AERIE PHARMACEUTICALS INC
Form 10-Q
November 12, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **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 001-36152

Aerie Pharmaceuticals, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**20-3109565**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification Number)**

135 US Highway 206, Suite 15

Bedminster, New Jersey 07921

(908) 470-4320

(Address of principal executive offices, zip code and telephone number, including area code)

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: x 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: x No: ¨

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. (Check one):

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer x (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: x

As of November 5, 2014, there were 23,984,485 shares of the registrant s common stock, par value $0.001, outstanding.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). We may, in some cases, use terms such as predicts, believes, potential, proposed, focused, estimates, expects, plans, intends, may, would, could, might, will, should, exploring, pursuing or other w uncertainty of future events or outcomes to identify these forward-looking statements.

Forward-looking statements appear in a number of places throughout this report and include statements regarding our intentions, beliefs, projections, outlook, analyses or current expectations concerning, among other things:

- the success, timing and cost of our ongoing and anticipated preclinical studies and clinical trials for our current product candidates, including statements regarding the timing of initiation and completion of the studies and trials;
- our expectations regarding the clinical effectiveness of our product candidates and results of our clinical trials;
- the timing of and our ability to obtain and maintain U.S. Food and Drug Administration or other regulatory authority approval of, or other action with respect to, our product candidates;
- our expectations related to the use of proceeds from our initial public offering (IPO) in October 2013 and the issuance and sale of our senior secured convertible notes in September 2014;
- our estimates regarding anticipated capital requirements and our needs for additional financing;
- the commercial launch and potential future sales of our current or any other future product candidates;
- our commercialization, marketing and manufacturing capabilities and strategy;
- third-party payor reimbursement for our product candidates;
- the glaucoma patient market size and the rate and degree of market adoption of our product candidates by eye-care professionals and patients;
- the timing, cost or other aspects of the commercial launch of our product candidates;

- our plans to pursue development of our product candidates for additional indications and other therapeutic opportunities;

- the potential advantages of our product candidates;

- our ability to protect our proprietary technology and enforce our intellectual property rights; and

- our expectations regarding licensing, acquisitions and strategic activities.

By their nature, forward-looking statements involve risks and uncertainties because they relate to events, competitive dynamics and industry change, and depend on regulatory approvals and economic and other environmental circumstances that may or may not occur in the future or may occur on longer or shorter timelines than anticipated. We discuss many of these risks in greater detail under the heading Risk Factors in Part II, Item IA of this report and in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2013, as filed with the Securities and Exchange Commission (SEC) on March 26, 2014. You should not rely upon forward-looking statements as predictions of future events.

Although we believe that we have a reasonable basis for each forward-looking statement contained in this report, we caution you that forward-looking statements are not guarantees of future performance and that our actual results of operations, financial condition and liquidity, and the development of the industry in which we operate may differ materially from the forward-looking statements contained in this report. In addition, even if our results of operations, financial condition and liquidity, and events in the industry in which we operate are consistent with the forward-looking statements contained in this report, they may not be predictive of results or developments in future periods.

Any forward-looking statements that we make in this report are as of the date of this report. Except as required by law, we are under no duty to update or revise any of the forward-looking statements, whether as a result of new information, future events or otherwise, after the date of this report.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

AERIE PHARMACEUTICALS, INC.

(A Development Stage Company)

Balance Sheets

(Unaudited)

(in thousands, except share and per share data)

	SEPTEMBER 30, 2014	DECEMBER 31, 2013
Assets		
Current assets		
Cash and cash equivalents	$ 148,884	$ 69,649
Short-term investments	22,177	
Prepaid expenses and other current assets	656	618
Total current assets	171,717	70,267
Furniture, fixtures and equipment, net	228	132
Other assets	1,338	59
Total assets	$ 173,283	$ 70,458
Liabilities and Stockholders Equity		
Current liabilities		
Accounts payable and other current liabilities	$ 6,999	$ 3,482
Total current liabilities	6,999	3,482
Convertible notes, net of discounts	124,125	
Total liabilities	131,124	3,482
Commitments and contingencies (Note 10)		
Stockholders equity		
Preferred stock, $0.001 par value; 15,000,000 shares authorized as of September 30, 2014 and December 31, 2013; None issued and outstanding		
Common stock, $0.001 par value; 150,000,000 shares authorized as of September 30, 2014 and December 31, 2013; 23,967,696 and 23,285,549 shares issued and outstanding as of September 30, 2014	24	23

and December 31, 2013, respectively				
Additional paid-in capital		168,844		162,021
Accumulated other comprehensive loss		(9)		
Deficit accumulated during the development stage		(126,700)		(95,068)
Total stockholders equity		42,159		66,976
Total liabilities and stockholders equity	$	173,283	$	70,458

The accompanying notes are an integral part of these financial statements.

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AERIE PHARMACEUTICALS, INC.

(A Development Stage Company)

Statements of Operations and Comprehensive Loss

(Unaudited)

(in thousands, except share and per share data)

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,		PERIOD FROM INCEPTION (JUNE 22, 2005) TO SEPTEMBER 30,
	2014	**2013**	**2014**	**2013**	**2014**
Operating expenses					
General and administrative	$ (4,944)	$ (3,287)	$ (13,723)	$ (6,693)	$ (43,907)
Research and development	(8,230)	(2,399)	(20,276)	(8,727)	(75,308)
Loss from operations	(13,174)	(5,686)	(33,999)	(15,420)	(119,215)
Other income (expense), net	27	(5,062)	2,367	(5,446)	(7,353)
Net loss	$ (13,147)	$ (10,748)	$ (31,632)	$ (20,866)	$ (126,568)
Net loss attributable to common stockholders basic and diluted	$ (13,147)	$ (10,887)	$ (31,632)	$ (21,279)	
Net loss per share attributable to common stockholders basic and diluted	$ (0.54)	$ (10.81)	$ (1.32)	$ (21.61)	
Weighted average number of common shares outstanding basic and diluted	24,325,166	1,006,893	23,980,963	984,727	
Net loss	$ (13,147)	$ (10,748)	$ (31,632)	$ (20,866)	$ (126,568)
Unrealized gain (loss) on available-for-sale investments	4		(9)		(9)
Comprehensive loss	$ (13,143)	$ (10,748)	$ (31,641)	$ (20,866)	$ (126,577)

The accompanying notes are an integral part of these financial statements.

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AERIE PHARMACEUTICALS, INC.

(A Development Stage Company)

Statements of Cash Flows

(Unaudited)

(in thousands, except share and per share data)

	NINE MONTHS ENDED SEPTEMBER 30, 2014	NINE MONTHS ENDED SEPTEMBER 30, 2013	PERIOD FROM INCEPTION (JUNE 22, 2005) TO SEPTEMBER 30, 2014
Cash flows from operating activities			
Net loss	$ (31,632)	$ (20,866)	$ (126,568)
Adjustments to reconcile net loss to net cash used in operating activities			
Depreciation	50	47	1,000
Amortization and accretion costs related to notes payable related parties		2,377	4,604
Loss (gain) on conversion of notes payable			1,916
Stock-based compensation	6,696	1,531	10,584
Interest payable related parties		488	1,725
Change in fair value measurements		3,850	3,718
Amortization of discount on available-for-sale investments	247		247
Changes in operating assets and liabilities			
Prepaid, current and other assets	(20)	(18)	(697)
Accounts payable and other current liabilities	2,267	1,025	5,768
Net cash used in operating activities	(22,392)	(11,566)	(97,703)
Cash flows from investing activities			
Purchase of available-for-sale investments	(34,593)		(34,593)
Maturity of available-for-sale investments	10,660		10,660
Sale of available-for-sale investments	1,500		1,500
Purchase of furniture, fixtures and equipment	(146)	(28)	(1,228)
Net cash used in investing activities	(22,579)	(28)	(23,661)
Cash flows from financing activities			
Proceeds from issuance of convertible notes, net of discounts	124,375		124,375

Payments of debt issuance costs	(297)		(412)
Proceeds from issuance of common stock in initial public offering, net of underwriting discounts			71,870
Payments of initial public offering costs		(1,713)	(3,644)
Proceeds from sale of preferred stock			45,000
Payments of stock issuance costs			(1,216)
Proceeds from notes payable to related parties		15,000	34,778
Dividends paid			(130)
Proceeds from sale of common stock			3
Proceeds from exercise of stock options	9	1	25
Proceeds from exercise of warrants			8
Proceeds from exercise of stock purchase rights	119		119
Payments of long-term debt			(528)
Net cash provided by financing activities	124,206	13,288	270,248
Net change in cash and cash equivalents	79,235	1,694	148,884
Beginning of period	69,649	2,925	
End of period	$ 148,884	$ 4,619	$ 148,884
Supplemental disclosures			
Noncash financing activities			
Conversion of preferred stock to common stock	$	$	$ 61,348
Conversion of convertible notes payable and accrued interest to common stock			18,604
Issuance of common stock upon net exercise of warrants			4,888
Reclassification of warrants from liabilities to equity			6,560
Conversion of long-term debt into preferred stock			17,364
Debt discount attributable to warrants		5,275	7,725
Accretion from conversion of note payable to related parties		220	775
Accretion of stock issuance costs		193	739
Deferred offering costs		617	
Deferred costs from issuance of convertible notes	250		250
Deferred financing costs	1,000		1,000

The accompanying notes are an integral part of these financial statements.

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AERIE PHARMACEUTICALS, INC.

(A Development Stage Company)

Notes to the Financial Statements

(Unaudited)

1. The Company

Aerie Pharmaceuticals, Inc. (the Company) is a development stage pharmaceutical company focused on the discovery, development and commercialization of topical, small molecule products to treat patients with glaucoma and other diseases of the eye. Incorporated in the State of Delaware on June 22, 2005, the Company maintains its corporate headquarters in Bedminster, New Jersey, conducts research in Research Triangle Park, North Carolina, and also has an office in Newport Beach, California.

To date, the Company is in the development stage and has not yet commenced primary operations or generated product revenue. The Company s activities since inception primarily consisted of developing product candidates, raising capital and performing research and development activities. The Company has no current source of revenue to sustain its present activities, and it does not expect to generate revenue until and unless it receives regulatory approval of and successfully commercializes its product candidates. The Company has incurred losses and experienced negative operating cash flows since inception, and has cumulative net cash flows used in operating activities of $97.7 million and cumulative net losses of $126.6 million for the period from inception (June 22, 2005) to September 30, 2014.

The Company has funded its operations primarily through the sale of equity securities and issuance of convertible notes. In October 2013, the Company completed its initial public offering (IPO) and issued 7,728,000 shares of its common stock at an IPO price of $10.00 per share, including 1,008,000 shares of common stock issued upon the exercise in full by the underwriters of their option to purchase additional shares to cover over-allotments. The Company received net proceeds from the IPO of approximately $68.3 million, after deducting underwriting discounts and commissions of $5.4 million and expenses of $3.6 million. On September 30, 2014, the Company issued $125.0 million aggregate principal amount of senior secured convertible notes (the Convertible Notes). The Company received net proceeds from the issuance of the Convertible Notes of approximately $124.1 million, after deducting discounts and certain expenses of $875,000. Refer to Note 7 for further information regarding the Convertible Notes.

If the Company does not successfully commercialize any of its product candidates, it may be unable to generate product revenue or achieve profitability. Accordingly, the Company may be required to obtain further funding through other public or private offerings, debt financing, collaboration and licensing arrangements or other sources. Adequate additional funding may not be available to the Company on acceptable terms, or at all. If the Company is unable to raise capital when needed or on attractive terms, it would be forced to delay, reduce or eliminate its research and development programs or commercialization efforts. The Company estimates that it has sufficient funding to sustain operations through product commercialization of Rhopressa™ and Roclatan™, pending successful outcome of their trials and FDA approval.

2. Significant Accounting Policies

Basis of Presentation

The Company s interim financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP). In the opinion of management, the Company has made all necessary adjustments, which include normal recurring adjustments necessary for a fair statement of the Company s financial position and results of operations for the interim periods presented. Certain information and disclosures normally included in the annual financial statements prepared in accordance with U.S. GAAP have been condensed or omitted. These interim financial statements should be read in conjunction with the audited financial statements and accompanying notes for the year ended December 31, 2013 included in the Company s Annual Report on Form 10-K. The results for the three months and nine months ended September 30, 2014 are not necessarily indicative of the results to be expected for a full year, any other interim periods or any future year or period.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of income and expenses during the reporting periods. Significant items subject to such estimates and assumptions include the valuation of stock options and operating expense accruals. Actual results could differ from these estimates.

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Investments

The Company determines the appropriate classification of its investments in debt and equity securities at the time of purchase. The Company s investments are comprised of certificates of deposit and corporate notes that are classified as available-for-sale in accordance with ASC 320, Investments Debt and Equity Securities. The Company classifies investments available to fund current operations as current assets on its balance sheet. Investments are classified as long-term assets on the balance sheet 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.

Available-for-sale investments are recorded at fair value, with unrealized gains or losses included in Accumulated other comprehensive gain (loss) on the Company s balance sheets. Realized gains and losses are determined using the specific identification method and are included as a component of Other income (expense), net (Note 3). There were no realized gains or losses recognized for the three months and nine months ended September 30, 2014 or 2013 or for the period from inception (June 22, 2005) to September 30, 2014.

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 its 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, the severity and the duration of the impairment and changes in value subsequent to period 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.

Deferred Financing Costs

Deferred financing costs consist of financing costs incurred by the Company in connection with the closing of the Company s Convertible Notes and are included in Other assets. The Company amortizes deferred financing costs through the earlier of maturity or the conversion of the Convertible Notes using the effective interest method. Refer to Note 7 for further information regarding the Convertible Notes.

Fair Value Measurements

The Company measures certain financial assets and liabilities at fair value based on the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants. The fair value of the Company s financial instruments, including cash and cash equivalents, short-term investments, other current assets, accounts payable and accrued expenses approximate their respective carrying values due to the short-term nature of these instruments. The estimated fair value of the Company s Convertible Notes also approximates carrying value as of September 30, 2014, the date of the Convertible Note transaction. Refer to Note 7 for further information regarding the Convertible Notes.

Recent Accounting Pronouncements

In August 2014, the Financial Accounting Standards Board (the FASB) issued ASU 2014-15, which provides guidance about management s responsibility to evaluate whether there is substantial doubt about an entity s ability to continue as a going concern and to provide related footnote disclosures. The new standard is effective for the Company for the annual period ending after December 15, 2016 and for annual and interim periods thereafter, with early adoption permitted. The Company is currently evaluating the impact of this accounting standard update on the

Company s financial statements.

In June 2014, the FASB issued ASU 2014-10, which eliminates the concept of a development stage entity in its entirety from current accounting guidance. The new standard is effective for the Company for interim and annual periods beginning after December 15, 2014, with early adoption permitted. Upon adoption of ASU 2014-10, the Company will no longer disclose inception-to-date information in its Statement of Operations and Comprehensive Loss, Cash Flows and Stockholders Deficit and the related notes thereto.

In July 2013, the FASB issued ASU 2013-11, which is an amendment to the accounting guidance on income taxes. This guidance provides clarification on the financial statement presentation of an unrecognized benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The amendment is effective for the Company for interim and annual periods beginning after December 15, 2013. The adoption of the provisions of this guidance did not have a material impact on the Company s financial statements.

In February 2013, the FASB issued ASU 2013-02 Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income, which requires that public and non-public companies present information about reclassification adjustments for accumulated other comprehensive income in their annual financial statements in a note or on the face of the financial statements. Public companies are also required to provide this information in interim financial statements. The new disclosure requirements are effective for fiscal years, and interim periods within those years, beginning after December 15, 2012. The adoption of the provisions of this guidance did not have a material impact on the Company s results of operations, cash flows and financial position.

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Net Loss per Share Attributable to Common Stock

Basic net loss per share attributable to common stock (Basic EPS) is calculated by dividing the net loss attributable to common stockholders by the weighted average number of shares of common stock outstanding for the period, without consideration for potentially dilutive securities with the exception of warrants for common stock with a $0.05 exercise price, which are exercisable for nominal consideration and are therefore included in the calculation of the weighted-average number of shares of common stock as common stock equivalents. Net loss attributable to common stockholders is calculated by adjusting the Company s net loss for accretion on convertible preferred stock, if any. Diluted net loss per share attributable to common stock (Diluted EPS) gives effect to all dilutive potential shares of common stock outstanding during this period. For Diluted EPS, net loss attributable to common stockholders used in calculating Basic EPS is adjusted for certain items related to the dilutive securities.

For all periods presented, the Company s potential common stock equivalents have been excluded from the computation of Diluted EPS as their inclusion would have the effect of reducing the net loss per share of common stock. Therefore, the denominator used to calculate Basic EPS and Diluted EPS is the same in all periods presented.

The Company s potential common stock equivalents that have been excluded from the computation of Diluted EPS for all periods presented consist of the following:

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2014	2013	2014	2013
Convertible Notes[1]	5,040,323		5,040,323	
Convertible preferred stock[2]		12,120,531		12,120,531
Outstanding stock options	3,792,152	3,189,660	3,792,152	3,189,660
Notes and interest payable to related parties[2]	$	$ 18,504,000	$	$ 18,504,000
Stock purchase warrants	309,506	1,277,686	309,506	1,277,686
Unvested restricted common stock awards	138,815	317,900	138,815	317,900

(1) Conversion is limited to a 9.985% ownership cap in shares of common stock by the holder. Additionally, the Convertible Notes provide for an increase in the conversion rate if conversion is elected in connection with a significant corporate transaction. Refer to Note 7 for further information regarding the Convertible Notes.

(2) In connection with the completion of the Company s IPO, the outstanding shares of convertible preferred stock and outstanding convertible notes to related parties and accrued interest thereon were converted into 12,120,531 and 1,860,363 shares of common stock, respectively.

3. Other Income (Expense), Net

Other income (expense), net consists of the following:

(in thousands)	THREE MONTHS ENDED SEPTEMBER 30, 2014	THREE MONTHS ENDED SEPTEMBER 30, 2013	NINE MONTHS ENDED SEPTEMBER 30, 2014	NINE MONTHS ENDED SEPTEMBER 30, 2013	PERIOD FROM INCEPTION (JUNE 22, 2005) TO SEPTEMBER 30, 2014
Interest expense	$	$ (1,477)	$	$ (2,865)	$ (6,329)
Loss on conversion of notes payable to related parties					(1,916)
Sale of New Jersey state tax benefit			2,288	1,268	3,556
Expense due to change in fair value measurements		(3,585)		(3,850)	(3,718)
Investment and other income, net	27		79	1	1,054
	$ 27	$ (5,062)	$ 2,367	$ (5,446)	$ (7,353)

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4. Investments

Cash, cash equivalents and investments as of September 30, 2014 included the following:

(in thousands)	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	FAIR VALUE
Cash and cash equivalents:				
Cash and money market accounts	$ 148,884	$	$	$ 148,884
Total cash and cash equivalents	$ 148,884	$	$	$ 148,884
Investments:				
Certificates of deposit (due within 1 year)	$ 9,869	$	$ (6)	$ 9,863
Corporate bonds (due within 1 year)	12,317	1	(4)	12,314
Total investments	$ 22,186	$ 1	$ (10)	$ 22,177
Total cash, cash equivalents, and investments	$ 171,070	$ 1	$ (10)	$ 171,061

The Company only held cash and cash equivalents at December 31, 2013 and did not hold any investments.

5. Fair Value Measurements

The Company records certain financial assets and liabilities at fair value in accordance with the provisions of ASC Topic 820 on fair value measurements. As defined in the guidance, fair value, defined as an exit price, represents the amount that would be received to sell an asset or pay to transfer a liability in an orderly transaction between market participants. As a result, fair value is a market-based approach that should be determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering these assumptions, the guidance defines a three-tier value hierarchy that prioritizes the inputs used in the valuation methodologies in measuring fair value.

Level 1 Unadjusted quoted prices in active, accessible markets for identical assets or liabilities.

Level 2 Other inputs that are directly or indirectly observable in the marketplace.

Level 3 Unobservable inputs that are supported by little or no market activity.

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The following tables summarize the fair value of financial assets and liabilities that are measured at fair value and the classification by level of input within the fair value hierarchy:

(in thousands)	FAIR VALUE MEASUREMENTS AS OF SEPTEMBER 30, 2014			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents:				
Cash and money market accounts	$ 148,884	$	$	$ 148,884
Total cash and cash equivalents	$ 148,884	$	$	$ 148,884
Investments:				
Certificates of deposit	$	$ 9,863	$	$ 9,863
Corporate bonds		$ 12,314		$ 12,314
Total investments	$	$ 22,177	$	$ 22,177
Total cash, cash equivalents, and investments	$ 148,884	$ 22,177	$	$ 171,061

(in thousands)	FAIR VALUE MEASUREMENTS AS OF DECEMBER 31, 2013			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents:				
Cash and money market accounts	$ 69,649	$	$	$ 69,649
Total cash and cash equivalents	$ 69,649	$	$	$ 69,649

As of September 30, 2014, the date of the Convertible Note transaction, the estimated fair value of the Company s Convertible Notes approximates carrying value.

The Company had no long-term debt as of December 31, 2013.

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6. Accounts Payable & Other Current Liabilities

Accounts payable and other current liabilities consist of the following:

(in thousands)		SEPTEMBER 30, 2014		DECEMBER 31, 2013
Accounts payable	$	3,039	$	1,442
Accrued expenses and other liabilities:				
Employee benefits and compensation related accruals(1)		1,170		966
General and administrative related accruals		757		411
Research and development related accruals		2,033		663
	$	6,999	$	3,482

(1) Comprised of accrued bonus, accrued vacation, accrued severance liabilities, and liabilities under the Company s employee stock purchase plan.

7. Convertible Notes

On September 30, 2014, the Company issued the Convertible Notes to Deerfield Partners, L.P., Deerfield International Master Fund, L.P., Deerfield Private Design Fund III, L.P., Deerfield Special Situations Fund, L.P. and Deerfield Special Situations International Master Fund, L.P. (collectively, Deerfield).

The Convertible Notes bear interest at a rate of 1.75% per annum payable quarterly in arrears on the first business day of each January, April, July and October, commencing on January 1, 2015. The Convertible Notes mature on the seventh anniversary from the date of issuance, unless earlier converted.

The Convertible Notes constitute a senior secured obligation of the Company, collateralized by a first priority security interest in substantially all of the assets of the Company. The Convertible Notes provide that, upon the request of the Company, Deerfield will release all of the liens on the collateral if both of the following occur: (i) beginning one month after U.S. Food and Drug Administration approval of either Rhopressa™ or Roclatan™, shares of the Company s common stock have traded at a price above $30 per share (subject to adjustment for any subdivision or combination of outstanding common stock) for 30 consecutive trading days, and (ii) the Company is prepared to close a financing that will be secured by a lien on the Company s assets, subject only to the release of the lien on the Company s assets by Deerfield.

At closing, the Company paid Deerfield a one-time transaction fee of $625,000. In addition, the Company reimbursed Deerfield in the amount of $250,000 for certain expenses incurred by Deerfield in connection with the transaction. The Company also incurred $1.3 million of legal and advisory fees in connection with the transaction.

The Convertible Notes are convertible at any time at the option of Deerfield, in whole or in part, into shares of common stock, including upon the repayment of the Convertible Notes at maturity (the Conversion Option). However, upon conversion, Deerfield (together with their affiliates) is limited to a 9.985% ownership cap in shares of common stock (the 9.985% Cap). The 9.985% Cap would remain in place upon any assignment of the Convertible Notes by Deerfield.

The initial conversion price is $24.80 per share of common stock (equivalent to an initial conversion rate of 40.32 shares of common stock per $1,000 principal amount of Convertible Notes), representing a 30% premium over the closing price of the common stock on September 8, 2014. The conversion rate and the corresponding conversion price are subject to adjustment for stock dividends (other than a dividend for which Deerfield would be entitled to participate on an as-converted basis), stock splits, reverse stock splits and reclassifications. In addition, in connection with certain significant corporate transactions, Deerfield, at its option, may (i) require the Company to prepay all or a portion of the principal amount of the Convertible Notes, plus accrued and unpaid interest, or (ii) convert all or a portion of the principal amount of the Convertible Notes into, depending upon the type of transaction, shares of common stock or the right to receive upon consummation of the transaction the consideration Deerfield would have received had Deerfield converted the Convertible Notes immediately prior to the consummation of the transaction. The Convertible Notes provide for an increase in the conversion rate if Deerfield elects to convert their Convertible Notes in connection with a significant corporate transaction. The maximum increase to the initial conversion rate, in connection with a significant corporate transaction, is 12.07 shares of common stock per $1,000 principal amount of Conversion Notes, which decreases over time and is determined by reference to the price of the common stock prior to the consummation of the significant corporate transaction or the value of the significant corporate transaction.

The agreement governing the Convertible Notes contains various representations and warranties, and affirmative and negative covenants, customary for financings of this type, including restrictions on the incurrence of additional debt and liens on the Company s assets. The agreement governing the Convertible Notes also provides for certain events of default, including the failure to pay principal and interest when due; inaccuracies in the Company s representations and warranties to Deerfield; failure to comply with any of the covenants; the Company s insolvency or the occurrence of certain bankruptcy-related events; certain judgments against the Company; the suspension, cancellation or revocation of

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governmental authorizations that are reasonably expected to have a material adverse effect on the Company s business; the acceleration of a specified amount of indebtedness; and the failure to deliver shares of common stock upon conversion of the Convertible Notes. If any event of default were to occur, and continue beyond any applicable cure period, the holders of more than 50% of the aggregate principal amount of the then outstanding Convertible Notes would be permitted to declare the principal and accrued and unpaid interest to be immediately due and payable.

The Company recorded the Convertible Notes as long-term debt at face value less debt discounts relating to fees and certain expenses paid to Deerfield in connection with the transaction. The Conversion Option is a derivative that qualifies for an exemption from bifurcation and liability accounting as provided for in ASC Topic 815 Derivatives and Hedging Contracts in Entity s Own Equity (ASC 815). Since the Conversion Option is not bifurcated as a derivative pursuant to ASC 815, the Company further evaluated the Conversion Option to determine whether it is considered a beneficial conversion feature (BCF). The Company determined that the initial accounting conversion price was greater than the fair value of the common stock at the close of trading on the date of issuance, therefore no BCF existed at inception. However, if Deerfield elects to convert their Convertible Notes in connection with a significant corporate transaction, the increase to the initial conversion rate may cause a contingent BCF to exist at the time of conversion. The contingent BCF, if any, will be recognized in earnings when the contingency is resolved and will be measured using the fair value of the common stock at the close of trading on the date of issuance and the accounting conversion price as adjusted for such an increase to the initial conversion rate.

As of September 30, 2014, the Company recognized unamortized debt discounts of $875,000. Debt discounts are amortized using the effective interest method through the earlier of maturity or the conversion of the Convertible Notes.

The table below summarizes the carrying value of the Convertible Notes as of September 30, 2014:

(in thousands)	**SEPTEMBER 30, 2014**	
Gross proceeds	$	125,000
Initial value of issuance costs recorded as debt discount		(875)
Amortization of debt discount		
Carrying value	$	124,125

For the three and nine months ended September 30, 2014, interest expense related to the Convertible Notes was $0.

8. Stock Purchase Warrants

As of September 30, 2014 and December 31, 2013, the following equity classified warrants were outstanding:

NUMBER OF UNDERLYING SHARES	EXERCISE PRICE PER SHARE	WARRANT EXPIRATION DATE	TYPE OF EQUITY SECURITY

2,006	$	5.00	March 2016	Common Stock
75,000	$	5.00	February 2019	Common Stock
75,000	$	5.00	November 2019	Common Stock
157,500	$	5.00	August 2020	Common Stock
408,295	$	0.05	December 2019	Common Stock

The warrants outstanding as of September 30, 2014 and December 31, 2013 are all currently exercisable with weighted-average remaining lives of 5.24 and 5.99 years, respectively.

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9. Stock-based Compensation

The Company maintains two equity compensation plans, the 2005 Aerie Pharmaceutical Stock Plan (the 2005 Plan) and the 2013 Omnibus Incentive Plan (the 2013 Equity Plan). The 2005 Plan and the 2013 Equity Plan are referred to collectively as the Plans.

On October 30, 2013, the effective date of the 2013 Equity Plan, the 2005 Plan was frozen and no additional awards will be made under the 2005 Plan. Any shares remaining available for future grant under the 2005 Plan were allocated to the 2013 Equity Plan. The 2013 Equity Plan provides for the granting of up to 3,229,068 equity awards for common stock of the Company. The Company granted stock options to employees to purchase 1,211,700 and 2,009,551 shares of common stock during the nine months ended September 30, 2014 and 2013, respectively.

The following table summarizes the stock option activity under the Plans:

	NUMBER OF SHARES	WEIGHTED AVERAGE EXERCISE PRICE	AGGREGATE INTRINSIC VALUE (000 s)
Options outstanding at December 31, 2013	3,189,660	$ 2.1634	$ 50,386
Granted	1,211,700	20.1937	
Exercised	(574,951)	0.3593	
Cancelled	(34,257)	14.3228	
Options outstanding at September 30, 2014	3,792,152	$ 8.0882	$ 47,788
Options exercisable at September 30, 2014	1,185,834	$ 2.0615	$ 22,090

The estimated fair value of options granted is determined on the date of grant using the Black-Scholes option pricing model. Options granted to non-employees are re-measured at each financial reporting period until required service is performed.

Stock-based compensation expense for options granted, restricted stock and stock purchase rights are reflected in the statement of operations as follows:

	THREE MONTHS ENDED SEPTEMBER 30,	NINE MONTHS ENDED SEPTEMBER 30,	PERIOD FROM INCEPTION (JUNE 22,

(in thousands)	2014	2013	2014	2013	2005) TO SEPTEMBER 30, 2014
Research and development	$ 220	$ 62	$ 1,072	$ 105	$ 1,472
General and administrative	2,172	1,068	5,624	1,426	9,112
Total	$ 2,392	$ 1,130	$ 6,696	$ 1,531	$ 10,584

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As of September 30, 2014, the Company had $24.5 million of unrecognized compensation expense related to options granted under the Plans. This cost is expected to be recognized over a weighted average period of 2.8 years as of September 30, 2014. The weighted average remaining contractual life on all outstanding options as of September 30, 2014 was 8.6 years.

Restricted Common Stock

On March 21, 2013, concurrent with the cancellation of 345,000 stock options, the Company issued 371,034 shares of restricted stock to an employee. The vesting of these awards is time-based with terms of two to four years. These restricted stock awards are subject to repurchase, such that the Company has the right, but not the obligation, to repurchase unvested shares upon the employee s termination. As of September 30, 2014, 138,815 shares of restricted stock awards were unvested and subject to repurchase.

Compensation expense related to these restricted stock awards is based on the market value of the Company s common stock on the date of grant and is expensed on a straight-line basis (net of estimated forfeitures) over the vesting period. The weighted average remaining contractual term for restricted stock awards as of September 30, 2014 was 1.47 years. Compensation expense related to restricted stock awards for the three months and nine months ended September 30, 2014 was $97,000 and $292,000, respectively and was included in general and administrative expense.

As of September 30, 2014, the Company had $340,000 of unrecognized compensation expense, related to unvested restricted stock awards. This cost is expected to be recognized over a weighted average period of 1.47 years as of September 30, 2014.

10. Commitments and Contingencies

Litigation

The Company is not party to any known litigation, is not aware of any unasserted claims and does not have contingency reserves established for any litigation liabilities.

Contract Service Providers

In the course of the Company s normal business operations, it has agreements with contract service providers to assist in the performance of its research and development, clinical research and manufacturing. Substantially all of these contracts are on an as-needed basis.

11. Related-Party Transactions

In connection with the completion of the Company s IPO in October 2013, the outstanding shares of convertible preferred stock and outstanding convertible notes to related parties and accrued interest thereon were converted into 12,120,531 and 1,860,363 shares of common stock, respectively. Prior to their conversion into common stock in connection with the IPO, the Company s convertible notes to related parties were due to holders of the Company s convertible preferred stock. Interest expense on those obligations for the three months and nine months ended September 30, 2013 was $266,000 and $488,000, respectively.

On September 6, 2013, the Company terminated its agreement to exclusively license its intellectual property for non-ophthalmic indications to Novaer Holding, Inc. Since September 6, 2013, the Company owns all of the worldwide rights to its current product candidates for all indications, both ophthalmic and non-ophthalmic.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis should be read in conjunction with our unaudited financial statements and related notes that appear elsewhere in this report and with our audited financial statements and related notes and management s discussion and analysis of financial condition and results of operations included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013, as filed with the SEC on March 26, 2014. This discussion and analysis contains forward-looking statements that involve risks and uncertainties. Please see Special Note Regarding Forward-Looking Statements for additional factors relating to such statements, and see Risk Factors in Part II, Item IA of this report and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013 for a discussion of certain risk factors applicable to our business, financial condition and results of operations. Past operating results are not necessarily indicative of operating results in any future periods.

Overview

We are a clinical-stage pharmaceutical company focused on the discovery, development and commercialization of first-in-class therapies for the treatment of patients with glaucoma and other diseases of the eye. Our lead product candidate, once-daily, triple-action Rhopressa , successfully completed a Phase 2b clinical trial in patients with open-angle glaucoma and ocular hypertension in May 2013. The first patients enrolled in our Phase 3 registration trials of Rhopressa were dosed in early July 2014. Two trials are being conducted in the United States and one safety-only study is being conducted in Canada. Our second product candidate, once-daily, quadruple-action Roclatan , which is a fixed-dose combination of Rhopressa and latanoprost, the most commonly prescribed drug for the treatment of patients with glaucoma, successfully completed a Phase 2b clinical trial in patients with open-angle glaucoma and ocular hypertension in June 2014. We expect Phase 3 registration trials to commence in mid-2015. Preparatory steps for these trials have already commenced.

We are developing Rhopressa as the first of a new class of compounds that is designed to lower intraocular pressure, or IOP, through novel biochemical targets. By inhibiting these targets, we believe Rhopressa reduces IOP via three separate mechanisms of action, or MOAs: (i) it increases fluid outflow through the trabecular meshwork, the diseased tissue of the eye, (ii) it reduces episcleral venous pressure, which represents the pressure of the blood in the episcleral veins of the eye where eye fluid drains into the bloodstream, and (iii) it reduces the production of eye fluid. Roclatan is a combination of Rhopressa and latanoprost and is designed to lower IOP through the same three MOAs as Rhopressa and, with a fourth MOA, through the ability of latanoprost to increase fluid outflow through the uveoscleral pathway, the eye s secondary drain.

We are focused on becoming a major ophthalmic pharmaceutical company. In addition to our primary product candidates, Rhopressa and Roclatan, we are in the preclinical development stage with AR-13533. We are also exploring the longer-term impact of Rhopressa and Roclatan on the diseased trabecular meshwork and evaluating possible uses of our existing proprietary portfolio of Rho Kinase inhibitors beyond glaucoma. We may license, acquire or develop additional product candidates to broaden our presence in ophthalmology. However, we have no present plans, agreements or commitments with respect to any potential acquisition, investment or license.

We have incurred net losses since our inception in June 2005. Our operations to date have been limited to research and development and raising capital. As of September 30, 2014, we had a deficit accumulated during the development stage of $126.7 million. We recorded net losses of $13.1 million and $31.6 million for the three months and nine months ended September 30, 2014, respectively, and net losses of $10.7 million and $20.9 million for the three months and nine months ended September 30, 2013, respectively. We anticipate that a substantial portion of our capital resources and efforts in the foreseeable future will be focused on completing development activities, obtaining regulatory approval, preparing for potential commercialization of our product candidates and potentially pursuing strategic opportunities.

Prior to our initial public offering (IPO), we raised net cash proceeds of $78.6 million from the private placement of $43.8 million of convertible preferred stock and $34.8 million of convertible notes. Subsequent to the issuance of the convertible notes, we made $0.5 million in cash payments, $16.2 million of the convertible notes were converted into shares of convertible preferred stock, which were subsequently converted into shares of common stock in connection with our IPO, and $18.0 million of the convertible notes were converted into shares of common stock in connection with our IPO. In connection with our IPO, all outstanding shares of convertible preferred stock were converted into shares of common stock.

On October 30, 2013, we completed our IPO and issued 7,728,000 shares of our common stock at an IPO price of $10.00 per share, including 1,008,000 shares of common stock issued upon the exercise in full by the underwriters of their option to purchase additional shares to cover over-allotments. Our shares began trading on the NASDAQ Global Market on October 25, 2013. We received net proceeds from the IPO of approximately $68.3 million, after deducting underwriting discounts and commissions of $5.4 million and expenses of $3.6 million.

On September 30, 2014, we issued $125.0 million aggregate principal amount of senior secured convertible notes (the Convertible Notes). We received net proceeds from the issuance of the Convertible Notes of approximately $124.1 million, after deducting discounts and certain expenses of $875,000.

We expect our research and development expenses to increase as we initiate and conduct clinical trials for our Rhopressa and Roclatan product candidates and pursue regulatory approval. As we prepare for commercialization, we will likely incur significant commercial, sales, marketing and outsourced manufacturing expenses. Since our IPO in October 2013, we are also incurring

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additional expenses associated with operating as a public company. As a result, we expect to continue to incur significant and increasing operating losses at least for the next several years. To date, we have not generated product revenue and we do not expect to generate product revenue unless and until we successfully complete development and obtain regulatory approval for one or more of our product candidates. If we do not successfully commercialize any of our product candidates, we may be unable to generate product revenue or achieve profitability.

Accordingly, we may be required to obtain further funding through public or private offerings, debt financing, collaboration and licensing arrangements or other sources. Adequate additional funding may not be available to us on acceptable terms, or at all. If we are unable to raise capital when needed or on acceptable terms, we would be forced to delay, reduce or eliminate our research and development programs or commercialization efforts.

Proceeds from the Convertible Notes financing in September 2014, together with proceeds from our IPO in October 2013, are expected to provide sufficient resources to complete all currently known non-clinical and clinical requirements for our development programs advancing Rhopressa™ and Roclatan™, and approval by the U.S. Federal Drug Administration (FDA) and product commercialization, pending successful outcome of the trials. We also intend to use the proceeds in part for general corporate purposes and potentially for strategic growth opportunities.

Financial Overview

Revenue

We have not generated any revenue from the sale of any products, and we do not expect to generate any revenue unless or until we obtain regulatory approval and commercialize our products.

General and Administrative Expenses

General and administrative expenses consist primarily of salaries, benefits and stock-based compensation for all officers and employees in general management, finance and administration. Other significant expenses include facilities expenses and professional fees for accounting, legal and other services.

We expect that our general and administrative expenses will increase with the continued advancement of our product candidates and with our increased management, legal, compliance, accounting and investor relations expenses as we continue to grow. We expect these increases will likely include increased expenses for insurance, expenses related to the hiring of additional personnel and payments to outside service providers, lawyers and accountants.

Research and Development Expenses

Since our inception, we have focused on our development programs. Research and development expenses consist primarily of costs incurred for the research and development of our preclinical and clinical candidates, which include:

- employee-related expenses, including salaries, benefits, travel and stock-based compensation expense for research and development personnel;

- expenses incurred under agreements with contract research organizations (CROs), contract manufacturing organizations and service providers that assist in conducting clinical trials and preclinical studies;

- costs associated with preclinical activities and development activities;

- costs associated with regulatory operations; and

- depreciation expense for assets used in research and development activities.

We expense research and development costs to operations as incurred. The costs for certain development activities, such as clinical trials, are recognized based on the terms of underlying agreements as well as an evaluation of the progress to completion of specific tasks using data such as patient enrollment, clinical site activations along with additional information provided to us by our vendors.

Expenses relating to activities, such as manufacturing and stability and toxicology studies, that are supportive of the product candidate itself, are classified as direct non-clinical. Expenses relating to clinical trials and similar activities, including costs associated with CROs, are classified as direct clinical. Expenses relating to activities that support more than one development program or activity such as personnel costs, stock-based compensation and depreciation are not allocated to direct clinical or non-clinical expenses and are separately classified as unallocated.