Aerie Pharmaceuticals

AERI : NASDAQ : US$20.35

BUY

Target: US$40.00

Corey Davis, PhD - Canaccord Genuity Inc. (US)
cdavis@canaccordgenuity.com 212.389.8045
Lidia Liu - Canaccord Genuity Inc. (US)
lliu@canaccordgenuity.com 212.389.8046

COMPANY STATISTICS:

Forecast Return:	96.6%
52-week Range:	10 - 27
Shares Out (M):	23.9
Market Cap (M):	US$486
Avg. Daily Vol. (000s):	376
Cash (M):	65
2014E Burn:	($35)
2015E Burn:	($46)
# Analysts:	4
Avg. Target:	38
# BUY:	4
Shares Short (M):	0.8
Days to Cover:	1.4

EARNINGS SUMMARY:

FYE Dec		2013A	2014E	2015E	2016E
EPS:		(1.42)	(1.47)	(1.55)	(1.46)
EPS:	Q1	(4.33)A	(0.20)A	--	--
	Q2	(0.27)	(0.39)A	--	--
	Q3	(0.42)	(0.44)	--	--
	Q4	(0.54)	(0.43)	--	--
Total		(1.42)	(1.47)	(1.55)	(1.46)

SHARE PRICE PERFORMANCE:

Source: Interactive Data Corporation

COMPANY DESCRIPTION:
AERI is a clinical-stage pharmaceutical company focused on the treatment of glaucoma (one of the largest segments in the global ophthalmic market) and other eye diseases. Its product candidates are the triple-action Rhopressa and quadruple-action Roclatan.

All amounts in US$ unless otherwise noted.

Life Sciences -- Specialty Pharmaceuticals

NOT MUCH NOT TO LIKE

Investment recommendation

At its analyst day, Aerie put to bed any lingering concerns about the strength of the Ph2b data on its two glaucoma drugs. We focus on six new items and the stock remains our top small-cap pick: 1) Rhopressa Ph3 enrollment took off like a rocket; 2) the $125M convert removes a financing overhang; 3) a new responder analysis of the Roclatan Ph2b data showed an impressive 46% of patients reached IOP ≤16mmHg vs. 18% for latanaprost; 4) a physician survey suggested its two drugs could have an eye-popping 40% market share by 2023; 5) VC ownership is now down from 70% to 40%, which we think had put selling pressure on the stock; and 6) the enthusiasm expressed by the KOL Dr. Parrish lends credence to our view that Roclatan should be one of the best glaucoma drugs.

Investment highlights

Enrollment rates – For the Rhopressa trials, ~80% of required clinical sites are approved and contracted. ROCKET 1, 2 and 3 are 57%, 17% and 0.4% enrolled. 57% is impressive given it's only been a few months.

New subset data from Roclatan Ph2b – 1) 46% of Roclatan patients got to IOP ≤16mmHg vs. 18% for latanaprost; 2) 36 hours after the last dose, Roclatan showed more of a sustained effect than latanoprost; 3) in patients with IOP reduced to ≤16mmHg, both Rhopressa and Roclatan had a faster onset than latanoprost.

Survey – Independent market research surveying 400 physicians showed that ~42-50% of U.S., French and Japanese physicians would switch at least a third of their patients to Rhopressa.

Valuation/risks

Our one-year forward price target of $40 is derived by using a 20x multiple of our 2020 EPS estimate of $6.81 and discounting back at 25% for 5.5 years. Risks include failure of either Rhopressa or Roclatan in Ph3 and/or failure to gain FDA approval.

Figure 1: Summary Aerie P&L model

($ In millions, except per share amount)

Year End: December 31	2012	2013	1Q14	2Q14	3Q14E	4Q14E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E
Rhopressa	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$25.5	$135.1	$243.6	$349.6	$455.5	$521.7
Roclatan	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$31.9	$126.8	$269.1	$356.8	$494.5
Total Revenue	**$0.0**	**$0.0**	**$0.0**	**$0.0**	**$0.0**	**$0.0**	**$0.0**	**$0.0**	**$0.0**	**$25.5**	**$167.0**	**$370.4**	**$618.6**	**$812.3**	**$1,016.2**
Gross Profit	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$22.9	$150.3	$333.4	$556.8	$731.0	$914.6
Gross Margin										*90.0%*	*90.0%*	*90.0%*	*90.0%*	*90.0%*	*90.0%*
SG&A	$5.0	$9.9	$3.6	$5.2	$5.0	$5.0	$18.8	$16.0	$17.0	$50.0	$65.0	$74.8	$86.0	$90.3	$94.8
R&D	9.3	12.3	5.4	6.7	8.0	8.0	28.0	40.0	45.0	47.3	49.6	52.1	54.7	52.0	49.4
Adj. Operating Income	**(14.3)**	**(32.2)**	**(9.0)**	**(11.8)**	**(13.0)**	**(13.0)**	**(46.8)**	**(56.0)**	**(62.0)**	**(74.3)**	**29.5**	**140.2**	**263.6**	**370.9**	**466.9**
Adj. Operating Margin											*17.7%*	*37.9%*	*42.6%*	*45.7%*	*45.9%*
Non-Op	(0.7)	(8.6)	2.3	0.0	0.1	0.1	2.4	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Tax Rate									0.0%	0.0%	0.0%	0.0%	0.0%	25.0%	38.0%
Adj. Net Income	(15.3)	(27.8)	(4.8)	(9.4)	(10.6)	(10.6)	(35.3)	(46.0)	(51.0)	(61.3)	44.5	157.2	282.6	298.9	310.1
Net Margin	*0%*	*0.0%*	*0%*								*26.7%*	*42.4%*	*45.7%*	*36.8%*	*30.5%*
GAAP EPS (diluted)	$0.00	($1.23)	($0.28)	($0.49)	($0.54)	($0.53)	($1.85)	($1.86)	($1.20)	($1.06)	$0.73	$3.44	$6.38	$6.66	$6.86
Adjusted EPS (diluted)	**$0.00**	**($1.42)**	**($0.20)**	**($0.39)**	**($0.44)**	**($0.43)**	**($1.47)**	**($1.55)**	**($1.46)**	**($1.52)**	**$1.09**	**$3.83**	**$6.81**	**$7.13**	**$7.33**
Diluted Shares (M)	0.0	19.6	23.7	23.9	24.1	24.4	24.0	29.6	34.9	40.3	40.7	41.1	41.5	41.9	42.3
Year-over-Year Growth															
Rhopressa											430%	80%	44%	30%	15%
Roclatan												298%	112%	33%	39%
Total Revenue											*556%*	*122%*	67%	31%	25%
Gross Profit											*556%*	*122%*	67%	31%	25%
SG&A			*146%*	*172%*	*52%*	*56%*	*91%*	*(15%)*	*6%*	*194%*	*30%*	*15%*	15%	5%	5%
R&D			*70%*	*115%*	*233%*	*122%*	*128%*	*43%*	*13%*	*5%*	*5%*	*5%*	5%	-5%	-5%
Operating Income												*375%*	88%	41%	26%
Net Income												*253%*	80%	6%	4%
Adj. EPS												***250%***	***78%***	***5%***	***3%***

Source: Company reports; CGI estimates

Investment risks

Clinical risk – Rhopressa's and Roclatan's Phase 3 programs may not be successful. While we believe there is strong positive precedent data for both from each of the respective Phase 2 studies, there is always a chance of failure in Phase 3. The Phase 2 trials only measured efficacy and safety at one month, but the Phase 3s will go out to three months for efficacy and one year for safety. In addition, a previous Aerie drug candidate showed roll-off of effect between month 1 and 3. However, we believe this older drug was more highly specific to ROCK inhibition than Rhopressa, which has low-level PKC inhibition activity as well. The PKC pathway may compensate for ROCK-mediated IOP lowering; therefore inhibiting both should result in sustained benefit. Given almost no systemic exposure with Rhopressa and Roclatan as eye drops, we expect continued clean safety, even with longer treatment duration in the upcoming Phase 3 trials versus the Phase 2.

Regulatory risk – FDA may not approve Rhopressa or Roclatan, as the agency is inherently unpredictable – even if the Phase 3 trials look successful on the surface. Should the FDA's interpretation of the relationship between IOP lowering and loss of visual acuity change, the agency may want additional measures of benefit to grant approval. We deem this highly unlikely given there have been many glaucoma drugs approved under the current and planned paradigm. Further, clinical trials could yield some new safety signal that could be of concern to the agency.

Competitive risk – There are a number of other current, well-established classes of glaucoma therapy on the market that clinicians have significant experience with; a number of other approved glaucoma drugs utilize different mechanisms to treat the disease. All of these drugs have been approved for years, if not decades; ophthalmologists have had significant experience treating patients with these medications, and have significant comfort with their efficacy and side effect profiles. As a result, ophthalmologists may continue to preferentially prescribe these drugs despite any potentially superior therapeutic profile of Rhopressa or Roclatan.

Commercialization/reimbursement risk – As we mentioned previously, most current glaucoma therapies are generics, and are available relatively cheaply compared to Aerie's intended pricing for Rhopressa ($110/month is our assumption) and Roclatan ($135/month is our assumption); therefore, there is no guarantee Aerie will be able to secure reimbursement for these drugs. Most (but not all) glaucoma medications are available in generic form in the US for <$30 per month. Branded glaucoma drugs like Lumigan and Alphagan are still able to secure reimbursement and meaningful market share, although many are restricted to second-line use with step-edits. Whether this ends up also being the case with Aerie will depend on the strength of the efficacy data – and whether Aerie is able to show evidence of disease modification.

Financial risk – Aerie's current cash position will last until mid-2016. While not really risk per se, we have assumed two additional capital raises in our model – one in Q4 2014 and one in 2017 prior to the launch of Rhopressa. We do not factor in any upfront payments from potential partnerships from ex-US markets. And an inability to raise enough capital to extend operations until profitability would present a risk.

APPENDIX: IMPORTANT DISCLOSURES

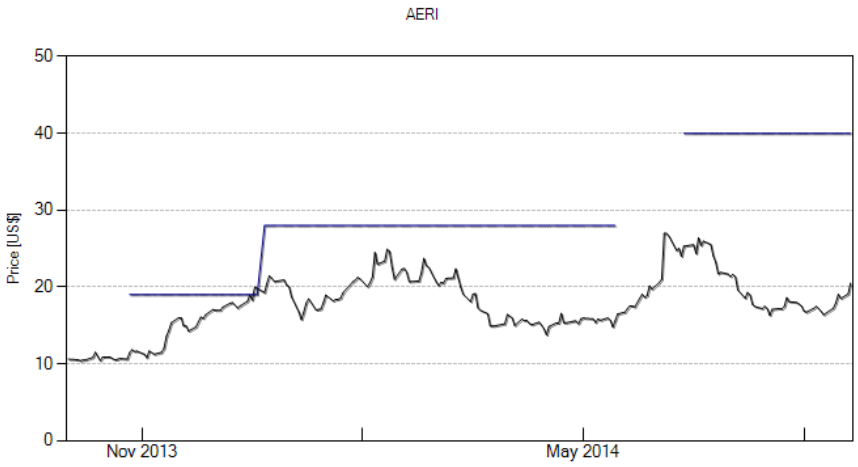
Analyst Certification: Each authoring analyst of Canaccord Genuity whose name appears on the front page of this research hereby certifies that (i) the recommendations and opinions expressed in this research accurately reflect the authoring analyst's personal, independent and objective views about any and all of the designated investments or relevant issuers discussed herein that are within such authoring analyst's coverage universe and (ii) no part of the authoring analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by the authoring analyst in the research.

Analysts employed outside the US are not registered as research analysts with FINRA. These analysts may not be associated persons of Canaccord Genuity Inc. and therefore may not be subject to the NASD Rule 2711 and NYSE Rule 472 restrictions on communications with a subject company, public appearances and trading securities held by a research analyst account.

Compendium Report: If this report covers six or more subject companies, it is a compendium report and Canaccord Genuity and its affiliated companies hereby direct the reader to the specific disclosures related to the subject companies discussed in this report, which may be obtained at the following website (provided as a hyperlink if this report is being read electronically) http://disclosures.canaccordgenuity.com/EN/Pages/default.aspx; or by sending a request to Canaccord Genuity Corp. Research, Attn: Disclosures, P.O. Box 10337 Pacific Centre, 2200-609 Granville Street, Vancouver, BC, Canada V7Y 1H2; or by sending a request by email to disclosures@canaccordgenuity.com. The reader may also obtain a copy of Canaccord Genuity's policies and procedures regarding the dissemination of research by following the steps outlined above.

Site Visit: An analyst has visited Aerie Pharmaceuticals' material operations in Bedminster, NJ. No payment or reimbursement was received from the issuer for the related travel costs.

Price Chart:*



	Date	Analyst	Rating	Target Price		Date	Analyst	Rating	Target Price
1)	11/19/2013	Baral	Buy	19.00	3)	06/06/2014	Research	Suspended	
2)	01/13/2014	Baral	Buy	28.00	4)	07/03/2014	Davis	Buy	40.00

*Price charts assume event 1 indicates initiation of coverage or the beginning of the measurement period.

Distribution of Ratings:
Global Stock Ratings
(as of 3 July 2014)

	Coverage Universe		IB Clients
Rating	#	%	%
Buy	602	61.2%	38.2%
Speculative Buy	49	5.0%	55.1%
Hold	290	29.5%	13.1%
Sell	41	4.2%	7.3%
	984	100.0%	

*Total includes stocks that are Under Review

Canaccord Genuity Ratings System:

BUY: The stock is expected to generate risk-adjusted returns of over 10% during the next 12 months.
HOLD: The stock is expected to generate risk-adjusted returns of 0-10% during the next 12 months.
SELL: The stock is expected to generate negative risk-adjusted returns during the next 12 months.
NOT RATED: Canaccord Genuity does not provide research coverage of the relevant issuer.

"Risk-adjusted return" refers to the expected return in relation to the amount of risk associated with the designated investment or the relevant issuer.

Risk Qualifier:

SPECULATIVE: Stocks bear significantly higher risk that typically cannot be valued by normal fundamental criteria. Investments in the stock may result in material loss.

Canaccord Genuity Research Disclosures as of 11 September 2014

Company	Disclosure
Aerie Pharmaceuticals	1A, 2, 3, 5, 7

1	The relevant issuer currently is, or in the past 12 months was, a client of Canaccord Genuity or its affiliated companies. During this period, Canaccord Genuity or its affiliated companies provided the following services to the relevant issuer: A. investment banking services. B. non-investment banking securities-related services. C. non-securities related services.
2	In the past 12 months, Canaccord Genuity or its affiliated companies have received compensation for Corporate Finance/Investment Banking services from the relevant issuer.
3	In the past 12 months, Canaccord Genuity or any of its affiliated companies have been lead manager, co-lead manager or co-manager of a public offering of securities of the relevant issuer or any publicly disclosed offer of securities of the relevant issuer or in any related derivatives.
4	Canaccord Genuity acts as corporate broker for the relevant issuer and/or Canaccord Genuity or any of its affiliated companies may have an agreement with the relevant issuer relating to the provision of Corporate Finance/Investment Banking services.
5	Canaccord Genuity or one or more of its affiliated companies is a market maker or liquidity provider in the securities of the relevant issuer or in any related derivatives.
6	In the past 12 months, Canaccord Genuity, its partners, affiliated companies, officers or directors, or any authoring analyst involved in the preparation of this research has provided services to the relevant issuer for remuneration, other than normal course investment advisory or trade execution services.
7	Canaccord Genuity or one or more of its affiliated companies intend to seek or expect to receive compensation for Corporate Finance/Investment Banking services from the relevant issuer in the next six months.
8	The authoring analyst, a member of the authoring analyst's household, or any individual directly involved in the preparation of this research, has a long position in the shares or derivatives, or has any other financial interest in the relevant issuer, the value of which increases as the value of the underlying equity increases.
9	The authoring analyst, a member of the authoring analyst's household, or any individual directly involved in the preparation of this research, has a short position in the shares or derivatives, or has any other financial interest in the relevant issuer, the value of which increases as the value of the underlying equity decreases.
10	Those persons identified as the author(s) of this research, or any individual involved in the preparation of this research, have purchased/received shares in the relevant issuer prior to a public offering of those shares, and such person's name and details are disclosed above.
11	A partner, director, officer, employee or agent of Canaccord Genuity or its affiliated companies, or a member of his/her household, is an officer, or director, or serves as an advisor or board member of the relevant issuer and/or one of its subsidiaries, and such person's name is disclosed above.
12	As of the month end immediately preceding the date of publication of this research, or the prior month end if publication is within 10 days following a month end, Canaccord Genuity or its affiliated companies, in the aggregate, beneficially owned 1% or more of any class of the total issued share capital or other common equity securities of the relevant issuer or held any other financial interests in the relevant issuer which are significant in relation to the research (as disclosed above).
13	As of the month end immediately preceding the date of publication of this research, or the prior month end if publication is within 10 days following a month end, the relevant issuer owned 1% or more of any class of the total issued share capital in Canaccord Genuity or any of its affiliated companies.
14	Other specific disclosures as described above.

"Canaccord Genuity" is the business name used by certain wholly owned subsidiaries of Canaccord Genuity Group Inc., including Canaccord Genuity Inc., Canaccord Genuity Limited, Canaccord Genuity Corp., and Canaccord Genuity (Australia) Limited, an affiliated company that is 50%-owned by Canaccord Genuity Group Inc.

The authoring analysts who are responsible for the preparation of this research are employed by Canaccord Genuity Corp. a Canadian broker-dealer with principal offices located in Vancouver, Calgary, Toronto, Montreal, or Canaccord Genuity Inc., a US broker-dealer with principal offices located in New York, Boston, San Francisco and Houston, or Canaccord Genuity Limited., a UK broker-dealer with principal offices located in London (UK) and Dublin (Ireland), or Canaccord Genuity (Australia) Limited, an Australian broker-dealer with principal offices located in Sydney and Melbourne.

The authoring analysts who are responsible for the preparation of this research have received (or will receive) compensation based upon (among other factors) the Corporate Finance/Investment Banking revenues and general profits of Canaccord Genuity. However, such authoring analysts have not received, and will not receive, compensation that is directly based upon or linked to one or more specific Corporate Finance/Investment Banking activities, or to recommendations contained in the research.

Canaccord Genuity and its affiliated companies may have a Corporate Finance/Investment Banking or other relationship with the issuer that is the subject of this research and may trade in any of the designated investments mentioned herein either for their own account or the accounts of their customers, in good faith or in the normal course of market making. Accordingly, Canaccord Genuity or their affiliated companies, principals or employees (other than the authoring analyst(s) who prepared this research) may at any time have a long or short position in any such designated investments, related designated investments or in options, futures or other derivative instruments based thereon.

Some regulators require that a firm must establish, implement and make available a policy for managing conflicts of interest arising as a result of publication or distribution of research. This research has been prepared in accordance with Canaccord Genuity's policy on managing conflicts of interest, and information barriers or firewalls have been used where appropriate. Canaccord Genuity's policy is available upon request.

The information contained in this research has been compiled by Canaccord Genuity from sources believed to be reliable, but (with the exception of the information about Canaccord Genuity) no representation or warranty, express or implied, is made by Canaccord Genuity, its affiliated companies or any other person as to its fairness, accuracy, completeness or correctness. Canaccord Genuity has not independently verified the facts, assumptions, and estimates contained herein. All estimates, opinions and other information contained in this research constitute Canaccord Genuity's judgement as of the date of this research, are subject to change without notice and are provided in good faith but without legal responsibility or liability.

Canaccord Genuity's salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients and our proprietary trading desk that reflect opinions that are contrary to the opinions expressed in this research. Canaccord Genuity's affiliates, principal trading desk, and investing businesses may make investment decisions that are inconsistent with the recommendations or views expressed in this research.

This research is provided for information purposes only and does not constitute an offer or solicitation to buy or sell any designated investments discussed herein in any jurisdiction where such offer or solicitation would be prohibited. As a result, the designated investments discussed in this research may not be eligible for sale in some jurisdictions. This research is not, and under no circumstances should be construed as, a solicitation to act as a securities broker or dealer in any jurisdiction by any person or company that is not legally permitted to carry on the business of a securities broker or dealer in that jurisdiction. This material is prepared for general circulation to clients and does not have regard to the investment objectives, financial situation or particular needs of any particular person. Investors should obtain advice based on their own individual circumstances before making an investment decision. To the fullest extent permitted by law, none of Canaccord Genuity, its affiliated companies or any other person accepts any liability whatsoever for any direct or consequential loss arising from or relating to any use of the information contained in this research.

For Canadian Residents:

This research has been approved by Canaccord Genuity Corp., which accepts sole responsibility for this research and its dissemination in Canada. Canadian clients wishing to effect transactions in any designated investment discussed should do so through a qualified salesperson of Canaccord Genuity Corp. in their particular province or territory.

For United States Residents:

Canaccord Genuity Inc., a US registered broker-dealer, accepts responsibility for this research and its dissemination in the United States. This research is intended for distribution in the United States only to certain US institutional investors. US clients wishing to effect transactions in any designated investment discussed should do so through a qualified salesperson of Canaccord Genuity Inc. Analysts employed outside the US, as specifically indicated elsewhere in this report, are not registered as research analysts with FINRA. These analysts may not be associated persons of Canaccord Genuity Inc. and therefore may not be subject to the NASD Rule 2711 and NYSE Rule 472 restrictions on communications with a subject company, public appearances and trading securities held by a research analyst account.

For United Kingdom and European Residents:

This research is distributed in the United Kingdom and elsewhere Europe, as third party research by Canaccord Genuity Limited, which is authorized and regulated by the Financial Conduct Authority. This research is for distribution only to persons who are Eligible Counterparties or Professional Clients only and is exempt from the general restrictions in section 21 of the Financial Services and Markets Act 2000 on the communication of invitations or inducements to engage in investment activity on the grounds that it is being distributed in the United Kingdom only to persons of a kind described in Article 19(5) (Investment Professionals) and 49(2) (High Net Worth companies, unincorporated associations etc) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended). It is not intended to be distributed or passed on, directly or indirectly, to any other class of persons. This material is not for distribution in the United Kingdom or elsewhere in Europe to retail clients, as defined under the rules of the Financial Conduct Authority.

For Jersey, Guernsey and Isle of Man Residents:

This research is sent to you by Canaccord Genuity Wealth (International) Limited (CGWI) for information purposes and is not to be construed as a solicitation or an offer to purchase or sell investments or related financial instruments. This research has been produced by an affiliate of CGWI for circulation to its institutional clients and also CGWI. Its contents have been approved by CGWI and we are providing it to you on the basis that we believe it to be of interest to you. This statement should be read in conjunction with your client agreement, CGWI's current terms of business and the other disclosures and disclaimers contained within this research. If you are in any doubt, you should consult your financial adviser.
CGWI is licensed and regulated by the Guernsey Financial Services Commission, the Jersey Financial Services Commission and the Isle of Man Financial Supervision Commission. CGWI is registered in Guernsey and is a wholly owned subsidiary of Canaccord Genuity Group Inc.

For Australian Residents:

This research is distributed in Australia by Canaccord Genuity (Australia) Limited ABN 19 075 071 466 holder of AFS Licence No 234666. To the extent that this research contains any advice, this is limited to general advice only. Recipients should take into account their own personal circumstances before making an investment decision. Clients wishing to effect any transactions in any financial products discussed in the research should do so through a qualified representative of Canaccord Genuity (Australia) Limited. Canaccord Genuity Wealth Management is a division of Canaccord Genuity (Australia) Limited.

For Singapore Residents:

This research is distributed pursuant to 32C of the Financial Advisers under an arrangement between each of the Canaccord Genuity entities that publish research and Canaccord Genuity Singapore Pte. Ltd who are an exempt financial adviser under section 23(1)(d) of the Financial Advisers Act. This research is only intended for persons who fall within the definition of accredited investor, expert investor or institutional investor as defined under section 4A of the Securities and Futures Act It is not intended to be distributed or passed on, directly or indirectly, to any other class of persons. Recipients of this report can contact Canaccord Genuity Singapore Pte. Ltd. (Contact Person: Tom Gunnersen's tel # is +852 3919 2561) in respect of any matters arising from, or in connection with, the [analyses or report].

For Hong Kong Residents:

This research is distributed in Hong Kong by Canaccord Genuity (Hong Kong) Limited who is licensed by the Securities and Futures Commission. This research is only intended for persons who fall within the definition of professional investor as defined in the Securities and Futures Ordinance. It is not intended to be distributed or passed on, directly or indirectly, to any other class of persons. Recipients of this report can contact Canaccord Genuity (Hong Kong). Ltd. (Contact Person: Tom Gunnersen's tel # is +852 3919 2561) in respect of any matters arising from, or in connection with, the research.

Additional information is available on request.