

# Kindred Biosciences

(KIN-NASDAQ)

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

March 7, 2014

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## Pipeline Moving Ahead on Schedule; First Pivotal Trial Results by Mid-Year

### Event

Kindred reported a 4Q13 loss of \$2.4MM, higher than our \$1.7MM forecast. G&A was higher than we expected (\$639M vs. \$272M) because of financing costs. R&D of \$1.7MM was in line. Management provided 2014 spending guidance of \$14-16MM, higher than our \$11.5MM forecast.

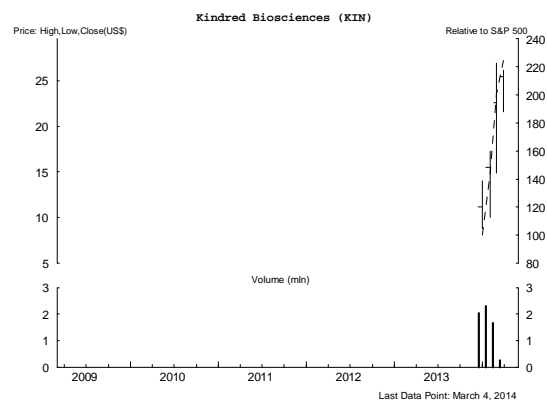
### Impact & Analysis

Overall, the company's expense guidance is understandable given the rapid pace of R&D and corporate development. Management had previously stated that each new drug should cost \$3-5MM to bring to market, and the guidance is mostly in line with this. Kindred should have ample cash to cover its costs until it is cash flow positive within three years. Investors' focus remains on the pipeline development, particularly for the three leading assets. Results from the CereKin osteoarthritis in dogs study are expected mid-year, and if successful, it could reach the market in 3Q15. We forecast peak sales potential of \$95MM in 2020. The AtoKin atopic dermatitis study was initiated in February and results are expected by 4Q14. If successful, AtoKin should enter the market in 4Q15, and we believe could reach sales of \$100MM in 2025. The SentiKin post-operative pain pivotal study should start this month, and should yield results by 4Q14. If successful, SentiKin could be filed before year-end. We advanced our SentiKin timeline and now forecast launch in 4Q15/1Q16, ahead of our previous 3Q16 estimate, and expect peak sales of \$67MM in 2020. We estimate a 70% probability of success for these assets and include risk-adjusted sales in our forecasts. Importantly, Kindred has already been approached by a number of larger animal health companies for partnership opportunities.

### Valuation & Recommendation

\$30/share: Average of DCF (\$25), P/E multiple (\$29), and multiple of sales or takeover valuation (\$36). Kindred has a promising pipeline, an experienced management team, and if some of its products are successful, we believe it will likely be an acquisition target given big pharma's interest in animal health. We maintain our Outperform (Speculative) rating.

**Price (6-Mar)** \$24.58 **52-Week High** \$26.89  
**Target Price** \$30.00 **52-Week Low** \$8.75



(FY-Dec.)	2012A	2013A	2014E	2015E
EPS	-\$0.06	-\$1.13	-\$0.83↓	-\$1.23↓
P/E			na	na
CFPS	-\$0.03	-\$0.35	-\$0.79↓	-\$1.05↓
P/CFPS			na	na
Rev. (\$mm)	na	\$0	\$0	\$7
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
2013A	-\$0.10	-\$0.10	-\$0.40	-\$0.40
2014E	-\$0.16↓	-\$0.22↓	-\$0.22↓	-\$0.22↓
Dividend	\$0.00			0.0%
Book Value	na			na
Shares O/S (mm)	16.2			\$398
Float O/S (mm)	8.2			\$202
Wkly Vol (000s)	500			\$7.8
Net Debt (\$mm)	-\$11			na
Yield				0.0%
Price/Book				na
Mkt. Cap (mm)				\$398
Float Cap (mm)				\$202
Wkly \$ Vol (mm)				\$7.8
Next Rep. Date				na

Notes: All values in US\$.

Major Shareholders:

First Call Mean Estimates: KINDRED BIOSCIENCES INC (US\$)  
 2013E: -\$0.76; 2014E: -\$0.68; 2015E: -\$0.98

Changes	Annual EPS	Annual CFPS	Quarterly EPS	
	2014E -\$0.65 to -\$0.83	2014E -\$0.58 to -\$0.79	Q1/14E -\$0.14 to -\$0.16	Q3/14E -\$0.17 to -\$0.22
	2015E -\$1.11 to -\$1.23	2015E -\$0.94 to -\$1.05	Q2/14E -\$0.17 to -\$0.22	Q4/14E -\$0.17 to -\$0.22

This report was prepared by an analyst(s) employed by BMO Nesbitt Burns Inc. Please refer to pages 7 to 10 for Important Disclosures, including the Analyst's Certification.

**Exhibit 1. Changes to Our Forecasts: Increased Revenue Due to the Earlier Launch of SentiKin;  
Increased Opex as per Management Guidance**

	2013 Actual	2014E		2015E		2016E	
		New	Prior	New	Prior	New	Prior
<b>Revenue</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$7,031</b>	<b>\$6,694</b>	<b>\$57,518</b>	<b>\$50,266</b>
Gross Margin	NA	NA	NA	54%	54%	61%	65%
R&D	\$3,141	\$12,274	\$10,378	\$11,094	\$9,867	\$11,292	\$10,016
G&A	\$1,079	\$2,682	\$1,142	\$15,106	\$13,437	\$18,826	\$17,040
Operating Profit	(\$4,219)	(\$14,957)	(\$11,520)	(\$22,403)	(\$19,693)	\$4,917	\$5,618
Effective Tax Rate	0%	0%	0%	0%	0%	0%	0%
Net Income	(\$4,213)	(\$14,750)	(\$11,311)	(\$22,253)	(\$19,528)	\$5,028	\$5,751
Net Margin	NA	NA	NA	-317%	-292%	9%	11%
<b>EPS</b>	<b>(\$1.13)</b>	<b>(\$0.83)</b>	<b>(\$0.65)</b>	<b>(\$1.23)</b>	<b>(\$1.11)</b>	<b>\$0.28</b>	<b>\$0.32</b>
Cash & Equivalents	\$65,329	\$51,236	\$54,654	\$32,239	\$38,088	\$39,585	\$45,920

Source: Kindred, BMO Capital Markets Pharmaceuticals Research

**Exhibit 2. Valuation \$30/Share: Average of DCF (\$25/share), P/E Multiple (\$29/share), and Multiple of Sales or Takeout Valuation (\$36/share)**

DCF Valuation, \$000		2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	>2025E
Cash flow from operations		(14,081)	(18,985)	7,359	38,648	50,597	61,234	64,417	40,114	36,147	34,731	32,991	31,689	32,481
Y/Y Growth			NM	NM	NM	31%	21%	5%	-38%	-10%	-4%	-5%	-4%	3%
CAPEX		(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
Free Cash Flow to the Firm (FCFF)		(14,093)	(18,997)	7,346	38,635	50,583	61,219	64,398	40,092	36,124	34,708	32,966	31,663	32,455
Y/Y Growth			NM	NM	NM	31%	21%	5%	-38%	-10%	-4%	-5%	-4%	3%
Discount Period		0.4	1.4	2.4	3.4	4.4	5.4	6.4	7.4	8.4	9.4	10.4	11.4	
Discount Rate	9%													
Discounted FCFF		(13,602)	(16,822)	5,968	28,795	34,587	38,404	37,062	21,169	17,499	15,424	13,441	11,843	
	Total, \$000s	Per share	BMO Comments:											
PV of FCFF (2014-2025)	193,768	\$11	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	499,309	\$28	Terminal growth rate assumption is 2.5% 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	186,766	\$11	TV is roughly 40% of our valuation and accounts for the 7 other candidates such as the biologics in the pipeline.											
Cash & Equivalents	65,329	\$4												
Total Debt	0	\$0												
Diluted shares, 000s	17,700	\$1												
Total Stockholders' Equity Value	\$445,862	\$25												

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

Average **\$30**

## P/E Multiple Valuation Using Non-GAAP EPS

		2017E	2018E	2019E	2020E	2021E
EPS		\$2.01	\$2.63	\$3.18	\$3.32	\$1.92
P/E	15x	\$22	\$27	\$30	\$29	\$15
	16x	\$24	\$29	\$32	\$31	\$16
	17x	\$25	\$31	\$34	\$33	\$17
	18x	\$27	\$32	\$36	\$34	\$18
	19x	\$28	\$34	\$38	\$36	\$19
Discount Period		3.4	4.4	5.4	6.4	7.4
<b>Average</b>		<b>\$29</b>	<b>Min</b>	<b>\$15</b>	<b>Max</b>	<b>\$38</b>
Discount rate		9%				

2017-2020  
EPS CAGR  
18.3%

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

		2017E	2018E	2019E	2020E	2021E
Sales per share		\$5.81	\$7.76	\$8.98	\$9.57	\$8.97
Sales Multiple	6.0x	\$26	\$32	\$34	\$33	\$28
	6.5x	\$28	\$34	\$37	\$36	\$31
	7.0x	\$30	\$37	\$39	\$39	\$33
	7.5x	\$32	\$40	\$42	\$41	\$36
	8.0x	\$35	\$42	\$45	\$44	\$38
Discount Period		3.4	4.4	5.4	6.4	7.4
<b>Average</b>		<b>\$36</b>	<b>Min</b>	<b>\$26</b>	<b>Max</b>	<b>\$45</b>
Discount rate		9%				

2017-2020  
CAGR  
18.1%

## 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	1,409	5,622	7,031	57,518
Cost of Sales	0	0	0	0	0	0	0	0	704	2,530	3,234	22,483
Gross Profit	0	0	0	0	0	0	0	0	704	3,092	3,797	35,036
Research and development	3,141	2,276	3,312	3,331	3,356	12,274	2,742	2,763	2,784	2,806	11,094	11,292
General and administrative	1,079	651	664	677	691	2,682	2,705	3,219	4,433	4,749	15,106	18,826
Earnings from operations	(4,219)	(2,927)	(3,976)	(4,007)	(4,046)	(14,957)	(5,447)	(5,981)	(6,513)	(4,462)	(22,403)	4,917
Other (Income) / Deductions - Net	(6)	(56)	(53)	(50)	(47)	(207)	(44)	(40)	(35)	(31)	(150)	(110)
Income From Continuing Operations Before Provision for Taxes on Income	(4,213)	(2,871)	(3,922)	(3,957)	(3,999)	(14,750)	(5,403)	(5,942)	(6,477)	(4,432)	(22,253)	5,028
(Benefit) / Provision for Taxes on Income	0	0	0	0	0	0	0	0	0	0	0	0
Net Income/ (loss)	(\$4,213)	(\$2,871)	(\$3,922)	(\$3,957)	(\$3,999)	(\$14,750)	(\$5,403)	(\$5,942)	(\$6,477)	(\$4,432)	(\$22,253)	\$5,028
Earnings Per Share - Basic	(\$1.13)	(\$0.17)	(\$0.24)	(\$0.24)	(\$0.24)	(\$0.89)	(\$0.32)	(\$0.35)	(\$0.38)	(\$0.26)	(\$1.32)	\$0.30
Earnings Per Share - Diluted	(\$1.13)	(\$0.16)	(\$0.22)	(\$0.22)	(\$0.22)	(\$0.83)	(\$0.30)	(\$0.33)	(\$0.36)	(\$0.24)	(\$1.23)	\$0.28
Weighted-Average Shares - Basic	3,732	16,500	16,564	16,625	16,685	16,594	16,743	16,800	16,854	16,907	16,826	17,032
Weighted-Average Shares - Diluted	3,732	17,700	17,764	17,825	17,885	17,794	17,943	18,000	18,054	18,107	18,026	18,232
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
<b>Growth Rates (YOY)</b>												
Revenues	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	718%
Gross Profit	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	823%
Operating Income (EBIT)	3427%	845%	1184%	230%	70%	254%	86%	50%	63%	10%	50%	-122%
Net Income	3423%	827%	1167%	227%	68%	250%	88%	51%	64%	11%	51%	-123%
EPS- Diluted	1894%	57%	114%	-45%	-45%	-27%	86%	49%	62%	9%	49%	-122%
<b>Margins</b>												
Gross Profit	NA	NA	NA	NA	NA	NA	NA	NA	50%	55%	54%	61%
Operating Profit	NA	NA	NA	NA	NA	NA	NA	NA	-462%	-79%	-319%	9%
Net Income	NA	NA	NA	NA	NA	NA	NA	NA	-460%	-79%	-317%	9%

Source: Kindred Biosciences SEC Filings, 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	7,031	57,518	106,996	144,133	168,140	180,251	169,960	156,202	145,549	137,442	131,428
Cost of Sales	0	0	3,234	22,483	38,759	50,790	58,849	63,088	59,486	54,671	50,942	48,105	46,000
Gross Profit	0	0	3,797	35,036	68,238	93,343	109,291	117,163	110,474	101,532	94,607	89,338	85,428
Research and development	3,141	12,274	11,094	11,292	11,494	11,703	11,918	12,141	20,395	17,182	14,555	13,744	13,143
General and administrative	1,079	2,682	15,106	18,826	19,917	20,842	21,616	22,240	39,091	37,489	34,932	32,986	31,543
Earnings from operations	(4,219)	(14,957)	(22,403)	4,917	36,827	60,799	75,756	82,782	50,988	46,861	45,120	42,607	40,743
Other (Income) / Deductions - Net	(6)	(207)	(150)	(110)	(178)	(329)	(518)	(733)	(924)	(1,055)	(1,176)	(1,293)	(1,404)
Income From Continuing Operations Before Provision for Taxes on Income	(4,213)	(14,750)	(22,253)	5,028	37,005	61,128	76,274	83,516	51,912	47,916	46,297	43,900	42,146
(Benefit) / Provision for Taxes on Income	0	0	0	0	0	12,226	16,780	20,879	15,574	14,375	13,889	13,170	12,644
Net Income/ (loss)	(\$4,213)	(\$14,750)	(\$22,253)	\$5,028	\$37,005	\$48,902	\$59,494	\$62,637	\$36,339	\$33,541	\$32,408	\$30,730	\$29,502
Earnings Per Share - Basic	(\$1.13)	(\$0.89)	(\$1.32)	\$0.30	\$2.15	\$2.81	\$3.40	\$3.55	\$2.05	\$1.88	\$1.81	\$1.71	\$1.63
Earnings Per Share - Diluted	(\$1.13)	(\$0.83)	(\$1.23)	\$0.28	\$2.01	\$2.63	\$3.18	\$3.32	\$1.92	\$1.76	\$1.69	\$1.60	\$1.53
Weighted-Average Shares - Basic	3,732	16,594	16,826	17,032	17,214	17,375	17,518	17,645	17,757	17,856	17,943	18,021	18,090
Weighted-Average Shares - Diluted	3,732	17,794	18,026	18,232	18,414	18,575	18,718	18,845	18,957	19,056	19,143	19,221	19,290
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
<b>Growth Rates (YOY)</b>													
Revenues	NA	NA	NA	718%	86%	35%	17%	7%	-6%	-8%	-7%	-6%	-4%
Gross Profit	NA	NA	NA	823%	95%	37%	17%	7%	-6%	-8%	-7%	-6%	-4%
Operating Income (EBIT)	3427%	254%	50%	-122%	649%	65%	25%	9%	-38%	-8%	-4%	-6%	-4%
Net Income	3423%	250%	51%	-123%	636%	32%	22%	5%	-42%	-8%	-3%	-5%	-4%
EPS- Diluted	1894%	-27%	49%	-122%	629%	31%	21%	5%	-42%	-8%	-4%	-6%	-4%
<b>Margins</b>													
Gross Profit	NA	NA	54%	61%	64%	65%	65%	65%	65%	65%	65%	65%	65%
Operating Profit	NA	NA	-319%	9%	34%	42%	45%	46%	30%	30%	31%	31%	31%
Net Income	NA	NA	-317%	9%	35%	34%	35%	35%	21%	21%	22%	22%	22%

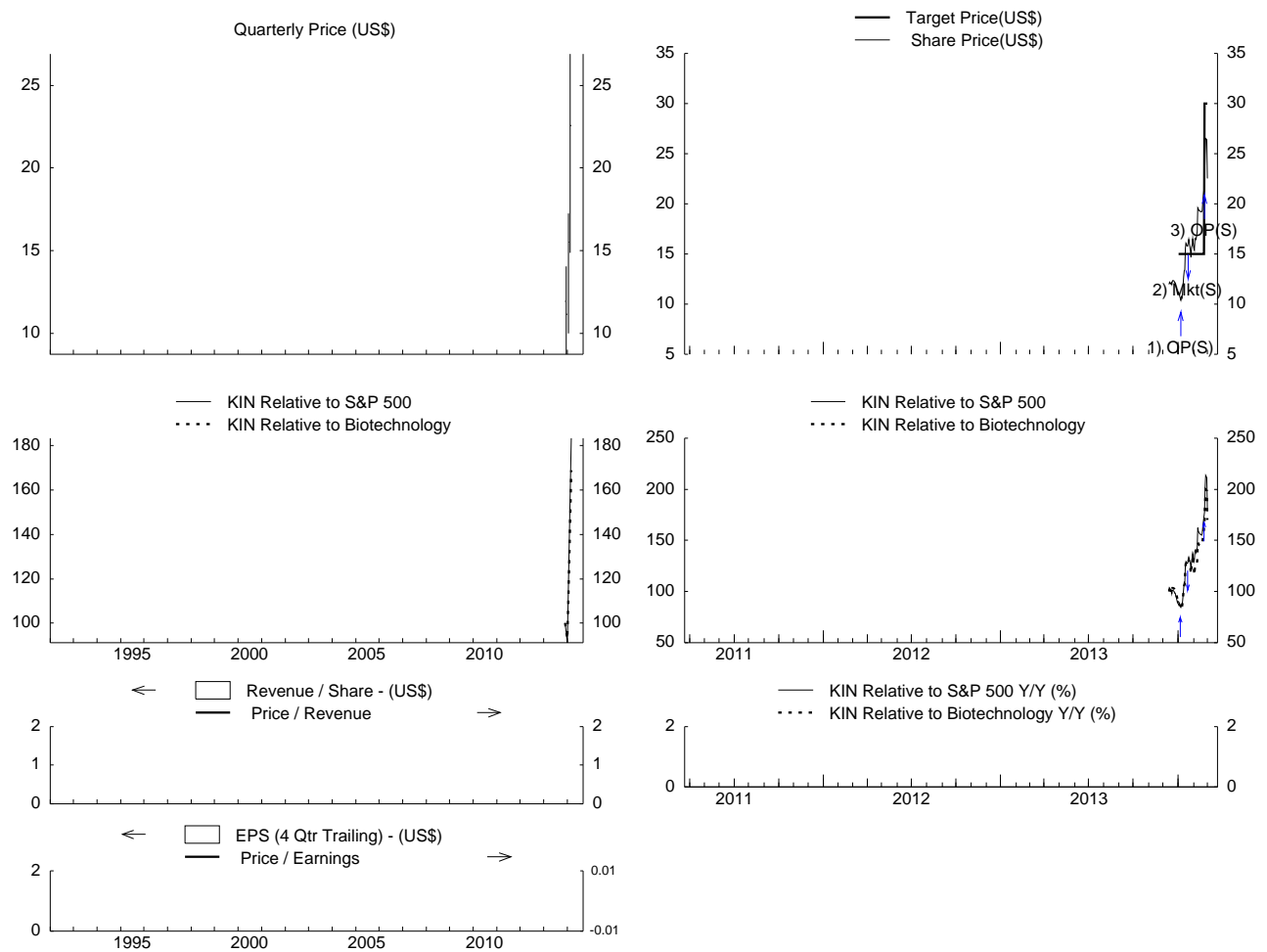
Source: Kindred Biosciences SEC Filings, BMO Capital Markets Pharmaceuticals Research

## Kindred Biosciences Balance Sheet

Kindred Balance Sheet, \$000	2013A	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
<b>Assets</b>													
Cash and cash equivalents	65,329	51,236	32,239	39,585	78,220	128,802	190,021	254,419	294,512	330,636	365,344	398,310	429,973
Prepaid expenses and other	148	1,100	2,053	2,160	2,252	2,334	2,406	2,467	3,868	3,573	3,250	3,083	2,961
Total current assets	65,476	52,336	34,292	41,745	80,472	131,136	192,427	256,887	298,379	334,209	368,594	401,393	432,934
Property and equipment, net	12	19	26	30	31	33	34	36	40	43	46	52	56
<b>Total Assets</b>	<b>65,488</b>	<b>52,355</b>	<b>34,317</b>	<b>41,775</b>	<b>80,503</b>	<b>131,169</b>	<b>192,462</b>	<b>256,923</b>	<b>298,419</b>	<b>334,252</b>	<b>368,640</b>	<b>401,445</b>	<b>432,990</b>
<b>Liabilities and Equity</b>													
Accounts payable	689	440	821	864	901	934	962	987	1,547	1,429	1,300	1,233	1,185
Due to related party	0	0	0	0	0	0	0	0	0	0	0	0	0
Accrued expenses	1,022	1,132	2,346	2,474	2,591	2,694	2,788	2,869	4,492	4,168	3,803	3,608	3,466
Total current liabilities	1,710	1,572	3,168	3,338	3,492	3,628	3,750	3,856	6,039	5,597	5,103	4,842	4,650
<b>Preferred Stock</b>													
<b>Total Equity</b>	<b>63,778</b>	<b>50,783</b>	<b>31,150</b>	<b>38,437</b>	<b>77,012</b>	<b>127,541</b>	<b>188,711</b>	<b>253,067</b>	<b>292,380</b>	<b>328,655</b>	<b>363,537</b>	<b>396,603</b>	<b>428,340</b>
Total liabilities and equity	65,488	52,355	34,317	41,775	80,503	131,169	192,462	256,923	298,419	334,252	368,640	401,445	432,990

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 11-Dec-13 = NR		
Range*:		na	na		NC				>15 >15			Date	Rating Change	Share Price
Current*	ND	na		0.00	0.0		na	NA	NA		na	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

\* 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 ( February 28, 2014): \$ND  
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 (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.

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

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

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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 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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