

Verastem, Inc.
Form 10-Q
October 30, 2014

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014

OR

**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)

117 Kendrick, Suite 500

Needham, MA

(Address of principal executive offices)

27-3269467

(I.R.S. Employer
Identification Number)

02494

(Zip Code)

(781) 292-4200

(Registrant's telephone number, including area code)

215 First Street, Suite 440

Cambridge, MA 02142

(617) 252-9300

(Former Address, if Changed Since Last Report)

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 Web site, 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

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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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated
filer

Accelerated
filer

Non-accelerated filer
(Do not check if a
smaller reporting
company)

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

As of October 23, 2014 there were 25,894,413 shares of Common Stock, \$0.0001 par value per share, outstanding.

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FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements that involve substantial risks and uncertainties. All statements, other than statements related to present facts or current conditions or historical facts, contained in this Quarterly Report on Form 10-Q, including statements regarding our strategy, future operations, future financial position, future revenues, projected costs, timeline for clinical development and regulatory approval of our product candidates, the expected timing for the reporting of data from ongoing trials, 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 programs and other operations, our ability to develop products of commercial value and to identify, discover and obtain rights to additional 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, the fact that the preclinical and clinical testing of our product candidates may not be predictive of the success of ongoing or later clinical trials, that data may not be available when we expect it to be, that enrollment of clinical trials may take longer than expected, 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 our 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.

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements (Unaudited).****Verastem, Inc.****CONDENSED CONSOLIDATED BALANCE SHEETS****(unaudited)****(in thousands, except per share amounts)**

	September 30, 2014	December 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	\$ 20,557	\$ 18,889
Short-term investments	72,809	82,423
Restricted cash	86	86
Prepaid expenses and other current assets	1,024	557
Total current assets	94,476	101,955
Property and equipment, net	2,885	631
Long-term investments		22,344
Restricted cash	203	
Other assets	319	331
Total assets	\$ 97,883	\$ 125,261
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 3,299	\$ 2,760
Accrued expenses	4,861	4,327
Liability classified stock-based compensation awards	225	717
Total current liabilities	8,385	7,804
Other liabilities	687	11
Stockholders' equity:		
Preferred stock, \$0.0001 par value; 5,000 shares authorized; none issued and outstanding		
Common stock, \$0.0001 par value; 100,000 shares authorized; 25,878 and 25,328 shares issued and outstanding at September 30, 2014 and December 31, 2013, respectively	3	3
Additional paid-in capital	215,851	205,068
Accumulated other comprehensive income	26	28
Accumulated deficit	(127,069)	(87,653)
Total stockholders' equity	88,811	117,446

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Total liabilities and stockholders' equity	\$	97,883	\$	125,261
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See accompanying notes.

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Verastem, Inc.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(unaudited)

(in thousands, except per share amounts)

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Operating expenses:				
Research and development	\$ 9,047	\$ 6,789	\$ 25,763	\$ 18,130
General and administrative	4,341	3,855	13,846	11,879
Total operating expenses	13,388	10,644	39,609	30,009
Loss from operations	(13,388)	(10,644)	(39,609)	(30,009)
Interest income	56	53	193	131
Net loss	\$ (13,332)	\$ (10,591)	\$ (39,416)	\$ (29,878)
Net loss per share basic and diluted	\$ (0.52)	\$ (0.44)	\$ (1.54)	\$ (1.37)
Weighted-average number of common shares used in net loss per share basic and diluted	25,811	24,127	25,654	21,797
Comprehensive loss	\$ (13,335)	\$ (10,508)	\$ (39,418)	\$ (29,820)

See accompanying notes.

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Verastem, Inc.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

(in thousands)

	Nine months ended September 30,	
	2014	2013
Operating activities		
Net loss	\$ (39,416)	\$ (29,878)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	242	174
Amortization of premiums and discounts on available for sale marketable securities	230	
Stock-based compensation expense	10,074	7,976
Common stock issued to purchase technology rights	1,197	
Loss on disposal of fixed assets	4	
Changes in operating assets and liabilities:		
Prepaid expenses, other current assets and other assets	(454)	(893)
Accounts payable	47	(12)
Accrued expenses and other liabilities	1,321	2,873
Liability classified stock-based compensation awards	(492)	
Net cash used in operating activities	(27,247)	(19,760)
Investing activities		
Purchases of property and equipment	(1,862)	(36)
Purchases of investments	(32,570)	(103,363)
Maturities of investments	64,295	77,214
Increase in restricted cash	(203)	
Net cash provided by (used in) investing activities	29,660	(26,185)
Financing activities		
Proceeds from the exercise of stock options	12	30
Net proceeds from the issuance of common stock		59,761
Cash used to settle restricted stock liability awards	(757)	(1,302)
Net cash provided by (used in) financing activities	(745)	58,489
Increase in cash and cash equivalents	1,668	12,544
Cash and cash equivalents at beginning of period	18,889	10,096
Cash and cash equivalents at end of period	\$ 20,557	\$ 22,640

See accompanying notes.

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Verastem, Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of significant accounting policies

Basis of presentation

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial reporting and as required by Regulation S-X, Rule 10-01. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (including those which are normal and recurring) considered necessary for a fair presentation of the interim financial information have been included. When preparing financial statements in conformity with GAAP, the Company must make estimates and assumptions that affect the reported amounts and related disclosures at the date of the financial statements. Actual results could differ from those estimates. Additionally, operating results for the three and nine months ended September 30, 2014 are not necessarily indicative of the results that may be expected for any other interim period or for the fiscal year ending December 31, 2014. For further information, refer to the financial statements and footnotes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013 as filed with the Securities and Exchange Commission ("SEC") on March 6, 2014.

Recent Accounting Pronouncements

On June 10, 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-10, which simplifies financial reporting for development stage entities by eliminating requirements specific to development stage entities. As a result, entities in a development stage will no longer need to present inception-to-date information about statement of operations line items, cash flows, and equity transactions. Instead, the new guidance clarifies how these entities should tailor existing disclosures to explain the risks and uncertainties related to their activities. This update is effective for annual periods beginning after December 15, 2014, and early application is permitted for any annual or interim period for which the entity's financial statements have not yet been issued. The Company adopted this guidance prior to issuing the interim financial statements in the Q2 2014 Form 10-Q. The adoption of ASU 2014-10 impacted disclosure only and did not have any impact on financial position or results of operations.

There have been no changes to the Company's significant accounting policies included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013 as filed with the Securities and Exchange Commission on March 6, 2014.

2. 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

Table of Contents**Verastem, Inc.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****2. Fair value of financial instruments (Continued)**

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 and liabilities that have been measured at fair value at September 30, 2014 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)
Financial assets				
Cash equivalents	\$ 18,686	\$ 18,686	\$	\$
Short-term investments	72,809		72,809	
Total financial assets	\$ 91,495	\$ 18,686	\$ 72,809	\$
Financial liabilities				
Liability classified stock-based compensation awards	\$ 225	\$ 225	\$	\$
Total financial liabilities	\$ 225	\$ 225	\$	\$

The following table presents information about the Company's financial assets and liabilities that have been measured at fair value at December 31, 2013 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)
Financial assets				
Cash equivalents	\$ 17,000	\$ 17,000	\$	\$
Short-term investments	82,423		82,423	
Long-term investments	22,344		22,344	

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Total financial assets	\$ 121,767	\$ 17,000	\$ 104,767	\$
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Financial liabilities

Liability classified stock-based compensation awards	\$ 717	\$ 717	\$	\$
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Total financial liabilities	\$ 717	\$ 717	\$	\$
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Verastem, Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. Fair value of financial instruments (Continued)

The Company's cash equivalents and investments are comprised of money market accounts, government-sponsored enterprise securities, corporate bonds and commercial paper of publicly traded companies. These investments have been initially valued at the transaction price and subsequently valued, at the end of each reporting period, utilizing third party pricing services or other market observable data. The pricing services utilize industry standard valuation models, including both income and market based approaches and observable market inputs to determine value. These observable market inputs include reportable trades, benchmark yields, credit spreads, broker/dealer quotes, bids, offers, current spot rates and other industry and economic events. The Company validates the prices provided by third party pricing services by reviewing their pricing methods and matrices, obtaining market values from other pricing sources, analyzing pricing data in certain instances and confirming that the relevant markets are active. After completing its validation procedures, the Company did not adjust or override any fair value measurements provided by the pricing services as of September 30, 2014.

The Company's liability classified stock-based compensation awards are comprised of restricted stock units (RSUs) that allow for greater than minimum statutory tax withholdings. These awards are valued based on the fair value of the Company's common stock underlying the awards, which is traded on an active market. During the first quarter of 2013, the Company amended the terms of certain RSUs to allow for cash tax withholdings greater than the minimum required statutory withholding amount. As a result of this change in the terms of the awards, the outstanding RSUs are considered to be liability instruments. As a result of this modification, the Company records a liability for the fair value of the awards as of each reporting date with the change in fair value recorded through the statement of operations. The Company will record stock-based compensation expense equal to the greater of the original grant date fair value of the awards or the settlement date fair value.

3. Investments

The Company's investments 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 income, until such gains and losses are realized. If a decline in the fair value is considered other-than-temporary, based on available evidence, the unrealized loss is transferred from other comprehensive income to the statement of operations. There were no charges taken for other-than-temporary declines in fair value of short-term or long-term investments during the three and nine months ended September 30, 2014 and 2013. The Company recorded approximate unrealized gains and (losses) of \$(3,000), \$(2,000), \$83,000 and \$58,000 during the three and nine months ended September 30, 2014 and 2013, respectively. Realized gains and losses are included in interest income in the statement of operations. There were no realized gains or losses recognized during the three and nine months ended September 30, 2014 or 2013. The Company utilizes the specific identification method as a basis to determine the cost of securities sold.

Table of Contents**Verastem, Inc.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****3. Investments (Continued)**

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 September 30, 2014, 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.

Cash, cash equivalents and investments at September 30, 2014 and December 31, 2013 consist of the following (in thousands):

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
September 30, 2014				
Cash and cash equivalents:				
Cash and money market accounts	20,557			20,557
Total cash and cash equivalents	\$ 20,557	\$	\$	\$ 20,557
Investments:				
Government-sponsored enterprise securities (due within 1 year)	\$ 12,707	\$ 4	\$	\$ 12,711
Corporate bonds and commercial paper (due within 1 year)	60,076	26	(4)	60,098
Total investments	\$ 72,783	\$ 30	\$ (4)	\$ 72,809
Total cash, cash equivalents, and investments	\$ 93,340	\$ 30	\$ (4)	\$ 93,366

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
December 31, 2013				
Cash and cash equivalents:				
Cash and money market accounts	\$ 18,889	\$	\$	\$ 18,889
Total cash and cash equivalents	\$ 18,889	\$	\$	\$ 18,889

Investments:

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Government-sponsored enterprise securities (due within 1 year)	\$	30,652	\$	12	\$	30,664
Government-sponsored enterprise securities (due within 1 - 2 years)		4,001		2		4,003
Corporate bonds and commercial paper (due within 1 year)		51,735		30	(6)	51,759
Corporate bonds and commercial paper (due within 1 - 2 years)		18,351		2	(12)	18,341
Total investments	\$	104,739	\$	46	(18)	\$ 104,767
Total cash, cash equivalents, and investments	\$	123,628	\$	46	(18)	\$ 123,656

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Verastem, Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Accrued expenses

Accrued expenses consist of the following (in thousands):

	September 30, 2014	December 31, 2013
Contract research organization costs	\$ 2,480	\$ 1,918
Compensation and related benefits	1,621	1,687
Professional fees	313	237
Deferred rent	137	38
License milestones	110	360
Other	200	87
	\$ 4,861	\$ 4,327

5. Net loss per share

Basic and diluted net loss per common share is calculated by dividing net loss 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 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. All potentially dilutive securities were excluded from the calculation of diluted net loss per share as the securities were anti-dilutive for all periods presented. The following potentially dilutive securities were excluded from the calculation of diluted net loss per share due to their anti-dilutive effect (shares in thousands):

	Three months ended		Nine months ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Outstanding stock options	4,225	2,313	4,225	2,313
Unvested restricted stock	16	434	16	434
Unvested restricted stock units	315	543	315	543

6. Stock-based compensation

In December 2011, the Company adopted the 2012 Incentive Plan (the 2012 Plan). The 2012 Plan became effective upon the closing of the Company's IPO in February 2012. The 2012 Plan provides for the grant of incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock awards, restricted stock units and other stock-based and cash awards. Upon effectiveness, the number of shares of common stock that are reserved under the 2012 Plan is the sum of 3,428,571 shares plus the number of shares available under the Company's prior 2010 Plan. The number of shares reserved under the 2012 Plan is increased by the number of shares of common stock (up to a maximum of 571,242 shares) subject to outstanding awards under the 2010 Plan that expire, terminate or are otherwise surrendered, cancelled, forfeited or repurchased. 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

Table of Contents**Verastem, Inc.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****6. Stock-based compensation (Continued)**

outstanding and an amount determined by the board of directors. On January 1, 2013 and 2014, the shares available under the 2012 Plan increased by 844,448 and 1,026,309 shares of common stock, respectively.

Restricted common stock

A summary of the Company's restricted common stock activity for the nine months ended September 30, 2014 and related information is as follows:

	Shares	Weighted- average purchase price per share
Unvested at December 31, 2013	329,282	\$ 0.034
Vested	(313,287)	0.022
Unvested at September 30, 2014	15,995	\$ 0.28

No restricted common stock was granted during the three and nine months ended September 30, 2014 and 2013. The total fair value of shares vested during the three and nine months ended September 30, 2014 and 2013 was an approximate \$605,000, \$2.2 million, \$1.0 million and \$2.5 million, respectively.

A summary of the Company's restricted stock units (RSUs) activity for the nine months ended September 30, 2014 and related information is as follows:

	Shares	Weighted- average grant date fair value
Outstanding at December 31, 2013	529,850	\$ 10.78
Settled	(204,416)	10.54
Forfeited	(10,740)	10.21
Outstanding at September 30, 2014	314,694	\$ 10.95

No RSUs were granted during the three and nine months ended September 30, 2014 and 2013. The total grant date fair value of RSUs vested during the three and nine months ended September 30, 2014 and 2013 was an approximate \$790,000, \$2.2 million, an approximate \$990,000 and \$3.5 million, respectively. As of September 30, 2014, there was \$2.3 million of total unrecognized stock-based compensation expense related to unvested RSUs granted under the 2012 Plan. The Company expects to recognize this expense over a weighted average period of 1.3 years.

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During the first quarter of 2013, the Company amended the terms of certain RSUs related to a total of 657,058 shares of common stock to allow for tax withholdings greater than the minimum required statutory withholding amount, of which 250,684 remain outstanding as of September 30, 2014. As a result of this change in the terms of the awards, the outstanding RSUs are considered to be liability instruments. As a result of this modification, the Company records a liability for the fair value of the awards as of each reporting date with the change in fair value recorded through the statement of operations. The Company will record stock-based compensation expense equal to the greater of the

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Verastem, Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. Stock-based compensation (Continued)

original grant date fair value of the awards or the settlement date fair value. During the three and nine months ended September 30, 2014, the Company deposited with taxing authorities approximately \$200,000 and approximately \$757,000, respectively, in respect of the tax liability for awards that settled during the periods.

Stock options

A summary of the Company's stock option activity and related information follows:

	Shares	Weighted- average price per share	Weighted- average remaining contractual term (years)	Aggregate intrinsic value
Outstanding at December 31, 2013	2,388,062	\$ 8.66		
Granted	1,917,602	12.45		
Exercised	(7,860)	1.48		
Forfeited	(72,946)	10.34		
Outstanding at September 30, 2014	4,224,858	\$ 10.36	8.6	\$ 2,367,483
Exercisable at September 30, 2014	1,533,342	\$ 8.64	8.0	\$ 1,844,658
Vested and expected to vest at September 30, 2014	3,940,943	\$ 10.32	8.6	\$ 2,351,739

The fair value of each stock option is estimated on the grant date using the Black-Scholes option-pricing model using the following weighted average assumptions:

	Nine months ended September 30,	
	2014	2013
Risk-free interest rate	2.0%	1.1%
Dividend yield		
Volatility	81%	75%
Expected term (years)	6.2	6.0

7. License agreements

Under the license agreement with Poniard Pharmaceuticals, Inc. ("Poniard") that the Company entered into in November 2011 relating to VS-4718 and certain other compounds, the Company paid an upfront license fee and agreed to pay Poniard milestone payments upon the

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achievement of specified development and regulatory milestones. In February 2014, the Company purchased the assets which were the subject of the license agreement with Poniard from Encarta, Inc. ("Encarta"), who had previously purchased these assets in 2013. In consideration for these assets, the Company issued to Encarta 97,500 shares of common stock, a warrant to purchase 142,857 shares of common stock with an exercise price equal to \$17.16 per share and paid \$25,000. All existing obligations under the license agreement, including an achieved development milestone and an obligation to issue a warrant, were settled as part of this transaction. The Company incurred \$1.2 million of research and development expense in the first quarter of 2014 as a result of this transaction. As the warrant that was issued was

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Verastem, Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

7. License agreements (Continued)

consistent with the existing obligation to issue a warrant, there were no charges recorded as a result of issuing the warrant. In connection with the asset purchase agreement, the Company also assumed the rights and obligations under the license agreement by and between the Scripps Research Institute ("Scripps") and Poniard, or the Scripps License Agreement. Pursuant to the Scripps License Agreement, the Company is obligated to pay Scripps potential product development milestone payments of up to an aggregate of \$3.0 million upon the achievement of specified development and regulatory milestones. In addition, the Company is obligated to pay Scripps low single-digit royalties as a percentage of net sales of licensed products, subject to adjustments in certain circumstances. The Company's obligation to pay royalties on net sales is on a country by country basis. The milestones and royalties payable to Scripps will be recorded as expense when the obligations are incurred.

8. Commitments and Contingencies

On April 15, 2014, the Company entered into a lease agreement for approximately 15,197 square feet of office and laboratory space in Needham, Massachusetts. The lease term commenced on April 15, 2014 and expires on September 30, 2019. The Company began using the leased premises as its corporate headquarters and commenced rent payments effective September 22, 2014. The Company has agreed to pay an initial annual base rent of approximately \$493,000, which base rent increases after every twelve-month period during the lease term to approximately \$554,000 for the last twelve-month period. The Company is recording rent expense on a straight-line basis, beginning in April 2014. The Company also received a tenant improvement allowance of approximately \$684,000 in connection with the lease. The Company has accounted for the allowance as a lease incentive, which is being recorded as a reduction to rent expense over the lease term. Deferred rent and lease incentive obligation are included in accrued expenses (current portion) and other liabilities (noncurrent portion) in the consolidated balance sheet. The Company has also agreed to pay its proportionate share of increases in operating expenses and property taxes for the building in which the leased space is located. The Company has provided a security deposit in the form of a letter of credit in the amount of approximately \$203,000, which may be reduced to approximately \$162,000 on April 15, 2016. The amount is included in long term restricted cash on the consolidated balance sheet.

9. Subsequent Events

The company reviews all activity subsequent to quarter end but prior to issuance of the condensed 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. During the period the Company did not have any material subsequent events.

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Item 2. 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 quarterly report. The following discussion contains forward-looking statements that involve risks and uncertainties. Our actual results and the timing of certain events could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those discussed below and elsewhere in this quarterly report or in our annual report on Form 10-K. Please also refer to the section under the heading "Forward-Looking Statements."

OVERVIEW

We are a biopharmaceutical company focused on discovering and developing drugs to treat cancer by the targeted killing of cancer stem cells. 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, has been assigned defactinib as the United States Adopted Name. We have received orphan drug designation for use of VS-6063 in mesothelioma in the European Union and in the United States. VS-6063 is currently in a registration-directed trial (COMMAND) in patients with mesothelioma, a Phase 1/1b trial in combination with weekly paclitaxel for patients with ovarian cancer, a Phase 2 study in patients with non-small cell lung cancer and a "Window of Opportunity" trial preceding surgery in mesothelioma. In addition to VS-6063, both our FAK inhibitor VS-4718 and our dual mTORC1/2 and PI3K inhibitor VS-5584 are in Phase 1 clinical trials in patients with advanced cancers.

We recently reported data from the Window of Opportunity study at the 12th Annual iMig Conference. An analysis of the preliminary data (n=10) showed that VS-6063 reduced FAK activity (pFAK-Y397) by an average of 70% in the patients evaluated to date and reduced the presence of cancer stem cell markers in the post-treatment biopsies in 5 out of the 7 patients with evaluable paired biopsies. Measurement of tumor size by CT/PET using RECIST modified for mesothelioma confirmed that there was no progression of disease while on the 12 day treatment with single agent VS-6063 in any of the 10 patients. Moreover, in 2 patients, tumor shrinkage consistent with a partial response (-30%, -49%) was noted. VS-6063 was well tolerated with no apparent negative impact on surgical outcome.

Our operations to date have been organizing and staffing our company, business planning, raising capital, acquiring and developing our technology, identifying potential product candidates and undertaking preclinical studies and clinical trials for our product candidates. To date, we have not generated any revenues and have financed our operations with net proceeds from the private placement of our preferred stock, our initial public offering in February 2012 and our follow-on offering in July 2013.

As of September 30, 2014, we had an accumulated deficit of \$127.1 million. We had net losses of \$39.4 million and \$29.9 million for the nine months ended September 30, 2014 and 2013, respectively. We expect our expenses to increase in connection with our ongoing activities, particularly as we continue the research and development and clinical trials of, and potentially 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

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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.

CRITICAL ACCOUNTING POLICIES AND SIGNIFICANT JUDGMENTS AND ESTIMATES

We believe that several accounting policies are important to understanding our historical and future performance. We refer to these policies as "critical" because these specific areas generally require us to make judgments and estimates about matters that are uncertain at the time we make the estimate, and different estimates which also would have been reasonable could have been used, which would have resulted in different financial results.

The critical accounting policies we identified in our most recent Annual Report on Form 10-K for the fiscal year ended December 31, 2013 related to accrued research and development expenses and stock-based compensation. There were no changes to these critical accounting policies in the three and nine months ended September 30, 2014. It is important that the discussion of our operating results that follows be read in conjunction with the critical accounting policies disclosed in our Annual Report on Form 10-K, as filed with the SEC on March 6, 2014.

The Company has elected to follow the extended transition period guidance provided for in Section 7(a)(2)(B) of the Securities Act of 1933, as amended, for complying with new or revised accounting standards. The Company will disclose the date on which adoption of such standards is required for non-emerging growth companies and the date on which the Company will adopt the recently issued accounting standards.

RESULTS OF OPERATIONS

Comparison of the Three Months ended September 30, 2014 and September 30, 2013

Research and development expense. Research and development expense for the three months ended September 30, 2014 (2014 Quarter) was \$9.0 million compared to \$6.8 million for the three months ended September 30, 2013 (2013 Quarter). The \$2.2 million increase from the 2013 Quarter to the 2014 Quarter was primarily related to an increase of \$2.4 million in contract research organization expense for outsourced biology, chemistry, development and clinical services, which includes our clinical trial costs, an approximate \$517,000 increase in personnel costs primarily due to increased headcount, an approximate increase of \$237,000 in occupancy expense partially due to the relocation to our new facility and an approximate \$181,000 increase in consulting fees. These increases were partially offset by an approximate \$765,000 decrease in license fees related primarily to the Poniard and S*Bio milestones incurred in the 2013 Quarter and an approximate decrease of \$280,000 in lab supplies partially due to lower activity as the Company transitioned to the new facility.

The table below summarizes our allocation of research and development expenses to our clinical programs for VS-6063, VS-4718 and VS-5584, for the three months ended September 30, 2014. Prior to 2014, we did not track research and development expenses for specific clinical programs. Our project costing methodology does not allocate personnel and other indirect costs to specific clinical programs.

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These unallocated research and development expenses are summarized in the table below and include \$1.6 million of personnel costs.

	Three months ended September 30, 2014	
	(in thousands)	
VS-6063	\$	4,266
VS-4718		501
VS-5584		748
Unallocated research and development expense		2,669
Unallocated stock-based compensation expense		863
Total research and development expense	\$	9,047

Due to the uncertainty in drug development and the stage of development of our product candidates, we are unable to predict the requirements, specific timing and estimated costs to complete the development of our product candidates or the timing of when material cash inflows may commence, if ever.

General and administrative expense. General and administrative expense for the 2014 Quarter was \$4.3 million compared to \$3.9 million for the 2013 Quarter. The approximately \$400,000 increase from the 2013 Quarter to the 2014 Quarter primarily resulted from an increase of approximately \$241,000 in personnel costs primarily related to increases in salaries and headcount, an increase in consulting fees of approximately \$90,000 primarily related to preparation for commercialization, an approximate increase of \$79,000 in occupancy expense partially related to the relocation to our new facility and an increase in stock-based compensation expense of approximately \$71,000 partially due to an increase in stock option grants. These increases were partially offset by a decrease in travel related costs of approximately \$79,000.

Interest income. Interest income increased to approximately \$56,000 for the 2014 Quarter from approximately \$53,000 for the 2013 Quarter.

Comparison of the Nine Months ended September 30, 2014 and September 30, 2013

Research and development expense. Research and development expense for the nine months ended September 30, 2014 (2014 Period) was \$25.8 million compared to \$18.1 million for the nine months ended September 30, 2013 (2013 Period). The \$7.7 million increase from the 2013 Period to the 2014 Period was primarily related to an increase of \$5.7 million in contract research organization expense for outsourced biology, chemistry, development and clinical services, which includes our clinical trial costs, \$1.0 million increase in personnel costs primarily due to increased headcount, an approximate \$411,000 increase in license fees related to the Encarta asset purchase partially offset by the Poniard and S*Bio milestones incurred in the 2013 Period, an approximate \$358,000 increase in stock-based compensation expense, an increase of approximately \$349,000 in occupancy and maintenance expenses partially due to the relocation to our new facility and an increase of approximately \$304,000 in consulting expense. These increases were partially offset by a decrease in lab supplies of approximately \$469,000 partially due to lower activity as the Company transitioned to the new facility.

The table below summarizes our allocation of research and development expenses to our clinical programs for VS-6063, VS-4718 and VS-5584, for the nine months ended September 30, 2014. Prior to 2014, we did not track research and development expenses for specific clinical programs. Our project costing methodology does not allocate personnel and other indirect costs to specific clinical programs.

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These unallocated research and development expenses are summarized in the table below and include \$4.2 million of personnel costs.

	Nine months ended September 30, 2014	
	(in thousands)	
VS-6063	\$	11,305
VS-4718		2,280
VS-5584		1,937
Unallocated research and development expense		7,198
Unallocated stock-based compensation expense		3,043
Total research and development expense	\$	25,763

Due to the uncertainty in drug development and the stage of development of our product candidates, we are unable to predict the requirements, specific timing and estimated costs to complete the development of our product candidates or the timing of when material cash inflows may commence, if ever.

General and administrative expense. General and administrative expense for the 2014 Period was \$13.8 million compared to \$11.9 million for the 2013 Period. The \$1.9 million increase from the 2013 Period to the 2014 Period primarily resulted from an increase of \$1.2 million in stock-based compensation expense partially due to an increase in stock option grants, an increase of approximately \$774,000 in personnel costs primarily due to an increase in salaries and headcount, an increase in consulting fees of approximately \$678,000 primarily related to preparation for commercialization and an increase of approximately \$133,000 in occupancy expense partially due to the relocation to our new facility. These increases were partially offset by a net decrease in professional fees and other costs of approximately \$885,000.

Interest income. Interest income increased to approximately \$193,000 for the 2014 Period from approximately \$131,000 for the 2013 Period. This increase was primarily due to a higher average investment balance for the 2014 Period compared to the 2013 Period.

LIQUIDITY AND CAPITAL RESOURCES**Sources of liquidity**

To date, we have not generated any revenues. Since our inception in August 2010, we have financed our operations principally through private placements, our initial public offering in February 2012 and our follow-on offering in July 2013. As of September 30, 2014, we had received \$68.1 million in net proceeds from the issuance of preferred stock and \$116.6 million in net proceeds from our public offerings. As of September 30, 2014, we had \$93.4 million in cash, cash equivalents and investments. We primarily invest our cash, cash equivalents and investments in a U.S. Treasury money market fund, government-sponsored enterprise securities, corporate bonds and commercial paper.

Cash flows

Operating activities. The use of cash in all periods resulted primarily from our net losses adjusted for non-cash charges and changes in the components of working capital. The \$6.8 million increase in cash used in operating activities for the 2014 Period compared to the 2013 Period is primarily due to a \$5.7 million increase in research and development expenses related to our ongoing clinical trials and development of product candidates and other changes in working capital.

Investing activities. The cash provided by investing activities for the 2014 Period primarily reflects the net maturities of investments of \$31.7 million partially offset by \$1.9 million of property and

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equipment purchases primarily associated with the buildout of our newly leased facility. The cash used by investing activities for the 2013 Period reflects net purchases of investments of \$26.1 million.

Financing activities. The cash used in financing activities for the 2014 Period reflects approximately \$757,000 used to satisfy the tax withholding obligations on certain restricted stock units that were net settled by employees. The cash provided by financing activities in the 2013 Period reflects the net proceeds of the July 2013 follow-on offering of approximately \$59.8 million, which was offset by approximately \$1.3 million used to satisfy the tax withholding obligations on certain restricted stock units that were net settled by employees.

Funding requirements

We have three product candidates currently in clinical trials. 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, preclinical and clinical development of our product candidates, including the registration-directed trial of VS-6063 in mesothelioma;

initiate additional clinical trials for our product candidates;

seek marketing approvals for any of 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;

acquire or in-license other products and technologies;

hire additional clinical, development 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 our existing cash, cash equivalents and investments will enable us to fund our current operating plan and capital expenditure requirements into the first half of 2016. 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 rate of progress, results and costs of completing of the registration-directed trial of VS-6063 in mesothelioma;

assuming favorable clinical results, the cost, timing and outcome of our efforts to seek approval of VS-6063 in mesothelioma in the United States and elsewhere in the world, including to fund the preparation and filing of regulatory submissions with the FDA and other regulatory agencies worldwide;

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the scope, progress and, results of our other ongoing and potential future clinical trials;

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;

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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 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

There have been no material changes to the contractual obligations set forth in our Annual Report on Form 10-K for the year ended December 31, 2013, except that on April 15, 2014, we entered into a lease agreement for approximately 15,197 square feet of office and laboratory space in Needham, Massachusetts. The lease term commenced on April 15, 2014 and expires on September 30, 2019. We began using the leased premises as our corporate headquarters and commenced rent payments effective September 22, 2014. We have agreed to pay an initial annual base rent of approximately \$493,000, which base rent increases after every twelve-month period during the lease term to approximately \$554,000 for the last twelve-month period. We have also agreed to pay our proportionate share of increases in operating expenses and property taxes for the building in which the leased space is located. We have provided a security deposit in the form of a letter of credit in the amount of approximately \$203,000, which may be reduced to approximately \$162,000 on April 15, 2016. The letter of credit is cash collateralized.

Under the terms of the lease, the landlord will provide a tenant improvement allowance in the amount of approximately \$684,000 toward the cost of initial improvements. As of September 30, 2014, the Company has recorded approximately \$2.0 million of leasehold improvements, \$566,000 of which is reimbursable by the landlord.

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.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk.

We had cash, cash equivalents and investments of \$93.4 million as of September 30, 2014, consisting of cash, U.S. Treasury money market funds, government-sponsored enterprise securities, corporate bonds and commercial paper. 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 interest-bearing. 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 of 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 our functional currency are recorded based on exchange rates at the time such transactions arise. We do not currently hedge our foreign currency exchange rate risk. As of September 30, 2014, \$1.5 million of our total liabilities were denominated in currencies other than our functional currency. At this time, an immediate 10% change in currency exchange rates would not have a material effect on our financial position, results of operations or cash flows.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2014. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act of 1934 (the "Exchange Act"), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of September 30, 2014, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control Over Financial Reporting

No change in our internal control over financial reporting occurred during the fiscal quarter ended September 30, 2014 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings.

None.

Item 1A. Risk Factors.

You should carefully review and consider the information regarding certain factors that could materially affect our business, financial condition or future results set forth under Item 1A. (Risk Factors) in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013. There have been no material changes from the factors disclosed in our 2013 Annual Report on Form 10-K, although we may disclose changes to such factors or disclose additional factors from time to time in our future filings with the Securities and Exchange Commission.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

RECENT SALES OF UNREGISTERED SECURITIES

None.

PURCHASE OF EQUITY SECURITIES

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

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

None.

Item 5. Other Information.

The following disclosure is provided in accordance with and in satisfaction of the requirements of Item 2.02 "*Results of Operations and Financial Condition*" of Form 8-K:

On October 30, 2014, Verastem, Inc. announced its financial results for the quarter ended September 30, 2014 and commented on certain corporate accomplishments and plans. The full text of the press release issued in connection with the announcement is furnished as Exhibit 99.1 hereto.

The information furnished in Item 5 (including Exhibit 99.1) shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), or otherwise subject to the liabilities of that section, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933, as amended, or the Exchange Act, except as expressly set forth by specific reference in such a filing.

Item 6. Exhibits.

The exhibits filed as part of this Quarterly Report on Form 10-Q are set forth on the Exhibit Index, which Exhibit Index is incorporated herein by reference.

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EXHIBIT INDEX

- 31.1 Certification of Chief Executive Officer pursuant to Rules 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- 31.2 Certification of Chief Financial Officer pursuant to Rules 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).
- 99.1 Press Release issued by Verastem, Inc. on October 30, 2014 (furnished herewith).
- 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.