

Aratana Therapeutics, Inc.

Third-Quarter Results, Take Two

- After Thursday's earnings call, we believe Aratana remains in an enviable position within the veterinary space after an active quarter, which included the acquisition of Vet Therapeutics. We continue to view the acquisition as transformational for the company as it added internal development capabilities in biologic therapies and a pipeline of potential products in addition to the lead compounds targeting CD20 for B-cell lymphomas and CD52 for T-cell lymphomas. While Vet Therapeutics will expedite Aratana's transition to a commercial-stage company, we expect only modest revenues in 2014 from initial sales of CD20 and CD52, given both will have only limited distribution under their conditional licenses. We expect both products to gain full license status sometime in 2015 most likely. With the impressive progress and a growing pipeline, we reiterate our Outperform rating on Aratana despite the stock's recent strength.
- AT-001 in Cats Going Chronic, Dog Data a Near-Term Catalyst.** Management has made an adjustment to its strategy for AT-001 in cats, now taking a lower dose into the chronic pain setting, which could alleviate some of the concerns the company had with liver function results at the higher dose. For the chronic pain setting, the company believes the efficacy should continue to hold given what it observed in the acute setting; however, the lack of concomitant anesthesia in the chronic pain setting should avoid the liver function anomalies observed in the acute setting. Management will update the Street with its AT-001 Cat development strategy sometime in early 2014. As there are no therapies approved for the treatment of chronic pain in cats, we believe even if some liver issues persist at the lower dose, AT-001 in cats remains a viable candidate and attractive asset. We continue to anticipate the dose-ranging field study in dogs by the end of this month, which we believe will be a significant catalyst for the company. While a positive trial would be viewed favorably and could serve as a pivotal study, given the attractive dynamics of veterinary therapeutic development, Aratana would still be able to run an additional pivotal study before launching the therapy in 2016 if needed. Manufacturing in the veterinary space is often a gating factor in development and launch of innovative therapies.

Aratana is a specialty biopharmaceutical company focused solely on the companion-animal market. The company was founded in Kansas City, Kansas, in 2010 to pursue in-licensing, development, and commercialization of novel therapeutics for cats and dogs. The company has three molecules focused on osteoarthritic pain, lack of appetite, and post-surgical pain in both dogs and cats, which, if effective, could reach the market by 2016.

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November 14, 2013

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

Symbol: PETX (NASDAQ)
Price: \$20.62 (52-Wk.: \$7-\$29)
Market Value (mil.): \$459
Fiscal Year End: December
Long-Term EPS Growth Rate:
Dividend/Yield: None

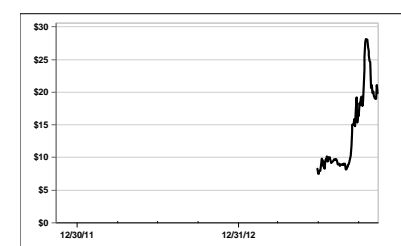
	2012A	2013E	2014E
Estimates			
EPS FY	\$-0.91	\$-0.95	\$-1.29
CY		\$-0.95	\$-1.29

Valuation			
FY P/E	NM	NM	NM
CY P/E		NM	NM

Trading Data (FactSet)	
Shares Outstanding (mil.)	1
Float (mil.)	3
Average Daily Volume	73,031

Financial Data (FactSet)	
Long-Term Debt/Total Capital (MRQ)	0.0
Book Value Per Share (MRQ)	-29.1
Enterprise Value (mil.)	45.4
EBITDA (TTM)	0.0
Enterprise Value/EBITDA (TTM)	0.0x
Return on Equity (TTM)	-40.6

Two-Year Price Performance Chart



Sources: FactSet, William Blair & Company estimates

- **Other Pipeline Compounds Continue to Progress.** AT-002 in cats will begin a three-week trial in the near term as the company has selected a final formulation, although some additional proof-of-concept work remains. Management expects these results during the first half of 2014. The AT-002 dog product will enter a pivotal study by year end, with a potential approval and launch by 2016 still on track. The AT-003 dog program continues in a dose-ranging study, with management likely to hold additional discussions with the agency by year end. The cat program for 003 has recently entered into a dose-ranging study in lab animals. Regarding the biologics programs, the initial data for the company's CD52 targeting program in T-cell lymphoma was filed with the agency and a conditional license should be granted during 2014, with a full license expected in 2015. We have included all updates for the company's pipeline in exhibit 1, which tracks previous language used for each program as well as the program's most current status following the third-quarter conference call.
- **Model Adjustments.** We have made some slight adjustments to our estimates, which we have detailed in exhibit 2. Aratana ended the quarter with cash, cash equivalents, and marketable securities of \$52.3 million and guidance suggests the previous expectation to end the year with \$45 million-\$50 million in cash remains unchanged. Guidance also confirmed that the current cash balance should last through the end of 2015. While we view Aratana as higher risk than other vet industry peers, we believe the \$423 million enterprise valuation (\$429 million market cap) and unique business model offer a compelling opportunity for small-cap investors.
- **Valuation.** Aratana is trading at \$429 million in market capitalization and an enterprise value of \$423 million. This compares with human therapeutics-oriented specialty pharmaceutical peers with similar clinical progress with a market cap in the \$150 million to \$500 million range. We believe fair value per share with the current portfolio is in the low-20s, with upside driven by additional compound in-licensing and acquisitions.
- **Risks.** We view the following as key risks for Aratana in the next three to five years: 1) the several molecules under clinical development might not be successful and might thus fail to reach the market; 2) larger competitors with greater financial resources, like Zoetis (ZTS \$31.68), might start pursuing a similar in-licensing strategy, causing deal terms to deteriorate; and 3) the company will probably need to raise additional capital within the next two to three years given that no product revenues are expected before 2016.

**Exhibit 1
Program Status for Each Program**

AT-001			
<u>Dog</u>	<u>Cat</u>		
September	November	September	November
- Pivotal Field Study initiated in 2012, Topline results expected in mid-2014	- Topline results from dose-ranging study in field animals expected in November 2013	- No update; previously expected to pursue acute pain indication	- Pursuing chronic pain indication
- Topline results from dose-ranging study expected in November 2013	- 2016 Launch		
- 2016 Launch			
AT-002			
<u>Dog</u>	<u>Cat</u>		
September	November	September	November
- Pivotal Field Study expected to be initiated in late 2013, Topline results expected in early 2015	- Agreement on Pivotal Field Study design reached; expected to be initiated in late 2013	- Pivotal Field Study expected to be initiated in late 2014, Topline results expected in late 2015	- 3-week treatment term and final formulation selected; further proof of concept work to be done; results expected in first half 2014
- 2016 Launch	- 2016 Launch	- 2017 Launch	
AT-003			
<u>Dog</u>	<u>Cat</u>		
September	November	September	November
- Pivotal Field Study expected to be initiated in mid-2014, Top line results expected in mid-2015	- Continued dose-ranging study in laboratory animals; expect further discussions in late 2013	- Pivotal Field Study expected to be initiated in mid-2014, Top line results expected in mid-2015	- Initiated dose-ranging study in laboratory animals
- 2016 Launch	- 2016 Launch	- 2016 Launch	
B-cell Lymphoma - dog only			
October	November		
- Received conditional license from USDA	- Completed submission for full license; expected within next 12-18 months		
T-cell Lymphoma - dog only			
October	November		
- Initial data submitted to USDA; expect conditional license in 2014 and full license in 2015	- Initial data submitted to USDA; expect conditional license in 2014 and full license in 2015		
Option Programs			
October	November		
- Three programs still being evaluated, company will advance at least program but likely not all following a decision in early 2014.	- Three programs still being evaluated, company will advance at least program but likely not all following a decision in early 2014.		

Source: William Blair & Company L.L.C.

Note: Shaded areas suggest updated language

Exhibit 2. Updated Aratana Income Statement (2011 to 2020E)

Income Statement																		
	2,011	2012	Q1A	Q2A	Q3E	Q4E	2013E	Q1E	Q2E	Q3E	Q4E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
Revenues																		
AT-001						-	-	-	-	-	-	-	-	9,174,000	18,104,320	25,105,600	37,128,000	56,867,200
% growth (y/y)																39%	48%	53%
AT-002						-	-	-	-	-	-	-	-	11,051,800	19,294,880	32,417,360	48,584,000	70,468,200
% growth (y/y)																68%	69%	65%
AT-003						-	-	-	-	-	-	-	-	1,970,000	11,000,000	19,800,000	29,800,000	40,186,000
% growth (y/y)																80%	51%	35%
B-Cell Revenue						-	-	210,000	210,000	210,000	210,000	840,000	4,200,000	8,400,000	12,600,000	16,800,000	19,320,000	21,000,000
% growth (y/y)																		
T-Cell Revenue						-	-	-	-	-	-	-	7,200,000	11,250,000	16,200,000	21,600,000	25,200,000	27,900,000
% growth (y/y)																		
Total Net Product Revenues						-	-	210,000	210,000	210,000	210,000	840,000	11,400,000	41,845,800	77,199,200	115,722,960	160,032,000	216,421,400
Royalty Revenue (E.U.)						-	-	-	-	-	-	-	-	1,970,000	7,006,250	13,093,750	19,191,413	25,918,791
Total Net Revenues	-	0.0	0.0	0.0	0.0	0.0	0	210,000	210,000	210,000	210,000	840,000	11,400,000	43,815,800	84,205,450.0	128,816,710.0	179,223,413	242,340,191
% growth (y/y)															92%	53%	39%	35%
Expenses																		
COGS	-	-				0	0	6,720	6,720	6,720	6,720	26,880	1,934,400	7,717,460	15,233,040	23,382,192	33,000,640	45,169,880
R&D expense	2,196,000	8,791,000	2,114,000	2,469,000	3,234,000	3,557,400	11,374,400	3,412,320	3,412,320	3,412,320	3,412,320	13,649,280	16,788,614	20,146,337	23,571,215	27,578,321	31,439,286	37,098,358
% growth (y/y)			20.7%	28.0%	95.1%	3.0%	29%	61.4%	38.2%	5.5%	-4.1%	20%	23%	20%	17%	17%	14%	18%
SG&A expense	1,274,000	2,987,000	1,226,000	1,258,000	1,427,000	1,455,540	5,366,540	3,929,675	3,929,675	3,929,675	3,929,675	15,718,700	23,933,367	29,558,041	36,428,488	46,313,616	57,746,795	70,197,072
In-process R&D	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total Operating Expenses	3,470,000	11,778,000	3,340,000	3,727,000	4,661,000	5,012,940	16,740,940	7,348,715	7,348,715	7,348,715	7,348,715	29,394,859.8	42,656,381.1	57,421,838	75,232,743	97,274,129	122,186,721	152,465,310
Operating (loss)/profit	(3,470,000)	(11,778,000)	(3,340,000)	(3,727,000)	(4,661,000)	(5,012,940)	(16,740,940)	(7,138,715)	(7,138,715)	(7,138,715)	(7,138,715)	(28,554,860)	(31,256,381.1)	(13,606,038)	8,972,707	31,542,581	57,036,691	89,874,881
Interest income	6,000	21,000	3,000	22,000	26,000	32,691	83,691	28,997	26,481	22,684	17,615	95,777	45,210.6	91,740	80,617	124,091	213,707	337,288
Interest expense	-	-	(24,000)	(78,000)	(80,000)	(206,250)	(388,250)	(239,814)	(239,814)	(239,814)	(239,814)	(959,255)	(959,255.0)	(959,255)	(959,255)	(959,255)	(959,255)	(959,255)
Other Income	-	121,000	68,000	343,000	44,000	50,000	505,000	25,000.0	25,000.0	25,000.0	25,000.0	100,000.0	100,000	100,000	100,000	100,000	100,000	100,000
Total Other Income	6,000	142,000	47,000	287,000	(10,000)	(123,559)	200,441	(185,817)	(188,332)	(192,130)	(197,199)	(763,478)	(814,044.4)	(767,515)	(778,638)	(735,163.8)	(645,548)	(521,967)
Net loss and comprehensive loss	(3,464,000)	(11,636,000)	(3,293,000)	(3,440,000)	(4,671,000)	(5,136,499)	(16,540,499)	(7,324,531)	(7,327,047)	(7,330,845)	(7,335,914)	(29,318,338)	(32,070,426)	(14,373,554)	8,194,069	30,807,417	56,391,143	89,352,913
Modifications of Series A convertible pref. stock	(276,000)	-	-	-	-	-	(1,540,499)	-	-	-	-	-	-	-	-	-	-	-
Unaccreted dividends on convertible pref. stock	(902,000)	(2,035,000)	(773,000)	(808,000)	-	-	(1,581,000)	-	-	-	-	-	-	-	-	-	-	-
Net income loss (gain) attributable to common stockholders, basic and diluted	(4,642,000)	(13,671,000)	(4,066,000)	(4,248,000)	(4,671,000)	(5,136,499)	(18,121,499)	(7,324,531)	(7,327,047)	(7,330,845)	(7,335,914)	(29,318,338)	(32,070,426)	(14,373,554)	8,194,068.979	30,807,417	56,391,143	89,352,913
Provision for income taxes	-	-	-	-	-	-	-	-	-	-	-	-	-	-	2,949,865	11,090,670	20,300,612	32,167,049
Effective tax rate	NM	NM	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	36%	36%	36%	36%
Net Income (loss)	(4,642,000)	(13,671,000)	(4,066,000)	(4,248,000)	(4,671,000)	(5,136,499)	(18,121,499)	(\$7,324,531)	(\$7,327,047.4)	(\$7,330,845.2)	(\$7,335,914.0)	(29,318,338)	(\$32,070,426)	(\$14,373,554)	\$5,244,204	\$19,716,747	\$36,090,332	\$57,185,865
EPS	(0.31)	(\$0.91)	(\$0.27)	(\$0.23)	(\$0.22)	(\$0.23)	(\$0.95)	(\$0.32)	(\$0.32)	(\$0.32)	(\$0.32)	(\$1.29)	(\$1.36)	(\$0.57)	\$0.21	\$0.77	\$1.40	\$2.20
Weighted average shares outstanding (basic)	14,972,266	14,972,266	14,972,266	18,805,599	20,806,352	22,665,727	19,312,486	22,720,727	22,775,727	22,830,727	22,885,727	22,803,227	23,510,727	25,210,727	25,410,727	25,610,727	25,810,727	26,010,727
Weighted average shares outstanding (diluted)	14,972,266	14,972,266	14,972,266	19,964,402	20,806,352	22,665,727	19,602,187	22,720,727	22,775,727	22,830,727	22,885,727	22,803,227	23,510,727	25,210,727	25,410,727	25,610,727	25,810,727	26,010,727
MARGIN ANALYSIS:																		
Gross Profit														82%	82%	82%	82%	81%
SG&A														67%	43%	36%	32%	29%
R&D														46%	28%	21%	18%	15%
Operating Income														NA	11%	24%	32%	37%
Tax Rate														0%	36%	36%	36%	36%
Net Income														NA	6%	15%	20%	24%
GROWTH METRICS:																		
Total Revenue															92%	53%	39%	35%
Gross Profit															91%	53%	39%	35%
SG&A			146%	102%	34%	82%	80%	221%	212%	175%	170%	193%	52%	24%	23%	27%	25%	22%
R&D			21%	28%	95%	3%	29%	61%	38%	6%	-4%	20%	23%	20%	17%	17%	14%	18%
Operating Income																252%	81%	58%
Net Income																276%	83%	58%
EPS																273%	82%	57%
Diluted Shares Outstanding		0%	0%	33%	39%	51%	31%	52%	14%	10%	1%	1%	3%	0%	0%	0%	0%	1%

E = William Blair & Company, L.L.C. estimate

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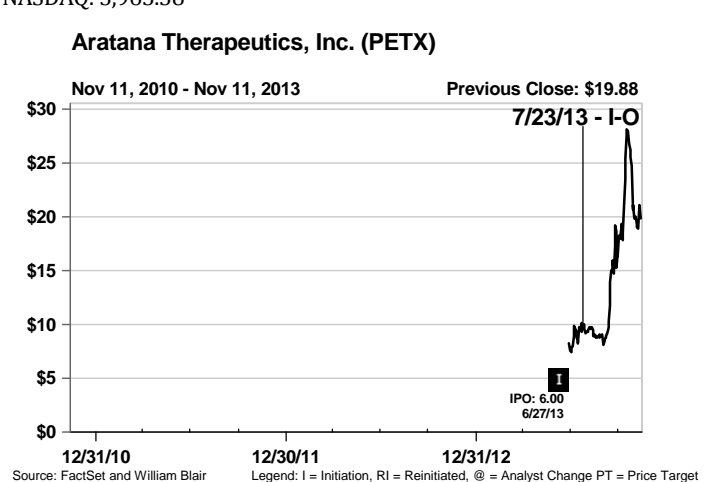
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DOW JONES: 15,821.63

S&P 500: 1,782.00

NASDAQ: 3,965.58



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Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	62	Outperform (Buy)	11
Market Perform (Hold)	34	Market Perform (Hold)	2
Underperform (Sell)	1	Underperform (Sell)	0

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