



## CRAIG-HALLUM CAPITAL GROUP LLC

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Changes	Previous	Current
Rating:		Buy
Fundamental Trend:		Improving
Price Target:	\$15.00	\$30.00
FY13E Rev M:	-	\$0.0
FY14E Rev M:	\$0.0	\$2.0
FY15E Rev M:	\$0.0	\$10.0
FY13E EPS:	-	(\$0.98)
FY14E EPS:	(\$1.15)	(\$1.08)
FY15E EPS:	(\$0.98)	(\$0.90)

Profile		
Price:		\$25.45
52 Wk Range:	\$6.56	\$26.66
Avg Daily Vol:		68,300
Shares Out M:		23.6
Market Cap M:		\$600.4
Insiders Own:		49%
Short Interest (M):		0.03
BV/Sh:		-\$1.99
Est LT EPS Gr:		15%
Net Cash/Sh:		\$2.21
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	\$2.0	\$10.0

EPS	2013E	2014E	2015E
Mar	(\$0.29)A	-	-
Jun	(\$0.30)A	-	-
Sep	(\$0.20)	-	-
Dec	(\$0.22)	-	-
FY	(\$0.98)	(\$1.08)	(\$0.90)

\*Share counts have been adjusted to reflect IPO shares, the 10/13 private placement, and stock issued in the acquisition of Vet Therapeutics.

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

Management	
CEO	Stephen St. Peter
CFO	Louise Mawhinney

October 15, 2013  
Institutional Research

## ALPHA SELECT LIST

### Aratana Therapeutics, Inc.

(PETX - \$25.45)

**BUY**

Price Target: \$30

**Aratana's Artful Acquisition Of Leading Vet Biologics Player Represents Likely Catalyst For Much More Rapid & Profound Evolution. Reiterating BUY & Raising Price Target To \$30.**

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

### OUR CALL

Yesterday, Aratana announced that it had entered into an agreement to acquire Vet Therapeutics, Inc., a leading edge companion animal biologics company located in San Diego that is harnessing a proprietary antibody-based platform. The Company has its first product currently being commercialized by a large animal health company (in return for a double digit royalty), another submitted to the USDA for review, and a substantial intellectual property portfolio and development pipeline. The acquisition bolsters Aratana's position as first mover in targeted pet therapeutics and substantially expands its reach, adding biologics to a significant small molecule product set fed by traditional in-licensing activities and a recently announced Option Program. We believe adding a potential several hundred million dollar per year oncology franchise (with revenue generation beginning near term), a proprietary pet specific antibody development engine, and a catalyst for Aratana's highly regarded Chief Commercial Officer to immediately begin building a top notch sales organization represents a large positive delta to the PETX investment equation.

### KEY TAKEAWAYS

	Q3'13		Q4'13		FY'13		FY'14	
	Rev	EPS	Rev	EPS	Rev	EPS	Rev	EPS
C-H Previous Est.:	\$0.0	(\$0.20)	\$0.0	(\$0.22)	\$0.0	(\$0.98)	\$0.0	(\$1.15)
Prior Consensus Est.:	\$0.0	(\$0.23)	\$0.0	(\$0.26)	\$0.0	(\$1.15)	\$0.4	(\$1.05)
C-H Revised Est.:	\$0.0	(\$0.20)	\$0.0	(\$0.22)	\$0.0	(\$0.98)	\$2.0	(\$1.08)

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

• **Aratana Acquires Leading Vet Biologics Product Portfolio & Development Platform** - PETX paid \$30M in cash, 625k shares of common stock and a \$3M promissory note (~\$49M total consideration at yesterday's close) to acquire Vet Therapeutics, Inc., a leading animal therapeutics company with a proprietary antibody-based biologics platform. To finance the transaction, the Company announced a share purchase agreement for a \$19.75M private placement of 1.2M shares plus the expansion and utilization of a now \$10M venture debt facility. We are updating our estimates to incorporate near term revenue prospects, increased share count, and plans to accelerate build out of a commercial sales organization.

### Large New Opportunities (Near & Far) For Proprietary Pet Biologics:

- **B-cell Lymphoma** - Vet Therapeutics recently received a conditional license from the U.S. Department of Agriculture (USDA) for its monoclonal antibody intended for the treatment of B-cell lymphoma in canines. The product is currently being commercialized by a very large animal health company. Upon acquisition closing, PETX will be entitled to receive double digit royalties on sales of the B-cell therapy. B-cell lymphoma accounts for ~2/3 of the 300K cases of canine lymphoma annually in the U.S. with current chemotherapeutic regimens averaging roughly \$5K per treatment.
- **T-cell Lymphoma** - Vet Therapeutics' therapy for canine T-cell lymphoma has been submitted to the USDA for review. PETX expects to launch via its planned oncology sales force following receipt of a conditional license from the USDA (likely within the next 12 months). T-cell lymphoma accounts for

roughly 1/3 of canine lymphoma cases and the Company believes that currently only about half of these animals receive treatment.

- **Broad Pet Specific mAb Platform Play** - Harnessing its proprietary biologics development engine, Vet Therapeutics already has products in development for 4 additional indications (Mast Cell Tumor, Atopic Dermatitis, Feline Lymphoma, and a diagnostic to support lymphoma phenotyping). As well, through the Vet Therapeutics acquisition, Aratana gains access to a broad intellectual property estate, which relates to the speciesization of antibodies, antibody constant domain regions, and monoclonal antibodies directed to canine CD20 and CD52 with patent lives extending to 2029-2031.

## ESTIMATES CHANGES

### 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	\$2.0	\$0.0
Y/Y Growth*	NM	NM	NM	NM	NM	NM
R&D	\$2.9	\$2.9	\$10.8	\$10.7	\$18.9	\$17.5
SG&A	\$1.5	\$1.5	\$5.7	\$5.5	\$8.2	\$7.1
Total Operating Expense	\$4.3	\$4.3	\$16.6	\$16.2	\$27.1	\$24.6
<b>Total Operating Income</b>	<b>(\$4.3)</b>	<b>(\$4.3)</b>	<b>(\$16.6)</b>	<b>(\$16.2)</b>	<b>(\$25.1)</b>	<b>(\$24.6)</b>
Y/Y growth	NM	NM	NM	NM	NM	NM
<b>EPS</b>	<b>(\$0.20)</b>	<b>(\$0.20)</b>	<b>(\$0.98)</b>	<b>(\$0.98)</b>	<b>(\$1.08)</b>	<b>(\$1.15)</b>
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

Per the table above, we have updated estimates to incorporate our initial read of likely contributions from Vet Therapeutics, Aratana's plans to more rapidly build out its commercial organization, and a higher share count. While we are now forecasting initial commercial revenues (from B-cell lymphoma product royalties) in 2014, additional expenses related to the operations of Vet Therapeutics and the quicker build out of commercial capabilities leave our net loss estimates little changed. Our 2013 EPS estimate remains (\$0.98) and for 2014 we are now forecasting losses of \$1.08 versus \$1.15 previously.

## 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. The addition of a potential several hundred million dollar per year oncology business, a proprietary pet biologics development engine, and more aggressive build-out of commercial capabilities enhance our confidence that PETX's strategy to introduce novel pharmaceutical therapies specially tailored to the companion animal market will be a winner and drive substantial returns. As such, we are reiterating our Buy rating on Aratana Therapeutics and raising our DCF driven target price to \$30 (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 disruptions to manufacturing processes at its suppliers or other interruption to the supply of its 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 expects to exit 2013 with between \$45M-\$50M in 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.
- **Future Expirations Of Lock-Up Agreements**  
Roughly 4M of the Company shares are subject to a lock-up restriction connected to the Company's public offering are scheduled to release at 4:00pm ET on December 9<sup>th</sup> 2013. Certain of the Company's officers, directors and other stakeholders (representing ~14M shares) have agreed to a new lock-up restriction for a period of 90 days following the closing of the Vet Therapeutics acquisition. The release or pending release of a large number of shares from a lock-up restriction may adversely affect the share price of the Company's stock.

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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>	-	-	-	-	-	-	-	2,000	10,000	43,250	99,000
Cost of Sales	-	-	-	-	-	-	-	-	2,500	16,435	38,622
<b>Total Gross Margin</b>	-	-	-	-	-	-	-	2,000	7,500	26,815	60,377
<b>Operating Expenses</b>											
Research and Development	2,196	7,291	2,114	2,469	2,850	3,401	10,834	18,900	13,600	14,353	17,052
Selling, General and Administrative	1,274	2,987	1,226	1,258	1,475	1,786	5,745	8,215	14,825	19,000	28,408
In-Process R&D	0	1,500	0	0	0	0	0	0	0	0	0
<b>Total GAAP Operating Expenses</b>	<b>3,470</b>	<b>11,778</b>	<b>3,340</b>	<b>3,727</b>	<b>4,325</b>	<b>5,187</b>	<b>16,579</b>	<b>27,115</b>	<b>28,425</b>	<b>33,353</b>	<b>45,460</b>
<b>GAAP Income (Loss) from Operations</b>	<b>(3,470)</b>	<b>(11,778)</b>	<b>(3,340)</b>	<b>(3,727)</b>	<b>(4,325)</b>	<b>(5,187)</b>	<b>(16,579)</b>	<b>(25,115)</b>	<b>(20,925)</b>	<b>(6,538)</b>	<b>14,917</b>
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>	<b>(3,464)</b>	<b>(11,636)</b>	<b>(3,293)</b>	<b>(3,440)</b>	<b>(4,383)</b>	<b>(5,245)</b>	<b>(16,361)</b>	<b>(25,467)</b>	<b>(21,429)</b>	<b>(7,112)</b>	<b>14,233</b>
Income Tax (benefit)	0	0	-	-	-	-	0	0	0	0	0
<b>GAAP Net Income</b>	<b>(3,464)</b>	<b>(11,636)</b>	<b>(3,293)</b>	<b>(3,440)</b>	<b>(4,383)</b>	<b>(5,245)</b>	<b>(16,361)</b>	<b>(25,467)</b>	<b>(21,429)</b>	<b>(7,112)</b>	<b>14,233</b>
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>	<b>(4,642)</b>	<b>(13,671)</b>	<b>(4,066)</b>	<b>(4,248)</b>	<b>(4,383)</b>	<b>(5,245)</b>	<b>(17,942)</b>	<b>(25,467)</b>	<b>(21,429)</b>	<b>(7,112)</b>	<b>14,233</b>
<b>EPS Attributable to Common Stockholders</b>	<b>(\$6.93)</b>	<b>(\$17.68)</b>	<b>(\$0.29)</b>	<b>(\$0.30)</b>	<b>(\$0.20)</b>	<b>(\$0.22)</b>	<b>(\$0.98)</b>	<b>(\$1.08)</b>	<b>(\$0.90)</b>	<b>(\$0.30)</b>	<b>\$0.60</b>
<b>Weighted Avg. Shares Outstanding DILUTED</b>	<b>500</b>	<b>658</b>	<b>13,936</b>	<b>14,120</b>	<b>21,750</b>	<b>23,339</b>	<b>18,286</b>	<b>23,662</b>	<b>23,722</b>	<b>23,782</b>	<b>23,842</b>
<b>Margin Analysis % of Sales</b>										0.62	0.61
Total Gross Margin	NM	NM	NM	NM	NM	NM	NM	NM	NM	62.0%	61.0%
Research and Development	NM	NM	NM	NM	NM	NM	NM	NM	NM	33.2%	17.2%
Selling, General and Administrative	NM	NM	NM	NM	NM	NM	NM	NM	NM	43.9%	28.7%
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	77.1%	45.9%
<b>GAAP Operating Margin</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>-15.1%</b>	<b>15.1%</b>
<b>Adj. EBITDA Margin</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>-15.1%</b>	<b>15.1%</b>
GAAP Pre-tax Income	NM	NM	NM	NM	NM	NM	NM	NM	NM	-16.4%	14.4%
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>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>-16.4%</b>	<b>14.4%</b>
<b>Percent Change (Yr/Yr)</b>											
Total Revenue	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	128.9%
Selling, General and Administrative	NM	134.5%	146.2%	101.9%	NM	NM	92.3%	43.0%	80.5%	28.2%	49.5%
Research and Development	NM	232.0%	20.7%	28.0%	NM	NM	48.6%	74.5%	-28.0%	5.5%	18.8%
Total GAAP Operating Expense	NM	239.4%	48.5%	46.0%	NM	NM	40.8%	63.6%	4.8%	17.3%	36.3%
<b>GAAP Operating Income</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>
Adj. EBITDA	NM	239.4%	48.5%	NM	NM	NM	40.6%	51.7%	-16.7%	-68.8%	-328.2%
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>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>

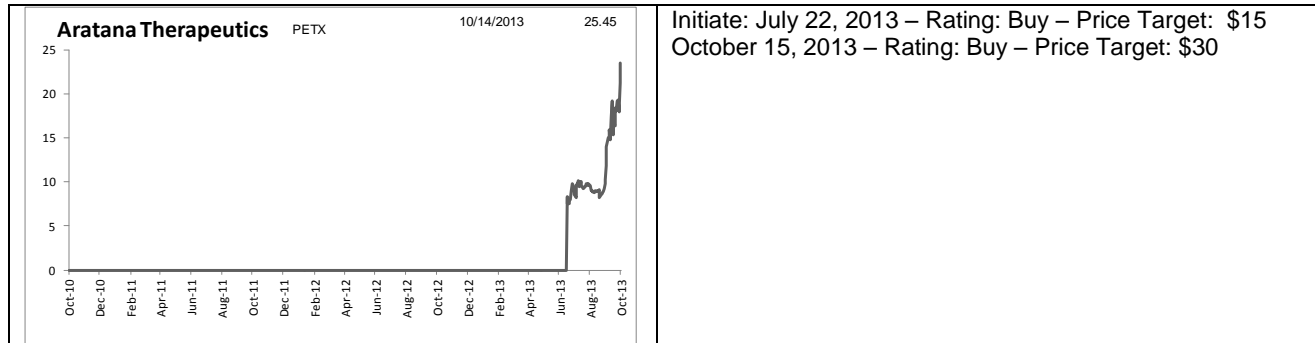
## Discounted Cash Flow Model

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

Estimates		2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
(\$ in Thousands)											
Total Sales		0	2,000	10,000	43,250	99,000	178,000	290,399	438,680	631,887	650,844
Operating Profit		(16,579)	(25,115)	(20,925)	(6,538)	14,917	46,999	95,832	162,312	252,755	244,066
Less: Cash Taxes Paid		0	0	0	0	0	0	9,583	60,055	93,519	90,305
Operating Profit After Tax		(16,579)	(25,115)	(20,925)	(6,538)	14,917	46,999	86,249	102,256	159,236	153,762
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	250	1,000	4,156	6,969	9,875	14,050	18,535	24,151	2,370
FCF		(16,659)	(25,450)	(23,864)	(11,310)	7,320	36,486	71,554	83,074	134,440	150,757
PV FCF		(14,874)	(20,288)	(16,986)	(7,187)	4,154	18,485	32,367	33,552	48,481	48,540
<b>Perpetual FCF</b>											
Base FCF		150,757									
Weighted Avg. Cost of Capital (k)		12.0%									
Perpetual Growth Rate (g)		3.0%									
Base Year		2012									
Perpetual Start Year		2022									
Perpetual Value		1,725,330									
PV of Perpetual Growth Period		555,510									
<b>Total FCF</b>											
Value of FCF		681,753									
<b>Intrinsic Value</b>											
Cash		47,100									
Debt		14,935									
After Tax ESO Liability		11,870									
Value of Equity		702,047									
Shares Outstanding		23,592									
<b>Intrinsic Value per Share</b>		<b>\$29.76</b>									

Sensitivity Analysis					
Terminal Period Variables		FCF Growth			
Cost of Capital	2.0%	2.5%	3.0%	3.5%	4.0%
	9.5%	\$45.47	\$48.57	\$52.19	\$56.47
	10.0%	\$41.06	\$43.64	\$46.61	\$50.09
	11.5%	\$30.99	\$32.56	\$34.32	\$36.32
	12.0%	\$28.41	<b>\$29.76</b>	\$31.26	\$32.96
	12.5%	\$26.12	\$27.29	\$28.58	\$30.03
	13.0%	\$24.08	\$25.09	\$26.21	\$27.45

**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 (9/30/2013)**

Rating	% Of Companies Covered	% With Investment Banking Relationships
Buy	75%	23%
Hold	22%	0%
Sell	4%	0%
Total	100%	17%

**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 has received investment banking revenue from 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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**REGULATION AC CERTIFICATION**

I, Steven F. Crowley, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject security and issuer. No part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views contained herein.