015E	FY 2016E	FY 2017E	FY 2018E	FY 2019E	FY 2020E	FY 2021E	FY 2022E	FY 2023E	FY 2024E	FY 2025E
	FY 2007A	FY 2008A	FY 2009A	FY 2010A	FY 2011A	FY 2012A	1QA	2QA	3QE	4QE													
Income Statement																							
Revenue	-	-	-	-	-	-	-	-	-	-	-	-	19,953	76,614	133,797	206,442	300,308	367,529	404,595	461,677	505,426	507,527	509,146
License/royalty income	-	-	-	4,488	12,985	19,687	-	-	-	-	-	39,000	599	4,022	18,028	20,483	26,427	35,283	41,269	47,091	54,586	54,813	54,988
Total revenue	-	-	-	4,488	12,985	19,687	-	-	-	-	-	39,000	20,552	80,636	151,825	226,926	326,736	402,812	445,864	508,768	560,012	562,339	564,134
Cost of goods sold	-	-	-	-	-	-	-	-	-	-	-	-	1,995	7,661	13,380	20,644	30,031	36,753	40,460	46,168	50,543	50,753	50,915
Sublicense expense	-	-	-	411	1,188	1,936	-	-	-	-	-	3,900	180	1,207	5,408	6,145	7,928	10,585	12,381	14,127	16,376	16,444	16,496
Total cost of revenue	-	-	-	411	1,188	1,936	-	-	-	-	-	3,900	2,175	8,868	18,788	26,789	37,959	47,338	52,840	60,295	66,918	67,197	67,411
Gross profit	-	-	-	4,077	11,797	17,751	-	-	-	-	-	35,100	18,377	71,768	133,037	200,136	288,777	355,474	393,024	448,473	493,094	495,143	496,723
R&D	9,012	15,672	9,823	14,842	15,766	43,183	10,034	7,767	10,000	10,000	37,801	15,000	8,000	8,000	8,000	8,000	8,000	8,000	8,000	8,000	8,000	8,000	8,000
SG&A	3,232	4,522	4,930	6,785	6,879	10,503	3,725	3,973	4,000	4,000	15,698	25,000	39,562	52,626	69,987	90,664	120,809	139,351	147,916	156,450	163,179	163,234	163,477
Total operating expense	12,244	20,194	14,753	21,627	22,645	53,686	13,759	11,740	14,000	14,000	53,499	40,000	47,562	60,626	77,987	98,664	128,809	147,351	155,916	164,450	171,179	171,234	171,477
Income (loss) from operations (EBIT)	(12,244)	(20,194)	(14,753)	(17,550)	(10,848)	(35,935)	(13,759)	(11,740)	(14,000)	(14,000)	(53,499)	(4,900)	(29,185)	11,142	55,050	101,472	159,968	208,123	237,108	284,022	321,915	323,909	325,245
Warrant & other interest income (expense)	810	457	(7)	589	(304)	(861)	(367)	(518)	(375)	(375)	(1,636)	(2,139)	(2,139)	(2,139)	(2,139)	(14)	-	-	-	-	-	-	-
Other income	-	-	-	930	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total other income (expense)	810	457	(7)	1,519	(304)	(861)	(367)	(518)	(375)	(375)	(1,636)	(2,139)	(2,139)	(2,139)	(2,139)	(14)	-	-	-	-	-	-	-
Earnings (loss) before tax (EBT)	(11,434)	(19,737)	(14,760)	(16,031)	(11,152)	(36,796)	(14,126)	(12,258)	(14,375)	(14,375)	(55,135)	(7,039)	(31,324)	9,003	52,910	101,458	159,968	208,123	237,108	284,022	321,915	323,909	325,245
Income tax (expense)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	2,646	15,219	55,989	79,087	90,101	107,928	122,328	123,086	123,593
NET INCOME	(11,434)	(19,737)	(14,760)	(16,031)	(11,152)	(36,796)	(14,126)	(12,258)	(14,375)	(14,375)	(55,135)	(7,039)	(31,324)	9,003	50,265	86,239	103,979	129,036	147,007	176,094	199,587	200,824	201,652
EPS	(8.53)	(14.62)	(10.85)	(11.64)	(7.98)	(2.62)	(0.77)	(0.67)	(0.78)	(0.78)	(2.99)	(0.38)	(1.68)	0.44	2.45	4.17	4.98	6.12	6.91	8.20	9.21	9.18	9.14
Basic shares outstanding	1,341	1,350	1,360	1,377	1,398	14,058	18,335	18,423	18,444	18,465	18,417	18,515	18,624	18,811	18,999	19,189	19,381	19,574	19,770	19,968	20,168	20,369	20,573
FD shares outstanding	1,341	1,350	1,360	1,377	1,398	14,058	18,335	18,423	18,444	18,465	18,417	18,515	18,624	20,311	20,499	20,689	20,881	21,074	21,270	21,468	21,668	21,869	22,073
Margins																							
Gross product margin												90%	90%	90%	90%	90%	90%	90%	90%	90%	90%	90%	90%
Gross sublicense margin																							
Gross margin												89%	89%	88%	88%	88%	88%	88%	88%	88%	88%	88%	88%
R&D												40%	10%	6%	4%	3%	2%	2%	2%	2%	2%	2%	2%
SG&A												198%	69%	52%	44%	40%	38%	37%	34%	32%	32%	32%	32%
Opex												238%	79%	58%	48%	43%	40%	39%	36%	34%	34%	34%	34%
Operating margin												-146%	15%	41%	49%	53%	57%	59%	62%	64%	64%	64%	64%
Pretax margin												-157%	12%	40%	49%	53%	57%	59%	62%	64%	64%	64%	64%
Tax rate														0%	5%	15%	35%	38%	38%	38%	38%	38%	38%
NET MARGIN												-157%	12%	38%	42%	35%	35%	35%	36%	38%	39%	40%	40%
Growth Rates																							
Revenue	n/a	n/a	n/a	189%	52%	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	-47%	292%	88%	49%	44%	23%	11%	14%	10%	0%
COGS	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	284%	75%	54%	45%	22%	10%	14%	9%	0%
Sublicense expense	n/a	n/a	n/a	189%	63%	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	-95%	572%	348%	14%	29%	34%	17%	14%	16%
Gross profit	n/a	n/a	n/a	189%	50%	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	-48%	291%	85%	50%	44%	23%	11%	14%	10%
R&D	74%	-37%	51%	6%	174%	55%	-7%	-28%	-30%	-12%	-60%	-47%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
SG&A	40%	9%	38%	1%	53%	70%	61%	64%	18%	49%	59%	58%	33%	33%	30%	33%	15%	6%	6%	4%	0%	0%	
Operating income	65%	-27%	47%	5%	137%	59%	8%	-14%	-21%	0%	-25%	19%	27%	29%	27%	31%	14%	6%	5%	4%	0%	0%	
Pretax income	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	488%	92%	58%	30%	14%	20%	13%	1%	
NET INCOME	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	458%	72%	21%	24%	14%	20%	13%	1%	
EPS	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	453%	70%	19%	23%	13%	19%	12%	0%	
FD shares outstanding (sequential)	1%	1%	1%	2%	906%	6%	0%	0%	0%	0%	31%	1%	1%	9%	1%	1%	1%	1%	1%	1%	1%	1%	

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

Kythera Biopharmaceuticals: Summary of Financials

Income Statement - Annual	FY12A	FY13E	FY14E	FY15E	Income Statement - Quarterly	1Q13A	2Q13A	3Q13E	4Q13E
Revenues	20	0	39	21	Revenues	0A	0A	0	0
Cost of products sold	(2)	0	(4)	(2)	Cost of products sold	0A	0A	0	0
Gross profit	18	0	35	18	Gross profit	0A	0A	0	0
SG&A	(11)	(16)	(25)	(40)	SG&A	(4)A	(4)A	(4)	(4)
R&D	(43)	(38)	(15)	(8)	R&D	(10)A	(8)A	(10)	(10)
Operating income	(36)	(53)	(5)	(29)	Operating income	(14)A	(12)A	(14)	(14)
Net interest (income) / expense	(1)	(2)	(2)	(2)	Net interest (income) / expense	(0)A	(1)A	(0)	(0)
Other income / (expense)	0	0	0	0	Other income / (expense)	0A	0A	0	0
Pretax income	(37)	(55)	(7)	(31)	Pretax income	(14)A	(12)A	(14)	(14)
Income taxes	0	0	0	0	Income taxes	0A	0A	0	0
Net income - recurring	(37)	(55)	(7)	(31)	Net income - recurring	(14)A	(12)A	(14)	(14)
Diluted shares outstanding	14	18	19	19	Diluted shares outstanding	18A	18A	18	18
EPS - excluding non-recurring	(2.62)	(2.99)	(0.38)	(1.68)	EPS - excluding non-recurring	(0.77)A	(0.67)A	(0.78)	(0.78)
EPS - recurring	(2.62)	(2.99)	(0.38)	(1.68)	EPS - recurring	(0.77)A	(0.67)A	(0.78)	(0.78)
Balance Sheet and Cash Flow Data	FY12A	FY13E	FY14E	FY15E	Ratio Analysis	FY12A	FY13E	FY14E	FY15E
Cash and cash equivalents	79	10	40	9	Sales growth	51.6%	(100.0%)	-	(47.3%)
Short Term Investment	-	-	-	-	EBIT growth	231.3%	48.9%	(90.8%)	495.6%
Accounts receivable	0	0	7	8	EPS growth - recurring	(67.2%)	14.4%	(87.3%)	342.4%
Inventories	0	0	0	0	Gross margin	90.2%	-	90.0%	89.4%
Other current assets	8	8	8	8	EBIT margin	(182.5%)	-	(12.6%)	(142.0%)
Current assets	88	18	54	26	Tax rate	0.0%	0.0%	0.0%	0.0%
PP&E	0	0	0	1	Net Profit Margin	(186.9%)	-	(18.0%)	(152.4%)
Total assets	96	25	62	33					
Total debt	3	18	25	25					
Total liabilities	27	40	48	47					
Shareholders' equity	69	17	14	(13)					
Net income (including charges)	(37)	(55)	(7)	(31)					
D&A	1	0	0	0					
Change in working capital	(1)	(2)	(7)	(3)					
Other	4	2	2	2					
Cash flow from operations	(33)	(55)	(12)	(33)					
Capex	(0)	(0)	(0)	(0)					
Free cash flow	(32)	(54)	(10)	(31)					
Cash flow from investing activities	(0)	(33)	32	(0)					
Cash flow from financing activities	78	19	10	2					

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

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

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Kythera Biopharmaceuticals (KYTH, KYTH US) Price Chart



Date	Rating	Share Price (\$)	Price Target (\$)
05-Nov-12	OW	23.94	30.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
Initiated coverage Nov 05, 2012.

The chart(s) show J.P. Morgan's continuing coverage of the stocks; the current analysts may or may not have covered it over the entire period.

J.P. Morgan ratings or designations: OW = Overweight, N= Neutral, UW = Underweight, NR = Not Rated

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	Overweight (buy)	Neutral (hold)	Underweight (sell)
J.P. Morgan Global Equity Research Coverage	44%	44%	12%
IB clients*	56%	50%	40%
JPMS Equity Research Coverage	42%	50%	8%
IB clients*	76%	66%	55%

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