

Foundation Medicine, Inc. (FMI)

Strong Start to the Year; Reiterate Market Outperform

MARKET DATA

| | |
|---------------------------|-------------------|
| Price | \$27.99 |
| 52-Week Range: | \$20.00 - \$45.00 |
| Shares Out. (M): | 28.1 |
| Market Cap (\$M): | \$786.5 |
| Average Daily Vol. (000): | 205.0 |

Source: Thomson Reuters and JMP Securities LLC

MARKET OUTPERFORM | Price: \$27.99 | Target Price: \$45.00

INVESTMENT HIGHLIGHTS

We reiterate our Market Outperform rating and \$45 price target on shares of Foundation Medicine following 1Q14 results. For the quarter, the company reported total revenue of \$11.4M (+121% y/y and 17% q/q), above our/consensus estimates of \$10.5M/\$11.3M and 4,702 clinical tests (+25% q/q). FoundationOne Heme started off strong at 751 tests (vs. our 250 test estimate), driven by interest across a wide variety of cancer indications. The company reaffirmed its revenue guidance for FY14 in the range of \$52M-\$58M. In our view, key drivers going forward include the launch of FoundationOne Heme and the continued adoption of the original FoundationOne test, the maturation of the company's sales force, and an ever-increasing number of academic articles, corporate partnerships, and master-trials. The company is at the center of an evolution of targeted cancer therapy, and we believe that its involvement in a wide variety of indications will enable to the company to sustain a first-mover advantage. We recently attended a biomarker workshop where literally every new biomarker team planned on using FoundationOne or Heme as part of the discovery or clinical trial design; in our view the company has entrenched itself in all the right academic/industry groups. While there is uncertainty around the timing of reimbursement and the sustainability of pricing, we believe the company can maintain its position even in the face of increased competition in the space. Our \$45 price target is predicated on an EV/S multiple of 15x FY15E sales as well as a 10-year DCF, discounting our 2025 revenue estimates by 12%, assuming a 4% growth rate.

STOCK PRICE PERFORMANCE



1Q14 results. Revenue of \$11.4M was reported in the quarter, of which \$7.1M came from FoundationOne Tests (vs. \$2.1M y/y), and the remainder from pharma partnerships. Average reimbursement in the quarter was ~\$3,400 per test. Management reported 751 Heme tests were ordered in the quarter, though clearly none of them have been recognized as revenue yet. Gross margin decreased to 53.7% from 56.5% due to timing differences from when test revenue was recorded. Operating expenses for 1Q14 were \$18.3M vs. \$9.9M y/y, driven by increases in sales and related marketing activities and the commercial launch of FoundationOne Heme. On the bottom line, a net loss of \$0.44 was reported for the quarter. The company ended the quarter with \$110M in cash and cash equivalents. Management maintained its guidance for 2014. They still expect revenues of \$52-\$58M on volumes of 22,000-25,000 tests.

Heme off to a strong start. Customers ordered 751 Heme tests in the quarter, using the tests in pediatric, acute lymphoma, myeloproliferative neoplasms, and other indications. A total of 4,951 FoundationOne tests were ordered, up from 3,750 in 4Q13. Management noted that a number of One tests that were ordered were switched to Heme once the new test became available.

Entrenched in all the right places. We attended a biomarker workshop earlier in the week. It was hosted by ASCO but attended and staffed by high-ranking members of the FDA's office of in-vitro diagnostics, thought leaders across a wide variety of cancer disciplines, and heads of R&D from both small and large biopharma companies. Our key takeaways were: 1) FoundationOne or Heme was at the heart of a number of theoretical projects ranging from biomarker discovery to basket-trials exploring targeted therapeutics (aside from the LungMap trial); 2) the company's notoriety was palpable across a broad variety of industry and academic disciplines including oncologists, biostatistics, early discovery, clinical planning, and regulatory; 3) the FDA fully supports the use of multi-gene NGS assays to more effectively shape future clinical trials.

Key drivers/catalysts: 1) ASCO in June: 18 abstracts including the results of the U.S. Oncology decision impact study. 2) Maturation of the salesforce; the company currently has 41 sales people, but over 50% were hired in the last six months, and it can take at least a year for the new hires to become productive. The company intends to end 2014 with 45 -50 reps. 3) A refresh to FoundationOne that will include more genes. According to our industry contacts this could bring the product closer to the 400 gene set that pharma partners have access to.

Company Description

Foundation Medicine is a commercial-stage, molecular diagnostics company. The company's first clinical product, FoundationOne, is the only commercially available, comprehensive molecular information product designed for use in routine clinical care of patients with cancer.

Investment Risks

Timing of Medicare and commercial payer coverage remains uncertain as FMI does not have a positive coverage decision from any commercial payer.

Competition is likely to increase. Foundation may have the first-mover advantage, but given that the genes found on FoundationOne are not proprietary, we believe it is only a matter of time before another competitor surfaces.

Clinical utility remains unproven. The company has not completed a clinical utility trial to demonstrate the value of FoundationOne beyond current tests.

Regulation is likely to increase and timing remains uncertain. Over the last few years, the FDA has stated its intent to more thoroughly regulate laboratory diagnostic tests (LDTs).

JMP FACTS AND DISCLOSURES

Analyst Certification:

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JMP Securities Disclosures:

JMP Securities currently makes a market in the security of Foundation Medicine, Inc.

JMP Securities Investment Opinion Definitions:

Market Outperform (MO): JMP Securities expects the stock price to outperform relevant market indices over the next 12 months.

Market Perform (MP): JMP Securities expects the stock price to perform in line with relevant market indices over the next 12 months.

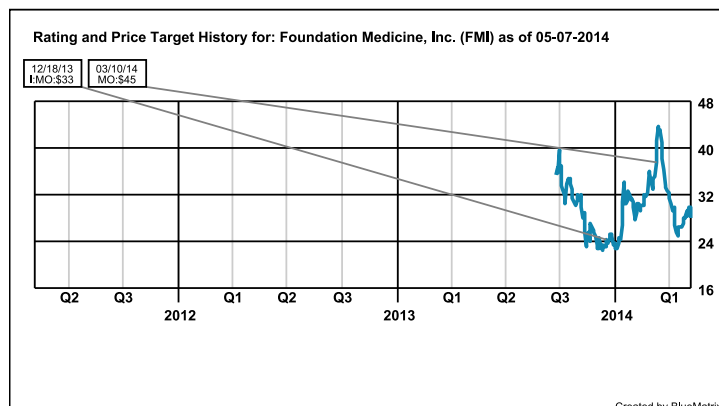
Market Underperform (MU): JMP Securities expects the stock price to underperform relevant market indices over the next 12 months.

JMP Securities Research Ratings and Investment Banking Services: (as of May 7, 2014)

| JMP Rating | Regulatory Equivalent | # Co's Under Coverage | % of Total | Regulatory Equivalent | # Co's Under Coverage | % of Total | # Co's Receiving IB Services in Past 12 Months | % of Co's With This Rating |
|------------------------|-----------------------|-----------------------|------------|-----------------------|-----------------------|------------|--|----------------------------|
| MARKET OUTPERFORM | Buy | 254 | 58.12% | Buy | 254 | 58.12% | 102 | 40.16% |
| MARKET PERFORM | Hold | 135 | 30.89% | Hold | 135 | 30.89% | 17 | 12.59% |
| MARKET UNDERPERFORM | Sell | 5 | 1.14% | Sell | 5 | 1.14% | 0 | 0% |
| COVERAGE IN TRANSITION | | 43 | 9.84% | | 43 | 9.84% | 0 | 0% |
| TOTAL: | | 437 | 100% | | 437 | 100% | 119 | 27.23% |

Stock Price Chart of Rating and Target Price Changes:

Note: First annotation denotes initiation of coverage or 3 years, whichever is shorter. If no target price is listed, then the target price is N/A. In accordance with NASD Rule 2711, the chart(s) below reflect(s) price range and any changes to the rating or price target as of the end of the most recent calendar quarter. The action reflected in this note is not annotated in the stock price chart. Source: JMP Securities.



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