

Kindred Biosciences

(KIN-NASDAQ)

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

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Focus Remains on AtoKin, SentiKin, and Other Data Readouts in 2015

Event

Yesterday, Kindred reported a 3Q14 loss of \$6.1 mm, lower than our \$9.3 mm forecast. The key driver for the lower expenses was R&D (\$3.8 mm vs. our estimate of \$6.7 mm). G&A of \$2.3 mm was closely in line with our estimate of \$2.5 mm. Kindred continues to expect 2014 OPEX to be \$25-35 mm excluding stock-based compensation expense of ~\$4.5 mm.

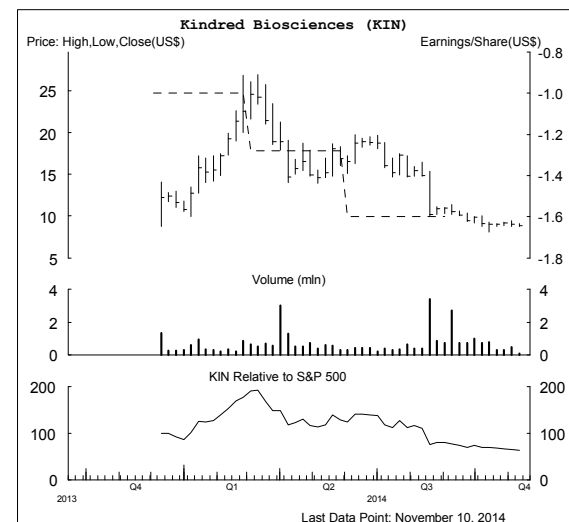
Impact & Analysis

Kindred has increased the size of the pivotal trials for AtoKin (for atopic dermatitis in dogs) and SentiKin (for post-operative pain in dogs) to increase the statistical power of the studies to >90%. Given the small incremental costs, we view this favorably. Both trials are finishing enrollment with results expected in mid-2015. We now expect these products to launch one quarter later in 2Q16. We continue to assign 70% probabilities of success for these trials and expect peak sales of ~\$100 mm for AtoKin, and ~\$70 mm for SentiKin (both in 2020). In addition, 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. The results of pilot studies for some of the earlier stage pipeline assets are expected in 1H15 (e.g., KIND012 for fever in horses). We now expect these products to start contributing to revenues in 2017 (previously 2016). Furthermore, given the cash balance, we are likely to see some business development activities in 1H15 as management continues to look at new opportunities.

Valuation & Recommendation

Our price target is \$19/share. This is the average of DCF (\$20) and P/E multiple (\$19) valuations. Overall, we look forward to an eventful 1H15 heading into the pivotal trial readouts, which should serve as an inflection point for KIN shares. If these programs are successful, we believe that KIN will likely be a takeout target given the consolidation we're seeing in the animal health market.

Price (13-Nov) \$8.98 52-Week High \$26.99
Target Price \$19.00 52-Week Low \$8.13



(FY-Dec.)	2012A	2013A	2014E	2015E
EPS	-\$0.06	-\$1.13	-\$1.58↑	-\$2.14↑
P/E			na	na
CFPS	-\$0.03	-\$0.43	-\$1.22↑	-\$1.83↑
P/CFPS			na	na
Rev. (\$mm)	na	\$0	\$0	\$0
EV (\$mm)	na	-\$24	\$68	\$115
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	-\$0.31a	-\$0.47↑
Dividend	\$0.00			
Book Value	na			
Shares O/S (mm)	19.7			
Float O/S (mm)	16.1			
Wkly Vol (000s)	702			
Net Debt (\$mm)	-\$106			
Yield				0.0%
Price/Book				na
Mkt. Cap (mm)				\$177
Float Cap (mm)				\$145
Wkly \$ Vol (mm)				\$10.4
Next Rep. Date				na

Notes: All values in US\$.

First Call Mean Estimates: KINDRED BIOSCIENCES INC (US\$)
2014E: -\$1.75; 2015E: -\$2.19

Changes	Annual EPS	Annual CFPS	Quarterly EPS
	2014E -\$1.83 to -\$1.58	2014E -\$1.45 to -\$1.22	Q4/14E -\$0.55 to -\$0.47
	2015E -\$2.43 to -\$2.14	2015E -\$2.12 to -\$1.83	

DCF Valuation, \$000		4Q14E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	>2025E
Cash flow from operations		(5,934)	(36,204)	(33,445)	(15,614)	5,490	24,641	39,472	43,353	43,018	42,392	40,097	38,095	38,857
Y/Y Growth			NM	NM	NM	-135%	349%	60%	10%	-1%	-1%	-5%	-5%	2%
CAPEX		(34)	(121)	(128)	(124)	(136)	(148)	(176)	(210)	(221)	(225)	(239)	(249)	(249)
Interest Expense (1-t)		0	0	0	0	0	0	0	0	0	0	0	0	0
Free Cash Flow to the Firm (FCFF)		(5,968)	(36,324)	(33,572)	(15,738)	5,354	24,493	39,295	43,142	42,796	42,167	39,859	37,845	38,607
Y/Y Growth			NM	NM	NM	-134%	357%	60%	10%	-1%	-1%	-5%	-5%	2%
Discount Period		0.1	1.1	2.1	3.1	4.1	5.1	6.1	7.1	8.1	9.1	10.1	11.1	
Discount Rate		9%												
Discounted FCFF		(5,935)	(33,201)	(28,204)	(12,152)	3,800	15,977	23,559	23,774	21,675	19,629	17,054	14,883	
	Total, \$000s	Per share	BMO Comments:											
PV of FCFF (2014-2025)	60,857	\$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	567,753	\$29	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	223,272	\$11	TV is 57% of our valuation and accounts for the other candidates such as the biologics in the pipeline.											
Cash & Equivalents	106,427	\$5	As at 2Q14											
Total Debt	0	\$0												
Diluted shares, 000s	19,713		Includes the secondary offering											
Total Stockholders' Equity Value	\$390,556	\$20												

P/E Multiple Valuation Using Non-GAAP EPS

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

		2018E	2019E	2020E	2021E
EPS		(\$0.11)	\$0.82	\$1.54	\$1.81
P/E	21x	-\$2	\$11	\$19	\$21
	22x	-\$2	\$12	\$20	\$22
	23x	-\$2	\$12	\$21	\$23
	24x	-\$2	\$13	\$22	\$24
	25x	-\$2	\$13	\$23	\$25
Discount Period		4.1	5.1	6.1	7.1
Average	\$19	Min	-\$2	Max	\$25
Discount rate		9%			

**2019-2021
EPS CAGR**
48%

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	15,341
Cost of Sales	0	0	0	0	0	0	0	0	0	0	7,290
Gross Profit	0	0	0	0	0	0	0	0	0	0	8,051
Research and development	4,498	5,639	3,755	6,764	20,656	6,690	6,852	7,019	7,190	27,751	29,840
General and administrative	1,679	2,499	2,342	2,493	9,013	2,988	3,608	3,797	4,472	14,864	17,450
Earnings from operations	(6,177)	(8,138)	(6,097)	(9,257)	(29,669)	(9,678)	(10,461)	(10,816)	(11,661)	(42,616)	(39,238)
Other (Income) / Deductions - Net	(9)	(28)	(25)	(24)	(86)	(22)	(21)	(19)	(17)	(78)	(45)
Income From Continuing Operations Before Provision for Taxes on Income	(6,168)	(8,110)	(6,072)	(9,234)	(29,584)	(9,655)	(10,440)	(10,797)	(11,645)	(42,538)	(39,194)
(Benefit) / Provision for Taxes on Income	0	0	0	0	0	0	0	0	0	0	0
Net Income/ (loss)	(\$6,168)	(\$8,110)	(\$6,072)	(\$9,234)	(\$29,584)	(\$9,655)	(\$10,440)	(\$10,797)	(\$11,645)	(\$42,538)	(\$39,194)
Earnings Per Share - Basic	(\$0.38)	(\$0.42)	(\$0.31)	(\$0.47)	(\$1.58)	(\$0.49)	(\$0.53)	(\$0.54)	(\$0.58)	(\$2.14)	(\$1.95)
Earnings Per Share - Diluted	(\$0.38)	(\$0.42)	(\$0.31)	(\$0.47)	(\$1.58)	(\$0.49)	(\$0.53)	(\$0.54)	(\$0.58)	(\$2.14)	(\$1.95)
Weighted-Average Shares - Basic	16,222	19,426	19,713	19,768	18,782	19,821	19,872	19,922	19,970	19,896	20,084
Weighted-Average Shares - Diluted	16,222	19,426	19,713	19,768	18,782	19,821	19,872	19,922	19,970	19,896	20,084
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%	-403%	-288%	-603%	-57%	-29%	-77%	-26%	-44%	8%
Net Income	-2654%	-1950%	-402%	-287%	-602%	-57%	-29%	-78%	-26%	-44%	8%
EPS- Diluted	-409%	-217%	24%	-16%	40%	-28%	-26%	-76%	-25%	-36%	9%
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	-256%
Net Income	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	-255%

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	15,341	52,963	94,441	130,075	157,028	162,703	152,779	140,726	131,494	124,569
Cost of Sales	0	0	0	7,290	23,755	39,075	48,683	54,572	56,946	53,473	49,254	46,023	43,599
Gross Profit	0	0	0	8,051	29,208	55,366	81,391	102,456	105,757	99,307	91,472	85,471	80,970
Research and development	3,141	20,656	27,751	29,840	31,710	33,610	32,519	31,406	27,659	22,917	16,887	15,779	14,948
General and administrative	1,079	9,013	14,864	17,450	19,675	24,572	27,240	28,639	24,405	22,917	21,109	19,724	18,685
Earnings from operations	(4,219)	(29,669)	(42,616)	(39,238)	(22,177)	(2,817)	21,632	42,410	53,692	53,473	53,476	49,968	47,336
Other (Income) / Deductions - Net	(6)	(86)	(78)	(45)	(21)	(14)	(25)	(53)	(89)	(128)	(166)	(203)	(238)
Income From Continuing Operations Before Provision for Taxes on Income	(4,213)	(29,584)	(42,538)	(39,194)	(22,156)	(2,803)	21,658	42,463	53,781	53,601	53,642	50,171	47,574
(Benefit) / Provision for Taxes on Income	0	0	0	0	0	(561)	4,765	10,616	16,134	16,080	16,093	15,051	14,272
Net Income/ (loss)	(\$4,213)	(\$29,584)	(\$42,538)	(\$39,194)	(\$22,156)	(\$2,242)	\$16,893	\$31,847	\$37,647	\$37,521	\$37,549	\$35,120	\$33,302
Earnings Per Share - Basic	(\$1.13)	(\$1.58)	(\$2.14)	(\$1.95)	(\$1.09)	(\$0.11)	\$0.82	\$1.54	\$1.81	\$1.80	\$1.80	\$1.67	\$1.58
Earnings Per Share - Diluted	(\$1.13)	(\$1.58)	(\$2.14)	(\$1.95)	(\$1.09)	(\$0.11)	\$0.82	\$1.54	\$1.81	\$1.80	\$1.80	\$1.67	\$1.58
Weighted-Average Shares - Basic	3,732	18,782	19,896	20,084	20,250	20,397	20,528	20,643	20,745	20,836	20,916	20,987	21,049
Weighted-Average Shares - Diluted	3,732	18,782	19,896	20,084	20,250	20,397	20,528	20,643	20,745	20,836	20,916	20,987	21,049
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	245%	78%	38%	21%	4%	-6%	-8%	-7%	-5%
Gross Profit	NA	NA	NA	NA	263%	90%	47%	26%	3%	-6%	-8%	-7%	-5%
Operating Income (EBIT)	-3427%	-603%	-44%	8%	43%	87%	868%	96%	27%	0%	0%	-7%	-5%
Net Income	-3423%	-602%	-44%	8%	43%	90%	853%	89%	18%	0%	0%	-6%	-5%
EPS- Diluted	1894%	40%	-36%	9%	44%	-90%	-849%	87%	18%	-1%	0%	-7%	-5%
Margins													
Gross Profit	NA	NA	NA	52%	55%	59%	63%	65%	65%	65%	65%	65%	65%
Operating Profit	NA	NA	NA	-256%	-42%	-3%	17%	27%	33%	35%	38%	38%	38%
Net Income	NA	NA	NA	-255%	-42%	-2%	13%	20%	23%	25%	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	9,856	13,532	12,960	7,721	13,075	37,568	76,863	120,006	162,802	204,969	244,828	282,673
Short-term Investments	0	90,603	50,603	17,603	7,103	7,103	7,103	7,103	7,103	7,103	7,103	7,103	7,103
Prepaid expenses and other	148	1,006	1,268	1,310	1,450	1,665	1,729	1,686	1,393	1,192	993	933	888
Total current assets	65,476	101,465	65,402	31,872	16,275	21,843	46,400	85,653	128,502	171,097	213,065	252,864	290,664
Property and equipment, net	12	211	241	284	297	310	327	346	381	409	441	496	538
Other assets	0	22	22	22	22	22	22	22	22	22	22	22	22
Total Assets	65,488	101,698	65,665	32,178	16,593	22,175	46,749	86,021	128,905	171,528	213,528	253,382	291,224
Liabilities and Equity													
Accounts payable	689	2,012	2,535	2,619	2,901	3,330	3,459	3,373	2,786	2,384	1,987	1,866	1,776
Due to related party	0	0	0	0	0	0	0	0	0	0	0	0	0
Accrued expenses	1,521	2,656	3,316	3,478	3,796	4,090	4,268	4,147	3,428	2,922	2,419	2,272	2,162
Total current liabilities	2,210	4,669	5,851	6,098	6,697	7,420	7,727	7,520	6,214	5,306	4,405	4,138	3,939
Long term liabilities	0	44	44	44	44	44	44	44	44	44	44	44	44
Total liabilities	2,210	4,713	5,895	6,142	6,741	7,464	7,771	7,564	6,258	5,350	4,449	4,182	3,983
Preferred Stock	0	0	0	0	0	0	0	0	0	0	0	0	0
Total Equity	63,279	97,029	59,815	26,080	9,897	14,756	39,022	78,501	122,691	166,222	209,123	249,244	287,285
Total liabilities and equity	65,488	101,698	65,665	32,178	16,593	22,175	46,749	86,021	128,905	171,528	213,528	253,382	291,224

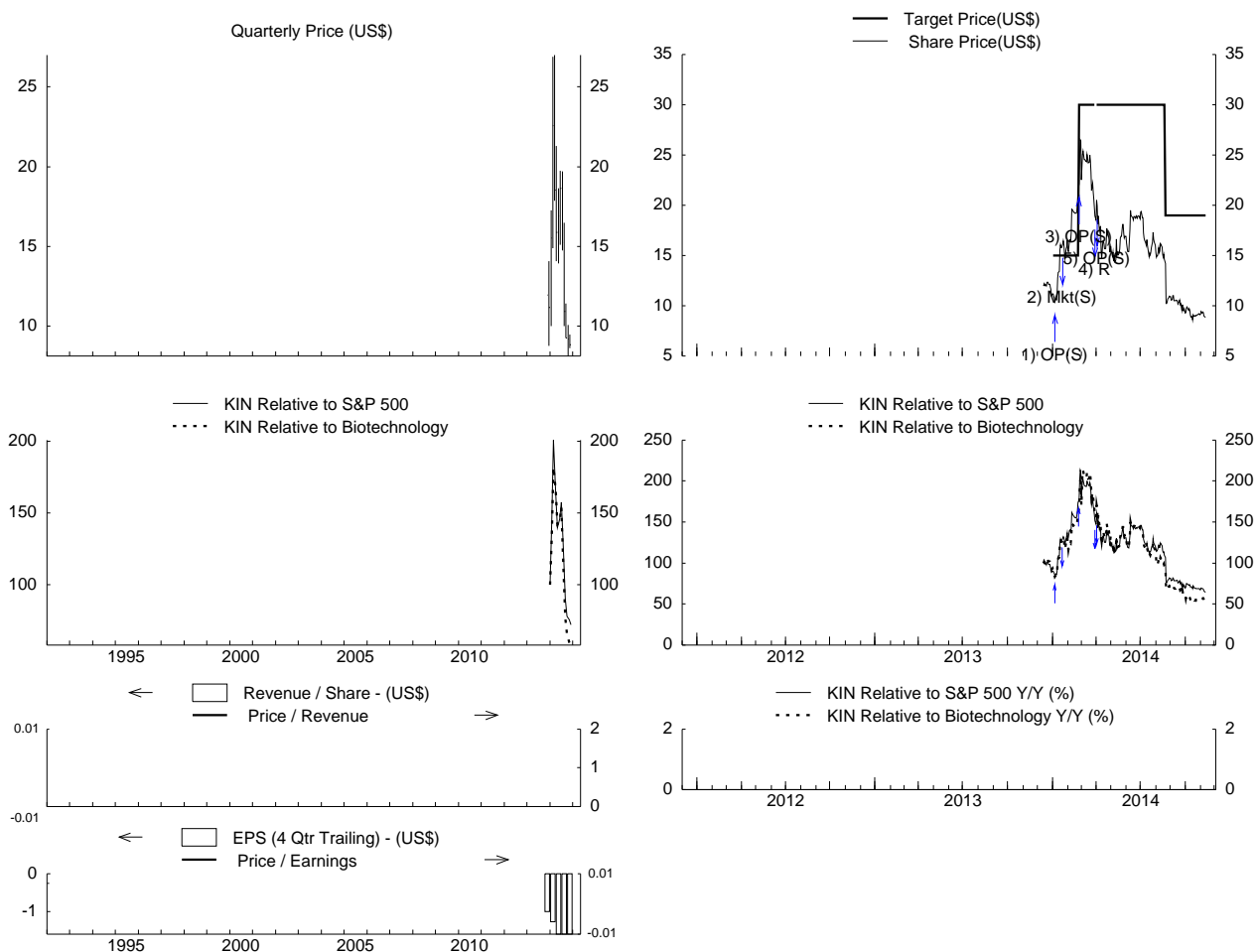
Source: Company Reports, BMO Capital Markets Pharmaceuticals Research

Kindred Biosciences Statement of Cash Flow

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)	(29,584)	(42,538)	(39,194)	(22,156)	(2,242)	16,893	31,847	37,647	37,521	37,549	35,120	33,302
Adjustments:													
Stock-based compensation expense	922	4,784	5,192	5,403	5,954	7,087	7,360	7,617	6,529	5,996	5,337	4,987	4,725
Depreciation expense	3	46	90	85	111	123	131	157	175	194	193	184	208
Amortization of premium on marketable securities	0	94	131	56	19	14	14	14	14	14	14	14	14
Changes in operating assets and liabilities	1,715	1,925	921	205	458	509	243	(164)	(1,013)	(707)	(702)	(207)	(154)
Net cash provided by operating activities	(1,573)	(22,734)	(36,204)	(33,445)	(15,614)	5,490	24,641	39,472	43,353	43,018	42,392	40,097	38,095
Investing Activities													
Purchase of Short-term Investments	0	(128,142)	0	0	0	0	0	0	0	0	0	0	0
Proceeds from Maturities of Short-term Investments	0	37,500	40,000	33,000	10,500	0	0	0	0	0	0	0	0
Purchase of property and equipment	(15)	(245)	(121)	(128)	(124)	(136)	(148)	(176)	(210)	(221)	(225)	(239)	(249)
Net cash used in investing activities	(15)	(90,887)	39,879	32,872	10,376	(136)	(148)	(176)	(210)	(221)	(225)	(239)	(249)
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	83	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	58,148	0	0	0	0	0	0	0	0	0	0	0
Net increase/(decrease) in cash and cash equivalents	64,391	(55,473)	3,676	(572)	(5,238)	5,354	24,493	39,295	43,142	42,796	42,167	39,859	37,845
Cash and cash equivalents, as of beginning of year	938	65,329	9,856	13,532	12,960	7,721	13,075	37,568	76,863	120,006	162,802	204,969	244,828
Cash and cash equivalents, as of end of year	65,329	9,856	13,532	12,960	7,721	13,075	37,568	76,863	120,006	162,802	204,969	244,828	282,673

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 (November 11, 2014): \$8.84
 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 (September 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	44.3%	18.0%	60.3%	43.9%	56.5%	56.0%
Hold	Market Perform	52.5%	9.7%	38.5%	51.6%	42.1%	39.1%
Sell	Underperform	3.2%	5.3%	1.3%	4.5%	1.4%	4.9%

* 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.

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