

Merrimack Pharmaceuticals, Inc.

MACK - BUY - 3Q12 Update; Strong Balance Sheet and Milestone-Rich Next 12 Months

November 16, 2012

- **MACK reported 3Q12 EPS of (\$0.25) vs. our (\$0.24) estimate.** With the \$40M debt facility in place, we believe MACK will have sufficient cash into '14. Based on our expectations for positive readouts for several of MACK's mid-to-late programs in '12/'13, we expect the stock to move meaningfully higher.
- **Expecting positive data from MM-121 Phase II trials in '13.** Based on a clear biological rationale for the Phase II combo trials and promising Phase I combo data, we see a good probability of positive Phase II trials in NSCLC (+Tarceva), neoadjuvant (+paclitaxel), and relapsed (+exemestane) HER2-mBC.
- **Moderate expectations for success of MM-398 Phase III pancreatic cancer (PC) trial.** Although we believe the Phase II data for '398 in relapsed PC are very encouraging, since the trial was uncontrolled and historical data for free irinotecan has been mixed, we view the trial as relatively high risk.
- **MM-111 Phase II in 2nd-line gastric cancer (GC).** MACK is focusing on HER2+/FISH+ and HER2+/FISH- patients, and we view the HER2+/FISH- GC as an attractive niche for '111. Based on the trials' design and Phase I data for MM-111 +Herceptin/Tykerb in HER2+ tumors, we see high likelihood for success.
- **Next 12-month data milestones.** Phase I data for MM-302 (Dec-'12), top-line Phase III data for MM-398 in PC (mid-'13), top-line Phase II data for MM-121 in breast/NSCLC (1H13), and ovarian cancer (2H13). Phase I trials for MM-141 and MM-DX-929 are expected to start over the next year.

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MACK BUY

EARNINGS RELEASE

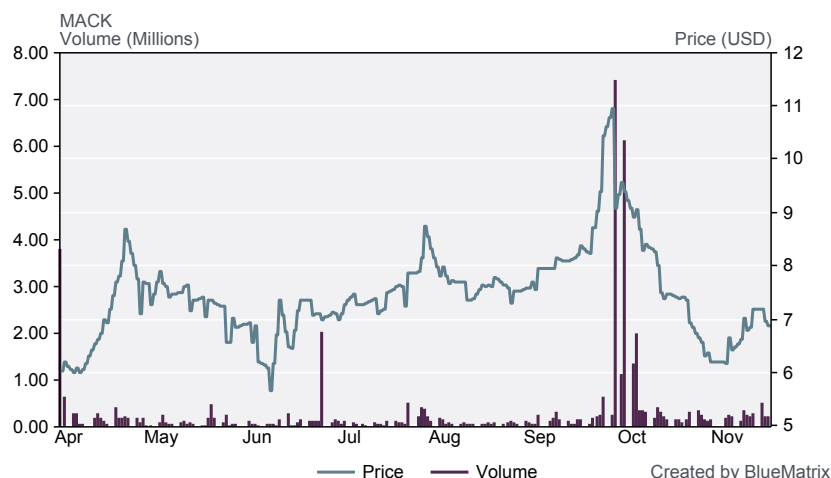
Investment Thesis: Growth

SHARE PRICE \$7.14
PRICE TARGET \$13.00

EPS (\$) (FY Dec)	1Q	2Q	3Q	4Q	FY
2011	(1.21)	(2.60)	(1.65)	(1.53)	(6.98)
P/E					NM
2012	(1.97)	(0.22)	(0.25)	(0.25)E	(0.97)E
Prior	—	—	(0.24)	—	(1.24)E
P/E					NM
2013	—	—	—	—	(0.95)E
Prior	—	—	—	—	(0.93)E
P/E					NM

Market Data

52-Week Range	\$5.66 - \$11.11
Shares Out (M)	94.2
Market Cap (M)	\$672
ADV (3 mo; 000)	467



VALUATION METHODOLOGY AND RISKS

Our valuation for our \$13 price target is based on sales estimates for MACK's MM-121 and MM-398 projected out to 2022, using a discount rate of 22.5%, terminal value at 1% growth rate, plus current net cash. Key risks to our price target include, but are not limited to, unfavorable clinical/regulatory outcomes for MACK's pipeline, as well as dilutive financings.

		Terminal growth rate										MACK Valuation		2012E					
		0.00%	0.25%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%	2.00%	Earnings per Share	(\$0.97)							
Discount rate	21.50%	\$	13.82	\$	13.92	\$	14.02	\$	14.13	\$	14.23	\$	14.34	\$	14.45	\$	14.57	\$	14.69
	21.75%	\$	13.45	\$	13.55	\$	13.65	\$	13.74	\$	13.85	\$	13.95	\$	14.06	\$	14.17	\$	14.28
	22.00%	\$	13.10	\$	13.19	\$	13.28	\$	13.38	\$	13.47	\$	13.57	\$	13.68	\$	13.78	\$	13.89
	22.25%	\$	12.75	\$	12.84	\$	12.93	\$	13.02	\$	13.11	\$	13.21	\$	13.31	\$	13.41	\$	13.51
	22.50%	\$	12.42	\$	12.50	\$	12.59	\$	12.67	\$	12.76	\$	12.85	\$	12.95	\$	13.04	\$	13.14
	22.75%	\$	12.09	\$	12.17	\$	12.26	\$	12.34	\$	12.42	\$	12.51	\$	12.60	\$	12.69	\$	12.79
	23.00%	\$	11.78	\$	11.86	\$	11.93	\$	12.02	\$	12.10	\$	12.18	\$	12.27	\$	12.35	\$	12.44
	23.25%	\$	11.48	\$	11.55	\$	11.62	\$	11.70	\$	11.78	\$	11.86	\$	11.94	\$	12.03	\$	12.11
	23.50%	\$	11.18	\$	11.25	\$	11.32	\$	11.40	\$	11.47	\$	11.55	\$	11.63	\$	11.71	\$	11.79
23.75%	\$	10.89	\$	10.96	\$	11.03	\$	11.10	\$	11.17	\$	11.25	\$	11.32	\$	11.40	\$	11.48	
Terminal growth rate																		1.00%	
Terminal Value																		\$	4,811
WACC Calculations																		MACK	
Equity (M)																		669	
Debt (M)																		40	
Equity %																		94%	
Debt %																		6%	
Rf(Risk free rate)																		1.8%	
Market premium																		13.0%	
Beta																		1.70	
Cost of equity																		23.9%	
Cost of debt (Pre-tax)																		10.6%	
Tax rate																		0%	
Cost of debt (Post-tax)																		-	
Share price																		7.14	
No. of Shares outstanding (Mn)																		94	
WACC																		22.50%	

Merrimack Pharmaceuticals, Inc.

	2012											
<i>Amounts in thousands, except per-share figures</i>	2011A	1QA	2QA	3QA	Prior 3QE	4QE	2012E	Prior 2012E	2013E	Prior 2013E	2014E	Prior 2014E
Income Statement												
Revenues:												
MM-398 pancreatic cancer sales	-	-	-	-	-	-	-	-	-	-	32,091	32,091
MM-121 breast cancer royalties	-	-	-	-	-	-	-	-	-	-	-	-
Collaborative revenue (Sanofi)	34,215	11,344	12,063	11,323	12,400	12,600	47,330	48,407	50,700	50,700	55,200	55,200
Total operating revenue	34,215	11,344	12,063	11,323	12,400	12,600	47,330	48,407	50,700	50,700	87,291	87,291
Operating expenses												
Cost of goods	-	-	-	-	-	-	-	-	-	-	3,690	3,690
Research & development	100,630	31,651	28,758	30,885	30,258	31,374	122,668	122,041	124,791	124,791	130,447	130,447
Selling, general & administrative	14,454	3,728	3,610	4,312	3,910	4,712	16,362	15,558	23,725	22,559	43,891	41,734
Contingent consideration/other	-	-	-	-	-	-	-	-	-	-	-	-
Total operating expenses	115,084	35,379	32,368	35,197	34,168	36,086	139,030	137,599	148,516	147,351	178,028	175,872
Income (loss) from operations	(80,869)	(24,035)	(20,305)	(23,874)	(21,768)	(23,486)	(91,700)	(89,192)	(97,816)	(96,651)	(90,737)	(88,580)
Interest income	56	9	54	64	20	64	191	103	666	415	861	758
Interest expense	(13)	(4)	-	-	(4)	(4)	(495)	(12)	(4,208)	(16)	(3,235)	(20)
Other, net	1,150	628	112	549	(135)	(140)	1,149	465	919	372	735	298
Pretax income (loss)	(79,676)	(23,402)	(20,139)	(23,261)	(21,887)	(23,566)	(90,855)	(88,636)	(100,440)	(95,879)	(92,376)	(87,544)
Benefit from income taxes	-	-	-	-	-	-	-	-	-	-	-	-
Net income (loss)	(79,676)	(23,402)	(20,139)	(23,261)	(21,887)	(23,566)	(90,855)	(88,636)	(100,440)	(95,879)	(92,376)	(87,544)
Less net loss attributable to NCI	(453)	(118)	(113)	(121)	(119)	(127)	(479)	(474)	(513)	(507)	(538)	(533)
Net income attributed to Merrimack	(79,223)	(23,284)	(20,026)	(23,140)	(21,768)	(23,439)	(90,376)	(88,162)	(99,927)	(95,372)	(91,838)	(87,012)
Net loss per share	(\$6.98)	(\$1.97)	(\$0.22)	(\$0.25)	(\$0.24)	(\$0.25)	(\$0.97)	(\$1.24)	(\$0.95)	(\$0.93)	(\$0.81)	(\$0.78)
Basic common shares outstanding	11,343	11,846	90,581	93,724	90,831	93,974	92,760	71,085	104,974	102,081	114,074	111,181
Diluted common shares outstanding	11,343	11,846	106,436	93,724	106,686	109,829	80,459	82,976	120,829	117,936	129,929	127,036

Source: Company documents and Guggenheim Securities LLC

ANALYST CERTIFICATION

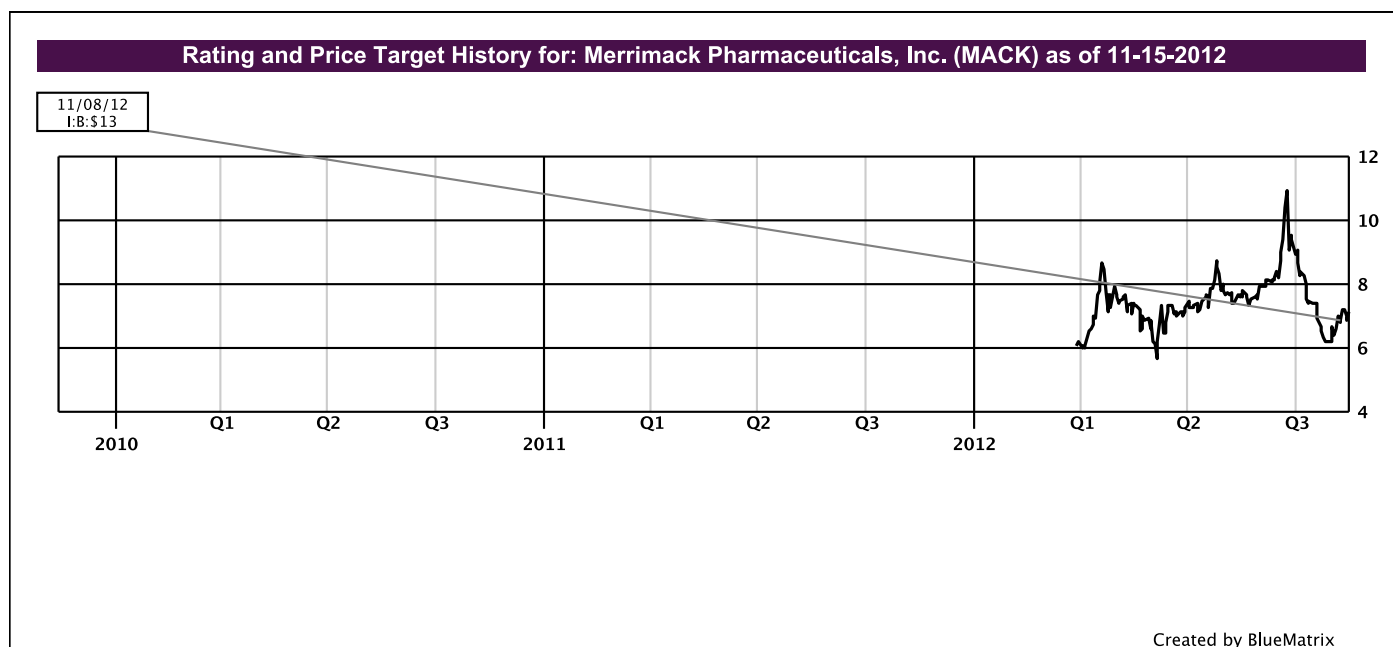
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