

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2020
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

KINDRED BIOSCIENCES, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State of incorporation)

46-1160142
(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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol	Name of each exchange on which registered
Common Stock, \$0.0001 par value	KIN	The NASDAQ Stock Market LLC
Preferred Stock Purchase Rights	KIN	The NASDAQ Stock Market LLC

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 every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input checked="" type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by checkmark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of April 30, 2020, Kindred Biosciences, Inc. had outstanding 39,289,624 shares of common stock, \$0.0001 par value.

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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)

	<u>March 31, 2020</u>	<u>December 31, 2019</u>
	<u>(Unaudited)</u>	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 13,960	\$ 15,986
Short-term investments	39,493	55,723
Accounts receivable	244	923
Inventories	824	4,218
Prepaid expenses and other	3,893	2,495
Total current assets	<u>58,414</u>	<u>79,345</u>
Property and equipment, net	30,292	29,777
Long-term investments	1,118	1,837
Operating lease right-of-use assets	2,833	3,001
Other assets	64	64
Total assets	<u>\$ 92,721</u>	<u>\$ 114,024</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 2,837	\$ 1,256
Accrued compensation	3,587	4,193
Accrued liabilities	3,153	4,131
Current portion of operating lease liabilities	618	644
Total current liabilities	<u>10,195</u>	<u>10,224</u>
Long-term liability		
Long-term operating lease liabilities	2,506	2,614
Long-term loan payable, net of debt issuance costs	19,350	19,265
Total liabilities	<u>32,051</u>	<u>32,103</u>
Commitments and contingencies (Note 10)		
Stockholders' equity:		
Common stock, \$0.0001 par value; 100,000,000 shares authorized; 39,289,624 and 39,203,533 shares issued and outstanding at March 31, 2020 and December 31, 2019, respectively	4	4
Additional paid-in capital	306,482	304,963
Accumulated other comprehensive income (loss)	4	13
Accumulated deficit	(245,820)	(223,059)
Total stockholders' equity	<u>60,670</u>	<u>81,921</u>
Total liabilities and stockholders' equity	<u>\$ 92,721</u>	<u>\$ 114,024</u>

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

Kindred Biosciences, Inc.
Condensed Consolidated Statements of Operations and Comprehensive Loss
(In thousands, except per share amounts)
(Unaudited)

	Three months ended March 31,	
	2020	2019
Net product revenues	\$ 603	\$ 515
Operating costs and expenses:		
Cost of product revenues ⁽¹⁾	3,577	92
Research and development	8,867	7,152
Selling, general and administrative	8,873	9,901
Restructuring costs	1,676	—
Total operating costs and expenses	22,993	17,145
Loss from operations	(22,390)	(16,630)
Interest and other (expense) income, net	(371)	575
Net loss	(22,761)	(16,055)
Change in unrealized gains or losses on available-for-sale securities	(9)	(2)
Comprehensive loss	\$ (22,770)	\$ (16,057)
Net loss per share, basic and diluted	\$ (0.58)	\$ (0.42)
Weighted-average number of common shares outstanding, basic and diluted	39,186	37,786

(1) Includes \$3,494,000 Finished Goods write-off related to the Dechra Asset Purchase Agreement, consistent with the transition to proprietary Dechra branding and regulatory best practices related to label transitions on asset divestitures.

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

Kindred Biosciences, Inc.
Condensed Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Three months ended March 31,	
	2020	2019
Cash Flows from Operating Activities		
Net loss	\$ (22,761)	\$ (16,055)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation expense	2,064	1,860
Depreciation and amortization expense	1,053	500
Loss/(gain) on disposal of property and equipment	—	1
Amortization of discount on marketable securities	(109)	(81)
Amortization of debt discount of long-term loan	85	—
Finished goods write off related to Dechra asset purchase ⁽¹⁾	3,494	—
Changes in operating assets and liabilities:		
Accounts receivable	679	628
Inventories	(100)	(955)
Prepaid expenses and other	(1,398)	(260)
Accounts payable	1,558	(1,575)
Accrued liabilities and accrued compensation	(1,677)	(2,717)
Net cash used in operating activities	(17,112)	(18,654)
Cash Flows from Investing Activities		
Purchases of investments	(16,720)	(20,281)
Maturities of investments	33,769	10,600
Purchases of property and equipment	(1,418)	(2,656)
Proceeds from sale of property and equipment	—	3
Net cash provided by (used in) investing activities	15,631	(12,334)
Cash Flows from Financing Activities		
Exercises of stock options	124	652
Payment of restricted stock awards and units tax liability on net settlement	(669)	(493)
Net proceeds from sale of common stock	—	43,125
Net cash (used in) provided by financing activities	(545)	43,284
Net change in cash and cash equivalents	(2,026)	12,296
Cash and cash equivalents at beginning of period	15,986	56,302
Cash and cash equivalents at end of period	\$ 13,960	\$ 68,598

(1) Includes \$3,494,000 Finished Goods write-off related to the Dechra Asset Purchase Agreement, due to the transition to proprietary Dechra branding on asset divestitures.

Supplemental disclosure of non-cash investing and financing activities:

Purchases of property and equipment included in accounts payable and accrued liabilities	\$ 1,224	\$ 1,600
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The accompanying notes are an integral part of these condensed consolidated financial statements.

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. ("KindredBio Equine"). KindredBio Equine 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 KindredBio Equine is 1,000. On February 1, 2019, we filed a Certificate of Incorporation with the State of Delaware for a wholly owned subsidiary, Centaur Biopharmaceutical Services, Inc. ("Centaur Biopharmaceutical Services"). Centaur Biopharmaceutical Services 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 Centaur Biopharmaceutical Services is 1,000.

We are a commercial-stage 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.

Our first product, Mirataz® (mirtazapine transdermal ointment) was approved in May 2018 and became commercially available to veterinarians in the United States in July 2018. In November 2019, our second product, Zimeta™ (dipyron injection) for the control of fever in horses was approved by the FDA and became commercially available in December 2019. In addition, we have multiple other product candidates, including several biologics, in various stages of development.

On March 16, 2020, we entered into an Asset Purchase Agreement whereby we agreed to sell Mirataz, our transdermal drug for the management of weight loss in cats, to Dechra Pharmaceuticals PLC ("Dechra") for a cash purchase price of \$43 million, of which \$38.7 million will be paid on the closing date and \$4.3 million will be paid out of escrow beginning in 12 months assuming no escrow claims, alongside an ongoing royalty on global net sales. The acquisition comprises worldwide marketing rights, intellectual property rights, marketing authorizations and associated regulatory documentation, third party supply contracts related to raw material and manufacture of the finished product, and certain product inventory. On April 15, 2020, we completed the sale of Mirataz to Dechra.

Concurrent with the divestiture of Mirataz, we announced a strategic realignment of our business model whereby KindredBio becomes a biologics-only company focused on accelerating our deep pipeline of late-stage biologics candidates in canine and feline markets, while discontinuing small molecule development for these species. We believe monoclonal antibodies are the future of veterinary medicine, and represent the greatest opportunity for value creation, given large potential markets for our programs and our competitive advantage in biologics. We plan to rely more on a partnership-based model for commercialization strategy similar to the traditional human biotech commercialization strategy whereby pipeline assets are partnered with larger commercial partners that can maximize product opportunity in return for upfront payments, contingent milestones, and royalties on future sales. Accordingly, the companion animal commercial infrastructure will be substantially reduced. In connection with this strategic shift, we eliminated 53 positions, representing about one-third of our current workforce. The eliminated positions primarily relate to the companion animal sales force and research and development for small molecule programs.

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.

Our contract manufacturers purchase raw materials from suppliers located in China and India in order to manufacture our products and product candidates. The December 2019 outbreak of the novel strain of coronavirus (COVID-19) in China and India and other countries with which we do business may result in the full or partial shutdown of manufacturers or other businesses that are affected by the coronavirus, which may adversely impact both our ability to obtain sufficient and timely

supplies of our products and other product candidates and our revenue from those products. In addition to adversely affecting our ability to obtain sufficient and timely supplies of products and product candidates from suppliers, any outbreak of contagious diseases, such as the recent novel strain of coronavirus (COVID-19) that is affecting the global community, could adversely affect our business and operations in other ways, many of which cannot currently be determined or quantified. These uncertain factors, including the duration of the outbreak, the severity of the disease and the actions to contain or treat its impact, could impair our operations including, among others, employee mobility and productivity, availability of facilities, conduct of our clinical trials, manufacturing and supply capacity, and availability and productivity of third party service suppliers.

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 financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2019 included in our annual report on Form 10-K as filed with the SEC on March 16, 2020. 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 financial statements.

The accompanying financial statements include the accounts of Kindred Biosciences and its wholly owned subsidiaries (the "Company"). All inter-company accounts and transactions have been eliminated in consolidation.

Stock Offerings

In January 2019, we completed a public offering of 4,847,250 shares of common stock, which includes the exercise in full of the underwriters' option to purchase 632,250 additional shares of our common stock, at a public offering price of \$9.50 per share for total gross proceeds of approximately \$46,049,000. Net proceeds, after deducting underwriting discounts and commissions and offering expense, were approximately \$43,140,000.

Borrowings

On September 30, 2019, we entered into a Loan and Security Agreement (the "Loan Agreement") with Solar Capital Ltd., as collateral agent and lender, and the other lenders named in the Loan Agreement (Solar Capital Ltd. and the other lenders collectively, the "Lenders"). The Lenders have agreed to make available to KindredBio an aggregate principal amount of up to \$50.0 million under the Loan Agreement. We plan to use the loan proceeds to support the development and commercialization of our products and product candidates as well as for working capital and general corporate purposes. The Loan Agreement provides for a term loan commitment of \$50.0 million in three tranches: (1) a \$20.0 million term A loan that was funded on September 30, 2019; (2) a \$15.0 million term B loan that is to be funded at our request, subject to certain conditions described in the Loan Agreement being satisfied, no later than December 31, 2020; and (3) a \$15.0 million term C loan that is to be funded at our request, subject to certain conditions described in the Loan Agreement being satisfied, on or before June 30, 2021. Each term loan has a maturity date of September 30, 2024. Each term loan bears interest at a floating per annum rate equal to the one-month LIBOR rate (with a floor of 2.17%) plus 6.75%. We are permitted to make interest-only payments on each term loan through October 31, 2021. The interest-only period can be extended by six months upon our satisfaction of the minimum liquidity requirements described in the Loan Agreement. See Note 6.

On March 16, 2020, we entered into a First Amendment to Loan and Security Agreement (the "First Amendment") with the Lenders in connection with the divestiture of our Mirataz asset. Among other things, the First Amendment increases the minimum cash amount, as defined in the Loan Agreement, required to be maintained by KindredBio to \$10,000,000 at any time prior to the initial funding date of any term B loan, to \$15,000,000 at all times on and after the initial funding date of any term B loan, and to \$20,000,000 at all times on and after the initial funding date of any term C loan, and releases Solar Capital's lien in and to the assets that are being sold by KindredBio. We agreed to pay an amendment fee of One Hundred Thousand Dollars (\$100,000), which was deemed fully earned and non-refundable on the Amendment Effective Date. The First Amendment also requires KindredBio to receive unrestricted net proceeds of at least \$10,000,000 prior to December 31, 2021 pursuant to a specified sale of preferred or common stock or convertible subordinated debt financing.

Liquidity

We have incurred losses and negative cash flows from operations and had an accumulated deficit of \$245,820,000 as of March 31, 2020. 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 commercialize any approved products. To date, we have been funded primarily through sales of our equity. We might require additional capital until such time as we can generate operating revenues in excess of operating expenses. We believe that our cash, cash equivalents and investments totaling \$54,571,000 as of March 31, 2020, proceeds of \$43 million from the sale of our Mirataz asset, revenues from anticipated partnerships, and additional draw down of \$30 million from our Loan Agreement which is contingent on the achievement of certain milestones, are sufficient to fund our planned operations through 2022. In addition, we entered into an ATM Agreement on April 8, 2020 ATM facility (see Note 13) which will provide us with access to cash if required.

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.

Revenue Recognition

Our revenues consist of product revenues resulting from the sales of Mirata and Zimeta. We account for a contract with a customer when there is a legally enforceable contract between us and our customer, the rights of the parties are identified, the contract has commercial substance, and collectability of the contract consideration is probable. Our customers could either be distributors who subsequently resell our products to third parties such as veterinarians, clinics or animals hospitals or the third parties themselves.

In accordance with FASB Accounting Standards Codification Topic 606 ("ASC 606"), Revenue from Contracts with Customers, which we adopted on January 1, 2018, we applied the following steps to recognize revenue for the sales of Mirataz and Zimeta that reflects the consideration to which we expect to be entitled to receive in exchange for the promised goods:

1. Identify the contract with a customer

A contract with a customer exists when we enter into an enforceable contract with a customer. These contracts define each party's rights, payment terms and other contractual terms and conditions of the sale. We apply judgment in determining the customer's ability and intention to pay, which is based on published credit and financial information pertaining to the customer.

2. Identify the performance obligations in the contract

Our product in a given purchase order is delivered at the same time and we do not separate an individual order into separate performance obligations. We have concluded the sale of finished goods and related shipping and handling are accounted for as a single performance obligation as there are no other promises to deliver goods beyond what is specified in each accepted customer order.

3. Determine the transaction price

The transaction price is determined based on the consideration which we will be entitled to receive in exchange for transferring goods to the customer, typically a fixed consideration in our contractual agreements.

4. Allocate the transaction price to the performance obligations

The transaction price is allocated entirely to the performance obligation to provide pharmaceutical products. The nature of the promises/obligations under our contracts is to transfer a distinct good. Accordingly, because a single performance obligation exists, no allocation of the transaction price is necessary.

5. Determine the satisfaction of performance obligation

Revenue is recognized when control of the finished goods is transferred to the customer, net of applicable reserves for variable consideration. Control of the finished goods is transferred at a point in time, upon delivery to the customer.

Reserves for Variable Consideration

Revenues from product sales are recorded at the net sales price, which includes estimates of variable consideration for which reserves are established. Components of variable consideration include product returns, allowances and discounts. These estimates take into consideration a range of possible outcomes for the expected value (probability-weighted estimate) or relevant factors such as current contractual and statutory requirements, specific known market events and trends, industry data, and forecasted customer buying and payment patterns. Overall, these reserves reflect our best estimates of the amount of consideration to which it is entitled based on the terms of the respective underlying contracts. The amount of variable consideration included in the transaction price may be constrained and is included in the net sales price only to the extent that it is probable that a significant reversal in the amount of the cumulative revenue recognized where the contract will not occur in a future period. Actual amounts of consideration ultimately received may differ from our estimates. If actual results in the future vary from our estimates, we will adjust these estimates, which would affect net product revenues and earnings in the period such variances become known.

Product Returns

Consistent with the industry practice, we generally offer customers a limited right of return of damaged or expired product that has been purchased directly from us. Our return policy generally allows customers to receive credit for expired products within 90 days after the product's expiration date. We estimate the amount of our product revenues that may be returned by our customers and record these estimates as a reduction of product revenues in the period the related product revenues are recognized, as well as within accrued liabilities, in the consolidated balance sheets. We currently estimate product return liabilities using probability-weighted available industry data and data provided by the our distributors such as the inventories remaining in the distribution channel. To-date, we have no returns and believe that returns of our product in future periods will be minimal. We do not record a return asset associated with the returned damaged or expired goods due to such asset is deemed to be fully impaired at the time of product return.

Sales Discounts and Allowances

We compensate our distributors for sales order management, data and distribution and other services through sales discounts and allowances. However, such services are not distinct from our sale of products to distributors and, therefore, these discounts and allowances are recorded as a reduction of product revenues in the consolidated statements of operations and comprehensive loss, as well as a reduction to accounts receivable in the consolidated balance sheets.

Sales Commissions

We generally expense sales commissions when incurred because the amortization period would have been one year or less. These costs are recorded within sales and marketing expenses.

Cost of Product Revenues

Cost of product revenues consists primarily of the cost of direct materials, direct labor and overhead costs associated with manufacturing, inbound shipping and other third-party logistics costs.

Inventories

We value inventory at the lower of cost or net realizable value. We determine the cost of inventory using the standard-cost method, which approximates actual cost based on a first-in, first-out method. We analyze our inventory levels quarterly and write down inventory subject to expire in excess of expected requirements, or that has a cost basis in excess of its expected net realizable value. These inventory related costs are recognized as cost of product revenues on the accompanying consolidated statements of operations and comprehensive loss. Currently our inventory consists of finished goods only. In the quarter ended March 31, 2020, we wrote off \$3,494,000 Mirataz inventory related to the Dechra Asset Purchase Agreement, due to the transition to Dechra brand labelling.

Property, Plant and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. We calculate depreciation using the straight-line method over the estimated useful lives of the assets, which range from two to five years for furniture, fixtures, lab and computer equipment and software, and fifteen to thirty-nine years for land improvements and real property. Land and assets held within construction in progress are not depreciated. Construction in progress is related to the construction or development of property and equipment that have not yet been placed in service for their intended use. Expenditures for repairs and maintenance of assets are charged to expense as incurred. We amortize leasehold improvements using the straight-line method over the estimated useful lives of the respective assets or the lease term, whichever is shorter. Upon retirement or sale, the cost and related accumulated depreciation and amortization of assets disposed of are removed from the accounts and any resulting gain or loss is included in other income/expense.

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 financial statements, and the reported amounts of revenues and expenses during the reporting periods. Estimates are based historical experiences or on forecasts, including information received from third parties and other assumptions that the Company believes are reasonable under the circumstances. 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 debt 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 August 2018, the FASB issued ASU No. 2018-13, "Fair Value Measurement (Topic 820)", changes to disclosure requirements for fair value measurement. The amendments of this update modify the disclosure requirements on fair value measurements about Topic 820. It applies to all reporting entities within the scope of the affected accounting guidance. It will take effect for public companies for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Our adoption of this new guidance in the first quarter of 2020 did not have a material impact on our financial statements.

In December 2019, the FASB issued ASU No. 2019-12, "Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes". The amendments of this update simplify the accounting for income taxes by removing several exceptions. One of the exceptions may affect our company is the following: exception to the incremental approach for intra-period tax allocation when there is a loss from continuing operations and income or a gain from other items (say, other comprehensive income). It applies to all reporting entities within the scope of the affected accounting guidance. It will take effect for public companies for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. Early adoption is permitted. Our adoption of this new guidance in the first quarter of 2020 did not have a material impact on our financial statements.

In March 2020, the FASB issued ASU No. 2020-04, "Reference Rate Reform (Topic 848)", changes to the interbank offered rates (IBORs), and, particularly, the risk of cessation of the London Interbank Offered Rate ("LIBOR"). The amendments provide optional expedients and exceptions for applying U.S. GAAP to contracts that reference LIBOR expected to be discontinued because of reference rate reform. The expedients and exceptions do not apply to contract modifications made after December 31, 2022. The following optional expedients are permitted for contracts that are modified because of reference rate reform and that meet certain scope guidance: Modifications of contracts within the scope of Topics 470, Debt, should be accounted for by prospectively adjusting the effective interest rate. The amendments also permit an entity to consider contract modifications due to reference rate reform to be an event that does not require contract remeasurement at the modification date or reassessment of a previous accounting determination. When elected, the optional expedients for contract modifications must be applied consistently for all contracts. It applies to all entities within the scope of the affected accounting guidance and will take effect as of March 12, 2020 through December 31, 2022. We have one loan contract which references LIBOR rate. We have not modified the contract with our lenders yet. We are currently evaluating the new guidance and have not determined the impact this standard may have on our financial statements.

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

2. Revenues and Cost of Product Revenues

Our revenues consist of product revenues resulting from the sale of Mirataz and Zimeta. We account for a contract with a customer when there is a legally enforceable contract between us and our customer, the rights of the parties are identified, the contract has commercial substance, and collectability of the contract consideration is probable. Our revenues are measured based on the consideration specified in the contract with each customer, net of product returns, discounts and allowances.

The following table presents revenues and cost of product revenues for the three months ended March 31, 2020 and 2019 (in thousands):

	Three months ended March 31,	
	2020	2019
Gross product revenues		
Mirataz	\$ 616	\$ 531
Zimeta	7	—
Total gross product revenues	623	531
Less allowance for product returns		
Mirataz	(20)	(16)
Zimeta	—	—
Total allowances for product returns	(20)	(16)
Net Product Revenues		
Mirataz	596	515
Zimeta	7	—
Total net product revenues	603	515
Cost of product revenues		
Mirataz ⁽¹⁾	(3,575)	(92)
Zimeta	(2)	—
Total cost of product revenues	(3,577)	(92)
Gross profit		
Mirataz	(2,979)	423
Zimeta	5	—
Total gross profit	\$ (2,974)	\$ 423

(1) Includes \$3,494,000 Finished Goods write-off related to the Dechra Asset Purchase Agreement, due to the transition to proprietary Dechra brand labelling..

Concentrations of credit risk

Our revenue was generated entirely from sales within the United States. Approximately 73% of our gross product revenues sold were to three distributors for the three months ended March 31, 2020 and 87% of our gross product revenues sold were to two distributors for the three months ended March 31, 2019.

Product returns

Our return policy generally allows customers to receive credit for expired products within 90 days after the product's expiration date. We currently estimate product return liabilities of 2% for Mirataz and 3% for Zimeta of gross revenue using

probability-weighted available industry data and data provided by our distributors such as the inventories remaining in the distribution channel. Adjustments will be made in the future if actual results vary from our estimates.

Accounts receivable and allowance for doubtful accounts

Accounts receivable are stated at their carrying values, net of any allowances for doubtful accounts. Accounts receivable consist primarily of amounts due from distributors, for which collection is probable based on the customer's intent and ability to pay. Receivables are evaluated for collection probability on a regular basis and an allowance for doubtful accounts is recorded, if necessary. We have no allowance for doubtful accounts as of March 31, 2020 and December 31, 2019 as our analysis did not uncover any collection risks.

3. 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:

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.

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 March 31, 2020			
	Total	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Cash equivalents:				
Money market funds	\$ 4,104	\$ 4,104	\$ —	\$ —
Commercial paper	8,891	—	8,891	—
Short-term investments:				
U.S. treasury bills	7,034	7,034	—	—
U.S. Treasury bonds and notes	802	—	802	—
Commercial paper	26,040	—	26,040	—
Corporate notes	5,617	—	5,617	—
Long-term investments:				
Corporate notes	1,118	—	1,118	—
	<u>\$ 53,606</u>	<u>\$ 11,138</u>	<u>\$ 42,468</u>	<u>\$ —</u>

Fair Value Measurements as of December 31, 2019

Description	Total	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Cash equivalents:				
Money market funds	\$ 1,592	\$ 1,592	\$ —	\$ —
Commercial paper	13,580	—	13,580	—
Short-term investments:				
U.S. treasury bills	8,524	8,524	—	—
Commercial paper	25,573	—	25,573	—
U.S. government agency notes	11,461	—	11,461	—
Corporate notes	10,165	—	10,165	—
Long-term investments:				
U.S. government agency notes	801	—	801	—
Corporate notes	1,036	—	1,036	—
	\$ 72,732	\$ 10,116	\$ 62,616	\$ —

During the three months ended March 31, 2020, there were no transfers of assets between Level 1, Level 2 or Level 3 of the fair value hierarchy.

At March 31, 2020 and December 31, 2019, we did not have any financial liabilities which were measured at fair value on a recurring basis.

4. 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 March 31, 2020 was as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Short-term investments:				
Commercial paper	\$ 26,052	\$ 4	\$ (16)	\$ 26,040
U.S. treasury bills	7,003	31	—	7,034
U.S. treasury bonds	801	1	—	802
Corporate notes	5,621	2	(6)	5,617
	39,477	38	(22)	39,493
Long-term investments:				
Corporate notes	1,129	—	(11)	1,118
Total available-for-sale investments	\$ 40,606	\$ 38	\$ (33)	\$ 40,611

The fair value of available-for-sale investments by type of security at December 31, 2019 was as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Short-term investments:				
U.S. treasury bills	\$ 8,517	\$ 7	\$ —	\$ 8,524
Commercial paper	25,576	3	(6)	25,573
U.S. government agency notes	11,460	2	(1)	11,461
Corporate notes	10,157	8	—	10,165
	<u>55,710</u>	<u>20</u>	<u>(7)</u>	<u>55,723</u>
Long-term investments:				
U.S. government agency notes	801	—	—	801
Corporate notes	1,036	—	—	1,036
	<u>1,837</u>	<u>—</u>	<u>—</u>	<u>1,837</u>
Total available-for-sale investments	\$ 57,547	\$ 20	\$ (7)	\$ 57,560

5. Accrued Liabilities

Accrued liabilities consisted of the following (in thousands):

	March 31, 2020	December 31, 2019
Accrued consulting	\$ 958	\$ 589
Accrued research and development costs	1,614	1,336
Other expenses	581	2,206
	<u>\$ 3,153</u>	<u>\$ 4,131</u>

6. Borrowings

On September 30, 2019, we entered into the Loan and Security Agreement with Solar Capital Ltd. The Lenders have agreed to make available to KindredBio an aggregate principal amount of up to \$50.0 million under the Loan Agreement. We plan to use the loan proceeds to support the development and commercialization of our products and product candidates as well as for working capital and general corporate purposes. The Loan Agreement provides for a term loan commitment of \$50.0 million in three tranches: (1) a \$20.0 million term A loan that was funded on September 30, 2019; (2) a \$15.0 million term B loan that is to be funded at our request, subject to certain conditions described in the Loan Agreement being satisfied, no later than December 31, 2020; and (3) a \$15.0 million term C loan that is to be funded at our request, subject to certain conditions described in the Loan Agreement being satisfied, on or before June 30, 2021. Each term loan has a maturity date of September 30, 2024. Each term loan bears interest at a floating per annum rate equal to the one-month LIBOR rate (with a floor of 2.17%) plus 6.75%. We are permitted to make interest-only payments on each term loan through October 31, 2021. The interest-only period can be extended by six months upon our satisfaction of the minimum liquidity requirements described in the Loan Agreement. We have agreed to maintain cash at all times equal to at least \$5.0 million prior to the funding of the term B loan, at least \$10.0 million after the funding of the term B loan and at least \$15.0 million after the funding of the term C loan, plus in each case the amount of our accounts payable that have not been paid within 90 days from the invoice date subject to certain exceptions. Equal monthly payments of principal will be due and payable commencing at the end of the interest-only period of the term loans. In connection with the term loan, we incurred closing costs of \$819,000, which are shown net of the proceeds and will be amortized over the term of the loan using the effective interest method. We are obligated to pay a facility fee in the amount of 0.50% of each term loan that is funded and a non-utilization fee in the amount of 0.25% of each term B loan and term C loan to the extent that such loans are not funded. We are obligated to pay a final fee equal to 3.60% of the aggregate amount of the term loans funded (or 4.35% of such funded loans if the interest-only period is extended as described above), such final fee to be due and payable upon the earliest to occur of (1) the maturity date, (2) the acceleration of the term loans, and (3) the

prepayment of the term loans. We have the option to prepay all, but not less than all, of the outstanding principal balance of the term loans under the Loan Agreement. If we prepay the term loans prior to the maturity date, we must pay the Lenders a prepayment premium fee based on a percentage of the outstanding principal balance, equal to 3.0% if the payment occurs on or before September 30, 2020, 2.0% if the prepayment occurs after September 30, 2020 but on or before September 30, 2021, or 1.0% if the prepayment occurs after September 30, 2021. Our obligations under the Loan Agreement are secured by a first-priority security interest in substantially all of KindredBio's assets, including our intellectual property, and a lien on our real property. The Loan Agreement contains customary representations, warranties and covenants and also includes customary events of default, including payment defaults, breaches of covenants, and a default upon the occurrence of a material adverse change affecting us. Upon the occurrence of an event of default, a default interest rate of an additional 5.00% per annum may be applied to the outstanding loan balance, and the Lenders may declare all outstanding obligations immediately due and payable and exercise all their rights and remedies as set forth in the Loan Agreement and under applicable law. We were in compliance with all covenants as of March 31, 2020.

In conjunction with the Dechra Asset Purchase Agreement, on March 16, 2020, we entered into a First Amendment to Loan and Security Agreement (the "First Amendment") with the Lenders in connection with the divestiture of our Mirataz asset. Among other things, the First Amendment increases the minimum cash amount, as defined in the Loan Agreement, required to be maintained by KindredBio to \$10,000,000 at any time prior to the initial funding date of any term B loan, to \$15,000,000 at all times on and after the initial funding date of any term B loan, and to \$20,000,000 at all times on and after the initial funding date of any term C loan, and releases Solar Capital's lien in and to the assets that are being sold by KindredBio. We agreed to pay an amendment fee of One Hundred Thousand Dollars (\$100,000), which shall be deemed fully earned and non-refundable on the Amendment Effective Date. The First Amendment also requires KindredBio to receive unrestricted net proceeds of at least \$10,000,000 prior to December 31, 2021 pursuant to a specified sale of preferred or common stock or convertible subordinated debt financing.

As of March 31, 2020, assuming the principal payments start on November 1, 2021, our future debt payment obligations towards the principal and final fee, excluding interest payments and exit fee, for the respective fiscal years are as follows (in thousands):

	2020	\$	—
	2021		1,111
	2022		6,667
	2023		6,667
	2024		6,275
Total principal and final fee payments			20,720
Less: Unamortized debt issuance costs			(722)
Less: Unaccrued value of final fee			(648)
Loan payable, long term		\$	19,350

7. Common Stock and Stock-Based Awards

Common Stock

During the three months ended March 31, 2020, we issued 12,604 shares of common stock in connection with the exercise of stock options for gross proceeds of \$124,000, vested 206,196 restricted stock awards and restricted stock units and withheld 21,563 shares of restricted common stock and 48,646 shares related to restricted stock units to satisfy employee tax withholding obligations arising in conjunction with the vesting of restricted stock and restricted stock units (see below).

Stock-Based Awards

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 ended March 31,	
	2020	2019
Shares underlying options granted	749,000	1,029,000
Weighted-average exercise price	\$9.81	\$9.93
Weighted average risk- free interest rate	1.66 %	2.54 %
Weighted average expected term (years)	5.8	5.9
Weighted average expected volatility	54%	57%
Expected dividend yield	—	—
Weighted-average grant date fair value per share	\$5.01	\$5.43

In June 2018, we adopted the 2018 Equity Incentive Plan (the "2018 Plan"), and reserved 3,000,000 shares of our common stock for issuance under the 2018 Plan. The 2018 Plan is the successor to our 2016 Equity Incentive Plan (the "2016 Plan"), which was retired on June 21, 2018 upon stockholders' approval of our 2018 Plan. The 2016 Plan was 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 2016 and 2012 Plans shall remain subject to the terms of these plans. Options granted under the 2018 Plan may be either incentive stock options or nonstatutory stock options. The 2018 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 one or four years from the date of grant. Options granted under the 2018 Plan expire no later than 10 years from the date of grant. As of March 31, 2020, there were 2,146,887 option shares outstanding, and 155,914 shares available for future grants under the 2018 Plan.

Our Employee Stock Purchase Plan (the "Stock Purchase Plan" or "ESPP"), 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. At the Annual Meeting of Stockholders of Kindred Biosciences, Inc. held on June 22, 2018, our stockholders approved an amendment to increase the number of shares that may be issued under the ESPP from 200,000 shares to 500,000 shares. 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 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 March 31,	
	2020	2019
Weighted average risk-free interest rate	1.63%	2.52%
Weighted average expected term (years)	0.5	0.5
Weighted average expected volatility	52.6%	48.2%
Expected dividend yield	—	—
Weighted-average grant date fair value per share	\$2.19	\$3.66

Under the Stock Purchase Plan, employees did not purchase any shares of common stock during the three months ended March 31, 2020. At March 31, 2020 and December 31, 2019, we had an outstanding liability of \$143,000 and \$40,000, 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 March 31,	
	2020	2019
Research and development	\$ 553	\$ 436
General and administrative	1,511	1,424
	<u>\$ 2,064</u>	<u>\$ 1,860</u>

We had an aggregate of approximately \$10,097,000 of unrecognized stock-based compensation expense for options outstanding and the Stock Purchase Plan as of March 31, 2020 which is expected to be recognized over a weighted-average period of 2.6 years.

Restricted Stock Award and Restricted Stock Units

On January 23, 2017, we granted 250,000 shares of restricted stock awards to four employees. Shares will vest 25% on each one year anniversary of the grant date provided that the employee is in the employment of the Company on such vesting date. On January 22, 2018, we granted 315,000 shares of restricted stock units to four employees. Shares will vest 25% on each one year anniversary of the grant date provided that the employee is in the employment of the Company on such vesting date. In Q1 2019, we granted 300,775 shares of restricted stock units to most of our current employees. Shares will vest 25% on each one year anniversary of the grant date provided that the employee is in the employment of the Company on such vesting date. In Q1 2020, we granted 586,915 shares of restricted stock units to most of our current employees. Shares will vest 25% on each one year anniversary of the grant date provided that the employee is in the employment of the Company on such vesting date. The total stock-based compensation expense related to all awards and units is \$13,288,000. As of March 31, 2020, we have an aggregate of approximately \$7,799,000 unrecognized stock-based compensation expense for restricted stock awards and units outstanding which is expected to be recognized over a weighted-average period of 3.2 years.

Restricted stock award and restricted stock units activity for three months ended March 31, 2020 was as follows:

Restricted Stock Award / Restricted Stock Units	Shares	Weighted Average Grant Date Fair Value
Unvested balance at December 31, 2019	625,325	\$9.01
Granted	586,915	9.84
Vested	(206,196)	8.58
Forfeited	(129,842)	10.07
<u>Unvested balance at March 31, 2020</u>	<u>876,202</u>	<u>\$9.51</u>

Stock Option Information

A summary of stock option activity under all stock plans for the three months ended March 31, 2020, is presented as follows:

Stock Options	Number of Outstanding	Weighted Average Exercise Price Per Share
Balance at December 31, 2019	6,353,370	\$7.94
Granted	749,000	9.81
Exercised	(12,604)	8.63
Forfeited	(152,288)	9.76
Expired	(5,938)	11.88
Balance at March 31, 2020	6,931,540	\$8.09

As of March 31, 2020, options to purchase 4,897,008 shares of common stock were exercisable at a weighted average price of \$7.48 per share.

8. Stockholders' Equity

Stockholders' Equity

The following tables present the changes in stockholders' equity (in thousands):

	Three months ended March 31, 2020					
	Common stock		Additional Paid in Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Stockholders' Equity
	Shares	Amount				
Balance at December 31, 2019	39,204	\$ 4	\$ 304,963	\$ 13	\$ (223,059)	\$ 81,921
Comprehensive loss						
Net loss	—	—	—	—	(22,761)	(22,761)
Change in unrealized gains on available for sale securities	—	—	—	(9)	—	(9)
Total comprehensive loss						(22,770)
Stock-based compensation	—	—	2,064	—	—	2,064
RSU issuance of shares when vested	95	—	(461)	—	—	(461)
Shares withheld related to net share settlement of equity awards	(22)	—	(208)	—	—	(208)
Exercise of common stock options	13	—	124	—	—	124
Balance at March 31, 2020	39,290	\$ 4	\$ 306,482	\$ 4	\$ (245,820)	\$ 60,670

Three months ended March 31, 2019

	Common stock		Additional Paid in Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Stockholders' Equity
	Shares	Amount				
Balance at December 31, 2018	33,948	\$ 3	\$ 252,885	\$ (11)	\$ (161,670)	\$ 91,207
Comprehensive loss						
Net loss	—	—	—	—	(16,055)	(16,055)
Change in unrealized gains on available for sale securities	—	—	—	(2)	—	(2)
Total comprehensive loss						(16,057)
Stock-based compensation	—	—	1,860	—	—	1,860
RSU issuance of shares when vested	51	—	(279)	—	—	(279)
Shares withheld related to net share settlement of equity awards	(21)	—	(214)	—	—	(214)
Exercise of common stock options	103	—	652	—	—	652
Public offering of common stock, net of \$2,924 of offering costs	4,847	1	43,124	—	—	43,125
Balance at March 31, 2019	38,928	\$ 4	\$ 298,028	\$ (13)	\$ (177,725)	\$ 120,294

9. Leases
Leases

We have non-cancelable operating leases for laboratory space in Burlingame, California with several amendments to expand the facility. In February 2020, we further amended non-cancelable operating leases for laboratory space in Burlingame, California for an expansion of an additional 2,260 square feet of laboratory space commencing on May 1, 2020 and expires on May 31, 2025. The total non-cancellable operating lease for the entire existing laboratory space is 13,736 square feet, expiring May 31, 2025. In August 2015, we entered into a new non-cancelable operating lease for 3,126 square feet of office space in San Diego, California and in June 2019, renewed the lease through February 2025. Our headquarters office lease for 8,090 square feet of office space in Burlingame, California expires November 30, 2020. In April 2019, we signed a short-term lease in Burlingame ("April 2019 lease"), consisting of 1,979 square feet of space through April 2020. In May 2019, we signed another lease in Burlingame ("May 2019 lease"), consisting of 1,346 square feet of space through April 2022. In addition, we have four equipment leases expiring through 2023.

Operating lease expense was \$265,000 and \$229,000 for the three months ended March 31, 2020 and 2019, which includes \$33,000 and \$26,000 of short-term lease expense, respectively. The following tables below do not include short term lease. The February 2020 lease is not included since the new lease term will not start until May 1, 2020. We also have various equipment operating lease agreements.

Supplemental cash flow information, as of March 31, 2020, related to operating leases as follows (in thousands):

Amortization of operating lease	\$ 187
Cash paid within operating cash flows	\$ 198
Right-of-use assets obtained in exchange for new lease liabilities	\$ 19

Supplemental balance sheet information, as of March 31, 2020, related to operating leases was as follows (in thousands, except lease term and discount rate):

Reported as:

Operating lease right-of-use assets	\$	2,833
Current portion of operating lease liabilities	\$	618
Long-term operating lease liabilities		2,506
Total lease liabilities	\$	<u>3,124</u>
Weighted average remaining lease term (years)		4.7 years
Weighted average discount rate		5.50%

As of March 31, 2020, we are obligated to make minimum lease payments under non-cancelable operating leases, as follows (in thousands):

Year ending December 31,	Lease Payments
2020 (remaining of year)	\$ 612
2021	656
2022	684
2023	704
2024	719
2015 and thereafter	204
Total lease payments	<u>3,579</u>
Less: imputed interest	(455)
Total lease liabilities	<u>\$ 3,124</u>

10. Commitments and contingencies
Purchase Commitments

In June 2018, we entered into a Strategic Supply Agreement (the "Agreement"), with Pall Corporation ("Pall") for the purchase of equipment and consumables to be used in support of our manufacturing requirements, including, but not limited to the Plant. Pursuant to the agreement, we will purchase certain pharmaceutical manufacturing equipment and related services in the aggregate amount of \$3.8 million with a seven year consumable purchase obligation in the aggregate amount of approximately \$16.5 million. The agreement is subject to customary undertakings, covenants, obligations, rights and conditions. We have incurred \$3,778,000 in equipment purchase costs in December 2019. As of March 31, 2020, we are obligated to make consumable purchases and committed purchases as follows (in thousands):

Year ending December 31,	Consumable commitments	Consumable purchases	Remaining commitments
2020	\$ 1,650	\$ 823	\$ 827
2021	3,300	—	3,300
2022	3,625	—	3,625
2023	3,625	—	3,625
2024	4,285	—	4,285
Total	<u>\$ 16,485</u>	<u>\$ 823</u>	<u>\$ 15,662</u>

11. Net Loss Per Share

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

	Three months ended March 31,	
	2020	2019
Basic and diluted net loss per share:		
Numerator:		
Net loss	\$ (22,761)	\$ (16,055)
Denominator:		
Weighted-average number of common shares outstanding, basic and diluted	39,186	37,786
Net loss per share, basic and diluted	\$ (0.58)	\$ (0.42)

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 6,931,540 shares of common stock, 62,500 shares unvested restricted stock awards and 813,702 restricted stock units as of March 31, 2020, were excluded from the computation of diluted net loss per share attributable to common stockholders for the three months ended March 31, 2020, because their effect was anti-dilutive.

Stock options to purchase 6,692,139 shares of common stock and 125,000 shares unvested restricted stock awards and 236,250 restricted stock units were excluded from the computation of diluted net loss per share attributable to common stockholders for the three months ended March 31, 2019, because their effect was anti-dilutive.

12. Restructuring plan

On March 16, 2020, we announced a strategic realignment of our business model whereby KindredBio becomes a biologics-only company focused on accelerating our deep pipeline of late-stage biologics candidates in canine and feline markets, while discontinuing small molecule development for these species. We plan to rely more on a partnership-based model for commercialization strategy whereby pipeline assets are partnered with larger commercial partners that can maximize product opportunity in return for upfront payments, contingent milestones, and royalties on future sales. Accordingly, the companion animal commercial infrastructure will be substantially reduced. In connection with this strategic shift, we eliminated 53 positions, representing about one-third of our current workforce. The eliminated positions primarily relate to the companion animal sales force and research and development for small molecule programs. Restructuring expenses and retirement costs related to severance and health care benefits are expected to be approximately \$1.7 million, exclusive of stock compensation.

13. Subsequent event

On April 8, 2020, we entered into an at the market offering agreement (the "offering agreement") with H.C. Wainwright & Co., LLC ("HCW") pursuant to which we may offer and sell from time to time through HCW shares of our common stock, having an aggregate offering price of up to \$25.0 million, which amount may be increased from time to time under the terms of the offering agreement. We have agreed to pay HCW a commission rate of up to 3.0% of the gross sales price per share of any of our shares of common stock sold under the offering agreement. We also have agreed to reimburse HCW for legal fees and disbursements, not to exceed a total of \$50,000, incurred by it in connection with the negotiation and preparation of the offering agreement and have provided HCW with customary indemnification rights.

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

In this section, "KindredBio," "we," "our," "ours," "us" and the "Company" refer to Kindred Biosciences, Inc. and our wholly owned subsidiaries KindredBio Equine, Inc. and Centaur Biopharmaceutical Services, 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," "continues" 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 include, but are not limited to, the following: our limited operating history and expectations of losses for the foreseeable future; the absence of significant revenue from our products and our product candidates for the foreseeable future; the likelihood that our revenue will vary from quarter to quarter; our potential inability to obtain any necessary additional financing; our substantial dependence on the success of our products and 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 products and our product candidates and the potential inability of these manufacturers to deliver a sufficient amount of supplies on a timely basis; the uncertain effect of the COVID-19 pandemic on our business, results of operations and financial condition; uncertainties regarding the outcomes of trials regarding our product candidates; our potential failure to attract and retain senior management and key scientific personnel; uncertainty about our ability to enter into satisfactory agreements with third-party licensees of our biologic products or to develop a satisfactory sales organization for our equine small molecule products; our significant costs of operating as a public company; potential cyber-attacks on our information technology systems or on our third-party providers' information technology systems, which could disrupt our operations; our potential inability to repay the secured indebtedness that we have incurred from third-party lenders, and the restrictions on our business activities that are contained in our loan agreement with these lenders; the risk that our 2020 strategic realignment plan will result in unanticipated costs or revenue shortfalls; uncertainty about the amount of royalties that we will receive from the sale of Mirataz® to Dechra Pharmaceuticals PLC; our potential inability to obtain and maintain patent protection and other intellectual property protection for our products and 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, 2019, which was filed with the SEC on March 16, 2020, 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.

Overview

We are a commercial-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 effectiveness 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. Our current portfolio includes over 20 product candidates in development consisting of both small molecule pharmaceuticals and biologics.

Our first product, Mirataz® (mirtazapine transdermal ointment) was approved in May 2018 and became commercially available to veterinarians in the United States in July 2018. In November 2019, our second product, Zimeta™ (dipyron injection) for the control of fever in horses was approved by the FDA and became commercially available in December 2019. In addition, we have multiple other product candidates, including several biologics, in various stages of development.

On March 16, 2020, we entered into an Asset Purchase Agreement whereby we agreed to sell Mirataz, our transdermal drug for the management of weight loss in cats, to Dechra for a cash purchase price of \$43 million, of which \$38.7 million will be paid on the closing date and \$4.3 million will be paid out of escrow beginning in 12 months assuming no escrow claims, alongside an ongoing royalty on global net sales. The acquisition comprises worldwide marketing rights, intellectual property rights, marketing authorizations and associated regulatory documentation, third party supply contracts related to raw material and manufacture of the finished product, and certain product inventory. On April 15, 2020, we completed the sale of Mirataz to Dechra.

Concurrent with the divestiture of Mirataz, we announced a strategic realignment of our business model whereby KindredBio becomes a biologics-only company focused on accelerating our deep pipeline of late-stage biologics candidates in canine and feline markets, while discontinuing small molecule development for these species. We believe monoclonal antibodies are the future of veterinary medicine, and represent the greatest opportunity for value creation, given large potential markets for our programs and our competitive advantage in biologics. We plan to rely more on a partnership-based model for commercialization strategy similar to the traditional human biotech commercialization strategy whereby pipeline assets are partnered with larger commercial partners that can maximize product opportunity in return for upfront payments, contingent milestones, and royalties on future sales. Accordingly, the companion animal commercial infrastructure will be substantially reduced. In connection with this strategic shift, we eliminated 53 positions, representing about one-third of our current workforce. The eliminated positions primarily relate to the companion animal sales force and research and development for small molecule programs.

Business and Development Updates

We recorded \$0.6 million and \$0.5 million in net revenues related to product sales in the three months ended March 31, 2020 and 2019. Substantially all of the revenues recorded in the first quarter of 2020 were for Mirataz, reflecting limited distributor stocking during the Mirataz asset sale negotiation. Sale of Mirataz from distributors to veterinary clinics reached a record \$1.6 million in the quarter, underscoring continued growth in customer adoption. Revenues for Zimeta were \$7,000, reflecting expected limited activity during the winter months and a downturn in equine transportation as a result of COVID-19.

Biologic Product Candidates

On October 30, 2018, we reported positive topline results from our pilot efficacy study of KIND-016, a fully caninized, high-affinity monoclonal antibody targeting interleukin-31 (IL-31), for the treatment of atopic dermatitis in dogs. Following the successful pilot efficacy study, we conducted a pilot field effectiveness study for our IL-31 antibody and reported positive topline results on July 29, 2019. The manufacturing scale-up process is proceeding as planned, and the pivotal efficacy study for KIND-016 is expected to start in the second half of 2020.

On March 24, 2020, we announced positive results from our pilot field efficacy study of KIND-025, a canine fusion protein targeting interleukin-4 (IL-4) and interleukin-13 (IL-13), for the treatment of atopic dermatitis in dogs. A higher treatment success rate was observed in the KIND-025 group over the placebo group from week 1 through week 4.

Positive efficacy signals were also detected with other endpoints including 20mm or higher reduction from baseline in PVAS score. Cell line development is being continued as we further evaluate this program. The IL-4 and IL-13 pathways are key drivers of the inflammation that underlies atopic dermatitis and other allergic diseases. The IL-4/13 SINK molecule binds to both IL-4 and IL-13 circulating in the blood and inhibits their interactions with their respective receptors, thereby modifying the clinical signs associated with atopic dermatitis.

In December 2019 we announced the outcome of a positive pilot laboratory study of KIND-032, a fully caninized monoclonal antibody targeting interleukin-4 receptor, for the treatment of atopic dermatitis in dogs. The CADESI scores were assessed by board-certified veterinary dermatologists who were blinded to treatment assignments. The study demonstrated that KindredBio's antibody was well-tolerated. Although the study was a single-dose study designed primarily to assess safety and pharmacokinetics, evidence of positive efficacy and dose response was observed at Week 1, as measured by CADESI-04. A second pilot study to further assess efficacy and dosing is planned for mid-2020. The IL-4 pathway is a key driver of the inflammation that underlies atopic dermatitis. KIND-032 binds to the IL-4 receptor on the surface of immune cells. The KIND-032 program is advancing ahead of schedule and is being prioritized ahead of IL-4/13 SINK.

Atopic dermatitis is an immune-mediated inflammatory skin condition in dogs. It is the leading reason owners take their dog to the veterinarian, and the current market size is over \$700 million annually and growing rapidly. KindredBio is pursuing a multi-pronged approach toward atopic dermatitis, with a portfolio of promising biologics.

We announced positive results from our pilot efficacy study of KIND-030, a chimeric, high-affinity monoclonal antibody targeting canine parvovirus (CVP) on August 1, 2019. This was a 12-dog study, of which 4 dogs were treated prophylactically and 2 dogs were treated after establishment of the infection. All treated dogs survived, compared to none in the applicable placebo group. The effect was seen in both prophylaxis setting, as well as in a treatment setting after establishment of infection. Pivotal studies for this molecule are expected to be completed in 2020, with approval timeline on track.

CVP is the most significant contagious viral cause of enteritis in dogs, especially puppies, with mortality rates reportedly as high as 91%. There are currently no FDA or USDA approved treatments for CPV, nor any other available treatment.

The pivotal efficacy study for KindredBio's feline recombinant erythropoietin was initiated in the fourth quarter. Due to COVID-19, a number of veterinary clinics are not conducting clinical trials currently. We are actively implementing practices consistent with guidance provided by the U.S. Food and Drug Administration (FDA) on studies conducted during the COVID-19 pandemic to minimize the impact on timelines. An update will be provided with the second quarter results. The product candidate is being developed for the management of non-regenerative anemia in cats. It has been engineered by the company to have a prolonged half-life compared to endogenous erythropoietin, a protein that regulates and stimulates production of red blood cells.

Anemia is a common condition that is estimated to afflict millions of older cats. It is often associated with chronic kidney disease, because kidneys produce erythropoietin and chronic kidney disease leads to decreased levels of endogenous erythropoietin. Chronic kidney disease affects approximately half of older cats, making it a leading cause of feline mortality. Human erythropoietins, which are multi-billion dollar products in the human market, have been shown to be immunogenic in many cats.

The pilot field effectiveness study for KindredBio's anti-TNF antibody for canine inflammatory bowel disease (IBD) is underway. Due to COVID-19, a number of veterinary clinics are not conducting clinical trials currently, and completion is now expected to extend beyond the first half of 2020. We are actively implementing practices consistent with guidance provided by the FDA on studies conducted during the COVID-19 pandemic to minimize the impact on timelines. An update will be provided with the second quarter results.

The majority of canine IBD cases involve chronic states of diarrhea, vomiting, gastroenteritis, inappetence, and other symptoms, certain of which are cited as among the most frequent disorders impacting dogs. For certain dog breeds, the prevalence of diarrhea exceeds 5%. Existing treatments can have significant drawbacks, including limited diets and excessive antibiotic use, which can lead to owner frustration, lapses in treatment adherence, or poor quality of life for the affected animal.

Equine Product Candidates

The pivotal field effectiveness study for KIND-012 (dipyron oral gel) for the treatment of fever in horses has been completed with positive results. The target animal safety study is also complete, and KIND-012 was found to be well-tolerated. KIND-012, which is a proprietary oral gel, is expected to expand use of the drug and build upon the success of Zimeta. We have agreed on a path forward with the FDA.

The pilot field effectiveness study of KIND-014 for the treatment of gastric ulcers in horses has been completed with positive results. The pivotal field efficacy study was initiated in the fourth quarter of 2019.

Equine gastric ulcer syndrome (EGUS) is a common condition in horses. Prevalence estimates have been reported to range from 60 to 90 percent in adult horses, depending on age, performance, and evaluated populations. A variety of clinical signs are associated with EGUS, including poor appetite, poor condition, colic, and behavioral issues.

Manufacturing

We have constructed a Good Manufacturing Practice, or GMP, biologics manufacturing plant in Burlingame, CA which is fully commissioned. We have proceeded to GMP manufacturing of our feline erythropoietin product candidate in January 2018. In addition, construction and commissioning of our biologics manufacturing lines in our manufacturing plant in Elwood, Kansas have also been completed. The Elwood facility includes approximately 180,000 square feet with clean rooms, utility, equipment, and related quality documentation suitable for biologics and small molecule manufacturing.

We are a commercial-stage company with two products just recently approved for marketing and sale. On April 15, 2020, we completed the sale of one of the products, Mirataz, to Dechra. We have incurred significant net losses since our inception. We incurred cumulative net losses of \$245,820,000 through March 31, 2020. 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. From our initial public offering in December 2013 through March 31, 2020, we raised approximately \$269.5 million in net proceeds, after deducting underwriting discounts and commissions and offering expenses. On April 8, 2020, we entered into an at the market offering agreement where we may offer and sell from time to time through HCW shares of our common stock, having an aggregate offering price of up to \$25.0 million.

On September 30, 2019, we entered into the Loan Agreement with the Lenders. The Loan Agreement provides KindredBio with up to \$50 million of borrowing capacity available in three tranches, each bearing interest at 1-Month LIBOR + 6.75% with a floor of 2.17%. Under the terms of the agreement, an initial tranche of \$20 million was funded at closing. KindredBio is required to make interest only payments on a monthly basis through October 2021. An additional \$30 million will be available in two tranches at our option, subject to certain conditions. The entire debt facility will mature on September 30, 2024. See Note 6 to our financial statements for further details.

As of March 31, 2020, we had cash, cash equivalents and investments of \$54,571,000. Our sale of Mirataz to Dechra completed on April 15, 2020 with proceeds of \$38.7 million received and the balance of \$4.3 million to be paid out from escrow beginning in 12 months assuming no escrow claims.

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 Center for Veterinary Medicine branch, or CVM, 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. The strategic realignment of our business model whereby we rely more on a partnership-based model for commercialization strategy similar to the traditional human biotech commercialization strategy whereby pipeline assets are partnered with larger commercial partners that can maximize product opportunity in return for upfront payments, contingent milestones, and royalties on future sales may require us to relinquish rights to certain of our technologies. In addition, we may never successfully complete development of, obtain adequate patent protection for, obtain necessary

regulatory approval, or achieve commercial viability for any other product candidates besides Mirataz and Zimeta. 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 unaudited 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 unaudited 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, 2019, which was filed with the SEC on March 16, 2020.

Results of Operations

In March 2020, we announced a strategic realignment of our business model whereby Kindredbio becomes a biologics-only company focused on accelerating our deep pipeline of late-stage biologics candidates in canine and feline markets, while discontinuing small molecule development for these species. We plan to rely more on a partnership-based model for commercialization strategy whereby pipeline assets are partnered with larger commercial partners that can maximize product opportunity in return for upfront payments, contingent milestones, and royalties on future sales. Accordingly, the companion animal commercial infrastructure will be substantially reduced. In connection with this strategic shift, we eliminated 53 positions, representing about one-third of our current workforce. The eliminated positions primarily relate to the companion animal sales force and research and development for small molecule programs. Restructuring expenses and retirement costs related to severance and health care benefits are expected to be approximately \$1.7 million, exclusive of stock compensation.

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

	Three months ended March 31,	
	2020	2019
Net product revenues	\$ 603	\$ 515
Operating costs and expenses:		
Cost of product revenues ⁽¹⁾	3,577	92
Research and development	8,867	7,152
Selling, general and administrative	8,873	9,901
Restructuring costs	1,676	—
Total operating costs and expenses	22,993	17,145
Loss from operations	(22,390)	(16,630)
Interest and other income, net	(371)	575
Net loss	\$ (22,761)	\$ (16,055)

(1) Includes \$3,494,000 Finished Goods write-off related to the Dechra Asset Purchase Agreement, due to the transition to proprietary Dechra brand labelling.

Revenues

We recorded \$0.6 million and \$0.5 million in net revenues related to product sales in the three months ended March 31, 2020 and 2019. Substantially all of the revenues recorded in the first quarter of 2020 were for Mirataz, reflecting limited distributor stocking during the Mirataz asset sale negotiation. Sale of Mirataz from distributors to veterinary clinics reached a record \$1.6 million in the quarter, underscoring continued growth in customer adoption. Revenues for Zimeta were \$7,000, reflecting a seasonally slow first quarter amid limited activity during the winter months and a downturn in equine transportation as a result of COVID-19.

Our product sales to three large distributors, namely MWI Animal Health, Midwest Veterinary Supply, and Covetrus, each accounted for more than 10% of total revenues for three months ended March 31, 2020. On a combined basis, these distributors accounted for approximately 73% of our product sales in the United States for the three months ended March 31, 2020.

Our product sales to two large distributors, namely Covetrus and Patterson, each accounted for more than 10% of total revenues for the quarter ended March 31, 2019. On a combined basis, these distributors accounted for approximately 87% of our product sales in the United States.

We currently estimate a 2% product return liability for Mirataz and 3% for Zimeta, using probability-weighted available industry data and data provided by the our distributors such as the inventories remaining in the distribution

channel (Notes 1 and 2). To-date we did not have any product returns. We did not record an allowance for doubtful accounts as our analysis did not uncover any collection risks.

(In thousands)	Three months ended March 31,	
	2020	2019
Gross product revenues		
Mirataz	\$ 616	\$ 531
Zimeta	7	—
Total gross product revenues	623	531
Less allowance for product returns		
Mirataz	(20)	(16)
Zimeta	—	—
Total allowances for product returns	(20)	(16)
Net Product Revenues		
Mirataz	596	515
Zimeta	7	—
Total net product revenues	603	515
Cost of product revenues		
Mirataz	(3,575)	(92)
Zimeta	(2)	—
Total cost of product revenues	(3,577)	(92)
Gross profit		
Mirataz	(2,979)	423
Zimeta	5	—
Total gross profit	\$ (2,974)	\$ 423

Cost of product revenues

Cost of product revenues consists primarily of the cost of direct materials, direct labor and overhead costs associated with manufacturing, inbound shipping and other third-party logistics costs.

As a result of the sale of Mirataz, we determined that the remaining Mirataz product not included in the sale of transferred assets to Dechra does not have any future use and will be scrapped. Accordingly, we wrote-off approximately \$3,494,000 Mirataz inventory upon the signing of the Asset Purchase Agreement on March 16, 2020, due to the transition to proprietary Dechra brand labelling.

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 ended March 31,		% Change
	2020	2019	
Payroll and related	\$ 3,817	\$ 3,279	16%
Consulting	164	778	(79)%
Field trial costs, including materials	1,127	668	69%
Biologics development and supplies	1,415	864	64%
Stock-based compensation	553	436	27%
Other	1,791	1,127	59%
	<u>\$ 8,867</u>	<u>\$ 7,152</u>	24%

During the three months ended March 31, 2020, research and development expense related primarily to advancing the development of KIND-012, KIND-014, KIND-510a and other early stage biologic programs.

Research and development expenses for the three months ended March 31, 2020, increased by 24% to \$8,867,000 compared with \$7,152,000 for the same period in 2019. The \$1,715,000 increase was primarily due to the inclusion of expenses from the Kansas facility as it began to manufacture clinical trial material. Prior to the first quarter, construction and commissioning expenditures associated with the Kansas facility had been categorized as general and administrative expenses. Outsourced research and development expenses related to new biologic projects, KIND-014, KIND-510a, KIND-012, CAD programs, and other product development programs for three months ended March 31, 2020 were \$400,000, \$300,000, \$186,000, \$83,000, \$47,000 and \$150,000, respectively. Outsourced research and development expense consists primarily of costs related to CMC, clinical trial costs and consulting.

We expect research and development expense for the rest of the year to remain consistent with prior quarters. 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.

Selling, General and Administrative Expense

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

	Three months ended March 31,		% Change
	2020	2019	
Payroll and related	\$ 3,127	\$ 4,140	(24)%
Consulting, legal and professional services	1,754	816	115%
Stock-based compensation	1,511	1,424	6%
Corporate and marketing expenses	1,263	1,501	(16)%
Other	1,218	2,020	(40)%
	<u>\$ 8,873</u>	<u>\$ 9,901</u>	(10)%

Selling, general and administrative expenses for the three months ended March 31, 2020 decreased by 10% to \$8,873,000, when compared to the same periods in 2019. The \$1,028,000 year-over-year decrease was mainly due to the re-categorization of Kansas plant expenditures as research and development expenses, offset by higher legal fees.

We expect selling, general and administrative expense to decrease going forward due to the restructuring and elimination of our companion animal sales force. We plan to rely more on a partnership-based model for

commercialization whereby our pipeline assets are partnered with larger commercial partners that can maximize product opportunity in return for upfront payment, contingent milestones, and royalties on future sales.

Interest and Other Income, Net

(In thousands)

	Three months ended March 31,	
	2020	2019
Interest and other (expense) income, net	\$ (371)	\$ 575

The decrease of approximately \$946,000 in the first three months ended March 31, 2020 compared to the same period in 2019 was the result of \$296,000 lower interest income due to lower cash and investment balances. In addition, the change was further impacted by interest expenses of approximately \$449,000, loan amendment fee of \$100,000, and other loan amortization fees of approximately \$85,000. There were no borrowings in the first quarter of 2019.

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 March 31, 2020, 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 since our inception in September 2012 through March 31, 2020. As of March 31, 2020, we had an accumulated deficit of \$245,820,000. Since inception and through March 31, 2020, we raised approximately \$269.5 million in net proceeds. On September 30, 2019, we entered into the Loan Agreement with the Lenders. The Lenders have agreed to make available to us an aggregate principal amount of up to \$50.0 million under the Loan Agreement. On September 30, 2019, we received the first tranche of loan \$19.2 million, net of debt issuance costs. An additional \$30 million will be available in two tranches at our option, subject to certain conditions.

As of March 31, 2020, we had cash, cash equivalents and investments of \$54,571,000. We believe our cash, cash equivalents and investments, proceeds of \$43 million from the sale of our Mirataz asset, revenues from anticipated partnerships, and additional draw down of \$30 million from our Loan Agreement which is contingent on the achievement of certain milestones, are sufficient to fund our planned operations through 2022. In addition, the April 8, 2020 ATM facility will provide us with access to cash if required.

Cash Flows

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

	Three months ended March 31,	
	2020	2019
	(In thousands)	
Net cash used in operating activities	\$ (17,112)	\$ (18,654)
Net cash provided by (used in) investing activities	\$ 15,631	\$ (12,334)
Net cash (used in) provided by financing activities	\$ (545)	\$ 43,284

Net cash used in operating activities

During the three months ended March 31, 2020, net cash used in operating activities was \$17,112,000. The net loss of \$22,761,000 for the three months ended March 31, 2020 included non-cash charges of \$2,064,000 for stock-based compensation expense, \$1,053,000 for depreciation and amortization, \$85,000 for amortization of the debt discount of long-term loan, \$3,494,000 for Mirataz finished goods write-off related to Dechra asset purchase, partially offset by \$109,000 for the amortization of discount on marketable securities. Net cash used in operating activities was further impacted by net changes in operating assets and liabilities of \$938,000.

During the three months ended March 31, 2019, net cash used in operating activities was \$18,654,000. Net cash used in operating activities resulted primarily from our net loss of \$16,055,000, included non-cash stock-based compensation of \$1,860,000, depreciation and amortization of \$500,000, loss on disposal of property and equipment of \$1,000, offset by \$81,000 for the amortization of premium on marketable securities. Net cash used was further impacted by net changes in operating assets and liabilities of \$4,879,000.

Net cash provided by investing activities

During the three months ended March 31, 2020, net cash provided by investing activities was \$15,631,000, which resulted from proceeds from maturities of marketable securities of \$33,769,000, offset by \$16,720,000 related to purchases of marketable securities and \$1,418,000 related to purchases of equipment.

During the three months ended March 31, 2019, net cash used in investing activities was \$12,334,000, due to proceeds from maturities of marketable securities of \$10,600,000, offset by the purchases of marketable securities of \$20,281,000 and purchases of property and equipment of \$2,656,000. In addition, we also received proceeds of \$3,000 from the sale of equipment.

Net cash provided by financing activities

During the three months ended March 31, 2020, net cash reduced by financing activities of \$545,000 was related to proceeds of \$124,000 from exercises of stock options, offset by payment of \$669,000 related to restricted stock awards and restricted stock units tax liability on net settlement.

During the three months ended March 31, 2019, net cash provided by financing activities of \$43,284,000 was related to net proceeds of \$43,125,000 from the sale of common stock from a public offering, proceeds of \$652,000 from the purchases of common stock through exercise of stock options, offset by payment of \$493,000 related to restricted stock awards tax liability on net settlement.

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;
- biologic clinical material manufacturing; and
- maintain the operations of biologics manufacturing plant in Kansas.

We believe our cash, cash equivalents and investments, proceeds of \$43 million from the sale of our Mirataz asset, revenues from anticipated partnerships, and additional draw down of \$30 million from our Loan Agreement which is contingent on the achievement of certain milestones, are sufficient to fund our planned operations through 2022. In addition, the April 8, 2020 ATM facility will provide us with access to cash if required. 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 the cost of 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
- 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

We have non-cancelable operating leases for laboratory space in Burlingame, California with several amendments to expand the facility. In February 2020, we further amended non-cancelable operating leases for laboratory space in Burlingame, California for an expansion of an additional 2,260 square feet of laboratory space commencing on May 1, 2020 and expires on May 31, 2025. The total non-cancellable operating lease for the entire existing laboratory space is 13,736 square feet, expiring May 31, 2025. In August 2015, we entered into a new non-cancelable operating lease for 3,126 square feet of office space in San Diego, California and in June 2019, renewed the lease through February 2025. Our headquarters office lease for 8,090 square feet of office space in Burlingame, California expires November 30, 2020. In April 2019, we signed a short-term lease in Burlingame ("April 2019 lease"), consisting of 1,979 square feet of space through April 2020. In May 2019, we signed another lease in Burlingame ("May 2019 lease"), consisting of 1,346 square feet of space through April 2022. In addition, we have four equipment leases expiring through 2023.

Under the operating leases we are obligated to make minimum lease payments as of March 31, 2020 totaling \$3,579,000 through May 2025, the timing of which is described in more detail in the notes to the condensed consolidated financial statements.

Off-Balance Sheet Arrangements

As of March 31, 2020, 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 August 2018, the FASB issued ASU No. 2018-13, "Fair Value Measurement (Topic 820)", changes to disclosure requirements for fair value measurement. The amendments of this update modify the disclosure requirements on fair value measurements about Topic 820. It applies to all reporting entities within the scope of the affected accounting guidance. It will take effect for public companies for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Our adoption of this new guidance in the first quarter of 2020 did not have a material impact on our financial statements.

In December 2019, the FASB issued ASU No. 2019-12, "Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes". The amendments of this update simplify the accounting for income taxes by removing several exceptions. One of the exceptions may affect our company is the following: exception to the incremental approach for intra-period tax allocation when there is a loss from continuing operations and income or a gain from other

items (say, other comprehensive income). It applies to all reporting entities within the scope of the affected accounting guidance. It will take effect for public companies for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. Early adoption is permitted. Our adoption of this new guidance in the first quarter of 2020 did not have a material impact on our financial statements.

In March 2020, the FASB issued ASU No. 2020-04, "Reference Rate Reform (Topic 848)", changes to the interbank offered rates (IBORs), and, particularly, the risk of cessation of the London Interbank Offered Rate (LIBOR). The amendments provides optional expedients and exceptions for applying U.S. GAAP to contracts that reference LIBOR expected to be discontinued because of reference rate reform. The expedients and exceptions do not apply to contract modifications made after December 31, 2022. The following optional expedients are permitted for contracts that are modified because of reference rate reform and that meet certain scope guidance: Modifications of contracts within the scope of Topics 470, Debt, should be accounted for by prospectively adjusting the effective interest rate. The amendments also permits an entity to consider contract modifications due to reference rate reform to be an event that does not require contract remeasurement at the modification date or reassessment of a previous accounting determination. When elected, the optional expedients for contract modifications must be applied consistently for all contracts. It applies to all entities within the scope of the affected accounting guidance and will take effect as of March 12, 2020 through December 31, 2022. We have one loan contract which references LIBOR rate. We have not modified the contract with our lenders yet. We are currently evaluating the new guidance and have not determined the impact this standard may have on our financial statements.

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

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 March 31, 2020, 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 Chief Financial Officer (the “Certifying Officers”), 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 Officers, as appropriate to allow timely decisions regarding required disclosure. Based on these evaluations, the Certifying Officers have 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 Officers, 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 March 31, 2020 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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, 2019 filed with the SEC on March 16, 2020. There have been no material changes to those Risk Factors.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS**EXHIBIT INDEX**

Exhibit Number	Description
31.1	Sarbanes-Oxley Act Section 302 Certification of Chief Executive Officer
31.2	Sarbanes-Oxley Act Section 302 Certification of Chief Financial Officer
32.1	Sarbanes-Oxley Act Section 906 Certification of Chief Executive Officer and Chief Financial Officer
101.INS	XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
101.SCH	Inline XBRL Taxonomy Extension Schema Document
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	Inline XBRL Taxonomy Extension Labels Linkbase Document
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document
104	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101)

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: May 7, 2020

Kindred Biosciences, Inc.

By: /s/ Wendy Wee

Wendy Wee
Chief Financial Officer
(Principal Financial and
Accounting Officer)

Certification of the Chief Executive Officer Under Section 302 of the Sarbanes-Oxley Act

I, Richard Chin, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Kindred Biosciences, Inc.
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report.
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report.
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a- 15(e) and 15d- 15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 7, 2020

By: /s/ Richard Chin

Name: Richard Chin, MD

Title: Chief Executive Officer

(Principal Executive Officer)

Certification of the Chief Financial Officer Under Section 302 of the Sarbanes-Oxley Act

I, Wendy Wee, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Kindred Biosciences, Inc.
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report.
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report.
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a- 15(e) and 15d- 15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 7, 2020

By: /s/ Wendy Wee

Name: Wendy Wee

Title: Chief Financial Officer

(Principal Financial and Accounting
Officer)

**CERTIFICATION OF THE PRINCIPAL EXECUTIVE OFFICER
AND PRINCIPAL FINANCIAL AND ACCOUNTING OFFICER**

Pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, each of the undersigned officers of Kindred Biosciences, Inc. (the “Company”) hereby certifies that, to his or her knowledge:

(i) The quarterly report on Form 10-Q for the period ended March 31, 2020 (the “Report”) fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(ii) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 7, 2020

By: /s/ Richard Chin

Name: Richard Chin, MD

Title: Chief Executive Officer

(Principal Executive Officer)

By: /s/ Wendy Wee

Name: Wendy Wee

Title: Chief Financial Officer

(Principal Financial and Accounting
Officer)