May 21, 2014

**OUTPERFORM**

**Marko Kozul, M.D.**
(415) 905-7221
Marko.Kozul@Leerink.com

LEERINK

Reason for report:

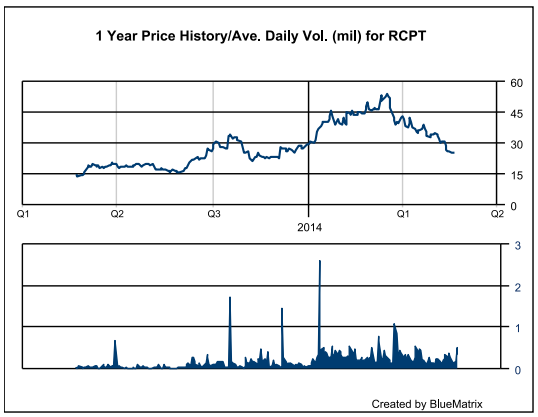
**COMPANY UPDATE**

# RECEPTOS, INC.

## RPC-1063 on Track in MS & UC; Attractive Risk/Reward; Reit. OP & $75 PT

• **Bottom Line:** Driven by our proprietary research on RPC-1063's ("1063") potential in ulcerative colitis (UC) (see our RCPT 4.11.14 note), we believe RCPT fundamentals have continued to improve in 1H14 despite broader market volatility and share price weakness. The only change (irrelevant to our UC thesis) is that top-line Phase II UC data may be pushed out by 1 quarter to 4Q14 (see our RCPT 5.13.14 note) which opens up a quandary in terms of inking a 1063-based deal vs. accelerating the multiple sclerosis (MS) program. If RCPT waits until 1H15 to forge a development stage 1063 deal (valuing both UC & MS Phase II trials), that could delay by 6-9 months initiation of a 2nd Phase III MS trial planned for ~3Q14. Conversely, advancing 1063 on time and independently may require a 2H14 offering to bolster financial resources heading into 1H15 partnership discussions and might also favor a commercial vs. development stage partnership that would also maximize longer-term shareholder value. While this may be less attractive for shorter-term focused investors hoping for a 2H14 deal/buyout, in our view RCPT continues to represent a very attractive near/longer risk-reward opportunity and we reiterate an Outperform rating & $75 price target.

| **Key Stats:** | **(NASDAQ:RCPT)** |
|---|---|
| **S&P 600 Health Care Index:** | **1,239.58** |
| **Price:** | **$25.56** |
| Price Target: | $75.00 |
| Methodology: | DCF analysis |
| 52 Week High: | $55.00 |
| 52 Week Low: | $13.00 |
| Shares Outstanding (mil): | 21.2 |
| Market Capitalization (mil): | $541.9 |
| Book Value/Share: | $0.22 |
| Cash Per Share: | $7.48 |
| Dividend (ann): | $0.00 |
| Dividend Yield: | 0.0% |




• **Positive 1063 Phase II MS data mid-14 (we est. July) defined by a competitive and differentiated safety profile vs. Gilenya could increase our PT by ~$10 on a higher probability of success (POS), to ~50% from mid-30s, and push the shares higher.** This is based on already conservative assumptions including 1063 requiring first-dose-heart-rate-monitoring (FDHRM) and pricing on par with Gilenya generics in 2020 (~$22K). We do not believe the Phase II efficacy endpoint assessing gadolinium lesions will be very helpful to handicapping the Phase III and approval endpoint of annual relapse rates (ARR). We are interested in brain atrophy data. This drives our focus on safety measures such as lymphocyte reductions, infection rates, liver function tests (LFTs), etc. The biggest risk to our thesis is emergence of an unforeseen serious adverse event occurring between month 3 and 6 of this trial.

• **RCPT ended 1Q14 with ~$158.6M in cash and cash equivalents ($7.48/share) which is enough to independently continue operations into 1H15 and through data reads for both Phase II trials in MS and UC.** Assuming positive MS data as we are defining it, we believe there should be appetite for an offering heading into 4Q14 UC data (which many investors still may still view as a free-call option) and a potential 1H15 partnership deal.

• **Positive 1063 Ph II UC data ~4Q14 could increase our PT by ~ $30-40 if MS is also positive, on higher POS to ~50% from mid-30s, & push the shares higher.** Enthusiasm for recently approved Entyvio (vedolizumab) with efficacy slightly inferior to anti-TNFs but superior safety (except PML potential) clears the path for 1063 to leapfrog Entyvio if efficacy is at least on par & worst characteristic is need for FDHRM.

| Dec Yr | 1Q | 2Q | 3Q | 4Q | FY Rev | 1Q | 2Q | 3Q | 4Q | FY EPS | P/E |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **2013A** | $1.5 | $1.2 | $1.1 | $0.8 | $4.6 | ($5.46) | ($0.98) | ($0.88) | ($0.86) | ($4.23) | NM |
| **2014E** | $1.4A | 0.0 | 0.0 | 0.0 | $1.3 | ($1.01)A | ($1.16) | ($1.39) | ($1.53) | ($5.10) | NM |
| **2015E** | -- | -- | -- | -- | 0.0 | -- | -- | -- | -- | ($6.60) | NM |

*Source: Company Information and Leerink Partners LLC Research*
*Revenues in $000s.*

## INVESTMENT THESIS

**We rate RCPT Outperform.** We believe RCPT shares are poised to appreciate near/longer term driven by clinical progress and commercialization of lead compound RPC-1063. Compared to other S1P1 compounds, RPC-1063 is earlier stage but emerging as "best in class." In 2014 or 2015, RCPT plans to sign an RPC-1063 partnership with large pharma, announce RPC-1063 Phase II data in relapsing MS (RMS) and Ulcerative Colitis (UC), and start two pivotal Phase III RMS trials. Our probability adjusted RPC1063 revenues from UC is in the mid-30s percentage range. We currently assume a mid-30 percentage probability of approval for RPC-1063 in RMS in 2018. The 2Q13 MEDACorp MS Survey suggests that if approved in 2018, RPC-1063 would take significant market share from Gilenya (~58%), Tecfidera (~13%), and Tysabri (15%) that could be worth $1.2B in U.S. revenue in 2019E. Core RPC-1063 Intellectual Property (IP) expires in 2029 but Gilenya (NVS) currently goes off patent in 2019. Assuming generic pricing starts in 2020, we model peak risk adjusted RPC-1063 WW revenues of ~$770M (or $2.2B non-risk adjusted) which leads to our base case NPV calculation of $1.7B, which leads to our base case NPV calculation of $1.7B including cash, based on approval and use in relapsing multiple sclerosis (RMS) and UC.

Milestones

| Product | Partner | Indication | Phase | Timing | Milestone |
|---|---|---|---|---|---|
| **RPC-1063 (S1P1)** | Proprietary | Relapsing MS | Phase III | **Mid-2014** | **Phase II data of 1st pivotal (RPC01-201)** |
| | | | | 2H14 | Initiate 2nd pivotal Phase III RMS trial (with SPA) |
| | | | | **Oct-2014** | **ECTRIMS Phase II MS data presentation** |
| | | | | 2017 | 2nd pivotal Phase III RMS trial data |
| | | | | YE17 | NDA submission |
| | | | | 2H18 | FDA Approval |
| | | Ulcerative Colitis (UC) | Phase II | 1H14 | Complete trial enrollment (80% as of 5.12.14) |
| | | | | **4Q14** | **Phase II UC trial data (might serve as 1 of 2 pivotals)** |
| | | | | 2015 | Initiate pivotal trial (possibly maintenance) |
| | | | | 2018 | Possible NDA submission |
| **RPC-4046 (IL-13)** | ABBV | Eosinophilic Esophagitis (EoE) | Phase II | 2H14 | Initiate Phase II data |
| | | | | **1H16** | **Phase II trial data** |

*Source: Company Reports, Leerink Partners estimates*

## VALUATION

We calculate a $75 DCF price target for RCPT in the next 12 months based on a discounted cash flow (DCF) analysis. Based on MEDACorp KOL feedback, our probability of success of RPC1063 in Ulcerative Colitis (UC) is mid-30s percentage and we assume launch in 2019. We only penetrate into fourth-line UC patients. We assigned a mid 30% probability of success for RPC-1063 in the MS setting, assuming launch in 2018. We apply a discount rate of 11% and a terminal growth rate of 1% which translates to a ~10x terminal multiple which we believe is comparable to biotechnology companies in a similar development stage. The 2Q13 MEDACorp MS Survey suggests that if approved in 2018, RPC-1063 would take significant market share from Gilenya (~58%), Tecfidera (~13%), and Tysabri (15%) that could be worth $1.2B in U.S. revenue in 2019E. Core RPC-1063 Intellectual Property (IP) expires in 2029, but Gilenya (NVS) currently goes off patent in 2019. Assuming generic pricing starts in 2020, we model peak risk adjusted RPC-1063 WW revenues of ~$770M ($2.2B non-risk adjusted) which leads to our base case NPV calculation of $1.7B including cash, based on approval and use in relapsing multiple sclerosis (RMS) and UC.

## RISKS TO VALUATION

An investment in RCPT is fundamentally a high-risk, high-reward investment, in our opinion. RCPT may face significant clinical, regulatory, and commercial risks for pipeline products. Most important is risk associated with potential failure of RPC-1063 (Relapse Remitting Multiple Sclerosis) to obtain regulatory approvals and capture market share in the MS treatment paradigm. RPC-1063 is also the earliest among other S1P receptor modulators. There is also risk that evolving therapeutic landscapes could render RCPT pipeline compounds non-competitive or less valuable once approved.

| RCPT P&L ($000s, except per share data) | 2013A | 1Q14A | 2Q14E | 3Q14E | 4Q14E | 2014E | 2015E | 2016E | 2017E | 2018E | 2019E | 2020E | 2021E | 2022E | 2023E | 2024E | 2025E |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Revenues** | | | | | | | | | | | | | | | | | |
| RPC1063 WW Revenue in MS | | | | | | | | | | $316,680 | $1,088,253 | $569,241 | $768,848 | $1,003,905 | $1,257,093 | $1,470,700 | $1,664,873 |
| *Probability of Success* | | | | | | | | | | *35%* | *35%* | *35%* | *35%* | *35%* | *35%* | *35%* | *35%* |
| **Risk Adjusted RPC1063 WW Revenue in MS** | | | | | | | | | | **$110,838** | **$380,889** | **$199,234** | **$269,097** | **$351,367** | **$439,983** | **$514,745** | **$582,706** |
| RPC1063 U.S. Revenue in UC | | | | | | | | | | - | $81,377 | $194,873 | $292,476 | $460,913 | $484,235 | $508,738 | $534,480 |
| *Probability of Success* | | | | | | | | | | *35%* | *35%* | *35%* | *35%* | *35%* | *35%* | *35%* | *35%* |
| **Risk Adjusted RPC1063 U.S. Revenue in UC** | | | | | | | | | | **-** | **$28,482** | **$68,205** | **$102,367** | **$161,320** | **$169,482** | **$178,058** | **$187,068** |
| **RPC4046** | | | | | | | | | | | | | | | | | |
| Collaborative Revenue | $4,641 | $1,350 | - | - | - | $1,350 | - | - | - | - | - | - | - | - | - | - | - |
| **Total Revenue** | **$4,641** | **$1,350** | **-** | **-** | **-** | **$1,350** | **-** | **-** | **-** | **$110,838** | **$409,371** | **$267,440** | **$371,464** | **$512,686** | **$609,465** | **$692,803** | **$769,774** |
| **Costs and Expenses** | | | | | | | | | | | | | | | | | |
| Probability Adjusted COGS | - | - | - | - | - | - | - | - | - | $11,084 | $40,937 | $26,744 | $37,146 | $41,015 | $48,757 | $55,424 | $61,582 |
| R&D | $43,585 | $20,007 | $22,045 | $27,250 | $30,340 | $99,642 | $149,463 | $186,829 | $209,248 | $100,250 | $80,000 | $81,600 | $83,232 | $84,897 | $86,595 | $88,326 | $90,093 |
| SG&A (Risk Adjusted from Time of RPC1063 Launch) | $8,949 | $2,759 | $3,600 | $3,800 | $4,000 | $14,159 | $15,292 | $16,515 | $51,197 | $43,000 | $68,800 | $75,680 | $80,978 | $85,836 | $90,986 | $96,446 | $102,232 |
| **Total Costs and Expenses** | **$52,534** | **$22,766** | **$25,645** | **$31,050** | **$34,340** | **$113,801** | **$164,755** | **$203,344** | **$260,445** | **$154,334** | **$189,737** | **$184,024** | **$201,356** | **$211,748** | **$226,338** | **$240,196** | **$253,907** |
| **Operating Income (EBIT)** | **($47,893)** | **($21,416)** | **($25,645)** | **($31,050)** | **($34,340)** | **($112,451)** | **($164,755)** | **($203,344)** | **($260,445)** | **($43,496)** | **$219,634** | **$83,416** | **$170,108** | **$300,939** | **$383,127** | **$452,607** | **$515,866** |
| *Y/Y growth* | | | | | | | | | | | | | | | | | |
| **Income Before Taxes** | **($50,376)** | **($21,500)** | **($25,829)** | **($31,234)** | **($34,524)** | **($113,086)** | **($166,520)** | **($205,109)** | **($261,540)** | **($43,496)** | **$219,634** | **$83,416** | **$170,108** | **$300,939** | **$383,127** | **$452,607** | **$515,866** |
| Provision for Taxes | | | | | | - | - | - | - | - | - | - | - | - | 93,771 | 153,886 | 175,395 |
| **Net income** | **($50,376)** | **($21,500)** | **($25,829)** | **($31,234)** | **($34,524)** | **($113,086)** | **($166,520)** | **($205,109)** | **($261,540)** | **($43,496)** | **$219,634** | **$83,416** | **$170,108** | **$300,939** | **$289,356** | **$298,721** | **$340,472** |
| EPS (LPS) Basic | **($4.23)** | **($1.01)** | **($1.16)** | **($1.39)** | **($1.53)** | ($5.10) | ($6.60) | ($7.40) | ($8.72) | ($1.44) | $7.18 | $2.70 | $5.45 | $9.55 | $9.09 | $9.29 | $10.48 |
| *Y/Y growth* | | | | | | | | | | | | | | | | | |
| Basic Shares* (000) | **11,916** | **21,195** | **22,279** | **22,390** | **22,502** | **22,161** | **25,240** | **27,714** | **29,992** | **30,291** | **30,594** | **30,900** | **31,209** | **31,521** | **31,837** | **32,155** | **32,477** |

*Source: Leerink Partners and company reports.*

**DCF Calcuation**

| | |
|---|---|
| *Discount rate* | *11%* |
| *Terminal Growth Rate* | *1%* |
| Valuation | **$1,691,110** |
| **Valuation / Share** | **$75** |

*Source: Leerink Partners estimates.*

**RCPT DCF Valuation / Share Sensitivity Analysis**

| Terminal Growth Rate \ Discount Rate | 9.0% | 10.0% | 11.0% | 12.0% | 13.0% |
|---|---|---|---|---|---|
| 0.0% | $104 | $86 | $71 | $59 | $50 |
| 1.0% | $112 | $91 | **$75** | $62 | $52 |
| 2.0% | $123 | $99 | $80 | $66 | $55 |
| 3.0% | $137 | $108 | $87 | $70 | $58 |
| 4.0% | $157 | $120 | $95 | $76 | $62 |

*Source: Leerink Partners estimates.*

# Disclosures Appendix

## Analyst Certification

I, Marko Kozul, M.D., certify that the views expressed in this report accurately reflect my views and that no part of my compensation was, is, or will be directly related to the specific recommendation or views contained in this report.

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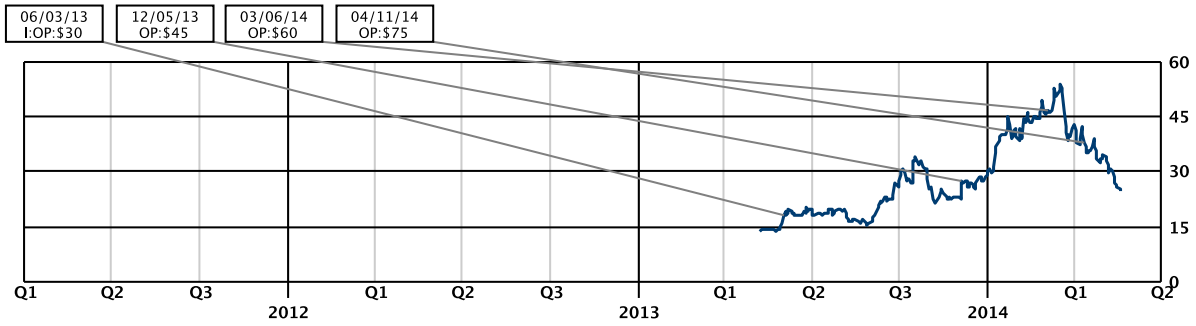
**Rating and Price Target History for: Receptos, Inc. (RCPT) as of 05-20-2014**




Leerink Swann initiated coverage of Receptos, Inc. with an Outperform rating on June 3, 2013. On June 11, 2013, Leerink Swann began a transition to specific price targets for the stocks under its coverage, replacing valuation ranges.

OP=Outperform MP=Market Perform UP=Underperform D=Drop Coverage I=Initiate SC=Suspend Coverage

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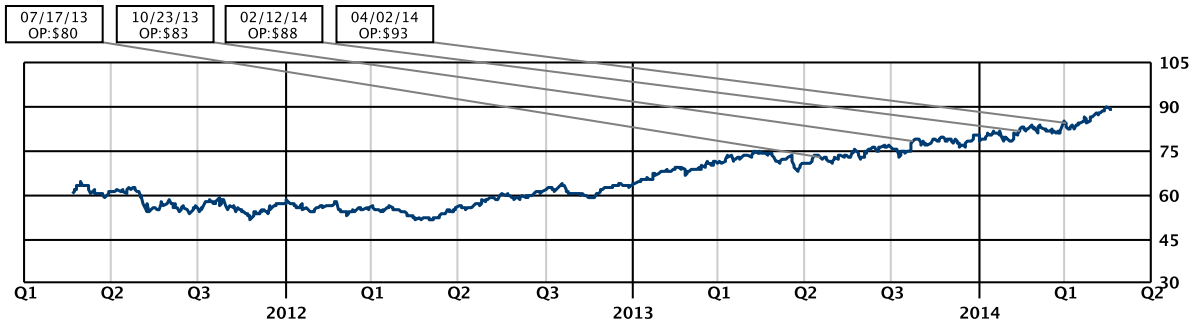
**Rating and Price Target History for: Novartis AG (NVS) as of 05-20-2014**




Leerink Swann initiated coverage of NVS with an Outperform rating on November 9, 2010. On June 11, 2013, Leerink Swann began a transition to specific price targets for the stocks under its coverage, replacing valuation ranges.

OP=Outperform MP=Market Perform UP=Underperform D=Drop Coverage I=Initiate SC=Suspend Coverage

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| Distribution of Ratings/Investment Banking Services (IB) as of 03/31/14 | | | IB Serv./Past 12 Mos. | |
|---|---|---|---|---|
| Rating | Count | Percent | Count | Percent |
| BUY [OP] | 131 | 68.23 | 46 | 35.11 |
| HOLD [MP] | 61 | 31.77 | 3 | 4.92 |
| SELL [UP] | 0 | 0.00 | 0 | 0.00 |

## Explanation of Ratings

**Outperform (Buy):** We expect this stock to outperform its benchmark over the next 12 months.

**Market Perform (Hold/Neutral):** We expect this stock to perform in line with its benchmark over the next 12 months.

**Underperform (Sell):** We expect this stock to underperform its benchmark over the next 12 months.The degree of outperformance or underperformance required to warrant an Outperform or an Underperform rating should be commensurate with the risk profile of the company.

For the purposes of these definitions the relevant benchmark will be the S&P 600® Health Care Index for issuers with a market capitalization of less than $2 billion and the S&P 500® Health Care Index for issuers with a market capitalization over $2 billion.

## Important Disclosures

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**In the past 12 months, the Firm has received compensation for providing investment banking services to Receptos, Inc. .**

**Leerink Partners LLC makes a market in Receptos, Inc.**

**Leerink Partners LLC is willing to sell to, or buy from, clients the common stock of Novartis AG on a principal basis.**

**Leerink Partners LLC has acted as a co-manager for a public offering of Receptos, Inc. in the past 12 months.**

## Leerink Partners LLC Equity Research

| | | | |
|---|---|---|---|
| **Director of Equity Research** | **John L. Sullivan, CFA** | (617) 918-4875 | john.sullivan@leerink |
| **Associate Director of Research** | **Alice C. Avanian, CFA** | (617) 918-4544 | alice.avanian@leerink |
| **Healthcare Strategy** | **John L. Sullivan, CFA** | (617) 918-4875 | john.sullivan@leerink |
| | **Alice C. Avanian, CFA** | (617) 918-4544 | alice.avanian@leerink |
| **Biotechnology** | **Howard Liang, Ph.D.** | (617) 918-4857 | howard.liang@leerink |
| | **Joseph P. Schwartz** | (617) 918-4575 | joseph.schwartz@leerink |
| | **Marko Kozul, M.D.** | (415) 905-7221 | marko.kozul@leerink |
| | **Michael Schmidt, Ph.D.** | (617) 918-4588 | michael.schmidt@leerink |
| | **Gena Wang, Ph.D., CFA** | (212) 277-6073 | gena.wang@leerink |
| | Jonathan Chang, Ph.D. | (617) 918-4015 | jonathan.chang@leerink |
| | Paul Matteis | (617) 918-4585 | paul.matteis@leerink |
| | Richard Goss | (617) 918-4059 | richard.goss@leerink |
| **Life Science Tools and Diagnostics** | **Dan Leonard** | (212) 277-6116 | dan.leonard@leerink |
| | Justin Bowers, CFA | (212) 277-6066 | justin.bowers@leerink |
| **Pharmaceuticals/Major** | **Seamus Fernandez** | (617) 918-4011 | seamus.fernandez@leerink |
| | Ario Arabi | (617) 918-4568 | ario.arabi@leerink |
| | Aneesh Kapur | (617) 918-4576 | aneesh.kapur@leerink |
| **Specialty Pharmaceuticals, Generics** | **Jason M. Gerberry, JD** | (617) 918-4549 | jason.gerberry@leerink |
| **Medical Devices, Cardiology & Orthopedics** | **Danielle Antalffy** | (212) 277-6044 | danielle.antalffy@leerink |
| | **Richard Newitter** | (212) 277-6088 | richard.newitter@leerink |
| | Ravi Misra | (212) 277-6049 | ravi.misra@leerink |
| **Healthcare Services** | **Ana Gupte, Ph.D.** | (212) 277-6040 | ana.gupte@leerink |
| **Healthcare Technology & Distribution** | **David Larsen, CFA** | (617) 918-4502 | david.larsen@leerink |
| | Christopher Abbott | (617) 918-4010 | chris.abbott@leerink |
| **Sr. Editor/Supervisory Analyst** | **Mary Ellen Eagan, CFA** | (617) 918-4837 | maryellen.eagan@leerink |
| Supervisory Analysts | Robert Egan | | bob.egan@leerink |
| | Amy N. Sonne | | amy.sonne@leerink |
| Editorial | Cristina Diaz-Dickson | (617) 918-4548 | cristina.diaz-dickson@leerink |


**New York**
299 Park Avenue, 21st floor
New York, NY 10171
(888) 778-1653

**Boston**
**One Federal Street, 37th Floor**
**Boston, MA 02110**
**(800) 808-7525**

**San Francisco**
201 Spear Street, 16th Floor
San Francisco, CA 94105
(800) 778-1164