

Kindred Biosciences

(KIN-NASDAQ)

Stock Rating: Outperform(S)
Industry Rating: Outperform

May 13, 2014

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Pipeline Advancing on Schedule; Focus Is on CereKin Pivotal Results

Event

Kindred reported a 1Q14 loss of \$6.2 mm, higher than our \$2.9 mm forecast. The key driver for the higher expenses was R&D (\$4.5 mm vs. our estimate of \$2.3 mm) and G&A (\$1.7 mm vs. our estimate of \$0.651 mm). Kindred announced that the CereKin pivotal study in dogs with OA has completed enrollment, and should read out in July/first half of August. The AtoKin and SentiKin pivotal trials are also ongoing and are also expected to read out by the end of the year to support NADA filings in 2014. Kindred expects 2014 opex to be \$25-\$35 mm excluding stock-based compensation expense of \$4-\$4.5 mm. Much of the increase will be in R&D as Kindred increases headcount and starts more pivotal trials to develop its relatively broad pipeline.

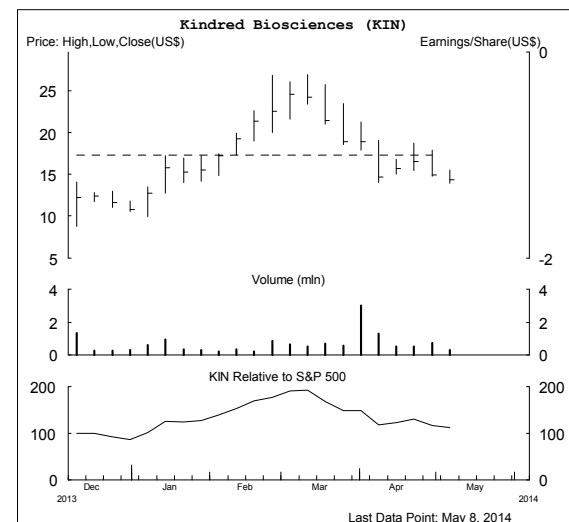
Impact & Analysis

Positive. Investors won't mind the higher-than-expected opex at this point as long as Kindred is advancing its pipeline and remains on schedule for the key milestones, particularly the pivotal data readouts. The focus remains on the first pivotal trial readout, which is the CereKin OA trial. [The study is about 90% powered to meet the primary efficacy endpoint vs. placebo \(links to our detailed discussion of this trial\)](#). We assign a 70% probability of success for the CereKin phase-3 trial, and forecast peak sales of ~\$95 million by 2019. We note that Kindred management also assigned a 70% probability of success for this trial, and other leading pivotal programs. We believe that the CereKin OA study is probably the riskiest of the three Kindred pivotal studies expected to read out this year, and as such, the results would likely have a disproportionate impact.

Valuation & Recommendation

\$30/share: Average of DCF (\$26), P/E Multiple (\$27), and Multiple of sales or takeover valuation (\$37). 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 (12-May) \$16.63 **52-Week High** \$26.99
Target Price \$30.00 **52-Week Low** \$8.75



(FY-Dec.)	2012A	2013A	2014E	2015E
EPS	-\$0.06	-\$1.13	-\$1.52↓	-\$1.89↓
P/E			na	na
CFPS	-\$0.03	-\$0.42	-\$1.34↓	-\$1.66↓
P/CFPS			na	na
Rev. (\$mm)	na	\$0	\$0	\$7
EV (\$mm)	na	\$164	\$164	\$164
Quarterly EPS	Q1	Q2	Q3	Q4
2012A	na	na	na	na
2013A	-\$0.10	-\$0.10	-\$0.40	-\$0.40
2014E	-\$0.38a	-\$0.33↑	-\$0.37↓	-\$0.43↓
Dividend	\$0.00			0.0%
Book Value	na			na
Shares O/S (mm)	16.2			\$269
Float O/S (mm)	8.2			\$136
Wkly Vol (000s)	680			\$11.9
Net Debt (\$mm)	-\$11			na
Yield				0.0%
Price/Book				na
Mkt. Cap (mm)				\$269
Float Cap (mm)				\$136
Wkly \$ Vol (mm)				\$11.9
Next Rep. Date				na

Notes: All values in US\$.

First Call Mean Estimates: KINDRED BIOSCIENCES INC (US\$)
 2014E: -\$0.90; 2015E: -\$1.57

Changes	Annual EPS	Annual CFPS	Quarterly EPS	
	2014E -\$0.90 to -\$1.52	2014E -\$0.87 to -\$1.34	Q2/14E -\$0.35 to -\$0.33	Q3/14E -\$0.19 to -\$0.37
	2015E -\$1.09 to -\$1.89	2015E -\$0.94 to -\$1.66		Q4/14E -\$0.19 to -\$0.43

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Exhibit 1. 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		(27,478)	(36,663)	(9,316)	15,269	39,313	61,019	73,767	65,222	59,078	54,255	50,512	47,655	48,608
Y/Y Growth			NM	NM	NM	157%	55%	21%	-12%	-9%	-8%	-7%	-6%	2%
CAPEX		(11)	(12)	(13)	(12)	(14)	(15)	(18)	(21)	(22)	(22)	(24)	(25)	(25)
Interest Expense (1-t)		0	0	0	0	0	0	0	0	0	0	0	0	0
Free Cash Flow to the Firm (FCFF)		(27,489)	(36,675)	(9,329)	15,257	39,299	61,005	73,749	65,201	59,056	54,233	50,488	47,630	48,583
Y/Y Growth			NM	NM	NM	158%	55%	21%	-12%	-9%	-8%	-7%	-6%	2%
Discount Period		0.3	1.3	2.3	3.3	4.3	5.3	6.3	7.3	8.3	9.3	10.3	11.3	
Discount Rate	9%													
Discounted FCFF		(26,762)	(32,817)	(7,672)	11,533	27,304	38,956	43,286	35,173	29,281	24,715	21,147	18,337	
		Total, \$000s	Per share	BMO Comments:										
PV of FCFF (2014-2025)	182,481	\$8	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	714,459	\$33	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	275,054	\$13	TV is roughly 48% of our valuation and accounts for the 7 other candidates such as the biologics in the pipeline.											
Cash & Equivalents	118,582	\$5	Includes 1Q14 cash balance and estimated net proceeds from the secondary offering											
Total Debt	0	\$0												
Diluted shares, 000s	21,810		Includes the secondary offering											
Total Stockholders' Equity Value	\$576,117	\$26												

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

P/E Multiple Valuation Using Non-GAAP EPS

		2017E	2018E	2019E	2020E	2021E
EPS		\$0.45	\$1.43	\$2.35	\$2.87	\$2.49
P/E	21x	\$7	\$21	\$32	\$35	\$28
	22x	\$8	\$22	\$33	\$37	\$30
	23x	\$8	\$23	\$35	\$39	\$31
	24x	\$8	\$24	\$36	\$40	\$32
	25x	\$9	\$25	\$38	\$42	\$34
Discount Period		3.3	4.3	5.3	6.3	7.3
Average		\$27	Min	\$7	Max	\$42
Discount rate		9%				

2017-2020
EPS CAGR
76.2%

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

		2017E	2018E	2019E	2020E	2021E
Sales per share		\$5.73	\$7.83	\$9.25	\$9.98	\$9.33
Sales Multiple	6.0x	\$26	\$33	\$35	\$35	\$30
	6.5x	\$28	\$35	\$38	\$38	\$33
	7.0x	\$30	\$38	\$41	\$41	\$35
	7.5x	\$32	\$41	\$44	\$44	\$38
	8.0x	\$35	\$43	\$47	\$47	\$40
Discount Period		3.3	4.3	5.3	6.3	7.3
Average		\$37	Min	\$26	Max	\$47
Discount rate		9%				

2017-2020
Revenue CAGR
20.3%

Valuation	
DCF	\$26
P/E Multiple	\$27
Sales Multiple	\$37
Average	\$30

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	1,409	5,622	7,031	66,120
Cost of Sales	0	0	0	0	0	0	0	704	2,755	3,459	31,612
Gross Profit	0	0	0	0	0	0	0	704	2,867	3,572	34,508
Research and development	4,498	5,499	6,371	7,365	23,733	7,127	7,317	7,513	7,715	29,672	32,063
General and administrative	1,679	1,755	1,799	2,090	7,323	3,295	3,848	4,084	4,422	15,649	16,581
Earnings from operations	(6,177)	(7,254)	(8,170)	(9,455)	(31,056)	(10,422)	(11,165)	(10,893)	(9,269)	(41,749)	(14,136)
Other (Income) / Deductions - Net	(9)	(8)	(15)	(14)	(47)	(13)	(12)	(11)	(9)	(45)	(29)
Income From Continuing Operations Before Provision for Taxes on Income	(6,168)	(7,245)	(8,155)	(9,441)	(31,009)	(10,408)	(11,153)	(10,883)	(9,260)	(41,704)	(14,106)
(Benefit) / Provision for Taxes on Income	0	0	0	0	0	0	0	0	0	0	0
Net Income/ (loss)	(\$6,168)	(\$7,245)	(\$8,155)	(\$9,441)	(\$31,009)	(\$10,408)	(\$11,153)	(\$10,883)	(\$9,260)	(\$41,704)	(\$14,106)
Earnings Per Share - Basic	(\$0.38)	(\$0.37)	(\$0.41)	(\$0.48)	(\$1.64)	(\$0.52)	(\$0.56)	(\$0.55)	(\$0.46)	(\$2.09)	(\$0.70)
Earnings Per Share - Diluted	(\$0.38)	(\$0.33)	(\$0.37)	(\$0.43)	(\$1.52)	(\$0.47)	(\$0.51)	(\$0.49)	(\$0.42)	(\$1.89)	(\$0.63)
Weighted-Average Shares - Basic	16,222	19,677	19,733	19,788	18,855	19,841	19,892	19,942	19,991	19,917	20,104
Weighted-Average Shares - Diluted	16,222	21,810	21,866	21,921	20,455	21,974	22,025	22,075	22,123	22,049	22,237
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	840%
Gross Profit	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	866%
Operating Income (EBIT)	NA	2242%	574%	296%	636%	69%	54%	33%	-2%	34%	-66%
Net Income	1892%	2240%	574%	296%	636%	69%	54%	33%	-2%	34%	-66%
EPS- Diluted	268%	222%	-8%	7%	34%	25%	52%	32%	-3%	25%	-66%
Margins											
Gross Profit	NA	NA	NA	NA	NA	NA	NA	50%	51%	51%	52%
Operating Profit	NA	NA	NA	NA	NA	NA	NA	-773%	-165%	-594%	-21%
Net Income	NA	NA	NA	NA	NA	NA	NA	-773%	-165%	-593%	-21%

Source: Kindred Biosciences, BMO Capital Markets Pharmaceuticals Research

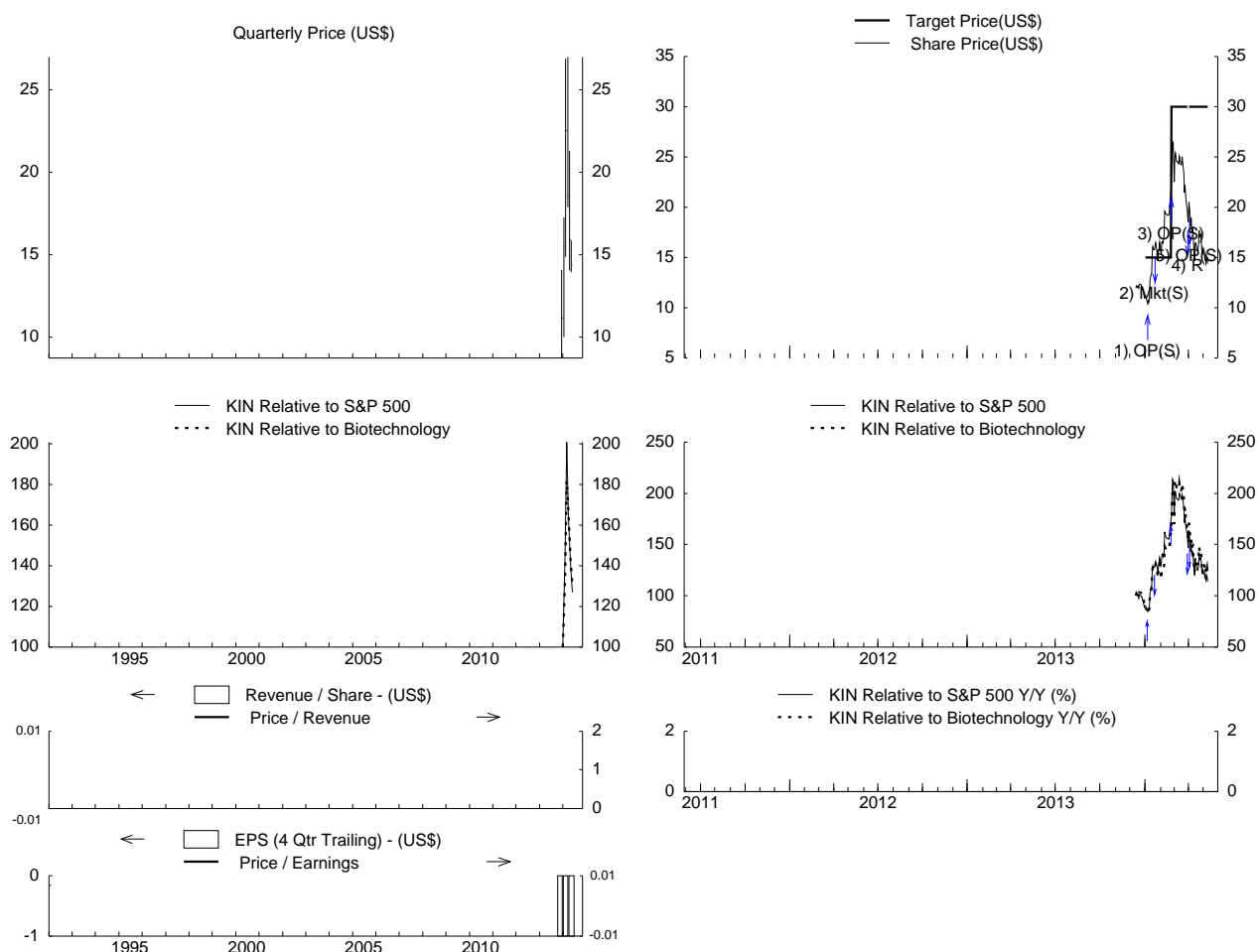
Kindred Biosciences Income Statement: Our GAAP Longer-Term Forecasts

GAAP Income Statement, \$000	2013A	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Revenues	0	0	7,031	66,120	128,427	176,464	209,764	227,498	213,621	192,855	176,550	163,888	154,206
Cost of Sales	0	0	3,459	31,612	57,688	73,117	78,588	79,053	74,767	67,499	61,793	57,361	53,972
Gross Profit	0	0	3,572	34,508	70,740	103,347	131,176	148,445	138,854	125,356	114,758	106,528	100,234
Research and development	3,141	23,733	29,672	32,063	34,909	36,603	31,465	27,300	25,635	23,143	21,186	19,667	18,505
General and administrative	1,079	7,323	15,649	16,581	25,685	26,470	31,465	34,125	32,043	28,928	26,483	24,583	23,131
Earnings from operations	(4,219)	(31,056)	(41,749)	(14,136)	10,145	40,275	68,247	87,021	81,176	73,285	67,089	62,278	58,598
Other (Income) / Deductions - Net	(6)	(47)	(45)	(29)	(29)	(43)	(70)	(106)	(146)	(180)	(212)	(241)	(268)
Income From Continuing Operations Before Provision for Taxes on Income	(4,213)	(31,009)	(41,704)	(14,106)	10,175	40,318	68,316	87,127	81,322	73,465	67,301	62,518	58,866
(Benefit) / Provision for Taxes on Income	0	0	0	0	0	8,064	15,030	21,782	24,397	22,040	20,190	18,756	17,660
Net Income/ (loss)	(\$4,213)	(\$31,009)	(\$41,704)	(\$14,106)	\$10,175	\$32,254	\$53,287	\$65,345	\$56,925	\$51,426	\$47,111	\$43,763	\$41,206
Earnings Per Share - Basic	(\$1.13)	(\$1.64)	(\$2.09)	(\$0.70)	\$0.50	\$1.58	\$2.59	\$3.16	\$2.74	\$2.47	\$2.25	\$2.08	\$1.96
Earnings Per Share - Diluted	(\$1.13)	(\$1.52)	(\$1.89)	(\$0.63)	\$0.45	\$1.43	\$2.35	\$2.87	\$2.49	\$2.24	\$2.04	\$1.89	\$1.78
Weighted-Average Shares - Basic	3,732	18,855	19,917	20,104	20,271	20,418	20,548	20,663	20,766	20,856	20,936	21,007	21,070
Weighted-Average Shares - Diluted	3,732	20,455	22,049	22,237	22,403	22,550	22,681	22,796	22,898	22,989	23,069	23,140	23,202
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	840%	94%	37%	19%	8%	-6%	-10%	-8%	-7%	-6%
Gross Profit	NA	NA	NA	866%	105%	46%	27%	13%	-6%	-10%	-8%	-7%	-6%
Operating Income (EBIT)	NA	636%	34%	-66%	-172%	297%	69%	28%	-7%	-10%	-8%	-7%	-6%
Net Income	3423%	636%	34%	-66%	-172%	217%	65%	23%	-13%	-10%	-8%	-7%	-6%
EPS- Diluted	1894%	34%	25%	-66%	-172%	215%	64%	22%	-13%	-10%	-9%	-7%	-6%
Margins													
Gross Profit	NA	NA	51%	52%	55%	59%	63%	65%	65%	65%	65%	65%	65%
Operating Profit	NA	NA	-594%	-21%	8%	23%	33%	38%	38%	38%	38%	38%	38%
Net Income	NA	NA	-593%	-21%	8%	18%	25%	29%	27%	27%	27%	27%	27%

Source: Kindred Biosciences, 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	ND	>15 >15	
Range*		na na		0.0 0.0			>15 >15	
Current*	-1.00	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 Q4/2013.
 * Valuation metrics are based on high and low for the fiscal year.
 * Range indicates the valuation range for the period presented above.

Last Price (May 8, 2014): \$14.38
 Sources: IHS Global Insight, Thomson Reuters, BMO Capital Markets.

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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 (March 31, 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	42.0%	21.5%	60.7%	40.8%	53.6%	53.6%
Hold	Market Perform	52.8%	10.8%	38.2%	52.8%	43.8%	40.8%
Sell	Underperform	5.2%	3.2%	1.1%	6.3%	2.7%	5.6%

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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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