

Kindred Biosciences

(KIN-NASDAQ)

Stock Rating: Outperform(S)
Industry Rating: Outperform

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Strike 2; Has Other Chances, But Execution in 2015 Now Critical

Event

Kindred Bio announced that it has decided to discontinue its AtoKin pivotal study in atopic dermatitis and direct resources to other programs in its portfolio.

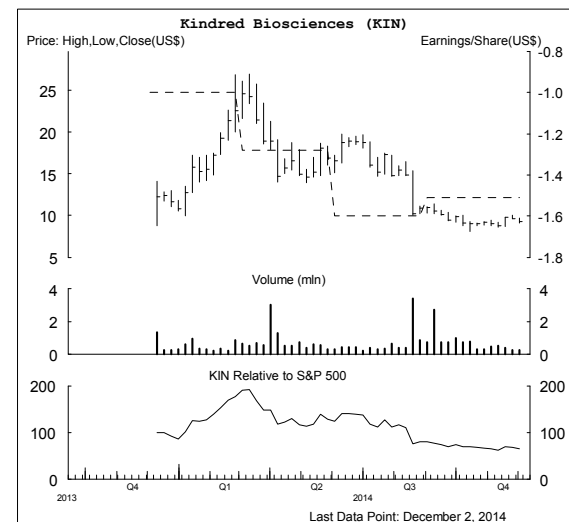
Impact & Analysis

Clearly negative given that now two of the three leading pivotal assets have failed. Management's decision to discontinue this pivotal study so close to the readout (mid 2015) after their recent announcement to increase the power of the study by increasing enrollment will undoubtedly disappoint investors. Based on our conversation with management, the decision was primarily based on the significantly better-than-expected launch of competitor Apoquel from Zoetis (ZTS, Outperform) with limited safety issues. Although the competitive threat from Apoquel is not new, Kindred planned to position AtoKin as a complementary product for milder cases and/or cases where safety was a concern with Apoquel. However, based on feedback from the vets, management now believes that the market opportunity is now much smaller than previously expected such that they could no longer justify the near-term multi-million dollar commercial and manufacturing expenses for AtoKin given that they have what they believe are superior products in the pipeline. Unfortunately, without the pivotal data from AtoKin and proof-of-concept data from the other emerging pipeline assets, such as KIND-010 for inappetence in cats and KIND-012 for fever in horses (both expected in 1H15), it is difficult to verify this argument. We've removed our risk adjusted AtoKin revenues of \$70MM by 2020.

Valuation & Recommendation

Now \$14/share based on average of DCF (\$13) and PE multiple (\$15). The stock is trading at ~\$7 after close corresponding to a market cap of ~\$140MM; however, Kindred has ~\$106MM or \$5/share in cash and although it will likely burn cash through 2018, we believe that market is undervaluing the rest of the pipeline. Nonetheless, successful execution of the pilot studies in 1H15 and the SentiKin pivotal trial in post-op pain by mid-2015 is now critical for Kindred.

Price (3-Dec) \$9.24
Target Price \$14.00 ↓
52-Week High \$26.99
52-Week Low \$8.13



(FY-Dec.)	2013A	2014E	2015E	2016E
EPS	-\$1.13	-\$1.58	-\$1.83 ↓	-\$1.80 ↓
P/E		na	na	na
CFPS	-\$0.42	-\$1.21	-\$1.55 ↓	-\$1.54 ↓
P/CFPS		na	na	na
Rev. (\$mm)	\$0	\$0	\$0	\$4
EV (\$mm)	\$164	\$164	\$164	na
Quarterly EPS	Q1	Q2	Q3	Q4
2013A	-\$0.07	-\$0.13	-\$0.40	-\$0.40
2014E	-\$0.38	-\$0.42	-\$0.31	-\$0.47
2015E	-\$0.42	-\$0.45	-\$0.46	-\$0.49
Dividend	\$0.00			
Book Value	na			0.0%
Shares O/S (mm)	16.2			na
Float O/S (mm)	8.2			\$150
Wkly Vol (000s)	679			\$76
Net Debt (\$mm)	-\$11			\$9.8
		Yield		Next Rep. Date
		Price/Book		na
		Mkt. Cap (mm)		\$150
		Float Cap (mm)		\$76
		Wkly \$ Vol (mm)		\$9.8
				na

Notes: All values in US\$.

First Call Mean Estimates: KINDRED BIOSCIENCES INC (US\$)
 2014E: -\$1.58; 2015E: -\$2.12; 2016E: -\$2.00

Changes	Annual EPS	Annual CFPS	Quarterly EPS	Target
	2014E na to -\$1.58	2014E na to -\$1.21	Q1/14E na to -\$0.38	\$19.00 to \$14.00
	2015E -\$0.06 to -\$1.83	2015E -\$0.03 to -\$1.55	Q2/14E na to -\$0.42	
	2016E -\$1.13 to -\$1.80	2016E -\$0.42 to -\$1.54	Q3/14E na to -\$0.31	
			Q1/15E na to -\$0.42	
			Q2/15E na to -\$0.45	
			Q3/15E na to -\$0.46	

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

DCF Valuation, \$000		4Q14E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	>2025E
Cash flow from operations		(5,934)	(30,828)	(30,848)	(21,467)	684	18,505	38,827	35,067	33,059	31,356	30,024	29,031	29,612
Y/Y Growth			NM	NM	NM	-103%	2605%	110%	-10%	-6%	-5%	-4%	-3%	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)	(30,948)	(30,975)	(21,591)	548	18,357	38,650	34,857	32,837	31,131	29,785	28,782	29,363
Y/Y Growth			NM	NM	NM	-103%	3251%	111%	-10%	-6%	-5%	-4%	-3%	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		10%												
Discounted FCFF		(5,931)	(27,959)	(25,439)	(16,121)	372	11,327	21,681	17,775	15,223	13,120	11,412	10,025	
	Total, \$000s	Per share	BMO Comments:											
PV of FCFF (2014-2025)	25,485	\$1	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	367,033	\$19	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	127,839	\$6	TV is 49% of our valuation and accounts for the other candidates such as the biologics in the pipeline.											
Cash & Equivalents	106,427	\$5												
Total Debt	0	\$0												
Diluted shares, 000s	19,713		Includes the secondary offering											
Total Stockholders' Equity Value	\$259,751	\$13												

P/E Multiple Valuation Using Non-GAAP EPS

Valuation	
DCF	\$13
P/E Multiple	\$15
Average	\$14

P/E Multiple		Valuation Using Non-GAAP E/P			
		2018E	2019E	2020E	2021E
EPS		(\$0.27)	\$0.56	\$1.37	\$1.27
P/E	21x	-\$4	\$7	\$16	\$14
	22x	-\$4	\$8	\$17	\$14
	23x	-\$4	\$8	\$18	\$15
	24x	-\$4	\$8	\$18	\$16
	25x	-\$5	\$9	\$19	\$16
Discount Period		4.1	5.1	6.1	7.1
Average		\$15	Min \$14	Max	\$17
Discount rate		10%			

Kindred Biosciences Income Statement: Our GAAP Near-Term Forecasts

GAAP Income Statement, \$000	2013A	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	0	3,542
Cost of Sales	0	0	0	0	0	0	0	0	0	0	0	1,680
Gross Profit	0	0	0	0	0	0	0	0	0	0	0	1,862
Research and development	3,141	4,498	5,639	3,755	6,764	20,656	5,459	5,465	5,472	5,479	21,874	21,210
General and administrative	1,079	1,679	2,499	2,342	2,493	9,013	2,914	3,518	3,738	4,400	14,569	16,914
Earnings from operations	(4,219)	(6,177)	(8,138)	(6,097)	(9,257)	(29,669)	(8,373)	(8,983)	(9,210)	(9,878)	(36,444)	(36,261)
Other (Income) / Deductions - Net	(6)	(9)	(28)	(25)	(24)	(86)	(22)	(21)	(19)	(17)	(80)	(51)
Income From Continuing Operations Before Provision for Taxes on Income	(4,213)	(6,168)	(8,110)	(6,072)	(9,234)	(29,584)	(8,350)	(8,962)	(9,191)	(9,861)	(36,364)	(36,210)
(Benefit) / Provision for Taxes on Income	0	0	0	0	0	0	0	0	0	0	0	0
Net Income/ (loss)	(\$4,213)	(\$6,168)	(\$8,110)	(\$6,072)	(\$9,234)	(\$29,584)	(\$8,350)	(\$8,962)	(\$9,191)	(\$9,861)	(\$36,364)	(\$36,210)
Earnings Per Share - Basic	(\$1.13)	(\$0.38)	(\$0.42)	(\$0.31)	(\$0.47)	(\$1.58)	(\$0.42)	(\$0.45)	(\$0.46)	(\$0.49)	(\$1.83)	(\$1.80)
Earnings Per Share - Diluted	(\$1.13)	(\$0.38)	(\$0.42)	(\$0.31)	(\$0.47)	(\$1.58)	(\$0.42)	(\$0.45)	(\$0.46)	(\$0.49)	(\$1.83)	(\$1.80)
Weighted-Average Shares - Basic	3,732	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	3,732	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	\$0.00

	2013A	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	NA
Gross Profit	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Operating Income (EBIT)	-3427%	-2658%	-1957%	-403%	-288%	-603%	-36%	-10%	-51%	-7%	-23%	1%
Net Income	-3423%	-2654%	-1950%	-402%	-287%	-602%	-35%	-11%	-51%	-7%	-23%	0%
EPS- Diluted	1894%	-409%	-217%	24%	-16%	40%	-11%	-8%	-50%	-6%	-16%	1%
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	-1024%
Net Income	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	-1022%

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	3,542	23,621	61,722	97,272	147,303	146,210	141,246	137,680	135,253	133,756
Cost of Sales	0	0	0	1,680	10,564	25,496	36,374	51,198	51,173	49,436	48,188	47,339	46,815
Gross Profit	0	0	0	1,862	13,057	36,226	60,898	96,105	95,036	91,810	89,492	87,915	86,941
Research and development	3,141	20,656	21,874	21,210	21,948	22,717	23,609	24,642	25,315	26,008	26,722	27,457	28,214
General and administrative	1,079	9,013	14,569	16,914	18,605	20,466	22,512	33,880	32,166	31,074	30,290	29,756	29,426
Earnings from operations	(4,219)	(29,669)	(36,444)	(36,261)	(27,496)	(6,956)	14,776	37,583	37,555	34,727	32,480	30,702	29,301
Other (Income) / Deductions - Net	(6)	(86)	(80)	(51)	(26)	(14)	(21)	(44)	(78)	(108)	(137)	(164)	(190)
Income From Continuing Operations Before Provision for Taxes on Income	(4,213)	(29,584)	(36,364)	(36,210)	(27,470)	(6,942)	14,797	37,628	37,632	34,835	32,617	30,866	29,492
(Benefit) / Provision for Taxes on Income	0	0	0	0	0	(1,388)	3,255	9,407	11,290	10,451	9,785	9,260	8,848
Net Income/ (loss)	(\$4,213)	(\$29,584)	(\$36,364)	(\$36,210)	(\$27,470)	(\$5,554)	\$11,542	\$28,221	\$26,343	\$24,385	\$22,832	\$21,606	\$20,644
Earnings Per Share - Basic	(\$1.13)	(\$1.58)	(\$1.83)	(\$1.80)	(\$1.36)	(\$0.27)	\$0.56	\$1.37	\$1.27	\$1.17	\$1.09	\$1.03	\$0.98
Earnings Per Share - Diluted	(\$1.13)	(\$1.58)	(\$1.83)	(\$1.80)	(\$1.36)	(\$0.27)	\$0.56	\$1.37	\$1.27	\$1.17	\$1.09	\$1.03	\$0.98
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	567%	161%	58%	51%	-1%	-3%	-3%	-2%	-1%
Gross Profit	NA	NA	NA	NA	601%	177%	68%	58%	-1%	-3%	-3%	-2%	-1%
Operating Income (EBIT)	-3427%	-603%	-23%	1%	24%	75%	312%	154%	0%	-8%	-6%	-5%	-5%
Net Income	-3423%	-602%	-23%	0%	24%	80%	308%	145%	-7%	-7%	-6%	-5%	-4%
EPS- Diluted	1894%	40%	-16%	1%	25%	-80%	-307%	143%	-7%	-8%	-7%	-6%	-5%
Margins													
Gross Profit	NA	NA	NA	53%	55%	59%	63%	65%	65%	65%	65%	65%	65%
Operating Profit	NA	NA	NA	-1024%	-116%	-11%	15%	26%	26%	25%	24%	23%	22%
Net Income	NA	NA	NA	-1022%	-116%	-9%	12%	19%	18%	17%	17%	16%	15%

Source: Company Reports, BMO Capital Markets Pharmaceuticals Research

Kindred Biosciences Balance Sheet

Kindred Balance Sheet, \$000	2012A	2013A	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Assets														
Cash and cash equivalents	938	65,329	9,856	18,907	20,932	9,841	10,389	28,746	67,396	102,253	135,090	166,222	196,007	224,789
Short-term Investments	0	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	1	148	1,006	1,074	1,046	1,113	1,185	1,266	1,670	1,611	1,605	1,608	1,617	1,632
Total current assets	938	65,476	101,465	70,584	39,582	18,057	18,677	37,115	76,169	110,967	143,798	174,932	204,727	233,524
Property and equipment, net	0	12	211	241	284	297	310	327	346	381	409	441	496	538
Other assets	0	0	22	22	22	22	22	22	22	22	22	22	22	22
Total Assets	938	65,488	101,698	70,847	39,887	18,376	19,009	37,463	76,537	111,370	144,230	175,395	205,245	234,084
Liabilities and Equity														
Accounts payable	5	689	2,012	2,147	2,093	2,226	2,371	2,532	3,340	3,222	3,210	3,215	3,234	3,264
Due to related party	5	0	0	0	0	0	0	0	0	0	0	0	0	0
Accrued expenses	60	1,521	2,656	2,750	2,696	2,820	2,749	2,927	3,843	3,709	3,697	3,705	3,728	3,764
Total current liabilities	70	2,210	4,669	4,897	4,789	5,046	5,120	5,459	7,183	6,931	6,908	6,920	6,962	7,028
Long term liabilities	0	0	44	44	44	44	44	44	44	44	44	44	44	44
Total liabilities	70	2,210	4,713	4,941	4,833	5,090	5,164	5,503	7,227	6,975	6,952	6,964	7,006	7,072
Preferred Stock	987	0	0	0	0	0	0	0	0	0	0	0	0	0
Total Equity	(119)	63,279	97,029	65,950	35,098	13,329	13,890	32,005	69,354	104,439	137,322	168,476	198,284	227,056
Total liabilities and equity	938	65,488	101,698	70,847	39,887	18,376	19,009	37,463	76,537	111,370	144,230	175,395	205,245	234,084

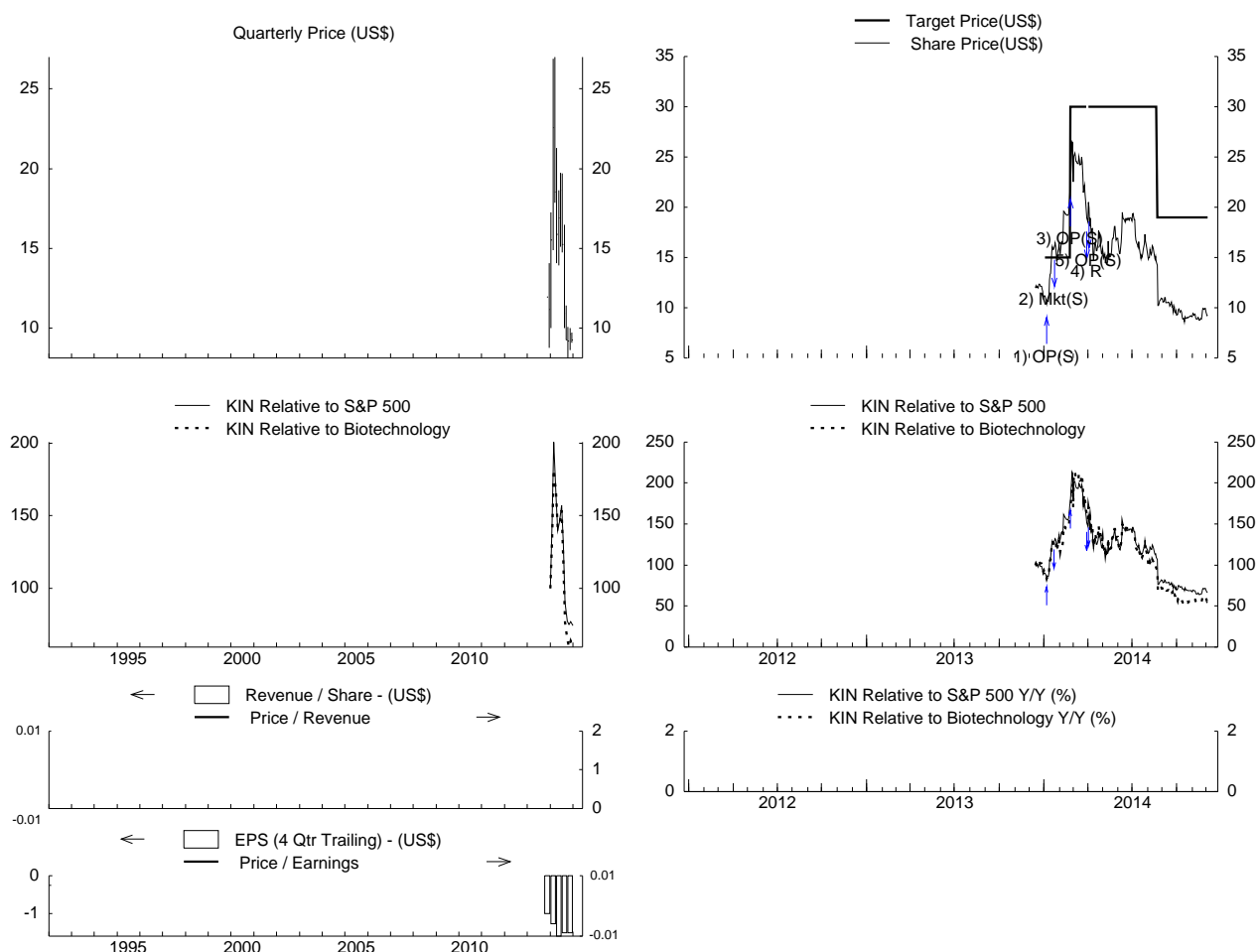
Source: Company Reports, BMO Capital Markets Pharmaceuticals Research

Kindred Biosciences Statement of Cash Flows

Kindred Statement of Cash Flows, \$000	2012A	2013A	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Operating activities														
Net income/(loss)	(120)	(4,213)	(29,584)	(36,364)	(36,210)	(27,470)	(5,554)	11,542	28,221	26,343	24,385	22,832	21,606	20,644
Adjustments:														
Stock-based compensation expense	11	922	4,784	5,154	5,302	5,682	6,100	6,559	9,114	8,729	8,483	8,307	8,188	8,114
Depreciation expense	0	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	161	(81)	191	1	258	1,321	(193)	(18)	10	32	51
Net cash provided by operating activities	(63)	(1,573)	(22,734)	(30,828)	(30,848)	(21,467)	684	18,505	38,827	35,067	33,059	31,356	30,024	29,031
Investing Activities														
Purchase of Short-term Investments	0	0	(128,142)	0	0	0	0	0	0	0	0	0	0	0
Proceeds from Maturities of Short-term Investments	0	0	37,500	40,000	33,000	10,500	0	0	0	0	0	0	0	0
Purchase of property and equipment	0	(15)	(245)	(121)	(128)	(124)	(136)	(148)	(176)	(210)	(221)	(225)	(239)	(249)
Net cash used in investing activities	0	(15)	(90,887)	39,879	32,872	10,376	(136)	(148)	(176)	(210)	(221)	(225)	(239)	(249)
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	83	0	0	0	0	0	0	0	0	0	0	0
Proceeds from sale of common stock	0	54,871	58,065	0	0	0	0	0	0	0	0	0	0	0
Net cash provided by/(used in) financing activities	1,000	65,979	58,148	0	0	0	0	0	0	0	0	0	0	0
Net increase/(decrease) in cash and cash equivalents	938	64,391	(55,473)	9,052	2,025	(11,091)	548	18,357	38,650	34,857	32,837	31,131	29,785	28,782
Cash and cash equivalents, as of beginning of year	0	938	65,329	9,856	18,907	20,932	9,841	10,389	28,746	67,396	102,253	135,090	166,222	196,007
Cash and cash equivalents, as of end of year	938	65,329	9,856	18,907	20,932	9,841	10,389	28,746	67,396	102,253	135,090	166,222	196,007	224,789

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*	-1.51	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 Q3/2014.
 * Valuation metrics are based on high and low for the fiscal year.
 * Range indicates the valuation range for the period presented above.

Last Price (December 2, 2014): \$9.26
 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.

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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.

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

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;

R = Restricted – Dissemination of research is currently restricted.

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