

Kindred Biosciences, Inc.  
Form 10-Q  
November 07, 2016  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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FORM 10-Q

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(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2016

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-36225

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KINDRED BIOSCIENCES, INC.  
(Exact name of registrant as specified in its charter)

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Delaware 46-1160142  
(State of incorporation) (I.R.S. Employer Identification No.)  
1555 Bayshore Highway, Suite 200  
Burlingame, California 94010  
(Address of principal executive office) (Zip code)  
Registrant's telephone number: (650) 701-7901

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Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter time that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company   
Indicate by checkmark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

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As of October 31, 2016, Kindred Biosciences, Inc. had outstanding 19,891,407 shares of common stock, \$0.0001 par value.

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Kindred Biosciences, Inc.

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## PART I - FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

Kindred Biosciences, Inc.

Condensed Consolidated Balance Sheets

(In thousands, except share and per share amounts)

|  | September 30, December 31,<br>2016                      2015<br>(Unaudited) |           |
|--|---|-----------|
| <b>ASSETS</b>  |   |           |
| Current assets:  |   |           |
| Cash and cash equivalents  | \$ 13,311   | \$ 19,992 |
| Short-term investments   | 47,168  | 53,051    |
| Prepaid expenses and other   | 887   | 712       |
| Total current assets   | 61,366  | 73,755    |
| Property and equipment, net  | 1,796   | 1,244     |
| Long-term investments  | 2,005   | 4,590     |
| Other assets   | 30  | 30        |
| Total assets   | \$ 65,197   | \$ 79,619 |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |   |           |
| Current liabilities:   |   |           |
| Accounts payable   | \$ 690  | \$ 717    |
| Accrued compensation   | 1,280   | 1,922     |
| Accrued liabilities  | 677   | 569       |
| Total current liabilities  | 2,647   | 3,208     |
| Long-term liability  | 18  | 40        |
| Total liabilities  | 2,665   | 3,248     |
| Commitments and contingencies (Note 6)   |   |           |
| Stockholders' equity:  |   |           |
| Common stock, \$0.0001 par value; 100,000,000 shares authorized; 19,891,407 and 19,836,360 shares issued and outstanding at September 30, 2016 and December 31, 2015, 2 respectively |   | 2         |
| Additional paid-in capital   | 137,810   | 135,021   |
| Accumulated other comprehensive income (loss)  | 12  | (50 )     |
| Accumulated deficit  | (75,292 )   | (58,602 ) |
| Total stockholders' equity   | 62,532  | 76,371    |
| Total liabilities and stockholders' equity   | \$ 65,197   | \$ 79,619 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

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Kindred Biosciences, Inc.

Condensed Consolidated Statements of Operations and Comprehensive Loss

(In thousands, except per share amounts)

(Unaudited)

|   | Three months<br>ended September<br>30, |           | Nine months ended<br>September 30, |            |
|---|--|-----------|------------------------------------|------------|
|   | 2016                                   | 2015      | 2016                               | 2015       |
| Operating expenses:   |  |           |                                    |            |
| Research and development  | \$3,754                                | \$5,033   | \$10,352                           | \$14,833   |
| General and administrative  | 2,022                                  | 2,095     | 5,907                              | 5,969      |
| Restructuring costs   | —                                      | —         | 655                                | —          |
| Total operating expenses  | 5,776                                  | 7,128     | 16,914                             | 20,802     |
| Loss from operations  | (5,776 )                               | (7,128 )  | (16,914 )                          | (20,802 )  |
| Interest and other income, net  | 93                                     | 33        | 224                                | 92         |
| Net loss  | (5,683 )                               | (7,095 )  | (16,690 )                          | (20,710 )  |
| Change in unrealized gains (losses) on available-for-sale securities    | (21 )                                  | 5         | 62                                 | 31         |
| Comprehensive loss  | \$(5,704)                              | \$(7,090) | \$(16,628)                         | \$(20,679) |
| Net loss per share, basic and diluted                                   | \$(0.29 )                              | \$(0.36 ) | \$(0.84 )                          | \$(1.05 )  |
| Weighted-average number of common shares outstanding, basic and diluted | 19,891                                 | 19,792    | 19,864                             | 19,758     |

The accompanying notes are an integral part of these condensed consolidated financial statements.

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Kindred Biosciences, Inc.

Condensed Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

|   | Nine months ended<br>September 30, |            |
|---|------------------------------------|------------|
|   | 2016                               | 2015       |
| Cash Flows from Operating Activities  |                                    |            |
| Net loss  | \$(16,690)                         | \$(20,710) |
| Adjustments to reconcile net loss to net cash used in operating activities: |                                    |            |
| Stock-based compensation expense  | 2,699                              | 3,103      |
| Depreciation and amortization expense                                       | 115                                | 108        |
| Amortization of premium on marketable securities                            | 199                                | 128        |
| Changes in operating assets and liabilities:                                |                                    |            |
| Prepaid expenses and other  | (175                               | ) 28       |
| Other assets  | —                                  | (8         |
| Accounts payable  | 141                                | (135       |
| Accrued liabilities and accrued compensation                                | (553                               | ) 258      |
| Net cash used in operating activities                                       | (14,264                            | ) (17,228  |
| Cash Flows from Investing Activities  |                                    |            |
| Purchase of investments   | (61,482                            | ) (81,086  |
| Sale of investments   | —                                  | 3,000      |
| Maturities of investments   | 69,813                             | 87,000     |
| Purchase of property and equipment  | (838                               | ) (322     |
| Net cash provided by investing activities                                   | 7,493                              | 8,592      |
| Cash Flows from Financing Activities  |                                    |            |
| Exercise of stock options and purchase of ESPP shares                       | 90                                 | 206        |
| Net cash provided by financing activities                                   | 90                                 | 206        |
| Net change in cash and cash equivalents                                     | (6,681                             | ) (8,430   |
| Cash and cash equivalents at beginning of period                            | 19,992                             | 12,969     |
| Cash and cash equivalents at end of period                                  | \$13,311                           | \$4,539    |

The accompanying notes are an integral part of these condensed consolidated financial statements.

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Kindred Biosciences, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Description of Business, Basis of Presentation and Summary of Significant Accounting Policies

Kindred Biosciences, Inc. ("KindredBio", "we", "us" or "our") was incorporated on September 25, 2012 (inception) in the State of Delaware. On April 25, 2016, we filed a Certificate of Incorporation with the State of Delaware for a wholly owned subsidiary, KindredBio Equine, Inc. ("Subsidiary"). The Subsidiary has one class of capital stock which is designated common stock, \$0.0001 par value per share. The authorized number of shares of common stock for the Subsidiary is 1,000.

We are a biopharmaceutical company focused on saving and improving the lives of pets. Our activities since inception have consisted principally of raising capital, establishing facilities, recruiting management and technical staff and performing research and development and advancing our product candidates seeking regulatory approval. Our headquarters are located in Burlingame, California.

We are subject to risks common to companies in the biotechnology and pharmaceutical industries. There can be no assurance that our research and development will be successfully completed, that adequate patent or other intellectual property protection for our technology will be obtained, that any products developed will obtain necessary government regulatory approval or that any approved products will be commercially viable. We operate in an environment of substantial competition from other animal health companies. In addition, we are dependent upon the services of our employees and consultants, as well as third-party contract research organizations and manufacturers. The accompanying unaudited interim condensed consolidated financial statements ("financial statements") have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America ("U.S. GAAP") for complete financial statements. These unaudited interim condensed consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto for the year ended December 31, 2015 included in our annual report on Form 10-K as filed with the SEC on March 4, 2016. In the opinion of management, all adjustments, consisting of a normal and recurring nature, considered necessary for a fair presentation, have been included in these unaudited interim condensed consolidated financial statements.

The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly owned Subsidiary. All intercompany accounts and transactions have been eliminated in consolidation.

Liquidity

We have incurred losses and negative cash flows from operations and have not generated any revenue since our inception. We expect to continue to incur losses and negative cash flows, which will increase significantly from historical levels as we expand our product development activities, seek regulatory approvals for our product candidates, establish a biologics manufacturing capability, and begin to commercialize any approved products. To date, we have been funded primarily through sales of our former convertible preferred stock, the sale of our common stock in our initial public offering in December 2013 and the sale of our common stock in our April 2014 follow-on public offering. We believe that our cash, cash equivalents, short-term and long-term investments totaling \$62,484,000 as of September 30, 2016, are sufficient to fund our planned operations for at least the next 24 months. If we require additional funding for operations, we may seek such funding through public or private equity or debt financings or other sources, such as corporate collaborations and licensing arrangements. We may not be able to obtain financing on acceptable terms, or at all, and we may not be able to enter into corporate collaborations or licensing arrangements. The terms of any financing may result in dilution or otherwise adversely affect the holdings or the rights of our stockholders.

Use of Estimates

The preparation of financial statements and related disclosures in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of

revenues and expenses during the

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reporting periods. Significant estimates and assumptions reflected in these condensed consolidated financial statements include, but are not limited to, the valuation of stock-based awards, the realization of deferred tax assets, the recoverability of long-lived assets and the accrual of research and development expenses. Estimates are periodically reviewed in light of changes in circumstances, facts and experience. Actual results could differ from those estimates.

### Comprehensive Loss

Our comprehensive loss includes the change in unrealized gains or losses on available-for-sale securities. The cumulative amount of gains or losses are reflected as a separate component of stockholders' equity in the condensed consolidated balance sheets as accumulated other comprehensive income (loss).

### Recently Issued Accounting Pronouncements

In November 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2015-17, "Balance Sheet Classification of Deferred Taxes", requiring all deferred tax assets and liabilities, and any related valuation allowance, to be classified as non-current on the consolidated balance sheet. The classification change for all deferred taxes as non-current simplifies entities' processes as it eliminates the need to separately identify the net current and net non-current deferred tax asset or liability in each jurisdiction and allocate valuation allowances. The update is effective for public business entities issuing consolidated financial statements for the annual periods beginning after December 15, 2016, and interim periods within those annual periods. We are currently evaluating the new guidance and have not determined the impact this standard may have on our condensed consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities", which amends the guidance in U.S. GAAP on the classification and measurement of financial instruments and also amends certain disclosure requirements associated with the fair value of financial instruments. The new guidance is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. We are currently evaluating the new guidance and have not determined the impact this standard may have on our condensed consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)", requiring organizations that lease assets—referred to as “lessees”—to recognize on the consolidated balance sheet the assets and liabilities for the rights and obligations created by those leases. Under the new guidance, a lessee will be required to recognize assets and liabilities for leases with lease terms of more than 12 months. The ASU on leases will take effect for public companies for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. We are currently evaluating the new guidance and have not determined the impact this standard may have on our condensed consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, “Improvements to Employee Share-Based Payment Accounting”, which amends ASC Topic 718, “Compensation - Stock Compensation”. The ASU includes provisions intended to simplify various aspects related to how share-based payments are accounted for and presented in the consolidated financial statements. ASU 2016-09 is effective for public business entities for annual reporting periods beginning after December 15, 2016, and interim periods within that reporting period. Early adoption will be permitted in any interim or annual period, with any adjustments reflected as of the beginning of the fiscal year of adoption. Our early adoption of this standard in the nine months ended September 30, 2016 did not have any material impact on our condensed consolidated financial statements.

We do not believe there are any other recently issued standards not yet effective that will have a material impact on our consolidated financial statements when the standards become effective.

### 2. Fair Value Measurements

Certain assets and liabilities are carried at fair value. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the

asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. A fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last is considered unobservable, is used to measure fair value:

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Level 1: Quoted prices in active markets for identical assets or liabilities.

Level 2: Observable inputs (other than Level 1 quoted prices) such as quoted prices in active markets for similar assets or liabilities, quoted prices in markets that are not active for identical or similar assets or liabilities, or other inputs that are observable or can be corroborated by observable market data.

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to determining the fair value of the assets or liabilities, including pricing models, discounted cash flow methodologies and similar techniques.

The carrying amount of financial instruments, including cash and cash equivalents, accounts payable and accrued liabilities approximate fair value due to the short maturities of these financial instruments. Financial assets, which consist of money market funds and available-for-sale securities, are measured at fair value on a recurring basis.

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Financial assets, which consist of money market funds and available-for-sale securities, are measured at fair value on a recurring basis and are summarized as follows (in thousands):

| Description                  | Fair Value Measurements as of September 30, 2016 |   |   |                               |
|------------------------------|--|---|---|-------------------------------|
|                              | Total  | Quoted Prices in Active Markets (Level 1) | Significant Other Observable Inputs (Level 2) | Unobservable Inputs (Level 3) |
| Cash equivalents:            |  |   |   |                               |
| Money market funds           | \$2,136  | \$2,136                                   | \$ —  | \$ —                          |
| U.S. treasury bills          | 1,999  | 1,999                                     | —   | —                             |
| U.S. government agency notes | 600  | —   | 600   | —                             |
| Commercial paper             | 6,399  | —   | 6,399   | —                             |
| Short-term investments:      |  |   |   |                               |
| U.S. treasury bills          | 9,491  | 9,491                                     | —   | —                             |
| U.S. treasury bonds          | 15,045   | 15,045                                    | —   | —                             |
| U.S. government agency notes | 9,643  | —   | 9,643   | —                             |
| Commercial paper             | 2,691  | —   | 2,691   | —                             |
| Corporate notes              | 10,298   | —   | 10,298  | —                             |
| Long-term investments:       |  |   |   |                               |
| Corporate notes              | 2,005  | —   | 2,005   | —                             |
|                              | \$60,307   | \$28,671                                  | \$ 31,636                                     | \$ —                          |
| Description                  | Fair Value Measurements as of December 31, 2015  |   |   |                               |
|                              | Total  | Quoted Prices in Active Markets (Level 1) | Significant Other Observable Inputs (Level 2) | Unobservable Inputs (Level 3) |
| Cash equivalents:            |  |   |   |                               |
| Money market funds           | \$8,169  | \$ 8,169                                  | \$ —  | \$ —                          |
| U.S. government agency notes | 4,385  | —   | 4,385   | —                             |
| Short-term investments:      |  |   |   |                               |
| U.S. treasury bills          | 41,282   | —   | 41,282  | —                             |
| U.S. government agency notes | 11,769   | —   | 11,769  | —                             |
| Long-term investments:       |  |   |   |                               |
| U.S. treasury bills          | 4,590  | —   | 4,590   | —                             |
|                              | \$70,195   | \$ 8,169                                  | \$ 62,026                                     | \$ —                          |

During the nine months ended September 30, 2016, U.S. treasury bills were transferred from Level 2 to Level 1. With the exception of U.S. treasury bills, there were no other transfers of assets between Level 1, Level 2 or Level 3 of the fair value hierarchy at September 30, 2016 or December 31, 2015.

At September 30, 2016 and December 31, 2015, we did not have any financial liabilities which were measured at fair value on a recurring basis.



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## 3. Investments

We classify all highly-liquid investments with stated maturities of greater than three months from the date of purchase and remaining maturities of less than one year as short-term investments. Investments with maturities beyond one year may be classified as short-term based on their highly liquid nature and because such investments are viewed as being available to support current operations. We classify and account for investments as available-for-sale and reflect realized gains and losses using the specific identification method. Changes in market value, if any, excluding other-than-temporary impairments, are reflected in other comprehensive income (loss).

The fair value of available-for-sale investments by type of security at September 30, 2016 was as follows (in thousands):

|                                      | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|--------------------------------------|-------------------|------------------------------|-------------------------------|---------------|
| Short-term investments:              |                   |                              |                               |               |
| U.S. treasury bills                  | \$ 9,485          | \$ 6                         | \$ —                          | \$9,491       |
| U.S. government agency notes         | 9,639             | 4                            | —                             | 9,643         |
| U.S. treasury bonds                  | 15,036            | 9                            | —                             | 15,045        |
| Commercial paper                     | 2,691             | —                            | —                             | 2,691         |
| Corporate notes                      | 10,308            | 2                            | (12 )                         | 10,298        |
|                                      | 47,159            | 21                           | (12 )                         | 47,168        |
| Long-term investments:               |                   |                              |                               |               |
| Corporate notes                      | 2,002             | 3                            | —                             | 2,005         |
| Total available-for-sale investments | \$ 49,161         | \$ 24                        | \$ (12 )                      | \$49,173      |

The fair value of available-for-sale investments by type of security at December 31, 2015 was as follows (in thousands):

|                                      | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|--------------------------------------|-------------------|------------------------------|-------------------------------|---------------|
| Short-term investments:              |                   |                              |                               |               |
| U.S. treasury bills                  | \$ 41,293         | \$ 14                        | \$ (25 )                      | \$41,282      |
| U.S. government agency notes         | 11,776            | —                            | (7 )                          | 11,769        |
| U.S. treasury bonds                  | 25                | 9                            | (34 )                         | —             |
|                                      | 53,094            | 23                           | (66 )                         | 53,051        |
| Long-term investments:               |                   |                              |                               |               |
| U.S. treasury bills                  | 4,597             | —                            | (7 )                          | 4,590         |
| Total available-for-sale investments | \$ 57,691         | \$ 23                        | \$ (73 )                      | \$57,641      |

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## 4. Accrued Liabilities

Accrued liabilities consisted of the following (in thousands):

|  | September<br>30, 2016 | December<br>31, 2015 |
|--|-----------------------|----------------------|
| Accrued consulting                     | \$ 168                | \$ 83                |
| Accrued research and development costs | 288                   | 345                  |
| Other expenses                         | 191                   | 128                  |
| Deferred rent                          | 48                    | 53                   |
|  | 695                   | 609                  |
| Less current portion                   | (677 )                | (569 )               |
| Long-term liability (deferred rent)    | \$ 18                 | \$ 40                |

## 5. Stock-Based Awards and Common Stock

The table below shows the number of shares of common stock underlying options granted to employees, directors and consultants, the assumptions used in the Black-Scholes option pricing model used to value those options and the resulting weighted-average grant date fair value per share:

| Stock Option Plan                                | Three months<br>ended |                       | Nine months<br>ended  |                       |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
|  | September 30,<br>2016 | September 30,<br>2015 | September 30,<br>2016 | September 30,<br>2015 |
| Shares underlying options granted                | 62,000                | 32,500                | 833,183               | 844,733               |
| Weighted-average exercise price                  | \$3.94                | \$6.37                | \$3.45                | \$6.67                |
| Weighted average risk-free interest rate         | 1.22 %                | 1.78 %                | 1.57%                 | 1.50%                 |
| Weighted average expected term (years)           | 6.3                   | 6.3                   | 6.3                   | 6.1                   |
| Weighted average expected volatility             | 87%                   | 90%                   | 83%                   | 96%                   |
| Expected dividend yield                          | —                     | —                     | —                     | —                     |
| Weighted-average grant date fair value per share | \$2.88                | \$4.80                | \$2.42                | \$5.14                |

In May 2016, we adopted the 2016 Equity Incentive Plan (the "2016 Plan"), and reserved 3,000,000 shares of our common stock for issuance under the 2016 Plan. The 2016 Plan is the successor to our 2012 Equity Incentive Plan (the "2012 Plan"), which was retired on May 23, 2016 upon stockholders' approval of our 2016 Plan. All awards made under the 2012 Plan shall remain subject to the terms of that plan. Options granted under the 2016 Plan may be either incentive stock options or nonstatutory stock options. The 2016 Plan also provides for the grant of stock appreciation rights, restricted stock awards, restricted stock unit awards, performance stock awards, performance cash awards and other stock awards. The exercise price of a stock option may not be less than 100% of the closing price of our common stock on the date of the grant. If, at any time we grant an incentive stock option, and the optionee directly or by attribution owns stock possessing more than 10% of the total combined voting power of all classes of KindredBio stock, the option price shall be at least 110% of the fair value and shall not be exercisable more than five years after the date of grant. Options generally vest over a period of two or four years from the date of grant. Options granted under the 2016 Plan expire no later than 10 years from the date of grant. As of September 30, 2016, there were 65,350 option shares outstanding and 2,934,650 shares available for future grants under the 2016 Plan.

Our Employee Stock Purchase Plan (the "Stock Purchase Plan"), adopted in December 2014, permits eligible employees to purchase common stock at a discount through payroll deductions during defined six-month consecutive offering periods beginning December 1 with the exception of our first offering period which commenced on January 1, 2015 for a five month duration. The price at which the stock is purchased is equal to the lower of 85% of the fair market value of the common stock on the first day of the offering or 85% of the fair market value of our common stock on the purchase date. A total of 200,000 shares of common stock are authorized for issuance under the Stock Purchase Plan. A participant may purchase a maximum of 2,000 shares of common stock during each offering period, not to exceed \$25,000 worth of common stock on the offering date during each calendar year. We use the

Black-Scholes option pricing model, in combination with

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the discounted employee price, in determining the value of the Stock Purchase Plan expense to be recognized during each offering period. The following assumptions were used in the Black-Scholes option pricing model to calculate employee stock-based compensation:

| Stock Purchase Plan                              | Three months ended September 30, |      | Nine months ended September 30, |        |
|--|----------------------------------|------|---------------------------------|--------|
|  | 2016                             | 2015 | 2016                            | 2015   |
| Weighted average risk-free interest rate         | —                                | —    | 0.46%                           | 0.07%  |
| Weighted average expected term (years)           | —                                | —    | 0.5                             | 0.5    |
| Weighted average expected volatility             | —                                | —    | 89%                             | 73%    |
| Expected dividend yield                          | —                                | —    | —                               | —      |
| Weighted-average grant date fair value per share | —                                | —    | \$1.46                          | \$2.14 |

Under the Stock Purchase Plan, employees purchased 22,797 shares of common stock for \$77,000 during the nine months ended September 30, 2016. At September 30, 2016 and December 31, 2015, we had an outstanding liability of \$56,000 and \$25,000, respectively, which is included in accrued compensation on the condensed consolidated balance sheets, for employee contributions to the Stock Purchase Plan for shares pending issuance at the end of the next offering period.

We recorded stock-based compensation expense as follows (in thousands):

|                            | Three months ended September 30, |         | Nine months ended September 30, |         |
|----------------------------|----------------------------------|---------|---------------------------------|---------|
|                            | 2016                             | 2015    | 2016                            | 2015    |
| Research and development   | \$411                            | \$439   | \$1,063                         | \$1,371 |
| General and administrative | 604                              | 567     | 1,636                           | 1,732   |
|                            | \$1,015                          | \$1,006 | \$2,699                         | \$3,103 |

We had an aggregate of approximately \$6,124,000 of unrecognized stock-based compensation expense for options outstanding and the Stock Purchase Plan as of September 30, 2016 which is expected to be recognized over a weighted-average period of 2.1 years.

#### 6. Commitments and Contingencies

In April 2014, we entered into new non-cancelable operating leases for 2,145 square feet of laboratory space through May 2017 and 6,900 square feet of office space through November 2017. In January, August and November 2015, we amended our original operating lease for laboratory space to expand the facility with an additional 2,431 square feet, 131 square feet and 123 square feet, respectively, of manufacturing space through May 2017. In August 2015, we entered into a new non-cancelable operating lease for 3,126 square feet of office space in San Diego, California through September 2019. In February and October 2016, we further amended our original operating lease for laboratory space to further expand the facility with an additional 3,599 square feet and 2,326 square feet, respectively, of laboratory space through May 2017. Commencing on June 1, 2017, the non-cancellable operating lease for the entire existing laboratory space of a total 10,755 square feet is extended for another 5 years through May 2022. In addition, we have three equipment leases expiring through 2020.

As of September 30, 2016 (including amendments entered into after period end), we are obligated to make minimum lease payments under noncancelable operating leases as follows (in thousands):

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|                          |                   |
|--------------------------|-------------------|
| Year ending December 31, | Lease<br>Payments |
| 2016 (remaining of year) | \$ 144            |
| 2017                     | 661               |
| 2018                     | 497               |
| 2019                     | 486               |
| 2020 and after           | 1,032             |
| Total                    | \$ 2,820          |

## 7. Net Loss Per Share

Basic and diluted net loss per share was calculated as follows (in thousands, except per share amounts):

|   | Three months<br>ended September<br>30, |           | Nine months ended<br>September 30, |            |
|---|--|-----------|------------------------------------|------------|
|   | 2016                                   | 2015      | 2016                               | 2015       |
| Basic and diluted net loss per share:                                   |  |           |                                    |            |
| Numerator:  |  |           |                                    |            |
| Net loss  | \$(5,683)                              | \$(7,095) | \$(16,690)                         | \$(20,710) |
| Denominator:  |  |           |                                    |            |
| Weighted-average number of common shares outstanding, basic and diluted | 19,891                                 | 19,792    | 19,864                             | 19,758     |
| Net loss per share, basic and diluted                                   | \$(0.29 )                              | \$(0.36 ) | \$(0.84 )                          | \$(1.05 )  |

There was no difference between the Company's net loss and the net loss attributable to common stockholders for all periods presented.

Stock options to purchase 3,573,955 shares of common stock as of September 30, 2016, were excluded from the computation of diluted net loss per share attributable to common stockholders for the three and nine months ended September 30, 2016, because their effect was anti-dilutive.

Stock options to purchase 3,078,065 shares of common stock were excluded from the computation of diluted net loss per share attributable to common stockholders for the three and nine months ended September 30, 2015, because their effect was anti-dilutive.

## 8. Restructuring Plan

On January 8, 2016, our Board of Directors committed to a restructuring plan intended to better align our workforce to our revised operating needs and program development plans. On January 11, 2016, we implemented the restructuring plan that focused on streamlining our development programs and to ensure our remaining funds are sufficient to fund our planned operations through 2018. To match these priorities, we reduced our workforce by 18 positions, or approximately 31% of our workforce, resulting in a total workforce of 39 positions. As a result of the restructuring plan which has been completed, we recorded a restructuring charge of approximately \$655,000 related to severance payments which was entirely paid in the quarter ended March 31, 2016. There were no further restructuring charges since then.

## 9. Subsequent Event

On October 5, 2016, we further amended our existing operating lease for laboratory space at the Mitten Road facility. The amendment to the original lease provides for an expansion of an additional 2,326 square feet of laboratory space for a total of 10,755 square feet through May 31, 2017. Commencing on June 1, 2017, the non-cancellable operating lease for the entire existing laboratory space of a total 10,755 square feet is extended for another 5 years through May 31, 2022.



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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

In this section, "Kindred," "we," "our," "ours," "us" and the "Company" refer to Kindred Biosciences, Inc. and our wholly owned subsidiary KindredBio Equine, Inc. You should read the following discussion and analysis of our consolidated financial condition and results of operations together with our consolidated financial statements and the related notes and other financial information included elsewhere in this Quarterly Report on Form 10-Q. Some of the information contained in this discussion and analysis or set forth elsewhere in this Quarterly Report on Form 10-Q consists of forward-looking statements such as statements regarding our expectations about the trials, regulatory approval, manufacturing, distribution and commercialization of our current and future product candidates and statements regarding our anticipated revenues, expenses, margins, profits and use of cash. In this Quarterly Report on Form 10-Q, the words "anticipates," "believes," "expects," "intends," "future," "could," "estimates," "plans," "would," "should," "potential" and similar words or expressions (as well as other words or expressions referencing future events, conditions or circumstances) often identify forward-looking statements.

These forward-looking statements are based on our current expectations. These statements are not promises or guarantees, but involve known and unknown risks, uncertainties and other important factors that may cause our actual results to be materially different from any future results expressed or implied by the forward-looking statements. These risks and uncertainties include, but are not limited to, the following: our limited operating history and expectations of losses for the foreseeable future; the absence of revenue from our product candidates for the foreseeable future; our potential inability to obtain any necessary additional financing; our substantial dependence on the success of our lead product candidates, which may not be successfully commercialized even if they are approved for marketing; the effect of competition; our potential inability to obtain regulatory approval for our existing or future product candidates; our dependence on third parties to conduct some of our development activities; our dependence upon third-party manufacturers for supplies of our product candidates; uncertainties regarding the outcomes of trials pertaining to our product candidates; our potential failure to attract and retain senior management and key scientific personnel; uncertainty about our ability to develop a satisfactory sales organization; our significant costs of operating as a public company; our potential inability to obtain patent protection and other intellectual property protection for our product candidates; potential claims by third parties alleging our infringement of their patents and other intellectual property rights; our potential failure to comply with regulatory requirements, which are subject to change on an ongoing basis; the potential volatility of our stock price; and the significant control over our business by our principal stockholders and management.

For a further description of these risks and uncertainties and other risks and uncertainties that we face, please see the "Risk Factors" sections that are contained in our filings with the U.S. Securities and Exchange Commission (the SEC), including the "Risk Factors" section of our Annual Report on Form 10-K for the year ended December 31, 2015, which was filed with the SEC on March 4, 2016, and any subsequent updates that may be contained in the "Risk Factors" sections of this Quarterly Report on Form 10-Q and our other Quarterly Reports on Form 10-Q filed with the SEC. As a result of the risks and uncertainties described above and in our filings with the SEC, actual results may differ materially from those indicated by the forward-looking statements made in this Quarterly Report on Form 10-Q. Forward-looking statements contained in this Quarterly Report on Form 10-Q speak only as of the date of this report and we undertake no obligation to update or revise these statements, except as may be required by law.

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### Overview

We are an early stage biopharmaceutical company focused on saving and improving the lives of pets. Our mission is to bring to our pets the same kinds of safe and effective medicines that our human family members enjoy. Our core strategy is to identify compounds and targets that have already demonstrated safety and efficacy in humans and to develop therapeutics based on these validated compounds and targets for pets, primarily dogs, cats and horses. We believe this approach will lead to shorter development times and higher approval rates than pursuing new, non-validated compounds and targets. We have submitted all major technical sections of the New Animal Drug Application, or NADA, to the Food and Drug Administration, or FDA, for two product candidates. In addition, we have multiple other product candidates, including several biologics, in various stages of development. We believe there are significant unmet medical needs for pets, and that the pet therapeutics segment of the animal health industry is likely to grow substantially as new therapeutics are identified, developed and marketed specifically for pets.

In November 2015, we completed a pivotal trial of Zimeta™ (dipyron injection), previously known as KIND-012, for pyrexia (fever) in horses with positive topline results. We submitted all major technical sections of the NADA for Zimeta to the FDA before the end of the first quarter of 2016. We have received the technical section complete letter for effectiveness from the FDA, responded to comments from the FDA regarding the Chemical, Manufacturing and Controls, or CMC, technical section and are in the process of responding to comments on the safety technical section. We anticipate the approval of Zimeta including product launch in the first half of 2017, assuming single cycle FDA review. We have initiated pre-launch activities including build-out of a small commercial team, preparations for distribution and commercial manufacturing.

We have also completed our formulation development of the oral gel form of Zimeta for the treatment of fever in horses. The pivotal trial for Zimeta (dipyron oral gel) is expected to initiate in the first half of 2017. The oral gel form of dipyron is expected to be an additional valuable tool for equine veterinarians by providing an easy-to-administer fever reducing agent for the horse and horse owner. In addition, we have incorporated an equine subsidiary, KindredBio Equine, Inc., for our equine business. We anticipate that we may, in the future, spin out or split out our equine business from our biologics business.

We announced positive topline results in May 2016 upon the successful completion of a pharmacokinetic study and a randomized, placebo-controlled pivotal study of Mirataz™ (mirtazapine 2% ointment), formerly known as KIND-010, for the management of weight loss in cats. All major technical sections of the NADA have been filed. We received comments from FDA on the CMC technical section and are currently addressing the comments. Based on the feedback, we anticipate the approval of Mirataz and are preparing for the commercial launch in mid 2017, assuming single cycle FDA review. In addition, we are in discussions with potential partners regarding the commercialization of Mirataz.

We conducted a pilot laboratory study to demonstrate the effectiveness and safety of two formulations of KIND-014, a development candidate for equine gastric ulcer in horses. Both formulations were well-tolerated and showed positive results for efficacy, as measured by gastric pH. A pilot field study initiated earlier in the year was completed recently. Based on the study results, we are currently optimizing the formulation.

Our epoCat™ (feline erythropoietin) program for the control of non-regenerative anemia in cats is advancing as planned. The initial laboratory study was completed, with a positive efficacy signal, as evidenced by increased reticulocyte formation. The pilot field efficacy study is underway and enrollment is ongoing.

Formulation for KIND-015, a development candidate for metabolic syndrome in horses, a disease similar to Type II diabetes in humans, is being optimized. We plan to initiate a pilot field efficacy study by the first quarter of 2017.

We initiated a pilot field study of atopic dermatitis in dogs in June 2016. The multi-center pilot study is designed to assess safety and efficacy of several molecules, including anti-cytokine antibodies. Enrollment is ongoing and the results will determine which candidate(s) will be taken into further development.

We also completed the first stage of a pilot field study in sick or septic foals to assess safety and efficacy of anti-TNF. Of the five foals enrolled, all survived to day 7, the primary endpoint of the study. The second stage of the study is planned to start in early 2017, during the next foaling season.

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Other biologics: Antibodies against cytokines and immune checkpoints are progressing on track, and initial pilot studies for some of the antibodies are anticipated in 2016. KIND-Bodies, a novel biologics scaffold with certain advantages over antibodies, including bi-specific binding, is proceeding on track.

We have constructed a Good Manufacturing Practice, or GMP, biologics manufacturing plant and it is currently undergoing commissioning. We anticipate proceeding to GMP manufacturing by the first quarter of 2017.

In addition to the product candidates discussed above, we are in the early stages of development for multiple additional indications, with the potential to attain approval for approximately two products annually for several years. We plan to commercialize our products in the United States through a direct sales force complemented by selected distributor relationships, and in the EU through distributors and other third parties. Because we seek to identify product candidates that are not protected by third-party patents, we typically do not need to obtain licenses or make any upfront, milestone or royalty payments in connection with our product candidates.

We are an early stage company with no products approved for marketing and sale, and we have not generated any revenue. We have incurred significant net losses since our inception. We incurred cumulative net losses of \$75,292,000 through September 30, 2016. These losses have resulted principally from costs incurred in connection with investigating and developing our product candidates, research and development activities and general and administrative costs associated with our operations.

Historically, our funding has been a combination of private and public offerings, most recently our initial public offering in December 2013 provided us with net proceeds of \$54,871,000 and a follow-on public offering in April 2014 provided us with net proceeds of \$58,065,000. As of September 30, 2016, we had cash, cash equivalents and investments of \$62,484,000.

For the foreseeable future, we expect to continue to incur losses, which will increase significantly from historical levels as we expand our product development activities, seek regulatory approvals for our product candidates and begin to commercialize them if they are approved by the CVM branch of the FDA, the U.S. Department of Agriculture, or USDA, or the European Medicines Agency, or EMA. If we are required to further fund our operations, we expect to do so through public or private equity offerings, debt financings, corporate collaborations and licensing arrangements. We cannot assure you that such funds will be available on terms favorable to us, if at all. Arrangements with collaborators or others may require us to relinquish rights to certain of our technologies or product candidates. In addition, we may never successfully complete development of, obtain adequate patent protection for, obtain necessary regulatory approval, or achieve commercial viability for any product candidate. If we are not able to raise additional capital on terms acceptable to us, or at all, as and when needed, we may be required to curtail our operations, and we may be unable to continue as a going concern.

### Critical Accounting Policies and Significant Judgments and Estimates

Our management's discussion and analysis of financial condition and results of operations is based on our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States, or U.S. GAAP. The preparation of our condensed consolidated financial statements and related disclosures requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, and revenue, costs and expenses and related disclosures during the reporting periods. On an ongoing basis, we evaluate our estimates and judgments, including those described below. We base our estimates on historical experience and on various other factors that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

There have been no significant changes to our critical accounting policies since the beginning of our fiscal year. Our critical accounting policies are described in the “Management’s Discussion and Analysis of Financial Condition and Results of Operations” section of our Annual Report on Form 10-K for the year ended December 31, 2015, which was filed with the SEC on March 4, 2016.



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## Results of Operations

The following table summarizes the results of our operations for the periods indicated (in thousands):

|                                | Three months<br>ended September<br>30, |           | Nine months ended<br>September 30, |            |
|--------------------------------|--|-----------|------------------------------------|------------|
|                                | 2016                                   | 2015      | 2016                               | 2015       |
| Operating expenses:            |  |           |                                    |            |
| Research and development       | \$3,754                                | \$5,033   | \$10,352                           | \$14,833   |
| General and administrative     | 2,022                                  | 2,095     | 5,907                              | 5,969      |
| Restructuring costs            | —                                      | —         | 655                                | —          |
| Total operating expenses       | 5,776                                  | 7,128     | 16,914                             | 20,802     |
| Loss from operations           | (5,776 )                               | (7,128 )  | (16,914 )                          | (20,802 )  |
| Interest and other income, net | 93                                     | 33        | 224                                | 92         |
| Net loss                       | \$(5,683)                              | \$(7,095) | \$(16,690)                         | \$(20,710) |

## Revenue

We do not have any products approved for sale, have not generated any revenue since our inception and do not expect to generate any material revenue in the near future. If our development efforts result in clinical success and regulatory approval or collaboration agreements with third parties for any of our product candidates, we may generate revenue from those product candidates.

## Research and Development Expense

All costs of research and development are expensed in the period incurred. Research and development costs consist primarily of salaries and related expenses for personnel, stock-based compensation expense, fees paid to consultants, outside service providers, professional services, travel costs and materials used in clinical trials and research and development. We are currently pursuing multiple product candidates for over a dozen indications. We typically use our employee and infrastructure resources across multiple development programs.

Research and development expense was as follows for the periods indicated (in thousands, except for percentages):

|  | Three months<br>ended<br>September 30, |         |             | Nine months<br>ended September<br>30, |          |             |
|--|--|---------|-------------|---------------------------------------|----------|-------------|
|  | 2016                                   | 2015    | %<br>Change | 2016                                  | 2015     | %<br>Change |
| Payroll and related                    | \$1,472                                | \$2,324 | (37 )%      | \$4,408                               | \$6,149  | (28 )%      |
| Consulting                             | 333                                    | 259     | 29 %        | 863                                   | 1,019    | (15 )%      |
| Field trial costs, including materials | 1,010                                  | 1,419   | (29 )%      | 2,287                                 | 4,501    | (49 )%      |
| Stock-based compensation               | 411                                    | 439     | (6 )%       | 1,063                                 | 1,371    | (22 )%      |
| Other                                  | 528                                    | 592     | (11 )%      | 1,731                                 | 1,793    | (3 )%       |
|  | \$3,754                                | \$5,033 | (25 )%      | \$10,352                              | \$14,833 | (30 )%      |

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During the three and nine months ended September 30, 2016, research and development expense related primarily to the completion of the pivotal field study of Mirataz for management of weight loss in cats, including completing the necessary regulatory requirements and preparing for the commercial launches for Mirataz and Zimeta, our other product candidate. During this period all technical sections of the NADA for Zimeta and Mirataz were completed and submitted to the FDA. In addition, the pilot field study for KIND-014 initiated earlier this year has been completed and based on the study results we are currently optimizing the formulation. We also initiated additional manufacturing work in preparation for commercialization of our two product candidates. We continue to advance additional product candidates in our small molecule programs as well as continue to advance our biologics program by building an in-house team to focus on setting-up a manufacturing process for our potential biologic candidates.

Research and development expenses for the three months ended September 30, 2016, decreased by 25% to \$3,754,000 compared with \$5,033,000 for the same period in 2015. The decrease in expenses were due to \$852,000 lower payroll and related expenses as a result of our corporate restructuring in January 2016. Our field trial costs decreased by \$409,000 as the completion of the pivotal study for Mirataz was earlier than expected, partially offset by the pilot field study costs for KIND-014, and the 2015 expenses included pivotal field trial costs for SentiKind and Zimeta, which we did not have in 2016. In addition, other research expenses and stock based compensation expense decreased by \$64,000 and \$28,000, respectively, offset in part by \$74,000 in consulting expenses. Outsourced research and development expenses related to our KIND-014, Zimeta, Mirataz and other product development programs for the three months ended September 30, 2016 were \$532,000, \$260,000, \$54,000 and \$379,000, respectively. Outsourced research and development expense consists primarily of costs related to CMC, clinical trial costs and consulting. Research and development expenses for the nine months ended September 30, 2016, decreased by 30% to \$10,352,000 compared with \$14,833,000 for the same period in 2015. The decrease in expenses were due to \$1,741,000 lower payroll and related expenses as a result of reduced headcount. Our field trial costs decreased by \$2,214,000 as the pivotal study for Mirataz was completed earlier than expected, offset in part by costs associated with the pilot field study for KIND-014, whereas expenses in 2015 included two pivotal field studies. In addition, stock-based compensation expense as well as consulting expense decreased by approximately \$308,000 and \$156,000, respectively. Outsourced research and development expenses related to our Mirataz, KIND-014, Zimeta and other product development programs for the nine months ended September 30, 2016 were \$838,000, \$689,000, \$626,000 and \$797,000, respectively.

We expect research and development expense to increase for the foreseeable future as we increase our headcount, commence pilot studies and further develop our small molecule compounds and biologics development programs. Due to the inherently unpredictable nature of our development, we cannot reasonably estimate or predict the nature, specific timing or estimated costs of the efforts that will be necessary to complete the development of our product candidates.

## General and Administrative Expense

General and administrative expense was as follows for the periods indicated (in thousands, except for percentages):

|  | Three months ended September 30, |         |          | Nine months ended September 30, |         |          |
|--|----------------------------------|---------|----------|---------------------------------|---------|----------|
|  | 2016                             | 2015    | % Change | 2016                            | 2015    | % Change |
| Payroll and related                              | \$571                            | \$535   | 7 %      | \$1,683                         | \$1,439 | 17 %     |
| Consulting, legal fees and professional services | 221                              | 361     | (39) %   | 696                             | 1,153   | (40) %   |
| Stock-based compensation                         | 604                              | 567     | 7 %      | 1,636                           | 1,732   | (6) %    |
| Corporate and marketing expenses                 | 334                              | 220     | 52 %     | 1,067                           | 799     | 34 %     |
| Other  | 292                              | 412     | (29) %   | 825                             | 846     | (2) %    |
|  | \$2,022                          | \$2,095 | (3) %    | \$5,907                         | \$5,969 | (1) %    |

General and administrative expenses for the three months ended September 30, 2016 decreased by 3% to \$2,022,000 compared with \$2,095,000 for the same period in 2015. The decrease in general and administrative expense



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was related to lower consulting, legal, professional services and other expenses. The decrease in expenses were offset in part by higher corporate and marketing expenses as we prepare for the launch of Zimeta and Mirataz as well as higher stock based compensation expense.

General and administrative expenses for the nine months ended September 30, 2016 remained unchanged compared to the same period in 2015. Lower expenses in consulting, legal, professional services and other expenses were offset by higher payroll, corporate and marketing expenses resulting in spending being flat year over year.

We expect general and administrative expense to increase going forward as we prepare for the commercial launches of Zimeta and Mirataz.

**Restructuring costs**

For the nine months ended September 30, 2016, we recorded a restructuring charge of \$655,000 in order to streamline our focus on our development programs and to ensure our remaining funds are sufficient to fund our planned operations through 2018. Eighteen employees were impacted by the restructuring and all restructuring charges were paid as of March 31, 2016. There was no restructuring charge in the second or third quarter of 2016.

**Income Taxes**

We have historically incurred operating losses and maintain a full valuation allowance against our net deferred tax assets. Our management has evaluated the factors bearing upon the realizability of our deferred tax assets, which are comprised principally of net operating loss carryforwards and concluded that, due to the uncertainty of realizing any tax benefits as of September 30, 2016, a valuation allowance was necessary to fully offset our deferred tax assets.

**Liquidity and Capital Resources**

We have incurred losses and negative cash flows from operations and have not generated any revenue since our inception in September 2012 through September 30, 2016. As of September 30, 2016, we had an accumulated deficit of \$75,292,000. Since inception, we raised a total of \$125,023,000, net of offering costs, through public offerings of our common stock and through the sale of preferred stock (subsequently converted to common stock at the time of our initial public offering). As of September 30, 2016, we had cash, cash equivalents and investments of \$62,484,000. We believe that our cash, cash equivalents and investments balances as of September 30, 2016, are sufficient to fund our planned operations for at least the next 24 months.

**Cash Flows**

The following table summarizes our cash flows for the periods set forth below:

|   | Nine months ended |            |
|---|-------------------|------------|
|   | September 30,     |            |
|   | 2016              | 2015       |
|   | (In thousands)    |            |
| Net cash used in operating activities     | \$(14,264)        | \$(17,228) |
| Net cash provided by investing activities | \$7,493           | \$8,592    |
| Net cash provided by financing activities | \$90              | \$206      |
| Net cash used in operating activities     |                   |            |

During the nine months ended September 30, 2016, net cash used in operating activities was \$14,264,000. The net loss of \$16,690,000 for the nine months ended September 30, 2016 included non-cash charges of \$2,699,000 for stock-based compensation expense, \$199,000 for the amortization of premium on marketable securities and \$115,000 for depreciation and amortization. Net cash used in operating activities was further impacted by changes in operating assets and liabilities of \$587,000.

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During the nine months ended September 30, 2015, net cash used in operating activities was \$17,228,000. Net cash used in operating activities resulted primarily from our net loss of \$20,710,000, partially offset by non-cash, stock-based compensation of \$3,103,000, depreciation and amortization of \$108,000, amortization of premium on marketable securities of \$128,000, and further impacted by changes in operating assets and liabilities of \$143,000. Net cash provided by investing activities

During the nine months ended September 30, 2016, net cash provided by investing activities was \$7,493,000, which resulted from proceeds from maturities of marketable securities of \$69,813,000, offset by \$61,482,000 related to the purchase of marketable securities and \$838,000 related to purchases of property and equipment.

During the nine months ended September 30, 2015, net cash used in investing activities was \$8,592,000 and related to proceeds from maturities of marketable securities of \$87,000,000 and sales of investments of \$3,000,000, offset by the purchase of marketable securities of \$81,086,000 and property and equipment of \$322,000.

Net cash provided by financing activities

During the nine months ended September 30, 2016, net cash provided by financing activities of \$90,000 was related to proceeds from the purchase of common stock through our Employee Stock Purchase Program and exercise of stock options.

During the nine months ended September 30, 2015, net cash provided by financing activities of \$206,000 was from the exercise of stock options and the purchase of common stock through our Employee Stock Purchase Program.

Future Funding Requirements

We anticipate that we will continue to incur losses for the next several years due to expenses relating to:

- pivotal trials of our product candidates;
- toxicology (target animal safety) studies for our product candidates;
- small molecule manufacturing;
- establishment of biologics manufacturing capability; and
- commercialization of one or more of our product candidates, if approved.

We believe our existing cash, cash equivalents and investments will be sufficient to fund our operating plan through the next 24 months. However, our operating plan may change as a result of many factors currently unknown to us, and we may need to seek additional funds sooner than planned, through public or private equity or debt financings or other sources, such as strategic collaborations. Such financing may result in dilution to stockholders, imposition of debt covenants and repayment obligations or other restrictions that may affect our business. In addition, we may seek additional capital due to favorable market conditions or strategic considerations even if we believe we have sufficient funds for our current or future operating plans.

Our future capital requirements depend on many factors, including, but not limited to:

- the scope, progress, results and costs of researching and developing our current or future product candidates;
- the timing of, and the costs involved in, obtaining regulatory approvals for any of our current or future product candidates;
- the number and characteristics of the product candidates we pursue;
- the cost of manufacturing our current and future product candidates and any products we successfully commercialize, including cost of building internal biologics manufacturing capacity;
- the cost of commercialization activities if any of our current or future product candidates are approved for sale, including marketing, sales and distribution costs;
- the expenses needed to attract and retain skilled personnel;
- the costs associated with being a public company;
- our ability to establish and maintain strategic collaborations, licensing or other arrangements and the financial terms of such agreements; and

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the costs involved in preparing, filing, prosecuting, maintaining, defending and enforcing possible patent claims, including litigation costs and the outcome of any such litigation.

Since inception, we have not engaged in the use of any off-balance sheet arrangements, such as structured finance entities, special purpose entities or variable interest entities.

### Contractual Obligations

In April 2014, we entered into noncancelable operating leases for laboratory space and office space and in January, August and November 2015, as well as February and October 2016, we amended one of the operating leases to include additional lab space. In June 2015, we entered into a noncancelable operating lease for office space in San Diego, California. Under the operating leases we are obligated to make minimum lease payments as of September 30, 2016 totaling \$2,820,000 through May 2022, the timing of which is described in more detail in the notes to the condensed consolidated financial statements.

### Off-Balance Sheet Arrangements

As of September 30, 2016, we did not have any material off-balance sheet arrangements as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

### Recently Issued Accounting Pronouncements

In November 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2015-17, "Balance Sheet Classification of Deferred Taxes", requiring all deferred tax assets and liabilities, and any related valuation allowance, to be classified as non-current on the consolidated balance sheet. The classification change for all deferred taxes as non-current simplifies entities' processes as it eliminates the need to separately identify the net current and net non-current deferred tax asset or liability in each jurisdiction and allocate valuation allowances. The update is effective for public business entities issuing consolidated financial statements for the annual periods beginning after December 15, 2016, and interim periods within those annual periods. We are currently evaluating the new guidance and have not determined the impact this standard may have on our condensed consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities", which amends the guidance in U.S. GAAP on the classification and measurement of financial instruments and also amends certain disclosure requirements associated with the fair value of financial instruments. The new guidance is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. We are currently evaluating the new guidance and have not determined the impact this standard may have on our condensed consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)", requiring organizations that lease assets—referred to as "lessees"—to recognize on the consolidated balance sheet the assets and liabilities for the rights and obligations created by those leases. Under the new guidance, a lessee will be required to recognize assets and liabilities for leases with lease terms of more than 12 months. The ASU on leases will take effect for public companies for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. We are currently evaluating the new guidance and have not determined the impact this standard may have on our condensed consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, "Improvements to Employee Share-Based Payment Accounting", which amends ASC Topic 718, "Compensation - Stock Compensation". The ASU includes provisions intended to simplify various aspects related to how share-based payments are accounted for and presented in the consolidated financial statements. ASU 2016-09 is effective for public business entities for annual reporting periods beginning after December 15, 2016, and interim periods within that reporting period. Early adoption will be permitted in any interim or annual period, with any adjustments reflected as of the beginning of the fiscal year of adoption. Our early adoption of this standard in the nine months ended September 30, 2016 did not have any material impact on our condensed consolidated financial statements.



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We do not believe there are any other recently issued standards not yet effective that will have a material impact on our consolidated financial statements when the standards become effective.



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**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The primary objective of our investment activities is to preserve capital. We do not utilize hedging contracts or similar instruments.

We are exposed to certain market risks relating primarily to (1) interest rate risk on our cash and cash equivalents, (2) market price risk on our investments, and (3) risks relating to the financial viability of the institutions which hold our capital and through which we have invested our funds. We manage such risks by investing in short-term, liquid, highly-rated instruments. As of September 30, 2016, our cash equivalents and investments are invested in money market funds, U.S. treasury bills, U.S. federal agency notes, corporate notes, commercial paper and U.S treasury bonds. We do not believe we have any material exposure to interest rate risk due to the extremely low interest rate environment, the short duration of the securities we hold and our ability to hold our investments to maturity if necessary. Declines in interest rates would reduce investment income, but would not have a material effect on our financial condition or results of operations.

We do not currently have exposure to foreign currency risk.

**ITEM 4. CONTROLS AND PROCEDURES**

**Disclosure Controls and Procedures**

As of the end of the period covered by this quarterly report on Form 10-Q, our management, with the participation of our Chief Executive Officer and Interim Chief Financial Officer (the “Certifying Officer”), evaluated the effectiveness of our disclosure controls and procedures. Disclosure controls and procedures are controls and procedures designed to reasonably assure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934 (the “Exchange Act”), such as this report, is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms. Disclosure controls and procedures are also designed to reasonably assure that such information is accumulated and communicated to our management, including the Certifying Officer, as appropriate to allow timely decisions regarding required disclosure. Based on these evaluations, the Certifying Officer has concluded, that, as of the end of the period covered by this report:

- (a) our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in the reports we file or submit under the Exchange Act was recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms; and
- (b) our disclosure controls and procedures were effective to provide reasonable assurance that material information required to be disclosed by us in the reports we file or submit under the Exchange Act was accumulated and communicated to our management, including the Certifying Officer, as appropriate to allow timely decisions regarding required disclosure.

**Changes in Internal Control over Financial Reporting**

There has not been any change in our internal control over financial reporting that occurred during the period ended September 30, 2016 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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**PART II — OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

None.

**ITEM 1A. RISK FACTORS**

You should consider the “Risk Factors” included under Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2015 filed with the SEC on March 4, 2016. There have been no material changes to those Risk Factors.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

Unregistered Sales of Equity Securities and Issuer Purchases of Equity Securities

None.

Use of Proceeds from the Sale of Registered Securities

On December 11, 2013, our registration statement on Form S-1 (File No. 333-192242) was declared effective by the Securities and Exchange Commission (SEC) for our initial public offering pursuant to which we sold an aggregate of 8,625,000 shares of our common stock at a price to the public of \$7.00 per share. There has been no material change in our use of proceeds from our initial public offering as described in our final prospectus filed with the SEC on December 12, 2013 pursuant to Rule 424(b).

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5. OTHER INFORMATION**

None.

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ITEM 6. EXHIBITS

EXHIBIT INDEX

| Exhibit<br>Number | Description  |
|-------------------|--|
| 31.1              | Sarbanes-Oxley Act Section 302 Certification of Chief Executive Officer and Interim Chief Financial Officer. |
| 32.1              | Sarbanes-Oxley Act Section 906 Certification of Chief Executive Officer and Interim Chief Financial Officer. |
| 101.INS           | XBRL Instance Document   |
| 101.SCH           | XBRL Taxonomy Extension Schema Document  |
| 101.CAL           | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.DEF           | XBRL Taxonomy Extension Definition Linkbase Document   |
| 101.LAB           | XBRL Taxonomy Extension Labels Linkbase Document   |
| 101.PRE           | XBRL Taxonomy Extension Presentation Linkbase Document   |

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 7, 2016

Kindred Biosciences, Inc.

By: /s/ Richard Chin

Richard Chin, M.D.

President and Chief Executive Officer and Interim Chief Financial Officer