

## 4Q13 Postview - Early Growing Pains

Fits, stops, and starts for ACLF trial

### What's Incremental

We view the modest timeline delay to the ACLF trial as part of the expected learning curve in the emerging area of liver failure treatments. The criteria changes & ongoing addition of US trial centers should result in top line pharmacokinetic data in the latter part of 2H14 along with NASH trial results & the start of the CLF & HCV-POLT trials. We model CNAT finishing 2014 with \$30M in cash before it enters into Ph-III. We remain encouraged by the promise of emricasan for treating liver failure. We maintain our Buy rating, \$17 PT.

### ACLF trial pushed back slightly, 4Q13 results fine (see Exhibit 1)

CNAT announced with 4Q13 results that ACLF pharmacokinetic (PK) and ALT/AST biomarker data would now top line in 2H14 instead of 1H14 due to delays in trial completion, which we view as a modest inconvenience but not altering the promising potential of emricasan as a treatment. Specifically, selection of severely ill patients resulted in challenges in data gathering due to patient deaths preventing follow up through the planned 28 days. CNAT has modified the inclusion/exclusion criteria to focus on earlier PK data and plans to include data from a subset of ACLF patients, the ongoing study of renally impaired patients, and a new trial of patients with hepatic impairment. CNAT believes the broader spectrum of patients should help tighten selection criteria for its roll out of future Phase III trials. Separately, CNAT management highlighted [an upcoming AASLD meeting on antifibrotic drug trials](#) at which a consensus on clinical endpoints could emerge. For the quarter, CNAT reported a loss of (\$0.33) vs. our (\$0.28) and consensus of (\$0.27), which reflected \$1M of higher spend split nearly equally between R&D and G&A.

### Our model assumes higher spend as multiple trials roll out

We raised our total 2014 R&D expense by \$5.5M to \$18.4M to reflect the resumption of the HCV-POLT trial as well as the potential addition of more centers added across the various trials to accelerate enrollments. Our model assumes a loss of (\$26.8M) which equates to (\$1.75) vs. our prior (\$1.29) and consensus of (\$1.31). We expect CNAT to finish 2014 with \$30M in cash, which is at the mid-point of its \$28M to \$32M range.

### Catalysts in 2014

Events that could move CNAT shares are: 1) competitor/market data from the European Association for the Study of the Liver (EASL) meeting in London from April 9-13; 2) the American Association for the Study of Liver Disease (AASLD's) Emerging Trends in Antifibrotic Drug meeting in Chicago from June 21-22; 3) ACLF data in 2H14; 4) NAFLD/NASH data in 2H14; 5) initiations of the CLF & HCV-POLT trials in 2H14; and 6) the annual AASLD meeting in Boston from November 7-11.

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**SEE PAGE 6 FOR REQUIRED DISCLOSURE INFORMATION**

Page 1

## Buy

**Price Target: \$17.00**  
Prior: \$17.00

### Δ Key Drivers

	From	To
<b>ACLF Data</b>	<b>1H14</b>	<b>2H14</b>
<i>A modest trial delay.</i>		
<b>2014 Cash Burn</b>	<b>\$20M</b>	<b>\$25M</b>
<i>Reflects restart of HCV-POLT trial.</i>		

Price (Mar. 27, 2014)	\$9.98
52-Wk Range	\$14.25-\$5.96
Market Cap (\$M)	\$153
ADTV	548,361
Shares Out (M)	15.4
Short Interest Ratio/% Of Float	13.2%
Dividend/Yield	\$0.00/0.0%
TR to Target	70.3%

Total Debt	\$1.0
BV/Share	\$3.45
Cash And Equivalents (\$M)	\$56.3

	2013A	2014E		2015E	
		Curr.	Prior	Curr.	Prior
EPS					
1Q	(\$0.25)	(\$0.38)	(\$0.27)	--	
2Q	\$0.16	(\$0.42)	(\$0.30)	--	
3Q	(\$0.28)	(\$0.48)	(\$0.37)	--	
4Q	(\$0.33)	(\$0.47)	(\$0.35)	--	
FY	(\$0.63)	(\$1.75)	(\$1.29)	(\$1.31)	(\$1.31)
P/E	NM	NM		NM	
Revenue (\$M)					
FY	\$0	\$0	\$0	\$0	\$0
FYE Dec					

**Exhibit 1: CNAT 4Q13 Variance Analysis**

(\$ thousands)	CNAT Actual		STRH Estimates		Variance vs. STRH		EPS Impact	Consensus 4Q13E	Actual 4Q12A
	4Q13A	% Chg. YOY	4Q13E	% Chg. YOY	U.S. \$	% Difference			
<b>Total Sales</b>	<b>0</b>	<b>NM</b>	<b>0</b>	<b>NM</b>	<b>0</b>	<b>NM</b>	<b>0.00</b>	<b>0</b>	<b>0</b>
COGS	0	NM	0	NM	0	NM	0.00	0	0
<b>Gross Profit (Loss)</b>	<b>0</b>	<b>NM</b>	<b>0</b>	<b>NM</b>	<b>0</b>	<b>NM</b>	<b>0.00</b>	<b>0</b>	<b>0</b>
R&D	2,977	98%	2,455	67%	522	21%	(0.03)	NA	1,506
General & Administrative	2,124	124%	1,640	73%	484	30%	(0.03)	NA	949
Sales & Marketing	0	NM	0	NM	0	NM	0.00	NA	0
<b>Operating Profit (Loss)</b>	<b>(5,101)</b>	<b>111%</b>	<b>(4,095)</b>	<b>69%</b>	<b>(1,006)</b>	<b>-25%</b>	<b>(0.07)</b>	<b>(3,870)</b>	<b>(2,422)</b>
Interest Income	14	342%	30	832%	(16)	-53%	(0.00)	NA	3
Interest Expense	(45)	157%	(150)	757%	105	70%	0.01	NA	(18)
Other Income (Expense)	6	266%	(100)	-5244%	106	-106%	0.01	NA	2
(Loss) gain on warrant fair value	0	NM	0	NM	0	NM	0.00	NA	0
<b>Pretax Income (Loss)</b>	<b>(5,126)</b>	<b>110%</b>	<b>(4,315)</b>	<b>77%</b>	<b>(811)</b>	<b>-19%</b>	<b>(0.05)</b>	<b>(3,870)</b>	<b>(2,435)</b>
Taxes (Benefit)	0	NM	0	NM	0	NM	0.00	NA	0
<b>Net Income (Loss)</b>	<b>(5,126)</b>	<b>111%</b>	<b>(4,315)</b>	<b>77%</b>	<b>(811)</b>	<b>-19%</b>	<b>(0.05)</b>	<b>(3,870)</b>	<b>(2,435)</b>
<b>EPS (LPS)</b>	<b>(0.33)</b>	<b>-86%</b>	<b>(0.28)</b>	<b>-108%</b>	<b>(0.06)</b>	<b>-21%</b>		<b>(0.27)</b>	<b>(2.36)</b>
Average Diluted Shares Outstanding	15,353	1389%	15,608	1442%	(255)	-2%	0.01	NA	1,031

Source: STRH Research, company reports, Thomson One Analytics.

**Exhibit 2: CNAT Income Statement 2011-2020E**

(\$ in thousands, except per share data)	2011A	2012A	2013A	1Q14E	2Q14E	3Q14E	4Q14E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
<b>Total risk-adjusted revenue</b>	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$6,843	\$22,953	\$55,432	\$106,173
Cost of goods sold (\$20K/kilo)	0	0	0					0	0	0	1,026	3,443	8,315	15,926
<b>Gross profit</b>	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$5,816	\$19,510	\$47,118	\$90,247
Research & Development	9,487	5,528	6,947	3,800	4,250	5,350	5,000	18,400	19,380	15,350	5,474	3,328	4,712	4,247
Total SG&A	2,875	3,086	4,651	1,743	1,868	1,743	1,868	7,220	7,647	8,051	14,160	15,874	18,624	20,109
Total expenses	\$12,361	\$8,615	\$11,598	\$5,543	\$6,118	\$7,093	\$6,868	\$25,620	\$27,027	\$23,401	\$19,634	\$19,202	\$23,335	\$24,355
<b>Operating Profit (Loss)</b>	<b>(\$12,361)</b>	<b>(\$8,615)</b>	<b>(\$11,598)</b>	<b>(\$5,543)</b>	<b>(\$6,118)</b>	<b>(\$7,093)</b>	<b>(\$6,868)</b>	<b>(\$25,620)</b>	<b>(\$27,027)</b>	<b>(\$23,401)</b>	<b>(\$13,818)</b>	<b>\$308</b>	<b>\$23,782</b>	<b>\$65,892</b>
Interest Income	\$28	\$26	\$22	20	20	20	20	\$80	\$149	\$228	\$251	\$150	\$99	\$131
Interest Expense	(114)	(70)	(463)	(18)	(18)	(18)	(18)	(70)	(70)	(70)	(70)	(70)	(70)	(35)
Other Income (Expense)	450	(90)	(3,578)	(300)	(300)	(300)	(300)	(1,200)	0	0	(6,000)	(6,000)	0	0
(Loss) gain on warrant liability	0	0	11,016	0	0	0	0	0	0	0	0	0	0	0
<b>Pretax Income (Loss)</b>	<b>(\$11,997)</b>	<b>(\$8,749)</b>	<b>(\$4,600)</b>	<b>(\$5,840)</b>	<b>(\$6,415)</b>	<b>(\$7,390)</b>	<b>(\$7,165)</b>	<b>(\$26,810)</b>	<b>(\$26,948)</b>	<b>(\$23,243)</b>	<b>(\$19,637)</b>	<b>(\$5,612)</b>	<b>\$23,811</b>	<b>\$65,988</b>
Tax Expense (Benefit)	0	0	0	0	0	0	0	0	0	0	0	0	0	0
<b>Net Income (Loss)</b>	<b>(\$11,997)</b>	<b>(\$8,749)</b>	<b>(\$4,600)</b>	<b>(\$5,840)</b>	<b>(\$6,415)</b>	<b>(\$7,390)</b>	<b>(\$7,165)</b>	<b>(\$26,810)</b>	<b>(\$26,948)</b>	<b>(\$23,243)</b>	<b>(\$19,637)</b>	<b>(\$5,612)</b>	<b>\$23,811</b>	<b>\$65,988</b>
EPS - basic		(\$8.60)	(\$0.63)	(\$0.38)	(\$0.42)	(\$0.48)	(\$0.47)	(\$1.75)	(\$1.31)	(\$1.13)	(\$0.95)	(\$0.27)	\$1.15	\$3.20
<b>EPS - diluted</b>	<b>(\$1.44)</b>	<b>(\$8.60)</b>	<b>(\$0.63)</b>	<b>(\$0.38)</b>	<b>(\$0.42)</b>	<b>(\$0.48)</b>	<b>(\$0.47)</b>	<b>(\$1.75)</b>	<b>(\$1.31)</b>	<b>(\$1.13)</b>	<b>(\$0.95)</b>	<b>(\$0.27)</b>	<b>\$1.15</b>	<b>\$3.20</b>
Basic share outstanding		1,017	7,358	15,353	15,353	15,353	15,353	15,353	20,616	20,616	20,616	20,616	20,616	20,616
Diluted shares outstanding	8,342	1,017	7,358	15,353	15,353	15,353	15,353	15,353	20,616	20,616	20,616	20,616	20,616	20,616
<b>Margin analysis</b>	<b>2011A</b>	<b>2012A</b>	<b>2013A</b>	<b>1Q14E</b>	<b>2Q14E</b>	<b>3Q14E</b>	<b>4Q14E</b>	<b>2014E</b>	<b>2015E</b>	<b>2016E</b>	<b>2017E</b>	<b>2018E</b>	<b>2019E</b>	<b>2020E</b>
Gross margin (on sales)	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	85.0%	85.0%	85.0%	85.0%
Research & Development	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	80.0%	14.5%	8.5%	4.0%
General & Administrative	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	127.1%	25.3%	14.5%	8.5%
Sales & Marketing	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	79.9%	43.8%	19.1%	10.4%
Total SG&A	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	206.9%	69.2%	33.6%	18.9%
<b>Operating profit</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>-201.9%</b>	<b>1.3%</b>	<b>42.9%</b>	<b>62.1%</b>
Pretax income	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	-287.0%	-24.5%	43.0%	62.2%
Effective tax rate	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	0.0%	0.0%	0.0%
<b>Net income</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>-287.0%</b>	<b>-24.5%</b>	<b>43.0%</b>	<b>62.2%</b>
<b>YoY % change</b>	<b>2011A</b>	<b>2012A</b>	<b>2013A</b>	<b>1Q14E</b>	<b>2Q14E</b>	<b>3Q14E</b>	<b>4Q14E</b>	<b>2014E</b>	<b>2015E</b>	<b>2016E</b>	<b>2017E</b>	<b>2018E</b>	<b>2019E</b>	<b>2020E</b>
<b>Total risk-adjusted revenue</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>235.4%</b>	<b>141.5%</b>	<b>91.5%</b>
Gross Profit	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	235.4%	141.5%	91.5%
Research & Development	NM	-41.7%	25.7%	292.7%	280.5%	183.7%	68.0%	164.8%	5.3%	-20.8%	-64.3%	-39.2%	41.6%	-9.9%
General & Administrative	NM	7.4%	50.7%	119.4%	145.0%	48.3%	-22.7%	41.3%	6.0%	5.8%	18.0%	-33.1%	38.6%	11.9%
Sales & Marketing	NM	NM	NM	NM	NM	NM	NM	NM	5.0%	0.0%	700.8%	84.1%	5.0%	5.0%
Total SG&A	NM	7.4%	50.7%	NM	NM	NM	NM	55.2%	5.9%	5.3%	75.9%	12.1%	17.3%	8.0%
<b>Operating profit</b>	<b>NM</b>	<b>-30.3%</b>	<b>34.6%</b>					<b>120.9%</b>	<b>5.5%</b>	<b>-13.4%</b>	<b>-41.0%</b>	<b>-102.2%</b>	<b>7628.4%</b>	<b>177.1%</b>
Pretax income	NM	-27.1%	-47.4%	154.3%	31.6%	122.5%	39.8%	482.8%	0.5%	-13.7%	-15.5%	-71.4%	-524.3%	177.1%
Tax Expense (Benefit)	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
Net Income (Loss)	NM	-27.1%	-47.4%	154.3%	-2966.7%	122.5%	39.8%	482.8%	0.5%	-13.7%	-15.5%	-71.4%	-524.3%	177.1%
<b>EPS - diluted</b>	<b>NM</b>	<b>498.3%</b>	<b>-92.7%</b>	<b>54.0%</b>	<b>-368.7%</b>	<b>69.1%</b>	<b>39.8%</b>	<b>179.3%</b>	<b>-25.1%</b>	<b>-13.7%</b>	<b>-15.5%</b>	<b>-71.4%</b>	<b>-524.3%</b>	<b>177.1%</b>

Source: STRH Research, company reports.

**Exhibit 3: CNAT Consolidated Balance Sheet**

(\$ in thousands except per share data)	2011A	2012A	1Q13A	2Q13A	3Q13A	4Q13A	2013A	2014E	2015E	2016E	2017E	2018E	2019E	2020E
<b>Assets</b>														
Cash and cash equivalents	\$3,073	\$4,036	\$4,840	\$3,281	\$35,135	\$28,140	\$28,140	\$30,131	\$53,452	\$30,497	\$9,670	\$9,966	\$22,001	\$76,391
Short-term investments	13,685	3,989	255	255	24,457	28,213	28,213	300	300	300	300	300	300	300
Accounts and trade receivables	0	0	0	0	0	0	0	0	0	0	3,079	6,886	16,630	31,852
Inventories	0	0	0	0	0	0	0	0	50	100	462	1,377	3,326	5,096
Prepaid and other current assets	165	76	83	158	614	546	546	546	546	546	137	459	1,109	2,123
<b>Total current assets</b>	<b>\$16,923</b>	<b>\$8,102</b>	<b>\$5,179</b>	<b>\$3,694</b>	<b>\$60,206</b>	<b>\$56,898</b>	<b>\$56,898</b>	<b>\$30,976</b>	<b>\$54,348</b>	<b>\$31,443</b>	<b>\$13,648</b>	<b>\$18,988</b>	<b>\$43,365</b>	<b>\$115,762</b>
Property and equipment, net	\$21	\$30	\$27	\$24	\$22	\$23	\$23	\$23	\$23	\$24	\$33	\$35	\$90	\$197
Deferred tax assets	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Other noncurrent assets	14	14	40	1,539	14	14	14	14	14	14	7	23	55	106
<b>Total noncurrent assets</b>	<b>\$36</b>	<b>\$44</b>	<b>\$67</b>	<b>\$1,564</b>	<b>\$36</b>	<b>\$37</b>	<b>\$37</b>	<b>\$38</b>	<b>\$38</b>	<b>\$38</b>	<b>\$40</b>	<b>\$58</b>	<b>\$146</b>	<b>\$303</b>
<b>Total assets</b>	<b>\$16,959</b>	<b>\$8,146</b>	<b>\$5,246</b>	<b>\$5,257</b>	<b>\$60,242</b>	<b>\$56,936</b>	<b>\$56,936</b>	<b>\$31,014</b>	<b>\$54,385</b>	<b>\$31,481</b>	<b>\$13,688</b>	<b>\$19,046</b>	<b>\$43,511</b>	<b>\$116,065</b>
<b>Liabilities and Stockholders' Equity</b>														
<b>Current Liabilities:</b>														
Short-term debt	\$0	0	0	975	0	0	0	0	0	0	0	0	1,000	0
Accounts payable & accrued expenses	\$1,179	1,087	390	1,354	775	2,491	2,491	2,491	2,491	2,491	770	2,410	3,326	3,185
Accrued compensation	542	326	351	370	381	326	326	326	326	326	3,421	11,476	8,315	10,617
<b>Total current liabilities</b>	<b>\$1,721</b>	<b>\$1,413</b>	<b>\$741</b>	<b>\$2,699</b>	<b>\$1,156</b>	<b>\$2,817</b>	<b>\$2,817</b>	<b>\$2,817</b>	<b>\$2,817</b>	<b>\$2,817</b>	<b>\$4,191</b>	<b>\$13,887</b>	<b>\$12,641</b>	<b>\$13,803</b>
Preferred stock warrant liability	69	160	708	4,104	0	0	0	0	0	0	0	0	0	0
Note payable	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	0	0
Other	0	0	0	0	0	0	0	0	0	0	0	0	0	0
<b>Total liabilities</b>	<b>\$2,790</b>	<b>\$2,573</b>	<b>\$2,448</b>	<b>\$7,803</b>	<b>\$2,156</b>	<b>\$3,817</b>	<b>\$3,817</b>	<b>\$3,817</b>	<b>\$3,817</b>	<b>\$3,817</b>	<b>\$5,191</b>	<b>\$14,887</b>	<b>\$12,641</b>	<b>\$13,803</b>
<b>Stockholders' Equity:</b>														
Common Stock (Series A)	\$32,209	\$32,209	\$32,209	\$24,709	\$0	\$91,367	\$91,367	\$91,541	\$141,733	\$141,944	\$142,286	\$143,434	\$146,205	\$151,514
Common Stock (Series B)	31,700	31,700	31,700	26,681	0	31,703	31,703	31,703	31,703	31,703	31,703	31,703	31,703	31,703
Common Stock	1	1	0	0	2	1	1	1	1	1	1	1	1	1
Additional paid-in capital	323	470	0	12,050	127,378	470	470	470	470	470	470	470	470	470
Accumulated other comprehensive income (deficit)	(4)	1	0	0	12	1	1	1	1	1	1	1	1	1
(Deficit)/Earnings accumulated	(50,058)	(58,808)	(61,111)	(65,984)	(69,305)	(59,406)	(59,406)	(57,589)	(84,410)	(107,525)	(127,034)	(132,519)	(108,580)	(42,496)
<b>Total stockholders' equity (deficit)</b>	<b>\$14,169</b>	<b>\$5,573</b>	<b>\$2,798</b>	<b>(\$2,545)</b>	<b>\$58,086</b>	<b>\$64,135</b>	<b>\$64,135</b>	<b>\$66,127</b>	<b>\$89,498</b>	<b>\$66,593</b>	<b>\$47,426</b>	<b>\$43,089</b>	<b>\$69,799</b>	<b>\$141,192</b>
<b>Total liabilities and stockholders' equity (deficit)</b>	<b>\$16,959</b>	<b>\$8,146</b>	<b>\$5,246</b>	<b>\$5,257</b>	<b>\$60,242</b>	<b>\$67,952</b>	<b>\$67,952</b>	<b>\$69,944</b>	<b>\$93,315</b>	<b>\$70,410</b>	<b>\$52,617</b>	<b>\$57,976</b>	<b>\$82,440</b>	<b>\$154,995</b>

Source: STRH Research, company reports.

**Exhibit 4: CNAT Statement of Cash Flows 2011-2020E**

(\$ in thousands except per share data)	2011A	2012A	1Q13A	2Q13A	3Q13A	4Q13E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
<b>Cash flows from operating activities:</b>														
Net Income (loss)	(\$11,997)	(\$8,749)	(\$2,297)	(\$4,873)	(\$3,321)	(\$5,126)	(\$4,600)	(\$26,810)	(\$26,948)	(\$23,243)	(\$19,637)	(\$5,612)	\$23,811	\$65,988
Depreciation and amortization	294	181	12	3	2	2	19	46	46	46	46	59	91	111
Stock-based compensation expense	160	144	21	4	75	57	158	174	192	211	342	1,148	2,772	5,309
Loss (gain) on changes in fair value of warrant liability						(11,177)	(11,177)	0	0	0	0	0	0	0
Deferred income taxes						0	0	0	0	0	0	0	0	0
Change in lease liability						0	0	0	0	0	0	0	0	0
Other	(455)	92	547	2,895	219	(3,569)	92	92	92	92	92	92	92	92
Changes in assets and liabilities:						0	0	0	0	0	0	0	0	0
Short term investments						0	0	0	0	0	0	0	0	0
Accounts and trade receivables						0	0	0	0	0	(3,079)	(3,807)	(9,744)	(15,222)
Inventories						0	0	0	(50)	(50)	(362)	(915)	(1,949)	(1,770)
Prepaid expenses & other current assets	(68)	89	(7)	(75)	(456)	68	(469)	0	0	0	409	(322)	(650)	(1,015)
Deferred tax assets						0	0	0	0	0	0	0	0	0
Other non-current assets	102	0	(26)	26	0	0	0	0	0	0	8	(16)	(32)	(51)
Accounts payable and other current liabilities	176	(92)	(697)	71	305	1,726	1,404	0	0	0	1,374	9,695	(2,246)	2,162
Other long-term liabilities	(308)	(229)	15	(15)	18	(18)	0	0	0	0	0	0	0	0
<b>Net cash generated (used) in operating activities</b>	<b>(\$12,096)</b>	<b>(\$8,564)</b>	<b>(\$2,431)</b>	<b>(\$1,965)</b>	<b>(\$3,157)</b>	<b>(\$18,036)</b>	<b>(\$14,573)</b>	<b>(\$26,498)</b>	<b>(\$26,668)</b>	<b>(\$22,944)</b>	<b>(\$20,807)</b>	<b>\$321</b>	<b>\$12,145</b>	<b>\$55,602</b>
<b>Cash flows from investing activities:</b>														
Maturities of investments	\$18,936	\$19,838	\$3,725	\$0	\$0	\$176	\$3,901	\$28,500	\$0	\$0	\$0	\$0	\$0	\$0
Purchases of investments	(32,908)	(10,309)	0	0	(24,224)	0	(24,224)	0	0	0	0	0	0	0
Capital Expenditures	(16)	(18)	0	0	0	0	0	(11)	(11)	(11)	(20)	(25)	(111)	(212)
<b>Net cash generated (used) in investing activities</b>	<b>(\$13,989)</b>	<b>\$9,511</b>	<b>\$3,725</b>	<b>\$0</b>	<b>(\$24,224)</b>	<b>\$176</b>	<b>(\$20,323)</b>	<b>\$28,489</b>	<b>(\$11)</b>	<b>(\$11)</b>	<b>(\$20)</b>	<b>(\$25)</b>	<b>(\$111)</b>	<b>(\$212)</b>
<b>Cash flows from financing activities:</b>														
Short-term borrowings	\$0	\$0	\$0	\$1,001	\$0		\$0	\$0	\$0	\$0	\$0	\$0	\$1,000	(\$1,000)
Proceeds from issuance of common stock	0	16	11	3	61,408	(2,421)	59,000	0	50,000	0	0	0	0	0
Proceeds from exercise of stock options / warrants (net of costs)	26,424	0	0	0	0	(0)	0	0	0	0	0	0	0	0
Share repurchase	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Proceeds from issuance of debt	0	0	0	0	0	0	0	0	0	0	0	0	(1,000)	0
Repayment of debt	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Repayment of finance leases	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Dividends	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Other	0	0	(500)	(599)	(2,172)	0	0	0	0	0	0	0	0	0
<b>Net cash flow provided (used) by financing activities</b>	<b>\$26,424</b>	<b>\$16</b>	<b>(\$489)</b>	<b>\$405</b>	<b>\$59,236</b>	<b>(\$2,422)</b>	<b>\$59,000</b>	<b>\$0</b>	<b>\$50,000</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>(\$1,000)</b>
Impact from Foreign Exchange	0	0	0	0	0	0	0	0	0	0	0	0	0	0
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>\$340</b>	<b>\$963</b>	<b>\$804</b>	<b>(\$1,560)</b>	<b>\$31,855</b>	<b>(\$20,282)</b>	<b>\$24,104</b>	<b>\$1,991</b>	<b>\$23,321</b>	<b>(\$22,955)</b>	<b>(\$20,827)</b>	<b>\$296</b>	<b>\$12,034</b>	<b>\$54,390</b>
Cash and cash equivalents, beginning of period	\$2,733	\$3,073	\$4,036	\$4,840	\$3,281	\$35,135	\$4,036	\$28,140	\$30,131	\$53,452	\$30,497	\$9,670	\$9,966	\$22,001
<b>Cash and cash equivalents, end of period</b>	<b>\$3,073</b>	<b>\$4,036</b>	<b>\$4,840</b>	<b>\$3,281</b>	<b>\$35,135</b>	<b>\$28,140</b>	<b>\$28,140</b>	<b>\$30,131</b>	<b>\$53,452</b>	<b>\$30,497</b>	<b>\$9,670</b>	<b>\$9,966</b>	<b>\$22,001</b>	<b>\$76,391</b>

Source: STRH Research, company reports.

### Company Description

Conatus Pharmaceuticals, Inc. is a clinical-stage biotechnology company focused on developing drugs to treat liver diseases. The company's lead compound, emricasan, is a first-in-class, orally active pan-caspase inhibitor designed to reduce inflammation and cell death, thereby disrupting the pathway leading to liver fibrosis and cirrhosis. The company is currently focused on developing emricasan for the treatment of patients with acute-on-chronic liver failure (ACLF), chronic liver failure (CLF), and HCV-related post-orthotopic liver transplants (HCV-POLT). In 2005, Pfizer acquired emricasan from Idun Pharmaceuticals (Conatus's predecessor company). In 2010, Conatus re-acquired emricasan from Pfizer and is continuing to develop it through the clinical stage process.

### Investment Thesis

We rate CNAT a Buy with a \$17 price target given its attractive risk-reward based on our conservative revenue and DCF assumptions. Our valuation analysis applies a significant discount rate appropriate for early clinical-stage companies to our heavily risk adjusted revenue and cash flow estimates, which suggests that CNAT's shares are undervalued. We view CNAT as a pioneer in the development of its 1st-in-class oral caspase protease inhibitor, emricasan, for treating liver disease & fibrosis. We view the clinical development and regulatory risks as high due to the challenging patient population. CNAT has attempted to minimize this risk through the favorable histological data that it has presented and pre-clinical studies that have had some conflicting results in key biomarkers for cell death and inflammation. On the regulatory front, there is uncertainty on the use of surrogate endpoints in liver disease clinical trials and their potential clinical utility in a patient population that frequently has other co-morbidities and high mortality rates. In Europe, regulators have expressed greater acceptance of surrogate endpoints in orphan liver trials, while in the US Conatus remains in ongoing discussions with the FDA regarding clinical trial design for emricasan. Our model assumes initial EU launches in chronic liver failure (CLF) & acute-on-chronic liver failure (ACLF) in 2017E, & Hepatitis C virus-related post-orthotopic liver transplant (HCV-POLT) in 2018E. In the US, we assume a CLF launch in 2018E, ACLF in 2019E & HCV-POLT in 2020E. However, given that lack of a clear pathway to US approval, Conatus could potentially be required to conduct additional trials which would not only result in longer timelines than we have modeled but also greater capital requirements. We view the commercial risk as low and offering a high degree of operating leverage since only 16/12 US/EU sales representatives would be needed to cover >90% of the liver transplant centers. In addition, the three potential orphan disease populations targeted have a high unmet medical need and represent a large market opportunity through the US/EU exclusivity periods of 2028/2027 withstanding any patent challenges and excluding any extensions. If Conatus is able to navigate the clinical and regulatory risks for emricasan, our 15 % risk adjustment to our \$430M revenue assumption in 2028E could prove to be overly conservative. Consequently, any upward revision to our sales forecast would have material upside to Conatus's earnings power as well as its intrinsic value.

### Valuation and Risks

#### Valuation

Conatus is a clinical stage company unlikely to achieve either revenues or profitability until the latter part of the decade, so we primarily value the company using a discounted cash flow (DCF) analysis. Also, the paucity of 2018+ consensus revenue and profitability estimates for most clinical stage and orphan disease companies makes valuing CNAT shares difficult; hence we do not include a peer group comparison in our valuation analysis. In our DCF we apply an estimated WACC of 16.7% and terminal growth rate of 1.0% to Conatus's projected free cash flows from the present through its 2028 exclusivity period. The present value of Conatus's 2013E-2028E cash flows are approximately \$140 million and the present value of its estimated terminal value is \$105 million. Adjusted for its average 2012A/2013E net cash position, our discounted cash flow valuation analysis of CNAT shares suggests an intrinsic value of approximately \$17 per share. We have also tested our DCF assumptions below by varying our estimated WACC and terminal growth rates in 50 basis points (bps) increments. Each 50 bps deviation from our WACC changes the intrinsic value by approximately 8%, whereas each 50 bps increment in the assumed terminal growth rate changes the intrinsic value by approximately 2%.

We would note that a significant portion of our estimate is derived from: 1) projected cash flows for 2018E and beyond which is the earliest timeframe that we forecast Conatus to become cash flow positive, and 2) the estimated present value of terminal value accounts for a large portion of our intrinsic value. Our model also assumes that Conatus will utilize its existing \$105M and anticipated

net operating losses (NOLs) to offset future tax expenses. Additionally, the projected cash flows in our model could differ materially from our estimate should Conatus fail to garner initial EU and US approval or other subsequent indications for emricasan.

**Risks**

Downside risks to our price target (PT) include: 1) regulatory risk since no drugs are approved in the liver diseases Conatus is targeting (acute-on-chronic liver failure (ACLF), chronic liver failure (CLF), and HCV-related post-orthotopic liver transplant (HCV-POLT), and regulators could require trial designs that increase the risk of securing approval (especially in the US); 2) clinical development risk since the endpoints in planned clinical trials have not demonstrated benefits in these populations; 3) uncertainty over the acceptability and predictive power of blood markers for inflammation and cell death used in future clinical trials. This risk is heightened by conflicting preclinical data that showed conflicting results in liver enzyme reduction, which creates risk for future clinical studies of emricasan; 4) dilution risk given future capital requirements to advance emricasan through the clinical, regulatory and commercial phases of the products life cycle. Upside risks to our PT includes overly conservative risk adjustments to the probability of clinical trial success for emricasan. If emricasan successfully advances through the clinical, regulatory and commercial stages, our estimates could prove conservative and provide upside to our PT.

**Analyst Certification**

I, John T. Boris, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

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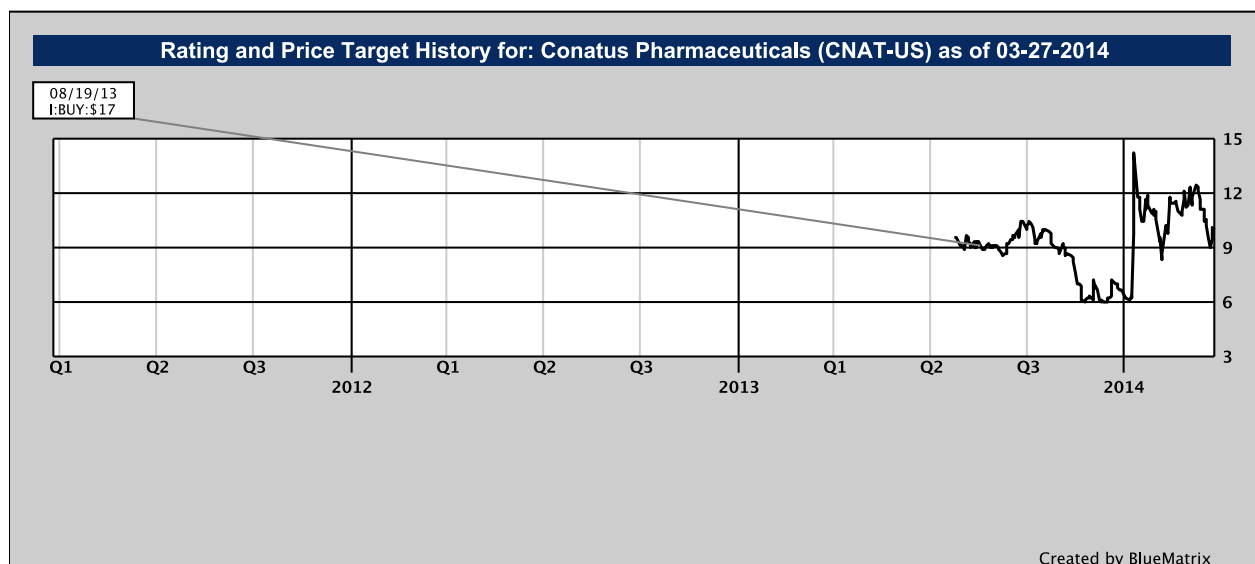
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Legend for Rating and Price Target History Charts:

D = drop coverage

I = initiate coverage

T = transfer coverage

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