

Merrimack Pharmaceuticals

Updating Model Post 3Q

Merrimack reported 3Q12 results with a GAAP loss of \$0.25 per share, in line with the consensus estimate of -\$0.26 (JPMc: -\$0.27). The company continues to make progress on the pipeline, and we look for detailed updates on tomorrow's conference call (11am ET). On the call, we look for updates on the pipeline, which is expected to include a description of the phase 2 MM-111 study, the ErbB3 inhibitor in the ErbB2 setting. Looking ahead over the next 12 months, we expect multiple meaningful catalysts, including data from the phase 3 NAPOLI-1 trial for lead asset MM-398 in mid 2013 and phase 2 data for MM-121 in 1H13. With a robust pipeline that continues to advance, we expect a significant flow of de-risking clinical events in 2013. As such, we reiterate our Overweight rating.

Pipeline. In 2012, Phase 1 data for MM-302 will be presented in December (SABC, Dec 4-8). Additionally, key top-line data from the phase 3 NAPOLI-1 trial of MM-398, in gemcitabine-resistant pancreatic cancer is expected in mid 2013. Additionally, top-line data from the phase 2 trials of MM-121 in breast cancer and NSCLC are expected in 1H13 with Phase 2 data in ovarian cancer expected in 2H13. Over the next 12 months, a phase 2 trial of MM-111 in second line gastric cancer, and phase 1 trials for both MM-141 and MM-DX-929 are expected to be initiated.

Adjusting estimates. We have updated our model to reflect 3Q12 and recent trends. Specifically, we have fine tuned operating expenses and included the impact of the recent loan and security agreement. The net impact of these changes is our 2012-14 GAAP EPS estimates change to (\$2.88), (\$1.21) and (\$0.48) from (\$2.90), (\$1.19) and (\$0.45), respectively.

Conference call at 11:00am EST tomorrow (Nov 15th): Dial in 877-564-1301 (US) or 224-357-2394 (International); Passcode 55448769.

Reiterate Overweight rating.

Overweight

MACK, MACK US

Price: \$6.97

Price Target: \$11.00

Biotechnology

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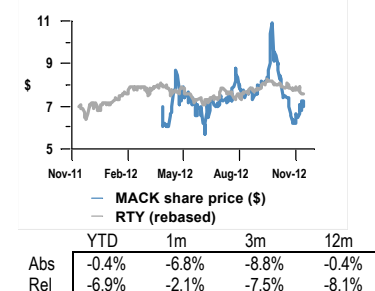
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Price Performance



Merrimack Pharmaceuticals (MACK;MACK US)

FYE Dec	2010A	2011A	2012E	2012E	2013E	2013E	2014E	2014E
			(Prev)	(Curr)	(Prev)	(Curr)	(Prev)	(Curr)
EPS Reported (\$)								
Q1 (Mar)	-	-	(2.14)A	(2.14)A	-	-	-	-
Q2 (Jun)	-	-	(0.22)A	(0.22)A	-	-	-	-
Q3 (Sep)	-	-	(0.27)	(0.25)A	-	-	-	-
Q4 (Dec)	-	-	(0.27)	(0.27)	-	-	-	-
FY	(5.57)	(7.67)	(2.90)	(2.88)	(1.19)	(1.21)	(0.45)	(0.48)
Bloomberg EPS FY (\$)	-	-	-	(1.28)	-	(0.92)	-	(0.75)

Source: Company data, Bloomberg, J.P. Morgan estimates.

Company Data

Price (\$)	6.97
Date Of Price	13 Nov 12
52-week Range (\$)	11.11 - 5.66
Mkt Cap (\$ mn)	688.11
Fiscal Year End	Dec
Shares O/S (mn)	99
Price Target (\$)	11.00
Price Target End Date	31 Dec 13

See page 5 for analyst certification and important disclosures.

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Changes to Our Model

We have updated our model to reflect 3Q12 and recent trends. Specifically, we have fine tuned operating expenses and included the impact of the recent loan and security agreement. The net impact of these changes is our 2012-14 GAAP EPS estimates change to (\$2.88), (\$1.21) and (\$0.48) from (\$2.90), (\$1.19) and (\$0.45), respectively.

Table 1: Change to Out Model

	2012E OLD	2012E NEW	2013E OLD	2013E NEW	2014E OLD	2014E NEW
Total Revenue	46.41	46.7	50.0	50.0	164.9	164.9
R&D	126.01	124.6	151.2	151.4	181.5	181.7
SG&A	14.94	16.1	17.2	18.5	21.5	23.1
Total Op Ex	140.95	140.6	168.4	169.8	213.9	215.7
Net income	(91.9)	(92.1)	(116.0)	(119.7)	(46.7)	(49.3)
EPS	(2.90)	(2.88)	(1.19)	(1.21)	(0.45)	(0.48)
<i>fully diluted shares</i>	70.9	72.5	97.1	98.7	103.6	103.7

Source: J.P. Morgan estimates.

Investment Thesis

Merrimack's proprietary Network Biology Platform has the potential to significantly improve the productivity of drug discovery / development in oncology. Indeed, the company has a robust pipeline (5 clinical, 3 preclinical assets) with multiple opportunities across a variety of cancers. Lead asset MM-398 is the key driver, currently in phase 3 development for pancreatic cancer with data in mid 2013 (\$900M peak opportunity in the US alone). Additionally, MM-121, partnered with Sanofi, is currently in Phase 2 trials for NSCLC, breast and ovarian cancer (data 2013-2014) with peak sales potential of \$1.3B in the US alone (driving royalties of ~\$320M). Importantly, we believe Merrimack's Network Biology Platform has been validated by the recent phase 1 data for MM-121 and MM-111 and to some extent the Sanofi partnership. We see multiple value creation opportunities with de-risking clinical events over the course of 2012-2013.

Valuation

Our \$11 December 2013 price target for MACK shares is based on our sum-of-the-parts analysis, which includes US sales of MM-398, MM-121, and MM-111. In our analysis, we use a discount rate of 15% (consistent with other biotech companies at similar stages of development) and assume no terminal value. For MM-398 we project US sales in pancreatic cancer to 2027 (consistent with patent expiration) with modest contributions from other indications (CRC, SCLC and GBM) and apply a 60% probability of success. This implies a value of \$7/share. For MM-121, we apply a 40% probability of success to royalties on US sales in NSCLC to 2028 with modest contribution from other indications (BC and OC). This implies a value of \$3/share. For MM-111 we apply a 25% probability of success to US sales in HER2+ breast cancer to 2029 with modest contribution in other cancers (gastric and bladder). This analysis implies a \$0.5/share. We assume net cash of \$1/share. Taken together, our sum-of-the-parts support our Dec 2013 target of \$11/share.

Risks to Rating and Price Target

We see three primary risks to our Overweight rating on MACK shares. These risks include: 1) failure of MM-398 to demonstrate a meaningful benefit in phase 3 in pancreatic cancer; 2) inability to gain regulatory approval for MM-398 and other pipeline assets; and 3) inability to defend existing patent estate.

Merrimack Pharmaceuticals: Summary of Financials

Income Statement - Annual	FY11A	FY12E	FY13E	FY14E	Income Statement - Quarterly	1Q12A	2Q12A	3Q12A	4Q12E
Revenues	34	47	50	165	Revenues	11A	12A	11A	12
Cost of products sold	101	125	151	182	Cost of products sold	32A	29A	31A	33
Gross profit	(66)	(78)	(101)	(17)	Gross profit	(20)A	(17)A	(20)A	(21)
SG&A	14	16	18	23	SG&A	4A	4A	4A	4
R&D	32	151	182	218	R&D	31A	33A	125A	-
Operating Income	(81)	(94)	(120)	(51)	Operating income	(24)A	(20)A	(24)A	(26)
Note: EBITDA	(81)	(94)	(120)	(51)	Note: EBITDA	(24)A	(20)A	(24)A	(26)
Net interest income / (expense)	0	1	(1)	1	Net interest income / (expense)	0A	0A	1A	0
Other income / (expense)	-	-	-	-	Other income / (expense)	-	-	-	-
Pretax income	(80)	(92)	(120)	(49)	Pretax income	(23)A	(20)A	(23)A	(26)
Income taxes	0	(0)	0	0	Income taxes	0A	(0)A	0A	0
Net income - GAAP	-	-	-	-	Net income - GAAP	-	-	-	-
Net income - recurring	-	-	-	-	Net income - recurring	-	-	-	-
Diluted shares outstanding	11	72	99	104	Diluted shares outstanding	12A	91A	94A	94
EPS - excluding non-recurring	(7.67)	(2.88)	(1.21)	(0.48)	EPS - excluding non-recurring	(2.14)A	(0.22)A	(0.25)A	(0.27)
EPS - recurring	0.00	0.00	0.00	0.00	EPS - recurring	0.00A	0.00A	0.00A	0.00
Balance Sheet and Cash Flow Data	FY11A	FY12E	FY13E	FY14E	Ratio Analysis	FY11A	FY12E	FY13E	FY14E
Cash and cash equivalents	50	69	45	56	Sales growth	-	-	-	-
Accounts receivable	7	9	11	13	EBIT growth	-	-	-	-
Inventories	-	-	-	-	EPS growth	-	-	-	-
Other current assets	0	0	0	0	Gross margin	-	-	-	-
Current assets	66	87	67	82	EBIT margin	-	-	-	-
PP&E	6	7	8	10	EBITDA margin	-	-	-	-
Total assets	85	107	89	105	Tax rate	-	-	-	-
Total debt	-	-	-	-	Net margin	-	-	-	-
Total liabilities	26	26	26	26	Debt / EBITDA	-	-	-	-
Shareholders' equity	(22)	0	(18)	(2)	Debt / Capital (book)	-	-	-	-
Net income (including charges)	-	-	-	-	Return on assets (ROA)	-	-	-	-
D&A	-	-	-	-	Return on equity (ROE)	-	-	-	-
Change in working capital	-	-	-	-	Return on invested capital (ROIC)	-	-	-	-
Other	-	-	-	-	Enterprise value / sales	-	-	-	-
Cash flow from operations	-	-	-	-	Enterprise value / EBITDA	-	-	-	-
Capex	-	-	-	-	Free cash flow yield	-	-	-	-
Free cash flow	-	-	-	-					
Cash flow from investing activities	-	-	-	-					
Cash flow from financing activities	-	-	-	-					
Dividends	-	-	-	-					
Dividend yield	-	-	-	-					

Source: Company reports and J.P. Morgan estimates.

Note: \$ in millions (except per-share data). Fiscal year ends Dec

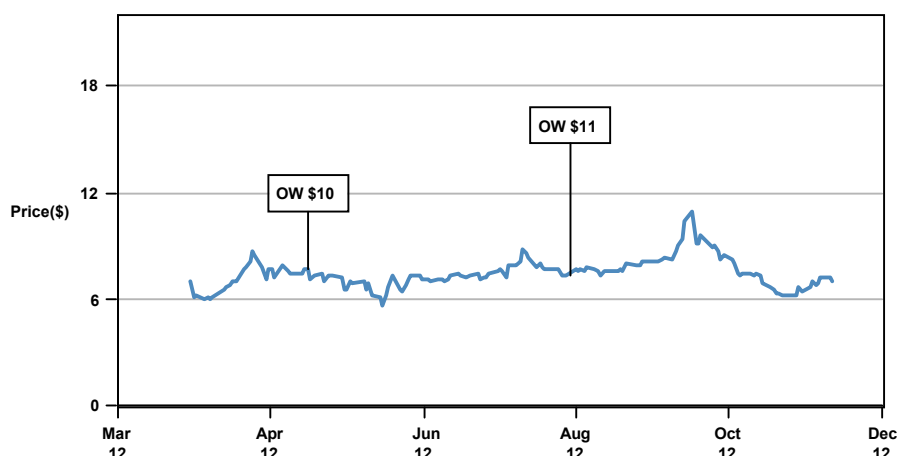
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Merrimack Pharmaceuticals (MACK, MACK US) Price Chart



Date	Rating	Share Price (\$)	Price Target (\$)
08-May-12	OW	7.62	10.00
10-Aug-12	OW	7.37	11.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
Initiated coverage May 08, 2012.

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IB clients*	69%	61%	53%

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