

Aratana Therapeutics Inc.

March towards commercialization

Last night's 1Q earnings report by Aratana was relatively uneventful, but the company showed a number of advancements in its pipeline of companion animal health products, particularly in the areas of oncology and pain management. Key studies are on track to support US marketing approval and commercialization in 2016, including AT-001 for pain and inflammation associated with osteoarthritis in dogs, AT-002 for appetite stimulation in dogs, and AT-003 (a companion-animal version of PCRX's Exparel) for post-operative pain management in dogs. The company now expects full licensure for AT-004 (partnered with Novartis/Elanco) for B-cell lymphoma in dogs in 2014 rather than 2015 and AT-005 in early 2015. This is not a big surprise since the conditional licenses came early, but marks an important transition for the company from development-stage to commercialization.

Aratana reported EPS of \$0.34 as we see it, adjusting reported income tax gain and write-down for in-process R&D. The company maintains its cash flow from operations guidance of \$35-40M for FY14, and plans to hire 6-8 employees as it begins to build out its targeted sales force in 2015 to support both AT-005 as well as lay the groundwork for its launch-rich 2016. Aratana also continues to stay active in business development, though company acquisitions unlikely for now. The company noted that it plans to continue traditional in-licensing activities similar to Advaxis and options programs like in previous quarters. Final decisions on two option programs are expected in the next couple months.

Catalyst rich close to 2014 and start to next year. With both AT-001 and AT-002 in pivotal studies, we expect data readouts at the end of 2014 or early 1Q15. Additionally, we expect full licensure by USDA for both the B-cell and T-cell lymphoma products. We have high confidence in success for all of these yet don't believe the company's valuation reflects the likelihood of success. We believe Aratana represents one of our favorite ideas in spec pharma.

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	-0.30E	-0.34A	-0.35E	-0.19E	-0.19E	-0.29E	86%	44%
Q2	-4.62A	-0.29E	-0.26E	-0.36E	-0.32E	-0.32E	-0.36E	94%	-23%
Q3	-0.22A	-0.30E	-0.30E	-0.38E	-0.32E	-0.32E	-0.36E	-36%	-7%
Q4	-0.40A	-0.30E	-0.33E	-0.35E	-0.33E	-0.33E	-0.37E	18%	0%
Year	-2.43A	-1.19E	-1.23E	-1.45E	-1.17E	-1.17E	-1.49E	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 5.

Stock Rating	OVERWEIGHT
	Unchanged
Industry View	POSITIVE
	Unchanged
Price Target	USD 30.00
	Unchanged

Price (13-May-2014)	USD 12.19
Potential Upside/Downside	+146%
Tickers	PETX

Market Cap (USD mn)	359
Shares Outstanding (mn)	29.45
Free Float (%)	87.83
52 Wk Avg Daily Volume (mn)	0.2
Dividend Yield (%)	N/A
Return on Equity TTM (%)	N/A
Current BVPS (USD)	3.67

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	560	5,920	36,324	N/A
EBITDA (adj)	-19,843	-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	-0.68	N/A
Diluted shares (k)	11,179.9	28,853.9	29,662.5	29,762.5	38.6%
DPS	N/A	N/A	N/A	N/A	N/A

Margin and return data	Average				
EBITDA (adj) margin (%)	N/A	-6,337.0	-594.0	-56.3	-2,329.1
EBIT (adj) margin (%)	N/A	-6,337.0	-594.0	-56.3	-2,329.1
Pre-tax (adj) margin (%)	N/A	-6,342.1	-584.7	-55.6	-2,327.5
Net (adj) margin (%)	N/A	-6,342.1	-584.7	-55.6	-2,327.5
ROIC (%)	N/A	N/A	N/A	N/A	N/A
ROA (%)	-17.2	-27.9	-37.6	-30.1	-28.2
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	56,269	27,605	11,164	-35.2%
Total assets	115,536	127,052	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	94,150	58,606	30,342	-29.3%
Change in working capital (\$mn)	11,381	-481	-1,020	-459	N/A
Cash flow from operations (\$mn)	-9,721	-35,191	-35,308	-20,286	N/A
Capital expenditure (\$mn)	-59	-546	-76	-76	N/A
Free cash flow (\$mn)	-8,403	-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 (%)	-6,165.8	-9,912.7	-9,979.4	-5,733.0	-7,947.7
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 (13-May-2014) USD 12.19
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.

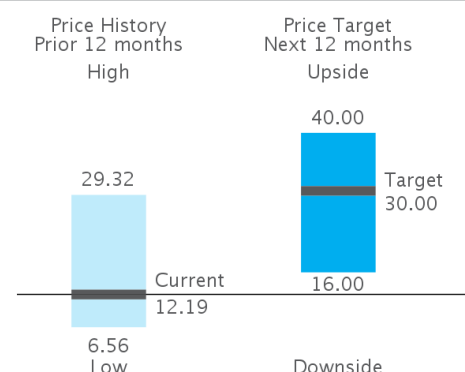
Upside case USD 40.00

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.

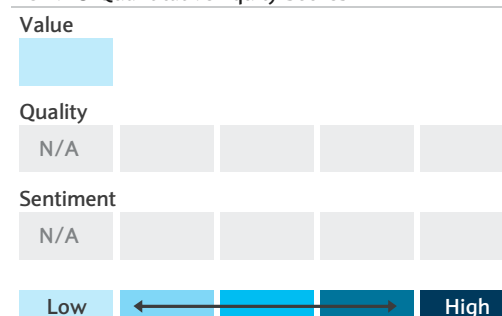
Downside case USD 16.00

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.

Thoughts after 1Q14 Earnings Call

We continue to believe that Aratana is uniquely positioned for growth in the coming years as it begins to commercialize products, freeing up capacity in its pipeline to add new product candidates. Given the long-lived dynamics of products in the animal health market – generic competition is less impactful – we believe Aratana can add to its initial tranche of product opportunities to build a formidable market presence in the companion animal space.

We also believe that a company of Aratana's size can effectively market products in the specialized pet cancer immunotherapy space, compared to a large scale industry player who is likely more focused on products catering more towards generalist veterinarians. Management also noted it has a more targeted customer base, as they work directly with a handful of veterinarians and clinics, rather than competing for formulary access with large scale insurance providers and widespread clinicians.

Management noted the clear communication and accessibility of the USDA for animal health in contrast with the FDA for human biopharmaceuticals. We see this as an advantage for experienced management teams running lean organizations such as Aratana.

FIGURE 1
Pipeline Update

COMPOUND	SPECIES	INDICATION	DEVELOPMENT STATUS UPDATE	EXPECTED NEXT STEP UPDATE
AT-001	Dog	Pain & inflammation associated with osteoarthritis	Initiated pivotal field effectiveness study in client owned dogs with once-daily dose	Study results expected in late 2014; U.S. marketing approval and commercialization still planned for 2016
	Cat	Pain & inflammation associated with osteoarthritis	Pilot studies	Dose confirmation study, pilot field study mid 2014
AT-002	Dog	Stimulation of appetite	Pivotal field effectiveness study enrolling as expected	Top line results 1H15; Submission for approval; approval expected in 2016
	Cat	Stimulation of appetite	Pilot studies	Dose confirmation study, pilot field study mid 2014
AT-003 (Exparel)	Dog	Post-operative pain management	Proof of concept study	Dose confirmation study; initiate pivotal trial in 2Q14, approval expected in 2016
	Cat	Post-operative pain management	Proof of concept study	Dose confirmation study, initiate pilot study 2Q14
AT-004	Dog	B-cell lymphoma	Submitted pivotal field effectiveness study, received conditional license from USDA	Currently sold by Novartis (Aratana receives attractive royalty rate); Full license expectation pulled forward to 2014
AT-005	Dog	T-cell lymphoma	Received conditional license, completed enrollment in study that will support full licensure	Full licensure expected 2015, initiated 2 new studies investigating use with chemotherapy
AT-006	Cat	Ocular herpes infection (Okapi)	Pivotal field study in Europe- continued enrollment	File for EU review in early 2015; Expect U.S. marketing approval in 2017 or 2018
AT-007	Cat	Feline immunodeficiency virus infection	Pilot study in Europe	Initiate field effectiveness study in 2015; expect U.S. marketing approval in 2017 or 2018
AT-008	Dog	Lymphoma	Pivotal field effectiveness study	Pivotal field effectiveness in the EU in 2014
AT-009	Dog	Mast cell tumor		Pilot studies
AT-010	Dog	Atopic dermatitis		Pilot studies
AT-011	Dog	Parvovirus infections	Lead selection	Proof of concept study
AT-012	Cat	Calicivirus infections	Lead selection	Proof of concept study

Source: Barclays Research

FIGURE 2

1Q14 Earnings and Estimates

PETX - 1Q14 Results; 2014 Estimates, 2014 Guidance						
(\$ in 000's except EPS)	1Q14			% Change Q/Q	FY14 Ests	
	Actual	Barclays	Cons		Barclays	Cons
Total Revenues	\$176	\$80	\$90	43.1%	\$560	\$790
SG&A	4,613	3,200		-3.3%	12,800	
R&D	3,572	5,500		14.9%	23,200	
In-process R&D	657					
Operating Income	(8,667)	(8,620)		6.5%	(35,440)	
D&A	539	5		41.8%	22	
EBITDA	(8,128)	(8,615)		4.8%	(35,418)	
NOPAT	(8,667)	(8,620)		6.5%	(35,440)	
Interest Income	(314)	175			700	
Other Income	(243)	2			5	
Net Other Income	(557)	177			705	
Income Before Taxes	(9,224)	(8,443)		10.6%	(34,735)	
Adjusted Net Income	(9,224)	(8,443)		10.6%	(34,735)	
Adjusted EPS	(\$0.34)	(\$0.30)	(\$0.35)	-13.8%	(\$1.19)	(\$1.45)
Shares (000's)	26,766	28,000		25.5%	29163	

Source: Company reports; Barclays Research

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Primary Stocks (Ticker, Date, Price)

Aratana Therapeutics Inc. (PETX, 13-May-2014, USD 12.19), Overweight/Positive, A/C/D/I/L

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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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USD 12.19 (13-May-2014)

Stock Rating

OVERWEIGHT

Industry View

POSITIVE

Rating and Price Target Chart - USD (as of 13-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

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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).

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