

UBS Investment Research

Verastem

Continuing to Broaden CSC Pipeline

■ What's new? 1Q12 results, continuing to round out CSC pipeline

Verastem reported 1Q12 results, including the in-licensing of a novel mTOR/PI3k inhibitor from S*Bio. We spoke with the company who noted the transaction is consistent with previous deals and was driven by the company's cancer stem cell screening (CSC) technology. We like the deal as it complements and broadens the pipeline with more CSC-implicated targets. As we noted previously, there are many ways to win, and we believe adding shots on goal through its proprietary screening methodology (while maintaining cost discipline) is a sound strategy.

■ Timing remains on-track: abstract at ASCO to support strategy

IND-enabling studies are continuing on track for the lead programs VS-507 (Wnt) and VS-4718/5095 (FAK), with phase I data possible as early as YE13 (UBSe). Following poster presentations at AACR, we expect the company to present further data at ASCO in June, highlighting progress in biomarker development.

■ Thoughts: New paradigms take time, expect continued investment

Our thesis on Verastem remains unchanged following the quarter. While OpEx was higher than expected, we note that 1Q12 results include ~\$2m in non-cash items, bringing total spend closer to expectations. Importantly, management reiterated cash-spend guidance consistent with a 2016 run-rate (\$109m in cash as of 1Q12). We believe continued investment in the pipeline is important, and view 1Q12 results as reflective of a baseline run-rate moving forward.

■ Valuation: Buy with \$20 PT by DCF and discounted multiple on sales

We have updated our model to reflect 1Q12 results, which is outlined on page 3.

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	-2.5	-2.0
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\$9.94 on 11 May 2012 19:38 EDT

Matthew Roden, PhD

Analyst
matthew.roden@ubs.com
+1-212-713 2491

Leah Batkiewicz, PhD

Associate Analyst
leah.batkiewicz@ubs.com
+1-212-713 4105

Andrew Peters

Associate Analyst
andrew.peters@ubs.com
+1-212-713 3241

Global Equity Research

Americas

Biotechnology

12-month rating **Buy**
Unchanged

12m price target US\$20.00
Unchanged

Price US\$9.94

RIC: VSTM.O BBG: VSTM US

14 May 2012

Trading data

52-wk range	US\$12.01-9.49
Market cap.	US\$0.15bn
Shares o/s	14.7m (COM)
Free float	29%
Avg. daily volume ('000)	27
Avg. daily value (m)	US\$0.3

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	+101.2%
Forecast dividend yield	0.0%
Forecast stock return	+101.2%
Market return assumption	5.3%
Forecast excess return	+95.9%

EPS (UBS, US\$)

	12/12E		12/11
	From	To	Cons. Actual
Q1	(0.20)	(0.47)	(0.28) (1.05)
Q2E	(0.20)	(0.32)	(0.22) (1.88)
Q3E	(0.21)	(0.30)	(0.23) (2.74)
Q4E	(0.21)	(0.31)	(0.24) (4.56)
12/12E	(0.82)	(1.36)	(0.95)
12/13E	(1.06)	(1.47)	(1.03)

Performance (US\$)



Source: UBS

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This report has been prepared by UBS Securities LLC

ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 6.

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Table 1: Verastem 1Q12 results vs. UBSe and Consensus expectations

	1Q12 Actual	1Q12 UBSe	Actual vs. UBSe
Revenues			
Total revenues	0	0	0
Operating Expenses			
Cost of Goods Sold	0	0	0
Research & Development	4,803	3,300	1,503
General & Administrative	2,125	1,100	1,025
Total Operating Expenses	6,928	4,400	2,528
Operating Income	(6,928)	(4,400)	(2,528)
Investment Income	57	117	(60)
Interest Expense	0	0	0
Pretax Income (Loss)	(6,871)	(4,283)	(2,588)
Income tax provision	0	0	0
Net Income (Loss)	(6,871)	(4,283)	(2,588)
Redemable preferred stock accretion	(6)		(6)
Net Income (Loss) for EPS	(6,877)	(4,283)	(2,594)
EPS basic	(\$0.47)	(\$0.20)	(\$0.26)
EPS diluted	(\$0.47)	(\$0.20)	(\$0.26)
Shares Outstanding (Basic)	14,693	21,059	(6,366)
Shares Outstanding (Diluted)	14,693	21,059	(6,366)

Source: Company reports and UBS research

Table 2: Verastem model changes 2012-2016

<i>(in thousands, except for EPS)</i>	2012E	2013E	2014E	2015E	2016E
Total revenues - New	-	-	-	15,000	15,000
Total revenues - Old	-	-	-	15,000	15,000
Change	-	-	-	-	-
Total Operating Expenses - New	27,069	29,516	32,596	36,792	44,137
Total Operating Expenses - Old	18,050	23,238	30,275	44,099	51,175
Change	9,019	6,278	2,321	(7,307)	(7,038)
Operating Income - New	(27,069)	(29,516)	(32,596)	(21,792)	(29,137)
Operating Income - Old	(18,050)	(23,238)	(30,275)	(29,099)	(36,175)
Change	(9,019)	(6,278)	(2,321)	7,307	7,038
Net Income (Loss) for EPS - New	(26,851)	(29,370)	(32,331)	(21,200)	(28,684)
Net Income (Loss) for EPS - Old	(17,582)	(22,877)	(29,654)	(27,840)	(35,230)
Change	(9,269)	(6,493)	(2,677)	6,640	6,546
EPS (GAAP - diluted) - New	(\$1.40)	(\$1.47)	(\$1.37)	(\$0.89)	(\$1.19)
EPS (GAAP - diluted) - Old	(\$0.82)	(\$1.06)	(\$1.17)	(\$1.09)	(\$1.37)
Change	(\$0.58)	(\$0.41)	(\$0.19)	\$0.20	\$0.18
Shares Outstanding (Basic) - New	19,768	19,965	23,665	23,902	24,141
Shares Outstanding (Basic) - Old	21,359	21,573	25,288	25,541	25,797
Change	(1,592)	(1,607)	(1,624)	(1,640)	(1,656)

Source: Company reports and UBS research

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

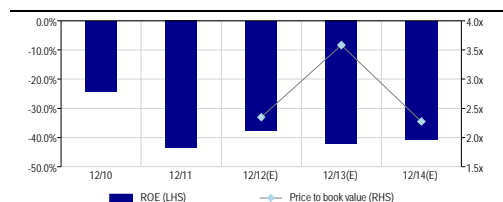
Source: Company accounts, UBS estimates. (UBS) valuations are stated before goodwill-related charges and other adjustments for abnormal and economic items at the analysts' judgement. Note: For some companies, the data represents an extract of the full company accounts.

Company profile

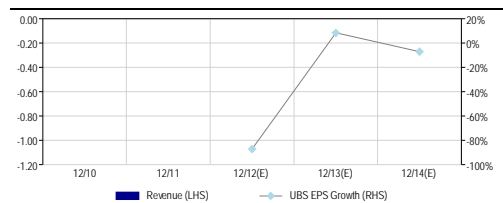
Verastem is a Cambridge, Massachusetts-based early-stage biotechnology company focused on the discovery and development of novel small molecule drugs and companion diagnostics targeting cancer stem cells. The proprietary EMT screening platform, licensed from the Whitehead Institute at MIT, has helped 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	-2.5	-2.0
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	-	-	146	146	146
+ 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	-	-	71	73	64

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	(99.0)	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\$9.94 on 11 May 2012 19:38 EDT Market cap(E) may include forecast share issues/buybacks.

Matthew Roden, PhD

Analyst

matthew.roden@ubs.com

+1-212-713 2491

Leah Batkiewicz, PhD

Associate Analyst

leah.batkiewicz@ubs.com

+1-212-713 4105

Andrew Peters

Associate Analyst

andrew.peters@ubs.com

+1-212-713 3241

■ 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

Each research analyst primarily responsible for the content of this research report, in whole or in part, certifies that with respect to each security or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about those securities or issuers and were prepared in an independent manner, including with respect to UBS, and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that research analyst in the research report.

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UBS Investment Research: Global Equity Rating Allocations

UBS 12-Month Rating	Rating Category	Coverage ¹	IB Services ²
Buy	Buy	51%	34%
Neutral	Hold/Neutral	40%	35%
Sell	Sell	9%	15%
UBS Short-Term Rating	Rating Category	Coverage ³	IB Services ⁴
Buy	Buy	less than 1%	25%
Sell	Sell	less than 1%	17%

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 31 March 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.

EXCEPTIONS AND SPECIAL CASES

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.

Core Banding Exceptions (CBE): Exceptions to the standard +/-6% bands may be granted by the Investment Review Committee (IRC). Factors considered by the IRC include the stock's volatility and the credit spread of the respective company's debt. As a result, stocks deemed to be very high or low risk may be subject to higher or lower bands as they relate to the rating. When such exceptions apply, they will be identified in the Company Disclosures table in the relevant research piece.

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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, 5, 6, 16}	VSTM.O	Buy	N/A	US\$9.94	11 May 2012

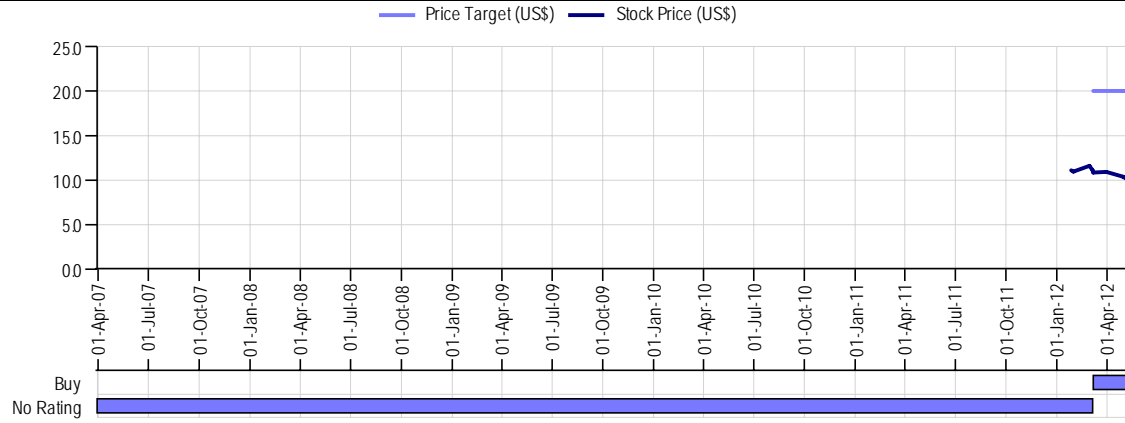
Source: UBS. All prices as of local market close.

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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Verastem (US\$)



Source: UBS; as of 11 May 2012

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