

Conatus Pharmaceuticals Inc. (CNAT)

Overweight

Reaffirmed ACLF Progress, Near-Term AASLD Risk-Reducing Data, Assuming Coverage

CONCLUSION

We are assuming coverage of Conatus Therapeutics and recently hosted management for meetings with investors. We are encouraged regarding the potential for the company's novel lead drug-candidate, covalent-binding caspase inhibitor emricasan, in multiple important orphan liver diseases. With pro-forma cash of ~\$60MM, the company remains funded through the most near-term major clinical milestone: data from the acute-on-chronic liver failure (ACLF) Phase IIb, that we expect in 1H14. With risk-reducing data on biomarkers from normal volunteers to be presented in a few weeks at AASLD, we anticipate investors to have increasing conviction in this novel and broadly applicable platform for fibrosis-driven liver diseases (CLF, HBV, etc) over the next 12-months and we are assuming coverage at Overweight with a \$16 price target. We have made modest updates to our model for 2Q reported results (Exhibit 1 and appended model).

Broad potential in liver indications. Recall that Conatus retains world-wide rights to emricasan following the company's acquisition of the program from Pfizer in late 2010. Conatus expects it can commercialize emricasan with a small North American plus European sales force of ~40 reps for the lead indications: ACLF, CLF (chronic liver failure), and HCV-POLT. Although we continue to model an equity financing in 2015, with positive Phase IIb data in ACLF that will read on changes in biomarkers associated with apoptosis and inflammation, and thus the potential for disease modification, we anticipate there to be increasing interest in the platform by strategic partners. In terms of definitive clinical benefit, which we expect requires an improvement in the proportion of patients that progress (require transplant, are ineligible for transplant, or demonstrate other organ failure) from ~45% in 28 days to ~30%, we don't "require" this to be shown in the short dosing duration (28 days), acutely ill and highly variable patient population being enrolled in the ongoing Phase IIb trial. However, we do believe that positive biomarker data from this study will inform dosing for a single-study Phase III program which could be rapidly enrolled beginning in late 2014. Finally, we believe a partnership for Japan, or other Asian country may be a likely outcome from this strategic interest, as we note that liver diseases are a relatively large problem in terms of incidence in Asia when compared to the US and EU.

RISKS TO ACHIEVEMENT OF PRICE TARGET

Principal risks to our price target include: 1) emergence of a safety signal or lack of efficacy; 2) new HCV anti-virals could reduce size of HCV-POLT market opportunity beyond our expectations 3) delay in emricasan to reach the market and 4) inability to raise capital.

COMPANY DESCRIPTION

Conatus focuses on treatments for liver disease.

PRICE: US\$9.37

TARGET: US\$16.00

DCF of projected 2015-2028 free cash flows, 15% discount rate

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Changes	Previous	Current
Rating	—	Overweight
Price Tgt	—	US\$16.00
FY13E Rev (mil)	—	US\$0.0
FY14E Rev (mil)	—	US\$0.0
FY13E EPS	US\$(0.75)	US\$(0.46)
FY14E EPS	US\$(1.55)	US\$(1.63)
52-Week High / Low	US\$11.24 / US\$8.26	
Shares Out (mil)	16.5	
Market Cap. (mil)	US\$154.6	
Book Value/Share	US\$0.34	
Net Cash Per Share	US\$3.80	
Debt to Total Capital	1%	
Yield	0.00%	
Fiscal Year End	Dec	

Price Performance - 1 Year



Source: Bloomberg

YEAR	REVENUE (US\$ m)						EARNINGS PER SHARE (US\$)					
	Mar	Jun	Sep	Dec	FY	FY	Mar	Jun	Sep	Dec	FY	FY P/E
2012A	—	—	—	—	0.0	NA	—	—	—	—	(0.91)	NM
2013E	0.0A	0.0A	0.0	0.0	0.0	NA	(1.10)A	0.16A	(0.15)	(0.22)	(0.46)	NM
2014E	0.0	0.0	0.0	0.0	0.0	NA	(0.27)	(0.35)	(0.44)	(0.57)	(1.63)	NM

Reflects Diluted Non-GAAP EPS

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Exhibit 1

DCF VALUATION

Conatus Pharmaceuticals Discounted Cash Flow Valuation						Piper Jaffray Biotechnology Research											
(\$ million, except per share amounts)																	
	0	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	
	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	
Net FCFF	(9,723.8)	(27,358.1)	(29,719.8)	(46,434.0)	(51,153.0)	(33,114.0)	(4,455.3)	33,386.5	80,323.8	125,073.4	158,274.1	192,053.7	233,442.7	251,100.7	265,612.5	275,333.5	
Growth		181%	9%	56%	10%	-35%	-87%	-849%	141%	56%	27%	21%	22%	8%	6%	4%	
PV of Net FCFF	-9,723.8	-27,358.1	-25,843.3	-35,110.8	-33,633.9	-18,933.0	-2,215.1	14,433.9	30,196.7	40,886.7	44,991.4	47,472.7	50,176.9	46,932.5	43,169.4	38,912.5	

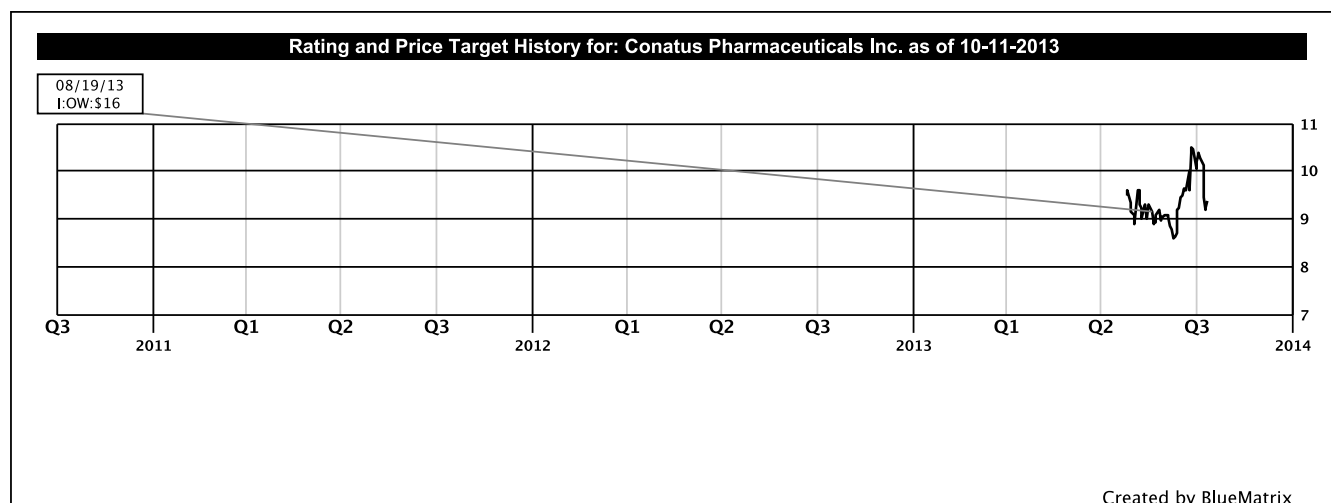
Discounted Cash Flow (DCF) and Equity Valuation (\$mn, except per share amount):

Assumed Discount Rate (%)	15.0%
Discounted Net Cash Flow (2014-28)	\$214,079
Terminal Growth Rate (%)	No TV
Implied Terminal Year FCF Multiple	0.0x
Present Value of Terminal Value	\$0
Terminal Value as % of total	0.0%
Enterprise Value	\$214,079
Add: Net Cash	57,941
Equity Value	\$272,020
Shares Outstanding 2013E (million)	16,573.9
Equity Value per Share	\$16

Source: Piper Jaffray, company reports

Conatus Pharmaceuticals Earnings Model	2012A	1Q 13A	2Q 13A	3Q 13E	4Q 13E	2013E	1Q 14E	2Q 14E	3Q 14E	4Q 14E	2014E	2015E	2016E	2017E	2018E
(\$ in 000s, except per share amounts)															
US Emricasan Sales	0	0	0	0	0	0	0	0	0	0	0	0	0	13,566	47,192
Ex-US Emricasan Sales	0	0	0	0	0	0	0	0	0	0	0	0	0	4,607	16,643
Total Product Sales	0	0	0	0	0	0	0	0	0	0	0	0	0	18,174	63,835
Other Revenue	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Total Revenues	0	0	0	0	0	0	0	0	0	0	0	0	0	18,174	63,835
Costs & Expenses:															
Cost of Goods Sold	0	0	0	0	0	0	0	0	0	0	0	0	0	3,907	13,405
R&D	5,528	968	1,117	1,676	2,932	6,693	3,460	4,325	5,623	7,591	20,999	24,149	28,979	39,121	50,858
SG&A	3,086	749	670	838	1,048	3,305	1,309	1,571	1,854	2,132	6,867	10,301	19,572	27,400	32,880
Total Operating Expenses	8,615	1,717	1,788	2,514	3,980	9,998	4,770	5,897	7,477	9,723	27,866	34,450	48,550	70,429	97,143
Operating Income	(8,614.6)	(1,717)	(1,788)	(2,514)	(3,980)	(9,998)	(4,770)	(5,897)	(7,477)	(9,723)	(27,866)	(34,450)	(48,550)	(52,255)	(33,308)
Interest Income	26	0	0	16	313	330	298	24	3	(28)	298	(273)	1,930	1,070	96
Interest Expense	(70)	(18)	(196)	0	0	(214)	0	0	0	0	0	0	0	0	0
Other income (expense), net	(90)	(563)	(2,890)	0	0	(3,452)	0	0	0	0	0	0	0	0	0
Pretax Income (Loss)	(8,749)	(2,297)	(4,873)	(2,497)	(3,667)	(13,334)	(4,471)	(5,872)	(7,474)	(9,751)	(27,568)	(34,723)	(46,620)	(51,185)	(33,212)
Provision for (benefit from) income taxes	0	0	0	0	0	0	0	0	0	0	0	0	0	0	(1,661)
Tax Rate	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0.0%	0.0%	0.0%	5.0%
Other	92	547	5,097	0	0	5,644	0	0	0	0	0	0	0	0	0
Net Income (Loss) GAAP	(8,658)	(1,750)	224	(2,497)	(3,667)	(7,690)	(4,471)	(5,872)	(7,474)	(9,751)	(27,568)	(34,723)	(46,620)	(51,185)	(31,552)
Stock option expense, tax adjusted	144	21	0	25	25	71	21	25	25	25	96	99	101	104	109
Other	90	563	0	0	0	3,452	0	0	0	0	0	0	0	0	0
Net Income (Loss) Non-GAAP	(8,423)	(1,165)	224	(2,472)	(3,642)	(4,166)	(4,450)	(5,847)	(7,449)	(9,726)	(27,472)	(34,624)	(46,519)	(51,081)	(31,443)
Diluted Earnings Per Share Non-GAAP	(\$0.91)	(\$1.10)	\$0.16	(\$0.15)	(\$0.22)	(\$0.46)	(\$0.27)	(\$0.35)	(\$0.44)	(\$0.57)	(\$1.63)	(\$1.27)	(\$1.66)	(\$1.78)	(\$1.07)
Earnings Per Share, Diluted Fully Taxed						nm					nm	nm	nm	nm	nm
Basic Earnings Per Share Non-GAAP	(\$0.91)	(\$1.10)	\$0.20	(\$0.15)	(\$0.22)	(\$0.47)	(\$0.27)	(\$0.35)	(\$0.44)	(\$0.57)	(\$1.63)	(\$1.27)	(\$1.68)	(\$1.82)	(\$1.10)
Diluted Earnings Per Share GAAP	(\$0.94)	(\$1.29)	\$0.16	(\$0.15)	(\$0.22)	(\$0.86)	(\$0.27)	(\$0.35)	(\$0.44)	(\$0.57)	(\$1.64)	(\$1.27)	(\$1.67)	(\$1.78)	(\$1.08)
Basic Earnings Per Share GAAP	(\$0.94)	(\$1.65)	\$0.20	(\$0.15)	(\$0.22)	(\$0.87)	(\$0.27)	(\$0.35)	(\$0.44)	(\$0.57)	(\$1.64)	(\$1.28)	(\$1.69)	(\$1.82)	(\$1.11)
Diluted Shares Outstanding (000s)	9,255	1,361	1,439	16,475	16,574	8,962	16,673	16,772	16,873	16,973	16,823	27,313	27,996	28,696	29,270
Basic Shares Outstanding (000s)	9,255	1,061	1,139	16,475	16,574	8,812	16,673	16,772	16,873	16,973	16,823	27,228	27,636	28,051	28,472

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UW: Underweight
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Distribution of Ratings/IB Services Piper Jaffray				
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			Count	Percent
BUY [OW]	334	56.80	67	20.06
HOLD [N]	228	38.78	13	5.70
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