Kindred Biosciences, Inc.

KIN - BUY - CereKin Misses Primary Endpoint, but We Are Still Optimistic Regarding AtoKin, SentiKin, and Business Development

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FLASH NOTE

SECTOR: Specialty Pharmaceuticals

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We would continue to be buyers of KIN (BUY, $14.21), especially on weakness tomorrow morning (stock is below $10 after-hours), ahead of three good catalysts before year-end: positive data for AtoKin and SentiKin as well as potential for an M&A deal. If KIN meets the primary endpoints for both AtoKin and SentiKin, we think the stock could see significant upside and business development would be additional upside, especially an accretive deal. On the CereKin conference call today, Richard Chin, the CEO, did note that profitability for KIN may not be pushed out if KIN could acquire an established company or products. Finally, CereKin is not completely finished. KIN will still develop the drug for horses, but unfortunately, we think the market will not subscribe much value to this effort. After the market closed today, Kindred announced that its pivotal study for Cerekin, an interleukin-1 inhibitor, did not meet its primary endpoint. Although CereKin is only one of many drug candidates in KIN's pipeline, the headline risk is greater than the financial impact since it was the first data release since KIN's IPO in December of 2013. Therefore, we think the Street will now assign a higher discount rate and lower multiple to the rest of KIN's pipeline.

Now that CereKin for dogs has been discontinued, KIN will save $5MM in launch costs that the company says it will use to accelerate its other development programs and/or pursue M&A. The total cost of the CereKin trial was approximately $4MM and KIN still has over $100MM in cash. KIN is continuing to enroll patients in the pivotal studies for AtoKin and SentiKin (started 1Q14 for both trials). A PK study of extended-release SentiKin for postoperative pain in cats has been completed. A PK study of a drug for the stimulation of appetite in cats has been initiated. A PK study of a drug for fever in horses is expected to start this quarter. Significant progress has been made in the biologics programs, including erythropoietin for cats with anemia and immune checkpoint inhibitors for dogs with cancer. All of these product candidates, if approved, would be first-in-class drugs in the pet therapeutic market.

There are two reasons we think SentiKin could do better than CereKin in trials: 1) SentiKin should have a lower placebo rate, and 2) Many of the dropouts in the CereKin trial were due to loose stools, which is a side effect of diacerin, the active ingredient in CereKin. Some of the investors we talked to were concerned about a negative read-through from CereKin to SentiKin, another pain drug in KIN's pipeline. With respect to the SentiKin trial, the placebo rate should be lower because the veterinarian is performing the assessment (based on need for rescue utilizing the Glasgow scale) versus the owner, who is not involved in any assessments. In other animal drug trials, owners of pets have similar placebo rates to those seen in human drug trials. Pet owners perceive an improvement when they think their pets are taking a drug. On the dropouts, KIN noted that in the high dose group the dropout rate was higher than expected. It is our understanding this was a result of loose stools, not the trial design.

Potential Catalysts. 1) Data from pivotal studies for AtoKin, SentiKin released in '14; 2) Approvals for AtoKin, SentiKin in '15+; 3) Additional pipeline advancements and approvals; 4) Partnerships & business development.

See pages 2 - 3 for analyst certification and important disclosures.

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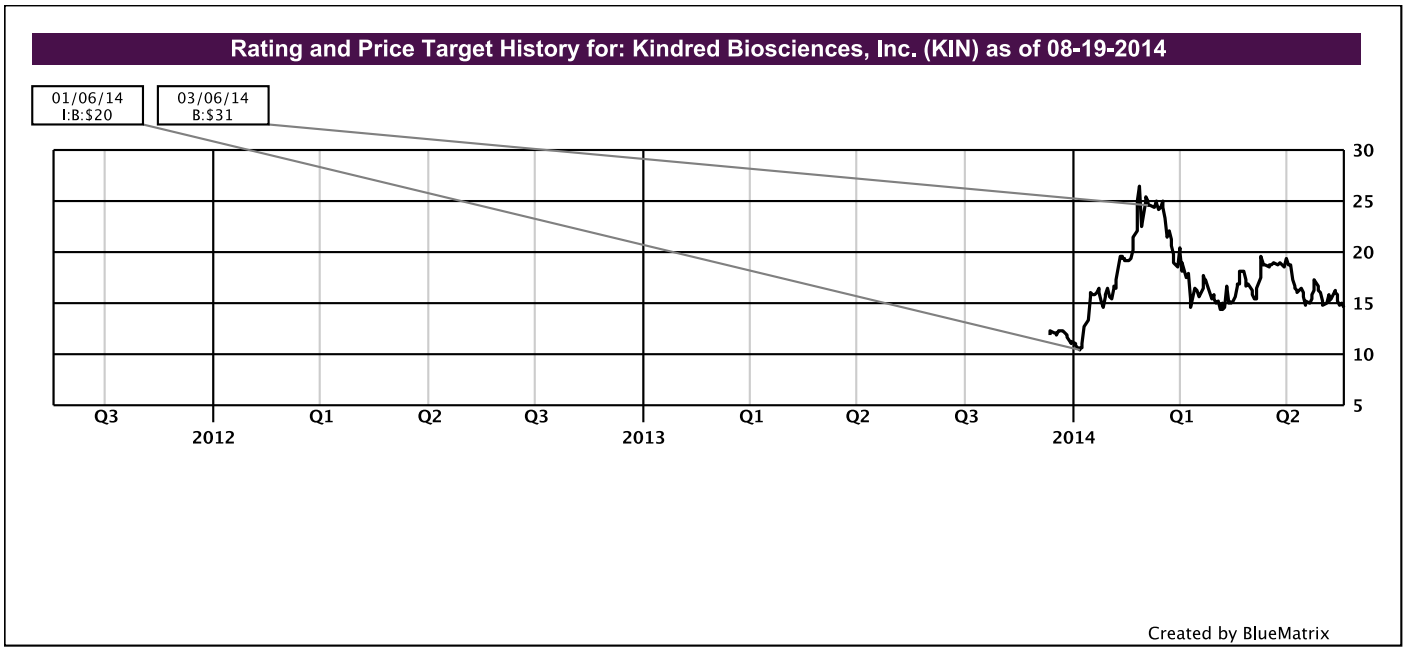

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