

# KaloBios Pharmaceuticals, Inc.

## Fourth-Quarter Results and Update

After the markets closed on Wednesday, KaloBios reported operating results (its first as a publicly traded company) for its full year 2012. In this note we discuss highlights from the news release as well as our opinion, and we note that reported results do not include the impact of the company's initial public offering, which occurred in January 2013.

### Key Highlights

- **Year-end 2012 financial results were uneventful.** Contract revenue for the year was \$6.1 million; R&D expenses were \$24.5 million and SG&A expenses were \$5.1 million. KaloBios finished with a net loss of \$23.5 million for the year. Relative to our expectations, R&D expenses were the material difference between our \$3.4 million estimate and what the company reported. Our updated estimates are in exhibit 1.
- **Focus remains on the company's pipeline and upcoming clinical catalysts.** During this year, we anticipate KaloBios filing for orphan drug status in the United States and European Union for KB001-A in the setting of cystic fibrosis; we also expect the company to complete the recruitment of its Phase II study in this indication. In addition, we expect the severe asthma Phase II study with KB003 to complete enrollment by year end. These near-term milestones should translate to proof-of-concept data from the Phase II trials in the first (asthma) and second (cystic fibrosis) quarters of next year. Ultimately, we expect the results to be positive, which should provide validation for the use of these antibodies in these disease settings. A timeline illustration of expected events is presented in exhibit 1.

KaloBios ended the quarter with cash, cash equivalents, and marketable securities of \$20.3 million, which does not take into account the \$70 million the company raised through an initial public offering of 8.75 million shares in January. We slightly modified our financial projections to come more in line with operating trends, and we continue to believe the company has enough cash to last it through 2014. We maintain our Outperform rating on KBIO shares.

Please see the following pages for additional details.

*Based in South San Francisco, California, KaloBios Pharmaceuticals, Inc. is a small-cap company focused on developing patient-targeted, first-in-class monoclonal antibodies using its proprietary Humaneered technology platform, with the intent to significantly improve the lives of seriously ill patients with difficult-to-treat diseases. The company has two agents in Phase II clinical testing in three different indications.*

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Please consult the last page of this report for all disclosures.

William Blair & Company, L.L.C. receives or seeks to receive compensation for investment banking services from KaloBios Pharmaceuticals, Inc. Investors should consider this report as a single factor in making an investment decision.

March 28, 2013

Stock Rating: **Outperform**  
Company Profile: **Aggressive Growth**

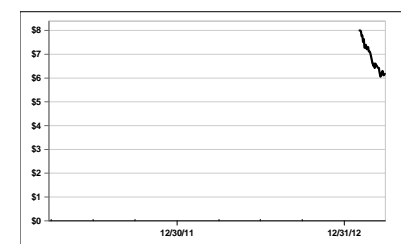
Symbol: KBIO (NASDAQ)  
Price: \$6.01 (52-Wk.: \$6-\$8)  
Market Value (mil.): \$149  
Fiscal Year End: December  
Long-Term EPS Growth Rate:  
Dividend/Yield: None

	2012A	2013E	2014E
<b>Estimates</b>			
EPS FY	\$-11.22	\$-1.65	\$-1.39
CY		\$-1.65	\$-1.39
Sales (mil.)	6	0	5
<b>Valuation</b>			
FY P/E	NM	NM	NM
CY P/E		NM	NM

<b>Trading Data (FactSet)</b>	
Shares Outstanding (mil.)	24
Float (mil.)	0
Average Daily Volume	86,594

<b>Financial Data (FactSet)</b>	
Long-Term Debt/Total Capital (MRQ)	0.0
Book Value Per Share (MRQ)	-10.8
Enterprise Value (mil.)	128.8
EBITDA (TTM)	-8.5
Enterprise Value/EBITDA (TTM)	-15.1x
Return on Equity (TTM)	-4.8

### Two-Year Price Performance Chart



Sources: FactSet, William Blair & Company estimates

**Exhibit 1**  
**KaloBios Pharmaceuticals**  
**Estimate Update**  
(dollars in millions except EPS)

	WB Previous 2013E	WB Revised 2013E	WB Unchanged 2014E	WB Unchanged 2015E
Total Revenues	\$0	\$0	\$5	\$0
R&D	\$33.0	\$33.1	\$37.0	\$38.6
SG&A	\$6.8	\$7.4	\$9.0	\$10.6
Net Income	(\$39.5)	(\$40.2)	(\$40.7)	(\$49.1)
EPS (basic)	(\$1.62)	(\$1.65)	(\$1.39)	(\$1.53)
EPS (diluted)	(\$1.62)	(\$1.65)	(\$1.39)	(\$1.53)

All numbers are non-GAAP and exclude stock-options expenses.

Sources: KaloBios reports and William Blair & Company, L.L.C. estimates.

**Exhibit 2**  
**KaloBios Pharmaceuticals**  
**Timeline**

Date	Drug	Indication	Event
2013	KB001-A	Cystic Fibrosis	File for orphan drug status in the U.S. and EU (Q2)
			Complete recruitment of Phase II study (Q4)
	KB003	Severe Asthma	Complete recruitment of Phase II study (Q3)
	KB004	Acute Myeloid Leukemia	Initiate expansion phase with EphA3 diagnostic test (Q3)
2014	KB001-A	Cystic Fibrosis	Top-line results from Phase II study (Q2)
		VAP Prevention	Initiate Sanofi Phase IIB study (Q3)
	KB003	Severe Asthma	Top-line results from Phase II study (Q1)
	KB004	Acute Myeloid Leukemia	Complete expansion phase (Q4)
		New Indication	Initiate Phase II study (Q1)

\*Triggers a \$5 million milestone payment upon initiation of the study

Sources: KaloBios Pharmaceuticals, Inc. reports

## Valuation

KaloBios is one of the only pure-play antibody companies to go public in the last decade. From a valuation standpoint, antibody platform companies (such as KaloBios) have historically performed well once entering the public markets. Some examples of companies that had attractive valuations after releasing positive Phase II clinical trial data include Seattle Genetics (\$1.4 billion market cap), Human Genome Sciences (\$1.4 billion), Alexion (\$580 million), Micromet (\$524 million), and ImmunoGen (\$457 million). Furthermore, when looking at antibody-focused companies (such as KaloBios) that have gone public over the last 27 years, we observed a compounded annual return rate of 17.1%. Combined with the fact that there are few public pure-play antibody platform companies between \$100 million and \$500 million in market cap, we believe KaloBios is trading at an attractive price versus its peers.

## Risks

**Financial risks.** As is the case with most small-cap drug companies, one of the primary risks for investors is whether the company has enough cash to develop its drug candidate all the way to the clinic. KaloBios recently became a publicly traded company with an initial public offering of \$70 million. Quarter-over-quarter increases in R&D and SG&A spending, which we expect will continue, as well as the company's cash position (currently about \$90 million) could become critical. As a result, to continue operations, the company will likely need to generate capital in some manner, which might come from stock issuance, debt issuance, or from additional partnerships, based on the company's drug discovery platform.

**Competitive risks.** Based on our evaluation of the competitive landscape, we believe the major competitors to KB001-A in VAP prevention are antibiotics like azithromycin; however, we acknowledge that these have not been widely adopted by the medical community. In the setting of cystic fibrosis (CF), the competitive landscape seems to be greater; however, half of the agents currently approved or still in development do *not* target the bacterial issues associated with this disease (Kalydeco, for example). Of the agents that could directly compete with KB001-A in cystic fibrosis, TOBI, Zithromax, and Cayston also target the *pseudomonas*. Lastly, with respect to severe and persistent asthma, Xolair seems to be the primary competitor on the market; however, its activity is restricted to patients with specific allergic asthma (IgE related), which is more restrictive than the currently sought-after indication for KaloBios.

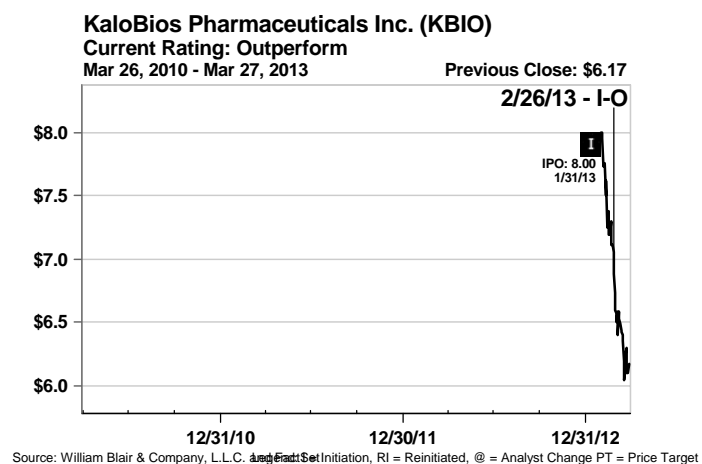
**Clinical/regulatory risks.** As with all biotechnology and pharmaceutical companies, regulatory authorities have the power to accept or deny the use of new drugs in the marketplace, based on a combination of clinical efficacy and safety data. One of the main features that differentiate KaloBios relative to most companies is the fact that the company is only developing biologicals, which historically have had a 32% success rate from submission of the investigational new drug application to approval (versus 13% for small molecules).

## William Blair & Company, L.L.C.

William Blair & Company, L.L.C. was a manager or co-manager of a public offering of equity securities for KaloBios Pharmaceuticals, Inc. within the prior 12 months.

William Blair & Company, L.L.C. is a market maker in the security of KaloBios Pharmaceuticals, Inc. and may have a long or short position.

Additional information is available upon request.



### Current Rating Distribution (as of 02/28/13)

Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	63	Outperform (Buy)	9
Market Perform (Hold)	33	Market Perform (Hold)	2
Underperform (Sell)	1	Underperform (Sell)	0

\*Percentage of companies in each rating category that are investment banking clients, defined as companies for which William Blair has received compensation for investment banking services within the past 12 months.

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