

## ZS Pharma

### 1Q Snapshot and Model Update

1Q15 proved to be a nonevent for ZS Pharma, as anticipated, with financial results generally in-line with our expectations (detailed below) to kick off the year. From a pipeline perspective, we're still looking for the ZS-9 NDA submission in hyperkalemia, which is still guided to occur by the end of this quarter, with the MAA to follow in the back half of the year. We continue to expect ZSPH to meet these goals and make their submissions within the given guidance. ZS Pharma maintains a healthy balance sheet as well after the March secondary that raised an additional \$173.6 million in net proceeds. ZSPH remains largely off the radar for most investors. However, we believe its story sets up very well over the next 12-18 months, and thus, it is one of our top small cap picks for patient investors. Reiterate Overweight.

- **Model updates.** We have updated our model to reflect actual financial results from the first quarter and maintain our \$57 price target.
- **1Q15 results.** Net loss per share for 1Q15 amounted to (\$1.05) per share vs. JPM of (\$0.99). Operating expenses of \$21.7 million were generally in-line with our estimates of \$20.4 million.
- **Balance sheet update.** ZS Pharma wrapped up the first quarter of 2015 with \$259.6 million in cash and cash equivalents. This sum is bolstered by the March secondary offering that brought in \$173.6 million in net proceeds.
- **Key upcoming events.** The most meaningful events for ZS Pharma in our eyes are the regulatory filings expected for ZS-9 in hyperkalemia. ZSPH is still guiding for the NDA filing to occur in 2Q15 with the MAA filing to follow in the second half of 2015. The company also plans to present clinical data for ZS-9 at several upcoming industry meetings including but not limited to the American Society of Hypertension (New York, May 15-19), the Heart Failure Association of the European Society of Cardiology (Sevilla, May 23-26), and the European Renal Association-European Dialysis and Transplant Association (London, May 28-31).

#### ZS Pharma, Inc (ZSPH;ZSPH US)

FYE Dec	2013A	2014A	2015E (Prev)	2015E (Curr)	2016E (Prev)	2016E (Curr)
EPS Reported (\$)						
Q1 (Mar)	(1.35)	(2.57)	(0.99)A	(1.05)A	-	-
Q2 (Jun)	-	(4.72)	(1.01)	(0.85)	-	-
Q3 (Sep)	-	(0.81)	(1.03)	(0.87)	-	-
Q4 (Dec)	-	(0.98)	(1.06)	(0.90)	-	-
FY	(8.52)	(5.47)	(4.09)	(3.64)	(5.93)	(5.10)

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

## Overweight

ZSPH, ZSPH US

Price: \$49.44

Price Target: \$57.00

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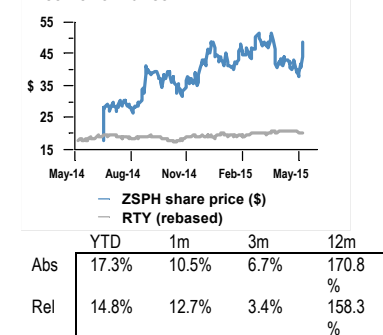
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#### Price Performance



#### Company Data

Price (\$)	49.44
Date Of Price	11 May 15
52-week Range (\$)	52.80-25.51
Market Cap (\$ mn)	1,235.65
Fiscal Year End	Dec
Shares O/S (mn)	25
Price Target (\$)	57.00
Price Target End Date	31-Dec-15

#### See page 5 for analyst certification and important disclosures.

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## Pipeline

Figure 1: ZSPH Pipeline

### Product Pipeline Highlights

Program	P/C	Ph 1	Ph 2	Ph 3	FDA	Mkt.	Partner	Comments
<b>ZS-9</b> Hyperkalemia							--	
<b>ZS-1</b> Elevated Ammonia							--	

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

## Key Upcoming Events

Figure 2: ZSPH Key Upcoming Events

Program	Event	Expected	Significance
<b>ZS-9</b>	NDA Filing	2Q15	Medium
	NDA and MAA filings	2H15	Medium
	US Launch	2016	High

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

## Investment Thesis, Valuation and Risks

### ZS Pharma (Overweight; Price Target: \$57.00)

#### Investment Thesis

We have an OW rating on ZSPH based on the potential of ZS-9 for the treatment of hyperkalemia – a relatively common and potentially lethal condition in CKD and CHF patients. We see ZS-9 as a differentiated treatment option in a large market with significant unmet need, which we think could lead to a majority market share over time vs. competitor RLYP's patiomer. Even assuming equal share, we believe ZSPH's valuation is highly compelling on both a comp and absolute basis. Maintain Overweight.

#### Valuation

Our probability-weighted Dec-15 PT of \$57 is based on a blended average of our proprietary probability-adjusted sum-of-the-parts scenario analysis (50% weighting) and risk-adjusted NPV model (50% weighting).

#### ZSPH Valuation Summary

ZSPH Valuation Summary			
Discount rate	12%		
4Q15 Fully Diluted Shares (mm)	28.8		
<b>Main value drivers</b>	Prob of approval	Peak WW sales est (avg. scenario)	Avg peak yr
ZS-9 US	75%	\$ 1,105	2020
ZS-9 EU/Japan	50%	\$ 570	2022
<b>Valuation methodology</b>	Value / share	Weighting	Adj. value/ share
DCF			
P/E 2016			
Real options scenario analysis	\$ 58.39	50%	29.20
Risk adjusted NPV analysis	\$ 55.11	50%	27.56
Total			\$ 56.75
Catalyst/liquidity discount			0%
<b>YE15 Price Target</b>			<b>\$ 57</b>

Source: J.P. Morgan estimates.

#### Risks to Rating and Price Target

ZSPH is susceptible to the standard risks that apply to the entire biotech industry, including development, regulatory, commercial, manufacturing, financing, and IP pitfalls. More specific risks to the downside include clinical setbacks for ZS-9, regulatory hurdles, commercial setbacks, and personnel risk.

## ZS Pharma: Summary of Financials

Income Statement - Annual	FY14A	FY15E	FY16E	FY17E	Income Statement - Quarterly	1Q15A	2Q15E	3Q15E	4Q15E
Revenues	0	0	52	-	Revenues	0A	0	0	0
Cost of products sold	0	0	(16)	-	Cost of products sold	0A	0	0	0
Gross profit	-	-	-	-	Gross profit	-	-	-	-
SG&A	(20)	(26)	(114)	-	SG&A	(6)A	(6)	(7)	(7)
R&D	(41)	(60)	(64)	-	R&D	(15)A	(15)	(15)	(15)
Operating income	(61)	(87)	(142)	-	Operating income	(22)A	(21)	(22)	(22)
EBITDA	(61)	(87)	(142)	-	EBITDA	(22)A	(21)	(22)	(22)
Net interest (income) / expense	(4)	(1)	(1)	-	Net interest (income) / expense	(0)A	(0)	(0)	(0)
Other income / (expense)	-	-	-	-	Other income / (expense)	-	-	-	-
Income taxes	0	0	0	-	Income taxes	0A	0	0	0
Net income - GAAP	(64)	(87)	(143)	-	Net income - GAAP	(22)A	(21)	(22)	(23)
Net income - recurring	(64)	(87)	(143)	-	Net income - recurring	(22)A	(21)	(22)	(23)
Diluted shares outstanding	12	24	28	-	Diluted shares outstanding	21A	25	25	25
EPS - excluding non-recurring	(5.47)	(3.64)	(5.10)	-	EPS - excluding non-recurring	(1.05)A	(0.85)	(0.87)	(0.90)
EPS - recurring	(5.47)	(3.64)	(5.10)	-	EPS - recurring	(1.05)A	(0.85)	(0.87)	(0.90)
Balance Sheet and Cash Flow Data	FY14A	FY15E	FY16E	FY17E	Ratio Analysis	FY14A	FY15E	FY16E	FY17E
Cash and cash equivalents	87	1	12	-	Sales growth	-	-	-	-
Accounts receivable	-	-	-	-	EBIT growth	88.0%	43.2%	63.9%	-
Inventories	-	-	-	-	EPS growth - recurring	(35.8%)	(33.4%)	40.2%	-
Other current assets	0	0	0	-	Gross margin	-	-	-	-
Current assets	87	1	12	-	EBIT margin	-	-	(274.7%)	-
PP&E	10	12	12	-	EBITDA margin	-	-	(274.7%)	-
Total assets	97	13	24	-	Tax rate	0.0%	0.0%	0.0%	-
Total debt	-	-	-	-	Net margin	-	-	(276.3%)	-
Total liabilities	8	8	8	-	Net Debt / EBITDA	-	-	-	-
Shareholders' equity	89	4	16	-	Net Debt / Capital (book)	-	-	-	-
Net income (including charges)	(64)	(87)	(143)	-	Return on assets (ROA)	(116.1%)	(160.0%)	(775.4%)	-
D&A	3	6	7	-	Return on equity (ROE)	(134.9%)	(187.4%)	(1405.6%)	-
Change in working capital	0	0	0	-	Enterprise value / sales	-	-	23.3	-
Other	2	3	4	-	Enterprise value / EBITDA	NM	NM	NM	-
Cash flow from operations	(59)	(79)	(132)	-	Free cash flow yield	(10.9%)	(7.2%)	(10.0%)	-
Capex	(8)	(8)	(8)	-					
Free cash flow	(63)	(85)	(138)	-					
Cash flow from investing activities	(8)	(8)	(8)	-					
Cash flow from financing activities	145	0	150	-					
Dividends	-	-	-	-					
Dividend yield	-	-	-	-					

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

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

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ZS Pharma (ZSPH, ZSPH US) Price Chart



Date	Rating	Share Price (\$)	Price Target (\$)
14-Jul-14	OW	29.49	43.00
16-Dec-14	OW	47.02	57.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.  
Initiated coverage Jul 14, 2014.

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