AERIE PHARMACEUTICALS INC
Form 10-Q
December 05, 2013
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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, 2013

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 incorporation or organization)	**(I.R.S. Employer 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: ¨ No: x

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 29, 2013, there were 23,273,626 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, continue, estimates, anticipates, plans, intends, may, could, might, will, should or other words that convey uncertainty of future events or c 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 clinical trials and anticipated Phase 3 and Phase 2b clinical trials for our current product candidates, including statements regarding the timing of initiation and completion of the trials;
- the timing of and our ability to obtain and maintain U.S. Food and Drug Administration (FDA) or other regulatory authority approval of, or other action with respect, to our product candidates;
- 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;
- our estimates regarding anticipated capital requirements and our needs for additional financing;
- our expectations regarding the clinical effectiveness of our product candidates and results of our clinical trials;
- 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;

our expectations related to the use of proceeds from our initial public offering; and

our expectations regarding licensing, acquisitions and strategic operations.

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 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 1A of this report and elsewhere in this report. 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 speak only 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, 2013	December 31, 2012
Assets		
Current assets		
Cash and cash equivalents	$ 4,619	$ 2,925
Prepaid expenses and other current assets	117	113
Deferred offering costs	2,330	
Total current assets	7,066	3,038
Furniture, fixtures and equipment, net	114	133
Other assets, net	62	48
Total assets	$ 7,242	$ 3,219
Liabilities, Convertible Preferred Stock and Stockholders Deficit		
Current liabilities		
Accounts payable and other current liabilities	$ 3,175	$ 1,437
Notes payable, net of discount related parties	14,433	2,331
Interest payable related parties	504	16
Total current liabilities	18,112	3,784
Warrants liability related parties	11,485	2,456
Total liabilities	29,597	6,240
Commitments and contingencies (Note 9)		
Convertible preferred stock, $0.001 par value, 87,872,909 shares authorized as of September 30, 2013 and 82,672,909 shares authorized as of December 31, 2012		
Series A-1 2,000,000 shares authorized as of September 30, 2013 and December 31, 2012; 2,000,000 shares issued and outstanding as of	1,000	1,000

September 30, 2013 and December 31, 2012		
Series A-2 10,010,029 shares authorized as of September 30, 2013 and December 31, 2012; 10,000,000 shares issued and outstanding as of September 30, 2013 and December 31, 2012	10,000	10,000
Series A-3 22,479,476 shares authorized as of September 30, 2013 and December 31, 2012; 20,979,476 shares issued and outstanding as of September 30, 2013 and December 31, 2012	20,979	20,979
Series A-4 5,683,404 shares authorized as of September 30, 2013 and December 31, 2012; 4,895,904 shares issued and outstanding as of September 30, 2013 and December 31, 2012	4,826	4,606
Series B 47,700,000 shares authorized as of September 30, 2013 and 42,500,000 shares authorized as of December 31, 2012; 22,727,273 shares issued and outstanding as of September 30, 2013 and December 31, 2012	24,506	24,313
Total convertible preferred stock	61,311	60,898
Stockholders deficit		
Common stock, $0.001 par value; 22,000,000 shares authorized as of September 30, 2013 and 20,000,000 shares authorized as of December 31, 2012; 1,021,209 and 964,880 shares issued and outstanding at September 30, 2013 (unaudited) and December 31, 2012, respectively;	1	1
Additional paid-in capital	1,123	4
Deficit accumulated during the development stage	(84,790)	(63,924)
Total stockholders deficit	(83,666)	(63,919)
Total liabilities, convertible preferred stock and stockholders deficit	$ 7,242	$ 3,219

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,
	2013	2012	2013	2012	2013
Operating expenses					
General and administrative	$ (3,287)	$ (1,416)	$ (6,693)	$ (3,701)	$ (26,590)
Research and development	(2,399)	(1,373)	(8,727)	(7,305)	(51,876)
Loss from operations	(5,686)	(2,789)	(15,420)	(11,006)	(78,466)
Other income (expense) net	(5,062)	(803)	(5,446)	(427)	(6,188)
Net loss	$ (10,748)	$ (3,592)	$ (20,866)	$ (11,433)	$ (84,654)
Comprehensive loss	$ (10,748)	$ (3,592)	$ (20,866)	$ (11,433)	$ (84,654)
Net loss attributable to common stockholders basic and diluted	$ (10,887)	$ (3,730)	$ (21,279)	$ (11,845)	
Net loss per share attributable to common stockholders basic and diluted	$ (10.81)	$ (3.87)	$ (21.61)	$ (12.38)	
Weighted average number of common shares outstanding basic and diluted	1,006,893	964,880	984,727	957,079	

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,		Period From Inception (June 22, 2005) to September 30,
	2013	**2012**	**2013**
Cash flows from operating activities			
Net loss	$ (20,866)	$ (11,433)	$ (84,654)
Adjustments to reconcile net loss to net cash used in operating activities			
Depreciation	47	104	933
Amortization and accretion costs related to notes payable related parties	2,377		3,774
Gain on conversion of notes payable			(821)
Stock-based compensation	1,531	292	2,561
Interest payable related parties	488		1,625
Change in fair value measurements	3,850	441	3,851
Changes in operating assets and liabilities			
Prepaid, current and other assets	(18)	39	(179)
Accounts payable and other current liabilities	1,025	(1,395)	2,481
Net cash used in operating activities	(11,566)	(11,952)	(70,429)
Cash flows from investing activities			
Purchase of furniture, fixtures and equipment	(28)	(51)	(1,047)
Net cash provided by (used in) investing activities	(28)	(51)	(1,047)
Cash flows from financing activities			
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)
Payments of debt issuance costs			(115)

Proceeds from sale of common stock			3
Proceeds from exercise of stock options	1	6	16
Payments of long-term debt			(528)
Payments of initial public offering costs	(1,713)		(1,713)
Net cash provided by financing activities	13,288	6	76,095
Net change in cash and cash equivalents	1,694	(11,997)	4,619
Beginning of period	2,925	15,068	
End of period	$ 4,619	$ 3,071	$ 4,619
Supplemental disclosures			
Noncash financing activities			
Conversion of long-term debt into preferred stock			17,364
Debt discount attributable to warrants	5,275		7,724
Accretion from conversion of note payable to related parties	220	219	755
Accretion of stock issuance costs	193	193	722
Deferred offering costs	617		617

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 drugs to treat patients with glaucoma and other diseases of the eye. Incorporated in the State of Delaware on June 22, 2005, the Company has its corporate headquarters in Bedminster, New Jersey, conducts research in Research Triangle Park, North Carolina, and has an office in Newport Beach, California. All technology of the Company is based on own use research and development.

To date, the Company is in the development stage since it has not yet commenced primary operations or generated significant revenue. The Company s activities since inception primarily consisted of developing product and technology rights, 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 accompanying financial statements have been prepared on a basis that assumes the Company will continue as a going concern, which contemplates the realization of assets and the satisfaction of liabilities and commitments in the normal course of business. The Company has funded its operations as of September 30, 2013 primarily through the sale of convertible preferred stock and issuance of convertible notes. In October 2013, the Company completed its initial public offering and issued 6,720,000 shares of its common stock at an initial offering price of $10.00 per share (Note 11). In addition, the Company sold an additional 1,008,000 shares of common stock directly to its underwriters when they exercised their over-allotment option in full at the initial offering price of $10.00 per share. The Company received net proceeds from the initial public offering of approximately $68.3 million, after deducting underwriting discounts and commissions of $5.4 million and expenses of $3.6 million. Including the net proceeds from the initial public offering, the Company estimates that it has sufficient funding to sustain operations through approximately mid-2016. Accordingly, the Company will 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.

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 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, 2012 included in the Company s final prospectus dated October 24, 2013 filed pursuant to Rule 424(b) under the Securities Act of 1933, as amended, with the Securities and Exchange Commission. The results for the three and nine months ended September 30, 2013 are not necessarily indicative of the results to be expected for a full year, any other interim periods or any future year or period.

Additionally, the Company closed the aforementioned initial public offering in October 2013 as further described in Note 11 to the financial statements. As a result, there have been significant changes to the Company s capital structure subsequent to the date of these financial statements.

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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 warrants and operating expense accruals.

Reverse Stock Split

The Company effected a 1-for-5 reverse stock split of its common stock on October 8, 2013. Accordingly, all share and per share amounts related to common stock and options for all periods presented in these financial statements and notes thereto, have been adjusted retroactively to reflect this reverse stock split. The Company s preferred stock was not subject to the reverse stock split.

Equity Issuances in the Quarter Ended September 30, 2013

In the context of its initial public offering, the Company determined that the probability of the conversion of preferred stock into common stock, based on the consent from the holders of the requisite number of preferred shares, was high as of September 30, 2013. As a result, the allocation of the determined equity value assumed conversion of all preferred stock into common stock. For financial reporting purposes, based on recommendations from management and taking into account advice and assistance provided by third-party valuation consultants engaged to assist in such valuations, the Company s board of directors determined that the fair value of its common stock for all equity transactions during the quarter ended September 30, 2013 and all transactions that require fair value measurement as of September 30, 2013 was consistent with the initial public offering price of $10.00. Accordingly, for the quarter ended September 30, 2013, the Company recognized a stock-based compensation charge of $0.2 million related to stock options granted on August 26, 2013 and September 12, 2013 and $0.7 million related to the remeasurement of grants to non-employees. The total unrecognized stock-based compensation expense related to the August and September 2013 option grants was $13.6 million and is expected to be recognized ratably through 2017, which represents the expected vesting period of the options (Note 8). In addition, the Company measured the stock purchase warrants issued on August 9, 2013 and September 30, 2013 using the initial public offering price as the deemed fair value of its common stock, resulting in an initial measurement of the warrant liability of $2.0 million and $1.4 million, respectively (Note 7).

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.

The Company s material financial instruments consist primarily of cash and cash equivalents, other current assets, accounts payable, accrued expenses, long-term debt and stock purchase warrant liabilities. The fair value of cash and cash equivalents, other current assets, accounts payable and accrued expenses approximate their respective carrying values due to the short-term nature of these instruments. The Company has determined its stock purchase warrants liability to be Level 3 fair value measurement (Note 7).

Recent Accounting Pronouncements

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 will be effective for the Company for interim and annual periods beginning after December 15, 2013, with early adoption permitted. The adoption of this standard is not expected to 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 statement 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 as the Company s net income is equal to its comprehensive income.

In June 2011, the FASB issued amended guidance intended to increase the prominence of items reported on other comprehensive income (loss). This amended guidance requires that all non-owner changes in stockholders equity (deficit) be presented in a single continuous statement of comprehensive income (loss) or in two separate but consecutive statements. The amended guidance became effective for periods beginning after

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December 15, 2011. The Company has applied this guidance beginning with its financial information for the year ended December 31, 2012. This amended guidance affects presentation, but does not have a material effect on the Company s financial statements.

Net Loss per Common Share

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 potential common stock instruments. Net loss attributable to common stockholders is calculated by adjusting the Company s net loss for accretion on convertible preferred stock (Note 6). 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, which include convertible preferred stock, stock options, notes payable to related parties and stock purchase warrants, have been excluded from the computation of diluted net loss per common share attributable to common stockholders as their inclusion would have the effect of reducing the net loss per common share. Therefore, the denominator used to calculate both basic and diluted net loss per common stock is the same in all periods presented. The Company s potential common stock equivalents that have been excluded from the computation of diluted net loss per share attributable to common stockholders for all periods presented because of their antidilutive effect consist of the following:

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2013	2012	2013	2012
Convertible preferred stock	60,602,653	60,602,653	60,602,653	60,602,653
Outstanding stock options	3,189,660	1,209,200	3,189,660	1,209,200
Notes and interest payable to related parties[(1)]	$ 18,504,000	$	$ 18,504,000	$
Stock purchase warrants	6,388,431	2,297,529	6,388,431	2,297,529
Unvested restricted common stock awards	317,900		317,900	

(1) The 2012 Notes and accrued interest thereon are convertible into capital stock at the option of the holders according to the terms of the 2012 Note and Warrant Agreement. See Note 5.

3. Other Income (Expense), Net

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

(in thousands)	THREE MONTHS ENDED SEPTEMBER 30, 2013	2012	NINE MONTHS ENDED SEPTEMBER 30, 2013	2012	PERIOD FROM INCEPTION (JUNE 22, 2005) TO

					SEPTEMBER 30, 2013
Interest expense	$ (1,477)	$ (15)	$ (2,865)	$ (15)	$ (5,399)
Gain on conversion of notes payable to related parties					821
Sale of New Jersey state tax benefit			1,268		1,268
(Expense)/income due to change in fair value measurements[1]	(3,585)	(788)	(3,850)	(441)	(3,851)
Other income, net			1	29	973
	$ (5,062)	$ (803)	$ (5,446)	$ (427)	$ (6,188)

(1) Includes change in fair value of warrant liabilities and change in fair value of a certain conversion feature related to the 2012 Notes that was determined to be an embedded derivative requiring bifurcation and separate accounting. See Note 7 and Note 5, respectively.

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4. Accounts Payable & Other Current Liabilities

Accounts payable and other current liabilities consist of the following:

(in thousands)	SEPTEMBER 30, 2013	DECEMBER 31, 2012
Accounts payable	$ 1,126	$ 174
Employee benefits and compensation related accruals[1]	1,051	400
Accrued expenses and other liabilities	998	863
	$ 3,175	$ 1,437

(1) Comprised of accrued bonus, accrued vacation and accrued severance liabilities.

5. Notes Payable

On December 7, 2012, the Company authorized the sale of convertible notes (the 2012 Notes) to related parties in the aggregate principal amount of $15.0 million. The 2012 Notes accrue interest at a rate of 8% per annum, with principal plus accrued interest thereon due upon maturity at September 30, 2013. The 2012 Notes are convertible into capital stock at the option of the holders upon the closing of an equity financing that raises at least $15.0 million, a qualified initial public offering, liquidation or any reorganization, consolidation or merger. The Company may, in its discretion, request a subsequent closing when its cash and cash equivalents balance drops below $1.5 million. The initial closing comprised of five individual convertible notes with an aggregate principal balance of $3.0 million. As of December 31, 2012, $12.0 million of 2012 Notes were authorized and available for sale. On March 28, 2013, May 23, 2013 and August 9, 2013, the Company completed the second, third and fourth closing of the 2012 Notes, respectively. The closings each comprised of five individual convertible notes with aggregate principal balances of $3.0 million, $4.5 million and $4.5 million, respectively. On August 9, 2013, the Company amended the agreements relating to the 2012 Notes. The amendment authorized the sale of an additional $3.0 million of convertible notes to related parties, resulting in an aggregate principal amount of $18.0 million being authorized. Additionally, the amendment extended the maturity date of the 2012 Notes from September 30, 2013 to December 31, 2013 and the issuance period through November 30, 2013. No other terms and conditions of the agreements were changed as part of the amendment. In accordance with ASC 470 *Debt*, the amendment met the criteria of a troubled debt restructuring and the amortization of the debt discount was revised to align with a new effective interest rate determined as of the amendment date. No gain was recorded as part of the restructuring. On September 30, 2013, the Company completed the fifth closing of the 2012 Notes. Aggregate proceeds to the Company were $3.0 million. The Company classified all convertible notes and related accrued interest as current obligations as of September 30, 2013 and December 31, 2012.

In connection with the issuance of the 2012 Notes, the Company determined that a certain conversion feature was an embedded derivative requiring bifurcation and separate accounting. To estimate the fair value, the Company compared the net present value of expected cash flows of the issued 2012 Notes with and without the conversion feature comprising the embedded derivative. The Company determined that the fair value of the embedded derivative was immaterial as of August 9, 2013, May 23, 2013, March 28, 2013 and December 7, 2012, representing the fourth, third, second and initial closing dates, and as of December 31, 2012. As of September 30, 2013, the fair value of the

embedded derivative was $96,000. The Company recorded the embedded derivative liability within accounts payable and other current liabilities and the change in fair value as a component of Other income (expense), net.

As of September 30, 2013 and December 31, 2012, the Company recognized unamortized debt discounts of $3.6 million and $669,000, respectively, relating to the detachable warrants issued in conjunction with the 2012 Notes (Note 7). Debt discounts are amortized using the effective interest method through the earlier of the date of maturity or the conversion of the debt. For the three months and nine month ended September 30, 2013, amortization of debt discounts and accrued interest expense amounted to $1.5 million and $2.9 million, respectively.

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6. Convertible Preferred Stock

Concurrent with this issuance of its Series B Convertible Preferred Stock in February 2011, the certificate of incorporation was amended to authorize the issuance of 15,734,582 shares of common stock and 63,672,909 shares of convertible preferred stock, of which 2,000,000 are designated as Series A-1 Convertible Preferred Stock; 10,010,029 are designated as Series A-2 Convertible Preferred Stock; 23,266,976 are designated as Series A-3 Convertible Preferred Stock; 4,895,904 are designated as Series A-4 Convertible Preferred Stock; and 23,500,000 are designated as Series B Convertible Preferred Stock.

In connection with the issuance of the 2012 Notes, the Certificate of Incorporation was amended on December 7, 2012, to authorize the issuance of 20,000,000 shares of common stock and 82,672,909 shares of preferred stock, of which 2,000,000 are designated as Series A-1 Preferred Stock; 10,010,029 are designated as Series A-2 Preferred Stock; 22,479,476 are designated as Series A-3 Preferred Stock; 5,683,404 are designated as Series A-4 Preferred Stock; and 42,500,000 are designated as Series B Preferred Stock.

Concurrent with the amendment to the 2012 Notes, the certificate of incorporation was amended to authorize the issuance of 22,000,000 shares of common stock and 90,172,909 shares of preferred stock, of which 2,000,000 are designated as Series A-1 Preferred Stock; 10,010,029 are designated as Series A-2 Preferred Stock; 22,479,476 are designated as Series A-3 Preferred Stock; 5,683,404 are designated as Series A-4 Preferred Stock; and 50,000,000 are designated as Series B Preferred Stock.

On September 16, 2013, the certificate of incorporation was amended to reflect the re-designation of 2,300,000 unissued shares of Series B Convertible Preferred Stock to common stock.

Carrying Value

The convertible preferred stock was originally recorded at the net proceeds received by the Company at issuance. The difference between the net proceeds and the total redemption price is being accreted on a straight-line basis over the period from issuance until the earliest redemption date. Accretion amounted to $65,000 and $193,000 for the three months and nine months ended September 30, 2013, respectively, and $65,000 and $193,000 for the three months and nine months ended September 30, 2012, respectively, and $722,000 for the period from inception (June 22, 2005) to September 30, 2013, respectively.

The Series A-4 Convertible Preferred Stock issued in connection with the conversion of the 2010 Notes (Note 5) in February 2011 was recorded at fair value. The difference between stated and fair value of $1.3 million is being accreted on a straight-line basis of the period from February 23, 2011 until the earliest redemption date. Accretion amounted to $74,000 and $220,000 for the three months and nine months ended September 30, 2013, respectively, and $73,000 and $219,000 for the three months and nine months ended September 30, 2012, respectively, and $755,000 for the period from February 23, 2011 to September 30, 2013, respectively. The Company determined that the straight-line method approximates the effective interest method.

7. Stock Purchase Warrants

In connection with the issuance of long-term debt and convertible notes, the Company granted and/or sold warrants to purchase 6,388,431 and 2,979,345 shares of convertible preferred stock as of September 30, 2013 and December 31, 2012, respectively. All warrants become automatically exercisable to common stock upon a qualified initial public offering or the conversion of the related convertible preferred stock (Note 11).

The Company recognizes all of its warrants with in its balance sheet as liabilities. The liability is revalued at each reporting period and changes in the fair value of the warrant liability are included as a component of Other income (expense), net. The initial recognition and subsequent changes in fair value of the warrant liability have no effect on the Company s cash flows.

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Key assumptions utilized in the fair value calculation as of September 30, 2013 and December 31, 2012 appear in the table below.

	SEPTEMBER 30, 2013	DECEMBER 31, 2012
Expected term (years)	5.39 6.91	6.13 7.66
Volatility	65.00%	60.00%
Risk-free interest rate	1.51% 2.00%	0.98% 1.31%
Dividend yield	0%	0%

For the three months and nine months ended September 30, 2013, the Company recorded $3.5 million and $3.8 million in Other income (expense), net, respectively, to reflect the change in fair value. For the three months and nine months ended September 30, 2012, the Company recorded $788,000 and $441,000 in Other income (expense), net, respectively, to reflect the change in fair value.

8. Stock-based Compensation

On July 13, 2005, the Company s board of directors adopted and approved the 2005 Aerie Pharmaceutical Stock Plan (the Plan), which, as amended in 2008, 2009, 2011 and 2013, provides for the granting of up to 3,586,227 stock- based awards to employees, directors and consultants of the Company. Stock-based awards vest over variable periods, generally ranging from one to five years, and expire not more than ten years after the date of grant. The Company granted stock options to employees to purchase 2,009,551 and 230,200 shares of common stock for the nine months ended September 30, 2013 and 2012, respectively.

	NUMBER OF SHARES	WEIGHTED AVERAGE EXERCISE PRICE	AGGREGATE INTRINSIC VALUE (000 S)
Options outstanding at December 31, 2012	1,554,200	$ 1.3890	$ 2,348
Granted	2,009,551	3.1121	
Exercised	(3,195)	0.3722	
Cancelled	(370,896)	1.3844	
Options outstanding at September 30, 2013	3,189,660	$ 2.1634	$ 24,996
Options exercisable at September 30, 2013	975,669	$ 0.5911	$ 9,180

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 and restricted stock are reflected in the statement of operations as follows:

(in thousands)	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012	Period From Inception (June 22, 2005) to September 30, 2013
Research and development	$ 62	$ 22	$ 105	$ 66	$ 284
General and administrative	1,068	86	1,426	226	2,277
Total[(1)]	$ 1,130	$ 108	$ 1,531	$ 292	$ 2,561

(1) For the three and nine months ended September 30, 2013, stock-based compensation expense includes $0.9 million of expense related to a stock-based compensation charge on the August and September 2013 option grants based on the assessment of certain assumptions utilized in determining the fair value of common stock in the context of the Company s initial public offering (Note 2).

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As of September 30, 2013, the Company had $14.4 million of unrecognized compensation expense related to options granted under the Plan. This cost is expected to be recognized over a weighted average period of 3.5 years as of September 30, 2013. The weighted average remaining contractual life on all outstanding options as of September 30, 2013 was 6.0 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, 2013, 317,900 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, 2013 was 2.3 years. Compensation expense related to restricted stock awards for the three months and nine months ended September 30, 2013 was $105,000 and $247,000, respectively and was included in general and administrative expense.

9. 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.

10. Related-Party Transactions

The notes issued in 2012 are 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, and is classified as a current obligation on the Company s balance sheets (Note 5).

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

11. Subsequent Events

On October 8, 2013, the Company effected a 1-for-5 reverse split of its common stock. All share and per share amounts related to common stock and options included in these financial statements and notes to financial statements have been restated to reflect the reverse stock split of the Company s common stock. The Company s preferred stock was not subject to the reverse stock split and, accordingly, the conversion ratios of the Company s preferred stock have been adjusted to reflect the reverse split.

As of October 11, 2013, the Company had obtained a written consent from the holders of its outstanding convertible notes in which the holders agreed to convert all principal and interest accrued thereon to common stock upon the completion of the Company s initial

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public offering at a conversion price equal to the per share offering price. In addition, the Company had obtained the consent from the holders of the requisite number of preferred shares to convert to shares of the Company s common stock upon the completion of the Company s initial public offering.

On October 30, 2013, the Company completed its initial public offering and issued 6,720,000 shares of its common stock at an initial offering price of $10.00 per share. In addition, the Company sold an additional 1,008,000 shares of common stock directly to its underwriters when they exercised their over-allotment option in full at the initial offering price of $10.00 per share. The Company received net proceeds from the initial public offering of approximately $68.3 million, after deducting underwriting discounts and commissions of $5.4 million and expenses of $3.6 million. In connection with the initial public offering, the following events occurred subsequent to September 30, 2013:

On October 24, 2013, 1,486,830 warrants to purchase convertible preferred stock were net exercised and were subsequently automatically converted into 297,366 shares of common stock on October 30, 2013;

On October 30, 2013, 931,240 warrants to purchase convertible preferred stock were net exercised and were subsequently automatically converted into 186,248 shares of common stock on October 30, 2013;

On October 30, 2013, the outstanding shares of convertible preferred stock automatically converted into an aggregate 12,120,531 shares of common stock;

On October 30, 2013, the principal and interest outstanding under our $18.0 million in aggregate principal amount of our 8% convertible notes due December 31, 2013 converted into 1,860,363 shares of common stock at a conversion price equal to the initial public offering price of $10.00 per share;

On October 30, 2013, 3,589,005 warrants to purchase convertible preferred stock were converted into 717,801 warrants to purchase common stock, at which time the liabilities were re-measured and reclassified to equity.

On October 30, 2013, the certificate of incorporation was amended to increase the number of authorized shares of common stock to 150,000,000 with a par value of $0.001 per share and decrease the number of authorized preferred stock to 15,000,000 with a par value of $0.001 per share.

On October 30, 2013, the Company s By-Laws were amended and restated in their entirety.

On October 30, 2013, the 2013 Omnibus Incentive Plan became effective under which 3,229,068 equity awards for common stock of the Company may be distributed.

On October 30, 2013, the 2013 Employee Stock Purchase Plan became effective under which a maximum of 645,814 shares may be issued.

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 included in Part I, Item 1 of this Quarterly Report on Form 10-Q and with our audited financial statements and related notes for the year ended December 31, 2012, included in our prospectus dated October 24, 2013 (the IPO Prospectus), filed with the U.S. Securities and Exchange Commission pursuant to Rule 424(b) under the Securities Act.

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, dual-action AR-13324, recently completed a Phase 2b clinical trial in patients with open-angle glaucoma and ocular hypertension. We are also developing a second product candidate, once-daily, triple-action PG324, which is a fixed-dose combination of AR-13324 and latanoprost, the most commonly prescribed drug for the treatment of patients with glaucoma. We are focused on glaucoma because we believe our product candidates provide important new opportunities to improve the treatment of the disease.

We are developing AR-13324 as the first of a new class of compounds that is designed to lower intraocular pressure, or IOP, in patients through a novel dual mechanism of action, or MOA. PG324 is designed to lower IOP through all three MOAs: increasing fluid outflow through the trabecular meshwork, or the TM, the eye s primary drain, increasing fluid outflow through the uveoscleral pathway, the eye s secondary drain, and reducing fluid production in the eye.

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We are a development stage company and have incurred net losses since our inception in June 2005. Our operations to date have been limited to research and development and raising capital. Through September 30, 2013, we have raised net cash proceeds of $78.6 million from the sale of $43.8 million of convertible preferred stock and $34.8 million of convertible notes. Subsequent to their issuance, $16.2 million of convertible notes converted into shares of convertible preferred stock and $0.5 million in cash payments were made. To date, we have not generated any revenue. As of September 30, 2013, we have primarily financed our operations through the private placement of our equity securities and issuance of convertible promissory notes. As of September 30, 2013, we had a deficit accumulated during the development stage of $84.8 million. We recorded net losses of $10.7 million and $20.9 million during the three months and nine months ended September 30, 2013, respectively, and net losses of $3.6 million and $11.4 million during the three months and nine months ended September 30, 2012, respectively. We anticipate that a substantial portion of our capital resources and efforts in the foreseeable future will be focused on completing the development and obtaining regulatory approval and preparing for potential commercialization of our product candidates.

We expect our research and development expenses to increase if and when we initiate Phase 3 and Phase 2b clinical trials for our AR-13324 and PG324 product candidates, respectively, and pursue regulatory approval. As we prepare for commercialization, we will likely incur significant commercial, sales, marketing and outsourced manufacturing expenses. We also expect to incur additional expenses associated with operating as a public company, as a consequence of our initial public offering and listing of our common stock on the NASDAQ Global Market, completed in October 2013. As a result, we expect to continue to incur significant and increasing operating losses at least for the next several years. 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.

On October 30, 2013, we completed our initial public offering and issued 7,728,000 shares of our common stock at an initial offering 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 initial public offering of approximately $68.3 million, after deducting underwriting discounts and commissions of $5.4 million and expenses of $3.6 million.

We anticipate that we will use approximately $37.4 million of the net proceeds from the offering for direct clinical and non-clinical costs associated with the completion of Phase 3 registration trials and filing of a New Drug Application with the Food and Drug Administration for our AR-13324 product candidate and approximately $9.8 million for direct clinical and non-clinical costs associated with the completion of the Phase 2b clinical trial and Phase 3 enabling activities for our PG324 product candidate. We intend to use the remainder of the proceeds of the offering for working capital and general corporate purposes. We expect that these funds will not be sufficient to enable us to complete all necessary development or commercially launch these product candidates. Accordingly, we will 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 us on acceptable terms, or at all. If we are unable to raise capital when needed or on attractive terms, we would be forced to delay, reduce or eliminate our research and development programs or commercialization efforts.

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 of 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 and legal services. We expect that our general and administrative expenses will increase with the continued

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advancement of our product candidates and with the increased management, legal, compliance, accounting and investor relations expenses we will have as we continue to operate as a public company. We expect these increases will likely include increased expenses for insurance, expenses related to the hiring of additional personnel and payments to outside consultants, 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 CROs, contract manufacturing organizations and consultants that conduct 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 salaries, stock-based compensation and depreciation are not allocated to direct clinical or non-clinical expenses and are separately classified as unallocated.

The following table shows our research and development expenses by type of activity for the three months and nine months ended September 30, 2013 and 2012:

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2013	2012	2013	2012
	(in thousands)			

AR-13324:				
Direct non-clinical	$ 1,139	$ 474	$ 2,040	$ 2,037
Direct clinical	32	170	1,333	700
Total	$ 1,171	$ 644	$ 3,373	$ 2,737
PG324:				
Direct non-clinical	$ 209	$	$ 209	$
Direct clinical				
Total	$ 209	$	$ 209	$
Discontinued product candidates:				
Direct non-clinical	$ 72	$ 210	$ 537	$ 1,629
Direct clinical	395	84	2,969	1,179
Total	$ 467	$ 294	$ 3,506	$ 2,808
Unallocated	552	435	1,639	1,760
Total research and development expense	$ 2,399	$ 1,373	$ 8,727	$ 7,305

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From inception through September 30, 2013, we did not incur any direct non-clinical or direct clinical costs for AR-13533. Costs for this product candidate were primarily comprised of internal employee salaries and were included in unallocated costs. Discontinued product candidates relate to previously developed AR-12286 and related compounds, as they did not meet their primary endpoints in clinical trials. We incurred direct non-clinical and direct clinical expenses for these discontinued product candidates in all periods presented.

Research and development activities associated with the discovery and development of new drugs and products for the treatment of diseases of the eye are central to our business model. Product candidates in later stages of clinical development generally have higher development costs than those in earlier stages of clinical development, primarily due to the increased size and duration of later-stage clinical trials. We expect our research and development expenses to increase as we initiate Phase 3 and Phase 2b clinical trials for our product candidates, or if the FDA requires us to conduct additional trials for approval.

Our research and development expenditures are subject to numerous uncertainties in timing and cost to completion. Development timelines, the probability of success and development expenses can differ materially from expectations. The cost of clinical trials may vary significantly over the life of a project as a result of differences arising during clinical development, including, among others, the following:

- number of trials required for approval;
- number of sites included in the trials;
- length of time required to enroll suitable patients;
- number of patients that participate in the trials;
- drop-out or discontinuation rates of patients;
- duration of patient follow-up;
- costs related to compliance with regulatory requirements;
- number and complexity of analyses and tests performed during the trial;
- phase of development of the product candidate; and
- efficacy and safety profile of the product candidate.

Our expenses related to clinical trials are based on estimates of patient enrollment and related expenses at clinical investigator sites as well as estimates for the services received and efforts expended pursuant to contracts with research institutions, consultants and CROs that conduct and manage clinical trials on our behalf. We generally accrue expenses related to clinical trials based on contracted amounts applied to the level of patient enrollment and activity according to the protocol. If future timelines or contracts are modified based upon changes in the clinical trial protocol or scope of work to be performed, we modify our estimates of accrued expenses accordingly on a prospective basis. Historically, such modifications have not been material.

As a result of the uncertainties discussed above, we are unable to determine with certainty the duration and completion costs of our development programs or precisely when and to what extent we will receive revenue from the commercialization and sale of our products. We may never succeed in achieving regulatory approval for one or more of our product candidates. The duration, costs and timing of clinical trials and development of our product candidates will depend on a variety of factors, including the uncertainties of future preclinical studies and clinical trials, uncertainties in the clinical trial enrollment rate and changing government regulation. In addition, the probability of success for each product candidate will depend on numerous factors, including efficacy and tolerability profiles, manufacturing capability, competition, and commercial viability.

Other Income (Expense), Net

Other income consists of interest earned on our cash and cash equivalents as well as the net proceeds from the sale of our net operating loss tax benefits for the state of New Jersey. Interest income is not considered significant to our historical financial statements and consists of interest earned on our cash and cash equivalents.

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Other expense consists of interest accrued under existing convertible notes, amortization of debt discounts and non-cash expense related to changes in the fair value of our warrants liability arising from the stock purchase warrants described in Note 3 to our unaudited financial statements appearing elsewhere in this report.

Accretion of Convertible Preferred Stock

Shares of our convertible preferred stock were initially recorded on our balance sheet at their cost, less associated issuance costs. Series A-1, A-2 and A-3 of our convertible preferred stock are fully accreted as of December 31, 2012.

Our Series A-4 Convertible Preferred Stock issued on February 23, 2011, resulting from the conversion of the notes issued in 2010, was recorded at fair value. The difference between redemption and initial carrying value of $1.3 million is being ratably accreted over the period from February 23, 2011 until the earliest redemption date, which is August 17, 2015.

Our Series B Convertible Preferred Stock issued on February 23, 2011 was recorded at fair value net of $1.2 million of issuance costs, which is being ratably accreted over the period from February 23, 2011 until the earliest redemption date, which is August 17, 2015.

The composition of our convertible preferred stock is further described in Note 6 to our unaudited financial statements appearing elsewhere in this report.

Debt Discounts

Our notes payable were issued with warrant coverage. We recorded notes payable on our balance sheet net of a discount equal to the estimated fair value of the associated warrant instrument. The discount is amortized ratably through interest expense over the term of the associated notes.

Critical Accounting Policies and Use of Estimates

Our management s discussion and analysis of financial condition and results of operations are based on our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States, or U.S. GAAP. The preparation of financial statements also requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, costs and expenses and related disclosures. We evaluate our estimates and judgments on an ongoing basis. Significant estimates include assumptions used in the determination of the fair value measurement of stock purchase warrants, stock-based compensation and certain research and development expenses. We base our estimates on historical experience and on various other factors that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Equity Issuances in the Quarter Ended September 30, 2013

In the context of our initial public offering, we determined that the probability of the conversion of preferred stock into common stock, based on the consent from the holders of the requisite number of preferred shares, was high as of September 30, 2013. As a result, the allocation of the determined equity value assumed conversion of all preferred stock into common stock. For financial reporting purposes, based on recommendations from management and taking into account advice and assistance provided by third-party valuation consultants engaged to assist in such valuations, our board of directors determined that the fair value of our common stock for all equity transactions during the quarter

ended September 30, 2013 and all transactions that require fair value measurement as of September 30, 2013 was consistent with the initial public offering price of $10.00. Accordingly, for the quarter ended September 30, 2013, we recognized a stock-based compensation charge of $0.2 million related to stock options granted on August 26, 2013 and September 12, 2013 and $0.7 million related to the re-measurement of grants to non-employees. The total unrecognized stock-based compensation expense related to the August and September 2013 option grants was $13.6 million and is expected to be recognized ratably through 2017, which represents the expected vesting period of the options (see Note 8 to our unaudited financial statements appearing elsewhere in this report). In addition, we measured the stock purchase warrants issued on August 9, 2013 and September 30, 2013 using the initial public offering price as the deemed fair value of our common stock, resulting in an initial measurement of the warrant liability of $2.0 million and $1.4 million, respectively (see Note 7 to our unaudited financial statements appearing elsewhere in this report).

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Our significant accounting policies are more fully described in Note 2 to our unaudited financial statements appearing elsewhere in this report and Note 2 to our audited financial statements included in the IPO Prospectus.

Results of Operations

Comparison of the three months ended September 30, 2013 and 2012

The following table summarizes the results of our operations for the three months ended September 30, 2013 and 2012:

	THREE MONTHS ENDED SEPTEMBER 30,		INCREASE (DECREASE)	% INCREASE (DECREASE)
	2013	2012		
	(unaudited)			
	(in thousands)			
Expenses				
General and administrative	$ (3,287)	$ (1,416)	$ 1,871	132%
Research and development	(2,399)	(1,373)	1,026	75%
Other financial income (expense), net	(5,062)	(803)	4,259	530%
Net loss	$ (10,748)	$ (3,592)		

General and administrative expenses

General and administrative expenses increased by $1.9 million for the three months ended September 30, 2013 as compared to the three months ended September 30, 2012. This increase was primarily attributable to an increase of $1.4 million in personnel costs, including new salaried employees and related employee stock-based compensation expense resulting in part from the hiring of a Chief Financial Officer in October 2012 and a President and Chief Operating Officer in August 2013. Accounting, legal and consulting fees increased by $0.5 million as a result of increased audit fees, intellectual property and patent expenses and other business related activities.

Research and development expens