

## Aratana Therapeutics, Inc.

### First Quarter Largely a Non-Event With Three Products in Pivotal Studies; Remain Outperform

- Aratana Therapeutics reported a net income loss of \$9.1 million in the first quarter, or a loss per share of \$0.34, ahead of our estimate for a loss of \$11.7 million, or a loss per share of \$0.43. Relative to our model, R&D spending of \$3.572 million was below our expectation for R&D expense of \$6.828 million, while SG&A spending of \$4.6 million was also below our estimate for \$5.097 million. While expenses were in general below our expectations, revenue at Aratana was also below our expectations though we have relatively low expectations until the company begins a full launch of multiple products in 2016. Revenue of \$176,000 was below our estimate for revenue of \$220,000, and we believe most of the revenue was reimbursements for clinical development, not royalties associated with AT-004 or initial sales from AT-005 following that product's conditional approval in January of this year. Management continues to expect cash burn during 2014 of \$35 million-\$40 million, in line with our previous estimates. Despite the recent sell-off, which we believe is likely related to lock-up liquidity, given the breadth of pipeline with two pivotal studies reporting out during the year (AT-002 and AT-006 in Europe), a third pivotal study initiated (AT-001), a potential full licensure of AT-004, full launch during the fourth quarter, and more than 15 additional product candidates, we see Aratana as holding one of the most significant opportunities in the animal health space. While we do not expect Aratana to have significant revenues (or earnings) for a few years, we believe investors will focus primarily on the clinical progress of the existing product portfolio over the coming year, along with the associated cash burn from those clinical programs. While we view Aratana as higher risk than other vet industry peers, we believe the \$359 million market cap and unique business model offer a compelling opportunity for small-cap investors.

*Aratana is a specialty biopharmaceutical company focused solely on the companion-animal market. The company was founded in Kansas City, Kansas, 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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May 13, 2014

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

Symbol: PETX (NASDAQ)  
Price: \$12.19 (52-Wk.: \$7-\$29)  
Market Value (mil.): \$364  
Fiscal Year End: December  
Long-Term EPS Growth Rate:  
Dividend/Yield: None

		2013A	2014E	2015E
<b>Estimates</b>				
EPS Q1		\$-0.27	A\$-0.34	NA
Q2		\$-0.23	\$-0.35	NA
Q3		\$-0.22	\$-0.43	NA
Q4		\$0.33	\$-0.45	NA
FY		\$-0.39	\$-1.55	\$-1.50
CY			\$-1.55	\$-1.50
Sales (mil.)		0	0	8
<b>Valuation</b>				
FY P/E		NM	NM	NM
CY P/E			NM	NM

<b>Trading Data (FactSet)</b>	
Shares Outstanding (mil.)	21
Float (mil.)	10
Average Daily Volume	286,107

<b>Financial Data (FactSet)</b>	
Long-Term Debt/Total Capital (MRQ)	0.0
Book Value Per Share (MRQ)	3.7
Return on Equity (TTM)	-6.5

#### Two-Year Price Performance Chart



Sources: FactSet, William Blair & Company estimates

## Key Points

- **Aratana has sufficient cash to fund operations through 2015.** Aratana ended the first quarter with cash, cash equivalents, and marketable securities of \$79.9 million. Management noted that it expects the current cash to last through the end of 2015.
- **B-cell lymphoma product affected by transition at Novartis Animal Health, T-cell product still launching in 2015.** Changes at Novartis Animal Health, which has been acquired by Eli Lilly's (LLY \$60.04) Animal Health Unit (ELANCO), have caused a disruption in the preliminary launch of AT-004. While the changes have delayed a full launch of the CD-20 targeting antibody product by several quarters, we had previously expected less than \$1 million in royalty revenue from the product during the year. Aratana now expects a full licensure of the product by the USDA during 2014, which should align well with a higher profile launch at a veterinary oncology conference held during the fourth quarter. Management continues to expect a launch of the CD-52 targeting T-cell lymphoma product during 2015. Several clinical studies have also been submitted for peer-reviewed publication during 2014, which should inform the dosing and sequencing of both AT-004 and AT-005, in combination with chemotherapy.
- **Remainder of pipeline progressing well.** There were few changes in timelines for the product portfolio, suggesting progress remains on track. Aratana initiated its pivotal effectiveness study in client-owned dogs with once-daily dosing; while a pilot study in cats will also begin by mid-2014. This timing is in line with prior guidance. The company is currently running pivotal field studies for AT-001 (osteoarthritis pain), AT-002 (appetite stimulation), and AT-006 (feline immunodeficiency virus, Europe only). We continue to expect pivotal data from all three programs through early 2015. Exhibit 2 below summarizes Aratana's most updated product portfolio and expected launch dates.
- **Valuation.** Following a rather severe correction, from share price highs of about \$24 per share, which we believe is related to lockup liquidity and a general sell-off in development stage therapeutic companies, Aratana is trading at \$359 million in market capitalization and an enterprise value of \$279 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 mid-20s, which suggests roughly a doubling of the company's share price, outside of additional compound in-licensing and acquisitions.
- **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 \$30.73; Outperform), 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.
- **Model adjustments.** Following Tuesday's conference call, we are making minor changes to 2014 operating expenses to \$42.4 million, up from \$37.4 million previously, although this number includes roughly \$2.1 million in amortization of intangibles and \$656,000 of in-process R&D related to the company's recent acquisitions. Exhibit 1, on the following page, details the first quarter's variance compared with our model. Exhibit 2 contains our adjusted estimates, and exhibit 3 includes Aratana's product portfolio. Our model is in exhibit 4, on page 5.

# Exhibit 1. First Quarter 2014 Earnings Variance Analysis

## Aratana Therapeutics, Inc. (PETX \$9.65)

First Quarter 2014 Earnings Review

(\$ in thousands, Fiscal Year ends December)

May 13, 2014	1Q FY14 (Actual)	1Q FY13 (Actual)	Year/Year % Change	1Q FY14 (Estimate)	Year/Year % Change	Act.-Est. Difference
Total Net Revenue	\$176,000		NA	\$220,500	NA	(\$44,500)
Cost of Product Sales and Royalty Expense	18,000		NA	7,056	NA	\$10,944
Research & Development	3,572,000	2,114,000	69.0%	6,828,125	223.0%	(\$3,256,125)
Selling, General & Administrative	4,613,000	1,226,000	276.3%	5,097,500	315.8%	(\$484,500)
Total operating expenses	8,203,000	3,340,000	145.6%	11,932,681	257.3%	(\$3,729,681)
Amortization of intangibles	538,500					
In-Process R&D	656,800					
Operating income	(9,222,300)	(3,340,000)	176.1%	(11,712,181)	250.7%	\$2,489,881
Interest and other income (net)	(557,000)	47,000	-1285.1%	(56,829)	-220.9%	(\$500,171)
Earnings before tax	(9,779,300)	(3,293,000)	197.0%	(11,769,010)	257.4%	\$1,989,710
Income taxes	(627,000)	0	NM		NM	(\$627,000)
<b>Net income (excl. extraord. incl. options)</b>	<b>(9,152,300)</b>	<b>(3,293,000)</b>	<b>177.9%</b>	<b>(11,769,010)</b>	<b>257.4%</b>	<b>\$2,616,710</b>
Shares outstanding	26,765,565	14,972,266	78.8%	27,295,775	82.3%	(\$530,210)
<b>EPS (excl. extraord. incl. options)</b>	<b>(\$0.34)</b>	<b>(\$0.22)</b>	<b>55.5%</b>	<b>(\$0.43)</b>	<b>96.0%</b>	<b>\$0.089</b>
% of Net Revenue:			Change		Change	
Direct costs	10%	NA	NA	3.2%	NA	NA
Gross profit	90%	NA	NA	96.8%	NA	NA
Selling, general and administrative	NA	NA	NA	NA	NA	NA
Depreciation and amortization	NA	NA	NA	NA	NA	NA
<b>Operating income (incl. options)</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>
Net income	NA	NA	NA	NA	NA	NA
Effective tax rate	NA	NA	NA	NA	NA	NA

# Exhibit 2. Aratana Adjusted Estimates

NEW	2014	2015	2016	2017	2018	2019	2020
TOTAL Revenue	\$ 369,500	\$ 8,430,611	\$ 44,496,321	\$ 92,248,631	\$ 174,954,195	\$ 250,695,522	\$ 340,735,493
Anti-CD52 Revenue	\$ 157,500	\$ 6,054,048	\$ 10,140,530	\$ 16,003,025	\$ 21,757,712	\$ 25,805,965	\$ 27,979,099
Anti-CD20 Royalty	\$ 48,000	\$ 2,177,776	\$ 4,140,717	\$ 7,766,801	\$ 10,461,284	\$ 13,310,445	\$ 16,973,987
Operating Expenses	\$ 42,308,327	\$ 49,654,539	\$ 68,897,345	\$ 87,361,025	\$ 117,650,032	\$ 150,237,615	\$ 188,228,905
Net Income	\$ (42,515,070)	\$ (41,421,607)	\$ (24,561,211)	\$ 3,015,392	\$ 36,575,498	\$ 64,262,580	\$ 97,685,055
<b>EPS</b>	<b>(\$1.55)</b>	<b>(\$1.50)</b>	<b>(\$0.83)</b>	<b>\$0.10</b>	<b>\$1.22</b>	<b>\$2.12</b>	<b>\$3.20</b>
WASO	27,223,223	27,540,775	29,690,775	29,890,775	30,090,775	30,290,775	30,490,775

OLD	2014	2015	2016	2017	2018	2019	2020
TOTAL Revenue	\$ 1,496,250	\$ 8,430,611	\$ 44,496,321	\$ 92,248,631	\$ 174,954,195	\$ 250,695,522	\$ 340,735,493
Anti-CD52 Revenue	\$ 614,250	\$ 6,054,048	\$ 10,140,530	\$ 16,003,025	\$ 21,757,712	\$ 25,805,965	\$ 27,979,099
Anti-CD20 Royalty	\$ 882,000	\$ 2,177,776	\$ 4,140,717	\$ 7,766,801	\$ 10,461,284	\$ 13,310,445	\$ 16,973,987
Operating Expenses	\$ 37,404,219	\$ 53,134,974	\$ 73,004,258	\$ 90,773,921	\$ 121,404,218	\$ 154,367,520	\$ 192,771,470
Net Income	\$ (36,056,223)	\$ (44,894,642)	\$ (28,660,583)	\$ 829,430	\$ 34,166,710	\$ 61,609,275	\$ 94,763,287
<b>EPS</b>	<b>(\$1.32)</b>	<b>(\$1.63)</b>	<b>(\$0.97)</b>	<b>\$0.03</b>	<b>\$1.14</b>	<b>\$2.03</b>	<b>\$3.11</b>
WASO	26,857,858	27,540,775	29,690,775	29,890,775	30,090,775	30,290,775	30,490,775

Changes	2014	2015	2016	2017	2018	2019	2020
Δ Revenue	\$ (1,126,750)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Δ Anti-CD52 Revenue	\$ (456,750)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Δ Anti-CD20 Royalty	\$ (834,000)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Δ Operating Expenses	\$ 4,904,108	\$ (3,480,435)	\$ (4,106,913)	\$ (3,412,896)	\$ (3,754,186)	\$ (4,129,905)	\$ (4,542,565)
Δ Net Income	\$ (6,458,847)	\$ 3,473,035	\$ 4,099,372	\$ 2,185,962	\$ 2,408,788	\$ 2,653,305	\$ 2,921,768
<b>Δ EPS</b>	<b>\$ (0.23)</b>	<b>\$ 0.13</b>	<b>\$ 0.14</b>	<b>\$ 0.07</b>	<b>\$ 0.08</b>	<b>\$ 0.09</b>	<b>\$ 0.09</b>
Δ WASO	365,365	0	0	0	0	0	0

Source: William Blair &amp; Company L.L.C. estimates

### Exhibit 3. Aratana Product Portfolio

Product	Proof of Concept	Pilot	Pivotal	Conditional License	Full License	Market	Launch Date	Comments/Timing
AT-004 Dog (B-cell Lymphoma)							2014	Received conditional license from the USDA. Aratana submitted data to support a full licensure, which is expected in 4Q14.
AT-005 Dog (T-cell Lymphoma)							2015	USDA granted conditional approval. Currently pursuing full license from USDA which is expected in 2015.
ADX5-cHER2 Dogs (Osteosarcoma)							2016 (est)	Plan to submit for conditional license within the next 12 months.
AT-001 Dog (Osteoarthritis)							2016	Initiating pivotal field effectiveness study with once-daily dose in 2Q14. Expect US FDA market approval in 2016.
AT-002 Dog (Appetite Stimulant)							2016	Currently performing pivotal field effectiveness study in client-owned dogs, actively enrolling patients. Expected US marketing approval in 2016.
AT-006 (Feline Herpes)							2015 - EU	Currently performing pivotal field study in Europe. Next step is to file for EU review in 2014. Expect US marketing approval in 2017 or 2018.
AT-008 Dog (Lymphoma)							2014 - EU	Currently performing pivotal field effectiveness study in EU. Only Have EU rights.
Diagnostic Koi Carp - KHV Infections							TBD	To be divested or spun-out after value inflection.
AT-007 (Feline Immunodeficiency)							2018	Pilot study in Europe. Initiate field effectiveness study in 2015. Expect US marketing approval in 2017 or 2018.
AT-001 Cat (Osteoarthritis)							2016	Currently performing pilot studies. Next step is dose confirmation study.
AT-002 Cat (Appetite Stimulant)							2016	Currently performing pilot studies. Next step is dose confirmation study.
Other Vet Therapeutics Compounds							2015+	Mast Cell, Atpopic Dermatitis, & Feline Lymphoma. Studies in two unspecified products expected to begin in 2014 and completed by 2015. Conditional licenses expected in mid-2015 for two products and a third in 2016.
AT-003 Dog (Post-operative Pain)							2016	Initiate pivotal field effectiveness study in 2Q14. Expect US FDA approval in 2016.
AT-003 Cat (Post-operative Pain)							2016	Currently performing proof of concept study. Next step is dose confirmation study.
Option Programs (Alpha, Beta, Gamma)							TBD	Three programs being evaluated, PETX expects decision on all three in 1H14.
AT-011 Dog (Canine Parvovirus)							TBD	Currently in lead selection. Expected next step is proof of concept study.
AT-012 Cat (Feline Calicivirus)							TBD	Currently in lead selection. Expected next step is proof of concept study.

## Exhibit 4. Aratana Income Statement (2011 to 2020E)

Income Statement														
	2011	2012	2013	Q1A	Q2E	Q3E	Q4E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
Revenues														
AT-001				-	-	-	-	-	-	10,238,800	19,988,540	26,918,320	39,279,240	59,682,480
% growth (y/y)														
AT-002				-	-	-	-	-	-	11,629,964	20,244,546	33,740,910	50,611,365	74,023,790
% growth (y/y)														
AT-003				-	-	-	-	-	-	4,095,000	12,180,000	28,400,000	36,592,000	48,600,000
% growth (y/y)														
T-Cell Revenue				-	-	-	157,500	157,500	6,054,048	10,140,530	16,003,025	21,757,712	25,805,965	27,979,099
% growth (y/y)														
Feline Immunodeficiency				-	-	-	-	-	-	-	-	23,659,200	41,515,200	57,585,600
% growth (y/y)														
Osteosarcoma - Dogs				-	-	-	-	-	-	465,000	1,860,000	3,255,000	4,650,000	6,045,000
% growth (y/y)														
Total Net Product Revenues				-	-	-	157,500	157,500	6,054,048	36,569,294	70,276,111	137,731,142	198,453,770	273,915,970
B-Cell Royalty			123,000	12,000	12,000	12,000	12,000	48,000	2,177,776	4,140,717	7,766,801	10,461,284	13,310,445	16,973,987
Royalty Revenue (E.U.)				-	-	-	-	-	198,788	3,786,311	12,085,319	23,284,313	33,842,346	43,569,153
Feline Herpes Royalty				-	-	-	-	-	-	-	2,120,400	3,477,456	5,088,960	6,276,384
Other Revenue				164,000										
Total Net Revenues	-	0.0	123,000	176,000	12,000	12,000	169,500	369,500	8,430,611	44,496,321	92,248,631	174,954,195	250,695,522	340,735,493
% growth (y/y)											107%	90%	43%	36%
Expenses														
COGS	-	-	109,000	1,000	384	384	39,759	41,527	1,583,201	8,362,888	16,417,329	31,965,361	45,295,190	61,867,754
Royalty expense				17,000										
R&D expense	2,196,000	8,791,000	10,925,000	3,572,000	5,500,000	7,500,000	8,000,000	24,572,000	31,206,440	36,823,599	41,610,667	45,771,734	50,348,907	55,383,798
% growth (y/y)			24%	69.0%	122.8%	131.9%	157.4%	150%	27%	18%	13%	10%	10%	10%
SG&A expense	1,274,000	2,987,000	8,952,000	4,613,000	4,000,000	4,125,000	4,300,000	17,038,000	16,864,898	23,710,857	29,333,029	38,912,937	54,593,818	70,977,353
In-process R&D	-	-	-	656,800	-	-	-	656,800	-	-	-	-	-	-
Amortization of intangibles	-	-	-	538,500	530,000	530,000	530,000	2,128,500	-	-	-	-	-	-
Total Operating Expenses	3,470,000	11,778,000	19,986,000	9,398,300	9,500,384	11,625,384	12,339,759	42,308,327	49,654,539	68,897,345	87,361,025	117,650,032	150,237,915	188,228,905
Operating (loss)/profit	(3,470,000)	(11,778,000)	(19,863,000)	(9,222,300)	(9,488,384)	(11,613,384)	(12,170,259)	(41,938,827)	(41,223,928)	(24,401,023)	4,887,606	57,304,163	100,457,606	152,506,589
Interest income	6,000	21,000	76,000	14,000	58,896	55,871	50,765	179,532	144,021	181,512	165,643	186,752	294,375	468,010
Interest expense	-	-	(432,000)	(328,000)	(110,425)	(110,425)	(110,425)	(659,275)	(441,700)	(441,700)	(441,700)	(441,700)	(441,700)	(441,700)
Other Income	-	121,000	478,000	(243,000.0)	25,000.0	25,000.0	25,000.0	100,000	100,000	100,000	100,000	100,000	100,000	100,000
Total Other Income	6,000	142,000	122,000	(557,000)	(26,529)	(29,554)	(34,660)	(647,743)	(197,679)	(160,188)	(176,057)	(154,948.1)	(47,325)	126,310
Net loss and comprehensive loss	(3,464,000)	(11,636,000)	(19,741,000)	(9,779,300)	(9,514,913)	(11,642,938)	(12,204,919)	(42,586,570)	(41,421,607)	(24,561,211)	4,711,549	57,149,215	100,410,281	152,632,899
Modifications of Series A convertible pref. stock	(276,000)	-	-	-	-	-	-	-	-	-	-	-	-	-
Unaccreted dividends on convertible pref. stock	(902,000)	(2,035,000)	(1,581,000)	-	-	-	-	-	-	-	-	-	-	-
Net income loss (gain) attributable to common stockholders, basic and diluted	(4,642,000)	(13,671,000)	(21,322,000)	(9,779,300)	(9,514,913)	(11,642,938)	(12,204,919)	(43,142,070)	(41,421,607)	(24,561,211)	4,711,549	57,149,215	100,410,281	152,632,899
Provision for income taxes	-	-	(15,455,000)	(627,000)	-	-	-	(627,000)	-	-	1,696,158	20,573,717	36,147,701	54,947,844
Effective tax rate	NM	NM	0%	0%	0%	0%	0%	0%	0%	0%	36%	36%	36%	36%
Net Income (loss)	(4,642,000)	(13,671,000)	(5,867,000)	(\$9,152,300)	(\$9,514,913)	(\$11,642,938)	(\$12,204,919)	(42,515,070)	(\$41,421,607)	(\$24,561,211)	\$3,015,392	\$36,575,498	\$64,262,580	\$97,685,055
EPS	(0.31)	(\$0.91)	(\$0.39)	(\$0.34)	(\$0.35)	(\$0.43)	(\$0.45)	(\$1.55)	(\$1.50)	(\$0.83)	\$0.10	\$1.22	\$2.12	\$3.20
Weighted average shares outstanding (diluted)	14,972,266	14,972,266	19,265,949	26,765,565	27,335,775	27,375,775	27,415,775	27,223,223	27,540,775	29,690,775	29,890,775	30,090,775	30,290,775	30,490,775
MARGIN ANALYSIS:														
Gross Profit										81%	82%	82%	82%	82%
SG&A										53%	32%	23%	22%	21%
R&D										83%	45%	26%	20%	16%
Operating Income										NA	5%	33%	40%	45%
Tax Rate										0%	36%	36%	36%	36%
Net Income										NA	3%	21%	26%	29%
GROWTH METRICS:														
Total Revenue											107%	90%	43%	36%
Gross Profit											110%	89%	44%	36%
SG&A			200%	276%	218%	189%	-15%	90%	-1%	41%	24%	36%	37%	30%
R&D				69%	123%	132%	157%	125%	27%	18%	13%	10%	10%	10%
Operating Income												1072%	75%	52%
Net Income												1113%	76%	52%
EPS												1105%	75%	51%
Diluted Shares Outstanding		0%	29%	79%	37%	32%	29%	28%	0%	8%	0%	0%	0%	1%

E = William Blair & Company, L.L.C. estimate

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William Blair & Company, L.L.C. has received compensation for investment banking services from the company within the past 12 months, or expects to receive or intends to seek compensation for investment banking services in the next 3 months.

# **IMPORTANT DISCLOSURES**

William Blair was a manager or co-manager of a public offering of equity securities for Aratana Therapeutics, Inc. within the prior 12 months.

William Blair and its affiliates beneficially own or control (either directly or through its managed accounts) 1% or more of the equity securities of Aratana Therapeutics, Inc. as of the end of the month ending not more than 40 days from the date herein.

William Blair is a market maker in the security of Aratana Therapeutics, Inc. and may have a long or short position.

William Blair intends to seek investment banking compensation in the next three months from Aratana Therapeutics, Inc.

Within the past 12 months William Blair has provided or is providing investment banking services to or has an investment services relationship with Aratana Therapeutics, Inc.

Additional information is available upon request.

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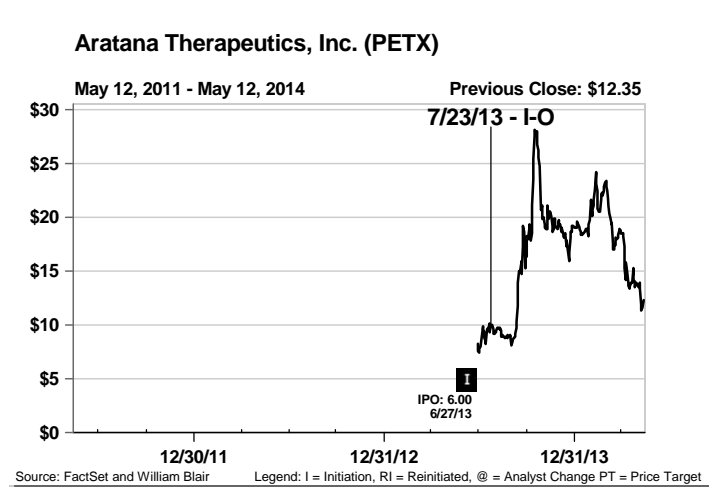
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DOW JONES: 16,695.47

S&P 500: 1,896.65

NASDAQ: 4,143.86



## **Current Rating Distribution (as of 04/30/14)**

Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	66	Outperform (Buy)	14
Market Perform (Hold)	31	Market Perform (Hold)	2
Underperform (Sell)	1	Underperform (Sell)	0

\*Percentage of companies in each rating category that are investment banking clients, defined as companies for which William Blair has received compensation for investment banking services within the past 12 months.

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