Aldeyra Therapeutics, Inc.
Form 10-Q
August 07, 2014
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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, 2014

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: 001-36332

ALDEYRA THERAPEUTICS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**20-1968197**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
15 New England Executive Park Burlington, MA	**01803**
(Address of principal executive offices)	**(Zip Code)**

(781) 270-0630

(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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

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 6, 2014, there were 5,565,415 shares of the registrant s common stock issued and outstanding.

Aldeyra Therapeutics, Inc.

Quarterly Report on Form 10-Q

For the Quarter Ended June 30, 2014

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Part I FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

ALDEYRA THERAPEUTICS, INC.

BALANCE SHEETS (Unaudited)

	June 30, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$ 11,535,788	$ 3,262,354
Prepaid expenses and other current assets	269,541	8,412
Total current assets	11,805,329	3,270,766
Deferred offering costs		472,467
Total assets	$ 11,805,329	$ 3,743,233
LIABILITIES, REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable	$ 556,061	$ 341,853
Convertible notes payable related parties		85,000
Accrued interest on convertible notes payable related parties		2,125
Accrued expenses	211,346	117,873
Current portion of credit facility	407,120	58,160
Total current liabilities	1,174,527	605,011
Credit facility, net of current portion and debt discount	815,825	1,129,015
Accrued deferred offering costs		394,368
Convertible preferred stock warrant liability		253,247
Convertible preferred stock warrant liabilities related parties		3,265,620
Total liabilities	1,990,352	5,647,261
Commitments and contingencies		
Redeemable convertible preferred stock:		
Series A Preferred Stock, $0.001 par value, none authorized, issued and outstanding as of June 30, 2014 and 24,000,000 shares authorized; 980,391 shares issued and outstanding as of December 31, 2013 (Liquidation preference of $36,000,000)		29,291,865
Series B Preferred Stock, $0.001 par value, none authorized, issued and outstanding as of June 30, 2014 and 38,000,000 shares authorized;1,316,681shares issued and outstanding as of December 31, 2013		9,025,433

(Liquidation preference of $20,377,506)		
Total redeemable convertible preferred stock		38,317,298
Stockholders equity (deficit):		
Preferred stock, $0.001 par value, 15,000,000 shares authorized, none issued and outstanding as of June 30, 2014; none authorized, issued or outstanding as of December 31, 2013		
Common stock, voting, $0.001 par value; 150,000,000 authorized and 5,565,415 shares issued and outstanding as of June 30, 2014; 65,000,000 shares authorized; 327,365 shares issued and outstanding as of December 31, 2013	5,565	327
Common stock, non-voting, $0.001 par value; none authorized, issued and outstanding as of June 30, 2014 and 65,000,000 shares authorized; none issued and outstanding as of December 31, 2013		
Additional paid-in capital	51,867,123	1,102,685
Accumulated deficit	(42,057,711)	(41,324,338)
Total stockholders equity (deficit)	9,814,977	(40,221,326)
Total liabilities, redeemable convertible preferred stock and stockholders equity (deficit)	$ 11,805,329	$ 3,743,233

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

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ALDEYRA THERAPEUTICS, INC.

STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS (Unaudited)

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
OPERATING EXPENSES:				
Research and development	$ 663,908	$ 325,050	$ 1,108,186	$ 475,283
General and administrative	982,579	660,640	1,783,225	801,945
Loss from operations	(1,646,487)	(985,690)	(2,891,411)	(1,277,228)
OTHER INCOME (EXPENSE):				
Change in fair value of preferred stock warrant liabilities	567, 588	(36,100)	2,327,502	(313,600)
Change in fair value of convertible preferred stock rights and rights option liabilities		(531,700)		(3,922,200)
Interest income		8	3	16
Interest expense	(56,246)	(15,301)	(169,467)	(30,705)
Total other income (expense), net	511,342	(583,093)	2,158,038	(4,266,489)
Net loss and comprehensive loss	(1,135,145)	(1,568,783)	(733,373)	(5,543,717)
Accretion of preferred stock	(141,513)	(150,095)	(333,082)	(273,254)
Deemed dividend	(4,053,570)		(4,053,570)	
Net loss attributable to common stockholders	$ (5,330,228)	$ (1,718,878)	$ (5,120,025)	$ (5,816,971)
Net loss per share attributable to common stockholders:				
Basic	$ (1.43)	$ (5.47)	$ (2.51)	$ (18.50)
Diluted	$ (1.56)	$ (5.47)	$ (3.53)	$ (18.50)
Weighted average common shares outstanding:				
Basic	3,737,675	314,419	2,041,941	314,419
Diluted	3,769,360	314,419	2,107,389	314,419

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

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ALDEYRA THERAPEUTICS, INC.

STATEMENTS OF REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS EQUITY (DEFICIT) (Unaudited)

	Redeemable Convertible Preferred Stock							Stockholders Equity (Deficit)		
	Series A Preferred Stock Preferred Stock		Series B Preferred Stock Preferred Stock		Total Redeemable Convertible Preferred Stock	Common Stock Voting				St
	Shares	Amount	Shares	Amount		Shares	Amount	Additional Paid-in Capital	Accumulated Deficit	
,	980,391	$ 29,291,865	1,316,681	$ 9,025,433	$ 38,317,298	327,365	$ 327	$ 1,102,685	$ (41,324,338)	$ (
n								1,114,107		
l s		78,037		255,045	333,082			(333,082)		
s						1,500,000	1,500	9,975,408		
f	(980,391)	(29,369,902)	(1,316,681)	(9,280,478)	(38,650,380)	3,642,799	3,643	38,646,736		
						74,001	74	1,191,290		
						21,250	21	169,979		
									(733,373)	
4						5,565,415	$ 5,565	$ 51,867,123	$ (42,057,711)	$

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

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ALDEYRA THERAPEUTICS, INC.

STATEMENTS OF CASH FLOWS (Unaudited)

	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (733,373)	$ (5,543,717)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation	1,114,107	674,824
President and CEO contributed services		120,000
Amortization of debt discount non-cash interest expense	120,770	14,670
Change in fair value of warrant liability, purchase rights and warrant purchase rights	(2,327,502)	4,235,800
Change in operating assets and liabilities:		
(Increase) decrease		
Prepaid expenses and other current assets	(261,129)	(4,923)
Accounts payable	37,433	(46,916)
Accrued interest on convertible notes payable-related parties	(2,125)	
Accrued expenses	93,473	(38,504)
Net cash used in operating activities	(1,958,346)	(588,766)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal payments on notes		(41,667)
Net proceeds from issuance of common stock	10,231,780	
Net proceeds from issuance of Series B redeemable convertible preferred stock		750,436
Net cash provided by financing activities	10,231,780	708,769
NET INCREASE IN CASH	8,273,434	120,003
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	3,262,354	1,223,638
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 11,535,788	$ 1,343,641
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$ 51,579	$ 16,318
Income taxes	$	$
SUPPLEMENTAL DISCLOSURES OF NON CASH INVESTING AND FINANCING ACTIVITIES:		
Accretion of redeemable convertible preferred stock	$ 333,082	$ 273,255
Conversion of notes payable	$ 170,000	$

Conversion of Series A preferred stock upon closing initial public offering	$ 29,369,902	$
Conversion of Series A preferred stock upon closing initial public offering	$ 9,280,478	$
Net exercise of warrants into common stock	$ 1,191,365	$
Offering costs of initial public offering not yet paid	$ 176,775	$
Warrants issued to underwriter in initial public offering	$ 315,388	$

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

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ALDEYRA THERAPEUTICS, INC.

NOTES TO THE FINANCIAL STATEMENTS (Unaudited)

1. NATURE OF BUSINESS

Aldeyra Therapeutics, Inc. (the Company) was incorporated in the state of Delaware on August 13, 2004 as Neuron Systems, Inc. On December 20, 2012, the Company changed its name to Aldexa Therapeutics, Inc. and on March 17, 2014, the Company changed its name to Aldeyra Therapeutics, Inc. The Company is developing a treatment for diseases thought to be related to high levels of free aldehydes, naturally occurring pro-inflammatory toxins.

The Company s principal activities to date include raising capital and research and development activities.

2. BASIS OF PRESENTATION

The accompanying interim unaudited financial statements and related disclosures are unaudited and have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by GAAP for complete financial statements and should be read in conjunction with the Company s financial statements for the year ended December 31, 2013 included in the Company s Registration Statement on Form S-1, as amended (File No. 333-193204) (Registration Statement), which was declared effective by the Securities and Exchange Commission (SEC) on May 1, 2014. The financial information as of June 30, 2014, the three and six months ended June 30, 2014 and 2013 is unaudited but, in the opinion of management, all adjustments, consisting only of normal recurring accruals, considered necessary for a fair statement of the results of these interim periods have been included. The balance sheet data as of December 31, 2013 was derived from audited financial statements. The results of the Company s operations for any interim period are not necessarily indicative of the results that may be expected for any other interim period or for a full fiscal year.

The Company s initial public offering of common stock (Initial Public Offering) was completed on May 7, 2014.

Use of estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates that affect the reported amounts of assets and liabilities at the date of the financial statements, disclosure of contingent assets and liabilities, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Reverse stock split

On January 23, 2014, the Company s board of directors and stockholders approved an amendment to the restated certificate of incorporation to effect a one-for-twelve reverse stock split of the Company s common stock, options for common stock, convertible preferred stock, and warrants for convertible preferred stock which became effective on May 1, 2014, prior to the effectiveness of the Registration Statement (the Reverse Stock Split). The par value and the authorized shares of the common and convertible preferred stock were not adjusted as a result of the Reverse Stock Split. All issued and outstanding common stock, options for common stock, convertible preferred stock, and rights and warrants for convertible preferred stock, as well as the exercise price of each option for common stock, each right and each warrant for convertible preferred stock, and each right for warrants for convertible preferred stock and the conversion price for convertible preferred stock, have been retroactively adjusted to reflect this Reverse Stock Split for all periods presented. All of the share and per share amounts have been adjusted, on a retroactive basis, to reflect the Reverse Stock Split.

New accounting pronouncements

Accounting Standards Update (ASU) No. 2014-10 Development Stage Entities (Topic 915); Elimination of Certain Financial Reporting Requirements, Including an Amendment to Variable Interest Entities, Guidance in Topic 810, Consolidation. The Financial Accounting Standards Board decided to remove the definition of development stage entity from the Master Glossary of the Accounting Standards Codification on the basis of the effects of its decisions to eliminate any special reporting requirements by development stage entities. For public business entities, the changes are effective for annual reporting periods beginning after December 15, 2014, and interim reporting periods therein. Entities are allowed to apply such guidance early for any annual reporting period or interim period for which the entity s financial statements have not yet been issued. The Company adopted ASU No. 2014-10 during the three months ended June 30, 2014. The adoption of ASU No. 2014-10, did not have a material effect on the Company s financial statements other than the elimination of inception-to-date reporting information in accordance with the provisions of ASU 2014-10. Prior to our adoption ASU 2014-10, we were considered in the development stage in accordance with existing generally accepted accounting principles.

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ALDEYRA THERAPEUTICS, INC.

NOTES TO THE FINANCIAL STATEMENTS (Unaudited)

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09). The amendments in ASU 2014-09 provide for a single, principles-based model for revenue recognition that replaces the existing revenue recognition guidance. ASU 2014-09 is effective for annual and interim periods beginning on or after December 15, 2016 and will replace most existing revenue recognition guidance under U.S. GAAP when it becomes effective. It permits the use of either a retrospective or cumulative effect transition method and early adoption is not permitted. As the Company has not generated revenues the Company has not yet selected a transition method and is in the process of evaluating the effect this standard will have on our financial statements and related disclosures.

3. NET LOSS ATTRIBUTABLE TO COMMON STOCKHOLDERS

Net loss attributable to common stockholders

The following table summarizes the computation of basic and diluted net loss per share attributable to common stockholders of the Company:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Numerator:				
Basic				
Net loss and comprehensive loss	$ (1,135,145)	$ (1,568,783)	$ (733,373)	$ (5,543,717)
Accretion of preferred stock	(141,513)	(150,095)	(333,082)	(273,254)
Deemed dividend	(4,053,570)		(4,053,570)	
Net loss attributable to common stockholders basic	$ (5,330,228)	$ (1,718,878)	$ (5,120,025)	$ (5,816,971)
Diluted				
Net loss attributable to common stockholders basic	$ (5,330,228)	$ (1,718,878)	(5,120,025)	(5,816,971)
Less: change in fair value of derivative liabilities	(567,588)		(2,327,502)	
Net loss available to common stockholders diluted	$ (5,897,816)	$ (1,718,878)	$ (7,447,527)	$ (5,816,971)
Denominator:				
Basic				

Weighted-average number of common shares basic	3,737,675	314,419	2,041,941	314,419
Diluted				
Weighted-average number of common shares basic	3,737,675	314,419	2,041,941	314,419
Warrants (treasury stock)	31,685		65,448	
Total weighted average number of common shares diluted	3,769,360	314,419	2,107,389	314,419
Net loss per share:				
Basic	$ (1.43)	$ (5.47)	$ (2.51)	$ (18.50)
Diluted	$ (1.56)	$ (5.47)	$ (3.53)	$ (18.50)

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ALDEYRA THERAPEUTICS, INC.

NOTES TO THE FINANCIAL STATEMENTS (Unaudited)

Because the Company reported a net loss for the three and six months ended June 30, 2013, diluted net loss per common share is the same as basic net loss per common share for that period.

The following potentially dilutive securities outstanding, prior to use of the treasury stock method or if-converted method, have been excluded from the computation of diluted weighted-average shares outstanding, because such securities had an antidilutive impact due to losses reported:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Options to purchase stock	87,241	67,232	87,258	67,232
Warrants to purchase Preferred Stock		67,376		65,439
Preferred Stock	1,240,955	3,642,799	2,435,245	3,642,799
Convertible note payable-related parties	8,640		14,910	
Rights to receive warrants for Preferred Stock		160,160		157,803
Investor rights to purchase Preferred Stock		640,638		631,211
Total of common equivalent shares	1,336,836	4,578,205	2,537,413	4,564,484

4. FAIR VALUE MEASUREMENTS

As of June 30, 2014 and December 31, 2013, the carrying amounts of cash and cash equivalents, prepaid expenses and other current assets, and accounts payable approximated their estimated fair values because of the short term nature of these financial instruments. The carrying value of the Company s credit facility and convertible notes related parties in current and long-term liabilities approximates fair value because the Company s interest rate yield is near current market rates available to the Company.

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) 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 are performed in a manner to maximize the use of observable inputs and minimize the use of unobservable inputs. ASC 820, *Fair Value Measurements*, establishes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value, which are the following:

Level 1 Quoted prices in active markets that are accessible at the market date for identical unrestricted assets or 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 for which all significant inputs 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.

ALDEYRA THERAPEUTICS, INC.

NOTES TO THE FINANCIAL STATEMENTS (Unaudited)

There were no liabilities measured at fair value at June 30, 2014. Liabilities measured at fair value on a recurring basis as of December 31, 2013 are as follows:

	Level 1	Level 2	Level 3	Total
December 31, 2013:				
Liabilities:				
Preferred Stock Warrant Liability Series B Preferred Stock	$	$	$ 3,439,059	$ 3,439,059
Preferred Stock Warrant Liability Series A Preferred Stock			79,808	79,808
Balance at end of period	$	$	$ 3,518,867	$ 3,518,867

The reconciliation of the Company s liabilities measured at fair value on a recurring basis using unobservable inputs (Level 3) is as follows:

Preferred stock warrant liability Series A Preferred Stock:

	Period Ended June 30, 2014	Year Ended December 31, 2013
Balance at beginning of period	$ 79,808	$ 87,600
Net exercise of Series A Warrants	(29,247)	
Change in fair value	(50,561)	(7,792)
Balance at end of period	$	$ 79,808

Preferred stock warrant liability Series B Preferred Stock:

	Period Ended June 30, 2014	Year Ended December 31, 2013
Balance at beginning of period	$ 3,439,059	$ 2,180,500
Net exercise of Series B Warrants	(1,162,118)	
		1,793,600

Exercise of warrants purchase rights into Series B Warrants		
Warrant liability Series B		177,952
Change in fair value	(2,276,941)	(712,993)
Balance at end of period	$	$ 3,439,059

The Company s preferred stock warrant liabilities were classified as level 3 and valued using the Black-Scholes model. The fair values were derived by applying the assumptions described below. These liabilities increased or decreased each period based on the fluctuations of the fair value of the underlying preferred security.

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ALDEYRA THERAPEUTICS, INC.

NOTES TO THE FINANCIAL STATEMENTS (Unaudited)

The table below shows the inputs used by instrument to determine the fair value measurements at December 31, 2013:

	December 31, 2013
Preferred stock warrant liability Series A	
Expected dividend yield	0%
Anticipated volatility	88.57%
Estimated stock price	$ 45.20
Exercise price	$ 12.24
Expected life (years)	5.28
Risk free interest rate	1.75%
Preferred stock warrant liabilities Series B	
Expected dividend yield	0%
Anticipated volatility	88.57%
Estimated stock price	$ 19.92
Exercise price	$ 5.16
Expected life (years)	3.97 6.89
Risk free interest rate	0.78% 2.45%

5. CONVERTIBLE NOTES PAYABLE RELATED PARTIES

In October 2013, the Company issued a convertible promissory note to Domain Partners VI, L.P., a related party, in a principal amount of $170,000, which was amended in February 2014 to extend its maturity date. The amendment to the note was determined to be a modification in accordance with ASC 470, *Debt*, and did not result in extinguishment. The note accrued interest at a rate of 6% per annum, and was to become due and payable in June 2014 unless converted into shares of the Company s capital stock prior to such time pursuant to its terms.

The Company recorded the difference between the current Series B Preferred Stock Conversion price and the fair value of the Series B Preferred Stock at the date of issuance, limited to the face amount of the convertible promissory note of $170,000, as a beneficial conversion feature. This is reflected as a debt discount and is being amortized to interest expense through the note s maturity date.

Upon the Company s Initial Public Offering in May 2014, the note automatically converted into 21,250 shares of the Company s common stock.

6. CREDIT FACILITY

On April 12, 2012, the Company entered into a loan and security agreement (Credit Facility) with a bank with availability in the amount of $500,000, to provide additional capital for general working capital purposes and for capital expenditures. Interest accrued from the date of each advance equal to the greater of (a) 2.75% above the prime rate then in effect per annum, or (b) 6.50% per annum. Any amounts outstanding were payable in 24 equal monthly installments of principal, plus all accrued interest, beginning on May 12, 2013 until the loan maturity date of April 13, 2015. There were no penalties for prepayment of the principal balance. The Credit Facility was subject to certain

ALDEYRA THERAPEUTICS, INC.

NOTES TO THE FINANCIAL STATEMENTS (Unaudited)

financial covenants. The interest rate since inception of this loan has been in accordance with (b) above, 6.50%. In conjunction with obtaining the Credit Facility, the Company issued a warrant to purchase for 2,042 shares of Series A Preferred Stock. The warrant was valued at $88,100 on the date of issuance and recorded as a discount on the Credit Facility and is being amortized using the effective interest method through the maturity date of the Credit Facility.

During 2012, the Company received two advance payments totaling $500,000, the maximum borrowings under the Credit Facility. In accordance with this agreement, the Company was only required to make monthly interest payments until April 12, 2013, at which time the Company was to begin making monthly principal payments in a fixed amount of $20,833 plus interest.

On November 20, 2013, the Company amended its Credit Facility with the same bank. The amendment provided an additional $1.0 million of available funds under the facility. The Company received an advance payment of $1.0 million in November 2013 through a term loan. The amended Credit Facility calls for interest only payments at a 6.50% interest rate per annum from November 2013 through November 2014 for all amounts outstanding, inclusive of those amounts originally drawn during 2012 prior to the amendment, at which point, the Company is required to make principal payments of $58,160 plus interest through the maturity date of the term loans in November 2016. The Credit Facility, as amended, may have financial covenants established at a future date.

Both the original Credit Facility and the Credit Facility, as amended, are secured by all the intellectual property of the Company.

In conjunction with obtaining the amended Credit Facility, the Company issued a warrant exercisable for 9,692 shares of Series B Preferred Stock with an exercise price of $5.16 per share and a term of seven years. The warrant was valued at $177,952 and, together with the fair value of the warrant issued in connection with the original Credit Facility ($88,100), was recorded as a discount on the Credit Facility. These discounts are being amortized using the effective interest method through the current maturity date of the Credit Facility in November 2016. The amendment to the Credit Facility was determined to be a modification in accordance with ASC 470, *Debt,* and did not result in extinguishment.

At June 30, 2014, the Credit Facility is shown net of a debt discount of $172,889 which is being amortized using the effective interest method through the maturity date of the Credit Facility.

7. INCOME TAXES

No provision for federal taxes has been recorded as the Company has incurred losses since inception for tax purposes. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

In assessing the realizability of net deferred taxes in accordance with ASC 740, *Income Taxes*, the Company considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. Based on the weight of available evidence, primarily the incurrence of net losses since inception and anticipated net losses in the near future, the Company does not consider it more likely than not that some or all of the net deferred taxes will be realized. Accordingly, a 100% valuation allowance has been applied against net deferred taxes.

Under the provisions of the Internal Revenue Code, certain substantial changes in the Company s ownership may result in a limitation on the amount of net operating loss carryforwards which can be used in future years.

All tax years are open for examination by the taxing authorities for both federal and state purposes.

The Company accounts for uncertain tax positions pursuant to ASC 740 which prescribes a recognition threshold and measurement process for financial statement recognition of uncertain tax positions taken or expected to be taken in a tax return. If the tax position meets this threshold, the benefit to be recognized is measured as the tax benefit having the highest likelihood of being realized upon ultimate settlement with the taxing authority. The Company recognizes interest accrued related to unrecognized tax benefits and penalties in the provision for income taxes. Management is not aware of any uncertain tax positions.

ALDEYRA THERAPEUTICS, INC.

NOTES TO THE FINANCIAL STATEMENTS (Unaudited)

8. STOCK INCENTIVE PLAN

The Company has three incentive plans. One was adopted in 2004 (2004 Plan) and provided for the granting of stock options and restricted stock awards to employees, board members and consultants and generally prescribed a contractual term of seven years. The 2004 Plan terminated in August 2010. However, grants made under the 2004 Plan are still governed by that plan. As of June 30, 2014, options to purchase 23,954 shares of common stock at an exercise price of $3.24 per share remained outstanding under the 2004 Plan.

The Company approved the 2010 Employee, Director and Consultant Equity Incentive Plan (2010 Plan) in September 2010 to replace the 2004 Plan. The 2010 Plan provided for the granting of stock options and restricted stock awards to certain employees, members of the board of directors and consultants of the Company. As of June 30, 2014, the number of shares of common stock authorized for issuance in connection with the 2010 Plan was 681,788. As of June 30, 2014, there were no shares available for issuance under the 2010 Plan.

The 2010 Plan terminated upon the Initial Public Offering. However, grants made under the 2010 Plan are still governed by that plan.

The Company approved the 2013 Equity Incentive Plan (2013 Plan) in October 2013. The 2013 Plan became effective immediately on adoption although no awards were to be made under it until the effective date of the Registration Statement for the Initial Public Offering. The 2013 Plan provides for the granting of stock options, restricted stock, stock appreciation rights, stock units, and performance cash awards to certain employees, members of the board of directors and consultants of the Company. As of June 30, 2014, the number of shares of common stock authorized for issuance in connection with the 2013 Plan was 625,000. As of the first business day of each fiscal year of the Company during the term of the Plan, commencing on the first day of the Company s 2015 fiscal year, the aggregate number of common shares that may be issued under the Plan shall automatically increase by a number equal to the least of (a) 4% of the total number of common shares outstanding on the last calendar day of the prior fiscal year, (b) subject to adjustment for certain corporate transactions, 333,333 common shares, or (c) a number of common shares determined by the Company s board of directors. As of June 30, 2014, there were 469,852 shares available for issuance under the 2013 Plan.

Options granted for the year ended December 31, 2013 include two grants of options exercisable for a total of 32,014 common shares for which vesting is contingent on certain performance conditions. For options granted containing performance conditions, the fair value is determined on the date of grant. For the three and six months ended June 30, 2014, there was $340,372 expense recorded relating to the options as the performance conditions were satisfied in May 2014.

There were stock options outstanding to purchase an aggregate of 764,990 shares of common stock at June 30, 2014 with a weighted average exercise price per share of $2.80 and stock options to purchase an aggregate of 609,842 shares of common stock outstanding at December 31, 2013 with a weighted average exercise price per share of $1.48. There were stock options to purchase an aggregate of 155,148 shares of common stock granted during the three months ended June 30, 2014 with an average exercise price per share of $8.00. The following table summarizes information about stock options exercisable at June 30, 2014:

Period Ending	Number Exercisable	Outstanding Shares Weighted-Average Remaining Contractual Life	Exercisable Shares Weighted-Average Remaining Contractual Life
June 30, 2014	115,622	9.12	7.80

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The Company has also issued stock options to non-employees at various grant dates from inception. In determining the expense associated with their vesting, those non-employee stock options were valued using the Black-Scholes option-pricing model using the fair value of the common stock and the following assumptions:

	June 30, 2014
Expected dividend yield	0%
Anticipated volatility	88.57%
Estimated stock price	$ 6.56
Exercise price	$ 0.552
Expected life (years)	9.195
Risk free interest rate	2.40%

There were no options granted to consultants during the six month period ended June 30, 2014. The stock-based compensation is subject to remeasurement and is being expensed over the related service term.

Stock-based compensation is recognized for stock options granted to employees and non-employees and has been reported in the Company s statement of operations as follows:

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Research and development expenses	$ 203,474	$ 156,846	$ 282,000	$ 206,165
General and administrative expenses	544,948	467,531	832,107	468,659
Total stock-based compensation expense	$ 748,422	$ 624,377	$ 1,114,107	$ 674,824

9. CONTRIBUTED SERVICES

The Company s President and Chief Executive Officer (CEO) was hired on January 6, 2012 on a half-time basis and on April 15, 2013, he began working full-time for the Company. During the period from January 6, 2012 through October 14, 2013, he was not paid a salary by the Company and was an employee and paid a salary by Domain Associates, LLC (Domain), a related party. The value of his services has been reflected in the statement of operations as an expense and recorded as a contribution of capital. For the three and six month period ended June 30, 2013, the value of his services was $78,000 and $120,000, respectively. There were no contributed services for the three or six month period ended June 30, 2014.

10. REDEEMABLE CONVERTIBLE PREFERRED STOCK

Series A Preferred Stock and Series B Preferred Stock

On May 7, 2014, the Company closed its Initial Public Offering, in which 1,500,000 shares of common stock were sold at a price to the public of $8.00 per share for an aggregate offering price of $12.0 million. The offer and sale of all of the shares in the Initial Public Offering were registered under the Securities Act of the 1933, as amended, pursuant to a registration statement on Form S-1 (File No. 333-193204), which was declared effective by the SEC on May 1, 2014. The offering commenced as of May 1, 2014 and did not terminate before all of the securities registered in the registration statement were sold. Aegis Capital Corp. acted as the sole manager of the offering and as representative of the underwriters. The Company raised approximately $10 million in net proceeds after deducting underwriting discounts and commissions of $0.8 million, $1.0 million in prepaid offering and printing costs and other offering costs of $0.2 million.

In connection with the Initial Public Offering, holders of at least 67% of the respective outstanding Series A and Series B Preferred Stock (Series A and Series B voting as separate single classes) elected to automatically convert the Series A Preferred Stock and Series B Preferred Stock into 3,642,800 shares of common stock. The remaining unamortized discount was considered a deemed dividend for the three and six month periods ended June 30, 2014.

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11. STOCK PURCHASE WARRANTS

On April 12, 2012, in connection with the signing of the Credit Facility agreement, the Company granted warrants to purchase 2,042 shares of Series A Preferred Stock (Series A Warrants) at an exercise price of $12.24 per share to Square 1 Bank.

On December 20, 2012, in connection with the sale and issuance of Series B Preferred Stock on that date, the Company granted warrants to purchase 96,921 shares of Series B Preferred Stock at an exercise price of $5.16 per share to the Series B Preferred Stock investors.

On August 14, 2013, in connection with the sale and issuance of Series B Preferred Stock on that date, the Company granted warrants to purchase 96,921 shares of Series B Preferred Stock at an exercise price of $5.16 per share to the Series B Preferred Stock investors.

On November 20, 2013, the Company granted a warrant exercisable for 9,692 shares of Series B Preferred Stock to Square 1 Bank in connection with the amendment to the Credit Facility. The warrant has an exercise price of $5.16.

In connection with the Initial Public Offering, the holders of the outstanding Series A and Series B Preferred Stock Warrants elected to net exercise the warrants and the shares of Series A Preferred Stock and Series B Preferred Stock issued upon such net exercise were automatically converted into 74,001 shares of common stock.

Also in connection with the Initial Public Offering, the Company issued the underwriters of the offering warrants to purchase up to 60,000 shares of common stock. The warrants are exercisable beginning on May 1, 2015 for cash or on a cashless basis at a per share price of $10.00. The warrants will expire on May 1, 2019.

12. RELATED PARTY TRANSACTIONS

In November 2013, the Company entered into a letter agreement with each of its CEO and Chief Operating Officer (COO) that became effective on the effective date of the Initial Public Offering. The letter agreements were subsequently amended in February 2014. Pursuant to these letter agreements, if the Company terminates the employment of its CEO or COO without cause or if such executive resigns for good reason, then he will be eligible to receive: continued payment of base salary for 12 months; a lump-sum cash payment equal to the greater of such executive s target bonus for the year in which such termination occurs or the actual bonus paid to the executive with respect to our most recently completed fiscal year; payment by the Company of the monthly premiums under COBRA for such executive and their eligible dependents for up to 12 months following the termination of such executive s employment; and accelerated vesting and exercisability with respect to all equity or equity-based awards held by such executive officer as if such executive officer has completed an additional 12 months of service with the Company, and up to 12 months following such termination to exercise any then-outstanding stock options or stock appreciation rights. Such payments are contingent on the officer s executing and not revoking a release of claims against the Company. As of June 30, 2014 and December 31, 2013, the Company assessed the likelihood for these events to occur and has determined that a liability related to these agreements is not likely to occur and therefore has not been recorded.

In June 2014, the Company entered into a letter agreement with its CFO. Pursuant to the letter agreements, if the Company terminates the employment of its CFO without cause or if such executive resigns for good reason, then he will be eligible to receive: continued payment of base salary for 9 months; a lump-sum cash payment equal to the greater of such executive s target bonus for the year in which such termination occurs or the actual bonus paid to the executive with respect to our most recently completed fiscal year; payment by the Company of the monthly premiums under COBRA for such executive and their eligible dependents for up to 9 months following the termination of such executive s employment; and accelerated vesting and exercisability with respect to all equity or equity-based awards held by such executive officer as if such executive officer has completed an additional 12 months of service with the Company, and up to 12 months following such termination to exercise any then-outstanding stock options or stock appreciation rights. Such payments are contingent on the officer s executing and not revoking a release of claims against the Company. As of June 30, 2014, the Company assessed the likelihood for these events to occur and has determined that a liability related to these agreements is not likely to occur and therefore has not been recorded.

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Convertible Promissory Note In October 2013, the Company issued a convertible promissory note to Domain Partners VI, L.P., in a principal amount of $170,000, which was amended in February 2014 to extend its maturity date.

The note accrued interest at a rate of 6% per annum, and would have become due and payable in June 2014 unless it converted into shares of the Company s capital stock prior to such time pursuant to its terms.

Upon the Company s Initial Public Offering in May 2014, the note automatically converted into 21,250 shares of the Company s common stock.

13. COMMITMENTS AND CONTINGENCIES

Guarantees and Indemnifications As permitted under Delaware law, the Company indemnifies its officers and directors for certain events or occurrences while the officer or director is, or was, serving at the Company s request in such capacity. The term of the indemnification is for the officer s or director s lifetime. Through June 30, 2014, the Company had not experienced any losses related to these indemnification obligations and no material claims were outstanding. The Company does not expect significant claims related to these indemnification obligations, and consequently, concluded that the fair value of these obligations is negligible, and no related reserves were established.

Other Contractual Arrangements In February 2010, the Company entered into a license and supply agreement providing the Company with an exclusive license to certain technology and access to purchase materials at certain costs. Under the terms of the license and supply agreement, the Company is obligated to make milestone payments up to an aggregate of $2.15 million upon reaching certain development and regulatory milestones in the development of the Company s product. Upon commercialization of the Company s product containing the licensed technology, the Company would be obligated to pay royalties based on net sales subject to an annual cap. The license and supply agreement runs through the 7th anniversary of the expiration of all patents licensed under the agreement, which the Company estimates to be April 2036, unless terminated earlier.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations
Cautionary Note Regarding Forward-Looking Statements

Various statements throughout this report are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements may appear throughout this report. Words such as, but not limited to, may, might, will, objective, intend, should, could, can, would, expect, believe, ant design, estimate, predict, potential, plan or the negative of these terms and similar expressions or words, identify forward-looking statements. These statements reflect our current views with respect to future events and are based on assumptions and subject to risks and uncertainties. Given these uncertainties, you should not place undue reliance on these forward-looking statements. Forward-looking statements include, but are not limited to, statements about:

the timing and success of preclinical studies and clinical trials conducted by us and our development partners;

the ability to obtain and maintain regulatory approval of our product candidates, and the labeling for any approved products;

the scope, progress, expansion, and costs of developing and commercializing our product candidates;

the size and growth of the potential markets for our product candidates and the ability to serve those markets;

our expectations regarding our expenses and revenue, the sufficiency of our cash resources and needs for additional financing;