

UBS Investment Research

Verastem

FDA Guidance an Incremental Positive

■ What's new? FDA draft guidance for neoadjuvant breast cancer endpts

The FDA has issued draft guidance on the use of a surrogate endpoint (pathologic complete response - pCR) for accelerated approval in the neoadjuvant treatment of high-risk breast cancer. As we noted in our March 7th initiation, a pCR trial in the neoadjuvant setting could provide a fast to market strategy for its CSC-targeting drugs. Given the potential role of CSCs in tumor biology, an anti-CSC agent, in combination with chemo could work in preoperative disease.

■ Guidance suggests a fast-to-market strategy is possible

In the document (link on page 2), FDA proposes pCR (absence of any residual cancer in the resected tissue as well as lymph nodes) can be used as a surrogate endpoint to allow for accelerated approval in high-risk patients (defined either by genetics or histology) in lieu of a longer DFS or OS trial. While final guidance is pending public commentary and data from an ongoing meta-analysis on pCR and OS, given the unmet need in high risk patients, we expect pCR to be adopted.

■ Thoughts: Guidance substantiates potential for accelerated value creation

While the phase Ib/II data (UBSe 2013-14) from the first Verastem anti-CSC compound will provide the most near-term value creating events (and proof of principle for the platform), we believe neoadjuvant could provide an accelerated path to market as well as a lower-risk patient population given that treatment benefits can be harder to quantify in heavily pre-treated metastatic patients.

■ Valuation: Buy rating with \$20 price target

We derive our price target using DCF based methodology.

Highlights (US\$m)	12/10	12/11	12/12E	12/13E	12/14E
Revenues	0	0	0	0	0
EBIT (UBS)	(1)	(14)	(27)	(30)	(33)
Net Income (UBS)	(1)	(14)	(27)	(29)	(32)
EPS (UBS, US\$)	(0.92)	(10.58)	(1.36)	(1.47)	(1.37)
Net DPS (UBS, US\$)	0.00	0.00	0.00	0.00	0.00
Profitability & Valuation	5-yr hist av.	12/11	12/12E	12/13E	12/14E
EBIT margin %	-	-	-	-	-
ROIC (EBIT) %	-	>500	>500	>500	>500
EV/EBITDA (core) x	-	-	-2.3	-2.2	-1.7
PE (UBS) x	-	-	NM	NM	NM
Net dividend yield %	-	-	0.0	0.0	0.0

Source: Company accounts, Thomson Reuters, UBS estimates. (UBS) valuations are stated before goodwill-related charges and other adjustments for abnormal and economic items at the analysts' judgement.

Valuations: based on an average share price that year, (E): based on a share price of US\$9.33 on 30 May 2012 18:41 EDT

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Global Equity Research

Americas

Biotechnology

12-month rating **Buy**
Unchanged

12m price target **US\$20.00**
Unchanged

Price **US\$9.33**

RIC: VSTM.O BBG: VSTM US

30 May 2012

Trading data

52-wk range	US\$12.01-9.32
Market cap.	US\$0.14bn
Shares o/s	14.7m (COM)
Free float	29%
Avg. daily volume ('000)	25
Avg. daily value (m)	US\$0.3

Balance sheet data 12/12E

Shareholders' equity	US\$0.08bn
P/BV (UBS)	2.2x
Net Cash (debt)	US\$0.09bn

Forecast returns

Forecast price appreciation	+114.4%
Forecast dividend yield	0.0%
Forecast stock return	+114.4%
Market return assumption	5.3%
Forecast excess return	+109.1%

EPS (UBS, US\$)

	12/12E	12/11
	UBS	Cons. Actual
Q1	(0.47)	(0.47) (1.05)
Q2E	(0.32)	(0.31) (1.88)
Q3E	(0.30)	(0.31) (2.74)
Q4E	(0.31)	(0.33) (4.56)
12/12E	(1.36)	(1.16)
12/13E	(1.47)	(1.32)

Performance (US\$)



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ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 5.

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Draft guidance document can be found here:

www.fda.gov/downloads/Drugs/GuidanceComplianceRegulatoryInformation/Guidances/UCM305501.pdf

Income statement (US\$m)											
	-	-	12/09	12/10	12/11	12/12E	% ch	12/13E	% ch	12/14E	% ch
Revenues	-	-	-	0	0	0	-	0	-	0	-
Operating expenses (ex depn)	-	-	-	-	-	-	-	-	-	-	-
EBITDA (UBS)	-	-	-	(1)	(14)	(27)	97.6	(30)	9.0	(33)	10.4
Depreciation	-	-	-	0	0	0	-	0	-	0	-
Operating income (EBIT, UBS)	-	-	-	(1)	(14)	(27)	97.6	(30)	9.0	(33)	10.4
Other income & associates	-	-	-	0	0	0	-	0	-	0	-
Net interest	-	-	-	0	0	0	217900.0	0	-33.0	0	81.5
Abnormal items (pre-tax)	-	-	-	0	0	0	-	0	-	0	-
Profit before tax	-	-	-	(1)	(14)	(27)	96.0	(29)	9.4	(32)	10.1
Tax	-	-	-	0	0	0	-	0	-	0	-
Profit after tax	-	-	-	(1)	(14)	(27)	96.0	(29)	9.4	(32)	10.1
Abnormal items (post-tax)	-	-	-	0	0	0	-	0	-	0	-
Minorities / pref dividends	-	-	-	0	0	0	-	0	-	0	-
Net income (local GAAP)	-	-	-	(1)	(14)	(27)	96.0	(29)	9.4	(32)	10.1
Net Income (UBS)	-	-	-	(1)	(14)	(27)	96.0	(29)	9.4	(32)	10.1
Tax rate (%)											
	-	-	-	0	0	0	-	0	-	0	-
Pre-abnormal tax rate (%)	-	-	-	0	0	0	-	0	-	0	-
Per share (US\$)											
	-	-	12/09	12/10	12/11	12/12E	% ch	12/13E	% ch	12/14E	% ch
EPS (local GAAP)	-	-	-	(0.92)	(10.58)	(1.36)	-87.2	(1.47)	8.3	(1.37)	-7.1
EPS (UBS)	-	-	-	(0.92)	(10.58)	(1.36)	-87.2	(1.47)	8.3	(1.37)	-7.1
Net DPS	-	-	-	0.00	0.00	0.00	-	0.00	-	0.00	-
Cash EPS	-	-	-	(0.92)	(10.58)	(1.36)	-87.2	(1.47)	8.3	(1.37)	-7.1
BVPS	-	-	-	2.50	45.94	4.23	-90.8	2.78	-34.4	4.37	57.5
Balance sheet (US\$m)											
	-	-	12/09	12/10	12/11	12/12E	% ch	12/13E	% ch	12/14E	% ch
Cash and equivalents	-	-	-	4	62	87	41.0	58	-33.3	105	80.9
Other current assets	-	-	-	0	0	0	97.6	0	9.0	0	10.4
Total current assets	-	-	-	4	62	87	41.0	58	-33.3	105	80.8
Net tangible fixed assets	-	-	-	0	1	1	104.3	2	54.5	3	39.7
Net intangible fixed assets	-	-	-	0	0	0	-	0	-	0	-
Investments / other assets	-	-	0	0	0	0	59.1	0	6.8	0	8.0
Total assets	-	-	-	4	63	89	41.8	61	-31.7	109	78.9
Trade payables & other ST liabilities	-	-	-	0	2	4	106.5	5	8.3	5	5.3
Short term debt	-	-	-	0	0	0	-	0	-	0	-
Total current liabilities	-	-	-	0	2	4	106.5	5	8.3	5	5.3
Long term debt	-	-	-	0	0	0	-	0	-	0	-
Other long term liabilities	-	-	-	0	1	1	-14.1	1	-34.9	0	-53.5
Total liabilities	-	-	-	0	3	5	62.9	5	0.1	5	-2.0
Equity & minority interests	-	-	-	3	59	84	40.6	55	-33.8	103	86.7
Total liabilities & equity	-	-	-	4	63	89	41.8	61	-31.7	109	78.9
Cash flow (US\$m)											
	-	-	12/09	12/10	12/11	12/12E	% ch	12/13E	% ch	12/14E	% ch
Net income	-	-	-	(1)	(14)	(27)	96.0	(29)	9.4	(32)	10.1
Depreciation	-	-	-	0	0	0	-	0	-	0	-
Net change in working capital	-	-	-	0	2	2	25.9	0	-98.6	0	348.2
Other (operating)	-	-	-	0	1	1	0.0	1	0.0	1	0.0
Net cash from operations	-	-	-	0	(11)	(24)	112.1	(29)	18.7	(31)	10.0
Capital expenditure	-	-	-	0	(1)	(1)	-0.5	(1)	6.7	(1)	12.5
Net (acquisitions) / disposals	-	-	-	0	0	0	-	0	-	0	-
Other changes in investments	-	-	-	0	0	0	-	0	-	0	-
Cash from investing activities	-	-	-	0	(1)	(1)	-0.5	(1)	6.0	(1)	11.3
Increase/(decrease) in debt	-	-	-	4	60	0	-	0	-	0	-
Share issues / (repurchases)	-	-	-	0	0	57	-	0	-	79	-
Dividends paid	-	-	-	0	0	0	-	0	-	0	-
Other cash from financing	-	-	-	0	0	0	-	0	-	0	-
Cash from financing activities	-	-	-	4	60	57	-5.6	0	-	79	-
Cash flow chge in cash & equivalents	-	-	-	4	48	32	-	(29)	-	46	-
FX / non cash items	-	-	-	-	10	(6)	-	0	-	1	58.0
Bal sheet chge in cash & equivalents	-	-	-	-	58	25	-	(29)	-	47	-
Core EBITDA	-	-	-	(1)	(14)	(27)	97.6	(30)	9.0	(33)	10.4
Maintenance capital expenditure	-	-	-	0	(1)	(1)	-0.5	(1)	6.7	(1)	12.5
Maintenance net working capital	-	-	-	0	0	0	-	0	-	0	-
Operating free cash flow, pre-tax	-	-	-	(1)	(14)	(28)	92.5	(30)	9.0	(33)	10.5

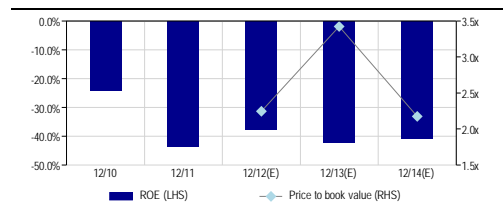
Source: Company accounts, UBS estimates. (UBS) valuations are stated before goodwill-related charges and other adjustments for abnormal and economic items at the analysts' judgement. Note: For some companies, the data represents an extract of the full company accounts.

Company profile

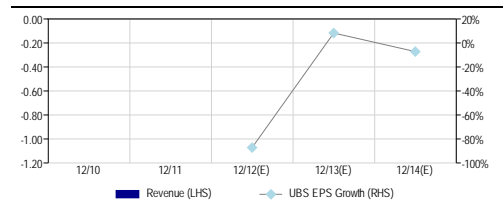
Verastem is a Cambridge, Massachusetts-based early-stage biotechnology company focused on the discovery and development of novel small molecule drugs and companion diagnostics targeting cancer stem cells. The proprietary EMT screening platform, licensed from the Whitehead Institute at MIT, has helped select and identify the company's 3 leading candidates (VS-507, a Wnt inhibitor, and two FAK inhibitors VS-4718 and VS-5095). The company plans to begin human trials over the next 12-15 months for VS-507 and one of the two FAK inhibitors, and could be in phase II trials as early as 2015.

Profitability

ROE v Price to book value



Growth (UBS EPS)



Valuation (x)	5Yr Avg	12/10	12/11	12/12E	12/13E	12/14E
P/E (local GAAP)	-	-	-	NM	NM	NM
P/E (UBS)	-	-	-	NM	NM	NM
P/CEPS	-	-	-	NM	NM	NM
Net dividend yield (%)	-	-	-	0.0	0.0	0.0
P/BV	-	-	-	2.2	3.4	2.1
EV/revenue (core)	-	-	-	-	-	-
EV/EBITDA (core)	-	-	-	-2.3	-2.2	-1.7
EV/EBIT (core)	-	-	-	NM	NM	NM
EV/OpFCF (core)	-	-	-	NM	NM	NM
EV/op. invested capital	-	-	-	NM	NM	NM

Enterprise value (US\$m)	12/10	12/11	12/12E	12/13E	12/14E
Average market cap	-	-	137	137	137
+ minority interests	0	0	0	0	0
+ average net debt (cash)	(4)	(33)	(74)	(73)	(82)
+ pension obligations and other	0	0	0	0	0
- non-core asset value	0	0	0	0	0
Core enterprise value	-	-	63	64	55

Growth (%)	5Yr Avg	12/10	12/11	12/12E	12/13E	12/14E
Revenue	-	-	-	-	-	-
EBITDA (UBS)	-	-	NM	97.6	9.0	10.4
EBIT (UBS)	-	-	NM	97.6	9.0	10.4
EPS (UBS)	-	-	NM	-87.2	8.3	-7.1
Cash EPS	-	-	NM	-87.2	8.3	-7.1
Net DPS	-	-	-	-	-	-
BVPS	-	-	NM	-90.8	-34.4	57.5

Margins (%)	5Yr Avg	12/10	12/11	12/12E	12/13E	12/14E
EBITDA / revenue	-	-	-	-	-	-
EBIT / revenue	-	-	-	-	-	-
Net profit (UBS) / revenue	-	-	-	-	-	-

Return on capital (%)	5Yr Avg	12/10	12/11	12/12E	12/13E	12/14E
EBIT ROIC (UBS)	-	-	NM	NM	NM	NM
ROIC post tax	-	-	NM	NM	NM	NM
Net ROE	-	(24.2)	(43.7)	(37.5)	(42.2)	(40.7)

Coverage ratios (x)	5Yr Avg	12/10	12/11	12/12E	12/13E	12/14E
EBIT / net interest	-	-	-	-	-	-
Dividend cover (UBS EPS)	-	-	-	-	-	-
Div. payout ratio (% UBS EPS)	-	-	-	-	-	-
Net debt / EBITDA	-	4.6	4.5	3.2	2.0	3.2

Efficiency ratios (x)	5Yr Avg	12/10	12/11	12/12E	12/13E	12/14E
Revenue / op. invested capital	-	-	0.0	0.0	0.0	0.0
Revenue / fixed assets	-	-	0.0	0.0	0.0	0.0
Revenue / net working capital	-	-	0.0	0.0	0.0	0.0

Investment ratios (x)	5Yr Avg	12/10	12/11	12/12E	12/13E	12/14E
OpFCF / EBIT	-	1.0	1.1	1.0	1.0	1.0
Capex / revenue (%)	-	-	-	-	-	-
Capex / depreciation	-	-	-	-	-	-

Capital structure (%)	5Yr Avg	12/10	12/11	12/12E	12/13E	12/14E
Net debt / total equity	-	NM	NM	NM	NM	NM
Net debt / (net debt + equity)	-	NM	NM	NM	NM	NM
Net debt (core) / EV	-	-	-	NM	NM	NM

Source: Company accounts, UBS estimates. (UBS) valuations are stated before goodwill-related charges and other adjustments for abnormal and economic items at the analysts' judgement.

Valuations: based on an average share price that year, (E): based on a share price of US\$9.33 on 30 May 2012 18:41 EDT Market cap(E) may include forecast share issues/buybacks.

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■ Verastem

Verastem is a Cambridge, Massachusetts-based early-stage biotechnology company focused on the discovery and development of novel small molecule drugs and companion diagnostics targeting cancer stem cells. The proprietary EMT screening platform, licensed from the Whitehead Institute at MIT, has helped select and identify the company's 3 leading candidates (VS-507, a Wnt inhibitor, and two FAK inhibitors VS-4718 and VS-5095). The company plans to begin human trials over the next 12-15 months for VS-507 and one of the two FAK inhibitors, and could be in phase II trials as early as 2015.

■ Statement of Risk

We see several risks to our Buy rating on VSTM shares. We see risk to our Buy rating if VS-705, VS-4718 and/or VS-5095 have unforeseen safety, tolerability or toxicity signals or fail to yield positive phase 1b clinical results. We also see downside risk if the companion diagnostic fails to identify the appropriate population or biomarkers to better quantify benefit/risk. Finally, we see further downside risk if competition shows better data with CSC-targeting therapies, which would potentially lessen the strategic value of Verastem's assets.

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UBS Investment Research: Global Equity Rating Allocations

UBS 12-Month Rating	Rating Category	Coverage ¹	IB Services ²
Buy	Buy	51%	34%
Neutral	Hold/Neutral	40%	35%
Sell	Sell	9%	15%
UBS Short-Term Rating	Rating Category	Coverage ³	IB Services ⁴
Buy	Buy	less than 1%	25%
Sell	Sell	less than 1%	17%

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 31 March 2012.

UBS Investment Research: Global Equity Rating Definitions

UBS 12-Month Rating	Definition
Buy	FSR is > 6% above the MRA.
Neutral	FSR is between -6% and 6% of the MRA.
Sell	FSR is > 6% below the MRA.
UBS Short-Term Rating	Definition
Buy	Buy: Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.
Sell	Sell: Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.

KEY DEFINITIONS

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

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Equity Price Targets have an investment horizon of 12 months.

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UBS Securities LLC: Matthew Roden, PhD; Leah Batkiewicz, PhD; Andrew Peters.

Company Disclosures

Company Name	Reuters	12-mo rating	Short-term rating	Price	Price date
Verastem ^{2, 4, 6, 16}	VSTM.O	Buy	N/A	US\$9.50	29 May 2012

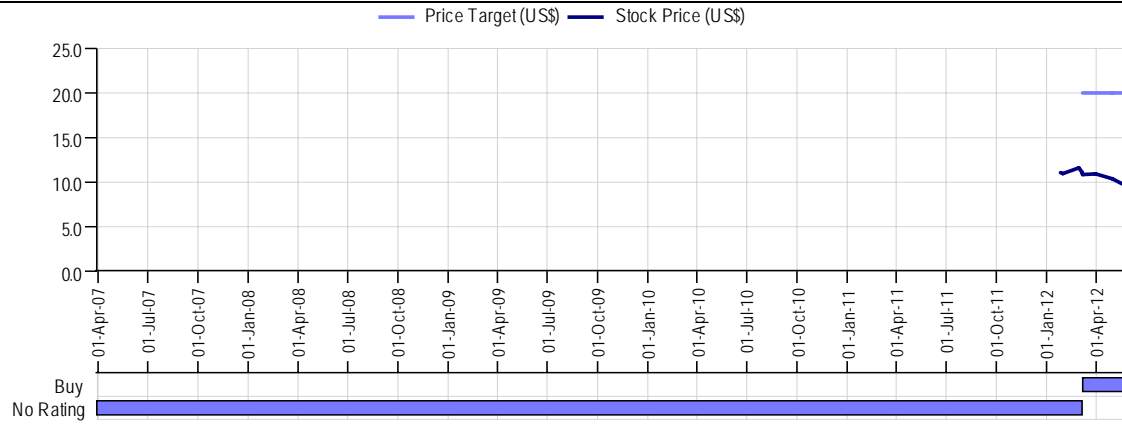
Source: UBS. All prices as of local market close.

Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

Verastem (US\$)



Source: UBS; as of 29 May 2012

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