

UBS Investment Research

Verastem

A Big Step Forward

■ What's new? Acquires ph2-ready asset from PFE; could be transformative

Verastem announced it has acquired VS-6063 (formerly PF-04554878), a ph2-ready product candidate targeting the FAK pathway from Pfizer. The deal, completed with a \$1.5m upfront payment to PFE, immediately transforms Verastem into a clinical stage company with a complementary asset to its core competency in cancer stem cell biology. We spoke to management, and understand VS-6063 was vetted with Verastem's cancer stem cell (CSC) screening platform, and complements new internal findings on FAK that will be discussed tomorrow.

■ What do we know about the drug? Expect details at tomorrow's R&D day

Several late-stage patients achieved stable disease (despite the ph1 trial design) and generated safety and PK data to support advancement to ph2. Serial biopsies were taken, suggesting that considerable biomarker data may be available. At the R&D day, management will specifically outline the VS-6063 development plans, as well as those for the existing pipeline. Based on the breadth of tumors in the ph1 trial, we suspect development could move beyond the current focus on breast cancer.

■ Implications: Leverageable deal vaults Verastem forward

We like the deal, which [1] moves anti-CSC development plans forward by ~18 months, [2] leverages Verastem's expertise in FAK biology (a critical regulator of CSC survival), and [3] complements the existing anti-CSC preclinical pipeline (including VS-507 and FAK inhibitors VS-4718 and VS-5095).

■ Valuation: Buy with \$20 price target

We derive our price target using a DCF-based valuation 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	-	-	-2.8	-2.6	-2.1
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\$10.19 on 11 Jul 2012 18:41 EST

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Global Equity Research

Americas

Biotechnology

12-month rating **Buy**
Unchanged

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

Price **US\$10.19**

RIC: VSTM.O BBG: VSTM US

11 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)	15
Avg. daily value (m)	US\$0.2

Balance sheet data 12/12E

Shareholders' equity	US\$0.08bn
P/BV (UBS)	2.4x
Net Cash (debt)	US\$0.09bn

Forecast returns

Forecast price appreciation	+96.3%
Forecast dividend yield	0.0%
Forecast stock return	+96.3%
Market return assumption	5.3%
Forecast excess return	+91.0%

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

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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)	(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

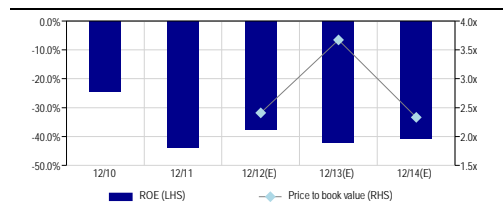
Source: Company accounts, UBS estimates. (UBS) valuations are stated before goodwill-related charges and other adjustments for abnormal and economic items at the analysts' judgement. Note: For some companies, the data represents an extract of the full company accounts.

Company profile

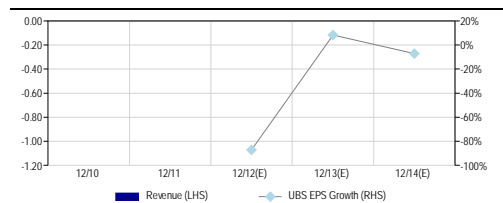
Verastem is a Cambridge, Massachusetts-based early-stage biotechnology company focused on the discovery and development of novel small molecule drugs and companion diagnostics targeting cancer stem cells. The proprietary EMT screening platform, licensed from the Whitehead Institute at MIT, has helped 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	-	-	-	2.4	3.7	2.3
EV/revenue (core)	-	-	-	-	-	-
EV/EBITDA (core)	-	-	-	-2.8	-2.6	-2.1
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	-	-	150	150	150
+ 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	-	-	75	77	68

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	-	-	-	(99.1)	(94.3)	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\$10.19 on 11 Jul 2012 18:41 EST 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	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.

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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\$10.19	11 Jul 2012

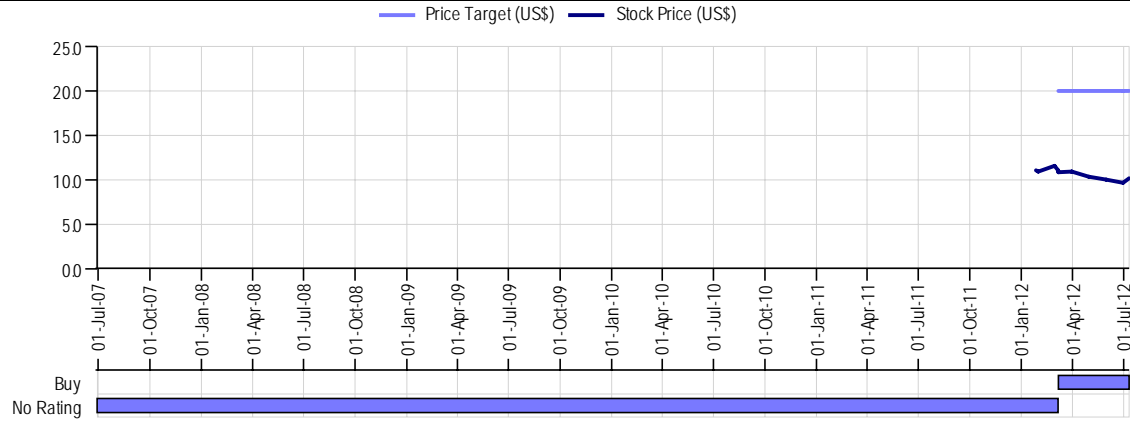
Source: UBS. All prices as of local market close.

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

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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 11 Jul 2012

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