

# Aratana Therapeutics, Inc.

## Fourth-Quarter Analysis; Product Portfolio on Track and Initial Revenues Achieved

Aratana Therapeutics reported positive net income of \$7.1 million in the fourth quarter due to a one-time \$15.5 million tax benefit related to the Vet Therapeutics acquisition. Excluding the income tax benefit, the normalized result would have been a net loss of \$8.3 million. Relative to our model and consensus, fourth-quarter operating losses were \$3.2 million and \$2.9 million more than expected, respectively, driven by increased costs associated with the Vet Therapeutics deal. Aratana also generated \$123,000 of revenue related to an AT-004 royalty payment from Novartis (NVS \$81.66). There were no significant changes in the clinical status of the company's portfolio, but management provided cash burn guidance for 2014 of \$35 million-\$40 million, which is a few million above our \$32.3 million operating loss target. This may have led to yesterday's selloff in a weak tape; however, given the breadth of pipeline with two pivotal studies reporting out during the year (AT-002 and AT-006 in Europe); further development of Aratana's T-cell lymphoma product, which received conditional approval in late January; and over 10 additional product candidates, the additional R&D spending is understandable. Because we do not expect Aratana to have significant revenues (or earnings) for a few years, we believe investors will focus primarily on the clinical progress of the existing product portfolio over the coming year, along with the associated cash burn from those clinical programs. While we view Aratana as higher risk than other vet industry peers, we believe the \$512 million market cap and unique business model offer a compelling opportunity for small-cap investors.

### Key Points

- **Aratana has sufficient cash to fund operations through 2015.** Aratana ended the fourth quarter with cash, cash equivalents, and marketable securities of \$46 million. Adjusting for the company's Okapi acquisition and recent offering in the first quarter, we estimate the current cash balance at roughly \$90 million. Management noted that it expects the current cash to last through the end of 2015.
- **High R&D guidance for 2014 after pipeline meaningfully expanded over the past several months.** Management anticipates spending between \$35 million and \$40 million in 2014, with roughly \$27 million going toward clinical development and post-licensure studies. Before the release, we estimated total operating expenses would be roughly \$32.2 million, evenly split between SG&A and R&D. We believe the higher-than-anticipated R&D guidance may have contributed to Thursday's 9% correction. Although 2014 spending guidance was modestly higher than consensus, we do not believe this signals a fundamental shift in Aratana's low risk/low cost business model of developing in-licensed compounds. Rather, the company has been aggressive in expanding its portfolio in the last six months. The company now has over 15 product candidates across oncology, pain, inappetence, and virology. We now forecast 2014 R&D expense of \$27.3 million.

*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 osteoarthritis 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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March 14, 2014

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

Symbol: PETX (NASDAQ)  
Price: \$17.60 (52-Wk.: \$7-\$29)  
Market Value (mil.): \$512  
Fiscal Year End: December  
Long-Term EPS Growth Rate:  
Dividend/Yield: None

	2013A	2014E	2015E
<b>Estimates</b>			
EPS Q1	\$-0.27	\$-0.43	NA
Q2	\$-0.19	\$-0.29	NA
Q3	\$-0.22	\$-0.30	NA
Q4	\$0.33	\$-0.30	NA
FY	\$-0.39	\$-1.32	\$-1.61
CY		\$-1.32	\$-1.61
Sales (mil.)	NA	1	8
<b>Valuation</b>			
FY P/E	NM	NM	NM
CY P/E		NM	NM

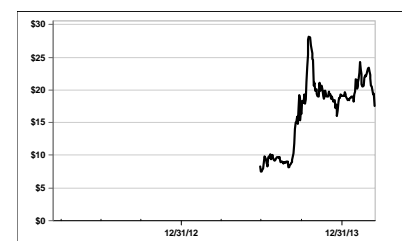
### Trading Data (FactSet)

Shares Outstanding (mil.)	21
Float (mil.)	10
Average Daily Volume	204,249

### Financial Data (FactSet)

Long-Term Debt/Total Capital (MRQ)	0.1
Book Value Per Share (MRQ)	2.1
Enterprise Value (mil.)	338.4
EBITDA (TTM)	0.0
Enterprise Value/EBITDA (TTM)	0.0x
Return on Equity (TTM)	-6.5

### Two-Year Price Performance Chart



Sources: FactSet, William Blair & Company estimates

- **Portfolio is making progress.** There were few changes in timelines for the product portfolio, suggesting progress remains on track. Recently, Aratana announced positive top-line data for its pivotal dose-ranging study of AT-001 (osteoarthritis pain) in dogs. It expects to initiate a pivotal field effectiveness study with a once-daily dose in the second quarter of 2014. We also expect pivotal data from AT-006, an asset brought in through the Okapi acquisition, during 2014. This European based field study may form the basis for an E.U. filing; Aratana has also started the process of initiating development of 006 in the United States. Aratana generated \$123,000 of revenue in the quarter related to royalties from AT-004 for the treatment of B-cell lymphoma. We also expect modest revenue from the company's T-cell product during 2014 as the company continues development under its conditional approval from the USDA. Exhibit 2, on page 4, summarizes Aratana's updated product portfolio and expected launch dates.
- **Valuation.** Following its 9% correction on Thursday (which seemed overdone, in our view), Aratana is trading at \$512 million in market capitalization and an enterprise value of \$438 million (based on post-secondary cash position). 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 mid-\$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 \$29.25; Outperform), 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.
- **Model Adjustments.** Following Thursday's conference call, we are increasing our estimate of 2014 operating expenses to \$37.4 million, up from \$33.3 million previously. Also, the early recognition of revenue associated with the B-cell royalty payment leads us to increase sales in 2014 from \$1.0 million to \$1.5 million. Based on increased operating expenses, we now estimate 2014 net loss of \$36.1 million, compared with a loss of \$32.9 million previously. Exhibit 1, on page 3, details the fourth quarter's variance compared with our model; exhibit 2 updates the company's product portfolio; and exhibit 3, on page 5, contains our updated model.

# Exhibit 1. Fourth Quarter 2013 Earnings Variance Analysis

(\$ in thousands, Fiscal Year ends June)

March 13, 2014	4Q FY13 (Actual)	4Q FY12 (Actual)	Year/Year % Change	4Q FY13 (Estimate)	Year/Year % Change	Act.-Est. Difference
Total Net Revenue	\$123,000	\$0	NA	\$0	NA	\$123,000
Direct Costs	109,000	0	NA	0	NA	\$109,000
Research & Development	3,108,000	3,453,000	-10.0%	3,557,400	3.0%	(\$449,400)
Selling, General & Administrative	5,041,000	801,000	529.3%	1,455,540	81.7%	\$3,585,460
Total operating expenses	8,258,000	4,254,000	94.1%	5,012,940	17.8%	\$3,245,060
Operating income	(8,135,000)	(4,254,000)	91.2%	(5,012,940)	17.8%	(\$3,122,060)
Interest and other income (net)	(202,000)	49,000	-512.2%	(123,559)	-352.2%	(\$78,441)
Earnings before tax	(8,337,000)	(4,205,000)	98.3%	(5,136,499)	22.2%	(\$3,200,501)
Income taxes	(15,455,000)	0	NM	0	NM	#####
<b>Net income (excl. extraord, incl. options)</b>	<b>7,118,000</b>	<b>(4,205,000)</b>	<b>-269.3%</b>	<b>(5,136,499)</b>	<b>22.2%</b>	<b>\$12,254,499</b>
Extraordinary item			NC	0	NC	\$0
Unaccreted dividends on convertible pref. stock		(542,000)		0		
Net income, after extra. Item	7,118,000	(4,747,000)	-249.9%	(5,136,499)	8.2%	\$12,254,499
Shares outstanding	21,320,775	14,972,266	42.4%	24,097,738	60.9%	(\$2,776,963)
<b>EPS (excl. extraord, incl. options)</b>	<b>\$0.33</b>	<b>(\$0.28)</b>	<b>-218.9%</b>	<b>(\$0.21)</b>	<b>-24.1%</b>	<b>\$0.547</b>
EPS (incl. extraord.)	\$0.33	(\$0.32)	-205.3%	(\$0.21)	-32.8%	\$0.547
% of Net Revenue:			Change		Change	
Direct costs	89%	NA	NA	NA	NA	NA
Gross profit	11%	NA	NA	NA	NA	NA
Selling, general and administrative	NA	NA	NA	NA	NA	NA
Depreciation and amortization	NA	NA	NA	NA	NA	NA
<b>Operating income (incl. options)</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>
Net income	NA	NA	NA	NA	NA	NA
Effective tax rate	NA	NA	NA	NA	NA	NA

## Exhibit 2. Aratana Product Portfolio

Product	Proof of Concept	Pilot	Pivotal	Conditional License	Full License	Market	Launch Date	Comments/Timing
AT-004 Dog (B-cell Lymphoma)							2014	Received conditional license from the USDA. Aratana submitted data to support a full licensure, which is expected in 4Q14 or 1Q15.
AT-005 Dog (T-cell Lymphoma)							2015	USDA granted conditional approval. Currently pursuing full license from USDA. Currently available to specialist vet practices. Initiating other studies to develop lymphoma market.
AT-001 Dog (Osteoarthritis)							2016	Initiating pivotal field effectiveness study with once-daily dose in 2Q14. Expect US FDA market approval in 2016.
AT-002 Dog (Appetite Stimulant)							2016	Currently performing pivotal field effectiveness study in client-owned dogs, actively enrolling patients. Expected US marketing approval in 2016.
AT-006 (Feline Herpes)							2015 - EU	Currently performing pivotal field study in Europe. Next step is to file for EU review in 2014. Expect US marketing approval in 2017 or 2018.
AT-008 Dog (Lymphoma)							2014 - EU	Currently performing pivotal field effectiveness study in EU. Only Have EU rights.
Diagnostic Koi Carp - KHV Infections							TBD	To be divested or spun-out after value inflection.
AT-007 (Feline Immunodeficiency)							2018	Pilot study in Europe. Initiate field effectiveness study in 2015. Expect US marketing approval in 2017 or 2018.
AT-001 Cat (Osteoarthritis)							2016	Currently performing pilot studies. Next step is dose confirmation study.
AT-002 Cat (Appetite Stimulant)							2016	Currently performing pilot studies. Next step is dose confirmation study.
Other Vet Therapeutics Compounds							2015+	Mast Cell, Atopic Dermatitis, & Feline Lymphoma. Studies in two unspecified products expected to begin in 2014 and completed by 2015. Conditional licenses expected in mid-2015 for two products and a third in 2016.
AT-003 Dog (Post-operative Pain)							2016	Initiate pivotal field effectiveness study in 2Q14. Expect US FDA approval in 2016.
AT-003 Cat (Post-operative Pain)							2016	Currently performing proof of concept study. Next step is dose confirmation study.
Option Programs (Alpha, Beta, Gamma)							TBD	Three programs being evaluated, PETX expects decision on all three in 1H14.
AT-011 Dog (Canine Parvovirus)							TBD	Currently in lead selection. Expected next step is proof of concept study.
AT-012 Cat (Feline Calicivirus)							TBD	Currently in lead selection. Expected next step is proof of concept study.

### Exhibit 3. Aratana Income Statement (2011 to 2020E)

	2,011	2012	Q1A	Q2A	Q3A	Q4E	2013	Q1E	Q2E	Q3E	Q4E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
Revenues																		
AT-001								-	-	-	-	-	-	10,238,800	19,988,540	26,918,320	39,279,240	59,682,480
% growth (y/y)								-	-	-	-	-	-	-	-	-	-	-
AT-002								-	-	-	-	-	-	11,629,964	20,244,546	33,740,910	50,611,365	74,023,790
% growth (y/y)								-	-	-	-	-	-	-	-	-	-	-
AT-003								-	-	-	-	-	-	4,095,000	12,180,000	28,400,000	36,592,000	48,600,000
% growth (y/y)								-	-	-	-	-	-	-	-	-	-	-
T-Cell Revenue								-	204,750	204,750	204,750	614,250	6,054,048	10,140,530	16,003,025	21,757,712	25,805,965	27,979,099
% growth (y/y)								-	-	-	-	-	-	-	-	-	-	-
Feline Immunodeficiency								-	-	-	-	-	-	-	-	23,659,200	41,515,200	57,585,600
% growth (y/y)								-	-	-	-	-	-	-	-	-	-	-
Total Net Product Revenues								-	204,750	204,750	204,750	614,250	6,054,048	36,104,294	68,416,111	134,476,142	193,803,770	267,870,970
B-Cell Royalty							123,000	220,500	220,500	220,500	220,500	882,000	2,177,776	4,140,717	7,766,801	10,461,284	13,310,445	16,973,987
Royalty Revenue (E.U.)								-	-	-	-	-	198,788	3,786,311	12,085,319	23,284,313	33,842,346	43,569,153
Feline Herpes Royalty								-	-	-	-	-	-	-	2,120,400	3,477,456	5,088,960	6,276,384
Total Net Revenues							0	220,500	425,250	425,250	425,250	1,496,250	8,430,611	44,031,321	90,388,631	171,699,195	246,045,522	334,690,493
% growth (y/y)		0.0	0.0	0.0	0.0	123,000	0	220,500	425,250	425,250	425,250	1,496,250	8,430,611	44,031,321	90,388,631	171,699,195	246,045,522	334,690,493
Expenses																		
COGS	-	-				109,000	109,000	7,056	58,244	58,244	58,244	181,787	1,583,201	8,269,888	16,045,329	31,314,361	44,365,190	60,658,754
R&D expense	2,196,000	8,791,000	2,114,000	2,469,000	3,234,000	3,108,000	10,925,000	6,828,125	6,828,125	6,828,125	6,828,125	27,312,500	34,140,625	39,261,719	43,187,891	47,506,680	52,257,348	57,483,082
% growth (y/y)			20.7%	28.0%	95.1%	-10.0%	24%	223.0%	176.6%	111.1%	119.7%	50%	25%	15%	10%	10%	10%	10%
SG&A expense	1,274,000	2,987,000	1,226,000	1,258,000	1,427,000	5,041,000	8,952,000	5,097,500	1,506,400	1,641,600	1,864,432	9,909,932	16,864,898	23,710,857	29,333,029	39,912,937	54,593,818	70,977,353
% growth (y/y)																		
In-process R&D	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total Operating Expenses	3,470,000	11,778,000	3,340,000	3,727,000	4,661,000	8,258,000	19,986,000	11,932,681	8,392,769	8,527,969	8,550,801	37,404,219	52,588,724	71,242,464	88,566,248	118,733,978	151,216,356	189,119,189
Operating (loss)/profit	(3,470,000)	(11,778,000)	(3,340,000)	(3,727,000)	(4,661,000)	(8,135,000)	(19,986,000)	(11,712,181)	(7,967,519)	(8,102,719)	(8,125,551)	(35,907,969)	(44,158,113)	(27,211,143)	1,822,383	52,965,217	94,829,166	145,571,304
Interest income	6,000	21,000	3,000	22,000	26,000	25,000	76,000	28,596	57,422	54,787	50,827	191,632	146,849	182,992	156,498	168,840	266,091	428,524
Interest expense	-	-	(24,000)	(78,000)	(80,000)	(250,000)	(432,000)	(110,425)	(110,425)	(110,425)	(110,425)	(441,700)	(441,700)	(441,700)	(441,700)	(441,700)	(441,700)	(441,700)
Other Income	-	121,000	68,000	343,000	44,000	23,000	478,000	25,000.0	25,000.0	25,000.0	25,000.0	100,000	100,000	100,000	100,000	100,000	100,000	100,000
Total Other Income	6,000	142,000	47,000	267,000	(10,000)	(202,000)	122,000	(56,829)	(28,003)	(30,638)	(34,598)	(150,068)	(194,851)	(158,708)	(185,202)	(172,860.4)	(75,609)	86,824
Net loss and comprehensive loss	(3,464,000)	(11,636,000)	(3,293,000)	(3,440,000)	(4,671,000)	(8,337,000)	(19,864,000)	(11,769,010)	(7,995,522)	(8,133,357)	(8,160,148)	(36,058,036)	(44,352,964)	(27,369,851)	1,637,180	52,792,357	94,753,557	145,658,128
Modifications of Series A convertible pref. stock	(276,000)	-	(773,000)	(808,000)	-	-	(1,581,000)	-	-	-	-	-	-	-	-	-	-	-
Unaccreted dividends on convertible pref. stock	(902,000)	(2,035,000)																
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)	(8,337,000)	(21,322,000)	(11,769,010)	(7,995,522)	(8,133,357)	(8,160,148)	(36,058,036)	(44,352,964)	(27,369,851)	1,637,180	52,792,357	94,753,557	145,658,128
Provision for income taxes	-	-	-	-	-	(15,455,000)	(15,455,000)	-	-	-	-	-	-	-	-	-	-	-
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)	7,118,000	(5,867,000)	(\$11,769,010)	(\$7,995,522)	(\$8,133,357)	(\$8,160,148)	(36,058,036)	(\$44,352,964)	(\$27,369,851)	\$1,047,795	\$33,787,108	\$60,642,276	\$93,221,202
EPS	(0.31)	(\$0.91)	(\$0.27)	(\$0.23)	(\$0.22)	\$0.33	(\$0.39)	(\$0.43)	(\$0.29)	(\$0.30)	(\$0.30)	(\$1.32)	(\$1.61)	(\$0.92)	\$0.04	\$1.12	\$2.00	\$3.06
Weighted average shares outstanding (diluted)	14,972,266	14,972,266	14,972,266	19,964,402	20,806,362	21,320,775	19,265,949	25,304,108	27,335,775	27,375,775	27,415,775	26,857,858	27,540,775	29,690,775	29,890,775	30,090,775	30,290,775	30,490,775
MARGIN ANALYSIS:																		
Gross Profit														81%	82%	82%	82%	82%
SG&A														54%	32%	23%	22%	21%
R&D														89%	48%	28%	21%	17%
Operating Income														NA	2%	31%	39%	43%
Tax Rate														0%	36%	36%	36%	36%
Net Income														NA	1%	20%	25%	28%
GROWTH METRICS:																		
Total Revenue															105%	90%	43%	36%
Gross Profit														108%	89%	44%	36%	36%
SG&A			146%	102%	34%	529%	200%	316%	20%	15%	-67%	11%	70%	41%	15%	10%	10%	10%
R&D			21%	28%	95%	-10%	24%	223%	177%	111%	120%	150%	25%	15%	10%	10%	10%	10%
Operating Income																2806%	79%	54%
Net Income																3125%	79%	54%
EPS																3103%	78%	53%
Diluted Shares Outstanding		0%	0%	33%	39%	42%	29%	69%	37%	32%	29%	26%	0%	8%	0%	0%	0%	1%

E = William Blair & Company, LLC estimate

William Blair & Company, L.L.C.

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William Blair is a market maker in the security of Aratana Therapeutics, Inc. and may have a long or short position.

William Blair intends to seek investment banking compensation in the next three months from Aratana Therapeutics, Inc.

Within the past 12 months William Blair has provided or is providing investment banking services to or has an investment services relationship with Aratana Therapeutics, Inc.

Additional information is available upon request.

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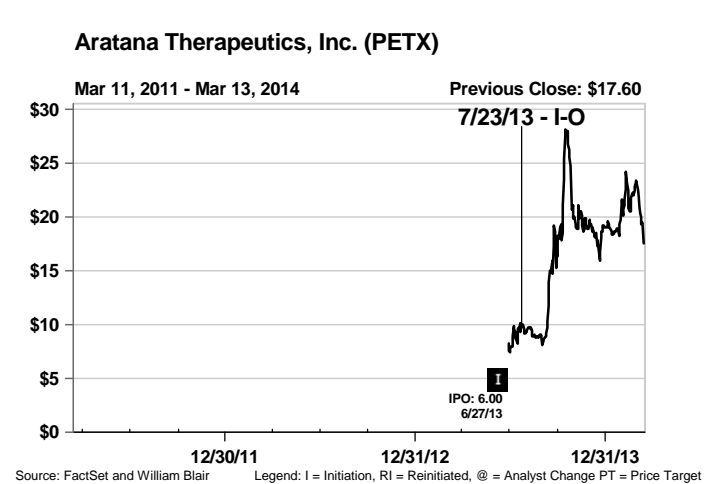
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DOW JONES: 16,108.89

S&P 500: 1,846.34

NASDAQ: 4,260.42



### **Current Rating Distribution (as of 02/28/14)**

Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	64	Outperform (Buy)	13
Market Perform (Hold)	33	Market Perform (Hold)	2
Underperform (Sell)	1	Underperform (Sell)	0

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