Zosano Pharma Corp
Form 10-Q
August 10, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2016

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number 001-36570

ZOSANO PHARMA CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**45-4488360**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

34790 Ardentech Court

Fremont, CA 94555

(Address of principal executive offices) (Zip Code)

(510) 745-1200

(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 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 ¨ (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 August 1, 2016, the registrant had a total of 12,015,997 shares of its common stock, $0.0001 par value per share, outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

ZOSANO PHARMA CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value)

	June 30, 2016 (unaudited)	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$ 10,057	$ 6,646
Interest receivable	54	101
Short-term investments in marketable securities	12,839	30,287
Prepaid expenses and other current assets	581	237
Total current assets	23,531	37,271
Restricted cash	35	35
Property and equipment, net	6,710	7,660
Other long-term assets	384	371
Total assets	$ 30,660	$ 45,337
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 887	$ 1,209
Accrued compensation	1,202	1,275
Secured promissory note, current portion (net of issuance cost and incl. accrued interest)	6,247	3,360
Other accrued liabilities	582	1,036
Total current liabilities	8,918	6,880
Deferred rent	51	45
Secured promissory note, net of issuance cost (including accrued interest)	9,109	11,910
Total liabilities	18,078	18,835
Commitments and contingencies		
Stockholders equity:		
Common stock, $0.0001 par value; 100,000 shares authorized as of June 30, 2016 and December 31, 2015; 12,016 shares and 11,967 shares issued and outstanding as of June 30, 2016 and December 31, 2015, respectively	1	1

Additional paid-in capital	194,109	193,438
Accumulated deficit	(181,526)	(166,891)
Accumulated other comprehensive loss	(2)	(46)
Stockholders equity	12,582	26,502
Total liabilities and stockholders equity	$ 30,660	$ 45,337

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

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ZOSANO PHARMA CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(unaudited; in thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	**2015**	**2016**	**2015**
Revenue:				
License fees revenue	$	$ 68	$	$ 170
Collaborative development support services		27		143
Total revenue		95		313
Operating expenses:				
Research and development	4,298	5,004	9,920	8,074
General and administrative	1,951	1,779	4,127	3,078
Total operating expenses	6,249	6,783	14,047	11,152
Loss from operations	(6,249)	(6,688)	(14,047)	(10,839)
Other income (expense):				
Interest expense, net	(321)	(441)	(637)	(933)
Other income (expense)	50	(4)	49	56
Loss on debt extinguishment		(446)		(446)
Net loss	(6,520)	(7,579)	(14,635)	(12,162)
Other comprehensive loss:				
Unrealized holding (loss) gain on marketable securities, net of tax effect	(37)	(38)	2	(38)
Comprehensive loss	$ (6,557)	$ (7,617)	$ (14,633)	$ (12,200)
Net loss per common share basic and diluted	$ (0.54)	$ (0.63)	$ (1.22)	$ (1.12)
Weighted-average shares used in computing net loss per common share basic and diluted	12,012	11,942	11,989	10,864

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

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ZOSANO PHARMA CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOW

(unaudited; in thousands)

	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
	(Unaudited)	
Cash flows from operating activities:		
Net loss	$ (14,635)	$ (12,162)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation	1,245	1,268
Stock-based compensation	665	203
Loss on debt extinguishment		446
Gain on sale of equipment	(51)	
Accretion of interest payment	185	(24)
Revaluation of warrants to fair value		(48)
Deferred rent	6	(63)
Change in operating assets and liabilities:		
Accounts and interest receivable	47	(13)
Prepaid expenses and other assets	(344)	477
Accounts payable	(322)	350
Accrued compensation and other accrued liabilities	(526)	(1,233)
Deferred revenue		(170)
Net cash flow used in operating activities	(13,730)	(10,969)
Cash flow from investing activities:		
Purchase of property and equipment	(307)	(95)
Proceeds from sales of property and equipment	63	
Purchase of marketable securities		(42,605)
Proceeds from maturities of investments in marketable securities	17,392	
Increase in investment	(13)	(22)
Net cash flow provided by (used in) investing activities	17,135	(42,722)
Cash flow from financing activities:		
Proceeds from initial public offering of securities, net of underwriting commissions and discounts		47,140
Payment of deferred offering costs		(1,325)
Proceeds from a private placement concurrent with the initial public offering, net of private placement fee		14,475
Proceeds from exercise of stock options and issuance of common stock	6	7
Proceeds from debt financing, net of issuance costs		11,705
Payment of loan principal		(11,465)

Net cash flow provided by financing activities		6		60,537
Net increase in cash and cash equivalents		3,411		6,846
Cash and cash equivalents at beginning of period		6,646		1,214
Cash and cash equivalents at end of period	$	10,057	$	8,060
Supplemental cash flow information:				
Interest paid	$	606	$	3,033
Non-cash investing and financing activities:				
Conversion of debt to common stock	$		$	7,407
Issuance of warrant in connection with debt financing	$		$	212
Reclassification of warrant liability to equity	$		$	252

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

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Zosano Pharma Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements

June 30, 2016

1. Organization

The Company

Zosano Pharma Corporation and subsidiaries (the Company) is a clinical stage specialty pharmaceutical company focusing on the treatment of a variety of indications using the Company s proprietary intracutaneous delivery system to administer drugs through the skin. Our intracutaneous technology offers rapid onset, consistent drug delivery, improved ease of use and room-temperature stability benefits that we believe would provide a potentially favorable alternative to using oral formulations or injections.

The Company was incorporated in Delaware as ZP Holdings, Inc. in January 2012 and changed its name to Zosano Pharma Corporation in June 2014. The Company was spun out of ALZA Corporation, a subsidiary of Johnson & Johnson, in October 2006, originally incorporated under the name The Macroflux Corporation, and changed its name to Zosano Pharma, Inc. in 2007, following the spin-off from Johnson & Johnson. In April 2012, in a transaction to recapitalize the business, a wholly-owned subsidiary of Zosano Pharma Corporation was merged into Zosano Pharma, Inc., whereby Zosano Pharma, Inc. was the surviving entity and became a wholly-owned subsidiary of Zosano Pharma Corporation. In June 2014, Zosano Pharma, Inc. changed its name to ZP Opco, Inc.

The Company has two wholly owned subsidiaries as of June 30, 2016: ZP Opco, Inc. (Opco), through which the Company conducts its primary research and development activities, and ZP Group LLC, originally a joint venture with Asahi Kasei Pharmaceuticals USA (Asahi). The joint venture ceased operations in December 2013.

Initial Public Offering

On January 30, 2015, the Company completed an initial public offering (IPO) of its common stock on the NASDAQ Capital Market. The Company sold an aggregate of 4,500,000 shares of common stock under a registration statement on Form S-1, declared effective on January 27, 2015, at a public offering price of $11.00 per share. Net proceeds to the Company were approximately $44.2 million, after deducting underwriting commissions and expenses. On February 27, 2015, the underwriters exercised the overallotment option resulting in the Company s issuing an additional 110,000 shares of its common stock at $11.00 per share, resulting in additional net proceeds of approximately $1.1 million after underwriting discounts.

Concurrent Private Placement

On January 30, 2015, the Company issued and sold 1,363,636 shares of its common stock to Eli Lilly and Company (Lilly) in a private placement pursuant to a common stock purchase agreement dated November 21, 2014 between the Company and Lilly and received net proceeds of $14.5 million, after underwriting discounts. The closing of this private placement took place concurrently with the Company s IPO. As of June 30, 2016, Lilly beneficially owned approximately 11% of the Company s outstanding common stock.

2. Summary of Significant Accounting Policies

Basis of Presentation and Use of Estimates

The accompanying condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) and as required by Regulation S-X, Rule 10-01 for interim financial reporting. The preparation of the accompanying condensed consolidated financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities as of the date of the condensed consolidated financial statements, and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates.

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Unaudited Interim Financial Information

The condensed consolidated balance sheet as of June 30, 2016, the condensed consolidated statements of operations and comprehensive loss for the three and six months ended June 30, 2016 and 2015, and the condensed consolidated statements of cash flows for the six months ended June, 2016 and 2015 are unaudited. The unaudited interim condensed consolidated financial statements have been prepared on the same basis as the annual audited consolidated financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary to state fairly the Company s financial position as of June 30, 2016, and the condensed consolidated results of operations for the three and six months ended June 30, 2016 and 2015, and the condensed consolidated statement of cash flows for the six months ended June 30, 2016 and 2015. The financial data and other information disclosed in these notes to the interim condensed consolidated financial statements as of June 30, 2016 and for the three and six month periods ended June 30, 2016 and 2015 are also unaudited. The results for the three and six months ended June 30, 2016 are not necessarily indicative of the results to be expected for the year ending December 31, 2016 or for any other interim period or for any future year. These financial statements should be read in conjunction with the Company s audited financial statements for the year ended December 31, 2015 included in the Company s annual report on Form 10-K filed with the Securities and Exchange Commission.

Liquidity

The Company has incurred significant operating losses and had an accumulated deficit of $181.5 million as of June 30, 2016. The Company has financed its operations primarily through sale of equity securities, debt financing and payments received under its former licensing and collaboration agreements with pharmaceutical companies. To date, none of the Company s product candidates have been approved for sale.

The Company will continue to require additional financing to develop its product candidates and fund operating losses. Management intends to seek funds through equity or debt financings, collaborative or other arrangements with corporate partners, or through other sources of financing. However, if such financing is not available at adequate levels or on acceptable terms, the Company could be required to significantly reduce its operating expenses and delay, reduce the scope of, or eliminate some of its development programs, out-license intellectual property rights, or a combination of the above, which may have a material adverse effect on the Company s business, results of operations, financial condition and/or its ability to meet its scheduled obligations on a timely basis, if at all. There can be no assurance that the Company will be successful in raising capital, or that any needed financing will be available in the future at terms acceptable to the Company.

Consolidation

The consolidated financial statements include the accounts of Zosano Pharma Corporation, ZP Opco, Inc., and ZP Group LLC post-termination of the joint venture. Intercompany balances and transactions have been eliminated in consolidation.

Significant Accounting Policies

There have been no material changes to the Company s significant accounting policies during the six months ended June 30, 2016, as compared to the significant accounting policies described in Note 2 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:

Research and Development Expenses

Research and development costs are charged to expense as incurred and consist of costs related to ((i) furthering the Company s research and development efforts, and (ii) designing and manufacturing the Company s intracutaneous microneedle patch and applicator for the Company s clinical and nonclinical studies. In 2015, research and development costs also consisted of costs related to servicing the Company s collaborative development efforts with other pharmaceutical companies.

For the three months ended June 30, 2016, the Company incurred research and development costs of approximately $2.5 million in connection with the Company s research and development efforts and approximately $1.7 million in the manufacturing of the Company s microneedle patch system for development of the Company s product candidate. For the three months ended June 30, 2015, the Company incurred less than $0.1 million in research and development costs in support of the Company s collaborative development services, approximately $1.9 million in connection with the Company s research and development efforts, and approximately $3.1 million in the manufacturing of the Company s microneedle patch system for the development of the Company s product candidate. For the six months ended June 30, 2016, the Company incurred research and development costs of approximately $5.2 million in connection with the Company s research and development efforts and approximately $4.7 million in the manufacturing of the Company s microneedle patch system for development of the Company s product candidate. For the six months ended June 30, 2015, the Company incurred research and development costs of approximately $0.1 million in support of the Company s collaborative development services, approximately $3.3 million in connection with the Company s research and development efforts, and approximately $4.7 million in the manufacturing of the Company s microneedle patch system for the development of the Company s product candidate.

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Comprehensive Income (Loss)

Comprehensive loss is comprised of net loss and the unrealized losses on the Company s marketable securities. Comprehensive loss is included in the Company s consolidated statements of operations and comprehensive loss for all periods presented.

Net Loss Per Common Share

Basic net income (loss) per common share is calculated by dividing the net income (loss) by the weighted- average number of common shares outstanding during the period, without consideration for potential dilutive common stock equivalents. Diluted net income (loss) per common share is computed by giving effect to all potential dilutive common stock equivalents outstanding for the period. For purposes of this calculation, convertible promissory notes, warrants and options to purchase common stock are considered potential dilutive common stock equivalents. For the three and six months ended June 30, 2016 and 2015, diluted net loss per common share was the same as basic net loss per common share since the effect of inclusion of potentially dilutive common stock equivalents would have an antidilutive effect due to the loss reported.

The following outstanding common stock equivalents were excluded from the computations of diluted net loss per common share for the periods presented as the effect of including such securities would be antidilutive:

	June 30,	
	2016	**2015**
	(unaudited; in shares)	
Warrants to purchase common stock	72,379	72,379
Options to purchase common stock	1,173,627	709,965
	1,246,006	782,344

Recent Accounting Pronouncements

In March 2016, FASB issued ASU 2016-09, *Compensation Stock Compensation*: *Improvements to Employee Share-Based Payment.* The new guidance simplifies several aspects of accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The new standard is effective for fiscal years, including interim periods within those fiscal years, beginning after December 15, 2016. The Company is currently evaluating the impact of this accounting standard.

In June 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-13, *Financial Instruments-Credit Losses: Measurement of Credit Losses on Financial Instruments*. The amendments in this ASU replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information for credit loss estimates. The new standard is effective for fiscal years, including interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted as early as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently evaluating the impact of this accounting standard.

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3. Cash, Cash Equivalents and Investments

The following is a summary of the Company s cash, cash equivalents, and marketable securities investments for each of the periods presented:

	June 30, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(unaudited; in thousands)			
Cash in bank	$ 3,814	$	$	$ 3,814
Money market funds	6,243			6,243
Certificates of deposit (restricted)	35			35
Certificates of deposit	1,920			1,920
Corporate bonds	4,909		(2)	4,907
U.S. government agency bonds	6,012			6,012
	$ 22,933	$	$ (2)	$ 22,931
Classified as:				
Cash and cash equivalent				$ 10,057
Restricted cash				35
Short-term investments in marketable securities				12,839
				$ 22,931

	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
Cash in bank	$ 2,997	$	$	$ 2,997
Money market funds	3,649			3,649
Certificates of deposit (restricted)	35			35
Certificates of deposit	5,040		(4)	5,036
Corporate bonds	11,749		(22)	11,727
U.S. government agency bonds	13,544		(20)	13,524
	$ 37,014	$	$ (46)	$ 36,968
Classified as:				
Cash and cash equivalent				$ 6,646
Restricted cash				35
Short-term investments in marketable securities				30,287

	$ 36,968

For the three and six months ended June 30, 2016, there were no realized gains and losses on available-for-sale securities. As of June 30, 2016, the maximum contractual maturity of the Company s available-for-sale investments was within 5 months. The Company does not intend to sell the investments that are in an unrealized loss position, and it is unlikely that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be at maturity. The Company has determined that the gross unrealized losses on its available-for-sale investments as of June 30, 2016 were temporary in nature.

4. Fair Value of Financial Instruments

The Company records its financial assets and liabilities at fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the reporting date. The accounting guidance establishes a three-tiered hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value as follows:

Level 1: Inputs which include quoted prices in active markets for identical assets and liabilities.

Level 2: Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; 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 assets or liabilities.

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

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The carrying values of certain assets and liabilities of the Company, such as cash and cash equivalents, accounts receivable, prepaid expenses and other current assets, accounts payable and accrued liabilities, approximate fair value due to their relatively short maturities. The carrying value of the Company s short-term notes payable approximates their fair value as the terms of the borrowing are consistent with current market rates and the duration to maturity is short. The carrying value of the Company s long-term notes payable approximates fair value because the interest rates approximate market rates that the Company could obtain for debt with similar terms and maturities.

The following tables set forth the fair value of the Company s financial instruments as of June 30, 2016 and December 31, 2015:

	June 30, 2016			
	Level I	Level II	Level III	Total
	(unaudited; in thousands)			
Financial Instruments:				
Certificates of deposit (restricted cash)	$ 35	$	$	$ 35
Money market funds	6,242			6,242
Certificates of deposit		1,920		1,920
Corporate bonds		4,907		4,907
U.S. government agency bonds		6,012		6,012
Total financial instruments	$ 6,277	$ 12,839	$	$ 19,116

	December 31, 2015			
	Level I	Level II	Level III	Total
	(in thousands)			
Financial Instruments:				
Certificates of deposit (restricted cash)	$ 35	$	$	$ 35
Money market funds	3,649			3,649
Certificates of deposit		5,036		5,036
Corporate bonds		11,727		11,727
U.S. government agency bonds		13,524		13,524
Total financial instruments	$ 3,684	$ 30,287	$	$ 33,971

5. Property and Equipment

The following summarizes the Company s property and equipment as of June 30, 2016 and December 31, 2015:

	June 30, 2016 *(unaudited)*	December 31, 2015
	(in thousands)	
Property and Equipment:		
Laboratory and office equipment	$ 1,093	$ 1,112
Manufacturing equipment	10,838	10,730
Computer equipment and software	297	229
Leasehold improvements	15,542	15,534
Construction in progress	2,181	2,066
	29,951	29,671
Less: accumulated depreciation	(23,241)	(22,011)
	$ 6,710	$ 7,660

Depreciation and amortization expense was approximately $0.6 million and $0.6 million for the three months ended June 30, 2016 and 2015, respectively, and $1.2 million and $1.3 for the six months ended June 30, 2016 and 2015, respectively.

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6. Research and Development Collaboration and License Agreements

Former Collaboration Agreement with Novo Nordisk

Pursuant to a collaboration agreement with Novo Nordisk dated January 31, 2014 related to the development of an intracutaneous presentation of select Novo Nordisk glucagon-like peptide-1 (GLP-1) analogues, the Company received a non-refundable upfront payment of $1.0 million. The upfront payment was recorded as deferred revenue in the consolidated balance sheet and recognized as license fees revenue over the performance period that was consistent with the term of performance obligations under the specified feasibility study plan.

In July 2015, the Company announced that Novo Nordisk had notified the Company of its intention to discontinue the collaboration agreement. The termination became effective on October 27, 2015, and all technology rights licensed to Novo Nordisk related to the field of GLP-1 products reverted to the Company. As of June 30, 2015, the collaboration with Novo Nordisk was no longer a source of revenue or research and development expense for the Company.

For the three months ended June 30, 2015, no service revenue pursuant to the Novo Nordisk collaboration agreement was recognized. For the six months ended June 30, 2015, the Company recognized $46,000 as service revenue pursuant to the Novo Nordisk collaboration agreement.

7. Debt Financing

Conversion of Related Parties Convertible Promissory Notes

On January 30, 2015, upon the closing of the Company s initial public offering, the principal and all unpaid and accrued interest on the September 2013, and the February and December 2014 convertible promissory notes outstanding as of January 30, 2015, totaling $7.4 million, automatically converted into an aggregate of 792,182 shares of common stock at a price equal to 85% of the initial public offering price, resulting in the liability for such notes being reclassified to permanent equity.

Previous Secured Financing with BMR

In connection with the recapitalization of the Company in April 2012, the Company renegotiated its lease agreement with its landlord, BioMed Realty Holdings, Inc. and affiliates (BMR Holdings), to include reduced rent obligations. In connection with the rent reduction, the Company issued a secured promissory note (the BMR Note) for the principal amount of approximately $8.6 million to BMR Holdings in 2012, which was subsequently assigned to its affiliate BMV Direct SOTRS LP, one of our largest stockholders, and all previously accrued interest, unpaid rent, future rent obligations and other fees due to BMR Holdings were either rolled into the BMR Note or eliminated. In June 2015, the Company terminated the BMR Note by prepaying the outstanding principal and all accrued interest totaling $11.4 million. As of June 30, 2015, the Company does not have any debt outstanding with BMR.

For the three and six months ended June 30, 2015, the Company recorded total interest of $0.3 million and $0.6 million, respectively, for the BMR Note. No interest expense was recorded in 2016 in connection with the BMR Note.

Senior Secured Term Loan with Hercules

In June 2014, the Company entered into a loan and security agreement with Hercules Technology Growth Capital, Inc. (Hercules) which provided the Company $4.0 million in debt financing. In June 2015, the Company entered into a first amendment to the loan and security agreement with Hercules to increase the aggregate principal amount of the loan to $15.0 million (the Hercules Term Loan). Upon the execution of the first amendment to the loan and security agreement, the Company used approximately $11.4 million of the Hercules Term Loan to prepay all amounts owing under the secured promissory note held by BMV Direct SOTRS LP, an affiliate of BioMed Realty Holdings, Inc.

The first amendment to the loan and security agreement with Hercules provides that the $15.0 million principal balance will be subject to a 12-month interest-only period beginning July 1, 2015, followed by equal monthly installment payments of principal and interest, with all outstanding amounts due and payable on December 1, 2018. The outstanding principal balance bears interest at a variable rate of the greater of (i) 7.95%, or (ii) 7.95% plus the prime rate as quoted in the Wall Street Journal minus 5.25%. In addition, the Company will be obligated to pay a $100,000 legacy end of term charge on the earlier of June 1, 2017 or the date the Company prepays the Hercules Term Loan and a $351,135 end of term charge on the earlier of loan maturity or at the date the Company prepays the Hercules Term Loan. The Company may prepay all, but not less than all, of the Hercules Term Loan subject to a prepayment charge of 1.0% of the then outstanding principal if prepaid prior to June 23, 2016, or 0.5% of the then outstanding principal if prepaid on or after June 23, 2016 but prior to June 23, 2017, with no prepayment charge if prepaid thereafter. The Hercules Term Loan is secured by a first priority security interest and lien in and to all of the Company s tangible and intangible properties and assets, including intellectual properties.

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In connection with the first amendment to the loan and security agreement with Hercules, the Company issued Hercules a warrant to purchase 40,705 shares of the Company s common stock at an exercise price of $7.37 per share. The warrant was recorded at fair value on the date of issuance and treated as a debt discount which is being amortized to interest expense over the term of the loan using the effective interest method. (See Note 8 for a discussion of warrants to purchase common stock.)

The following is a summary of the Company s long-term debt, net of unamortized debt discount and issuance costs, as of June 30, 2016 and December 31, 2015:

	June 30, 2016 *(unaudited)*	December 31, 2015
	(in thousands)	
Principal amount	$ 15,000	$ 15,000
Less: unamortized debt issuance costs	(64)	(91)
unamortized fair value of free standing warrant	(117)	(163)
Plus: unamortized fair value debt premium	222	310
accrued terminal interest	216	111
accrued interest	99	103
Long-term debt, net of unamortized debt issuance cost and premium	$ 15,356	$ 15,270

For the three and six months ended June 30, 2016, the Company recorded total interest expense of $0.3 million and $0.7 million, respectively, related to the Hercules Term Loan. For the three and six months ended June 30, 2015, the Company recorded total interest of $0.1 million and $0.3 million, respectively, in connection with the agreement with Hercules.

8. Warrant to Purchase Common Stock

In connection with the Company s entry into the loan and security agreement with Hercules in June 2014, the Company issued Hercules a warrant to purchase $280,000 worth of the Company s stock. The warrant was initially recorded on the Company s consolidated balance sheet at fair value on the date of issuance and treated as a debt discount that is being amortized to interest expense over the debt repayment period using the effective interest method. As a result of the pricing of the Company s IPO on January 27, 2015, and pursuant to the agreement the exercise price was fixed at $8.84 per share, resulting in the warrant being exercisable for 31,674 shares (warrant amount of $280,000 divided by $8.84 per share) of the Company s common stock. Accordingly, management concluded that the requirements for equity classification had been met and effected a reclassification of the warrant liability of $0.3 million to equity. The warrant is exercisable at any time, in whole or in part, until five years from the date of the Company s IPO. For the three and six months ended June 30, 2015, the Company recorded other income of zero and $48,000, respectively, related to the change in fair value of the warrant before equity reclassification, which was determined by using the Black-Scholes option valuation model with the following assumptions: expected term of 5.00 years; volatility of 89%; risk free interest rate of 1.32%; and no dividend yield.

In connection with the Company s entry into the first amendment to loan and security agreement with Hercules in June 2015, the Company issued Hercules a warrant to purchase 40,705 shares of the Company s common stock at an exercise price of $7.37 per share. Hercules can exercise its purchase right under the warrant, in whole or in part, at any time until June 23, 2020. The warrant was recorded at fair value on the date of issuance and treated as a debt discount that is being amortized to interest expense over the term of the loan using the effective interest method. The Company classified the warrant to equity and recorded the fair value of the warrant of $212,000 to additional paid-in capital in its consolidated balance sheet. The warrant fair value was determined by using the Black-Scholes option valuation model with the following assumptions: expected term of 5.00 years; volatility of 89%; risk free interest rate of 1.73% and no dividend yield.

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9. Commitments and Contingencies

The Company has an operating lease with BMR-34790 Ardentech Court LP, an affiliate of BMR Holdings, for its office, research and development, and manufacturing facilities in Fremont, California. In April 2012, the Company amended the lease agreement to reduce future rent obligations with a new lease term of seven years in exchange for a potential reduction of premises from a recapturable premises clause. In June 2015, the Company entered into another amendment to the lease, pursuant to which BMR-34790 Ardentech Court LP s option to recapture a specified portion of the leased premises (comprising approximately 29,348 square feet of the approximate total 55,588 square feet of leased premises) has been suspended. The Company had the option until December 31, 2015 to extend the term of the lease. The Company did not exercise this option and as a result, the terms of the previous amendment entered in April 2012 remain in effect.

For the three months ended June 30, 2016 and 2015, rental expense under operating leases was $0.2 million and $0.2 million, respectively. For the six months ended June 30, 2016 and 2015, rent expense under operating leases was $0.4 million and $0.4 million, respectively.

As of June 30, 2016 future minimum payments under non-cancelable operating leases for each year ending December 31 are as follows:

	Total *(in thousands)*
2016	$ 320
2017	632
2018	650
2019	164
	$ 1,766

10. Stock-Based Compensation

The Company has reserved 1.4 million shares of common stock for issuance under the Company s 2014 Equity and Incentive Plan (the 2014 Plan). In connection with the Company s IPO of its common stock in January 2015, the Company s board of directors terminated the Company s 2012 Stock Incentive Plan (the 2012 Plan) effective as of January 27, 2015 and no further awards may be issued under the 2012 Plan. However, the awards outstanding under the 2012 Plan at January 27, 2015 continue to be governed by the terms of the 2012 Plan.

The following table summarizes option and award activity and related information under the 2012 Plan and 2014 Plan combined:

	Shares Available for Grant	Shares Subject to Outstanding Options	Weighted-Average Exercise Price per Share	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value

					(In Years)	
Options at December 31, 2015	858,606	972,951	$	2.35	7.40	
Options granted	(540,463)	540,463	$	2.46		
Options exercised		(145,892)	$	1.53		
Options cancelled/forfeited	193,895	(193,895)	$	2.87		
Restricted stock units granted	(9,478)		$			
Shares expired under 2012 Plan	(17,895)		$			
Balance at June 30, 2016	484,665	1,173,627	$	2.42	8.67	$
Exercisable at June 30, 2016		284,450	$	2.05	6.29	$
Vested and expected to vest at June 30, 2016		1,114,153	$	2.42	8.62	$

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The aggregate intrinsic values of options outstanding and exercisable, vested and expected to vest were calculated as the difference between the exercise price of the options and the closing market value of the Company s common stock as reported on NASDAQ as of June 30, 2016.

The following summarizes the composition of stock options outstanding and exercisable as of June 30, 2016 (unaudited):

	Options Outstanding and Exercisable	
Exercise Price	Number of Shares	Weighted-Average Remaining Contractual Life (in years)
\$1.28 - \$1.40	254,469	1.36
\$2.04 - \$7.33	886,158	2.47
\$9.05 - \$9.29	33,000	9.26
	1,173,627	

On March 29, 2016, the Board of Directors of the Company approved the grant of certain performance-based stock options to employees of the Company for a total of 164,500 option shares with an aggregate grant date fair value of approximately \$0.3 million. As of June 30, 2016, a total of 58,125 of such options vested upon achievement of certain specified performance conditions. The company accounts for these performance-based stock options in accordance with the provisions under ASC 718 and recognized compensation expense when the performance conditions are considered probable of achievement.

Stock-Based Compensation Expense

Total stock-based compensation expense recognized was as follows:

	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
	(unaudited; in thousands)		*(unaudited; in thousands)*	
Research and development	\$ 136	\$ 51	\$ 275	\$ 63
General and administrative	217	122	390	140
Total stock-based compensation expense	\$ 353	\$ 173	\$ 665	\$ 203

As of June 30, 2016, the Company had \$2.6 million of total unrecognized stock-based compensation, net of estimated forfeitures, related to outstanding stock options that will be recognized over a weighted-average period of 3.47 years.

The Company uses the Black-Scholes model for valuing its options and awards granted to employees and non-employees. Stock-based compensation in connection with non-employee grants was immaterial for the three and six months ended June 30, 2016 and 2015. The following table illustrates the input assumptions used to value employee stock option grants for the three and six months ended June 30, 2016 and 2015 (unaudited):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	**2015**	**2016**	**2015**
Dividend yield	0%	0%	0%	0%
Risk-free interest rate	1.06%-1.54%	1.94% - 2.01%	1.06%-1.97%	1.94% -2.01%
Expected volatility	89%	89%	89%	89%
Expected term (years)	6.08	6.08	6.08	6.08

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11. Restructuring and Severance

In January 2016, the Company terminated the employment of its Chief Executive Officer (CEO). Pursuant to the terms of his employment agreement, the Company is obligated to its former CEO for certain severance payments, continuation of benefits, and acceleration of vesting of all of his outstanding unvested stock options. The Company recorded a liability and an expense of approximately $0.4 million for the postemployment benefits provided to its former CEO during the three months ended March 31, 2016. In addition, the Company recorded a stock-based compensation expense of approximately $16,000 in the three months period ended March 31, 2016 related to the acceleration of vesting of the former CEO s stock options. The Company paid approximately $0.3 million in the six months ended June 30, 2016, with the remaining $0.1 million included within accrued compensation on the condensed consolidated balance sheet as of June 30, 2016. Management expects the amount to be paid in full by September 2016.

In March 2016, the Company consolidated its operations with the primary focus on continued development of M207 (previously known as ZP-Triptan). In accordance with ASC 420, Exit or Disposal Cost Obligations, the aggregate restructuring charges of approximately $0.5 million represent one-time termination benefits, comprised principally of severance, benefit continuation costs and outplacement services. For the three months ended March 31, 2016, approximately $0.5 million was recorded as a liability and an expense in the Company s financial statements. The Company paid approximately $0.3 million in the six months ended June 30, 2016, with the remaining $0.2 million included within accrued compensation on the condensed consolidated balance sheet as of June 30, 2016. Management expects the amount to be paid in full by July 2016. In addition, the Company recorded a stock-based compensation expense of approximately $5,000 in the three months period ended March 31, 2016 on the acceleration of vesting of certain stock options related to the elimination of certain senior positions in connection with the workforce reduction.