

## ZS Pharma

### Model Update; PT to \$57

Heading into 2015, we are updating our ZSPH model to reflect a higher probability of success for ZS-9 in the US following the presentation of full Phase 3 data from the ZS004 trial (see note [here](#)) and the company's recent analyst day (note [here](#)). We now assume a 75% probability of success in the US (vs. 70% previously), and we have also redistributed our scenario analysis probability weightings slightly more towards the aggressive cases given the strong Phase 3 data. We have also lowered our discount rate (derived from the company's WACC) and now apply a 12% discount rate. Our revenue estimates are unchanged: to be conservative, we currently assume market shares are split 50/50 with Relypsa 4-5 years post launch. We also assume a net, compliance-adjusted price of \$700/month and that patients are on therapy for an average of 4 months in any given year. These (we believe highly conservative) assumptions result in peak US sales for ZS-9 at ~\$1B by 2020E.

The net effect of our changes is an increase in our YE15 price target to \$57 from \$43. Maintain OW.

## Overweight

### ZSPH, ZSPH US

Price: \$47.02

▲ **Price Target: \$57.00**  
Previous: \$43.00

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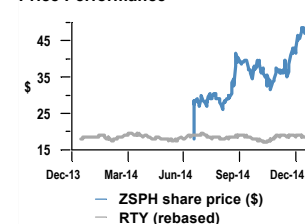
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### Price Performance



	YTD	1m	3m	12m
Abs	161.2	23.2%	25.0%	161.2
	%			%
Rel	162.1	26.1%	25.5%	159.4
	%			%

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

FYE Dec	2013A	2014E	2015E	2016E
EPS Reported (\$)				
Q1 (Mar)	(1.35)	(2.57)A	-	-
Q2 (Jun)	-	(4.72)A	-	-
Q3 (Sep)	-	(0.81)A	-	-
Q4 (Dec)	-	(0.84)	-	-
FY	(8.52)	(4.99)	(3.09)	(4.65)

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

### Company Data

Price (\$)	47.02
Date Of Price	15 Dec 14
52-week Range (\$)	49.77-25.51
Market Cap (\$ mn)	978.91
Fiscal Year End	Dec
Shares O/S (mn)	21
Price Target (\$)	57.00
Price Target End Date	31-Dec-15

### See page 4 for analyst certification and important disclosures.

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## 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)	27.8		
<b>Main value drivers</b>	<b>Prob of approval</b>	<b>Peak WW sales est (avg. scenario)</b>	<b>Avg peak yr</b>
ZS-9 US	75%	\$ 1,105	2020
ZS-9 EU/Japan	50%	\$ 570	2022
<b>Valuation methodology</b>	<b>Value / share</b>	<b>Weighting</b>	<b>Adj. value/ shar</b>
DCF			
P/E 2016			
Real options scenario analysis	\$ 61.47	50%	30.74
Risk adjusted NPV analysis	\$ 51.62	50%	25.81
Total			\$ 56.54
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	FY13A	FY14E	FY15E	FY16E	Income Statement - Quarterly	1Q14A	2Q14A	3Q14A	4Q14E
Revenues	0	0	0	52	Revenues	0A	0A	0A	0
Cost of products sold	0	0	0	(16)	Cost of products sold	0A	0A	0A	0
Gross profit	-	-	-	-	Gross profit	-	-	-	-
SG&A	(8)	(20)	(26)	(114)	SG&A	(4)A	(5)A	(6)A	(6)
R&D	(25)	(38)	(41)	(44)	R&D	(5)A	(10)A	(11)A	(12)
Operating income	(32)	(58)	(67)	(122)	Operating income	(9)A	(15)A	(17)A	(17)
EBITDA	(32)	(58)	(67)	(122)	EBITDA	(9)A	(15)A	(17)A	(17)
Net interest (income) / expense	(2)	(4)	(1)	(1)	Net interest (income) / expense	(1)A	(2)A	(0)A	(0)
Other income / (expense)	-	-	-	-	Other income / (expense)	-	-	-	-
Income taxes	0	0	0	0	Income taxes	0A	0A	0A	0
Net income - GAAP	(34)	(62)	(67)	(123)	Net income - GAAP	(11)A	(16)A	(17)A	(18)
Net income - recurring	(34)	(62)	(67)	(123)	Net income - recurring	(11)A	(16)A	(17)A	(18)
Diluted shares outstanding	4	12	22	26	Diluted shares outstanding	4A	3A	21A	21
EPS - excluding non-recurring	(8.52)	(4.99)	(3.09)	(4.65)	EPS - excluding non-recurring	(2.57)A	(4.72)A	(0.81)A	(0.84)
EPS - recurring	(8.52)	(4.99)	(3.09)	(4.65)	EPS - recurring	(2.57)A	(4.72)A	(0.81)A	(0.84)
Balance Sheet and Cash Flow Data	FY13A	FY14E	FY15E	FY16E	Ratio Analysis	FY13A	FY14E	FY15E	FY16E
Cash and cash equivalents	9	89	24	55	Sales growth	-	-	-	-
Accounts receivable	-	-	-	-	EBIT growth	295.6%	79.5%	15.1%	83.5%
Inventories	-	-	-	-	EPS growth - recurring	224.3%	(41.5%)	(38.0%)	50.6%
Other current assets	0	0	0	0	Gross margin	-	-	-	-
Current assets	9	90	24	55	EBIT margin	-	-	-	(236.1%)
PP&E	5	10	12	12	EBITDA margin	-	-	-	(236.1%)
Total assets	14	99	35	67	Tax rate	0.0%	0.0%	0.0%	0.0%
Total debt	-	-	-	-	Net margin	-	-	-	(237.6%)
Total liabilities	8	8	8	8	Net Debt / EBITDA	-	-	-	-
Shareholders' equity	6	92	27	59	Net Debt / Capital (book)	-	-	-	-
Net income (including charges)	(34)	(62)	(67)	(123)	Return on assets (ROA)	(172.9%)	(108.6%)	(99.7%)	(239.2%)
D&A	1	3	6	7	Return on equity (ROE)	(235.2%)	(125.7%)	(113.1%)	(285.1%)
Change in working capital	3	0	0	0	Enterprise value / sales	-	-	-	17.9
Other	4	2	3	4	Enterprise value / EBITDA	NM	NM	NM	NM
Cash flow from operations	(27)	(56)	(58)	(112)	Free cash flow yield	(14.9%)	(10.4%)	(6.4%)	(9.5%)
Capex	(4)	(8)	(8)	(8)					
Free cash flow	(28)	(61)	(65)	(118)					
Cash flow from investing activities	(4)	(8)	(8)	(8)					
Cash flow from financing activities	15	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	30.49	43.00

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

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