

UBS Investment Research

First Read: Verastem

Updates From Meeting With New CMO

■ What's new? We met with Verastem's new Chief Medical Officer

We met with Verastem management, including new CMO Dr. Joanna Horobin, who was previously the President/CEO at Syndax Pharmaceuticals where she implemented the ph2 clinical development of entinostat in metastatic breast and lung cancer. Dr. Horobin brings with her over 30 years of drug development experience, including seminal work on taxol. We view her as an important addition to the Verastem team ahead of key ph2 clinical trial execution.

■ Focus on clinical endpoints, translational medicine

A topic of discussion was clinical endpoints, whereby PFS, though a "blunt instrument", will still likely be employed in certain settings. Although traditional tumor responses may not be appropriate for targeting cancer stem cells, duration of response should be useful. Further, patient selection will continue to be a primary focus. Indeed, Merlin-negative mesothelioma patients who responded to chemo should have increased FAK activity and therefore are candidates for VS-6063.

■ Thoughts: No major changes to core development program, or our thesis

Development priorities are essentially unchanged, although the expertise has improved. In our view, an experienced CMO was the critical addition to mgmt at this point. The primary focus remains on executing a full clinical program for VS-6063 for mesothelioma and other indications (breast, ovarian), while additional translational work is planned for VS-5584 as it moves toward ph1 studies in 2013.

■ Valuation: Buy rating with \$20 price target

We derive our price target using a DCF-based methodology.

Highlights (US\$m)	12/10	12/11	12/12E	12/13E	12/14E
Revenues	0	0	0	0	0
EBIT (UBS)	(1)	(14)	(29)	(31)	(35)
Net Income (UBS)	(1)	(14)	(28)	(31)	(34)
EPS (UBS, US\$)	(0.92)	(10.58)	(1.47)	(1.44)	(1.35)
Net DPS (UBS, US\$)	0.00	0.00	0.00	0.00	0.00
Profitability & Valuation	5-yr hist av.	12/11	12/12E	12/13E	12/14E
EBIT margin %	-	-	-	-	-
ROIC (EBIT) %	-	>500	>500	>500	>500
EV/EBITDA (core) x	-	-	-1.5	-1.5	-1.2
PE (UBS) x	-	-	NM	NM	NM
Net dividend yield %	-	-	0.0	0.0	0.0

Source: Company accounts, Thomson Reuters, UBS estimates. (UBS) valuations are stated before goodwill-related charges and other adjustments for abnormal and economic items at the analysts' judgement.

Valuations: based on an average share price that year, (E): based on a share price of US\$7.99 on 22 Oct 2012 19:38 EDT

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Global Equity Research

Americas

Biotechnology

12-month rating **Buy**
Unchanged

12m price target **US\$20.00**
Unchanged

Price **US\$7.99**

RIC: VSTM.O BBG: VSTM US

23 October 2012

Trading data

52-wk range	US\$12.01-7.99
Market cap.	US\$0.12bn
Shares o/s	14.7m (COM)
Free float	29%
Avg. daily volume ('000)	10
Avg. daily value (m)	US\$0.1

Balance sheet data 12/12E

Shareholders' equity	US\$0.08bn
P/BV (UBS)	1.9x
Net Cash (debt)	US\$0.09bn

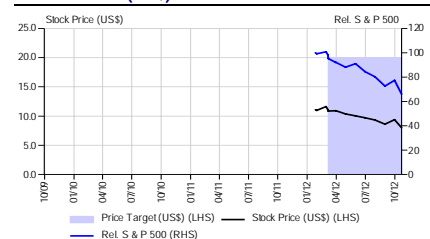
Forecast returns

Forecast price appreciation	+150.3%
Forecast dividend yield	0.0%
Forecast stock return	+150.3%
Market return assumption	5.3%
Forecast excess return	+145.0%

EPS (UBS, US\$)

	12/12E	12/11
	UBS	Cons. Actual
Q1	(0.47)	(0.47) (1.05)
Q2	(0.34)	(0.34) (1.88)
Q3E	(0.38)	(0.36) (2.74)
Q4E	(0.31)	(0.36) (4.56)
12/12E	(1.47)	(1.50)
12/13E	(1.44)	(1.60)

Performance (US\$)



Source: UBS

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ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 5.

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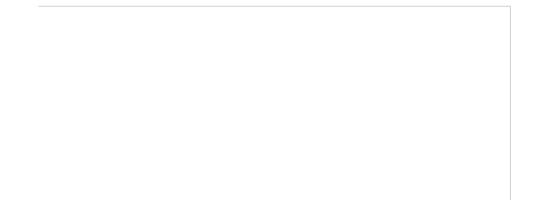
Income statement (US\$m)		12/09	12/10	12/11	12/12E	% ch	12/13E	% ch	12/14E	% ch
Revenues	-	-	0	0	0	-	0	-	0	-
Operating expenses (ex depn)	-	-	-	-	-	-	-	-	-	-
EBITDA (UBS)	-	-	(1)	(14)	(29)	109.1	(31)	9.1	(35)	10.5
Depreciation	-	-	0	0	0	-	0	-	0	-
Operating income (EBIT, UBS)	-	-	(1)	(14)	(29)	109.1	(31)	9.1	(35)	10.5
Other income & associates	-	-	0	0	0	-	0	-	0	-
Net interest	-	-	0	0	0	267900.0	0	-45.5	0	81.5
Abnormal items (pre-tax)	-	-	0	0	0	-	0	-	0	-
Profit before tax	-	-	(1)	(14)	(28)	107.1	(31)	9.6	(34)	10.2
Tax	-	-	0	0	0	-	0	-	0	-
Profit after tax	-	-	(1)	(14)	(28)	107.1	(31)	9.6	(34)	10.2
Abnormal items (post-tax)	-	-	0	0	0	-	0	-	0	-
Minorities / pref dividends	-	-	0	0	0	-	0	-	0	-
Net income (local GAAP)	-	-	(1)	(14)	(28)	107.1	(31)	9.6	(34)	10.2
Net Income (UBS)	-	-	(1)	(14)	(28)	107.1	(31)	9.6	(34)	10.2
Tax rate (%)	-	-	0	0	0	-	0	-	0	-
Pre-abnormal tax rate (%)	-	-	0	0	0	-	0	-	0	-
Per share (US\$)		12/09	12/10	12/11	12/12E	% ch	12/13E	% ch	12/14E	% ch
EPS (local GAAP)	-	-	(0.92)	(10.58)	(1.47)	-86.1	(1.44)	-2.3	(1.35)	-6.0
EPS (UBS)	-	-	(0.92)	(10.58)	(1.47)	-86.1	(1.44)	-2.3	(1.35)	-6.0
Net DPS	-	-	0.00	0.00	0.00	-	0.00	-	0.00	-
Cash EPS	-	-	(0.92)	(10.58)	(1.47)	-86.1	(1.44)	-2.3	(1.35)	-6.0
BVPS	-	-	2.50	45.94	4.27	-90.7	2.42	-43.2	3.82	57.7
Balance sheet (US\$m)		12/09	12/10	12/11	12/12E	% ch	12/13E	% ch	12/14E	% ch
Cash and equivalents	-	-	4	62	86	39.3	55	-35.7	99	79.0
Other current assets	-	-	0	0	0	109.1	0	9.1	0	16.9
Total current assets	-	-	4	62	86	39.3	55	-35.7	99	79.0
Net tangible fixed assets	-	-	0	1	1	104.3	2	54.5	3	39.7
Net intangible fixed assets	-	-	0	0	0	-	0	-	0	-
Investments / other assets	-	-	0	0	0	66.1	0	6.9	0	13.1
Total assets	-	-	4	63	88	40.2	58	-34.0	103	77.0
Trade payables & other ST liabilities	-	-	0	2	5	117.5	5	8.4	6	11.6
Short term debt	-	-	0	0	0	-	0	-	0	-
Total current liabilities	-	-	0	2	5	117.5	5	8.4	6	11.6
Long term debt	-	-	0	0	0	-	0	-	0	-
Other long term liabilities	-	-	0	1	1	-14.1	1	-34.9	0	-53.5
Total liabilities	-	-	0	3	6	69.9	6	0.5	6	3.9
Equity & minority interests	-	-	3	59	82	38.5	52	-36.3	97	84.8
Total liabilities & equity	-	-	4	63	88	40.2	58	-34.0	103	77.0
Cash flow (US\$m)		12/09	12/10	12/11	12/12E	% ch	12/13E	% ch	12/14E	% ch
Net income	-	-	(1)	(14)	(28)	107.1	(31)	9.6	(34)	10.2
Depreciation	-	-	0	0	0	-	0	-	0	-
Net change in working capital	-	-	0	2	2	41.4	0	-97.7	0	804.0
Other (operating)	-	-	0	1	1	0.0	1	0.0	1	0.0
Net cash from operations	-	-	0	(11)	(25)	123.4	(30)	19.4	(33)	9.0
Capital expenditure	-	-	0	(1)	(1)	-0.5	(1)	6.7	(1)	12.5
Net (acquisitions) / disposals	-	-	0	0	0	-	0	-	0	-
Other changes in investments	-	-	0	0	0	-	0	-	0	-
Cash from investing activities	-	-	0	(1)	(1)	-0.5	(1)	6.0	(1)	11.3
Increase/(decrease) in debt	-	-	4	60	0	-	0	-	0	-
Share issues / (repurchases)	-	-	0	0	57	-	0	-	79	-
Dividends paid	-	-	0	0	0	-	0	-	0	-
Other cash from financing	-	-	0	0	0	-	0	-	0	-
Cash from financing activities	-	-	4	60	57	-5.6	0	-	79	-
Cash flow chge in cash & equivalents	-	-	4	48	30	-	(31)	-	45	-
FX / non cash items	-	-	-	10	(6)	-	0	-	(1)	-
Bal sheet chge in cash & equivalents	-	-	-	58	24	-	(31)	-	44	-
Core EBITDA	-	-	(1)	(14)	(29)	109.1	(31)	9.1	(35)	10.5
Maintenance capital expenditure	-	-	0	(1)	(1)	-0.5	(1)	6.7	(1)	12.5
Maintenance net working capital	-	-	0	0	0	-	0	-	0	-
Operating free cash flow, pre-tax	-	-	(1)	(14)	(29)	103.4	(32)	9.0	(35)	10.5

Source: Company accounts, UBS estimates. (UBS) valuations are stated before goodwill-related charges and other adjustments for abnormal and economic items at the analysts' judgement. Note: For some companies, the data represents an extract of the full company accounts.

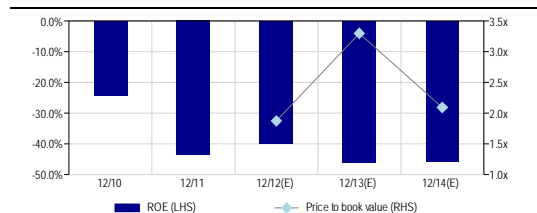
Company profile

Verastem is a Cambridge, Massachusetts-based early-stage biotechnology company focused on the discovery and development of novel small molecule drugs and companion diagnostics targeting cancer stem cells. The proprietary EMT screening platform, licensed from the Whitehead Institute at MIT, has helped select and identify the company's 3 leading candidates (VS-507, a Wnt inhibitor, and two FAK inhibitors VS-4718 and VS-5095). The company plans to begin human trials over the next 12-15 months for VS-507 and one of the two FAK inhibitors, and could be in phase II trials as early as 2015.

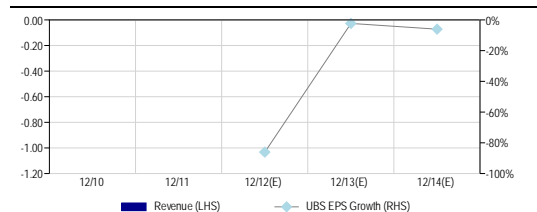
Profitability



ROE v Price to book value



Growth (UBS EPS)



Valuation (x)	5Yr Avg	12/10	12/11	12/12E	12/13E	12/14E
P/E (local GAAP)	-	-	-	NM	NM	NM
P/E (UBS)	-	-	-	NM	NM	NM
P/CEPS	-	-	-	NM	NM	NM
Net dividend yield (%)	-	-	-	0.0	0.0	0.0
P/BV	-	-	-	1.9	3.3	2.1
EV/revenue (core)	-	-	-	-	-	-
EV/EBITDA (core)	-	-	-	-1.5	-1.5	-1.2
EV/EBIT (core)	-	-	-	NM	NM	NM
EV/OpFCF (core)	-	-	-	NM	NM	NM
EV/op. invested capital	-	-	-	NM	NM	NM

Enterprise value (US\$m)	12/10	12/11	12/12E	12/13E	12/14E
Average market cap	-	-	117	117	117
+ minority interests	0	0	0	0	0
+ average net debt (cash)	(4)	(33)	(74)	(71)	(77)
+ pension obligations and other	0	0	0	0	0
- non-core asset value	0	0	0	0	0
Core enterprise value	-	-	43	47	40

Growth (%)	5Yr Avg	12/10	12/11	12/12E	12/13E	12/14E
Revenue	-	-	-	-	-	-
EBITDA (UBS)	-	-	NM	109.1	9.1	10.5
EBIT (UBS)	-	-	NM	109.1	9.1	10.5
EPS (UBS)	-	-	NM	-86.1	-2.3	-6.0
Cash EPS	-	-	NM	-86.1	-2.3	-6.0
Net DPS	-	-	-	-	-	-
BVPS	-	-	NM	-90.7	-43.2	57.7

Margins (%)	5Yr Avg	12/10	12/11	12/12E	12/13E	12/14E
EBITDA / revenue	-	-	-	-	-	-
EBIT / revenue	-	-	-	-	-	-
Net profit (UBS) / revenue	-	-	-	-	-	-

Return on capital (%)	5Yr Avg	12/10	12/11	12/12E	12/13E	12/14E
EBIT ROIC (UBS)	-	-	NM	NM	NM	NM
ROIC post tax	-	-	NM	NM	NM	NM
Net ROE	-	(24.2)	(43.7)	(40.0)	(46.1)	(45.8)

Coverage ratios (x)	5Yr Avg	12/10	12/11	12/12E	12/13E	12/14E
EBIT / net interest	-	-	-	-	-	-
Dividend cover (UBS EPS)	-	-	-	-	-	-
Div. payout ratio (% , UBS EPS)	-	-	-	-	-	-
Net debt / EBITDA	-	4.6	4.5	3.0	1.8	2.9

Efficiency ratios (x)	5Yr Avg	12/10	12/11	12/12E	12/13E	12/14E
Revenue / op. invested capital	-	-	0.0	0.0	0.0	0.0
Revenue / fixed assets	-	-	0.0	0.0	0.0	0.0
Revenue / net working capital	-	-	0.0	0.0	0.0	0.0

Investment ratios (x)	5Yr Avg	12/10	12/11	12/12E	12/13E	12/14E
OpFCF / EBIT	-	1.0	1.1	1.0	1.0	1.0
Capex / revenue (%)	-	-	-	-	-	-
Capex / depreciation	-	-	-	-	-	-

Capital structure (%)	5Yr Avg	12/10	12/11	12/12E	12/13E	12/14E
Net debt / total equity	-	NM	NM	NM	NM	NM
Net debt / (net debt + equity)	-	NM	NM	NM	NM	NM
Net debt (core) / EV	-	-	-	NM	NM	NM

Source: Company accounts, UBS estimates. (UBS) valuations are stated before goodwill-related charges and other adjustments for abnormal and economic items at the analysts' judgement.

Valuations: based on an average share price that year, (E): based on a share price of US\$7.99 on 22 Oct 2012 19:38 EDT Market cap(E) may include forecast share issues/buybacks.

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■ Verastem

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■ Statement of Risk

We see several risks to our Buy rating on VSTM shares. We see risk to our Buy rating if VS-705, VS-4718 and/or VS-5095 have unforeseen safety, tolerability or toxicity signals or fail to yield positive phase 1b clinical results. We also see downside risk if the companion diagnostic fails to identify the appropriate population or biomarkers to better quantify benefit/risk. Finally, we see further downside risk if competition shows better data with CSC-targeting therapies, which would potentially lessen the strategic value of Verastem's assets.

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UBS Investment Research: Global Equity Rating Allocations

UBS 12-Month Rating	Rating Category	Coverage ¹	IB Services ²
Buy	Buy	50%	31%
Neutral	Hold/Neutral	41%	31%
Sell	Sell	9%	20%
UBS Short-Term Rating	Rating Category	Coverage ³	IB Services ⁴
Buy	Buy	less than 1%	33%
Sell	Sell	less than 1%	0%

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 30 September 2012.

UBS Investment Research: Global Equity Rating Definitions

UBS 12-Month Rating	Definition
Buy	FSR is > 6% above the MRA.
Neutral	FSR is between -6% and 6% of the MRA.
Sell	FSR is > 6% below the MRA.
UBS Short-Term Rating	Definition
Buy	Buy: Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.
Sell	Sell: Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.

KEY DEFINITIONS

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

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Equity Price Targets have an investment horizon of 12 months.

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UBS Securities LLC: Matthew Roden, PhD; Leah Batkiewicz, PhD; Andrew Peters.

Company Disclosures

Company Name	Reuters	12-mo rating	Short-term rating	Price	Price date
Verastem ^{2, 4, 6, 16}	VSTM.O	Buy	N/A	US\$7.99	22 Oct 2012

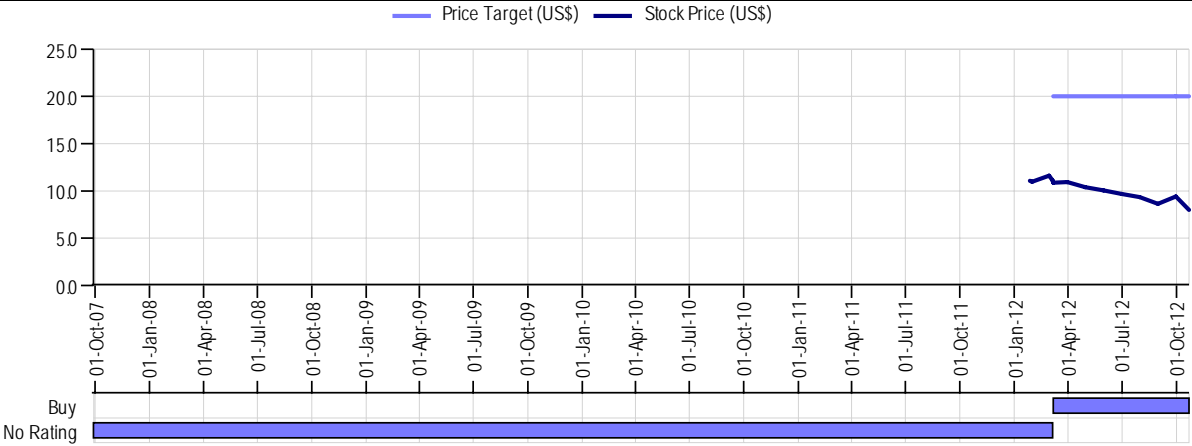
Source: UBS. All prices as of local market close.

Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

Verastem (US\$)



Source: UBS; as of 22 Oct 2012

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