

# ZS Pharma

(ZSPH-NASDAQ)

**Stock Rating:** Outperform  
**Industry Rating:** Outperform

September 24, 2014

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## Good Phase III Top-Line Data; Raising Price Target to \$45

### Event

ZS Pharma has reported positive top-line results from ZS004, its second Phase III clinical trial of ZS-9 for the treatment of hyperkalemia. Preliminary results showed that all three doses (5g, 10g, and 15g) of 1x/daily ZS-9 met the primary and the safety, tolerability and adverse events were in line with previous ZS-9 clinical studies. The full data will be presented at the American Heart Association Scientific meeting in November.

### Impact & Analysis

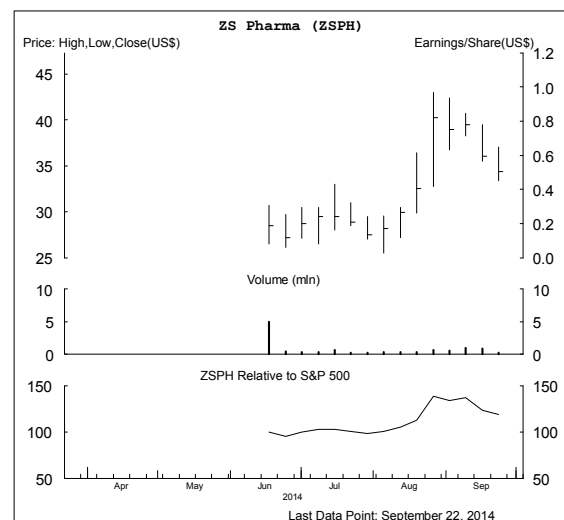
Given the positive data, we believe that ZS shares are now slightly de-risked. As a result, we are lowering our discount rate from 15% to 12%, and raising our price target to \$45 from \$38. We will be revisiting our model over the next several weeks following the presentation of the data; however, we note that our 2014 and 2015 EPS estimates have changed following the 2Q results. We believe the positive data also makes ZS Pharma a credible acquisition target, something we have not yet included in our valuation. Despite the timely completion of ZS004, we continue to take a conservative approach to our forecast by delaying the timeline by six months and risk-adjusting our sales forecast. Further, our model continues to reflect an additional financing in 2015 but recognize ZS Pharma believes it is well-positioned to fund operations into 2016.

### Valuation & Recommendation

We continue to view ZS Pharma's position as a late-stage asset for an unmet medical need with a limited physician target pool as an attractive opportunity for in-licensing or acquisition by large pharma. We maintain our Outperform rating and are raising our price target to \$45 price target.

**Price (23-Sep)** \$38.05  
**Target Price** \$45.00 ↑

**52-Week High** \$43.00  
**52-Week Low** \$25.51



(FY-Dec.)	2012A	2013A	2014E	2015E
EPS	-\$6.74	-\$21.84	-\$5.05 ↓	-\$3.06 ↑
P/E			na	na
CFPS	na	na	-\$4.20	-\$3.50
P/CFPS			na	na
Rev. (\$mm)	\$0	\$0	\$0	\$0
EV	na	na	na	na
EBITDA (\$mm)	-\$8	-\$32	-\$55	-\$73
EV/EBITDA	na	na	na	na
Quarterly EPS	Q1	Q2	Q3	Q4
2012A	na	na	na	na
2013A	na	na	na	na
2014E	-\$6.60a	-\$4.72a	-\$0.77	-\$0.76 ↑
Dividend	\$0.00			0.0%
Book Value	\$1.16			32.8x
Shares O/S (mm)	18.7			Mkt. Cap (mm)
Float O/S (mm)	na			\$713
Wkly Vol (000s)	789			Float Cap (mm)
Net Debt (\$mm)	na			na
				Wkly \$ Vol (mm)
				\$24.8
				Next Rep. Date
				na

Notes: All values in US\$

Major Shareholders:

First Call Mean Estimates: ZS PHARMA INC (US\$) 2014E: -\$3.95;  
 2015E: -\$3.08

## Changes

## Annual EPS

2014E -\$3.90 to -\$5.05  
 2015E -\$3.10 to -\$3.06

## Quarterly EPS

Q4/14E -\$0.78 to -\$0.76

## Target

\$38.00 to \$45.00

## Details & Analysis

ZS Pharma has reported positive top-line results from ZS004, its second Phase III clinical trial of ZS-9 for the treatment of hyperkalemia. Preliminary results showed that all three doses (5g, 10g, and 15g) of 1x/daily ZS-9 met the primary endpoint, which compared the mean serum potassium level of each ZS-9 treatment group to that of placebo over the interval between day 8 and day 28 of the randomized withdrawal period. Patients who completed the initial 28 day maintenance phase were able to enroll in ZS004E, an ongoing open label extension study. The safety, tolerability and adverse events were in line with previous ZS-9 clinical studies and the full data will be presented at the American Heart Association Scientific meeting in November.

Patient exposure now represents approximately 1,000 patients, many of whom have been treated with ZS-9 for over five months.

The timing of completion for ZS004 is in line with our expectations, and we believe ZS Pharma remains on track to submit the NDA and MAA filings in 1H2015 with the NDA approval in 4Q15-2Q16 and the MAA approval in 2016. ZS Pharma believes it is well-positioned to fund operations into 2016. We continue to take a conservative approach to our forecast by delaying the timeline by six months and risk-adjusting our sales forecast. As a result, we have modeled an additional financing in 2015 but recognize that by doing so, we are modeling a larger cash balance than what ZS Pharma would likely need to fund operations.

Given the positive data, we believe that ZS shares are now slightly de-risked. As a result, we are lowering our discount rate from 15% to 12%, and our price target rises to \$45 from \$38. We will be revisiting our model over the next several weeks following the presentation of the data; however, we note that our 2014 and 2015 EPS estimates have changed following the 2Q results. We believe the positive data also makes ZS Pharma a credible acquisition target, something we have not yet included in our valuation.

We continue to view ZS Pharma's position as a late-stage asset for an unmet medical need with a limited physician target pool as an attractive opportunity for in-licensing or acquisition by large pharma. We maintain our Outperform rating and have revised our price target to \$45.

## Exhibit 1: ZS Pharma Income Statement (\$ millions, except per share data)

ZS Pharma Income Statement	2012A	2013A	2014E	2015E	2016E	2017E	2018E	2019E	2020E
Net revenue for CKD patients					\$13.1	\$99.2	\$187.1	\$270.0	\$327.2
Net revenue for HF patients					\$2.9	\$27.2	\$41.3	\$60.1	\$72.9
ZS-9 episodic net revenues					\$1.4	\$8.4	\$27.8	\$33.4	\$39.0
Total ZS US net revenue					\$17.4	\$134.8	\$256.3	\$363.5	\$439.0
ZS Pharma Income Statement	2012A	2013A	2014E	2015E	2016E	2017E	2018E	2019E	2020E
Total revenues	\$0.0	\$0.0	\$0.0	\$0.0	\$17.4	\$136.4	\$269.0	\$392.4	\$481.9
% growth							97.3%	45.9%	22.8%
COGS	\$0.0	\$0.0	\$0.0	\$0.0	\$3.5	\$27.0	\$46.1	\$54.5	\$65.9
COGS as % of US sales					20.0%	20.0%	18.0%	15.0%	15.0%
Gross profit	\$0.0	\$0.0	\$0.0	\$0.0	\$13.9	\$109.4	\$222.9	\$337.9	\$416.1
Gross margin					80.0%	80.2%	82.9%	86.1%	86.3%
R&D	\$7.0	\$24.5	\$40.8	\$36.0	\$20.0	\$20.2	\$25.6	\$36.3	\$41.7
R&D as % of US sales					114.9%	15.0%	10.0%	10.0%	9.5%
S&M	\$0.0	\$0.0	\$3.0	\$29.9	\$39.0	\$45.9	\$64.1	\$80.0	\$91.1
S&M as % of US sales					224.0%	34.1%	25.0%	22.0%	20.8%
G&A	\$1.1	\$7.7	\$11.8	\$8.4	\$1.3	\$5.4	\$10.3	\$14.5	\$17.6
G&A as % of US sales					7.4%	4.0%	4.0%	4.0%	4.0%
Royalties					\$5.8	\$12.2	\$21.2	\$31.8	\$43.6
Operating profit	(\$8.1)	(\$32.2)	(\$55.6)	(\$74.3)	(\$52.1)	\$25.7	\$101.8	\$175.2	\$222.0
Operating margin						18.9%	37.8%	44.7%	46.1%
Interest expense (income)	\$2.1	(\$0.0)	\$0.3	\$0.8	\$0.8	\$0.8	\$0.8	\$0.8	\$0.8
Other expense (income)	\$0.1	\$1.4	\$3.1	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Pretax income	(\$10.3)	(\$33.6)	(\$59.0)	(\$75.1)	(\$52.9)	\$24.9	\$101.0	\$174.4	\$221.2
Pretax margin						18.3%	37.5%	44.5%	45.9%
Taxes	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$3.7	\$15.2	\$26.2	\$66.4
Tax rate	0.0%	0.0%	0.0%	0.0%	0.0%	15.0%	15.0%	15.0%	30.0%
Net income	(\$10.3)	(\$33.6)	(\$59.0)	(\$75.1)	(\$52.9)	\$21.2	\$85.9	\$148.3	\$154.9
Preferred stock accretion	(\$0.2)	(\$0.7)	(\$0.3)	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Net income to common stockholders	(\$10.5)	(\$34.3)	(\$59.3)	(\$75.1)	(\$52.9)	\$21.2	\$85.9	\$148.3	\$154.9
Net margin						15.5%	31.9%	37.8%	32.1%
Shares out (diluted)	1.6	1.6	11.7	24.5	25.1	25.8	25.8	25.8	25.8
Earnings per share	(\$6.74)	(\$21.84)	(\$5.05)	(\$3.06)	(\$2.11)	\$0.82	\$3.33	\$5.75	\$6.00
EPS % growth							305.5%	72.6%	4.4%

Source: Company reports and BMO Capital Markets estimates

## Exhibit 2: ZS Pharma Discounted Cash Flow Statement (\$ millions)

WACC	12.0%									
Terminal Value EV/EBITDA Multiple	8.0x									
<b>Unlevered Free Cash Flows</b>										
		<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>
Net Sales		\$0.0	\$0.0	\$0.0	\$0.0	\$17.4	\$136.4	\$269.0	\$392.4	\$481.9
Growth Rate							683.2%	97.3%	45.9%	22.8%
EBIT		(\$8.1)	(\$32.2)	(\$55.6)	(\$74.3)	(\$52.1)	\$25.7	\$101.8	\$175.2	\$222.0
Margin							18.9%	37.8%	44.7%	46.1%
Pre-tax income		(\$10.3)	(\$33.6)	(\$59.0)	(\$75.1)	(\$52.9)	\$24.9	\$101.0	\$174.4	\$221.2
Tax		\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	(\$3.9)	(\$15.3)	(\$26.3)	(\$66.6)
Tax rate		0.0%	0.0%	0.0%	0.0%	0.0%	15.0%	15.0%	15.0%	30.0%
EBIAT		(\$8.1)	(\$32.2)	(\$55.6)	(\$74.3)	(\$52.1)	\$21.9	\$86.5	\$148.9	\$155.4
Plus: Depreciation and Amortization		\$0.0	\$0.7	\$1.4	\$1.7	\$1.8	\$1.9	\$2.0	\$2.1	\$2.2
Less: Capital Expenditures		(\$0.7)	(\$3.8)	(\$9.7)	(\$16.0)	(\$16.0)	(\$15.0)	(\$15.0)	(\$15.0)	(\$15.0)
Less: Change in Net Working Capital		\$0.6	\$2.8	\$5.6	(\$0.3)	(\$1.9)	(\$9.4)	(\$4.7)	(\$4.6)	\$1.2
<b>Unlevered Free Cash Flow</b>		<b>(\$8.2)</b>	<b>(\$32.5)</b>	<b>(\$58.4)</b>	<b>(\$88.8)</b>	<b>(\$68.2)</b>	<b>(\$0.6)</b>	<b>\$68.9</b>	<b>\$131.4</b>	<b>\$143.8</b>
Cumulative Unlevered FCF	\$157.09	0	0	0.5	1.5	2.5	3.5	4.5	5.5	6.5
Terminal Value <sup>2</sup>	\$1,793.7									
PV of Free Cash flow	(\$6.3)	-\$8.2	-\$32.5	-\$58.4	-\$88.8	-\$68.2	-\$0.6	\$41.3	\$70.4	\$68.8
PV of Terminal Value	\$858.7									
Implied Enterprise Value	\$852.4									
<b>Implied Equity Value Sensitivity Table</b>										
Plus: Cash & Equivalents (4Q14)	\$104.0									
Less: Total Debt (1Q14)	\$15.0									
Implied Value of Equity	\$941.4									
Diluted Shares Outstanding	20.8									
Implied Value per Share	\$45.26									
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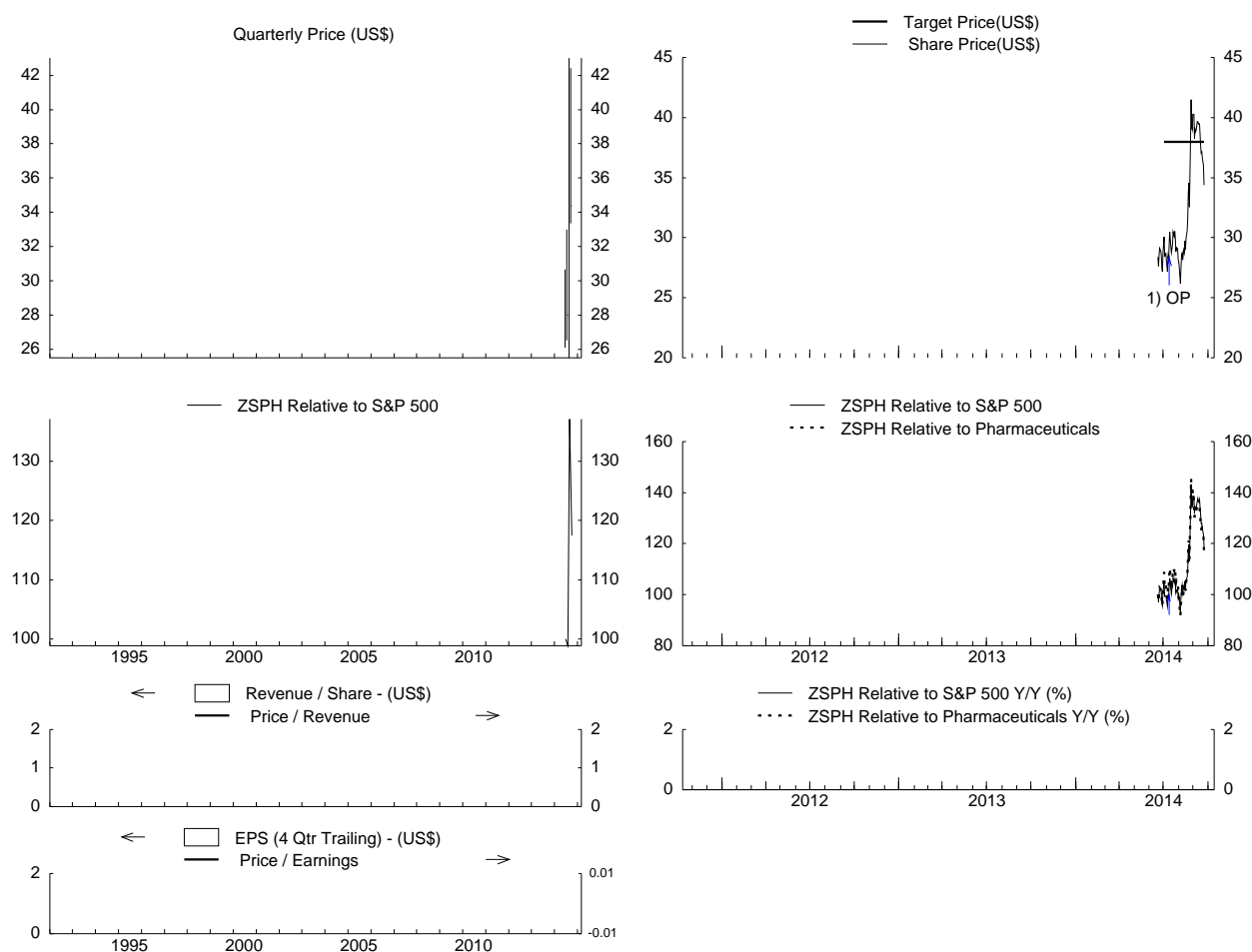
Implied Equity Value Sensitivity Table

EBITDA Multiple Terminal Value

WACC	\$45.26	7.0x	8.0x	9.0x
	14.0%	\$35.35	\$39.95	\$44.55
	15.0%	\$33.20	\$37.54	\$41.89
	16.0%	\$31.17	\$35.28	\$39.39

Source: Company Reports and BMO Capital Markets Estimates

## ZS Pharma (ZSPH)



FYE (Dec.)	EPS US\$	P/E Hi - Lo	DPS US\$	Yield% Hi - Lo	Payout %	BV US\$	P/B Hi - Lo	ROE %	ZSPH - Rating as of 17-Jun-14 = NR		
Range*:		na na		NC			>15 >15		Date	Rating Change	Share Price
Current*	ND	na	0.00	0.0	na	1.2	34.7	na	1 11-Jul-14	NR to OP	\$29.49

\* Current EPS is the 4 Quarter Trailing to Q1/2014.

\* Valuation metrics are based on high and low for the fiscal year.

\* Range indicates the valuation range for the period presented above.

Last Price ( September 22, 2014): \$34.36  
Sources: IHS Global Insight, Thomson Reuters, BMO Capital Markets.

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**Methodology:** We arrive at our target price using a discounted cash flow analysis, a sector multiple applied to discounted earnings, and as a multiple of sales.

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Rating Category	BMO Rating	BMOCM US Universe*	BMOCM US IB Clients**	BMOCM US IB Clients***	BMOCM Universe****	BMOCM IB Clients*****	Starmine Universe
Buy	Outperform	44.1%	21.1%	67.5%	43.3%	58.6%	55.4%
Hold	Market Perform	50.9%	8.4%	31.3%	51.2%	39.9%	39.5%
Sell	Underperform	5.0%	3.4%	1.3%	5.5%	1.5%	5.1%

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(S) = speculative investment;

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