Ophthotech

Our Thoughts Post the 2Q Call

Overweight

OPHT, OPHT US
Price: $37.90

Price Target: $51.00

Ophthotech's 2Q call this morning focused primarily on the Fovista development strategy beyond the ongoing pivotal phase 3 studies which remain on track to read out in 2016. Taken together with the pivotal trials, these studies outline a comprehensive effort to flesh out the drug's clinical utility across multiple wet AMD patient populations, as well as to differentiate it from anti-VEGF monotherapy. Importantly, these trials should also provide catalysts in the 2015/2016 period leading up to the pivotal study readouts. In the near-term, we are also encouraged by a number of scheduled presentations at the upcoming ASRS/AAO medical meetings. Given the commercial opportunity in wet AMD, the robust phase 2b dataset for Fovista, and the optionality with Zimura in geographic atrophy (GA), we reiterate our Overweight rating

- **Sub-retinal fibrosis study.** Yesterday, Ophthotech disclosed that it had initiated its sub-retinal fibrosis study of Fovista and anti-VEGF therapy. In our view, this is the most meaningful of the Fovista expansion studies as it could be the most disruptive to the current treatment paradigm for wet AMD. Though only a phase 2 open-label study, positive results could lend significant support to the view that addressing sub-retinal fibrosis can reverse long-term declines in visual acuity with anti-VEGF therapy in some patients, while also more tightly linking combination use of both agents.

- **Data at upcoming ophthalmology conferences.** Sub-retinal fibrosis at AAO - Subgroup analysis from the phase 2b study showing a reduction in sub-retinal fibrosis will be presented at AAO (Oct 21, Chicago); recall, the company shared some of this data at its Analyst event earlier this year. These data should provide a basis for expectations from the ongoing phase 2, open-label study. ASRS - Next week at the American Society of Retinal Surgeons annual meeting (Aug 12, San Diego) data will also be presented comparing the changes in visual gains of Fovista plus Lucentis to Lucentis alone after one month.

Biotechnology

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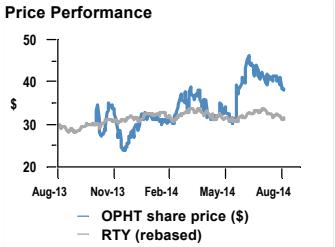
Price Performance



	YTD	1m	3m	12m
Abs	17.2%	-4.4%	16.3%	27.6%
Rel	20.8%	2.8%	16.7%	22.1%

Ophthotech Corp. (OPHT;OPHT US)

FYE Dec	2013A	2014E (Prev)	2014E (Curr)	2015E (Prev)	2015E (Curr)	2016E (Prev)	2016E (Curr)
EPS ($)							
Q1 (Mar)	(6.07)	(0.64)A	(0.64)A	-	-	-	-
Q2 (Jun)	(6.07)	(0.64)	(1.57)A	-	-	-	-
Q3 (Sep)	(10.26)	(0.70)	(0.85)	-	-	-	-
Q4 (Dec)	(0.65)	(0.77)	(1.01)	-	-	-	-
FY	(6.34)	(2.75)	(4.08)	(3.22)	(3.77)	-	(2.50)

Source: Company data, Bloomberg, J.P. Morgan estimates. Note: Q1, Q2 2013 numbers reflect JPMe as co. still to disclose actual numbers; increaed share count plus IPO account for numbers not summing.

Company Data	
Price ($)	37.90
Date Of Price	05 Aug 14
52-week Range ($)	47.99-22.61
Market Cap ($ mn)	1,223.49
Fiscal Year End	Dec
Shares O/S (mn)	32
Price Target ($)	51.00
Price Target End Date	31-Dec-14

See page 6 for analyst certification and important disclosures.

- **Zimura development.** Reaffirmed plans to start two studies of Zimura: (1) in combination with Fovista in patients with anti-VEGF resistant wet AMD (2015), and (2) in geographic atrophy (GA; late 2014/early 2015). Of note, Roche's lampalizumab is expected to enter phase 3 in GA by YE14; it is unclear whether the company will focus on a biomarker-defined segment of GA market, or enroll a more general GA population. Our assessment of the dry AMD market can be found here.

- **Adjusting estimates**. Following 2Q results and recent trends, we are updating our model. We note that the company highlighted that it will be recognizing the $200M upfront not until approval in the EU (2018). The company is also entitled to $130M in enrollment milestones. The net impact is that our FY14 and 15 EPS estimates change to -$4.08 and -$3.77 from -$2.75 and -$3.22. We also establish at FY16 EPS estimate of -$2.50.

- **Reiterate Overweight**.

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Changes to Our Model

Following 2Q results and recent trends, we are updating our model. We note that the company highlighted that it will be recognizing the $200M upfront not until approval in the EU (2018). The company is also entitled to $130M in enrollment milestones. The net impact is that our FY14 and 15 EPS estimates change to -$4.08 and -$3.77 from -$2.75 and -$3.22. We also establish at FY16 EPS estimate of -$2.50.

Table 1: Changes to Our Model

	2014E OLD	2014E NEW	2015E OLD	2015E NEW	2016E NEW
Expenses					
R&D	76.0	96.0	100.0	100.0	115.0
SG&A	24.3	29.5	26.5	31.0	39.0
Total Op Ex	100.3	125.5	126.5	131.0	154.0
Net income	-91.4	-135.7	-110.8	-130.0	-87.0
GAAP EPS ($)	**-2.75**	**-4.08**	**-3.22**	**-3.77**	**-2.50**
shares	33.2	33.3	34.4	34.5	34.8

Source: J.P. Morgan estimates.

Investment Thesis, Valuation and Risks

Ophthotech *(Overweight; Price Target: $51.00)*

Investment Thesis

Fovista is the key value driver for OPHT shares. Based on the efficacy data from the phase 2b, the combination of an anti-PDGF and anti-VEGF offers potentially best-in-class efficacy with meaningful improvements against the traditional regulatory endpoints of visual acuity, as well as an underappreciated endpoint, regression of neovascularization lesions, against which traditional therapy had minimal effect. As such, we view the phase 3 results as being significantly de-risked and believe Fovista will find use in both treatment-naïve AMD patients, and those requiring monthly anti-VEGF injections. We further view the company's recent licensing deal with Novartis as validation. We believe Fovista has a two- to three-year head start over other anti-PDGF therapies in development.

Valuation

Our Dec-14 $51 price target is based on our sum-of-the-parts NPV analysis. Our analysis is based on projected Fovista sales from a projected launch in 2017 through 2025. We conservatively modeled a 12.5% WACC and zero terminal values for the drug in the US and EU. Based on the above projections and assumptions, as well as probability of success adjustments, we derive a valuation of $51/share, comprising US sales of Fovista of $24/sh, OUS sales of Fovista of $15/sh, and $12/sh for net

cash. Fovista downstream milestones and any value from the company's second asset, Zimura, should be viewed as upside to our model.

Risks to Rating and Price Target

Key downside risks to our rating and price target include (1) clinical risk associated with outcome of the phase 3 studies of Fovista, (2) commercial risk that the drug will offer meaningful benefit over the current treatment paradigm as well as the impact of competing agents risk, and (3) reimbursement risk for Fovista.

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Ophthotech: Summary of Financials

Income Statement - Annual	FY13A	FY14E	FY15E	FY16E	Income Statement - Quarterly	1Q14A	2Q14A	3Q14E	4Q14E
Revenues	0	0	0	65	Revenues	0A	0A	0	0
Cost of products sold	0	0	0	0	Cost of products sold	0A	0A	0	0
Gross profit	-	-	-	-	Gross profit	-	-	-	-
SG&A	(14)	(30)	(31)	(39)	SG&A	(6)A	(8)A	(8)	(8)
R&D	(33)	(96)	(100)	(115)	R&D	(14)A	(35)A	(21)	(26)
Operating income	(47)	(126)	(131)	(89)	Operating income	(21)A	(42)A	(29)	(34)
EBITDA	(47)	(126)	(131)	(89)	EBITDA	(21)A	(42)A	(29)	(34)
Net interest (income) / expense	-	-	-	-	Net interest (income) / expense	-	-	-	-
Other income / (expense)	(4)	0	1	2	Other income / (expense)	0A	0A	0	0
Income taxes	0	(10)	0	0	Income taxes	0A	(10)A	0	0
Net income - GAAP	(57)	(136)	(130)	(87)	Net income - GAAP	(21)A	(52)A	(29)	(34)
Net income - recurring	(57)	(136)	(130)	(87)	Net income - recurring	(21)A	(52)A	(29)	(34)
Diluted shares outstanding	9	33	34	35	Diluted shares outstanding	32A	33A	34	34
EPS - excluding non-recurring	(6.34)	(4.08)	(3.77)	(2.50)	EPS - excluding non-recurring	(0.64)A	(1.57)A	(0.85)	(1.01)
EPS - recurring	(6.34)	(4.08)	(3.77)	(2.50)	EPS - recurring	(0.64)A	(1.57)A	(0.85)	(1.01)

Balance Sheet and Cash Flow Data	FY13A	FY14E	FY15E	FY16E	Ratio Analysis	FY13A	FY14E	FY15E	FY16E
Cash and cash equivalents	211	421	291	204	Sales growth	-	-	-	-
Accounts receivable	7	7	7	7	EBIT growth	246.6%	164.6%	4.4%	(32.0%)
Inventories	-	-	-	-	EPS growth - recurring	151.1%	(35.6%)	(7.6%)	(33.7%)
Other current assets	0	0	0	0					
Current assets	217	428	298	211	Gross margin	-	-	-	-
PP&E	0	1	1	1	EBIT margin	-	-	-	(137.0%)
Total assets	218	464	334	247	EBITDA margin	-	-	-	(137.0%)
					Tax rate	0.0%	(8.2%)	0.0%	0.0%
Total debt	0	-	-	-	Net margin	-	-	-	(133.9%)
Total liabilities	48	319	290	290					
Shareholders' equity	170	145	44	(43)	Net Debt / EBITDA	444.1%	-	-	-
					Net Debt / Capital (book)	515.2%	-	-	-
Net income (including charges)	(51)	(136)	(130)	(87)					
D&A	0	0	0	0	Return on assets (ROA)	(51.3%)	(39.8%)	(32.6%)	(30.0%)
Change in working capital	(3)	230	0	0	Return on equity (ROE)	(246.6%)	(86.3%)	(137.5%)	(10850.8%)
Other	5	20	0	0					
Cash flow from operations	(49)	114	(130)	(87)	Enterprise value / sales	-	-	-	15.7
					Enterprise value / EBITDA	NM	NM	NM	NM
Capex	(0)	(0)	(0)	0	Free cash flow yield	(14.3%)	9.0%	(10.0%)	(6.6%)
Free cash flow	(49)	113	(130)	(87)					
Cash flow from investing activities	(0)	(0)	(0)	0					
Cash flow from financing activities	255	97	0	0					
Dividends	-	-	-	-					
Dividend yield	-	-	-	-					

Source: Company reports and J.P. Morgan estimates.
Note: $ in millions (except per-share data).Fiscal year ends Dec

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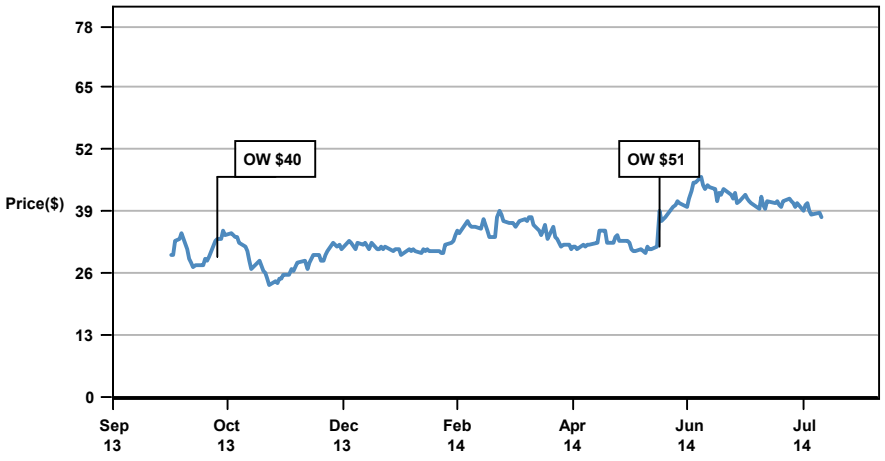
Ophthotech (OPHT, OPHT US) Price Chart



Date	Rating	Share Price ($)	Price Target ($)
21-Oct-13	OW	29.25	40.00
19-May-14	OW	31.46	51.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
Initiated coverage Oct 21, 2013.

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