UBS

UBS Investment Research

Verastem

Broadening and Deepening the Approach

■ Assets are accumulating: Unto which to invest?

We are reiterating our Buy rating on VSTM shares following the company's first R&D day, where 2 new assets were discussed as well as the existing pipeline. On value creation, Verastem is certainly ahead of schedule following the acquisition of the clinical-stage FAK inhibitor VS-6063. However, the acquisition of it and the preclinical candidate VS-5584 raises the question of capital allocation, so we were not surprised it has deferred development of VS-507 and VS-5095 in favor of the 3 most promising assets for mesothelioma, as well as breast and ovarian cancers.

■ Key points from the inaugural R&D day (see inside for more)

[1] Verastem's pipeline assets have broadened to 5, though only 3 will be invested in near term. [2] The FAK program is unambiguously the lead, while management seeks to optimize its Wnt pathway options. [3] The new assets enable Verastem to expand beyond its prior breast cancer focus. [4] Verastem's expertise enables it to add value to VS-6063, which didn't screen well with traditional cancer approaches.

■ Transitioning from proof of principle to clinical proof of concept 2013-14

Although the biological plausibility of Verastem's approach is obvious, clinical proof of concept data looks possible in 2014 for the FAK and PI3k/mTOR programs. Unlike prior communications, the company appears to not be conducting ph1b trials in selected triple-negative breast cancer patients, but it does have a cogent value creation plan, including a fast-to-market strategy in mesothelioma.

■ Valuation: Buy rating with $20 PT

We derive our price target using DCF methodology.

Highlights (US$m)	12/10	12/11	12/12E	12/13E	12/14E
Revenues	0	0	0	0	0
EBIT (UBS)	(1)	(14)	(27)	(30)	(33)
Net Income (UBS)	(1)	(14)	(27)	(29)	(32)
EPS (UBS, US$)	(0.92)	(10.58)	(1.36)	(1.47)	(1.37)
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	-	-	-2.6	-2.4	-1.9
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$9.87 on 10 Jul 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$9.87

RIC: VSTM.O BBG: VSTM US

12 July 2012

Trading data	
52-wk range	US$12.01-9.32
Market cap.	US$0.15bn
Shares o/s	14.7m (COM)
Free float	29%
Avg. daily volume ('000)	16
Avg. daily value (m)	US$0.2

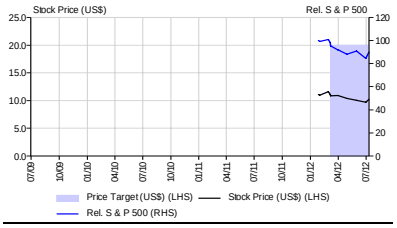
Balance sheet data 12/12E	
Shareholders' equity	US$0.08bn
P/BV (UBS)	2.3x
Net Cash (debt)	US$0.09bn

Forecast returns	
Forecast price appreciation	+102.6%
Forecast dividend yield	0.0%
Forecast stock return	+102.6%
Market return assumption	5.3%
Forecast excess return	+97.3%

EPS (UBS, US$)

	12/12E		12/11
	UBS	Cons.	Actual
Q1	(0.47)	(0.47)	(1.05)
Q2E	(0.32)	(0.31)	(1.88)
Q3E	(0.30)	(0.31)	(2.74)
Q4E	(0.31)	(0.33)	(4.56)
12/12E	(1.36)	*(1.36)*	
12/13E	(1.47)	*(1.32)*	

Performance (US$)



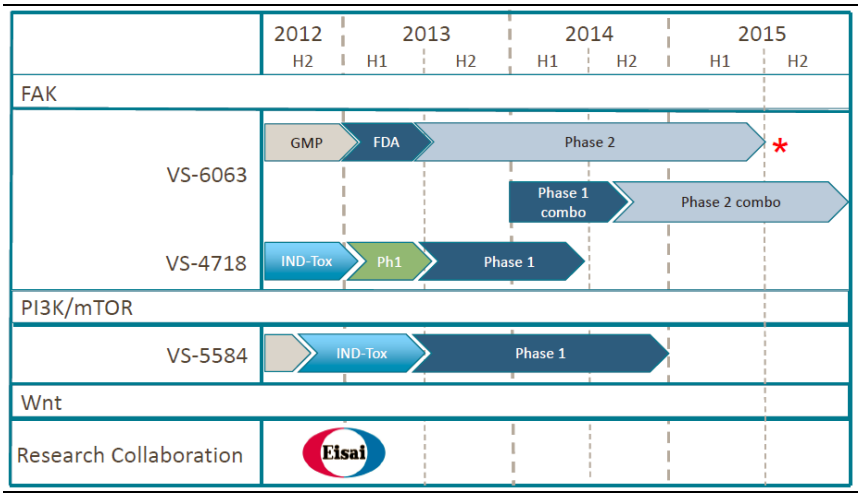
Source: UBS

www.ubs.com/investmentresearch

Targeting CSCs through 3 different pathways

Today's Verastem R&D day provided the scientific rationale for the new focus on FAK inhibition as the primary development target, as well as outlined clinical development plans over the next several years to get through proof-of-concept data without having to do a dilutive financing. Following the in-licensing of VS-6063 from Pfizer yesterday, FAK inhibition is now the primary target for the company, with VS-6063 and backup FAK inhibitor VS-4718 expected to be in clinical trials by mid-2013. Further, Verastem now expects VS-5584, a dual PI3K/mTOR inhibitor to begin phase 1 trials in 2013 as well. The result of this newly accelerated development plan however, is that the previous lead candidate, Wnt-inhibitor VS-507 has been de-prioritized and partnered with Eisai as part of a research collaboration to develop optimized analogs of VS-507 that may have improved pharmacologic properties from the original compound. Overall, we view the recent corporate progress as a step forward that accelerated the path to value creation. While early data indicate the path forward for VS-6063 in mesothelioma is promising, we believe additional data validating the CSC-targeting approach will be needed for a true valuation step-up.

Figure 1: Verastem Clinical Development Plan – 3 Ways to Win with anti-CSCs



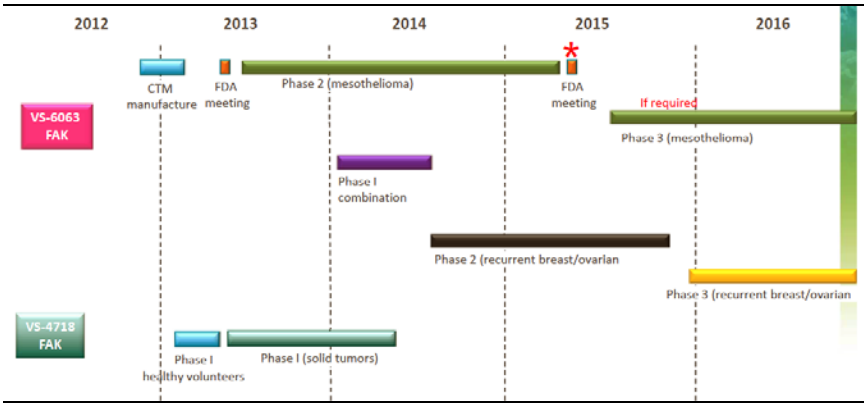
Source: Company reports and UBS research

Leading the way in FAK inhibition

Verastem has planned an aggressive development strategy for its FAK inhibition program, with the newly licensed VS-6063 having accelerated development timelines by ~12-18 months. The company highlighted that FAK (Focal Adhesion Kinase) is over-expressed in advanced stage cancers across many tumor types (primarily invasive, metastatic tumors), and FAK inhibitors screen very well in Verastem's proprietary cancer stem cell assays. Given the implicated role of facilitating CSC self-renewal and tumor growth, it is possible that FAK inhibition could reduction both the primary tumor mass as well as the cancer stem cells. We note that scientific co-founded Dr. Robert Weinberg spoke at the R&D day about the need to target both cell populations, making FAK inhibition especially attractive.

Following the acquisition of the Pfizer FAK assets (and related IP), Verastem is now one of three companies developing FAK inhibitors, with GlaxoSmithKline having presented data from their phase 1 FAK program (GSK2256098) at ASCO in June. Similar to the Pfizer (now Verastem) data, the phase 1 '098 trial saw signs of activity, including stable disease despite the phase 1 trial design. Importantly, based on the data presented, of the 57 patients enrolled in the trial, 23 (40%) had mesothelioma, the primary indication Verastem is targeting with their FAK. Further, patients with mesothelioma were among the tumor types that saw responses in the trial. This is not surprising however, given that CSCs have been identified in 90% of human mesothelioma patient samples, and that patients refractory to standard of care (pemetrexed) have been found to have CSC-enriched tumors.

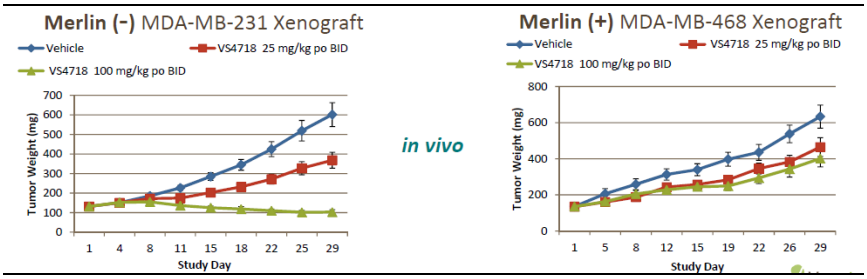
Figure 2: FAK inhibitor proposed development plan



Source: Company reports and UBS research

Verastem has proposed an accelerated development plan for VS-6063 (Figure 2 above), with mesothelioma the primary focus. A phase 2 study is expected to start mid-2013, with PFS likely the primary endpoint, although patients will be evaluated for OS, response rates, and biomarker data as well. Importantly, the company will try to enrich as well as stratify patients by Merlin protein status, whose absence has been correlated with increased efficacy of FAK inhibitors in pre-clinical models (Figure 3). We believe the development plan is well aligned and consistent with the company's underlying corporate strategy as it targets tumor types enriched for CSCs, and has established biomarkers (Merlin, phosphor-FAK) that further increase the likelihood that day will play out favorably.

Figure 3: FAK inhibitor efficacy is impacted by Merlin protein status



Source: Company reports and UBS research

In addition to mesothelioma, Verastem plans to start combination trials in other tumor types (likely breast or ovarian cancer) that are enriched for CSCs, and are impacted by Merlin status. We note preclinical work is ongoing to determine if sequencing the combination is likely the best strategy (i.e. first de-bulk the tumor mass and then target the CSCs), although we do not expect near-term resolution of this question.

Also entering the PI3K/mTOR fray

In addition to targeting FAK, Verastem plans to initiate a phase 1 study in healthy volunteers for their recently acquired dual PI3K/mTOR inhibitor VS-5584 (acquired from S*BIO in 2Q12). Similar to the FAK program, the PI3K/mTOR pathway plays a key role in CSC survival, with PI3K mutations seen in ~50% of breast cancers and 25% of colon cancer. Further, PTEN (mTOR) loss is seen in up to 70% of prostate cancer, and ~40% of glioblastoma patients. The company views VS-5584 as a potentially best-in-class asset, with equivalent potency, high selectivity, and excellent PK/PD. Importantly however, VS-5584 targets cancer stem cells and screens well on Verastem's proprietary screening platform. The company plans to initiate both a phase 1 monotherapy dose escalation study as well as a combination study with standard of care. We note however that the company guided that the development strategy will continue to be defined as additional data is generated on the CSC data.

VS-507 is still a viable asset

Following the R&D day we spoke with management who again reiterated that the de-prioritization of VS-507 was the result of a pipeline/portfolio review and capital allocation strategy, and was not caused by any deleterious safety or efficacy signals seen in the preclinical data. Management seems committed to staying within previous guidance on use of cash, and in order to fund the phase 1 and 2 FAK programs as well as the phase 1 PI3K/mTOR, the Wnt program was de-prioritized and partnered with Esai to see if additional chemical optimization can be performed to improve on VS-507s existing profile. We understand investor confusion, but believe the de-prioritization supports the view that FAK provides the quickest path to value creation, and leverages the company's core competencies and development focus.

Verastem

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)	(27)	*97.6*	(30)	*9.0*	(33)	*10.4*
Depreciation	-	-	-	0	0	0	-	0	-	0	-
Operating income (EBIT, UBS)	-	-	-	(1)	(14)	(27)	*97.6*	(30)	*9.0*	(33)	*10.4*
Other income & associates	-	-	-	0	0	0	-	0	-	0	-
Net interest	-	-	-	0	0	0	*217900.0*	0	*-33.0*	0	*81.5*
Abnormal items (pre-tax)	-	-	-	0	0	0	-	0	-	0	-
Profit before tax	-	-	-	(1)	(14)	(27)	*96.0*	(29)	*9.4*	(32)	*10.1*
Tax	-	-	-	0	0	0	-	0	-	0	-
Profit after tax	-	-	-	(1)	(14)	(27)	*96.0*	(29)	*9.4*	(32)	*10.1*
Abnormal items (post-tax)	-	-	-	0	0	0	-	0	-	0	-
Minorities / pref dividends	-	-	-	0	0	0	-	0	-	0	-
Net income (local GAAP)	-	-	-	(1)	(14)	(27)	*96.0*	(29)	*9.4*	(32)	*10.1*
Net Income (UBS)	-	-	-	(1)	(14)	(27)	*96.0*	(29)	*9.4*	(32)	*10.1*
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)	(1.36)	*-87.2*	(1.47)	*8.3*	(1.37)	*-7.1*
EPS (UBS)	-	-	-	(0.92)	(10.58)	(1.36)	*-87.2*	(1.47)	*8.3*	(1.37)	*-7.1*
Net DPS	-	-	-	0.00	0.00	0.00	-	0.00	-	0.00	-
Cash EPS	-	-	-	(0.92)	(10.58)	(1.36)	*-87.2*	(1.47)	*8.3*	(1.37)	*-7.1*
BVPS	-	-	-	2.50	45.94	4.23	*-90.8*	2.78	*-34.4*	4.37	*57.5*

Balance sheet (US$m)	-	-	12/09	12/10	12/11	12/12E	% ch	12/13E	% ch	12/14E	% ch
Cash and equivalents	-	-	-	4	62	87	*41.0*	58	*-33.3*	105	*80.9*
Other current assets	-	-	-	0	0	0	*97.6*	0	*9.0*	0	*10.4*
Total current assets	-	-	-	4	62	87	*41.0*	58	*-33.3*	105	*80.8*
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	0	*59.1*	0	*6.8*	0	*8.0*
Total assets	-	-	-	4	63	89	*41.8*	61	*-31.7*	109	*78.9*
Trade payables & other ST liabilities	-	-	-	0	2	4	*106.5*	5	*8.3*	5	*5.3*
Short term debt	-	-	-	0	0	0	-	0	-	0	-
Total current liabilities	-	-	-	0	2	4	*106.5*	5	*8.3*	5	*5.3*
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	5	*62.9*	5	*0.1*	5	*-2.0*
Equity & minority interests	-	-	-	3	59	84	*40.6*	55	*-33.8*	103	*86.7*
Total liabilities & equity	-	-	-	4	63	89	*41.8*	61	*-31.7*	109	*78.9*

Cash flow (US$m)	-	-	12/09	12/10	12/11	12/12E	% ch	12/13E	% ch	12/14E	% ch
Net income	-	-	-	(1)	(14)	(27)	*96.0*	(29)	*9.4*	(32)	*10.1*
Depreciation	-	-	-	0	0	0	-	0	-	0	-
Net change in working capital	-	-	-	0	2	2	*25.9*	0	*-98.6*	0	*348.2*
Other (operating)	-	-	-	0	1	1	*0.0*	1	*0.0*	1	*0.0*
Net cash from operations	-	-	-	0	(11)	(24)	*112.1*	(29)	*18.7*	(31)	*10.0*
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	32	-	(29)	-	46	-
FX / non cash items	-	-	-	-	10	(6)	-	0	-	1	*58.0*
Bal sheet chge in cash & equivalents	-	-	-	-	58	25	-	(29)	-	47	-
Core EBITDA	-	-	-	(1)	(14)	(27)	*97.6*	(30)	*9.0*	(33)	*10.4*
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)	(28)	*92.5*	(30)	*9.0*	(33)	*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.

Verastem

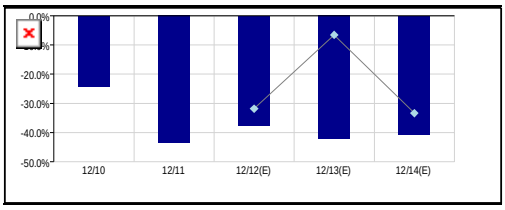
12-month rating	Buy
12m price target	US$20.00

Company profile

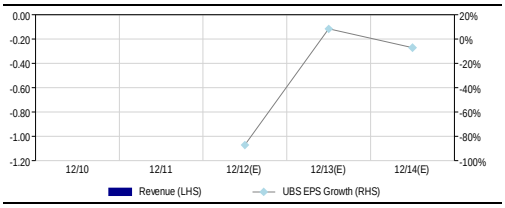
Verastem is a Cambridge, Massachusetts-based early-stage biotechnology company focused on the discovery and development of novel small molecule drugs and companion diagnostics targeting cancer stem cells. The proprietary EMT screening platform, licensed from the Whitehead Institute at MIT, has helped 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	-	-	-	2.3	3.6	2.3
EV/revenue (core)	-	-	-	-	-	-
EV/EBITDA (core)	-	-	-	-2.6	-2.4	-1.9
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		-	-	145	145	145
+ minority interests		0	0	0	0	0
+ average net debt (cash)		(4)	(33)	(74)	(73)	(82)
+ pension obligations and other		0	0	0	0	0
- non-core asset value		0	0	0	0	0
Core enterprise value		-	-	70	72	63

Growth (%)	5Yr Avg	12/10	12/11	12/12E	12/13E	12/14E
Revenue	-	-	-	-	-	-
EBITDA (UBS)	-	-	NM	97.6	9.0	10.4
EBIT (UBS)	-	-	NM	97.6	9.0	10.4
EPS (UBS)	-	-	NM	-87.2	8.3	-7.1
Cash EPS	-	-	NM	-87.2	8.3	-7.1
Net DPS	-	-	-	-	-	-
BVPS	-	-	NM	-90.8	-34.4	57.5

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)	(37.5)	(42.2)	(40.7)

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	3.2	2.0	3.2

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$9.87 on 10 Jul 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.

■ Analyst Certification

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UBS Investment Research: Global Equity Rating Allocations

UBS 12-Month Rating	Rating Category	Coverage[1]	IB Services[2]
Buy	**Buy**	55%	33%
Neutral	**Hold/Neutral**	37%	31%
Sell	**Sell**	8%	16%
UBS Short-Term Rating	**Rating Category**	**Coverage[3]**	**IB Services[4]**
Buy	**Buy**	less than 1%	0%
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 June 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.

Short-Term Ratings reflect the expected near-term (up to three months) performance of the stock and do not reflect any change in the fundamental view or investment case.

Equity Price Targets have an investment horizon of 12 months.

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UK and European Investment Fund ratings and definitions are: Buy: Positive on factors such as structure, management, performance record, discount; Neutral: Neutral on factors such as structure, management, performance record, discount; Sell: Negative on factors such as structure, management, performance record, discount.

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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$10.01	12 Jul 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

2. UBS AG, its affiliates or subsidiaries has acted as manager/co-manager in the underwriting or placement of securities of this company/entity or one of its affiliates within the past 12 months.
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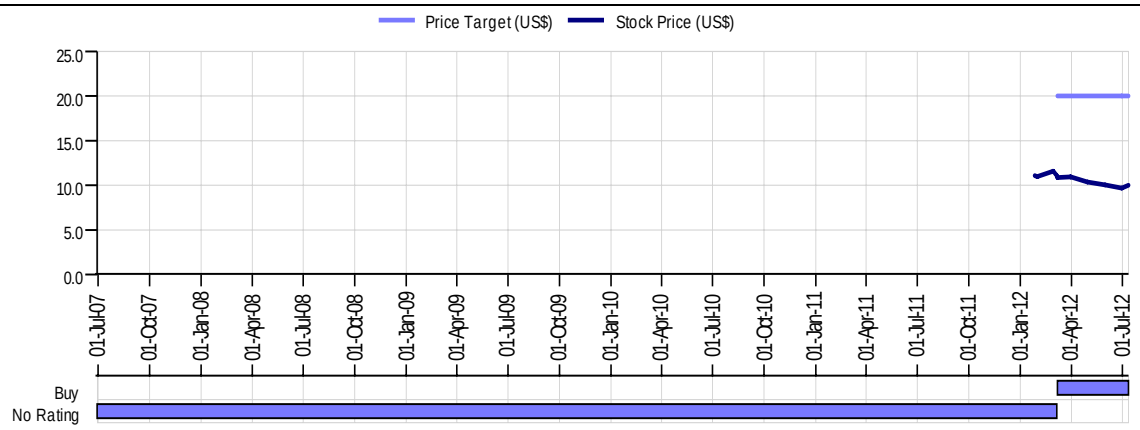
Verastem (US$)



Source: UBS; as of 12 Jul 2012

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