

August 13, 2012

HEALTHCARE/BIOTECHNOLOGY

Stock Rating:

OUTPERFORM

12-18 mo. Price Target \$16.00
VSTM - NASDAQ \$8.92

3-5 Yr. EPS Gr. Rate NM
52-Wk Range \$12.24-\$8.46
Shares Outstanding 19.9M
Float 8.3M
Market Capitalization \$180.3M
Avg. Daily Trading Volume 12,538
Dividend/Div Yield NM/NM
Book Value NM
Fiscal Year Ends Dec
2012E ROE NM
LT Debt \$0.0M
Preferred NA
Common Equity \$102,369M
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	(0.34)A	(0.35)	(0.36)	(1.50)	NM
Prior (E)	--	(0.30)	(0.31)	(0.34)	(1.38)	NM
2013E	--	--	--	--	(1.39)	NM
Prior (E)	--	--	--	--	(1.27)	NM

Verastem, Inc.

2Q12 Results; CSC Programs Remain On Track

SUMMARY

VSTM reported 2Q12 results. The company is on track to initiate a ph.II mesothelioma trial for recently acquired FAK inhibitor, VS-6063, in mid-2013. Although the success of the FAK program is difficult to handicap, we believe development in mesothelioma provides VSTM an accelerated timeline to proof-of-concept and potential regulatory approval. We continue to believe VS-6063 and in-house FAK inhibitor VS-4718, which will enter the clinic in 1Q13, have broad potential, given FAK's implicated role in tumorigenesis/metastasis and overexpression in a variety of cancer types. We see longer-term potential with PI3K/mTOR inhibitor VS-5584, slated to enter ph.I in 1Q13, and the preclinical Wnt program, partnered with Eisai. We are reiterating our Outperform and \$16 price target.

KEY POINTS

- **2Q loss per share of (\$0.34) was greater than our (\$0.30) est.** This was largely due to higher operating expense to support expanding clinical development and personnel costs. VSTM ended 2Q with \$104M in cash, which we estimate should be sufficient to fund operations until ph.II results for VS-6063 in 2H15.
- **VS-6063 progressing toward proof-of-concept.** VSTM will initiate a ph.II trial in mesothelioma, which exhibits high CSC incidence, and in merlin loss patients, who may be more sensitive to FAK inhibition. Positive initial PFS/OS results in 2H15 could provide validation for the CSC platform and support accelerated filing, given poor mortality with current mesothelioma therapies.
- **FAK program has broader potential.** We believe FAK inhibition has potential in several major solid cancers such as prostate. We believe VS-6063 and VS-4718 (has potentially greater CSC-selectivity) could be developed strategically in different indications. We also believe CSC-targeted therapies would show greatest benefit in the combo setting and expect VS-6063+chemo testing in 2014.
- **Additional programs progressing.** We expect ph.I VS-5584 results at YE2014. Despite limited prior data, we view PI3K/mTOR as validated targets in oncology. We expect the Wnt program to remain preclinical near-term and look for updates from VSTM/Eisai on a potential lead candidate over the next 12 months.
- **Model changes.** After 2Q12 results, we are adjusting our expense and share count estimates. Our new 2012 loss per share forecast is (\$1.50) vs. a prior (\$1.38).

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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Verastem Income Statement 2010A-2015E

Amounts in thousands, except per-share figures

	2012											
	2010A	2011A	1QA	2QA	Prior 2QE	3QE	4QE	2012E	Prior 2012E	2013E	2014E	2015E
Revenues:												
Product royalty	-	-	-	-	-	-	-	-	-	-	-	-
Other revenue	-	-	-	-	-	-	-	-	-	-	-	-
Total operating revenue	-	-	-	-	-	-	-	-	-	-	-	-
Operating expenses:												
Cost of goods	-	-	-	-	-	-	-	-	-	-	-	-
Research & development	400	9,883	4,803	4,683	4,350	4,800	5,100	19,386	18,853	19,750	21,050	22,450
Selling, general & administrative	384	3,815	2,125	2,213	2,050	2,238	2,258	8,834	8,350	9,011	9,281	9,559
Total operating expenses	784	13,698	6,928	6,896	6,400	7,038	7,358	28,220	27,203	28,761	30,331	32,009
Income (Loss) from operations	(784)	(13,698)	(6,928)	(6,896)	(6,400)	(7,038)	(7,358)	(28,220)	(27,203)	(28,761)	(30,331)	(32,009)
Other income (expense)	(2)	(17)	51	71	75	91	85	298	280	378	324	125
Pretax income (loss)	(786)	(13,715)	(6,877)	(6,825)	(6,325)	(6,947)	(7,273)	(27,922)	(26,923)	(28,383)	(30,007)	(31,885)
Income tax provision (benefit)	-	-	-	-	-	-	-	-	-	-	-	-
Net income (loss)	(786)	(13,715)	(6,877)	(6,825)	(6,325)	(6,947)	(7,273)	(27,922)	(26,923)	(28,383)	(30,007)	(31,885)
Basic & diluted net loss per share	(\$0.92)	(\$10.59)	(\$0.47)	(\$0.34)	(\$0.30)	(\$0.35)	(\$0.36)	(\$1.50)	(\$1.38)	(\$1.39)	(\$1.44)	(\$1.50)
Basic & diluted common shares outstanding (1)	850	1,295	14,693	19,863	21,109	19,963	20,063	18,646	19,543	20,463	20,863	21,263
(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 lead candidate VS-6063, a FAK inhibitor into ph.II testing in mid-2013. Based on early-stage data and compelling biological rationale, we believe FAK inhibition has broad anticancer potential across cancer types. 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 for the FAK and Wnt programs. We model a ~52% EBIT margin and ~30% tax rate in the out years, resulting a 2027 free cash flow of \$83M and estimated 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.

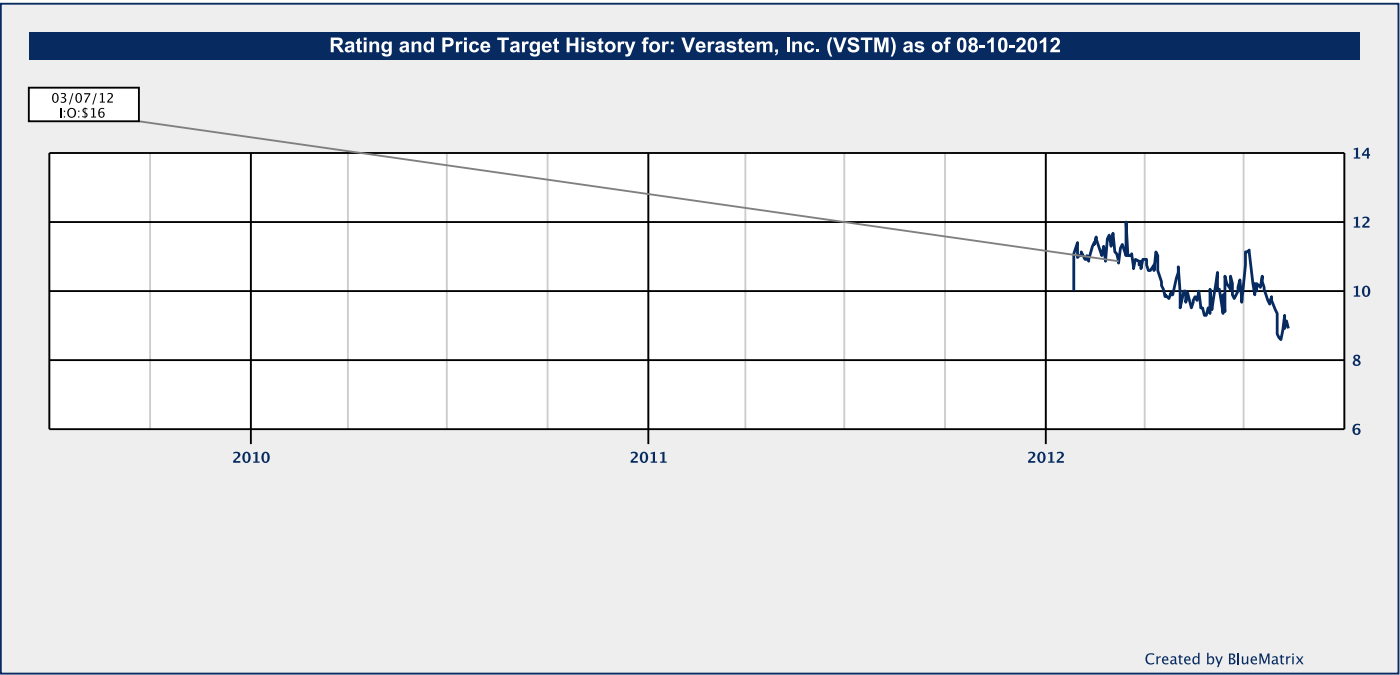
Stock prices of other companies mentioned in this report (as of 8/13/2012):
Eisai Co. Ltd. (ESALY-NASDAQ, \$45.39, Not Rated)

Important Disclosures and Certifications

Analyst Certification - The author certifies that this research report accurately states his/her personal views about the subject securities, which are reflected in the ratings as well as in the substance of this report. The author certifies that no part of his/her compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in this research report.

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Sell - anticipates that the shares will depreciate 10% or more in price within the next 12 months, due to fundamental weakness perceived in the company or for valuation reasons, or are expected to perform significantly worse than equities within the peer group.

Distribution of Ratings/IB Services Firmwide				
Rating	IB Serv/Past 12 Mos.			
	Count	Percent	Count	Percent
OUTPERFORM [O]	322	56.10	135	41.93
PERFORM [P]	249	43.38	88	35.34
UNDERPERFORM [U]	3	0.52	1	33.33

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