

## UBS Investment Research

### Verastem

## Updating Model on 2Q12 Results

### ■ What's new? 2Q12 results; expect 3 programs in clinic by 2013

Verastem reported an in-line 2Q12 with EPS of (\$0.34) vs. consensus (\$0.34) and UBSe (\$0.32). While near-term financial results are not a key driver for the stock, we believe the company is managing opex well, and that management has said the ~\$104m reported at the end of 2Q12 will last through 2015 and proof-of-concept (POC) data. Following the licensing deal with Pfizer, Verastem is poised to launch three clinical programs in 2013 (VS-6063, VS-4718, VS-5584), with the ph2 mesothelioma trial for VS-6063 providing a path toward accelerated approval.

### ■ Wnt pathway still in the works: prioritizing resources a good thing

One of the most common questions we got following the July R&D day was on the de-prioritization of lead program VS-507 (Wnt inhibitor). In our view, given the pace of development and flurry of business development activity at Verastem, it is not surprising that fiscal restraint was shown and resources are now being guided toward more advanced targets. While mesothelioma is unambiguously the lead, we believe both '4718 and '5584 could target selected triple-negative breast cancer patients given the biologic rationale for targeting CSCs in these patients.

### ■ Thoughts: Model changes limited on in-line quarter

With 2Q12 results in line with expectations (lower share count key difference vs. UBSe), we are only modestly revising our model. Focusing development on smaller indications can help maintain opex spend and cash balances through POC.

### ■ Valuation: Buy rating with \$20 price target

We derive our price target using 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	-	-	-1.7	-1.7	-1.3
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\$8.35 on 15 Aug 2012 18:41 EDT

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## Global Equity Research

Americas

Biotechnology

12-month rating **Buy**  
**Unchanged**

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

Price **US\$8.35**

RIC: VSTM.O BBG: VSTM US

16 August 2012

### Trading data

52-wk range	US\$12.01-8.02
Market cap.	US\$0.12bn
Shares o/s	14.7m (COM)
Free float	29%
Avg. daily volume ('000)	13
Avg. daily value (m)	US\$0.1

### Balance sheet data 12/12E

Shareholders' equity	US\$0.08bn
P/BV (UBS)	2.0x
Net Cash (debt)	US\$0.09bn

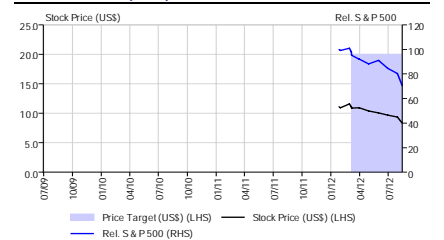
### Forecast returns

Forecast price appreciation	+139.5%
Forecast dividend yield	0.0%
Forecast stock return	+139.5%
Market return assumption	5.3%
Forecast excess return	+134.2%

### EPS (UBS, US\$)

	12/12E		12/11	
	From	To	Cons.	Actual
Q1	(0.47)	(0.47)	(0.47)	(1.05)
Q2	(0.32)	(0.34)	(0.34)	(1.88)
Q3E	(0.30)	(0.38)	(0.34)	(2.74)
Q4E	(0.31)	(0.31)	(0.36)	(4.56)
12/12E	(1.36)	(1.47)	(1.50)	
12/13E	(1.47)	(1.44)	(1.57)	

### Performance (US\$)



Source: UBS

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ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 6.

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Table 1: 2Q12 Verastem results vs. consensus and UBSe expectations

	2Q12 Actual	2Q12 Consensus	2Q12 UBSe	Actual vs. Consensus	Actual vs. UBSe
<b>Revenues</b>					
<b>Total revenues</b>	0	0	0	0	0
<b>Operating Expenses</b>					
Cost of Goods Sold	0		0		0
Research & Development	4,683		4,722		(39)
General & Administrative	2,213		2,150		63
<b>Total Operating Expenses</b>	<b>6,896</b>		<b>6,872</b>		<b>24</b>
<b>Operating Income</b>	<b>(6,896)</b>		<b>(6,872)</b>		<b>(24)</b>
Investment Income	71		54		17
Interest Expense	0		0		0
<b>Pretax Income (Loss)</b>	<b>(6,825)</b>		<b>(6,818)</b>		<b>(7)</b>
Income tax provision	0		0		0
<b>Net Income (Loss)</b>	<b>(6,825)</b>		<b>(6,818)</b>		<b>(7)</b>
Redeemable preferred stock accretion	0				0
<b>Net Income (Loss) for EPS</b>	<b>(6,825)</b>		<b>(6,818)</b>		<b>(7)</b>
EPS basic	(\$0.34)		(\$0.32)		(\$0.02)
<b>EPS diluted</b>	<b>(\$0.34)</b>	<b>(\$0.34)</b>	<b>(\$0.32)</b>	<b>(\$0.00)</b>	<b>(\$0.02)</b>
Shares Outstanding (Basic)	19,863		21,259		(1,396)
Shares Outstanding (Diluted)	19,863		21,259		(1,396)

Source: Company reports and UBS estimates

Table 2: Post-2Q12 Verastem model changes

	2012E	2013E	2014E	2015E	2016E
Total revenues - New	-	-	-	15,000	15,000
Total revenues - Old	-	-	-	15,000	15,000
<i>Change</i>	-	-	-	-	-
<b>Operating Expenses</b>					
Cost of Goods Sold - New	-	-	-	-	-
Cost of Goods Sold - Old	-	-	-	-	-
<i>Change</i>	-	-	-	-	-
Research & Development - New	19,802	21,782	24,396	28,055	33,667
Research & Development - Old	18,419	20,261	22,692	26,096	31,837
<i>Change</i>	1,383	1,521	1,704	1,959	1,829
General & Administrative - New	8,839	9,458	10,120	10,929	12,569
General & Administrative - Old	8,650	9,256	9,903	10,696	12,300
<i>Change</i>	189	202	216	234	269
Total Operating Expenses - New	28,641	31,240	34,516	38,985	46,235
Total Operating Expenses - Old	27,069	29,516	32,596	36,792	44,137
<i>Change</i>	1,572	1,724	1,920	2,193	2,098
Operating Income - New	(28,641)	(31,240)	(34,516)	(23,985)	(31,235)
Operating Income - Old	(27,069)	(29,516)	(32,596)	(21,792)	(29,137)
<i>Change</i>	(1,572)	(1,724)	(1,920)	(2,193)	(2,098)
Net Income (Loss) for EPS - New	(28,379)	(31,094)	(34,251)	(23,393)	(30,782)
Net Income (Loss) for EPS - Old	(26,851)	(29,370)	(32,331)	(21,200)	(28,684)
<i>Change</i>	(1,528)	(1,724)	(1,920)	(2,193)	(2,098)
EPS (GAAP - diluted) - New	(\$1.50)	(\$1.44)	(\$1.35)	(\$0.91)	(\$1.19)
EPS (GAAP - diluted) - Old	(\$1.40)	(\$1.47)	(\$1.37)	(\$0.89)	(\$1.19)
<i>Change</i>	(\$0.10)	\$0.04	\$0.02	(\$0.03)	(\$0.00)
Shares Outstanding (Diluted) - New	19,315	21,666	25,382	25,636	25,892
Shares Outstanding (Diluted) - Old	19,768	19,965	23,665	23,902	24,141
<i>Change</i>	(453)	1,700	1,717	1,735	1,752

Source: Company reports and UBS estimates

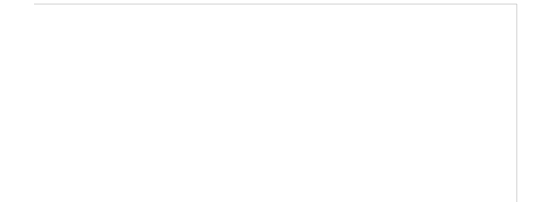
Income statement (US\$m)	-	-	12/09	12/10	12/11	12/12E	% ch	12/13E	% ch	12/14E	% ch
Revenues	-	-	-	0	0	0	-	0	-	0	-
Operating expenses (ex depn)	-	-	-	-	-	-	-	-	-	-	-
EBITDA (UBS)	-	-	-	(1)	(14)	(29)	109.1	(31)	9.1	(35)	10.5
Depreciation	-	-	-	0	0	0	-	0	-	0	-
Operating income (EBIT, UBS)	-	-	-	(1)	(14)	(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	3.88	60.4
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	101	81.5
Other current assets	-	-	-	0	0	0	109.1	0	9.1	0	10.5
Total current assets	-	-	-	4	62	86	39.3	55	-35.7	101	81.4
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	66.1	0	6.9	0	8.2
Total assets	-	-	-	4	63	88	40.2	58	-34.0	104	79.3
Trade payables & other ST liabilities	-	-	-	0	2	5	117.5	5	8.4	5	5.7
Short term debt	-	-	-	0	0	0	-	0	-	0	-
Total current liabilities	-	-	-	0	2	5	117.5	5	8.4	5	5.7
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	-1.4
Equity & minority interests	-	-	-	3	59	82	38.5	52	-36.3	99	87.9
Total liabilities & equity	-	-	-	4	63	88	40.2	58	-34.0	104	79.3
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	203.3
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)	10.1
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)	-	44	-
FX / non cash items	-	-	-	-	10	(6)	-	0	-	1	56.5
Bal sheet chge in cash & equivalents	-	-	-	-	58	24	-	(31)	-	45	-
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.

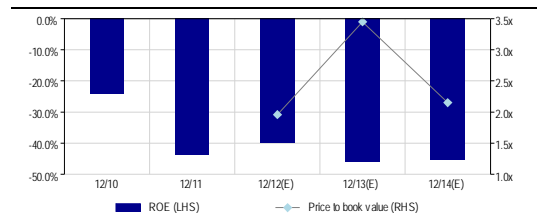
## Company profile

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.

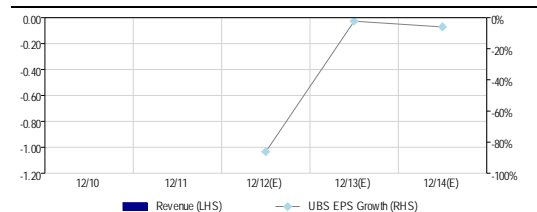
## Profitability



## 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	-	-	-	2.0	3.4	2.1
EV/revenue (core)	-	-	-	-	-	-
EV/EBITDA (core)	-	-	-	-1.7	-1.7	-1.3
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	-	-	123	123	123
+ minority interests	0	0	0	0	0
+ average net debt (cash)	(4)	(33)	(74)	(71)	(78)
+ pension obligations and other	0	0	0	0	0
- non-core asset value	0	0	0	0	0
Core enterprise value	-	-	49	52	45

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	60.4

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)	(45.3)

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.

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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 <sup>1</sup>	IB Services <sup>2</sup>
Buy	Buy	55%	33%
Neutral	Hold/Neutral	37%	31%
Sell	Sell	8%	16%
UBS Short-Term Rating	Rating Category	Coverage <sup>3</sup>	IB Services <sup>4</sup>
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.

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**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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**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 <sup>2, 4, 6, 16</sup>	VSTM.O	Buy	N/A	US\$8.35	15 Aug 2012

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

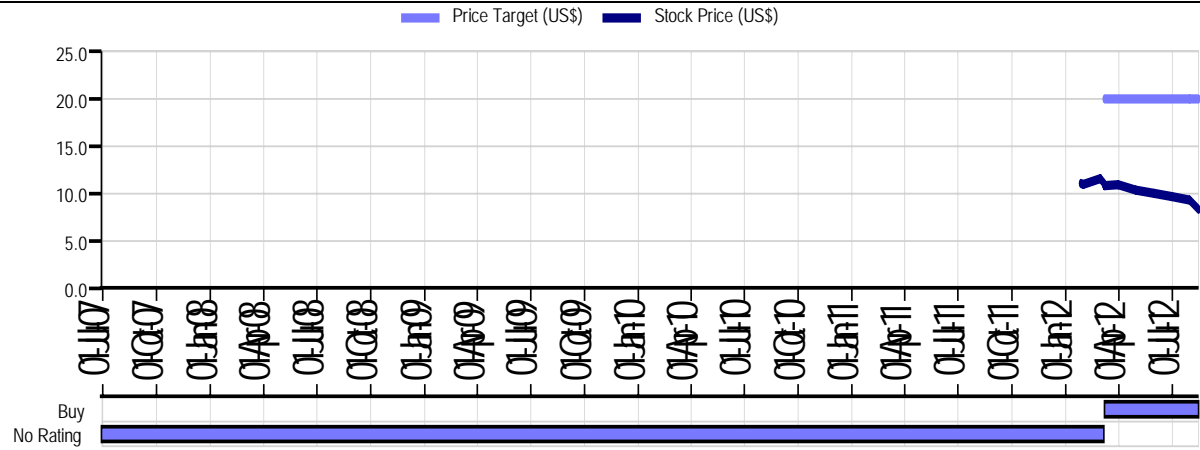
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Verastem (US\$)



Source: UBS; as of 15 Aug 2012

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