

ZS Pharma

2Q Snapshot & Model Update

We are updating our ZSPH model based on the company's 2Q results (there was no conference call). After its initial public offering in June and our recent initiation ([here](#)), there isn't much in the press release. The company reiterated progress during the Q (completing enrollment in the Phase 3 ZS004 trial, and initiating the long-term Phase 3 safety study ZS005). Everything remains on track for an NDA filing for ZS-9 in hyperkalemia in 1H15. 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 patiromer. Even assuming equal share, we believe ZSPH's valuation is highly compelling on both a comp (RLYP's market cap is ~\$900 vs. ZSPH's ~\$600M) and absolute basis (using our rNPV and SOTP models). Maintain Overweight.

- **Upcoming events: Phase 3 data in 4Q14.** The key remaining catalyst for ZSPH in 2014 should be Phase 3 data from the ZS004 trial (28-day treatment), which is anticipated in 4Q14. While we anticipate positive data, we still think longer-term Phase 3 data could be a significant catalyst for the stock as it provides further de-risking ahead of NDA/MAA filing (1H15). Further, given that the data generated to date for ZS-9 has been relatively short term, long-term data on the efficacy/safety of maintenance dosing will be important for doc (and investor) perception of the market opportunity.
- **2Q results.** 2Q EPS was \$(4.72) vs. JPMe of (\$1.02), driven largely by pre-IPO share counts (3.5M weighted average shares vs. JPMe of 12.4M; shares outstanding as of June 30 were 20.8M). 2Q OpEx of \$14.5M was slightly higher than JPMe of \$12.5M. That said, ZSPH is not yet an earnings story.
- **Estimate changes.** We have updated our model for 2Q results; changes were minimal. We are maintaining our Dec 15 \$43 target.
- **Balance sheet update.** ZSPH ended 2Q with \$130M in cash (and no debt), after having raised \$112M in its June IPO (J.P. Morgan acted as a joint book-runner). The current cash position should be sufficient through the expected approval of ZS-9 in early 2016.

Overweight

ZSPH, ZSPH US

Price: \$29.02

Price Target: \$43.00

Biotechnology

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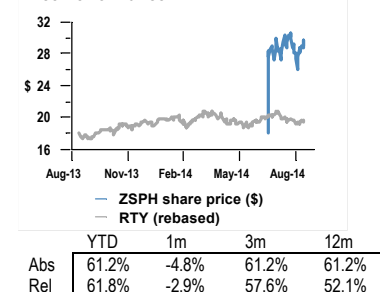
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Price Performance



ZS Pharma, Inc (ZSPH;ZSPH US)

FYE Dec	2012A	2013A	2014E	2014E	2015E	2015E	2016E	2016E
			(Prev)	(Curr)	(Prev)	(Curr)	(Prev)	(Curr)
EPS Reported (\$)								
Q1 (Mar)	-	(1.35)	(2.57)	(2.57)A	-	-	-	-
Q2 (Jun)	-	-	(1.02)	(4.72)A	-	-	-	-
Q3 (Sep)	-	-	(0.63)	(0.82)	-	-	-	-
Q4 (Dec)	-	-	(0.64)	(0.85)	-	-	-	-
FY	(2.63)	(8.52)	(3.43)	(5.01)	(3.12)	(3.16)	(4.69)	(4.71)

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

Company Data

Price (\$)	29.02
Date Of Price	14 Aug 14
52-week Range (\$)	33.00-25.51
Market Cap (\$ mn)	101.06
Fiscal Year End	Dec
Shares O/S (mn)	3
Price Target (\$)	43.00
Price Target End Date	31-Dec-15

See page 6 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
ZS-9								
Hyperkalemia							--	
ZS-1								
Elevated Ammonia							--	

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

Upcoming Events

Figure 2: ZSPH Upcoming Events

Anticipated Newsflow Highlights

Program	Event	Expected Timing	Significance
ZS-9	top-line data from ZS004 Ph 3 study	Sept-Oct	High
	Full ZS004 data presentation (medical meeting)	4Q14	High
	Initiate ZS005 study to assess long-term safety/efficacy	2Q14	Low
	NDA and MAA filings	1H15	Medium
	US Launch	2016	High

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

Figure 3: ZSPH Income Statement

ZS Pharmaceuticals Income Statement											
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	2013A	1Q14A	2Q14A	3Q14E	4Q14E	2014E	2015E	2016E	2017E	2018E	2019E
ZS-9 Revenues											
US Revenues	-	-	-	-	-	-	-	51.7	189.5	402.5	728.9
Ex-US Royalty	-	-	-	-	-	-	-	-	3.6	14.8	33.9
Total Revenues	-	-	-	-	-	-	-	51.7	193.1	417.3	762.8
COGS	-	-	-	-	-	-	-	15.5	59.9	112.7	175.4
R&D	24.5	5.3	10.0	10.5	11.0	36.7	41.0	44.0	48.0	54.0	70.0
SG&A	7.7	4.0	4.6	4.7	4.8	18.1	25.5	114.3	117.8	123.1	128.6
Total Operating Expenses	32.2	9.3	14.5	15.2	15.8	54.8	66.5	173.8	225.7	289.8	374.1
Operating Income	(32.2)	(9.3)	(14.5)	(15.2)	(15.8)	(54.8)	(66.5)	(122.1)	(32.6)	127.5	388.7
Net interest & other income	(2.1)	(1.5)	(1.9)	(1.9)	(1.9)	(7.2)	(2.3)	(2.3)	(2.3)	(2.3)	(2.3)
Income Tax (benefit)	-	-	-	-	-	-	-	-	-	12.5	77.3
GAAP Net Income	(34.3)	(10.7)	(16.4)	(17.1)	(17.7)	(62.0)	(68.8)	(124.4)	(34.9)	112.7	309.1
Non-GAAP Net Income	(34.3)	(10.5)	(16.2)	(16.9)	(17.5)	(61.2)	(67.3)	(121.6)	(30.9)	117.9	315.6
GAAP Basic EPS	(8.52)	(2.57)	(4.72)	(0.82)	(0.85)	(5.01)	(3.16)	(4.71)	(1.23)	3.63	9.02
GAAP Diluted EPS	(8.52)	(2.57)	(4.72)	(0.82)	(0.85)	(5.01)	(3.16)	(4.71)	(1.23)	3.04	7.67
Basic Shares Outstanding	4.0	4.2	3.5	20.9	21.0	12.4	21.8	26.4	28.4	31.0	34.3
Diluted Shares Outstanding	4.0	4.2	3.5	20.9	21.0	12.4	21.8	26.4	28.4	37.0	40.3
Margin Analysis:											
Gross margin	NM	NM	NM	NM	NM	NM	NM	70%	69%	73%	77%
Operating margin	NM	NM	NM	NM	NM	NM	NM	NM	NM	30.56%	50.96%
Net margin	NM	NM	NM	NM	NM	NM	NM	NM	NM	27.01%	40.53%
Tax Rate	0%	0%	0%	0%	0%	0%	0.0%	0.0%	5.0%	10.0%	20.0%
Cost Analysis:											
COGS as % of tot. prod. sales	NM	NM	NM	NM	NM	NM	NM	30%	31%	27%	23%
R&D as % of tot. revenue	NM	NM	NM	NM	NM	NM	NM	85%	25%	13%	9%
SG&A as % of tot. revenue	NM	NM	NM	NM	NM	NM	NM	221%	61%	29%	17%
Year-over-year growth:											
Total revenue		NM	NM	NM	NM	NM	NM	NM	273.41%	116.13%	82.80%
R&D Expense		19.28%	NM	NM	NM	49.89%	11.61%	7.32%	9.09%	12.50%	29.63%
SG&A Expense		461.82%	NM	NM	NM	135.40%	40.94%	348.04%	3.11%	4.49%	4.50%
Total operating expenses		81.03%	NM	NM	NM	70.30%	21.29%	161.30%	29.86%	28.41%	29.10%
Operating income		NM	NM	NM	NM	NM	NM	83.54%	-73.31%	-491.43%	204.80%
Net income		NM	NM	NM	NM	NM	NM	NM	NM	NM	517.20%
EPS		NM	NM	NM	NM	NM	NM	49.06%	-73.92%	-347.47%	152.19%
Basic Shares		4.58%	NM	NM	NM	207.44%	75.92%	21.25%	7.58%	9.24%	10.48%
Diluted Shares		NM	NM	NM	NM	NM	NM	7.14%	17.21%	7.58%	9.24%

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

Investment Thesis, Valuation and Risks

ZS Pharma (Overweight; Price Target: \$43.00)

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 \$43 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	13%		
4Q15 Fully Diluted Shares (mm)	27.8		
Main value drivers	Prob of approval	Peak WW sales est (avg. scenario)	Avg peak yr
ZS-9 US	70%	\$ 1,105	2020
ZS-9 EU/Japan	50%	\$ 570	2022
Valuation methodology	Value / share	Weighting	Adj. value/ share
DCF			
P/E 2016			
Real options scenario analysis	\$ 45.04	50%	22.52
Risk adjusted NPV analysis	\$ 40.51	50%	20.25
Total			\$ 42.77
Catalyst/liquidity discount			0%
YE15 Price Target			\$ 43

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	3Q14E	4Q14E
Revenues	0	0	0	52	Revenues	0A	0A	0	0
Cost of products sold	0	0	0	(16)	Cost of products sold	0A	0A	0	0
Gross profit	-	-	-	-	Gross profit	-	-	-	-
SG&A	(8)	(18)	(26)	(114)	SG&A	(4)A	(5)A	(5)	(5)
R&D	(25)	(37)	(41)	(44)	R&D	(5)A	(10)A	(11)	(11)
Operating income	(32)	(55)	(67)	(122)	Operating income	(9)A	(15)A	(15)	(16)
EBITDA	(32)	(55)	(67)	(122)	EBITDA	(9)A	(15)A	(15)	(16)
Net interest (income) / expense	(2)	(7)	(2)	(2)	Net interest (income) / expense	(1)A	(2)A	(2)	(2)
Other income / (expense)	-	-	-	-	Other income / (expense)	-	-	-	-
Income taxes	0	0	0	0	Income taxes	0A	0A	0	0
Net income - GAAP	(34)	(62)	(69)	(124)	Net income - GAAP	(11)A	(16)A	(17)	(18)
Net income - recurring	(34)	(62)	(69)	(124)	Net income - recurring	(11)A	(16)A	(17)	(18)
Diluted shares outstanding	4	12	22	26	Diluted shares outstanding	4A	3A	21	21
EPS - excluding non-recurring	(8.52)	(5.01)	(3.16)	(4.71)	EPS - excluding non-recurring	(2.57)A	(4.72)A	(0.82)	(0.85)
EPS - recurring	(8.52)	(5.01)	(3.16)	(4.71)	EPS - recurring	(2.57)A	(4.72)A	(0.82)	(0.85)
Balance Sheet and Cash Flow Data	FY13A	FY14E	FY15E	FY16E	Ratio Analysis	FY13A	FY14E	FY15E	FY16E
Cash and cash equivalents	9	89	22	51	Sales growth	-	-	-	-
Accounts receivable	-	-	-	-	EBIT growth	295.6%	70.3%	21.3%	83.5%
Inventories	-	-	-	-	EPS growth - recurring	224.3%	(41.2%)	(36.9%)	49.1%
Other current assets	0	0	0	0	Gross margin	-	-	-	-
Current assets	9	89	22	51	EBIT margin	-	-	-	(236.1%)
PP&E	5	10	12	12	EBITDA margin	-	-	-	(236.1%)
Total assets	14	99	34	64	Tax rate	0.0%	0.0%	0.0%	0.0%
Total debt	-	-	-	-	Net margin	-	-	-	(240.6%)
Total liabilities	8	8	8	8	Net Debt / EBITDA	-	-	-	-
Shareholders' equity	6	91	25	55	Net Debt / Capital (book)	-	-	-	-
Net income (including charges)	(34)	(62)	(69)	(124)	Return on assets (ROA)	(172.9%)	(109.6%)	(103.7%)	(255.4%)
D&A	1	3	6	7	Return on equity (ROE)	(235.2%)	(126.9%)	(117.9%)	(307.6%)
Change in working capital	3	0	0	0	Enterprise value / sales	-	-	-	1.0
Other	4	2	3	4	Enterprise value / EBITDA	NM	NM	NM	NM
Cash flow from operations	(27)	(57)	(60)	(113)	Free cash flow yield	(24.1%)	(16.1%)	(10.3%)	(15.4%)
Capex	(4)	(8)	(8)	(8)					
Free cash flow	(28)	(58)	(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

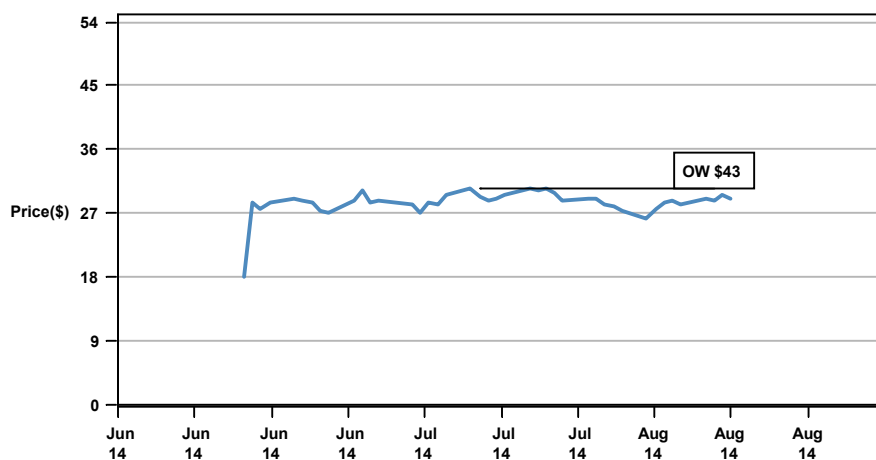
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ZS Pharma (ZSPH, ZSPH US) Price Chart



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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IB clients*	75%	66%	54%

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