

Foundation Medicine, Inc. (FMI)

Strong Quarter Sets the Stage for a Productive Year Ahead; Reiterate Market Outperform

MARKET DATA

Price	\$32.44
52-Week Range:	\$20.00 - \$41.50
Shares Out. (M):	28.1
Market Cap (\$M):	\$911.6
Average Daily Vol. (000):	136.0

Source: Thomson Reuters and JMP Securities LLC

MARKET OUTPERFORM | Price: \$32.44 | Target Price: \$33.00

INVESTMENT HIGHLIGHTS

We reiterate our Market Outperform rating and \$33 price target on shares of Foundation Medicine following 4Q13 results. The company had pre-announced its financial results, so there were no surprises to the revenue line. For the quarter, the company reported total revenue of \$9.7M (+86.5% y/y and 18.3% q/q) and 3,752 clinical tests (+45.6% q/q). On the bottom line, the company reported EPS of (\$0.48) for the quarter. 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 company's FoundationOne test is currently the only commercially available pan-cancer panel that delivers concise, comprehensive, actionable, and patient-specific treatment options. The company has a clear first-mover advantage and 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 \$33 price target implies a 2015E EV/Sales multiple of 11.8x, representing an 18% premium relative to its peer group. FMI is also being valued as a biotech company and we believe that our price target reflects a reasonable enterprise value (using projected levels of debt and cash) that is ~13x our revenue estimate for the 12 months ended September 2015, a multiple in line with the peer group median.

FY DEC		2013A	2014E	2015E
Revenue (\$M)	1Q	\$5.2	\$10.8	\$19.3
	2Q	\$5.9	\$12.6	\$20.9
	3Q	\$8.2	\$14.3	\$22.3
	4Q	\$9.7	\$18.9	\$23.3
	FY	\$29.0	\$56.6	\$85.8
EPS	1Q	(\$0.33)	(\$0.36)	(\$0.44)
	2Q	(\$0.48)	(\$0.40)	(\$0.48)
	3Q	(\$3.51)	(\$0.40)	(\$0.47)
	4Q	(\$0.48)	(\$0.46)	(\$0.50)
	FY	(\$4.64)	(\$1.63)	(\$1.21)
P/E		NM	NM	NM
Previous FY		(\$1.79)	NC	NC

Source: Company reports and JMP Securities LLC

STOCK PRICE PERFORMANCE



4Q13 and FY13 results. Revenue of \$9.7M was reported in the quarter, of which \$5.3M came from FoundationOne Tests (vs. \$1.4M y/y) and the remainder from pharma partnership. Community-based practices (55% of reported tests) is now outpacing academic centers and we believe this trend should continue over the next quarter. Average reimbursement in the quarter was ~\$3,400 per test. Gross margin decreased to 56% from 65% due to timing differences from when test revenue was recorded. Operating expenses for 4Q13 were \$18.9M (inclusive of \$2.3M in stock-based comp) vs. \$8.65M y/y, driven by increases in sales and related marketing activities and the commercial launch of FoundationOne Heme. Total revenue for FY13 was \$29.0M (vs. \$10.6M y/y). For the full year, op ex was \$59.1M (vs. \$26.9M y/y). On the bottom line, a net loss of \$4.64 loss was reported for FY13. The company exited the year with \$124.3M in cash and cash equivalents (vs. \$55M y/y), boosted by IPO proceeds of \$110M in 3Q13.

2013 accomplishments. With the collaboration of the Memorial Sloan-Kettering Cancer Center, the company successfully launched its second clinical product, FoundationOne Heme in December 2013 (ahead of schedule), demonstrating its commitment to ongoing product innovation. FoundationOne Heme is a fully informative genomic profile for hematologic cancers such as leukemia, lymphoma, and myeloma, as well as sarcomas and pediatric cancers.

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In January 2014, the company extended and expanded its ongoing collaboration with Novartis to provide molecular information and comprehensive genomic profiling analysis in support of many of Novartis' clinical oncology programs. Overall, more than 9,000 FoundationOne clinical tests were reported to physicians in 2013, up from 1,750 in 2012.

Update on initial claims submitted to Medicare. The company submitted code identifiers for FoundationOne and FoundationHeme. Adopted by Palmetto, these identifiers determine coverage in payment for Medicare in 17 states. Management noted that although Massachusetts is yet to be included, the program is expected to be adopted by many other administrative contractors and U.S. commercial payers. However, details around timing were not specified.

Solid outlook on FY14. FMI expects FY14 revenue to be in the range of \$52M-\$58M. The company expects to deliver 22K-25K (including FoundationOne Heme) over the course of the year (representing +160% y/y). Operationally, expenses of \$85-\$95M are expected, driven by commercial growth, clinical trials, R&D, and new added features, such as interactive cancer explorer. Management expects GMs to vary between 55-65% and margins should increase over time as scale efficiencies enable further clinical tests to be consistently paid.

Pipeline progress. Major enhancements that bode well for continued adoption are: 1) the introduction in 1H14 of an updated version of FoundationOne, including an expanded set of genes for solid tumors (compared to the original 239 genes); 2) introduction of new features for the Interactive Cancer Explorer physician portal, including outcomes collection capabilities in 2H14. Management noted on the call today that the expanded version of FoundationOne will not affect pricing dynamics.

Upcoming catalysts. In our view, the main forthcoming catalysts are: 1) the ASCO meeting in June, where the company is expected to report further analytic and clinical validation; and 2) top-line data from the U.S. oncology study around mid-year.

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

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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.

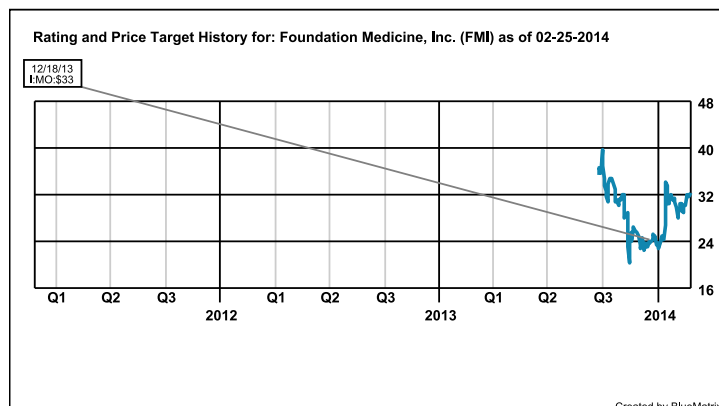
Market Underperform (MU): JMP Securities expects the stock price to underperform relevant market indices over the next 12 months.

JMP Securities Research Ratings and Investment Banking Services: (as of February 25, 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	241	56.05%	Buy	241	56.05%	90	37.34%
MARKET PERFORM	Hold	138	32.09%	Hold	138	32.09%	21	15.22%
MARKET UNDERPERFORM	Sell	8	1.86%	Sell	8	1.86%	0	0%
COVERAGE IN TRANSITION		43	10.00%		43	10.00%	0	0%
TOTAL:		430	100%		430	100%	111	25.81%

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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