

Life Sciences Technology

Foundation Medicine, Inc.

(FMI) - NEUTRAL

Price: \$25.65

Fair Value Estimate: \$28.00
52-Week Range: \$18.00-\$45.00
Market Cap (MM): \$723
Shr.O/S-Diluted (mm): 28.2
Average Daily Volume: 355,317
Book Value: \$3.87

FYE: Dec	2013A	2014E	2015E
EPS:	\$(4.64)A	\$(1.89)E	\$(1.32)E
Prior EPS:		\$(1.86)	NC
P/E:	NA	NA	NA

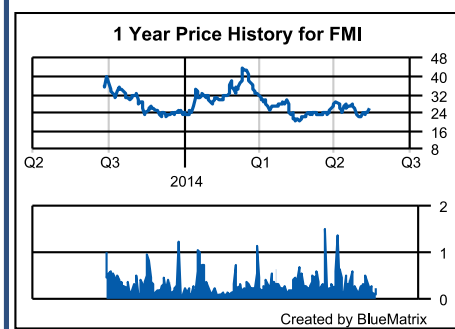
Quarterly EPS:

	2013A	2014E	2015E
Q1	\$(2.56)A	\$(0.44)A	NA
Q2	\$(3.33)A	\$(0.49)A	NA
Q3	\$(3.51)A	\$(0.48)E	NA
Q4	\$(0.48)A	\$(0.48)E	NA

FYE: Dec	2013A	2014E	2015E
Revenue (M):	\$29.0A	\$60.2E	\$110.0E

Quarterly Revenue (M):

	2013A	2014E	2015E
Q1	\$5.2A	\$11.5A	NA
Q2	\$5.9A	\$14.5A	NA
Q3	\$8.2A	\$16.2E	NA
Q4	\$9.7A	\$18.0E	NA



Equity Research
Note

Making Strides Commercially; Coverage next?

INVESTMENT CONCLUSION:

Foundation Medicine reported a solid 2Q revenue beat driven by a sequential acceleration in clinical test volume growth. FMI is set up to exceed 2014 guidance, as commercial expansion and pharmaceutical partner adoption was stronger than expected in 1H14. While timing is uncertain, the company is making major strides towards a positive national coverage decision. The announcement of New York State approval was a major milestone for FMI as it supports the clinical validity of the FoundationOne and FoundationOne Heme tests. We reiterate our Neutral rating and fair value estimate of \$28.

KEY POINTS:

- FMI reported sales of \$14.5 million in 2Q, which exceeded our \$13.0 million estimate and the Street's \$13.4 million. Clinical test adoption outpaced our expectations in the quarter as FMI reported 5,908 tests sold versus our modeled 5,450. The FoundationOne Heme test accounted for 16% of total clinical volumes, up from 15.2% in 1Q. The QoQ improvement in testing volume mix resulted in an \$200 per test increase in average reimbursement to \$3,600. We estimate that FMI received payment for approximately 44% of the total clinical tests performed, relatively flat QoQ. FMI reported 2Q EPS of \$(0.49) compared to our and consensus' \$(0.47).
- Management reiterated its full year guidance of \$52-58 million in revenues and clinical testing volumes of 22,000-25,000. We believe that these numbers are conservative. Last year, the company reported 30% of its clinical testing volume in 1H13. Through the first half of 2014, FMI has reported 10,152 clinical tests or 42.4-48.2% of management's full year guidance. While summer seasonality and the year-end holiday season could present a headwind for FMI, the company's adoption curve is still in its early stages. We see the potential for upside to management's numbers, as commercial expansion continues to grow at a torrid pace and the overall market remains underserved.
- We raise our 3Q and 4Q clinical testing volume by 450 to 6,750 and 200 to 7,450, respectively. Flowing through those adjusted volumes at \$3,600 per test and applying a back half reimbursement rate of 43.5%, we anticipate Foundation Medicine to report sales of \$16.2 million (+\$0.7 million) in 3Q14 and \$18.0 million (+\$1.0 million) 4Q14. We maintain our outer year revenue estimates. While volume growth remains important to the overall FMI story, we believe that positive reimbursement decisions from Medicare and national commercial payors will be vital for the company to reach our estimates in 2016 and 2017. We view the New York State Department of Health approvals of the FoundationOne and FoundationOne Heme as important milestones for FMI, because it supports the clinical validity of the company's tests. Additional clinical utility data in 3Q and 4Q will go a long way to accelerating the already ongoing coverage dialogue between FMI and payors.
- Our fair value is based upon the blended price-to-revenue multiple of 5x on our 2015 and 2016 estimates. Foundation is currently valued at 6.5x our 2015 revenue and 3.7x our 2016 forecast. At a 5x multiple-of-revenue, our fair value of FMI would be \$35 per share and \$20 per share on 2016 and 2015, respectively. We average both prices to get to our fair value estimate of \$28 per share.

Research Analyst Certifications and Important Disclosures are on pages 2 - 3 of this report

IMPORTANT DISCLOSURES

Research Analyst Certification

I, Paul Knight, the Primarily Responsible Analyst for this research report, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject securities or issuers. No part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views I expressed in this research report.

Janney Montgomery Scott LLC ("Janney") Equity Research Disclosure Legend

Janney Montgomery Scott LLC intends to seek or expects to receive compensation for investment banking services from Foundation Medicine, Inc. in the next three months.

The research analyst is compensated based on, in part, Janney Montgomery Scott's profitability, which includes its investment banking revenues.

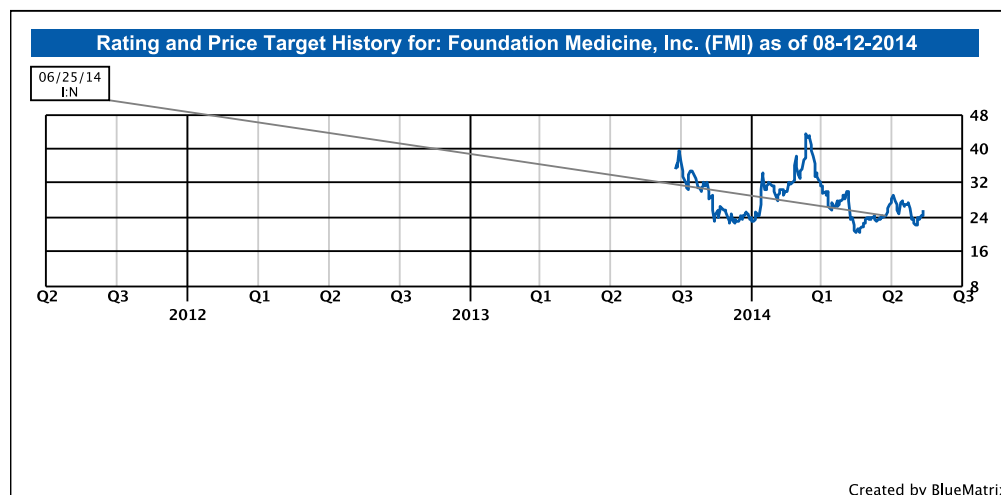
Definition of Ratings

BUY: Janney expects that the subject company will appreciate in value. Additionally, we expect that the subject company will outperform comparable companies within its sector.

NEUTRAL: Janney believes that the subject company is fairly valued and will perform in line with comparable companies within its sector. Investors may add to current positions on short-term weakness and sell on strength as the valuations or fundamentals become more or less attractive.

SELL: Janney expects that the subject company will likely decline in value and will underperform comparable companies within its sector.

Price Charts



Janney Montgomery Scott Ratings Distribution as of 6/30/14

Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY [B]	207	53.80	53	25.60
NEUTRAL [N]	176	45.70	28	15.90
SELL [S]	2	0.50	0	0.00

***Percentages of each rating category where Janney has performed Investment Banking services over the past 12 months.**

Other Disclosures

Janney Montgomery Scott LLC, is a U.S. broker-dealer registered with the U.S. Securities and Exchange Commission and a member of the New York Stock Exchange, the Financial Industry Regulatory Authority and the Securities Investor Protection Corp.

This report is for your information only and is not an offer to sell or a solicitation of an offer to buy the securities or instruments named or described in this report. Interested parties are advised to contact the entity with which they deal or the entity that provided this report to them, should they desire further information. The information in this report has been obtained or derived from sources believed by Janney Montgomery Scott LLC, to be reliable. Janney Montgomery Scott LLC, however, does not represent that this information is accurate or complete. Any opinions or estimates contained in this report represent the judgment of Janney Montgomery Scott LLC at this time and are subject to change without notice.

Investment opinions are based on each stock's 6-12 month return potential. Our ratings are not based on formal price targets, however, our analysts will discuss fair value and/or target price ranges in research reports. Decisions to buy or sell a stock should be based on the investor's investment objectives and risk tolerance and should not rely solely on the rating. Investors should read carefully the entire research report, which provides a more complete discussion of the analyst's views. Supporting information related to the recommendation, if any, made in the research report is available upon request.