

Aratana Therapeutics, Inc.

CFO Transition Unexpected but Appears to Signal Faster Growth Rather Than Signs of Trouble

Conclusion

Monday morning, November 11, Aratana Therapeutics announced a transition in the role of chief financial officer. Current CFO Louise Mawhinney will remain at Aratana but move into another operational role (we assume she will focus on the integration of Vet Therapeutics). Effective immediately, Craig Tooman will assume the CFO role after having served as a director and audit committee chairperson since 2012. While we generally view any change in the CFO role as a troubling sign, this move by Aratana appears to be more about bulking up the financial team in the midst of faster-than-expected growth than a sign of trouble. We expect a broader update from the expanded management team this Thursday, when the company releases third-quarter earnings results, and we understand that both Ms. Mawhinney and Mr. Tooman will participate. Despite the significant appreciation of shares since the company's IPO (roughly 250%), we continue to believe the opportunity for Aratana is attractive and highly differentiated versus other early-stage human therapeutics companies—particularly since the addition of Vet Therapeutics was announced last month. We therefore reiterate our Outperform rating on PETX shares.

CFO Transition Details

- Before joining Aratana as CFO in September 2012, Ms. Mawhinney served as CFO at two other early-stage companies, Ikonisys and Helicos BioSciences. After the transition, Ms. Mawhinney will stay at Aratana in a new role, which we assume will focus on operations and the integration of prior deals, such as Vet Therapeutics. Incoming CFO Craig Tooman joined Aratana's board and audit committee in May 2012. Mr. Tooman brings 20 years of biopharma experience with both large and smaller companies, including Pharmacia & Upjohn, Enzon (ENZN \$1.44), and ILEX Oncology.
- As is typical for development-stage companies, the skill set for a CFO in the start-up and pre-IPO stage is quite different from what is required once revenues and earnings commence. With the completion of the Vet Therapeutics purchase (announced last month—for more details, see our October 15 note, "Entering Biologics and Oncology Through Vet Therapeutics Acquisition, Significantly Enhancing Long-Term Growth Opportunity"), we expect Aratana to begin generating nominal revenues in 2014 rather than in 2016 as originally planned. Given this two-year acceleration in the company's development timeline, we believe it makes sense to broaden the company's management team and add a CFO with large-company and commercial experience.

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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November 11, 2013

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

Symbol: PETX (NASDAQ)
Price: \$20.50 (52-Wk.: \$7-\$29)
Market Value (mil.): \$476
Fiscal Year End: December
Long-Term EPS Growth Rate:
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

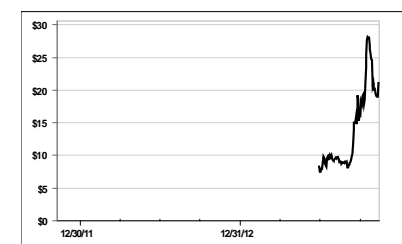
Trading Data (FactSet)

Shares Outstanding (mil.)	1
Float (mil.)	3
Average Daily Volume	73,062

Financial Data (FactSet)

Long-Term Debt/Total Capital (MRQ)	0.0
Book Value Per Share (MRQ)	-29.1
Enterprise Value (mil.)	46.1
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

- Aratana is scheduled to release third-quarter earnings results this Thursday morning. On this call, we expect an update on: 1) the new management structure (given today's announcement), 2) the new timeline for commercialization in the wake of the Vet Therapeutics acquisition, 3) the three products optioned a few months ago, and 4) the data for AT-001 in dogs. As noted last month, we view Vet Therapeutics as a significant addition for the company as it accelerates the transition to revenue generation by as much as two years. More importantly, it adds an internal R&D platform in biologics to Aratana's specialty pharma model.
- On Thursday's call, we also expect to hear key updates on the following: 1) the results of a dose-ranging study of AT-001 in dogs for osteoarthritis pain, which is expected in November; 2) a possible decision on which, if any, of the three option products (which came with a nine-month assessment period) to move forward with; and 3) further detail on the B-cell and T-cell lymphoma products acquired through the Vet Therapeutics acquisition. Following the acquisition, we now expect modest revenue in 2014 (\$840,000), ramping up to \$11 million in 2015. However, despite revenue coming in earlier than initially expected, we continue to model 2017 as the first year of profitability. Please see our summarized model below for more detail.

Exhibit 1 Aratana Income Statement Summary, 2011-2020 (Estimated)

Income Statement	2011	2012	Q1A	Q2A	Q3E	Q4E	2013E	Q1E	Q2E	Q3E	Q4E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
Revenues																		
AT-001							-	-	-	-	-	-	-	9.2	18.1	25.1	37.1	56.9
% growth (y/y)							-	-	-	-	-	-	-	NM	97%	39%	46%	53%
AT-002							-	-	-	-	-	-	-	11.1	19.3	32.4	48.6	70.5
% growth (y/y)							-	-	-	-	-	-	-	NM	75%	68%	50%	45%
AT-003							-	-	-	-	-	-	-	2.0	11.0	19.8	29.8	40.2
% growth (y/y)							-	-	-	-	-	-	-	NM	458%	80%	51%	35%
B-Cell Revenue							-	0.21	0.21	0.21	0.21	0.84	4.20	8.40	12.60	16.80	19.32	21.00
% growth (y/y)							-	-	-	-	-	-	7.20	11.25	16.20	21.60	25.20	27.90
T-Cell Revenue							-	-	-	-	-	-	-	-	-	-	-	-
% growth (y/y)							-	-	-	-	-	-	-	-	-	-	-	-
Total Net Product Revenues							-	0.21	0.21	0.21	0.21	0.84	11.40	41.85	77.20	115.72	160.03	216.42
Royalty Revenue (E.U.)							-	-	-	-	-	-	-	2.0	7.0	13.1	19.2	25.9
Total Net Revenues	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.2	0.2	0.2	0.8	11.4	43.8	84.2	128.8	179.2	242.3
% growth (y/y)														NM	92%	53%	39%	35%
Expenses																		
COGS	-	-				0	0	0	0	0	0	0	2	8	15	23	33	45
R&D expense	2.196	8.791	2.114	2.469	3.027	3.027	10.6	3.4	3.4	3.4	3.4	13.4	16.5	19.8	22.9	26.4	30.1	34.3
% growth (y/y)			20.7%	28.0%	18.5%	18.5%	21%	58.5%	35.7%	10.7%	10.7%	26%	23%	20%	16%	15%	14%	14%
SG&A expense	1.274	2.987	1.226	1.258	1.458	2.208	6.2	3.4	3.8	4.2	4.6	15.8	24.2	30.0	36.9	46.3	56.9	69.3
In-process R&D	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total Operating Expenses	3.470	11.778	3.340	3.727	4.5	5.2	16.8	6.7	7.1	7.5	7.9	29.2	42.7	57.6	75.2	96.2	120.1	148.9
Operating (loss)/profit	(3.470)	(11.778)	(3.340)	(3.7)	(4.5)	(5.2)	(16.8)	(6.5)	(6.9)	(7.3)	(7.7)	(28.4)	(31.3)	(13.8)	9	33	59	93
Interest income	0.006	0.021	0.003	0.022	0.020	0.032	0.1	0.0287	0.0267	0.0228	0.0168	0.1	0.0	0.1	0.1	0.1	0.2	0.3
Interest expense	0.000	-	-0.024	-0.078	(0.032)	(0.175)	(0.31)	(0.195)	(0.195)	(0.195)	(0.195)	(0.8)	(0.8)	(0.8)	(0.8)	(0.8)	(0.8)	(0.8)
Other Income	0.000	0.121	0.068	0.343	0.1	0.1	0.1	0.025	0.025	0.025	0.025	0.100	0.100	0.100	0.100	0.100	0.100	0.100
Total Other Income	0.006	0.142	0.047	0.287	0.0	(0.1)	0.3	(0.141)	(0.143)	(0.147)	(0.153)	(0.584)	(0.6)	(0.6)	(0.6)	(0.6)	(0.5)	(0.3)
Net loss and comprehensive loss	(3.464)	(11.636)	(3.293)	(3.440)	(4.45)	(5)	(17)	(7)	(7)	(7)	(8)	(29)	(32)	(14)	8	32	59	93
Modifications of Series A convertible pref. stock	(0.276)	0.000	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Unaccreted dividends on convertible pref. stock	(0.902)	(2.035)	-0.773	-0.808	-	-	(1.581)	-	-	-	-	-	-	-	-	-	-	-
Net income loss (gain) attributable to common stockholders, basic and diluted	(4.642)	(13.671)	(4.07)	(4.248)	(4.447)	(5.33)	(18.089)	(6.640)	(7.042)	(7.446)	(7.852)	(28.979)	(31.970)	(14.371)	8.413	32.099	58.638	93.075
Provision for income taxes	-	-	-	-	-	-	-	-	-	-	-	-	-	-	3	12	21	34
Effective tax rate	NM	NM	0%	0%	0%	36%	9%	36%	36%	36%	36%	36%	36%	0%	36%	36%	36%	36%
Net Income (loss)	(\$4.642)	(\$13.671)	(\$4.1)	(\$4.248)	(\$4.4)	(\$5.33)	(\$18.1)	(\$7)	(\$7.0)	(\$7.4)	(\$7.9)	(\$29.0)	(\$32.0)	(\$14.4)	\$5.4	\$20.5	\$37.5	\$59.6
EPS	(\$0.31)	(\$0.91)	(\$0.27)	(\$0.23)	(\$0.21)	(\$0.24)	(\$0.95)	(\$0.29)	(\$0.31)	(\$0.33)	(\$0.34)	(\$1.28)	(\$1.36)	(\$0.57)	\$0.20	\$0.77	\$1.40	\$2.20
Weighted average shares outstanding (basic)	14,972	14,972	14,972	18,806	20,722	22,582	19,270	22,637	22,682	22,747	22,802	22,719	23,427	25,127	25,327	25,527	25,727	25,927
Weighted average shares outstanding (diluted)	14,972	14,972	14,972	19,964	21,881	23,740	20,140	23,795	23,850	23,905	23,960	23,878	24,585	26,285	26,485	26,685	26,885	27,085
MARGIN ANALYSIS:																		
Gross Profit														82%	82%	82%	82%	81%
SG&A														69%	44%	36%	32%	29%
R&D														45%	27%	20%	17%	14%
Operating Income														NA	11%	25%	33%	39%
Tax Rate														0%	36%	36%	36%	36%
Net Income														NA	6%	16%	21%	25%
GROWTH METRICS:																		
Total Revenue															92%	53%	39%	35%
Gross Profit															91%	53%	39%	35%
SG&A			146%	102%	56%	137%	106%	174%	199%	185%	106%	157%	53%	24%	23%	25%	23%	22%
R&D			21%	28%	18%	18%	21%	58%	36%	11%	11%	26%	23%	20%	16%	15%	14%	14%
Operating Income																262%	81%	58%
Net Income																282%	83%	59%
EPS																279%	81%	58%
Diluted Shares Outstanding		0%	0%	33%	46%	59%	35%	59%	19%	9%	1%	1%	3%	0%	0%	0%	0%	1%

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

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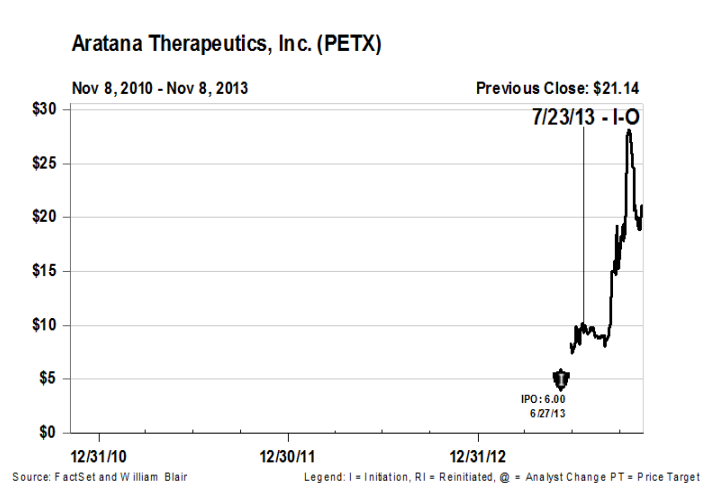
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DOW JONES: 15,761.78

S&P 500: 1,770.61

NASDAQ: 3,919.23



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