Aratana Therapeutics, Inc.

Okapi Acquisition Brings in Antiviral Franchise and European Beachhead

Conclusions

This morning, Aratana announced the acquisition of Okapi Sciences NV for €33.3 million ($45.3 million) in a deal composed of a mixture of cash, debt, and equity. Falling just two months after the Vet Therapeutics addition, the Okapi deal is further evidence that Aratana has staked out an aggressive leadership position in the emerging pet therapeutics arena. Following its June 2013 IPO with 6 product candidates in its portfolio focused on pain, the company now has more than 20 product candidates across pain, oncology, and virology, which encompass both small molecules and biologics. Based in Belgium, Okapi also gives the company a platform in Europe. We are quite encouraged by the company's progress in the past six months and believe the stock remains compelling despite its recent strength for small-cap animal health investors.

Transaction Details

- Aratana held $52.3 million in cash and equivalents as of the end of the third quarter; however, this number did not include a $19.75 million private placement executed in October and an increase in its term loan facility with Square 1 Bank from $5 million to $15 million. We have adjusted our estimates based on Monday's announcement and have assumed the $45.3 million acquisition payment will be completed by April with cash on hand, proceeds from debt, and stock issuance.

- We updated our model to reflect our initial expectations for Okapi. Given the assumed increase in expenses associated with Okapi, along with interest expense and the higher share count, we are increasing our loss target for 2014 to $34.4 million from $29.3 million, and increasing our loss per share estimate to $1.40 from $1.29. Longer term, we are reducing our 2017 EPS estimate to $0.06 (from $0.21), but increasing EPS estimates for 2018 through 2020 as the two main Okapi products become commercialized. Specifically, our 2018 EPS target goes from $0.77 to $1.09, our 2019 target goes from $1.40 to $1.99, and our 2020 target goes from $2.20 to $3.10.

- We had previously estimated a capital raise in 2015, but due to the increased spending associated with the Okapi programs and European facilities, we now believe Aratana will raise an additional $50 million by the second half of 2014. We note that nondilutive sources of capital funds will likely be available to the company given the breadth of the company's pipeline and potential for regional or worldwide rights to its 20 pipeline candidates.

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.

January 06, 2014

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

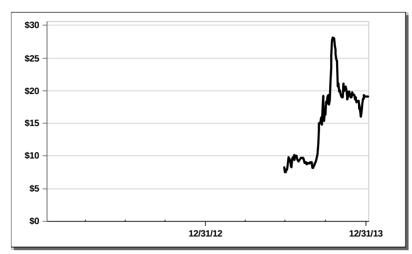
Symbol:	PETX (NASDAQ)
Price:	$19.67 (52-Wk.: $7-$29)
Market Value (mil.):	$468
Fiscal Year End:	December
Long-Term EPS Growth Rate:	
Dividend/Yield:	None

	2012A	2013E	2014E
Estimates			
EPS FY	$-0.91	$-0.95	$-1.40
CY		$-0.95	$-1.40
Valuation			
FY P/E	NM	NM	NM
CY P/E		NM	NM

Trading Data (FactSet)	
Shares Outstanding (mil.)	21
Float (mil.)	3
Average Daily Volume	99,300

Financial Data (FactSet)	
Long-Term Debt/Total Capital (MRQ)	0.0
Book Value Per Share (MRQ)	2.1
Enterprise Value (mil.)	361.9
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

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- The acquisition of Okapi adds an antiviral franchise containing six product candidates in various stages of development. The lead program (AT-006) is in development for the treatment of feline herpes and is estimated to be launched in 2015. Following the close of the acquisition, Aratana is set to receive a royalty from Novartis Animal Health based on future sales of AT-006. As Okapi becomes integrated, management has mentioned it will begin giving timeline guidance, but in the meantime domestic AT-006 development is expected to lag the European timeline.

- The market for AT-006 looks attractive with the product on pace to become the first antiviral approved for the treatment of a companion animal. Feline herpes is a common virus in cats with 95% of cats exposed, although only 3% exhibit symptoms. Kittens may be vaccinated for feline herpes at a young age; however, the efficacy of vaccination is limited. Assuming 86 million companion cats in both the United States and Europe, we believe more than 2.45 million companion cats exhibit symptoms of feline herpes, which suggests a large market for AT-006. The second-most advanced product from Okapi (AT-007) is in development for the treatment of feline immunodeficiency. The incidence of the disease approximates 2% in the United States; however, it is several times greater in Europe and Asia with the incidence in those regions exceeding 10%.

- Aside from AT-006, compounds include a product for feline immunodeficiency (with a launch estimate of 2017), a canine lymphoma (2017 or later) and parvovirus (2018 or later), a feline calicivirus product (2018 or later), and an unnamed product (2019 or later). Following the acquisition of Vet Therapeutics in October 2013, which bolstered Aratana's biologic capabilities, the company now holds a 20-product-strong development pipeline, including six products in the pivotal or commercial stages of development. We have included an updated product portfolio for the company in exhibit 1. The next upcoming development catalyst for Aratana should be the decision by the USDA for the conditional approval of the company's T-cell lymphoma product brought in through the Vet Therapeutics acquisition. Following that, we should hear decisions regarding three option products the company is evaluating for licensing.

- As in-licensing and product opportunities have become more competitive in the innovative animal health space, we believe management's ability to continue adding products to the pipeline will not only de-risk the portfolio, but leverage future relationships within the animal health industry. Leuven, Belgium will be Aratana's headquarters for all European regulatory and business development, which should give the company a solid platform to expand operations abroad. All 15 Okapi employees will remain in Belgium.

Stock Thoughts

Given the news surrounding Aratana, shares have been quite volatile as of late, trading as high as $29 in October and as low $16 in December. Within the last month shares have come back, but we believe the pending lock-up expiration in February is preventing shares from trading higher, because investors anticipate a liquidity event. We believe Aratana is quickly solidifying itself as a leader in the innovative veterinary medicine space for companion animals, and we view the recent acquisitions of Okapi and Vet Therapeutics as transformational for the company, which now boasts a 20-product-deep pipeline. We also note the final lock-up expiration for the remaining 14 million shares is scheduled to take place in mid-February after a one-month delay due to today's deal. We reiterate our Outperform rating on Aratana and expect 2014 to be an impressive year for clinical validation of the company's portfolio.

Valuation

We have used two different valuation methodologies for Aratana—a net present value (NPV) calculation and an EPS-multiple-based approach, discounting 2019 earnings to 2014. While we are not formally placing a price target on shares of Aratana, both valuation exercises suggest 12-month upside potential to be in the mid- to upper-$20 range.

- For our NPV analysis, we estimate revenue for the company of $43.8 million in 2016, ramping up to $306.4 million in 2020. Using a 10% discount rate, an EBIT margin that should reach 44% by 2020, and terminal growth of 3% suggests a reasonable value of roughly $581 million including cash, or roughly $25.60 per share. We outline our NPV assumptions below in exhibit 2.

- We also calculated several multiple-based valuation metrics for Aratana shares using a range of forward earnings multiples between 24 and 28 times and discount rates ranging from 10% to 25%. This calculation results in a value of between $19 per share on the low end (using a 24-times EPS multiple and a 20% discount rate) and $28 on the high end (using a 28-times EPS multiple and a 15% discount rate). We include this matrix for various multiples and discount rates below in exhibit 3.

Exhibit 1. Program Status for Portfolio

AT-001			
Dog		Cat	
September 2013	December 2013	September 2013	December 2013
- Pivotal Field Study initiated in 2012, Topline results expected in mid-2014 - Topline results from dose-ranging study expected in November 2013 - 2016 Launch	- Pivitol study expected to be initiated in 2014 - 2016 Launch	- No update; previously expected to pursue acute pain indication	- Pursuing chronic pain indication
AT-002			
Dog		Cat	
September 2013	December 2013	September 2013	December 2013
- Pivotal Field Study expected to be initiated in late 2013, Topline results expected in early 2015 - 2016 Launch	- Agreement on Pivotal Field Study design reached; expected to be initiated in late 2013 - 2016 Launch	- Pivotal Field Study expected to be initiated in late 2014, Topline results expected in late 2015 - 2017 Launch	- Pivotal Field Study expected to be initiated in mid 2014, Topline results expected in late 2015 - 3-week treatment term and final formulation selected; further proof of concept work to be done; results expected in fist half 2014
AT-003			
Dog		Cat	
September 2013	December 2013	September 2013	December 2013
- Pivotal Field Study expected to be initiated in mid-2014, Top line results expected in mid-2015 - 2016 Launch	- Pivotal Field Study expected to be initiated in mid-2014, Top line results expected in mid-2015 - Continued dose-ranging study in laboratory animals - 2016 Launch	-Pivotal Field Study expected to be initiated in mid-2014, Top line results expected in mid-2015 - 2016 Launch	-Pivotal Field Study expected to be initiated in mid-2014, Top line results expected in mid-2015 - Initiated dose-ranging study in laboratory animals in late 2013

AT-004 B-cell Lymphoma - dog only	
October 2013	December 2013
- Received conditional license from USDA	- Completed submission for full license; expected within next 12-18 months
AT-005 T-cell Lymphoma - dog only	
October 2013	December 2013
- Initial data submitted to USDA; expect conditional license in 2014 and full license in 2015	- Initial data submitted to USDA; expect conditional license in 2014 and full license in 2016
Option Programs	
October 2013	December 2013
- Three programs still being evaluated, company will advance at least program but likely not all following a decision in early 2014.	- Three programs still being evaluated, company will advance at least one program but likely not all following a decision in the first quarter 2014.
Other Vet Therapeutics Compounds for Mast Cell Tumors, Aptopic Dermatitis, and Feline Lymphoma	
October 2013	December 2013
- N/A	- Studies in two unspecified products expected to begin in 2014 and be completed by 2015; conditional licenses expected in mid-2015 for two products and a third product in 2016
AT-006 - Feline Herpes	
January 2014	
Currently performing clinical studies. Expected lauch in 2015.	
AT-007 - Feline Immunodeficiency	
January 2014	
Currently performing clinical studies. Expected launch in 2017.	
AT-008 - Dog Lymphoma	
January 2014	
Expected to end Pre-Clinical stage (No specific date given). Expected launch after 2017	
AT-011 - Dog Canine Parvovirus	
January 2014	
Pre-Clinical stage. Expected launch after 2018	
AT-012 - Cat Feline Calicivirus	
January 2014	
Pre-Clinical stage. Expected launch after 2018	
Diagnostic Koi Carp KHV Infections	
January 2014	
To be divested or spun-out after value inflection. Currently in pivotal stage	

Note: Shaded areas suggest updated language
Source: William Blair & Company, L.L.C.

Exhibit 2
Net Present Value of Estimated Cash Flows (12-Month Outlook)

	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018	12/31/2019	12/31/2020	12/31/2021	12/31/2022	12/31/2023	12/31/2024	12/31/2025	12/31/2026	12/31/2027	TV
Total Cost	33.14	47.88	63.09	81.93	109.50	139.12	171.96	189.73	211.28	229.85	243.65	254.07	238.01	240.82	
Revenue	0.84	11.40	43.82	86.72	157.35	225.52	306.41	370.75	444.90	511.64	562.80	602.20	507.61	517.76	
Effective tax rate	36%	36%	36%	36%	36%	36%	36%	36%	36%	36%	36%	36%	36%	36%	
Net Cash Flow	(20.67)	(23.35)	(12.34)	3.07	30.62	55.30	86.04	115.85	149.52	180.34	204.25	222.80	172.54	177.24	182.56
NPV of Cash Flows	(20.67)	(21.20)	(10.17)	2.29	20.80	34.10	48.16	58.87	68.98	75.54	77.65	76.90	54.07	50.42	51.94

All numbers in millions and dollars

Time of Valuation	12/31/14
Year of Terminal Value	2027

NPV ($ Thousand)	$567.69
NPV (Per Share)	**$24.99**
Cash	$13.65
NPV+Cash	**$25.59**

Exhibit 3
PETX Valuation on 2019 EPS (12-Month Outlook)

PETX Valuation of 2019 EPS

Earnings Muliple

	18	20	22	24	26	28	30	32
10%	$22	$25	$27	$30	$32	$35	$37	$40
15%	$18	$20	$22	$24	$26	$28	$30	$32
20%	$14	$16	$18	$19	$21	$22	$24	$26
25%	$12	$13	$14	$16	$17	$18	$20	$21

Exhibit 4
Aratana Income Statement (2011 to 2020E)

	2,011	2012	2013E	Q1E	Q2E	Q3E	Q4E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
Revenues														
AT-001				-	-	-	-	-	-	9,174,000	18,104,320	25,105,600	37,128,000	56,867,200
% growth (y/y)														
AT-002				-	-	-	-	-	-	11,051,800	19,294,880	32,417,360	48,584,000	70,468,200
% growth (y/y)														
AT-003				-	-	-	-	-	-	1,970,000	11,000,000	19,800,000	29,800,000	40,186,000
% growth (y/y)														
T-Cell Revenue				-	-	-	-	-	7,200,000	11,250,000	16,200,000	21,600,000	25,200,000	27,900,000
% growth (y/y)														
Feline Immunodeficiency												24,768,000	41,280,000	57,792,000
% growth (y/y)														
Total Net Product Revenues				-	-	-	-	-	7,200,000	33,445,800	64,599,200	123,690,960	181,992,000	253,213,400
B-Cell Royalty				210,000	210,000	210,000	210,000	840,000	4,200,000	8,400,000	12,600,000	16,800,000	19,320,000	21,000,000
Royalty Revenue (E.U.)				-	-	-	-	-	-	1,970,000	7,006,250	13,093,750	19,191,413	25,918,791
Feline Herpes Royalty									-	-	2,509,824	3,764,736	5,019,648	6,274,560
Total Net Revenues	-	0.0	0	210,000	210,000	210,000	210,000	840,000	11,400,000	43,815,800	86,715,274	157,349,446	225,523,061	306,406,751
% growth (y/y)											98%	81%	43%	36%
Expenses														
COGS	-	-	0	6,720	6,720	6,720	6,720	26,880	1,934,400	7,717,460	15,345,982	28,505,205	41,482,524	57,010,635
R&D expense	2,196,000	8,791,000	11,374,400	3,838,860	3,838,860	3,838,860	3,838,860	15,355,440	21,497,616	25,367,187	29,172,265	33,256,382	37,912,275	42,840,871
% growth (y/y)			*29%*	*81.6%*	*55.5%*	*18.7%*	*7.9%*	*35%*	*40%*	*18%*	*15%*	*14%*	*14%*	*13%*
SG&A expense	1,274,000	2,987,000	5,366,540	4,439,496	4,439,496	4,439,496	4,439,496	17,757,985	24,447,481	30,005,927	37,407,113	47,738,464	59,721,003	72,111,133
In-process R&D	-		-	-	-	-	-	-	-	-	-	-	-	-
	-	-	-	-	-	-	-	-	-	-	-	-	-	-
	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total Operating Expenses	3,470,000	11,778,000	16,740,940	8,285,076	8,285,076	8,285,076	8,285,076	33,140,305	47,879,497	63,090,574	81,925,360	109,500,051	139,115,802	171,962,640
Operating (loss)/profit	(3,470,000)	(11,778,000)	(16,740,940)	(8,075,076)	(8,075,076)	(8,075,076)	(8,075,076)	(32,300,305)	(36,479,497)	(19,274,774)	4,789,914	47,849,395	86,407,258	134,444,111
													38%	
Interest income	6,000	21,000	83,691	31,584	8,534	14,751	41,914	96,783	138,734	84,627	55,729	96,388	208,327	379,544
Interest expense	-		(388,250)	(567,018)	(567,018)	(567,018)	(567,018)	(2,268,070)	(2,268,070)	(2,268,070)	(2,268,070)	(2,268,070)	(2,268,070)	(2,268,070)
Other Income	-	121,000	505,000	25,000.0	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	200,441	(510,433)	(533,483)	(527,267)	(500,103)	(2,071,287)	(2,029,336)	(2,083,443)	(2,112,341)	(2,071,682.2)	(1,959,743)	(1,788,526)
	-										-	-	-	-
Net loss and comprehensive loss	(3,464,000)	(11,636,000)	(16,540,499)	(8,585,510)	(8,608,560)	(8,602,343)	(8,575,179)	(34,371,592)	(38,508,833)	(21,358,217)	2,677,574	45,777,713	84,447,515	132,655,585
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)	(18,121,499)	(8,585,510)	(8,608,560)	(8,602,343)	(8,575,179)	(34,371,592)	(38,508,833)	(21,358,217)	2,677,573.750	45,777,713	84,447,515	132,655,585
Provision for income taxes	-		-					-	-	-	963,927	16,479,977	30,401,105	47,756,011
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)**	**(18,121,499)**	**($8,585,510)**	**($8,608,559.6)**	**($8,602,343.2)**	**($8,575,179.5)**	**(34,371,592)**	**($38,508,833)**	**($21,358,217)**	**$1,713,647**	**$29,297,736**	**$54,046,410**	**$84,899,575**
EPS	**(0.31)**	**($0.91)**	**($0.95)**	**($0.38)**	**($0.36)**	**($0.33)**	**($0.33)**	**($1.40)**	**($1.46)**	**($0.80)**	**$0.06**	**$1.09**	**$1.99**	**$3.10**
Weighted average shares outstanding (basic)	14,972,266	14,972,266	19,312,486	22,715,727	23,620,727	26,175,727	26,230,727	24,685,727	26,355,727	26,555,727	26,755,727	26,955,727	27,155,727	27,355,727
Weighted average shares outstanding (diluted)	14,972,266	14,972,266	19,602,187	22,715,727	23,620,727	26,175,727	26,230,727	24,685,727	26,355,727	26,555,727	26,755,727	26,955,727	27,155,727	27,355,727
MARGIN ANALYSIS:														
Gross Profit										82%	82%	82%	82%	81%
SG&A										68%	43%	30%	26%	24%
R&D										58%	34%	21%	17%	14%
Operating Income										NA	6%	30%	38%	44%
Tax Rate										0%	36%	36%	36%	36%
Net Income										NA	2%	19%	24%	28%
GROWTH METRICS:														
Total Revenue											98%	81%	43%	36%
Gross Profit											98%	81%	43%	36%
SG&A			80%	262%	253%	211%	205%	231%	38%	23%	25%	28%	25%	21%
R&D			29%	82%	55%	19%	8%	35%	40%	18%	15%	14%	14%	13%
Operating Income												899%	81%	56%
Net Income												1610%	84%	57%
EPS												1597%	83%	56%
Diluted Shares Outstanding		0%	31%	52%	18%	26%	16%	9%	0%	0%	0%	0%	0%	1%

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

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IMPORTANT DISCLOSURES

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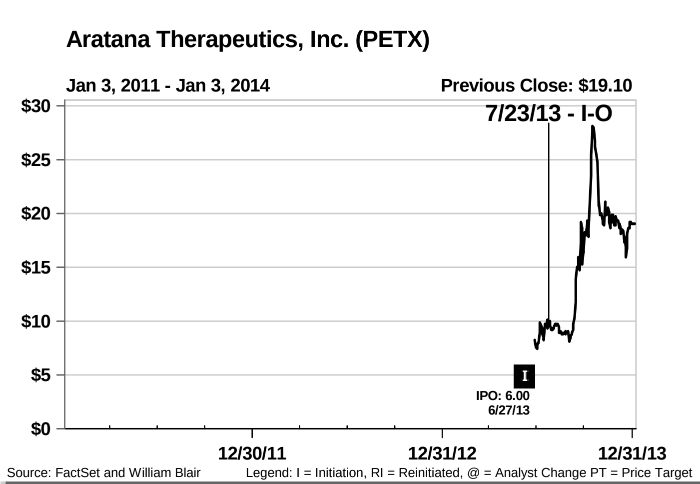
DOW JONES: 16,425.10
S&P 500: 1,826.77
NASDAQ: 4,113.68



Current Rating Distribution (as of 12/31/13)

Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	63	Outperform (Buy)	16
Market Perform (Hold)	33	Market Perform (Hold)	3
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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