

August 13, 2012

Market Outperform / Speculative Risk

### VSTM Reports FY2Q12 Results

#### MARKET DATA Intraday - 8/13/2012

Price	\$9.08
Exchange	NASDAQ
Target Price	\$19.00
52 Wk Hi - Low	\$12.24 - \$7.69
Market Cap(MM)	\$191.2
EV(MM)	\$150.2
Shares Out (MM)	21.1
Public Mkt Float (MM)	21.1
Avg. Daily Vol	12,543
Short Interest	445,850

#### BALANCE SHEET METRICS

Cash (MM)	\$104.3
LTD (MM)	\$0.0
Total Debt/Capital	NA
Cash/Share	\$7.06
Book Value(MM)	NA
Book Value/Share	\$5.44

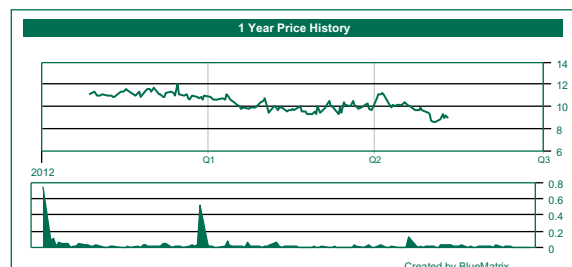
Cash (MM): Includes cash and equivalents, short-term and long-term securities.

#### EARNINGS DATA (\$)

FY - Dec	2011E	2012E	2013E
Q1 (Mar)	--	(0.47)A	--
Q2 (Jun)	--	(0.34)A	--
Q3 (Sep)	--	(0.37)	--
Q4 (Dec)	(4.01)	(0.39)	--
Full Year EPS	(10.59)	(1.64)	(1.40)

#### INDICES

DJIA	13,190.9
SP-500	1,402.7
NASDAQ	2,725.9
NBI	1,375.9



VSTM released FY2Q12 results before the market open this morning, reporting EPS of (\$0.34), lower than our EPS estimate of (\$0.49) primarily due to a greater than anticipated increase in shares outstanding over the prior quarter. As an early stage biotech, the key to VSTM share value continues to be the successful execution of development milestones with its FAK inhibitor assets, VS-6063 and VS-4718, and its PI3K/mTOR inhibitor VS-5584. Operating expenses for the quarter totaled \$6.9MM, comprising \$4.7MM in R&D expense (less than our estimate of \$5.1MM) and G&A expense of \$2.2MM (slightly less than our estimate of \$2.3MM). VSTM recorded a weighted average of 19.863MM shares outstanding for 2Q12 compared with 14.693MM shares for previous quarter. The Company finished the quarter with \$104.3MM in cash, equivalents and short-term investments. A comparison of our estimates versus 2Q12 actual results is detailed in Table 2.

**Little news since the Company R&D Update in July.** The end of the second quarter, culminating with the R&D day presentation on July 12, was certainly a busy period for VSTM: i) a reprioritization of the clinical development plan to one more focused on the FAK pathway; ii) the acquisition of VS-6063, a Phase II-ready FAK inhibitor, from Pfizer; iii) the acquisition of a dual PI3K/mTOR inhibitor from S\*Bio; iv) the formation of drug discovery collaboration with Eisai to develop next generation Wnt pathway inhibitors (refer to our notes from July 12<sup>th</sup>, 13<sup>th</sup> and 23<sup>rd</sup> for further detail around these announcements). As such, little in the way of further news was cited in today's results. VSTM remains on track to begin clinical development of its FAK inhibitor portfolio in early 2013, starting with a Phase I healthy volunteer study of VS-4718 in 1Q13 and the initiation of a Phase II study of VS-6063 in patients with mesothelioma by mid-2013 (see Table 1 for upcoming milestones). Going forward, we expect the company will be on an aggressive hunt for clinic-ready compounds, as well as novel technologies, in order to advance its discovery and development pipeline.

**Changes to our model.** Few changes have been made to our model going forward. Share count estimates for the third and fourth quarters of 2012, as well as in subsequent years, have been increased to reflect higher numbers of outstanding shares reported in today's results. These changes and their impact to EPS estimates are detailed in Table 3 and Table 4 of this note.

**We maintain our Market Outperform rating for VSTM shares and \$19 price target.** We derive our price target through a combination of methodologies, including a DCF-based valuation of \$18 and a CAGR valuation of \$22. Risks to our valuation include the risk of clinical failure related to any of VSTM's central development programs including VS-6063, VS-4718 and VS-5584 for reasons of safety or inactivity. In our view, the value of VSTM shares will continue to be primarily milestone-driven over the next six to twelve months, as VS-6063 is prepared for Phase II evaluation and as VS-4718 and VS-5584 complete IND tox assessment heading into Phase I trials beginning 2013.

**Table 1. Upcoming Milestones**

<b>Milestone</b>	<b>Date</b>
• Initiation of VS-4718 Phase I healthy volunteer study	1Q 2013
• Initiation of VS-4718 Phase I study in patients with solid tumors	2Q 2013
• Initiation of VS-6063 Phase II study in patients with mesothelioma	2Q 2013
• Initiation of VS-5584 Phase I study in patients with solid tumors	2H 2013
• VS-6063 Phase I combination study	1H 2014

**Table 2. Rodman Estimates vs. FY2Q12 Actual Results**

<b>Verastem, Inc. (VSTM)</b>			
<b>Forecasted Results vs. Actual (\$MM)</b>	<b>R&amp;R Estimates</b>	<b>Actual</b>	<b>Variance</b>
<b>Total Revenues</b>	0.00	0.00	0.00
R&D Expense	5.10	4.68	(0.42)
SG&A Expense	2.25	2.21	(0.04)
<b>Operating Expenses</b>	7.35	6.90	(0.45)
<b>Operating Income (loss)</b>	(7.35)	(6.90)	0.45
Other Income	0.00	0.07	0.07
<b>Net Income (loss)</b>	(7.35)	(6.83)	0.53
Accretion of preferred stock	0.00	0.00	0.00
<b>Net Income Spplicable to Shareholders</b>	(7.35)	(6.83)	0.53
<i>Basic Shares Outstanding</i>	14.91	19.86	4.95
<i>Diluted Shares Outstanding</i>	14.91	19.86	4.95
<b>Basic EPS</b>	(0.49)	(0.34)	0.15
<b>Diluted EPS</b>	(0.49)	(0.34)	0.15

Table 3. Changes to Our Income Statement

<b>Verastem, Inc (VSTM)</b>												
New vs. Old Income Statement (\$MM)	Old 3Q12 FY2012E	New 3Q12 FY2012E	Old 4Q12 FY2012E	New 4Q12 FY2012E	Old 2012 FY2012E	New 2012 FY2012E	Old 2013 FY2013E	New 2013 FY2013E	Old 2014 FY2014E	New 2014 FY2014E	Old 2015 FY2015	New 2015 FY2015
<b>Total Revenues</b>	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
R&D Expense	5.40	5.40	5.70	5.70	21.00	20.59	23.00	23.00	35.65	35.65	57.04	57.04
SG&A Expense	2.40	2.40	2.60	2.60	9.38	9.34	10.00	10.00	12.00	12.00	15.95	15.95
<b>Operating Expenses</b>	7.80	7.80	8.30	8.30	30.38	29.92	33.00	33.00	47.65	47.65	72.99	72.99
<b>Operating Income (loss)</b>	(7.80)	(7.80)	(8.30)	(8.30)	(30.38)	(29.92)	(33.00)	(33.00)	(47.65)	(47.65)	(72.99)	(72.99)
Other Income	0.00	0.00	0.00	0.00	0.06	0.13	0.00	0.00	0.00	0.00	0.00	0.00
<b>Net Income</b>	(7.80)	(7.80)	(8.30)	(8.30)	(30.32)	(29.80)	(33.00)	(33.00)	(47.65)	(47.65)	(72.99)	(72.99)
Basic Shares Outstanding	15.14	21.05	15.36	21.58	14.92	18.21	20.08	23.57	24.28	27.81	24.52	28.09
Dilute Shares Outstanding	15.14	21.05	15.36	21.58	14.92	18.21	20.08	23.57	24.28	27.81	24.52	28.09
<b>Basic EPS (GAAP)</b>	(0.52)	(0.37)	(0.54)	(0.38)	(2.03)	(1.64)	(1.64)	(1.40)	(1.96)	(1.71)	(2.98)	(2.60)
<b>Diluted EPS (GAAP)</b>	(0.52)	(0.37)	(0.54)	(0.38)	(2.03)	(1.64)	(1.64)	(1.40)	(1.96)	(1.71)	(2.98)	(2.60)

Table 4. Updated Income Statement

Verastem, Inc. (VSTM)																					
Condensed Statements of Operations (\$MM)		1Q12A	2Q12A	3Q12E	4Q12E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E		
<b>Product Sales and Royalties</b>																					
VS-6063 (FAK inhibitor), US Sales										25.4	52.9	447.5	781.3	997.5	1,131.9	1,228.9	1,313.3	1,379.9	1,433.5		
VS-6063, Ex-US Royalties										0.0	9.2	18.5	63.9	110.3	145.5	165.2	177.2	181.5	186.6		
VS-5584 (PI3K/mTOR), US Sales											62.4	160.0	295.3	370.0	413.8	441.9	463.9	483.0	502.7		
VS-5584, Ex-US Royalties												7.3	20.2	37.8	48.9	54.8	57.9	60.0	62.2		
<b>Total Product Sales and Royalties</b>										<b>25.4</b>	<b>124.5</b>	<b>633.4</b>	<b>1,160.7</b>	<b>1,515.6</b>	<b>1,740.0</b>	<b>1,890.8</b>	<b>2,012.3</b>	<b>2,104.4</b>	<b>2,185.0</b>		
<b>License and Milestone Revenue</b>																					
<b>Collaboration Revenue</b>																					
<b>Total Revenue</b>										<b>25.4</b>	<b>124.5</b>	<b>633.4</b>	<b>1,160.7</b>	<b>1,515.6</b>	<b>1,740.0</b>	<b>1,890.8</b>	<b>2,012.3</b>	<b>2,104.4</b>	<b>2,185.0</b>		
<b>Cost of Goods Sold</b>										2.8	12.1	60.8	107.7	136.8	154.6	167.1	177.7	186.3	191.7		
<b>Gross Profit</b>									0.0	22.6	112.4	572.6	1,053.1	1,378.8	1,585.5	1,723.7	1,834.6	1,918.1	1,993.3		
<b>Operating expenses:</b>																					
R&D		4.8	4.7	5.4	5.7	20.6	23.0	35.7	57.0	94.1	122.4	151.7	180.5	207.6	226.3	235.4	240.1	244.9	249.8		
G&A		2.1	2.2	2.4	2.6	9.3	10.0	12.0	15.9	39.9	59.8	71.8	82.5	88.3	91.8	95.5	99.3	103.3	107.4		
<b>Total operating expenses</b>		<b>6.9</b>	<b>6.9</b>	<b>7.8</b>	<b>8.3</b>	<b>29.9</b>	<b>33.0</b>	<b>47.7</b>	<b>73.0</b>	<b>134.0</b>	<b>182.2</b>	<b>223.5</b>	<b>263.1</b>	<b>295.9</b>	<b>318.1</b>	<b>330.9</b>	<b>339.4</b>	<b>348.2</b>	<b>357.2</b>		
<b>Operating income (loss)</b>		(6.9)	(6.9)	(7.8)	(8.3)	(29.9)	(33.0)	(47.7)	(73.0)	(111.4)	(69.8)	349.1	790.0	1,082.9	1,267.3	1,392.8	1,495.2	1,569.9	1,636.1		
<b>Other income (expense)</b>																					
Interest income		0.1	0.1																		
Interest (expense)																					
<b>Total other income</b>		0.1	0.1	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
<b>Pretax Income</b>		(6.9)	(6.8)	(7.8)	(8.3)	(16.1)	(33.0)	(47.7)	(73.0)	(111.4)	(69.8)	349.1	790.0	1,082.9	1,267.3	1,392.8	1,495.2	1,569.9	1,636.1		
Provision for Income Tax											(1.7)	69.8	237.0	324.9	380.2	417.9	448.6	471.0	490.8		
Effective Tax Rate											2.5%	20.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%		
<b>Net income</b>		(6.87)	(6.83)	(7.80)	(8.30)	(29.8)	(33.0)	(47.7)	(73.0)	(111.4)	(68.0)	279.3	553.0	758.0	887.1	975.0	1,046.6	1,098.9	1,145.3		
Accretion of preferred stock		(0.0)																			
<b>Net income applicable to common shareholders</b>		(6.9)	(6.8)	(7.8)	(8.3)	(29.8)	(33.0)	(47.7)	(73.0)	(111.4)	(68.0)	279.3	553.0	758.0	887.1	975.0	1,046.6	1,098.9	1,145.3		
<b>Basic EPS to common shareholders</b>		\$ (0.47)	\$ (0.34)	\$ (0.37)	\$ (0.38)	\$ (1.64)	\$ (1.40)	\$ (1.71)	\$ (2.60)	\$ (3.78)	\$ (2.25)	\$ 9.15	\$ 17.93	\$ 24.34	\$ 28.20	\$ 30.69	\$ 32.62	\$ 33.91	\$ 34.99		
<b>Diluted EPS to common shareholders</b>		\$ (0.47)	\$ (0.34)	\$ (0.37)	\$ (0.38)	\$ (1.64)	\$ (1.40)	\$ (1.71)	\$ (2.60)	\$ (3.78)	\$ (2.25)	\$ 7.90	\$ 15.49	\$ 21.03	\$ 24.36	\$ 26.55	\$ 28.25	\$ 29.41	\$ 30.35		
Basic Shares Outstanding		14.693	19.863	21.055	21.581	18.205	23.572	27.808	28.086	29.490	30.228	30.530	30.835	31.144	31.455	31.770	32.087	32.408	32.732		
Diluted Shares Outstanding		14.693	19.863	21.055	21.581	18.205	23.572	27.808	28.086	29.490	30.228	35.343	35.696	36.053	36.414	36.728	37.046	37.367	37.741		
% change in diluted shares outstanding				6.0%	2.5%		6.1%	1.0%	1.0%	5.0%	2.5%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%		

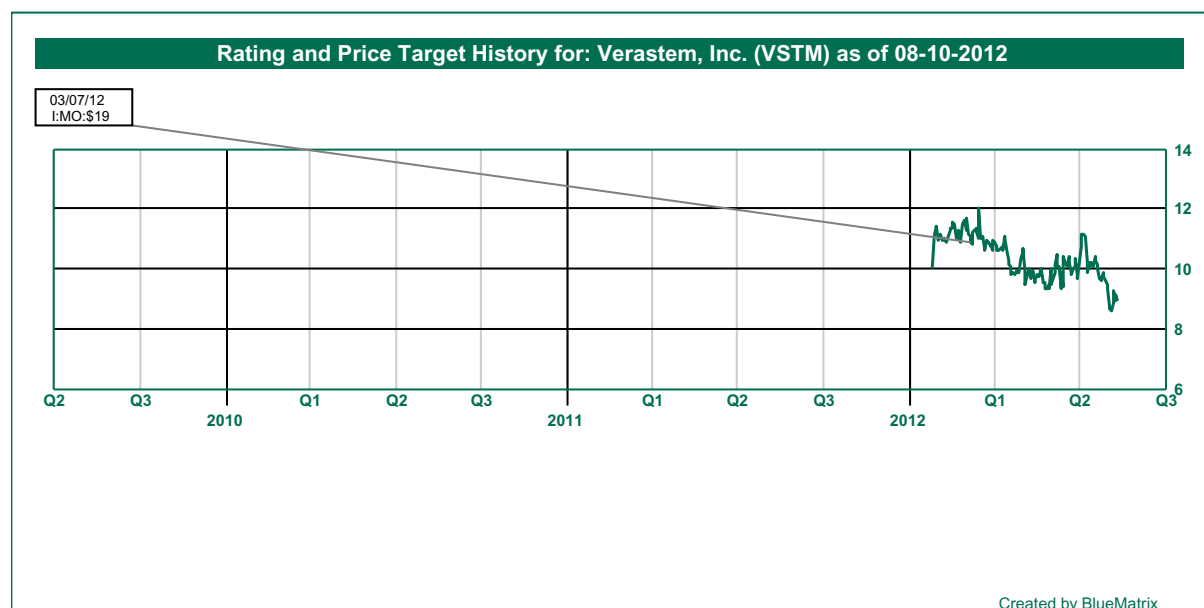
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### RETURN ASSESSMENT

- **Market Outperform (Buy):** The common stock of the company is expected to outperform a passive index comprised of all the common stock of companies within the same sector, as defined by First Call.
- **Market Perform (Hold):** The common stock of the company is expected to mimic the performance of a passive index comprised of all the common stock of companies within the same sector, as defined by First Call.
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- **Speculative -** The common stock risk level is significantly greater than market risk. The stock price of these equities is exceptionally volatile.
- **Aggressive -** The common stock risk level is materially higher than market level risk. The stock price is typically more volatile than the general market.
- **Moderate -** The common stock is moderately risky, or equivalent to stock market risk. The stock price volatility is typically in-line with movements in the general market.



### RATING SUMMARY

Distribution of Ratings Table				
Rating	Count	Percent	IB Serv./Past 12 Mos	
			Count	Percent
Market Outperform(MO)	21	32.31%	3	14.29%
Market Perform(MP)	4	6.15%	0	0.00%
Market Underperform(MU)	2	3.08%	0	0.00%
Under Review(UR)	38	58.46%	8	21.05%
Total	65	100%	11	100%

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