Capnia, Inc.
Form 10-Q/A
August 09, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q/A

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

For the quarterly period ended March 31, 2016
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: 001-36593

CAPNIA, INC.
(Exact name of registrant as specified in its charter)

Delaware	77-0523891
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1235 Radio Road, Suite 110,
Redwood City, California
(Address of principal executive offices)
94065
(Zip Code)
(650) 213-8444
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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 ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

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 May 1, 2016 there were 15,461,531 shares of the registrant's Common Stock, par value $0.001 per share, outstanding.

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EXPLANATORY NOTE

The purpose of this amended Form 10-Q/A to Capnia, Inc's Quarterly Report on Form 10-Q for the period ended March 31, 2016, filed with the Securities and Exchange Commission on May 12, 2016 is to correct the disclosure under Management's Report on Internal Control Over Financial Reporting (Item 4, Page 20) indicating that we have performed an assessment of our internal control over financial reporting in the interim period. In addition, we have included corrected officer certifications to include the language referring to internal control over financial reporting that should appear as per Exchange Act Rule 13a-14(a) and Item 601(b)(31) of Regulation S-K. Lastly, we included a corrected Section 906 certification to reflect the fiscal quarter ended date of March 31, 2016.

No other changes have been made to the Form 10-Q. This amended Form 10-Q speaks as of the original filing date of the Form 10-Q, does not reflect events that may have occurred subsequent to the original filing date, and does not modify or update in any way disclosures made in the original Form 10-Q.

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements
Capnia, Inc.
Condensed Consolidated Balance Sheets
(unaudited)
(In thousands except share and per share data)

	March 31, 2016	December 31, 2015
Assets		
Current assets		
Cash and cash equivalents	$6,492	$ 5,495
Accounts receivable	187	156
Restricted cash	35	35
Inventory	653	551
Prepaid expenses and other current assets	216	167
Total current assets	7,583	6,404
Long-term assets		
Property and equipment, net	121	86
Goodwill	718	718
Other intangible assets, net	892	917
Other assets	76	76
Total assets	$9,390	$ 8,201
Liabilities and stockholders' equity		
Current liabilities		
Accounts payable	$1,262	$ 695
Accrued compensation and other current liabilities	1,317	1,634
Series B warrant liability	—	865
Total current liabilities	2,579	3,194
Long-term liabilities		
Series A warrant liability	558	1,213
Series C warrant liability	219	462
Other long-term liabilities	200	109
Commitments and contingencies (Note 6)	—	—
Stockholders' equity		
Series A convertible preferred stock, $0.001 par value, 40,000 shares authorized, 8,335 and 4,555 issued and outstanding at March 31, 2016 and December 31, 2015, respectively.	—	—
Common stock, $0.001 par value, 100,000,000 shares authorized, 15,403,111 and 14,017,909 shares issued and outstanding at March 31, 2016 and December 31, 2015, respectively.	15	14
Additional paid-in-capital	95,255	89,456
Accumulated deficit	(89,436)	(86,247)
Total stockholders' equity	5,834	3,223
Total liabilities and stockholders' equity	$9,390	$ 8,201

See accompanying notes to condensed consolidated financial statements

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Capnia, Inc.
Condensed Consolidated Statements of Operations
(unaudited)
(In thousands except share and per share data)

	Three Months Ended March 31,	
	2016	2015
Product revenue	$447	$22
Cost of product revenue	461	18
Gross profit (loss)	(14)	4
Expenses		
Research and development	1,772	878
Sales and marketing	538	260
General and administrative	1,939	1,292
Total expenses	4,249	2,430
Operating loss	(4,263)	(2,426)
Interest and other income (expense)		
Interest expense, net	—	(1)
Change in fair value of warrants liabilities (expense)	1,170	(6,174)
Cease-use expense	(94)	—
Other expense	(2)	—
Inducement charge for Series C warrants	—	(3,050)
Interest and other income (expense), net	1,074	(9,225)
Net loss	$(3,189)	$(11,651)
Basic and diluted net loss per common share	$(0.22)	$(1.67)
Weighted-average common shares outstanding used to calculate basic and diluted net loss per common share	14,796,11[illegible]	6,965,483

See accompanying notes to condensed consolidated financial statements

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Capnia, Inc.
Condensed Consolidated Statements of Cash Flows
(unaudited)
(In thousands)

	Three Months Ended March 31,	
	2016	2015
Cash flows from operating activities:		
Net loss	$(3,189)	$(11,651)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	20	15
Stock-based compensation expense	136	401
Change in fair value of common stock warrants	(1,170)	6,174
Inducement charge for Series C warrants	—	3,050
Change in fair value of contingent consideration	19	—
Change in operating assets and liabilities:		
Accounts receivable	(31)	(8)
Inventory	(102)	(97)
Prepaid expenses and other assets	(49)	(7)
Accounts payable	627	199
Accrued compensation and other current liabilities	(317)	115
Other long-term liabilities	72	—
Net cash used in operating activities	(3,984)	(1,809)
Cash flows from investing activities:		
Purchase of property and equipment	(19)	(1)
Net cash used in investing activities	(19)	(1)
Cash flows from financing activities:		
Proceeds from sale of Series A preferred convertible stock	5,071	—
Series A preferred convertible stock transaction costs paid	(71)	—
Proceeds from exercise of common stock options	—	12
Proceeds from exercise of Series A warrants	—	156
Proceeds from exercise of Series B warrants (Private Transaction)	—	3,832
Proceeds from exercise of Series B warrants (Tender offer)	—	189
Series B warrant transaction costs paid	—	(175)
Initial public offering costs paid	—	(530)
Repayment of credit line	—	(102)
Net cash provided by financing activities	5,000	3,382
Net increase in cash and cash equivalents	997	1,572
Cash and cash equivalents, beginning of period	5,495	7,957
Cash and cash equivalents, end of period	$6,492	$9,529
Supplemental disclosures of noncash investing and financing information		
Conversion of Series A preferred to common stock	1,665	—
De-recognition of Series B warrant liability (cash exercise)	—	6,748
De-recognition of Series B warrant liability (cashless exercise)	593	417
De-recognition of Series A warrant liability (cash exercise)	—	42
Reduction in initial public offering costs payable	—	45
Fixed asset costs included in accounts payable	11	—
Series B Warrant transaction costs accrued and included in accrued compensation and other current liabilities	—	131

See accompanying notes to condensed consolidated financial statements.

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Capnia, Inc.
March 31, 2016
Notes to Condensed Consolidated Financial Statements
(unaudited)

Note 1. Description of Business

Capnia, Inc. (the “Company”) was incorporated in the State of Delaware on August 25, 1999, and is located in Redwood City, California. The Company develops and commercializes neonatology devices and diagnostics. The Company also has a therapeutics platform based on its proprietary technology for precision metering of gas flow.

On September 8, 2015, the Company established NeoForce, Inc. ("NeoForce"), a wholly owned subsidiary of the Company and acquired substantially all of the assets of an unrelated privately held company NeoForce Group, Inc.("NFG"). NeoForce develops innovative pulmonary resuscitation solutions for the inpatient and ambulatory neonatal markets.

On April 27, 2015, the Company established Capnia UK Limited, a wholly owned foreign subsidiary in the United Kingdom. Capnia UK Limited began sales and marketing operations in the first quarter of 2016.

The Company’s first diagnostic product, CoSense®, aids in diagnosis of excessive hemolysis, a condition in which red blood cells degrade rapidly. When present in neonates with jaundice, hemolysis is a dangerous condition which can lead to adverse neurological outcomes. CoSense has 510(k) clearance for sale in the U.S. with a specific Indication for Use related to hemolysis issued, and has received CE Mark certification for sale in the European Union (“E.U.”). CoSense is commercially available in the U.S. In addition, the Company is applying its research and development efforts to additional diagnostic products based on its Sensalyze Technology Platform, a portfolio of proprietary methods and devices which enables CoSense and can be applied to detect a variety of analytes in exhaled breath and other products for the neonatology market. The Company has also obtained CE Mark certification in the E.U. for Serenz, a therapeutic product candidate for the treatment of symptoms related to allergic rhinitis (“AR”) (see Note 10).

Note 2. Liquidity, Financial Condition and Management’s Plans

The Company had a net loss of $3.2 million for the three months ended March 31, 2016 and has an accumulated deficit of approximately $89.4 million at March 31, 2016 from having incurred losses since its inception. The Company has approximately $5.0 million of working capital at March 31, 2016 and used $4.0 million of cash in its operating activities during the three months ended March 31, 2016. The Company has financed its operations principally through issuances of debt and equity securities.

On July 24, 2015, the Company entered into a Common Stock Purchase Agreement (the "Aspire Purchase Agreement") with Aspire Capital, LLC ("Aspire") which provides that, upon the terms and subject to the conditions and limitations set forth therein, Aspire is committed to purchase up to an aggregate of $10.0 million in value of shares of the Company’s Common Stock over the 24-month term of the Aspire Purchase Agreement. As of April 4, 2016, the restrictions on the use of the Aspire Purchase Agreement imposed by the Sabby Purchase Agreement expired.

On October 12, 2015, the Company entered into a Securities Purchase Agreement (the “Sabby Purchase Agreement”) with funds managed by Sabby Management, LLC ("Sabby"), to purchase up to $10 million worth of Series A Convertible Preferred Stock (the “Series A Preferred Stock”). The sale of the Series A Preferred Stock closed in two separate closings. On October 15, 2015, the date of the first closing, the Company received proceeds of approximately $4.1 million, net of $0.4 million in estimated expenses. Upon the second closing on January 8, 2016, the Company received proceeds of approximately $5.0 million, net of $0.5 million in estimated expenses.

The Company expects to continue incurring losses for the foreseeable future and may be required to raise additional capital to pursue its product development initiatives and penetrate markets for the sale of its products. Management believes that the Company's commercial products, including CoSense, the other neonatology products and Serenz, and the distribution strategies implemented will begin to generate meaningful revenue and corresponding cash in the near term. In addition, the Company has been successful over the last 12 months in raising additional capital, including closing pursuant to the Aspire Purchase Agreement and most recently in January of 2016 with the second closing pursuant to the Sabby Purchase Agreement. Management believes that the Company has access to capital resources through possible public or private equity offerings, debt financings, corporate collaborations or other means; however, the Company has not secured any commitment for new financing at this time nor can it provide any assurance that new financing will be available on commercially acceptable terms, if at all. If

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the Company is unable to secure additional capital, it may be required to curtail its development of new products and take additional measures to reduce costs in order to conserve its cash in amounts sufficient to sustain operations and meet its obligations. These measures could cause significant delays in the Company's efforts to commercialize its products, which is critical to the realization of its business plan and the future operations of the Company.

Note 3. Summary of Significant Accounting Policies

There have been no material changes to the significant accounting policies during the three months ended March 31, 2016, as compared to the significant accounting policies described in Note 3 of the "Notes to Consolidated Financial Statements" in the Company's Annual Report on Form 10-K for the year ended December 31, 2015. Below are those policies with current period updates:

Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and the applicable rules and regulations of the Securities and Exchange Commission ("SEC") for interim financial information. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. The condensed consolidated balance sheet at December 31, 2015 has been derived from the audited consolidated financial statements at that date, but does not include all disclosures, including notes, required by GAAP for complete financial statements.

The unaudited interim condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and, in the opinion of management, reflect all adjustments of a normal recurring nature considered necessary to present fairly the Company's financial position as of March 31, 2016 and results of its operations and cash flows for the three months ended March 31, 2016 and 2015. The interim results are not necessarily indicative of the results for any future interim period or for the entire year. Certain prior period amounts have been reclassified to conform to current period presentation.

The accompanying condensed consolidated financial statements and related financial information should be read in conjunction with the audited consolidated financial statements and the related notes thereto for the year ended December 31, 2015 included in the Company's Annual Report on Form 10-K.

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates
and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities, and
reported amounts of expenses in the financial statements and accompanying notes. Actual results could differ from those
estimates. Key estimates included in the financial statements include the valuation of deferred income tax assets, liability and equity instruments, stock-based compensation, acquired intangibles, contingent earn-out consideration, and allowances for accounts receivable and inventory.

Inventory

As of December 31, 2015 and March 31, 2016, the Company's inventory was comprised of the following (in thousands):

	March 31, 2016	December 31, 2015
Raw materials	$ 290	$ 106
Work-in-process	267	399
Finished goods	96	46
Total inventory	$ 653	$ 551

Inventory is stated at the lower of cost or market under the first-in, first-out (FIFO) method.

Intangible Assets

Intangible assets with finite lives are amortized on a straight-line basis over their estimated useful lives, which range in term from 5 to 12 years. The useful life of the intangible asset is evaluated each reporting period to determine whether events and circumstances warrant a revision to the remaining useful life.

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Goodwill

The Company tests its goodwill for impairment annually, or whenever events or changes in circumstances indicate an impairment may have occurred, by comparing its reporting unit's carrying value to its implied fair value. Impairment may result from, among other things, deterioration in the performance of the acquired business, adverse market conditions, adverse changes in applicable laws or regulations and a variety of other circumstances. If the Company determines that an impairment has occurred, it is required to record a write-down of the carrying value and charge the impairment as an operating expense in the period the determination is made. In evaluating the recoverability of the carrying value of goodwill the Company must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the acquired assets. Changes in strategy or market conditions could significantly impact those judgments in the future and require an adjustment to the recorded balances. There was no impairment of goodwill for the three months ended March 31, 2016. Such goodwill is not deductible for tax purposes and represents the value placed on entering new markets and expanding market share.

Common Stock Purchase Warrants and Other Derivative Financial Instruments

The Company classifies Common Stock purchase warrants and other free standing derivative financial instruments as equity if the contracts (i) require physical settlement or net-share settlement or (ii) give the Company a choice of net-cash settlement or settlement in its own shares (physical settlement or net-share settlement). The Company classifies any contracts that (i) require net-cash settlement (including a requirement to net cash settle the contract if an event occurs and if that event is outside the control of the Company), (ii) give the counterparty a choice of net-cash settlement or settlement in shares (physical settlement or net-share settlement), or (iii) contain reset provisions as either an asset or a liability. The Company assesses classification of its freestanding derivatives at each reporting date to determine whether a change in classification between assets and liabilities is required. The Company determined that certain freestanding derivatives, which principally consist of Series A, Series B, and Series C Warrants to purchase Common Stock, do not satisfy the criteria for classification as equity instruments due to the existence of certain cash settlement features that are not within the sole control of the Company or variable settlement provision that cause them to not be indexed to the Company's own stock.

Due to certain provisions contained in the Series B Warrant agreement that provides for the Company potentially issuing an unlimited number of shares upon exercise, the Company had adopted a sequencing policy that reclassified contracts, with the exception of stock options, from equity to assets or liabilities for those with the latest inception date first. The Company had evaluated the issuance of securities as to reclassification as a liability under this sequencing policy through February 12, 2016, the date that the Series B Warrants expired.

Recent Accounting Pronouncements

There have been no new accounting pronouncements or changes to accounting pronouncements during the three months ended March 31, 2016 as compared to the recent accounting pronouncements described in the Company's Annual Report on Form 10-K for the year ended December 31, 2015 that are of significance or potential significance to the Company.

Note 4. Fair Value of Financial Instruments

The carrying value of the Company's cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued liabilities, approximate fair value due to the short-term nature of these items.

Fair value is defined as the exchange price that would be received for an asset or an exit price paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs.

The fair value hierarchy defines a three-level valuation hierarchy for disclosure of fair value measurements as follows:

- Level I Unadjusted quoted prices in active markets for identical assets or liabilities;

- Level II Inputs other than quoted prices included within Level I that are observable, unadjusted quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the related assets or liabilities; and
- Level III Unobservable inputs that are supported by little or no market activity for the related assets or liabilities.

The categorization of a financial instrument within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

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The following table sets forth the Company’s financial instruments that were measured at fair value on a recurring basis by level within the fair value hierarchy (in thousands):

	Fair Value Measurements at March 31, 2016			
	Total	Level 1	Level 2	Level 3
Assets				
Money market fund	$3,975	$3,975	$ —	$ —
Liabilities				
Series A warrant liability	$558	$558	$ —	$ —
Series C warrant liability	219	—	—	219
Total liabilities	$777	$558	$ —	$219

	Fair Value Measurements at December 31, 2015			
	Total	Level 1	Level 2	Level 3
Assets				
Money market fund	$3,804	$3,804	$ —	$ —
Liabilities				
Series A warrant liability	$1,213	$1,213	$ —	$ —
Series B warrant liability	865	—	—	865
Series C warrant liability	462	—	—	462
Total common stock warrant liability	$2,540	$1,213	$ —	$1,327

The Series A Warrant is a registered security that trades on the open market. The fair value of the Series A Warrant liability is based on the publicly quoted trading price of the warrants which is listed on and obtained from NASDAQ. Accordingly, the fair value of Series A Warrants is a Level 1 measurement. The fair value measurements of the Series B and Series C Warrants are based on significant inputs that are unobservable and thus represent Level 3 measurements. The Company’s estimated fair value of the Series B Warrant liability is calculated using a Monte Carlo simulation. Key assumptions include the volatility of the Company’s stock, the expected warrant term, expected dividend yield and risk-free interest rates (see Note 5). The Company’s estimated fair value of the Series C Warrant liability is calculated using the Black-Scholes valuation model. Key assumptions include the volatility of the Company’s stock, the expected warrant term, expected dividend yield and risk-free interest rates (see Note 5). The Level 3 estimates are based, in part, on subjective assumptions.

The agreement to pay the annual royalty in the NFG acquisition resulted in the recognition of a contingent consideration, which was recognized at the inception of the acquisition. Subsequent changes to estimate of the amounts of contingent consideration to be paid will be recognized as charges or credits in the statement of operations. The fair value of the contingent consideration is based on preliminary cash flow projections, growth in expected product sales and other assumptions. Based on the assumptions, the fair value of the royalty was determined to be $153 thousand at the date of acquisition and $172 thousand as of March 31, 2016. The fair value of the royalty was determined by applying the income approach, using several significant unobservable inputs for projected cash flows and a discount rate of 20% commensurate with the Company's cost of capital and expectation of the revenue growth for products at their life cycle stage. These inputs are considered Level 3 inputs under the fair value measurements and disclosure guidance.

On January 13, 2016 we entered into an agreement to sublease our excess space located in Redwood City. By the end of February we removed all equipment, furniture and fixtures being stored in this excess space and ceased use of this space. The fair value of the cease-use liability was calculated using the remaining lease payments, offset by future sub-lease payments, offset by deferred rent amortization, and discounted to present value using our current cost of capital of 20%. These inputs are considered Level 3 inputs under the fair value measurements and disclosure guidance.

During the periods presented, the Company has not changed the manner in which it values liabilities that are measured at fair value using Level 3 inputs. The Company recognizes transfers between levels of the fair value hierarchy as of the end of the reporting period. There were no transfers within the hierarchy during the periods presented.

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The following table sets forth a summary of the changes in the fair value of the Company’s Level 1 and Level 3 warrants, which are treated as liabilities, as follows (dollars in thousands):

Series A Warrant	Series B Warrant