

Foundation Medicine, Inc. (FMI)

Second Quarter Results Continue to Support Adoption Trends; Reiterate Market Outperform Rating

MARKET DATA

Price	\$25.65
52-Week Range:	\$19.51 - \$45.00
Shares Out. (M):	28.2
Market Cap (\$M):	\$723.3
Average Daily Vol. (000):	111.0

Source: Thomson Reuters and JMP Securities LLC

MARKET OUTPERFORM | Price: \$25.65 | Target Price: \$45.00

INVESTMENT HIGHLIGHTS

We reiterate our Market Outperform rating and \$45 price target on the shares of Foundation Medicine following 2Q14 results. The company reported total revenue of \$14.5 million (+145% y/y), above our/consensus estimates of \$12.7 million/\$13 million, and 5,908 clinical tests (+263% y/y). FoundationOne test volume continues unchecked, driven by interest across a wide variety of cancer indications. The company reaffirmed its revenue guidance for 2014 in the range of \$52-\$58 million despite the stronger than expected quarter, more a sign of conservatism rather than a dour outlook, in our view. The key drivers going forward include the ongoing launch of FoundationOne Heme, and the continued adoption of the original FoundationOne test, the maturation of the company's salesforce, and an ever increasing number of academic articles, corporate partnerships, and master trials. While there continues to be uncertainty around the timing of reimbursement, we believe that clarity around CMS' reimbursement framework, and the continued adoption of the tests will allay these longer-term concerns. Near-term, we believe investors should remain squarely focused on the ASHG conference in October, where we expect to see a large number of FoundationOne Heme abstracts/papers touting the broad applicability of the product. Our \$45 price target is predicated on an EV/S multiple of 15x 2015E sales, as well as a 10-year DCF, discounting our 2025 revenue estimates by 12%, assuming a 4% growth rate.

FY DEC		2013A	2014E	2015E
Revenue (\$M)	1Q	\$5.2	\$11.4A	\$21.3
	2Q	\$5.9	\$14.5A	\$23.7
	3Q	\$8.2	\$13.5	\$25.8
	4Q	\$9.7	\$16.9	\$28.9
	FY	\$29.0	\$56.3	\$99.7
EPS	1Q	(\$0.33)	(\$0.44)A	(\$0.46)
	2Q	(\$0.48)	(\$0.49)A	(\$0.50)
	3Q	(\$3.51)	(\$0.46)	(\$0.50)
	4Q	(\$0.48)	(\$0.40)	(\$0.55)
	FY	(\$4.64)	(\$1.79)	(\$1.15)
Previous FY		NC	(\$1.75)	(\$1.12)

Source: Company reports and JMP Securities LLC

STOCK PRICE PERFORMANCE



2Q14 results. The company reported revenue of \$14.5 million in the quarter, of which \$9.4 million came from FoundationOne tests (vs. \$2.9 million in 2Q13), and the remainder from pharma partnerships. Average reimbursement in the quarter was approximately \$3,600 per test. Management reported that 948 Heme tests were ordered in the quarter, up from 750 in 1Q14, although the vast majority have not been recognized as revenue yet. Gross margin increased to 54.5%. Operating expenses for 2Q14 were \$21.5 million vs. \$13.7 million y/y, driven by increases in sales and related marketing activities, and the commercial launch of FoundationOne Heme. The company ended the quarter with \$97 million in cash and cash equivalents.

Management maintained guidance. The company still expects 2014 revenues of \$52-\$58 million on volumes of 22,000-25,000 tests. We note that the company performed 4,960 solid tumor tests, and 948 Heme tests in the quarter.

ASHG viewed as a near-term catalyst for Heme adoption. The October ASHG conference in San Diego, CA should provide a platform for early adoptors to tout their experiences with the Heme product. While management did not mention any specifics, we believe that physician exposure to the broad utility of Heme will drive adoption trends in 2015 and beyond.

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 the routine clinical care of cancer patients.

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 past few years, the FDA has stated its intent to more thoroughly regulate laboratory diagnostic tests (LDTs).

JMP FACTS AND DISCLOSURES

Analyst Certification:

The research analyst(s) who prepared this report does/do hereby certify that the views presented in this report are in accordance with my/our personal views on the securities and issuers discussed in this report. As mandated by SEC Regulation AC no part of my/our compensation was, is or will be directly or indirectly related to the specific views or recommendations expressed herein. This certification is made under the obligations set forth in SEC Regulation AC. Any other person or entity may not use it for any other purpose. This certification is made based on my/our analysis on the date of this report's publication. I/We assume no obligation to update this certification to reflect any facts, circumstances or events that may subsequently come to my/our attention. Signed J.T. Haresco

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.

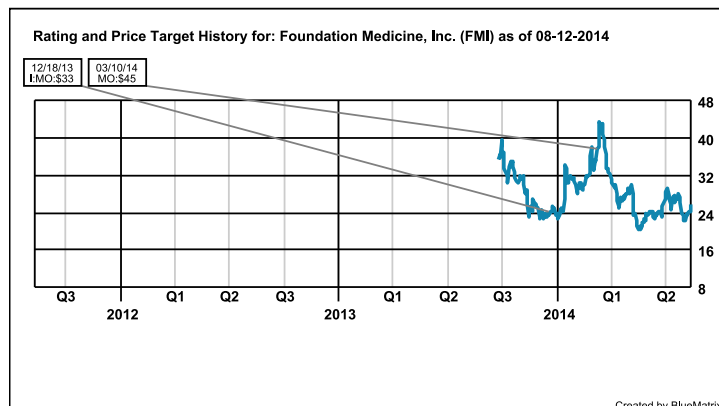
Market Underperform (MU): JMP Securities expects the stock price to underperform relevant market indices over the next 12 months.

JMP Securities Research Ratings and Investment Banking Services: (as of August 13, 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	267	60.00%	Buy	267	60.00%	97	36.33%
MARKET PERFORM	Hold	138	31.01%	Hold	138	31.01%	18	13.04%
MARKET UNDERPERFORM	Sell	4	0.90%	Sell	4	0.90%	0	0%
COVERAGE IN TRANSITION		36	8.09%		36	8.09%	0	0%
TOTAL:		445	100%		445	100%	115	25.84%

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.



JMP Disclaimer:

JMP Securities LLC (the "Firm") compensates research analysts, like other Firm employees, based on the Firm's profitability, which includes revenues from the Firm's institutional sales, trading, and investment banking departments as well as on the quality of the services and activities performed that are intended to benefit the Firm's institutional clients. These data have been prepared by JMP Securities LLC for informational purposes only and are based on information available to the public from sources that we believe to be reliable, but we do not guarantee their accuracy or completeness. Any opinions and projections expressed herein reflect our judgment at this date and are subject to change without notice. These data are neither intended nor should be considered as an offer to sell or a solicitation or a basis for any contract for the purchase of any security or other financial product. JMP Securities LLC, its affiliates, JMP Group LLC, Harvest Capital Strategies LLC, and their respective partners, directors, officers, and associates may have a long or short position in, may act as a market maker for, or may purchase or sell a position in the securities mentioned herein. JMP Securities LLC or its affiliates may be performing, have performed, or seek to perform investment banking, advisory, or other services and may have acted as manager or co-manager for a public offering of securities for any company mentioned herein. The reader should assume that JMP Securities LLC will solicit business from the company covered in this report. Members of our Sales and Trading Department provide oral and/or written market opinions and trading strategies to our clients that reflect their personal opinions about stocks that are the subject of the firm's research reports. Our research analysts discuss trading strategies with clients that sometimes reflect short-term expectations for the price of the securities that are the subject of research reports. These trading strategies are distinct from the analysts' fundamental rating for the stock, which is based upon the analysts' view compared to other stocks under coverage for the relevant time period. © Copyright 2014. All rights reserved by JMP Securities LLC. JMP Securities LLC is a member of FINRA, NASDAQ, and SIPC.

Jeffrey H. Spurr
Director of Research
 (415) 835-3903

RESEARCH PROFESSIONALS

FINANCIAL SERVICES

Alternative Asset Managers

Devin Ryan	(212) 906-3578
Brian McKenna	(212) 906-3545

Commercial & Specialty Finance

Christopher York	(415) 835-8965
Hannah Kim, CFA	(415) 835-8962

Consumer Finance

David M. Scharf	(415) 835-8942
Jeremy Frazer	(312) 768-1796

Financial Processing & Outsourcing

David M. Scharf	(415) 835-8942
Jeremy Frazer	(312) 768-1796

Insurance

Matthew J. Carletti	(312) 768-1784
Christine Worley	(312) 768-1786

Investment Banks & Brokers

Devin Ryan	(212) 906-3578
Brian McKenna	(212) 906-3545

Mortgage Operating Companies

REITs: Agency, Hybrid, & Commercial Mortgage

Steven C. DeLaney	(404) 848-7773
Trevor Cranston, CFA	(415) 869-4431
Charter Robinson	(757) 613-8955
Benjamin Zucker	(212) 906-3529

HEALTHCARE

Biotechnology

Liisa A. Bayko	(312) 768-1785
Andrew Prigodich, PhD	(312) 768-1788
Bhumika Sharma, PhD	(312) 768-1795
Jason N. Butler, PhD	(212) 906-3505
Caroline Palomeque	(212) 906-3509
Michael G. King, Jr.	(212) 906-3520
Bryan Czyzewski, PhD	(212) 906-3577
Eric Joseph, PhD	(212) 906-3514

Healthcare Services & Facilities

Peter L. Martin, CFA	(415) 835-8904
Aaron Hecht	(415) 835-3963
Arthur Kwok	(415) 835-8908

Life Science Tools & Diagnostics

J. T. Haresco, III, PhD	(415) 869-4477
Marie T. Casey, PhD	(415) 835-3955

Medical Devices

J. T. Haresco, III, PhD	(415) 869-4477
Marie T. Casey, PhD	(415) 835-3955

Medical Devices & Supplies

David Turkaly	(212) 906-3563
John Gillings	(212) 906-3564

Specialty Pharmaceuticals

Oren G. Livnat, CFA	(212) 906-3566
Nazibur Rahman	(212) 906-3519

REAL ESTATE

Housing & Land Development

Peter L. Martin, CFA	(415) 835-8904
Aaron Hecht	(415) 835-3963
Bharathwajan Iyengar	(415) 835-3902

Lodging & Leisure

Robert A. LaFleur	(212) 906-3510
Whitney Stevenson	(212) 906-3538

Property Services

Mitch Germain	(212) 906-3546
Peter Lunenburg	(212) 906-3537

REITs: Healthcare, Residential, & Specialty

Peter L. Martin, CFA	(415) 835-8904
Aaron Hecht	(415) 835-3963
Arthur Kwok	(415) 835-8908

REITs: Office, Industrial, & Diversified

Mitch Germain	(212) 906-3546
Peter Lunenburg	(212) 906-3537

Residential Services

Peter L. Martin, CFA	(415) 835-8904
Aaron Hecht	(415) 835-3963
Bharathwajan Iyengar	(415) 835-3902

TECHNOLOGY

Communications Equipment & Internet Security

Erik Suppiger	(415) 835-3918
John Lucia	(415) 835-3920

Internet & Digital Media

Ronald V. Josey III	(212) 906-3528
Andrew Boone, CFA	(415) 835-3957
Michael Wu	(415) 835-8996

Software

Patrick Walravens	(415) 835-8943
Peter Lowry	(415) 869-4418
Greg McDowell	(415) 835-3934

Wireless & Cloud Computing Technologies

Alex Gauna	(415) 835-8998
------------	----------------

ADDITIONAL CONTACTS

Thomas R. Wright
Director of Equities
 (212) 906-3599

Dan Wychulis
Director of Institutional Sales
 (617) 235-8530

600 Montgomery Street, Suite 1100
 San Francisco, CA 94111
www.jmpsecurities.com