

Aratana Therapeutics, Inc.

First Look at Third-Quarter Results; Product Portfolio on Track

Aratana Therapeutics reported third-quarter results on Wednesday, November 13. Results included a loss of \$4.7 million, which compared with our estimate for a loss of \$4.4 million and the consensus expectation for a loss of \$5.2 million. Total expenses were slightly higher than our \$4.5 million estimate and accounted for the difference relative to our model. Given that the company's product portfolio is in its early stages, we believe investor focus on Thursday's 7 a.m. CT conference call will be on progress developing the current compounds as well as the integration of Vet Therapeutics, which was announced in mid-October. While we view Aratana as higher risk than other vet industry peers, we believe the \$399 million enterprise valuation (\$447 million market cap) and unique business model offer a compelling opportunity for small-cap investors. We will make final changes to our model following Thursday's conference call, but we do not expect major changes.

Key Points

- We believe Aratana has sufficient cash to fund operations through the middle of 2015.** Aratana ended the quarter with cash, cash equivalents, and marketable securities of \$52 million, and guidance suggests that the previous expectation to end the year with \$45 million-\$50 million in cash remains unchanged. Guidance also confirmed that the current cash balance should last through the end of 2015.
- Several clinical catalysts are expected beginning late in 2013/2014.** There were few changes in timelines for the product portfolio, suggesting that progress remains on track. Still, there are several key events expected before the end of 2013 that are potential catalysts for the stock, most notably the top-line results from the dose-range field study of AT-001 in dogs (expected later this month). In addition, AT-001 is being pursued for chronic pain in cats, a program that seemed less certain in previous discussions. AT-002 is expected to initiate a pivotal study in dogs later this year, while progress was made on the formulation of AT-002 for cats. Results from the cat study in AT-002 are expected in the first half of 2014. AT-003 in dogs (for the treatment of post-operative pain) initiated dose-ranging studies in the second quarter, and management is still anticipating initial discussions with the FDA's CVM on a development program later this year. AT-003 also initiated a dose-ranging study. We continue to expect regulatory filings for all these compounds in 2015, with potential approvals in 2016.

The lymphoma products acquired from Vet Therapeutics are also progressing according to plan, with the B-cell product (targeting CD20, similar to the human product Rituxan) regulatory submission to the USDA complete and a full license expected in 12-18 months. The T-cell product (targeting CD52, similar to the human product Campath) is expected to have a conditional license in 2014 with a full license expected in 2015. The approval of the CD52 antibody should propel Aratana into a commercial-stage company, and we expect more discussion of this transformation to be a focus on Thursday's conference call.

Aratana is focused solely on the companion-animal market. The company was founded in 2010 to pursue in-licensing, development, and commercialization of novel therapeutics for cats and dogs. The company has three molecules focused on osteoarthritic 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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November 13, 2013

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

Symbol: PETX (NASDAQ)
Price: \$20.40 (52-Wk.: \$7-\$29)
Market Value (mil.): \$447
Fiscal Year End: December
Long-Term EPS Growth Rate: NA
Dividend/Yield: None

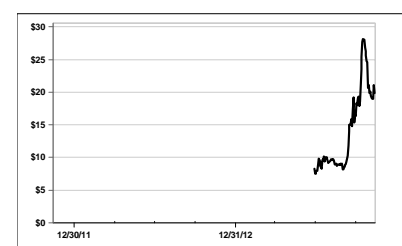
	2012A	2013E	2014E
Estimates			
EPS FY	\$-0.91	\$-0.84	\$-0.94
CY		\$-0.84	\$-0.94

Valuation			
FY P/E	NM	NM	NM
CY P/E		NM	NM

Trading Data (FactSet)	
Shares Outstanding (mil.)	1
Float (mil.)	3
Average Daily Volume	73,274

Financial Data (FactSet)	
Long-Term Debt/Total Capital (MRQ)	0.0
Book Value Per Share (MRQ)	-29.1
Enterprise Value (mil.)	45.0
EBITDA (TTM)	0.0
Enterprise Value/EBITDA (TTM)	0.0x
Return on Equity (TTM)	-40.6

Two-Year Price Performance Chart



Sources: FactSet, William Blair & Company estimates

We note that Louise Mawhinney, Aratana's former CFO, recently announced her transition into a role focused more on internal operations at the company, and we believe initially she will be working extensively on the integration of Vet Therapeutics. Craig Tooman, Aratana's new CFO, will participate in the company's call Thursday, his first call since being appointed CFO on Monday.

- **Valuation.** PETX is trading at \$447 million in market capitalization and an enterprise value of \$399 million. 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 low-\$20 range, with upside driven by additional compound in-licensing and acquisitions. We look for additional information on Thursday's call regarding the updated timelines for the product portfolio as well as additional information on the integration of Vet Therapeutics.
- **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 \$31.72), 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 given that no product revenues are expected before 2016.
- **Results.** Exhibit 1 summarizes Aratana's third-quarter results compared with our model (losses were roughly \$200,000 above our model, driven by higher R&D spending). We currently estimate a year-end cash balance of \$46.7 million, compared with management guidance of \$45 million to \$50 million. We will update our estimates and our cash-use assumptions following Thursday's conference call.

Exhibit 1. Third Quarter 2013 Earnings Variance Analysis

November 13, 2013	3Q FY13 (Actual)	3Q FY12 (Actual)	Year/Year % Change	3Q FY13 (Estimate)	Year/Year % Change	Act.-Est. Difference
Total Net Revenue	\$0	\$0	NA	\$0	NA	\$0
Direct Costs	0	0	NA	0	NA	\$0
Research & Development	3,234,000	1,658,000	95.1%	3,027,055	82.6%	\$206,945
Selling, General & Administrative	1,427,000	1,065,000	34.0%	1,458,000	36.9%	(\$31,000)
Total operating expenses	4,661,000	2,723,000	71.2%	4,485,055	64.7%	\$175,945
Operating income	(4,661,000)	(2,723,000)	71.2%	(4,485,055)	64.7%	(\$175,945)
Interest and other income (net)	(10,000)	86,000	-111.6%	37,728	-56.1%	(\$47,728)
Earnings before tax	(4,671,000)	(2,637,000)	77.1%	(4,447,327)	68.7%	(\$223,673)
Income taxes	0	0	NM	0	NM	\$0
Net income (excl. extraord, incl. options)	(4,671,000)	(2,637,000)	77.1%	(4,447,327)	68.7%	(\$223,673)
Extraordinary item	0	0	NC	0	NC	\$0
Unaccreted dividends on convertible pref. stock	0	(527,000)		0		
Net income, after extra. item	(4,671,000)	(3,164,000)	47.6%	(4,447,327)	40.6%	(\$223,673)
Shares outstanding	20,806,352	14,972,266	39.0%	20,722,266	38.4%	\$84,086
EPS (excl. extraord, incl. options)	(\$0.22)	(\$0.18)	27.5%	(\$0.21)	21.9%	(\$0.010)
EPS (incl. extraord.)	(\$0.22)	(\$0.21)	6.2%	(\$0.21)	1.6%	(\$0.010)
% of Net Revenue:			<u>Change</u>		<u>Change</u>	
Direct costs	NA	NA	NA	NA	NA	NA
Gross profit	NA	NA	NA	NA	NA	NA
Selling, general and administrative	NA	NA	NA	NA	NA	NA
Depreciation and amortization	NA	NA	NA	NA	NA	NA
Operating income (incl. options)	NA	NA	NA	NA	NA	NA
Net income	NA	NA	NA	NA	NA	NA
Effective tax rate	NA	NA	NA	NA	NA	NA

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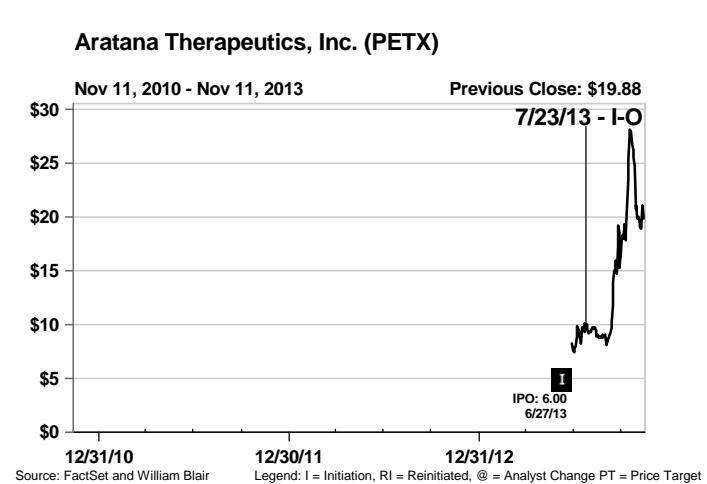
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DOW JONES: 15,750.67

S&P 500: 1,767.69

NASDAQ: 3,919.92



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Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	62	Outperform (Buy)	11
Market Perform (Hold)	34	Market Perform (Hold)	2
Underperform (Sell)	1	Underperform (Sell)	0

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