

March 15, 2012

Stock Rating:

OUTPERFORM

12-18 mo. Price Target	\$16.00
VSTM - NASDAQ	\$11.00

3-5 Yr. EPS Gr. Rate	NM
52-Wk Range	\$11.99-\$10.00
Shares Outstanding	21.1M
Float	7.5M
Market Capitalization	\$231.7M
Avg. Daily Trading Volume	NA
Dividend/Div Yield	NM/NM
Fiscal Year Ends	Dec
Book Value	NM
2012E ROE	NM
LT Debt	\$0.0M
Preferred	NA
Common Equity	NA
Convertible Available	No
52 Wk High: Range since January 2012 IPO.	

EPS Diluted	Q1	Q2	Q3	Q4	Year	Mult.
2010A	--	--	--	--	(0.92)	NM
2011A	(1.85)	(2.89)	(2.68)	(2.87)	(10.59)	NM
Prior (E)	(0.29)A	(0.46)A	(0.56)A	(0.24)	(1.39)	NM
2012E	(0.25)	(0.26)	(0.27)	(0.30)	(1.09)	NM
Prior (E)	(0.17)	(0.18)	(0.19)	(0.31)	(0.85)	NM
2013E	--	--	--	--	(1.09)	NM
Prior (E)	--	--	--	--	(1.31)	NM

HEALTHCARE/BIOTECHNOLOGY

Verastem, Inc.

FY11 Results; WNT/FAK Programs Progressing Toward Clinic

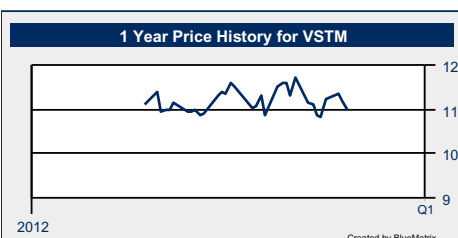
SUMMARY

On 3/14, VSTM reported FY11 results. The company remains on track to advance VS-507 (WNT pathway inhibitor) or either VS-4718/VS-5095 (FAK inhibitors) into the clinic in early '13. Based on high cancer stem cell (CSC) selectivity and clear evidence of the importance of the WNT pathway and FAK in several cancers, we believe these early-stage compounds have a good probability of long-term success. VSTM plans to initially triple negative breast cancer, which represents a significant unmet need and a blockbuster market for any one of these compounds. We believe VSTM is attractive on the long-term value of the company's CSC discovery platform, and expect share appreciation with pipeline progress and additional high profile scientific CSC publications.

KEY POINTS

- **FY11 net loss of \$13.7M was above our \$11.2M estimate.** This was largely due to higher than expected R&D spend in 4Q, as VSTM is accelerating preclinical development of VS-507/VS-4718/VS-5095. Following the recent IPO, we estimate VSTM has >\$100M in cash, which gives it a long cash run rate, potentially into '16.
- **VS-507 targets a key oncology pathway.** Inhibition of WNT pathway is promising, in our view, as aberrant WNT activation is associated with tumor formation/CSC self-renewal. VS-507 shows at least additive activity with chemotherapy in preclinical data, and we believe initial ph.I combination data, likely in 2H13, will be a major milestone for VSTM.
- **VS-4718/VS-5095 not far behind competitive FAK inhibitors.** PFE/GSK have FAK inhibitors in ph.I testing, but we estimate VS-4718/VS-5095 are only about 18-24 mos. behind. Near-term PFE/GSK clinical results are likely to give a positive read-through for VS-4718/VS-5095, in our view, and we believe VSTM's candidates may be differentiated on high CSC selectivity.
- **VSTM has a unique discovery platform.** Few companies are focusing on CSC-targeted small molecule cancer drugs, and we view VSTM's IP position as a significant obstacle to new entrants. With the ability to isolate additional new CSC focused therapies, we believe the long-term value of VSTM's platform is under-appreciated.

Stock Price Performance



Company Description

Verastem, Inc. is a biopharmaceutical company focused on discovering and developing novel drugs that selectively target cancer stem cells.

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Changes to Our Model

Following 4Q11 results, we are updating our model. Our new 2012-2016 EPS estimates are (\$1.09), (\$1.09) (\$1.34), (\$1.38), and (\$1.11), respectively, compared to our prior estimates of (\$0.85), (\$1.31), (\$1.56), (\$1.55) and (\$1.23), respectively.

Verastem Income Statement 2010A-2016E

Amounts in thousands, except per-share figures

	2011						2012													
	2010A	1QA	2QA	3QA	4QA	Prior 4QE	2011A	Prior 2011E	1QE	2QE	3QE	4QE	2012E	Prior 2012E	2013E	2014E	2015E	2016E		
Revenues:																				
TNBC royalty	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-		
Other revenue	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-		
Total operating revenue	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-		
Operating expenses:																				
Cost of goods	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-		
Research & development	400	1,200	2,000	2,283	4,400	2,500	9,883	7,983	4,300	4,350	4,500	5,200	18,350	13,250	17,700	22,250	22,750	23,250		
Selling, general & administrative	384	500	700	995	1,620	1,010	3,815	3,205	1,070	1,150	1,200	1,250	4,670	4,675	5,838	7,297	8,027	8,829		
Total operating expenses	784	1,700	2,700	3,278	6,020	3,510	13,698	11,188	5,370	5,500	5,700	6,450	23,020	17,925	23,538	29,547	30,777	32,079		
Income (Loss) from operations	(784)	(1,700)	(2,700)	(3,278)	(6,020)	(3,510)	(13,698)	(11,188)	(5,370)	(5,500)	(5,700)	(6,450)	(23,020)	(17,925)	(23,538)	(29,547)	(30,777)	(32,079)		
Other income (expense)	(2)	(5)	(6)	(7)	1	(7)	(17)	(25)	5	19	26	33	83	5	127	266	87	297		
Pretax income (loss)	(786)	(1,705)	(2,706)	(3,285)	(6,019)	(3,517)	(13,715)	(11,213)	(5,365)	(5,481)	(5,674)	(6,417)	(22,937)	(17,920)	(23,410)	(29,281)	(30,689)	(31,782)		
Income tax provision (benefit)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-		
Net income (loss)	(786)	(1,705)	(2,706)	(3,285)	(6,019)	(3,517)	(13,715)	(11,213)	(5,365)	(5,481)	(5,674)	(6,417)	(22,937)	(17,920)	(23,410)	(29,281)	(30,689)	(31,782)		
Basic & diluted net loss per share	(\$0.92)	(\$1.85)	(\$2.89)	(\$2.68)	(\$2.87)	(\$0.24)	(\$10.59)	(\$1.39)	(\$0.25)	(\$0.26)	(\$0.27)	(\$0.30)	(\$1.09)	(\$0.85)	(\$1.09)	(\$1.34)	(\$1.38)	(\$1.11)		
Basic & diluted shares outstanding (1, 2)	850	920	936	1,226	2,098	14,734	1,295	8,071	21,059	21,109	21,159	21,209	21,134	21,134	21,484	21,834	22,184	28,534		

(1) IPO in 1Q12 results in conversion of preferred stock to common stock

(2) Prior 4Q11 and 2011 share count estimates are proforma, while current share count estimates are GAAP

Source: Company documents and Oppenheimer & Co. Inc.

Investment Thesis

Based on a unique discovery platform, VSTM is developing cancer stem cell (CSC)-targeted therapies. We believe there is growing evidence CSCs have a key role in tumor initiation/metastasis. VSTM expects to advance Wnt pathway inhibitor VS-507 and a FAK inhibitor (VS-4718/VS-5095) into ph.I by 1Q13. Based on preclinical results and compelling biological rationale, we believe these compounds have broad anticancer potential. VSTM first plans to pursue triple negative breast cancer (TNBC), which we believe is a substantially underserved, multi-billion dollar market. We believe VSTM is an attractive long-term investment and expect the stock to appreciate as clinical progress and high profile scientific publications further underscore the importance of CSCs.

Price Target Calculation

Our price target of \$16 is based on a forward DCF valuation, which includes probability-adjusted product royalties and milestones in triple negative breast cancer. We model a ~52% EBIT margin and ~30% tax rate in the out years, resulting a 2027 free cash flow of \$83M and terminal value of cash flow of ~\$715M. We utilize a 15% discount rate to reflect the early stage of VSTM's drug candidates, but utilize a 3% terminal growth rate to reflect the productivity of the company's discovery platform. Our valuation also includes \$200M in technology value, which we believe is conservative based on platform acquisition comps.

Key Risks to Price Target

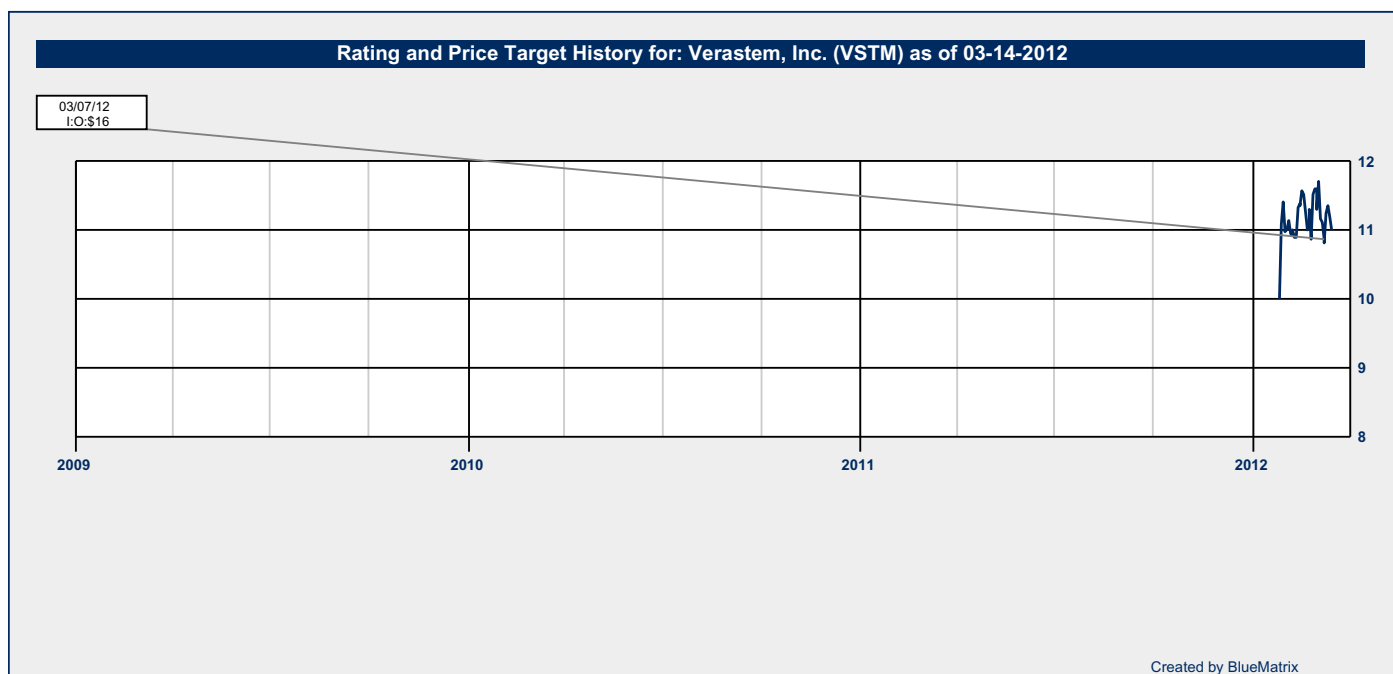
Key risks to our price target include, but are not limited to, clinical failure of VSTM's drug candidates, success of competing drugs in the clinic, and failure to secure funding for operations. There is liquidity risk with the shares, based on the company's float.

Important Disclosures and Certifications

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Distribution of Ratings/IB Services Firmwide

Rating	Count	IB Serv/Past 12 Mos.		Count	Percent
		Percent	Count		
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PERFORM [P]	255	42.79	86	33.73	
UNDERPERFORM [U]	7	1.17	3	42.86	

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In the past 12 months Oppenheimer & Co. Inc. has received compensation for investment banking services from VSTM.

Oppenheimer & Co. Inc. makes a market in the securities of VSTM.

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