

Kindred Biosciences

(KIN-NASDAQ)

Stock Rating: Market Perform(S)↓
Industry Rating: Market Perform

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Downgrading Because of Valuation, but Maintaining Positive Bias

Event

We are downgrading KIN from Outperform (S) to Market Perform (S).

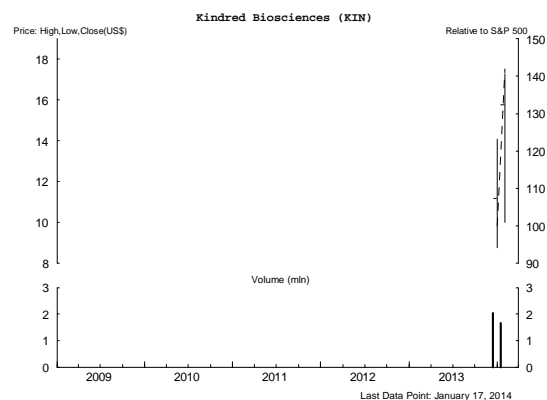
Impact & Analysis

KIN shares are up 130% since the company's successful IPO on December 12, 2013 and almost 50% since our [coverage initiation](#) on January 6, 2014. The stock has exceeded our \$15 price target, and although we maintain a positive bias, we do not have any incrementally new information that would lead us to increase our price target. The next major catalyst is the results of the phase-3 trial evaluating the company's lead product CereKin (Diacerein) for the treatment of osteoarthritis in dogs; it is expected in 2Q14. We estimate a 70% probability of success because Diacerein has modest efficacy in humans and can cause diarrhea in up to 40% of cases as well as a rare liver toxicity. However, there are encouraging signs of symptomatic and disease modifying activity in dogs and no diarrhea at the ph-3 doses. We forecast peak sales of \$95MM for CereKin by 2020. We also estimate a 70% probability of success for the other lead products and forecast \$30MM for AtoKin (atopic dermatitis) by 2020 and \$64MM for SentiKin (post-operative pain) by 2021. Kindred should have enough cash to develop its pipeline and establish a 50-person salesforce.

Valuation & Recommendation

\$15/share using DCF as well as P/E and Price/Sales multiple. Kindred will probably not be profitable until 2017. Thus, our DCF is based on our long-term forecasts for the three leading products, a terminal value that accounts for the rest of the pipeline, and the company's net cash position. Our DCF is supported by relative valuations (please see Exhibit 1). Kindred has a promising pipeline and an experienced and capable management team. We believe if some of the leading products are successful, Kindred will likely partner with or be acquired by one of the larger animal health companies (e.g., Zoetis, Eli Lilly's Elanco). As such, we maintain our positive bias on the stock as we wait for more data.

Price (21-Jan) \$15.77 **52-Week High** \$17.27
Target Price \$15.00 **52-Week Low** \$8.75



(FY-Dec.)	2012A	2013E	2014E	2015E
EPS	-\$0.06	-\$0.85	-\$0.65	-\$1.18
P/E		na	na	na
CFPS	-\$0.03	-\$0.56	-\$0.58	-\$1.01
P/CFPS		na	na	na
Rev. (\$mm)	na	\$0	\$0	\$5
EV (\$mm)	na	\$164	\$164	\$164
na	na	na	na	na
na	na	na	na	na
Quarterly EPS	Q1	Q2	Q3	Q4
2012A	na	na	na	na
2013E	-\$0.10a	-\$0.10a	-\$0.40a	-\$0.22
2014E	-\$0.14	-\$0.17	-\$0.17	-\$0.17
Dividend	\$0.00			0.0%
Book Value	na			na
Shares O/S (mm)	16.2			\$255
Float O/S (mm)	8.2			\$129
Wkly Vol (000s)	618			\$7,832
Net Debt (\$mm)	-\$11			na
Yield				0.0%
Price/Book				na
Mkt. Cap (mm)				\$255
Float Cap (mm)				\$129
Wkly \$ Vol (mm)				\$7,832
Next Rep. Date				na

Notes: Off
Major Shareholders: Off
First Call Mean Estimates: Not Available

Changes

Rating
OP(S) to Mkt(S)

Exhibit 1. We Value Kindred Biosciences at \$15/Share Based on Both DCF as well as P/E and Price/Sales Multiple

DCF Valuation, \$000		Q4 2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	>2025E
Cash flow from operations		(1,343)	(10,087)	(17,717)	(4,025)	18,126	30,215	39,373	42,285	28,892	25,128	22,599	20,060	18,015	18,376
Y/Y Growth				NM	NM	NM	67%	30%	7%	-32%	-13%	-10%	-11%	-10%	2%
CAPEX		(2)	(12)	(12)	(13)	(13)	(14)	(15)	(18)	(22)	(23)	(23)	(25)	(26)	(26)
Interest Expense (1-t)		0	0	0	0	0	0	0	0	0	0	0	0	0	0
Free Cash Flow to the Firm (FCFF)		(1,344)	(10,098)	(17,729)	(4,038)	18,113	30,201	39,357	42,266	28,870	25,105	22,576	20,035	17,989	18,350
Y/Y Growth				NM	NM	NM	67%	30%	7%	-32%	-13%	-10%	-11%	-10%	2%
Discount Period		0	1	2	3	4	5	6	7	8	9	10	11	12	
Discount Rate	9%														
Discounted FCFF		(1,344)	(9,265)	(14,922)	(3,118)	12,832	19,629	23,468	23,121	14,489	11,559	9,536	7,764	6,396	
BMO Comments: Although we use a relatively low discount rate for a development stage company, our revenue and OPEX forecasts are risk adjusted based on our expected probability of success for each program. Terminal growth rate assumption is 2% based on 1) relatively low generic competition and brand loyalty, 2) effectiveness of lifecycle management tactics in this market. TV is roughly 36% of our valuation and accounts for the 7 other candidates such as the biologics in the pipeline.															
PV of FCFF (2013-2025)	Total, \$000s	100,144													
Terminal Value at 2025		262,140													
PV of Terminal Value		93,200													
Cash & Equivalents, pre-IPO		10,992													
Total Debt		0													
Total Stockholders' Equity Value; Pre-IPO Capital	204,336														
Shares Issued at IPO	8,625	\$7.00													
Net Proceeds from IPO	\$55,097	\$3.19													
Diluted shares Post IPO, 000s	17,273														
Total Stockholders' Equity Value, Post IPO	\$259,433	\$15													

PE Multiple Valuation Using Non-GAAP EPS

		2017E	2018E	2019E	2020E	2021E	
	EPS	\$0.93	\$1.58	\$2.07	\$2.21	\$1.43	2017-20 EPS CAGR
	15	\$10	\$15	\$18	\$18	\$11	33.6%
	16	\$10	\$16	\$20	\$19	\$11	
	17	\$11	\$17	\$21	\$21	\$12	
	18	\$12	\$18	\$22	\$22	\$13	
	19	\$12	\$20	\$23	\$23	\$14	
Discount Period		4	5	6	7	8	
Average	\$16		Min	\$10	Max	\$23	
Discount rate	9%						

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

		2017E	2018E	2019E	2020E	2021E	
	Sales per share	\$3.83	\$5.50	\$6.58	\$7.07	\$6.68	2017-20 CAGR
	3.0	\$8	\$11	\$12	\$12	\$10	22.7%
	3.5	\$9	\$13	\$14	\$14	\$12	
	4.0	\$11	\$14	\$16	\$15	\$13	
	4.5	\$12	\$16	\$18	\$17	\$15	
	5.0	\$14	\$18	\$20	\$19	\$17	
Discount Period		4	5	6	7	8	
Average	\$14		Min	\$8	Max	\$20	
Discount rate	9%						

Source: Kindred Biosciences Form S-1, BMO Capital Markets Pharmaceuticals Research

Key Investment Risks:

- **Success of the leading phase-3 programs is uncertain.** All programs are speculative and have relatively modest supporting data in dogs. Most of the supporting evidence comes from human data.
- **Regulatory approval of the products remains uncertain in both the US and other major markets.**
- **Commercial success: All leading products would be entering highly competitive markets with cheap generics.** Currently, only 6% of dog owners have pet insurance; however, the purchase of pet insurance is expected to increase more than 11% annually through 2016. As more owners get pet insurance, there will be increased focus on cost containment. Therefore, the performance of the products could be below our expectation.

Kindred Biosciences Income Statement: Our GAAP Near-Term Forecasts

	2013E					2014E						
GAAP Income Statement, \$000	2012A	Q1 2013	Q2 2013	Q3 2013	Q4 2013	2013E	Q1 2014	Q2 2014	Q3 2014	Q4 2014	2014E	2015E
Revenues	0	0	0	0	0	0	0	0	0	0	0	4,579
Cost of Sales	0	0	0	0	0	0	0	0	0	0	0	2,131
Gross Profit	0	0	0	0	0	0	0	0	0	0	0	2,448
Research and development	75	220	220	954	1,451	2,846	2,215	2,728	2,719	2,716	10,378	9,867
General and administrative	45	89	89	259	272	710	277	283	288	294	1,142	13,437
Earnings from operations	(120)	(310)	(310)	(1,213)	(1,724)	(3,556)	(2,492)	(3,011)	(3,007)	(3,010)	(11,520)	(20,856)
Other (Income) / Deductions - Net	(0)	0	0	(3)	(9)	(12)	(55)	(54)	(51)	(49)	(209)	(165)
Income From Continuing Operations Before Provision for Taxes on Income	(120)	(310)	(310)	(1,210)	(1,714)	(3,544)	(2,437)	(2,957)	(2,956)	(2,961)	(11,311)	(20,691)
(Benefit) / Provision for Taxes on Income	0	0	0	0	0	0	0	0	0	0	0	0
Net Income/ (loss)	(\$120)	(\$310)	(\$310)	(\$1,210)	(\$1,714)	(\$3,544)	(\$2,437)	(\$2,957)	(\$2,956)	(\$2,961)	(\$11,311)	(\$20,691)
Earnings Per Share - Basic	(\$0.06)	(\$0.10)	(\$0.10)	(\$0.40)	(\$0.23)	(\$0.86)	(\$0.15)	(\$0.18)	(\$0.18)	(\$0.18)	(\$0.70)	(\$1.25)
Earnings Per Share - Diluted	(\$0.06)	(\$0.10)	(\$0.10)	(\$0.40)	(\$0.22)	(\$0.85)	(\$0.14)	(\$0.17)	(\$0.17)	(\$0.17)	(\$0.65)	(\$1.18)
Weighted-Average Shares - Basic	2,113	3,000	3,000	3,001	7,399	4,100	16,173	16,236	16,298	16,358	16,266	16,499
Weighted-Average Shares - Diluted	2,113	3,000	3,000	3,001	7,766	4,192	17,273	17,336	17,398	17,458	17,366	17,599
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

	2012A	Q1 2013	Q2 2013	Q3 2013	Q4 2013	2013E	Q1 2014	Q2 2014	Q3 2014	Q4 2014	2014E	2015E
Growth Rates (YOY)												
Revenues	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Gross Profit	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Operating Income (EBIT)	NA	NA	NA	NA	1341%	2872%	705%	872%	148%	75%	224%	81%
Net Income	NA	NA	NA	NA	1333%	2863%	687%	855%	144%	73%	219%	83%
EPS- Diluted	NA	NA	NA	NA	290%	1393%	37%	65%	-58%	-23%	-23%	81%
Margins												
Gross Profit	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	53%
Operating Profit	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	-456%
Net Income	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	-452%

Source: Kindred Biosciences SEC Filings, BMO Capital Markets Pharmaceuticals Research

Kindred Biosciences Income Statement: Our GAAP Longer-Term Forecasts

GAAP Income Statement, \$000	2012A	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Revenues	0	0	0	4,579	32,031	68,823	99,842	120,432	130,246	123,813	109,011	94,946	83,646	74,595
Cost of Sales	0	0	0	2,131	11,211	24,088	34,945	42,151	45,586	43,335	38,154	33,231	29,276	26,108
Gross Profit	0	0	0	2,448	20,820	44,735	64,897	78,281	84,660	80,479	70,857	61,715	54,370	48,487
Research and development	75	2,846	10,378	9,867	10,016	10,167	10,322	10,482	10,646	14,858	11,991	9,495	8,365	7,460
General and administrative	45	710	1,142	13,437	17,040	18,046	18,918	19,649	20,228	28,477	26,163	22,787	20,075	17,903
Earnings from operations	(120)	(3,556)	(11,520)	(20,856)	(6,235)	16,523	35,657	48,150	53,786	37,144	32,703	29,433	25,930	23,125
Other (Income) / Deductions - Net	(0)	(12)	(209)	(165)	(116)	(130)	(210)	(327)	(467)	(595)	(689)	(772)	(845)	(911)
Income From Continuing Operations Before Provision for Taxes on Income	(120)	(3,544)	(11,311)	(20,691)	(6,119)	16,653	35,868	48,476	54,253	37,739	33,392	30,205	26,776	24,036
(Benefit) / Provision for Taxes on Income	0	0	0	0	0	0	7,174	10,665	13,563	11,322	10,018	9,061	8,033	7,211
Net Income/ (loss)	(\$120)	(\$3,544)	(\$11,311)	(\$20,691)	(\$6,119)	\$16,653	\$28,694	\$37,812	\$40,690	\$26,418	\$23,375	\$21,143	\$18,743	\$16,825
Earnings Per Share - Basic	(\$0.06)	(\$0.86)	(\$0.70)	(\$1.25)	(\$0.37)	\$0.99	\$1.68	\$2.20	\$2.35	\$1.52	\$1.33	\$1.20	\$1.06	\$0.95
Earnings Per Share - Diluted	(\$0.06)	(\$0.85)	(\$0.65)	(\$1.18)	(\$0.34)	\$0.93	\$1.58	\$2.07	\$2.21	\$1.43	\$1.25	\$1.13	\$1.00	\$0.89
Weighted-Average Shares - Basic	2,113	4,100	16,266	16,499	16,705	16,887	17,048	17,191	17,317	17,429	17,528	17,616	17,694	17,763
Weighted-Average Shares - Diluted	2,113	4,192	17,366	17,599	17,805	17,987	18,148	18,291	18,417	18,529	18,628	18,716	18,794	18,863
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	\$0.00

	2012A	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Growth Rates (YOY)														
Revenues	NA	NA	NA	NA	600%	115%	45%	21%	8%	-5%	-12%	-13%	-12%	-11%
Gross Profit	NA	NA	NA	NA	751%	115%	45%	21%	8%	-5%	-12%	-13%	-12%	-11%
Operating Income (EBIT)	NA	2872%	224%	81%	-70%	-365%	116%	35%	12%	-31%	-12%	-10%	-12%	-11%
Net Income	NA	2863%	219%	83%	-70%	-372%	72%	32%	8%	-35%	-12%	-10%	-11%	-10%
EPS- Diluted	NA	1393%	-23%	81%	-71%	-369%	71%	31%	7%	-35%	-12%	-10%	-12%	-11%
Margins														
Gross Profit	NA	NA	NA	53%	65%	65%	65%	65%	65%	65%	65%	65%	65%	65%
Operating Profit	NA	NA	NA	-456%	-19%	24%	36%	40%	41%	30%	30%	31%	31%	31%
Net Income	NA	NA	NA	-452%	-19%	24%	29%	31%	31%	21%	21%	22%	22%	23%

Source: Kindred Biosciences SEC Filings, BMO Capital Markets Pharmaceuticals Research

Kindred Biosciences Balance Sheet

Kindred Balance Sheet, \$000	2012A	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Assets														
Cash and cash equivalents	938	64,753	54,654	36,925	32,887	51,001	81,202	120,559	162,826	191,696	216,800	239,376	259,411	277,401
Prepaid expenses and other	1	468	818	1,850	1,949	2,033	2,108	2,173	2,228	2,816	2,437	2,071	1,832	1,642
Total current assets	938	65,221	55,472	38,775	34,836	53,034	83,310	122,732	165,053	194,512	219,237	241,447	261,244	279,043
Property and equipment, net	0	13	21	27	32	33	34	36	38	42	45	48	54	58
Total Assets	938	65,234	55,493	38,802	34,868	53,067	83,344	122,769	165,091	194,554	219,282	241,495	261,298	279,101
Liabilities and Equity														
Accounts payable	5	187	327	740	779	813	843	869	891	1,126	975	828	733	657
Due to related party	5	5	5	5	5	5	5	5	5	5	5	5	5	5
Accrued expenses	60	748	766	2,023	2,139	2,241	2,333	2,413	2,480	3,123	2,720	2,322	2,055	1,842
Total current liabilities	70	940	1,098	2,768	2,923	3,059	3,180	3,287	3,376	4,254	3,700	3,155	2,793	2,503
Preferred Stock	987													
Total Equity	(119)	64,294	54,395	36,035	31,944	50,008	80,164	119,482	161,716	190,300	215,582	238,340	258,505	276,598
Total liabilities and equity	938	65,234	55,493	38,802	34,868	53,067	83,344	122,769	165,091	194,554	219,282	241,495	261,298	279,101

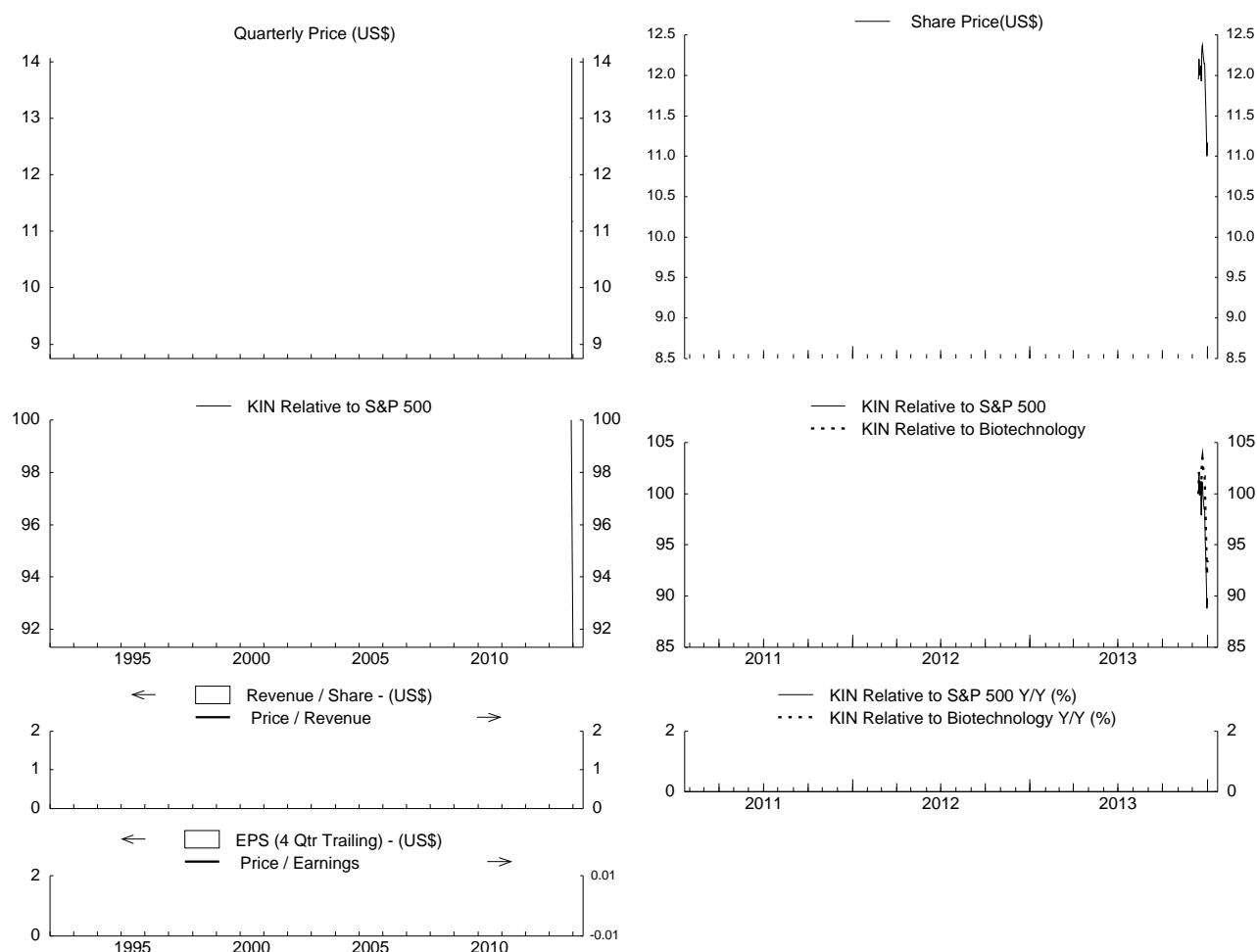
Source: Kindred Biosciences Form S-1, BMO Capital Markets Pharmaceuticals Research

Kindred Biosciences Statement of Cash Flow

Kindred Statement of Cash Flows, \$000	2012A	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Operating activities														
Net income/(loss)	(120)	(3,544)	(11,311)	(20,691)	(6,119)	16,653	28,694	37,812	40,690	26,418	23,375	21,143	18,743	16,825
Adjustments:														
Stock-based compensation expense	11	848	1,152	2,330	2,029	1,411	1,462	1,507	1,544	2,167	1,908	1,614	1,422	1,268
Depreciation expense	0	2	4	6	9	12	13	14	16	18	20	20	19	22
Changes in operating assets and liabilities														
Net cash provided by operating activities	(63)	(2,374)	(10,087)	(17,717)	(4,025)	18,126	30,215	39,373	42,285	28,892	25,128	22,599	20,060	18,015
Investing Activities														
Purchase of property and equipment	0	(15)	(12)	(12)	(13)	(13)	(14)	(15)	(18)	(22)	(23)	(23)	(25)	(26)
Net cash used in investing activities	0	(15)	(12)	(12)	(13)	(13)	(14)	(15)	(18)	(22)	(23)	(23)	(25)	(26)
Financing activities														
Proceeds from preferred stock issuance	990	11,097	0	0	0	0	0	0	0	0	0	0	0	0
Proceeds from note payable to related party	10	0	0	0	0	0	0	0	0	0	0	0	0	0
Exercise of stock options	0	11	0	0	0	0	0	0	0	0	0	0	0	0
Proceeds from sale of common stock	0	55,097	0	0	0	0	0	0	0	0	0	0	0	0
Net cash provided by/(used in) financing activities	1,000	66,205	0	0	0	0	0	0	0	0	0	0	0	0
Net increase/(decrease) in cash and cash equivalents	938	63,815	(10,098)	(17,729)	(4,038)	18,113	30,201	39,357	42,266	28,870	25,105	22,576	20,035	17,989
Cash and cash equivalents, as of beginning of year	0	938	64,753	54,654	36,925	32,887	51,001	81,202	120,559	162,826	191,696	216,800	239,376	259,411
Cash and cash equivalents, as of end of year	938	64,753	54,654	36,925	32,887	51,001	81,202	120,559	162,826	191,696	216,800	239,376	259,411	277,401

Source: Kindred Biosciences Form S-1, 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 %	KIN - Rating as of 19-Dec-13 = NR
Range*:	na	na		NC			>15 >15		
Current*	ND	na	0.00	0.0	na	NA	NA	na	

* Current EPS is the 4 Quarter Trailing to Q3/2013.
 * Valuation metrics are based on high and low for the fiscal year.
 * Range indicates the valuation range for the period presented above.

Last Price (December 31, 2013): \$11.17
 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.

Analysts who prepared this report are compensated based upon (among other factors) the overall profitability of BMO Capital Markets and their affiliates, which includes the overall profitability of investment banking services. Compensation for research is based on effectiveness in generating new ideas and in communication of ideas to clients, performance of recommendations, accuracy of earnings estimates, and service to clients.

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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 (December 31, 2013)

Rating Category	BMO Rating	BMOCM US Universe*	BMOCM US IB Clients**	BMOCM US IB Clients***	BMOCM Universe****	BMOCM IB Clients*****	Starmine Universe
Buy	Outperform	38.0%	20.4%	49.0%	38.8%	50.4%	52.5%
Hold	Market Perform	56.1%	13.8%	49.0%	54.0%	46.5%	41.8%
Sell	Underperform	5.8%	5.6%	2.0%	7.2%	3.1%	5.7%

* 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.

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

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

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

Rating and Sector Key (as of April 5, 2013):

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