

May 14, 2012

HEALTHCARE/BIO TECHNOLOGY

Stock Rating:
OUTPERFORM

12-18 mo. Price Target \$16.00
VSTM - NASDAQ \$9.94

3-5 Yr. EPS Gr. Rate NM
52-Wk Range \$12.24-\$8.89
Shares Outstanding 21.1M
Float 7.5M
Market Capitalization \$209.3M
Avg. Daily Trading Volume 27,096
Dividend/Div Yield NM/NM
Book Value NM
Fiscal Year Ends Dec
2012E ROE NM
LT Debt \$0.0M
Preferred NA
Common Equity NA
Convertible Available No
Range since January 2012 IPO.

EPS Diluted	Q1	Q2	Q3	Q4	Year	Mult.
2010A	--	--	--	--	(0.92)	NM
2011A	(1.85)	(2.89)	(2.68)	(2.87)	(10.59)	NM
2012E	(0.47)A	(0.30)	(0.31)	(0.34)	(1.38)	NM
Prior (E)	(0.25)	(0.26)	(0.27)	(0.30)	(1.09)	NM
2013E	--	--	--	--	(1.27)	NM
Prior (E)	--	--	--	--	(1.09)	NM

Verastem, Inc.

Reports 1Q12; Builds Pipeline with mTOR/PI3K Inhibitor In-licensing

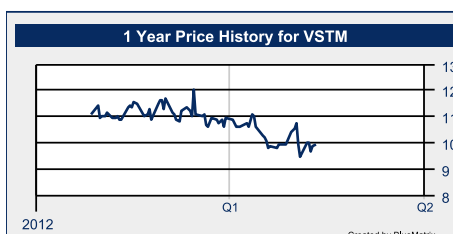
SUMMARY

On 5/14, VSTM reported 1Q results. We continue to expect the company to advance VS-507 (WNT pathway inhibitor) and either VS-4718 or VS-5095 (FAK inhibitors) into the clinic by early '13. VSTM also broadened the pipeline with the in-licensing of SB2343, a dual mTOR/PI3K inhibitor from S*Bio. VSTM also presented promising preclinical data at AACR on 4/2 demonstrating the therapeutic potential of inhibiting WNT and FAK in models of triple negative breast cancer (TNBC), the planned first indication for VS-507 and VS-4718/VS-5095. We view VSTM as an attractive long-term value, based on the company's CSC discovery platform, and expect appreciation in the stock with pipeline progress and additional high profile scientific CSC publications.

KEY POINTS

- **1Q loss of \$6.9M was above our \$5.4M estimate.** This was largely due to higher R&D spend (\$4.8M vs. \$4.3M est.) and higher SG&A spend (\$2.1M vs. \$1.1M est.). VSTM had \$109.3M in cash on 3/31, which should be sufficient to fund operations into '16.
- **In-licensing of SB2343 strategically important.** The PI3K and mTOR pathways have been implicated in CSC survival/growth in several different tumor types. Based on this, we believe SB2343 is a good strategic fit for VSTM. Importantly, we believe the drug holds potential in tumor types other than those targeted by VS-507/FAK programs.
- **VS-507 targets a key oncology pathway.** VSTM presented data at AACR showing that VS-507 inhibits CSC function, self-renewal and tumorigenicity in preclinical TNBC models, which supports VSTM's plan to initially focus on TNBC in the clinic. We expect initial ph.I results for VS-507 will be a major milestone for VSTM in 2H13.
- **FAK inhibitors VS-4718/VS-5095 advance towards ph.I.** VSTM recently presented results for FAK inhibitors VS-4718 and VS-5095 showing the drugs inhibited the self-renewal of breast cancer stem cells in a dose-dependent manner. We expect VS-4718/VS-5095 to enter the clinic in '13, and initial ph.I results in '13/'14.

Stock Price Performance



Company Description

Verastem, Inc. is a biopharmaceutical company focused on discovering and developing novel drugs that selectively target cancer stem cells.

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Changes to Our Model

Following 1Q12 results, we are updating our model. Our new 2012-2016 EPS estimates are (\$1.38), (\$1.27) (\$1.41), (\$1.43), and (\$1.13), compared to our prior estimates of (\$1.09), (\$1.09), (\$1.34), (\$1.38) and (\$1.13), respectively.

Verastem Income Statement 2010A-2016E

Amounts in thousands, except per-share figures

	2010A	2011A	2012								2012E	Prior 2012E	2013E	2014E	2015E	2016E
			1QA	Prior 1QE	2QE	Prior 2QE	3QE	Prior 3QE	4QE	Prior 4QE						
Revenues:																
TNBC royalty	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other revenue	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total operating revenue	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Operating expenses:																
Cost of goods	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Research & development	400	9,883	4,803	4,300	4,350	4,350	4,500	4,500	5,200	5,200	18,853	18,350	19,050	22,250	22,750	23,250
Selling, general & administrative	384	3,815	2,125	1,070	2,050	1,150	2,075	1,200	2,100	1,250	8,350	4,670	8,601	8,859	9,124	9,398
Total operating expenses	784	13,698	6,928	5,370	6,400	5,500	6,575	5,700	7,300	6,450	27,203	23,020	27,651	31,109	31,874	32,648
Income (Loss) from operations	(784)	(13,698)	(6,928)	(5,370)	(6,400)	(5,500)	(6,575)	(5,700)	(7,300)	(6,450)	(27,203)	(23,020)	(27,651)	(31,109)	(31,874)	(32,648)
Other income (expense)	(2)	(17)	51	5	75	19	80	26	74	33	280	83	295	289	105	310
Pretax income (loss)	(786)	(13,715)	(6,877)	(5,365)	(6,325)	(5,481)	(6,495)	(5,674)	(7,226)	(6,417)	(26,923)	(22,937)	(27,356)	(30,819)	(31,769)	(32,338)
Income tax provision (benefit)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Net income (loss)	(786)	(13,715)	(6,877)	(5,365)	(6,325)	(5,481)	(6,495)	(5,674)	(7,226)	(6,417)	(26,923)	(22,937)	(27,356)	(30,819)	(31,769)	(32,338)
Basic & diluted net loss per share	(\$0.92)	(\$10.59)	(\$0.47)	(\$0.25)	(\$0.30)	(\$0.26)	(\$0.31)	(\$0.27)	(\$0.34)	(\$0.30)	(\$1.38)	(\$1.09)	(\$1.27)	(\$1.41)	(\$1.43)	(\$1.13)
Basic & diluted common shares outstanding (1)	850	1,295	14,693	21,059	21,109	21,109	21,159	21,159	21,209	21,209	19,543	21,134	21,559	21,909	22,259	28,609

(1) IPO in 1Q12 results in conversion of preferred stock to common stock

Source: Company documents and Oppenheimer & Co. Inc.

Investment Thesis

Based on a unique discovery platform, VSTM is developing cancer stem cell (CSC)-targeted therapies. We believe there is growing evidence CSCs have a key role in tumor initiation/metastasis. VSTM expects to advance Wnt pathway inhibitor VS-507 and a FAK inhibitor (VS-4718/VS-5095) into ph.I by 1Q13. Based on preclinical results and compelling biological rationale, we believe these compounds have broad anticancer potential. VSTM first plans to pursue triple negative breast cancer (TNBC), which we believe is a substantially underserved, multi-billion dollar market. We believe VSTM is an attractive long-term investment and expect the stock to appreciate as clinical progress and high profile scientific publications further underscore the importance of CSCs.

Price Target Calculation

Our price target of \$16 is based on a forward DCF valuation, which includes probability-adjusted product royalties and milestones in triple negative breast cancer. We model a ~52% EBIT margin and ~30% tax rate in the out years, resulting a 2027 free cash flow of \$83M and terminal value of cash flow of ~\$715M. We utilize a 15% discount rate to reflect the early stage of VSTM's drug candidates, but utilize a 3% terminal growth rate to reflect the productivity of the company's discovery platform. Our valuation also includes \$200M in technology value, which we believe is conservative based on platform acquisition comps.

Key Risks to Price Target

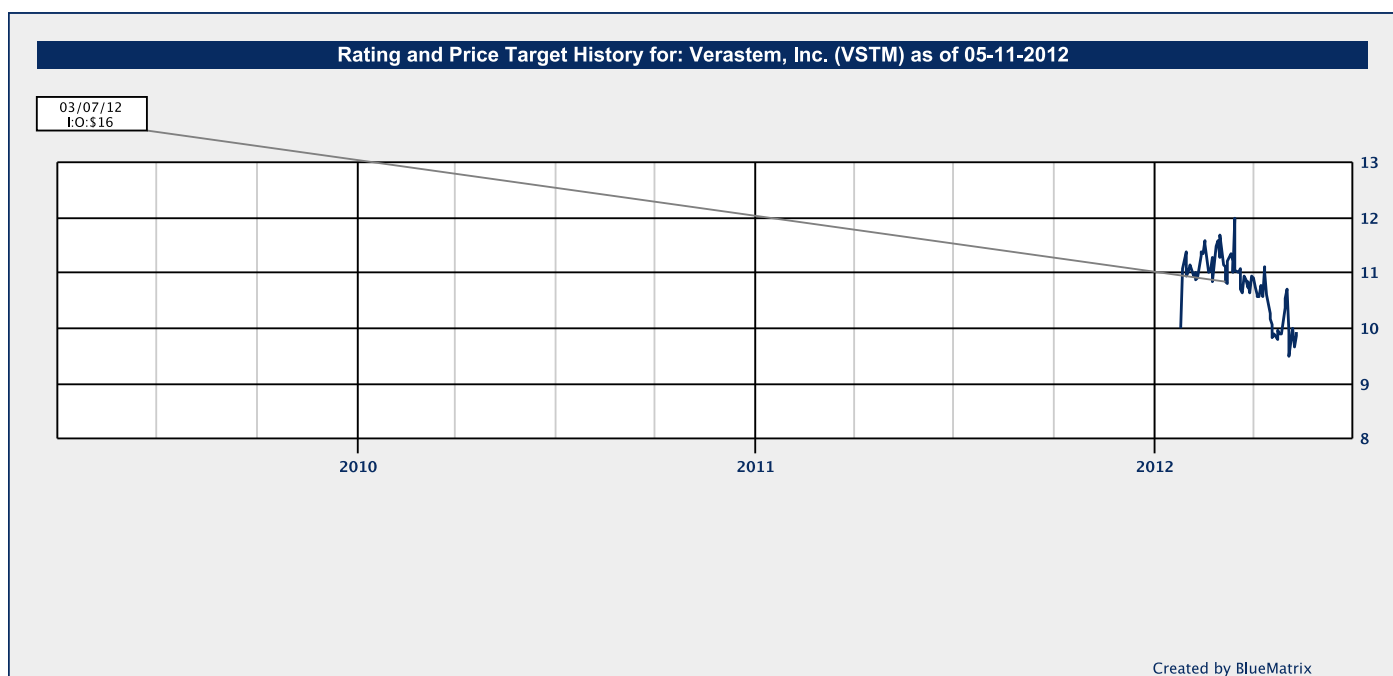
Key risks to our price target include, but are not limited to, clinical failure of VSTM's drug candidates, success of competing drugs in the clinic, and failure to secure funding for operations. There is liquidity risk with the shares, based on the company's float.

Important Disclosures and Certifications

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Distribution of Ratings/IB Services Firmwide

Rating	IB Serv/Past 12 Mos.			
	Count	Percent	Count	Percent
OUTPERFORM [O]	325	55.65	145	44.62
PERFORM [P]	251	42.98	85	33.86
UNDERPERFORM [U]	8	1.37	3	37.50

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