

Concert Pharmaceuticals, Inc. (CNCE)

CNCE Reports 4Q14 and FY14 Earnings Results

MARKET DATA

Price	\$14.54
52-Week Range:	\$7.12 - \$15.84
Shares Out. (M):	17.9
Market Cap (\$M):	\$260.3
Average Daily Vol. (000):	98.0
Cash (M):	\$79
Cash/Share:	\$1.31
Enterprise Value (M):	\$52
Float (M):	16.0
LT Debt (M):	\$5

Source: Thomson Reuters and JMP Securities LLC

MARKET OUTPERFORM | Price: \$14.54 | Target Price: \$24.00

INVESTMENT HIGHLIGHTS

Concert Pharmaceuticals detailed 4Q14 and FY14 earnings results and pipeline progress; reiterate our Market Outperform rating and \$24 price target, based on DCF and SOTP valuation methodologies. During the call, CNCE announced updates on the progress of its pipeline with its three ongoing collaborators (CELG, MO, \$133; JAZZ, MO, Livnat; AVNR/Otsuka, NC) which, in our view, are a more relevant valuation metric than earnings. CNCE reported a FY14 net loss of \$32MM or EPS of (\$2.00), in line with the JMP estimate of (\$1.99). Total operating expense was \$40MM, comparable to our \$41.62MM estimate, which was primarily due to expenses associated with the development of CTP-354, JZP-386 and CTP-730. CNCE finished the quarter with \$79.2MM in cash, cash equivalents and short-term investments, providing sufficient cash runway into 2016. A summary of 4Q14 and FY14 actual results versus JMP estimates is shown in Figure 2, as well as changes to our model based on our expectations regarding operations costs (Figure 3).

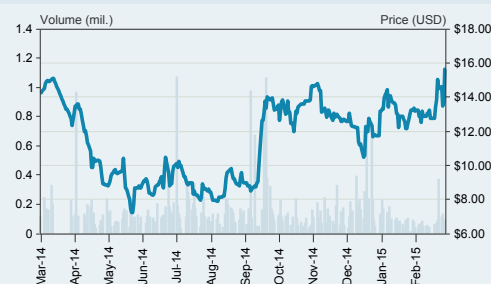
Slower pace than anticipated, but pipeline progress continues. Chief among the list of drivers for shareholder value is the continued advancement of AVP-786, partnered with AVNR, in the treatment of agitation in patients with Alzheimer's disease. As a reminder, Otsuka Pharmaceuticals, maker of the schizophrenia and depression drug Abilify, recently acquired AVNR. Importantly, since the acquisition, no licensing changes have been implemented. Per the original agreement, CNCE may receive \$2MM in milestone payments if AVP-786 moves into a Phase III trial. To that end, CNCE's partner is expected to meet with the FDA to discuss its potential advancement into a registrational study. Presently, AVP-786 is also in a Phase II trial for major depressive disorder (MDD). We remind investors that the company may be able to strategically steer AVP-786 into other indications. Also expected in 2015 are data from the second Phase I dosing trial of JZP-386 in the treatment of narcolepsy, partnered with JAZZ, in 2Q15. Collaborating with partner CELG, CNCE initiated a Phase I trial in inflammatory disease, which the company anticipates completing this year. Upon achieving this milestone, CNCE will realize \$8MM in payments from CELG. Although some were disappointed in the lack of greater clarity on the timing of the completion of the Special Protocol Assessment (SPA) for CTP-499 for diabetic neuropathy, CNCE expects to complete the molecule's registration pathway sometime before year-end 2015.

New candidate tries to take Kalydeco to a new level. CNCE announced a new clinical candidate it is pursuing: a deuterium-modified ivacaftor for the treatment of genetic disease cystic fibrosis (CF). Recall that Kalydeco (ivacaftor; VRTX, MO, Bayko) is currently approved for the treatment of CF in patients with the following mutations in the CFTR gene: G551D, G1244E, G1349D, G178R, G551S, S1251N, S1255P, S549N,

FY DEC	2013A	2014A	2015E
Revenue (\$M) 1Q	--	\$1.6	\$1.2
2Q	\$24.0	\$1.2	\$4.4
3Q	\$24.0	\$4.4	\$1.3
4Q	\$1.4	\$1.3	\$8.6
FY	\$25.4	\$8.6	\$14.0
EPS 1Q	--	(\$0.76)	(\$0.57)
2Q	(\$0.01)	(\$0.45)	(\$0.58)
3Q	(\$0.01)	(\$0.43)	(\$0.40)
4Q	(\$4.66)	(\$0.49)	(\$0.26)
FY	(\$4.99)	(\$2.00)	(\$1.67)
Previous FY	NC	(\$1.99)	(\$2.42)

Source: Company reports and JMP Securities LLC

STOCK PRICE PERFORMANCE



or S549R. While the two analogs (to define the one to advance) that CNCE is expecting to evaluate this year may exhibit greater stability and greater half-life than the currently approved ivacaftor, we currently ascribe no value to the program for the time being.

Further development of CTP-345 delayed until 2016. While the company did not disclose the findings of the study it obtained in January, following a three-month non-clinical investigation into the species-specific adverse events observed earlier in 3Q14 with CTP-345, CNCE did confirm that they were only seen in only one of two species studied. However, out of an abundance of caution, the company fully informed the FDA in 2014 of its findings, and delayed moving ahead to Phase II studies (as a treatment for spasticity). Further, the company reminded investors that the toxicology results seen with the single species may not translate into humans. Going forward, CNCE plans to conduct an additional non-clinical evaluation before advancing the development of CTP-345. We remain cautiously optimistic of the CTP-345 program.

Despite the CTP-354 delay, we continue to see significant upside potential for this deuterated drug company. We remain bullish on Concert Pharmaceuticals shares seeing several opportunities for growth over the next several years in addition to CTP-499 including: AVP-786, JZP-386, CTP-730, CTP-354, and a newly announced clinical candidate for CF. In our opinion, the company's DCE Platform[®] has all the requisite ingredients to allow CNCE to become one of the leading developers of unique, deuterated-therapeutic compounds.

FIGURE 1. Upcoming Milestones

Timing	Drug	Milestones
2Q15	JZP-386	Announce data from Phase I trial in normal volunteers (narcolepsy)
1H15	AVP-786	Conduct end of Phase 2 FDA meeting
1H15	deuterated-modified ivacaftor	Initiate clinical testing
1H15	CTP-354	Release results of non-clinical evaluation (further tox studies)
2015	AVP-786	Potential to initiate Phase 3 Alzheimer's Agitation study
2015	CTP-499	Potential for SPA
2015	CTP-730	Completion of Phase I clinical program (anti-inflammation)

Source: JMP Securities LLC and Company Reports

FIGURE 2. 4Q14 and FY14 Results vs. JMP Estimates

Concert Pharmaceuticals (CNCE) Abridged Income Statement (\$ MM)	4Q14 Results			FY14 Results		
	JMP Estimate	Actual	Variance (JMP vs. Actual)	JMP Estimate	Actual	Variance (JMP vs. Actual)
Total Revenues	-	1.31		7.27	8.58	
License revenue	-	1.31		5.27	6.58	
Milestone revenue	-	-		2.00	2.00	
Operating Expenses	11.50	10.06	(2.45)	41.62	39.17	(2.4)
Research and development	9.00	24.19	(2.43)	29.91	27.47	(2.4)
General and administrative	2.50	7.27	(0.01)	11.71	11.70	(0.0)
Operating income (loss)	(11.50)	(8.75)	3.76	(34.35)	(30.60)	3.8
Other income (expense)	0.00	(1.83)	0.00	0.00	(1.10)	(1.10)
			-			0.00
Pretax income (loss)	(11.50)	(8.75)	3.76	(34.35)	(31.70)	2.65
Net income (loss)	(9.50)	(20.83)	3.57	(35.21)	(31.64)	3.57
EPS Calculations						
Basic EPS	\$ (0.54)	\$ (1.82)	\$ (1.29)	\$ (1.99)	\$ (2.00)	\$ (0.01)
Diluted EPS	\$ (0.54)	\$ (1.82)	\$ (1.29)	\$ (1.99)	\$ (2.00)	\$ (0.01)
Basic shares outstanding	17.724	11.210	(1.881)	17.681	15.842	(1.839)
Diluted shares outstanding	17.724	11.210	(1.881)	17.681	15.842	(1.839)

Source: JMP Securities LLC and Company Reports

FIGURE 3. Changes to Our Model

Concert Pharmaceuticals (CNCE) (\$ MM)	4Q14E		FY 2014E		FY 2015E		FY 2016E	
	Old	New	Old	New	Old	New	Old	New
License revenue	2.8	1.3	2.8	6.6	0.0	0.0	0.0	0.0
Milestone revenue	2.0	0.0	2.0	2.0	0.0	0.0	0.0	0.0
Other								
Total Revenues	4.8	0.0	4.8	4.85	0.0	4.85	0.0	-
COGS	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross Profit	-	1.3	4.85	8.58	2.00	14.00	2.00	2.00
Operating Expenses	12.5	10.1	41.1	39.2	50.3	47.8	63.5	60.1
Research and development	9.5	7.1	30.3	27.5	37.9	34.3	49.3	44.6
General and administrative	3.0	3.0	10.8	11.7	12.4	15.5	14.2	15.5
Operating income (loss)	(12.5)	(8.7)	(36.2)	(30.6)	(48.3)	(33.8)	(61.5)	(58.1)
Other income (expense)	0.0	(0.2)	0.0	(1.10)	0.0	-	0.0	-
Interest income	0.0	0.0	0.0	(1.10)	0.0	-	0.0	-
Pretax income	(12.5)	(8.9)	(36.2)	(31.7)	(48.3)	(33.8)	(61.5)	(58.1)
Net income	(12.5)	(8.9)	(36.9)	(31.7)	(70.0)	(33.8)	(61.5)	(58.1)
Basic EPS	(\$0.70)	\$ (0.49)	(\$2.09)	\$ (2.00)	(\$2.39)	\$ (1.67)	(\$2.71)	\$ (2.56)
Diluted EPS	(\$0.70)	\$ (0.49)	(\$2.09)	\$ (2.00)	(\$2.39)	\$ (1.67)	(\$2.71)	\$ (2.56)
Basic shares outstanding	17.89	18.27	17.68	15.84	20.22	20.22	22.71	22.71
Diluted shares outstanding	17.89	18.27	17.68	15.84	20.22	20.22	22.71	22.71

Source: JMP Securities LLC and Company Reports

FIGURE 4. Income Statement

Concert Pharmaceuticals (CNCE)	1Q14A	2Q14A	3Q14A	4Q14A	2014A	1Q15E	2Q15E	3Q15E	4Q15E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Income Statement (\$MM)	1Q14A	2Q14A	3Q14A	4Q14A	2014A	1Q15E	2Q15E	3Q15E	4Q15E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Product Sales and Royalties:																				
CTP-354										8.0										
US Sales														48.7	218.7	351.9	471.8	614.0	701.5	731.8
ROW Royalties																				
CTP-499																				
US Sales														7.0	24.7	57.0	108.7	148.1	154.1	160.3
ROW Royalties															5.9	23.5	57.1	102.7	118.9	133.9
JZP-386																				
Royalties from Jazz													1.8	7.6	25.4	46.9	81.0	117.3	142.6	147.7
Milestone Payments										4.0		8.0	35.0					70.0		
AVP-786										2.0										
Royalties from Avanir											2.0			4.3	16.4	45.8	89.6	134.2	146.8	161.5
Milestone Payments														37.0	43.0			125.0		
Total Product Sales and Royalties	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	14.0	2.0	8.0	36.8	104.6	334.1	525.0	808.2	1,186.3	1,388.8	1,335.3
License and research and development revenue	1.6	1.2	2.4	1.31	6.6	1.0	1.0	1.0	1.0											
Milestone Revenue	0.0		2.0	0.0	2.0			4.0	10.0											
Total Revenue	1.6	1.2	4.4	1.3	8.6	1.0	1.0	5.0	7.0	14.0	2.0	8.0	36.8	104.6	334.1	525.0	808.2	1,186.3	1,388.8	1,335.3
Cost of Goods Sold											0.0	0.0	0.0	3.9	17.5	28.2	37.7	49.1	56.1	58.5
Gross Profit	1.6	1.2	4.4	1.3	8.6	1.0	1.0	5.0	7.0	14.0	2.0	8.0	36.8	100.7	316.6	496.9	770.5	1,137.2	1,332.7	1,276.8
Operating Expenses:																				
Research and Development	5.6	6.2	8.6	7.1	27.5	8.0	8.0	8.5	8.5	34.3	44.6	51.3	57.5	62.1	67.1	72.4	78.2	82.1	88.7	95.8
General and administrative	2.5	2.7	3.5	3.0	11.7	3.5	3.5	3.7	3.7	13.5	15.5	23.2	29.0	33.4	38.9	38.9	42.0	45.4	49.0	51.5
Total operating expenses	8.1	9.0	12.0	10.1	39.2	11.5	11.5	12.2	12.2	47.8	60.1	74.6	86.5	95.5	103.1	111.4	120.3	127.5	137.7	147.3
Operating income (loss)	(6.5)	(7.7)	(7.6)	(8.7)	(30.6)	(10.5)	(10.5)	(7.2)	(5.2)	(33.8)	(58.1)	(66.6)	(49.8)	5.3	213.5	385.5	650.2	1,009.6	1,195.0	1,129.5
Other income (expense):																				
Investment income	0.0	0.0																		
Interest expense	(0.4)	-0.3	(0.2)	0.0	-1.1															
Payment to GSK													(2.5)							
Total other income, net	(0.4)	(0.3)	(0.2)	(0.2)	(1.1)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other comprehensive loss:																				
Unrealized loss on investments	0.0																			
Change in fair value of preferred stock warrant liability																				
Foreign currency transaction gain (loss)																				
Pretax income (loss)	(6.9)	(8.0)	(7.8)	(8.9)	(31.7)	(10.5)	(10.5)	(7.2)	(5.2)	(33.8)	(58.1)	(66.6)	(49.8)	5.3	213.5	385.5	650.2	1,009.6	1,195.0	1,129.5
Income tax benefit (provision)					0.0					0.0	0.0	0.0	0.0	0.0	(32.0)	(77.1)	(162.6)	(302.9)	(418.2)	(395.3)
Tax Rate					0%					0%	0%	0%	0%	0%	15%	20%	25%	30%	35%	35%
Comprehensive income (loss)	(6.9)	(8.0)	(7.8)	(8.9)	(31.7)	(10.5)	(10.5)	(7.2)	(5.2)	(33.8)	(58.1)	(66.6)	(49.8)	5.3	181.5	308.4	487.7	706.7	776.7	734.2
Accretion of redeemable convertible preferred stock	0.06				-0.06															
Net income (loss) attributable to common stockholders	(6.9)	(8.0)	(7.8)	(8.9)	(31.6)	(10.5)	(10.5)	(7.2)	(5.2)	(33.8)	(58.1)	(66.6)	(49.8)	5.3	181.5	308.4	487.7	706.7	776.7	734.2
Basic EPS to common shareholders	\$ (0.76)	\$ (0.45)	\$ (0.43)	\$ (0.49)	\$ (2.00)	\$ (0.57)	\$ (0.58)	\$ (0.40)	\$ (0.26)	\$ (1.67)	\$ (2.56)	\$ (2.93)	\$ (1.98)	\$ 0.19	\$ 6.56	\$ 10.24	\$ 14.95	\$ 21.68	\$ 23.84	\$ 22.54
Diluted EPS to common shareholders	\$ (0.76)	\$ (0.45)	\$ (0.43)	\$ (0.49)	\$ (2.00)	\$ (0.57)	\$ (0.58)	\$ (0.40)	\$ (0.26)	\$ (1.67)	\$ (2.56)	\$ (2.93)	\$ (1.98)	\$ 0.19	\$ 6.60	\$ 10.28	\$ 15.02	\$ 21.77	\$ 23.94	\$ 22.64
Basic shares outstanding	9.2	17.8	18.1	18.3	15.8	18.5	18.2	18.0	20.4	20.2	22.7	22.7	25.2	27.7	27.6	30.1	32.6	32.6	32.6	32.6
Diluted shares outstanding	9.2	17.8	18.1	18.3	15.8	18.5	18.2	18.0	20.4	20.2	22.7	22.7	25.2	27.5	27.5	30.0	32.5	32.5	32.4	32.4
% change in diluted shares outstanding						27.6%	12.3%	-0.1%	11.0%	9.3%	-0.1%	9.0%	8.3%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%

Source: JMP Securities LLC and Company Reports

Company Description

Concert Pharmaceuticals is a clinical stage biopharmaceutical company seeking to discover and develop novel small molecule drugs through the improvement of existing drugs and clinical candidates, via deuterium substitution. Deuterium substitution can lead to drugs with superior pharmacokinetic or metabolic properties, improved clinical safety, tolerability, and/or efficacy. Deuterated analogs of approved drugs may also be able to enjoy expedited pathways to FDA approval. The firm currently has a trio of clinical-stage product candidates, including CTP-354, for spasticity associated with multiple sclerosis, CTP-499 for diabetic kidney disease, and AVP-786 for neurologic and psychiatric disorders, through a collaboration with Avanir Pharmaceuticals. The firm is also in ongoing collaboration with Celgene Corporation for deuterated compounds, including CTP-730 for inflammatory diseases, and with Jazz Pharmaceuticals for JZP-386, the active ingredient in Xyrem, which is in pre-clinical development for narcolepsy.

Investment Risks

Clinical risk. Products undergoing clinical trials may have serious safety concerns, lack efficacy, or fail to demonstrate statistical significance, any of which would preclude them from continuing clinical development and eventual commercialization. If the company's Deuterated Chemical Entity (DCE) Platform® technology is not proven, there will likely be downside to the share price as well as risk to the viability of the company. In addition, CNCE has not yet demonstrated an ability to successfully conduct a large-scale pivotal clinical trial, obtain marketing approvals, manufacture a commercial scale product, or to conduct the sales and marketing activities necessary for successful product commercialization.

Collaboration risk. CNCE will depend upon collaborations with third parties for the development and commercialization of some of the company's product candidates and expects to continue to do so in the future. CNCE's business model relies on making use of its DCE platform to partner with Pharmaceutical and Biotechnology companies to improve existing drug candidates. CNCE's prospects with respect to those product candidates will depend in significant part on the success of those collaborations.

Manufacturing risk. CNCE is a clinical-stage biopharmaceutical company applying its extensive knowledge of deuterium chemistry to discover and develop novel small molecule drugs. Because there are limited sources of deuterium, CNCE and its collaborators are exposed to a number of risks and uncertainties associated with the company's deuterium supply. In particular, manufacturing processes for many drug candidates, including those for CTP-499 and certain others, are projected to require large quantities of deuterium for late-stage clinical trials and for commercialization. Consequently, any adverse impact on CNCE's ability to obtain deuterium oxide could have a significant impact on the company's ability to develop or commercialize product candidates. Similarly, CNCE's collaborators will also need to obtain supplies of deuterium and will be subject to risks and requirements in connection with sourcing deuterium similar to the ones the company faces.

Intellectual property risk. As of December 31, 2013, CNCE held 100 issued patents worldwide, including 50 issued patents in the United States. CNCE's patents and patent applications for its lead programs are set to expire between 2028 and 2034. The company may be sued by a competitor on patent infringement or have to undergo litigation that would incur substantial fees. The company could lose a case, which would make it susceptible to generic risk.

Financial risk. Concert Pharmaceuticals currently derives revenue from research and development funding and from license or collaboration agreements. The company is not yet profitable and has a history of operating losses that are expected to continue in the near future. Developing pharmaceutical products, including conducting pre-clinical studies and clinical trials, is a time-consuming, expensive, and uncertain process that takes years to complete. CNCE needs to continue financing clinical trials through to completion and it may be unable to secure additional funding, forcing it to delay, reduce, or eliminate product development programs or commercialization efforts. The company has incurred significant losses since its inception and should expect losses to occur for the next several years.

Competitive risk. CNCE faces competition from marketers of other treatments for the indications that it seeks to develop drugs for, including major pharmaceutical firms and biotech firms. The firm's products will also have to compete with existing treatments that have already become generically available (e.g., CTP-354 will have to compete with other spasticity drugs, such as baclofen, tizanidine, diazepam, and dantrolene).

Regulatory risk. CNCE or its collaborators, may, in some instances, be able to secure clearances from the FDA or comparable foreign regulatory authorities to use expedited development pathways. If it is unable to obtain such clearances, CNCE or its collaborators may be required to conduct additional pre-clinical studies or clinical trials beyond those contemplated, which could increase the expense of obtaining, and delay the receipt of, necessary marketing approvals.

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 Michael G. King

JMP Securities Disclosures:

JMP Securities currently makes a market in the securities of Concert Pharmaceuticals, Inc., Avanir Pharmaceuticals, Inc., Celgene Corporation, Jazz Pharmaceuticals, Inc. and Vertex Pharmaceuticals Incorporated

JMP Securities was manager or co-manager of a public offering of securities for Avanir Pharmaceuticals, Inc. (AVNR) in the past 12 months, and received compensation for doing so.

JMP Securities expects to receive OR intends to seek compensation for investment banking services from Concert Pharmaceuticals, Inc., Avanir Pharmaceuticals, Inc. and Jazz Pharmaceuticals, Inc. in the next 3 months.

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.

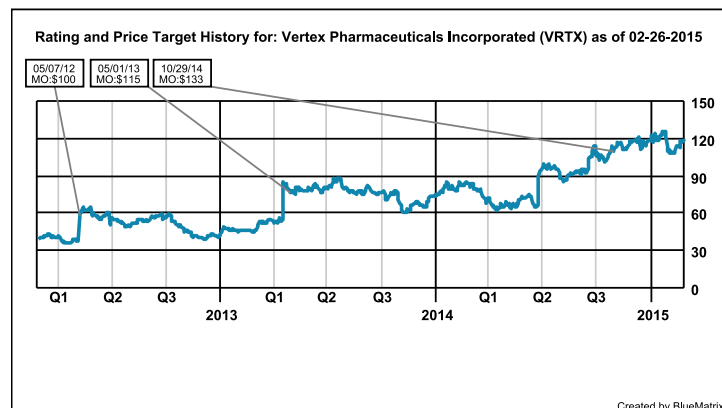
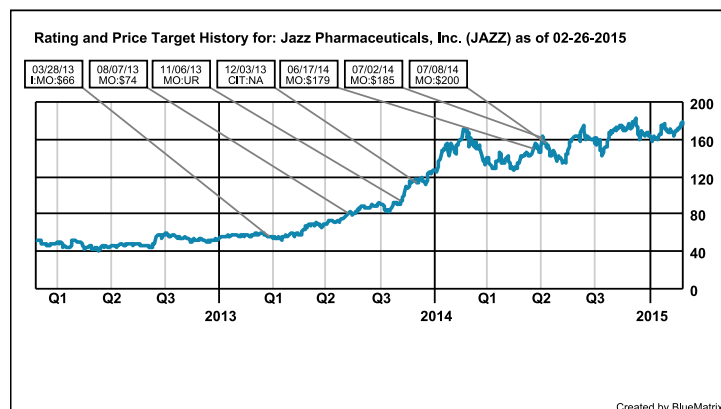
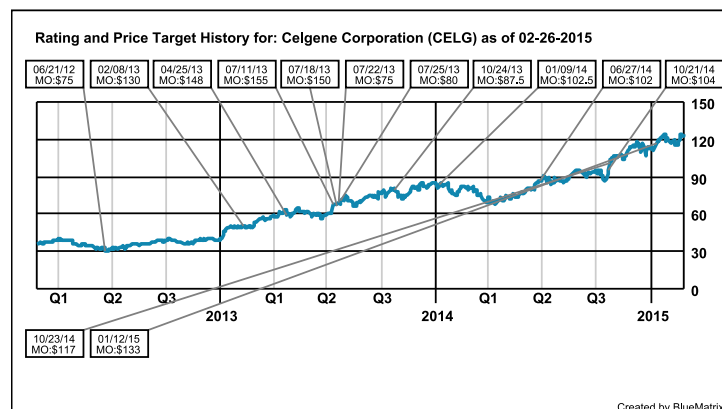
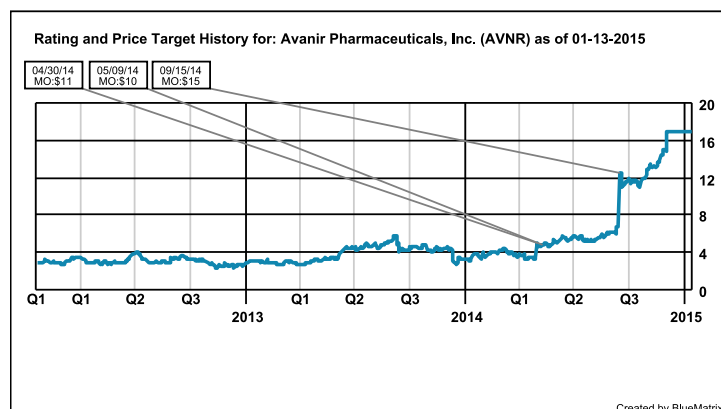
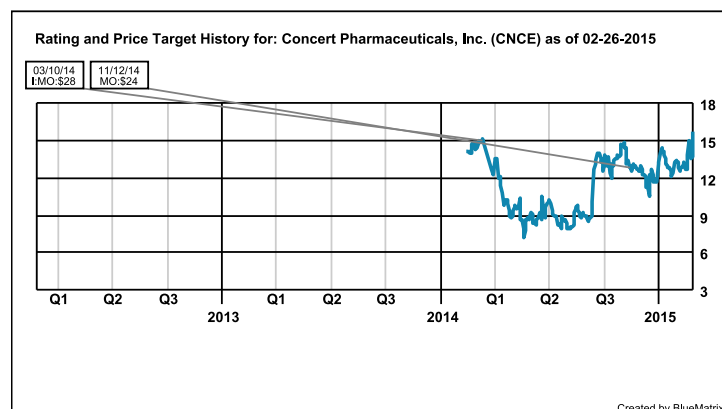
Market Underperform (MU): JMP Securities expects the stock price to underperform relevant market indices over the next 12 months.

JMP Securities Research Ratings and Investment Banking Services: (as of February 27, 2015)

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	282	62.95%	Buy	282	62.95%	89	31.56%
MARKET PERFORM	Hold	155	34.60%	Hold	155	34.60%	22	14.19%
MARKET UNDERPERFORM	Sell	8	1.79%	Sell	8	1.79%	0	0%
COVERAGE IN TRANSITION		1	0.22%		1	0.22%	0	0%
TOTAL:		448	100%		448	100%	113	25.22%

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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