

## Aratana Therapeutics Inc.

# Looking to run up the score

**We came away with bolstered confidence in the PETX story after hosting investor meetings with senior management last week.** Last week, we had the opportunity to host investor meetings with Aratana management. CEO Steven St. Peter and Craig Tooman provided updates on their strategy, and insights on key upcoming catalysts for the second half of 2014. Importantly, all of PETX's key pipeline assets remain on track for launch in 2016 and they remain confident in their ability to commercialize.

**First mover advantage still intact.** There's been no shortage of capital markets activity in the animal health segment over the last year including those attempting to be "fast followers" in the companion animal health sector. However, we suspect shortcuts in clinical development being taken by some competitors to speed time-to-market will leave them disadvantaged compared to PETX's more deliberate approach, especially around extensive dose-ranging work. While PETX doesn't intend to commercialize diagnostics themselves, the Okapi acquisition gave them the ability to develop testing which could be used to facilitate adoption of its therapeutics.

**Pipeline development transitioning to "management" over "build."** Over the last 12 months, PETX has done an impressive job building its portfolio, most notably through the Vet Therapeutics and Okapi acquisitions as well as Advaxis in-license. Mgmt reiterated that it doesn't anticipate more company acquisitions for the time being, and the pace of new programs will likely slow. Mgmt noted it sees itself transitioning to a period of pipeline "management" rather than buildout.

**Entering a period of newsflow as PETX progresses towards commercialization of key assets.** PETX shares have been under pressure recently given an excess of available shares caused by some VC selling, although we believe that imbalance is normalizing. Numerous data readouts for PETX in the closing months of 2014 and 1Q15 – all of which we have conviction will be successful – should take shares higher as PETX's leadership in the companion animal sector will gain appreciation.

### PETX: Quarterly and Annual EPS (USD)

|        | 2013   |        | 2014   |        | 2015   |        | Change y/y |      |      |
|--------|--------|--------|--------|--------|--------|--------|------------|------|------|
| FY Dec | Actual | Old    | New    | Cons   | Old    | New    | Cons       | 2014 | 2015 |
| Q1     | -2.43A | -0.34A | -0.34A | -0.34A | -0.19E | -0.19E | -0.29E     | 86%  | 44%  |
| Q2     | -4.62A | -0.26E | -0.26E | -0.36E | -0.32E | -0.32E | -0.36E     | 94%  | -23% |
| Q3     | -0.22A | -0.30E | -0.30E | -0.41E | -0.32E | -0.32E | -0.36E     | -36% | -7%  |
| Q4     | -0.40A | -0.33E | -0.33E | -0.39E | -0.33E | -0.33E | -0.37E     | 18%  | 0%   |
| Year   | -2.43A | -1.23E | -1.23E | -1.51E | -1.17E | -1.17E | -1.55E     | 49%  | 5%   |
| P/E    | N/A    |        | N/A    |        |        | N/A    |            |      |      |

Source: Barclays Research.

Consensus numbers are from Thomson Reuters

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PLEASE SEE ANALYST CERTIFICATION(S) AND IMPORTANT DISCLOSURES BEGINNING ON PAGE 7.

|               |                   |
|---------------|-------------------|
| Stock Rating  | <b>OVERWEIGHT</b> |
|               | Unchanged         |
| Industry View | <b>POSITIVE</b>   |
|               | Unchanged         |
| Price Target  | <b>USD 30.00</b>  |
|               | Unchanged         |

|                           |           |
|---------------------------|-----------|
| Price (30-May-2014)       | USD 14.06 |
| Potential Upside/Downside | +113%     |
| Tickers                   | PETX      |

|                             |        |
|-----------------------------|--------|
| Market Cap (USD mn)         | 414    |
| Shares Outstanding (mn)     | 29.45  |
| Free Float (%)              | 89.94  |
| 52 Wk Avg Daily Volume (mn) | 0.2    |
| Dividend Yield (%)          | N/A    |
| Return on Equity TTM (%)    | -12.98 |
| Current BVPS (USD)          | 5.88   |

Source: Thomson Reuters

|                   |                 |
|-------------------|-----------------|
| Price Performance | Exchange-Nasdaq |
| 52 Week range     | USD 29.32-6.56  |



[Link to Barclays Live for interactive charting](#)

### U.S. Specialty Pharmaceuticals

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## U.S. Specialty Pharmaceuticals

Industry View: POSITIVE

## Aratana Therapeutics Inc. (PETX)

Stock Rating: OVERWEIGHT

| Income statement (\$k) | 2013A    | 2014E    | 2015E    | 2016E    | CAGR  |
|------------------------|----------|----------|----------|----------|-------|
| Revenue                | 0        | 656      | 5,920    | 36,324   | N/A   |
| EBITDA (adj)           | -19,483  | -34,931  | -35,140  | -20,417  | N/A   |
| EBIT (adj)             | -19,863  | -35,487  | -35,164  | -20,441  | N/A   |
| Pre-tax income (adj)   | -21,322  | -35,516  | -34,612  | -20,201  | N/A   |
| Net income (adj)       | -21,322  | -35,516  | -34,612  | -20,201  | N/A   |
| EPS (adj) (\$)         | -2.43    | -1.23    | -1.17    | -0.64    | N/A   |
| Diluted shares (k)     | 11,179.9 | 28,853.9 | 29,662.5 | 31,737.5 | 41.6% |
| DPS                    | N/A      | N/A      | N/A      | N/A      | N/A   |

| Margin and return data   | Average |          |        |       |          |
|--------------------------|---------|----------|--------|-------|----------|
| EBITDA (adj) margin (%)  | N/A     | -5,409.6 | -594.0 | -56.3 | -2,020.0 |
| EBIT (adj) margin (%)    | N/A     | -5,409.6 | -594.0 | -56.3 | -2,020.0 |
| Pre-tax (adj) margin (%) | N/A     | -5,414.0 | -584.7 | -55.6 | -2,018.1 |
| Net (adj) margin (%)     | N/A     | -5,414.0 | -584.7 | -55.6 | -2,018.1 |
| ROIC (%)                 | N/A     | N/A      | N/A    | N/A   | N/A      |
| ROA (%)                  | -17.2   | -29.1    | -37.6  | -30.1 | -28.5    |
| ROE (%)                  | N/A     | N/A      | N/A    | N/A   | N/A      |

| Balance sheet and cash flow (\$k) | CAGR    |         |         |         |        |
|-----------------------------------|---------|---------|---------|---------|--------|
| Tangible fixed assets             | 98      | 1,200   | 1,300   | 1,400   | 142.6% |
| Intangible fixed assets           | N/A     | N/A     | N/A     | N/A     | N/A    |
| Cash and equivalents              | 41,084  | 51,000  | 27,605  | 11,164  | -35.2% |
| Total assets                      | 115,536 | 121,783 | 93,517  | 67,827  | -16.3% |
| Short and long-term debt          | N/A     | N/A     | N/A     | N/A     | N/A    |
| Other long-term liabilities       | 3,284   | 14,928  | 14,928  | 14,928  | 65.7%  |
| Total liabilities                 | 29,495  | 32,902  | 34,912  | 37,485  | 8.3%   |
| Net debt/(funds)                  | N/A     | N/A     | N/A     | N/A     | N/A    |
| Shareholders' equity              | 86,041  | 88,881  | 58,606  | 30,342  | -29.3% |
| Change in working capital (\$mn)  | -13,291 | -481    | -1,020  | -459    | N/A    |
| Cash flow from operations (\$mn)  | -16,158 | -35,191 | -35,308 | -20,286 | N/A    |
| Capital expenditure (\$mn)        | -31,088 | -546    | -76     | -76     | N/A    |
| Free cash flow (\$mn)             | -1,671  | -34,866 | -36,084 | -20,800 | N/A    |

| Valuation and leverage metrics | Average  |          |          |          |          |
|--------------------------------|----------|----------|----------|----------|----------|
| P/E (adj) (x)                  | N/A      | N/A      | N/A      | N/A      | N/A      |
| EV/sales (x)                   | N/A      | N/A      | N/A      | N/A      | N/A      |
| EV/EBITDA (adj) (x)            | N/A      | N/A      | N/A      | N/A      | N/A      |
| FCF yield (%)                  | -1,063.0 | -8,594.3 | -8,652.1 | -4,661.2 | -5,742.7 |
| P/BV (x)                       | N/A      | N/A      | N/A      | N/A      | N/A      |
| Dividend yield (%)             | N/A      | N/A      | N/A      | N/A      | N/A      |
| Total debt/capital (%)         | N/A      | N/A      | N/A      | N/A      | N/A      |

| Selected operating metrics | Average |      |      |      |      |
|----------------------------|---------|------|------|------|------|
| SG&A/sales (%)             | N/A     | N/A  | N/A  | N/A  | N/A  |
| R&D/sales (%)              | N/A     | N/A  | N/A  | N/A  | N/A  |
| R&D growth (%)             | 105.7   | 26.5 | 26.5 | 0.0  | 39.7 |
| SG&A growth (%)            | 198.0   | 85.5 | -3.7 | 60.4 | 85.0 |

Price (30-May-2014) USD 14.06  
Price Target USD 30.00

**Why Overweight?** We rate PETX at Overweight since we believe it will capitalize on the growing companion animal health market with its portfolio of in-development products for osteoarthritis, inappetence, post-surgical pain, and lymphoma. We believe PETX has a differentiated model that will attract a broad investor audience.

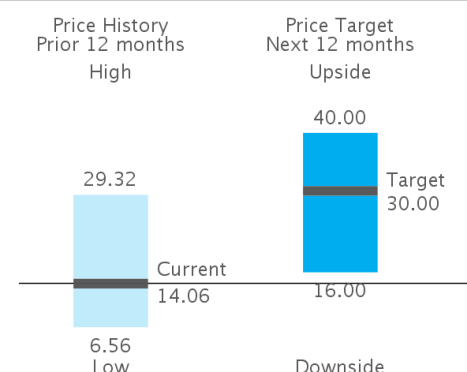
**Upside case** USD 40.00

We believe upside could come from additional business development which accelerates the expansion of PETX's pipeline. Additionally, we could see earlier-than-expected approvals for pipeline assets which accelerates the company's earnings ramp.

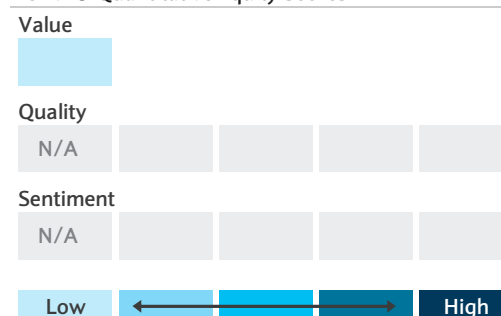
**Downside case** USD 16.00

Downside would come from setbacks to the company's pipeline assets. Additionally, PETX is developing treatments in many unproven markets, such as oncology, inappetence, and post-surgical pain. Those might not prove as attractive end-markets as we currently expect.

## Upside/Downside scenarios



## POINT® Quantitative Equity Scores



Source: POINT®. The scores are valid as of the date of this report and are independent of the fundamental analysts' views. To view the latest scores, please go to the equity company page on Barclays Live.

## Key Takeaways

Last week, we had the opportunity to host investor meetings with Aratana management. CEO Steven St. Peter and Craig Tooman provided updates on their strategy, and insights on key upcoming catalysts for the second half of 2014. Overall, they remain confident in their ability to commercialize and sell products in the companion animal therapeutics segment. When asked about competition, CEO St. Peter noted that he'd be disappointed if the company isn't able to establish a dominant position in the companion animal health segment. We believe they are uniquely positioned to target this segment given their nimble structure, experienced management team, and industry-leading pipeline of companion animal therapeutics. We also believe that there is unmet need and significant opportunity in this space given the lack of payers and regulatory burden.

While pets are increasingly seen as family members in the United States and around the world, Aratana management estimates that only approximately \$10/month is spent on pet medications. We believe this is due to a lack of available medicines rather than a shortage of demand. We also see improvements in veterinary science and clinical development procedures as favourable trends for Aratana, given their pipeline of over 20 products.

### *Best in class development will lead to commercial success:*

There's been no shortage of capital markets activity in the animal health segment over the last year including those attempting to be "fast followers" in the companion animal health sector. However, we suspect shortcuts in clinical development being taken by some competitors to speed time-to-market will leave them disadvantaged compared to PETX's more deliberate approach, especially around extensive dose-ranging work.

We came away impressed with Aratana's careful attention to its development programs, with an eye not simply on approval but providing data that can be used to support commercialization as well. Management noted it will soon begin enrolling patients in studies for its lymphoma antibodies to show how they can be used effectively in combination with the current chemo-therapy regimes.

Management also noted additional areas of expertise acquired with Okapi include animal health diagnostics. Management emphasized that they do not intend to market diagnostic products, but their development could be useful in clinical trials and potentially licensed. For example, Okapi had developed a diagnostic to identify herpes infestations in Japanese coy fish which were particularly useful for farmers. Management noted that the expansion of such diagnostics into therapeutic areas like lymphoma could help them identify dogs with T-Cell or B-Cell lymphoma at the point of diagnosis, allowing them to more quickly determine the proper medication for the patient.

### *Acquisition of Novartis Animal Health by Elanco:*

**Aratana expects to receive a full commercial license from USDA for its B-Cell Lymphoma product, AT-004, in October of this year.** This event marks a key catalyst for investors, as the full-license will allow for commercialization of the product, and Aratana will begin selling the product at the veterinary clinics where the trials are currently taking place.

AT-004 and AT-005 (for T-Cell Lymphoma) were acquired with the purchase of Vet Therapeutics in 2013. AT-004 is partnered with Novartis Animal Health, with Aratana due a high-teens-to-twenty percent royalty on sales. However, Novartis Animal Health was recently acquired by Eli Lilly's Elanco and since the two will be busy with the integration during the commercial launch period for AT-004, we think the timing could be fortuitous for the company to recoup rights to the product.

**Co-marketing agreement for AT-004 seems most likely outcome.** Rather than a complete transfer back to Aratana or decision by Elanco to commercialize on their own, we

believe the two parties will reach a co-marketing agreement. Given that Aratana is running the clinical trials and manufacturing the product, we don't believe it would make sense for Elanco to deploy its own sales force for the purpose of commercialization, or limit Aratana's medical science liaisons, who will have relationships with the veterinarians running the trials, from commercializing the product as soon as possible. In addition to its high royalty, Aratana will be owed a \$5 million for full licensure and manufacturing transfer. We believe this provides leverage for Aratana and is additional incentive for Elanco to complete a deal.

#### *Canine Lymphoma Market and Salesforce Structure:*

AT-004 and AT-005 are the first monoclonal antibodies for B-Cell and T-Cell lymphoma in dogs. There are approximately 300,000 cases of canine lymphoma each year in the United States, of which approximately 76% or 228,000 are B-Cell and 24% or 72,000 are T-Cell.

The current standard of care in this therapeutic area is chemotherapy, which is burdensome for the veterinarian as it requires specialized training, expensive equipment, and regular inspections. Monoclonal antibodies are easier to administer, and also have a cleaner tolerability profile compared to chemotherapy. The current cost of chemotherapy in the veterinary space is estimated to be \$5,000 (frequently above). Aratana expects it will be able to price in-line with the market while maintaining healthy margins and keep the veterinarians economics in place.

We believe that Aratana's nimble and lean organization can more effectively commercialize AT-004 and AT-005 compared to a large animal health company. Aratana plans to hire 3-5 medical science liaisons to assist with commercialization of AT-004 at the approximately 20-30 veterinary sites currently enrolled in the trials. They plan to evaluate the initial commercialization data in October before expanding the size of that team to approximately 12 liaisons. Management plans to market directly to veterinarians through presence at industry conferences such as the American College of Veterinary Internal Medicine (AVCIM) this week. This is a unique, targeted approach in contrast to national product launches that require significant investments in both marketing and personnel.

#### *Cash Burn:*

Aratana's shares have been under pressure with an "over supply" of shares caused by venture capital selling and declines in the broader healthcare sector in general, but some investors expressed concern regarding dilution from additional financings. Aratana has just under \$80 million in cash and investors seem reluctant to believe that this is enough to build out their business, particularly in the areas of manufacturing and SG&A, without raising additional capital.

Management addressed these concerns by pointing out the differences in their approach to sales force build out and product commercialization. **Management confirmed that they have more than enough manufacturing capacity to cover current consensus estimates.** Their strategy in the small molecule space is to continue leveraging their outsourced relationships, where there are numerous vendors offering competitive rates. In the large molecule category, where the development process is more intricate, they indicated a preference for a greater level of control. Management also stated that they have purchased a manufacturing company in Belgium, and they intend to leverage their experienced management team to implement many of the best practices used in the pharmaceutical industry.

#### *Differentiated Market Segment for Pet Therapeutics:*

**Aratana and investors both see pet therapeutics as a new and differentiated market segment within the broader Animal Health industry.** Larger animal health companies, such as Zoetis and Elanco, tend to focus more on the livestock and poultry ("edible" in

Aratana's management's words) animal segment, as well as therapeutics targeting diseases that affect large herds of these animals. Aratana on the other hand targets a narrower and arguably more profitable niche, focusing only on medicines for dogs and cats (or "petible" animals). They see more direct competition from animal-health companies like Kindred Biosciences and Parnell. They also don't focus on fleas, ticks, heart worm or other commonly treated diseases, but rather on therapeutic areas like cancer and pain.

We believe that consumer demand for products in these therapeutic areas is underestimated, as evidenced by the launch of Apoquel for atopic dermatitis in dogs by Zoetis. Demand for the product has been so strong that there is a supply shortage lasting through 2014. Additionally, Zoetis' success with Rimadyl for over 15 years, despite generic competition, speaks to the favourable dynamics of the market.

*Pipeline-driven growth amongst industry consolidation:*

While the larger Animal Health companies are mainly focused on market share expansion and margin, Aratana is able to focus mainly on their pipeline. We expect additional deal-making in animal health, although we expect Aratana to remain an organically driven story as its pipeline matures. Aratana has the most robust pipeline in pet therapeutics, with over 20 products in development.

While the large animal health companies seem reluctant to allocating meaningful resources towards these products, Aratana is able to do so with a strong ROI due to their size and scale; Zoetis' manufacturing shortage of Apoquel speaks to this reluctance to pursue the market aggressively. Rather than pursuing it with persistence, the large companies seem opportunistic on single projects, monetizing them over several years, rather than building a pipeline that will yield a regular cadence of new products.

Aratana believes their approach to R&D increases their ability to advance products in their pipeline and achieve product approval. They take an adaptive approach to clinical trials, and are able to monitor and change aspects like dosage during the trial to increase their chance of success.

*USDA as Governing Body for Pet Therapeutics:*

Management noted differences in the USDA approval process for pet therapeutics compared to human medications. When they first sought approval for a pet lymphoma medicine, it was unclear which regulatory body would be tasked with evaluation and approval. The USDA was given the responsibility of oversight for Aratana's pet therapeutics and will be evaluating these products going forward. This sets a precedent for which we believe the outcome is yet to be seen. **While the USDA is a less rigid organization than the FDA, it remains to be seen how the bureaucratic process of product approvals in companion animal therapeutics will play out as this segment expands in the coming years.**

*Comments on Okapi and Additional Business Development:*

Over the last 12 months, Aratana built its pipeline aggressively from its "core" three lead assets to nearly 20 product opportunities today. The biggest expansion came through the Vet Therapeutics and Okapi acquisitions as well as Advaxis in-license. Aratana reiterated that it doesn't anticipate more company acquisitions for the time being, and the pace of new programs will likely slow. Management noted it sees itself transitioning to a period of pipeline "management" rather than buildout.

Regarding assets acquired with Okapi, management recognized that opportunities for development exist both in the US and EU. **Management also noted that their trials conducted in the US can be used for submission for EU approval, a point they feel is**

**often overlooked.** The acquisition of Okapi expanded their customer base from dog owners to cats as well. They expect to launch feline therapeutics in the next 2-3 years.

With regards to business development, management is not planning additional large scale acquisitions but said they would consider licensing deals on an opportunistic basis. In particular, they don't see the need to acquire a product simply for revenues while their pipeline assets are in the final stages of approval. **Management indicated that rather than acquiring products to build their brand with consumers, they intend to target veterinarians directly through participation in industry events such as the ACVIM conference this week in Nashville.** The company has developed targeted materials for the event and plans to have a large marketing presence.

*Aratana remains one of our favourite ideas in the animal health segment and spec pharma more broadly. Aratana shares have been under pressure recently given an excess of available shares caused by some VC selling, although we believe that imbalance is normalizing. Numerous "fast followers" in the animal health segment has perhaps diluted the appearance of Aratana's differentiation, though we believe the company's competitive advantages and pipeline quality and breadth are just as strong as ever. Numerous data readouts for Aratana in the closing months of 2014 and 1Q15 – all of which we have conviction will be successful – should take shares higher as Aratana's leadership in the companion animal sector will gain renewed investor appreciation.*

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### Primary Stocks (Ticker, Date, Price)

Aratana Therapeutics Inc. (PETX, 30-May-2014, USD 14.06), Overweight/Positive, A/C/D/J/L

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In addition to the stock rating, we provide industry views which rate the outlook for the industry coverage universe as Positive, Neutral or Negative (see definitions below). A rating system using terms such as buy, hold and sell is not the equivalent of our rating system. Investors should carefully read the entire research report including the definitions of all ratings and not infer its contents from ratings alone.

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**Overweight** - The stock is expected to outperform the unweighted expected total return of the industry coverage universe over a 12-month investment horizon.

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**Neutral** - industry coverage universe fundamentals/valuations are steady, neither improving nor deteriorating.

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### U.S. Specialty Pharmaceuticals

|                                  |                                       |                                  |
|----------------------------------|---------------------------------------|----------------------------------|
| Actavis, Inc. (ACT)              | Allergan Inc. (AGN)                   | Aratana Therapeutics Inc. (PETX) |
| Charles River Laboratories (CRL) | Covance Inc. (CVD)                    | Forest Laboratories Inc. (FRX)   |
| ICON plc (ICLR)                  | Jazz Pharmaceuticals PLC (JAZZ)       | Mallinckrodt (MNK)               |
| Mylan Inc. (MYL)                 | Pacira Pharmaceuticals Inc. (PCRX)    | PAREXEL International (PRXL)     |
| Quintiles Transnational (Q)      | Teva Pharmaceutical Industries (TEVA) | Zoetis Inc. (ZTS)                |

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45% have been assigned an Overweight rating which, for purposes of mandatory regulatory disclosures, is classified as a Buy rating; 55% of companies with this rating are investment banking clients of the Firm.

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15% have been assigned an Underweight rating which, for purposes of mandatory regulatory disclosures, is classified as a Sell rating; 43% of companies with this rating are investment banking clients of the Firm.

### Guide to the Barclays Research Price Target:

Each analyst has a single price target on the stocks that they cover. The price target represents that analyst's expectation of where the stock will trade in the next 12 months. Upside/downside scenarios, where provided, represent potential upside/potential downside to each analyst's price target over the same 12-month period.

### Guide to the POINT® Quantitative Equity Scores:

The POINT Quantitative Equity Scores (POINT Scores) are based on consensus historical data and are independent of the Barclays fundamental analysts' views. Each score is composed of a number of standard industry metrics.

A high/low Value score indicates attractive/unattractive valuation. Measures of value include P/E, EV/EBITDA and Free Cash Flow.

A high/low Quality score indicates financial statement strength/weakness. Measures of quality include ROIC and corporate default probability.

A high/low Sentiment score indicates bullish/bearish market sentiment. Measures of sentiment include price momentum and earnings revisions.

These scores are valid as of the date of this report. To view the latest scores, which are updated monthly, [click here](#).

For a more detailed description of the underlying methodology for each score, please [click here](#).

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Aratana Therapeutics Inc. (PETX)

USD 14.06 (30-May-2014)

Stock Rating

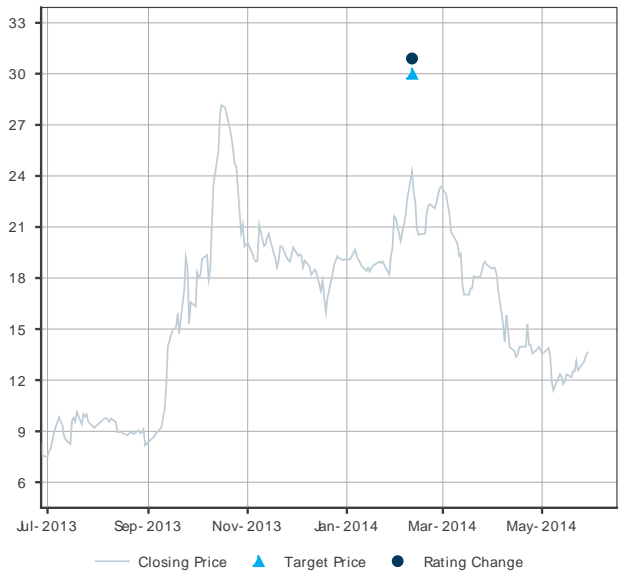
OVERWEIGHT

Industry View

POSITIVE

Rating and Price Target Chart - USD (as of 30-May-2014)

Currency=USD



| Date        | Closing Price | Rating     | Adjusted Price Target |
|-------------|---------------|------------|-----------------------|
| 10-Feb-2014 | 24.28         | Overweight | 30.00                 |

Source: Thomson Reuters, Barclays Research

Historical stock prices and price targets may have been adjusted for stock splits and dividends.

Source: IDC, Barclays Research

[Link to Barclays Live for interactive charting](#)

A: Barclays Bank PLC and/or an affiliate has been lead manager or co-lead manager of a publicly disclosed offer of securities of Aratana Therapeutics Inc. in the previous 12 months.

C: Barclays Bank PLC and/or an affiliate is a market-maker and/or liquidity provider in equity securities issued by Aratana Therapeutics Inc. or one of its affiliates.

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J: Barclays Bank PLC and/or an affiliate trades regularly in the securities of Aratana Therapeutics Inc..

L: Aratana Therapeutics Inc. is, or during the past 12 months has been, an investment banking client of Barclays Bank PLC and/or an affiliate.

**Valuation Methodology:** We base our \$30 price target on 5x our FY20 sales estimate of \$325 million discounted back to the present (8% discount rate).

**Risks which May Impede the Achievement of the Barclays Research Price Target:** Inability to get pipeline candidates approved by the FDA or USDA; lack of demand by consumers since pet therapeutics remains an emerging market; inability to manufacture products at a cost level which allows PETX to price products in a competitive manner.

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