

Kindred Biosciences

(KIN-NASDAQ)

Stock Rating: Outperform(S)**Industry Rating:** Outperform

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Pipeline Continues to Advance; Focus Remains on CereKin

Event

Yesterday, Kindred reported a 2Q14 loss of \$8.1mm, higher than our \$7.2mm forecast. The key driver for the higher expenses was G&A (\$2.5mm vs. our estimate of \$1.8mm). R&D of \$5.6mm was closely in line with our estimate of \$5.5mm. Kindred expects 2014 OPEX to be \$25-35mm, excluding stock-based compensation expense of ~\$4.5mm. Much of the increase will be in SG&A as the company starts to develop its commercialization capabilities.

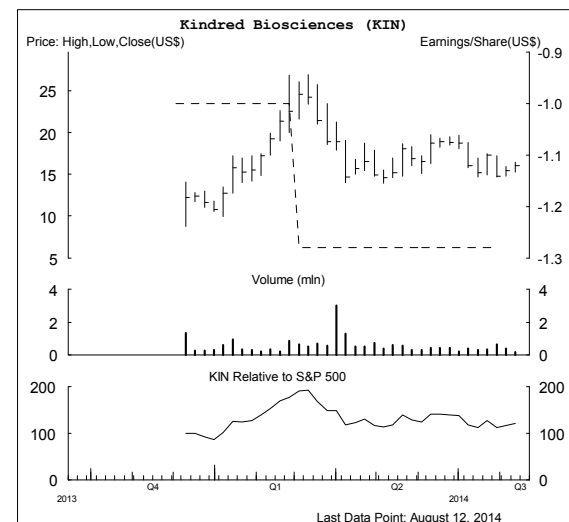
Impact & Analysis

The focus remains on CereKin as top-line data should be released next week. We believe that this study is probably the riskiest of the three Kindred pivotal studies expected to read out this year, and thus, the results are likely to have a disproportionate impact. We are somewhat concerned about the CSO's announced departure one week before Kindred's first major trial result. Nonetheless, we assign a 70% probability of success, and forecast risk-adjusted peak sales of \$60mm by 2019. For detailed discussion of the CereKin OA trial please click [here](#). The AtoKin and SentiKin pivotal trials are enrolling, and management expects NADA filings by year-end, with approval 12-14 months later. We assign 70% probabilities of success for these trials as well. Kindred has other products in the pipeline, including an appetite stimulant for cats, fever medication for horses, a drug for cat anemia, and an immune checkpoint inhibitor for dogs. Furthermore, management indicated that it has been pursuing several targets and products. Given the large cash balance and the company's desire to acquire something with an existing commercial infrastructure, we believe a deal is likely in the near future.

Valuation & Recommendation

\$30/share: Average of DCF (\$25), P/E multiple (\$26), and multiple of sales or takeover valuation (\$38). We continue to believe that Kindred has a robust pipeline, and if some of its products are successful, it will likely be an acquisition target given big pharma's interest in animal health. We maintain our Outperform (Speculative) rating.

Price (14-Aug) \$15.82 52-Week High \$26.99
Target Price \$30.00 52-Week Low \$8.75



(FY-Dec.)	2012A	2013A	2014E	2015E
EPS	-\$0.06	-\$1.13	-\$1.83↓	-\$2.53↓
P/E			na	na
CFPS	-\$0.03	-\$0.42	-\$1.44↓	-\$2.19↓
P/CFPS			na	na
Rev. (\$mm)	na	\$0	\$0	\$1
EV (\$mm)	na	\$164	\$164	\$164
Quarterly EPS	Q1	Q2	Q3	Q4
2012A	na	na	na	na
2013A	-\$0.10	-\$0.10	-\$0.40	-\$0.40
2014E	-\$0.38a	-\$0.42a	-\$0.47↓	-\$0.55↓
Dividend	\$0.00			
Book Value	na			
Shares O/S (mm)	16.2			
Float O/S (mm)	8.2			
Wkly Vol (000s)	580			
Net Debt (\$mm)	-\$11			
Yield				0.0%
Price/Book				na
Mkt. Cap (mm)				\$256
Float Cap (mm)				\$130
Wkly \$ Vol (mm)				\$10.1
Next Rep. Date				na

Notes: All values in US\$.

First Call Mean Estimates: KINDRED BIOSCIENCES INC (US\$)
2014E: -\$1.57; 2015E: -\$2.00

Changes	Annual EPS	Annual CFPS	Quarterly EPS
	2014E -\$1.52 to -\$1.83	2014E -\$1.34 to -\$1.44	Q3/14E -\$0.37 to -\$0.47
	2015E -\$1.89 to -\$2.53	2015E -\$1.66 to -\$2.19	Q4/14E -\$0.43 to -\$0.55

Please refer to pages 7 to 10 for Important Disclosures, including the Analyst's Certification.

Exhibit 1. Valuation \$30/Share: Average of DCF (\$25/share), P/E Multiple (\$26/share), and Multiple of Sales or Takeout Valuation (\$38/share)

DCF Valuation, \$000	2014 Q3-Q4E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	>2025E
Cash flow from operations	(16,092)	(43,065)	(23,374)	8,986	30,942	55,503	67,349	58,408	52,271	47,429	43,648	40,761	41,576
Y/Y Growth		NM	NM	NM	244%	79%	21%	-13%	-11%	-9%	-8%	-7%	2%
CAPEX	(40)	(77)	(81)	(79)	(87)	(94)	(112)	(134)	(141)	(143)	(152)	(159)	(159)
Interest Expense (1-t)	0	0	0	0	0	0	0	0	0	0	0	0	0
Free Cash Flow to the Firm (FCFF)	(16,133)	(43,142)	(23,455)	8,907	30,855	55,409	67,236	58,275	52,131	47,286	43,496	40,602	41,418
Y/Y Growth		NM	NM	NM	246%	80%	21%	-13%	-11%	-9%	-8%	-7%	2%
Discount Period	0.2	1.2	2.2	3.2	4.2	5.2	6.2	7.2	8.2	9.2	10.2	11.2	
Discount Rate	9%												
Discounted FCFF	(15,876)	(39,021)	(19,499)	6,806	21,669	35,765	39,889	31,776	26,127	21,782	18,416	15,800	
BMO Comments:													
PV of FCFF (2014-2025)	143,635	\$7	Although we use a relatively low discount rate for a development stage company, our revenue forecast is risk adjusted based on our expected probability of success for each program.										
Terminal Value at 2025	609,082	\$31	Terminal growth rate assumption is 2% based on 1) relatively low generic competition and brand loyalty, 2) biologics pipeline, and 3) effectiveness of lifecycle management tactics in this market.										
PV of Terminal Value	237,019	\$12	TV is 48% of our valuation and accounts for the other candidates such as the biologics in the pipeline.										
Cash & Equivalents	112,438	\$6	As at 2Q14										
Total Debt	0	\$0											
Diluted shares, 000s	19,426		Includes the secondary offering										
Total Stockholders' Equity Value	\$493,092	\$25											

Source: Company Reports, BMO Capital Markets Pharmaceuticals Research

P/E Multiple Valuation Using Non-GAAP EPS

	2017E	2018E	2019E	2020E	2021E
EPS	\$0.11	\$1.22	\$2.41	\$2.96	\$2.55
21x	\$2	\$18	\$33	\$37	\$29
22x	\$2	\$19	\$34	\$39	\$31
23x	\$2	\$20	\$36	\$40	\$32
24x	\$2	\$21	\$37	\$42	\$33
25x	\$2	\$21	\$39	\$44	\$35
Discount Period	3.2	4.2	5.2	6.2	7.2
Average	\$26	Min	\$2	Max	\$44
Discount rate	9%				

2017-2020
EPS CAGR
182.1%

Revenues per Share Multiple Valuation (i.e. Take out valuation)

Valuation	
DCF	\$25
P/E Multiple	\$26
Sales Multiple	\$38
Average	\$30

	2017E	2018E	2019E	2020E	2021E
Sales per share	\$5.55	\$7.90	\$9.49	\$10.30	\$9.56
6.0x	\$25	\$33	\$37	\$37	\$31
6.5x	\$28	\$36	\$40	\$40	\$34
7.0x	\$30	\$39	\$43	\$43	\$36
7.5x	\$32	\$42	\$46	\$46	\$39
8.0x	\$34	\$44	\$49	\$49	\$42
Discount Period	3.2	4.2	5.2	6.2	7.2
Average	\$38	Min	\$25	Max	\$49
Discount rate	9%				

2017-2020
Revenue CAGR
22.9%

Kindred Biosciences Income Statement: Our GAAP Near-Term Forecasts

GAAP Income Statement, \$000	Q1 2014	Q2 2014	Q3 2014	Q4 2014	2014E	Q1 2015	Q2 2015	Q3 2015	Q4 2015	2015E	2016E
Revenues	0	0	0	0	0	0	0	0	1,409	1,409	47,988
Cost of Sales	0	0	0	0	0	0	0	0	690	690	22,911
Gross Profit	0	0	0	0	0	0	0	0	718	718	25,076
Research and development	4,498	5,639	6,576	7,627	24,340	7,422	7,629	7,843	8,062	30,956	33,473
General and administrative	1,679	2,499	2,691	3,109	9,978	4,148	4,765	5,089	5,504	19,506	20,682
Earnings from operations	(6,177)	(8,138)	(9,267)	(10,736)	(34,318)	(11,570)	(12,395)	(12,932)	(12,848)	(49,744)	(29,079)
Other (Income) / Deductions - Net	(9)	(28)	(28)	(26)	(91)	(24)	(22)	(19)	(16)	(81)	(42)
Income From Continuing Operations Before Provision for Taxes on Income	(6,168)	(8,110)	(9,239)	(10,710)	(34,226)	(11,546)	(12,373)	(12,913)	(12,831)	(49,663)	(29,037)
(Benefit) / Provision for Taxes on Income	0	0	0	0	0	0	0	0	0	0	0
Net Income/ (loss)	(\$6,168)	(\$8,110)	(\$9,239)	(\$10,710)	(\$34,226)	(\$11,546)	(\$12,373)	(\$12,913)	(\$12,831)	(\$49,663)	(\$29,037)
Earnings Per Share - Basic	(\$0.38)	(\$0.42)	(\$0.47)	(\$0.55)	(\$1.83)	(\$0.59)	(\$0.63)	(\$0.66)	(\$0.65)	(\$2.53)	(\$1.46)
Earnings Per Share - Diluted	(\$0.38)	(\$0.42)	(\$0.47)	(\$0.55)	(\$1.83)	(\$0.59)	(\$0.63)	(\$0.66)	(\$0.65)	(\$2.53)	(\$1.46)
Weighted-Average Shares - Basic	16,222	19,426	19,482	19,537	18,667	19,590	19,641	19,691	19,739	19,665	19,853
Weighted-Average Shares - Diluted	16,222	19,426	19,482	19,537	18,667	19,590	19,641	19,691	19,739	19,665	19,853
Dividend per Share	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00

	Q1 2014	Q2 2014	Q3 2014	Q4 2014	2014E	Q1 2015	Q2 2015	Q3 2015	Q4 2015	2015E	2016E
Growth Rates (YOY)											
Revenues	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	3307%
Gross Profit	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	3390%
Operating Income (EBIT)	-2658%	-1957%	-664%	-350%	-713%	-87%	-52%	-40%	-20%	-45%	42%
Net Income	-2654%	-1950%	-663%	-349%	-712%	-87%	-53%	-40%	-20%	-45%	42%
EPS- Diluted	-409%	-217%	-18%	-36%	62%	-55%	-51%	-38%	-19%	-38%	42%
Margins											
Gross Profit	NA	NA	NA	NA	NA	NA	NA	NA	51%	51%	52%
Operating Profit	NA	NA	NA	NA	NA	NA	NA	NA	-912%	-3531%	-61%
Net Income	NA	NA	NA	NA	NA	NA	NA	NA	-911%	-3526%	-61%

Source: Company Reports, BMO Capital Markets Pharmaceuticals Research

Kindred Biosciences Income Statement: Our GAAP Longer-Term Forecasts

GAAP Income Statement, \$000	2013A	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Revenues	0	0	1,409	47,988	111,057	159,308	192,628	210,260	196,070	174,984	158,351	145,355	135,330
Cost of Sales	0	0	690	22,911	49,871	65,997	72,162	73,062	68,625	61,244	55,423	50,874	47,366
Gross Profit	0	0	718	25,076	61,186	93,310	120,466	137,197	127,446	113,739	102,928	94,481	87,965
Research and development	3,141	24,340	30,956	33,473	36,733	38,768	28,894	25,231	23,528	20,998	19,002	17,443	16,240
General and administrative	1,079	9,978	19,506	20,682	22,211	23,896	28,894	31,539	29,411	26,248	23,753	21,803	20,300
Earnings from operations	(4,219)	(34,318)	(49,744)	(29,079)	2,241	30,646	62,678	80,427	74,507	66,494	60,174	55,235	51,426
Other (Income) / Deductions - Net	(6)	(91)	(81)	(42)	(31)	(49)	(89)	(150)	(215)	(271)	(321)	(367)	(409)
Income From Continuing Operations Before Provision for Taxes on Income	(4,213)	(34,226)	(49,663)	(29,037)	2,273	30,694	62,766	80,577	74,721	66,764	60,494	55,601	51,834
(Benefit) / Provision for Taxes on Income	0	0	0	0	0	6,139	13,809	20,144	22,416	20,029	18,148	16,680	15,550
Net Income/ (loss)	(\$4,213)	(\$34,226)	(\$49,663)	(\$29,037)	\$2,273	\$24,555	\$48,958	\$60,433	\$52,305	\$46,735	\$42,346	\$38,921	\$36,284
Earnings Per Share - Basic	(\$1.13)	(\$1.83)	(\$2.53)	(\$1.46)	\$0.11	\$1.22	\$2.41	\$2.96	\$2.55	\$2.27	\$2.05	\$1.88	\$1.74
Earnings Per Share - Diluted	(\$1.13)	(\$1.83)	(\$2.53)	(\$1.46)	\$0.11	\$1.22	\$2.41	\$2.96	\$2.55	\$2.27	\$2.05	\$1.88	\$1.74
Weighted-Average Shares - Basic	3,732	18,667	19,665	19,853	20,020	20,167	20,297	20,412	20,514	20,605	20,685	20,756	20,819
Weighted-Average Shares - Diluted	3,732	18,667	19,665	19,853	20,020	20,167	20,297	20,412	20,514	20,605	20,685	20,756	20,819
Dividend per Share	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00

	2013A	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Growth Rates (YOY)													
Revenues	NA	NA	NA	3307%	131%	43%	21%	9%	-7%	-11%	-10%	-8%	-7%
Gross Profit	NA	NA	NA	3390%	144%	53%	29%	14%	-7%	-11%	-10%	-8%	-7%
Operating Income (EBIT)	-3427%	-713%	-45%	42%	108%	1267%	105%	28%	-7%	-11%	-10%	-8%	-7%
Net Income	-3423%	-712%	-45%	42%	108%	981%	99%	23%	-13%	-11%	-9%	-8%	-7%
EPS- Diluted	1894%	62%	-38%	42%	108%	973%	98%	23%	-14%	-11%	-10%	-8%	-7%
Margins													
Gross Profit	NA	NA	51%	52%	55%	59%	63%	65%	65%	65%	65%	65%	65%
Operating Profit	NA	NA	-3531%	-61%	2%	19%	33%	38%	38%	38%	38%	38%	38%
Net Income	NA	NA	-3526%	-61%	2%	15%	25%	29%	27%	27%	27%	27%	27%

Source: Company Reports, BMO Capital Markets Pharmaceuticals Research

Kindred Biosciences Balance Sheet

Kindred Balance Sheet, \$000	2013A	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Assets													
Cash and cash equivalents	65,329	1,205	2,063	3,608	12,515	43,371	98,779	166,016	224,291	276,421	323,707	367,203	407,806
Short-term Investments	0	95,100	51,100	26,100	26,100	26,100	26,100	26,100	26,100	26,100	26,100	26,100	26,100
Prepaid expenses and other	148	1,400	1,769	1,815	2,083	2,115	1,969	1,847	1,634	1,466	1,333	1,230	1,151
Total current assets	65,476	97,705	54,933	31,523	40,698	71,586	126,848	193,962	252,025	303,987	351,140	394,534	435,057
Property and equipment, net	12	136	174	201	209	218	229	241	263	281	301	336	363
Total Assets	65,488	97,841	55,107	31,724	40,908	71,804	127,077	194,203	252,288	304,268	351,442	394,870	435,420
Liabilities and Equity													
Accounts payable	689	2,684	3,391	3,478	3,993	4,054	3,773	3,539	3,132	2,809	2,555	2,358	2,207
Due to related party	0	0	0	0	0	0	0	0	0	0	0	0	0
Accrued expenses	1,521	2,893	3,813	3,863	4,397	4,419	4,233	4,033	3,568	3,201	2,912	2,687	2,514
Total current liabilities	2,210	5,577	7,204	7,342	8,389	8,473	8,006	7,572	6,700	6,010	5,467	5,045	4,721
Preferred Stock													
Total Equity	63,279	92,265	47,903	24,382	32,519	63,331	119,071	186,632	245,587	298,258	345,975	389,825	430,699
Total liabilities and equity	65,488	97,841	55,107	31,724	40,908	71,804	127,077	194,203	252,288	304,268	351,442	394,870	435,420

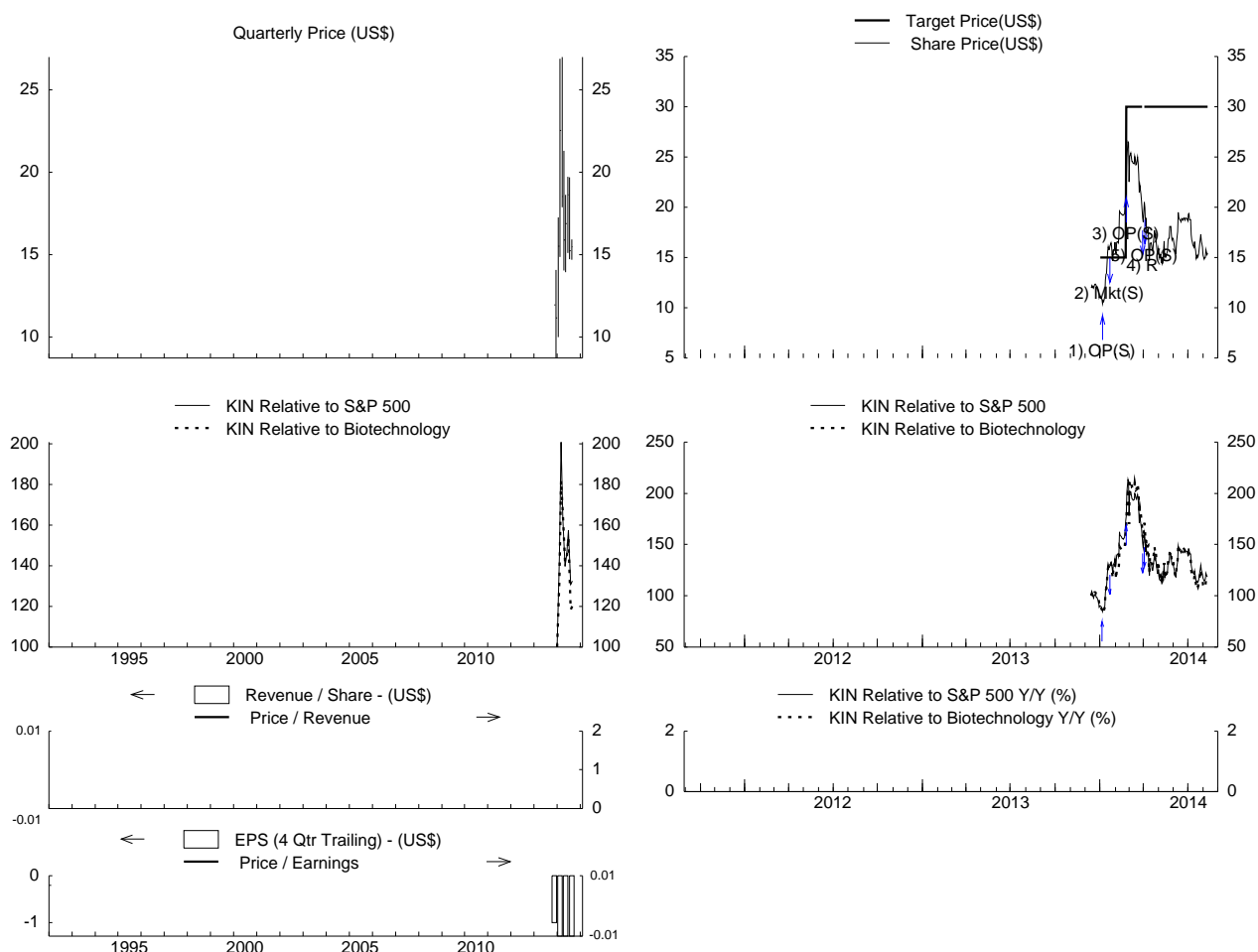
Source: Company Reports, BMO Capital Markets Pharmaceuticals Research

Kindred Biosciences Statement of Cash Flows

Kindred Statement of Cash Flows, \$000	2013A	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Operating activities													
Net income/(loss)	(4,213)	(34,226)	(49,663)	(29,037)	2,273	24,555	48,958	60,433	52,305	46,735	42,346	38,921	36,284
Adjustments:													
Stock-based compensation expense	922	4,782	5,301	5,516	5,864	6,257	6,782	7,128	6,651	5,935	5,371	4,930	4,590
Depreciation expense	3	26	38	54	71	78	84	100	111	123	122	117	132
Changes in operating assets and liabilities													
Net cash provided by operating activities	(1,573)	(26,995)	(43,065)	(23,374)	8,986	30,942	55,503	67,349	58,408	52,271	47,429	43,648	40,761
Investing Activities													
Purchase of Short-term Investments	0	(106,125)	0	0	0	0	0	0	0	0	0	0	0
Proceeds from Maturities of Short-term Investments	0	11,000	44,000	25,000	0	0	0	0	0	0	0	0	0
Purchase of property and equipment	(15)	(150)	(77)	(81)	(79)	(87)	(94)	(112)	(134)	(141)	(143)	(152)	(159)
Net cash used in investing activities	(15)	(95,275)	43,923	24,919	(79)	(87)	(94)	(112)	(134)	(141)	(143)	(152)	(159)
Financing activities													
Proceeds from preferred stock issuance	11,097	0	0	0	0	0	0	0	0	0	0	0	0
Proceeds from note payable to related party	0	0	0	0	0	0	0	0	0	0	0	0	0
Exercise of stock options	11	82	0	0	0	0	0	0	0	0	0	0	0
Proceeds from sale of common stock	54,871	58,065	0	0	0	0	0	0	0	0	0	0	0
Net cash provided by/(used in) financing activities	65,979	58,147	0	0	0	0	0	0	0	0	0	0	0
Net increase/(decrease) in cash and cash equivalents	64,391	(64,124)	858	1,545	8,907	30,855	55,409	67,236	58,275	52,131	47,286	43,496	40,602
Cash and cash equivalents, as of beginning of year	938	65,329	1,205	2,063	3,608	12,515	43,371	98,779	166,016	224,291	276,421	323,707	367,203
Cash and cash equivalents, as of end of year	65,329	1,205	2,063	3,608	12,515	43,371	98,779	166,016	224,291	276,421	323,707	367,203	407,806

Source: Company Reports, BMO Capital Markets Pharmaceuticals Research

Kindred Biosciences (KIN)



FYE (Dec.)	EPS US\$	P/E Hi - Lo	DPS US\$	Yield% Hi - Lo	Payout %	BV US\$	P/B Hi - Lo	ROE %
2013	-1.13	na na	0.00	0.0 0.0	0	3.9	3.6 2.2	
Range*		na na		0.0 0.0			3.6 2.2	
Current*	-1.28	na	0.00	0.0	0	NA	NA	na

KIN - Rating as of 11-Dec-13 = NR

Date	Rating Change	Share Price
1 6-Jan-14	NR to OP(S)	\$10.39
2 21-Jan-14	OP(S) to Mkt(S)	\$16.13
3 24-Feb-14	Mkt(S) to OP(S)	\$22.12
4 28-Mar-14	OP(S) to R	\$18.91
5 2-Apr-14	R to OP(S)	\$19.96

* 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 (August 8, 2014): \$15.47
 Sources: IHS Global Insight, Thomson Reuters, BMO Capital Markets.

IMPORTANT DISCLOSURES**Analyst's Certification**

I, Alex Arfaei, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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Company Specific Disclosure

Disclosure 1: BMO Capital Markets has undertaken an underwriting liability with respect to this issuer within the past 12 months.

Disclosure 2: BMO Capital Markets has provided investment banking services with respect to this issuer within the past 12 months.

Disclosure 3: BMO Capital Markets has managed or co-managed a public offering of securities with respect to this issuer within the past 12 months.

Disclosure 4: BMO Capital Markets or an affiliate has received compensation for investment banking services from this issuer within the past 12 months.

Disclosure 6: This issuer is a client (or was a client) of BMO NB, BMO Capital Markets Corp., BMO CM Ltd. or an affiliate within the past 12 months: Investment Banking Services.

Disclosure 9: BMO Capital Markets makes a market in this security.

Methodology and Risks to Price Target/Valuation

Methodology: DCF and P/E Multiple

Risks: Success of pipeline assets, particularly CereKin

Distribution of Ratings (June 30, 2014)

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%

* Reflects rating distribution of all companies covered by BMO Capital Markets Corp. equity research analysts.

** Reflects rating distribution of all companies from which BMO Capital Markets Corp. has received compensation for Investment Banking services as percentage within ratings category.

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