



## CRAIG-HALLUM CAPITAL GROUP LLC

### Steven F. Crowley, CFA

Managing Director – Health Care Research  
Senior Research Analyst  
612-334-6304

[steve.crowley@craig-hallum.com](mailto:steve.crowley@craig-hallum.com)

### Matt G. Hewitt

Senior Research Analyst  
612-334-6314

[matthew.hewitt@craig-hallum.com](mailto:matthew.hewitt@craig-hallum.com)

### Matt H. Tiampo

Research Analyst  
612-334-6356

[matt.tiampo@craig-hallum.com](mailto:matt.tiampo@craig-hallum.com)

[www.craig-hallum.com](http://www.craig-hallum.com)

Changes	Previous	Current
Rating:		Buy
Fundamental Trend:		Improving
Price Target:	-	\$15.00
FY13E Rev M:	-	\$0.0
FY14E Rev M:	-	\$0.0
FY15E Rev M:	-	\$0.0
FY13E EPS:	(\$0.90)	(\$0.98)
FY14E EPS:	(\$1.20)	(\$1.15)
FY15E EPS:	(\$1.00)	(\$0.98)

Profile		
Price:		\$9.21
52 Wk Range:	\$6.56	- \$10.67
Avg Daily Vol:		46,800
Shares Out M:		21.7
Market Cap M:		\$200.2
Insiders Own:		49%
Short Interest (M):		0.01
BV/Sh:		-\$1.99
Est LT EPS Gr:		15%
Net Cash/Sh:		\$2.40
Debt / Capital:		-21.4%
Year Ends:		Dec.

Rev (M)	2013E	2014E	2015E
Mar	\$0.0A	-	-
Jun	\$0.0A	-	-
Sep	\$0.0	-	-
Dec	\$0.0	-	-
FY	\$0.0	\$0.0	\$0.0

EPS	2013E	2014E	2015E
Mar	(\$0.29)A	-	-
Jun	(\$0.30)A	-	-
Sep	(\$0.20)	-	-
Dec	(\$0.22)	-	-
FY	(\$0.98)	(\$1.15)	(\$0.98)

\*Share Counts are adj. to reflect the post IPO  
Shares including the dividend and conversion of  
the preferred stock.

FY P/E	NA	NA	NA
FY EV/S	NA	NA	NA

Management	
CEO	Stephen St. Peter
CFO	Louise Mawhinney

## ALPHA SELECT LIST

### Aratana Therapeutics, Inc.

**BUY**

(PETX - \$9.21 intraday)

Price Target: \$15

### New "Option Program" Agreements Add Another Dimension To PETX. We Reiterate Our BUY Rating And \$15 Price Target.

*Aratana Therapeutics licenses and develops innovative human pharmaceutical products for the companion animal therapeutics market.*

### OUR CALL

This morning, Aratana hosted its first quarterly conference call as a public company, providing updates on financial results and condition, status of its three major development programs, and outlined a new "Option Program" which enables it to quickly evaluate development candidates while securing appropriate in-licensing terms up front. This avenue to a larger pipeline of new products is in addition to its traditional in-licensing and acquisition activities. We see Aratana very well positioned as first mover with a likely lucrative strategy to bring novel and specifically targeted specialty pharmaceuticals for companion animals to the veterinary market.

### KEY TAKEAWAYS

	Q2'13		Q3'13		FY'13		FY'14	
	Rev	EPS	Rev	EPS	Rev	EPS	Rev	EPS
<b>Actuals:</b>	<b>\$0.0</b>	<b>(0.30)</b>	--	--	--	--	--	--
C-H Previous Est.:	\$0.0	(0.25)	\$0.0	(0.20)	\$0.0	(0.90)	\$0.0	(1.20)
Prior Consensus Est.:	\$0.0	(0.31)	\$0.0	(0.21)	\$0.0	(0.97)	\$0.5	(1.04)
C-H Revised Est.:	\$0.0	(0.20)	\$0.0	(0.20)	\$0.0	(0.98)	\$0.0	(1.15)

Source: Aratana Therapeutics, Inc., First Call, Craig-Hallum Capital Group

### • "Options Program" Represents A New Path To Pipeline Expansion -

Management disclosed another dimension to its efforts to aggressively expand its product development pipeline, via the roll out of an "Option Program" and the signing of three such agreements. The new vehicle allows the Company to quickly and cost effectively de-risk development candidates (predominantly from human therapeutics companies) while securing appropriate in-licensing terms upfront. One agreement was executed during Q2 with two more subsequent to its close; all candidates came with canine safety data while two had preliminary efficacy data. The financial template for these agreements involves an initial \$250-\$350K payment, a \$1M upfront license fee if Aratana chooses to proceed, roughly \$5M of aggregate milestones during development, and a single digit downstream royalty.

### PETX also updated the status of its 3 development programs which reflected only minor shifts (measured in months) to prior schedules:

- **AT-001**, intended for treatment for chronic pain, is expected to have updated field results for dogs and additional proof of concept data for cats in November of this year. As a reminder, we believe that AT-001 has the potential to generate downstream revenue of >\$120M/year as a preferable alternative to currently marketed NSAID pain relievers.
- **AT-002**, a novel treatment for inappetence in dogs and cats, is expected to begin its pivotal study in dogs, late this year or early next after study design discussions with the CVM are completed. A pilot study intended to establish proof of concept in cats is anticipated to generate results during 1H14. We also believe the revenue opportunity for this product exceeds \$100M/year.
- **AT-003**, a bupivacaine injection with a novel drug delivery system (from Pacira) for extended treatment of post-operative pain, has seen completion of a safety study in cats and initiation of a dose-ranging study in dogs. PETX plans to engage the CVM in discussions later this year to define the canine development program. We've sized annual sales potential here to be >\$50M.

**Management of PETX will be participating in the Craig-Hallum Alpha Select Investor Conference on September 26, 2013 in New York City.**

**FINANCIAL PERFORMANCE & OUTLOOK****Aratana Second Quarter Results Snapshot**

	Actual	Estimate	Variance	Notes:	Last Q	Q/Q Growth	Last Y	Y/Y Growth
Revenue	\$0.0	\$0.0	\$0.0	As anticipated, given pre-revenue stage of maturity of the Company	\$0.0	NM	\$0.0	NM
R&D	\$2.5	\$2.1	\$0.4	Includes additional expense related to first "Option Program" agreement	\$2.1	17%	\$1.9	28%
SG&A	\$1.3	\$1.5	(\$0.2)	Slightly better than est. due to timing of ramp of new Public Co. expenses	\$1.2	3%	\$0.6	102%
Operating Income	(\$3.7)	(\$3.6)	(\$0.2)	Very much in-line with our expectation	(\$3.3)	12%	(\$2.6)	46%
EPS GAAP	(\$0.30)	(\$0.25)	(\$0.05)	Lingering impact (given shift of IPO timing into early Q3) of unaccreted dividends on convertible preferred stock was responsible for variance	(\$0.29)	0%	(\$10.21)	100%
Gross Margin	NM	NM	NA		NM		NM	
Operating Margin	NM	NM	NA		NM		NM	
Net Margin	NM	NM	NA		NM		NM	

Source: Aratana Therapeutics, Inc. and Craig-Hallum Capital Group

We are making only minor modifications to our model to reflect the variables disclosed and discussed in today's press release and call. Our FY13 and FY14 estimates now show a loss per share of \$0.98 and \$1.15, respectively.

**Estimate Changes**

\$ in mils	Q3'13 New	Q3'13 Prev.	FY13 New	FY13 Prev.	FY14 New	FY14 Prev.
Total Revenue	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Y/Y Growth*	NM	NM	NM	NM	NM	NM
R&D	\$2.9	\$2.6	\$10.7	\$9.9	\$17.5	\$17.0
SG&A	\$1.5	\$1.5	\$5.5	\$5.6	\$7.1	\$8.0
Total Operating Expense	\$4.3	\$4.0	\$16.2	\$15.5	\$24.6	\$25.0
Total Operating Income	(\$4.3)	(\$4.0)	(\$16.2)	(\$15.5)	(\$24.6)	(\$25.0)
Y/Y growth	NM	NM	NM	NM	NM	NM
EPS	(\$0.20)	(0.20)	(\$0.98)	(\$0.90)	(\$1.15)	(\$1.20)
Y/Y growth	NM	NM	NM	NM	NM	NM
Gross Margin	NM	NM	NM	NM	NM	NM
Operating Margin	NM	NM	NM	NM	NM	NM
Net Margin	NM	NM	NM	NM	NM	NM

Source: Craig-Hallum

PETX finished Q2 with \$20.2M of cash and \$4.9M of debt on the balance sheet. Following a recently completed IPO (July), which generated net proceeds of \$34.2M, cash totaled ~\$57.1M. Management guided to a FY13 yearend cash position of \$45-\$50M and the expectation that this is likely to be sufficient to fund operations through at least the end of FY15.

**STOCK OPPORTUNITY**

We believe PETX has the management team, opportunity and strategy to become a leading provider of innovative specialty pharmaceuticals within the emerging Pet Therapeutics market. We see success with these efforts dramatically improving companion animal veterinary care and driving substantial gains for the Company's shareholders. As such, we are reiterating our Buy rating on Aratana Therapeutics. Our \$15 target price is a function of a long term DCF analysis (see page 5).

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## RISKS

We believe an investment in Aratana involves the following risks:

- **Government Regulation**  
The Animal Therapeutic industry is highly regulated by the Center for Veterinary Medicine at both the state and federal level. Changes to existing regulation or new legislation could have a material adverse effect on the PETX's business and financial performance.
- **Dependence On Suppliers**  
The Company's business model relies on third parties to manufacture its products. Any malfunctions in the manufacturing processes of its suppliers or other sources of interruption to the supply of products could have an adverse impact on the Company's financial results.
- **Generic Products**  
Generic products may be viewed as more cost effective than branded therapeutics. While the Company's IP should protect its products from generic entry in the near term, substantially cheaper generic versions of competing products, even if they are less efficacious, may represent a challenge to the commercialization of the Company's products.
- **Intellectual Property And Trade Secrets**  
The Company's financial success is in part dependent on its ability to secure and enforce its substantial intellectual property. If PETX is forced to defend its intellectual property through litigation or if it is unable to maintain propriety of its trade secrets, the Company may incur extra expenses and financial results may be adversely affected.
- **Ongoing Need To Finance Growth**  
While the Company currently has ~\$51M (post over allotment) in net cash on its balance sheet and estimates that its current capital is sufficient to fund its operations for over 2 years, the Company may need to seek additional capital in order to continue to fund its operations in the future. Such financing could be dilutive to stockholders or impose debt covenants and obligations.

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## CRAIG-HALLUM ALPHA SELECT LIST

The Alpha Select list is an actively researched collection of small, under-followed public companies that we believe have the potential to become much larger. An "acorn" list of sorts, The Alpha Select List will typically consist of sub-\$250M market cap companies with attractive business models, above average growth trends, favorable macro/secular themes and management teams that we believe have the ability to take the business to the next level.

## Financials

### Aratana Therapeutics, Inc. Financial Model FISCAL YEAR ENDS DECEMBER

(\$ thousands)	Fiscal 2011A	Fiscal 2012A	Mar Q1-13A	Jun Q2-13A	Sep Q3-13E	Dec Q4-13E	Fiscal 2013E	Fiscal 2014E	Fiscal 2015E	Fiscal 2016E	Fiscal 2017E
<b>Total Revenue</b>	-	-	-	-	-	-	-	-	-	13,250	39,000
Cost of Sales	-	-	-	-	-	-	-	-	-	7,288	18,143
<b>Total Gross Margin</b>	-	-	-	-	-	-	-	-	-	5,963	20,857
<b>Operating Expenses</b>											
Research and Development	2,196	7,291	2,114	2,469	2,850	3,301	10,734	17,500	12,100	9,000	11,940
Selling, General and Administrative	1,274	2,987	1,226	1,258	1,475	1,536	5,495	7,115	8,825	15,500	24,000
In-Process R&D	0	1,500	0	0	0	0	0	0	0	0	0
<b>Total GAAP Operating Expenses</b>	3,470	11,778	3,340	3,727	4,325	4,837	16,229	24,615	20,925	24,500	35,940
<b>GAAP Income (Loss) from Operations</b>	(3,470)	(11,778)	(3,340)	(3,727)	(4,325)	(4,837)	(16,229)	(24,615)	(20,925)	(18,538)	(15,083)
Interest income	6	21	3	22	30	30	85	100	68	36	16
Interest Expense	0	0	(24)	(78)	(138)	(138)	(378)	(552)	(572)	(610)	(700)
Other Income	0	121	68	343	50	50	511	100	0	0	0
<b>Pre-tax GAAP Income</b>	(3,464)	(11,636)	(3,293)	(3,440)	(4,383)	(4,895)	(16,011)	(24,967)	(21,429)	(19,112)	(15,767)
Income Tax (benefit)	0	0	-	-	-	-	0	0	0	0	0
<b>GAAP Net Income</b>	(3,464)	(11,636)	(3,293)	(3,440)	(4,383)	(4,895)	(16,011)	(24,967)	(21,429)	(19,112)	(15,767)
Modification of Series A Convertible Preferred Stock	(276)	0	0	0	0	0	0	0	0	0	0
Unaccreted Dividends on Convertible Preferred Stock	(902)	(2,035)	(773)	(808)	0	0	(1,581)	0	0	0	0
<b>Net Loss Attributable to Common Stockholders</b>	(4,642)	(13,671)	(4,066)	(4,248)	(4,383)	(4,895)	(17,592)	(24,967)	(21,429)	(19,112)	(15,767)
<b>EPS Attributable to Common Stockholders</b>	(\$6.93)	(\$17.68)	(\$0.29)	(\$0.30)	(\$0.20)	(\$0.22)	(\$0.98)	(\$1.15)	(\$0.98)	(\$0.87)	(\$0.72)
Weighted Avg. Shares Outstanding DILUTED	500	658	13,936	14,120	21,750	21,765	17,893	21,803	21,863	21,923	21,983
<b>Margin Analysis % of Sales</b>											
Total Gross Margin	NM	NM	NM	NM	NM	NM	NM	NM	NM	45.0%	53.5%
Research and Development	NM	NM	NM	NM	NM	NM	NM	NM	NM	67.9%	30.6%
Selling, General and Administrative	NM	NM	NM	NM	NM	NM	NM	NM	NM	117.0%	61.5%
In-Process R&D	NM	NM	NM	NM	NM	NM	NM	NM	NM	0.0%	0.0%
Total GAAP Operating Expense	NM	NM	NM	NM	NM	NM	NM	NM	NM	184.9%	92.2%
<b>GAAP Operating Margin</b>	NM	NM	NM	NM	NM	NM	NM	NM	NM	-139.9%	-38.7%
<b>Adj. EBITDA Margin</b>	NM	NM	NM	NM	NM	NM	NM	NM	NM	-139.9%	-38.7%
GAAP Pre-tax Income	NM	NM	NM	NM	NM	NM	NM	NM	NM	-144.2%	-40.4%
Tax Rate (Effective)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
<b>GAAP Net Margin</b>	NM	NM	NM	NM	NM	NM	NM	NM	NM	-144.2%	-40.4%
<b>Percent Change (Yr/Yr)</b>											
Total Revenue	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	194.3%
Selling, General and Administrative	NM	134.5%	146.2%	101.9%	NM	NM	84.0%	29.5%	24.0%	75.6%	54.8%
Research and Development	NM	232.0%	20.7%	28.0%	NM	NM	47.2%	63.0%	-30.9%	-25.6%	32.7%
Total GAAP Operating Expense	NM	239.4%	48.5%	46.0%	NM	NM	37.8%	51.7%	-15.0%	17.1%	46.7%
<b>GAAP Operating Income</b>	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
Adj. EBITDA	NM	239.4%	48.5%	NM	NM	NM	37.6%	51.9%	-15.0%	-11.4%	-18.6%
GAAP Pre-tax Income	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
GAAP Net Income	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
<b>GAAP Earnings Per Share</b>	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM

## Discounted Cash Flow Model

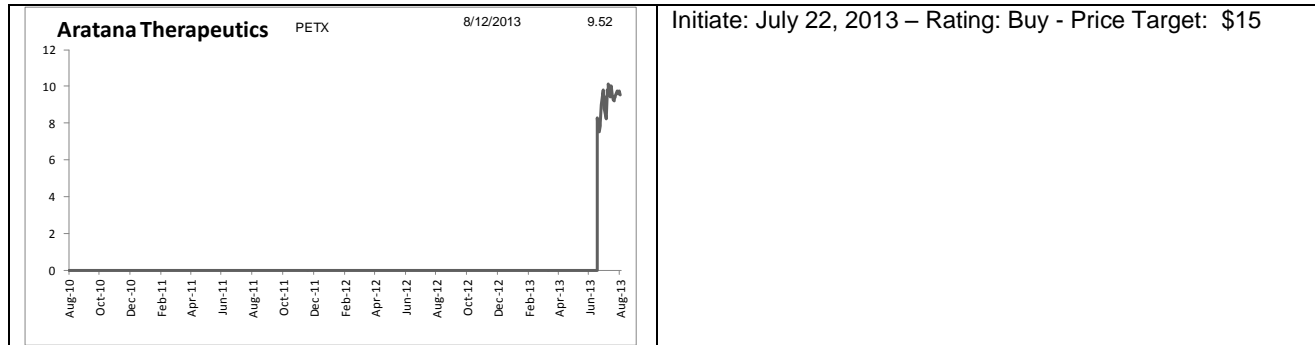
### Aratana Therapeutics, Inc. Discounted Cash Flow Model

Estimates		2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
(\$ in Thousands)											
Total Sales		0	0	0	13,250	39,000	78,000	140,399	238,680	381,887	393,344
Operating Profit		(16,229)	(24,615)	(20,925)	(18,538)	(15,083)	2,999	28,080	65,637	124,113	118,003
Less: Cash Taxes Paid		0	0	0	0	0	0	0	0	37,234	43,661
Operating Profit After Tax		(16,229)	(24,615)	(20,925)	(18,538)	(15,083)	2,999	28,080	65,637	86,879	74,342
Depreciation & Amortization		20	23	175	547	616	693	779	877	986	1,109
Fixed Cap Expenditures		100	107	2,114	1,163	1,244	1,331	1,424	1,524	1,630	1,745
Working Cap Increase		0	0	0	1,656	3,219	4,875	7,800	12,285	17,901	1,432
FCF		(16,309)	(24,700)	(22,864)	(20,809)	(18,930)	(2,514)	19,635	52,705	68,334	72,275
PV FCF		(14,562)	(19,690)	(16,274)	(13,225)	(10,741)	(1,274)	8,882	21,287	24,642	23,270
<b>Perpetual FCF</b>											
Base FCF		72,275									
Weighted Avg. Cost of Capital (k)		12.0%									
Perpetual Growth Rate (g)		3.0%									
Base Year		2012									
Perpetual Start Year		2022									
Perpetual Value		827,143									
PV of Perpetual Growth Period		266,318									
<b>Total FCF</b>											
Value of FCF		268,633									
<b>Intrinsic Value</b>											
Cash		57,100									
Debt		4,935									
After Tax ESO Liability		2,758									
Value of Equity		318,040									
Shares Outstanding		21,732									
<b>Intrinsic Value per Share</b>		<b>\$14.63</b>									

Sensitivity Analysis					
Terminal Period Variables		FCF Growth			
Cost of Capital	2.5%	3.0%	3.5%	4.0%	
	9.5%	\$22.59	\$24.20	\$26.08	\$28.31
	10.0%	\$20.34	\$21.68	\$23.23	\$25.04
	11.5%	\$15.23	\$16.05	\$16.97	\$18.01
	12.0%	\$13.93	<b>\$14.63</b>	\$15.42	\$16.30
	12.5%	\$12.78	\$13.39	\$14.06	\$14.82
	13.0%	\$11.76	\$12.29	\$12.87	\$13.52



## REQUIRED DISCLOSURES



Source: Baseline

**Ratings definitions:**

**Buy** rated stocks generally have twelve month price targets that are more than 20% above the current price. **Hold** rated stocks generally have twelve month price targets near the current price. **Sell** rated stocks generally have no price target and we would sell the stock.

**Fundamental trend definitions:**

**Improving** means growth rates of key business metrics are generally accelerating. **Stable** means growth rates of key business metrics are generally steady. **Mixed** means growth rates of some key business metrics are positive but others are negative. **Declining** means growth rates of key business metrics are generally decelerating.

**Ratings Distribution (6/30/2013)**

Rating	% Of Companies Covered	% With Investment Banking Relationships
Buy	72%	19%
Hold	27%	0%
Sell	1%	0%
Total	100%	14%

**Information about valuation methods and risks can be found in the “STOCK OPPORTUNITY” and “RISKS” sections, respectively, of this report.**

CHLM makes a market in this security.

CHLM has managed or co-managed an offering of securities for the subject company in the last 12 months. CHLM expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months.

Analysts receive no direct compensation in connection with the firm's investment banking business. Analysts may be eligible for bonus compensation based on the overall profitability of the firm, which takes into account revenues from all of the firm's business, including investment banking.

**OTHER DISCLOSURES**

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