

Kindred Biosciences

(KIN-NASDAQ)

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

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CereKin Miss Clearly Disappointing, But Has Other Shots on Goal

Event

Yesterday after the market close, Kindred announced that its pivotal study of CereKin for the treatment of osteoarthritis in dogs did not meet its primary endpoint of change in the Canine Brief Pain Inventory (CBPI) at 8 weeks.

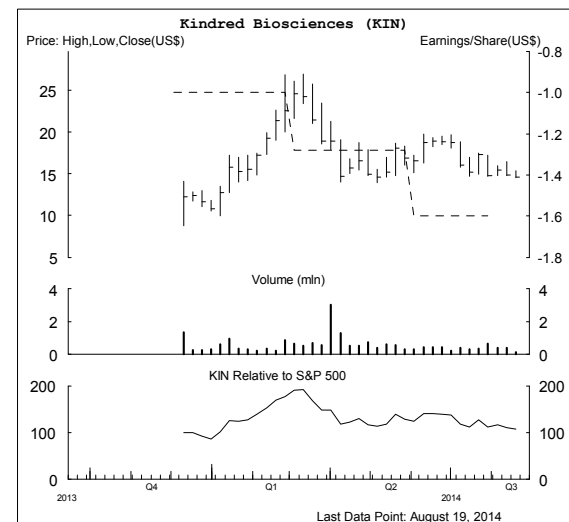
Impact & Analysis

Negative. While the data has not yet been fully analyzed, the result appears to be driven by a higher-than-expected placebo response rate. Although this result is clearly disappointing, we had consistently maintained that this was Kindred's riskiest pivotal trial. We have removed CereKin from our forecasts, eliminating risk-adjusted peak sales of ~\$90mm in 2019. We have also decreased SG&A because of reduced launch costs and increased R&D because of potential acceleration of other programs. Investor focus will now shift to the pivotal trials for AtoKin for atopic dermatitis or AD in dogs and SentiKin for post-operative pain in dogs, which are currently enrolling. Management expects NADA filings by year end, with approval 12-14 months later. We continue to assign 70% probabilities of success for these trials and expect to reach peak sales of ~\$90mm for AtoKin, and ~\$60mm for SentiKin (both in 2020). In addition to these lead products, Kindred has a good pipeline and many more shots on goal. Given the large cash balance and the company's desire to make an acquisition with an existing commercial infrastructure, we believe a deal is likely in the near future.

Valuation & Recommendation

Our price target is now \$19/share, down from \$30/share. This is the average of DCF (\$18) and P/E multiple (\$20) valuations. With roughly \$6/share in cash and a broad pipeline including two upcoming phase 3 readouts that we believe are less risky, we would be buyers of KIN on today's expected weakness.

Price (20-Aug) \$14.21
Target Price \$19.00 ↓
52-Week High \$26.99
52-Week Low \$8.75



(FY-Dec.)	2012A	2013A	2014E	2015E
EPS	-\$0.06	-\$1.13	-\$1.83	-\$2.43 ↑
P/E			na	na
CFPS	-\$0.03	-\$0.42	-\$1.45 ↓	-\$2.12 ↑
P/CFPS			na	na
Rev. (\$mm)	na	\$0	\$0	\$0
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	-\$0.48 ↓	-\$0.55
Dividend	\$0.00			0.0%
Book Value	na			na
Shares O/S (mm)	16.2			Mkt. Cap (mm)
Float O/S (mm)	8.2			\$230
Wkly Vol (000s)	575			Float Cap (mm)
Net Debt (\$mm)	-\$11			\$117
				Wkly \$ Vol (mm)
				\$10.0
				Next Rep. Date
				na

Notes: All values in US\$.

Major Shareholders:

First Call Mean Estimates: KINDRED BIOSCIENCES INC (US\$)
2014E: -\$1.75; 2015E: -\$2.33

Changes	Annual EPS	Annual CFPS	Quarterly EPS	Target
	2015E -\$2.53 to -\$2.43	2014E -\$1.44 to -\$1.45	Q3/14E -\$0.47 to -\$0.48	\$30.00 to \$19.00
		2015E -\$2.19 to -\$2.12		

Exhibit 1. Changes To Our Forecasts: We Have Eliminated CereKin Revenues, Decreased SG&A Because Of Reduced Launch Costs, And Increased R&D To Potentially Accelerate Other Programs.

	2013 Actual	2014E		2015E		2016E	
		Prior	New	Prior	New	Prior	New
Revenue	\$0	\$0	\$0	\$1,409	\$0	\$47,988	\$28,018
Gross Margin	NA	NA	NA	51%	NA	52%	52%
R&D	\$3,141	\$24,340	\$24,992	\$30,956	\$32,812	\$33,473	\$34,338
G&A	\$1,079	\$9,978	\$9,319	\$19,506	\$14,974	\$20,682	\$17,009
Operating Profit	(\$4,219)	(\$34,318)	(\$34,312)	(\$49,744)	(\$47,786)	(\$29,079)	(\$36,697)
Effective Tax Rate	0%	0%	0%	0%	0%	0%	0%
Net Income	(\$4,213)	(\$34,226)	(\$34,221)	(\$49,663)	(\$47,705)	(\$29,037)	(\$36,657)
Net Margin	NA	NA	NA	-3526%	NA	-61%	-131%
EPS	(\$1.13)	(\$1.83)	(\$1.83)	(\$2.53)	(\$2.43)	(\$1.46)	(\$1.85)
Cash & ST Investments	\$65,329	\$96,305	\$95,595	\$53,163	\$53,657	\$29,708	\$21,923

Source: Kindred, BMO Capital Markets Pharmaceuticals Research

DCF Valuation, \$000		2014 Q3-Q4E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	>2025E
Cash flow from operations		(16,303)	(41,861)	(31,653)	(10,187)	8,609	37,656	48,527	43,100	38,958	35,727	33,246	31,402	32,030
Y/Y Growth			NM	NM	NM	-185%	337%	29%	-11%	-10%	-8%	-7%	-6%	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)		(16,343)	(41,937)	(31,734)	(10,266)	8,522	37,562	48,415	42,966	38,817	35,585	33,094	31,244	31,872
Y/Y Growth			NM	NM	NM	-183%	341%	29%	-11%	-10%	-8%	-7%	-6%	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		(16,096)	(37,962)	(26,402)	(7,851)	5,990	24,265	28,747	23,448	19,470	16,405	14,023	12,168	
	Total, \$000s	Per share	BMO Comments:											
PV of FCFF (2014-2025)	56,205	\$3	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	468,703	\$24	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	182,539	\$9	TV is 52% of our valuation and accounts for the other candidates such as the biologics in the pipeline.											
Cash & Equivalents	111,938	\$6	As at 2Q14											
Total Debt	0	\$0	Includes the secondary offering											
Diluted shares, 000s	19,426													
Total Stockholders' Equity Value	\$350,682	\$18												

P/E Multiple Valuation Using Non-GAAP EPS

Valuation	
DCF	\$18
P/E Multiple	\$20
Average	\$19

		2018E	2019E	2020E	2021E
EPS		\$0.16	\$1.66	\$2.11	\$1.87
P/E	21x	\$2	\$23	\$26	\$21
	22x	\$2	\$24	\$28	\$22
	23x	\$3	\$25	\$29	\$23
	24x	\$3	\$26	\$30	\$24
	25x	\$3	\$27	\$31	\$25
Discount Period		4.2	5.2	6.2	7.2
Average	\$20	Min	\$2	Max	\$31
Discount rate		9%			

**2018-2021
EPS CAGR
127.8%**

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	0	0	28,018
Cost of Sales	0	0	0	0	0	0	0	0	0	0	13,369
Gross Profit	0	0	0	0	0	0	0	0	0	0	14,649
Research and development	4,498	5,639	6,744	8,111	24,992	7,904	8,109	8,301	8,498	32,812	34,338
General and administrative	1,679	2,499	2,546	2,595	9,319	2,996	3,601	3,892	4,485	14,974	17,009
Earnings from operations	(6,177)	(8,138)	(9,290)	(10,707)	(34,312)	(10,900)	(11,710)	(12,193)	(12,983)	(47,786)	(36,697)
Other (Income) / Deductions - Net	(9)	(28)	(28)	(26)	(91)	(24)	(22)	(19)	(16)	(81)	(40)
Income From Continuing Operations Before Provision for Taxes on Income	(6,168)	(8,110)	(9,262)	(10,680)	(34,221)	(10,876)	(11,688)	(12,174)	(12,967)	(47,705)	(36,657)
(Benefit) / Provision for Taxes on Income	0	0	0	0	0	0	0	0	0	0	0
Net Income/ (loss)	(\$6,168)	(\$8,110)	(\$9,262)	(\$10,680)	(\$34,221)	(\$10,876)	(\$11,688)	(\$12,174)	(\$12,967)	(\$47,705)	(\$36,657)
Earnings Per Share - Basic	(\$0.38)	(\$0.42)	(\$0.48)	(\$0.55)	(\$1.83)	(\$0.56)	(\$0.60)	(\$0.62)	(\$0.66)	(\$2.43)	(\$1.85)
Earnings Per Share - Diluted	(\$0.38)	(\$0.42)	(\$0.48)	(\$0.55)	(\$1.83)	(\$0.56)	(\$0.60)	(\$0.62)	(\$0.66)	(\$2.43)	(\$1.85)
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	NA
Gross Profit	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Operating Income (EBIT)	-2658%	-1957%	-666%	-349%	-713%	-76%	-44%	-31%	-21%	-39%	23%
Net Income	-2654%	-1950%	-665%	-348%	-712%	-76%	-44%	-31%	-21%	-39%	23%
EPS- Diluted	-409%	-217%	-18%	-35%	62%	-46%	-43%	-30%	-20%	-32%	24%
Margins											
Gross Profit	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	52%
Operating Profit	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	-131%
Net Income	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	-131%

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	0	28,018	70,715	105,217	132,649	150,002	143,562	129,391	118,348	109,856	103,451
Cost of Sales	0	0	0	13,369	31,751	43,579	49,676	52,127	50,247	45,287	41,422	38,450	36,208
Gross Profit	0	0	0	14,649	38,963	61,638	82,973	97,874	93,316	84,104	76,926	71,407	67,243
Research and development	3,141	24,992	32,812	34,338	36,134	37,569	19,897	18,000	17,227	15,527	14,202	13,183	12,414
General and administrative	1,079	9,319	14,974	17,009	19,330	20,104	19,897	22,500	21,534	19,409	17,752	16,478	15,518
Earnings from operations	(4,219)	(34,312)	(47,786)	(36,697)	(16,501)	3,965	43,178	57,374	54,554	49,169	44,972	41,745	39,311
Other (Income) / Deductions - Net	(6)	(91)	(81)	(40)	(17)	(13)	(33)	(76)	(123)	(164)	(202)	(236)	(269)
Income From Continuing Operations Before Provision for Taxes on Income	(4,213)	(34,221)	(47,705)	(36,657)	(16,484)	3,978	43,211	57,450	54,676	49,333	45,174	41,982	39,580
(Benefit) / Provision for Taxes on Income	0	0	0	0	0	796	9,506	14,362	16,403	14,800	13,552	12,594	11,874
Net Income/ (loss)	(\$4,213)	(\$34,221)	(\$47,705)	(\$36,657)	(\$16,484)	\$3,182	\$33,705	\$43,087	\$38,274	\$34,533	\$31,622	\$29,387	\$27,706
Earnings Per Share - Basic	(\$1.13)	(\$1.83)	(\$2.43)	(\$1.85)	(\$0.82)	\$0.16	\$1.66	\$2.11	\$1.87	\$1.68	\$1.53	\$1.42	\$1.33
Earnings Per Share - Diluted	(\$1.13)	(\$1.83)	(\$2.43)	(\$1.85)	(\$0.82)	\$0.16	\$1.66	\$2.11	\$1.87	\$1.68	\$1.53	\$1.42	\$1.33
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	NA	152%	49%	26%	13%	-4%	-10%	-9%	-7%	-6%
Gross Profit	NA	NA	NA	NA	166%	58%	35%	18%	-5%	-10%	-9%	-7%	-6%
Operating Income (EBIT)	-3427%	-713%	-39%	23%	55%	124%	989%	33%	-5%	-10%	-9%	-7%	-6%
Net Income	-3423%	-712%	-39%	23%	55%	119%	959%	28%	-11%	-10%	-8%	-7%	-6%
EPS- Diluted	1894%	62%	-32%	24%	55%	-119%	952%	27%	-12%	-10%	-9%	-7%	-6%
Margins													
Gross Profit	NA	NA	NA	52%	55%	59%	63%	65%	65%	65%	65%	65%	65%
Operating Profit	NA	NA	NA	-131%	-23%	4%	33%	38%	38%	38%	38%	38%	38%
Net Income	NA	NA	NA	-131%	-23%	3%	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	4,995	3,057	4,323	4,557	13,080	50,642	99,057	142,024	180,841	216,425	249,520	280,763
Short-term Investments	0	90,600	50,600	17,600	7,100	7,100	7,100	7,100	7,100	7,100	7,100	7,100	7,100
Prepaid expenses and other	148	1,397	1,693	1,682	1,901	1,793	1,375	1,343	1,199	1,087	999	933	883
Total current assets	65,476	96,991	55,351	23,605	13,558	21,973	59,117	107,500	150,323	189,028	224,525	257,552	288,746
Property and equipment, net	12	136	174	201	209	218	229	241	263	281	301	336	363
Total Assets	65,488	97,127	55,525	23,806	13,767	22,191	59,345	107,741	150,586	189,309	224,826	257,889	289,109
Liabilities and Equity													
Accounts payable	689	2,677	3,246	3,223	3,643	3,437	2,635	2,574	2,299	2,083	1,915	1,788	1,692
Due to related party	0	0	0	0	0	0	0	0	0	0	0	0	0
Accrued expenses	1,521	2,857	3,568	3,511	3,977	3,649	2,954	2,931	2,618	2,372	2,181	2,036	1,927
Total current liabilities	2,210	5,534	6,814	6,734	7,620	7,085	5,590	5,505	4,916	4,455	4,097	3,823	3,619
Preferred Stock													
Total Equity	63,279	91,593	48,711	17,072	6,147	15,105	53,756	102,236	145,670	184,854	220,729	254,065	285,490
Total liabilities and equity	65,488	97,127	55,525	23,806	13,767	22,191	59,345	107,741	150,586	189,309	224,826	257,889	289,109

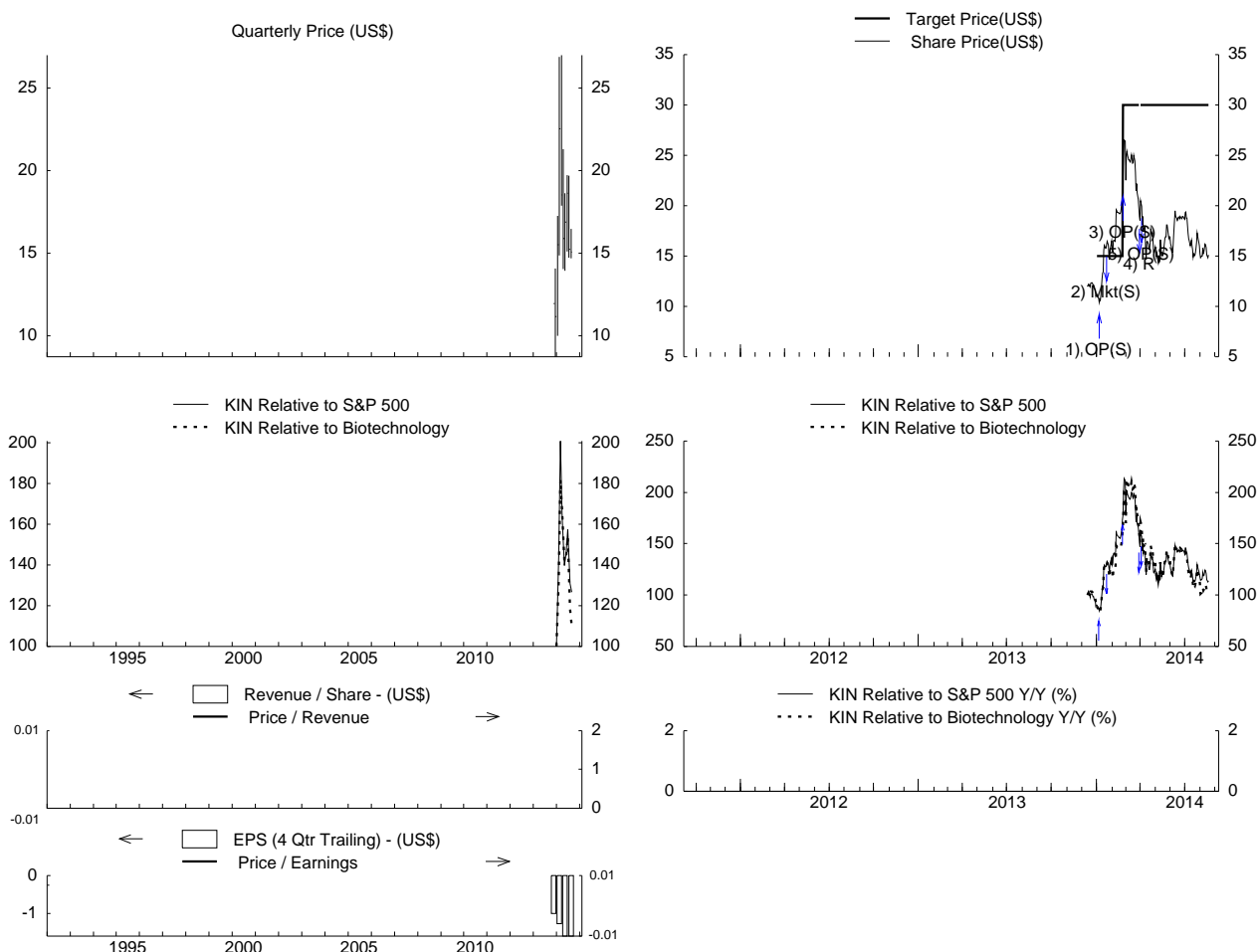
Source: Company Reports, BMO Capital Markets Pharmaceuticals Research

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)	(34,221)	(47,705)	(36,657)	(16,484)	3,182	33,705	43,087	38,274	34,533	31,622	29,387	27,706
Adjustments:													
Stock-based compensation expense	922	4,605	4,823	5,019	5,559	5,776	4,946	5,393	5,160	4,651	4,254	3,949	3,719
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)	(27,206)	(41,861)	(31,653)	(10,187)	8,609	37,656	48,527	43,100	38,958	35,727	33,246	31,402
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	15,000	40,000	33,000	10,500	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)	(91,275)	39,923	32,919	10,421	(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	(60,334)	(1,937)	1,266	234	8,522	37,562	48,415	42,966	38,817	35,585	33,094	31,244
Cash and cash equivalents, as of beginning of year	938	65,329	4,995	3,057	4,323	4,557	13,080	50,642	99,057	142,024	180,841	216,425	249,520
Cash and cash equivalents, as of end of year	65,329	4,995	3,057	4,323	4,557	13,080	50,642	99,057	142,024	180,841	216,425	249,520	280,763

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*	-1.60	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 Q2/2014.
 * 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 18, 2014): \$15.09
 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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We use the following ratings system definitions:

OP = Outperform - Forecast to outperform the analyst's coverage universe on a total return basis

Mkt = Market Perform - Forecast to perform roughly in line with the analyst's coverage universe on a total return basis

Und = Underperform - Forecast to underperform the analyst's coverage universe on a total return basis

(S) = speculative investment;

NR = No rating at this time;

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