A Biotech Blockbuster in the $60 Billion Pet Industry
Artana Therapeutics: “Off the Radar” and Undervalued

Our next profile is a unique biopharma that is literally for the “dogs,” and that is a good thing for investors. The name of the company is called Aratana Therapeutics which has a more than appropriate ticker symbol of PETX. The company just came public a few years ago and just recently started to experience its first of hopefully many commercialized successes.

The biotech landscape is full of companies tackling diseases and medical issues that plague humans. Aratana is taking a different approach to the pharmaceutical market by developing products to treat animals. U.S. pet owners spent nearly $60 billion on their animal companions in 2014, and that number will only rise as effective pet therapeutics hit the market. The market for veterinary medicine is less crowded than that for humans. 45 new drug applications (NDAs) were filed with the FDA for new drugs for humans in 2015, only five for animals were.

Approximately two-thirds of households in the U.S. own a cat or a dog. As the owner of a seven-year-old Golden Retriever named Cooper that spends most of his time sunning himself on my balcony overlooking the ocean, I can tell you that American society increasingly views its pets as members of the family. As a result, pet owners are more willing to spend money on veterinarian care and just about anything else to make their "children" happy and healthy. Let’s take a look at Aratana’s development platform and how the firm leverages the human biopharmaceutical industry to create new therapeutics for animals.
Portfolio Development:

Aratana’s business model centers on finding treatments that work for humans and retooling those therapies to address the needs of pets. Focused on cats and dogs, the company looks for human therapeutics that can demonstrate safety and effectiveness when reformulated for animals. Management also seeks to identify products already in development for pets so it can potentially license or acquire them.

The firm tries to de-risk its investment in products by only targeting those drugs for which toxicology data is readily available, manufacturing is scaled-up, and effectiveness is displayed in clinical trials. The medical issues Aratana aims to treat typically have an unmet medical need or high incidence rate in the pet market.

The process for achieving regulatory approval of pharmaceutical products for pets is less rigorous than the same process for human products. Where it can easily cost a company over one billion dollars to formulate, test, and receive FDA approval of a new drug for humans, it costs approximately $10 million for Aratana to develop a new drug candidate. In addition, the timeline for developing a drug candidate for pets is shorter by about five years.

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Pipeline:

Aratana owns some 15 novel therapeutic candidates in development that target cancer, pain, lack of appetite, viral diseases, and allergy. Several of these treatments are approaching commercialization and have important approval milestones in the near future. One “Galliprant” has been approved and resulted in a large collaboration deal which we will discuss in detail a bit later on in our analysis. This is part of Aratana’s desired Big Company/Small company approach and may be the first of several beneficial collaboration deals.

Let’s take a look at couple of the key products in the pipeline especially those that look on their way to approval in the near future.
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The firm's AT-003 or “Nocita” is an extended-release injectable candidate designed to help relieve post-operative pain in both dogs and cats. The compound that comprises AT-003 is the key component of a product launched by Pacira in 2012 to help relieve pain in humans. The compound has successfully completed trials and Aratana expects to file the NDA and have this product on the market by the end of this year.

Current pain relief products on the market for cats and dogs cause significant side effects and can damage an animal’s liver or gastrointestinal system. So far, AT-003 has demonstrated a favorable safety profile with a lower risk of toxicity. Veterinarians perform approximately 19 million dog surgeries and 14 million cat surgeries per year, so the size of the market for this product is large.

AT-002 or Entyce has also successfully completed trials and achieved FDA approval on May 16, 2016. Artana expects commercial availability of this drug by February 2017.

Entyce mimics a naturally occurring hormone to help stimulate appetite in cats and dogs. No currently approved products exist on the market to help tackle this problem, which is commonly seen in pets when they age or suffer from chronic illness. Animals typically must suffer through feeding tubes or face euthanasia if they struggle to eat and maintain muscle mass.

AT-002 could be used daily at home by pet owners to safely stimulate appetite. The candidate demonstrated significant results on eating habits and weight gain in a pilot study. I think the potential market for a product like this will be large because nearly every pet owner is familiar with the struggle to get an aging or sick animal to maintain a healthy diet.

Aratana had two therapies in the oncology market for canines that represent first-in-class products. AT-004 targeted B-cell lymphoma and has been granted full licensing rights by the USDA, while AT-005 treats T-cell lymphoma and received a conditional license from the USDA. Unfortunately, due to disappointing results these trials were curtailed late in the summer of 2015.

The rest of company’s pipeline is in earlier stages but represents additional “shots on goal”.

Collaboration Deal and Outlook:

Late in April, PETX entered into a licensing deal with Eli Lilly's (NYSE:LLY) Elanco Animal Health Division. The transaction gives Elanco the right to develop, manufacture, market, and commercialize grapiprant products, including Galliprant, Aratana's first approved drug. Elanco will have exclusive rights ex-U.S. and co-exclusive rights with Aratana in the United States. Galliprant was just approved for use in late March.

Aratana will receive an upfront payment of $45 million, as well a $4 million milestone payment upon Galliprant’s approval in Europe. Aratana will also get a $4 million milestone payout related to the manufacturing of Galliprant and up to $75 million in sales-based milestones and mid-single-digit to low-double-digit royalties. For a company that at the time had a less than 200 million market capitalization, this was a significant deal.
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The company had almost $75 million of cash already on the books at the end of the first quarter and the upfront and milestone payments will increase that amount significantly. The company estimated its cash burn at $45 million to $55 million for FY2016 as it develops grapiprant products as well as other products in the pipeline. Cash burn will start to be offset by accelerating royalties from Galliprant in the future. That should reduce further as two new compounds come to market and Galliprant starts to earn sales milestones in addition to royalties. The company has approximately $40 million of long-term debt.

In early June, Credit Suisse reiterated their Buy rating and $11.00 a share price target on PETX, and early in May, Jefferies reiterated their Buy rating and $12.00 a share price target on Aratana. This is well over the current $9.00 a share price on PETX. The analyst firm is positive on the deal with Elanco and encouraged by the developmental progress on the other drugs with Aratana’s pipeline as well. $12.00 a share is also the median price target by the six analysts that cover Aratana on the stock.

This is not that outlandish of a price given the stock traded near $20.00 a share before the company had to discontinue trials for AT-004 and AT-005 in late September which cratered the shares. Now that the company is starting to see some of its pipeline commercialized it could start to claw back some of these losses. The stock should be bolstered by success of AT-002 and/or AT-003 as well as any collaboration deals a la the one for Galliprant. If all goes well, the company should have three significant drugs on the market for this rapidly growing and off the radar part of medicine by the end of 2016.

Recommendation: BUY PETX up to $10.00 a share, price target is currently $12.00.

Position: Long PETX