

September 30, 2013

HEALTHCARE/BIO AND SPECIALTY PHARMACEUTICALS

**Stock Rating:**
**OUTPERFORM**

12-18 mo. Price Target \$94.00  
ICPT - NASDAQ \$69.03

3-5 Yr. EPS Gr. Rate NA  
52-Wk Range \$72.64-\$15.00  
Shares Outstanding 20.7M  
Float 7.0M  
Market Capitalization \$1,324.1M  
Avg. Daily Trading Volume 92,513  
Dividend/Div Yield NA/NM  
Book Value \$3.66  
Fiscal Year Ends Dec  
2013E ROE NA  
LT Debt NA  
Preferred NA  
Common Equity \$66M  
Convertible Available No

EPS	Q1	Q2	Q3	Q4	Year	Mult.
<b>Diluted</b>						
2011A	--	--	--	--	(4.73)	NM
2012A	(1.03)	(1.75)	(1.86)	(2.02)	(7.36)	NM
2013E	(0.62)A	(0.79)A	(0.41)	(0.42)	(2.22)	NM
2014E	--	--	--	--	(2.04)	NM
2015E	--	--	--	--	(0.13)	NM
Prior (E)	--	--	--	--	(0.78)	NM

## Intercept Pharmaceuticals

### Pulling Valuation Lever on OCA Pricing Assumptions; Raising PT to \$94

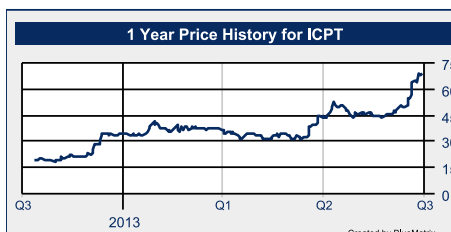
#### SUMMARY

We evaluated our model after ICPT recently eclipsed our prior \$64 target. While the stock may not be immune to a pull-back in the near term, we continue to believe that shares have room to trade meaningfully higher next year around the Phase 3 data read-out for OCA in PBC. As discussed in our initiation report (6/20/13), we highlighted that several of our assumptions regarding OCA were likely conservative, particularly with regards to the drug's pricing. Although ICPT has not provided any specific guidance, our conversations with management suggest to us that the Street's prior pricing assumptions for OCA were low. We are increasing our pricing assumptions, thereby increasing our 2015 revenue/EPS estimates and fair value estimate.

#### KEY POINTS

- **Stock keeps moving higher, now what?** Shares of ICPT have run from ~\$45 to \$69 since late August, eclipsing our prior \$64 target. We remain bullish on the stock and think shares have ample room to trade higher with pivotal Phase 3 data on the horizon in 2Q14.
- **Our new pricing estimate for OCA is less conservative, but flexibility remains.** We now estimate \$60K/yr for OCA therapy in PBC (vs. \$40K previously), which we believe is closer to where ICPT will price the drug. That said, the potential range remains wide, and pricing could ultimately be higher.
- **Valuation supports room for shares to trade higher over the coming year.** We point out that our probability-adjusted valuation still reflects a sizable discount factor for approval risk in PBC (24%), BAD (67%) and PH (72%). These discount rates would decrease upon positive data readouts over the coming months.
- Key upcoming catalysts include updated data from Phase 2a studies of OCA in portal hypertension (PESTO study) and bile-acid diarrhea (OBADIAH study) in 4Q13, followed by the results of the pivotal Phase 3 POISE study in PBC in 2Q14.
- **Reiterate Outperform and raising price target to \$94 from \$64.** Our new \$94 PT reflects higher pricing assumptions for OCA. While near-term pullback in the stock remains possible, we expect shares to trade meaningfully higher next year in conjunction with the Phase 3 data release for PBC.

#### Stock Price Performance



#### Company Description

Intercept is a biopharmaceutical company focused on the development of novel treatments for liver diseases. Lead drug OCA is in Phase 3 for the treatment of Primary Biliary Cirrhosis (PBC).

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Akiva Felt  
415-399-5728  
Akiva.Felt@opco.com

Angad Verma  
212-667-8165  
Angad.Verma@opco.com

**Exhibit 1: ICPT Probability-Weighted Valuation Analysis**

Drug/Indication	Expected Launch	Peak Sales Estimate (\$MM)	Est. Probability of Success	P-Adj NPV (\$MM)	P-Adj Value / Share
OCA - Primary Biliary Cirrhosis	2015	\$1,073	76%	\$1,578	\$73
OCA/INT-767 - Portal Hypertension	2018	\$637	28%	\$244	\$11
OCA/INT-767 - Bile Acid Diarrhea	2018	\$541	33%	\$201	\$9
<b>Pipeline Value</b>				<b>\$2,022</b>	<b>\$94</b>
Net Cash				\$152	\$7
<b>Total Equity Value</b>				<b>\$2,022</b>	<b>\$94</b>

Diluted Shares Outstanding Used for Valuation (MM)

21.5

Source: Oppenheimer &amp; Co.

**Exhibit 2: ICPT Upcoming Catalysts**

Expected Date	Event Description
4Q13	Additional presentations of PBC "supergroup" data
4Q13	Update data from Phase 2a trial of OCA in bile-acid diarrhea (OBADIAH study)
4Q13	Update data from Phase 2a trial of OCA in portal hypertension (PESTO study)
4Q13	Initiation of Phase 3 OCA confirmatory outcomes study in PBC
2Q14	Topline data from pivotal Phase 3 POISE study of OCA in PBC
4Q14	Topline data from Phase 2 study of OCA in NASH (FLINT study)
4Q14	FDA and EMA regulatory filings for OCA in PBC
2014	Potential updates regarding clinical development plans for PH/BAD
mid-2015	Potential approval of OCA for PBC

Source: Company Documents and Oppenheimer &amp; Co.

## Intercept Pharma. (ICPT)

(\$000's) [FY - DEC]

## Oppenheimer &amp; Co.

	2011A	2012A					2013E				2014E	2015E	
	FY:11A	Q1A	Q2A	Q3A	Q4A	FY:12A	Q1A	Q2A	Q3E	Q4E	FY:13E	FY:14E	FY:15E
Revenues/Royalties on Product Sales	-	-	-	-	-	-	-	-	-	-	-	-	56,580
OCA - Primary Biliary Cirrhosis	-	-	-	-	-	-	-	-	-	-	-	-	56,580
OCA or INT-767 - Portal Hypertension	-	-	-	-	-	-	-	-	-	-	-	-	0
OCA or INT-767 PBAD	-	-	-	-	-	-	-	-	-	-	-	-	0
Licensing revenue and Milestones	1,805	759	759	523	405	2,446	405	405	405	405	1,620	1,620	1,620
Total revenues	\$ 1,805	\$ 759	\$ 759	\$ 523	\$ 405	\$ 2,446	\$ 405	\$ 405	\$ 405	\$ 405	\$ 1,620	\$ 1,620	\$ 58,200
Cost of Goods	-	-	-	-	-	-	-	-	-	-	-	-	5,238
Gross profit	1,805	759	759	523	405	2,446	405	405	405	405	1,620	1,620	52,962
Operating expenses													
Research and development	11,426	3,060	5,018	3,318	4,787	16,183	4,833	5,133	5,236	5,340	20,542	24,650	32,045
Selling, general and administrative	4,209	1,059	944	991	2,183	5,177	2,397	2,891	2,978	3,067	11,333	16,432	24,649
Other	-	-	-	-	-	-	-	-	-	-	-	-	-
Total expenses	15,636	4,119	5,962	4,309	6,970	21,360	7,229	8,024	8,213	8,407	31,874	41,082	56,693
Operating income	(13,830)	(3,360)	(5,203)	(3,786)	(6,565)	(18,914)	(6,824)	(7,619)	(7,808)	(8,002)	(30,254)	(39,462)	(3,731)
Revaluation of warrants	1,045	678	302	(1,418)	(24,187)	(24,625)	(3,683)	(5,572)	-	-	(9,255)	-	-
Other income (expense)	0	(750)	(942)	(1,000)	(130)	(2,822)	296	(287)	25	24	58	87	75
Pre-tax income	(12,738)	(3,430)	(5,836)	(6,187)	(30,821)	(46,274)	(10,210)	(13,478)	(7,783)	(7,978)	(39,450)	(39,375)	(3,581)
Income tax expense (benefit)	3,000	-	-	-	-	-	-	-	-	-	-	-	(537)
Net income	(\$15,738)	(\$3,430)	(\$5,836)	(\$6,187)	(\$30,821)	(\$46,274)	(\$10,210)	(\$13,478)	(\$7,783)	(\$7,978)	(\$39,450)	(\$39,375)	(\$3,044)
Basic shares outstanding	3,330	3,330	3,330	3,330	15,223	6,283	16,558	16,971	18,781	18,931	17,810	19,306	19,922
Diluted shares outstanding					18,197		19,423	19,693	21,504	21,654	20,568	22,029	22,699
GAAP EPS (basic and diluted)	(\$4.73)	(\$1.03)	(\$1.75)	(\$1.86)	(\$2.02)	(\$7.36)	(\$0.62)	(\$0.79)	(\$0.41)	(\$0.42)	(\$2.22)	(\$2.04)	(\$0.13)
Cash and Equivalents	\$ 17,707	\$ -	\$ -	\$ 36,049	\$ 110,194	\$ 110,194	\$ 104,220	\$ 161,799	\$ 157,924	\$ 154,276	\$ 154,276	\$ 94,244	\$ 98,426

Source: Oppenheimer &amp; Co. Inc., Company Reports

## Investment Thesis

We believe ICPT's lead asset, obeticholic acid (OCA), which is in a Phase 3 trial for the treatment of primary biliary cirrhosis (PBC), and in earlier stages of development for the treatment of portal hypertension, bile acid diarrhea and NASH, has well-defined commercial potential and an overall risk/reward profile that appears highly favorable at the current share price. Specifically, we believe OCA will be able fill a much-needed role as a second-line therapy in PBC, as the current standard of care, Urso, is ineffective in up to 40%-50% of patients. We also believe OCA's development in other liver diseases represents significant upside potential for ICPT.

## Price Target Calculation

Our \$94 price target is based on a sum-of-the-parts analysis for ICPT's lead asset, OCA, being developed for the treatment of PBC, portal hypertension, and bile acid diarrhea. We value ICPT using a probability-adjusted net present value (pNPV) approach, calculating anticipated profits from OCA (or the follow-on drug INT-767) through 2026, discounted at 10.5% with no terminal value. We then adjust for clinical and regulatory risk by assigning an estimated probability of success (i.e., reaching commercialization), based on stage of clinical development and our assessment of the available clinical data and characteristics of the proposed indication. Specifically, we estimate a \$73/share valuation for OCA in PBC assuming a 76% chance of success and peak sales of ~\$1,100M; \$11/share for OCA/INT-767 in portal hypertension assuming a 28% chance of success and peak sales of ~\$640M; and \$9/share for OCA/INT-767 in bile acid diarrhea assuming a 33% chance of success and peak sales of \$540M. Our price target has increased from \$64 after raising our assumption on annual pricing for OCA in PBC to \$60K/year from \$40K/year previously. Based on our conversations with management, we believe our initial pricing assumptions were overly conservative for a novel orphan disease drug to treat an unmet medical need.

## Key Risks to Price Target

**Clinical Risk.** Intercept's drugs will be required to demonstrate efficacy and safety in clinical trials before they can be approved by regulatory agencies.

**Regulatory Risk.** ICPT has yet to submit for or receive approval for any of its drugs in the US, and may face difficulties in doing so, potentially delaying commercialization. The company intends to seek accelerated approval in the US for OCA in PBC, which carries additional risks compared to traditional approval.

**Commercialization Risk.** Despite ICPT's ability to potentially attain approval of its development candidates, the company may face unpredictable commercialization challenges.

**Intellectual Property Risk.** There is inherent uncertainty in both the interpretation of patent claims and the application of patent law, regardless of the apparent strength of ICPT's patent portfolio.

**Manufacturing Risk.** ICPT does not possess its own manufacturing capabilities to clinically or commercially supply sufficient quantities of its drugs.

**Competitive Risk.** The indications being targeted by ICPT are also being targeted by several competitors, some with superior resources.

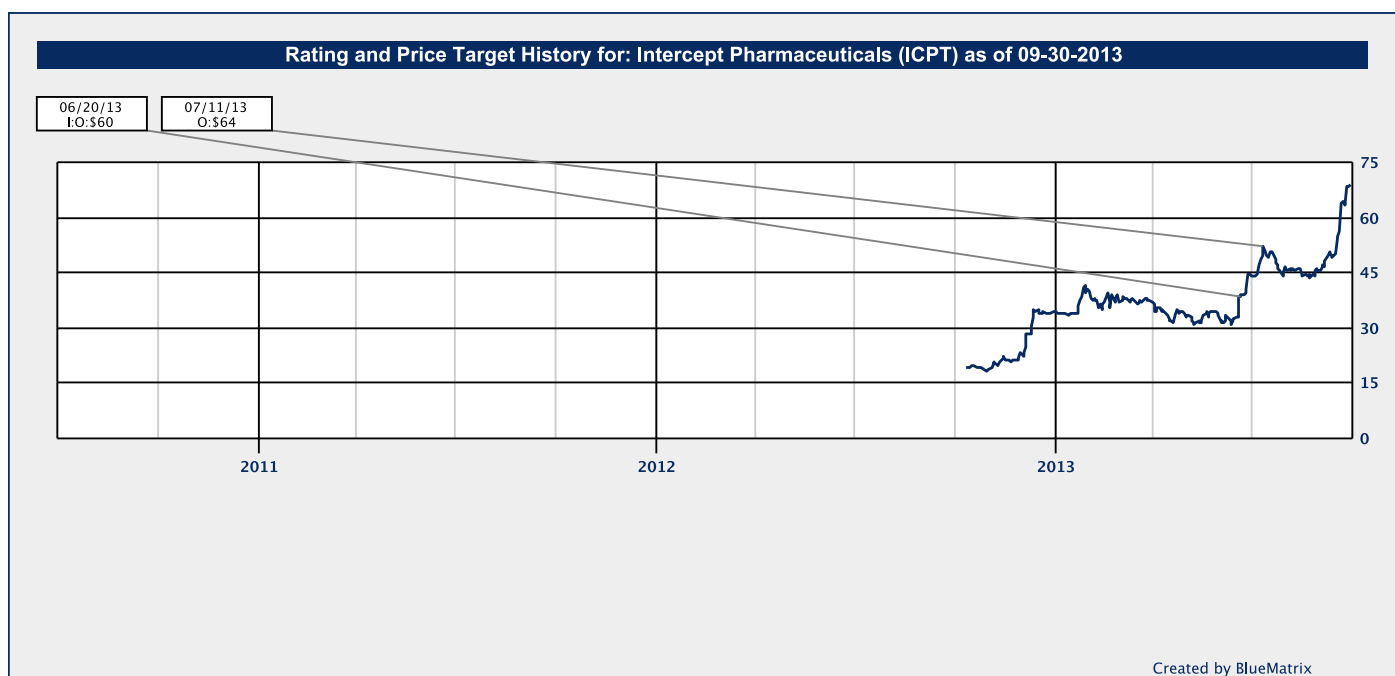
**Financing Risk.** While we believe ICPT is sufficiently capitalized to reach significant value inflection points, any unexpected clinical or regulatory setbacks may prompt capital raising before ICPT is able to generate sufficient revenues from the commercial activities.

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	Count	Percent	Count	Percent
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PERFORM [P]	280	47.62	95	33.93
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