

Verastem, Inc.  
Form 10-K  
March 26, 2013

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

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**FORM 10-K**

(Mark  
One)

ý **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2012**

or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number 001-35403**

**Verastem, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**27-3269467**  
(I.R.S. Employer  
Identification No.)

**215 First Street, Suite 440**  
**Cambridge, Massachusetts**  
(Address of principal executive offices)

**02142**  
(Zip Code)

Registrant's telephone number, including area code: **(617) 252-9300**

Securities registered pursuant to Section 12(b) of the Act:

**Title of each class**  
Common Stock, \$0.0001 par value

**Name of each exchange on which registered**  
NASDAQ Global Market

Securities registered pursuant to Section 12(g) of the Act: **None**

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## Edgar Filing: Verastem, Inc. - Form 10-K

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.  Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer       Accelerated filer       Non-accelerated filer       Smaller reporting company

(Do not check if a  
smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  Yes  No

Aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 29, 2012 was \$89,675,000.

The number of shares outstanding of the registrant's common stock as of February 28, 2013 was 21,152,465.

### DOCUMENTS INCORPORATED BY REFERENCE

Portions of our definitive proxy statement to be delivered to stockholders in connection with the 2013 Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report on Form 10-K.

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**FORWARD-LOOKING STATEMENTS**

This Annual Report on Form 10-K contains forward-looking statements that involve substantial risks and uncertainties. All statements, other than statements of historical facts, contained in this Annual Report on Form 10-K, including statements regarding our strategy, future operations, future financial position, future revenues, projected costs, prospects, plans and objectives of management, are forward looking statements. The words "anticipate," "believe," "estimate," "expect," "intend," "may," "plan," "predict," "project," "target," "potential," "will," "would," "could," "should," "continue" and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words.

Forward-looking statements are not guarantees of future performance and our actual results could differ materially from the results discussed in the forward-looking statements. Factors that could cause actual results to differ materially from those in the forward-looking statements include, but are not limited to, our ability to raise additional capital to support our clinical development program and other operations, our ability to develop products of commercial value and to identify, discover and obtain rights to additional potential product candidates, our ability to protect and maintain our intellectual property and the ability of our licensors to obtain and maintain patent protection for the technology or products that we license from them, the outcome of research and development activities and the fact that the preclinical and clinical testing of our compounds may not be predictive of the success of later clinical trials, our reliance on third-parties, competitive developments, the effect of current and future legislation and regulation and regulatory actions, as well as other risks described in this Annual Report on Form 10-K and other filings with the Securities and Exchange Commission, or SEC.

As a result of these and other factors, we may not actually achieve the plans, intentions or expectations disclosed in our forward-looking statements, and you should not place undue reliance on our forward-looking statements. Our forward-looking statements do not reflect the potential impact of any future acquisitions, mergers, dispositions, joint ventures or investments we may make. We do not assume any obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

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**PART I**

**Item 1. Business**

**OVERVIEW**

We are a clinical biopharmaceutical company focused on discovering and developing drugs to treat cancer by the targeted killing of cancer stem cells. We also develop proprietary companion diagnostics. A cancer stem cell is a particularly aggressive type of tumor cell, resistant to conventional cancer therapy, that we believe is an underlying cause of tumors, their recurrence and metastasis. We have proprietary technology to create a stable population of cancer stem cells that we use to screen for and identify small molecule compounds that target cancer stem cells. Our most advanced programs target the Focal Adhesion Kinase, or FAK, and the PI3K/mTOR signaling pathways. Our lead FAK inhibitor, VS-6063, is currently in Phase 1/1b testing in ovarian cancer and we expect to initiate a potentially pivotal trial of VS-6063 in mesothelioma midyear 2013 for which we have applied for orphan drug designation in both the United States and the European Union. In addition to VS-6063, our FAK inhibitor VS-4718 and PI3K/mTOR inhibitor VS-5584 are expected to enter Phase 1 clinical trials in patients with advanced cancers in the first and second half of 2013, respectively.

Cancer is a group of diseases characterized by uncontrolled growth and spread of abnormal cells. The American Cancer Society estimated that in the United States in 2011, approximately 1.6 million new cases of cancer would be diagnosed and nearly 600,000 people would die from the disease. Current treatments for cancer include surgery, radiation therapy, chemotherapy, hormone therapy and targeted therapy. According to estimates by the National Institutes of Health, in the United States in 2010, the direct medical costs of cancer of all types exceeded \$100 billion. IMS Health estimates that in the United States in 2010, approximately \$22 billion was spent on drugs to treat cancer, representing the largest class of drug spending in the United States. Despite years of intensive research and clinical use, current treatments often fail to cure cancer.

We believe that a key reason for the ultimate failure of many current therapies to achieve a durable clinical response is the presence of cancer stem cells, or CSCs, which are also sometimes referred to as tumor-initiating cells, within tumors. CSCs have been identified in many types of cancer, including mesothelioma, ovarian, breast, pancreatic, colon, brain, lung and leukemia. Following many cancer treatments, the tumor can remain with a high percentage of CSCs and become more aggressive and resistant to further treatment. In addition, patients who relapse often develop metastatic disease in which the cancer spreads to other sites in the body. Tumor metastasis to critical organs is the cause of more than 90% of cancer deaths. We believe that it is the drug resistance and ability of CSCs to spread to other sites in the body that may be the root causes of these therapies failing. Accordingly, our mission is to develop drugs targeting CSCs that either in combination with other cancer treatments or alone can target all of the cells comprising a tumor and, thus, create a durable clinical response.

Our most advanced product candidates are VS-6063, VS-4718 and VS-5584. We are currently evaluating these compounds in preclinical and, in the case of VS-6063, clinical studies as potential therapies for certain cancers, including mesothelioma, ovarian and breast. We believe that these compounds may be especially beneficial as therapeutics in aggressive cancers driven by CSCs that have a poorer prognosis and lower overall survival rate than other types of cancer.

An important element of our business strategy is the development and use of proprietary, companion diagnostics in connection with the development of our therapeutic drug candidates. We plan to use these diagnostics as part of a personalized medicine approach to identify patients that we believe will benefit most from our therapies. We also believe that our diagnostics may be used to monitor patients' progress on therapy and aid physicians' ongoing treatment decisions.

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**OUR MANAGEMENT TEAM AND SCIENTIFIC CO-FOUNDERS AND ADVISORS**

Our experienced management team includes our Chairman, Chief Executive Officer and co-founder Christoph Westphal, M.D., Ph.D., our President and Chief Operating Officer, Robert Forrester, our Chief Medical Officer, Joanna Horobin, M.B., Ch.B., our Vice President, Head of Research, Jonathan Pachter, Ph.D., and our Vice President, Head of Corporate Development and Diagnostics, Daniel Paterson.

Dr. Westphal has been involved in founding a number of biotechnology companies as chief executive officer, including Sirtris Pharmaceuticals, Inc., which was acquired by GlaxoSmithKline plc in 2008, as well as Alnylam Pharmaceuticals, Inc. and Momenta Pharmaceuticals, Inc. Dr. Westphal also co-founded Alnara Pharmaceuticals, Inc., which was acquired by Eli Lilly and Co. in 2010.

Mr. Forrester has been the chief executive officer, chief operating officer and chief financial officer of both private and public life science companies, including Forma Therapeutics, Inc., CombinatoRx, Inc., now Zalicus Inc., and Coley Pharmaceutical Group, Inc., which was acquired by Pfizer Inc. in 2007.

Dr. Horobin has 30 years of pharmaceutical drug development experience in senior development and executive roles in both public and private companies. Dr. Pachter has over 20 years of experience in leading the discovery and translational research of small molecule and monoclonal antibody therapeutics for the treatment of cancer, most recently as the Senior Director of Cancer Biology at OSI Pharmaceuticals Inc., which was acquired by Astellas Pharma Inc. in 2010. Mr. Paterson has over 20 years of experience in management roles at healthcare and biotechnology companies, including as Chief Executive Officer and Chief Operating Officer, and specific expertise in oncology drug and diagnostic product development.

Our scientific co-founders are recognized leaders in the field of cancer biology. Robert Weinberg, Ph.D., Founding Member of the Whitehead Institute and Professor of Biology at MIT, has played a key role in identifying the genetic basis of cancer. Dr. Weinberg discovered the first tumor oncogene, the first tumor suppressor gene, the role of a protein related to the cell surface receptor HER2 in preclinical studies and the mechanisms underlying the formation of CSCs. Eric Lander, Ph.D., Founding Director of the Broad Institute, Professor of Biology at MIT and Professor of Systems Biology at Harvard Medical School, played a central role in the Human Genome Project. Collaborative research in the labs of Dr. Lander and Dr. Weinberg developed our proprietary technology for use in the identification of drugs targeting CSCs and a genetic expression signature, useful as a biomarker, to monitor the effect of treatment.

Our management team is supported by our scientific advisory board comprised of leading academic and industry scientists. Our scientific advisory board consists of:

*Scientific advisory board*

Robert Weinberg, Ph.D.

*Scientific co-founder and chair*

Founding Member of the Whitehead Institute for Biomedical Research, Professor of Biology at the Massachusetts Institute of Technology and recipient of the 1997 National Medal of Science

Eric Lander, Ph.D.

*Scientific co-founder*

Founding Director of the Broad Institute, Professor of Biology at the Massachusetts Institute of Technology and Professor of Systems Biology at Harvard Medical School

José Baselga, M.D., Ph.D.

Physician in Chief at Memorial Sloan Kettering Cancer Center  
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*Scientific advisory board*

George Daley, M.D., Ph.D.	Professor of Hematology and Oncology and Director of the Stem Cell Transplantation Program at Children's Hospital and Professor of Biological Chemistry and Molecular Pharmacology at Harvard Medical School
Peter Elliott, Ph.D.	Former Senior Vice President and Head of Research and Development of Sirtris Pharmaceuticals, Inc., former Vice President of Pharmacology and Drug Development of Millennium Pharmaceuticals, Inc. and co-developer of Velcade
Daniel Haber, M.D., Ph.D.	Director of the Massachusetts General Hospital Cancer Center and Professor of Medicine at Harvard Medical School
Richard Sackler, M.D.	Co-chairman, Purdue Pharma and Adjunct Professor of Genetics at Rockefeller University
Joseph (Yossi) Schlessinger, Ph.D.	Chairman and Professor in the Department of Pharmacology at Yale School of Medicine
Phillip A. Sharp, Ph.D.	Institute Professor at the David H. Koch Institute for Integrative Cancer Research at the Massachusetts Institute of Technology and recipient of the 1993 Nobel Prize in Medicine and Physiology
Roger Tung, Ph.D.	President and Chief Executive Officer of Concert Pharmaceuticals, Inc., former Vice President of Drug Discovery of Vertex Pharmaceuticals, Inc. and co-inventor of Lexiva and Agenerase
Christopher Walsh, Ph.D.	Hamilton Kuhn Professor in the Department of Biological Chemistry and Molecular Pharmacology at Harvard Medical School
Max Wicha, M.D.	Director, University of Michigan Comprehensive Cancer Center and Distinguished Professor of Oncology at the University of Michigan
Eric Winer, M.D.	Director of the Breast Oncology Center at the Dana Farber Cancer Institute and Professor of Medicine at Harvard Medical School

**THE PROBLEM**

The cancer death rate in the United States has only decreased modestly since the early 1990s. Cancer remains one of the world's most serious health problems and is the second most common cause of death in the United States after heart disease. The American Cancer Society estimated that in the United States in 2011, approximately 1.6 million new cases of cancer would be diagnosed and nearly 600,000 people would die from the disease. According to estimates by the National Institutes of Health, in the United States in 2010, the direct medical cost of cancer of all types exceeded \$100 billion and the cancer type responsible for the highest individual disease costs was breast cancer at \$16.5 billion.

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The following table sets forth the U.S. annual incidence, based on 2011 estimates from the American Cancer Society, and the prevalence, or the number of people in the United States who have been previously diagnosed with cancer, based on 2010 estimates from the National Cancer Institute, for select cancers in which CSCs have been implicated.

<b>Cancer type</b>	<b>U.S. annual incidence</b>	<b>U.S. prevalence</b>
Breast	230,480	2,645,621
Lung and bronchus	221,130	373,489
Colorectal	141,210	1,110,077
Leukemia	44,600	253,350
Pancreatic	44,030	34,657
Brain and other nervous system cancers	22,340	128,193

For tumors that have not yet metastasized and remain localized to the site of original tumor formation, current treatments for cancer can be effective in initially reducing tumor burden. However, for many forms of cancer, current treatments lack sufficient efficacy to achieve a durable clinical response. Following initial treatment, the tumor may recur at the same site or metastasize and spread to other sites in the body. The vast majority of patients who succumb to cancer are killed by tumors that have metastasized. This is illustrated by the information in the following table, which shows, according to the National Cancer Institute's SEER Cancer Statistics Review, 2001-2007, the reduction in five-year survival rate for breast cancer patients based on the stage of the disease at the time at which the disease is diagnosed. The percentage of patients diagnosed at each stage of disease, referred to as stage distribution, is included below for comparative purposes.

<b>Breast cancer stage at diagnosis</b>	<b>Stage distribution(1)</b>	<b>Five-year relative survival rate</b>
Localized (confined to primary site)	60%	98.6%
Regional (spread to regional lymph nodes)	33%	83.8%
Distant (cancer has metastasized)	5%	23.4%

(1) 2% of breast cancer cases were designated as unknown stage.

With the application of new technologies and key discoveries, we believe that we are now entering an era of cancer research characterized by a more sophisticated understanding of the biology of cancer. We believe that the discovery of CSCs and the role that they play in cancer development are important new insights that present the opportunity to develop more effective treatments.

Cancer stem cells

We believe that CSCs, which are sometimes referred to as tumor-initiating cells, are responsible for the initiation, metastasis and recurrence of many cancers. CSCs have the ability to:

move freely and proliferate without attachment to other cells or surfaces;

initiate a tumor;

self-renew;

produce other cancer cell types; and

resist many current cancer treatments.

CSCs are often characterized by a distinctive set of biomarkers, which we believe may be a key to identifying patients with tumors that are likely to respond to therapies targeting CSCs.





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CSCs may be more resistant to current cancer treatments than other types of cancer cells. Thus, as illustrated in the figure below, while current treatments may succeed at initially decreasing tumor burden, they may leave behind a population of CSCs that can regenerate tumors. Therefore, the presence of a mixture of CSCs and other types of cancer cells within a tumor may necessitate a therapeutic approach combining drugs that can kill both cell populations.

The need to target CSCs may apply across the treatment of a broad range of cancers. CSCs have been isolated and characterized from many types of cancer, including mesothelioma, ovarian, breast, pancreatic, colon, brain, lung and leukemia. The CSCs isolated from each of these tumor types have been found to confer greater tumor-forming capability when transplanted into mice than other types of cancer cells from the same tumor.

Several specific signaling pathways have been implicated in CSC biology. FAK is a central signaling node in the development of CSCs and critical for the establishment of metastases. In 2012, research conducted in Dr. Weinberg's laboratory and published in *Cancer Discovery* elucidated the role of FAK in breast cancer disease progression. This work found that increased FAK activity leads to increases in the metastatic capability of cancer cells following the process of epithelial to mesenchymal transition, an underlying mechanism in CSC development. Similarly, the role of PI3K/mTOR signaling has also been linked to disease progression and the survival of CSCs in multiple types of solid tumors and leukemia.

An increase in the proportion of CSCs in response to chemotherapy has been observed in clinical studies. For example, at the Baylor College of Medicine, breast cancer biopsies were taken from patients at the time of initial diagnosis and again following 12 weeks of treatment with docetaxel, a standard cancer chemotherapy widely used to treat breast cancer. The biopsies taken after 12 weeks of treatment showed increased expression of biomarkers for CSCs and an increased number of chemoresistant cells as compared to biopsies taken at the time of initial diagnosis. This result indicates that the CSC component of the tumor was relatively resistant to the chemotherapy. Moreover, it supports our belief that either a combination of treatments or a single therapy that can effectively target both CSCs and other types of cancer cells is critical to create a durable clinical response.

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**OUR SOLUTION**

Our solution is to discover and develop a next generation of oncology therapeutics targeting CSCs along with companion diagnostics. We believe that by developing therapeutics that target CSCs we can address the problem of cancer recurrence and metastasis. To achieve a durable clinical response, we believe that it may be necessary to kill both CSCs and other types of cancer cells in a tumor, as illustrated in the figure below, either with a combination of current cancer treatments and CSC-targeted drugs or a single therapeutic found to target both cancer cell populations.

*Our proprietary technology*

A persistent problem in the discovery of drugs targeting CSCs is the difficulty of isolating large numbers of CSCs. Without such large numbers, the discovery of drugs targeting CSCs using high-throughput screening is extremely difficult. Moreover, when CSCs are isolated, they typically do not remain stable in culture. Instead, over a short period of time, CSCs convert into other types of cancer cells. To address this problem, our scientific co-founders developed proprietary technology to create a stable population of CSCs that are suitable for use in high-throughput screening of small molecule compounds. These stable CSCs are similar to natural CSCs in that they are drug resistant and capable of initiating new tumors. We and scientists at the Whitehead Institute and the Broad Institute have used our technology and high-throughput screening methods to evaluate the ability of over 300,000 compounds to kill CSCs.

*Biomarkers and diagnostics*

Because of the high level of toxicity of traditional chemotherapies and the variability in response of tumors to these treatments, it is critically important to get the right cancer drug to the right patient. As a result, the oncology field has been at the forefront of developing diagnostics to select patients who may benefit from specific therapies, which is sometimes referred to as personalized medicine. We are developing diagnostics designed to enhance our ability to deliver the right drug to the right patient.

We believe that our diagnostics will enable us to identify patients that are the most likely to benefit from our drug candidates. By screening to identify these patients, we expect to be able to select appropriate patients for enrollment in our clinical trials and ultimately, if we obtain marketing approval, patients who are likely to respond to our therapies. We also plan to use these diagnostics to measure the selective killing of CSCs by our drug candidates as one of the ways of determining their efficacy.

We expect that our use of proprietary diagnostics may accelerate the clinical development process. We believe that use of these diagnostics may provide early, objective signals of drug activity to guide us to optimal dosing and the sequencing of agents more quickly. We also believe that this approach may ultimately enable physicians to identify patients who are likely to benefit most from these therapies and make better clinical decisions during therapy.

We are working on companion diagnostics for our therapeutic programs based on both in-licensed and internally developed technology and science. We believe that augmenting our internal capabilities

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with external collaborations with experienced third parties can reduce development risk and accelerate our progress in this field.

**OUR STRATEGY**

We believe that a key reason for the failure of many current cancer treatments is that they fail to kill CSCs, which we believe are responsible for the initiation, metastasis and recurrence of many cancers. Our goal is to build a leading biopharmaceutical company focused on the discovery, development and, ultimately, commercialization of novel drugs and companion diagnostics targeting CSCs. Key elements of our strategy to achieve this goal are:

Execute on the potentially pivotal trial of VS-6063 in mesothelioma. We have met with the regulatory agencies in the United States and the United Kingdom and, based on these discussions, we believe that positive results from this trial will enable us to seek regulatory approval for VS-6063 in mesothelioma.

Rapidly advance our product candidates through clinical development. We have initiated a clinical trial combining VS-6063 with the standard chemotherapy paclitaxel in patients with ovarian cancer. We are planning additional clinical trials with VS-6063, VS-4718 and VS-5584 in 2013 and we expect to initiate further clinical trials over the next several years.

Expand the indications in which our product candidates may be used. In parallel to the mesothelioma and ovarian trials, we plan to pursue additional disease indications as we believe CSCs are implicated in many types of tumors, including ovarian, breast, pancreatic, colon, brain, lung and leukemia.

Develop diagnostics for therapeutic products targeting CSCs. We plan to develop companion diagnostic products to support our therapeutic product candidates. We believe that use of these diagnostics may aid in the selection of patients for enrollment in our clinical trials and, if we obtain marketing approval, patients who are most likely to benefit from therapy with our drugs. We also believe that these diagnostics may be used to monitor patients' progress on therapy and aid physicians' ongoing treatment decisions.

Collaborate selectively to augment and accelerate translational research, development and commercialization. We may seek third-party collaborators for the development and eventual commercialization of our product candidates. In particular, we may enter into third-party arrangements for target oncology indications in which our potential collaborator has particular expertise or for which we need access to additional research, development or commercialization resources.

Consider in-licensing rights to additional compounds. We may pursue the acquisition or in-license from third parties of rights to additional compounds that target CSCs. We believe that our approach of identifying CSC targeting drug candidates from external sources at various stages of development to supplement our internal programs may allow us to initiate clinical development of a diverse pipeline of compounds more quickly than if we were to focus solely on internally developed candidates.

Maintain scientific leadership in the CSC field. We plan to continue to conduct research in the CSC field to further our understanding of the underlying biology of cancer progression and metastasis. We also plan to continue fostering relationships with top scientific advisors, researchers and physicians. We believe that investing in the recruitment of exceptional advisors, employees and management is critical to leadership in the CSC field.

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**OUR PRODUCT CANDIDATES**

Overview

Using our proprietary technology and high-throughput screening methods, we are evaluating compounds for their activity against CSCs in a way that we believe has not been previously possible. We are focused on the discovery and development of small molecules to allow flexibility in the design of molecules for optimized efficacy and safety primarily as orally available drug candidates.

We intend to incorporate patient selection markers and CSC-specific biomarkers into companion diagnostics for our product candidates for use in identifying patients who are likely to benefit from treatment. We may use this information to aid in the selection of patients for late stage clinical trials. For example, we may use a clinical test for the expression status of the protein merlin in our potentially pivotal mesothelioma trial. We also plan to utilize these diagnostics to measure the effect that our product candidates have on CSCs in a tumor.

Conventional chemotherapy works by stopping the function of cancer cells through a variety of mechanisms. Chemotherapies are usually not targeted at any specific differences between cancer cells and normal cells. Rather, they kill cancer cells because cancer cells generally grow more rapidly than normal cells and, as a result, are relatively more affected by the chemotherapy than normal cells. Because CSCs exhibit mechanisms of resistance, including a slower rate of growth than other cancer cells, they are often not susceptible to conventional chemotherapy. As a result, the treatments may succeed at initially decreasing tumor burden but ultimately fail to kill the CSCs.

To enhance therapeutic benefit, we may use our product candidates in combination with existing therapies in an effort to target both CSCs and other types of cancer cells. This approach is being utilized in our ongoing ovarian cancer trial of VS-6063 in combination with paclitaxel. A second approach to using CSC-targeting drugs in combination with chemotherapy is based upon the timing (or sequencing) of drug treatment. We believe that using our CSC-targeting drugs immediately following chemotherapeutic treatments (known as maintenance therapy) may complement the overall effect of treatment by eliminating the residual CSCs following chemotherapeutic treatment. We intend to use this approach in our planned potentially pivotal study of VS-6063 in mesothelioma.

We are developing our product candidates for the treatment of multiple cancer types, initially mesothelioma, ovarian and breast cancer, and in the future, other cancers driven by CSCs. We believe that our product candidates target CSCs that have been implicated in aggressive cancers, metastasis and chemotherapeutic resistance.

**MESOTHELIOMA**

Overview

Malignant mesothelioma is a malignant tumor of mesothelial cells which make up the pleura, or tissue lining, of many internal organs. Mesothelioma most commonly occurs in the pleura surrounding the lung, but occasionally involving the peritoneum surrounding internal organs of the digestive tract, the lining of the heart or the lining of the testis.

Asbestos fibers are the cause of most cases of mesothelioma. The proportion of men with mesothelioma directly attributable to occupational asbestos exposure is approximately 85%. However, mesothelioma can also result from para-occupational exposures (for example, people who have laundered contaminated clothing) and non-industrial environmental exposures. The latency period between first exposure to asbestos and death from mesothelioma is typically very long (20 to more than 40 years).

Mesothelioma is a relatively rare disease; best estimates are that the prevalence within the United States is approximately 2,500-3,000 cases per year and in the European Union it is approximately 3,500-4,000 cases per year.

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A large majority of mesothelioma patients present with the pleural form around the lungs. Typically, symptoms are chest pain, shortness of breath, or both. The pain is usually dull, diffuse and characteristically worsens during the course of the illness. The pain may be described as heaviness or aching in the shoulder, arm, chest wall and upper abdomen.

A 2011 study published in *Oncogene* reported that 90% of mesothelioma patient samples contained CSCs and implicated these cells in the development of drug resistance. In addition, the treatment of mesothelioma cells with Alimta led to an increase in the tumor-initiating capability of the drug resistant cells, as compared to those treated with placebo control.

Biomarkers

Neurofibromatosis 2 (NF2) is a tumor suppressor gene that encodes the protein merlin. Inactivation of NF2 by mutation and/or deletion, leading to a reduction in the merlin protein, occurs in approximately 50% of malignant mesotheliomas. Merlin has been demonstrated to play roles in cell adhesion, invasion and cell motility in tumor cell lines partially through regulation of FAK. In turn, FAK mediates signal transduction by integrins and growth factor receptors. Increased activation of FAK has been demonstrated in merlin-low mesothelioma cells, indicating that FAK may represent an important therapeutic target for malignant mesothelioma. We are developing a diagnostic for merlin to aid the use of VS-6063 in mesothelioma. We believe the patients with tumors that are merlin-low may respond better to treatment with VS-6063.

Current Treatment

Malignant mesothelioma carries a poor prognosis with a median survival of approximately 12 months from diagnosis. Mesothelioma is currently treated with a combination of surgery, radiotherapy and chemotherapy. The only approved drug treatment regimen for mesothelioma is Alimta in combination with carboplatinum or cisplatin, referred to here collectively as cisplatin. A study by Vogelzang in 2003 reported that the median survival of patients treated with the combination of Alimta and cisplatin was 12.1 months as compared to the median survival of patients treated with cisplatin alone, which was 9.3 months. Following this first-line treatment, the duration of which is often limited by toxicity patients are monitored but do not receive further therapy until disease progression. As reported at ASCO 2011 by Baas et al., the median time to disease progression (progression free survival, or PFS) is approximately 4 months. Once progression occurs, there is no approved standard of care. As reported by Krug et al., in 2011 in an evaluation of 332 patients, this second-line setting has a median PFS of 6 weeks.

**OVARIAN CANCER**

Overview

Ovarian cancer forms in tissues of the ovary, one of a pair of female reproductive glands in which the ova, or eggs, are formed. Most ovarian cancers are either ovarian epithelial carcinoma, cancer that begins in the cells on the surface of the ovary, or malignant germ cell tumors that begin in egg cells. According to the National Cancer Institute, epithelial carcinoma of the ovary is one of the most common gynecologic malignancies and the fifth most frequent cause of cancer death in women, with 50% of all cases occurring in women older than 65 years.

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The National Cancer Institute estimated that in January 2009 there were approximately 182,000 women in the United States with a history of ovarian cancer and in 2013 approximately 22,000 new cases of ovarian cancer will be diagnosed and approximately 14,000 women will die from the disease.

Prognosis

For patients with ovarian cancer the most important prognostic factor is stage of the disease. Unfortunately, most patients with ovarian cancer have widespread disease at diagnosis. This may be partly explained by relatively early spread to the rest of the abdominal cavity. General symptoms such as abdominal pain and swelling, gastrointestinal symptoms, and pelvic pain often go unrecognized, leading to delays in diagnosis. This is illustrated by the information in the following table, which shows, according to the National Cancer Institute's SEER Cancer Statistics Review, 2002-2008, the reduction in five-year survival rate for ovarian cancer patients based on the stage of the disease at the time at which the disease is diagnosed. The percentage of patients diagnosed at each stage of disease, referred to as stage distribution, is included below for comparative purposes.

<b>Stage at Diagnosis</b>	<b>Stage Distribution (%)</b>	<b>5-year Relative Survival (%)</b>
Localized (confined to primary site)	15	91.5
Regional (spread to regional lymph nodes)	17	71.9
Distant (cancer has metastasized)	61	26.9
Unknown (unstaged)	7	22.0

Current Treatment

Most patients are treated with a combination of surgery, chemotherapy and radiation therapy. Surgery is often comprehensive to remove as much of the tumor as possible and may include removal of the ovaries or a total hysterectomy where the uterus is also removed.

Unfortunately, chemotherapy is rarely curative in the treatment of ovarian cancer and many tumors become resistant to platinum-based chemotherapy, which is the primary treatment regimen. Further therapy with conventional chemotherapy is generally palliative, not curative, as the tumor is able to metastasize and spread to other sites in the body. We believe it is the presence of CSCs that lead to this resistance and eventual disease progression.

**BREAST CANCER**Overview

The National Cancer Institute estimated that in January 2008 there were approximately 2.6 million women in the United States with a history of breast cancer. Breast cancer is currently the second most frequently diagnosed and the second most deadly cancer among women in the United States. The American Cancer Society estimated that in the United States in 2011, approximately 230,500 new cases of invasive breast cancer would be diagnosed in women and approximately 39,500 women would die from the disease.

Breast cancers can be segregated into subtypes based upon the positive presence of three protein receptors:

estrogen receptor, or ER;

progesterone receptor, or PR; and

human epidermal growth factor receptor 2, or HER2.

Triple negative breast cancer, or TNBC, is a type of breast cancer that does not express any of these three receptors. According to results from a population-based study of the California Cancer Registry published by the American Cancer Society in 2007, approximately 15% of all breast cancers were classified as TNBC. In comparison with other breast cancers, TNBC tends to grow faster and has

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a higher rate of metastases. Furthermore, TNBC tends to recur more often than other subtypes of breast cancer. Patients with TNBC generally have a poorer prognosis and lower overall survival rate than patients with breast cancers that are positive for the hormone receptors ER and PR.

We believe that the natural disease progression of TNBC exhibits the key hallmarks of CSCs. Specifically, we believe that:

TNBC is initially responsive to chemotherapy because chemotherapy kills the majority of cancer cells, but not the CSCs.

TNBC returns more often than other types of breast cancer in part because there are CSCs that are not killed by current cancer treatments.

The site of recurrence is often at another place in the body as compared to the original tumor because the CSCs which are not killed are able to metastasize.

The recurring tumor may be resistant to therapy because it contains a high percentage of CSCs.

Current treatment of breast cancer

Surgery, radiation therapy, targeted therapy, hormone therapy and combinations of conventional chemotherapy are often used to treat breast cancer. However, these therapies carry significant side effects and frequently do not result in a durable clinical response, especially for patients with TNBC.

The choice of cancer drugs used to treat breast cancer is guided by clinical classification of the tumor as ER positive or negative, PR positive or negative and HER2 positive or negative. The presence, absence or combination of these biomarkers in patient tumors informs the selection of prescribed drugs, which include the anti-estrogen therapies Tamoxifen and aromatase inhibitors, as well as agents that directly target HER2, such as Herceptin, Tykerb and Kadcyla. These treatments may slow or stop cancer growth and are currently considered the most successful treatments for breast cancer. However, because TNBC patients are negative for ER, PR and HER2, the treatment options for these patients are limited. In particular, the targeted therapies, including Herceptin, Tykerb and anti-estrogen treatments, are not effective for these patients. For example, in a study conducted at Baylor College of Medicine, in which biopsies were taken from breast cancer patients both before and after conventional chemotherapy treatment, the percentage of CSCs increased over the 12-week treatment period, indicating the survival of these cells.

If tumors recur, which happens more often in TNBC than other breast cancers, further therapy with conventional chemotherapy is generally palliative, not curative, as the CSCs are able to metastasize and spread to other sites in the body.

**FAK Inhibition Program**

Overview

FAK expression is greater in many tumor types compared to normal tissue, particularly in cancers that have a high invasive and metastatic capability. The contact between cancer cells and connective tissue stimulates FAK signaling. However, CSCs acquire the ability to survive in the absence of contact with connective tissue. We believe that FAK signaling in CSCs may be maintained through alternative mechanisms, thus providing CSCs the ability to survive in the absence of cell contact. Accordingly, we believe that FAK signaling may be a central component of CSC biology that allows CSCs to survive after exiting from a tumor mass and enable metastatic growth at other sites in the body.

In 2012, our scientific co-founder Robert Weinberg reported in Cancer Discovery that FAK is a critical regulator of CSCs and inhibition of this signaling pathway prevented disease progression and initiation of new metastatic lesions. An additional study by Dr. Weinberg reported in PNAS in 2009, demonstrated that in a mouse model of breast cancer FAK signaling was required to enable lung metastasis. Non-CSCs, which lack the ability to increase their FAK signaling activity through alternative mechanisms, remained non-metastatic in this model and did not survive dissemination to the lungs.



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Researchers at McGill University reported in PNAS that in a genetically modified mouse model the specific deletion of FAK from the mammary cells prevented primary tumor formation and metastasis. Similarly, researchers at the University of Michigan demonstrated that specific deletion of FAK from mammary tumors prevented tumor initiating capacity in recipient mice.

Scientific research suggests that increased FAK expression and activity is associated with metastatic progression and poor prognosis in multiple cancer types. For example, a 2009 retrospective study published in the Journal of Clinical Investigation identified the amplification, or increase in number, of the gene encoding FAK in breast cancers. This gene amplification, and resulting high FAK expression, significantly correlated with the progression of early stage, primary breast cancer to advanced metastatic disease. In an analysis of 295 breast cancer patients that was part of this study, elevated FAK expression was a marker of poor survival. The correlation of elevated FAK expression with poor survival was more significant than, and independent of, other commonly used clinical parameters such as hormone receptor status. A similar finding was described in the Journal of Clinical Investigation in 2010 where it was reported that in women with ovarian cancer elevated FAK expression is correlated with advanced disease, metastases and poor prognosis. A comparison of FAK activity in biopsies from patients revealed that high FAK activity correlated with a decrease in overall survival, from 3.2 to 1.7 years.

**VS-6063**

Overview

We are currently evaluating VS-6063 as a potential therapy for mesothelioma, ovarian cancer and other solid tumors driven by CSCs. We believe VS-6063 targets CSCs through inhibition of FAK signaling. We have initiated a Phase 1/1b clinical trial of VS-6063 in combination with paclitaxel for patients with ovarian cancer and expect to initiate a potentially pivotal clinical trial of VS-6063 in mesothelioma midyear 2013. We have applied for orphan drug designation for VS-6063 in mesothelioma in both the United States and the European Union.

Development status of VS-6063

*Phase 1 clinical trial in advanced solid tumors.* VS-6063 demonstrated a good safety profile and initial signs of clinical activity in a Phase 1 trial in 46 patients with advanced solid tumors. Patients were selected on the basis of a confirmed diagnosis of a non-hematologic malignancy that was unresponsive to currently available therapies or for which no standard therapy existed. VS-6063 was administered on a twice daily (BID) schedule and dose cohorts initially included a minimum of 3 patients. Dosing was based on flat milligram increments without adjustment for body size, the starting dose being 12.5 mg BID in the initial cohort. Safety, activity and pharmacokinetics, the process by which a drug is adsorbed, distributed and metabolized in the body, were measured.

16/37 (43%) subjects enrolled at doses  $\geq$ 100 mg BID (predicted active dose) experienced stable disease as their best response to treatment. The recommended Phase 2 dose based on safety, pharmacokinetics and activity was determined to be 400-425 mg/BID.

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VS-6063 development plan

*Potentially pivotal study in mesothelioma.* We are planning a randomized, double-blind, multi-center, multi-national study of VS-6063 in patients with controlled mesothelioma post first-line therapy. We have met with the regulatory agencies in the US and the UK and, based on these discussions, we believe that positive results from this trial will enable us to seek regulatory approval for VS-6063 in mesothelioma.

Even when front line therapy of Alimta plus cisplatin produces an objective response or stable disease, patients are noted to have progression of disease within approximately four months of completing therapy. The ability to maintain the responses seen with first line therapy and delay further progression is therefore a critical goal in this disease. We believe it is the presence of chemotherapy-resistant CSCs in the residual tumor that lead to progression and it is our goal to extend the amount of disease control time for patients through treatment with VS-6063.

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Researchers hypothesized in 2010 in the International Journal of Oncology that early relapse of mesothelioma and further progression following Alimta plus cisplatin results from the presence of a relatively small number of CSCs which exhibit resistance to standard therapy. This hypothesis is supported by our experiments with human mesothelioma cell lines which show that chemotherapeutic agents such as Alimta and cisplatin enrich for CSCs. As shown below, in contrast to Alimta, inhibition of FAK by VS-6063 effectively reduces the proportion of CSCs, as determined by the biomarker Aldefluor. This suggests that targeting FAK might be expected to reduce the CSC population and overcome the resistance that develops to Alimta and cisplatin in mesothelioma.

In a report at the NCI-AACR-EORTC conference in 2012, in a Phase 1 study of the orally available FAK inhibitor GSK2256098 by GlaxoSmithKline (GSK), a median PFS of 17.7 weeks was observed in 29 patients with recurrent mesothelioma in comparison to the previously reported median PFS of just 6.1 weeks in 332 similar patients receiving placebo. In addition, GSK evaluated the response to treatment based upon the status of the biomarker merlin. Patients who were deemed to be merlin-low had a median PFS of 24.1 weeks compared with 11.4 weeks for those patients whose tumors were deemed to be merlin-high. These observations generally suggest that FAK inhibition in mesothelioma may be helpful to slow disease progression and indicate that use of a diagnostic to identify patients with low levels of the biomarker merlin may predict for those most likely to have the greatest response to treatment with a FAK inhibitor.

Our potentially pivotal trial is designed to treat patients who have not progressed on at least 4 cycles of Alimta plus cisplatin as their most recent therapy. Immediately following completion of the front-line chemotherapy, patients would begin to take VS-6063 or placebo by mouth, twice a day. This treatment strategy is known as a maintenance setting therapy and there is no current standard of care recommended for patients with mesothelioma in this setting. Within both the VS-6063 and placebo treatment groups, the patients will be stratified by their merlin expression, as described more below. The endpoints of the study are overall survival, PFS and quality of life. Based on discussions with the regulatory agencies in the United States and United Kingdom, we believe that if VS-6063 significantly increases PFS, it may lead to an accelerated regulatory approval.

Mesothelioma is a rare disease making it important to derive as much information as possible, with as great a certainty as possible, from each clinical trial. It is hypothesized that the treatment effect in the subjects with merlin low tumors is likely to be greater than that in the merlin high group. Therefore, our design incorporates a sample size reassessment at a pre-planned, interim analysis. The goals of the adaptive design approach are:

To identify if the overall population is benefitting or if the merlin low sub population is responding better to treatment.

To modify patient enrollment and only continue enrolling patients with merlin low tumors if those patients are responding better to treatment.

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This study design enables an analysis that could support approval in either the full treatable mesothelioma population or the approximately half of the patients with merlin low tumors. We believe the use of a companion diagnostic test to select the merlin low patients who may respond better to FAK treatment in mesothelioma may increase our ability to properly treat this patient population.

We believe the sequential dosing of chemotherapy (eg. Alimta plus cisplatin) and a CSC-targeted agent (VS-6063) in the maintenance setting will allow us to treat both the non-CSCs and CSCs.

*Phase 1/1b combination study in ovarian cancer.* Ovarian cancer rapidly develops resistance to chemotherapy. Following development of resistance to front-line platinum therapy, there is not an approved standard of care although treatment with the chemotherapeutic paclitaxel is often used. We are currently conducting a clinical trial to evaluate the safety and efficacy of VS-6063 administered in combination with paclitaxel in patients with advanced ovarian cancer.

This clinical study is comprised of 2 parts. Phase 1 is a dose escalation of oral VS-6063 twice daily in addition to the standard dose of weekly paclitaxel. The purpose of Phase 1 is to assess the safety, evaluate pharmacokinetic parameters and determine the recommended Phase 1b dose in combination with paclitaxel. Phase 1b will include patients who will be treated with the recommended Phase 1b dose of VS-6063 in combination with paclitaxel. The purpose of Phase 1b is to evaluate the pharmacodynamic effect, the biochemical and physiological effect of a drug on the body, of VS-6063 through measurement of biomarkers from tumor biopsies pre- and post-treatment and assess the anti-cancer activity of VS-6063 when administered in combination with paclitaxel according to Response Evaluation criteria in Solid Tumors (RECIST) guidelines.

We believe this approach will allow us to treat both the non-CSCs and CSCs simultaneously by the combination of chemotherapy (eg. paclitaxel) and a CSC-targeted agent (VS-6063) to hopefully enable a more durable clinical response.

**VS-4718**

Overview

We identified the CSC-targeted activity and are currently evaluating VS-4718 as a potential therapy for cancers driven by CSCs. We believe VS-4718 targets CSCs through inhibition of FAK signaling similar to VS-6063. We expect to initiate a clinical trial with VS-4718 during the first half of 2013.

Preclinical development

We are conducting a comprehensive program to study VS-4718 as a potential treatment for cancers associated with CSCs and increased FAK activity. Key results to date from preclinical studies of VS-4718 are summarized below.

*Biochemical and cellular tests.* In biochemical testing, VS-4718 inhibited purified FAK and demonstrated in vitro selectivity against a panel of 107 different protein kinases. In addition, in various in vitro assessments of drug effects on CSCs, VS-4718 exhibited potent activity and a preferential effect, or selectivity, for CSCs as compared to other types of cancer cells.

*Pharmacokinetics, pharmacokinetics and tolerability in mice.* VS-4718 was well tolerated in mice after both acute and chronic dosing. VS-4718 also exhibited acceptable pharmacokinetics in mice. In mouse models assessing pharmacodynamics, a single dose of VS-4718 inhibited FAK activity in tumors over a 12-hour period indicating that twice daily dosing may maintain constant FAK inhibition.

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*Effect of FAK inhibition in merlin low cell lines and mouse tumor models of mesothelioma.* VS-4718 has exhibited in vitro cytotoxic effects on mesothelioma cell lines and tumor growth inhibition in mouse models of mesothelioma. Merlin low cells lines derived from mesothelioma tumors were observed to be particularly sensitive to FAK inhibition. VS-4718 was also tested in models in which merlin low mesothelioma cells were implanted into a mouse and the tumor was allowed to develop. Upon tumor formation, the mice were treated with VS-4718 by oral administration at concentrations of 25 or 50 mg/kg of body weight or a placebo control through the end of the experiment. As shown in the figure below, single agent VS-4718 treatment caused tumor regression in a dose-dependent fashion in contrast to placebo control.

*Mouse models of breast cancer.* VS-4718 has exhibited tumor growth inhibition and reduction of metastatic burden in several mouse models of breast cancer. In one experiment, VS-4718 was tested in a model in which breast cancer cells were implanted into a mouse and the tumor was allowed to develop. Upon tumor formation, the mice were treated with VS-4718 in drinking water at a concentration of 0.5 mg/ml or a placebo control beginning at day 12 through the end of the experiment. As shown in the figure below, the tumor volume in the VS-4718 treatment group was significantly smaller than in the placebo group from day 27 through the end of the experiment. In addition, at day 70 the weight of the primary tumor and the number of lung metastases in the VS-4718 treatment group were both significantly less than in the placebo group.

The vertical line on each data point in the tumor volume figure above represents the standard deviation from the mean. The box and vertical line for each data point in the tumor weight and metastases figures above show the distribution of the data. The square data point inside the box

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represents the mean. The bottom of the box represents the 25th percentile, the middle line in the box represents the median and the top of the box represents the 75th percentile. The vertical lines projecting from the bottom and top of the box represent the 5th and 95th percentiles.

VS-4718 development plan

We expect to file the Investigational New Drug (IND) submission, that includes preclinical efficacy and toxicology studies, and to initiate a Phase 1 clinical trial with VS-4718 during the first half of 2013. In the Phase 1 clinical trial, we plan to enroll patients with advanced solid tumors where CSCs are implicated in disease progression. The dose escalation portion of the Phase 1 clinical trial would be designed to determine the biologically active dose and maximum tolerated dose. Additional patients will be enrolled to assess safety, tolerability and to evaluate initial signs of activity.

**PI3K/mTOR Inhibition Program**

Overview

The PI3 kinase/mTOR pathway plays a central role in cancer cell proliferation and survival. Depending on the mode of pathway activation, different PI3K isoforms and mTOR complexes have been shown to play essential roles in oncogenesis and survival of CSCs. There are four Class 1 PI3K enzymes, known as alpha, beta, gamma and delta, and two mTOR complexes known as mTORC1 and mTORC2.

Studies published in Nature in 2006 reported that genetic activation of the PI3K/mTOR pathway in adult blood cells led to generation of leukemia CSCs. In addition, multiple studies have shown that PI3K pathway activity contributes to the maintenance of CSCs in breast, lung, and prostate cancers.

**VS-5584**

Overview

VS-5584 is an orally available small molecule that potently and selectively inhibits PI3K/mTOR signaling. VS-5584 is currently in IND-enabling toxicology studies and is expected to enter Phase 1 clinical trials in patients with advanced cancers in the second half of 2013.

Preclinical development

We are conducting a comprehensive preclinical program to study VS-5584 as a potential treatment for cancer. Key results of this program to date are summarized below.

*Biochemical testing.* In biochemical testing, VS-5584 was equipotent against all four human Class 1 PI3K isoforms and mTOR kinase, the enzymatic component of both mTORC1 and mTORC2 (IC<sub>50</sub> values displayed below in nM). In general, the more potent a drug is, the lower the dose required for a therapeutic effect. An IC<sub>50</sub> value measures the dose at which the activity of the enzyme is reduced by 50%, a commonly used measure of potency. VS-5584 has demonstrated a selective effect for these kinases versus a panel of over 400 kinases.

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*In vitro killing of CSCs.* In an in vitro test, SUM159 triple negative breast cancer cells were treated with VS-5584 or paclitaxel for 4 days, and the percentage of Aldefluor-positive CSCs was assessed. VS-5584 dose-dependently decreased the percentage of CSCs, while paclitaxel increased the percentage of CSCs.

VS-5584 clinical development plan

Assuming successful completion of preclinical studies, we expect to initiate a Phase 1 clinical trial with VS-5584 during the second half of 2013. We anticipate enrolling patients with advanced cancer. The Phase 1 clinical trial will be designed to determine the safety profile of VS-5584 and initial signs of clinical activity.

**LICENSES**

**Whitehead Institute for Biomedical Research**

*Drug discovery platform license agreement*

In October 2010, we entered into an exclusive license agreement with the Whitehead Institute, or the drug discovery platform license agreement, which we amended and restated in January 2012, both on its own behalf and as sole and exclusive agent of Harvard and MIT. Under the drug discovery platform license agreement, we acquired an exclusive, royalty-bearing, worldwide license under patent rights owned by the Whitehead Institute, Harvard and MIT to develop, make, use and sell products covered by the licensed patent rights for use in treating cancer, and to develop and perform licensed processes, in each case, for all human therapeutic, prognostic and diagnostic uses.

We are required to use commercially reasonable efforts to develop and commercialize licensed products under the agreement. In particular, we are required to fulfill specific development and regulatory milestones by particular dates and, during each calendar year, either spend a specified amount for research and development, actively conduct one or more clinical trials for a licensed product or a product identified using a licensed process that does not constitute a licensed product, which we refer to as an identified product, prepare, file or pursue a filed application for regulatory approval of a licensed product or an identified product, or launch or sell a licensed product or identified product.

Under the agreement, we paid the Whitehead Institute an upfront license fee and reimbursed patent related fees and costs incurred by the Whitehead Institute, Harvard and MIT totaling \$104,000 in the aggregate and issued 166,664 shares of our common stock to the Whitehead Institute and entities and individuals affiliated with the Whitehead Institute.

We also agreed to pay the Whitehead Institute annual license maintenance fees, milestone payments, royalties as a percentage of net sales and a percentage of sublicense income that we receive.

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Annual license maintenance fees are creditable against royalties, which are described below, earned during the same calendar year. Milestone payments are triggered upon the achievement of specified development, regulatory and commercialization milestones and are not creditable against the royalties described below. For each licensed product, we agreed to make milestone payments of up to an aggregate of \$1,560,000 plus an additional amount for each subsequent approval of additional indications for a maximum number of licensed products. For each identified product that is not a licensed product, we agreed to make milestone payments of up to an aggregate of \$815,000 plus an additional amount for each subsequent approval of additional indications for a maximum number of identified products. Each type of specified milestone payment is payable only for each of the maximum number of licensed products and the maximum number of identified products, as the case may be, to achieve the applicable milestone. In addition, a separate milestone payment is due upon the first commercial sale of each licensed product or identified product that is a diagnostic or prognostic test. A single additional milestone payment is due for the first issuance of licensed patent rights in the United States, the United Kingdom, France, Germany, Spain or Italy. The royalty rate is in the low single digits as a percentage of net sales for licensed products that are therapeutics, the mid single digits for licensed products that are diagnostics or prognostics and less than one percent for identified products.

The Whitehead Institute, Harvard and MIT retain the right to, and may grant licenses to other academic and non-profit institutions for the right to, practice the licensed patent rights for research, teaching and educational purposes. The Whitehead Institute, Harvard, MIT or any such other institution could seek to license to third parties any intellectual property rights that it discovers using the licensed patent rights while pursuing these purposes. Under the agreement, we have a right, subject to the Whitehead Institute's obligations under third party research funding agreements, to negotiate a license for any compounds identified prior to a specified date in the Whitehead Institute's laboratory run by Dr. Weinberg that selectively target CSCs generated by induction through the EMT process.

After a specified period of time, if a third party requests to sublicense the patent rights for a product or process that is not directly competitive with our products or processes, we must enter into good-faith negotiations to grant a sublicense for such proposed product or process. If we do not grant a sublicense within a specified period of time after receiving a written request, the Whitehead Institute may grant a license to the third party and our rights in the field of use of such sublicense will terminate. Additionally, after a specified period of time, if we are not actively conducting high-throughput screening using the licensed patent rights to identify product candidates, then, except for any rights directed to uses that we are actively developing, the Whitehead Institute may convert our license to the licensed patent rights from exclusive to non-exclusive.

We have the right to terminate the agreement for any reason upon at least 90 days' prior written notice. The Whitehead Institute has the right to terminate the agreement if we and all of our sublicensees cease to carry on business related to the agreement for a specified period of time, we fail to pay any amounts due and payable under the agreement to the Whitehead Institute, subject to a grace period, we materially breach the agreement and fail to cure such breach within a specified grace period or we or a sublicensee challenge the licensed patent rights in a legal or administrative proceeding. The agreement otherwise terminates upon the expiration or abandonment of all licensed patents and patent applications.

*Cancer diagnostic license agreement*

In October 2010, we entered into a separate license agreement with the Whitehead Institute, or the cancer diagnostic license agreement, under which we acquired a non-exclusive, worldwide license to patent rights owned by the Whitehead Institute for research purposes. In December 2011, we amended and restated this agreement with the Whitehead Institute. Under the amended and restated cancer diagnostic license agreement, we acquired an exclusive, royalty-bearing, worldwide license under these patent rights to develop, make, use and sell products covered by the licensed patent rights and to



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develop and perform services using a licensed product or the practice of the licensed patent rights for or on behalf of a third party, in each case, for cancer diagnostics and companion clinical uses.

Under the agreement, we paid the Whitehead Institute upfront license fees and reimbursed patent related fees and costs incurred by the Whitehead Institute totaling \$70,000 in the aggregate. We also agreed to pay the Whitehead Institute annual license maintenance fees, milestone payments, royalties as a percentage of net sales and a percentage of sublicense income that we receive. Annual license maintenance fees are creditable against royalties, which are described below, earned during the same calendar year. Milestone payments of up to an aggregate of \$825,000 are triggered upon the achievement of specified regulatory and commercialization milestones and are not creditable against the royalties described below. The royalty rate is in the mid single digits as a percentage of net sales.

If we are required to pay royalties to a third party in consideration of a license or similar right in order to make, use or sell a licensed product or licensed service, then we may deduct up to 50% of the amounts paid to such third party, subject to specified limitations, from the payments that we owe to the Whitehead Institute for such licensed product or licensed service.

We are required to use commercially reasonable efforts to develop and commercialize licensed products or licensed services under the agreement. In particular, we are required to fulfill specific development, regulatory and commercialization milestones by particular dates and to commit a specified number of full time staff equivalents toward the development of a licensed product or licensed service until the first commercial sale of a licensed product or performance of a licensed service.

The Whitehead Institute retains the right to, and may grant licenses to other academic and non-profit institutions for the right to, practice the licensed patent rights for research, teaching and educational purposes. The Whitehead Institute or any such other institution could seek to license to third parties any intellectual property rights that it discovers using the licensed patent rights while pursuing these purposes.

After a specified period of time, if a third party requests to sublicense the patent rights for a product or service that is not directly competitive with our products or services, we must enter into good-faith negotiations to grant a sublicense for such proposed product or service. If we do not grant such a sublicense within a specified period of time after receiving a written request, the Whitehead Institute may grant a license to the third party and our rights in the field of use of such sublicense will terminate. Additionally, after a specified period of time, if the market is not being reasonably served by us, as determined by the Whitehead Institute, and a third party requests to sublicense the patent rights for a product or service that is directly competitive with our products or services, we must enter into good-faith negotiations to grant a sublicense for such proposed product or service. If we do not grant such a sublicense within a specified period of time after receiving a written request, we and the Whitehead Institute have agreed to mutually select a qualified independent third party to set commercially reasonable terms and conditions consistent with similar technology in the industry under which we would sublicense our rights for such proposed product or service to the third party. Additionally, after a specified period of time, if we are not actively conducting efforts to validate, use or commercialize a license product or licensed service, then the Whitehead Institute may convert our license to the licensed patent rights from exclusive to nonexclusive.

We have the right to terminate the agreement for any reason upon at least 90 days' prior written notice. The Whitehead Institute has the right to terminate the agreement if we and all of our sublicensees cease to carry on business related to the agreement for a specified period of time, we fail to pay any amounts due and payable under the agreement to the Whitehead Institute, subject to a grace period, we materially breach the agreement and fail to cure such breach within a specified grace period or we or a sublicensee challenge the licensed patent rights in a legal or administrative

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proceeding. The agreement otherwise terminates upon the expiration or abandonment of all licensed patents and patent applications.

**Poniard Pharmaceuticals, Inc.**

In November 2011, we entered into a license agreement with Poniard under which we acquired an exclusive, worldwide license under patent rights and know-how owned or controlled by Poniard to develop, make, use and sell compounds and products covered by the licensed patent rights for the diagnosis, treatment, prevention or control of all human diseases and conditions. The licensed compounds include VS-4718 and any other compounds covered by a licensed patent right under the agreement that have the inhibition of FAK as a primary mode of action. These licensed patent rights include patent rights owned by Scripps and licensed to Poniard. In accordance with the agreement between Poniard and Scripps, Scripps retains the right to grant non-exclusive licenses, without the right to sublicense, to nonprofit or academic institutions to use for any noncommercial research or education purposes any licensed patent rights owned by Scripps and licensed to Poniard.

Under the agreement, we paid Poniard an upfront license fee and agreed to pay Poniard milestone payments of up to an aggregate of \$13,250,000 upon the achievement of specified development and regulatory milestones. We also agreed to issue to Poniard a warrant to purchase 142,857 shares of our common stock upon the first dosing of the first patient in our first Phase 1 clinical trial of a licensed product. The exercise price of such warrant would be equal to the average closing price of our common stock during the five trading days preceding such issue date. In addition, we agreed to pay low to mid single digit royalties to Poniard as a percentage of net sales of licensed products. Our obligation to pay royalties continues on a country by country basis until the expiration of all licensed patent rights covering licensed products in such country. If the royalty term under our agreement with Poniard expires with respect to a licensed product in a country and Poniard continues to have royalty payment obligations under its agreement with Scripps with respect to our net sales of licensed products in such country, we agreed to pay Poniard the royalty amount due to Scripps with respect to net sales of such licensed product in such country.

Poniard is responsible for all amounts payable to any third party under any agreement to which Poniard was a party as of the date of our agreement that are applicable to rights licensed to us, including amounts payable to Scripps with respect to the patent rights owned by Scripps and licensed to Poniard. If we license or acquire technology from a third party in order to develop or commercialize a licensed product and are required to pay such third party license fees, milestone payments, royalties or other amounts, then we may deduct up to 50% of the amount paid to such third party from the payments that we owe to Poniard for such licensed product. This deduction is subject to specified limitations, including that in no event will any such deduction reduce a payment that we owe to Poniard to less than 50% of the otherwise applicable amount.

We are required to use commercially reasonable efforts to develop and, subject to regulatory approval, commercialize licensed products in the United States, the United Kingdom, France, Germany and Japan.

We have the right to terminate the agreement or any portion of our licensed rights under the agreement upon at least 90 days' prior written notice. We and Poniard each have the right to terminate the agreement if the other party materially breaches the agreement and fails to cure such breach within a specified grace period, subject to the right of either party to submit a dispute to arbitration. The agreement otherwise terminates upon the last to expire licensed patent right covering a licensed product.

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**Pfizer Inc.**

On July 11, 2012, we entered into a license agreement with Pfizer Inc., or Pfizer, under which Pfizer granted us worldwide, exclusive rights to research, develop, manufacture and commercialize products containing certain of Pfizer's inhibitors of focal adhesion kinase for all therapeutic, diagnostic and prophylactic uses in humans. We have the right to grant sublicenses under the foregoing licensed rights, subject to certain restrictions. We are solely responsible, at our own expense, for the clinical development of these products, which is to be conducted in accordance with an agreed-upon development plan. We are also responsible for all manufacturing and commercialization activities at our own expense. Pfizer is required to provide us with an initial quantity of clinical supply of one of the products for an agreed upon price.

Upon entering into the license agreement, we made a one-time cash payment to Pfizer in the amount of \$1.5 million and issued to Pfizer 192,012 shares of our common stock. Pfizer is also eligible to receive up to \$2 million in developmental milestones and up to an additional \$125 million based on the successful attainment of regulatory and commercial sales milestones. Pfizer is also eligible to receive high single to mid double digit royalties on future net sales of the products. Our royalty obligations with respect to each product in each country begin on the date of first commercial sale of the product in that country, and end on the later of 10 years after the date of first commercial sale of the product in that country or the date of expiration or abandonment of the last claim contained in any issued patent or patent application licensed by Pfizer to us that covers the product in that country.

The license agreement will remain in effect until the expiration of all of our royalty obligations to Pfizer, determined on a product-by-product and country-by-country basis. So long as we are not in breach of the license agreement, we have the right to terminate the license agreement at will on a product-by-product and country-by-country basis, or in its entirety, upon 90 days written notice to Pfizer. Either party has the right to terminate the license agreement in connection with an insolvency event involving the other party or a material breach of the license agreement by the other party that remains uncured for a specified period of time. If the license agreement is terminated by either party for any reason, worldwide rights to the research, development, manufacture and commercialization of the products revert back to Pfizer.

**COMPETITION**

The biotechnology and pharmaceutical industries are characterized by rapidly advancing technologies, intense competition and a strong emphasis on proprietary products. While we believe that our technology, development experience and scientific knowledge provide us with competitive advantages, we face potential competition from many different sources, including major pharmaceutical, specialty pharmaceutical and biotechnology companies, academic institutions and governmental agencies and public and private research institutions. Any product candidates that we successfully develop and commercialize will compete with existing therapies and new therapies that may become available in the future.

There are other companies working to develop therapies that target CSCs. These companies include divisions of large pharmaceutical companies including Astellas Pharma Inc., Sanofi-Aventis U.S. LLC, GlaxoSmithKline plc, Boehringer Ingelheim GmbH, Pfizer Inc. and others. There are also biotechnology companies of various sizes that are developing therapies against CSCs, including OncoMed Pharmaceuticals, Inc., Boston Biomedical Inc. and Stemline Therapeutics, Inc.

Many of our competitors may have significantly greater financial resources and expertise in research and development, manufacturing, preclinical testing, conducting clinical trials, obtaining regulatory approvals and marketing approved products than we do. Mergers and acquisitions in the pharmaceutical, biotechnology and diagnostic industries may result in even more resources being concentrated among a smaller number of our competitors. These competitors also compete with us in

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recruiting and retaining qualified scientific and management personnel and establishing clinical trial sites and patient registration for clinical trials, as well as in acquiring technologies complementary to, or necessary for, our programs. Smaller or early stage companies may also prove to be significant competitors, particularly through collaborative arrangements with large and established companies.

The key competitive factors affecting the success of all of our product candidates, if approved, are likely to be their efficacy, safety, convenience, price, the effectiveness of companion diagnostics in guiding the use of related therapeutics, the level of generic competition and the availability of reimbursement from government and other third-party payors.

Our commercial opportunity could be reduced or eliminated if our competitors develop and commercialize products that are safer, more effective, have fewer or less severe side effects, are more convenient or are less expensive than any products that we may develop. Our competitors also may obtain FDA or other regulatory approval for their products more rapidly than we may obtain approval for ours, which could result in our competitors establishing a strong market position before we are able to enter the market. In addition, our ability to compete may be affected in many cases by insurers or other third-party payors seeking to encourage the use of generic products. There are many generic products currently on the market for the indications that we are pursuing, and additional products are expected to become available on a generic basis over the coming years. If our therapeutic product candidates are approved, we expect that they will be priced at a significant premium over competitive generic products.

The most common methods of treating patients with cancer are surgery, radiation and drug therapy, including chemotherapy, hormone therapy and targeted drug therapy. There are a variety of available drug therapies marketed for cancer. In many cases, these drugs are administered in combination to enhance efficacy. While our product candidates may compete with many existing drug and other therapies, to the extent they are ultimately used in combination with or as an adjunct to these therapies, our product candidates will not be competitive with them. Some of the currently approved drug therapies are branded and subject to patent protection, and others are available on a generic basis. Many of these approved drugs are well established therapies and are widely accepted by physicians, patients and third-party payors. In general, although there has been considerable progress over the past few decades in the treatment of cancer and the currently marketed therapies provide benefits to many patients, these therapies all are limited to some extent in their efficacy and frequency of adverse events, and none of them are successful in treating all patients. As a result, the level of morbidity and mortality from cancer remains high.

In addition to currently marketed therapies, there are also a number of products in late stage clinical development to treat cancer. These products in development may provide efficacy, safety, convenience and other benefits that are not provided by currently marketed therapies. As a result, they may provide significant competition for any of our product candidates for which we obtain market approval.

## **MANUFACTURING**

We do not own or operate, and currently have no plans to establish, any manufacturing facilities. We currently rely, and expect to continue to rely, on third parties for the manufacture of our product candidates and any products that we may develop, other than small amounts of compounds that we may synthesize ourselves for preclinical testing. To date, we have obtained starting materials for our supply of the bulk drug substance for our product candidates from one third-party manufacturer. We obtain our supplies from this manufacturer on a purchase order basis and do not have a long-term supply arrangement in place. We do not currently have arrangements in place for redundant supply or a second source for bulk drug substance. If our current third-party manufacturer should become unavailable to us for any reason, we believe that there are several potential replacements, although we might incur some delay in identifying and qualifying such replacements.

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All of our drug candidates are organic compounds of low molecular weight, generally called small molecules. We select compounds not only on the basis of their potential efficacy and safety, but also for their ease of synthesis and reasonable cost of their starting materials. We expect to continue to develop drug candidates that can be produced cost-effectively at third-party manufacturing facilities.

**GOVERNMENT REGULATION**

Government authorities in the United States, at the federal, state and local level, and in other countries extensively regulate, among other things, the research, development, testing, manufacture, including any manufacturing changes, packaging, storage, recordkeeping, labeling, advertising, promotion, distribution, marketing, post-approval monitoring and reporting, import and export of pharmaceutical products, such as those we are developing.

**United States drug approval process**

In the United States, the FDA regulates drugs under the Federal Food, Drug, and Cosmetic Act, or FDCA, the Public Health Service Act and implementing regulations. The process of obtaining regulatory approvals and the subsequent compliance with appropriate federal, state, local and foreign statutes and regulations requires the expenditure of substantial time and financial resources. Failure to comply with the applicable United States requirements at any time during the product development process, approval process or after approval, may subject an applicant to a variety of administrative or judicial sanctions, such as the FDA's refusal to approve pending applications, withdrawal of an approval, imposition of a clinical hold, issuance of warning letters, product recalls, product seizures, total or partial suspension of production or distribution injunctions, fines, refusals of government contracts, restitution, disgorgement of profits or civil or criminal penalties.

The process required by the FDA before a drug may be marketed in the United States generally involves the following:

completion of preclinical laboratory tests, animal studies and formulation studies in compliance with the FDA's good laboratory practice, or GLP, regulations;

submission to the FDA of an IND, which must become effective before human clinical trials may begin;

approval by an independent institutional review board, or IRB, at each clinical site before each trial may be initiated;

performance of adequate and well-controlled human clinical trials in accordance with good clinical practices, or GCP, to establish the safety and efficacy of the proposed drug for each indication;

submission to the FDA of a new drug application, or NDA;

satisfactory completion of an FDA advisory committee review, if applicable;

satisfactory completion of an FDA inspection of the manufacturing facility or facilities at which the product is produced to assess compliance with current good manufacturing practices, or cGMP, requirements and to assure that the facilities, methods and controls are adequate to preserve the drug's identity, strength, quality and purity; and

FDA review and approval of the NDA.

*Preclinical studies*

Preclinical studies include laboratory evaluation of product chemistry and formulation, as well as *in vitro* and animal studies to assess the potential for adverse events and in some cases to establish a



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rationale for therapeutic use. The conduct of preclinical studies is subject to federal regulations and requirements, including GLP regulations for safety/toxicology studies. An IND sponsor must submit the results of the preclinical tests, together with manufacturing information, analytical data, any available clinical data or literature and plans for clinical studies, among other things, to the FDA as part of an IND. Some long-term preclinical testing, such as animal tests of reproductive adverse events and carcinogenicity, may continue after the IND is submitted. An IND automatically becomes effective 30 days after receipt by the FDA, unless before that time the FDA raises concerns or questions related to one or more proposed clinical trials and places the trial on clinical hold. In such a case, the IND sponsor and the FDA must resolve any outstanding concerns before the clinical trial can begin. As a result, submission of an IND may not result in the FDA allowing clinical trials to commence.

*Clinical trials*

Clinical trials involve the administration of the investigational new drug to human subjects under the supervision of qualified investigators in accordance with GCP requirements, which include, among other things, the requirement that all research subjects provide their informed consent in writing before their participation in any clinical trial. Clinical trials are conducted under written study protocols detailing, among other things, the objectives of the study, the parameters to be used in monitoring safety and the effectiveness criteria to be evaluated. A protocol for each clinical trial and any subsequent protocol amendments must be submitted to the FDA as part of the IND. In addition, an IRB at each institution participating in the clinical trial must review and approve the plan for any clinical trial before it commences at that institution, and the IRB must conduct continuing review. The IRB must review and approve, among other things, the study protocol and informed consent information to be provided to study subjects. An IRB must operate in compliance with FDA regulations. Information about certain clinical trials must be submitted within specific timeframes to the National Institutes of Health for public dissemination on their [ClinicalTrials.gov](http://ClinicalTrials.gov) website.

Human clinical trials are typically conducted in three sequential phases, which may overlap or be combined:

*Phase 1:* The drug is initially introduced into healthy human subjects or patients with the target disease or condition and tested for safety, dosage tolerance, absorption, metabolism, distribution, excretion and, if possible, to gain an early indication of its effectiveness.

*Phase 2:* The drug is administered to a limited patient population to identify possible adverse effects and safety risks, to preliminarily evaluate the efficacy of the product for specific targeted diseases and to determine dosage tolerance and optimal dosage.

*Phase 3:* The drug is administered to an expanded patient population in adequate and well-controlled clinical trials to generate sufficient data to statistically confirm the efficacy and safety of the product for approval, to establish the overall risk-benefit profile of the product and to provide adequate information for the labeling of the product.

Progress reports detailing the results of the clinical trials must be submitted at least annually to the FDA and more frequently if serious adverse events occur. Phase 1, Phase 2 and Phase 3 clinical trials may not be completed successfully within any specified period, or at all. Furthermore, the FDA or the sponsor may suspend or terminate a clinical trial at any time on various grounds, including a finding that the research subjects are being exposed to an unacceptable health risk. Similarly, an IRB can suspend or terminate approval of a clinical trial at its institution if the clinical trial is not being conducted in accordance with the IRB's requirements or if the drug has been associated with unexpected serious harm to patients.

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*Marketing approval*

Assuming successful completion of the required clinical testing, the results of the preclinical and clinical studies, together with detailed information relating to the product's chemistry, manufacture, controls and proposed labeling, among other things, are submitted to the FDA as part of an NDA requesting approval to market the product for one or more indications. Under federal law, the submission of most NDAs is additionally subject to a substantial application user fee, currently exceeding \$1.8 million, and the sponsor of an approved NDA is also subject to annual product and establishment user fees, currently exceeding \$98,000 per product and \$520,000 per establishment. These fees are typically increased annually.

The FDA conducts a preliminary review of all NDAs within the first 60 days after submission before accepting them for filing to determine whether they are sufficiently complete to permit substantive review. The FDA may request additional information rather than accept an NDA for filing. In this event, the application must be resubmitted with the additional information. The resubmitted application is also subject to review before the FDA accepts it for filing. Once the submission is accepted for filing, the FDA begins an in-depth substantive review. The FDA has agreed to specified performance goals in the review of NDAs. Under these goals, the FDA has committed to review most such applications for non-priority products within 10 months, and most applications for priority review products, that is, drugs that the FDA determines represent a significant improvement over existing therapy, within six months. These performance goals likely will be extended by several months when the Prescription Drug User Fee Act is reauthorized in 2012. The review process may be extended by the FDA for three additional months to consider certain information or clarification regarding information already provided in the submission. The FDA may also refer applications for novel drugs or products that present difficult questions of safety or efficacy to an advisory committee, typically a panel that includes clinicians and other experts, for review, evaluation and a recommendation as to whether the application should be approved. The FDA is not bound by the recommendations of an advisory committee, but it considers such recommendations carefully when making decisions.

Before approving an NDA, the FDA typically will inspect the facility or facilities where the product is manufactured. The FDA will not approve an application unless it determines that the manufacturing processes and facilities are in compliance with cGMP requirements and adequate to assure consistent production of the product within required specifications. In addition, before approving an NDA, the FDA will typically inspect one or more clinical sites to assure compliance with GCP and integrity of the clinical data submitted.

The testing and approval process requires substantial time, effort and financial resources, and each may take many years to complete. Data obtained from clinical activities are not always conclusive and may be susceptible to varying interpretations, which could delay, limit or prevent regulatory approval. The FDA may not grant approval on a timely basis, or at all. We may encounter difficulties or unanticipated costs in our efforts to develop our product candidates and secure necessary governmental approvals, which could delay or preclude us from marketing our products.

After the FDA's evaluation of the NDA and inspection of the manufacturing facilities, the FDA may issue an approval letter or a complete response letter. An approval letter authorizes commercial marketing of the drug with specific prescribing information for specific indications. A complete response letter generally outlines the deficiencies in the submission and may require substantial additional testing or information in order for the FDA to reconsider the application. If and when those deficiencies have been addressed to the FDA's satisfaction in a resubmission of the NDA, the FDA will issue an approval letter. The FDA has committed to reviewing such resubmissions in two or six months depending on the type of information included. Even with submission of this additional information, the FDA ultimately may decide that the application does not satisfy the regulatory criteria for approval and refuse to approve the NDA.



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Even if the FDA approves a product, it may limit the approved indications for use for the product, require that contraindications, warnings or precautions be included in the product labeling, require that post-approval studies, including Phase 4 clinical trials, be conducted to further assess a drug's safety after approval, require testing and surveillance programs to monitor the product after commercialization, or impose other conditions, including distribution restrictions or other risk management mechanisms, which can materially affect the potential market and profitability of the product. The FDA may prevent or limit further marketing of a product based on the results of post-market studies or surveillance programs. After approval, some types of changes to the approved product, such as adding new indications, manufacturing changes and additional labeling claims, are subject to further testing requirements and FDA review and approval.

*Fast track designation*

The FDA is required to facilitate the development and expedite the review of drugs that are intended for the treatment of a serious or life-threatening condition for which there is no effective treatment and which demonstrate the potential to address unmet medical needs for the condition. Under the fast track program, the sponsor of a new drug candidate may request the FDA to designate the product for a specific indication as a fast track product concurrent with or after the filing of the IND for the product candidate. The FDA must determine if the product candidate qualifies for fast track designation within 60 days after receipt of the sponsor's request.

In addition to other benefits, such as the ability to use surrogate endpoints and have greater interactions with the FDA, the FDA may initiate review of sections of a fast track product's NDA before the application is complete. This rolling review is available if the applicant provides and the FDA approves a schedule for the submission of the remaining information and the applicant pays applicable user fees. However, the FDA's time period goal for reviewing a fast track application does not begin until the last section of the NDA is submitted. In addition, the fast track designation may be withdrawn by the FDA if the FDA believes that the designation is no longer supported by data emerging in the clinical trial process.

*Priority review*

Under FDA policies, a product candidate may be eligible for priority review, or review within a six-month time frame from the time a complete application is received. Products regulated by the FDA's Center for Drug Evaluation and Research, or CDER, are eligible for priority review if they provide a significant improvement compared to marketed products in the treatment, diagnosis or prevention of a disease. A fast track designated product candidate would ordinarily meet the FDA's criteria for priority review.

*Accelerated approval*

Under the FDA's accelerated approval regulations, the FDA may approve a drug for a serious or life-threatening illness that provides meaningful therapeutic benefit to patients over existing treatments based upon a surrogate endpoint that is reasonably likely to predict clinical benefit. In clinical trials, a surrogate endpoint is a measurement of laboratory or clinical signs of a disease or condition that substitutes for a direct measurement of how a patient feels, functions or survives. Surrogate endpoints can often be measured more easily or more rapidly than clinical endpoints. A product candidate approved on this basis is subject to rigorous post-marketing compliance requirements, including the completion of Phase 4 or post-approval clinical trials to confirm the effect on the clinical endpoint. Failure to conduct required post-approval studies, or confirm a clinical benefit during post-marketing studies, would allow the FDA to withdraw the drug from the market on an expedited basis. All promotional materials for drug candidates approved under accelerated regulations are subject to prior review by the FDA.

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*Orphan drugs*

Under the Orphan Drug Act, the FDA may grant orphan drug designation to drugs intended to treat a rare disease or condition, which is generally defined as a disease or condition that affects fewer than 200,000 individuals in the United States. Orphan drug designation must be requested before submitting an NDA. After the FDA grants orphan drug designation, the generic identity of the drug and its potential orphan use are disclosed publicly by the FDA. Orphan drug designation does not convey any advantage in, or shorten the duration of, the regulatory review and approval process. The first NDA applicant to receive FDA approval for a particular active ingredient to treat a particular disease with FDA orphan drug designation is entitled to a seven-year exclusive marketing period in the United States for that product, for that indication. During the seven-year exclusivity period, the FDA may not approve any other applications to market the same drug for the same orphan indication, except in limited circumstances, such as a showing of clinical superiority to the product with orphan drug exclusivity in that it is shown to be safer, more effective or makes a major contribution to patient care. Orphan drug exclusivity does not prevent the FDA from approving a different drug for the same disease or condition, or the same drug for a different disease or condition. Among the other benefits of orphan drug designation are tax credits for certain research and a waiver of the NDA application user fee.

*Pediatric information*

Under the Pediatric Research Equity Act of 2003, as amended and reauthorized by the Food and Drug Administration Amendments Act of 2007, or the FDAAA, an NDA or supplement to an NDA must contain data that are adequate to assess the safety and effectiveness of the drug for the claimed indications in all relevant pediatric subpopulations, and to support dosing and administration for each pediatric subpopulation for which the product is safe and effective. The FDA may, on its own initiative or at the request of the applicant, grant deferrals for submission of some or all pediatric data until after approval of the product for use in adults, or full or partial waivers from the pediatric data requirements. Unless otherwise required by regulation, the pediatric data requirements do not apply to products with orphan drug designation.

**The Hatch-Waxman act**

*Abbreviated new drug applications*

In seeking approval for a drug through an NDA, applicants are required to list with the FDA each patent with claims that cover the applicant's product or a method of using the product. Upon approval of a drug, each of the patents listed in the application for the drug is then published in the FDA's Approved Drug Products with Therapeutic Equivalence Evaluations, commonly known as the Orange Book. Drugs listed in the Orange Book can, in turn, be cited by potential competitors in support of approval of an abbreviated new drug application, or ANDA. Generally, an ANDA provides for marketing of a drug product that has the same active ingredients in the same strengths, dosage form and route of administration as the listed drug and has been shown to be bioequivalent through *in vitro* or *in vivo* testing or otherwise to the listed drug. ANDA applicants are not required to conduct or submit results of preclinical or clinical tests to prove the safety or effectiveness of their drug product, other than the requirement for bioequivalence testing. Drugs approved in this way are commonly referred to as "generic equivalents" to the listed drug, and can often be substituted by pharmacists under prescriptions written for the original listed drug.

The ANDA applicant is required to certify to the FDA concerning any patents listed for the approved product in the FDA's Orange Book, except for patents covering methods of use for which the

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ANDA applicant is not seeking approval. Specifically, the applicant must certify with respect to each patent that:

the required patent information has not been filed;

the listed patent has expired;

the listed patent has not expired, but will expire on a particular date and approval is sought after patent expiration; or

the listed patent is invalid, unenforceable or will not be infringed by the new product.

A certification that the new product will not infringe the already approved product's listed patents or that such patents are invalid or unenforceable is called a Paragraph IV certification. If the applicant does not challenge the listed patents or indicate that it is not seeking approval of a patented method of use, the ANDA application will not be approved until all the listed patents claiming the referenced product have expired.

If the ANDA applicant has provided a Paragraph IV certification to the FDA, the applicant must also send notice of the Paragraph IV certification to the NDA and patent holders once the ANDA has been accepted for filing by the FDA. The NDA and patent holders may then initiate a patent infringement lawsuit in response to the notice of the Paragraph IV certification. The filing of a patent infringement lawsuit within 45 days after the receipt of a Paragraph IV certification automatically prevents the FDA from approving the ANDA until the earlier of 30 months, expiration of the patent, settlement of the lawsuit or a decision in the infringement case that is favorable to the ANDA applicant.

The ANDA also will not be approved until any applicable non-patent exclusivity period, such as exclusivity for obtaining approval of a new chemical entity, for the referenced product has expired. Federal law provides a period of five years following approval of a drug containing no previously approved active moiety during which ANDAs for generic versions of those drugs cannot be submitted unless the submission contains a Paragraph IV challenge to a listed patent, in which case the submission may be made four years following the original product approval. Federal law provides for a period of three years of exclusivity during which the FDA cannot grant effective approval of an ANDA if a listed drug contains a previously approved active moiety, but FDA requires as a condition of approval new clinical trials conducted by or for the sponsor. This three-year exclusivity period often protects changes to a previously approved drug product, such as a new dosage form, route of administration, combination or indication. Under the Best Pharmaceuticals for Children Act, federal law also provides that periods of patent and non-patent marketing exclusivity listed in the Orange Book for a drug may be extended by six months if the NDA sponsor conducts pediatric studies identified by the FDA in a written request. For written requests issued by the FDA after September 27, 2007, the date of enactment of the FDAAA, the FDA must grant pediatric exclusivity no later than nine months prior to the date of expiration of patent or non-patent exclusivity in order for the six-month pediatric extension to apply to that exclusivity period.

**Section 505(b)(2) new drug applications**

Most drug products obtain FDA marketing approval pursuant to an NDA or an ANDA. A third alternative is a special type of NDA, commonly referred to as a Section 505(b)(2) NDA, which enables the applicant to rely, in part, on the FDA's previous approval of a similar product, or published literature, in support of its application.

505(b)(2) NDAs often provide an alternate path to FDA approval for new or improved formulations or new uses of previously approved products. Section 505(b)(2) permits the filing of an NDA where at least some of the information required for approval comes from studies not conducted by or for the applicant and for which the applicant has not obtained a right of reference. If the

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505(b)(2) applicant can establish that reliance on the FDA's previous approval is scientifically appropriate, it may eliminate the need to conduct certain preclinical or clinical studies of the new product. The FDA may also require companies to perform additional studies or measurements to support the change from the approved product. The FDA may then approve the new product candidate for all or some of the label indications for which the referenced product has been approved, as well as for any new indication sought by the Section 505(b)(2) applicant.

To the extent that the Section 505(b)(2) applicant is relying on studies conducted for an already approved product, the applicant is required to certify to the FDA concerning any patents listed for the approved product in the Orange Book to the same extent that an ANDA applicant would. As a result, approval of a 505(b)(2) NDA can be stalled until all the listed patents claiming the referenced product have expired, until any non-patent exclusivity, such as exclusivity for obtaining approval of a new chemical entity, listed in the Orange Book for the referenced product has expired, and, in the case of a Paragraph IV certification and subsequent patent infringement suit, until the earlier of 30 months, settlement of the lawsuit or a decision in the infringement case that is favorable to the Section 505(b)(2) applicant.

**Combination products**

The FDA regulates combinations of products that cross FDA centers, such as drug, biologic or medical device components that are physically, chemically or otherwise combined into a single entity, as a combination product. The FDA center with primary jurisdiction for the combination product will take the lead in the premarket review of the product, with the other center consulting or collaborating with the lead center.

The FDA's Office of Combination Products, or OCP, determines which center will have primary jurisdiction for the combination product based on the combination product's "primary mode of action." A mode of action is the means by which a product achieves an intended therapeutic effect or action. The primary mode of action is the mode of action that provides the most important therapeutic action of the combination product, or the mode of action expected to make the greatest contribution to the overall intended therapeutic effects of the combination product.

Often it is difficult for the OCP to determine with reasonable certainty the most important therapeutic action of the combination product. In those difficult cases, the OCP will consider consistency with other combination products raising similar types of safety and effectiveness questions, or which center has the most expertise to evaluate the most significant safety and effectiveness questions raised by the combination product.

A sponsor may use a voluntary formal process, known as a Request for Designation, when the product classification is unclear or in dispute, to obtain a binding decision as to which center will regulate the combination product. If the sponsor objects to that decision, it may request that the agency reconsider that decision.

**Overview of FDA regulation of companion diagnostics**

We are developing *in vitro* and *in vivo* companion diagnostics for use in selecting the patients that we believe will respond to our cancer therapeutics.

FDA officials have issued draft guidance that, when finalized, would address issues critical to developing *in vitro* companion diagnostics, such as biomarker qualification, establishing clinical validity, the use of retrospective data, the appropriate patient population and when the FDA will require that the device and the drug be approved simultaneously. The draft guidance issued in July 2011 states that if safe and effective use of a therapeutic product depends on an *in vitro* diagnostic, then the FDA generally will require approval or clearance of the diagnostic at the same time that the FDA approves

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the therapeutic product. The FDA has yet to issue further guidance, and it is unclear whether it will do so, or what the scope would be.

The FDA previously has required *in vitro* companion diagnostics intended to select the patients who will respond to the cancer treatment to obtain Pre-Market Approval, or PMA, simultaneously with approval of the drug. Based on the draft guidance, and the FDA's past treatment of companion diagnostics, we believe that the FDA will require one or more of our *in vitro* companion diagnostics to obtain PMA for our companion diagnostics to identify patient populations suitable for our cancer therapies, such as the *in vitro* companion diagnostic for our product candidates. The review of these *in vitro* companion diagnostics in conjunction with the review of our cancer treatments involves coordination of review by CDER and by the FDA's Center for Devices and Radiological Health Office of In Vitro Diagnostics Device Evaluation and Safety.

*PMA approval pathway*

A medical device, including an *in vitro* diagnostic, or IVD, to be commercially distributed in the United States must receive either 510(k) clearance or PMA approval from the FDA prior to marketing. Devices deemed by the FDA to pose the greatest risk, such as life-sustaining, life supporting or implantable devices, or devices deemed not substantially equivalent to a previously 510(k) cleared device or a preamendment class III device for which PMA applications have not been called, are placed in Class III requiring PMA approval. The PMA approval pathway requires proof of the safety and effectiveness of the device to the FDA's satisfaction.

The PMA approval pathway generally takes from one to three years or even longer from submission of the application.

A PMA application for an IVD must provide extensive preclinical and clinical trial data. Preclinical data for an IVD includes many different tests, including how reproducible the results are when the same sample is tested multiple times by multiple users at multiple laboratories. The clinical data need to establish that the test is sufficiently safe, effective and reliable in the intended use population. In addition, the FDA must be convinced that a device has clinical utility, meaning that an IVD provides information that is clinically meaningful. A biomarker's clinical significance may be obvious, or the applicant may be able to rely upon published literature or submit data to show clinical utility.

A PMA application also must provide information about the device and its components regarding, among other things, device design, manufacturing and labeling. The sponsor must pay an application fee.

As part of the PMA review, the FDA will typically inspect the manufacturer's facilities for compliance with Quality System Regulation, or QSR, requirements, which impose elaborate testing, control, documentation and other quality assurance procedures.

Upon submission, the FDA determines if the PMA application is sufficiently complete to permit a substantive review, and, if so, the FDA accepts the application for filing. The FDA then commences an in-depth review of the PMA application. The entire process typically takes one to three years, but may take longer. The review time is often significantly extended as a result of the FDA asking for more information or clarification of information already provided. The FDA also may respond with a not approvable determination based on deficiencies in the application and require additional clinical trials that are often expensive and time-consuming and can substantially delay approval.

During the review period, an FDA advisory committee, typically a panel of clinicians, may be convened to review the application and recommend to the FDA whether, or upon what conditions, the device should be approved. Although the FDA is not bound by the advisory panel decision, the panel's recommendation is important to the FDA's overall decision making process.

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If the FDA's evaluation of the PMA application is favorable, the FDA typically issues an approvable letter requiring the applicant's agreement to specific conditions, such as changes in labeling, or specific additional information, such as submission of final labeling, in order to secure final approval of the PMA. If the FDA concludes that the applicable criteria have been met, the FDA will issue a PMA for the approved indications, which can be more limited than those originally sought by the manufacturer. The PMA can include post-approval conditions that the FDA believes necessary to ensure the safety and effectiveness of the device, including, among other things, restrictions on labeling, promotion, sale and distribution. Failure to comply with the conditions of approval can result in material adverse enforcement action, including the loss or withdrawal of the approval.

Even after approval of a PMA, a new PMA or PMA supplement may be required in the event of a modification to the device, its labeling or its manufacturing process. Supplements to a PMA often require the submission of the same type of information required for an original PMA, except that the supplement is generally limited to the information needed to support the proposed change from the product covered by the original PMA.

*Clinical trials*

A clinical trial is almost always required to support a PMA application. In some cases, one or more smaller Investigational Device Exemption, or IDE, studies may precede a pivotal clinical trial intended to demonstrate the safety and efficacy of the investigational device.

All clinical studies of investigational devices must be conducted in compliance with the FDA's requirements. If an investigational device could pose a significant risk to patients pursuant to FDA regulations, the FDA must approve an IDE application prior to initiation of investigational use. IVD trials usually do not require an IDE, as the FDA does not judge them to be a significant risk because the results do not affect the patients in the study. However, for a trial where the IVD result directs the therapeutic care of patients with cancer, we believe that the FDA would consider the investigation to present significant risk.

An IDE application must be supported by appropriate data, such as laboratory test results, showing that it is safe to test the device in humans and that the testing protocol is scientifically sound. The FDA typically grants IDE approval for a specified number of patients. A nonsignificant risk device does not require FDA approval of an IDE. Both significant risk and nonsignificant risk investigational devices require approval from IRBs at the study centers where the device will be used.

During the trial, the sponsor must comply with the FDA's IDE requirements for investigator selection, trial monitoring, reporting and record keeping. The investigators must obtain patient informed consent, rigorously follow the investigational plan and study protocol, control the disposition of investigational devices and comply with all reporting and record keeping requirements. Prior to granting PMA approval, the FDA typically inspects the records relating to the conduct of the study and the clinical data supporting the PMA application for compliance with applicable requirements.

Although the QSR does not fully apply to investigational devices, the requirement for controls on design and development does apply. The sponsor also must manufacture the investigational device in conformity with the quality controls described in the IDE application and any conditions of IDE approval that the FDA may impose with respect to manufacturing.

*Post-market*

After a device is on the market, numerous regulatory requirements apply. These requirements include: the QSR, labeling regulations, the FDA's general prohibition against promoting products for unapproved or "off label" uses, the Medical Device Reporting regulation, which requires that manufacturers report to the FDA if their device may have caused or contributed to a death or serious injury or malfunctioned in a way that would likely cause or contribute to a death or serious injury if it

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were to recur, and the Reports of Corrections and Removals regulation, which requires manufacturers to report recalls and field actions to the FDA if initiated to reduce a risk to health posed by the device or to remedy a violation of the FDCA.

The FDA enforces these requirements by inspection and market surveillance. If the FDA finds a violation, it can institute a wide variety of enforcement actions, ranging from a public warning letter to more severe sanctions such as: fines, injunctions and civil penalties; recall or seizure of products; operating restrictions, partial suspension or total shutdown of production; refusing requests for PMA approval of new products; withdrawing PMA approvals already granted; and criminal prosecution.

**Other regulatory requirements**

Any drug manufactured or distributed by us pursuant to FDA approvals are subject to pervasive and continuing regulation by the FDA, including, among other things, requirements relating to recordkeeping, periodic reporting, product sampling and distribution, advertising and promotion and reporting of adverse experiences with the product. After approval, most changes to the approved product, such as adding new indications or other labeling claims are subject to prior FDA review and approval.

The FDA may impose a number of post-approval requirements as a condition of approval of an NDA. For example, the FDA may require post-marketing testing, including Phase 4 clinical trials, and surveillance to further assess and monitor the product's safety and effectiveness after commercialization. Regulatory approval of oncology products often requires that patients in clinical trials be followed for long periods to determine the overall survival benefit of the drug.

In addition, drug manufacturers and other entities involved in the manufacture and distribution of approved drugs are required to register their establishments with the FDA and state agencies, and are subject to periodic unannounced inspections by the FDA and these state agencies for compliance with cGMP requirements. Changes to the manufacturing process are strictly regulated and often require prior FDA approval before being implemented. FDA regulations also require investigation and correction of any deviations from cGMP and impose reporting and documentation requirements upon us and any third-party manufacturers that we may decide to use. Accordingly, manufacturers must continue to expend time, money and effort in the areas of production and quality control to maintain cGMP compliance.

Once an approval is granted, the FDA may withdraw the approval if compliance with regulatory requirements and standards is not maintained or if problems occur after the product reaches the market. Later discovery of previously unknown problems with a product, including adverse events of unanticipated severity or frequency, or with manufacturing processes, or failure to comply with regulatory requirements, may result in revisions to the approved labeling to add new safety information, imposition of post-market studies or clinical trials to assess new safety risks or imposition of distribution or other restrictions under a Risk Evaluation and Mitigation Strategy program. Other potential consequences include, among other things:

restrictions on the marketing or manufacturing of the product, complete withdrawal of the product from the market or product recalls;

fines, warning letters or holds on post-approval clinical trials;

refusal of the FDA to approve pending applications or supplements to approved applications, or suspension or revocation of product license approvals;

product seizure or detention, or refusal to permit the import or export of products; or

consent decrees, injunctions or the imposition of civil or criminal penalties.

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The FDA strictly regulates marketing, labeling, advertising and promotion of products that are placed on the market. Drugs may be promoted only for the approved indications and in accordance with the provisions of the approved label. The FDA and other agencies actively enforce the laws and regulations prohibiting the promotion of off label uses, and a company that is found to have improperly promoted off label uses may be subject to significant liability.

**Additional provisions**

*Anti-kickback and false claims laws*

In addition to FDA restrictions on marketing of pharmaceutical products, several other types of state and federal laws have been applied to restrict certain marketing practices in the pharmaceutical industry in recent years. These laws include anti-kickback statutes and false claims statutes. The federal healthcare program anti-kickback statute prohibits, among other things, knowingly and willfully offering, paying, soliciting or receiving remuneration to induce or in return for purchasing, leasing, ordering or arranging for the purchase, lease or order of any healthcare item or service reimbursable under Medicare, Medicaid or other federally financed healthcare programs. This statute has been interpreted to apply to arrangements between pharmaceutical manufacturers on the one hand and prescribers, purchasers and formulary managers on the other. Violations of the anti-kickback statute are punishable by imprisonment, criminal fines, civil monetary penalties and exclusion from participation in federal healthcare programs. Although there are a number of statutory exemptions and regulatory safe harbors protecting certain common activities from prosecution or other regulatory sanctions, the exemptions and safe harbors are drawn narrowly, and practices that involve remuneration intended to induce prescribing, purchases or recommendations may be subject to scrutiny if they do not qualify for an exemption or safe harbor.

Federal false claims laws prohibit any person from knowingly presenting, or causing to be presented, a false claim for payment to the federal government, or knowingly making, or causing to be made, a false statement to have a false claim paid. Recently, several pharmaceutical and other healthcare companies have been prosecuted under these laws for allegedly inflating drug prices they report to pricing services, which in turn were used by the government to set Medicare and Medicaid reimbursement rates, and for allegedly providing free product to customers with the expectation that the customers would bill federal programs for the product. In addition, certain marketing practices, including off-label promotion, may also violate false claims laws. The majority of states also have statutes or regulations similar to the federal anti-kickback law and false claims laws, which apply to items and services reimbursed under Medicaid and other state programs, or, in several states, apply regardless of the payor.

*Physician drug samples*

As part of the sales and marketing process, pharmaceutical companies frequently provide samples of approved drugs to physicians. The Prescription Drug Marketing Act, or the PDMA, imposes requirements and limitations upon the provision of drug samples to physicians, as well as prohibits states from licensing distributors of prescription drugs unless the state licensing program meets certain federal guidelines that include minimum standards for storage, handling and record keeping. In addition, the PDMA sets forth civil and criminal penalties for violations.



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**Foreign regulation**

In order to market any product outside of the United States, we would need to comply with numerous and varying regulatory requirements of other countries regarding safety and efficacy and governing, among other things, clinical trials, marketing authorization, commercial sales and distribution of our products. Whether or not we obtain FDA approval for a product, we would need to obtain the necessary approvals by the comparable regulatory authorities of foreign countries before we can commence clinical trials or marketing of the product in those countries. The approval process varies from country to country and can involve additional product testing and additional administrative review periods. The time required to obtain approval in other countries might differ from and be longer than that required to obtain FDA approval. Regulatory approval in one country does not ensure regulatory approval in another, but a failure or delay in obtaining regulatory approval in one country may negatively impact the regulatory process in others.

To date, we have not initiated any discussions with the European Medicines Agency or any other foreign regulatory authorities with respect to seeking regulatory approval for any of our products in Europe or in any other country outside the United States.

**New legislation and regulations**

From time to time, legislation is drafted, introduced and passed in Congress that could significantly change the statutory provisions governing the testing, approval, manufacturing and marketing of products regulated by the FDA. For example, the FDAAA discussed above was enacted in 2007. In addition to new legislation, FDA regulations and policies are often revised or interpreted by the agency in ways that may significantly affect our business and our products. It is impossible to predict whether further legislative changes will be enacted or whether FDA regulations, guidance, policies or interpretations changed or what the effect of such changes, if any, may be.

**Pharmaceutical coverage, pricing and reimbursement**

Significant uncertainty exists as to the coverage and reimbursement status of any drug products for which we obtain regulatory approval. Sales of any of our product candidates, if approved, will depend, in part, on the extent to which the costs of the products will be covered by third-party payors, including government health programs such as Medicare and Medicaid, commercial health insurers and managed care organizations. The process for determining whether a payor will provide coverage for a drug product may be separate from the process for setting the price or reimbursement rate that the payor will pay for the drug product once coverage is approved. Third-party payors may limit coverage to specific drug products on an approved list, or formulary, which might not include all of the approved drugs for a particular indication.

In order to secure coverage and reimbursement for any product that might be approved for sale, we may need to conduct expensive pharmacoeconomic studies in order to demonstrate the medical necessity and cost-effectiveness of the product, in addition to the costs required to obtain FDA or other comparable regulatory approvals. Our product candidates may not be considered medically necessary or cost-effective. A payor's decision to provide coverage for a drug product does not imply that an adequate reimbursement rate will be approved. Third-party reimbursement may not be sufficient to enable us to maintain price levels high enough to realize an appropriate return on our investment in product development.

The containment of healthcare costs has become a priority of federal, state and foreign governments, and the prices of drugs have been a focus in this effort. Third-party payors are increasingly challenging the prices charged for medical products and services and examining the medical necessity and cost-effectiveness of medical products and services, in addition to their safety and efficacy. If these third-party payors do not consider our products to be cost-effective compared to other

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available therapies, they may not cover our products after approval as a benefit under their plans or, if they do, the level of payment may not be sufficient to allow us to sell our products at a profit. The U.S. government, state legislatures and foreign governments have shown significant interest in implementing cost containment programs to limit the growth of government-paid health care costs, including price controls, restrictions on reimbursement and requirements for substitution of generic products for branded prescription drugs. Adoption of such controls and measures, and tightening of restrictive policies in jurisdictions with existing controls and measures, could limit payments for pharmaceuticals such as the drug candidates that we are developing and could adversely affect our net revenue and results.

Pricing and reimbursement schemes vary widely from country to country. Some countries provide that drug products may be marketed only after a reimbursement price has been agreed. Some countries may require the completion of additional studies that compare the cost-effectiveness of a particular product candidate to currently available therapies. For example, the European Union provides options for its member states to restrict the range of drug products for which their national health insurance systems provide reimbursement and to control the prices of medicinal products for human use. European Union member states may approve a specific price for a drug product or may instead adopt a system of direct or indirect controls on the profitability of the company placing the drug product on the market. Other member states allow companies to fix their own prices for drug products, but monitor and control company profits. The downward pressure on health care costs in general, particularly prescription drugs, has become very intense. As a result, increasingly high barriers are being erected to the entry of new products. In addition, in some countries, cross-border imports from low-priced markets exert competitive pressure that may reduce pricing within a country. There can be no assurance that any country that has price controls or reimbursement limitations for drug products will allow favorable reimbursement and pricing arrangements for any of our products.

The marketability of any products for which we receive regulatory approval for commercial sale may suffer if the government and third-party payors fail to provide adequate coverage and reimbursement. In addition, an increasing emphasis on managed care in the United States has increased and we expect will continue to increase the pressure on drug pricing. Coverage policies, third-party reimbursement rates and drug pricing regulation may change at any time. In particular, the Patient Protection and Affordable Care Act was enacted in the United States in March 2010 and contain provisions that may reduce the profitability of drug products, including, for example, increased rebates for drugs sold to Medicaid programs, extension of Medicaid rebates to Medicaid managed care plans, mandatory discounts for certain Medicare Part D beneficiaries and annual fees based on pharmaceutical companies' share of sales to federal health care programs. Even if favorable coverage and reimbursement status is attained for one or more products for which we receive regulatory approval, less favorable coverage policies and reimbursement rates may be implemented in the future.

**EMPLOYEES**

As of March 8, 2013, we had 24 full-time employees, including a total of ten employees with M.D. or Ph.D. degrees. Of these full-time employees, 16 employees are engaged in research and development activities. None of our employees is represented by a labor union or covered by a collective bargaining agreement. We consider our relationship with our employees to be good.

Table of Contents**BUSINESS EXECUTIVE OFFICERS OF THE REGISTRANT**

The following table sets forth the name, age and position of each of our executive officers as of March 15, 2013.

<b>Name</b>	<b>Age</b>	<b>Position</b>
Christoph Westphal, M.D., Ph.D.	44	Chief Executive Officer and Director
Robert Forrester	49	President, Chief Operating Officer
Joanna Horobin, M.B., Ch.B.	58	Chief Medical Officer
Jonathan Pachter, Ph.D.	55	Vice President, Head of Research
Daniel Paterson	52	Vice President, Head of Corporate Development and Diagnostics

*Christoph Westphal, M.D., Ph.D.* has served as our Chief Executive Officer since September 2011. He served as our President from September 2011 until January 2013. He has served on our board of directors since August 2010 and as the Chairman of our board of directors since March 2011. Dr. Westphal has served as a partner of Longwood Fund, LP, a venture capital investment fund, since 2010. He served as the President of SR One, the corporate venture capital arm of GlaxoSmithKline, from 2010 until 2011. Dr. Westphal has previously been involved in founding a number of biotechnology companies as chief executive officer. Dr. Westphal co-founded Sirtris Pharmaceuticals, Inc., which was acquired by GlaxoSmithKline plc in 2008, and served as its Chief Executive Officer from 2004 to 2010. He also co-founded Alnara Pharmaceuticals, Inc., Acceleron Pharma, Inc., serving as its Chief Executive Officer in 2003, Alnylam Pharmaceuticals, Inc., serving as its Chief Executive Officer in 2002, and Momenta Pharmaceuticals, Inc., serving as its Chief Executive Officer in 2001. Dr. Westphal serves on the Board of Fellows of Harvard Medical School and the Board of Overseers for the Boston Symphony Orchestra and is a member of the Research Advisory Council at the Massachusetts General Hospital. He earned his M.D. from Harvard Medical School, his Ph.D. in genetics from Harvard University and his B.A. from Columbia University.

*Robert Forrester* has served as our Chief Operating Officer since March 2011 and our President since January 2013. Mr. Forrester has previously held executive level positions at both private and public life sciences companies. Prior to joining us, Mr. Forrester served as Chief Operating Officer of Forma Therapeutics, Inc. from 2010 until 2011. Previously he served as Interim President and Chief Executive Officer of CombinatoRx, Inc., now Zalicus Inc., from 2009 until 2010 and as its Executive Vice President and Chief Financial Officer from 2004 to 2009. Mr. Forrester served as Senior Vice President, Finance and Corporate Development at Coley Pharmaceuticals Group, Inc. from 2000 to 2003. He earned his LL.B. from Bristol University in England.

*Joanna Horobin, M.B., Ch.B.* has served as our Chief Medical Officer since October 2012. Dr. Horobin has 30 years of pharmaceutical drug development experience. Prior to joining us, Dr. Horobin served as President of Syndax Pharmaceuticals from April 2012 to October 2012 and President and CEO from May 2006 to April 2012. At Syndax, Dr. Horobin designed and implemented the phase 2 clinical development of Entinostat in metastatic breast and lung cancer. Previously, she served as VP, Oncology at Rhone-Poulenc Rorer (now Sanofi, NYSE: SNY), COO of CombinatoRx (NASDAQ: CRXX, now ZLCS) and EVP at EntreMed with experience spanning clinical development, marketing, and general management in both public and private companies. At Rhone-Poulenc Rorer (now Sanofi, NYSE: SNY) Dr. Horobin led the global oncology business, including the successful global launch of Taxotere® (docetaxel) in breast cancer and Campto/Camptosar® (CPT11) for colorectal cancer. Dr. Horobin also led a successful joint venture with Chugai to launch Granocyte® (lenograstim). Previously, Dr. Horobin played significant leadership roles in the approvals of Lovenox®, Celectol®, Augmentin®, Timentin®, temocillin, Bactroban® and Relafen®/Reliflex®. Dr. Horobin received her medical degree from the University of Manchester, England. While in clinical practice she

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gained membership to the Royal College of General Practitioners in the United Kingdom and holds a diploma of pharmaceutical medicine from the Royal College of Physicians in the United Kingdom.

*Jonathan Pachter, Ph.D.* has served as our Vice President, Head of Research since July 2011. Prior to joining us, Dr. Pachter served as the Senior Director of Cancer Biology at OSI Pharmaceuticals, Inc., which was acquired by Astellas Pharma Inc. in 2010, from 2005 to 2011. He earned his Ph.D. in Neuroscience and his M.S. in Pharmacology from Baylor College of Medicine.

*Dan Paterson* has served as our Vice President, Head of Corporate Development and Diagnostics since March 2012. Prior to joining us, Mr. Paterson was a consultant in 2011 until joining us in 2012. From 2009 through 2010, Mr. Paterson was the COO of On-Q-ity. Mr. Paterson was the President and CEO of The DNA Repair Company from 2006 until 2009, when it was acquired by On-Q-ity. Previously, he held senior level positions at IMS Health, CareTools, OnCare and Axion.

**OUR CORPORATE INFORMATION**

We were incorporated under the laws of the State of Delaware in August 2010. Our principal executive offices are located at 215 First Street, Suite 440, Cambridge, Massachusetts 02142 and our telephone number is (617) 252-9300.

**ADDITIONAL INFORMATION**

We maintain a website at [www.verastem.com](http://www.verastem.com). We make available, free of charge on our website, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, or the Exchange Act, as soon as reasonably practicable after we electronically file those reports with, or furnish them to, the Securities and Exchange Commission, or SEC. We also make available, free of charge on our website, the reports filed with the SEC by our executive officers, directors and 10% stockholders pursuant to Section 16 under the Exchange Act as soon as reasonably practicable after copies of those filings are provided to us by those persons. The information contained on, or that can be accessed through, our website is not a part of or incorporated by reference in this annual report on Form 10-K.

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**ITEM 1A. Risk Factors.**

**RISKS RELATED TO OUR FINANCIAL POSITION AND NEED FOR ADDITIONAL CAPITAL**

*We have incurred significant losses since our inception. We expect to incur losses for the foreseeable future and may never achieve or maintain profitability.*

Since inception, we have incurred significant operating losses. As of December 31, 2012, we had a deficit accumulated during the development stage of \$46.5 million. To date, we have not generated any revenues and have financed our operations through private placements of our preferred stock and our initial public offering completed in February 2012. We have devoted substantially all of our efforts to research and development. We have only recently initiated clinical development on one of our product candidates and expect that it will be many years, if ever, before we have a product candidate ready for commercialization. We expect to continue to incur significant expenses and increasing operating losses for the foreseeable future. The net losses we incur may fluctuate significantly from quarter to quarter. We anticipate that our expenses will increase substantially if and as we:

continue our research, preclinical and clinical development of our product candidates;

seek to identify additional product candidates that target cancer stem cells, or CSCs;

acquire or in-license other products and technologies;

initiate additional clinical trials for our product candidates;

seek marketing approvals for our product candidates that successfully complete clinical trials;

ultimately establish a sales, marketing and distribution infrastructure to commercialize any products for which we may obtain marketing approval;

maintain, expand and protect our intellectual property portfolio;

hire additional clinical, quality control and scientific personnel; and

add operational, financial and management information systems and personnel, including personnel to support our product development and planned future commercialization efforts.

To become and remain profitable, we must develop and eventually commercialize a product or products with significant market potential. This will require us to be successful in a range of challenging activities, including completing preclinical testing and clinical trials of our product candidates, obtaining marketing approval for these product candidates and manufacturing, marketing and selling those products for which we may obtain marketing approval. We may never succeed in these activities and, even if we do, may never generate revenues that are significant or large enough to achieve profitability. We are only in the early stages of clinical development. We recently initiated a Phase 1/1b trial of VS-6063 in combination with paclitaxel for the treatment of advanced ovarian cancer. We are currently only in the preclinical testing stages for our other most advanced product candidates and have not yet completed preclinical development of our other lead product candidates, VS-4718 and VS-5584. If we do achieve profitability, we may not be able to sustain or increase profitability on a quarterly or annual basis. Our failure to become and remain profitable would decrease the value of the company and could impair our ability to raise capital, maintain our research and development efforts, expand our business or continue our operations. A decline in the value of our company could also cause you to lose all or part of your investment.

*Our short operating history may make it difficult for you to evaluate the success of our business to date and to assess our future viability.*

## Edgar Filing: Verastem, Inc. - Form 10-K

We are an early stage company. We commenced active operations in the second half of 2010. Our operations to date have been limited to organizing and staffing our company, business planning, raising

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capital, acquiring and developing our technology, identifying potential product candidates and undertaking preclinical studies of our most advanced product candidates. We completed our initial public offering in February 2012. In January 2013, we initiated a Phase 1/1b trial of VS-6063. All of our other product candidates are still in preclinical development. We have not yet demonstrated our ability to initiate or successfully complete any clinical trials, including large-scale, pivotal clinical trials, obtain marketing approvals, manufacture a commercial scale product, or arrange for a third party to do so on our behalf, or conduct sales and marketing activities necessary for successful product commercialization. It takes about ten to 15 years to develop one new medicine from the time it is discovered to when it is available for treating patients. Consequently, any predictions you make about our future success or viability may not be as accurate as they could be if we had a longer operating history.

In addition, as a new business, we may encounter unforeseen expenses, difficulties, complications, delays and other known and unknown factors. We will need to transition from a company with a research focus to a company capable of supporting commercial activities. We may not be successful in such a transition.

***We will continue to need substantial additional funding. If we are unable to raise capital when needed, we would be forced to delay, reduce or eliminate our product development programs or commercialization efforts.***

We expect our expenses to increase in connection with our ongoing activities, particularly as we continue the research and development and initiate additional clinical trials of, and seek marketing approval for, our product candidates. In addition, if we obtain marketing approval for any of our product candidates, we expect to incur significant commercialization expenses related to product sales, marketing, manufacturing and distribution. Accordingly, we will need to obtain substantial additional funding in connection with our continuing operations. If we are unable to raise capital when needed or on attractive terms, we would be forced to delay, reduce or eliminate our research and development programs or any future commercialization efforts.

We expect our existing cash, cash equivalents and investments, will enable us to fund our current operating plan and capital expenditure requirements into late 2015. Our future capital requirements will depend on many factors, including:

the scope, progress, results and costs of compound discovery, preclinical development, laboratory testing and clinical trials for our product candidates;

the extent to which we acquire or in-license other products and technologies;

the costs, timing and outcome of regulatory review of our product candidates;

the costs of future commercialization activities, including product sales, marketing, manufacturing and distribution, for any of our product candidates for which we receive marketing approval;

revenue, if any, received from commercial sales of our product candidates, should any of our product candidates receive marketing approval;

the costs of preparing, filing and prosecuting patent applications, maintaining and enforcing our intellectual property rights and defending intellectual property-related claims; and

our ability to establish collaborations on favorable terms, if at all.

Identifying potential product candidates and conducting preclinical testing and clinical trials is a time-consuming, expensive and uncertain process that takes years to complete, and we may never generate the necessary data or results required to obtain marketing approval and achieve product sales. In addition, our product candidates, if approved, may not achieve commercial success. Our commercial

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revenues, if any, will be derived from sales of products that we do not expect to be commercially available for many years, if at all. Accordingly, we will need to continue to rely on additional financing to achieve our business objectives. Adequate additional financing may not be available to us on acceptable terms, or at all.

***Raising additional capital may cause dilution to our stockholders, restrict our operations or require us to relinquish rights to our technologies or product candidates.***

Until such time, if ever, as we can generate substantial product revenues, we expect to finance our cash needs through a combination of equity offerings, debt financings, collaborations, strategic alliances and licensing arrangements. We do not have any committed external source of funds. To the extent that we raise additional capital through the sale of equity or convertible debt securities, the ownership interest of our existing stockholders will be diluted, and the terms of these securities may include liquidation or other preferences that adversely affect the rights of our existing stockholders. Debt financing, if available, may involve agreements that include covenants limiting or restricting our ability to take specific actions, such as incurring additional debt, making capital expenditures or declaring dividends.

If we raise additional funds through collaborations, strategic alliances or licensing arrangements with third parties, we may have to relinquish valuable rights to our technologies, future revenue streams, research programs or product candidates or to grant licenses on terms that may not be favorable to us. If we are unable to raise additional funds through equity or debt financings when needed, we may be required to delay, limit, reduce or terminate our product development or future commercialization efforts or grant rights to develop and market product candidates that we would otherwise prefer to develop and market ourselves.

**RISKS RELATED TO THE DISCOVERY, DEVELOPMENT AND COMMERCIALIZATION OF OUR PRODUCT CANDIDATES**

***Our approach to the discovery and development of product candidates that target CSCs is unproven, and we do not know whether we will be able to develop any products of commercial value.***

Our scientific approach focuses on using proprietary technology to create a stable population of CSCs in the laboratory that we then use to screen for and identify product candidates targeting these CSCs. Research on CSCs is an emerging field and, consequently, there is ongoing debate regarding the existence of CSCs, whether the appropriate nomenclature to refer to these cells is cancer stem cells, tumor-initiating cells or another term and the importance of these cells as an underlying cause of tumor recurrence and metastasis.

Although there is general consensus that some cancer cells have tumor-initiating capacity, there also is some debate in the scientific community regarding the defining characteristics of these cells, which we call CSCs, and the origin of these cells. Some believe that normal adult stem cells mutate and transform into CSCs. Others believe that all cancer cells have tumor-initiating capabilities, these capabilities cannot be attributed to a factor intrinsic to a particular cell and, therefore, a definitive CSC cannot be isolated or targeted. We believe that the discovery by our scientific co-founders of the link between the epithelial-to-mesenchymal transition, or EMT, and the emergence of cancer stem cells is one way a cancer cell can transition to a CSC, but this view is not universally accepted.

Even if our beliefs regarding the existence, characteristics and function of CSCs are correct, any drugs that we develop may not effectively target CSCs. We do not believe that any drugs that target CSCs have been successfully developed to date for the treatment of cancer. If we are able to develop a drug that targets CSCs in preclinical studies, we may nonetheless not succeed in demonstrating safety and efficacy of the drug in human clinical trials. Our focus on using our proprietary technology to



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screen for and identify product candidates targeting CSCs may not result in the discovery and development of commercially viable drugs to treat cancer.

***We may not be successful in our efforts to identify or discover additional potential product candidates.***

A key element of our strategy is to identify and test additional compounds that target CSCs in a variety of different types of cancer. A significant portion of the research that we are conducting involves new compounds, new uses of existing compounds and new and unproven drug discovery methods, including our proprietary technology. The drug discovery that we are conducting using our EMT technology may not be successful in identifying compounds that are useful in treating cancer. Our research programs may initially show promise in identifying potential product candidates, yet fail to yield product candidates for clinical development for a number of reasons, including:

the research methodology used may not be successful in identifying potential product candidates; or

potential product candidates may, on further study, be shown to have harmful side effects or other characteristics that indicate that they are unlikely to be products that will receive marketing approval and achieve market acceptance.

In particular, because our EMT technology induces the EMT process to create a stable population of CSCs, it is possible that these stable CSCs may not react in precisely the same manner as naturally occurring CSCs when treated with a particular product candidate. As a result, a product candidate that shows initial promise in targeting our stable population of CSCs may not have the same effect on tumors with naturally occurring CSCs.

Research programs to identify new product candidates require substantial technical, financial and human resources. We may choose to focus our efforts and resources on a potential product candidate that ultimately proves to be unsuccessful.

If we are unable to identify suitable compounds for preclinical and clinical development, we will not be able to obtain product revenues in future periods, which likely would result in significant harm to our financial position and adversely impact our stock price.

***We may not be successful in obtaining necessary rights to compounds and product candidates for our development pipeline through acquisitions and in-licenses.***

Because we are screening a range of compounds, including compounds with proprietary rights held by third parties, for their activity against CSCs, the growth of our business will depend in significant part on our ability to acquire or in-license rights to these compounds. However, we may be unable to acquire or in-license any compounds or product candidates from third parties that we identify using our proprietary EMT technology or otherwise. The licensing and acquisition of proprietary compounds is a competitive area, and a number of more established companies are also pursuing strategies to license or acquire compounds and product candidates that we may consider attractive. These established companies may have a competitive advantage over us due to their size, cash resources and greater clinical development and commercialization capabilities.

The Whitehead Institute and affiliated parties have retained the right to use the EMT technology that we license from it for research, teaching and educational purposes and could seek to license to third parties any intellectual property rights that it discovers using the EMT technology while pursuing these purposes. Pursuant to our drug discovery platform license agreement with the Whitehead Institute, we will have an opportunity, subject to the Whitehead Institute's obligations under any third-party research funding agreements, to negotiate a license to any such intellectual property under the drug discovery platform license agreement that is developed or conceived on or prior to a specified date in Robert Weinberg's laboratory at the Whitehead Institute. Our failure to reach an agreement

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with either the Broad Institute or the Whitehead Institute for any applicable intellectual property could result in a third party acquiring the related rights.

In addition, companies that perceive us to be a competitor may be unwilling to assign or license rights to us. We also may be unable to license or acquire the relevant compound or product candidate on terms that would allow us to make an appropriate return on our investment. In addition, we expect competition for acquisition and in-licensing product candidates that are attractive to us may increase in the future, especially if our approach of targeting CSCs gains greater scientific acceptance, which may mean fewer suitable opportunities for us as well as higher acquisition or licensing prices. If we are unable to successfully obtain rights to suitable compounds or product candidates, our business, financial condition and prospects for growth could suffer.

***Preclinical testing and clinical trials of our product candidates may not be successful. If we are unable to commercialize our product candidates or experience significant delays in doing so, our business will be materially harmed.***

We have invested a significant portion of our efforts and financial resources in the identification and preclinical development of drugs that target CSCs. In January 2013, we initiated our first clinical trial of one of our product candidates, VS-6063. Our other lead product candidates are still in preclinical development. Our ability to generate product revenues, which we do not expect will occur for many years, if ever, will depend heavily on the successful development and eventual commercialization of our product candidates. The success of our product candidates will depend on several factors, including the following:

- successful completion of preclinical studies and clinical trials;
- receipt of marketing approvals from applicable regulatory authorities;
- establishing commercial manufacturing capabilities or making arrangements with third-party manufacturers;
- obtaining and maintaining patent and trade secret protection and regulatory exclusivity for our product candidates;
- launching commercial sales of the products, if and when approved, whether alone or in collaboration with others;
- acceptance of the products, if and when approved, by patients, the medical community and third-party payors;
- effectively competing with other therapies; and
- a continued acceptable safety profile of the products following approval.

If we do not achieve one or more of these factors in a timely manner or at all, we could experience significant delays or an inability to successfully commercialize our product candidates, which would materially harm our business.

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***If clinical trials of our product candidates fail to demonstrate safety and efficacy to the satisfaction of regulatory authorities or do not otherwise produce positive results, we may incur additional costs or experience delays in completing, or ultimately be unable to complete, the development and commercialization of our product candidates.***

Before obtaining marketing approval from regulatory authorities for the sale of our product candidates, we must complete extensive clinical trials to demonstrate the safety and efficacy of our product candidates in humans. Clinical testing is expensive, difficult to design and implement, can take many years to complete and is uncertain as to outcome. A failure of one or more clinical trials can occur at any stage of testing. The outcome of preclinical testing and early clinical trials may not be predictive of the success of later clinical trials, and interim results of a clinical trial do not necessarily predict final results. Moreover, preclinical and clinical data are often susceptible to varying interpretations and analyses, and many companies that have believed their product candidates performed satisfactorily in preclinical studies and clinical trials have nonetheless failed to obtain marketing approval of their products. For example, standard measures of clinical activity with respect to solid tumors, such as Response Criteria in Solid Tumors, or RECIST, measurement guidelines, which are based on gross changes in the size of tumor lesions, may not be sufficient to detect the targeting of CSCs by our product candidates.

We may experience numerous unforeseen events during, or as a result of, clinical trials that could delay or prevent our ability to receive marketing approval or commercialize our product candidates, including:

regulators or institutional review boards may not authorize us or our investigators to commence a clinical trial or conduct a clinical trial at a prospective trial site;

we may have delays in reaching or fail to reach agreement on acceptable clinical trial contracts or clinical trial protocols with prospective trial sites;

clinical trials of our product candidates may produce negative or inconclusive results, and we may decide, or regulators may require us, to conduct additional clinical trials or abandon product development programs;

the number of patients required for clinical trials of our product candidates may be larger than we anticipate, enrollment in these clinical trials may be slower than we anticipate or participants may drop out of these clinical trials at a higher rate than we anticipate;

our third-party contractors may fail to comply with regulatory requirements or meet their contractual obligations to us in a timely manner, or at all;

we might have to suspend or terminate clinical trials of our product candidates for various reasons, including a finding that the participants are being exposed to unacceptable health risks;

regulators or institutional review boards may require that we or our investigators suspend or terminate clinical research for various reasons, including noncompliance with regulatory requirements or a finding that the participants are being exposed to unacceptable health risks;

the cost of clinical trials of our product candidates may be greater than we anticipate;

the supply or quality of our product candidates or other materials necessary to conduct clinical trials of our product candidates may be insufficient or inadequate; and

our product candidates may have undesirable side effects or other unexpected characteristics, causing us or our investigators, regulators or institutional review boards to suspend or terminate the trials.



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If we are required to conduct additional clinical trials or other testing of our product candidates beyond those that we currently contemplate, if we are unable to successfully complete clinical trials of our product candidates or other testing, if the results of these trials or tests are not positive or are only modestly positive or if there are safety concerns, we may:

be delayed in obtaining marketing approval for our product candidates;

not obtain marketing approval at all;

obtain approval for indications or patient populations that are not as broad as intended or desired;

obtain approval with labeling that includes significant use or distribution restrictions or safety warnings, including boxed warnings;

be subject to additional post-marketing testing requirements; or

have the product removed from the market after obtaining marketing approval.

Our product development costs will also increase if we experience delays in testing or marketing approvals. We do not know whether any clinical trials will begin as planned, will need to be restructured or will be completed on schedule, or at all. Significant clinical trial delays also could shorten any periods during which we may have the exclusive right to commercialize our product candidates or allow our competitors to bring products to market before we do and impair our ability to successfully commercialize our product candidates and may harm our business and results of operations.

***If we experience delays or difficulties in the enrollment of patients in clinical trials, our receipt of necessary regulatory approvals could be delayed or prevented.***

We may not be able to initiate or continue clinical trials for our product candidates if we are unable to locate and enroll a sufficient number of eligible patients to participate in these trials as required by the U.S. Food and Drug Administration, or FDA, or similar regulatory authorities outside the United States. In addition, many of our competitors have ongoing clinical trials for product candidates that treat the same indications as our product candidates, and patients who would otherwise be eligible for our clinical trials may instead enroll in clinical trials of our competitors' product candidates.

Patient enrollment is affected by other factors including:

severity of the disease under investigation;

eligibility criteria for the study in question;

perceived risks and benefits of the product candidate under study;

efforts to facilitate timely enrollment in clinical trials;

patient referral practices of physicians;

the ability to monitor patients adequately during and after treatment; and

proximity and availability of clinical trial sites for prospective patients.

Our inability to enroll a sufficient number of patients for our clinical trials would result in significant delays or may require us to abandon one or more clinical trials altogether. Enrollment delays in our clinical trials may result in increased development costs for our product candidates, which would cause the value of our company to decline and limit our ability to obtain additional financing.

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***If serious adverse or inappropriate side effects are identified during the development of our product candidates, we may need to abandon or limit our development of some of our product candidates.***

All of our product candidates are in preclinical development or early stages of clinical development and their risk of failure is high. It is impossible to predict when or if any of our product candidates will prove effective or safe in humans or will receive marketing approval. If our product candidates are associated with undesirable side effects or have characteristics that are unexpected, we may need to abandon their development or limit development to certain uses or subpopulations in which the undesirable side effects or other characteristics are less prevalent, less severe or more acceptable from a risk-benefit perspective. Many compounds that initially showed promise in early stage testing for treating cancer have later been found to cause side effects that prevented further development of the compound.

***We may expend our limited resources to pursue a particular product candidate or indication and fail to capitalize on product candidates or indications that may be more profitable or for which there is a greater likelihood of success.***

Because we have limited financial and managerial resources, we focus on research programs and product candidates that we identify for specific indications. As a result, we may forego or delay pursuit of opportunities with other product candidates or for other indications that later prove to have greater commercial potential. Our resource allocation decisions may cause us to fail to capitalize on viable commercial products or profitable market opportunities. Our spending on current and future research and development programs and product candidates for specific indications may not yield any commercially viable products. If we do not accurately evaluate the commercial potential or target market for a particular product candidate, we may relinquish valuable rights to that product candidate through collaboration, licensing or other royalty arrangements in cases in which it would have been more advantageous for us to retain sole development and commercialization rights to such product candidate.

***If we are unable to successfully develop companion diagnostics for our therapeutic product candidates, or experience significant delays in doing so, we may not realize the full commercial potential of our therapeutics.***

We plan to develop companion diagnostics for our therapeutic product candidates. There has been limited success to date industry wide in developing these types of companion diagnostics. To be successful, we would need to address a number of scientific, technical and logistical challenges. We have only recently initiated development of companion diagnostics. We have limited experience in the development of diagnostics and may not be successful in developing appropriate diagnostics to pair with any of our therapeutic product candidates that receive marketing approval. Companion diagnostics are subject to regulation by the FDA and similar regulatory authorities outside the United States as medical devices and require separate regulatory approval prior to commercialization. Given our limited experience in developing diagnostics, we expect to rely in part on third parties for their design and manufacture. For example, we entered into an agreement with Laboratory Corporation of America Holdings to assist us in validating biomarkers for VS-6063 in the development of an applicable companion diagnostic. If we or any third parties that we engage to assist us, are unable to successfully develop companion diagnostics for our therapeutic product candidates, or experience delays in doing so:

the development of our therapeutic product candidates may be adversely affected if we are unable to appropriately select patients for enrollment in our clinical trials;

our therapeutic product candidates may not receive marketing approval if safe and effective use of a therapeutic product candidate depends on an in vitro diagnostic; and

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we may not realize the full commercial potential of any therapeutics that receive marketing approval if, among other reasons, we are unable to appropriately select patients who are likely to benefit from therapy with our drugs.

As a result, our business would be harmed, possibly materially.

***Even if any of our product candidates receive marketing approval, they may fail to achieve the degree of market acceptance by physicians, patients, healthcare payors and others in the medical community necessary for commercial success.***

If any of our product candidates receive marketing approval, they may nonetheless fail to gain sufficient market acceptance by physicians, patients, healthcare payors and others in the medical community. For example, current cancer treatments like chemotherapy and radiation therapy are well established in the medical community, and doctors may continue to rely on these treatments. If our product candidates do not achieve an adequate level of acceptance, we may not generate significant product revenues and we may not become profitable. The degree of market acceptance of our product candidates, if approved for commercial sale, will depend on a number of factors, including:

efficacy and potential advantages compared to alternative treatments;

the ability to offer our products for sale at competitive prices;

convenience and ease of administration compared to alternative treatments;

the willingness of the target patient population to try new therapies and of physicians to prescribe these therapies;

the strength of marketing and distribution support;

sufficient third-party coverage or reimbursement; and

the prevalence and severity of any side effects.

***If, in the future, we are unable to establish sales and marketing capabilities or enter into agreements with third parties to sell and market our product candidates, we may not be successful in commercializing our product candidates if and when they are approved.***

We do not have a sales or marketing infrastructure and have no experience in the sale, marketing or distribution of pharmaceutical products. To achieve commercial success for any approved product, we must either develop a sales and marketing organization or outsource these functions to third parties. In the future, we may choose to build a focused sales and marketing infrastructure to market or co-promote some of our product candidates if and when they are approved.

There are risks involved with both establishing our own sales and marketing capabilities and entering into arrangements with third parties to perform these services. For example, recruiting and training a sales force is expensive and time consuming and could delay any product launch. If the commercial launch of a product candidate for which we recruit a sales force and establish marketing capabilities is delayed or does not occur for any reason, we would have prematurely or unnecessarily incurred these commercialization expenses. This may be costly, and our investment would be lost if we cannot retain or reposition our sales and marketing personnel.

Factors that may inhibit our efforts to commercialize our products on our own include:

our inability to recruit and retain adequate numbers of effective sales and marketing personnel;



the inability of sales personnel to obtain access to physicians or persuade adequate numbers of physicians to prescribe any future products;

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the lack of complementary products to be offered by sales personnel, which may put us at a competitive disadvantage relative to companies with more extensive product lines; and

unforeseen costs and expenses associated with creating an independent sales and marketing organization.

If we enter into arrangements with third parties to perform sales, marketing and distribution services, our product revenues or the profitability of these product revenues to us are likely to be lower than if we were to market and sell any products that we develop ourselves. In addition, we may not be successful in entering into arrangements with third parties to sell and market our product candidates or may be unable to do so on terms that are favorable to us. We likely will have little control over such third parties, and any of them may fail to devote the necessary resources and attention to sell and market our products effectively. If we do not establish sales and marketing capabilities successfully, either on our own or in collaboration with third parties, we will not be successful in commercializing our product candidates.

***We face substantial competition, which may result in others discovering, developing or commercializing products before or more successfully than we do.***

The development and commercialization of new drug products is highly competitive. We face competition with respect to our current product candidates, and will face competition with respect to any product candidates that we may seek to develop or commercialize in the future, from major pharmaceutical companies, specialty pharmaceutical companies and biotechnology companies worldwide. There are a number of large pharmaceutical and biotechnology companies that currently market and sell products or are pursuing the development of products for the treatment of the disease indications for which we are developing our product candidates. Some of these competitive products and therapies are based on scientific approaches that are the same as or similar to our approach, and others are based on entirely different approaches. Potential competitors also include academic institutions, government agencies and other public and private research organizations that conduct research, seek patent protection and establish collaborative arrangements for research, development, manufacturing and commercialization.

We are developing our product candidates for the treatment of cancer. There are a variety of available therapies marketed for cancer. In many cases, these drugs are administered in combination to enhance efficacy. Some of these drugs are branded and subject to patent protection, and others are available on a generic basis. Many of these approved drugs are well established therapies and are widely accepted by physicians, patients and third-party payors. Insurers and other third-party payors may also encourage the use of generic products. We expect that if our product candidates are approved, they will be priced at a significant premium over competitive generic products. This may make it difficult for us to achieve our business strategy of using our product candidates in combination with existing therapies or replacing existing therapies with our product candidates.

There are also a number of products in clinical development by third parties to treat cancer by targeting CSCs. These companies include divisions of large pharmaceutical companies, including Astellas Pharma US, Inc., Sanofi-Aventis US LLC, GlaxoSmithKline plc, Boehringer Ingelheim GmbH, Pfizer Inc. and others. There are also biotechnology companies of various sizes that are developing therapies against CSCs, including OncoMed Pharmaceuticals, Inc., Boston Biomedical, Inc. and Stemline Therapeutics, Inc. Our competitors may develop products that are more effective, safer, more convenient or less costly than any that we are developing or that would render our product candidates obsolete or non-competitive. In addition, our competitors may discover biomarkers that more efficiently measure CSCs than our methods, which may give them a competitive advantage in developing potential products. Our competitors may also obtain marketing approval from the FDA or other regulatory

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authorities for their products more rapidly than we may obtain approval for ours, which could result in our competitors establishing a strong market position before we are able to enter the market.

Many of our competitors have significantly greater financial resources and expertise in research and development, manufacturing, preclinical testing, conducting clinical trials, obtaining regulatory approvals and marketing approved products than we do. Mergers and acquisitions in the pharmaceutical and biotechnology industries may result in even more resources being concentrated among a smaller number of our competitors. Smaller and other early stage companies may also prove to be significant competitors, particularly through collaborative arrangements with large and established companies. These third parties compete with us in recruiting and retaining qualified scientific and management personnel, establishing clinical trial sites and patient registration for clinical trials, as well as in acquiring technologies complementary to, or necessary for, our programs.

***Even if we are able to commercialize any product candidates, the products may become subject to unfavorable pricing regulations, third-party reimbursement practices or healthcare reform initiatives, which would harm our business.***

The regulations that govern marketing approvals, pricing and reimbursement for new drug products vary widely from country to country. In the United States, recently passed legislation may significantly change the approval requirements in ways that could involve additional costs and cause delays in obtaining approvals. Some countries require approval of the sale price of a drug before it can be marketed. In many countries, the pricing review period begins after marketing or product licensing approval is granted. In some foreign markets, prescription pharmaceutical pricing remains subject to continuing governmental control even after initial approval is granted. As a result, we might obtain marketing approval for a product in a particular country, but then be subject to price regulations that delay our commercial launch of the product, possibly for lengthy time periods, and negatively impact the revenues we are able to generate from the sale of the product in that country. Adverse pricing limitations may hinder our ability to recoup our investment in one or more product candidates, even if our product candidates obtain marketing approval.

Our ability to commercialize any products successfully also will depend in part on the extent to which reimbursement for these products and related treatments will be available from government health administration authorities, private health insurers and other organizations. Government authorities and third-party payors, such as private health insurers and health maintenance organizations, decide which medications they will pay for and establish reimbursement levels. A primary trend in the U.S. healthcare industry and elsewhere is cost containment. Government authorities and third-party payors have attempted to control costs by limiting coverage and the amount of reimbursement for particular medications. Increasingly, third-party payors are requiring that drug companies provide them with predetermined discounts from list prices and are challenging the prices charged for medical products. We cannot be sure that reimbursement will be available for any product that we commercialize and, if reimbursement is available, the level of reimbursement. Reimbursement may impact the demand for, or the price of, any product candidate for which we obtain marketing approval. Obtaining reimbursement for our products may be particularly difficult because of the higher prices often associated with drugs administered under the supervision of a physician. If reimbursement is not available or is available only to limited levels, we may not be able to successfully commercialize any product candidate for which we obtain marketing approval.

There may be significant delays in obtaining reimbursement for newly approved drugs, and coverage may be more limited than the purposes for which the drug is approved by the FDA or similar regulatory authorities outside the United States. Moreover, eligibility for reimbursement does not imply that any drug will be paid for in all cases or at a rate that covers our costs, including research, development, manufacture, sale and distribution. Interim reimbursement levels for new drugs, if applicable, may also not be sufficient to cover our costs and may not be made permanent.

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Reimbursement rates may vary according to the use of the drug and the clinical setting in which it is used, may be based on reimbursement levels already set for lower cost drugs and may be incorporated into existing payments for other services. Net prices for drugs may be reduced by mandatory discounts or rebates required by government healthcare programs or private payors and by any future relaxation of laws that presently restrict imports of drugs from countries where they may be sold at lower prices than in the United States. Third-party payors often rely upon Medicare coverage policy and payment limitations in setting their own reimbursement policies. Our inability to promptly obtain coverage and profitable payment rates from both government-funded and private payors for any approved products that we develop could have a material adverse effect on our operating results, our ability to raise capital needed to commercialize products and our overall financial condition.

***Product liability lawsuits against us could cause us to incur substantial liabilities and to limit commercialization of any products that we may develop.***

We face an inherent risk of product liability exposure related to the testing of our product candidates in human clinical trials and will face an even greater risk if we commercially sell any products that we may develop. If we cannot successfully defend ourselves against claims that our product candidates or products caused injuries, we will incur substantial liabilities. Regardless of merit or eventual outcome, liability claims may result in:

decreased demand for any product candidates or products that we may develop;

injury to our reputation and significant negative media attention;

withdrawal of clinical trial participants;

significant costs to defend the related litigation;

substantial monetary awards to trial participants or patients;

loss of revenue; and

the inability to commercialize any products that we may develop.

We currently hold \$5.0 million in product liability insurance coverage in the aggregate, with a per incident limit of \$5.0 million, which may not be adequate to cover all liabilities that we may incur. We may need to increase our insurance coverage as we initiate additional clinical trials or upon the commercialization of our product candidates, if ever. Insurance coverage is increasingly expensive. We may not be able to maintain insurance coverage at a reasonable cost or in an amount adequate to satisfy any liability that may arise.

***If we fail to comply with environmental, health and safety laws and regulations, we could become subject to fines or penalties or incur costs that could have a material adverse effect on the success of our business.***

We are subject to numerous environmental, health and safety laws and regulations, including those governing laboratory procedures and the handling, use, storage, treatment and disposal of hazardous materials and wastes. Our operations involve the use of hazardous and flammable materials, including chemicals and biological materials. Our operations also produce hazardous waste products. We generally contract with third parties for the disposal of these materials and wastes. We cannot eliminate the risk of contamination or injury from these materials. In the event of contamination or injury resulting from our use of hazardous materials, we could be held liable for any resulting damages, and any liability could exceed our resources. We also could incur significant costs associated with civil or criminal fines and penalties.

Although we maintain workers' compensation insurance to cover us for costs and expenses we may incur due to injuries to our employees resulting from the use of hazardous materials, this insurance



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may not provide adequate coverage against potential liabilities. We do not maintain insurance for environmental liability or toxic tort claims that may be asserted against us in connection with our storage or disposal of biological, hazardous or radioactive materials.

In addition, we may incur substantial costs in order to comply with current or future environmental, health and safety laws and regulations. These current or future laws and regulations may impair our research, development or production efforts. Failure to comply with these laws and regulations also may result in substantial fines, penalties or other sanctions.

**RISKS RELATED TO OUR DEPENDENCE ON THIRD PARTIES**

*We may depend on collaborations with third parties for the development and commercialization of our product candidates. If those collaborations are not successful, we may not be able to capitalize on the market potential of these product candidates.*

We may seek third-party collaborators for the development and commercialization of our product candidates. Our likely collaborators for any collaboration arrangements include large and mid-size pharmaceutical companies, regional and national pharmaceutical companies and biotechnology companies. If we do enter into any such arrangements with any third parties, we will likely have limited control over the amount and timing of resources that our collaborators dedicate to the development or commercialization of our product candidates. Our ability to generate revenues from these arrangements will depend on our collaborators' abilities to successfully perform the functions assigned to them in these arrangements.

Collaborations involving our product candidates would pose the following risks to us:

collaborators have significant discretion in determining the efforts and resources that they will apply to these collaborations;

collaborators may not pursue development and commercialization of our product candidates or may elect not to continue or renew development or commercialization programs based on clinical trial results, changes in the collaborator's strategic focus or available funding or external factors such as an acquisition that diverts resources or creates competing priorities;

collaborators may delay clinical trials, provide insufficient funding for a clinical trial program, stop a clinical trial or abandon a product candidate, repeat or conduct new clinical trials or require a new formulation of a product candidate for clinical testing;

collaborators could independently develop, or develop with third parties, products that compete directly or indirectly with our products or product candidates if the collaborators believe that competitive products are more likely to be successfully developed or can be commercialized under terms that are more economically attractive than ours;

a collaborator with marketing and distribution rights to one or more products may not commit sufficient resources to the marketing and distribution of such product or products;

collaborators may not properly maintain or defend our intellectual property rights or may use our proprietary information in such a way as to invite litigation that could jeopardize or invalidate our proprietary information or expose us to potential litigation;

disputes may arise between the collaborators and us that result in the delay or termination of the research, development or commercialization of our products or product candidates or that result in costly litigation or arbitration that diverts management attention and resources; and

collaborations may be terminated and, if terminated, may result in a need for additional capital to pursue further development or commercialization of the applicable product candidates.



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Collaboration agreements may not lead to development or commercialization of product candidates in the most efficient manner or at all. If a present or future collaborator of ours were to be involved in a business combination, the continued pursuit and emphasis on our product development or commercialization program could be delayed, diminished or terminated.

***If we are not able to establish collaborations, we may have to alter our development and commercialization plans.***

Our drug development programs and the potential commercialization of our product candidates will require substantial additional cash to fund expenses. For some of our product candidates, we may decide to collaborate with pharmaceutical and biotechnology companies for the development and potential commercialization of those product candidates.

We face significant competition in seeking appropriate collaborators. Whether we reach a definitive agreement for a collaboration will depend, among other things, upon our assessment of the collaborator's resources and expertise, the terms and conditions of the proposed collaboration and the proposed collaborator's evaluation of a number of factors. Those factors may include the design or results of clinical trials, the likelihood of approval by the FDA or similar regulatory authorities outside the United States, the potential market for the subject product candidate, the costs and complexities of manufacturing and delivering such product candidate to patients, the potential of competing products, the existence of uncertainty with respect to our ownership of technology, which can exist if there is a challenge to such ownership without regard to the merits of the challenge and industry and market conditions generally. The collaborator may also consider alternative product candidates or technologies for similar indications that may be available to collaborate on and whether such a collaboration could be more attractive than the one with us for our product candidate. We may also be restricted under existing license agreements from entering into agreements on certain terms with potential collaborators. Collaborations are complex and time-consuming to negotiate and document. In addition, there have been a significant number of recent business combinations among large pharmaceutical companies that have resulted in a reduced number of potential future collaborators.

We may not be able to negotiate collaborations on a timely basis, on acceptable terms, or at all. If we are unable to do so, we may have to curtail the development of such product candidate, reduce or delay its development program or one or more of our other development programs, delay its potential commercialization or reduce the scope of any sales or marketing activities, or increase our expenditures and undertake development or commercialization activities at our own expense. If we elect to increase our expenditures to fund development or commercialization activities on our own, we may need to obtain additional capital, which may not be available to us on acceptable terms or at all. If we do not have sufficient funds, we may not be able to further develop our product candidates or bring them to market and generate product revenue.

***We expect to rely on third parties to conduct our clinical trials and some aspects of our compound formulation research and preclinical testing, and those third parties may not perform satisfactorily, including failing to meet deadlines for the completion of such trials, research or testing.***

We do not plan to independently conduct all aspects of clinical trials of our product candidates. In addition, we do not expect to independently conduct all aspects of our compound formulation research or preclinical testing of our product candidates. We expect to rely on third parties, such as contract research organizations, clinical data management organizations, medical institutions and clinical investigators, to conduct our clinical trials. For example, we currently rely on third parties in the development of various formulations of VS-5584 and VS-4718. We cannot finish preclinical testing and initiate clinical trials of these product candidates until the development of a formulation is complete. Any of these third parties may terminate their engagements with us at any time. If we need to enter into alternative arrangements, it would delay our product development activities.



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Our reliance on these third parties for research and development activities will reduce our control over these activities but will not relieve us of our responsibilities. For example, we will remain responsible for ensuring that each of our clinical trials is conducted in accordance with the general investigational plan and protocols for the trial. Moreover, the FDA requires us to comply with standards, commonly referred to as Good Clinical Practices, for conducting, recording and reporting the results of clinical trials to assure that data and reported results are credible and accurate and that the rights, integrity and confidentiality of trial participants are protected. We also are required to register ongoing clinical trials and post the results of completed clinical trials on a government-sponsored database, ClinicalTrials.gov, within certain timeframes. Failure to do so can result in fines, adverse publicity and civil and criminal sanctions.

Furthermore, these third parties may also have relationships with other entities, some of which may be our competitors. If these third parties do not successfully carry out their contractual duties, meet expected deadlines or conduct our clinical trials in accordance with regulatory requirements or our stated protocols, we will not be able to obtain, or may be delayed in obtaining, marketing approvals for our product candidates and will not be able to, or may be delayed in our efforts to, successfully commercialize our product candidates.

We also expect to rely on other third parties to store and distribute drug supplies for our clinical trials. Any performance failure on the part of our distributors could delay clinical development or marketing approval of our product candidates or commercialization of our products, producing additional losses and depriving us of potential product revenue.

***We contract with third parties for the manufacture of our product candidates for preclinical testing and expect to continue to do so for clinical trials and for commercialization. This reliance on third parties increases the risk that we will not have sufficient quantities of our product candidates or products or such quantities at an acceptable cost, which could delay, prevent or impair our development or commercialization efforts.***

We do not have any manufacturing facilities or personnel. We currently rely, and expect to continue to rely, on third-party manufacturers for the manufacture of our product candidates for preclinical testing, other than small amounts of compounds that we may synthesize ourselves for such purpose. To date, we have obtained starting materials for our supply of the cGMP bulk drug substances for our product candidates from third-party manufacturers. We do not have a long term supply agreement with any of these third-party manufacturers, and we purchase our required drug supply on a purchase order basis.

We currently obtain all of our supply of VS-6063 for clinical development from Pfizer. We expect to rely on third-party manufacturers or third-party collaborators for the manufacture of our product candidates for clinical trials and for commercial supply of any of these product candidates for which we or our collaborators obtain marketing approval. We may be unable to establish any agreements with third-party manufacturers or to do so on acceptable terms. Even if we are able to establish agreements with third-party manufacturers, reliance on third-party manufacturers entails additional risks, including:

reliance on the third party for regulatory compliance and quality assurance;

the possible breach of the manufacturing agreement by the third party; and

the possible termination or nonrenewal of the agreement by the third party at a time that is costly or inconvenient for us.

Third-party manufacturers may not be able to comply with current good manufacturing practices, or cGMP, regulations or similar regulatory requirements outside the United States. Our failure, or the failure of our third-party manufacturers, to comply with applicable regulations could result in sanctions being imposed on us, including fines, injunctions, civil penalties, delays, suspension or withdrawal of approvals, license revocation, seizures or recalls of product candidates or products, operating

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restrictions and criminal prosecutions, any of which could significantly and adversely affect supplies of our products and harm our business and results of operations.

Any products that we may develop may compete with other product candidates and products for access to manufacturing facilities. There are a limited number of manufacturers that operate under cGMP regulations and that might be capable of manufacturing for us.

Any performance failure on the part of our existing or future manufacturers could delay clinical development or marketing approval. We do not currently have arrangements in place for redundant supply or a second source for bulk drug substance. If our current contract manufacturer cannot perform as agreed, we may be required to replace that manufacturer. Although we believe that there are several potential alternative manufacturers who could manufacture our product candidates, we may incur added costs and delays in identifying and qualifying any such replacement.

Our current and anticipated future dependence upon others for the manufacture of our product candidates or products may adversely affect our future profit margins and our ability to commercialize any products that receive marketing approval on a timely and competitive basis.

**RISKS RELATED TO OUR INTELLECTUAL PROPERTY**

*If we fail to comply with our obligations under our intellectual property licenses with third parties, we could lose license rights that are important to our business.*

We are a party to a number of intellectual property license agreements with third parties, including the Whitehead Institute, Poniard Pharmaceuticals, Inc., or Poniard, and Pfizer, Inc., or Pfizer, and expect to enter into additional license agreements in the future. In particular, we have exclusively licensed rights to our most advanced product candidate, VS-6063, from Pfizer. Our existing license agreements impose, and we expect that future license agreements will impose, various diligence, milestone payment, royalty, insurance and other obligations on us. For example, under our license agreements with the Whitehead Institute, Poniard, and Pfizer, we are required to use commercially reasonable efforts to develop and commercialize licensed products under the agreement and to satisfy other specified obligations. If we fail to comply with our obligations under these licenses, our licensors may have the right to terminate these license agreements, in which event we might not be able to market any product that is covered by these agreements, or to convert the exclusive licenses to non-exclusive licenses, which could materially adversely affect the value of the product candidate being developed under these license agreements. Termination of these license agreements or reduction or elimination of our licensed rights may result in our having to negotiate new or reinstated licenses with less favorable terms. If the Whitehead Institute were to terminate its drug discovery platform license agreement with us for any reason, we would lose access to the EMT technology and the ability to use the stable population of CSCs for high-throughput screening. If Poniard were to terminate its license agreement with us for any reason, we would lose our rights to VS-4718. If Pfizer were to terminate its license agreement with us for any reason, we would lose our rights to VS-6063, which is our lead product candidate.

*If we are unable to obtain and maintain patent protection for our technology and products, or if our licensors are unable to obtain and maintain patent protection for the technology or products that we license from them, or if the scope of the patent protection obtained is not sufficiently broad, our competitors could develop and commercialize technology and products similar or identical to ours, and our ability to successfully commercialize our technology and products may be adversely affected.*

Our success depends in large part on our and our licensors' ability to obtain and maintain patent protection in the United States and other countries with respect to our proprietary technology and products. We and our licensors seek to protect our proprietary position by filing patent applications in the United States and abroad related to our novel technologies and products that are important to our

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business. We cannot be certain that any patents will issue with claims that cover our proprietary technology or product candidates.

The patent prosecution process is expensive and time-consuming, and we may not be able to file and prosecute all necessary or desirable patent applications at a reasonable cost or in a timely manner. It is also possible that we will fail to identify patentable aspects of our research and development output before it is too late to obtain patent protection. Moreover, in some circumstances, we do not have the right to control the preparation, filing and prosecution of patent applications, or to maintain the patents, covering technology or products that we license from third parties and are reliant on our licensors. For example, we do not control the prosecution of the patent applications licensed to us under our agreements with the Whitehead Institute or those patent applications owned by The Scripps Research Institute, or Scripps, licensed to us under our agreement with Poniard. Therefore, we cannot be certain that these patents and applications will be prosecuted and enforced in a manner consistent with the best interests of our business. If such licensors fail to maintain such patents, or lose rights to those patents, the rights we have licensed may be reduced or eliminated.

The patent position of biotechnology and pharmaceutical companies generally is highly uncertain, involves complex legal and factual questions and has in recent years been the subject of much litigation. As a result, the issuance, scope, validity, enforceability and commercial value of our and our licensors' patent rights are highly uncertain. Our and our licensors' pending and future patent applications may not result in patents being issued which protect our technology or products or which effectively prevent others from commercializing competitive technologies and products. Changes in either the patent laws or interpretation of the patent laws in the United States and other countries may diminish the value of our patents or narrow the scope of our patent protection.

The laws of foreign countries may not protect our rights to the same extent as the laws of the United States. Publications of discoveries in the scientific literature often lag behind the actual discoveries, and patent applications in the United States and other jurisdictions are typically not published until 18 months after filing, or in some cases not at all. Therefore we cannot be certain that we or our licensors were the first to make the inventions claimed in our owned or licensed patents or pending patent applications, or that we or our licensors were the first to file for patent protection of such inventions.

Assuming the other requirements for patentability are met, currently, in the United States, the first to make the claimed invention is entitled to the patent, while outside the United States, the first to file a patent application is entitled to the patent. In March 2013, the United States will transition to a first inventor to file system in which, assuming the other requirements for patentability are met, the first inventor to file a patent application will be entitled to the patent. We may be subject to a third party preissuance submission of prior art to the U.S. Patent and Trademark Office, or become involved in opposition, derivation, reexamination, inter parties review or interference proceedings challenging our patent rights or the patent rights of others. An adverse determination in any such submission, proceeding or litigation could reduce the scope of, or invalidate, our patent rights, allow third parties to commercialize our technology or products and compete directly with us, without payment to us, or result in our inability to manufacture or commercialize products without infringing third-party patent rights.

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Even if our owned and licensed patent applications issue as patents, they may not issue in a form that will provide us with any meaningful protection, prevent competitors from competing with us or otherwise provide us with any competitive advantage. Our competitors may be able to circumvent our owned or licensed patents by developing similar or alternative technologies or products in a non-infringing manner.

The issuance of a patent is not conclusive as to its inventorship, scope, validity or enforceability, and our owned and licensed patents may be challenged in the courts or patent offices in the United States and abroad. Such challenges may result in loss of exclusivity or freedom to operate or in patent claims being narrowed, invalidated or held unenforceable, which could limit our ability to stop others from using or commercializing similar or identical technology and products, or limit the duration of the patent protection of our technology and products. Given the amount of time required for the development, testing and regulatory review of new product candidates, patents protecting such candidates might expire before or shortly after such candidates are commercialized. As a result, our owned and licensed patent portfolio may not provide us with sufficient rights to exclude others from commercializing products similar or identical to ours.

***We may become involved in lawsuits to protect or enforce our patents, which could be expensive, time consuming and unsuccessful.***

Competitors may infringe our patents. To counter infringement or unauthorized use, we may be required to file infringement claims, which can be expensive and time consuming. In addition, in an infringement proceeding, a court may decide that a patent of ours is invalid or unenforceable, or may refuse to stop the other party from using the technology at issue on the grounds that our patents do not cover the technology in question. An adverse result in any litigation proceeding could put one or more of our patents at risk of being invalidated or interpreted narrowly. Furthermore, because of the substantial amount of discovery required in connection with intellectual property litigation, there is a risk that some of our confidential information could be compromised by disclosure during this type of litigation. In addition, our licensors may have rights to file and prosecute such claims and we are reliant on them.

***Third parties may initiate legal proceedings alleging that we are infringing their intellectual property rights, the outcome of which would be uncertain and could have a material adverse effect on the success of our business.***

Our commercial success depends upon our ability and the ability of our collaborators to develop, manufacture, market and sell our product candidates and use our proprietary technologies without infringing the proprietary rights of third parties. We have yet to conduct comprehensive freedom-to-operate searches to determine whether our use of certain of the patent rights owned by or licensed to us would infringe patents issued to third parties. We may become party to, or threatened with, future adversarial proceedings or litigation regarding intellectual property rights with respect to our products and technology, including interference proceedings before the U.S. Patent and Trademark Office. Third parties may assert infringement claims against us based on existing patents or patents that may be granted in the future. If we are found to infringe a third party's intellectual property rights, we could be required to obtain a license from such third party to continue developing and marketing our products and technology. However, we may not be able to obtain any required license on commercially reasonable terms or at all. Even if we were able to obtain a license, it could be non-exclusive, thereby giving our competitors access to the same technologies licensed to us. We could be forced, including by court order, to cease commercializing the infringing technology or product. In addition, we could be found liable for monetary damages. A finding of infringement could prevent us from commercializing our product candidates or force us to cease some of our business operations, which could materially

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harm our business. Claims that we have misappropriated the confidential information or trade secrets of third parties could have a similar negative impact on our business.

For example, we are aware of a U.S. patent application filed by a third party almost one year after the priority date of the U.S. patent application filed by Scripps and licensed to us by Poniard, which has pending generic claims that, if issued as written, potentially cover VS-4718. The third-party patent application also specifically discloses VS-4718. Although the Scripps patent application has a priority date that is earlier than the priority date of the third-party application, we cannot be sure which party was the first to make the claimed invention. Because the United States currently uses a first to invent standard to determine priority, if a patent issues under the third-party patent application covering the composition of matter of VS-4718 and such third party was determined to be the first to make the claimed invention, we would need to obtain a license to the patented technology to commercialize VS-4718 in the United States, which would cause us to incur licensing related costs. However, a license to this patent might not be available on commercially reasonable terms, or at all. Our failure to obtain a license to any such patent could delay or prevent our potential commercialization of VS-4718 in the United States.

***We may be subject to claims that our employees have wrongfully used or disclosed alleged trade secrets of their former employers.***

Many of our employees were previously employed at universities or other biotechnology or pharmaceutical companies, including our competitors or potential competitors. Although we try to ensure that our employees do not use the proprietary information or know-how of others in their work for us, we may be subject to claims that we or these employees have used or disclosed intellectual property, including trade secrets or other proprietary information, of any such employee's former employer. Litigation may be necessary to defend against these claims. If we fail in defending any such claims, in addition to paying monetary damages, we may lose valuable intellectual property rights or personnel. Even if we are successful in defending against such claims, litigation could result in substantial costs and be a distraction to management.

***Intellectual property litigation could cause us to spend substantial resources and distract our personnel from their normal responsibilities.***

Even if resolved in our favor, litigation or other legal proceedings relating to intellectual property claims may cause us to incur significant expenses, and could distract our technical and management personnel from their normal responsibilities. In addition, there could be public announcements of the results of hearings, motions or other interim proceedings or developments and if securities analysts or investors perceive these results to be negative, it could have a substantial adverse effect on the price of our common stock. Such litigation or proceedings could substantially increase our operating losses and reduce the resources available for development activities or any future sales, marketing or distribution activities. We may not have sufficient financial or other resources to adequately conduct such litigation or proceedings. Some of our competitors may be able to sustain the costs of such litigation or proceedings more effectively than we can because of their greater financial resources. Uncertainties resulting from the initiation and continuation of patent litigation or other proceedings could have a material adverse effect on our ability to compete in the marketplace.

***If we are unable to protect the confidentiality of our trade secrets, our business and competitive position would be harmed.***

In addition to seeking patents for some of our technology and products, we also rely on trade secrets, including unpatented know-how, technology and other proprietary information, to maintain our competitive position. We seek to protect these trade secrets, in part, by entering into non-disclosure and confidentiality agreements with parties who have access to them, such as our employees, corporate

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collaborators, outside scientific collaborators, contract manufacturers, consultants, advisors and other third parties. We also enter into confidentiality and invention or patent assignment agreements with our employees and consultants. Despite these efforts, any of these parties may breach the agreements and disclose our proprietary information, including our trade secrets, and we may not be able to obtain adequate remedies for such breaches. Enforcing a claim that a party illegally disclosed or misappropriated a trade secret is difficult, expensive and time-consuming, and the outcome is unpredictable. In addition, some courts inside and outside the United States are less willing or unwilling to protect trade secrets. If any of our trade secrets were to be lawfully obtained or independently developed by a competitor, we would have no right to prevent them from using that technology or information to compete with us. If any of our trade secrets were to be disclosed to or independently developed by a competitor, our competitive position would be harmed.

**RISKS RELATED TO REGULATORY APPROVAL OF OUR PRODUCT CANDIDATES AND OTHER LEGAL COMPLIANCE MATTERS**

*If we are not able to obtain, or if there are delays in obtaining, required regulatory approvals, we will not be able to commercialize our product candidates, and our ability to generate revenue will be materially impaired.*

Our product candidates and the activities associated with their development and commercialization, including their design, testing, manufacture, safety, efficacy, recordkeeping, labeling, storage, approval, advertising, promotion, sale and distribution, are subject to comprehensive regulation by the FDA and other regulatory agencies in the United States and by comparable authorities in other countries. Failure to obtain marketing approval for a product candidate will prevent us from commercializing the product candidate. We have not received approval to market any of our product candidates from regulatory authorities in any jurisdiction. We have only limited experience in filing and supporting the applications necessary to gain marketing approvals and expect to rely on third-party contract research organizations to assist us in this process. Securing FDA approval requires the submission of extensive preclinical and clinical data and supporting information to the FDA for each therapeutic indication to establish the product candidate's safety and efficacy. Securing FDA approval also requires the submission of information about the product manufacturing process to, and inspection of manufacturing facilities by, the FDA. Our product candidates may not be effective, may be only moderately effective or may prove to have undesirable or unintended side effects, toxicities or other characteristics that may preclude our obtaining marketing approval or prevent or limit commercial use.

The process of obtaining marketing approvals, both in the United States and abroad, is expensive, may take many years if additional clinical trials are required, if approval is obtained at all, and can vary substantially based upon a variety of factors, including the type, complexity and novelty of the product candidates involved. Changes in marketing approval policies during the development period, changes in or the enactment of additional statutes or regulations, or changes in regulatory review for each submitted product application, may cause delays in the approval or rejection of an application. The FDA has substantial discretion in the approval process and may refuse to accept any application or may decide that our data is insufficient for approval and require additional preclinical, clinical or other studies. In addition, varying interpretations of the data obtained from preclinical and clinical testing could delay, limit or prevent marketing approval of a product candidate. Any marketing approval we ultimately obtain may be limited or subject to restrictions or post-approval commitments that render the approved product not commercially viable.

If we experience delays in obtaining approval or if we fail to obtain approval of our product candidates, the commercial prospects for our product candidates may be harmed and our ability to generate revenues will be materially impaired.

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***Failure to obtain marketing approval in international jurisdictions would prevent our product candidates from being marketed abroad.***

In order to market and sell our products in the European Union and many other jurisdictions, we or our third-party collaborators must obtain separate marketing approvals and comply with numerous and varying regulatory requirements. The approval procedure varies among countries and can involve additional testing. The time required to obtain approval may differ substantially from that required to obtain FDA approval. The regulatory approval process outside the United States generally includes all of the risks associated with obtaining FDA approval. In addition, in many countries outside the United States, it is required that the product be approved for reimbursement before the product can be approved for sale in that country. We or these third parties may not obtain approvals from regulatory authorities outside the United States on a timely basis, if at all. Approval by the FDA does not ensure approval by regulatory authorities in other countries or jurisdictions, and approval by one regulatory authority outside the United States does not ensure approval by regulatory authorities in other countries or jurisdictions or by the FDA. We may not be able to file for marketing approvals and may not receive necessary approvals to commercialize our products in any market.

***We have applied for orphan disease status for VS-6063 for Mesothelioma in the United States and the European Union, but there can be no assurance that we will receive orphan drug designation in any jurisdiction or that we will be able to prevent third parties from developing and commercializing products that are competitive to VS-6063.***

We filed for orphan drug designation in the U.S. and the EU for the use of VS-6063 in mesothelioma. If VS-6063 is designated as an orphan drug and then obtains marketing authorization, it will receive orphan drug exclusivity. Orphan drug exclusivity grants seven years of marketing exclusivity under the Federal Food, Drug and Cosmetic Act and up to 10 years of marketing exclusivity in Europe. We cannot assure that we will receive orphan drug designation in any jurisdiction, and a competitor may receive orphan drug marketing authorization prior to us for the same indication for which we are developing VS-6063. Other companies have received orphan drug designations for compounds other than VS-6063 for mesothelioma in the U.S. and EU. While the orphan drug exclusivity for VS-6063 would, if granted, provide market exclusivity in the U.S., Europe, and other countries, we would not be able to exclude other companies from manufacturing and/or selling drugs using the same active ingredient for the same indication beyond that timeframe on the basis of orphan drug designation. Furthermore, the marketing exclusivity in Europe can be reduced from 10 years to six years if the initial designation criteria have significantly changed since the market authorization of the orphan medicinal product. Even if we were to receive orphan drug designation for a particular drug indication, we cannot guarantee that another company also with orphan drug designation will not receive marketing authorization for the same indication before we do. If that were to happen, our applications for that indication may not be approved until the competing company's period of exclusivity has expired. Even if we are the first to obtain marketing authorization for an orphan drug indication, there are circumstances under which a competing product may be approved for the same indication during the seven-year period of marketing exclusivity, such as if the later product is shown to be clinically superior to our product, or if the later product is a different drug than VS-6063. Further, the seven-year marketing exclusivity would not prevent competitors from obtaining approval of the same compound for other indications or the use of other types of drugs for the same use as the orphan drug.

***Any product candidate for which we obtain marketing approval could be subject to restrictions or withdrawal from the market and we may be subject to penalties if we fail to comply with regulatory requirements or if we experience unanticipated problems with our products, when and if any of them are approved.***

Any product candidate for which we obtain marketing approval, along with the manufacturing processes, post-approval clinical data, labeling, advertising and promotional activities for such product,

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will be subject to continual requirements of and review by the FDA and other regulatory authorities. These requirements include submissions of safety and other post-marketing information and reports, registration and listing requirements, cGMP requirements relating to quality control, quality assurance and corresponding maintenance of records and documents, requirements regarding the distribution of samples to physicians and recordkeeping. Even if marketing approval of a product candidate is granted, the approval may be subject to limitations on the indicated uses for which the product may be marketed or to the conditions of approval, or contain requirements for costly post-marketing testing and surveillance to monitor the safety or efficacy of the product. The FDA closely regulates the post-approval marketing and promotion of drugs to ensure drugs are marketed only for the approved indications and in accordance with the provisions of the approved labeling. The FDA imposes stringent restrictions on manufacturers' communications regarding off-label use and if we do not market our products for their approved indications, we may be subject to enforcement action for off-label marketing.

In addition, later discovery of previously unknown problems with our products, manufacturers or manufacturing processes, or failure to comply with regulatory requirements, may yield various results, including:

restrictions on such products, manufacturers or manufacturing processes;

restrictions on the labeling or marketing of a product;

restrictions on product distribution or use;

requirements to conduct post-marketing clinical trials;

warning or untitled letters;

withdrawal of the products from the market;

refusal to approve pending applications or supplements to approved applications that we submit;

recall of products;

fines, restitution or disgorgement of profits or revenue;

suspension or withdrawal of marketing approvals;

refusal to permit the import or export of our products;

product seizure; or

injunctions or the imposition of civil or criminal penalties.

***Our relationships with customers and third-party payors will be subject to applicable anti-kickback, fraud and abuse and other healthcare laws and regulations, which could expose us to criminal sanctions, civil penalties, contractual damages, reputational harm and diminished profits and future earnings.***



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Healthcare providers, physicians and third-party payors play a primary role in the recommendation and prescription of any product candidates for which we obtain marketing approval. Our future arrangements with third-party payors and customers may expose us to broadly applicable fraud and abuse and other healthcare laws and regulations that may constrain the business or financial arrangements and relationships through which we market, sell and distribute our products for which we obtain marketing approval. Restrictions under applicable federal and state healthcare laws and regulations, include the following:

the federal healthcare anti-kickback statute prohibits, among other things, persons from knowingly and willfully soliciting, offering, receiving or providing remuneration, directly or indirectly, in cash or in kind, to induce or reward either the referral of an individual for, or the

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purchase, order or recommendation of, any good or service, for which payment may be made under federal and state healthcare programs such as Medicare and Medicaid;

the federal False Claims Act imposes criminal and civil penalties, including civil whistleblower or qui tam actions, against individuals or entities for knowingly presenting, or causing to be presented, to the federal government, claims for payment that are false or fraudulent or making a false statement to avoid, decrease or conceal an obligation to pay money to the federal government;

the federal Health Insurance Portability and Accountability Act of 1996, as amended by the Health Information Technology for Economic and Clinical Health Act, imposes criminal and civil liability for executing a scheme to defraud any healthcare benefit program and also imposes obligations, including mandatory contractual terms, with respect to safeguarding the privacy, security and transmission of individually identifiable health information;

the federal false statements statute prohibits knowingly and willfully falsifying, concealing or covering up a material fact or making any materially false statement in connection with the delivery of or payment for healthcare benefits, items or services;

the federal transparency requirements under the Health Care Reform Law requires manufacturers of drugs, devices, biologics and medical supplies to report to the Department of Health and Human Services information related to physician payments and other transfers of value and physician ownership and investment interests; and

analogous state laws and regulations, such as state anti-kickback and false claims laws, may apply to sales or marketing arrangements and claims involving healthcare items or services reimbursed by non-governmental third-party payors, including private insurers, and some state laws require pharmaceutical companies to comply with the pharmaceutical industry's voluntary compliance guidelines and the relevant compliance guidance promulgated by the federal government in addition to requiring drug manufacturers to report information related to payments to physicians and other health care providers or marketing expenditures.

Efforts to ensure that our business arrangements with third parties will comply with applicable healthcare laws and regulations will involve substantial costs. It is possible that governmental authorities will conclude that our business practices may not comply with current or future statutes, regulations or case law involving applicable fraud and abuse or other healthcare laws and regulations. If our operations are found to be in violation of any of these laws or any other governmental regulations that may apply to us, we may be subject to significant civil, criminal and administrative penalties, damages, fines, exclusion from government funded healthcare programs, such as Medicare and Medicaid, and the curtailment or restructuring of our operations. If any of the physicians or other providers or entities with whom we expect to do business are found to be not in compliance with applicable laws, they may be subject to criminal, civil or administrative sanctions, including exclusions from government funded healthcare programs.

***Recently enacted and future legislation may increase the difficulty and cost for us to obtain marketing approval of and commercialize our product candidates and affect the prices we may obtain.***

In the United States and some foreign jurisdictions, there have been a number of legislative and regulatory changes and proposed changes regarding the healthcare system that could prevent or delay marketing approval of our product candidates, restrict or regulate post-approval activities and affect our ability to profitably sell any product candidates for which we obtain marketing approval.

In the United States, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, or Medicare Modernization Act, changed the way Medicare covers and pays for pharmaceutical products. The legislation expanded Medicare coverage for drug purchases by the elderly and introduced

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a new reimbursement methodology based on average sales prices for physician administered drugs. In addition, this legislation provided authority for limiting the number of drugs that will be covered in any therapeutic class. Cost reduction initiatives and other provisions of this legislation could decrease the coverage and price that we receive for any approved products. While the Medicare Modernization Act applies only to drug benefits for Medicare beneficiaries, private payors often follow Medicare coverage policy and payment limitations in setting their own reimbursement rates. Therefore, any reduction in reimbursement that results from the Medicare Modernization Act may result in a similar reduction in payments from private payors.

More recently, in March 2010, President Obama signed into law the Health Care Reform Law, a sweeping law intended to broaden access to health insurance, reduce or constrain the growth of healthcare spending, enhance remedies against fraud and abuse, add new transparency requirements for health care and health insurance industries, impose new taxes and fees on the health industry and impose additional health policy reforms. Effective October 1, 2010, the Health Care Reform Law revises the definition of "average manufacturer price" for reporting purposes, which could increase the amount of Medicaid drug rebates to states. Further, the new law imposes a significant annual fee on companies that manufacture or import branded prescription drug products. Substantial new provisions affecting compliance have also been enacted, which may affect our business practices with health care practitioners. We will not know the full effects of the Health Care Reform Law until applicable federal and state agencies issue regulations or guidance under the new law. Although it is too early to determine the effect of the Health Care Reform Law, the new law appears likely to continue the pressure on pharmaceutical pricing, especially under the Medicare program, and may also increase our regulatory burdens and operating costs.

Legislative and regulatory proposals have been made to expand post-approval requirements and restrict sales and promotional activities for pharmaceutical products. We cannot be sure whether additional legislative changes will be enacted, or whether the FDA regulations, guidance or interpretations will be changed, or what the impact of such changes on the marketing approvals of our product candidates, if any, may be. In addition, increased scrutiny by the U.S. Congress of the FDA's approval process may significantly delay or prevent marketing approval, as well as subject us to more stringent product labeling and post-marketing testing and other requirements.

**RISKS RELATED TO EMPLOYEE MATTERS AND MANAGING GROWTH**

*Our future success depends on our ability to retain our chief executive officer and other key executives and to attract, retain and motivate qualified personnel.*

We are highly dependent on Christoph Westphal, our Chief Executive Officer, Robert Forrester, our President and Chief Operating Officer, and Joanna Horobin, our Chief Medical Officer, as well as the other principal members of our management and scientific teams, including our scientific co-founders, Robert Weinberg and Eric Lander. Although we have formal employment agreements with Christoph Westphal, Robert Forrester and Joanna Horobin, these agreements do not prevent them from terminating their employment with us at any time. We do not maintain "key person" insurance for any of our executives or other employees. The loss of the services of any of these persons could impede the achievement of our research, development and commercialization objectives.

In addition to his role as Chairman of the board of directors and Chief Executive Officer of our company, Dr. Westphal also serves as a general partner of Longwood Fund, LP, a venture capital investment fund and one of our principal stockholders. We and Dr. Westphal anticipate that he will transition to an executive Chairman role at our company in the future based on our having meaningfully advanced our discovery, research and development efforts, the overall growth of our company and our identifying and hiring a suitable successor. In connection with Dr. Westphal's transition to this role, we will need to recruit and hire a new principal executive officer. Our inability to hire a suitable executive to assume this position in a timely fashion could delay the execution of our business plans or disrupt our operations.

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Recruiting and retaining qualified scientific, clinical, manufacturing and sales and marketing personnel will also be critical to our success. We may not be able to attract and retain these personnel on acceptable terms given the competition among numerous pharmaceutical and biotechnology companies for similar personnel. We also experience competition for the hiring of scientific and clinical personnel from universities and research institutions. In addition, we rely on consultants and advisors, including scientific and clinical advisors, to assist us in formulating our research and development and commercialization strategy. Our consultants and advisors, including our scientific co-founders, may be employed by employers other than us and may have commitments under consulting or advisory contracts with other entities that may limit their availability to us.

***We expect to expand our development, regulatory and future sales and marketing capabilities, and as a result, we may encounter difficulties in managing our growth, which could disrupt our operations.***

We expect to experience significant growth in the number of our employees and the scope of our operations, particularly in the areas of drug development, regulatory affairs and sales and marketing. To manage our anticipated future growth, we must continue to implement and improve our managerial, operational and financial systems, expand our facilities and continue to recruit and train additional qualified personnel. Due to our limited financial resources and the limited experience of our management team in managing a company with such anticipated growth, we may not be able to effectively manage the expansion of our operations or recruit and train additional qualified personnel. The physical expansion of our operations may lead to significant costs and may divert our management and business development resources. Any inability to manage growth could delay the execution of our business plans or disrupt our operations.

**RISKS RELATED TO OUR COMMON STOCK**

***Our executive officers, directors and principal stockholders maintain the ability to control all matters submitted to stockholders for approval.***

As of December 31, 2012, our executive officers, directors and stockholders who owned more than 5% of our outstanding common stock, in the aggregate, beneficially owned shares representing approximately 53% of our capital stock. As a result, if these stockholders chose to act together, they would be able to control all matters submitted to our stockholders for approval, as well as our management and affairs. For example, these persons, if they chose to act together, would control the election of directors and approval of any merger, consolidation or sale of all or substantially all of our assets. This concentration of voting power could delay or prevent an acquisition of our company on terms that other stockholders may desire.

***Provisions in our corporate charter documents and under Delaware law could make an acquisition of us, which may be beneficial to our stockholders, more difficult and may prevent attempts by our stockholders to replace or remove our current management.***

Provisions in our corporate charter and our bylaws may discourage, delay or prevent a merger, acquisition or other change in control of us that stockholders may consider favorable, including transactions in which you might otherwise receive a premium for your shares. These provisions could also limit the price that investors might be willing to pay in the future for shares of our common stock, thereby depressing the market price of our common stock. In addition, because our board of directors is responsible for appointing the members of our management team, these provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it

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more difficult for stockholders to replace members of our board of directors. Among other things, these provisions:

establish a classified board of directors such that not all members of the board are elected at one time;

allow the authorized number of our directors to be changed only by resolution of our board of directors;

limit the manner in which stockholders can remove directors from the board;

establish advance notice requirements for stockholder proposals that can be acted on at stockholder meetings and nominations to our board of directors;

require that stockholder actions must be effected at a duly called stockholder meeting and prohibit actions by our stockholders by written consent;

limit who may call stockholder meetings;

authorize our board of directors to issue preferred stock without stockholder approval, which could be used to institute a "poison pill" that would work to dilute the stock ownership of a potential hostile acquirer, effectively preventing acquisitions that have not been approved by our board of directors; and

require the approval of the holders of at least 75% of the votes that all our stockholders would be entitled to cast to amend or repeal certain provisions of our charter or bylaws.

Moreover, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which prohibits a person who owns in excess of 15% of our outstanding voting stock from merging or combining with us for a period of three years after the date of the transaction in which the person acquired in excess of 15% of our outstanding voting stock, unless the merger or combination is approved in a prescribed manner.

***The market price of our common stock has been, and may continue to be, highly volatile.***

Our stock price has been volatile. Since January 27, 2012, when we became a public company, the price for one share of our common stock has reached a high of \$12.24 and a low of \$6.25. We cannot predict whether the price of our common stock will rise or fall. The market price for our common stock may be influenced by many factors, including:

the success of competitive products or technologies;

results of clinical trials of our product candidates or those of our competitors;

regulatory or legal developments in the United States and other countries;

developments or disputes concerning patent applications, issued patents or other proprietary rights;

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the recruitment or departure of key personnel;

the level of expenses related to any of our product candidates or clinical development programs;

the results of our efforts to discover, develop, acquire or in-license additional product candidates or products;

actual or anticipated changes in estimates as to financial results, development timelines or recommendations by securities analysts;

variations in our financial results or those of companies that are perceived to be similar to us;

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changes in the structure of healthcare payment systems;

market conditions in the pharmaceutical and biotechnology sectors;

general economic, industry and market conditions; and

the other factors described in this "Risk Factors" section.

In addition, the stock market in general and the market for small pharmaceutical companies and biotechnology companies in particular have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of particular companies. Broad market and industry factors may negatively affect the market price of our common stock, regardless of our actual operating performance. In the past, following periods of volatility in the market, securities class-action litigation has often been instituted against companies. Such litigation, if instituted against us, could result in substantial costs and diversion of management's attention and resources, which could materially and adversely affect our business and financial condition.

***Because we do not anticipate paying any cash dividends on our capital stock in the foreseeable future, capital appreciation, if any, will be the source of gain for our stockholders.***

We have never declared or paid cash dividends on our capital stock. We currently intend to retain all of our future earnings, if any, to finance the growth and development of our business. In addition, the terms of any future debt agreements may preclude us from paying dividends. As a result, capital appreciation, if any, of our common stock will be the sole source of gain for our stockholders for the foreseeable future.

***We are an "emerging growth company," and our election to delay adoption of new or revised accounting standards applicable to public companies may result in our financial statements not being comparable to those of other public companies. As a result of this and other reduced disclosure requirements applicable to emerging growth companies, our common stock may be less attractive to investors.***

We are an "emerging growth company," as defined in the Jumpstart Our Business Startups Act, or JOBS Act, and may remain an emerging growth company for up to five years, until December 31, 2017, although if the market value of our common stock that is held by non-affiliates exceeds \$700 million as of any June 30 before that time or if we have annual gross revenues of \$1 billion or more in any fiscal year, we would cease to be an emerging growth company as of December 31 of the applicable year. For so long as we remain an emerging growth company, we are permitted and intend to rely on exemptions from certain reporting requirements that are applicable to other public companies that are not emerging growth companies. These exemptions include not being required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act of 2002, not being required to comply with any requirement that may be adopted by the Public Company Accounting Oversight Board regarding mandatory audit firm rotation or a supplement to the auditor's report providing additional information about the audit and the financial statements, reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements, and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and shareholder approval of any golden parachute payments not previously approved.

Among other provisions, the JOBS Act provides that an emerging growth company can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act of 1933, as amended, or the Securities Act, for complying with new or revised accounting standards. This allows an emerging growth company to delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. We are electing to delay such adoption of new or revised accounting standards, and as a result, we may not comply with new or revised accounting standards on the relevant dates on which adoption of such standards is required for public companies

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that are not emerging growth companies. As a result of such election, our financial statements may not be comparable to the financial statements of other public companies.

We cannot predict whether investors will find our common stock less attractive because we will rely on these exemptions. If some investors find our common stock less attractive as a result, there may be a less active trading market for our common stock and our stock price may be more volatile.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

We occupy approximately 7,484 square feet of office and laboratory space in Cambridge, Massachusetts under a lease that expires in October 2014. We believe that our facility is sufficient to meet our current needs and that suitable additional space will be available as and when needed.

**Item 3. Legal Proceedings**

None.

**Item 4. Mine Safety Disclosures**

Not applicable.



Table of Contents**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuers Purchases of Equity Securities****MARKET INFORMATION**

Our common stock is publicly traded on the NASDAQ Global Market under the symbol "VSTM." Trading of our common stock commenced on January 27, 2012, following the completion of our initial public offering. The following table sets forth, for the periods indicated, the high and low sales prices for our common stock as reported on the NASDAQ Global Market.

Year ended December 31, 2012	High	Low
First quarter (beginning January 27, 2012)	\$ 12.24	\$ 10.05
Second quarter	\$ 11.58	\$ 8.89
Third quarter	\$ 12.00	\$ 7.56
Fourth quarter	\$ 9.67	\$ 6.25

**HOLDERS**

As of March 8, 2013, there were [51] holders of record of our common stock and the closing price of our common stock on the NASDAQ Global Market as of that date was \$9.30. The number of holders of record does not include beneficial owners whose shares are held by nominees in street name.

**DIVIDENDS**

We have never declared or paid cash dividends on our common stock, and we do not expect to pay any cash dividends on our common stock in the foreseeable future.

**SECURITIES AUTHORIZED FOR ISSUANCE UNDER EQUITY COMPENSATION PLANS**

The following table contains information about our equity compensation plans as of December 31, 2012. There are no equity compensation plans that have not been approved by our security holders.

Plan category	Number of securities to be issued upon exercise of outstanding stock options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans
Equity compensation plans approved by security holders(1)	1,424,241	\$ 6.90	1,534,973

(1)

Includes information regarding our 2010 Equity Incentive Plan and 2012 Incentive Plan.

Table of Contents**PERFORMANCE GRAPH**

The following performance graph and related information shall not be deemed to be "soliciting material" or to be "filed" with the SEC, nor shall such information be incorporated by reference into any future filing under the Securities Act, except to the extent that we specifically incorporate it by reference into such filing.

The following graph compares the performance of our common stock to the NASDAQ Composite Index and to the NASDAQ Biotechnology Index from January 27, 2012 (the first date that shares of our common stock were publicly traded) through December 31, 2012. The comparison assumes \$100 was invested after the market closed on January 27, 2012 in our common stock and in each of the foregoing indices, and it assumes reinvestment of dividends, if any.

**COMPARISON OF 1 YEAR CUMULATIVE TOTAL RETURN\***

Among Verastem, Inc., the NASDAQ Composite Index, and the NASDAQ Biotechnology Index

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\*  
\$100 invested on 1/27/12 in stock or 12/31/11 in index, including reinvestment of dividends.  
Fiscal year ending December 31.

**Cumulative Total Return Comparison**

	1/27/12	1/12	2/12	3/12	4/12	5/12	6/12	7/12	8/12	9/12	10/12	11/12	12/12
Verastem, Inc.	100.00	98.83	104.60	98.56	93.60	90.53	87.38	84.22	77.73	84.67	71.60	61.41	79.26
NASDAQ Composite	100.00	105.41	110.14	114.22	113.19	106.11	111.06	111.58	115.48	116.86	112.11	112.38	112.30
NASDAQ Biotechnology	100.00	108.15	110.22	112.16	113.85	110.05	115.34	119.43	122.58	127.72	121.09	127.20	126.50

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**RECENT SALES OF UNREGISTERED SECURITIES**

Set forth below is information regarding certain shares of common stock, preferred stock, and stock options issued by us during the period covered by this Annual Report on Form 10-K that were not registered under the Securities Act. Also included is the consideration, if any, received by us for the securities and information relating to the section of the Securities Act, or rule of the SEC, under which exemption from registration was claimed.

*Issuances of securities*

In July 2012, we issued 192,012 shares of common stock to Pfizer, Inc. The securities were issued to Pfizer Inc in reliance upon the exemption from the registration requirements of the Securities Act, as set forth in Section 4(2).

**PURCHASE OF EQUITY SECURITIES**

We did not purchase any of our registered equity securities during the period covered by this Annual Report on Form 10-K.

**USE OF PROCEEDS FROM REGISTERED SECURITIES**

In February 2012, we completed an initial public offering of 6,325,000 shares of our common stock at a price of \$10.00 per share for an aggregate offering price of \$63.3 million. The offer and sale of all of the shares in the offering were registered under the Securities Act pursuant to a registration statement on Form S-1 (File No. 333-177677), which was declared effective by the SEC on January 26, 2012, and a registration statement on Form S-1 (File No. 333-179910) filed pursuant to Rule 462(b) of the Securities Act.

As of February 28, 2013, we have used approximately \$26.4 million of the net proceeds primarily to fund the preclinical development of our lead product candidates to advance and expand the research and preclinical development of additional product candidates and companion diagnostics and for working capital, capital expenditures and other general corporate purposes. We have invested the balance of the net proceeds from the offering in a variety of capital preservation investments, including investment grade, interest bearing instruments and U.S. government securities. There has been no material change in our planned use of the balance of the net proceeds from the offering as described in our final prospectus filed with the SEC pursuant to Rule 424(b) under the Securities Act.

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You should read the following selected financial data together with our consolidated financial statements and the related notes appearing elsewhere in this Annual Report on Form 10-K and the "Management's discussion and analysis of financial condition and results of operations" section of this Annual Report on Form 10-K. The selected historical financial information in this section is not intended to replace our financial statements and the related notes therein. Our historical results for any prior period are not necessarily indicative of results to be expected in any future period.

Statement of operations data:	Period from	Years Ended		Period from
	August 4, 2010 (inception) to December 31, 2010	December 31, 2011	December 31, 2012	August 4, 2010 (inception) to December 31, 2012
	(in thousands, except per share amounts)			
<b>Operating expenses:</b>				
Research and development	\$ 400	\$ 9,883	\$ 21,712	\$ 31,995
General and administrative	384	3,815	10,518	14,717
Total operating expenses	784	13,698	32,230	46,712
Loss from operations	(784)	(13,698)	(32,230)	(46,712)
Interest income		15	246	261
Net loss	\$ (784)	\$ (13,683)	\$ (31,984)	\$ (46,451)
Accretion of preferred stock	(2)	(32)	(6)	(40)
Net loss applicable to common stockholders	\$ (786)	\$ (13,715)	\$ (31,990)	\$ (46,491)
Net loss per share applicable to common stockholders basic and diluted	\$ (0.91)	\$ (10.59)	\$ (1.70)	\$ (5.44)
Weighted-average number of common shares used in net loss per share applicable to common stockholders basic and diluted	850	1,295	18,765	8,547

Balance sheet data:	As of December 31,		
	2010	2011	2012
	(in thousands)		
Cash, cash equivalents and investments	\$ 3,584	\$ 56,805	\$ 91,520
Working capital	3,228	44,795	54,683
Total assets	3,604	59,037	92,923
Redeemable convertible preferred stock	3,923	68,141	
Deficit accumulated during the development stage	(784)	(14,467)	(46,451)
Total stockholders' (deficit) equity	(687)	(12,766)	90,466

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

You should read the following discussion and analysis of our financial condition and results of operations together with our financial statements and related notes appearing elsewhere in this Annual Report on Form 10-K. Some of the information contained in this discussion and analysis or set forth elsewhere in this Annual Report on Form 10-K, including information with respect to our plans and strategy for our business and related financing, includes forward-looking statements that involve risks and uncertainties. You should read the "Risk factors" section of this Annual Report on Form 10-K for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained in the following discussion and analysis.

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**OVERVIEW**

We are a clinical-stage biopharmaceutical company focused on discovering and developing proprietary small molecule drugs targeting cancer stem cells along with proprietary companion diagnostics. A cancer stem cell is a particularly aggressive type of tumor cell, resistant to conventional cancer therapy, that we believe is an underlying cause of tumor recurrence and metastasis. Our scientific co-founders have made discoveries that link the epithelial-to-mesenchymal transition, or EMT, to the emergence of cancer stem cells. This transition involves the transformation of one type of cancer cell into a more aggressive and drug resistant type of cancer cell. Building on these discoveries, our scientific co-founders developed proprietary technology to create a stable population of cancer stem cells that we use to screen for and identify small molecule compounds that target cancer stem cells. We expect to initiate multiple clinical trials with our product candidates VS-6063, VS-4718 and VS-5584 in 2013, including a potentially pivotal trial of VS-6063 in mesothelioma.

We commenced active operations in the second half of 2010. Our operations to date have been limited to organizing and staffing our company, business planning, raising capital, acquiring and developing our technology, identifying potential product candidates, undertaking preclinical studies of our most advanced product candidates and, recently, initiating a clinical trial for VS-6063. To date, we have not generated any revenues and have financed our operations with net proceeds from the private placement of our preferred stock and our initial public offering.

As of December 31, 2012, we had a deficit accumulated during the development stage of \$46.5 million. Our net loss was \$32.0 million for the year ended December 31, 2012, \$13.7 million for the year ended December 31, 2011, \$784,000 for the period from August 4, 2010 (inception) to December 31, 2010 and \$46.5 million for the period from August 4, 2010 (inception) to December 31, 2012. We expect to incur significant expenses and increasing operating losses for the foreseeable future. We expect our expenses to increase in connection with our ongoing activities, particularly as we continue the research and development and initiate clinical trials of, and seek marketing approval for, our product candidates. In addition, if we obtain marketing approval for any of our product candidates, we expect to incur significant commercialization expenses related to product sales, marketing, manufacturing and distribution. Accordingly, we will need to obtain substantial additional funding in connection with our continuing operations. Adequate additional financing may not be available to us on acceptable terms, or at all. If we are unable to raise capital when needed or on attractive terms, we would be forced to delay, reduce or eliminate our research and development programs or any future commercialization efforts. We will need to generate significant revenues to achieve profitability, and we may never do so.

**FINANCIAL OPERATIONS OVERVIEW**

**Revenue**

To date, we have not generated any revenues. Our ability to generate product revenues, which we do not expect will occur for many years, if ever, will depend heavily on the successful development and eventual commercialization of our product candidates.

**Research and development expenses**

Research and development expenses consist of costs associated with our research activities, including our drug discovery efforts, and the development of our therapeutic product candidates and companion diagnostics. Our research and development expenses consist of:

employee-related expenses, including salaries, benefits, travel and stock-based compensation expense;

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external research and development expenses incurred under arrangements with third parties, such as contract research organizations, or CROs, manufacturing organizations and consultants, including our scientific advisory board;

license fees; and

facilities, depreciation and other allocated expenses, which include direct and allocated expenses for rent and maintenance of facilities, depreciation of leasehold improvements and equipment, and laboratory and other supplies.

We expense research and development costs to operations as incurred. We account for nonrefundable advance payments for goods and services that will be used in future research and development activities as expenses when the service has been performed or when the goods have been received, rather than when the payment is made.

We use our employee and infrastructure resources across multiple research and development projects. We do not allocate employee-related expenses or depreciation to any particular project. Because all of our development projects are in preclinical development, we do not track research and development costs by project. The components of our research and development costs are described in more detail in " Results of operations."

We anticipate that our research and development expenses will increase significantly in future periods as we increase the scope and rate of our drug discovery efforts and begin costlier development activities, including clinical trials for our current and additional product candidates in the future.

The successful development of our product candidates is highly uncertain. At this time, we cannot reasonably estimate or know the nature, timing and estimated costs of the efforts that will be necessary to complete development of our product candidates or the period, if any, in which material net cash inflows from our product candidates may commence. This is due to the numerous risks and uncertainties associated with developing drugs, including the uncertainty of:

the scope, rate of progress and expense of our drug discovery efforts and other research and development activities;

the potential benefits of our product candidates over other therapies;

our ability to market, commercialize and achieve market acceptance for any of our product candidates that we are developing or may develop in the future;

clinical trial results;

the terms and timing of regulatory approvals; and

the expense of filing, prosecuting, defending and enforcing patent claims and other intellectual property rights.

A change in the outcome of any of these variables with respect to the development of a product candidate could mean a significant change in the costs and timing associated with the development of that product candidate. For example, if the FDA or other regulatory authority were to require us to conduct clinical trials beyond those which we currently anticipate will be required for the completion of clinical development of a product candidate or if we experience significant delays in enrollment in any clinical trials, we could be required to expend significant additional financial resources and time on the completion of clinical development.

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**General and administrative expenses**

General and administrative expenses consist primarily of salaries and related costs for personnel, including stock-based compensation expense, in our executive, finance and business development functions. Other general and administrative expenses include allocated facility costs and professional fees for legal, patent, investor and public relations, consulting, insurance premiums, and accounting services.

**Interest income**

Prior to September 30, 2011, our cash and cash equivalents were invested in non-interest-bearing accounts. As a result, we didn't earn interest income until the last three months of 2011.

**Accretion of preferred stock**

Prior to the conversion of our preferred stock into 11,740,794 shares of common stock upon the closing of our initial public offering in February 2012, our preferred stock was redeemable beginning in 2016 at its original issue price plus any declared but unpaid dividends upon a specified vote of the preferred stockholders. Accretion of preferred stock reflects the periodic accretion of issuance costs on our preferred stock to its redemption value.

**CRITICAL ACCOUNTING POLICIES AND SIGNIFICANT JUDGMENTS AND ESTIMATES**

Our management's discussion and analysis of our financial condition and results of operations is based on our financial statements, which we have prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities and expenses and the disclosure of contingent assets and liabilities in our financial statements. On an ongoing basis, we evaluate our estimates and judgments, including those related to accrued expenses and stock-based compensation described in greater detail below. We base our estimates on our limited historical experience, known trends and events and various other factors that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Our significant accounting policies are described in more detail in the notes to our consolidated financial statements appearing elsewhere in this Annual Report on Form 10-K. However, we believe that the following accounting policies are the most critical to aid you in fully understanding and evaluating our financial condition and results of operations.

**Accrued research and development expenses**

As part of the process of preparing our financial statements, we are required to estimate our accrued expenses. This process involves reviewing quotations and contracts, identifying services that have been performed on our behalf and estimating the level of service performed and the associated cost incurred for the service when we have not yet been invoiced or otherwise notified of the actual cost. The majority of our service providers invoice us monthly in arrears for services performed or when contractual milestones are met. We make estimates of our accrued expenses as of each balance sheet date in our financial statements based on facts and circumstances known to us at that time. We periodically confirm the accuracy of our estimates with the service providers and make adjustments if necessary. The significant estimates in our accrued research and development expenses include fees paid to CROs in connection with research and development activities for which we have not yet been invoiced.

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We base our expenses related to CROs on our estimates of the services received and efforts expended pursuant to quotes and contracts with CROs that conduct research and development on our behalf. The financial terms of these agreements are subject to negotiation, vary from contract to contract and may result in uneven payment flows. There may be instances in which payments made to our vendors will exceed the level of services provided and result in a prepayment of the research and development expense. In accruing service fees, we estimate the time period over which services will be performed and the level of effort to be expended in each period. If the actual timing of the performance of services or the level of effort varies from our estimate, we adjust the accrual or prepaid accordingly. Although we do not expect our estimates to be materially different from amounts actually incurred, our understanding of the status and timing of services performed relative to the actual status and timing of services performed may vary and could result in us reporting amounts that are too high or too low in any particular period.

**Stock-based compensation**

Prior to becoming a public company, we utilized significant estimates and assumptions in determining the fair value of our common stock. We granted stock options at exercise prices not less than the fair market value of our common stock as determined by the board of directors, with input from management. The board of directors determined the estimated fair value of our common stock based on a number of objective and subjective factors, including external market conditions affecting the biotechnology industry sector and the prices at which we sold shares of redeemable convertible preferred stock, the superior rights and preferences of securities senior to our common stock at the time and the likelihood of achieving a liquidity event, such as an initial public offering or sale of our company.

We utilized various valuation methodologies in accordance with the framework of the 2004 American Institute of Certified Public Accountants Technical Practice Aid, *Valuation of Privately-Held Company Equity Securities Issued as Compensation*, to estimate the fair value of our common stock. The methodologies included an asset-based approach and the current value method for our initial common stock valuation as of November 30, 2010, the option pricing method utilizing the reverse backsolve method to estimate our underlying equity value as of July 31, 2011 and a methodology that determined an estimated value under an initial public offering scenario and a sale scenario based upon an assessment of the probability of occurrence of each scenario as of September 30, 2011, November 17, 2011, and December 31, 2011. Each valuation methodology included estimates and assumptions that required our judgment. These estimates included assumptions regarding future performance, including the successful completion of preclinical studies and clinical trials and the time to completing an initial public offering or sale. Significant changes to the key assumptions used in the valuations could have resulted in different fair values of common stock at each valuation date.

We recognize stock-based compensation expense for stock options issued to employees based on the grant date fair value of the awards on a straight-line basis over the requisite service period. We record stock-based compensation expense for stock options issued to non-employees based on the estimated fair value of the services received or of the equity instruments issued, whichever is more reliability measured, based on the vesting date fair value of the awards on a straight-line basis over the vesting period.

We estimate the fair value of the share-based awards, including stock options, using the Black-Scholes option-pricing model. Determining the fair value of share-based awards requires the use of subjective assumptions, including the expected term of the award and expected stock price volatility. The assumptions used in determining the fair value of share-based awards represent management's best estimates, which involve inherent uncertainties and the application of management judgment. As a result, if factors change, and we use different assumptions, our share-based compensation could be materially different in the future. The risk-free interest rate used for each grant is based on a U.S.



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Treasury instrument whose term is consistent with the expected term of the stock option. Because we do not have a sufficient history to estimate the expected term, we use the simplified method as described in SAB Topic 14.D.2 for estimating the expected term. The simplified method is based on the average of the vesting tranches and the contractual life of each grant. Because there was no public market for our common stock prior to our initial public offering, we lacked company-specific historical and implied volatility information. Therefore, we used the historical volatility of a representative group of public biotechnology and life sciences companies with similar characteristics to us. In 2012, subsequent to our initial public offering, we began to use a blended volatility rate using our own historical volatility and that of a representative group of public biotechnology and life sciences companies with similar characteristics to us. We have not paid and do not anticipate paying cash dividends on our shares of common stock; therefore, the expected dividend yield is assumed to be zero. We also recognize compensation expense for only the portion of options that are expected to vest. Accordingly, we have estimated expected forfeitures of stock options based on our historical forfeiture rate, adjusted for known trends, and used these rates in developing a future forfeiture rate.

We have also granted performance-based stock options with terms that allow the recipients to vest in a specific number of shares based upon the achievement of performance-based milestones as specified in the grants. Share-based compensation expense associated with these performance-based stock options is recognized if the performance condition is considered probable of achievement using management's best estimates of the time to vesting for the achievement of the performance-based milestones. If the actual achievement of the performance-based milestones varies from our estimates, share-based compensation expense could be materially different than what is recorded in the period. The cumulative effect on current and prior periods of a change in the estimated time to vesting for performance-based stock options will be recognized as compensation cost in the period of the revision, and recorded as a change in estimate.

While the assumptions used to calculate and account for share-based compensation awards represents management's best estimates, these estimates involve inherent uncertainties and the application of management's judgment. As a result, if revisions are made to our underlying assumptions and estimates, our share-based compensation expense could vary significantly from period to period.

As of December 31, 2012, there was approximately \$5.4 million, \$6.7 million and \$4.2 million of unrecognized share-based compensation, net of estimated forfeitures, related to stock options, restricted stock units and shares of restricted stock awards, respectively, which are expected to be recognized over weighted average periods of 3.0 years, 3.1 and 1.75 years, respectively. The total unrecognized share-based compensation cost will be adjusted for future changes in estimated forfeitures. See Notes 2 and 8 to our consolidated financial statements located in this Annual Report on Form 10-K for further discussion of share-based compensation.

## **RESULTS OF OPERATIONS**

The information reported within our consolidated financial statements from August 4, 2010 to December 31, 2011 was based solely on the accounts of Verastem, Inc. In December 2012, Verastem Securities Company, our wholly owned subsidiary, was incorporated. All financial information presented after December 31, 2011 has been consolidated and includes the accounts of our wholly owned subsidiary. All significant intercompany balances and transactions have been eliminated in consolidation.

### **Comparison of the Year Ended December 31, 2012 to the Year Ended December 31, 2011**

*Research and development expense.* Research and development expense for the year ended December 31, 2012 was \$21.7 million compared to \$9.9 million for the year ended December 31, 2011. The \$11.8 million increase is primarily related to increased contract research organization expense of

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\$4.1 million, an increase of \$3.6 million in license fees due to our agreement with Pfizer, Inc., including expense associated with the issuance of 192,012 shares of common stock, an increase of \$3.3 million for personnel costs, including stock-based compensation of \$2.0 million, primarily due to a higher fair value of our common stock, an increase of \$404,000 for laboratory supplies, an increase of \$118,00 for depreciation due to additional laboratory equipment and \$86,000 in additional occupancy costs due to a full year of costs associated with our new facility that we occupied in May 2011.

*General and administrative expense.* General and administrative expense for the year ended December 31, 2012 was \$10.5 million compared to \$3.8 million for the year ended December 31, 2011. The \$6.7 million increase resulted from an increase of \$4.6 million for personnel costs, including stock-based compensation of \$3.8 million, primarily due to higher fair value of our common stock, an increase of \$1.1 million in professional fees primarily related to additional legal and accounting fees for being a publicly traded company, an increase of \$389,000 in insurance costs primarily related to being a publicly traded company, an increase of \$272,000 in consulting fees and an increase of travel and entertainment costs of \$95,000.

*Interest income.* Interest income increased to \$246,000 for the year ended December 31, 2012 from \$15,000 for the year ended December 31, 2011. The increase in interest income was caused by an increase in the average cash balances available for investment and an increase in interest rates earned on investments. The increase in the average cash balances for investment was primarily due to the net proceeds from the sale of Series C redeemable convertible preferred stock in November 2011 and net proceeds from our initial public offering in February 2012. For most of the year ended December 31, 2011, our cash was deposited in non-interest bearing accounts.

*Accretion of preferred stock.* During 2012, we recorded \$6,000 of accretion reflecting the periodic accretion of issuance costs associated with our series A, series B and series C preferred stock through the date of our initial public offering when all outstanding shares of preferred stock converted into common stock compared to \$32,000 for the year ended December 31, 2011.

**Discussion of the Year Ended December 31, 2011**

We were incorporated on August 4, 2010. As a result, our results of operations reflect the year ended December 31, 2011 and the period from August 4, 2010 (inception) to December 31, 2010. There is no comparable period for 2010.

*Research and development expenses.* Research and development expenses were \$9.9 million for the year ended December 31, 2011. Expenses during the year included:

Contract research organization expenses of \$3.7 million, representing 37% of total research and development expenses during the year, comprised of expenses for outsourced biology, chemistry and development services.

Payroll expense of \$1.5 million, representing 15% of total research and development expenses during the year, including salaries, payroll taxes and benefits for our employees in research and development. We had 11 employees in research and development at December 31, 2011. Payroll expense also included stock-based compensation expense for employees of \$30,000.

Consulting fees of \$1.3 million, representing 13% of total research and development expenses during the year, including \$476,000 for our scientific advisory board, \$232,000 for recruitment consultants and \$143,000 for database consultants.

Laboratory supply expense of \$1.0 million, representing 11% of total research and development expenses during the year.

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Non-employee stock-based compensation expense of \$1.0 million, representing 10% of total research and development expenses during the year, related to stock options and restricted stock awarded to members of our scientific advisory board.

License fee expense of \$842,000, representing 9% of total research and development expense during the year, comprised of upfront and annual license fees, including \$406,000 for the obligation to issue a warrant for the purchase of 142,857 shares of our common stock to Poniard Pharmaceuticals, Inc.

Occupancy expense of \$465,000, representing 5% of total research and development expenses during the year, which is an allocated portion of rent and other occupancy costs.

*General and administrative expenses.* General and administrative expenses were \$3.8 million for the year ended December 31, 2011. Expenses during the year included:

Payroll expense of \$1.4 million, representing 38% of total general and administrative expenses during the year, including salaries, payroll taxes and benefits for our general and administrative employees. Payroll expense included stock-based compensation expense for employees of \$62,000.

Consulting fees of \$696,000, representing 18% of total general and administrative expenses during the year, including business development, public relations and finance consultants.

Professional fee expense of \$666,000, representing 18% of total general and administrative expenses during the year, comprised of fees for audit, tax and legal services, including the reimbursement to the Whitehead Institute of patent costs related to our licenses with the Whitehead Institute.

Non-employee stock-based compensation expense of \$592,000, representing 16% of total general and administrative expenses during the year, related to restricted stock awarded to our co-founders.

Occupancy expense of \$207,000, representing 5% of total general and administrative expenses during the year, which is an allocated portion of rent and other occupancy costs.

Travel expense of \$190,000, representing 5% of total general and administrative expenses during the year, including travel, meals, entertainment and conferences.

*Interest income.* We recorded \$15,000 of interest income in the year ended December 31, 2011 associated with our cash equivalents and investments.

*Accretion of preferred stock.* We recorded \$32,000 of accretion in the year ended December 31, 2011 reflecting the periodic accretion of issuance costs associated with our series A, series B and series C preferred stock.

## **LIQUIDITY AND CAPITAL RESOURCES**

### **Sources of liquidity**

To date, we have not generated any revenues. We have financed our operations to date through private placements of our preferred stock and our initial public offering, which we completed in February 2012. As of December 31, 2012, we had received \$68.1 million in net proceeds from the issuance of preferred stock and \$56.8 million in net proceeds from our initial public offering in February 2012. As of December 31, 2012, we had \$91.5 million in cash, cash equivalents, short-term investments and long-term investments. We primarily invest our cash, cash equivalents and investments in a U.S. Treasury money market fund, U.S. agency notes and corporate bonds.



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The following table sets forth the primary sources and uses of cash for each of the periods set forth below.

	Period from August 4, 2010 (inception) to December 31, 2010	Years Ended December 31,	
		2011	2012
Net cash provided by (used in)			
Net cash used in operating activities	\$ (330)	\$ (9,372)	\$ (22,601)
Net cash used in investing activities	(8)	(36,722)	(45,859)
Net cash provided by financing activities	3,922	63,464	57,602
Net increase (decrease) in cash and cash equivalents	\$ 3,584	\$ 17,370	\$ (10,858)

*Operating activities.* The use of cash in all periods resulted primarily from our net losses adjusted for non-cash charges and favorable changes in the components of working capital. The increase in cash used in operating activities for the year ended December 31, 2012 compared to the year ended December 31, 2011 is due to an increase in research and development expenses as we increased our research and development headcount and increased spending on external research and development costs. The significant increase in cash used in operating activities for the year ended December 31, 2011 compared to the period from August 4, 2010 (inception) to December 31, 2010 is due to an increase in research and development expenses as we increased our research and development headcount, increased spending on external research and development costs and from increases in the balance of accounts payable, accrued expenses and deferred rent. In addition, we commenced operations in August 2010 and, as such, the period ended December 31, 2010 reflects only five months of activity. We expect cash used in operating activities to continue to increase for the foreseeable future as we fund our increased research and development activities.

*Investing activities.* The cash used in investing activities for the year ended December 31, 2012 reflects the net purchases of investments of \$45.5 million and the purchase of \$310,000 of property and equipment. The cash used in investing activities for the year ended December 31, 2011 included \$35.9 million purchase of investments, \$785,000 purchase of property and equipment and an \$86,000 increase in restricted cash related to a standby letter of credit issued as a security deposit for our facility lease. The cash used in investing activities for the year ended December 31, 2010 included \$8,000 purchase of property and equipment.

*Financing activities.* The cash provided by financing activities for the year ended December 31, 2012 reflects the \$56.8 million of net proceeds from our initial public offering. The cash provided by financing activities in the year ended December 31, 2011 is the result of the sale and issuance of 12,000,000 shares of our series A preferred stock for net proceeds of \$12.0 million, the sale and issuance of 16,025,000 shares of our series B preferred stock for net proceeds of \$31.9 million, the sale and issuance of 9,067,825 shares of our series C preferred stock for net proceeds of \$20.2 million and \$38,000 of net proceeds from the sale of restricted stock to employees. The cash provided by financing activities in the period from August 4, 2010 (inception) to December 31, 2010 is primarily the result of the sale and issuance of 4,000,000 shares of our series A preferred stock for net proceeds of \$3.9 million.

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**Funding requirements**

We recently initiated a Phase 1/1b clinical trial for VS-6063 in ovarian cancer. All of our other product candidates are still in preclinical development. We expect to continue to incur significant expenses and increasing operating losses for the foreseeable future. We anticipate that our expenses will increase substantially if and as we:

continue our research and preclinical and clinical development of our product candidates;

seek to identify additional product candidates that target cancer stem cells;

acquire or in-license other products and technologies;

initiate additional clinical trials for our product candidates;

seek marketing approvals for our product candidates that successfully complete clinical trials;

ultimately establish a sales, marketing and distribution infrastructure to commercialize any products for which we may obtain marketing approval;

maintain, expand and protect our intellectual property portfolio;

hire additional clinical, quality control and scientific personnel; and

add operational, financial and management information systems and personnel, including personnel to support our product development and planned future commercialization efforts.

We expect that our existing cash, cash equivalents and investments will enable us to fund our current operating plan and capital expenditure requirements into late 2015. We have based this estimate on assumptions that may prove to be wrong, and we could use our available capital resources sooner than we currently expect. Because of the numerous risks and uncertainties associated with the development and commercialization of our product candidates, and the extent to which we may enter into collaborations with third parties for development and commercialization of our product candidates, we are unable to estimate the amounts of increased capital outlays and operating expenses associated with completing the development of our current product candidates. Our future capital requirements will depend on many factors, including:

the scope, progress, results and costs of compound discovery, preclinical development, laboratory testing and clinical trials for our product candidates;

the extent to which we acquire or in-license other products and technologies;

the costs, timing and outcome of regulatory review of our product candidates;

the costs of future commercialization activities, including product sales, marketing, manufacturing and distribution, for any of our product candidates for which we receive marketing approval;

revenue, if any, received from commercial sales of our product candidates, should any of our product candidates receive marketing approval;

the costs of preparing, filing and prosecuting patent applications, maintaining and enforcing our intellectual property rights and defending intellectual property-related claims; and

our ability to establish collaborations on favorable terms, if at all.

Until such time, if ever, as we can generate substantial product revenues, we expect to finance our cash needs through a combination of equity offerings, debt financings, collaborations, strategic alliances and licensing arrangements. We do not have any committed external source of funds. To the extent that we raise additional capital through the sale of equity or convertible debt securities, the ownership

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interest of our existing stockholders will be diluted, and the terms of these securities may include liquidation or other preferences that adversely affect the rights of our existing stockholders. Debt financing, if available, may involve agreements that include covenants limiting or restricting our ability to take specific actions, such as incurring additional debt, making capital expenditures or declaring dividends. If we raise additional funds through collaborations, strategic alliances or licensing arrangements with third parties, we may have to relinquish valuable rights to our technologies, future revenue streams, research programs or product candidates or grant licenses on terms that may not be favorable to us. If we are unable to raise additional funds through equity or debt financings when needed, we may be required to delay, limit, reduce or terminate our product development or future commercialization efforts or grant rights to develop and market product candidates that we would otherwise prefer to develop and market ourselves.

**CONTRACTUAL OBLIGATIONS AND COMMITMENTS**

The following table summarizes our contractual obligations at December 31, 2012.

(in thousands)	Total	Less than 1 year	1 - 3 years	3 - 5 years	More than 5 years
Operating lease obligations	\$ 667	\$ 360	\$ 307		
License agreements(1)					

(1)

As discussed in Note 11 to the financial statements appearing elsewhere in this Annual Report on Form 10-K, we have executed several agreements to license intellectual property. The license agreements require us to pay upfront license fees and ongoing annual license maintenance fees, totaling a minimum of \$150,000 per year beginning in 2013 up to a maximum amount of \$480,000 per year beginning in 2017, as well as reimburse certain patent costs incurred by the licensors, as applicable. We have not included maintenance fees in the table above since the minimum annual payments are perpetual and the agreements are cancelable by us at any time upon prior written notice to the licensor.

In July 2012, we entered into a License Agreement with Pfizer Inc., ("Pfizer"), under which Pfizer granted us worldwide, exclusive rights to research, develop, manufacture and commercialize products containing certain of Pfizer's inhibitors of focal adhesion kinase (the "Products") for all therapeutic, diagnostic and prophylactic uses in humans. We have the right to grant sublicenses under the foregoing licensed rights, subject to certain restrictions. We are solely responsible, at our own expense, for the clinical development of the Products, which is to be conducted in accordance with an agreed-upon development plan. We are also responsible for all manufacturing and commercialization activities at our own expense. Pfizer is required to provide us with an initial quantity of clinical supply of one of the Products for an agreed upon price. We made a one-time cash payment to Pfizer in the amount of \$1.5 million and issued to Pfizer 192,012 shares of our common stock. Pfizer is also eligible to receive up to \$2 million in developmental milestones and up to an additional \$125 million based on the successful attainment of regulatory and commercial sales milestones. Pfizer is also eligible to receive high single to mid double digit royalties on future net sales of Products. Our royalty obligations with respect to each Product in each country begin on the date of first commercial sale of the Product in that country, and end on the later of 10 years after the date of first commercial sale of the Product in that country or the date of expiration or abandonment of the last claim contained in any issued patent or patent application licensed by Pfizer to us that covers the Product in that country.

Under our drug discovery platform license agreement, which we amended and restated in January 2012, we also have agreed to make milestone payments to the Whitehead Institute upon achieving various development, regulatory and commercialization milestones. For each licensed product, we agreed to make milestone payments of up to an aggregate of \$1,560,000 plus an additional amount for



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each subsequent approval of additional indications for a maximum number of licensed products. For each identified product that is not a licensed product, we agreed to make milestone payments of up to an aggregate of \$815,000 plus an additional amount for each subsequent approval of additional indications for a maximum number of identified products. Each type of specified milestone payment is payable only for each of the maximum number of licensed products and the maximum number of identified products, as the case may be, to achieve the applicable milestone. In addition, a separate milestone payment is due upon the first commercial sale of each licensed product or identified product that is a diagnostic or prognostic test. A single additional milestone payment is due for the first issuance of licensed patent rights in the United States, the United Kingdom, France, Germany, Spain or Italy. In addition, we have agreed to pay the Whitehead Institute royalties as a percentage of net sales of licensed products. The royalty rate is in the low single digits as a percentage of net sales for licensed products that are therapeutics, the mid single digits for licensed products that are diagnostics or prognostics and less than one percent for identified products.

Under our license agreement with Poniard Pharmaceuticals, Inc., or Poniard, that we entered into in November 2011 relating to VS-4718 and VS-5095 and other compounds covered by a licensed patent right under that agreement that have the inhibition of Focal Adhesion Kinase as a primary mode of action, we paid an upfront license fee and agreed to pay Poniard milestone payments of up to an aggregate of \$13,250,000 upon the achievement of specified development and regulatory milestones. We also agreed to issue to Poniard a warrant to purchase 142,857 shares of our common stock upon the first dosing of the first patient in our first Phase 1 clinical trial of a licensed product. The exercise price of such warrant would be equal to the average closing price of our common stock during the five trading days preceding such issue date. In addition, we agreed to pay low to mid-single digit royalties to Poniard as a percentage of net sales of licensed products.

Under our separate exclusive license agreement with the Whitehead Institute, or the cancer diagnostic license agreement, which we amended and restated in December 2011, we paid an upfront license fee and agreed to make milestone payments of up to an aggregate of \$825,000 to the Whitehead Institute upon achieving specified regulatory and commercialization milestones. In addition, we have agreed to pay the Whitehead Institute royalties as a percentage of net sales of licensed products. The royalty rate is in the mid-single digits as a percentage of net sales.

**OFF-BALANCE SHEET ARRANGEMENTS**

We did not have during the periods presented, and we do not currently have, any off-balance sheet arrangements, as defined under Securities and Exchange Commission rules.

**TAX LOSS CARRYFORWARDS**

As of December 31, 2012, we had federal and state net operating loss carryforwards of \$31.9 million, which are available to reduce future taxable income. We also had federal tax credits of \$358,000 and state tax credits of \$229,000, which may be used to offset future tax liabilities. The net operating loss and tax credit carryforwards will expire at various dates through 2032. Net operating loss and tax credit carryforwards are subject to review and possible adjustment by the Internal Revenue Service and state tax authorities and may become subject to an annual limitation in the event of certain cumulative changes in the ownership interest of significant stockholders over a three-year period in excess of 50%, as defined under Sections 382 and 383 of the Internal Revenue Code, as well as similar state provisions. This could limit the amount of tax attributes that can be utilized annually to offset future taxable income or tax liabilities. The amount of the annual limitation is determined based on the value of our company immediately prior to the ownership change. Subsequent ownership changes may further affect the limitation in future years. At December 31, 2012, we recorded a 100% valuation allowance against our net operating loss and tax credit carryforwards of approximately \$15.5 million, as we believe it is more likely than not that the tax benefits will not be fully realized. In the future, if we

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determine that a portion or all of the tax benefits associated with our tax carryforwards will be realized, net income would increase in the period of determination.

**RECENTLY ADOPTED ACCOUNTING STANDARDS**

We have not recently adopted any new accounting standards.

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to market risk related to changes in interest rates. We had cash, cash equivalents and investments of \$56.8 million as of December 31, 2011. We had cash, cash equivalents and investments of \$91.5 million as of December 31, 2012, consisting of cash, money market funds, and United States Treasuries and federal agency bonds. Our primary exposure to market risk is interest rate sensitivity, which is affected by changes in the general level of U.S. interest rates, particularly because most of our investments are in short-term securities. Our available for sale securities are subject to interest rate risk and will fall in value if market interest rates increase. Due to the short-term duration most of our investment portfolio and the low risk profile of our investments, an immediate 100 basis point change in interest rates would not have a material effect on the fair market value of our portfolio.

We contract with CROs and contract manufacturers globally. We may be subject to fluctuations in foreign currency rates in connection with these agreements. Transactions denominated in currencies other than the functional currency are recorded based on exchange rates at the time such transactions arise. As of December 31, 2012 and 2011, approximately \$42,000 and \$7,000 of our total liabilities was denominated in currencies other than the functional currency, respectively.

**Item 8. Financial Statements and Supplementary Data**

Our consolidated financial statements, together with the report of our independent registered public accounting firm, appear on pages F-1 through F-28 of this Annual Report on Form 10-K.

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

**Item 9A. Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

Our Chief Executive Officer and our Chief Operating Officer evaluated the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act, as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and our Chief Operating Officer concluded that our disclosure controls and procedures as of the end of the period covered by this report were effective.

**Management's Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over our financial reporting. Internal control over financial reporting is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act as the process designed by, or under the supervision of, our Chief Executive Officer and our Chief Operating Officer, and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of our

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financial reporting and the preparation of our financial statements for external purposes in accordance with generally accepted accounting principles, and includes those policies and procedures that:

- (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of assets;
- (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures are being made only in accordance with the authorizations of management and directors; and
- (3) provide reasonable assurance regarding the prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on our financial statements.

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Operating Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework provided in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2012.

**Changes in Internal Control Over Financial Reporting**

No change in our internal control over financial reporting occurred during the fiscal quarter ended December 31, 2012 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**Item 9B. Other Information**

None

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**PART III**

**Item 10. Directors, Executive Officers, and Corporate Governance**

Other than the information regarding our executive officers provided in Part I of this report under the heading "Business Executive Officers of the Registrant," the information required to be furnished pursuant to this item is incorporated herein by reference to our definitive proxy statement for the 2013 Annual Meeting of the Stockholders.

**Item 11. Executive Compensation**

The information required by this Item 11 is incorporated herein by reference from our definitive proxy statement for the 2013 Annual Meeting of Stockholders.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The information required by this Item 12 is incorporated herein by reference from our definitive proxy statement for the 2013 Annual Meeting of Stockholders.

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

The information required by this Item 13 is incorporated herein by reference from our definitive proxy statement for the 2013 Annual Meeting of Stockholders.

**Item 14. Principal Accountant Fees and Services**

The information required by this Item 14 is incorporated herein by reference from our definitive proxy statement for the 2013 Annual Meeting of Stockholders.

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**PART IV**

**Item 15. Exhibits and Financial Statement Schedules**

**Financial Statements**

See Part II, Item 8 for the Financial Statements required to be included in this Annual Report on Form 10-K.

**Financial Statement Schedules**

All financial statement schedules are omitted because they are not applicable or the required information is included in the financial statements or notes thereto.

**Exhibits**

Those exhibits required to be filed by Item 601 of Regulation S-K are listed in the Exhibit Index immediately preceding the exhibits hereto and such listing is incorporated herein by reference.

Table of Contents**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on this 26<sup>th</sup> day of March 2013.

VERASTEM, INC.

By:                   /s/ CHRISTOPH WESTPHAL, M.D., PH.D.

Christoph Westphal, M.D., Ph.D.  
*Chief Executive Officer*

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant in the capacities and on the dates indicated.

Signature	Title	Date
<u>                  /s/ CHRISTOPH WESTPHAL, M.D., PH.D.</u> Christoph Westphal, M.D., Ph.D.	Chief Executive Officer and Director (Principal executive officer)	March 26, 2013
<u>                  /s/ ROBERT FORRESTER</u> Robert Forrester	President and Chief Operating Officer (Principal financial officer and Principal accounting officer)	March 26, 2013
<u>                  /s/ RICHARD ALDRICH</u> Richard Aldrich	Director	March 26, 2013
<u>                  /s/ JOHN K. CLARKE</u> John K. Clarke	Director	March 26, 2013
<u>                  /s/ ALISON LAWTON</u> Alison Lawton	Director	March 26, 2013
<u>                  /s/ MICHAEL KAUFFMAN, M.D., PH.D.</u> Michael Kauffman, M.D., Ph.D.	Director	March 26, 2013
<u>                  /s/ S. LOUISE PHANSTIEL</u> S. Louise Phanstiel	Director	March 26, 2013
<u>                  /s/ STEPHEN SHERWIN, M.D.</u> Stephen Sherwin, M.D.	Director	March 26, 2013
<u>                  /s/ HENRI TERMEER</u> Henri Termeer	Director	March 26, 2013



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**Verastem, Inc.**  
**(A development stage company)**

**CONSOLIDATED FINANCIAL STATEMENTS**

**Period from August 4, 2010 (inception) to December 31, 2010 and the years ended December 31, 2011 and 2012, and the period from August 4, 2010 (inception) to December 31, 2012**

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<u>Consolidated Statements of Redeemable Convertible Preferred Stock and Stockholders' (Deficit) Equity</u>	<u>F-5</u>
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**Verastem, Inc.**  
**(A development stage company)**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders of  
Verastem, Inc.

We have audited the accompanying consolidated balance sheets of Verastem, Inc. (a development stage company) (the Company) as of December 31, 2011 and 2012, and the related consolidated statements of operations and comprehensive loss, redeemable convertible preferred stock and stockholders' (deficit) equity and cash flows for the period from August 4, 2010 (inception) to December 31, 2010, the years ended December 31, 2011 and 2012, and for the period from August 4, 2010 (inception) to December 31, 2012. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Verastem, Inc. as of December 31, 2011 and 2012 and the consolidated results of its operations and its cash flows for the period from August 4, 2010 (inception) to December 31, 2010, the years ended December 31, 2011 and 2012, and the period from August 4, 2010 (inception) to December 31, 2012, in conformity with U.S. generally accounting principles.

/s/ Ernst & Young LLP

Boston, Massachusetts  
March 26, 2013

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**Verastem, Inc.**  
(A development stage company)

**CONSOLIDATED BALANCE SHEETS**

(in thousands, except per share amounts)

	December 31,	
	2011	2012
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 20,954	\$ 10,096
Short-term investments	26,857	46,480
Prepaid expenses and other current assets	130	506
Total current assets	47,941	57,082
Property and equipment, net	709	811
Long-term investments	8,994	34,944
Other assets	1,307	
Restricted cash	86	86
Total assets	\$ 59,037	\$ 92,923
<b>Liabilities, redeemable convertible preferred stock and stockholders' (deficit) equity</b>		
Current liabilities:		
Accounts payable	\$ 2,273	\$ 1,848
Accrued expenses	873	551
Total current liabilities	3,146	2,399
Deferred rent	74	38
Liability for shares subject to repurchase	36	20
Obligation to issue warrant	406	
Commitments and contingencies (Note 10)		
Redeemable convertible preferred stock	68,141	
Stockholders' (deficit) equity:		
Convertible preferred stock, \$0.0001 par value; no and 5,000 shares authorized at December 31, 2011 and 2012, respectively, no shares issued and outstanding		
Common stock, \$0.0001 par value; 53,093 and 100,000 shares authorized at December 31, 2011 and 2012, respectively, 1,559 and 20,364 shares issued and outstanding at December 31, 2011 and 2012, respectively	1	2
Additional paid-in capital	1,702	136,893
Accumulated other comprehensive (loss) income	(2)	22
Deficit accumulated during the development stage	(14,467)	(46,451)
Total stockholders' (deficit) equity	(12,766)	90,466
Total liabilities, redeemable convertible preferred stock and stockholders' (deficit) equity	\$ 59,037	\$ 92,923

See accompanying notes.

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**Verastem, Inc.**  
(A development stage company)

**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS**

(in thousands, except per share amounts)

	Period from August 4, 2010 (inception) to December 31, 2010	Years Ended December 31,		Period from August 4, 2010 (inception) to December 31, 2012
		2011	2012	
<b>Operating expenses:</b>				
Research and development	\$ 400	\$ 9,883	\$ 21,712	\$ 31,995
General and administrative	384	3,815	10,518	14,717
Total operating expenses	784	13,698	32,230	46,712
Loss from operations	(784)	(13,698)	(32,230)	(46,712)
Interest income		15	246	261
Net loss	(784)	(13,683)	(31,984)	(46,451)
Accretion of preferred stock	(2)	(32)	(6)	(40)
Net loss applicable to common stockholders	\$ (786)	\$ (13,715)	\$ (31,990)	\$ (46,491)
Net loss per share applicable to common stockholders	\$ (0.91)	\$ (10.59)	\$ (1.70)	\$ (5.44)
Weighted-average number of common shares used in net loss per share applicable to common stockholders basic and diluted	850	1,295	18,765	8,547
Net loss	\$ (784)	\$ (13,683)	\$ (31,984)	\$ (46,451)
Unrealized (losses) gains on available-for-sale securities		(2)	24	22
Comprehensive loss	\$ (784)	\$ (13,685)	\$ (31,960)	\$ (46,429)

See accompanying notes.

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**Verastem, Inc.**  
(A development stage company)

**CONSOLIDATED STATEMENTS OF REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS'  
(DEFICIT) EQUITY**

(in thousands, except share data)

	Redeemable convertible preferred stock		Common stock		Additional paid-in capital	Accumulated other comprehensive loss	Deficit accumulated during the development stage	Totals stockholder's deficit
	Shares	Amount	Shares	Amount				
<b>Balance at August 4, 2010 (inception)</b>		\$		\$	\$	\$	\$	\$
Sale of common stock to founders			714,286	1				1
Vesting of restricted stock			133,926					
Issuance of common stock in exchange for license			166,664		46			46
Issuance of Series A redeemable convertible preferred stock, net of offering costs of \$79	4,000,000	3,921						
Accretion of redeemable convertible preferred stock to redemption value		2			(2)			(2)
Stock-based compensation expense					52			52
Net loss							(784)	(784)
<b>Balance at December 31, 2010</b>	<b>4,000,000</b>	<b>\$ 3,923</b>	<b>1,014,876</b>	<b>\$ 1</b>	<b>\$ 96</b>	<b>\$</b>	<b>\$ (784)</b>	<b>\$ (687)</b>
Net loss							(13,683)	(13,683)
Unrealized loss on investments						(2)		(2)
Issuance of Series A redeemable convertible preferred stock	12,000,000	12,000						
Issuance of Series B redeemable convertible preferred stock, net of offering costs of \$113	16,025,000	31,937						
Issuance of Series C redeemable convertible preferred stock, net of offering costs of \$153	9,067,825	20,249						
Accretion of redeemable convertible preferred stock to redemption value		32			(32)			(32)
Vesting of restricted stock			543,712		3			3
Stock-based compensation expense					1,635			1,635
<b>Balance at December 31, 2011</b>	<b>41,092,825</b>	<b>\$ 68,141</b>	<b>1,558,588</b>	<b>\$ 1</b>	<b>\$ 1,702</b>	<b>\$ (2)</b>	<b>\$ (14,467)</b>	<b>\$ (12,766)</b>
Net loss							(31,984)	(31,984)
Unrealized gain on investments						24		24
Accretion of redeemable convertible preferred stock to redemption value		6			(6)			(6)
Conversion of redeemable convertible preferred stock into common stock	(41,092,825)	(68,147)	11,740,794	1	68,146			68,147
Issuance of common stock, net of issuance costs of \$1,984			6,325,000		56,838			56,838
Issuance of common stock in exchange for license			192,012		1,957			1,957
Vesting of restricted stock			542,421		16			16
Issuance of common stock resulting from exercise of stock options			5,395		3			3
Obligation to issue a warrant					837			837
Stock-based compensation expense					7,400			7,400
<b>Balance at December 31, 2012</b>		<b>\$</b>	<b>20,364,210</b>	<b>\$ 2</b>	<b>\$ 136,893</b>	<b>\$ 22</b>	<b>\$ (46,451)</b>	<b>\$ 90,466</b>

See accompanying notes.



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**Verastem, Inc.**  
(A development stage company)

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

	Period from August 4, 2010 (inception) to December 31, 2010	Years Ended December 31,		Period from August 4, 2010 (inception) to December 31, 2012
	2010	2011	2012	2012
Net loss	\$ (784)	\$ (13,683)	\$ (31,984)	\$ (46,451)
Adjustments to reconcile net loss to net cash used in operating activities:				
Depreciation and amortization		83	207	290
Stock-based compensation expense	52	1,635	7,400	9,087
Common stock issued in exchange for license	46		1,957	2,003
Obligation to issue a warrant in exchange for license		439		439
Change in fair value of obligation to issue a warrant		(33)	431	398
Changing in operating assets and liabilities:				
Prepaid expenses and other current assets	(12)	(118)	(376)	(506)
Accounts payable	279	1,994	(425)	1,848
Accrued expenses and deferred rent	89	311	189	589
Net cash used in operating activities	(330)	(9,372)	(22,601)	(32,303)
<b>Investing activities</b>				
Purchases of property and equipment	(8)	(785)	(310)	(1,103)
Purchases of investments		(35,851)	(154,028)	(189,879)
Maturities of investments			108,479	108,479
Increase in restricted cash		(86)		(86)
Net cash used in investing activities	(8)	(36,722)	(45,859)	(82,589)
<b>Financing activities</b>				
Proceeds from the issuance of redeemable convertible preferred stock	3,921	64,186		68,107
Proceeds from the exercise of stock options			3	3
Net proceeds (costs) from the issuance of common stock and restricted common stock	1	(722)	57,599	56,878
Net cash provided by financing activities	3,922	63,464	57,602	124,988
Increase (decrease) in cash and cash equivalents	3,584	17,370	(10,858)	10,096
Cash and cash equivalents at beginning of period		3,584	20,954	
Cash and cash equivalents at end of period	\$ 3,584	\$ 20,954	\$ 10,096	\$ 10,096
<b>Supplemental disclosure of non-cash financial activity</b>				
Accretion of redeemable convertible preferred stock to redemption value	\$ 2	\$ 32	\$ 6	\$ 40
Conversion of redeemable convertible preferred stock upon initial public offering	\$	\$	\$ 68,148	\$ 68,148
Reclassification of obligation to issue warrant from liabilities to equity	\$	\$	\$ 837	\$ 837

See accompanying notes.

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**Verastem, Inc.**  
**(A development stage company)**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Nature of business**

Verastem, Inc. (the "Company"), incorporated on August 4, 2010 as a Delaware corporation, is a biopharmaceutical company focused on discovering and developing proprietary small molecule drugs targeting cancer stem cells along with proprietary companion diagnostics. The Company's operations to date have been limited to organizing and staffing the Company, business planning, raising capital, acquiring and developing its technology, identifying potential product candidates and undertaking preclinical studies of its most advanced product candidates. The Company has not commenced its planned principal operations. Accordingly, the Company is considered to be in the development stage as defined in Financial Accounting Standards Board Accounting Standards Codification Topic 915, *Development Stage Entities*.

The Company is subject to a number of risks similar to other life science companies in the development stage, including, but not limited to, the need to obtain adequate additional funding, possible failure of preclinical testing or clinical trials, inability to obtain marketing approval of product candidates, competitors developing new technological innovations, market acceptance of the Company's products and protection of proprietary technology. If the Company does not successfully commercialize any of its product candidates, it will be unable to generate product revenue or achieve profitability. As of December 31, 2012, the Company had a deficit accumulated during the development stage of \$46.5 million. The Company expects to continue to incur operating losses in future periods. The Company had cash, cash equivalents and investments of \$91.5 million as of December 31, 2012. The Company believes that its existing cash, cash equivalents and investments will be sufficient to fund its current operating plan and capital expenditure requirements for at least the next 12 months.

**Initial public offering**

In February 2012, the Company closed the initial public offering (IPO) of its common stock pursuant to a registration statement on Form S-1, as amended. An aggregate of 6,325,000 shares of common stock registered under the registration statement were sold at a price of \$10.00 per share, including the over-allotment option. Net proceeds of the IPO were \$56.8 million. All shares of the Company's Redeemable Convertible Preferred Stock were converted into 11,740,794 shares of common stock as part of the IPO.

**Reverse stock split**

In January 2012, the Company's board of directors and stockholders approved a one-for-3.5 reverse stock split of the Company's common stock. The reverse stock split became effective on January 10, 2012. All share and per share amounts in the financial statements have been retroactively adjusted for all periods presented to give effect to the reverse stock split, including reclassifying an amount equal to the reduction in par value to additional paid-in capital.

**2. Significant accounting policies**

**Basis of consolidation**

The information reported within the Company's financial statements from August 4, 2010 to December 31, 2011 was based solely on the accounts of Verastem, Inc. Effective December 2012, Verastem Securities Company was incorporated as a wholly owned subsidiary of the Company. Effective December 2012, all financial information presented has been consolidated and includes the accounts of



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**Verastem, Inc.**  
**(A development stage company)**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**2. Significant accounting policies (Continued)**

the Company and its wholly owned subsidiary. All intercompany balances and transactions have been eliminated in consolidation.

**Use of estimates**

The preparation of the Company's financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. On an ongoing basis, management evaluates its estimates, including estimates related to accruals and stock-based compensation expense. The Company bases its estimates on historical experience and other market-specific or other relevant assumptions that it believes to be reasonable. Actual results could differ from such estimates.

Prior to becoming a public company in February 2012, the Company utilized significant estimates and assumptions in determining the fair value of its common stock. The Company granted stock options at exercise prices not less than the fair market value of its common stock as determined by the board of directors, with input from management. The board of directors determined the estimated fair value of the Company's common stock based on a number of objective and subjective factors, including external market conditions affecting the biotechnology industry sector and the prices at which the Company sold shares of redeemable convertible preferred stock, the superior rights and preferences of securities senior to the Company's common stock at the time and the likelihood of achieving a liquidity event, such as an IPO or sale of the Company.

The Company utilized various valuation methodologies in accordance with the framework of the American Institute of Certified Public Accountants Technical Practice Aid, *Valuation of Privately-Held Company Equity Securities Issued as Compensation*, to estimate the fair value of its common stock. The methodologies included an asset-based approach and the current value method for the Company's initial common stock valuation as of November 30, 2010, the option pricing method utilizing the reverse backsolve method to estimate the Company's underlying equity value as of July 31, 2011 and a methodology that determined an estimated value under an IPO scenario and a sale scenario based upon an assessment of the probability of occurrence of each scenario as of September 30, 2011, November 17, 2011, and December 31, 2011. Each valuation methodology included estimates and assumptions that required the Company's judgment. These estimates included assumptions regarding future performance, including the successful completion of preclinical studies and clinical trials and the time to completing an IPO or sale. Significant changes to the key assumptions used in the valuations could result in different fair values of common stock at each valuation date.

**Segment and geographic information**

Operating segments are defined as components of an enterprise about which separate discrete information is available for evaluation by the chief operating decision maker, or decision-making group, in deciding how to allocate resources and in assessing performance. The Company views its operations and manages its business in one operating segment, which is the business of developing drugs that target cancer stem cells. The Company operates in only one geographic area.

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**Verastem, Inc.**  
(A development stage company)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**2. Significant accounting policies (Continued)**

**Cash and cash equivalents**

The Company considers all highly liquid investments with an original or remaining maturity of three months or less at the date of purchase to be cash equivalents. Cash equivalents consist of money market funds, U.S. agency notes and corporate bonds. Cash equivalents are reported at fair value.

**Fair value of financial instruments**

The Company is required to disclose information on all assets and liabilities reported at fair value that enables an assessment of the inputs used in determining the reported fair values. The fair value hierarchy prioritizes valuation inputs based on the observable nature of those inputs. The fair value hierarchy applies only to the valuation inputs used in determining the reported fair value of the investments and is not a measure of the investment credit quality. The hierarchy defines three levels of valuation inputs:

Level 1 inputs	Quoted prices in active markets for identical assets or liabilities
Level 2 inputs	Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly
Level 3 inputs	Unobservable inputs that reflect the Company's own assumptions about the assumptions market participants would use in pricing the asset or liability

The following table presents information about the Company's financial assets that have been measured at fair value at December 31, 2012 and indicates the fair value hierarchy of the valuation inputs utilized to determine fair value (in thousands).

Description	Total	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<b>Financial assets</b>				
Cash equivalents	\$ 8,171	\$ 8,171	\$	\$
Short-term investments	46,480		46,480	
Long-term investments	34,944		34,944	
<b>Total financial assets</b>	<b>\$ 89,595</b>	<b>\$ 8,171</b>	<b>\$ 81,424</b>	<b>\$</b>

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**Verastem, Inc.**  
(A development stage company)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**2. Significant accounting policies (Continued)**

The following table presents information about the Company's financial assets that have been measured at fair value at December 31, 2011 and indicates the fair value hierarchy of the valuation inputs utilized to determine such fair value (in thousands).

Description	Total	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<b>Financial assets</b>				
Cash equivalents	\$ 4,102	\$ 3,102	\$ 1,000	\$
Short-term investments	26,857		26,857	
Long-term investments	8,994		8,994	
<b>Total financial assets</b>	<b>\$ 39,953</b>	<b>\$ 3,102</b>	<b>\$ 36,851</b>	<b>\$</b>
<b>Financial liabilities</b>				
Obligation to issue warrant	\$ 406	\$	\$	\$ 406
<b>Total financial liabilities</b>	<b>\$ 406</b>	<b>\$</b>	<b>\$</b>	<b>\$ 406</b>

In connection with the license agreement with Poniard Pharmaceuticals Inc. (Poniard), the Company is obligated to issue a warrant to Poniard for the purchase of the Company's common stock upon the first patient dosing using a product licensed under the agreement with Poniard; such warrant will have a three year term from the date of issuance. Prior to the Company's initial public offering, the exercise price of the warrant would have been equal to the fair value of the common stock on the date of the most recent preferred stock financing prior to the issuance of the warrant. Upon the completion of the Company's initial public offering in January 2012, the exercise price of the warrant will be equal to the average closing price of the Company's common stock during the five trading days preceding the issuance of the warrant.

Prior to January 2012, the obligation to issue the warrant was a level 3 liability because its value measurement was based, in part, on significant inputs not observed in the market and reflects the Company's assumptions as to the expected warrant exercise price and the expected volatility of the Company's common stock. The obligation to issue the warrant was initially recorded at fair value and, prior to the Company's initial public offering, was revalued at the end of each reporting period, with the change in the fair value reported in research and development expense within the statement of operations. Upon the completion of the Company's initial public offering, the obligation to issue the warrant met the definition of an equity-classified derivative instrument since the remaining variable inputs were consistent with those in a fixed for fixed forward option agreement, and was therefore revalued as of January 26, 2012 with the change in fair value reported in research and development expense within the statement of operations. The fair value of the obligation to issue the warrant was then reclassified from liabilities to additional paid-in-capital on the Company's consolidated balance sheet. The Company will reassess the equity classification of the obligation to issue the warrant upon a change in facts and circumstances in future reporting periods.

As of December 31, 2011, the most recent issuance of the Company's Preferred Stock had been the issuance of the Series C Preferred Stock in November 2011. The Company estimated the value of

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**Verastem, Inc.**  
(A development stage company)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**2. Significant accounting policies (Continued)**

the obligation to issue the warrant using a probability-weighted scenario analysis that incorporated the probability of the completion of an initial public offering. The analysis included estimating the stock price on each measurement date assuming that achievement of the milestone would be 100% probable. The estimated stock price contingent upon milestone achievement was determined by analyzing the post-announcement returns for public companies that progressed to Phase 1 clinical trials. The following inputs were used to determine the fair value of the obligation to issue the warrant:

	January 26, 2012	December 31, 2011	
		Non-IPO	IPO
Exercise price	\$ 11.09	\$ 6.86	\$ 10.00
Estimated stock price contingent upon milestone achievement	\$ 12.60	\$ 3.22	\$ 8.54
Expected term	4.0 years	4.1 years	4.1 years
Volatility	75%	70%	70%
Dividend yield	0.00%	0.00%	0.00%
Risk-free rate	0.54%	0.60%	0.60%
Probability of achieving milestone	80%	80%	80%
Probability of scenario	100%	20%	80%

As of December 31, 2011, the fair value of the obligation to issue the warrant was recorded at \$406,000. As a result of the change in inputs to the valuation model, the fair value of the obligation to issue the warrant increased by \$431,000 to \$837,000 at January 26, 2012. Reasonable changes in the assumptions used to calculate the fair value of the obligation to issue the warrant would not result in significant changes in the fair value.

**Investments**

Investments and cash equivalents consist of investments in money market accounts, government-sponsored enterprise securities and commercial paper of publicly traded companies secured by the U.S. government that are classified as available-for-sale pursuant to Accounting Standards Codification (ASC) 320, *Investments Debt and Equity Securities*. The Company classifies investments available to fund current operations as current assets on its balance sheets. Investments are classified as long-term assets on the balance sheets if (i) the Company has the intent and ability to hold the investments for a period of at least one year and (ii) the contractual maturity date of the investments is greater than one year. Investments are carried at fair value with unrealized gains and losses included as a component of accumulated other comprehensive loss, which is a separate component of stockholders' equity (deficit), until such gains and losses are realized. The fair value of these securities is based on quoted prices for identical or similar assets. If a decline in the fair value is considered other-than-temporary, based on available evidence, the unrealized loss is transferred from other comprehensive loss to the statement of operations. There were no other-than-temporary declines in fair value of short-term or long-term investments for the period from August 4, 2010 (inception) to December 31, 2010, the year ended December 31, 2011 and the year ended December 31, 2012. Realized gains and losses are determined using the specific identification method and are included in interest income in the statement of operations. There were no realized gains or losses recognized for the period from August 4, 2010

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**Verastem, Inc.**  
(A development stage company)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**2. Significant accounting policies (Continued)**

(inception) to December 31, 2010, the year ended December 31, 2011 and the year ended December 31, 2012.

The Company reviews investments for other-than-temporary impairment whenever the fair value of an investment is less than the amortized cost and evidence indicates that an investment's carrying amount is not recoverable within a reasonable period of time. To determine whether an impairment is other-than-temporary, the Company considers the intent to sell, or whether it is more likely than not that the Company will be required to sell, the investment before recovery of the investment's amortized cost basis. Evidence considered in this assessment includes reasons for the impairment, compliance with the Company's investment policy, the severity and the duration of the impairment and changes in value subsequent to year end. As of December 31, 2011 and 2012, there were no investments with a fair value that was significantly lower than the amortized cost basis or any investments that had been in an unrealized loss position for a significant period.

As of December 31, 2012, cash, cash equivalents and investments included (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Cash and cash equivalents:</b>				
Cash and money market accounts	\$ 10,096	\$	\$	\$ 10,096
Government-sponsored enterprise securities				
<b>Total cash and cash equivalents</b>	<b>\$ 10,096</b>	<b>\$</b>	<b>\$</b>	<b>\$ 10,096</b>
<b>Investments:</b>				
Government-sponsored enterprise securities (due within 1 year)	\$ 44,480	\$ 14	\$ (3)	\$ 44,491
Government-sponsored enterprise securities (due within 1 - 2 years)	36,920	14	(1)	36,933
<b>Total investments</b>	<b>\$ 81,400</b>	<b>\$ 28</b>	<b>\$ (4)</b>	<b>\$ 81,424</b>
<b>Total cash, cash equivalents, and investments</b>	<b>\$ 91,496</b>	<b>\$ 28</b>	<b>\$ (4)</b>	<b>\$ 91,520</b>

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**Verastem, Inc.**  
(A development stage company)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**2. Significant accounting policies (Continued)**

As of December 31, 2011, cash, cash equivalents and investments included (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Cash and cash equivalents:</b>				
Cash and money market accounts	\$ 19,954	\$	\$	\$ 19,954
Government-sponsored enterprise securities	1,000			1,000
<b>Total cash and cash equivalents</b>	<b>\$ 20,954</b>	<b>\$</b>	<b>\$</b>	<b>\$ 20,954</b>
<b>Investments:</b>				
Government-sponsored enterprise securities (due within 1 year)	\$ 10,900	\$ 2	\$ (1)	\$ 10,901
Government-sponsored enterprise securities (due within 1 - 2 years)	8,998	1	(5)	8,994
Commercial paper secured by the U.S. government (due within 1 year)	15,954	3	(1)	15,956
<b>Total investments</b>	<b>\$ 35,852</b>	<b>\$ 6</b>	<b>\$ (7)</b>	<b>\$ 35,851</b>
<b>Total cash, cash equivalents, and investments</b>	<b>\$ 56,806</b>	<b>\$ 6</b>	<b>\$ (7)</b>	<b>\$ 56,805</b>

**Concentrations of credit risk and off-balance sheet risk**

Cash and cash equivalents and investments are financial instruments that potentially subject the Company to concentrations of credit risk. As of December 31, 2012, the Company's cash, cash equivalents and investments were deposited at two financial institutions. The Company maintains its cash and cash equivalents and investments with high quality, accredited financial institutions and, accordingly, the Company believes it is not exposed to any significant credit risk on these funds. The Company has no significant off-balance sheet concentrations of credit risk, such as foreign currency exchange contracts, option contracts or other hedging arrangements.

**Property and equipment**

Property and equipment consists of laboratory equipment, office furniture, and computer equipment. Expenditures for repairs and maintenance are recorded to expense as incurred, whereas major betterments are capitalized as additions to property and equipment. Depreciation is calculated using the straight-line method over the following estimated useful lives of the assets:

Laboratory equipment	5 years
Furniture	5 years
Computer equipment	3 years

Upon retirement or sale, the cost of the disposed asset and the related accumulated depreciation are removed from the accounts and any resulting gain or loss is recognized.

The Company reviews its long-lived assets for impairment whenever events or changes in business circumstances indicate that the carrying value of assets may not be recoverable. Recoverability is

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**Verastem, Inc.**  
**(A development stage company)**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**2. Significant accounting policies (Continued)**

measured by comparison of the asset's book value to future net undiscounted cash flows that the assets are expected to generate. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the book value of the assets exceed their fair value, which is measured based on the projected discounted future net cash flows arising from the assets. No such impairment losses have been recorded through December 31, 2012.

**Organizational costs**

All organizational costs have been expensed as incurred.

**Research and development costs**

The Company expenses research and development costs to operations as incurred. Research and development expenses consist of costs associated with research activities, including drug discovery efforts and the development of therapeutic product candidates and companion diagnostics. The Company accounts for nonrefundable advance payments for goods and services that will be used in future research and development activities as expenses when the service has been performed or when the goods have been received rather than when the payment is made. Research and development expenses consist of:

employee-related expenses, including salaries, benefits, travel and stock-based compensation expense;

external research and development expenses incurred under arrangements with third parties, such as contract research organizations, or CROs, manufacturing organizations and consultants, including the scientific advisory board;

license fees; and

facilities, depreciation and other expenses, which include direct and allocated expenses for rent and maintenance of facilities, depreciation of equipment, and laboratory supplies.

**Stock-based compensation**

The Company expenses the fair value of employee stock options over the requisite service period, which is the vesting period. Compensation expense is measured using the fair value of the award at the grant date, net of estimated forfeitures, and is adjusted annually to reflect actual forfeitures. The grant date fair value of each stock-based award is estimated using the Black-Scholes option pricing model and is expensed on a straight-line basis over the vesting period.

Stock-based awards issued to nonemployees, including directors for non-board related services, are accounted for based on the fair value of such services received or of the equity instruments issued, whichever is more reliably measured. Stock option awards are revalued at each vesting date using the Black-Scholes option pricing model and are expensed on a straight-line basis over the vesting period.

Prior to becoming a public company, the exercise prices for options granted were set by the board of directors, the members of which have extensive experience in the life science industry, with input from management of the Company, based on the board's determination of fair value of the common stock at the time of the grants. The Company performed contemporaneous valuations, utilizing a

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**Verastem, Inc.**  
**(A development stage company)**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**2. Significant accounting policies (Continued)**

combination of valuation methods described in the American Institute of Certified Public Accountants Technical Practice Aid, *Valuation of Privately-Held-Company Equity Securities Issued as Compensation*, (Practice Aid).

**Income taxes**

The Company accounts for income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases using enacted tax rates in effect for the year in which the differences are expected to affect taxable income. Tax benefits are recognized when it is more likely than not that a tax position will be sustained during an audit. Deferred tax assets are reduced by a valuation allowance if current evidence indicates that it is considered more likely than not that these benefits will not be realized.

**Net loss per share**

Basic and diluted net loss per common share is calculated by dividing net loss applicable to common stockholders by the weighted-average number of common shares outstanding during the period, without consideration for common stock equivalents. The Company's potentially dilutive shares, which include redeemable convertible preferred stock, outstanding stock options, restricted stock units, and unvested restricted stock are considered to be common stock equivalents and are only included in the calculation of diluted net loss per share when their effect is dilutive.

The following potentially dilutive securities were excluded from the calculation of diluted net loss per share due to their anti-dilutive effect:

	Period from August 4, 2010 (inception) to December 31, 2010	Years Ended December 31,		Period from August 4, 2010 (inception) to December 31, 2012
		2011	2012	2012
Preferred Stock	1,142,857	11,740,794		
Outstanding stock options	177,143	405,141	1,424,241	1,424,241
Restricted stock units			899,204	899,204
Unvested restricted stock	2,008,926	1,434,734	747,000	747,000
	3,328,926	13,580,669	3,070,445	3,070,445



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**Verastem, Inc.**  
(A development stage company)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**3. Property and equipment**

Property and equipment and related accumulated depreciation are as follows (in thousands):

	December 31, 2011	December 31, 2012
Laboratory equipment	\$ 721	\$ 1,017
Computer equipment	27	27
Furniture	44	44
	792	1,088
Less: accumulated depreciation	(83)	(277)
	\$ 709	\$ 811

Total depreciation expenses amounted to \$0, \$83,000, \$207,000 and \$290,000 for the period from August 4, 2010 (inception) to December 31, 2010, the year ended December 31, 2011, the year ended December 31, 2012 and the period from August 4, 2010 (inception) to December 31, 2012, respectively.

**4. Prepaid expenses and other current assets**

Prepaid expenses and other current assets consist of the following (in thousands):

	December 31, 2011	December 31, 2012
Prepaid contract research organization costs	\$ 274	\$ 274
Interest receivable	53	161
Prepaid other	77	71
	\$ 130	\$ 506

**5. Accrued expenses**

Accrued expenses are as follows (in thousands):

	December 31,	
	2011	2012
Professional fees	\$ 520	\$ 183
Compensation and related benefits	86	173
Contract research organization costs	217	69
Consulting	27	36
Deferred rent	27	36
Other	23	54
	\$ 873	\$ 551

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**Verastem, Inc.**  
(A development stage company)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**6. Redeemable convertible preferred stock**

On February 1, 2012, immediately prior to the closing of the Company's initial public offering, all outstanding shares of the Company's redeemable convertible preferred stock were converted into 11,740,794 shares of common stock. As of December 31, 2012, the Company does not have any redeemable convertible preferred stock authorized, issued, or outstanding.

Prior to the closing of the initial public offering, the Company's redeemable preferred stock consisted of the following (in thousands except share and per share amounts):

	As of December 31,	
	2011	2012
Series A redeemable convertible preferred stock, \$0.0001 par value; 16,000 and no shares authorized, 16,000 and no shares issued and outstanding at December 31, 2011 and 2012, respectively (Liquidation preference of \$16,000 as of December 31, 2011)	15,939	
Series B redeemable convertible preferred stock, \$0.0001 par value; 16,025 and no shares authorized, 16,025 and no shares issued and outstanding at December 31, 2011 and 2012, respectively (Liquidation preference of \$32,050 as of December 31, 2011)	31,948	
Series C redeemable convertible preferred stock, \$0.0001 par value; 9,068 and no shares authorized, 9,068 and no shares issued and outstanding at December 31, 2011 and 2012, respectively (Liquidation preference of \$20,403 as of December 31, 2011)	20,254	
	\$ 68,141	\$

In November 2010, the Company sold 4 million shares of Series A redeemable convertible preferred stock (Series A Preferred Stock) at a price of \$1.00 per share for gross proceeds of \$4 million. In accordance with the terms of the Series A Stock Purchase Agreement, the Company sold an additional 12 million shares at \$1.00 per share in a second subsequent closing. The Company incurred approximately \$79,000 of issuance costs as part of the first closing of the Series A Preferred Stock. No additional issuance costs were incurred as part of the second closing.

In July 2011, the Company sold approximately 16 million shares of series B redeemable convertible preferred stock (Series B Preferred Stock) at a price of \$2.00 per share for gross proceeds of approximately \$32 million. The Company incurred approximately \$113,000 of issuance costs as part of the closing of the Series B Preferred Stock.

In November 2011, the Company sold approximately 9.1 million shares of Series C redeemable convertible preferred stock (Series C Preferred Stock) at a price of \$2.25 per share for gross proceeds of \$20.4 million. The Company incurred approximately \$153,000 of issuance costs as part of the closing of the Series C Preferred Stock. The issuance costs associated with the Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock (collectively, the Preferred Stock) were accreted through the earliest redemption date.

The Company assessed the Preferred Stock for any beneficial conversion features or embedded derivatives that would require bifurcation from the Preferred Stock and receive separate accounting treatment. On the date of each issuance, the value of the common stock into which the Preferred Stock was convertible had a fair value less than the effective conversion price of the Preferred Stock and, as

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**Verastem, Inc.**  
(A development stage company)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**6. Redeemable convertible preferred stock (Continued)**

such, there was no intrinsic value on the respective commitment dates. No embedded derivatives were identified that would require bifurcation.

**7. Common stock**

As of December 31, 2012 and December 31, 2011, the Company had reserved the following shares of common stock for the potential conversion of outstanding Preferred Stock, the issuance of common stock for vested restricted stock units and the exercise of stock options (in thousands):

	December 31, 2011	December 31, 2012
Series A Preferred Stock	4,571	
Series B Preferred Stock	4,579	
Series C Preferred Stock	2,591	
Shares reserved under equity compensation plans	563	3,930
	12,304	3,930

Each share of common stock is entitled to one vote, subject to certain voting rights of the Preferred Stock as discussed in Note 6. The holders of the common stock are also entitled to receive dividends whenever funds are legally available and when declared by the board of directors, subject to the prior rights of the Preferred Stockholders.

**8. Stock-based compensation**

Stock-based compensation expense as reflected in the Company's consolidated statements of operations and comprehensive loss was as follows (in thousands):

	Period from August 4, 2010 (Inception) to December 31, 2010		Year Ended December 31, 2011		Year Ended December 31, 2012		Period from August 4, 2010 (Inception) to December 31, 2012	
Research and development	\$	24	\$	981	\$	2,956	\$	3,961
General and administrative		28		654		4,444		5,126
Total stock-based compensation expense	\$	52	\$	1,635	\$	7,400	\$	9,087

The Company maintains two equity compensation plans, the 2012 Incentive Plan (the "2012 Plan") and the 2010 Equity Incentive Plan (the "2010 Plan"). Terms of stock award agreements, including vesting requirements, are determined by the board of directors, subject to the provisions of the individual plans. To date, most options granted by the Company vest twenty five percent (25%) one year from vesting start date and seventy-five percent (75%) in equal installments over the subsequent twelve quarters (subject to acceleration of vesting in the event of certain change of control transactions) and are exercisable from the date of grant for a period of ten years.

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**Verastem, Inc.**  
**(A development stage company)**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**8. Stock-based compensation (Continued)**

**2012 Incentive Plan**

In December 2011, the Company adopted the 2012 Plan. The 2012 Plan became effective immediately upon the closing of the Company's IPO in February 2012. Upon effectiveness of the 2012 Plan, the Company ceased making awards under the 2010 Plan. The 2012 Plan allows the Company to grant awards for up to 3,428,571 shares of common stock plus the number of shares of common stock available for grant under the 2010 Plan as of the effectiveness of the 2012 Plan (which was an additional 30,101 shares) plus that number of shares of common stock related to awards outstanding under the 2010 Plan which terminate by expiration, forfeiture, cancellation or otherwise. The 2012 Plan includes an "evergreen provision" that allows for an annual increase in the number of shares of common stock available for issuance under the 2012 Plan. The annual increase will be added on the first day of each year beginning in 2013 and each subsequent anniversary until the expiration of the 2012 Plan, equal to the lowest of 1,285,714 shares of common stock, 4.0% of the number of shares of common stock outstanding and an amount determined by the board of directors. Awards under the 2012 Plan may include the following award types: incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock awards, restricted stock units (RSUs), other stock-based or cash-based awards and any combination of the foregoing. As of December 31, 2012, under the 2012 Plan, the Company has granted stock options for 1,039,714 shares of common stock, of which 8,328 have been forfeited and restricted stock units for 909,918 shares of common stock, of which 10,714 have been forfeited. The exercise price of each option has been equal to the closing price of a share of our common stock on the grant date.

**2010 Equity Incentive Plan**

In November 2010, the Company adopted the 2010 Plan, under which it was authorized to grant stock-based awards to purchase up to 404,762 shares of common stock to eligible employees, officers, directors and consultants. In March 2011, the 2010 Plan was amended to increase the aggregate number of shares of common stock available to be issued under the 2010 Plan to 571,242 shares of common stock. As of December 31, 2012, a total of 405,141 options and 256,000 restricted stock awards have been granted, 5,395 options have been exercised and 126,891 have been forfeited and repurchased, under the 2010 Plan. As of February 2012, the Company ceased making awards under the 2010 Plan and the remaining 30,101 shares available for future grants were added to the total number of shares reserved for issuance under the 2012 Plan. For options granted under the 2010 Plan, the exercise price equaled the estimated fair value of the common stock as determined by the board of directors on the date of grant.

**Restricted common stock**

In connection with the Company's formation, the founders purchased an aggregate of 2,857,138 shares of Company common stock at fair value on the date of issuance. The shares were issued subject to restricted stock agreements between the Company and each founder, which allow the Company, at its discretion, to repurchase unvested shares if the founder's relationship with the Company is terminated. Under these agreements, twenty five percent (25%) of the shares vested immediately, and the remaining seventy-five percent (75%) of shares vest ratably in quarterly installments over the subsequent four years.

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**Verastem, Inc.**  
(A development stage company)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**8. Stock-based compensation (Continued)**

The Company records stock-based compensation expense for the common stock subject to repurchase, or restricted common stock grants, based on the grant date intrinsic value for employees and the vesting date intrinsic value for non-employees. All of the restricted shares were issued at fair value. The Company recorded stock-based compensation expense associated with restricted common stock grants of approximately \$51,000, \$1.4 million, \$3.3 million and \$4.8 million for the period August 4, 2010 (inception) to December 31, 2010, the year ended December 31, 2011, the year ended December 31, 2012 and the period from August 4, 2010 (inception) to December 31, 2012, respectively.

A summary of the Company's restricted stock activity and related information is as follows:

	Shares	Weighted-average fair value per share
Unvested at December 31, 2011	1,434,734	\$ 0.02530
Granted		
Vested	(542,421)	0.02920
Forfeited	(145,313)	0.00035
Unvested at December 31, 2012	747,000	\$ 0.02730

The weighted-average grant date fair value of restricted stock granted during the period from August 4, 2010 (inception) to December 31, 2010, the year ended December 31, 2011 and the period from August 4, 2010 (inception) to December 31, 2012 was \$0.00035, \$0.28 and \$0.02 per share, respectively. No restricted stock was granted during the year ended December 31, 2012. As of December 31, 2012, there was \$4.2 million of total unrecognized stock-based compensation expense related to unvested restricted stock. The Company expects to recognize this expense over a remaining weighted-average period of 1.75 years.

**Restricted stock units**

A summary of the Company's RSUs as of December 31, 2012 and changes during the year ended December 31, 2012 is as follows (in thousands, except per share data):

	Shares	Weighted- average grant date fair value per share
Unvested at December 31, 2011		\$
Granted	909,918	10.62
Vested	(77,479)	9.68
Cancelled	(10,714)	11.10
Unvested at December 31, 2012	899,204	\$ 10.70

As of December 31, 2012, there was \$6.5 million of total unrecognized stock-based compensation expense related to unvested RSUs granted under the 2012 Plan. The expense is expected to be recognized over a weighted-average period of 3.0 years.

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**Verastem, Inc.**  
(A development stage company)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**8. Stock-based compensation (Continued)**

During 2012, the Company issued a restricted stock unit for 103,306 shares to an employee. The award vests up to 25% per year based on the achievement of stated objectives. The objectives related to 2012 were modified in December 2012 and the Company recorded expense of \$126,000 in connection with the modification.

**Stock Options**

A summary of the Company's stock option activity and related information follows:

	Shares	Weighted-average exercise price per share	Weighted-average remaining contractual term (years)	Aggregate intrinsic value (in thousands)
Outstanding at December 31, 2011	405,141	\$ 0.75		
Granted	1,039,714	9.25		
Exercised	(5,395)	0.56		
Cancelled	(15,219)	6.50		
<b>Outstanding at December 31, 2012</b>	<b>1,424,241</b>	<b>6.90</b>	<b>9.3</b>	<b>3,451</b>
Vested at December 31, 2012	384,712	6.00	9.0	1,343
<b>Vested and expected to vest at December 31, 2012(1)</b>	<b>1,382,496</b>	<b>\$ 6.87</b>	<b>9.3</b>	<b>3,415</b>

(1)

This represents the number of vested options as of December 31, 2012, plus the number of unvested options expected to vest as of December 31, 2012, based on the unvested options at December 31, 2012, adjusted for the estimated forfeiture rate.

The fair value of each employee stock option was estimated at the date of grant using a Black-Scholes option-pricing model with the following assumptions:

	Period from August 4, 2010 (Inception) to December 31, 2010	Year Ended December 31,	
		2011	2012
Risk-free interest rate	2.0%	1.1% - 2.7%	0.8% - 1.7%
Volatility	67%	69% - 70%	70% - 77%
Dividend yield			
Expected term (years)	6.1	6.25	5.3 - 6.1

The Company uses the simplified method as prescribed by the Securities and Exchange Commission Staff Accounting Bulletin Topic 14.D.2 to calculate the expected term as it does not have sufficient historical exercise data to provide a reasonable basis upon which to estimate the expected term for options granted to employees. The expected term is applied to the stock option grant group as a whole, as the Company does not expect substantially different exercise or post-vesting termination behavior among its employee population. The computation of expected volatility is based on the historical volatility of a representative group of public biotechnology and life sciences companies with similar characteristics to the Company, including early stage of product development and therapeutic



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**Verastem, Inc.**  
**(A development stage company)**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**8. Stock-based compensation (Continued)**

focus. Subsequent to the initial public offering, the Company began to use a blended volatility rate comprised of its own historical volatility and that of the representative group of companies. The risk-free interest rate is based on a treasury instrument whose term is consistent with the expected term of the stock options. Management assesses expected forfeitures based on the experience of the Company coupled with comparison to data from the representative group of companies and recognizes compensation costs only for those equity awards expected to vest.

For the period from August 4, 2010 (inception) to December 31, 2010 the Company did not recognize any stock-based compensation for employee stock option grants. The Company recorded stock-based compensation expense of \$19,000 for the year ended December 31, 2011, and \$1.6 million for the year ended December 31, 2012 and the period from August 4, 2010 (inception) to December 31, 2012, associated with employee stock options. The weighted-average grant date fair value of options granted in the period from August 4, 2010 (inception) to December 31, 2010, the year ended December 31, 2011, the year ended December 31, 2012 and the period from August 4, 2010 (inception) to December 31, 2012 was \$0.18, \$0.75, \$6.03 and \$4.48 per share, respectively.

At December 31, 2012, there was \$5.4 million of total unrecognized compensation cost related to unvested stock options. As of December 31, 2012, the Company expects to recognize this cost over a remaining weighted-average period of 3.0 years.

**9. Income taxes**

As of December 31, 2012 the Company had federal net operating loss carryforwards of approximately \$31.9 million and state net operating loss carryforwards of \$31.9 million, which are available to reduce future taxable income. The Company also had federal tax credits of \$358,000 and state tax credits of \$229,000, which may be used to offset future tax liabilities. The net operating loss (NOL) and tax credit carryforwards will expire at various dates through 2032. Net operating loss and tax credit carryforwards are subject to review and possible adjustment by the Internal Revenue Service and state tax authorities and may become subject to an annual limitation in the event of certain cumulative changes in the ownership interest of significant shareholders over a three-year period in excess of 50%, as defined under Sections 382 and 383 of the Internal Revenue Code, as well as similar state provisions. This could limit the amount of tax attributes that can be utilized annually to offset future taxable income or tax liabilities. The amount of the annual limitation is determined based on the value of the Company immediately prior to the ownership change. Subsequent ownership changes may further affect the limitation in future years.



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**Verastem, Inc.**  
(A development stage company)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**9. Income taxes (Continued)**

A reconciliation of income taxes computed using the U.S. federal statutory rate to that reflected in operations follows:

	Year ended December 31,	
	2011	2012
Income tax benefit using U.S. federal statutory rate	34.00%	34.00%
State income taxes, net of federal benefit	4.78%	4.61%
Research and development tax credits	1.65%	%
Permanent items	(4.78)%	(5.96)%
Change in the valuation allowance	(35.65)%	(32.19)%
Other	%	(0.46)%
	%	%

The principal components of the Company's deferred tax assets are as follows (in thousands):

	December 31,	
	2011	2012
Deferred tax assets:		
Net operating loss carryforwards	\$ 4,562	\$ 12,532
Capitalized research and development	148	1,664
Research and development credits	385	508
Stock-based compensation	82	797
Other	20	(23)
Gross deferred tax assets	5,197	15,478
Valuation allowance	(5,197)	(15,478)
Net deferred tax asset	\$	\$

The Company has recorded a valuation allowance against its deferred tax assets at December 31, 2012 because the Company's management believes that it is more likely than not that these assets will not be fully realized. The increase in the valuation allowance of \$320,000, \$4.9 million and \$10.3 million in the period from August 4, 2010 (inception) to December 31, 2010, the years ended December 31, 2011 and 2012 primarily relates to the net loss incurred by the Company.

Upon inception, the Company adopted accounting guidance related to accounting for uncertainty in income taxes. The Company's reserves related to taxes are based on a determination of whether and how much of a tax benefit taken by the Company in its tax filings or positions is more likely than not to be realized following resolution of any potential contingencies present related to the tax benefit. Upon adoption, the Company recognized no material adjustment for unrecognized income tax benefits. As of the adoption date and through December 31, 2012, the Company had no unrecognized tax benefits or related interest and penalties accrued. The Company has not, as yet, conducted a study of research and development (R&D) credit carryforwards. This study may result in an adjustment to the Company's R&D credit carryforwards; however, until a study is completed and any adjustment is known, no amounts are being presented as an uncertain tax position. A full valuation allowance has been provided against the Company's R&D credits and, if an adjustment is required, this adjustment

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**Verastem, Inc.**  
**(A development stage company)**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**9. Income taxes (Continued)**

would be offset by an adjustment to the valuation allowance. Thus, there would be no impact to the consolidated balance sheet or statement of operations if an adjustment were required. The Company would recognize both accrued interest and penalties related to unrecognized benefits in income tax expense. The Company's uncertain tax positions are related to years that remain subject to examination by relevant tax authorities. Since the Company is in a loss carryforward position, the Company is generally subject to examination by the U.S. federal, state and local income tax authorities for all tax years in which a loss carryforward is available.

**10. Commitments and contingencies**

From November 2010 through May 2011, the Company leased office space from a shareholder. There was no formal lease arrangement with the shareholder. Rent paid to the shareholder was \$12,000, \$34,000, and none for the period from August 4, 2010 (inception) to December 31, 2010, the year ended December 31, 2011 and the year ended December 31, 2012, respectively.

In May 2011, the Company entered into a non-cancelable operating lease for office and laboratory space, which expires October 31, 2014. The lease agreement provides for free rent for the first four months of the lease term and includes escalating rent payments. The rent expense is recorded on a straight-line basis over the lease term. The Company is also obligated to pay for certain operating costs and a proportional share of certain common area costs. The Company has the right to extend the lease for a two-year period. The annual rent for each additional year is determined annually at the then fair market rate. The Company secured a letter of credit for \$86,000 in connection with the lease, which is included in restricted cash on the balance sheet. The minimum aggregate future lease commitments are as follows (in thousands):

2013	360
2014	307
	\$ 667

The Company recorded rent expense of \$12,000, \$251,000, \$323,000 and \$786,000 for the period from August 4, 2010 (inception) to December 31, 2010, the year ended December 31, 2011, the year ended December 31, 2012 and the period from August 4, 2010 (inception) to December 31, 2012, respectively.

Pursuant to the terms of various agreements, the Company may be required to pay various development, regulatory and commercial milestones. In addition, if any products related to these agreements are approved for sale, the Company may be required to pay significant royalties on future sales. The payment of these amounts, however, is contingent upon the occurrence of various future events, which have a high degree of uncertainty of occurring.

**11. License agreements**

In October 2010, the Company entered into an exclusive license agreement, which was amended and restated in January 2012, with the Whitehead Institute for Biomedical Research (the Licensor) for certain intellectual property. The Company paid the Licensor an upfront license fee and reimbursed patent related fees and costs incurred by the Licensor and affiliates of the Licensor totaling \$104,000 in the aggregate and issued 166,664 shares of common stock to the Licensor and entities and individuals

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**Verastem, Inc.**  
**(A development stage company)**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**11. License agreements (Continued)**

affiliated with the Licensor. The fair value of the common stock was determined to be \$0.28 per share, and the fair value was determined to be more readily determinable than the fair value of the license. As a result, the fair value of the shares of approximately \$46,000 was recorded as research and development expense. Under the terms of the agreement, the Company also agreed to pay annual license maintenance fees, milestone payments, royalties as a percentage of net sales and a percentage of sublicense income the Company receives. Annual license maintenance fees are creditable against royalties earned during the same calendar year and are not material to the financial statements. Milestone payments are triggered upon the achievement of specified development, regulatory and commercialization milestones and are not creditable against royalties. Actual amounts due under the agreement will vary depending on the number of products developed, the type and development path of the products, and other related factors. Milestone payments could total up to \$1.6 million. The Company may terminate the agreement at any time with 90 days' prior written notice.

On December 16, 2011, the Company amended and restated an existing non-exclusive license agreement with the Licensor pursuant to which the Company obtained an exclusive license to certain intellectual property. The Company paid the Licensor an upfront license fee and agreed to make milestone payments of up to \$825,000 upon the achievement of specified regulatory and commercialization milestones. In addition, the Company agreed to pay royalties as a percentage of net sales of licensed products.

On November 17, 2011, the Company entered into an exclusive, worldwide license agreement with Poniard Pharmaceuticals, Inc. to develop, make, use and sell compounds and products covered by the licensed patent rights for the diagnosis, treatment, prevention or control of human diseases and conditions. Under the agreement, the Company paid an upfront license fee and agreed to pay \$13.3 million upon the achievement of specified development and regulatory milestones. The Company also agreed to issue to Poniard a warrant to purchase 142,857 shares of common stock upon the first dosing of the first patient in a Phase 1 clinical trial of a licensed product. The exercise price of such warrant would be equal to the average closing price of the Company's common stock during the five trading days preceding such issue date. In addition, the Company agreed to pay royalties as a percentage of net sales of licensed products. The Company may terminate the agreement at any time with 90 days' prior written notice.

On May 11, 2012, the Company acquired from S\*Bio Pte Ltd (S\*Bio), compounds identified as dual inhibitors of PI3K and mTOR, including related patent rights. Under the agreement, the Company paid S\*Bio an upfront fee of \$350,000 and has agreed to pay S\*Bio milestone payments of up to an aggregate of approximately \$21.0 million upon the achievement of specified development and regulatory milestones. In addition, the Company agreed to pay to S\*Bio tiered, low to mid single digit royalties as a percentage of annual net sales of each product containing an acquired compound as an ingredient. The obligation to pay royalties continues on a product by product and country by country basis until the expiration of all acquired patent rights covering the product in such country. If the Company obtains a license from a third party in order to commercialize an acquired compound contained in a product in a particular country, then the Company may deduct up to 50% of the amount paid to such third party from the royalty payments that Company owes to S\*Bio for such product. The deduction is subject to specified limitations, including that in no event will any such deduction reduce a royalty payment owed to S\*Bio by more than 50% as a result of all such deductions in the aggregate. There were no ongoing clinical trials at the time of the acquisition of the compounds, and the compounds acquired do not have alternative future uses, nor have they reached a stage of

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**Verastem, Inc.**  
**(A development stage company)**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**11. License agreements (Continued)**

technological feasibility. As no process or activities were acquired, the Company accounted for the transaction as an asset acquisition by recording the \$350,000 payment made to S\*Bio to research and development expense for the year ended December 31, 2012.

On July 11, 2012, the Company entered into a license agreement with Pfizer Inc. (Pfizer), under which Pfizer granted the Company worldwide, exclusive rights to research, develop, manufacture and commercialize products containing certain of Pfizer's inhibitors of focal adhesion kinase (Products) for all therapeutic, diagnostic and prophylactic uses in humans. The Company is solely responsible, at its expense, for the clinical development of the Products, which is to be conducted in accordance with an agreed-upon development plan. The Company is also responsible for all manufacturing and commercialization activities at its own expense. Pfizer is required to provide the Company with an initial quantity of clinical supply of one of the Products for an agreed upon price. Under the agreement, the Company made a one-time cash payment to Pfizer in the amount of \$1.5 million and issued to Pfizer 192,012 shares of its common stock. Pfizer is also eligible to receive up to \$2 million in developmental milestones and up to an additional \$125 million based on the successful attainment of regulatory and commercial sales milestones. Pfizer is also eligible to receive high single to mid double digit royalties on future net sales of Products. The Company's royalty obligations with respect to each Product in each country begin on the date of first commercial sale of the Product in that country, and end on the later of 10 years after the date of first commercial sale of the Product in that country or the date of expiration or abandonment of the last claim contained in any issued patent or patent application licensed by Pfizer to the Company that covers the Product in that country. The Company accounted for the license agreement as the licensing of in-process research and development with no alternative future use. Accordingly, the Company recorded research and development expense for the year ended December 31, 2012 associated with the cash payment of \$1.5 million and the fair value of shares of common stock issued to Pfizer of \$2.0 million.

**12. Employee benefit plan**

In June 2011, the Company adopted a 401(k) retirement and savings plan (the 401(k) Plan) covering all employees. The 401(k) Plan allows employees to make pre-tax or post-tax contributions up to the maximum allowable amount set by the IRS. Under the 401(k) Plan, the Company may make discretionary contributions as approved by the board of directors. The Company made contributions to the 401(k) Plan of \$0, \$46,000, \$116,000 and \$162,000 for the period from August 4, 2010 (inception) to December 31, 2010, the year ended December 31, 2011, the year ended December 31, 2012 and the period from August 4, 2010 (inception) to December 31, 2012, respectively.

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**Verastem, Inc.**  
(A development stage company)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**13. Quarterly Financial Information (unaudited, in thousands, except per share data)**

	First Quarter Ended March 31, 2012	Second Quarter Ended June 30, 2012	Third Quarter Ended September 30, 2012	Fourth Quarter Ended December 31, 2012
Operating expenses:				
Research and development	\$ 4,803	\$ 4,683	\$ 8,132(b)	\$ 4,094
General and administrative	2,125	2,213	2,298	3,882
Total operating expenses	6,928	6,896	10,430	7,976
Loss from operations	(6,928)	(6,896)	(10,430)	(7,976)
Interest income	57	71	63	55
Net loss	\$ (6,871)	\$ (6,825)	\$ (10,367)	\$ (7,921)
Net loss per share applicable to common stockholders-basic and diluted	\$ (0.47)	\$ (0.34)	\$ (0.51)	\$ (0.39)
Weighted average number of common shares used in net loss per share applicable to common stockholders-basic and diluted	14,693(a)	19,863	20,160	20,309
	First Quarter Ended March 31, 2011	Second Quarter Ended June 30, 2011	Third Quarter Ended September 30, 2011	Fourth Quarter Ended December 31, 2011
Operating expenses:				
Research and development	\$ 675	\$ 1,726	\$ 3,082	\$ 4,400
General and administrative	471	759	965	1,620
Total operating expenses	1,146	2,485	4,047	6,020
Loss from operations	(1,146)	(2,485)	(4,047)	(6,020)
Interest income				15
Net loss	\$ (1,146)	\$ (2,485)	\$ (4,047)	\$ (6,005)
Net loss per share applicable to common stockholders-basic and diluted	\$ (1.06)	\$ (2.03)	\$ (2.98)	\$ (4.01)
Weighted average number of common shares used in net loss per share applicable to common stockholders-basic and diluted	1,089	1,225	1,361	1,500

(a)

In February 2012, the Company completed its initial public offering, which resulted in net proceeds of approximately \$56.8 million from the issuance of 6,325,000 shares of common stock, which includes the sale of 825,000 shares under the underwriters' over-allotment option. In connection with the initial public offering, all of the outstanding shares of the Company's redeemable convertible preferred stock were converted into 11,740,794 of common stock.

(b)

In the quarter ended September 30, 2012, the Company paid a license fee of \$1.5 million in cash and issued 192,012 shares of the Company's common stock, which were valued at \$2.0 million on the date of issuance.



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**Verastem, Inc.**  
**(A development stage company)**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**13. Quarterly Financial Information (unaudited, in thousands, except per share data) (Continued)**

The Company was incorporated on August 4, 2010; however, it did not commence operations until the fourth quarter of 2010. Activity incurred during the period from August 4, 2010 (inception) to September 30, 2010 is limited to organizational costs which were expensed when incurred.

**14. Subsequent events**

The Company reviews all activity subsequent to year end but prior to the issuance of the consolidated financial statements for events that could require disclosure or that could impact the carrying value of assets or liabilities as of the balance sheet date. All significant subsequent events have been properly disclosed in the consolidated financial statements.

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**EXHIBIT INDEX**

<b>Exhibit number</b>	<b>Description of exhibit</b>
3.1	Restated Certificate of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 to Annual Report on Form 10-K (File No. 001-35403) filed by the Registrant on March 30, 2012)
3.2	Amended and Restated Bylaws of the Registrant (incorporated by reference to Exhibit 3.4 to Amendment No. 3 to the Registration Statement on Form S-1 (File No. 333-177677) filed by the Registrant on January 13, 2012)
4.1	Second Amended and Restated Investors' Rights Agreement, dated November 1, 2011, by and among the Registrant and the other parties thereto (incorporated by reference to Exhibit 4.2 to the Registration Statement on Form S-1 (File No. 333-177677) filed by the Registrant on November 3, 2011)
4.2	Registration Rights Agreement, dated July 11, 2012, by and between the Registrant and Pfizer Inc. (incorporated by reference to Exhibit 4.1 to Current Report on Form 8-K (File No. 001-35403) filed by the Registrant on July 11, 2012)
4.3	Specimen certificate evidencing shares of common stock (incorporated by reference to Exhibit 4.1 to Amendment No. 3 to the Registration Statement on Form S-1 (File No. 333-177677) filed by the Registrant on January 13, 2012)
10.1#	2010 Equity Incentive Plan (incorporated by reference to Exhibit 10.1 to the Registration Statement on Form S-1 (File No. 333-177677) filed by the Registrant on November 3, 2011)
10.2#	2012 Incentive Plan (incorporated by reference to Exhibit 10.2 to Amendment No. 3 to the Registration Statement on Form S-1 (File No. 333-177677) filed by the Registrant on January 13, 2012)
10.3#	Form of Incentive Stock Option Agreement under 2012 Incentive Plan (incorporated by reference to Exhibit 10.3 to Amendment No. 3 to the Registration Statement on Form S-1 (File No. 333-177677) filed by the Registrant on January 13, 2012)
10.4#	Form of Nonqualified Stock Option Agreement under 2012 Incentive Plan (incorporated by reference to Exhibit 10.4 to Amendment No. 3 to the Registration Statement on Form S-1 (File No. 333-177677) filed by the Registrant on January 13, 2012)
10.5#	Form of Restricted Stock Unit Agreement under 2012 Incentive Plan (incorporated by reference to Exhibit 10.16 to Amendment No. 3 to the Registration Statement on Form S-1 (File No. 333-177677) filed by the Registrant on January 13, 2012)
10.6#	Amended and Restated Employment Agreement between the Registrant and Robert Forrester (incorporated by reference to Exhibit 10.5 to Amendment No. 3 to the Registration Statement on Form S-1 (File No. 333-177677) filed by the Registrant on January 13, 2012)
10.7#	Amended and Restated Employment Agreement between the Registrant and Jonathan Pachter (incorporated by reference to Exhibit 10.6 to Amendment No. 3 to the Registration Statement on Form S-1 (File No. 333-177677) filed by the Registrant on January 13, 2012)
10.8#	Form of Indemnification Agreement between the Registrant and each director (incorporated by reference to Exhibit 10.7 to Amendment No. 1 to the Registration Statement on Form S-1 (File No. 333-177677) filed by the Registrant on December 7, 2011)
10.9	Lease Agreement, dated May 2, 2011, between the Registrant and ARE-MA Region No. 38, LLC (incorporated by reference to Exhibit 10.8 to the Registration Statement on Form S-1 (File No. 333-177677) filed by the Registrant on November 3, 2011)



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<b>Exhibit number</b>	<b>Description of exhibit</b>
10.10	Amended and Restated Exclusive Patent License Agreement and Tangible Property Agreement, dated January 11, 2012, by and among the Registrant and the Whitehead Institute for Biomedical Research (incorporated by reference to Exhibit 10.9 to Amendment No. 3 to the Registration Statement on Form S-1 (File No. 333-177677) filed by the Registrant on January 13, 2012)
10.11	Exclusive Patent License Agreement, dated December 16, 2011, by and among the Registrant and the Whitehead Institute for Biomedical Research (incorporated by reference to Exhibit 10.10 to Amendment No. 2 to the Registration Statement on Form S-1 (File No. 333-177677) filed by the Registrant on December 22, 2011)
10.12	License Agreement, dated November 17, 2011, between the Registrant and Poniard Pharmaceuticals, Inc. (incorporated by reference to Exhibit 10.15 to Amendment No. 2 to the Registration Statement on Form S-1 (File No. 333-177677) filed by the Registrant on December 22, 2011)
10.13	Letter Agreement, dated October 1, 2010, between the Registrant and the Broad Institute (incorporated by reference to Exhibit 10.11 to the Registration Statement on Form S-1 (File No. 333-177677) filed by the Registrant on November 3, 2011)
10.14#	Letter Agreement, dated August 20, 2010, between the Registrant and Eric Lander, Ph.D. (incorporated by reference to Exhibit 10.13 to the Registration Statement on Form S-1 (File No. 333-177677) filed by the Registrant on November 3, 2011)
10.15#	Letter Agreement, dated July 30, 2010, as amended October 18, 2010, between the Registrant and Robert Weinberg, Ph.D. (incorporated by reference to Exhibit 10.14 to the Registration Statement on Form S-1 (File No. 333-177677) filed by the Registrant on November 3, 2011)
10.16#	Restricted Stock Purchase Agreement, dated August 11, 2010, between the Registrant and Christoph Westphal (incorporated by reference to Exhibit 10.17 to Annual Report on Form 10-K (File No. 001-35403) filed by the Registrant on March 30, 2012)
10.17#	Restricted Stock Purchase Agreement, dated August 11, 2010, between the Registrant and Richard Aldrich (incorporated by reference to Exhibit 10.18 to Annual Report on Form 10-K (File No. 001-35403) filed by the Registrant on March 30, 2012)
10.18*#	Employment Agreement, dated March 1, 2012, between the Registrant and Daniel Paterson
10.19	Asset Purchase Agreement, dated May 10, 2012, by and between the Registrant and S*Rio Pte Ltd. (incorporated by reference to Exhibit 10.1 to Quarterly Report on Form 10-Q (File No. 001-35403) filed by the Registrant on August 13, 2012)
10.20	License Agreement, dated July 11, 2012, by and between the Registrant and Pfizer Inc. (incorporated by reference to Exhibit 10.2 to Quarterly Report on Form 10-Q (File No. 001-35403) filed by the Registrant on August 13, 2012)
10.21#	Offer Letter, dated as of September 18, 2012, by and between the Registrant and Christoph Westphal, M.D., Ph.D. (incorporated by reference to Exhibit 10.1 to Quarterly Report on Form 10-Q (File No. 001-35403) filed by the Registrant on November 11, 2013)
10.22#	Restricted Stock Unit Agreement, dated as of September 18, 2012, by and between the Registrant and Christoph Westphal, M.D., Ph.D. (incorporated by reference to Exhibit 10.2 to Quarterly Report on Form 10-Q (File No. 001-35403) filed by the Registrant on November 11, 2013)
10.23#	Restricted Stock Unit Agreement, dated as of September 18, 2012, by and between the Registrant and Christoph Westphal, M.D., Ph.D. (incorporated by reference to Exhibit 10.3 to Quarterly Report on Form 10-Q (File No. 001-35403) filed by the Registrant on November 11, 2013)

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<b>Exhibit number</b>	<b>Description of exhibit</b>
10.24#	Employment Agreement, dated as of October 23, 2012, by and between the Registrant and Joanna Horobin (incorporated by reference to Exhibit 10.4 to Quarterly Report on Form 10-Q (File No. 001-35403) filed by the Registrant on November 11, 2013)
10.25*#	Amendment to Form of Restricted Stock Unit Agreement under 2012 Incentive Plan
21.1*	Subsidiaries of the Registrant
23.1*	Consent of Ernst & Young LLP
31.1*	Certification of the Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a)
31.2*	Certification of the Chief Operating Officer pursuant to Exchange Act Rule 13a-14(a)
32.1*	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Certification of the Chief Operating Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document

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Submitted electronically herewith.

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Filed herewith.

Confidential treatment granted as to portions of the exhibit. Confidential materials omitted and filed separately with the Securities and Exchange Commission.

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Management contract or compensatory plan, contract or agreement.

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