

Foundation Medicine, Inc. (FMI)

Takeaways from Management Meeting; Raising Price Target to \$45 on Better Solid Tumor Penetration

MARKET DATA

Price	\$35.02
52-Week Range:	\$20.00 - \$41.50
Shares Out. (M):	28.1
Market Cap (\$M):	\$984.1
Average Daily Vol. (000):	106.0

Source: Thomson Reuters and JMP Securities LLC

MARKET OUTPERFORM | Price: \$35.02 | Target Price: \$45.00

INVESTMENT HIGHLIGHTS

We reiterate our Market Outperform rating on shares of Foundation Medicine and raise our price target from \$33 to \$45. We met with several members of FMI's management team last week at their headquarters. Key takeaways from our meeting are: 1) FoundationOne adoption continues unimpeded, with salesforce expansion a key driver of growth this year; 2) management remains optimistic about FoundationOne Heme, but reiterates that it is far too early to determine the utilization patterns; and 3) the company remains committed to pipeline expansion. We believe the company ended FY13 having penetrated approximately 1.6% of the available solid tumor market, slightly ahead of our expectations. As such, we are raising our FY15 revenue estimate from \$85.8M to \$93.5M on the belief that FoundationOne will reach ~4.5% penetration into the solid tumor market by the end of 2015. The next major catalyst for the stock should be the AACR conference, where we expect to see more presentations regarding the potential utility of the FoundationOne Heme test. Our target is predicated on an EV/S multiple of 15x FY15 sales (vs. 12x previously) as well as a 10-year DCF, discounting our 2025 revenue estimates by 12%, assuming a 4% growth rate.

FoundationOne Heme off to a slow but solid start. The new test is has been on the market less than 70 days, with KOLs driving the bulk of the testing. Like the original FoundationOne test, the initial rollout can best be described as a "learning period" where users are exploring the utility across a broad variety of hematological and pediatric cancers. According to management, there are no discernible utilization patterns yet. Nevertheless, they seem upbeat on the initial uptake, noting that oncologists who treat this set of diseases already have a propensity to aggressively use genetic tests. There seems to be a particular interest in recent findings suggesting mutations linked to solid tumors may be found in hematological cancers, offering patients a previously unmapped set of treatment options.

Committed to pipeline expansion. A key differentiating factor for Foundation Medicine is its rapid development cycle; FoundationOne Heme was launched roughly two years after the original FoundationOne test (vs. four to five years for other companies). While management did not offer specifics, they noted treatment monitoring, immunotherapy, and cell-free DNA diagnostics all offer potential opportunities.

Changes to our estimates. FoundationOne penetrated approximately 1% of the solid tumor market in 2013. Management's guidance suggests that the company will end 2014 with approximately 2% penetration. Our prior estimates did not take into account the rapid expansion of the sales team over the next 24 months, and as such we are raising our FY15 estimates from \$86.8M to \$93.5M. Of this, FoundationOne makes up \$74.4M in sales. This is based on the assumption that FoundationOne ends FY15 with approximately 4.5% penetration into the solid tumor market (vs. 3% previously).

FY DEC		2013A	2014E	2015E
Revenue (\$M)	1Q	\$5.2	\$10.5	\$19.6
	2Q	\$5.9	\$12.0	\$21.2
	3Q	\$8.2	\$13.7	\$23.8
	4Q	\$9.7	\$19.2	\$28.8
	FY	\$29.0	\$55.3	\$93.5
EPS	1Q	(\$0.33)	(\$0.38)	(\$0.45)
	2Q	(\$0.48)	(\$0.41)	(\$0.48)
	3Q	(\$3.51)	(\$0.42)	(\$0.49)
	4Q	(\$0.48)	(\$0.49)	(\$0.54)
	FY	(\$4.64)	(\$1.71)	(\$1.15)
P/E		NM	NM	NM
Previous FY		NC	(\$1.63)	(\$1.21)

Source: Company reports and JMP Securities LLC

STOCK PRICE PERFORMANCE



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).

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JMP Securities Disclosures:

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

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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.

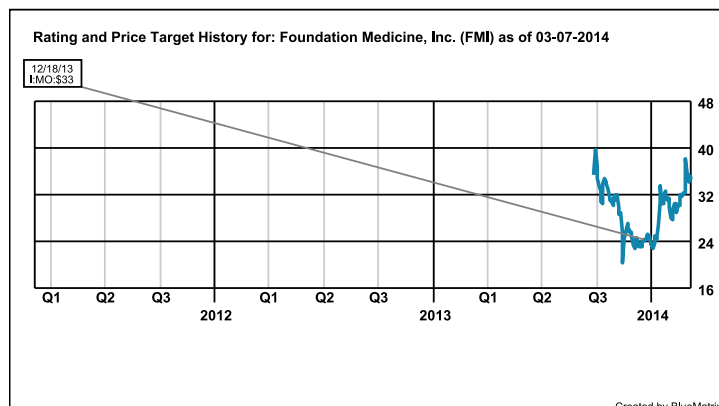
Market Underperform (MU): JMP Securities expects the stock price to underperform relevant market indices over the next 12 months.

JMP Securities Research Ratings and Investment Banking Services: (as of March 9, 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	247	56.52%	Buy	247	56.52%	99	40.08%
MARKET PERFORM	Hold	139	31.81%	Hold	139	31.81%	19	13.67%
MARKET UNDERPERFORM	Sell	8	1.83%	Sell	8	1.83%	0	0%
COVERAGE IN TRANSITION		43	9.84%		43	9.84%	0	0%
TOTAL:		437	100%		437	100%	118	27.00%

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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