

KaloBios Pharmaceuticals, Inc.

First Quarter 2013 Results and Update

After the close on Tuesday, May 14, KaloBios reported operating results for its first quarter in 2013. We discuss the highlights from the press release as well as our opinion below, and note that reported results now include the impact of the company's initial public offering, which occurred in January of this year. A variance analysis between our estimates and the company's actual results for the quarter is summarized in exhibit 1.

Key Highlights:

- **First-quarter financial results were uneventful.** Contract revenue for the quarter was \$16,000; R&D expenses were \$6.3 million and SG&A expenses were \$2.0 million. KaloBios finished with a net loss of \$8.57 million for the quarter, and a net loss per share of \$0.55. Relative to our expectations, R&D expenses were the material difference between our estimate (\$7.7 million) and what the company reported, along with the expected outstanding share count (15.6 million versus our estimate of 24.2 million). We expect 24.2 million shares outstanding to be the baseline going forward. Our updated estimates are presented in exhibit 2.
- **Focus remains on the company's pipeline and upcoming clinical catalysts.** During this year, we expect the full recruitment of the Phase II study with KB003 in the setting of severe asthma, top-line data from which is expected in the first quarter of next year. In addition, we expect the cystic fibrosis Phase II study with KB001-A to complete enrollment by year-end, with interim results expected in the middle 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 3.

KaloBios ended the quarter with cash, cash equivalents, and marketable securities of \$69.9 million, which now takes into account the \$70 million the company raised through an initial public offering of 8.75 million shares in January. We have slightly modified our financial projections to come more in line with operating trends, and continue to believe the company has enough cash to last it through 2014. We maintain our Outperform rating.

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.

May 15, 2013

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

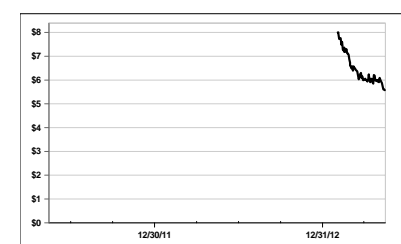
Symbol: KBIO (NASDAQ)
Price: \$5.57 (52-Wk.: \$6-\$8)
Market Value (mil.): \$135
Fiscal Year End: December
Long-Term EPS Growth Rate:
Dividend/Yield: None

	2012A	2013E	2014E
Estimates			
EPS FY	\$-11.22	\$-1.75	\$-1.39
CY		\$-1.75	\$-1.39
Sales (mil.)	6	0	5
Valuation			
FY P/E	NM	NM	NM
CY P/E		NM	NM

Trading Data (FactSet)	
Shares Outstanding (mil.)	2
Float (mil.)	11
Average Daily Volume	75,056

Financial Data (FactSet)	
Long-Term Debt/Total Capital (MRQ)	0.1
Book Value Per Share (MRQ)	-43.4
Enterprise Value (mil.)	20.3
EBITDA (TTM)	-23.2
Enterprise Value/EBITDA (TTM)	-0.9x
Return on Equity (TTM)	-53.3

Two-Year Price Performance Chart



Sources: FactSet, William Blair & Company estimates

Exhibit 1
KaloBios Pharmaceuticals
First Quarter 2013 Variance Analysis
(dollars in thousands except EPS)

	KBIO Q1 2013A	WB Q1 2013E
Total Revenues	\$0	\$0
R&D	\$6	\$8
SG&A	\$2	\$2
Net Income	(\$9)	(\$9)
EPS	(\$0.55)	(\$0.38)

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

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

Exhibit 2
KaloBios Pharmaceuticals
Estimate Update
(dollars in millions except EPS)

	WB Previous 2013E	WB Revised 2013E	WB Previous 2014E	WB Revised 2014E	WB Unchanged 2015E
Total Revenues	\$0	\$0	\$5	\$5	\$0
R&D	\$33.1	\$29.5	\$37.0	\$37.0	\$38.6
SG&A	\$7.4	\$7.7	\$9.0	\$9.0	\$10.6
Net Income	(\$40.2)	(\$37.8)	(\$40.7)	(\$40.8)	(\$49.1)
EPS (basic)	(\$1.65)	(\$1.75)	(\$1.39)	(\$1.39)	(\$1.53)
EPS (diluted)	(\$1.65)	(\$1.75)	(\$1.39)	(\$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 3
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 and Risks

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) (SGEN \$37.89; Outperform), Human Genome Sciences (\$1.4 billion), Alexion (\$580 million) (ALXN \$103.89; Outperform), Micromet (\$524 million), and ImmunoGen (\$457 million) (IMGN \$16.45; Outperform). 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 currently 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. When looking at the company's financial statements, quarter-over-quarter increases in spending (R&D and SG&A), which we expect will continue, and the company's cash position (currently about \$70 million) could become critical going forward. As a result, to continue operations, the company will likely need to generate capital in some manner, which may 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 such as azithromycin, but 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 CF, TOBI, Zithromax and Cayston also target the pseudomonas. Lastly, with respect to severe/persistent asthma, Xolair seems to be the primary competitor currently on the market, but its activity is restricted to patients with specific allergic asthma (IgE-related), which is more restrictive than the currently sought-after indication for KaloBios.

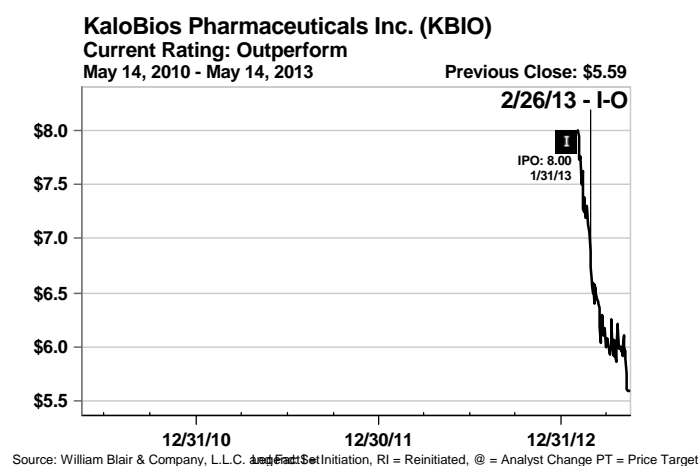
Clinical/Regulatory Risks. As with all biotechnology and pharmaceutical companies, regulatory authorities have the power to accept or deny the use of new drugs in the marketplace, based on a combination of clinical efficacy and safety data. One of the main features that differentiates KaloBios relative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

William Blair & Company, L.L.C.

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Additional information is available upon request.



Current Rating Distribution (as of 04/30/13)

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